Part I : Responses to the Consultation Paper from a DCM practice perspective

Overview of DCM market

In 2020, the Asia ex-Japan G3 corporate bond issuance amounted to over US$340 billion, with around 44.2% of such issuances listed in Hong Kong. For CNHK G3 corporate bonds issued in 2020, approximately 89% of the issuance by deal size were repeat issuers. *(Source: Bloomberg)*

Introduction and executive summary

We are supportive of the regulatory intent behind the Consultation Paper and very much welcome the SFC's efforts in promoting more transparent and accountable practices in the bookbuilding process and ensuring collaborative conduct within the syndicate for DCM transactions in Hong Kong. Transparency and accountability are fundamental not only in safeguarding the interests of market participants, particularly of issuers and investors, but also in managing conflicts of interest and ensuring an open and fair market.

At the same time, any sound regulatory or other measures introduced in addressing such objectives (such as those contemplated under the Consultation Paper) must also address other key considerations:

- firstly, the appropriateness of such measures to ensure they reflect the unique features of different markets and are clear and workable solutions in addressing the regulatory objectives of enhancing transparency and accountability;
- secondly, the need to provide for a level playing field for all market participants and for Hong Kong based participants to compete with their peers in other markets; and
- finally, the continued maintenance of Hong Kong's efficiency as the key international financial centre for international DCM transactions.

We do not believe it is the SFC's objective in implementing any new measures that they impose a disproportionate burden on market participants so as to diminish the overall efficiency of the market.

Against this background, we would like to set out some key concerns we share on certain aspects of the Proposed Code.

1. Appropriateness of the measures to ensure they reflect the unique features of DCM

It is important in our view that the requirements under the Proposed Code should take into account the unique features of DCM in Hong Kong. The Proposed Code seeks to introduce a regime whereby a majority of the detailed and prescriptive requirements are largely replicated across both the ECM and DCM space, without a detailed consideration of the significant differences between the two markets. In particular, we believe the scope of the Proposed Code, in so far as it applies to DCM transactions, is excessively wide as explained further in our response to Question 2 below. In our opinion, it is difficult to reconcile the limited scope of ECM activities with the extremely wide scope of DCM activities under the Proposed Code.

Diverse range of issuers – By way of background, a unique feature of DCM in Hong Kong is the wide spectrum of the types of issuers involved in bond transactions.

As the wholesale bond markets in Asia have developed in sophistication and maturity over the last decade, increasingly, a greater proportion of corporate bond issuances in Asia are undertaken by issuers with significant prior experience in the capital markets. For example, of the China/Hong Kong G3[3] corporate bonds issued in 2020, approximately 89% of such issuances by deal size were done by repeat issuers.[4] In fact, in the past 15 years, debut issuances in Asia accounted for only 4% to 12% of all bond issuances in each year, with the figure dropping below this range during the 2008 financial crisis (representing 1% and 3% for 2008 and 2009, respectively).[5] In addition, we estimate that close to half of the issuance volume is accounted for by issuances by financial institutions ("**FI**") including banks and securities houses who themselves are OCs and CMIs and also the key investors of bonds. To many issuers, their active participation in the order book is beneficial (and sometimes critical) to the success of their transactions and represents merely a natural extension of the lending relationships or corporate finance services.

Unlike issuers in the ECM space (which, by definition in the context of IPOs, are relatively inexperienced and "debut" players), DCM issuers are often far more sophisticated, experienced and knowledgeable and therefore, do not necessarily require the same controls afforded to ECM issuers. They should be allowed to continue with the flexibility currently enjoyed by them in the conduct of their transactions – for example, when to engage syndicate banks, how to allocate their responsibilities, when and how to set their fees, and whether to allocate to proprietary and private bank ("**PB**") orders and the priority to be given to such orders.

While some issuers may prefer large orders from financial institutions or banks (as they generally tend to be "buy to hold" investors and are therefore more stable), other issuers may prefer market orders. In other cases, some issuers rely more on PB orders in order to execute the trades, particularly where PB orders may be needed in order to build the deal to a benchmark size. So long as the syndicate has provided advice to the issuer and adequately disclosed the nature of orders in the order book to the issuer, it should be up to each individual issuer to what extent they would like to include certain types of investors. The use of prescriptive requirements (such as strict rules requiring market orders to have priority over proprietary orders) therefore fails to take into account the wide diversity of issuer preferences and interests in the Hong Kong bond markets. To implement such wide ranging and prescriptive changes in the Proposed Code of Conduct also seems inappropriate, which will result in very significant impact on the issuers, which are also one of the key stakeholders in the capital market fund raising activities. At the very least, we believe the SFC should actively consult and seek feedbacks from issuers before considering such changes and implementing the Proposed Code. We believe the interests of issuers can be adequately protected so long as any potential conflicts of interest are properly disclosed to them to

[3] "G3" refers to bonds issued in USD, EUR, or GBP

[4] Source: *Bloomberg*

[5] Source: *ICMA analysis using Dealogic data (January 2021) from "The Asian International Bond Markets: Development and Trends (March 2021)" published by the International Capital Market Association*

enable them to make an informed decision. The regulators should only intervene if there is clear evidence that disclosure is not an effective measure.

Dominance of professional investors – Further, bond transactions conducted in Hong Kong are placed to professional and licenced investors. Even for placements to high-net-worth individuals, these bonds are sold to the individuals through their PBs, that presumably should have provided professional advices to those individuals. The bond market (both primary and secondary) is dominated by investors who are professional investors with significant experience in financial and investment related matters. This contrasts with ECM transactions (and specifically IPO) where the investor base of the equity market includes significant presence of retail and/or unsophisticated investors. Likewise, DCM investors should be allowed to choose from a wider variety of transactions with different investor compositions based on changing market conditions at the time. They can decide for themselves whether to participate in a transaction with a concentration of proprietary and PB orders (whether or not with rebate to PB investors) or the presence of significant orders from associate or related parties, so long as such information is disclosed to them. We believe their interests are better protected by adequate disclosure and prompt and regular updates during the bookbuilding process.

"Pot" deals - Most international DCM transactions conducted in Hong Kong (and Asia more generally) are syndicated according to a "pot" deals system, meaning that each manager is expected to contribute to the success of the overall deal by providing liquidity and diversity in investor orders irrespective of its underwriting commitment. Each manager (whether it is an OC or a CMI) should have equal access to the issuer and the order book. Therefore, certain aspects of the Proposed Code which appear to entrench the power of, and confer additional responsibilities and privileges on, the OC (versus a CMI) are, in our view, inappropriate, and could have the unintended consequence of undermining the collaborative intent behind a "pot" deals syndicate.

We would therefore stress that any new requirements to be included in the Proposed Code should duly consider and adequately take into account the unique features of the bond markets in Hong Kong. The "broad brush" application under the Proposed Code to DCM activities also brings with it a considerable degree of uncertainty and potential opportunity for regulatory arbitrage, the adverse consequences of which will be discussed in more detail in our response to Question 2 below.

2. Maintaining the overall efficiency of the bond markets and Hong Kong's competitiveness as an international financial centre for DCM activities

We encourage the SFC to reconsider the application of the Proposed Code to DCM activities in its current form as set out in the Consultation Paper and the potential impact on the efficiency of the Hong Kong markets and Hong Kong's competitiveness as an international financial centre for DCM activities.

Certain new requirements introduced under the Proposed Code (such as the requirement that syndicate appointments should take place at an early stage of a DCM transaction) would seem to limit the flexibility of issuers in structuring and executing bond transactions. Other requirements (such as the delineation between the roles of OCs compared to CMIs and the requirement to maintain documentary evidence of every change throughout the bookbuilding process)

could have the effect of creating disproportionately burdensome operational and practical complexities for underwriting entities in the conduct of the bookbuilding and placing process. Such requirements are in fact far more detailed and prescriptive relative to other international markets and could jeopardise Hong Kong's attractiveness as a leading DCM financial centre for issuers and other market participants.

In our view, a large number of the measures outlined under the Proposed Code (such as the requirement that client orders must have priority over proprietary orders at all times, the categorisation of syndicate members into OCs and CMIs, and the requirement that syndicate appointments should take place at an early stage of a DCM transaction) remain untested and could have unintended material consequences which are difficult to guard against, including reducing the overall efficiency of the bond markets.

For example, issuers should have the opportunity to appoint new syndicate members later on in a transaction (i.e. after deal launch but prior to pricing) if such new syndicate members are able to bring quality orders to the order book and facilitate price discovery. Any restriction on "late" appointments could unduly limit an issuer's flexibility in executing a bond transaction, reduce an issuer's flexibility to incentivise its syndicate, and potentially restrict the issuer's access to the best advice and orders. On a wider level, it could potentially also have a negative impact on the Hong Kong bond markets, in increasing instances of failed trades and reducing the overall efficiency in the bookbuilding and price discovery process.

Similarly, the blanket requirement under the Proposed Code to allow client orders to have priority over proprietary orders *at all times* is, we believe, inappropriate and disproportionately wide, given the important role played by FI investors in supporting our bond markets. In fact, many FI investors are cornerstone and anchor investors on DCM transactions, without whom may result in a smaller or weaker order book. So long as such proprietary orders are genuine and represent bona fide demand, an issuer should have the flexibility and discretion to treat them *on equal terms* as client orders when considering the entire order book. In particular, where such FI investors subscribe for an issuer's bonds, this often represents another form of lending from the FI investor to the issuer – the issuer may have other existing borrowing arrangements in place with the FI investor in the form of bank loans or derivative transactions, and the placing of an order by the FI investor in the issuer's bond issuance is simply a natural extension of the lending relationship between such FI investor and the issuer. To impose a blanket rule requiring client orders to have priority over proprietary orders would be arbitrary and fail to take into account the important role FI investors play in supporting the bond markets. This would also be unfair to the FI investors since their orders are subordinated to other investors' orders.

3. The need to provide for a level playing field for all market participants

The requirements set out in the Proposed Code for DCM activities, in our view, go beyond the general "principles-based" recommendations outlined under the IOSCO paper on conflicts of interest and associated conduct risks in debt capital raisings, and could also result in Hong Kong becoming a regulatory outlier in terms of the scope and breadth of intervention in relation to DCM bookbuilding activities. Such requirements are in fact far more detailed, burdensome and prescriptive relative to other major international markets and could potentially

damage the competitiveness of Hong Kong DCM houses against their international peers in the race of attracting DCM business and talents.

In particular, we would ask the SFC to consider, to the extent it has not already done so, the very real financial impact these measures could have in curtailing the dynamic and efficient nature of the Hong Kong bond markets. We note in particular that the Consultation Paper has not specified any instances where similar measures (noting the wide scope and prescriptive requirements under the Consultation Paper) on DCM bookbuilding activities have been adopted by regulators in overseas jurisdictions and the SFC's views on what impact this has had on those bond markets.

