

5th July 2012

Sent by Email and by Mail

Securities and Futures Commission
8th Floor, Chater House
8 Connaught Road Central
Hong Kong

Dear Sirs,

Re: Consultation Paper on the regulation of sponsors

The Hong Kong Society of Financial Analysts welcomes the opportunity to participate in the Securities and Futures Commission's consultation paper regarding the regulation of sponsors.

The HKSFA subscribes to the fact that there has been a marked deterioration in the quality of IPOs brought to the market in the past few years. Despite SFC's repeated warning of sub-standard work done by some sponsors, it seems little improvement has been observed in the market. To ensure the sustainability of Hong Kong being an international financial market, we broadly agree to SFC's recommendations that sponsors should raise the standard of their due diligence work and bear a greater responsibility for the information contained in the prospectus on which investors rely to make their investment. SFC's proposal is generally in line with the HKSFA's mission of raising the standard of practice as well as the ethical standard among the financial professionals in Hong Kong.

While we agree that sponsors should take a bigger role in the improvement of the IPO market, other parties such as regulating authorities, approval bodies and expert professionals also need to contribute to the improvement. Should the SFC decide to place the burden of criminal liabilities on sponsors, it should make sure the new requirements are consistently applied and the rules on raising the standard of due diligence work are specifically defined. In other words, the new IPO regime should take into consideration the practical problems that could be faced by the licensed individuals and licensed corporations.

General comments on the proposals

1. The SFC may also want to consider raising the standard of information disclosures for backdoor listings.
2. Regarding information contained in the prospectus, SFC can specify the requirement of disclosing two categories of information: general and specific. This could help the sponsors to submit relevant information for independent investor assessment.
3. In the cases of multiple sponsors, it may require that each sponsor should disclose its duties and responsibilities.
4. In addition to holding the sponsor responsible for expert opinions, SFC should be working to improve the standard of work that is supplied by the usual experts such as auditors, lawyers, technical consultants and valuation firms.

Based on our positions, we state our comments to the specific questions as set out in the Consultation Paper as follows:

Q1. Do you agree a sponsor should have a sound understanding of a listing applicant for which it acts?

Yes. The HKSFA is of the view that as a licensed professional, a sponsor should comply with the "know your client" rule, which is a minimum standard it should meet in operating its business. In addition, since investors rely significantly on the work of the sponsor for their investment decision, a thorough understanding of the applicant before accepting it as a client is important for the sponsor to play its dual role.

Q2. Do you agree that a sponsor should advise and guide a listing applicant and its directors as to their responsibilities under the Listing Rules and other applicable regulatory requirements and take all reasonable steps to ensure that at all stages of the listing application process they understand and meet these responsibilities?

Yes. A sponsor should advise and guide a listing applicant and its directors as to their responsibilities under the Listing Rules and other applicable regulatory requirements. However, the HKSFA is of the view that regarding other applicable regulatory requirements of which it lacks experience, a sponsor should be allowed to rely on expert opinion.

Q3. Do you agree that a sponsor should provide appropriate advice and recommendations to a listing applicant on any material deficiencies identified in relation to its operations and structure, procedures and systems, or its directors and key senior managers and ensure that any material deficiencies are remedied prior to the submission of a listing application?

Yes. A sponsor should provide appropriate advice and recommendations to a listing applicant on any material deficiencies identified in relation to its operations and structure, procedures and systems, or its directors and key senior managers. The HKSFA is of the view that a sponsor should ensure “substantial” material deficiencies are remedied prior to the submission of a listing application, with the rest being remedied in a given time horizon after the submission.

Q4. Do you agree that before submitting a listing application a sponsor should complete all reasonable due diligence on the listing applicant save only any matters that by their nature can only be dealt with at a later date?

Yes. Before submitting a listing application a sponsor should complete all reasonable due diligence on the listing applicant. However, the HKSFA is of the view that SFC should define what “reasonable due diligence” means as much as it can. For key due diligence issues, they should be dealt with before the submission of application.

