



SECURITIES AND
FUTURES COMMISSION
證券及期貨事務監察委員會

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

February 2021

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Foreword

The Securities and Futures Commission (**SFC**) invites market participants and interested parties to submit written comments on the proposals discussed in this consultation paper or to comment on related matters that might have a significant impact upon the proposals by no later than 7 May 2021. Any person wishing to comment on the proposals on behalf of any organisation should provide details of the organisation whose views they represent.

Please note that the names of the commentators and the contents of their submissions may be published on the SFC's website and in other documents to be published by the SFC. In this connection, please read the Personal Information Collection Statement attached to this consultation paper.

You may not wish your name or submission to be published by the SFC. If this is the case, please state that you wish your name, submission or both to be withheld from publication when you make your submission.

Written comments may be sent as follows:

By mail to: The Securities and Futures Commission
54/F, One Island East
18 Westlands Road
Quarry Bay, Hong Kong
Re: Consultation Paper on (i) the Proposed Code of Conduct on
Bookbuilding and Placing Activities in Equity Capital Market and
Debt Capital Market Transactions and (ii) the "Sponsor Coupling"
Proposal

By fax to: (852) 2284-4660

By online submission at: <https://apps.sfc.hk/edistributionWeb/gateway/EN/consultation/>

By e-mail to: ECM_DCM_consultation@sfc.hk

All submissions received before the expiry of the consultation period will be taken into account before the proposals are finalised and a consultation conclusions paper will be published in due course.

Securities and Futures Commission
Hong Kong

February 2021

Personal Information Collection Statement

1. This Personal Information Collection Statement (**PICS**) is made in accordance with the guidelines issued by the Privacy Commissioner for Personal Data. The PICS sets out the purposes for which your Personal Data¹ will be used following collection, what you are agreeing to with respect to the SFC's use of your Personal Data and your rights under the Personal Data (Privacy) Ordinance (Cap. 486) (**PDPO**).

Purpose of collection

2. The Personal Data provided in your submission to the SFC in response to this consultation paper may be used by the SFC for one or more of the following purposes:
 - (a) to administer the relevant provisions² and codes and guidelines published pursuant to the powers vested in the SFC;
 - (b) in performing the SFC's statutory functions under the relevant provisions;
 - (c) for research and statistical purposes; or
 - (d) for other purposes permitted by law.

Transfer of personal data

3. Personal Data may be disclosed by the SFC to members of the public in Hong Kong and elsewhere as part of the public consultation on this consultation paper. The names of persons who submit comments on this consultation paper, together with the whole or any part of their submissions, may be disclosed to members of the public. This will be done by publishing this information on the SFC's website and in documents to be published by the SFC during the consultation period or at its conclusion.

Access to data

4. You have the right to request access to and correction of your Personal Data in accordance with the provisions of the PDPO. Your right of access includes the right to obtain a copy of your Personal Data provided in your submission on this consultation paper. The SFC has the right to charge a reasonable fee for processing any data access request.

Retention

5. Personal Data provided to the SFC in response to this consultation paper will be retained for such period as may be necessary for the proper discharge of the SFC's functions.

¹ Personal Data means personal data as defined in the Personal Data (Privacy) Ordinance (Cap. 486).

² The term "relevant provisions" is defined in section 1 of Part 1 of Schedule 1 to the Securities and Futures Ordinance (Cap. 571) and refers to the provisions of that Ordinance together with certain provisions in the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32), the Companies Ordinance (Cap. 622) and the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (Cap. 615).



Enquiries

6. Any enquiries regarding the Personal Data provided in your submission on this consultation paper, or requests for access to Personal Data or correction of Personal Data, should be addressed in writing to:

The Data Privacy Officer
The Securities and Futures Commission
54/F, One Island East
18 Westlands Road
Quarry Bay, Hong Kong

7. A copy of the Privacy Policy Statement adopted by the SFC is available upon request.

Executive summary

1. Hong Kong, one of the world's largest capital raising centres, is an active market for initial public offerings (**IPOs**) and debt offerings. A transparent and robust price discovery process through bookbuilding—the mechanism for determining fair prices—and ensuring that securities are fairly allocated are both crucial for the development of a healthy capital market. However, there are currently no specific requirements governing the conduct of bookbuilding or placing activities by intermediaries in either the equity or debt capital markets.
2. As an international financial centre, it is important for our regulatory requirements to be consistent with global standards. The International Organization of Securities Commissions (**IOSCO**) recently issued reports to address conflicts of interest and associated conduct risks in equity and debt capital raising.
3. Against this background, we conducted a thematic review of licensed intermediaries engaged in equity capital market (**ECM**) or debt capital market (**DCM**) activities and engaged both buy-side and sell-side participants to discuss the state of the market as well as the practices and conduct of intermediaries.
4. We found that for some offerings, the price discovery process has been hampered by a number of factors, including inflated or opaque demand. Furthermore, we noted examples of undesirable intermediary conduct, such as brokers without a mandate “swarming” order books at the last minute with orders of unknown quality. Such behaviour could be attributable to specific competitive pressures amongst intermediaries in an environment where fee arrangements affect incentives. This state of affairs can impact the fairness and orderliness of our capital markets and may affect investor confidence and future market development. We also noted a number of good practices, such as disclosures of rebates and conflicts of interest, which were adopted by a number of intermediaries. We are of the view that these good practices should be codified to enhance the quality of intermediary conduct and ensure a level playing field. Separately, we noted that sponsors' incentives and liabilities were often not aligned, especially in larger IPOs. This leads to concerns that a sponsor may compromise its due diligence enquiries in order to become the head of the underwriting syndicate and earn much higher fees to compensate for sponsor costs and responsibilities.
5. In view of the above and to meet our regulatory objectives³, we have formulated
 - (a) a new paragraph 21 in the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (**Code of Conduct**) on Bookbuilding and Placing Activities in Equity Capital Market and Debt Capital Market Transactions (**Proposed Code**) which would apply to intermediaries conducting bookbuilding and placing activities in Hong Kong (see Appendix 1); and

³ Under section 4 of the Securities and Futures Ordinance, the SFC's regulatory objectives include: (i) to maintain and promote the fairness, efficiency, competitiveness, transparency and orderliness of the securities industry; and (ii) to provide protection for members of the public investing in or holding equities and debt securities.

- (b) a proposal to couple the roles of a head of syndicate and a sponsor, including a proposed amendment to paragraph 17 of the Code of Conduct (see Appendix 2).
6. Whilst each of the proposed requirements aims to address a specific problem, together they are integral parts of a single policy package for the benefit of investors in Hong Kong by:
- (a) addressing intermediaries' conduct issues;
 - (b) tackling issues arising from competitive pressures; and
 - (c) aligning incentives with the responsibilities of intermediaries.
7. Key features of the Proposed Code include:
- (a) defining the intermediaries involved in these activities as capital market intermediaries (**CMIs**) and further defining the overall coordinator (**OC**) as the head of syndicate by the activities it conducts (such as the overall management of an offering, coordination of bookbuilding or placing activities conducted by the syndicate and the provision of advice to the issuer);
 - (b) setting out the standards of conduct expected of CMIs, covering a wide spectrum of activities, including bookbuilding, allocation and placing, to address issues including inflated or opaque demand, preferential treatment and rebates, misleading "book messages", proprietary orders which may negatively impact on the price discovery process and orders which conceal the identities of investors. Since OCs play a lead role and shoulder greater responsibility, they would be subject to additional conduct requirements, for example, in advising the issuer of pricing, allocation and marketing strategies; and
 - (c) requiring that syndicate membership and fee arrangements (including the fixed fees and fee payment schedule) be determined at an early stage and formal appointments of CMIs through written agreements specifying the roles and responsibilities and fee arrangements, to enhance accountability amongst syndicate CMIs and discourage undesirable behaviours.
8. In addition, we propose "sponsor coupling" which, in broad terms, would require that for IPOs at least one OC, which is either within the same legal entity or the same group of companies, also acts as a sponsor. This sponsor has to be independent of the issuer. We believe this should be beneficial in the following ways:
- (a) the intermediary playing both the roles of an OC and a sponsor, with a better understanding of the issuer through its due diligence work, should be in a better position to give quality advice to the issuer; and
 - (b) this would help address the concern that sponsors may compromise their due diligence enquiries in order to win the lucrative OC role, especially given that sponsors often face fierce competition from non-sponsors for that role.
9. In formulating the Proposed Code, we have taken into account the reports issued by IOSCO on ECM and DCM activities, observations noted during the thematic review

and feedback received during our extensive soft consultations with industry stakeholders.

