

# Client Alert.

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May 10, 2012

## SFC Looks to Enhance the Regulation of Sponsors in Hong Kong

### *Potential Civil and Criminal Penalties under Consideration*

Against a background where Hong Kong has been the world's leading IPO center for the third year in a row, the Hong Kong Securities and Futures Commission (SFC) has published its much-anticipated consultation paper on the regulation of sponsors. In an effort to improve the quality of listings in Hong Kong, the SFC's proposals concern the conduct of sponsors in meeting their responsibilities in connection with new listings and aim to provide a regulatory basis for defining the expected quality of sponsor work.

One of the key proposals in the consultation paper, prospectus liability of sponsors, was first discussed in an SFC consultation in 2005 but subsequently it was considered premature to proceed at that time as the new non-statutory sponsor regime had yet to be fully implemented.<sup>1</sup> In recent years, the SFC has noted in a number of cases that sponsors failed to address issues that were fundamental to the listing applications. This culminated in a HK\$42 million fine and the revocation of the sponsor license for Mega Capital in April 2012. For a summary of the case and other key SFC enforcement actions to date, please click [here](#).

The first part of the consultation paper relates to the SFC's licensing regime for sponsors, with the SFC proposing to consolidate all key sponsor obligations in a new paragraph 17 in the Code of Conduct for Persons Licensed by or Registered with the SFC (Code of Conduct). The second part of the consultation paper relates to the legal liability of sponsors under the Companies Ordinance.

We set out a summary of the key proposals in the consultation paper below.

#### **Prospectus liability<sup>2</sup>**

To clarify<sup>3</sup> that a sponsor will have civil and criminal liability for untrue statements (including any material omissions) in a prospectus under Sections 40 and 40A of the Companies Ordinance.

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<sup>1</sup> To see SFC's Consultation Conclusions on the Consultation Paper on Possible Reforms to the Prospectus Regime in the Companies Ordinance issued in September 2006, please click [here](#).

<sup>2</sup> Under the proposal, public investors would be able to take legal action against sponsors (among others) in connection with untrue statements in a prospectus. It would also enable prosecutions of sponsors in serious cases.

<sup>3</sup> In the consultation paper, the SFC noted that it has been argued that sponsors may already be subject to civil and criminal liability under the Companies Ordinance for untrue statements in prospectuses, as they may fall under the definition of "promoters" (who are subject to civil liability) or a person "who has authorized the issue of the prospectus" (who are subject to civil and criminal liability). However, there is currently no case law in Hong Kong addressing whether sponsors are subject to these provisions.

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## Multiple sponsors<sup>4</sup>

To provide greater assurance to the market as to the quality of the listing documents, each listing transaction is restricted to either (i) a sole independent sponsor only; or (ii) a limited number of sponsors, each of whom should be independent of the listing applicant.

## Principals<sup>5</sup>

To increase the number of individuals who may qualify as Principals through (i) expanding the eligibility criteria by recognizing relevant experience acquired overseas in comparable jurisdictions, (ii) greater emphasis on experience in the area of due diligence, either in Hong Kong or elsewhere, and/or (iii) new examinations for Principals.

## Publication of first draft prospectus online at A1 stage

To encourage the submission of quality listing documents and to enhance the efficiency of the application process, the first draft of the listing document submitted with a listing application is to be made available on the website of the Stock Exchange of Hong Kong (Stock Exchange) when the application is made.

## Due diligence

To require sponsors to complete all reasonable due diligence on a listing applicant before submitting a listing application, save only any matters that by their nature can only be dealt with at a later date.

To codify the expectation in the Listing Rules concerning the quality of the listing application by requiring that before submitting a listing application, a sponsor should come to a reasonable opinion that the information in the listing application is substantially complete.

To clarify that a sponsor be able to form a reasonable opinion in relation to issues concerning eligibility criteria, internal systems and controls, and the credentials of directors prior to making a listing application.

To clarify that a sponsor should provide appropriate advice and

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<sup>4</sup> The current requirement under the Listing Rules of the Hong Kong Stock Exchange (Listing Rules) is for at least one sponsor to be independent of the applicant.

<sup>5</sup> To qualify as a Principal, an individual must, *inter alia*, demonstrate that in the five years immediately preceding his appointment as a Principal, he has played a "substantial role" in advising listing applicants, in the capacity of a sponsor, in at least two completed IPO transactions on the Main Board or the GEM Board of the Stock Exchange.

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recommendations to the 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.

To clarify certain interview practices when interviewing major business stakeholders (e.g., customers, suppliers, creditors and bankers) in order to ensure the interview results are accurate, complete and reliable.

## **Reliance on experts**

Sponsor should be able to show it is reasonable for it to rely on the expert sections of the listing document at the time of issue.<sup>6</sup>

## **Reliance on non-expert third parties to conduct due diligence**

To clarify a sponsor's obligations when working with third parties, including professionals such as legal counsel, and make clear that a sponsor cannot delegate its regulatory obligation to conduct due diligence.

## **Information to regulators**

To enhance disclosure to the regulators by the sponsors, including disclosing to the Stock Exchange in a timely manner any material information relating to the applicant or the application concerning non-compliance with the Listing Rules or other legal or regulatory requirements, and notifying the regulators of the reasons for ceasing to act.

## **Records**

To document certain prescribed matters in respect of each listing transaction, such as due diligence procedures, bases for the opinions, assurances and conclusions, involvement and supervision of sponsor's management.

To maintain a complete set of sponsor's records for at least seven years in Hong Kong.

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<sup>6</sup> To demonstrate reasonable reliance on the experts, including accountants and valuers, the proposed paragraph 17.6(g) of Code of Conduct sets out certain typical steps a sponsor should perform.

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### Resources, systems and procedures

To ensure sufficient resources are allocated to each listing transaction, with clear and effective reporting lines and channels.

Sponsor's management to review standard and extent of due diligence work, and to be closely involved in resolving suspicious circumstances, difficult or sensitive issues, conflicting information and material non-compliance.

The consultation period ends on July 6, 2012, and interested parties are encouraged to submit their comments in writing to the SFC. The SFC has stated that there is no definite timetable in place for implementing the proposed regulatory changes should they be adopted. In addition, any revisions to the prospectus liability provisions of the Companies Ordinance would be subject to further consultation with the Hong Kong government and would need to go through the normal legislative process, and accordingly would be on a slower timetable than potential revisions to the Code of Conduct and the Listing Rules.

For a copy of the consultation paper, please click [here](#).

For a copy of our Sponsors' Milestones guide, please click [here](#).

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