

SFC 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

Our response to the said consultation will have two major sections, part 1 is our major concern which is not mentioned in the question as stated in the Proposed Code; and part 2 is the comment where in respect to the questions as stated in the Proposed Code.

Part 1

1. The Consultation refers to the IOSCO Reports published in 2018 and 2020, which provide guidance on conflicts of interest and conduct risks during equity and debt capital raising processes, relating to:
 - Conflicts of interest and pressure on analysts;
 - Conflicts of interest during the allocation of securities;
 - Conflicts of interest and conduct risks in the pricing of securities offerings; and
 - Conflicts of interest and conduct risks stemming from personal transactions.

The first and the fourth issues are largely covered by existing rules and regulations in Hong Kong and not included in the Consultation and the Proposed Code. However, it is our view that the second and the third issues are not correctly addressed, *inter alia*, in **paragraphs 94-105** or other parts of the Consultation and the related Proposed Code – see our specific comments in question related to pricing and allocation below, assuming one of the key objectives the proposed regulations is to adopt the IOSCO guidelines in Hong Kong.

Given the **potential significant impacts** on or **distortion** to market development and the industry which has a wide spectrum of participants in Hong Kong as a **major international financial centre** for corporate fund raising through share and debt offerings, we recommend the Commission to take further reviews and consultations before concluding on the current proposals

2. Objection to include brokers (distributor) as non-syndicate CMLs

Under point 50(c) of the said consultation when defining “Non-syndicate CMLs”, “.....(ii) *brokers which only collate orders received from their investor*”

clients, place them with the syndicate CMIs and distribute the securities to their clients if they receive allocations from the syndicate CMIs.” We considered that the non-syndicate CMIs that being the sub-placing agent which has an indirect relationship with the issuer, however, if it also covers the broker that being distributors of relevant securities, the following rules are likely impossible to carry out :

(a) s.21.3.1 – Assessment of issuer client and offering

As a distributor, non-syndicate CMIs broker is not engaged by the issuer, but merely broker of the investor client, except requesting the information from the OC and/or syndicate CMI or relying on information publicly available e.g. prospectus, non-syndicate CMIs broker cannot take any further reasonable step to obtain any accurate information, moreover, as a distributor, it is rather remote to assess actual or potential conflict of interest between them and issuer.

(b) s.21.3.2 – appointment of CMI

Appointment of non-syndicate CMIs normally happened depends on market condition, such as potential shortfall on subscription, sub-placing agent maybe appointed to boost up the placing activities, to avoid some CMIs merely obtained the title as syndicate member, role and responsibilities should be defined upon appointment, but hardly unlikely it can be happened prior to bookbuilding. For non-syndicate CMI being distributor only, they are the broker of the client which do not have the underwriting obligation but merely an settlement agent for the client who intends to subscribe for the securities, as their role is functioned at the last stage of the trading cycle, it is likely impossible to appoint them prior to bookbuilding.

2. **Assessment of Issuer Client s21.3.1 and s21.4.7**

We agreed that assessment of the issuer client is of paramount, however the requirement in the Proposed Code is beyond broadly.

(a) While OC is responsible to share information about the issuer client with CMIs or take reasonable steps to ensure that issuer client provides this information to them, in the case where multiple OCs are appointed, information to be shared may not be consistent;

(b) While CMI is required to take reasonable steps to obtain an accurate understanding of the issuer client and formulate governance framework to review, in reality, CMI can only rely on information

provided by the OC, with limited information, hardly CMI can form any standard for reviewing purpose. OC might also be reluctant to share information to CMI, particularly to non-syndicate CMI, due to confidentiality concern and in the cases where MNPI might possibly be involved e.g. spin-off.

- (c) While CMI is also required to share the information to the non-syndicate CMI, the burden on the non-syndicate CMI is too high to conduct the responsibilities in (2) above (except for the assessment on conflict of interest which is already governed by SFC Code of Conduct as well as the Main Board Listing Rules – Placing Guidelines for Equity Securities), as their role and responsibilities are indeed very limit, i.e. merely a settlement agent

General Conclusion

Whilst we agree and support the principles and objectives of enhancing robust price discovery, fair allocation and level playing field set out in the Consultation, we do not believe the proposed regulations would achieve those principles and objectives. In fact, most of the proposed requirements would go in the **opposite direction** of promoting and enhancing market competition at the expense of freedom of choice of the issuers, investors, other market participants and the healthy and continuous development of Hong Kong as a major and competitive international financial centre potentially in favour of a **handful of dominant players**.