10. Separately, in light of the introduction of the Proposed Code and to avoid duplicating requirements, we propose to make consequential changes to the Guideline to sponsors, underwriters and placing agents involved in the listing and placing of GEM stocks (**GEM Placing Guidelines**) issued in January 2017 (see Appendix 3).
11. To facilitate the implementation of the Proposed Code, subject to the responses to this consultation, the SFC and The Stock Exchange of Hong Kong Limited (**SEHK**) will work together to implement changes to the Rules Governing the Listing of Securities on SEHK (**Main Board Listing Rules**) and the Rules Governing the Listing of Securities on GEM of SEHK (**GEM Listing Rules**) (collectively referred to as "**Listing Rules**").
12. The SFC invites market participants and interested parties to submit written comments on the proposals and implementation timeline discussed in this consultation paper by 7 May 2021.

Background

13. Hong Kong is a major international financial centre for corporate fund raising through share and debt offerings.
 - (a) Hong Kong's IPO market was the world's largest in 2019 for the seventh time in the past 11 years⁴ and it has remained very active despite the COVID-19 pandemic. During the first nine months of 2020, equity funds raised increased by around \$77.8 billion, or 58%, to \$211.4 billion from \$133.6 billion during the same period in 2019.
 - (b) Hong Kong's position as a leading corporate bond centre in Asia has advanced rapidly. Issuance of corporate bonds increased to \$255 billion in 2019⁵, up 177% from \$92 billion in 2018, and amounted to \$191 billion in the 10 months from January to October 2020. Over the past three years, the total issuance of corporate bonds during January 2018 to October 2020 amounted to \$539 billion, which was 21% higher than the total issuance in the three years from 2015 to 2017.
 - (c) Dim Sum bonds also registered significant growth, reflecting Hong Kong's position as the leading offshore renminbi centre. Issuance totalled RMB183.4 billion in 2019⁶, up 210% from RMB59.1 billion in the previous year.
14. Hong Kong provides a unique platform where companies (mostly from mainland China) can access local and international demand for equity and debt investments. The pricing of these offerings can be affected by the different objectives of issuers and investors. Issuers have incentives to maximise the IPO price or minimise debt financing costs. Investors have incentives in the opposite direction.
15. Market-driven pricing of equity or debt offerings should work to reconcile these incentives. Typically, "price discovery" is conducted by way of bookbuilding, which is a long established and widely accepted mechanism for pricing both equity and debt offerings. A transparent and fair bookbuilding process which builds a sound investor base for issuers serves the interests of both issuers and investors. However, over time, competitive pressures seem to have led intermediaries to engage in conduct which often tips the scale in favour of issuers. This, in turn, can distort the price discovery process as well as the manner in which equity and debt offerings are allocated to investors.
16. Rules and regulations govern sponsors' work⁷, stock price stabilisation⁸ and the preparation of pre-deal research⁹ on securities listed or to be listed on SEHK. However, there are no specific conduct requirements for intermediaries involved in bookbuilding and placing activities.

⁴ The Hong Kong Exchanges and Clearing Limited's *Annual Report 2019*.

⁵ Based on Dealogic data.

⁶ Based on Dealogic data.

⁷ As set out under paragraph 17 of the Code of Conduct.

⁸ As set out in the Securities and Futures (Price Stabilizing) Rules (Cap. 571W).

⁹ As set out under paragraph 16 of the Code of Conduct.

17. Globally, the conduct of intermediaries in capital raising activities has attracted heightened regulatory attention. In September 2018, IOSCO issued a report on conflicts of interest and associated conduct risks in the equity capital raising process (**IOSCO ECM Report**). IOSCO published a further report on the debt capital market in September 2020 (**IOSCO DCM Report**) (collectively referred to as “**IOSCO Reports**”).
18. The reports proposed measures for the better governance of ECM and DCM activities and encouraged IOSCO members to consider adopting them in their jurisdictions (**IOSCO Guidance**). For example, the IOSCO Guidance addresses conflicts of interest associated with pricing and allocation in both ECM and DCM activities.
19. Against this background, we conducted a thematic review of selected licensed corporations engaging in ECM and DCM bookbuilding and placing activities to better understand current market practices. We also sought views from other buy-side and sell-side market participants on the practices and behaviour of intermediaries engaged in bookbuilding and placing activities. Our policy deliberations were informed by these views and the results of the thematic review.

Findings of thematic review and industry consultations

20. Our thematic review of selected licensed corporations engaging in ECM and DCM bookbuilding identified substandard practices and control deficiencies in various areas, including bookbuilding and allocation. Some of the issues we identified—in the thematic review and in our wider discussions with the industry—have serious implications for the transparency and effectiveness of the bookbuilding process, making it difficult, if not impossible, to assess real demand and determine a fair price.

Roles and responsibilities of different intermediaries

21. Many intermediaries engage in capital raising activities in Hong Kong. Their roles include:
- (a) heads of syndicates responsible for a share or debt offering, commonly called joint global coordinators (**JGCs**); heads of syndicates responsible for a share offering are sometimes referred to as Joint Representatives (**JRs**) and heads of syndicates responsible for a debt offering are sometimes referred to as the Billing and Delivery Banks (**B&D Banks**). JGCs and B&D Banks act as lead underwriters and typically, guide the bookbuilding and placing process and play a leading role throughout the capital raising process, including advising issuers;
 - (b) other syndicate members which are also underwriters of the offering, including joint bookrunners, lead-managers, co-managers and placing agents; and
 - (c) brokers which are not part of the syndicate; these can be sub-placing agents or distributors of shares or debt securities to their own clients.
22. We have observed that:
- (a) the written agreements entered into by these intermediaries generally do not clearly set out their roles or functions; and
 - (b) intermediaries are sometimes given titles which have little bearing on their seniority or responsibilities in a transaction. Moreover, these titles have evolved over time (JR titles have only been used in recent share offerings).

Buy-side firms repeatedly pointed out that not having clearly defined roles and functions can be very confusing and may result in a lack of accountability for the conduct of an offering.

Syndicate membership and incentive structures

23. We understand from some market participants that conventional, appropriate issuer practices have included:
- (a) appointing the heads of syndicate at the outset of transactions, eg, prior to kick-off;
 - (b) treating the heads of syndicate as their trusted advisors and listening to their advice on a marketing strategy and the pricing and allocation;

- (c) determining the total fees to be paid to all syndicate members for participating in a share or debt offering¹⁰ at the outset of a transaction, comprising:
 - (i) a fixed fee portion paid to the heads of syndicate and other syndicate members for their advice and preparatory work as well as the amount of the offering they are expected to sell; and
 - (ii) a discretionary fee portion to incentivise sales outperformance, especially in difficult market conditions; and
 - (d) confirming the fees to be paid to the heads of syndicate for services rendered prior to the launch of the transaction.
24. However, market participants have complained that in recent years some issuers have deviated from the above practices, waiting until shortly before the publication of the prospectus (for IPOs) or shortly before book close (for debt offerings) to decide on the fee arrangements, thus allowing intermediaries to join a syndicate at the last minute. In some cases, payment of fees was not made until several months or more after listing. Furthermore, where fixed fees have traditionally accounted for the lion's share of total underwriting fees, some issuers have increased the discretionary fees portion significantly.
25. The general market perception is that more issuers were adopting fluid incentive structures (eg, the late determination of fee arrangements) which incentivise sell-side firms to compete more aggressively to join a syndicate, often at a late stage in an offering. This in turn has led to very late finalisation of the syndicate's membership. Some market participants pointed out that these latecomers were often unfamiliar with the issuer and the offering and, as a result, were unable to market the offering properly.
26. We also understand from market participants that issuers may reward syndicate members for their ability to support very aggressive pricing. Rather than focusing on order quality, syndicate members may place more emphasis on the quantity of orders sourced, especially price-insensitive orders from corporate and individual investors who may not be as capable as institutional investors when evaluating or pricing a deal. Such price-insensitive demand can then be used to drive up the price of an offering to a level desired by the issuer but not sustainable in secondary market trading; there have been numerous examples of cases where there were sharp declines in post-IPO share prices amidst thin liquidity, which some market participants attribute to these types of behaviour.