We also ask the SFC to reconsider whether a number of the proposals outlined in the Proposed Code (such as the distinction drawn between the roles of OCs versus CMIs) could potentially have the effect of favouring larger and more established intermediaries (particularly those with a global franchise) at the expense of smaller, local or less established securities house and intermediaries. These concerns are further elaborated in more detail in our responses to Questions 1, 2, 3, 4, 7 and 18 below.

We believe such an outcome would be highly undesirable at the current stage of development of the Hong Kong bond markets – in our view, it would be contrary to the SFC's objectives of promoting an open and fair market, and does not establish a level playing field for all market participants.

Conclusion

We are supportive of the underlying regulatory intent behind the Consultation Paper and believe that transparency, accountability and the appropriate management of conflicts of interest are essential building blocks of a fair and open market.

However, we are concerned that the Proposed Code, as it applies to DCM in its current form, takes a disproportionately prescriptive and wide-sweeping approach in addressing the concerns outlined in the IOSCO reports on conflicts of interest and associated conduct risks in debt capital raisings.

Given that the principal concerns of IOSCO and the SFC appear to be conflicts of interest and ensuring transparency and accountability, we believe these concerns would be best addressed by enhanced disclosure of any conflicts of interests to investors and issuers. For example, from the perspective of investors, concerns around conflicts of interests can be addressed by ensuring adequate disclosure is provided through timely order book updates, including information on the nature and extent of proprietary orders – this focus on enhanced disclosure is a more appropriate approach towards dealing with proprietary orders, rather than a blanket rule requiring client orders to have priority. Likewise enhanced disclosure on PB rebates or the presence of significant orders from associates or related persons of the issuer should address any conflicts of interests which may arise. As mentioned above, professional investors have the necessary experience to make an informed decision based on such disclosure and can decide for themselves whether they wish to participate in a bond offering. Similarly, from the perspective of issuers, concerns around conflicts of interests can be addressed by ensuring adequate disclosure by syndicate members to the issuer who are often experienced and repeat issuers.

The General Principles set out in the SFC's existing Code of Conduct already provide a sufficient basis for this "principles-based" approach and reliance on this existing "tool box" of General Principles is we believe a more appropriate and measured way of achieving

the SFC's objectives. These existing Guiding Principles can, if needed, be accompanied in due course by more detailed guidance from the SFC on specific topics, reflecting market consensus (including consultations with underwriter, issuer and buy-side participants) and taking into account the unique features of the bond markets in Hong Kong. A "principles-based" approach would also have the benefit of retaining flexibility in the market, avoid Hong Kong becoming a regulatory outliner in the global markets and mitigate any risks of uncertainties associated with untested detailed and prescriptive regulatory measures and maintaining a level playing field.

The following sets out our responses from a DCM perspective to each of the questions in the Consultation Paper: -

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
   ☐ No

Response
We generally consider that the definitions of "bookbuilding activities" and "placing activities" under the Proposed Code are clear and sufficient to cover key capital raising activities. It would be helpful if clearer definitions of "club deals" could be provided, for example the maximum number of investors in such transactions.

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

   ☐ Yes
   ☑ No

Response
We note the scope of ECM activities in the Consultation Paper is limited to: (a) shares to be listed on SEHK issued by a listing applicant or a listed company via (i) an IPO, (ii) an offering of shares of a new listed class or (iii) an offering of new shares of an existing listed class under a general or special mandate; and (b) placings of existing listed shares by a shareholder to third party investors followed by a top-up subscription of new listed shares by the shareholder. It appears therefore from the Consultation Paper that, in the case of ECM activities, the key nexus required is that the relevant shares **are listed on SEHK**. A number of other common ECM transactions are (for good reason) **not** within scope, including: (a) a "professionals" only offering of unlisted shares; (b) a placing of shares (listed on an exchange other than SEHK) in Hong Kong;

(c) a pure "sell down" of SEHK listed shares by an existing shareholder; and

(d) an offering of global depositary receipts where the underlying shares are listed on SEHK.

Contrast this with the position taken under the Proposed Code in relation to DCM transactions where all types of debt offerings would be covered "*provided that the offering involves bookbuilding or placing activities conducted by intermediaries in Hong Kong*". This, in our mind, would cover a very wide range of bond transactions including:

(a) an offering of **unlisted** bonds;

(b) an offering of bonds **listed on an exchange other than SEHK**;

(c) any offering of convertible bonds or exchangeable bonds, **including where the underlying shares are not listed on SEHK**; and

(d) an offering of bonds **by a foreign (non Hong Kong) issuer where the primary market is not Hong Kong** but, nonetheless, a small portion of the placing activities has been conducted in Hong Kong because of a small number of Hong Kong professional investors.

According to data from Bloomberg, in 2020, only 44.2% of the Asia ex-Japan G3 corporate bond issuances were listed on SEHK. To require the application of the Proposed Code to all types of debt offerings whenever there is some bookbuilding or placing activity conducted by intermediaries in Hong Kong (even where the bonds themselves are not listed on SEHK) appears excessive and disproportionate, particularly in light of the more narrow ambit proposed for ECM activities.

In our view, the proposed scope of DCM activities outlined in the Consultation Paper is unnecessarily wide and introduces a significant degree of uncertainty. For example, we would urge the SFC to provide more clarity on the meaning of "club deals" and "bilateral agreements" referred to in paragraph 44(a) of the Consultation Paper, which are described as out of scope under the Proposed Code. It is also unclear what constitutes precisely "*bookbuilding or placing activities conducted by intermediaries in Hong Kong*" – to illustrate with some hypothetical questions:

(a) given that the focus is on bookbuilding and placing activities, is the required "nexus" the location of the relevant syndicate team (i.e. whether it is based in Hong Kong)? What if, for a particular debt offering, an intermediary uses its syndicate desks within as well as outside of Hong Kong? Would only the activities of such intermediary's Hong Kong syndicate desk be subject to the Proposed Code but not those of the syndicate desks based in Singapore or Europe?

(b) what is the application of the Proposed Code where the investment banking team is based in Hong Kong to advise the issuer on pricing or marketing strategy but the syndicate team responsible for the bookbuilding and placing activities is based outside of Hong Kong, or vice versa?

(c) what is the geographical reach of the Consultation Paper if a portion of the intermediaries on a DCM transaction are based outside of Hong Kong, but one intermediary is based in Hong Kong – does this bring the whole debt offering (and therefore the scope of the entire bookbuilding and placing process) within

the scope of the Proposed Code?

(d) what is the application of the Proposed Code for a debt offering that is largely European or US originated (for example, because the issuer is based in those jurisdictions and the syndicate desks are also based overseas) but a small portion of the debt securities are sold to Hong Kong investors using a Hong Kong sales team?

The above hypothetical examples serve to illustrate our concerns around the uncertainty in the scope of DCM activities outlined in the Consultation Paper.

A natural corollary of this is the opportunity for regulatory arbitrage – for example, the ability for certain intermediaries to structure their teams outside Hong Kong in order to avoid the application of the Proposed Code. Not only would this be detrimental to the competitive position of Hong Kong as one of the leading financial centres of Asia, but it would also place Mainland China and Hong Kong headquartered financial institutions or smaller local financial institutions at a competitive disadvantage given their DCM operations are predominately based in Hong Kong. In contrast, intermediaries with existing Asia-wide operations could more easily migrate certain teams involved in DCM activities to other jurisdictions in Asia, particularly if such jurisdictions are perceived to impose less stringent regulations on DCM activities. In this respect, we note that no equivalent regime or similar code or guidelines on bookbuilding and placing activities exists in Singapore and Macau for example.

By way of illustration, in 2020, Hong Kong arranged[6] 34% (by nominal amount of bond issuance) of Asian bond transactions, while Singapore arranged 5%.[7] In relation to listing venue, Singapore and Hong Kong represent the most popular venues for bond listings in Asia, with 31% and 28% of bond issuances from Asia, respectively.[8] One observation from these figures is that Singapore attracts an outsize share of bond listings (31%), especially as compared with its small arranger activity share (5%). While the location of where a bond is arranged can depend on a variety of factors (such as the location of the issuer), one compelling factor is a financial centre's regulatory and legal system and the perceived stringency of local regulatory requirements – the high percentage of Singapore bond listings relative to its arranger activity is perhaps an indication of the mobility of DCM operations, and how easily DCM activities can be migrated to different jurisdictions. We would therefore caution against the implementation of such strict requirements as set out in the Proposed Code, which could jeopardise Hong Kong's attractiveness as a leading financial centre for DCM activities and talents.

We would like to stress that we are very supportive of the SFC's objectives in maintaining and promoting the fairness and competitiveness of the DCM industry. However, we are concerned that the unnecessarily wide scope of the Proposed Code in respect of DCM activities could potentially provide larger and more established intermediaries and in particular those with an overseas network with the opportunity for regulatory arbitrage by structuring their teams outside of Hong Kong, while putting smaller, less established local securities house and intermediaries at a competitive

[6] For this purpose, a bond is considered as "arranged" in the location where a majority of its arranging activities take place. Bond arranging activities comprise originating and structuring, legal and transaction documentation preparation, and sale and distribution.

[7] Source: *ICMA analysis using Dealogic data (January 2021) from "The Asian International Bond Markets: Development and Trends (March 2021)" published by the International Capital Market Association*

[8] Source: *ICMA analysis using Dealogic data (January 2021) from "The Asian International Bond Markets: Development and Trends (March 2021)" published by the International Capital Market Association*

disadvantage. Such an outcome we believe is contrary to the SFC's objectives, and will not achieve the purpose of regulating all market participants equally.

Looking at the Consultation Paper as a whole, we note that ECM and specifically IPO practices are key areas addressed in the Consultation Paper. This, in our view, seems to be a key focus of the SFC and of IOSCO in addressing conflicts of interests and associated conduct risks. This focus on ECM seems justifiable especially because of the Hong Kong retail nature of ECM and IPO transactions and the inherent nature of equity securities (e.g. (i) the price of an equity security should reflect a share of a company's business and it would be objectionable if this is valued differently for different participants, (ii) certain sensitivities around dilution of shareholder value and voting control by insiders etc., (iii) equity is more risky and equity prices are typically more volatile and (iv) price discovery is more involved for IPOs since there are no credit ratings or established yield curves etc.). However, we firmly believe some restraint, and a cost/benefit approach, should be applied when transferring desirable practices in the equities market to the bond market. In particular, retail bonds are still rare, and the protection of retail investors should not drive the approach to overall regulation in the way that may be appropriate for IPOs and ECM transactions. In fact, almost all of the bond transactions conducted in Hong Kong are professionals only transactions where the instrument has no underlying equity component, and therefore do not need the same protections as equity or equity-related instruments. To look at it slightly differently, whilst the SFC's role in regulating equities to be listed and publicly traded on the SEHK is very clear, it is less so in relation to bonds distributed internationally to professional investors and usually traded "over the counter" outside of Hong Kong. These observations reinforce our points outlined above and in our introductory section, namely our concern around the uncertainty and unnecessary breadth of the proposed scope of DCM activities set out in the Consultation Paper, and the potentially detrimental and inappropriately restrictive impact it could have on the bond markets in Hong Kong.

