

立法會
Legislative Council

LC Paper No. CB(1)1128/12-13(05)

Ref: CB1/PL/FA

Panel on Financial Affairs
Meeting on 3 June 2013

Background brief on
sponsor regulation and other investor protection initiatives

Purpose

This paper sets out background information on the initiative to enhance sponsor regulation introduced by the Administration and Securities and Futures Commission ("SFC"), and provides a summary of the major views and concerns expressed by Members on related issues since 2004.

Roles of and regulatory regime on sponsors

2. The market relies heavily on the sponsor as a principal "gatekeeper" to protect investors as the Stock Exchange of Hong Kong Limited ("Stock Exchange") and the investors rely on the work of sponsors to provide assurance that the listing applicant meets the requirements of the Listing Rules and, as set out in the Companies Ordinance (Cap. 32) ("CO"), the prospectus provides sufficient particulars and information for investors to form a valid and justifiable opinion on the company's shares and its financial condition and profitability. A sponsor also advises and guides the listing applicant as to the Listing Rules and other regulatory requirements.

3. Currently, sponsors are regulated by SFC under the licensing regime enshrined in Securities and Futures Ordinance (Cap. 571) ("SFO"). Under SFO, sponsors are required to obtain a licence to carry out Type 6 regulated activity, i.e. advising on corporate finance. The regulatory regime enshrined in SFO empowers SFC to set standards, investigate into misconduct and impose disciplinary sanctions on sponsors. The Listing Rules¹ also describe the role of a sponsor principally in terms of the obligations of the sponsor towards the Stock Exchange. In addition, sponsors are subject to the following three documents on their conducts:

¹ A sponsor is required to comply with the requirements of Chapter 3A and Practice Note 21 ("PN21") of the Listing Rules when acting as a sponsor to a listing applicant. PN21 contains detailed guidance on sponsors' due diligence obligations.

- (a) the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission ("Code of Conduct"), which sets out overall principles and requirements applicable to the conduct of all licensed and registered persons to which they must adhere in ensuring that they are fit and proper to remain licensed and registered;
- (b) the Corporate Finance Adviser Code of Conduct ("CFA Code") which provides specific conduct guidance to corporate finance advisers; and
- (c) the Additional Fit and Proper Guidelines for Corporations and Authorised Financial Institutions applying or continuing to act as Sponsors and Compliance Advisers ("Sponsor Guidelines"), which set out continuing compliance requirements, including specific competence requirements as well as the responsibilities of management and sponsor principals.

4. Besides, sponsors are also required to maintain proper systems, controls and procedures in accordance with the Management, Supervision and Internal Control Guidelines for Persons Licensed by or Registered with the Securities and Futures Commission.

Consultation on the regulation of sponsors conducted by the Securities and Futures Commission in 2012

5. While SFC implemented in 2007 a regulatory regime setting out the relevant requirements for eligibility and compliance specific to sponsors, it remained concerned that standards of sponsor work might fall short of reasonable expectations and had continued to conduct routine inspections of sponsors from time to time. In 2011, SFC concluded a theme inspection and issued a report detailing specific deficiencies in the work of sponsors.

6. In May 2012, SFC further launched a two-month consultation on proposals to enhance the regulatory regime of sponsors. The proposals combining new and existing sponsor requirements would become part of the Code of Conduct². The key elements of the proposed regime covered the following areas relating to sponsors:

² SFC proposed to set out the key standards and requirements for sponsor conduct in a new paragraph 17 of the Code of Conduct. The general principles already contained in the Code of Conduct will continue to apply to sponsors as they do for all licensed or registered persons.

- (a) requirements on the submission of a listing application;
- (b) requirements on due diligence;
- (c) responsibility of sponsors for disclosure;
- (d) resources and management of sponsors;
- (e) restricting the number of independent sponsors for each listing to one only or a limited number; and
- (f) making clear in sections 40 and 40A of CO that sponsors have civil and criminal liability for untrue statements (including material omissions) in a prospectus.

7. On 12 December 2012, SFC published the conclusions on proposals concerning regulation of initial public offering ("IPO") sponsors. Having regard to respondents' comments, SFC refined a number of original proposals while adopting most of the key reforms, which aimed to ensure that sponsors thoroughly understood any company aspiring to access Hong Kong's public capital markets before a listing application was made. Key aspects of the reforms are set out in the following paragraphs:

(a) Prospectus liability

- (i) The law should be clarified so that sponsor firms have civil and criminal liability for defective prospectuses; and
- (ii) Criminal liability should depend on whether a sponsor firm knowingly or recklessly approved a prospectus containing an untrue statement (including an omission) which was materially adverse from an investor's perspective.

(b) Publication of application proof

The advanced draft prospectus filed with a listing application would be published on the website of the Stock Exchange.

(c) Clarification on sponsors' reliance on experts and requirement of making meaningful Management Discussion and Analysis

(d) Initiatives to enhance sponsors' role

To ensure that a sponsor's ability to carry out its "gatekeeping" role is not undermined by competitive tensions, SFC shall require that:

- (i) a listing applicant formally appoints a sponsor at least two months before a listing application;
- (ii) a sponsor notifies the regulators of any instances of non-compliance and explains why if and when it ceases to act for a listing applicant;
- (iii) a listing applicant commits that it and all professional advisers involved in the IPO will fully co-operate with the sponsor in discharging the latter's duties; and
- (iv) sponsor fees must be specified in a sponsor's terms of engagement and be based solely on a sponsor's role.

