By email: ECM_DCM_consultation@sfc.hk
The Securities and Futures Commission
54/F, One Island East
18 Westlands Road
Quarry Bay, Hong Kong

7 May 2021

Dear Sirs

**Re. Consultation Paper on (i) the Proposed Code of Conduct on Bookbuilding and Placing Activities in Equity Capital Market and Debt Capital Market Transactions and (ii) the "Sponsor Coupling" Proposal**

This response is submitted by Charltons on behalf of Altus Capital Limited, Anglo Chinese Corporate Finance Limited, Asian Capital Limited and Frontpage Capital Limited (together the "Group" ). Capitalised terms used in this response bear the same meanings as in the consultation paper.

Overall, the Group agrees that there are a number of unsatisfactory aspects to the bookbuilding and allocation process for the international placing tranche of IPOs in Hong Kong and the recommendations set out in the consultation paper address some of these. However, the Group considers that the proposals fail to address the central issue of the conflict of interest between the issuer and the OC when it comes to the pricing and distribution of the issuer's securities. This is much more evident in equity issues than for debt. This, and the Group's other principal concerns are outlined below.

It must be evident that the interests of the issuer and the OC are not necessarily aligned. The most obvious of these conflicts is the propensity to underprice issues which may benefit underwriting syndicate members in many ways but clearly not the issuer. This is a key focus of the IOSCO ECM report. The Group appreciates that the IPO price is set at a level below where the price is expected to trade on listing. This is to enable a sustainable price to be determined through actual trades and the discount gives some headroom for this occur. When we refer to underpricing we refer to a price level lower than that required to assist in the price discovery process following listing, described above. This underpricing is particularly evident in large issues for which a heavy over-subscription is expected. In this circumstance, the OC may have in its gift the disposition of many hundreds of millions of US Dollars of potential short-term trading profits. The distribution of these potential profits must open the possibility of collateral benefits to the OC which more than fully compensate it for possibly lower aggregate underwriting fees by the underpricing of the issue. The type of information the consultation paper proposes to require will shine a light on the pricing and allocation process but it does not appear than this information will necessarily be made available to the issuer or give an issuer adequate time to receive impartial advice on how to respond to it.

The encouragement to underprice issues is also caused by the almost universal addition of the green shoe option to an IPO offering. Here the OC, in particular, earns further underwriting fees when no serious risk is being assumed or additional work undertaken. In many cases, it is difficult to see how the issuer benefits from the arrangement.

We suggest that whatever is proposed to improve the conduct of the bookbuilding and allocation process should also address the implicit conflict between the issuer and the OC. In order to do so, we believe that the issuer should be separately advised by a firm which is unconnected to those leading the

underwriting syndicate in connection with the pricing and distribution of the issuer's equity securities, so that the issuer is in a proper position to approve the pricing and the conduct of the distribution of its securities. This will require that the issuer and its financial adviser receive on a timely basis the information the paper proposes to make available to underwriting syndicate members.

The conflict of interest between the issuer and the OC is exacerbated if the OC is also the sole sponsor or the sole independent sponsor of the issue, because it gives the Sponsor OC far too great a leverage when it comes to decisions relating to the pricing and distribution of the issuer's securities. As the SFC knows, the sponsor needs to be in place at least two months before an application is made for listing. In practice, it is often in place for a period much longer than this. An underwriting syndicate need not be in position until quite late in the application process and that process should not be affected adversely by changes in the membership of an underwriting syndicate and, in particular, its OC. If an issuer decides to change its Sponsor OC this effectively sends the issuer back to the beginning of the listing process, causing months of delay and substantial additional costs. It also risks missing the market altogether. There is no such risk if an OC is replaced, provided it is not the sole or sole independent sponsor. For this reason, an issuer should not be put in a position of potentially being at the mercy of its Sponsor OC. We are therefore fundamentally opposed to the proposal that the independent sponsor must also act as OC. The sponsor should be in a position to decide whether to also agree to act as OC based on commercial negotiation and the merits of each case, as is the current position. The Group sees no justification whatsoever for preventing a firm from acting as the independent sponsor to a listing application solely because it lacks underwriting capabilities. The stated rationale for the sponsor coupling proposal is the risk of sponsors compromising their due diligence in order to win the more lucrative role as head of the underwriting syndicate.[1] However, if the SFC's primary concern relates to the quality of due diligence, the Group considers that this is best addressed by ensuring that sponsor work is properly remunerated by sponsor fees and that the sponsor's objectivity and impartiality is preserved by allowing it to not act as OC and thus unaffected by the exigencies of marketing and distributing the issue. The proposal also ignores the very different roles of sponsorship and leading an underwriting syndicate. Firms that possess one set of skills do not necessarily possess the other.

