COMMENT LETTER IN RESPONSE TO THE 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

We, China International Capital Corporation Hong Kong Securities Limited, are pleased to submit this response letter to the 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 (the "Consultation Paper").

Hong Kong has been a major international finance centre for corporate fund raisings via offerings of equity and debt securities. It is therefore vital to promote high standards of behaviour amongst the intermediaries who arrange offerings. We support the SFC's initiative to bring regulatory regime governing the conduct of bookbuilding or placing activities by intermediaries in Hong Kong in line with the international best practice.

Given the potential impacts of the Proposed Code on the bookbuilding and placing process, Asia Securities Industry & Financial Markets Association ("ASIFMA") and International Capital Market Association ("ICMA") have held several rounds of discussions with their respective members in respect of the proposals in the Consultation Paper. We, as a member of ASIFMA and ICMA, have actively participated in the discussions, and our responses to each of the questions set out in the Consultation Paper will be reflected in the detailed responses of ASIFMA and ICMA. Below are our views on certain specific aspects of the proposals that we wish to highlight to the SFC. The terms used in this response letter shall have the same meanings as those defined in the Consultation Paper unless otherwise defined herein.

Introduction of "CMI" and "OC" roles

The Consultation Paper proposes to introduce new roles for intermediaries, namely, "OC" and "CMI". Under the existing framework of ECM and DCM markets, there have been long-established titles in capital markets such as sponsor, joint global coordinators ("JGC") and joint bookrunners ("JBR") and different roles perform different functions. Therefore, we welcome more clarify on how the new roles fit into the existing framework.

We suggest:

- For IPOs, the SFC require (i) all sponsors to be appointed as OCs (i.e. sponsor OC); (ii) non-sponsor OC roles to be performed by JGCs; and (iii) CMI roles to be performed by JBRs.
- For other ECM and DCM transactions, OC roles should be performed by JGCs and CMI roles be performed by JBRs.

We believe our proposal would avoid disruption to the market and be in line with overseas capital markets. Although there are boutique corporate finance firms that act as sponsors only, a vast majority of the sponsors also act as JGCs. Under the existing sponsor regime, sponsors are required to conduct comprehensive due diligence by PN21 of the Listing Rules and paragraph 17

of the Code of Conduct, which would enable them to fulfil the responsibilities of OCs as set out in the Proposed Code. Further, the responsibilities of JGCs and JBRs are similar to OCs and CMIs, respectively.

Compensation of intermediaries

In a typical HK IPO, compensation of an intermediary that acts as sponsor and normally also JGC consists of (i) sponsor fee; (ii) underwriting commission; (iii) brokerage fee; and (iv) discretionary incentive fee. (i), (ii) and (iii) are fixed fees and (iv) is discretionary fee.

Fee arrangement

Paragraph 131 of the Consultation Paper states that *"[b]ased on the feedback received during soft consultations and as derived from IPO prospectuses published between 1 January and 30 September 2020, the market norm for fees in share offerings is around 70-75% fixed fees and 25-30% discretionary fees"*.

We propose that 75%-85% of the fixed fees should be allocated to sponsor OCs for the following reasons:

- The Code of Conduct requires that a sponsor *"should have (i) performed all reasonable due diligence on the listing applicant except in relation to matters that by their nature can only be dealt with at a later date, and (ii) ensure that all material information as a result of this due diligence has been included in the Application Proof"*. The Application Proof is required to be substantially complete under SEHK guidance letter (HKEX-GL56-13). Therefore, sponsors have already conducted substantial due diligence before A1 submission, and also before appointment of non-sponsor OCs as those OCs are only required to be appointed two weeks after A1 submission. Further, after the reform of sponsor's regime in 2013, sponsors are responsible for accuracy of prospectus disclosure. Accordingly, sponsors are entitled to compensation that is commensurate with their responsibilities.

- We understand that there are complaints from buy-side market participants that the bankers who interact with them do not have a reasonable level of seniority to provide proper service. This is because sponsor fee for an Hong Kong IPO ranges from US$0.5 million to US$1 million and the rate of underwriting commission in Hong Kong is relatively low compared to the US and PRC. As a result, intermediaries' compensation in Hong Kong IPOs does not allow heavy involvement of senior execution bankers.

Stabilization profits

Stabilisation is a necessary form of market manipulation to facilitate issuers' capital raising by addressing short-term fluctuations resulting from the sudden increase in supply in the secondary market. Therefore, the Securities and Futures (Price Stabilizing) Rules ("the Rules") provide a limited safe harbor from the market misconduct provisions of the SFO for stabilizing

activity carried out in accordance with the Rules. Pursuant to the Rules, stabilizing managers have various regulatory obligations to fulfil in performing their role. To preserve the integrity of the safe harbour, the Rules prohibit communications between stabilization traders and issuers that could be interpreted as directing, procuring or influencing the conduct of such traders.

It has been the market practice that the underwriters will share any stabilisation profit or loss among themselves. This is sensible because stabilizing managers should be compensated for its work. However, in recent years, we start to see aggressive issuers claim a portion or even all of the stabilisation profits.