8. According to the press release of SFC issued on 12 December 2012 in relation to the consultation conclusions on regulation of IPO sponsors, the new requirements would apply to listing applications submitted on or after 1 October 2013. Related amendments to the SFC's CFA Code and Sponsor Guidelines will also become effective on the same day. Legislative amendments will follow a separate timetable. The Stock Exchange will make appropriate changes to the Listing Rules with a view to bringing the revised rules into force when the requirements become effective.

Discussions at the Panel on Financial Affairs and Council Meetings

9. The Panel on Financial Affairs ("FA Panel") discussed at its special meeting on 21 December 2009 issues relating to the listing of Asian Citrus Holdings Limited³, which included, inter alia, the Hong Kong Exchanges and Clearing Limited ("HKEx")'s handling of information provided by sponsors. Panel members expressed concern about whether adequate information on the company had been made available to investors, the role of sponsor and HKEx in ensuring the company had fulfilled its obligation to keep the investing public informed of relevant information of the company when applied listing, whether HKEx had reminded the relevant sponsor that important information of the company should be displayed prominently in the listing document, and whether HKEx had fulfilled its duty on information disclosure in the incident if it simply displayed the information provided by the sponsor without making its own assessment. HKEx explained that it was not its practice to interpret or alter the data in the listing document without receiving such a request from the sponsor of the company concerned. The Panel urged both HKEx and SFC to

³ The shares of Asian Citrus Holdings Limited, which was previously listed in London's Alternative Investment Market and PLUS, was listed on the Stock Exchange by way of introduction on 26 November 2009. There was wide public concern on the unusual price volatility of the shares on the first day of listing (i.e. 26 November 2009). Trading of the shares was suspended and resumed by Stock Exchange on 26 and 27 November 2009 respectively.

investigate the incident and handle the matter seriously in order to protect investors' interests and maintain the reputation of Hong Kong as an international financial centre.

10. During the Second and Third Legislative Council ("LegCo"), Members have raised four questions at the Council meetings of 4 February 2004, 26 October 2005, 18 April 2007, and 30 May 2007 on monitoring IPO of enterprises in Hong Kong, regulation of Mainland companies listed in Hong Kong and corporate governance. The issues covered in the questions included measures and initiatives of the Administration and SFC to strengthen regulation of sponsors, such as requiring sponsors to bear legal liability in respect of the contents of the prospectuses. Details of the LegCo questions and the Administration's replies are given in the **Appendix**.

11. At the Council meeting on 6 December 2012, Members passed a motion on "Supporting the development of the securities industry" moved by Hon Christopher CHEUNG and as amended by Hon WONG Kwok-hing, Hon Ronny TONG, Hon SIN Chung-kai, Hon NG Leung-sing and Hon Martin LIAO. During the debate of the motion, a Member expressed support on SFC's consultation in 2012 on proposals to enhance the role and requirement of sponsors.

Recent development

12. During the briefing by the Secretary for Financial Services and the Treasury on the relevant policy initiatives in the Chief Executive's 2013 Policy Address at the meeting of the FA Panel on 28 January 2013, the Administration advised that one of the new initiatives in the area of financial services was to refine the regulation of sponsors for IPOs. The Administration would, in relation to SFC's 2012 public consultation on sponsors, follow up with SFC on legislative amendments to clarify the responsibilities of sponsors.

13. The Administration will brief the FA Panel at the meeting on 3 June 2013 on sponsor regulation and other investor protection initiatives.

Relevant papers

14. A list of relevant papers is in the **Appendix**.

List of relevant papers

Date	Event	Paper/Minutes of meeting
4 February 2004	Hon SIN Chung-kai raised a written question on monitoring initial public offerings of enterprises in Hong Kong	Hansard
26 October 2005	Hon Hon Wong Ting-kwong raised a written question on regulating the listing of Mainland enterprises in Hong Kong	Hansard
18 April 2007	Hon Bernard Chan raised a written question on corporate governance	Hansard
30 May 2007	Hon Albert Ho raised an oral question on regulation of Mainland companies listed in Hong Kong	Hansard
21 December 2009	The Panel on Financial Affairs ("FA Panel") discussed issues relating to the listing of Asian Citrus Holdings Limited	Minutes (LC Paper No. CB(1)1499/09-10) Report of FA Panel to the Legislative Council on 7 July 2010 (LC Paper No. CB(1)2426/09-10)
9 May 2012	The Securities and Futures Commission ("SFC") launched a consultation on the regulation of sponsors	Press release Consultation paper

Date	Event	Paper/Minutes of meeting
6 December 2012	The Legislative Council passed the motion on "Supporting the development of the securities industry "	Hansard Wording of the motion passed Progress report
12 December 2012	SFC published the consultation conclusions on the regulation of IPO sponsors	Press release Consultation conclusions
28 January 2013	The FA Panel discussed the relevant policy initiatives in the Chief Executive's 2013 Policy Address	Discussion paper (LC Paper No. CB(1)422/12-13(01))