Inflated demand

27. During our thematic review, we also noted practices where intermediaries knowingly placed orders in the order book which they knew had been inflated (**knowingly inflated orders**). In one debt offering, an investor informed an intermediary that its real interest was to subscribe for US\$5 million worth of debt securities, but the intermediary placed an order of US\$20 million in the order book on the client's instruction. In another

¹⁰ This includes fees for providing advice to the issuer, marketing, bookbuilding, making pricing and allocation recommendations and placing these securities with investor clients. This is also commonly referred to as "underwriting fees" by the industry.

case the heads of syndicate disseminated misleading “book messages” which overstated the demand for an IPO. Submitting knowingly inflated orders or disseminating misleading “book messages” undermines the price discovery process and can mislead investors.

Lack of transparency

28. From our review of DCM bookbuilding activities, we also noted the use of “X-orders”, which are orders where the identities of investors are concealed. Investors’ identities are only known to the syndicate members who place the orders and to the issuers. We are concerned that unusual, duplicated or potentially fictitious orders might not be identified when the identities of prospective investors are concealed by “X-orders”. We also understand from market participants that issuers may often request “X-orders” to conceal the identities of prospective investors with whom they are closely associated to inflate what may seem to be market driven demand in the order book. Sell-side market participants stated that they sometimes use “X-orders” to prevent other syndicate members from poaching their clients. Some investors, especially sovereign wealth funds, may request “X-orders” to conceal their participation in a DCM transaction.
29. We are concerned that the practice of placing “X-orders” reduces the transparency of the order book and prevents the heads of syndicate from assessing real demand or identifying unusual or irregular orders.

Conflicts of interest

30. There is an inherent conflict of interest where a syndicate member or its group company places orders both for its own proprietary trading or investment purposes as well as for its investor clients. Our thematic review showed that some syndicate members did not give priority to orders placed by their investor clients.
31. In addition, we are concerned that syndicate members with access to the order book are privy to non-public information which, for example, they could use to increase their chances of allocation in popular deals by submitting or revising their orders such that they are slightly more favourable than those of other investors.

Preferential treatment or rebates paid to investors

32. Payment of rebates to private banks is not uncommon in DCM transactions and is usually disclosed in the deal “launch message” for targeted investors. Whilst these rebates are not meant to be passed on to the private banks’ clients, we are given to understand that this does occur. This undermines fair treatment of investors, as different investors in effect pay different prices for the same debt securities.
33. There have also been indications of syndicate members rebating brokerage fees to IPO investors, so that these investors will pay a lower price for shares than others.

Lack of documentation

34. Based on our thematic review, heads of syndicate did not maintain records, or maintained insufficient or inadequate records, of incoming client orders, important discussions with the issuer or the rest of the syndicate, or the basis for making

allocation recommendations. Whilst relevant personnel could broadly explain why they made some key decisions, intermediaries would not be able to reconstruct the decision-making process if relevant personnel leave or cannot recall the details of past deals. Written documentation ensures the integrity of the book-building process, eg, contemporaneous records to establish the position in case of any dispute. This also facilitates the SFC's assessment of intermediaries' compliance with regulatory requirements.

Potential breaches of SEHK requirements

35. In some cases, syndicate members attempted to allocate IPO shares to clients with which they were associated without seeking prior consent from SEHK. This is in breach of SEHK requirements.

Proposed Code

Overall framework

36. Addressing deficiencies in the price discovery process attributable to intermediary behaviours and distorted incentives is important to anchor investor confidence in Hong Kong's capital markets. It is imperative that intermediaries fulfil their basic obligations under the Code of Conduct¹¹ to: (i) conduct their business activities in the best interests of the integrity of the market and (ii) ensure fair treatment of their clients, including striking a proper balance between the interests of the issuer and investors.
37. The Proposed Code sets out the types of intermediaries involved in share and debt offerings and defines the roles of OCs and CMLs.
38. A major part of the Proposed Code has been developed to rectify specific problems in intermediary behaviours and codify good industry practices, focusing on expected standards of conduct and systems and controls in the following areas:
 - (a) assessment of the issuer and the offering;
 - (b) appointment of CMLs and OCs;
 - (c) advice to the issuer;
 - (d) marketing;
 - (e) rebates and preferential treatment;
 - (f) assessment of investors;
 - (g) bookbuilding, including order placement and order book management, pricing and allocation;
 - (h) conflicts of interest; and
 - (i) disclosures to the issuer, other CMLs and investors.
39. To tackle fluid syndicate membership and fee arrangements and thereby the types of competitive pressures which lead to undesirable intermediary behaviours, the Proposed Code sets out a timeframe within which fee arrangements should be determined and requires related disclosures to be made to the SFC. The amount of fees to be paid to individual syndicate CMLs will continue to be determined on an entirely commercial basis; however, issuers should appoint syndicate CMLs and agree their fees early in the process.
40. Whilst each of the proposed requirements under the Proposed Code aims to address a specific problem, together they are integral parts of a single policy package.

¹¹ General Principles 1 (Honesty and Fairness), 2 (Diligence) and 6 (Conflicts of Interest) of the Code of Conduct.

41. Separately, share and debt offerings differ in nature and complexity, and a CMI may play varying roles in different offerings. Senior management of each intermediary are reminded of their responsibilities to establish and implement adequate policies, procedures and controls which are commensurate with the intermediary's business operations.

Scope of coverage (paragraph 21.1 of the Proposed Code)

42. The Proposed Code is designed to regulate the conduct of intermediaries involved in any of the following activities conducted in Hong Kong:
- (a) collating investors' orders (including indications of interest) in a share or debt offering in order to facilitate:
 - (i) the price determination and the allocation of shares or debt securities to investors; or
 - (ii) the process of assessing demand and making allocations(collectively referred to as "**bookbuilding activities**");
 - (b) distributing shares or debt securities to investors pursuant to bookbuilding activities (referred to as "**placing activities**"); and
 - (c) advising, guiding and assisting the issuer in bookbuilding and placing activities.

Intermediaries engaged in any of the above-mentioned capital market activities are referred to as CMIs.

43. For the avoidance of doubt, CMIs do not include financial advisers or other professionals who only provide advice to the issuer (eg, on pricing or marketing strategy) but do not participate in any bookbuilding or placing activities.

Types of offerings

44. The Proposed Code does not cover offerings which do not involve bookbuilding activities. The following are examples of offerings which are out of scope:
- (a) bilateral agreements or arrangements between the issuer and the investors (such as "club deals");
 - (b) transactions where only one or several investors are involved and the terms of the offering are negotiated and agreed directly between the issuer and the investors; and
 - (c) transactions where shares or debt securities are allocated to investors on a pre-determined basis.
45. The types of share and debt offerings to be covered under the Proposed Code are set out below.

ECM

46. The Proposed Code would cover shares¹² to be listed on SEHK issued by a listing applicant or a listed company, as the case may be, via:
- (a) IPOs (for the avoidance of doubt, this includes share offerings in connection with a secondary listing);
 - (b) offerings of shares of a class new to listing; or
 - (c) offerings of new shares of a class already listed under a general or special mandate.

It has been our long-established policy to regulate SFC-authorized real estate investment trusts (**REITs**) in the same manner as listed companies. Since REITs conduct similar equity market fund raising activities via intermediaries, the Proposed Code would also cover units or interests in SFC-authorized REITs listed or to be listed on SEHK.