The **two significant risks** identified by the **IOSCO Reports** of the real conflicts of interest between the issuer and the lead underwriters on pricing influence and dominance, and conduct behaviours relating to unfair allocations to most valued clients (if not also other parts of the firm's business) are **not addressed** specifically or as integral parts of a single policy package.

In view of the **potential significant impacts** on or **distortion** to market development and the industry which has a wide spectrum of participants in Hong Kong as a **major international financial centre** for corporate fund raising through share and debt offerings, we recommend the Commission to take further reviews and consultations before concluding on the current proposals.

Part 2

- 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.**

As the Proposed Code is governed the licensed corporation who is engaged in providing service on bookbuilding and placing activities, some licensed corporations may use their oversea entity as the OC to avoid being regulated under the Proposed Code, hence, it is suggested that the OC (or at least one OC) must be a Hong Kong SFC regulated entity.

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

Please clarify whether or not club deal and/or any other transaction where the issuer and the investor(s) have direct pre-arrangement existed.

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

The Consultation refers to comments by buy-side firms regarding confusions as to the roles and responsibilities of the intermediaries in an offering. However, it is our view that it is well understood in the market that the senior members (ie JGCs) are responsible for the book-building and final allocation. This is similar to the roles and responsibilities of a sponsor, which is well understood internationally.

To add new terminology or titles to the participants of an offering (ie OCs and CMLs) will not address but in fact increase the confusion including, without limitation, whether such new terms or titles will be separately disclosed to the market (eg at the time of appointment and changes) and/or in public documents of an offering.

Contrast this with the Commission’s licensing regime and regulations on Responsible Offers, Licensed Representatives, Overall Management Oversight and Managers- in-Charge etc, which are purely within the remit of the Commission and the market participants upon which it regulates in Hong Kong, and does not concern investors in Hong Kong or internationally per se and are not separately disclosed in public documents in any offering which use internationally understood terminology.

One option is to retain the use of the term JGCs (and non-JGC participants) for the purposes of any new regulations and let the market and its participants decide whether to assume the roles and responsibilities for which they may be regulated. This would also help to prevent “title inflation” in an offering whereby only those participants who actually undertake the regulated roles and responsibilities should be appointed and publicly disclosed as such and investor would have no confusion in this regard as pointed out by the Consultation.

The market participants who choose not to assume the regulated roles and responsibilities (ie active participation in the book-building and final allocation) could choose to adopt a title commensurate with their actual roles and responsibilities and also regulated accordingly.

As regards to the difference between non-JGC participants who are named in the public documents of an offering and other distributors who are not named in the public documents (ie sub-underwriters and distributors), investors would also have no confusion as to their respective roles and responsibilities by reference to the public documents of an offering.

In the event that the Commission disagrees with retaining the use of the term of JGCs (and the established market non-JGC titles) for the proposed regulations, the Consultation does not make clear whether the appointment of the OCs (and CMLs) should be **publicly disclosed** (presumably **at the time of appointment**) or separately in the **application proof and subsequent public documents** of an offering.

In fact, it is currently not a practice or requirement to disclose the names of the underwriter(s) in the application proof of an offering. Does the Commission intend to make it a rule to change the **current practice and requirement**? Please clarify.

We agree with the requirements of assessment of the issuer and the offering by the top level and other underwriters, including the **sharing of information**. However, the Consultation falls short on how and to what extent such information must be shared, particularly by the OCs, which we believe is difficult to regulate and enforce in practice.

4. **Do you agree that the appointments of OCs and other CMLs and the determination of their roles, responsibilities and fee arrangements, should all take place at an early stage? If not, please explain.**

The proposed regulations have the effect of imposing the issuer to grant a **written mandate** to the OCs (and each of the CMIs) which is not an established practice in other jurisdictions including the US and the UK. Whilst we welcome the perceived advantage in securing the roles and responsibilities of the OCs and CMIs at an early stage, there is a strong risk that the terms of such mandate **may prove very general**, including the description of remuneration may be in a range instead of any exact amount or percentage.

In addition, as the composition of the CMIs may change widely between appointment and actual launch and completion of the book-building, which may take several months, this would add **extra burdens** on the issuer in evaluating and agreeing terms with each OC and CMI well before the offering is ready for marketing, and may **not be conducive** in the continuing development of Hong Kong as a **competitive financial centre**.