In view of the above, we believe a much wider canvas of the IPO market and the activities of participants is required and that the thematic review which is the basis of the present consultation is insufficient if real changes are to be made in the conduct of IPO bookbuilding and distribution to the benefit of issuers and market participants generally.

**Question 1: Do you consider the definitions of "bookbuilding activities" and "placing activities" to be clear and sufficient to cover key capital raising activities? If not, please explain.**

Yes, the Group agrees with the proposed definitions.

**Question 2: Do you agree with the proposed scope of coverage for both ECM and DCM activities?**

Yes.

**Question 3: Do you consider the role of an OC to be properly defined? If not, please explain.**

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[1] At paragraphs 4 and 8(b) to the Consultation Paper.

No. The Group does not consider it appropriate for the OC to be advising the issuer on the pricing and distribution of its securities due to a clear conflict of interest and considers that the issuer should instead by advised on these matters by a party (who could be an independent sponsor or financial adviser) who is not a lead underwriter. As detailed in the response to Question 18, below, the IOSCO ECM Report highlights circumstances where the underwriters may have an interest in pricing an equity IPO below its fair market value contrary to the interests of the issuer and sets out allocation practices which may advance the interests of banks or their other clients in a manner that is inconsistent with the interests of the issuer.[2] The Group also proposes that the OC should be required to provide the issuer and its adviser with the information it has at all stages of the bookbuilding and pricing process through to the exercise of the green-shoe. In practice, issuers are often left uninformed.

**Question 4: Do you agree that the appointments of OCs and other CMIs and the determination of their roles, responsibilities and fee arrangements, should all take place at an early stage?**

No. The role of the underwriters is very different to that of the sponsors. Whereas sponsors need to be in place from the beginning of the IPO process, the underwriting syndicate does not need to be in place until a much later stage. There is no practical need for the OCs to be appointed within two weeks of submission of the listing application. Further, there is no need for constancy in the make-up of the underwriting syndicate: on the contrary, flexibility is needed to cater for changes in liquidity in dynamic markets. This proposal risks seriously undermining the competitive dynamism and flexibility of the Hong Kong market, which is one of its strengths.

***Anti-competitive nature of proposal***

The Group questions the anti-competitive nature of requiring OCs to be locked in at such an early stage of the process. With regard to the Sponsor OC, the Group fundamentally disagrees with the sponsor coupling proposal. However, if it were to be adopted, the Group sees no justification for essentially preventing a change in the OC throughout a process which may last in excess of a year. There may be reasons why a firm wants to cease to act as OC – for example a market downturn – or is forced to cease to act as OC – for example, insolvency. The sponsor coupling proposal would then greatly disadvantage the issuer by forcing it to appoint a new sponsor OC and go back to the beginning of the IPO process with a new listing application. The Group considers that a firm should be able to continue to act as sponsor despite no longer wishing to act as OC. The issuer should retain the right to appoint the OC of its choice, based on commercial factors at the time.

The proposal that all OCs must be appointed within two weeks of the listing application is also anti-competitive and potentially detrimental to the interests of the issuer. The Group considers that the issuer should be able to change the make-up of the underwriting syndicate, including the OCs, until the offer is publicly launched or re-launched. This could not possibly prejudice the interests of investors.

***Entrenchment of asymmetrical underwriter/issuer relationship***

The contractual obligations of issuers and underwriters are already asymmetrical. Underwriting agreements impose binding obligations on the issuer, but represent what effectively amounts to an option for the underwriter(s). The proposed early appointment of OCs and CMIs will entrench that asymmetry

[2] IOSCO. *"Conflicts of interest and associated conduct risks during the equity capital raising process: Final Report"*. September 2018. At page 13.

which is contrary to the interests of issuers who should be free to change syndicate members (including OCs) to ensure that their best interests (and not those of the underwriters) are served.