47. The Proposed Code would also cover shares listed on SEHK when a shareholder places its existing listed shares to third-party investors followed by a top-up subscription of new shares by the shareholder. The issuer is always closely involved in this process. The issuer and the shareholder together are responsible for appointing a CMI to assist them in the placing and, in substance, this type of offering is equivalent to a placing of new shares to investors. As such, the requirements under the Proposed Code should apply equally to these offerings to the extent that they involve bookbuilding activities.
48. For the avoidance of doubt, 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.

DCM

49. Debt offerings in Hong Kong include bonds with complex features, bonds issued by sovereigns or corporates, bonds targeting retail or professional investors, listed or unlisted bonds and, high yield issues. The Proposed Code would cover all types of debt offerings, provided that the offering involves bookbuilding or placing activities conducted by intermediaries in Hong Kong.

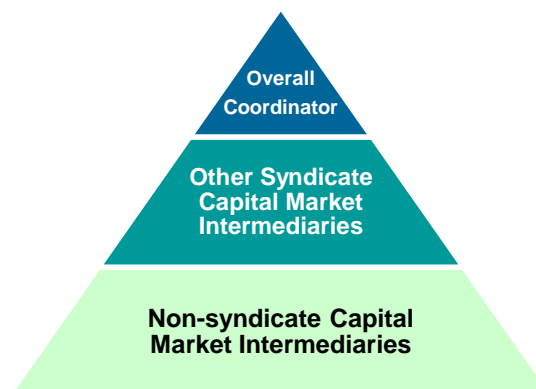
Question 1: Do you consider the definitions of “bookbuilding activities” and “placing activities” to be clear and sufficient to cover key capital raising activities? If not, please explain.

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

¹² References to “shares” in this consultation paper include depositary receipts and units or interests in SFC-authorized real estate investment trusts listed or to be listed in Hong Kong.

Types of CMIs (paragraph 21.2 of the Proposed Code)

50. For share and debt offerings the issuer usually forms a syndicate and engages CMIs to carry out different roles and assume different responsibilities. A variety of titles are currently associated with these CMIs, for example:
- (a) heads of a syndicate are commonly referred to as JGCs or JRs for ECM transactions¹³ and JGCs or B&D Banks for DCM transactions. Generally, they are also the lead underwriters and advisors to the issuer, helping to formulate a marketing strategy, plan roadshows, access investors, make pricing and allocation recommendations and act as the overall coordinators of the offering;
 - (b) other senior syndicate CMIs are commonly referred to as bookrunners or lead managers and less senior syndicate CMIs are commonly referred to as co-managers and placing agents. These tend to be involved only in bookbuilding or placing but not in coordinating the offering, nor do they have advisory roles; and
 - (c) non-syndicate CMIs can be: (i) sub-placing agents engaged by syndicate CMIs or other non-syndicate CMIs for the placing of shares or debt securities; or (ii) brokers which only collate orders received from their investor clients, place them with the syndicate CMIs and distribute the securities to their clients if they receive allocations from the syndicate CMIs.



51. For the purposes of the Proposed Code, heads of syndicate for an offering are referred to as OCs. Other CMIs would fall within the category of syndicate CMIs or non-syndicate CMIs as the case may be.
52. Whilst we can easily classify CMIs as syndicate CMIs or non-syndicate CMIs depending on whether they have a mandate and a direct relationship with the issuer, the position is not as straightforward in the case of OCs given that:
- (a) heads of syndicate can play different roles (eg, a JGC in a debt offering may only work on the transaction documentation with lawyers or deal with credit rating agencies); and

¹³ Where these titles are not used, they may be referred to as bookrunners or lead managers.

- (b) titles may be misleading, for example, some joint bookrunners may secure the more prestigious JGC title, even though they may only have been involved in placing shares or debt securities.

Under the Proposed Code, OCs are identified solely by reference to the activities they actually carry out rather than by their titles. For the avoidance of doubt, issuers would still be free to award titles such as “JGC” to syndicate CMI even if they do not carry out the activities of an OC as stipulated in the Proposed Code.

OCs

53. We regard some activities to be of such importance and they should only be carried out by OCs.

- (a) In the case of a share offering, an OC is a syndicate CMI which, solely or jointly, conducts one or more of the following activities:
 - (i) overall management of the share offering, coordinating the bookbuilding or placing activities conducted by other CMIs, exercising control over bookbuilding activities and making allocation recommendations to the issuer;
 - (ii) advising the issuer of the offer price and being a party to the price determination agreement with the issuer;
 - (iii) exercising the discretion to reallocate shares between the placing tranche and public subscription tranche, reduce the number of offer shares, or exercise an upsize option or over-allotment option; or
 - (iv) acting as the stabilising manager.
- (b) In the case of a debt offering, an OC is a syndicate CMI which, solely or jointly, conducts the overall management of the debt offering, coordinates the bookbuilding or placing activities conducted by other CMIs, exercises control over bookbuilding activities and makes pricing or allocation recommendations to the issuer.

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

Standards of conduct expected of OCs and CMIs

- 54. The standards of conduct expected of CMIs are set out under paragraph 21.3 of the Proposed Code. These are baseline requirements with which all CMIs would have to comply. Additional requirements applicable only to OCs are set out under paragraph 21.4 of the Proposed Code.
- 55. Key requirements applicable to OCs and CMIs are further discussed below. Paragraphs 56 to 125 cover standards of conduct (including systems and controls) expected of OCs and CMIs when discharging their functions in an offering. Paragraphs

126 to 139 cover proposed measures to tackle problems with fluid syndicate membership and fee arrangements.

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

56. Based on observations during our thematic review and discussions with market participants, CMIs would generally conduct assessments of the issuer and the offering before participating in the offering. However, these assessments can vary significantly in scope and depth. In some cases, CMIs conduct very detailed assessments, whilst others conduct limited assessments before marketing the securities to their investor clients, especially if they only join a syndicate at a late stage.
57. Having a proper understanding of the issuer and the offering is important to enable a CMI to market the shares or debt securities to its investor clients and for the OC to provide appropriate advice to the issuer. We propose to set out our expectations for what these assessments should cover.
58. Under the Proposed Code, before engaging in an offering, a CMI should:
 - (a) take reasonable steps to obtain an accurate understanding of the issuer; and
 - (b) establish a formal governance process to review and assess the offering.
59. The assessment of the issuer should include a sufficient understanding of its history and background, business and performance, financial conditions and prospects, operations and structure. An exception to this is where the CMI for a debt offering had been a CMI for previous debt offering made by the same issuer. In that case, the CMI should ascertain whether there have been any material changes in the issuer's circumstances of relevance to its role as CMI.
60. We acknowledge that an assessment of the issuer may vary depending on the type of offering and the role played by the CMI (eg, whether it is an OC). For example, for an offering which involves a top-up subscription where shares are only offered to a limited number of investors and does not require a prospectus or offering document, the CMI's assessment may largely be based on the information available in the public domain.
61. Some CMIs have commented that:
 - (a) they may only have access to information about the issuer and the offering which is in the public domain and this is not sufficient for them to conduct the necessary assessment; and
 - (b) whilst some issuers may arrange a due diligence conference call or a discussion with their lawyers and other professional parties for syndicate CMIs to learn more about the offering or obtain additional information, this is not common market practice.
62. To help CMIs conduct the necessary assessments, we propose that an OC should share information about the issuer with syndicate CMIs, or take reasonable steps to ensure that the issuer provides this information to them. This information should, in turn, be shared with non-syndicate CMIs.

63. Separately, we propose that a CMI should establish a formal governance process to review the offering and assess actual or potential conflicts of interest between the CMI and the issuer as well as associated risks.
64. This would generally involve designating a member or members of senior management to assess, for example:
- (a) the structure of the offering;
 - (b) any actual or potential conflicts of interest between the CMI and the issuer. For example, conflicts of interest may arise where the CMI is also involved in a transaction for a competitor of the issuer; and
 - (c) associated risks involved in participating in the offering, whether financial or reputational.
65. A CMI should maintain sufficient resources and have effective systems and controls in place to ensure that it can properly discharge its obligations and responsibilities.