In addition, if the appointment is to be disclosed to the public presumably at the time of appointment, any subsequent or frequent change (unless also prohibited) would cause even more confusion to investors. Moreover, as the proposed rules require the appointment of the OCs within **two weeks** of a listing application, the Consultation is silent on whether any subsequent change of the OCs would require the **re-submission** of the listing application, with or without any **"cooling period"** similar to the change of sponsors.

If the change of OCs after initial appointment requires re-submission of a listing application, this would constitute **unfair competition** in favour of the initial appointees irrespective whether they may or may not be able to deliver their promises to the issuer whilst a later appointee may be able to perform as good or even better work.

Moreover, if the initial appointment becomes "cast iron" and difficult to change, the terms of the appointment, including the fee arrangements which the appointees would aim to maximize for its benefits, may prove not conducive to attract and **incentivize subsequent appointment** of other OCs and CMIs, and therefore contrary to the objective to promote the overall success, price discovery and fair allocation of the offering.

In principle, we do not object that OCs and CMIs be formally engaged and defined their roles and responsibilities before conducting bookbuilding activities. However, for appointment of OC (including the Sponsor OC or other OCs) which should be appointed 2 months before submission of A1 and 2 weeks after A1, respectively; and CMI which should be appointed 4 days before the hearing, flexibility should be given to the issuer to cope with adverse situation such as any change in market conditions and the management of the OC/CMI, etc.

For fee arrangement, we do not agree that the total fee payable to all syndicate CMI's (i.e. including the total fee, the fixed to discretionary ratio and allocation of fixed portion to each syndicate CMI), to be determined before the hearing. Fee determination must take into account various factors, such as the background of the listing applicant, the investors' responses to the offer; the market condition at the material times of offering, the investor's appetite, the in-depth coverage of the CMI's to reach potential investors, hence, it is suggested that fee should be determined and submitted to the Commission prior to the bookbuilding activity or shortly before closing of the Pre-deal Investor Education ("PDIE") where a relatively concrete situation can be obtained from the market and fee can be properly determined.

- 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?**

Yes, generally we agreed it is a common practice for the OC to provide advice to the issuer on marketing strategy, pricing and allocation, however, the issuer may have its own opinion especially on the syndicate membership and fee arrangement.

- 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 comment.

- 7. Do you agree that an OC should provide relevant information to CMI's 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.**

For debt offering, we strongly disagree that the OC should take reasonable steps to obtain sufficient information and to provide to the CMI where CMI also expect to take reasonable steps to identify the list of investor clients to the OC whom these investor clients may have any association with the issuer client, the CMI's or a company in the same group of companies as the CMI. (*reference to s.21.3.3 and s21.4.6*) It is highly improbable if not impossible to execute, especially in the case where number of OCs and/or CMI's are appointed,

whether the investor client is associated with another CMI or in the same group companies as the CMIs, either investor client's (or the controlling person in a corporation) personal data and/or the organization chart of a CMI as well as its controlling person information will be required to share among all CMI for cross reference check. Moreover, definition of "group of companies" for debt offering as set out in paragraph 88 of the Paper and the Guidance Letter GL85-16 issued by the Stock Exchange on the Placing Guideline for share offering is different. This may cause confusion to the market and one CMI may not be able to access all information within its group companies.

For share offering, the proposal to require the OCs to advise and develop an appropriate **marketing and investor strategy**, and that CMIs should not market to investors who fall outside the strategy, sounds good in principle. However, in reality, in order to allow for maximum flexibility and unnecessary frequent changes, such strategy may prove to be general except for restrictions against **Restricted Clients** etc, which are already covered by existing rules and regulations. Similar "distribution guidelines" issued by the JGCs and the deal counsels are in fact established market practice without the need of regulations which do not add specific new requirements under the proposal.

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.**

There are existing clear and strict rules and regulations relating to the **disclosure** of the identities of all allocated investors to the **regulators**. For commercial reasons and client confidentiality correctly stated in the Consultation, we do not agree that information about the underlying investors should be provided to an OC by CMIs placing orders on an omnibus basis. In line with **established market practice**, the issuer (and the OCs) may choose not to allocate to the omnibus account, but there is **no mandatory rule** in other jurisdictions including the US and the UK.

It is our view that the proposed requirement under Question 8 does not in itself or in totality (with other parts of the proposed rules) in fact address the issue of fair allocation (by the OCs) any perceived "deliberate hiding" of investor information for non bona fide investors etc (by a participant of omnibus order).