Q5. Do you agree that before submitting a listing application a sponsor should come to a reasonable opinion that the information in the Application Proof is substantially complete?

Yes. Before submitting a listing application a sponsor should come to a reasonable opinion that the information in the Application Proof is substantially complete. Regarding the completeness of information, we believe it varies from industry to industry, and may require some specification.

Q6. Do you agree that before submitting a listing application a sponsor should come to a reasonable opinion that the applicant has complied with all applicable listing conditions (except to the extent that waivers from compliance have been applied for), has established adequate systems and procedures and the directors have the necessary experience, qualifications and competence?

Yes.

Q7. Do you agree that a sponsor should ensure that all material issues known to it which, in its reasonable opinion, are necessary for the consideration of the application as described in paragraph 57 above are disclosed to the regulators when submitting a listing application?

Yes. We agree to the proposal, but it may need to specify what SFC may look at when considering whether the applicant is suitable for listing or not.

Q8. Do you agree that a sponsor, after reasonable due diligence, should ensure that at the time of issue a listing document contains sufficient particulars and information to enable a reasonable person to form a valid and justifiable opinion of the financial condition and profitability of the listing applicant?

Yes. We agree to the proposal, but we may need some specification about sufficient particulars and information as they may vary from industry to industry and from country to country.

Q9. Do you agree that a sponsor, after reasonable due diligence, should have reasonable grounds to believe and does believe that at the time of issue of a listing document the information in the non-expert sections is true, accurate and complete in all material respects and that there are no material omissions?

Yes. We agree that a sponsor, after reasonable due diligence, should have reasonable grounds to believe and does believe that at the time of issue of a listing document the information in the non-expert sections is true, accurate and complete in all material respects and that there are no material omissions.

Q10. Do you agree that at the time of issue of a listing document a sponsor should be in a position to demonstrate that it is reasonable for it to rely on the expert sections of the listing document?

Yes. Although a sponsor may not possess the specialized knowledge and qualifications to ensure that the expert's report is true and that there are no material omissions, a sponsor should satisfy itself that it is reasonable to rely on expert's report and specify the scope of their reliance on the reports. It will be helpful to ascertain whether performing all the steps set out in PN21, a sponsor would be released from legal responsibilities if material misstatement is found in the report.

For the benefit of the investors, the HKSFA is of the view that more details about the underlying assumptions in the expert opinion section should be disclosed. If in doubt, a sponsor should review the working papers of those experts it hires.

Q11. Do you agree that the sponsor should take these steps in connection with an expert report? Are the steps set out in paragraph 17.6(g) of the draft Provisions sufficient and appropriate?

Yes. The steps set out in paragraph 17.6(g) of the draft Provisions are sufficient and appropriate in order for a sponsor to demonstrate that it is reasonable for it to rely on an expert report.

Q12. Do you agree that a sponsor cannot delegate responsibility for due diligence?

Yes, a sponsor has the ultimate responsibility for the overall due diligence exercise and this responsibility cannot be delegated. Although admittedly a sponsor may not possess all the required knowledge and will rely on experts in the due diligence process, it is expected that a sponsor should demonstrate it is reasonable for it to rely on the expert reports by taking typical steps to check the qualifications and experience of the expert, and to assess the bases on which the expert has made assumptions.

Q13. Are the steps we propose a sponsor should take when seeking assistance from a third party in its due diligence work sufficient and appropriate?

Yes. Sponsors cannot delegate their responsibilities for due diligence but we recognize there is a need to engage outside professionals in helping due diligence work. That said, the sponsor's responsibilities should be in the supervision areas and must be clearly defined.

Q14. Do you agree that a sponsor should reasonably satisfy itself that all information provided to the Stock Exchange and SFC during the listing application process is accurate, complete and not misleading and, if it becomes aware that the information provided does not meet this requirement, the sponsor should inform them promptly?