Appointment of CMIs and OCs (paragraphs 21.3.2 and 21.4.1 of the Proposed Code)

66. We understand that in some transactions heads of syndicate may not be formally appointed or enter into any written agreement with the issuer. It is the market norm for issuers in debt offerings to appoint heads of syndicate verbally without entering into written agreements.
67. Furthermore, underwriting agreements for share offerings and subscription agreements for debt offerings are generally entered into only at a very late stage (usually when the price of the shares or debt securities is determined and allocations to investors are finalised) and do not clearly set out the roles and responsibilities of the CMIs. Although a CMI's underwriting commitment is specified in the underwriting agreement for share offerings, this does not necessarily correspond to its fee entitlement.
68. Clearly defined roles and responsibilities at the outset of the offering are important for CMIs to allocate the right team and sufficient resources to discharge their duties properly. For example, only CMIs appointed as OCs should advise the issuer on issues related to pricing and allocation. Furthermore, 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 have full access to the order book. As a result, they have concerns about the reliability of information (such as "book colour") provided by an intermediary when assessing the offering.
69. In view of the above, under the Proposed Code:
- (a) before a CMI (other than an OC) starts any bookbuilding or placing activities, it should ensure that:

- (i) it has been formally appointed by the issuer (or another CMI in the case of a non-syndicate CMI) under a written agreement to conduct such activities; and
 - (ii) the written agreement clearly specifies the roles and responsibilities of the CMI as well as a description of any remuneration (and the basis for payment) (hereafter referred to as “fee arrangements”); and
- (b) before an OC provides any services as stipulated in the Proposed Code (see paragraph 53(a)) to the issuer client for a share offering (and in any event no later than two weeks after the submission of the listing application by or on behalf of the issuer to SEHK) (see also paragraph 143(a)), or before an OC participates in any bookbuilding or placing activities for a debt offering, it should ensure that:
- (i) it has been formally appointed by the issuer under a written agreement to conduct such activities; and
 - (ii) the written agreement clearly specifies the roles and responsibilities of the OC as well as a description of the fee arrangements.

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

Advice to the issuer (paragraphs 21.4.2 and 21.4.3 of the Proposed Code)

70. Some issuers may lack sufficient knowledge of how a mature international financial market operates. In particular, they may require advice and guidance to appropriately price an offering and to establish a sound and appropriately diverse investor base.
71. We therefore propose that an OC should provide advice to the issuer on syndicate membership, fee arrangements, marketing strategy as well as pricing and allocation.
72. An OC should ensure that its advice and recommendations are balanced and based on thorough analysis, taking into account the issuer’s preferences and objectives as well as prevailing market conditions and sentiment.
73. An OC should always ensure that its advice is aligned with all legal and regulatory requirements. In particular, for a share offering, OCs should advise and guide the issuer and its directors as to their responsibilities under the SEHK requirements which apply to placing activities and take reasonable steps to ensure that they understand and meet these responsibilities. Similarly, OCs and CMIs should be aware of and ensure compliance with the specific requirements for an offering of debt securities listed on SEHK (eg, Chapter 37 bonds which should only be offered to Professional Investors¹⁴).

¹⁴ “Professional investor” is defined under section 1 of Part 1 of Schedule 1 to the Securities and Futures Ordinance.

74. It is also of paramount importance for an OC to explain the basis of its advice and recommendations to the issuer, including any advantages and disadvantages, and provide its advice in a timely manner.
75. In cases where the issuer decides not to adopt an OC's advice or recommendations in relation to pricing or allocation or, in the case of a share offering, its decisions may lead to a lack of open market, an inadequate spread of investors or may significantly and negatively affect the trading of such shares in the secondary market, the OC should explain its concerns and advise the issuer against making these decisions. The OC should also document final decisions of the issuer which deviate materially from the advice or recommendations provided by the OC, including the OC's explanation to the issuer of any concerns associated with these decisions and the advice provided. In the case of a share offering, if decisions made by the issuer amount to material non-compliance with the SEHK Requirements related to, among other things, the placing activities conducted by itself or the issuer, the OC should report the circumstances to the SFC.

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

Marketing (paragraphs 21.3.4, 21.4.4 and 21.4.7(b) of the Proposed Code)

76. Under the Proposed Code, an OC should advise and assist the issuer in developing an appropriate marketing and investor targeting strategy.
77. The strategy may specify, for example, the types of investors targeted, such as institutional clients, sovereign wealth funds, pension funds, hedge funds, family offices, high net worth individuals and retail investors, and the proportion of an offering to be allocated to each type of investors to establish the desired shareholder or investor base. For IPOs, the strategy should also include the types of investors who may be appropriate to be cornerstone investors. It should also aim to achieve an open market and an adequate spread of investors and promote orderly and fair secondary market trading of the offered shares.
78. As market conditions and sentiment may change during the course of an offering, an OC should advise the issuer to adjust the strategy as appropriate.
79. Under the Proposed Code, an OC should inform other syndicate CMI's of the marketing and investor targeting strategy so that they can carry out their own activities accordingly. Syndicate CMI's would be required to inform CMI's they engage of the strategy so that it can serve as the basis for the latter's selling activities.
80. CMI's should not market to investor clients who fall outside the strategy. A CMI should be satisfied that shares are marketed to a sufficient number of investor clients so that the likelihood of undue concentration of shareholdings is minimised. Investor clients who fall within the strategy but to whom the CMI does not actively market should

nevertheless have the opportunity to participate in an offering if they indicate an interest.

Rebates and preferential treatment (paragraphs 21.3.7, 21.3.8, 21.4.4(c), 21.4.5(b) and 21.4.7(c) of the Proposed Code)

81. During our thematic review, it was noted that:
- (a) in the case of debt offerings, some issuers offer rebates to private banks to incentivise them to sell debt securities to their clients. In some cases, private banks have passed on these rebates to clients; and
 - (b) in IPOs, some CMI have paid their clients rebates from the 1% brokerage fee (in whole or in part).
82. Whilst the market is familiar with guaranteed share allocations to cornerstone investors in IPOs, it is important that any other preferential treatment extended to investors be disclosed fully, accurately and in a timely manner. We understand that the terms of rebates provided to private banks are usually disclosed in the “launch message” for targeted investors in DCM deals.
83. Under the Proposed Code:
- (a) a CMI should not offer any rebates to its investor clients or pass on any rebates provided by the issuer. This prevents some investors participating in an offering at a price that is effectively lower than that offered to other investors. In addition:
 - (i) for an IPO, a CMI should not enable any investor clients to pay, for each of the shares allocated, less than the total consideration as disclosed in the listing documents (including the 1% brokerage fee); and
 - (ii) for a debt offering, a CMI should not enter into any arrangements which may result in investor clients paying different prices for the debt securities allocated; and
 - (b) a CMI should disclose to the issuer, the OCs, all of its targeted investors and the non-syndicate CMIs it appoints, any rebates offered by the issuer to CMIs and any preferential treatment of any CMIs or targeted investors (such as guaranteed allocations). In the case of a share offering, the disclosures should be made by a CMI upon becoming aware of any such rebates or preferential treatment. In the case of a debt offering, the disclosures should be made no later than the dissemination of the deal “launch message” to targeted investors.
84. In addition, an OC should:
- (a) disseminate this information (whether received from the issuer or other CMIs) to all syndicate CMIs for their onward disclosure to targeted investors and the non-syndicate CMIs they appoint;
 - (b) advise the issuer against providing any arrangements whereby:

- (i) in the case of an IPO, the investor clients would pay, for each of the shares allocated, less than the total consideration as disclosed in the listing documents; and
 - (ii) in the case of a debt offering, the investor clients would pay different prices for the debt securities allocated; and
- (c) provide advice and guidance to the issuer on the relevant disclosures.