The Group would also question whether, rather than creating more layers of intermediaries, there should be greater anticipation of a move towards direct listings as already seen on US markets.

***Dichotomy between large and small IPOs***

The Consultation Paper is written mainly in the context of large IPOs. While the proposals for the early appointment of the underwriting syndicate and OCs may serve the interests of bulge bracket bank sponsors of large IPOs, they fail to reflect the very different market dynamics on smaller IPOs and GEM IPOs. The issues facing firms on these very different transactions cannot be dealt with by the proposed one-size-fits-all solution proposed. As elaborated on in the response to Question 19 below, on smaller IPOs, potential underwriters typically expect the Listing Committee hearing date to be known before they commit. The insistence on determining the identity of the underwriters and the terms of underwriting early is thus likely to kill many smaller IPOs, and will greatly increase the number of IPOs which have to be pulled when syndicate members withdraw and cannot be replaced because of the timing requirements for the appointment of the syndicate.

The Consultation Paper notes that *some* market participants have informed it that market practice is to appoint OCs and determine syndicate membership and fees at the outset of transactions.[3] While this may be the case on larger IPOs, it is not the case for smaller deals.

**Question 5: Do you agree that an OC should provide advice to the issuer on: (i) syndicate membership and fee arrangements; (ii) marketing strategy; and (iii) pricing and allocation? If not, please explain. What else should the OC advise the issuer about?**

Given the conflict of interests inherent in the role of the lead underwriter, the Group disagrees with the proposal for OCs to advise issuers on syndicate fees, pricing and allocation. As noted above, the Group recommends that the issuer should be advised on these matters by an independent financial adviser who is not related to the lead underwriters.

The OC could however advise on syndicate membership and marketing strategy.

**Question 6: Do you agree that a private bank should not pass on to investor clients any rebates provided by the issuer? If not, please explain**.

No. The Group views this as a disclosure matter and considers that private banks should be permitted to pass these rebates on to investor clients subject to full disclosure being made.

**Question 7: Do you agree that an OC should provide relevant information to CMIs to enable them to identify investor clients which are Restricted Investors in share offerings or have associations with the issuer in debt offerings? If not, please explain.**

Yes.

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[3] At paragraph 23 of the Consultation Paper

**Question 8: Do you agree that information about the underlying investors should be provided to an OC by CMIs placing orders on an omnibus basis when they place orders in the order book? If not, please explain.**

No. The Group considers that the order book should disclose the identities of all investors, including the underlying investors of omnibus orders. Alternative methods of tackling the issue of CMIs poaching clients could be adopted, such as no-poach agreements.

If it is ultimately decided that the identities of underlying investors should not be included in the order book, then as set out at paragraph 92 of the consultation paper, their identities should be provided to both the OC and the issuer.

**Question 9: Do you think there would be difficulties in a large IPO or debt offering for OCs to remove duplicated orders and identify irregular or unusual orders in the order book? If so, please provide examples.**

No. Banks' fees should cater for the costs of checking for duplicate, irregular or unusual orders. The Group considers that standard obligations should be imposed which apply irrespective of the size of the issue: the requirements for large banks should not be less onerous than those for smaller banks.

In relation to IPOs, the problem of duplicate or invalid orders is one of the matters proposed to be addressed by the proposed Fast Interface of New Issuance ("FINI"). According to the Hong Kong Stock Exchange's November 2020 Concept Paper, all public offer subscriptions will be checked for duplicates at the point of submission and placees submitted by distributors in the institutional offer tranche will be checked against other placees and the list of public offer subscribers.[4] However, FINI is not expected to be launched before the second quarter of 2022, at the earliest. The Group also notes the need to identify investors who place multiple orders using different identity documents (such as using different reported names as shown on HKID cards, PRC ID cards and Mainland Travel Permits for Hong Kong and Macau residents).