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.**

Under para. 4.5 & 4.6 of PN18 of the Listing Rule and it is also a market practice for DCM to strive to avoid duplicated order, however, the information of the investor may be varied, for instance, a person may use his ID and passport number with various CMI, without a centralized system for identifying an investor ID and scrutinizing all orders, it is rather difficult if not impossible to have a 100% clearance on such requirements, hence, a more clear guideline as to the extent of due diligence work should be given on this regard.

Identities of investors are normally disclosed in the order book by a participant who would like the orders to be recognized and approved by the issuer. To the extent that certain investors who may not want their names to be disclosed during the book-building process, they risk their orders not being recognized and approved by the issuer and might lead to privacy issue.

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

Paragraphs 90 of the Consultation states that CMIs are often rewarded based on the **volume of the orders** they bring to a deal. We believe this may be the exception rather than the norm as participants are normally rewarded by **actual allocation** instead of size or number of orders. Discretionary rewards can be made based on marketing efforts, such as “pot orders”, which is not based on a fixed formula or volume of orders, although in any event, the lion share (over 80%) of the overall fees and commission is normally allocated to the JGCs, irrespective of actual performance or whether in terms of volume of orders or actual allocation. It's common that the large portion of underwriting fee will be paid to the syndicate members based on the actual allocation of their clients in IPO transactions. Therefore, the issuer has to reward the Sponsor JGCs through paying discretionary bonus to the Sponsor JGC considering their efforts put into both early stage of sponsor works and marketing works as coordinator at late stage, regardless how much of shares they actually sold.

It is also a common practice that certain investors choose to place “**pot orders**” with more than one participant to show recognition of those participants who make genuine efforts in showing the offering (and often independent views on pricing and order size recommendations) to those investors who know very well that they will only get actual allocation with orders through top level of the syndicate (JGCs). The investor would usually flag to the participants when they place “pot orders” to avoid double counting of its order. It is fully transparent and not difficult to identify the pot orders which are not “**duplicated orders**” who tries

to hide its identity in order to get higher share allocation from different syndicate members.

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

To the extent there might be duplicated orders behind the omnibus orders, they can be dealt with on the basis of the preceding paragraph, and ultimately disclosed to the regulators upon allocation under existing clear and strict regulations. For these reasons, we do not believe there is strong incentive for investors or participants to deliberately hide duplicated orders or difficult for OCs to identify duplicated orders in the order book.

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

No comment.

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

As far as equity offering is concerned, there are existing rules relating to restrictions on allocation to investors which have **associations with the issuer and/or with the participants** (including their employees). The IOSCO Reports identify the risk of **conflicts of interest between the issuer and the participants** (normally the JGCs) who have strong influence **on the pricing and allocation** of an offering for their own or their clients' interests.

The Consultation has not addressed this risk and the proposed rules relating to early appointment of the OCs (with potential exclusion of later participants) does not promote market oriented competition but **has the potential impact of increasing the conflicts of interest risk** between the issuer and the OCs and in turn a strong risk of conflicts of interest to the market as a whole as **identified by IOSCO** not correctly addressed in the Consultation.

We agree that the OCs (or currently the JGCs) should establish and implement **allocation policies**; however, such policies may prove to be general such as to take into account the background and spread of investors, size and number of orders etc, to give maximum flexibility to the OCs and the issuers, and may not have real impact on perceived improvements in **fair allocation – another strong risk of conflicts of interest and conduct issue identified by IOSCO** not correctly addressed by the Consultation.

However, we believe the **concern** about potential unfair allocation amongst investors of a CMI is **misplaced**. This is because in reality, allocations by the JGCs to non-JGC participants are based on actual orders by the participants. They are not lump sum allocations for which the non-JGC participants may have discretion on sub-allocation amongst their investors (except for the omnibus orders already discussed above, which should not account for the bulk of the participants' orders or actual allocations).

To the extent that the **non-JGC participants** may get allocations on their omnibus orders, we agree that such participants should also establish and implement **allocation policies** in respect of the investors behind the omnibus accounts only.

As regards **bona fide** or "inflated orders", in reality, the risk is not as high as it may be perceived to be. This is because not only does it call into question the credibility of the participants in the market for consistently inflating orders, any inflated order also risks being fully allocated. This is the case even in a "hot deal" where market conditions may change quickly, and the participants or their investors may not have time to reduce their orders before allocation, and suffer financially.

Experienced participants and investors only place orders often with clear price limits and potential maximum allocation in mind. We are not aware of specific regulations in other jurisdiction including the US and the UK concerning "inflated orders" other than the general rules of professional conducts.

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

No comment.

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

No comment.

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.

No comment.