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

Assessment of investor clients (paragraphs 21.3.3 and 21.4.6 of the Proposed Code)

85. To ensure that investor clients fall within categories identified by the marketing and investor targeting strategy, a CMI should take reasonable steps to assess each investor client's profile, including investment preferences (eg, long or short investment horizons) and past investment history (eg, familiarity with the issuer's industry sector), in addition to the know-your-client requirements under paragraph 5.1 of the Code of Conduct.
86. Specific SEHK requirements¹⁵ govern the placing of shares. The allocation of shares to certain groups of investors, eg, connected clients and core connected persons¹⁶ of the issuer, are either subject to restrictions or require prior consent from SEHK (**Restricted Investors**). Under the Proposed Code, a CMI should take reasonable steps to identify Restricted Investors and inform the OC before placing an order on behalf of such clients.
87. Currently, in order to identify whether there are any Restricted Investors, an OC relies on its syndicate CMIs (and in turn the non-syndicate CMIs) not to place orders on behalf of their own substantial shareholders, directors or employees and to require their investor clients to declare whether they are Restricted Investors. CMIs may not have access to complete information about persons or entities which are related to the issuer. We propose that an OC should provide more information to CMIs to facilitate their identification of investors related to the issuer. An OC is therefore expected to obtain from the issuer a list of such persons or entities and provide the same to all CMIs. An OC should take reasonable steps to identify Restricted Investors so that they will only be allocated shares in accordance with SEHK requirements.
88. Similarly, for debt offerings, 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 companies¹⁷ as the CMI (**Group Company**) and we expect the OC to provide sufficient information to CMIs to enable them to identify such investors. The CMI should inform

¹⁵ Appendix 6 to the Main Board Listing Rules – Placing Guidelines for Equity Securities or Chapter 10 of the GEM Listing Rules.

¹⁶ As defined under the Main Board Listing Rules.

¹⁷ For the purposes of the Proposed Code, "group of companies" has the same meaning as in section 1 of Part 1 of Schedule 1 of the Securities and Futures Ordinance.

the OC of these investors to enable the OC to assess whether any orders may negatively impact the price discovery process.

Question 7: Do you agree that an OC should provide relevant information to CMI 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.

Bookbuilding

89. The bookbuilding process comprises the collation of client orders and the determination of pricing and allocation. A CMI has the responsibility to ensure that the price discovery process is credible and that the order book is transparent and incorporates only bona fide orders. An OC should ensure that the pricing and allocation recommendations made to the issuer fully take into account the principles and factors stipulated under the Proposed Code. For example, that the price is determined based on orders received from targeted investors during the bookbuilding process and that the securities are allocated to investors who can build a strong investor or shareholder base for the issuer.

Order book (paragraphs 21.3.5 and 21.4.5(a) of the Proposed Code)

90. CMIs are often rewarded based on the volume of the orders they bring to a deal. They are effectively incentivised to source as many orders as possible to maximise their fees. Some CMIs place knowingly inflated orders. We also understand that in debt offerings some CMIs place orders in their own names. These may be proprietary orders, clients' orders or a combination of both.
91. Whilst market feedback indicates that certain investors (such as sovereign wealth funds) prefer to remain anonymous to other CMIs by using "X-orders", there are concerns that issuers may ask CMIs to use "X-orders" to conceal the identities of prospective investors with whom they are closely associated (such as family members) to hide the fact that these orders may not be market-driven, or for other purposes (eg, to conceal fictitious orders). In some share and debt offerings, CMIs may be reluctant to disclose the names of investors for fear that other CMIs will poach their clients. However, if the identities of the investors are concealed, an OC, which is responsible for managing the order book, will be unable to identify duplicated orders placed through different CMIs, or provide fully informed advice to the issuer about allocations.
92. We propose to require the identities of all investors to be disclosed in the order book, except for orders placed on an omnibus basis. For the latter, information about the underlying investors should still be provided to the OC and the issuer, but need not appear in the order book. This should alleviate the "poaching" concern referred to above.
93. We also propose that:
- (a) a CMI should:

- (i) take reasonable steps to ensure that all orders placed in the order book on behalf of its own investor clients, itself and its Group Companies represent bona fide demand. The CMI must not place knowingly inflated orders;
 - (ii) make enquiries with its investor clients about orders which appear unusual, eg, orders which are not commensurate with the client's financial profile, before placing these orders¹⁸; and
 - (iii) maintain adequate records of orders placed by its investor clients so as to substantiate that there are no fictitious or knowingly inflated orders placed in the order book.
- (b) An OC should:
- (i) ensure that the identities of all investor clients are disclosed in the order book, except for orders placed on an omnibus basis;
 - (ii) make enquiries with CMIs if any orders appear to be unusual or irregular (eg, orders which appear to be related to the issuer);
 - (iii) consolidate the order book by taking reasonable steps to identify and eliminate duplicated orders, inconsistencies and errors; and
 - (iv) segregate and clearly identify in the order book any proprietary orders of CMIs and their Group Companies.

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

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

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

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

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

¹⁸ Otherwise, a CMI would be obliged to place investor clients' orders as they are received in the order book.

Pricing and allocation (paragraphs 21.3.6, 21.4.2(a)(iii), 21.4.5(b), 21.4.5(c) and 21.4.6(a)(ii) of the Proposed Code)

94. According to the IOSCO Reports, conflicts of interest between the issuer and the CMI or its investor clients may result in under-pricing or over-pricing. To ensure a healthy market, the pricing of an offer should reflect bona fide market demand and should not be unduly influenced by the preferences of the issuer or price-insensitive orders which are not market-driven. In addition, CMIs should keep the issuer informed of key decisions or actions which could influence the pricing outcome¹⁹.
95. Under the Proposed Code, an OC should discuss with and advise the issuer on the final offer price taking into account the results of bookbuilding activities, the issuer's characteristics and prevailing market conditions and sentiment. For a debt offering, the OC should ensure that the orders placed by investors which have associations with the issuer, CMIs and their Group Companies will not negatively impact the price discovery process.
96. Allocations of shares or debt securities should be conducted fairly. The IOSCO ECM Report noted that some practices, such as allocations to a firm's most valued clients, to other parts of the firm's business (eg, its asset management division) or its employees, may indicate that allocation decisions are being affected by conflicts of interest. Furthermore, allocation decisions might advance the firm's own interests (or those of its other clients) in a way which could be inconsistent with the interests of the issuer. Similarly, according to the IOSCO DCM report, conflicts of interest arise due to allocations to investor clients who have a relationship with a CMI, such as allocations to group companies of the CMI.
97. IOSCO expects regulators to consider requiring firms to: (i) maintain an allocation policy which sets out their approach for determining allocations in a share or debt offering, considers issuer preferences and provides the issuer with an opportunity to be involved in the process; and (ii) maintain records of allocation decisions to demonstrate that conflicts of interest are appropriately managed²⁰.
98. During our thematic review, we noted that allocation recommendations were based primarily on the judgement of individual staff and their understanding of the issuer's objectives or preferences. Whilst some CMIs had an allocation policy, the criteria set out in the policy were broad and did not provide sufficient guidance to staff. In particular, some CMI allocation policies did not properly address potential conflicts of interest in handling proprietary and client orders. Furthermore, in most cases, documentation of allocation decisions and their rationale was insufficient to demonstrate compliance with an allocation policy and appropriate management of conflicts. This also made it difficult to conduct post-transaction compliance reviews.
99. To address these issues, under the Proposed Code, an OC should develop and maintain an allocation policy which sets out the criteria for making allocation recommendations to the issuer. This policy should, at a minimum, take into account the following factors:

¹⁹ Measure 7 of the IOSCO ECM Report and Measure 1 of the IOSCO DCM Report.

²⁰ Measures 5 and 6 of the IOSCO ECM Report and Measures 5, 6, 7 and 8 of the IOSCO DCM Report.