One Group member noted that the checking of duplicate orders is primarily an IT issue which will require an IT solution. It observed that the current system involves inherent difficulties in checking duplicate orders which it may only be possible to address on a best efforts basis. This member also noted that improvements in the data captured from orders and the settlement process could improve CMIs' ability to identify duplicate orders.

**Question 10: Do you agree that OCs and CMIs should not accept knowingly inflated orders? If not, please explain.**

No. The Group considers that it may be virtually impossible to establish whether or not an order is "knowingly inflated". If this obligation is to be imposed, accurate criteria will need to be established for identifying of "knowingly inflated" orders. Moreover, on popular issues, subscribers and placees have a commercial rationale for "tactically inflating" their orders to improve their chances of receiving an allotment on issues that are over-subscribed.

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[4] HKEx. "Concept Paper: Modernising Hong Kong's IPO Settlement Process". November 2020. See page 44.

**Question 11: Do you agree that OCs should ensure the transparency of the order book? If not, please explain.**

The Group requests clarification as to who the OC would be ensuring "transparency" for, the other syndicate members and the issuer? The Group considers it essential that the order book should be transparent to both the issuer and the CMIs.

**Question 12: Do you agree that "X-orders" should be prohibited? If not, please explain.**

Yes. If the aim is transparency, X-orders should be prohibited.

**Question 13: Do you agree that OCs and CMIs should be required to establish and implement allocation policies? If not, please explain.**

Yes. The Group generally agrees with this proposal as there needs to be some basis for the allocation to be fair. However, some degree of flexibility would need to be built in to allow for deviation from an allocation policy in exceptional circumstances.

**Question 14: Do you agree that client orders must have priority over proprietary orders at all times? If not, please explain.**

Yes. This is already a requirement under the SFC Code of Conduct (at paragraphs 9.1 and 9.2). If there are concerns that intermediaries are prioritising proprietary orders over client orders, the SFC has ample powers of investigation and enforcement under the SFO to put a stop to these activities.

**Question 15: Do you agree that proprietary orders can only be price takers? If not, please explain.**

The Group would like clarification as to the meaning of "price takers" as used in proposed paragraph 21.3.10(b)(ii) of the Code of Conduct and the proposed scope of the provision.

While the Group obviously agrees that CMIs should not be able to use proprietary orders to manipulate pricing, it fails to understand why proprietary orders should not be allowed to be used for price discovery and is concerned that excluding proprietary orders could lead to under-pricing.

**Question 16: Do you agree that a CMI's proprietary orders and those of its Group Companies should also include orders placed on behalf of funds and portfolios in which a CMI or its Group Companies have a substantial interest? If not, please explain.**

Yes.

**Question 17: Orders received and entries placed in the order book are subject to constant amendments and updates throughout the bookbuilding process. Do you think it is feasible for the OC and CMIs to maintain records which evidence every change? If not, please explain.**

Yes.

**Question 18: Do you agree with the scope of fee-related advice to be provided by an OC to an issuer? If not, please explain.**

No. As noted in the response to Question 3 above, the IOSCO ECM report referenced in the Consultation Paper emphasises underwriters' conflict of interest regarding pricing, and the risk of under-pricing to mitigate the underwriting risk contrary to the interests of the issuer. In relation to its proposed Measure 7, the IOSCO ECM report states that:

> *"Regulators should consider introducing Guidance which explicitly requires the firm to manage any conflicts of interest in relation to the pricing of an equity securities offering, ensuring that pricing does not reflect its own interests or those of its investor clients in a way which compromises the issuer's interests."*[5]

The proposed Code of Conduct provisions do not contain any obligation on an OC to manage the conflict of interest arising where underwriters advise on pricing. Given that first-time issuers have no experience of pricing and the conflict identified by IOSCO, the Group considers that where serious conflict of interest has the potential to exist, the issuer should be advised on pricing by an independent third party adviser to the issuer.

The Group also considers the term "fee-related advice" to be misplaced. The OC should instead be required to provide the issuer with transparent fee-related information, on the basis of which the overall fee should be negotiated.

The Group additionally points out that if the SFC expects issuers to manage their investor base in the future, issuers need to be provided with transparent information on allocation.