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

☐ Yes
☑ No

Response

While we agree that the roles given to intermediaries should be by reference to their actual activities rather than the formal titles awarded by the issuer, we harbour some concerns around the distinction between OCs and CMIs under the Proposed Code. In particular, we would recommend that the separate concept of an OC be removed (whilst retaining the CMI concept) as the OC role would only introduce greater uncertainty, conflict and confusion in the bookbuilding and deal execution process. We have provided a few key observations below in support of our recommendation.

Traditional roles of managers on "pot" deals and entrenching the position of an OC

Most international bonds are syndicated according to a "pot" deals system. A key benefit of the "pot" deals system is that each underwriter is expected to contribute to the success of the overall deal by providing liquidity and diversity in investor orders irrespective of its underwriting commitment. This is compared to the less common "retention" basis deals where each syndicate member is just responsible for matching

investor orders to its corresponding underwriting commitment. The Consultation Paper refers to an OC as the intermediary that "*exercises control over bookbuilding activities*" – it is unclear what this means exactly, since institutional bond deals in Asia are generally conducted on a "pot" basis – therefore each manager (whether it be an OC or a CMI) should have equal access to the issuer and the order book. To create an artificial distinction between an OC (who would have greater access to such information) and a CMI (who would have less access to such information) would inappropriately entrench the power of the OC.

Position of the issuer and the role of managers in DCM transactions

In addition, we are concerned that the power and responsibilities conferred on an OC under the Consultation Paper may lead to sub-optimal outcomes for issuers. From an issuer's perspective, deal execution is most effective where each and every underwriter has a role in contributing to the formulation of a marketing strategy, planning roadshows, accessing information on investors and making pricing and allocation recommendations. In other words, an issuer would benefit from a pricing and marketing strategy that reflects the collective input and experience of the entire syndicate. In practice, deal responsibility and role allocation amongst managers is not generally split along OC/CMI lines, but rather based on who is responsible for specific workstreams such as documentation, due diligence, roadshow, ratings, regulatory approvals and billing and delivery function. Allocating roles in this manner is the most efficient and effective approach to deal execution as it allows each manager to focus on and be responsible for a particular and distinct workstream, particularly where the deal execution window is short. If a CMI is deemed to be an OC where it conducts **any** of the activities set out in paragraph 21.2.4 of the Proposed Code, there will most likely be too many OCs on a deal as these roles are often separated and distributed amongst the syndicate. The detailed obligations of OCs set out in paragraph 21.2.4 will not work in practice as too many underwriters will be obliged to do the same role.

Furthermore, the Consultation Paper envisages that the OC should share information about the issuer with syndicate CMIs, or take reasonable steps to ensure that the issuer provides this information to them. However, each CMI should conduct, and be responsible for, the level of due diligence and assessment of an issuer that it deems appropriate depending on its own internal policies, its existing level of familiarity with the specific issuer and the particular nature of the debt offering. The process of due diligence is specific to each syndicate member and each syndicate member is best placed to assess what information it requires to satisfy itself of its due diligence requirements – it should not be limited to the information provided by the OCs and it would be inappropriate to interpose the OC between the CMI and the issuer in each CMI's due diligence process. Moreover, such a requirement could give rise to unnecessary confusion or conflicts – for example, where multiple OCs are appointed but the information shared by each of the OCs may not be consistent, or where an OC may be reluctant to share information to a CMI due to client confidentiality or other concerns.

General impact on the DCM market in Hong Kong

We noted above how the creation of an OC role and CMI role would draw an arbitrary distinction resulting in some members of the syndicate (the OCs) having disproportionate access to the issuer and to order book information. It would in our view be undesirable in a highly competitive underwriting market that some participants (namely the OCs) would have disproportionate access to information including underlying investor details from each CMI's omnibus orders, which may be

inappropriate due to commercial and confidentiality reasons.

In addition, to the extent an OC should be performing all the roles in paragraph 21.2.4 of the Proposed Code (which uses the conjunctive "*and*", as opposed to the disjunctive "*any*" in paragraph 21.2.5), the scope of the OC role could potentially favour larger established investment houses and operate to the disadvantage of newer and smaller participants. This is highly undesirable at the current stage of development of our bond markets and would be contrary to the SFC's regulatory objective in maintaining a fair and competitive industry for DCM.

The position in other jurisdictions

In considering the definitions of "bookbuilding activities" and "placing activities" and the role of OCs and CMIs under the Consultation Paper, we have also considered by analogy the position under the regulatory regimes of other jurisdictions such as the Markets in Financial Instruments Directive 2014/65/EU ("**MiFID II**") in the European Union. One of the key areas of MiFID II is the differentiation between a "manufacturer" (essentially an investment firm which creates, develops, issues and/or designs financial instruments) and a "distributor" (essentially an investment firm that offers and/or recommends investment products and services to clients). There are some parallels between the concept of a non-syndicate CMI (under the Consultation Paper) and a distributor under MiFID II, in that both roles relate to intermediaries whose role is limited to the placing and distribution of securities to clients. Importantly, however, as regards to the role of OCs and CMIs, MiFID II makes no distinction between different "types" of product manufacturers (unlike the Consultation Paper which introduces the concept of an OC and CMI) – that is, there is no "tiering" under MiFID II whereby certain manufacturers have additional or higher levels of responsibility compared with other manufacturers. This approach under MiFID II is we believe a more appropriate one. As mentioned above, it will be difficult in practice to distinguish between the role of OCs and CMIs and we don't believe such a distinction is necessary for the purposes of regulating the roles of syndicate members. Moreover, we are concerned that the Consultation Paper forces a distinction which is not currently drawn (in Hong Kong or elsewhere) and will result in unnecessary bureaucracy and costs with no demonstrated benefit to investors or issuers. Whilst the arguments for the distinction may be made in the ECM and IPO context, we query whether this approach is necessary in the professional cross-border bond markets. We believe caution should be exercised in adopting the same approach where Hong Kong has been chosen as the base for professional activities which service an international market, but could be performed elsewhere.

Consequently, even if the SFC is keen to retain the concept of a "CMI", we would suggest that the separate concept of an "OC" be removed, given the difficulty with formulating any "bright line" tests to distinguish between these two roles.

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? If not, please explain.

☐ Yes
☑ No

Response

For the reasons set out below, we do not agree that the appointment of OCs and other CMIs and the determination of their roles, responsibilities and fee arrangements, should all take place at an early stage of a transaction. We believe the negative consequences of this would outweigh any perceived benefits, and would only result in greater inefficiencies in the conduct of bond offerings. In particular, we wish to draw the SFC's attention to the following points:

(a) **Frequent issuers:** for issuers who are frequent issuers in the DCM, it should be possible for issuers to appoint CMIs at a later stage of the bond offering (i.e. after launch of a bond offering but before pricing) as the work needed to be done by the new CMIs in assessing the issuer and the debt offering will be relatively less compared to that needed for a debut issuer or an issuer with which they are not already familiar. As such, any concerns around such "late" appointments creating a disorderly bookbuilding process are significantly reduced. In this respect, we note in the past 15 years, debut issuances in Asia accounted for only 4% to 12% of all issuances in each year.[9] In fact, in relation to China/Hong Kong G3 corporate bonds issued in 2020, approximately 89% of such issuances by deal size were undertaken by repeat issuers[10];

(b) **Preventing failed trades**: in some cases, CMIs who are appointed at a later stage of a bond offering are able to bring in orders to support the overall order book and prevent a failed trade in difficult or volatile markets. For example, a CMI that is appointed at a later stage of a bond offering may be able to provide tangible support and momentum to the order book by providing additional investor demand and liquidity to the trade. We therefore believe such appointments can serve a constructive and positive role for issuers, investors and the market overall, as they can provide appropriate momentum to an order book;

(c) **Imposing constraints on issuer's commercial decisions around fees**: requiring issuers to determine the fee arrangements of underwriters at an early stage can also lead to sub-optimal outcomes for issuers. For example, it may not always be practicable for issuers to determine deal economics and fee allocation in the early stages of a transaction, and requiring an issuer to do so may demotivate members of the syndicate. Issuers will often prefer to decide on fee allocations after deal completion based on each syndicate member's contribution, particularly in less favourable market conditions;

(d) **KYC and other administrative hurdles**: in some cases, a syndicate member's KYC procedures on an issuer can take longer than expected and, for internal compliance reasons, the syndicate member may not be in a position to sign formal documentation with the issuer (appointing them as an OC or CMI) until the KYC process is complete, which may be later in the transaction. In these circumstances, a blanket rule prohibiting an issuer from appointing the syndicate member as an OC or CMI at a later stage of the transaction would seem excessively stringent;

(e) **Retaining flexibility for issuers**: in the case of debut issuers who may be inexperienced or unfamiliar with DCM transactions, the appointment of OCs and

[9] Source: *ICMA analysis using Dealogic data (January 2021) from "The Asian International Bond Markets: Development and Trends (March 2021)" published by the International Capital Market Association*

[10] Source: *Bloomberg*

CMIs at an early stage may mean that these issuers may not have the full opportunity to assess the suitability and capabilities of these underwriters, and these issuers would be constrained from engaging more underwriters at a later stage that could make a stronger contribution to the transaction. In this respect, it is worth noting that each underwriter institution has its own strengths (for example, some institutions may have greater coverage of certain investor bases) so to restrict the ability of issuers to appoint OCs and CMIs at a later stage of a transaction can be detrimental to the overall interests of issuers and the success of bond offerings. It also has the negative effect of ring-fencing the syndicate prematurely in a transaction, to the exclusion of smaller or local players who in practice may often only join a syndicate at a later stage of a transaction (as issuers may prefer to appoint larger financial institutions with a global franchise in the early stages of a transaction to assist with the preparatory ground work involved for a bond offering);

(f) **Market soundings**: CMIs should be permitted to conduct some market sounding activity (subject to applicable law) before a written appointment is entered into. If this is not permitted, newer and smaller financial intermediaries and their customers may be shut out, as the preliminary market sounding process allows such newer and smaller players to assess the market, connect with potential investor interest and understand in more detail the nature and dynamics of the bond transaction, before committing their more limited resources to a bond transaction. Prohibiting such preliminary market sounding could have unintended consequence in that syndicates would grow enormously if issuers want to capture the greatest possible distribution market if they have to appoint CMIs before they can engage in any distribution activities; and

(g) **Non-syndicate CMIs**: finally, certain CMIs (namely non-syndicate CMIs) may only perform a broker function in a DCM transaction – in essence, their role is limited to acting as settlement agent to facilitate the settlement of the bonds, and they do not participate in any bookbuilding or placing activities. Due to the nature of their role, such CMIs are only involved at a much later stage of the bond transaction – to require their appointment to be confirmed prior to bookbuilding would not be possible in most cases.