Yes, this is consistent with the current requirements and general principle 2 of the Code of Conduct. However, it is also of paramount importance that all aspects of the listing application process should be improved and tightened, such as the quality of work by other parties. It was reported that there was one incident where HKEx listing division gave a waiver to a valuer who was hired to check plantation assets but the valuer admitted that the firm had not been able to independently verify the assets as an aerial survey of stated land buildings could not be done. The local government had not permitted flyover inspections due to the location of the site being in a major military base. In this case, if HKEx did not give the waiver, the IPO listing would have been shelved until further assessment could be made.

To better addressing specific financial misstatement and corporate governance problems, the HKSFA is of the view that SFC may include some specific examples of problematic IPO issues in the past in its guidelines to sponsors.

Q15. Do you agree that a sponsor should deal with all enquires raised by the regulators in a cooperative, truthful and prompt manner?

Yes, it is the responsibility of the sponsor to provide information and answers to all enquiries raised by the regulators.

Q16. Do you agree that a sponsor should disclose to the Stock Exchange in a timely manner any material information relating to a listing applicant or listing application of which it becomes aware which concerns non-compliance with the Listing Rules or other applicable legal or regulatory requirements?

Yes. We believe it is also important that once a red flag is raised, other parties (e.g. HKEX and regulators) involved in the listing application process should take a serious look at the matter and make appropriate decision accordingly. The incident mentioned under Q14 is a good example. The listing committee should not give waivers regarding due diligence work and their role as the gatekeeper of the gatekeepers should also be clarified.

Q17. Do you agree that if a sponsor ceases to act for a listing applicant during the listing application process, it is required to inform the Stock Exchange in a timely manner of the reasons for ceasing to act?

Yes, timely disclosure of reasons for ceasing to act for a listing applicant should be communicated to the Stock Exchange in a timely manner. The HKSFA is of the view that the Stock Exchange may specify certain reasons for reporting.

Q18. Do you agree that the Application Proof submitted with a listing application should be made publically available when the application is made?

Yes. Barring the practical issues, the HKSFA is of the view that the Application Proof should be made publically available when the application is made. One drawback for the proposal is to make the process in the initial stage quite lengthy, which could still be acceptable for the interest of investor protection.

Q19. Do you agree that a sponsor's records should be sufficient to demonstrate that the sponsor has complied with all applicable legal and regulatory requirements and in particular compliance with the Provisions?

Yes. However, it should not be limited to a sponsor's records. Other circumstantial evidence should be taken into account when assessing whether a sponsor fulfills its fiduciary duties.

Q20. Do you agree that a complete set of a sponsor's records in connection with a listing transaction should be retained in Hong Kong for at least seven years after completion or termination of the transaction?

Yes. Records should be retained in Hong Kong for at least seven years. "Records" should be clearly defined to include certified true copies and/or original documents since some countries may require all original documents to be kept in the countries.

Q21. Do you agree that before accepting any appointment as a sponsor, a firm should ensure that, taking account of other commitments, it has sufficient staff with appropriate levels of knowledge, skills and experience to devote to the assignment throughout the period of the assignment?

Yes. Although this may mean that sponsor fees will be raised to reflect higher costs and resources involved in the listing application. This is a price that the industry will pay in order to raise the quality of due diligence work and maintain the reputation of Hong Kong as a key financial centre.

Q22. Do you agree that the provisions of the Sponsor Guidelines concerning the Transaction Team should be transferred to the Code of Conduct?

Yes.

Q23. Do you agree that a sponsor should maintain effective systems and procedures to ensure that an appropriate due diligence plan is formulated, updated as necessary and implemented in respect of each assignment and there are clear and effective reporting lines to ensure that key issues are escalated to Management for deliberation?

Yes. Effective systems and procedures should be maintained and updated as necessary. However, even with the state-of-the-art system/procedure and tight internal control, it is hard to detect fraudulent activities or false information provided by employees of a sponsor, or directors of the listing applicant deliberately.