**Question 19: Would you envisage substantial practical difficulties in an issuer determining the syndicate membership, the ratio between the fixed and discretionary portions of the fees to be paid to all syndicate CMIs and fixed fees allocation four clear business days before the Listing Committee Hearing? If yes, please cite examples.**

Without proper advice, the process of determining the syndicate composition and related fees is likely to be difficult for a new issuer for which this will be a new experience. However, if the issuer is independently advised by a financial adviser which is not the lead underwriter, as the Group suggests, the position should be considerably improved.

Generally, the OC should be in a position to decide on the ratio of fixed to discretionary fees. As to the proposed timing, the Group considers that this could prove problematic: market conditions can change overnight with changes to the liquidity in the market and numerous other factors, requiring the total fees amount and the fixed/discretionary fee ratio to be renegotiated. In this situation, the OC would need to be able to notify the SFC of changes to the fee information previously provided.

***Dichotomy of position on larger and smaller IPOs***

The Consultation Paper appears to be primarily concerned with the position on larger IPOs where the bulge bracket banks may have an interest in getting the syndicate and their fees locked in at an early stage of the transaction. However, the market dynamics on smaller IPOs, and particularly GEM IPOs, are

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[5] IOSCO ECM Report at page 21.

completely different. For that reason, the Group would question the proposed adoption of a "one-size-fits-all" solution, as noted above.

A prime example of the dichotomy between large and small IPOs can be seen in relation to the degree of uncertainty that listing approval will be granted which may be virtually non-existant for many large IPOs, but high for small IPOs. The proposed requirement to notify the syndicate membership and fees four clear business days before the Listing Committee hearing is thus unlikely to be problematic for large deals, but completely impractical for smaller deals.

The SEHK typically only confirms the Listing Committee hearing date a few days prior to the hearing, sometimes on a Tuesday for a Thursday hearing the same week. That being the case, the OC on a smaller IPO currently approaches potential underwriters after receiving confirmation of the Listing Committee hearing date but not before. If the SFC requires confirmation of the matters referred to in paragraph 135 four clear business days before the Listing Committee hearing, the pre-marketing would need to be brought forwards. However, with small deals in particular, underwriters are generally unwilling to commit until there is reasonable assurance that the deal will go ahead. Potential underwriters typically expect the Listing Committee hearing date to be known before they commit. Even on large transactions, problems can still arise at a late stage, as was the case on Ant Group's proposed IPO. The proposed timing for OCs to provide the SFC with details of the underwriting syndicate and fees is therefore unlikely to be achievable on smaller IPOs.

**Question 20: Would you envisage substantial difficulties in issuers determining the allocation of discretionary fees and the fee payment schedule no later than listing? If yes, please cite examples.**

No.

**Question 21: Do you agree that: (i) the syndicate membership (including the names of OCs) should be disclosed at an early stage; (ii) the total fees to be paid to all syndicate CMIs participating in the offering for the international placing tranche should be disclosed in the prospectus; and (iii) the total monetary benefits paid to each syndicate CMI should be disclosed after listing? If not, please explain.**

With regard to (i), please see the response to Question 19 above as to the difficulties of disclosing syndicate membership four clear business days before the listing committee hearing date on smaller IPOs.

With regard to (ii) – disclosure of the total fees paid to all syndicate CMIs in the international placing tranche, the Group is of the view that it may be more appropriate to disclose this information in an announcement, rather than the prospectus, as this information may not be fixed and available at the time the prospectus is published.

With regard to (iii), disclosure of this information and putting it into the public domain is considered to be helpful.

**Question 22: Do you agree with the "sponsor coupling" proposal? If not, please explain.**

No. The Group strongly objects to mandating that the sponsor be the OC. The preparation of a company for listing and the underwriting of an issue are two very different processes, with the former starting much earlier than the latter. As already noted in the introduction to this response, the proposed sponsor coupling proposal will entrench the OC's conflict of interest vis a vis the issuer. If an OC who is also the

sole sponsor or the sole independent sponsor decides it no longer wants to underwrite an issue, the issuer will be forced to appoint a new sponsor forcing a delay of at least two months and probably longer. As noted above, the sponsor coupling proposal would effectively allow the Sponsor OC to hold the issuer hostage in these circumstances.