We note the SFC has also shared concerns that unclear roles and responsibilities may also cause confusion to buy-side participants. For example, some buy-side participants have complained that many different intermediaries may market an offering to them, but they do not know with certainty which intermediaries are from the syndicate and they may not have full access to the order book. However, if the SFC's intention is to encourage or require the use of the "OC" and "CMI" roles as terms to be used for marketing purposes by financial intermediaries (when facing buy-side participants), our concern is that this may also cause confusion to non-Hong Kong market participants in the international capital markets since such roles are not used elsewhere. Conversely, if the intention is not to use such roles for marketing purposes, then we query the benefit of such roles to buy-side participants given they would not be able to differentiate between the different roles. In any case, a buy-side participant in a professionals only bond offering can also choose not to participate in the deal if they believe that have not received adequate or clear information from the issuer and/or the syndicate – in this way, issuers and underwriters are already incentivised to ensure that the bookbuilding process is conducted in a transparent and orderly manner. In addition, we note the SFC has previously suggested that an issuer will still have the flexibility to make adjustments to the syndicate composition at a later stage of a bond offering – if this is indeed the case, we query how this sits alongside the requirement that the appointment of OCs

and other CMIs and the determination of their roles, responsibilities and fee arrangements, should all take place at an early stage.

Given the dynamic nature of the Hong Kong bond markets and the diverse types of issuers who are active in this market, we believe issuers should have the flexibility to decide when and how to appoint new members to join the syndicate – any strict rules requiring the appointment of OCs and other CMIs and the determination of their roles, responsibilities and fee arrangements at an early stage of a bond transaction have the potential to create a number of sub-optimal outcomes, not only for the syndicate but also to issuers and investors.

We therefore do not believe that implementing such a requirement through the existing Code of Conduct is the most appropriate approach given the impact it could have on issuers in the market. We strongly encourage the SFC to actively consult the views of issuers and investors in the market first and to consider the concerns set out above as we believe there are valid reasons why it may be appropriate for underwriters to join a debt offering at a later stage of the transaction.

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
☑ No

Response

Please see our response to Question 3 above.

We are of the view that the entire syndicate (including CMIs and syndicate members who joined at a later stage of a transaction), and not only the OC, should be able to provide advice to the issuer on the above-mentioned matters. In particular:

(a) as mentioned above, most international bonds are syndicated according to a "pot" deals system. A key benefit of the "pot" deals system is that each underwriter is expected to contribute to the success of the overall deal by providing liquidity and diversity in investor orders irrespective of its role and/or underwriting commitment. If only the OC could advise the issuer on matters such as the marketing strategy and pricing and allocation, it would inappropriately entrench the power of the OC. This is also not consistent with the collaborative nature of the bookbuilding and allocation process; and

(b) we believe it is essential that issuers have the opportunity to receive fair and balanced recommendations from the whole syndicate – ultimately, it should be the choice of the issuer from whom (whether it is an OC or a CMI) they wish to receive recommendations, and we believe it is in the best interest of issuers to have this flexibility. We query whether issuers would receive fair and comprehensive advice if only OCs are permitted to advise them on the above matters.

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.

☑ Yes
☐ No

Response
We agree that the issue price offered to all investors should be transparent in order to ensure fair treatment to all investors. However, we also wish to draw the SFC's attention to the following thoughts over PBs: (a) under the Proposed Code, it is unclear whether a PB should be regarded as a CMI. Presumably a private bank which makes an order for its discretionary clients (i.e. which it will allocate according to its discretionary mandates) is not a CMI, but is an end investor; however, a PB which contacts its non-discretionary clients to solicit interest should be a CMI – appointed usually as a non-syndicate CMI. This should be the way in which target investor restrictions and control of investor fee rebates are enforced. We would be grateful for further clarity from the SFC in this regard; and (b) OCs and CMIs cannot control the activities of PBs (who are themselves licensed and regulated intermediaries subject to the Code of Conduct). We agree that after the rebates are provided to the PBs, the rebates should not be passed on to the end investors. However, the actions of PBs are not necessarily within the control of the OCs and CMIs as they are not able to supervise or control what the PBs do. If the intention is to regulate the activities of PBs, then such regulation should be enforced directly by the SFC *vis a vis* with the PBs, rather than through OCs and CMIs. We firmly support the need for more transparent and accountable practices in the bookbuilding and placing process for bond transactions and, in the context of PB rebates, we believe the most appropriate approach is to ensure clear and adequate disclosure on the existence of such rebates. Where a PB rebate is provided by an issuer, this should be properly disclosed to all buy-side participants, who (being professional investors) can then decide based on this information if and to what extent they would like to participate in the bond offering.

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
☑ No

Response
While we agree with the SFC on the importance of maintaining fairness and transparency in DCM offerings, the burden of gathering relevant information on

investors which have an association with the issuer should not be placed on OCs/CMIs. In particular:

(a) It should be the issuer's and each individual investor's responsibility to disclose and provide the necessary information to identify investor clients which have associations with the issuer, as the issuer and the investors have the most complete and accurate information on their own position and are best placed to identify if they have any associations with the issuer. In contrast, an OC and CMI may not have access to complete and accurate information about persons or entities which are related to the issuer.

(b) While each syndicate member can take reasonable steps to ascertain information on the investors which form a part of such syndicate member's own orders, it would be extremely difficult for a syndicate member to be responsible for gathering information on investors from the orders of other syndicate members. In addition, we believe each syndicate member should only rely on their own due diligence efforts and independent investigations on investors, and should not place undue reliance on others (such as the OCs) to provide "shortcuts".

(c) If an OC is expected to obtain information on associated persons from the issuer and provide this to all CMIs, such a role will increase the risk of information asymmetry within the syndicate and inappropriately entrench the power of an OC. As mentioned in our previous responses, larger and more sophisticated underwriters will be favoured in determining the OC role as a result.

(d) We note that paragraph 88 of the Consultation Paper states that a CMI should identify whether its investor clients may have any associations with the issuer, the CMI or a company in the same group of companies as the CMI, and the OC is responsible for providing sufficient information to CMIs to enable them to identify such investors. A further concern with this proposal is the disproportionate complexity this can introduce in practice where there is a syndicate with a large number of OCs and CMIs.

(e) To our mind, no similar requirement is imposed on syndicate members in other jurisdictions in the context of bond transactions offered to professional investors. The imposition of such a requirement would place Hong Kong as a regulatory outlier and be detrimental to the overall competitiveness of Hong Kong as a key financial centre for DCM activities.

In addition, for debt issuers which are listed corporations, concerns around ensuring transparency and imposing disclosure obligations on listed corporations to identify associated persons or persons in control (such as substantial shareholders or directors and chief executives) are already addressed under the existing Part XV framework of the Securities and Futures Ordinance (Cap. 571). If the intention of the SFC is to impose additional requirements on top of the Part XV framework, one way to address the concern may be to limit the application of these additional requirements to certain products, which because of their complexity, necessitate such enhanced disclosure, such as convertible bonds or secured high yield bonds.

If the SFC insists that, despite the above, OCs are required to provide the relevant information to CMIs, we would propose that practical guidelines should be released by the SFC addressing some of the practical issues around compliance. For instance, for funds investors and PB investors, the OCs would not be able to identify who the end

investors are and would not be able to gather relevant information relating to those investors.

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.

☐ Yes
☑ No

Response

Please also see our response to Question 3 above in relation to the proposed distinction between the OC and CMI roles.

We are not supportive of this proposal and we encourage the SFC to clarify the definition of "*orders placed on an omnibus basis*" under the Proposed Code. Unless further elaboration of what constitutes an "omnibus basis order" can be provided or how an "omnibus basis order" referred in the Consultation Paper differs from the current market practice of placing omnibus orders or X-orders, we are of the view that the identities of investor clients in "omnibus basis orders" should remain anonymous and that X-orders should not be prohibited – we set out some key reasons for this below:

(a) Commercial interests of investors

We understand that omnibus orders are orders placed from an omnibus account, which is an account where a broker manages the trades of multiple investor clients. Since the trades are carried out in the name of the broker on behalf of the investor clients, identities of the investor clients will remain anonymous.

In some cases, it is in the commercial interests of the underlying investors to keep information about themselves anonymous and confidential (even though in most cases, the issuer may be aware of the identity of the investor). For example, for orders from central banks, sovereign wealth funds and other investors who have a genuine need to maintain confidentiality, there may be a genuine commercial interest in the investors keeping their identity and other information confidential (at least from other members of the syndicate). Similarly, an investor client who maintains a commercial relationship with an OC, may decide not to place its orders with the OC but to place an "X-order" with a fellow CMI instead. If "X-orders" are no longer allowed, the aforesaid scenario would create significant sensitivity for the investor client, and would also affect the commercial relationship between the OC and the investor. On a wider scale, this may also lead to a disruption of, and result in greater imbalances, in the market more generally. For that reason, we believe omnibus orders and X-orders should be permitted where there are legitimate commercial reasons.

(b) Commercial interests of OCs/CMIs

We note from the Proposed Code that the identities of the underlying investor clients of orders placed on an omnibus basis would not be required to be disclosed in the order book but will have to be disclosed to the OC and the issuer. This, however, would appear to conflict with the original rationale behind

placing omnibus orders since the identities of the underlying investor clients would still be required to be disclosed to the OC. In this respect, there is a real concern that the provision of such sensitive information relating to underlying investor clients to the OC will increase the risk of "poaching" (i.e. an OC inappropriately making use of such sensitive information to approach the clients of other CMI syndicate members). Moreover, we do not see any particular reason why information about underlying investors should be provided to an OC only, as this could lead to information asymmetry within the entire syndicate. If the objective is to enhance transparency, then all CMIs shall have right to see and contribute to information in the order book to ensure that the price discovery process is credible and that the order book is transparent.

(c) Private bank orders

We note that PB investors' orders are still permitted under the Proposed Code. One concern we have is that the requirement to disclose information about the underlying investors to an OC under the Proposed Code may lead to some investors deciding to place orders via a PB, even where such an approach may not be considered appropriate, simply in order to circumvent the need to disclose information about themselves to the OC.

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.

☑ Yes
☐ No

Response

Please also see our response to Question 3 above in relation to the proposed distinction between the OC and CMI roles.

We agree that syndicate members should not accept knowingly inflated orders and syndicate members should ensure the transparency of the order book – while syndicate members should take reasonable steps to ensure such transparency, we would like to stress that determining whether an order is "irregular", "unusual" or "knowingly inflated" is a very difficult area to police as investors may make large orders for a number of legitimate reasons. In particular:

(a) **Commercial reasons for splitting orders amongst the syndicate**: some investors may deliberately choose to split their order and place separate, legitimate orders with different members of the syndicate – they may do this for a number of legitimate commercial reasons (for example, for relationship reasons to show "support" for different financial institutions), none of which necessarily mean that the order is duplicated, irregular, unusual or knowingly inflated.