- (a) the issuer's objectives, preferences or recommendations;
 - (b) prevailing market conditions and sentiment;
 - (c) the type and characteristics as well as the circumstances (such as clients' financial profiles, investment experience and objectives) of targeted investors;
 - (d) the spread of investors, such as the sizes and number of large holdings; and
 - (e) the overall subscription rate for the offer.
100. An OC should communicate its allocation policy to the issuer at an early stage to ensure that the issuer understands the factors determining allocation recommendations.
101. An OC should make allocation recommendations to the issuer in line with the allocation policy. In the case of an IPO, allocation recommendations should ensure that allocations to Restricted Investors comply with SEHK requirements and be made with a view to achieving an open market, an adequate spread of shareholders and promoting the orderly and fair trading of shares in the secondary market. The OC should also document allocation recommendations provided to the issuer, including its rationale.
102. CMI's also need to establish and implement an allocation policy to ensure a fair allocation of shares or debt securities to their investor clients where they place an order on an omnibus basis and an OC gives them an overall allocation. This policy should set out, for example:
- (a) the marketing and investor targeting strategy as agreed with the issuer;
 - (b) the investor clients' order sizes and circumstances (such as clients' financial profiles, investment experience and objectives);
 - (c) price limits for the investor clients' orders;
 - (d) any minimum allocation amounts indicated by investor clients; and
 - (e) any applicable legal and regulatory requirements—for example, debt securities offered in Hong Kong pursuant to Chapter 37 of the Main Board Listing Rules should only be offered to Professional Investors.
103. Whilst a CMI should only include bona fide orders of its investor clients in the order book (as discussed in paragraph 93 above), when allocating shares or debt securities it is expected to assess whether the investor client has the ability to take up the allocation and whether the size of the order appears unusual (eg, if an order from a fund exceeds the fund's net asset value). This also applies to an OC when making recommendations to the issuer regarding allocations of shares or debt securities to its own investor clients.
104. The allocation policy should also prevent any practices which may result in the unfair treatment of investor clients or knowingly distort demand for other share or debt

offerings. Examples of such practices²¹ include an allocation made to compensate laddering²² or an allocation made to an existing or potential client which is expressly or implicitly conditional on future business.

105. A CMI should allocate shares or debt securities to investor clients in accordance with its allocation policy. The CMI should also document the reasons for any material deviations from its allocation policy.

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

Conflicts of interest and proprietary orders of CMIs and their Group Companies (paragraph 21.3.10 of the Proposed Code)

106. In DCM deals, it appears to be common practice for CMIs or their Group Companies to place proprietary orders in the order book. There could be conflicts of interest for CMIs who exercise control over bookbuilding activities and also make pricing or allocation recommendations to the issuer client if their own proprietary orders may have an impact on the price discovery process.
107. There are other concerns about proprietary orders.
- (a) CMIs may take advantage of non-public information about the order book when placing proprietary orders to increase their chances of allocation in popular deals.
 - (b) In a popular offering, a CMI might allocate more shares or debt securities to its proprietary orders than its client orders. Some but not all CMIs have implemented controls for dealing with potential conflicts between proprietary and client orders²³.
108. We propose that a CMI should:
- (a) establish and implement policies and procedures to identify, manage and disclose actual and potential conflicts of interest with investor clients which may arise when the CMI has a proprietary interest in an offering;
 - (b) establish and implement policies to govern the process for generating its own proprietary orders as well as making allocations to such orders;
 - (c) give priority to investor clients' orders over its own proprietary orders and those of its Group Companies; and

²¹ More examples will be provided through an FAQ or circular.

²² For example, where very high commissions or fees are paid to an OC or any of its Group Companies by an investor client for unrelated services in order to secure a better allocation in the offering. This could result in unfair treatment of other investor clients who might not obtain the same allocation despite being of similar quality.

²³ Examples of controls noted in some CMIs include: (i) the allocation to prospective investors should have priority over proprietary orders; (ii) proprietary interest in the offering should not exceed a certain percentage of the order book; and (iii) management approval of the size of the proprietary order and the respective commitments should be obtained.

- (d) only be a “price taker” in relation to its proprietary orders and those of its Group Companies and ensure that these orders are based on market-driven demand and would not materially influence the pricing of the offering.

For the purposes of the Proposed Code, proprietary orders placed by a Group Company exclude those placed on behalf of its clients or funds and portfolios under its management, but include orders placed on behalf of funds and portfolios in which the CMI or its Group Companies have a substantial interest.

109. The OC and CMI should also segregate and clearly identify in the order book and “book messages” its own proprietary orders and those of its Group Companies, other CMIs and their Group Companies.
110. According to the IOSCO DCM Report, it is common for issuers, investors and syndicate members to enter into interest rate swaps or other instruments to mitigate the risk that reference rates used to price debt securities may move between initial and final pricing. Conflicts of interest may arise if these transactions cause idiosyncratic movements in reference rates. This could compromise the integrity and efficiency of both reference rates and the pricing of the debt securities. Also, since these transactions are often carried out by the dealing desk of the CMI, managing the debt offering could create a conflict of interest in relation to the pricing of the offering²⁴. In this connection, under the Proposed Code, a CMI should take reasonable steps to disclose to the issuer why any risk management transactions it intends to carry out for itself, the issuer or its investor clients would not affect the pricing of the new offering.

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

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

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

Review and approval of orders and allocations (paragraph 21.3.11(b) of the Proposed Code)

111. To better address potential conflicts and ensure compliance with the applicable rules and regulations, we propose that the senior management of a CMI should review and approve certain types of orders and allocations, including:
- (a) proprietary orders of the CMI and any of its Group Companies;
 - (b) orders from investor clients which may appear unusual (eg, orders which might appear to be related to the issuer); and

²⁴ Measure 2 of the IOSCO DCM Report.

- (c) allocations to Restricted Investors in the case of share offerings.

Communications with issuers, other CMI and targeted investors (paragraphs 21.3.8 and 21.4.7 of the Proposed Code)

- 112. Throughout the offering, a CMI will receive information from the issuer, OCs, other CMI and its investor clients which materially affects the offering, including information about the offer price and the ways in which the OC and CMI should discharge their responsibilities.
- 113. According to the IOSCO Reports, CMI should provide a range of information to investors in share or debt offerings on a timely basis²⁵ to support the development of a balanced price range and to set the parameters for price formation during the bookbuilding process.
- 114. In this connection, we propose that a CMI should disseminate material information related to the offering to all stakeholders (including the OC, its investor clients and the CMI it appoints). For example, CMI should:
 - (a) provide information about Restricted Investors for a share offering, and about investor clients which have associations with the issuer, CMI and their Group Companies for a debt offering, to the OC and non-syndicate CMI appointed by them to enable them to properly discharge their duties;
 - (b) disseminate the marketing and investor targeting strategy to non-syndicate CMI to facilitate their marketing of the shares or debt securities to investor clients; and
 - (c) provide “book messages” and other information related to the offering (such as preferential treatment and rebates offered to CMI) to enable investor clients to make informed decisions.
- 115. An OC and a CMI should disseminate information in a timely manner and ensure that it is complete, accurate and has a proper basis. For example, if the OC would like to provide “book colour” for the offering (eg, whether the offer is oversubscribed or undersubscribed or the number of times the offer is oversubscribed) in a “book message”, it should take reasonable steps to ensure that the message has a proper basis and is supported by bona fide demand in the order book.

Keeping of records (paragraphs 21.3.9 and 21.4.8 of the Proposed Code)

- 116. A CMI should maintain books and records which are sufficient to evidence work done throughout the entire transaction and demonstrate compliance with legal and regulatory requirements as well as internal policies and procedures. This includes:
 - (a) documenting key communications with the issuer, investors and other CMI;
 - (b) maintaining audit trails from the receipt of orders, the placing of orders in the order book through to final order allocation; and

²⁵ Measure 4 of the IOSCO ECM Report and Measure 3 of the IOSCO DCM Report.

- (c) documenting the basis of allocation decisions with justifications as well as any material deviations from the CMI's allocation policy.

117. In addition, the OCs should document, for example, all changes in the orders in the order book throughout the bookbuilding process and all key discussions with, and key advice or recommendations provided to, the issuer.