***Inconsistency with approach in 2012 consultation on sponsor regime***

The proposal is also inconsistent with the thinking behind the 2013 sponsor regime which recognised the need for an independent sponsor to ensure the objectivity of the due diligence process etc. Indeed the SFC's original proposal was to allow only one independent sponsor, and if multiple sponsors were allowed, these would all need to be independent.[6] The sponsor coupling proposal is thus entirely contrary to the spirit of the sponsor regime which put the emphasis on the independent aspect of sponsor work. Moreover, the proposal ignores the potential for conflict between the role of the sponsor and that of the lead underwriter.

The fees paid to sponsors are clearly not commensurate with the amount of sponsor work undertaken. The SFC notes in the present consultation paper that, "*When sponsors also act as the head of syndicate, the total fees may properly compensate the additional sponsor resource commitments and responsibilities. However, if sponsors are not appointed as head of syndicate from the outset, there are concerns that they may be incentivized to compromise due diligence to secure the appointment*".[7] This explanation is however entirely contrary to that given by the SFC in the 2012/2013 sponsor consultation where it argued that "*... the sponsor's role is crucial and should be recognized as such in [the] fees charged. By not allocating an appropriate amount of the overall fee to the sponsor's role, firms risk sending a signal to their staff and their clients that the sponsor's role is less important and relevant than the bookbuilding, pricing and other services provided in connection with a listing which may in turn contribute to standards in some sponsors falling below expectations. Accordingly we encourage all firms to ensure than an appropriate portion of the total fee is designated as the sponsor fee*".[8] The Consultation Conclusions supported this position stating that "*sponsor fees should appropriately reflect the role and responsibilities to be discharged by a sponsor and should not be confused with other services, notably bookbuilding, pricing and similar functions governed by underwriting and related agreements.*[9]

Accordingly, if the SFC is concerned about the quality of due diligence, the answer lies in requiring the sponsor fee to be set separately at an amount which properly reflects the amount of work the sponsor will perform. This objective will not be achieved by seeking to remunerate the sponsor largely from success-based commissions.

***Disadvantaging boutique sponsor firms***

The Group is additionally concerned that some sponsor firms, particularly smaller firms, may be very well set up to sponsor issues but not to underwrite them. As noted in the Consultation Paper, 6% of sponsors do not have a Type 1 licence or a group member with a Type 1 licence. This proposal would place many small but highly professional firms at a severe disadvantage. The Group is not convinced that there is any need for this proposal as they do not find there to be any evidence of difficulties where the sponsor has

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6 SFC. Consultation Paper on the regulation of sponsors. May 2012. At paragraph 108.

7 At paragraph 140(e).

8 SFC. Consultation Paper on the regulation of sponsors. May 2012. At paragraph 99

9 SFC. Consultation Conclusions on the regulation of IPO sponsors. December 2012. At paragraph 60

not also been the lead underwriter. On the contrary, many of the SFC enforcement actions against sponsors have involved sponsors which also acted as lead underwriters, for example on the IPOs of Tianhe Chemicals Group Limited and China Forestry Holdings Company Limited.

The sponsor coupling proposal ignores the fact that the skill set a firm requires to act as sponsor is completely different to that required for underwriting. The preparation of a company for listing and the conduct of due diligence is a specialised role which does not require a balance sheet large enough to act as underwriter nor the ability to distribute shares internationally. Conversely, a large balance sheet and distribution capabilities do not mean that a firm is suitable to act as sponsor.

The Group would ask that the SFC reconsider this proposal, the practical effect of which will be to make it impossible for many small highly professional sponsors to act as sponsors. A boutique sponsor could act as a joint sponsor in theory, but not in practice. In 2020, just 50 of the 136 new listings on the Main Board[10] had joint sponsors. These were all large IPOs. Boutique sponsors are even less likely to be appointed as joint sponsors on GEM IPOs. Given the replication of due diligence work involved in joint sponsorship, joint sponsorship is only seen on the very largest deals in Hong Kong. Taken together with the SEHK's proposals to only allow extremely large companies able to meet the proposed increased financial tests to list on the Main Board, the SFC's proposal to require the independent sponsor to also be the lead underwriter risks driving smaller sponsors out of business. Since these are generally Hong Kong businesses, this will also deprive the market of local expertise and reduce employment opportunities for the local population.