(b) **Investment decisions of professional investors**: as mentioned previously, almost all of the bond transactions conducted in Hong Kong are professionals only transactions where (unlike investors on ECM transactions who are largely retail and/or unsophisticated) the investors involved are professional and licenced investors. Ultimately, each investor has its own interpretation as to the

attractiveness of a particular bond (and the relevant issuer's credit) – this is a highly subjective exercise and each investor will have their own commercial and other considerations in mind when deciding the amount of order they wish to place – while a syndicate member should not accept an order that has been knowingly inflated and should take reasonable steps to ensure that the order book is transparent and does not contain irregularities, it should not be the place of syndicate members to second guess every investor's order.

(c) **Dynamism of bond markets**: Hong Kong, as one of the world's top financial centers, can from time to time experience volatility in its financial markets where significant price movements and other anomalies can take place within a short period of time in response to political issues, domestic and overseas market performance as well as other factors. Price volatility can also depend on whether the market is viewed as bullish or bearish at any particular time. Given the numerous factors that can drive pricing volatility, this can create significant difficulties for OCs and CMIs to police irregular, unusual or knowingly inflated orders.

(d) **Existing practices are sufficient**: we believe that current market practices are already sufficient in ensuring transparency of the order book. For example, we note that for bonds which are listed on the SEHK, the syndicate is already required to provide to the SEHK a breakdown of investor information by category (namely, categories according to Institutional Professional Investors, Corporate Professional Investors, Individual Professional Investors and private banking clients).

(e) **Need for more guidance**: given orders are placed by investors on a subjective basis, it is very difficult to define "irregular", "unusual" or "knowingly inflated" orders. We would therefore encourage the SFC to provide more clarity over these definitions including guidance and/or a list of factors pointing to these types of orders, as well as guidance to define the extent of "transparency" (including transparency to whom).

Finally, we believe it should be the individual responsibility of each CMI to take reasonable steps to ensure that all orders placed by it in the order book represent bona fide demand and that each CMI does not accept a knowingly inflated order. The OC should not be able to second guess the veracity of any orders submitted by CMIs since each CMI is required to comply with its own obligations under the Code of Conduct.

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

☑ Yes
☐ No

Response
Please see our response to Question 9 above.

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

☐ Yes
☑ No

Response
Please see our response to Question 9 above.

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

☐ Yes
☑ No

Response
Please see our response to Questions 8 and 9 above.

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

☑ Yes
☐ No

Response
An allocation policy established and implemented by each OC and CMI would not serve the exact purpose for every deal as the market sentiment and nature of each deal differs. For instance, some deals might be market driven while other deals are commercially driven. If each deal were to adhere to the same set of allocation policies, there would be a potential risk where the interests of the issuer and investors cannot be fully maximised. Conversely, establishing allocation policies for each deal would be equally impractical to cover all issues arising from a deal. In light of the above, we recommend that OCs and CMIs should adopt a master allocation policy that sets out standard policies that could be applied to each deal while exercising their professional judgment when it comes to the actual allocation process for each deal.

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

☐ Yes
☑ No

Response

We are supportive of the intent behind this proposal which is to ensure that the order book represents bona fide demand, however, we do not believe that a blanket rule requiring client orders to have priority over all proprietary orders and requiring proprietary orders to only be price takers is necessarily appropriate. Any order that does not represent genuine demand or is not arm's length should not be afforded the same priority. Examples of this would include backstop underwriting orders, direct orders from syndicate desks or solicited trading orders. Nevertheless, we do not believe that a blanket rule is appropriate.

(a) Proprietary orders could be arm's length orders and represent genuine demand

If the proprietary orders are arm's length orders and represent genuine demand, we believe such orders should be treated *pari passu* with client orders. If it is in the commercial interest of a FI investor to invest in a significant amount of bonds and be a volume driver in the transaction, we see no reason why it should be a price taker only. For example, an order from the internal treasury or balance sheet management desk of a CMI which is an arm's length order should still be treated as genuine demand – it represents a genuine order from a distinct and separate business unit, independent of the DCM or syndicate desks. In addition, such proprietary orders often play a key role in the bookbuilding process as they bring momentum to, and help sustain, the order book. In some cases, such proprietary orders represent anchor trades without which the entire trade may fail, particularly during difficult markets. To exclude or confer lower priority on such orders could have the unintended consequence of depressing the demand and overall quality of the order book, as well as increase instances of failed trades. On a wider level this could be harmful to the competitiveness of Hong Kong as a key international financial centre for DCM activities.

(b) This proposal is counter intuitive in the context of PB orders

By way of analogy, we note that under the Proposed Code, orders by PB clients (which are fairly common in the DCM) would still be treated as client orders and therefore be treated *pari passu* with other client orders. If the concern is that proprietary orders (which are generally derived from the trading or asset management desk of the CMI or its group companies) represent a "conflict of interest" and therefore should be given lower priority, then arguably the same could be said about PB orders, which are similarly derived from the PB affiliates of the CMI or its group companies. In our view, a blanket rule requiring proprietary orders to be treated with lower priority would not seem to be a fair and appropriate treatment.

(c) Investors in debt securities are largely professional investors

We would like to reiterate that investor clients for debt securities are largely professional investors, who are competent and knowledgeable in financial markets and are able to make, and be accountable for, their investment decisions. If genuine proprietary orders have the natural effect of driving down the yield/return of a bond during the bookbuilding and price discovery process, information on this process is regularly disclosed (by way of book order updates) to investors who, being professional investors, are at liberty to control or reduce their order, or walk away entirely from the transaction if the final yield/return is ultimately not acceptable to them.

(d) Existing practices adequately address concerns around the transparency of the order book

We believe existing practices already adopted in the market should adequately address concerns around the transparency of the order book. For example, the general prevailing practice in the Asian market (in line with European market practice) is for syndicate members to disclose the level of arm's length proprietary interest in order book updates in order to enhance transparency – this is done by disclosing the quantum of the total order book that consists of arm's length proprietary orders. Similarly, underwriters will typically have existing internal controls in place to manage conflicts of interest arising from the bookbuilding and placing process in a bond issuance – for example, Chinese walls will be set up segregating different business units (such as the DCM and trading desks) while some underwriters may already have internal policies in place which specify that proprietary orders should not be given priority over client orders.

(e) Investors should be able to decide what type of deal is most appropriate, provided they are provided with sufficient disclosure

Finally, investors should be able to decide for themselves what type of deal is most appropriate for them, so long as they are provided with adequate information by way of disclosure.

For professional investors, the focus should be on ensuring proper and timely disclosure of order book information during the bookbuilding process. Provided such disclosure has been given, investors should be allowed to determine for themselves whether to participate in an order book with a concentration of proprietary and PB orders or the presence of significant orders from associate or related parties. Investors should be allowed to choose from a wide variety of transactions with different investor compositions in light of the market conditions at the time and we believe their interests are best protected through ensuring proper disclosure, as opposed to the implementation of stringent rules requiring certain types of orders to have priority over others. Likewise for issuers, so long as the syndicate provides full disclosure of the nature of investors in the order book, such issuers should be able to decide for themselves to what extent certain orders should be given priority over others. This is particular so given the wide spectrum of issuers in the bond markets in Hong Kong, with some issuers preferring FI orders (as they generally tend to be "buy to hold" investors and are therefore more stable), while other issuers may prefer market orders or PB orders.

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

☐ Yes
☑ No

Response
Please see our response to Question 14 above.

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
☑ No

Response
Orders placed on behalf of funds and portfolios, regardless of whether the CMI or its Group Companies have a substantial interest in such funds or portfolios, are completely independent investment decisions made by separate and distinct business units within the financial institutions. As such, these orders should not be regarded as a CMI's proprietary order. Consequently, these are bona fide orders and should not be treated any differently from external investors.

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
☑ No

Response
It would not be feasible for the CMIs to maintain records which evidence every change since the bookbuilding process is a fluid one and such a requirement would be unduly burdensome for market participants, particularly given the number of investors involved and volume of changes. As an alternative, it is proposed that CMIs should maintain key communications with the issuer, investors and other CMIs. While most firms would have implemented a record keeping system, we recommend the SFC to provide further guidance and/or a list of factors that would define the extent and scope of "key communications" referred to in paragraph 116 of the Consultation Paper.

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

☐ Yes
☑ No

Response
Please see our response to Questions 3 to 5 above. For the reasons set out below, we do not agree that fee-related advice should be given

solely by an OC to the issuer:

(a) Inherent conflict of interest

Fee arrangements for the services to be provided by a syndicate member to an issuer are a key commercial issue, which should only be agreed after negotiations between the two parties involved. Each party should have the right to negotiate its own fee arrangement to better protect its own interests, and one syndicate member should not be entitled to negotiate fees on behalf of another. In light of the inherent conflict of interest involved, we firmly believe it would not be appropriate for the issuer to rely on an OC to provide it with advice on the fee arrangements applicable to not only the OC itself but also to other syndicate members.

As mentioned in our response to Question 4 above, issuers may often appoint larger financial institutions with a global franchise as OCs in the early stages of a transaction to assist with the preparatory ground work involved for a bond offering. Allowing OCs to provide advice on fees to an issuer (to the exclusion of non OCs who are often smaller, local financial intermediaries) would not be conducive in promoting competition and fairness in the debt capital markets.

(b) Scenario where there is more than one OC

In circumstances where an issuer has appointed more than one OC, it is unclear how the issuer would be able to resolve conflicting advice obtained from the OCs.

(c) Role of CMIs

From a practical perspective, it is also unclear how such a requirement can work in practice and whether this places an additional burden on OCs to ensure CMIs do not overstep the scope of their roles – for example, if only OCs are able to provide fee-related advice to an issuer, OCs cannot prevent CMIs from providing similar advice to the issuer nor can they "control" what specific interactions CMIs may have with the issuer.

If the SFC insists that, despite the above, OCs are required to provide fee-related advice to the issuer, we propose that all CMIs, not only the OCs, should be able to do so. This should address some of the concerns around conflicts of interests, and will allow the issuer to have the option of receiving advice from the entire syndicate if it so wishes so that it can make the final decision after considering all advice received.

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.

☐ Yes
☐ No

Response

No comment as this relates to ECM activities.

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.

☐ Yes
☐ No

Response
No comment as this relates to ECM activities.

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.

☐ Yes
☐ No

Response
No comment as this relates to ECM activities.

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

☐ Yes
☐ No

Response
No comment as this relates to ECM activities.

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.

☐ Yes
☐ No

Response
No comment as this relates to ECM activities.

Part II : Response to the Consultation Paper from an ECM practice perspective

Overview of ECM market

From an ECM perspective, we believe adequate measures regulating bookbuilding and placing activities in Hong Kong have already been adopted and put in place in addressing some of the SFC's concerns such as disclosure of identities of investor clients and restrictions of investor clients if they are connected with the financial intermediaries and/or the issuers. For instance, the placing guidelines set out in Appendix 6 to the Main Board Listing Rules and Guidance Letter HKEX-GL85-16 issued by the SEHK have set out the detailed requirements to restrict the undisclosed participations of underwriting syndicates including their affiliates when conducting placing activities for an initial public offering.