Allowing issuers to take stabilization profits may distort and adversely affect the smooth running of the stabilization mechanism. Also such allocation of stabilization profits is unfair given that it is the stabilization manager who leads the time-consuming and labour-intensive stabilization process and bear the risks and costs. Moreover, allowing issuers to keep stabilization profit may incentivise issuers to fix the IPO price at the high end so that the share price is more likely to fall after listing, or even deliberately release negative news to push down share price. In either scenario, the issuers will benefit at the expense of retail investors. From a regulatory perspective, there is sufficient transparency around stabilization profits, which can be calculated from the stabilization announcement. Accordingly, the stabilization process is subject to sufficient public scrutiny and we do not see any compelling need to change the current dynamics of stabilization, including the allocation of stabilization profits.

Rebates from brokerage fee

Paragraph 83(a) of the Consultation Paper states that "*[u]nder the Proposed Code, a CMI should not offer any rebates to its investor clients or pass on any rebates provided by the issuer*".

We support the proposal. We note that certain institutional investors with strong bargaining power have requested rebates from the brokerage fee. Paying rebates to those investors would result in such investors participating in an offering at a price that is effectively lower than that offered to other investors, which is inconsistent with the requirement of equal treatment of holders of listed securities under Rule 2.03(4) of the Listing Rules.

DCM transactions

Application of the Proposed Code to DCM and ECM transactions

It seems that the SFC's intention is for the same set of proposed rules to be applied to both ECM and DCM transactions. We suggest rules be tailor-made for each of ECM and DCM markets as the two markets are different in terms of market dynamics, market players and investor base.

In particular, while ECM transactions can involve retail investors or are even required to allocate certain portion of the offer shares to retail investors, DCM transactions in Hong Kong are predominantly offerings of debt securities under Chapter 37 of the Listing Rules and therefore may only be marketed to institutional and professional investors. As such, relative sophistication of the target investor bases is fundamentally different. The difference between DCM and ECM

transactions is also evidenced by the different requirements of listing of debt securities and equity securities under the Listing Rules. Issuers of debt securities listed under Chapter 37 are subject to much less onerous requirements compared to companies applying for listing of their shares on the SEHK.

Further, the Consultation Paper mentioned the reports published by IOSCO on conflicts of interest and associated conduct risks as reference point of global standards. IOSCO published separate reports for DCM and ECM transactions, namely the Report on Conflicts of Interest and Associated Conduct Risks during the Debt Capital Raising Process in September 2020 and the Report on Conflicts of Interest and Associated Conduct Risks during the Equity Capital Raising Process in September 2018.

Scope of coverage

We suggest that the Proposed Code should be applied to DCM transactions with a certain degree of Hong Kong nexus, for instance, (i) debt securities that are listed on SEHK or (ii) debt securities offering where a majority of syndicate members are SFC-licensed banks based in Hong Kong and a majority of the demand is expected to be from Hong Kong investors.

Proprietary orders

Paragraph 108 of the Consultation Paper states that *"[w]e propose that a CMI should... give priority to investor clients' orders over its own proprietary orders and those of its Group Companies and only be a 'price taker' in relation to its proprietary orders and those of its Group Companies"*.

Although it has been an established market practice for orders made by flow trading desk for market making purpose to give priority to investor clients' orders, we consider that (i) proprietary orders of CMIs funded by their own money and (ii) orders from external investor clients should be treated pari passu with other orders in terms of both pricing and allocation for the following reasons:

- Based on our experience, proprietary orders from our asset management and fixed income departments are made on an arm's length basis.

- It is a common practice for PRC issuers to require investment banks to provide commitment letter as a pre-condition to participate in their debt securities offering. Orders made in such circumstances are not for the purpose of discriminating external orders. Therefore, subordinating the ranking of such proprietary orders will not serve the purpose of resolving potential conflicts of interest.

- Proprietary orders from well-established financial institutions are a sign of confidence in prospect of the relevant issuer, and help attracting investors thereby facilitating the bookbuilding process.

- Such proposal may deprive the CMIs' proprietary trading desks of the natural right to invest vis-à-vis other investors in the market.

- The Management, Supervision and Internal Control Guidelines for Persons Licensed by or Registered with the SFC and the Corporate Financial Advisor Code of Conduct require investment banks to establish a Chinese Wall between their proprietary trading desk and the capital market desk (which would perform the functions of OC or CMI). Accordingly, there is no exchange of information between the two business units, so proprietary traders, like other investors in the market, place orders solely based on their professional judgment with no access to any inside information.

Timing of appointment of CMIs

For DCM transactions, we suggest that the CMIs should be appointed by issuance of the initial price guidance ("IPG") for repeated issuers as such transactions can be launched with IPG message only and be completed within a day. Debut issuer will need to announce the mandate when the transaction is formally launched and may face some uncertainties and challenges from investors. Therefore, such issuers should be given the flexibility to appoint additional CMIs after the mandate announcement is issued to mitigate market risks.