Q24. Do you agree that a sponsor's Management is obliged to adequately supervise the performance of due diligence including but not limited to the key issues discussed in paragraph 97?

No. The definition of management is too wide. Our suggestion is that management bearing statutory responsibility should be principals and responsible officers, the ones who are directly in charge of the licensed activity. Responsibilities of other senior management at the board level are already covered by requirements of SFC and the Company Ordinance.

Q25. Which, if any, of the proposals in paragraph 103 would achieve the objectives of enlarging the category of individuals qualified to act as Principals whilst not affecting the overall quality of sponsor work?

Do you have alternative suggestions to address the issues?

Yes. We support the recommendation to enlarge the category of individuals qualified to act as Principals as there is a shortage of qualified principals in the industry. The current SFC requirements make it difficult to increase the number. By relaxing the criteria for Principals, it may be helpful to increase the talent pool and improve the overall quality of sponsor work. However, high standard for licensed persons involving sponsor work should be maintained. Professional designations, such as CFA charter, may be beneficial. For 100 (c), the SFC may consider to relax such requirement to some extent if a new sponsorship examination can be administered.

All of the proposals in paragraph 103 can to a certain extent enlarge the pool of individuals qualified to act as Principles. That being said, the proposals have their own inherited implications and problems. For instance, the recognition of relevant experience acquired overseas in comparable jurisdictions, the practices of equity capital markets and IPO fund raising may be different from Hong Kong; relevant experiences accumulated overseas may not be useful in Hong Kong. In addition, how to select the comparable jurisdictions will also be problematic and controversial, though the Recognized Jurisdiction Schemes under the Code on Unit Trusts and Mutual Funds can be of reference.

**Q26. Do you agree that there should only be one sponsor on each engagement?
If you do not agree, should the number of sponsors be limited and, if so, to how many?
If you do not agree that the numbers of sponsors should be limited, why not?**

No. The SFC should allow more than one sponsor on each engagement. However, there should be a limit set according to the size of the issue or the size of the applicant.

**Q27. If more than one sponsor is allowed, do you agree that they should all be required to meet the Listing Rules independence requirements?
If not why not?**

No. Criminal liabilities and other steps to raise the quality of due diligence should be sufficient to mitigate the potential conflicts of interest issue so we do not believe that all sponsors should be required to meet the Listing Rules independence requirements.

Q28. Do you agree that if more than one sponsor is appointed each sponsor's responsibilities should remain unaffected and that each sponsor should comply with all the expectations of a sponsor?

Yes.

Q29. Do you agree that the provisions of the CFA Code relating to the management of a public offer should be transferred to the Code of Conduct?

Yes

Q30. Do you agree that the obligation in the CFA Code relating to the provision of information to analysts should be transferred to the Code of Conduct?

Yes.

Q31. Do you agree that the Provisions should equally apply to a listing agent appointed for the listing of a REIT?

Yes.

Q32. Do you agree that it should be made clear that sponsors are liable for untrue statements (including material omissions) in a prospectus?

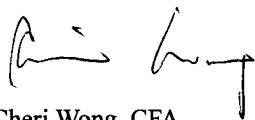
Yes. The HKSFA is of the view that it should be made clear that sponsors should be liable for untrue statements and frauds in a prospectus. It is important that there is clarity as to the basis of bringing a criminal indictment (i.e. intentionally or recklessly) as well as consistency with the existing mechanisms.

Q33. Do you have any views on the proposed definition of “sponsor”? Please explain your views.

No.

HKSFA appreciates the opportunity to comment on SFC’s consultation paper on the regulation of sponsors. We trust you find our comments useful and constructive.

Yours Sincerely,
For and on behalf of
The Board of The Hong Kong Society of Financial Analysts



Cheri Wong, CFA
Chief Executive Officer