Furthermore, the Code of Conduct regulates and sets out detailed standards expected of a SFC licensee and practices to be adopted. On 20 January 2017, the SFC has issued the "Guideline to sponsors, underwriters and placing agents involved in the listing and placing of GEM stocks" containing principles-based regulatory expectations on the sponsors, underwriters and placing agents involved in the listing and placing of GEM stocks, which has already been successful in regulating the unusual price volatility of GEM stocks after issuance of such guideline. Throughout the years, ECM market participants have conducted bookbuilding and placing activities by complying with the respective rules and regulations while taking issuers' commercial interests into consideration.

However, the proposals set out in the Consultation Paper appear to vary the market practice by merging and codifying rules and regulations that go beyond the general "principle-based" approach of which most of the other overseas regulators currently adopt. In particular, certain requirements of the Proposed Code are more applicable to the DCM practice (examples of which are set out in our response to the questions below e.g. questions 6, 14-16). While the Association appreciates that changes to existing rules and regulations may be necessary to respond to the everchanging financial market in Hong Kong, we are of the general view that the Proposed Code should specifically be tailored to cater for each practice, rather than adopting the one size fits all approach.

The following sets out our responses from an ECM practice perspective to each of the questions in the Consultation Paper: -

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
   ☐ No

Response
In general, we submit that the proposed definitions for "bookbuilding activities" and "placing activities" are clear and sufficient to cover the key capital raising activities which take place in Hong Kong.

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

☑ Yes
☐ No

Response
In general, we agree with the proposed scope of coverage for ECM activities. However, we seek the following clarifications from the SFC: 1 In light of the broad definitions used in paragraph 21.1.1 of the Proposed Code and in order to ensure that intermediaries do not inadvertently breach the relevant requirements, we seek from the SFC some practical illustrations (in the form of published guidance materials like FAQs) of what typical activities by a CMI will or will not be caught under that paragraph. 2 Specifically, clarification is required on the general application of the Proposed Code where the bookbuilding activity occurring outside Hong Kong in respect of an IPO offered in Hong Kong. For example, a member of the underwriting syndicate has office in Hong Kong involving in advising on pricing and allocation while their Singapore sales office was involved in taking orders – to what extent does the Proposed Code be applicable in syndicate members with cross-border office set up? 3 Please provide a clear definition on "club deals" as referred to in paragraph 44(a) of the Consultation Paper. Would private placements (including those private deals with Bloomberg messages published or placing with more than 6 placees with no bookbuilding activity) be included? 4 Paragraph 48 of the Consultation Paper stated that the Proposed Code would not cover a share offering which has been subscribed by an intermediary as principal deploying its own balance sheet, for onward selling to investors or otherwise. Please kindly clarify (a) whether "otherwise" means "to a third party other than an investor" or "whether or not it was for onward selling", e.g. it will be held as long term investment; and (b) whether "debt offering" is also covered under that paragraph, since currently only "share offering" is mentioned.

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

☐ Yes
☑ No

Response
We are of the view that the current definition for OC is too broad and should be properly narrowed down to reflect actual market practice. For ECM transactions, we note that a syndicate CMI which conducts any one of the 4 types of activities set out in paragraph 21.2.3 of the Proposed Code would constitute an OC. However, according to current market practice, an intermediary which exercises overall coordination of an ECM transaction (i.e. usually known as the Sole Global

Coordinator or a Joint Global Coordinator, the heads of syndicate) actually conducts all of the activities set out in sub-paragraphs (a) to (c) of that paragraph. For example, certain syndicate CMIs which are not heads of syndicate might still provide advice on the bookbuilding activities and can bring the desired mix of investors to a deal by making allocation recommendation to the issuer (mentioned in sub-paragraph (a)) in accordance with the issuer's preference. We do not agree that simply because such syndicate CMIs make allocation recommendations to the issuer, without actual overall coordination responsibilities, they should constitute an OC under the Proposed Code and be subject to more onerous obligations thereunder. Likewise for brokers who are only engaged by investor clients to facilitate the subscription and settlement of securities merely as settlement agent should not be treated as a non-syndicate CMI.

Another point to note is that in practice, a head of syndicate might or might not in a particular case also act as the stabilising manager referred to in sub-paragraph (d), although in most cases it does. In our view, a syndicate CMI which only acts as a stabilising manager without other overall coordination roles should not be considered as an OC under the Proposed Code. In any event, acting as the stabilising manager is not the most essential role of a head of syndicate in an ECM transaction and therefore should not be a factor to be taken into account to determine whether a syndicate CMI is an OC.

Our proposal

In light of the above, we propose that paragraph 21.2.3 of the Proposed Code be amended so that an OC is defined as a syndicate CMI which conducts all 3 types of activities set out in sub-paragraphs (a) to (c), and sub-paragraph (d) can be deleted.

SGC and JGC

Lastly, since "Sole Global Coordinator" and "Joint Global Coordinators" are already terms commonly used in ECM transactions, in order not to create confusion to potential investors, we submit that it is preferable not to create a new "OC" title under the Proposed Code.

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? If not, please explain.

☐ Yes
☑ No

Response

We do not agree that the appointments[11] of OCs and other CMIs and the determination of their roles, responsibilities and fee arrangements, should all take place at an early stage, reasons of which are set out in the paragraphs here in below. Instead, the market should be allowed to continue to regulate on its own based on years of market practice (i.e. the

[11] The only exception to this is the timing of the appointment of the Sponsor OC, which must take place not less than 2 months prior to submission of the listing application as required under the Listing Rules.

appointment of syndicates to take place prior to the launch of a proposed transaction as opposed to during the preliminary stage of a transaction). Further, based on the current drafting of the Proposed Code, OCs will not be allowed to be appointed after the proposed deadlines as stipulated under the Proposed Code. In the event that OCs may still be appointed after such proposed deadlines, one would have challenged what is the rationale and necessity of codifying the early appointment of OCs and CMIs as stipulated under the Proposed Code.

1 Volatile market

Hong Kong is a free economy with free inflow and outflow of funds and at the same time, is truly integrated with the global economy. As a result, Hong Kong's stock market has always been extremely volatile, including being highly sensitive to new developments both within and outside Hong Kong. It has therefore always been the practice in Hong Kong that OCs and CMIs engaged in the bookbuilding exercise of an ECM transaction are not engaged until a much later stage of the deal. It is neither practical nor possible for the OCs and CMIs to determine their roles and responsibilities at a preliminary stage of a deal, since the essence of their job in securing investors for the issuer depends on the overall market conditions when the deal is launched, which is uncontrollable and cannot be predicted with much certainty. Requiring non-sponsor OCs to be appointed within 2 weeks after submission of listing application and syndicate CMIs to be appointed at least four clear business days prior to the Listing Committee Hearing, is not reasonable. As the SFC is aware, the actual bookbuilding process does not even commence until after approval of the listing application by the Listing Committee.

2 Unfair to the issuer: Incentivise lack of efforts and penalise making extra efforts (獎懶罰勤) and reduces flexibility

If OCs and CMIs are mandatorily required to determine their appointment and roles and responsibilities during the preliminary stage of a deal, out of their own self-interest, they would need to act prudently (in light of the volatile nature of our market) and make a discount to whatever price range for the offering they propose to the issuer. Once their fees are determined at the outset, the OCs and CMIs would have less incentive to find investors which are willing to pay at a market price, i.e. they will likely use less efforts in the bookbuilding process. Pursuant to the proposals in the Proposed Code, since additional OCs cannot be appointed after the proposed deadlines, even if they are able to secure other high quality investors in the interest of the issuer and its shareholders, they would not be able to join the deal as heads of syndicate given the constraint under the Proposed Code.

In the above scenario, the OCs and CMIs who are the "early birds" will be rewarded despite their as yet proven contribution and efforts, while the late-comer prospective OCs and CMIs will be unfairly penalised, even though they could have secured better investor clients (i.e. 獎懶罰勤). In relation to the issuer, its access to the buyside is therefore limited and this results in the issuer not being able to price the deal at the most appropriate market price, if the market was allowed to work on its own.

Requiring an issuer to appoint all the OCs and CMIs and determine their respective fees at an early stage also reduces the flexibility currently enjoyed by an issuer. In particular, in relation to discretionary fees, which depend on the actual performance of each CMI when the deal is launched at a later stage, they cannot be determined at an early stage.

3 Detrimental to all players in the market

In certain circumstances, after the bookbuilding process starts, the OCs and CMIs who were appointed and fixed at an early stage might be unable to secure sufficient orders for the offering. This might result in the deal being pulled. As the SFC is aware, most deals in the Hong Kong market do not involve "hard-underwriting" and the force majeure clause is drafted so broadly that it is not difficult for the underwriters to pull a deal. Meanwhile, other intermediaries might have been able to source last minute orders. However, since their fees are only determined at a later stage, they may not be well incentivised to secure last minute orders to save the deal.

If the early appointment requirement results in more deals being pulled in Hong Kong, potential listing applicants (including quality applicants) would be less inclined to apply for a listing in Hong Kong and would prefer seeking a listing in other jurisdictions which do not have such early appointment requirement. As far as we are aware, most other developed jurisdictions, including the US and the UK, do not have such mandatory early appointment requirement. Also, contrary to what is stated in paragraph 129 of the Consultation Paper, the normal market practice in the US and the UK is also not early appointment. We understand that it is common in the US market that the issuer is allowed to appoint new or change the syndicate composition at a later stage even after the official launch of the IPO. The SEHK's attractiveness as a listing venue would therefore be weakened or compromised. This is detrimental to both intermediaries and investors in the market.

4 Other practical difficulties

In practice, terms of engagement usually require a long period of negotiation, especially because most listing applicants lack prior experience in entering into an ECM transaction. Based on the current market practice, the Association is of the view that the proposed timing under the Proposed Code is unrealistic and prevents other bookrunners to join at a later stage. Particularly for ECM deals or deals involving State-Owned Enterprises, it would take a long time to secure a written agreement in light of the many layers of approval they need to go through.

5 Alleged concerns

We note that the SFC has proposed the early appointment of OCs and CMIs to address alleged concerns raised regarding "last minute swarming", "price-insensitive orders" and "buy-side confusion". We submit that those concerns are ill-founded.

(a) Last minute swarming

We submit that it is factually incorrect that the normal market practice is as stated in paragraph 23 of the Consultation Paper. As discussed above, in light of Hong Kong market's volatility, OCs and CMIs normally are not appointed at an early stage of an ECM deal. An OC or syndicate CMI might join a deal at a late stage for various commercial reasons, but there is nothing inherently improper regarding that. All OCs and CMIs are licensed and regulated by the SFC and have to meet high standards of conduct. We do not understand what is the basis for the observation stated in paragraph 25 of the Consultation Paper that "latecomers were often unfamiliar with the issuer and the offering and, as a result, were unable to market the offering properly". All non-sponsor OCs and CMIs are on the same level playing field, in that all of them rely on the same information set out in the prospectus of the issuer to determine whether they are able to secure orders from their investor clients. Whether the OC or CMI was appointed earlier or later does not affect the information they possess, nor

their responsibilities or abilities and hence, their ability to carry out bookbuilding activities.