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 CMLs to maintain records which evidence every change? If not, please explain.**

It has been market practice to keep the record of major changes on the order but not tracking every changes, moreover, the Proposed Code is not only covered the any changes in the order book but also the “key discussions, key advice and key recommendations” provide to the issuer which with regard to the number of OCs and CMLs involved in the offering, the consistency of the records among the OCs and CMLs may be varied, clarification on the extent of the requirement is needed.

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

We agree that **timing (as well as structure)** of fee determination is a **key factor affecting the behaviours of participants**. However, we disagree with the claim that formalization of the underwriting syndicate close to the launch and completion of an offering (which reflects all known factors of then market conditions and investor demands) creates incentive for brokers to “swarm” the order book and **more importantly** create adverse impacts on price discovery or unsustainable post IPO price.

On the contrary, the current Consultation proposal will create strong incentive for the early “mandated” syndicates to not make the appropriate efforts in securing adequate demand at the right price and a strong risk of “**under-pricing**” the offering as pointed out by the IOSCO Reports.

Equally, we do not believe there is any correlation between “**overly-favourable**” research and the timing of appointment of syndicate members. In fact, the issue of truly independent research relates directly to senior members of the syndicate no matter when they are formally appointed, and the reason why experienced investors reward more junior members of the syndicate for independent advice in terms of pricing and order size such as pot orders aforementioned.

Experience tells us that **regulated fee arrangements** such as scale fees etc, in other professions prove to be **anti-competition** and **distorts market oriented participation**. The proposal about prescribing **fixed and discretionary fees** is to a large extent **already market practice** although the split and timing of agreement is rightly left closer to the launch and completion of an offering. To

the extent that if it is concluded that a **fixed advisory fee** is desirable, then it could be left to the issuer and the lead underwriter(s) to agree as to the timing and amount of such advisory fees which do not need to be part of the underwriting commission.

- 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 CMLs and fixed fees allocation four clear business days before the Listing Committee Hearing? If yes, please cite examples.**

We also disagree with the proposed requirement to finalise and submit details of syndicate membership and fees to the Commission **four clear business days** prior to the Listing Committee Hearing for an IPO. Depending on market conditions, there could mean up to 10-14 days before actual launch of an offer during which time significant marketing efforts may only begin and materialize. In addition, the requirement of **timely updates** of such information would add unnecessary burden and a reason for the mandated syndicate members to **resist changes** even if it may prove beneficial to the success of the offering.

There is currently a large volume of information exchange between the sponsor, underwriters, other professional parties as well as the regulators after Listing Committee Hearing all the way up to formal listing, including daily orders and subscription, details of allocations, independence confirmations of investors etc. The proposed additional requirement adds little real information but **administrative burdens** to all parties concerned during the crucial time of a successful offering.

- 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 comment.

- 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 CMLs 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.**

For (i) – agreed in principle but flexibility on the change at any point of the offering cycle should be given

For (ii) – the fee to be paid to all syndicate CMLs should be a commercial terms and subject to change depends on the market condition, it would be misleading if disclose in the prospectus while the actual payment is different.

For (iii) – please clarify whether it is required to disclose to the public or to the Commission. Anyhow, the total monetary benefit should reference to various factors, such as the quality and the size of the offering, also, the market sentiment at the time of offering is crucial where issuer may consider incentivize the best contributed syndicate CMS, solely disclose the monetary benefit for each syndicate CML even after listing would not have any significant benefit to the public but to create a rather unhealthy rival among the issuer, OCs and CMLs.

22. Do you agree with the “sponsor coupling” proposal? If not, please explain.

The proposal goes against the **global trend of unbundling** in many industries, including financial services. The proposed requirement that the Sponsor OC should come from a Group Company of the Sponsor also creates **unfair disadvantages** against market participants who may be specialized and are very good at sponsor work but may not be the case for distribution and *vice versa*.

Moreover, the proposal further seeks to require the appointment of the Sponsor OC at the same time as the Sponsor, which is at least **two months** before the filing of a listing application, and could be **months before the Listing Committee Hearing**. This is inconsistent and additional to the requirement under **Question 4** of the Consultation regarding the timing of appointment of OCs within **two weeks** of a listing application and on which we have commented above and disagree with the proposal.

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.

24. Do you have any comments on the proposed implementation timeline?

The Proposed Code involved vast amendment on the relevant policies and procedures, revision on the parties agreement and specification on the execution, especially on many of the area, issuer education is high required, hence, we suggest at least 18 months of implementation is needed.