The Group is particularly surprised that the SFC is proposing a provision which is anti-competitive.

***Lack of justification for proposal***

The misalignment between sponsor fees and sponsor costs and responsibilities which is given as one of the reasons for the proposed sponsor coupling is noted as being a feature of larger IPOs at paragraph 140(e) of the Consultation Paper. If that is the case, the Group would question the justification for extending the proposal to all IPOs, particularly smaller GEM IPOs. The Group also fundamentally disagrees with the SFC's statement that in "larger IPOs ... sponsors typically incur substantial costs and ... the potential consequences of regulatory breach can be severe". There is not necessarily a substantial difference in the amount of sponsor due diligence conducted between small and large IPOs. In 2014, the Securities and Futures Appeals Tribunal rejected the argument that a smaller GEM listing warranted less due diligence than a Main Board listing given the lower sponsor fees paid on GEM listings compared to Main Board listings. The Appeals Tribunal confirmed that there is no difference in the standards of due diligence required on GEM and Main Board listings, noting: "*the same level of care and expertise is required in the manufacture of a Mini as a Rolls-Royce.*[11] As demonstrated by the SFC's revocation of the sponsor licence of Mega Capital (Asia) Company Limited for its work on the Hontex International Holdings Company Ltd IPO, the consequences for sponsors of regulatory breach can be more severe on smaller IPOs than larger ones. The extent of sponsor work and risks on smaller (typically GEM) IPOs lends support to the argument that sponsor fees should be required to properly reflect the work and responsibilities involved. This would prevent boutique sponsor firms being disadvantaged where they lack the capacity to act as underwriters.

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[10] Excluding transfers from GEM and listings by introduction

[11] Decision of the Securities and Futures Appeals Tribunal in Sun Hung Kai International Limited v Securities and Futures Commission SFAT Application No. 3/2013

***Proposal not supported by the IOSCO ECM Report***

There is nothing in the IOSCO ECM report to warrant the proposed sponsor coupling. If anything, the conflicted position of underwriters in advising issuers on pricing referred to above would seem to support a decoupling rather than a coupling of the roles of the independent sponsor and OC. While the Listing Rule definition of sponsor "independence"[12] does not prevent an OC from acting as an independent sponsor, the inherent conflict in the underwriters' position identified by IOSCO surely raises questions as to the extent to which a Sponsor OC can really be regarded as independent and impartial where it has an interest in mitigating its risk as underwriter. The Group would request that the SFC explain its rationale for entrenching an obvious conflict of interest which will disadvantage issuers and potentially benefit underwriters.

***Retention of the status quo***

In the event that the sponsor coupling proposal were not to be rejected completely, to the extent that an OC can be a sponsor, there should be arrangements to deal with any conflicts that arise.

**Question 23: Do you think one Sponsor OC is adequate or should more OCs be required to act as sponsors? For example, should the majority of OCs be required to act as sponsors (ie, if the issuer appoints three OCs, two must also act as sponsor)? Please explain.**

Given the conflict of interest between the issuer and the lead underwriter, there should be no requirement for an OC to act as a sponsor. As was recognised by the 2012 sponsor consultation, there is considerable advantage in having an independent sponsor conduct due diligence on a listing applicant. As already noted, the Group strongly disagrees with the proposal to mandate that the independent sponsor should be the lead underwriter. It must be possible for a firm to act as sponsor without also being an underwriter. The Group would not generally encourage joint sponsorship which tends to be onerous and expensive for the issuer without yielding any more in terms of results.

**Question 24: Do you have any comments on the proposed implementation timeline?**

The proposed 6-month transition period is too short. Many smaller IPOs take 12-18 months and sometimes longer to list. In these cases, the proposed implementation time could mean that a sponsor that has already been appointed is disqualified from acting if it does not have underwriting capabilities.

[12] Listing Rule 3A.07