(b) Price-insensitive orders

Paragraph 26 of the Consultation Paper also referred to "price-insensitive orders from corporate and individual investors who may not be as capable as institutional investors when evaluating or pricing a deal". The implication made is that any order secured by a latecomer from a non-institutional investor which is willing to pay a higher price would be deemed as "price-insensitive". We submit that this labelling is not fair and inappropriate. In a perfect world, each intermediary would have access to all potential investor clients which might be interested in an ECM deal. As it is, in reality, since each intermediary has its own business focus and connections, they have different pools of investor clients. Therefore, no negative inferences should be drawn, just because an intermediary appointed at a later stage is able to secure a higher paying investor, which the earlier appointed intermediary was not able to.

(c) Buy-side confusion

It is stated in paragraph 68 of the Consultation Paper that some buy-side participants have complained that many different intermediaries may market an offering to them, without knowing with certainty whether such intermediaries have full access to the order book. We trust this only applies to DCM deals where there is no sponsor. We submit that this does not happen in ECM deals in Hong Kong, since the sponsor of a deal is usually also a head of syndicate, which takes the lead in the deal. As the sponsor and global coordinator(s) (i.e. the head(s) of syndicate) are identified in the prospectus, there should not be any confusion by the buy-side as to which intermediary has done sufficient due diligence and knows the applicant well, in an ECM deal.

(d) Equal treatment of all investors

We also note that in paragraph 26 of the Consultation Paper, the SFC has made the presumption that corporate and individual investors are not as capable as institutional investors to evaluate and price a deal and therefore orders from them are considered as "price-insensitive" in nature. We are of the view that no such presumption should be made and as a free market economy, all investors in Hong Kong (whether institutional or not) should be treated equally and not be discriminated against.

We agree with the SFC that a transparent and fair bookbuilding process serves the interests of all market participants and the conduct engaged in by intermediaries must not distort the price discovery process. However, as illustrated above, since the concerns alleged are not substantiated, we submit that the market should continue to be allowed to function on its own, and there is no need to change the status quo and artificially require the appointments of OCs and CMIs to be accelerated to an early stage. As a matter of fact, we submit that imposing such early appointment requirement will distort the price discovery process, in light of the other practical issues we have discussed above.

Confirmation sought:

We seek confirmation from the SFC as to whether placing agents for private placements are regarded as CMIs as well.

Assessment of the issuer and the offering (paragraphs 21.3.1 and 21.4.7 of Proposed Code)

In connection with the CMI's proposed responsibility to assess the issuer and the offering, we agree that assessment of the issuer client is of paramount importance, however the requirement under the Proposed Code is overly broad:

1 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.

2 While CMI is required to take reasonable steps to obtain an accurate understanding of the issuer client and formulate governance framework to review and assess the offering, in reality, CMI can only rely on information provided by the OC, which is often limited information. It would be difficult for CMIs to form a standard for reviewing purpose. The OC might also be reluctant to share information with CMI, particularly to non-syndicate CMI, due to confidentiality concern and in the cases where material non-public information might possibly be involved e.g. spin-off.

3 While CMI is also required to share the information with non-syndicate CMIs, the burden on the non-syndicate CMI is too high to conduct the responsibilities under the Proposed Code 21.3 (CMI Obligations and expected standards of conduct) (except for the assessment on conflict of interest which is already governed by the Code of Conduct as well as the Main Board Listing Rules – Placing Guidelines for Equity Securities), as their roles and responsibilities are indeed very limited, i.e. merely acting as a settlement agent.

In view of the above, we wish to clarify with the SFC the following issues and seek guidance in relation to the feasibility and logistics of OCs sharing information with syndicate CMIs in this regard:

1 How could the OC ensure that all of the requested information of the issuer will be provided?

2 What would be defined as "reasonable steps"?

3 How will the OC determine what information to be shared with the syndicate and non-syndicate CMIs?

4 Will the OC be responsible to the CMI for the legitimacy and accuracy of the information shared?

5 Will the OC be required to share information it obtained through its internal sources with the CMIs?

6 How could the CMIs strike a balance between disclosure obligations and confidentiality obligations?

The above clarifications would provide better clarity to OC and CMIs while carrying out their responsibilities. In particular, it is essential to delineate the liabilities of the respective parties where OC/ CMIs are to share information with the syndicate parties.

It is suggested that the SFC can consider that the sponsor OC should be the party responsible to ensure adequate and accurate information should be obtained from the

issuer client for assessment purpose. Rather than requiring the CMI to take reasonable steps to obtain an accurate understanding of the issuer, the CMI's assessment of the issuer could be based on the information given by the sponsor OC and information from its own source obtained using reasonable steps. Non-syndicate CMI should be excluded from performing the assessment of issuer client except for the requirement to avoid potential conflict of interest.

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
☑ No

Response

We are of the view that the whole syndicate (including syndicate members who joined later in the deal), and not only the OC, should provide advice to the issuer on the above-mentioned areas, and the issuer should decide over the final allocations.

It is not consistent with the collaborative nature of the bookbuilding and allocation process if only the OC could advise the issuer on these matters. It is essential to maintain a fair and balance of recommendations received by the issuer from the whole syndicate and it is uncertain how a "fair" advice can be achieved if only the OC can advise the issuer and would create more conflicts of interest if the OC has been given too much power in the decision making process on the entire bookbuilding process.

Moreover, we wish to clarify with and seek guidance from the SFC on the following issues:

1 The requirement is too onerous and there are concerns on the practicality in view of the timing of certain type of deals. For example, in a top-up placing and subscription transaction, where the timetable is always short, there may not be ample time to provide advice to the issuer and their directors the SEHK requirements which apply to placing activities and ensure that they do actually understand and meet these responsibilities.

2 The documentation requirement especially the advice and recommendations should be documented if issuer's final decision deviate materially, may not be practical. It is difficult to ascertain what is the "material deviation".

3 Is it appropriate for OC to recommend detailed syndicate membership or fee arrangement to issuer? We disagree with OC recommending on detailed syndicate membership or fee arrangement to issuer. The OC is not impartial given it has self-interests and the role to advise the issuer on fee arrangements and syndicate membership creates significant conflict of interests among CMIs within the syndicate. This undoubtedly enabled the OC to gain an upper hand and put other syndicate members and bookrunners in a weaker position. This is unclear how this could improve the accountability of the conduct of the share offering. In fact, this would reduce the transparency of the fee arrangements and hinder information flow and create imbalance amongst the syndicate members.

4 Would the OC owe any liability to the issuer? Under current market practice, underwriting agreements usually disclaim underwriter's fiduciary duty to issuer. A director himself owes both a statutory duty of care under the Companies Ordinance to exercise reasonable care, skill and diligence in carrying out his functions as a director as well as a fiduciary duty to act bona fide (i.e. in good faith) in the best interest of the company. The requirement that placing agents and underwriters have to ensure listed issuer and their directors comply with the relevant listing requirements in relation to placing activities has significantly increased their burden and potential liability, which in certain circumstances such as a top-up placing and subscription, the effort required is disproportionate with their return and fees.

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.

☐ Yes
☐ No

Response
No comment as this relates to DCM activities.

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
☑ No

Response
For ECM transactions, placing agents are already subject to detailed rules and requirements under the Listing Rules and relevant guidance materials issued by the SEHK in relation to the assessment of investor clients and placing of shares to them. These include the Placing Guidelines in Appendix 6 of the Listing Rules and relevant Guidance Letters, such as "Placing to connected clients, and existing shareholders or their close associates, under the Rules" (HKEX-GL85-16) and "Pre-vetting for placing to connected clients in an initial public offering" (HKEX-GL110-21). We believe these rules are already sufficient to deal with concerns in connection with the assessment of identity of investor clients and no additional rules are required. Nonetheless, in relation to the proposed requirement for OC to provide information to CMIs in this regard, we have the following concerns: 1 It is difficult and impracticable to ensure that all CMIs would be vested with the same information received from the issuer. The OC would also be vested with a higher burden. Further, would this mean that the OC would be liable if the issuer shared false information to the CMIs? Data privacy and confidentiality are other big concerns

in this kind of information passing. This higher level of expectation and additional responsibility imposed on the OC may adversely affect syndicates and hinder them from joining a deal.

2 Syndicates would have their own in-house due diligence and KYC procedures. They should not rely on the information shared by the OC to demonstrate their compliance with the KYC requirements under the SFC's Code of Conduct. Information should be directly provided by the issuer to the syndicate CMI instead.

3 As to information for non-syndicate CMIs appointed by CMIs, in practice, they are required to conduct their own due diligence work based on the prospectus provided, which should have already included all material information. It would add extra burden to the syndicate CMIs to have to share information to them (this issue is also in connection with the Proposed Code paragraphs 21.3.8 and 21.4.7).

4 It is important to clarify what is "sufficient information". This would minimise confusion and disputes between OC and CMIs and among CMIs.

5 It is proposed that the Sponsor OC only, rather than all OCs, should be responsible to provide the list of core connected persons of the issuer client to CMIs. This is in line with the SEHK's Guidance Letter HKEX-GL85-16.

6 In the event that OC would be required to provide information to CMI as proposed under the Consultation Paper, should OC be allowed to charge documentation fee for the provision of such information?

Moreover, in practice, it is difficult for OC to obtain information about the identity of the investors, hence we consider that it is more appropriate to request the issuer to provide information of any Restricted Investors or list of connected parties of the issuer to the OCs, all CMIs and non-syndicate CMIs.

Similar to information sharing in respect of assessment of issuer and the offering, it is essential to delineate the liabilities of the respective parties where OC/ CMIs are to share information with the syndicate parties.

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.

☐ Yes
☑ No

Response

We recommend the SFC to provide clear guidance and/or list of factors the SFC would take into consideration of what constitutes as "omnibus basis orders" before we can fully formulate our opinion in response to this question.

Generally speaking, omnibus orders are orders placed from an omnibus account, which is an account where a broker manages the trades of multiple investor clients. Since the trades are carried out in the name of the broker on behalf of the investor clients, the

identities of the investor clients will remain anonymous.

We note from your proposal that identities of the underlying investor clients of orders placed on an omnibus basis would not be required to be disclosed in the order book but will have to be disclosed to the OC and the issuer. It is believed that this would alleviate the concern and reduce the likelihood of other CMIs being aware of and poaching the underlying investor clients.

With reference to the practice of placing omnibus orders, it appears that the proposal in the Consultation Paper conflicts with the rationale of placing omnibus orders. Unless further elaboration of what constitutes an "omnibus basis orders" can be provided or how the "omnibus basis orders" referred in the Consultation Paper differ from the current market practice of placing omnibus orders, we are of the view that the identities of investor clients in "omnibus basis orders" should remain anonymous.

Separately, the launch of the SEHK's Fast Interface for New Issuance platform (**"FINI"**) platform will require the submissions of placee lists to the FINI platform with identification details of the investors by distributors for regulatory clearance. Hence, we consider that the launch of the FINI platform should alleviate the SFC's concern regarding the transparency of the order book.

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.

☑ Yes
☐ No

Response

We are of the view that there will be grave difficulty for OCs to identify irregular or unusual orders in the order book.

It is difficult to define what constitutes "irregular" or "unusual" orders as orders are placed by investor clients on a subjective basis. For instance, some investor clients may find the operations and future development of a proposed issuer in a small scale IPO to be favourable and consequently subscribe for a large quantity of shares for long term investment, while lower quantity of shares may be subscribed for in a large scale IPO if the investor client considers that the issuer is overvalued and overrated by the market. Taking the latter as an example, although the number of shares to be subscribed for may be far lower than those in other subscriptions, it would not raise concerns of being a potential issue due to the popularity of the deal and the market sentiment, but rather to conclude such case as an "irregular" order on the order book. At the end of the day, each investor client has their own interpretation of how a stock would perform, which is highly subjective and would also factor commercial considerations when an order is placed. As such, we recommend the SFC to provide further guidance on what constitutes "irregular" or "unusual" orders.

As for duplicated orders, we have mentioned in our response to question 7 that the SEHK intends to launch the FINI by 2022, where one of its functions enable it to stamp out multiple or duplicate applications by requiring the brokers to submit certain identification details of their clients. This would essentially close a loophole where investor clients

register accounts with different brokers for the same IPO. On the assumption that the transparency of order book will be further enhanced as the OCs (including principal bookrunners, lead broker and underwriters) determine the final offer price and place the IPO shares to clients and sub-place to other distributors through the FINI system (which has presumably rejected duplicated orders by the FINI system), we do not expect a problem arising from duplicated orders in the future. Nonetheless, this would be subject to the actual functions and performance abilities when FINI system officially launches by the SEHK in the future.

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

☑ Yes
☐ No

Response
We agree that OCs and CMIs should not accept knowingly inflated orders. However, we are of the view that OCs and CMIs are not in the capacity to determine whether an order from other OC or CMI is inflated or not. Furthermore, what constitutes "knowingly inflated orders" are unclear. With reference to our response to Question 9, investor clients have a subjective interpretation of how the proposed issuer would perform and would factor their own commercial considerations when an order is placed. Furthermore, Hong Kong, being one of the world's top financial centers, has an extremely volatile financial market where significant pricing changes take place within a short period of time in response to, among others, political issues, overall market performance and foreign market performance. Price changes would also occur depending on whether the market is bullish or bearish. Considering the numerous possibilities that could affect price changes, it creates grave difficulties as there are no definitive bases for OCs and CMIs to ascertain whether an order is inflated or not. In light of the above, we are of the view that OCs and CMIs should act in accordance with their client's instructions but should not be burdened to determine whether an order is inflated or not. We further recommend the SFC to provide guidance on what constitutes "knowingly inflated orders" in order for OCs and CMIs to ascertain whether certain orders fall under this ambit and can be accepted accordingly.

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

☐ Yes
☐ No

Response
We recommend the SFC to provide clear guidance and/or list of factors that would define

the extent of "transparency" referred to in this question before we can fully formulate our opinion in response to this question. From a practical standpoint, if the entire order book is transparent and shared amongst all OCs and CMIs, this may lead to a potential problem where the identities of the syndicates' respective investor clients are disclosed and commercial relationships between syndicates and investor clients may be disrupted.

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

☐ Yes
☐ No

Response
No comment as this relates to DCM activities.

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

☑ Yes
☐ No

Response
While we acknowledge that an allocation policy would theoretically assist OCs and CMIs to explain allocation principles to the issuer, such allocation policy would not serve the exact purpose for every deal as the market sentiment and nature of each deal differs. For instance, some deals might be market driven while other deals are commercially driven. If each deal was to adhere to the same set of allocation policies, there would be a potential risk where the interests of the issuer cannot be fully maximized. Conversely, establishing allocation policies for each deal would be equally impractical as it would not set out a degree of information covering all issues arising from a deal. In light of the above, we recommend that OCs and CMIs should adopt a master allocation policy that sets out standard policies that could be applied to each deal while exercising their professional judgment when it comes to the actual allocation process for each deal.

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

☐ Yes
☐ No

Response
We hold a neutral point of view to this question for ECM as the SEHK has already put in place relevant rules and detailed guidance on circumstances where proprietary orders are acceptable. Hence, we consider that it mainly concerns debt capital markets practice. Please refer to our submission relating to DCM practice separately.

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

☐ Yes
☐ No

Response
We hold a neutral point of view to this question for ECM as the SEHK has already put in place relevant rules and detailed guidance on circumstances where proprietary orders are acceptable. Hence, we consider that it mainly concerns DCM markets practice. Please refer to our submission relating to DCM practice separately.

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
☐ No

Response
We hold a neutral point of view to this question for ECM as the SEHK has already put in place relevant rules and detailed guidance on circumstances where proprietary orders are acceptable. Hence, we consider that it mainly concerns DCM practice. Please refer to our submission relating to DCM practice separately.

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
☐ No

Response

While we generally agree that records should be kept (as required by the current rules) throughout the bookbuilding process and that a record keeping system is already in place for members of the Association so that original records may be retrieved if required, it appears that maintaining records evidencing every change would be too onerous. As discussed in the response to Questions 4 and 10 above, Hong Kong has an extremely volatile financial market where significant pricing changes take place within a short period and are affected by various factors. If records are required to be maintained for the most minute changes (e.g. a price change $10.29 to $10.28), this would be unduly burdensome for market participants.

Our Proposal

As an alternative, we suggest the SFC to explore the possibility of (i) suggesting the keeping of records based on changes within a quantifiable range; or (ii) sharing the final bookbuilding / placement results amongst OCs for mutual observation purposes.

Moreover, it is proposed that CMIs should maintain key communications with the issuer, investors and other CMIs. While most firms would have implemented a record keeping system, we recommend the SFC to provide further guidance and/or list of factors that would define the extent and scope of "key communications" referred to in paragraph 116 of the Consultation Paper.

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

☐ Yes
☑ No

Response

For the reasons set out below, we do not agree that fee-related advice as stated in paragraph 134 of the Consultation Paper should be given by an OC to the issuer:

(a) Inherent conflict of interest

Fee arrangement for the services to be provided by an OC to an issuer is a key commercial issue, which would be agreed after negotiations between the two parties. Each party would naturally negotiate the fee arrangement to better protect its own rights. In light of the inherent conflict of interest involved, it is therefore not appropriate for the issuer to rely on an OC to provide it with advice on the OC's fee arrangement.

In practice, if an issuer has any major concerns on this issue, it usually appoints a separate financial adviser to obtain independent advice.

(b) More than one OC

In circumstances where an issuer has appointed more than one OC, it is unclear as to how the issuer would be able to resolve conflicting advice obtained from such OCs.

(c) Fee advice to the issuer

Notwithstanding our reasons set out in paragraphs (a) and (b) hereinabove, if the SFC insists that OCs are required to provide the relevant fee-related advice to the issuer, we submit that all CMIs, not only the OCs, should be able to do so. The issuer will make the final decision after considering all such advice received.

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.

☑ Yes
☐ No

Response
Please see our response to Question 4 above.

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.

☑ Yes
☐ No

Response
Please see our response to Question 4 above. ***Confirmation sought:*** We seek confirmation from the SFC as to whether the word "paid" should be replaced with "payable" in the table set out in paragraph 2 of Schedule 11 to the Proposed Code. We note for instance, it is impossible for underwriters/ syndicates to be paid within two weeks after the listing of H-Share companies where the IPO proceeds (net of stamp duty, brokerage and necessary fees) will be remitted back to the PRC and the underwriters' commission will only be paid months after listing.

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.

☐ Yes
☑ No

Response
Please see our response to Questions 4 and 18 above. Regarding question 21(iii), we are of the view that total monetary benefits paid to each syndicate CMI is not a material information which needs to be disclosed to the SFC or the public. It should be sufficient that the total fees payable to all syndicate CMIs are disclosed in the prospectus as per question 21(ii). Disclosing benefits paid to each syndicate CMI would only create unnecessary tension and awkwardness when the issuer negotiates with each individual syndicate CMI, since their respective remuneration might vary, depending on their respective performance and other various commercial factors, which are arrived at after arm's length negotiations.

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

☑ Yes
☐ No

Responses
We agree with the "sponsor coupling" proposal in general. However, one member is of the view that an issuer's right to appoint its different advisers should not be limited. Such member suggests that as a general rule, at least one sponsor of an issuer should be an OC. However, an issuer should be given the right not to follow this rule and can appoint separate parties as its sponsor and OC, provided that it states the reason for doing so, e.g. the different expertise of the parties.

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.

☑ Yes
☐ No

Response
We are of the view that one Sponsor OC is adequate.

Part III : Response to the Consultation Paper on the proposed implementation timeline of the Proposed Code

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

☑ Yes
☐ No

Response
We would urge the SFC to: (a) extend the consultation period in order to solicit views from issuers to ensure that the market impact of the measures outlined in the Proposed Code is understood and market consensus amongst all ECM and DCM market participants is achieved; (b) conduct a second round of consultation on the Proposed Code. Based on feedback we have so far obtained from our members and other market participants, we expect that significant amendments to the Proposed Code would be required in order to address the extensive and varied concerns raised by them. The amended version of the Proposed Code should then be published for a second round of consultation. In light of the drastic change to the current market practice being proposed, we submit that the SFC should not rush the implementation of the Proposed Code. (c) commission and publish a thorough comparative study of the regulations of DCM and ECM bookbuilding activities in other international financial centres so that market participants may analyse the measures outlined in the Proposed Code in light of regulatory practices in other jurisdictions; and (d) consider, to the extent the SFC decides to implement any of the measures outlined in the Proposed Code, a minimum of 18 to 24 months staged transition period, as: (i) Once the proposed amendments are adopted by the SFC, our members would need to go through and review all their respective internal policies and procedures and make appropriate changes. Since the changes will affect many different aspects of their operations, systems and different departments, including ECM, DCM, compliance, investment banking, accounts and IT, would be involved. For members which have larger operations, they will likely need support from external advisers and other vendors in this regard. (ii) After the written policies and procedures are updated, internal training for staff from all the relevant departments would be required. It is expected that during such training, additional issues would likely be identified, which will result in further modification of the policies and procedures. (iii) For some of our members with larger operations, they might even need to hire additional staff to monitor this aspect of their operations on an ongoing basis. (iv) Many of our members have operations outside Hong Kong. In order to ensure that such overseas operations involved in the international tranche of global offerings are conducted in strict compliance with the proposals, such members would also need to liaise with their overseas counterparts after the Hong Kong

internal policies and procedures are appropriately amended.

(v) Internal trial testing/dry run would likely be conducted before the effective date, to ensure any glitches or deficiencies in practice can be identified and resolved. For members which have larger operations, they might seek advice from an internal control consultant and conduct "walk-through" tests accordingly.

(vi) To match with the expected launch date of FINI by the SEHK in 2022.

- End -