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

Resources, systems and controls (paragraph 21.3.11 of the Proposed Code)

118. General Principle 3 of the Code of Conduct provides that an intermediary should have and effectively employ the resources and procedures which are needed for the proper performance of its business activities. The Proposed Code sets out specific requirements covering the following:

Chinese walls

119. When a CMI (usually as an OC) also acts as a sponsor for an IPO, staff of the sponsor team and the ECM team typically work together during the share offering. Staff (such as research professionals) may be brought "over the wall" at an early stage and be provided with information which may be confidential or price sensitive. Whilst most CMIs have Chinese wall policies in place, they may not adequately deal with a situation where the CMI is part of a company or group of companies undertaking multiple activities covering different aspects of the same offering, eg, sponsor work, preparation and issuance of research reports, bookbuilding and placing activities.

120. Under the Proposed Code, a CMI should take adequate measures to prevent the flow of information which may be confidential or price sensitive amongst staff performing different activities and to prevent and manage any conflicts of interest which may arise. In particular, the CMI should establish and maintain effective Chinese walls and wall-crossing policies and procedures.

Appointment of non-syndicate CMIs

121. From time to time, CMIs may engage non-syndicate CMIs to assist in the placing of shares or debt securities (ie, sub-placing agents). These appointments might be made without reviewing the procedures and controls used by sub-placing agents to ensure compliance with applicable legal and regulatory requirements, eg, the identification of Restricted Investors as required under SEHK's Placing Guidelines for Equity Securities²⁶.

²⁶ Appendix 6 to the Main Board Listing Rules Chapter 10 of GEM Listing Rules.

122. The appointment of sub-placing agents to assist in the distribution of shares or debt securities is similar to an outsourcing arrangement, where intermediaries can delegate their work but not their responsibilities.
123. We propose requiring a CMI which identifies a non-syndicate CMI to assist it in placing shares or debt securities to exercise due skill, care and diligence in the selection and appointment. In particular, a CMI should take reasonable steps to ensure that the non-syndicate CMI is able to comply with the Proposed Code. This may involve making enquiries with the non-syndicate CMI and understanding and reviewing:
- (a) its marketing strategy and assessing how it ensures that all investor clients which are targeted investors and have indicated an interest in the offering are allowed to participate in the offering;
 - (b) its process for assessing whether investor clients are independent from or associated with the issuer (eg, understanding the non-syndicate CMI's know-your-client procedures and reviewing pro forma placing letters to be signed by investor clients to ascertain whether they contain an independence declaration);
 - (c) its procedures and controls to ascertain whether it can reasonably ensure that all orders are bona fide; and
 - (d) its allocation policy, to ensure that it addresses or takes into account the requirements under the Proposed Code, and the procedures to ensure that allocation is made in compliance with that policy.

Surveillance and monitoring

124. Some CMIs have compliance monitoring programmes but these may not specifically cover ECM or DCM activities, or may not cover all the staff members who are involved in a share or debt offering.
125. Under the Proposed Code, a CMI should conduct independent surveillance and monitoring on a regular basis to detect irregularities, conflicts of interest and leakage of price sensitive or confidential information as well as potential non-compliance with applicable legal and regulatory requirements or its own internal policies and procedures.

Fee arrangements (paragraphs 21.3.2, 21.4.1, 21.4.3 and 21.4.9 of the Proposed Code and Schedule 11 to the Code of Conduct)

126. During soft consultations, a number of buy-side and sell-side participants expressed serious concerns about fluid syndicate membership and fee arrangements. Under the Proposed Code, fee arrangements are required to be specified in the written agreements with the CMIs and OCs (please see paragraph 69) and OCs are required to advise issuers on the fee arrangements (please see paragraph 71). However, these are not sufficient to fully address what we understand to be one of the root causes of undesirable intermediary behaviours.
127. Based on market feedback, timing of fee determination is a key factor affecting the behaviours of ECM and DCM participants. For example,

- (a) where substantial fixed fees have already been allocated to syndicate CMIs, there should be less of an incentive for brokers without a mandate to “swarm” order books at the last minute and bring in large price insensitive orders even if they suspect that the offer price, in the case of a share offering, is unsustainable post-IPO; and
 - (b) OCs and syndicate CMIs could not properly plan their work or allocate appropriate resources without knowing at an early stage the basis on which they were to be paid.
128. We are therefore of the view that if syndicate membership and fee arrangements are determined at an early stage of the offering, the OCs and the CMIs should be able to focus their efforts and devote their resources to providing advice to the issuer and conducting bookbuilding and placing activities in compliance with the proposed conduct requirements. This would, in turn, enhance the transparency and credibility of the price discovery and allocation process.
129. Early agreement of fixed fees is consistent with international market practice, including in the US and the UK. It is proposed that the fixed fees to be paid to the OCs should be determined at the time of their appointment and that this should cover the advisory services provided by an OC as well as proportions of shares or debt securities ordinarily expected to be sold by the OC. The issuer can subsequently appoint other syndicate CMIs, and at the time of their appointment determine their fixed fees based on the volumes they are expected to sell. Separately, the issuer can still pay CMIs discretionary fees to incentivise sales outperformance, especially in difficult market conditions and these fees can only be determined when the selling process is complete or substantially complete.
130. Fees are primarily a commercial matter; fee ratios and allocations necessarily vary from one offering to another, and may be affected by unforeseen circumstances, including changes in market sentiment at the time of the offering. However, in light of the issues discussed above, it would seem appropriate for the ratios of fixed fees to discretionary fees and allocations of fixed fees to syndicate members to also be agreed at an early stage.
131. The fixed fee is generally expected to account for a larger portion of the total fees to be paid to syndicate CMIs participating in an offering. Based on the feedback received during soft consultations and as derived from IPO prospectuses published between 1 January and 30 September 2020, the market norm for fees in share offerings is around 70-75% fixed fees and 25-30% discretionary fees. We however recognise that the ratio between fixed and discretionary fees may differ in situations where an additional discretionary element is used to further incentivise the syndicate to market the offering.
132. Separately, fluid syndicate membership and fee payment have a combined effect of enabling issuers to achieve an unsustainably high offer price and, in the case of a share offering, potentially incentivising overly-favourable research.
133. We therefore propose each written agreement to be entered by an OC or CMI to specify the fee arrangements (including the allocation of fixed fees to that CMI as a percentage of the total fees to be paid to all syndicate CMIs participating in the offering) and the fee payment schedule.

134. Given the importance of appropriate fee arrangements in an offering, an OC should advise and guide an issuer on fee-related matters, and more specifically, in the determination of:
- (a) the ratio of fixed to discretionary fees to be paid to all syndicate CMIs participating in the offering;
 - (b) the basis of allocation of fixed fees to syndicate CMIs;
 - (c) the basis of allocation of any discretionary fees to syndicate CMIs. In the case of a debt offering, this allocation should be determined no later than at the time of pricing²⁷; and
 - (d) the fee payment schedule.

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

135. Whilst we fully acknowledge that syndicate membership and fees are primarily commercial decisions, in the case of a share offering, early disclosure of such information to the SFC will help us identify arrangements that are substantially different from market norms and take appropriate action in the event that there is any suspected misconduct. In this connection, we propose that the following be submitted to the SFC four clear business days prior to the Listing Committee Hearing for an IPO²⁸:
- (a) information about the syndicate membership, indicating roles (ie, whether appointed as OCs or not);
 - (b) the total fees to be paid to all syndicate CMIs participating in the offering (as a percentage of the gross amount of funds raised);
 - (c) the ratio between the fixed and discretionary portions of the fees to be paid to all syndicate CMIs participating in the offering (in percentage terms); and
 - (d) the allocation of the fixed portion of the fees paid by the issuer to each syndicate CMI participating in the offering.

This information would provide the SFC with the opportunity to make enquiries. This should also prompt issuers to carefully consider fee structures at an early stage and OCs to provide relevant advice.

136. Issuers may make alterations to fee allocations as an IPO timetable progresses. The SFC should be informed of any material changes once they are agreed between the issuer and syndicate CMIs together with the rationale for such changes.

²⁷ In the case of a fixed price offering, the allocation of discretionary fees to syndicate CMIs should be determined at or before allocation.

²⁸ Reference to “Listing Committee Hearing” in the consultation paper refers to the expected date of the issue of the approval-in-principle letter by the SFC in the context of a REIT seeking the SFC’s authorisation.

137. The disclosure to the SFC of the information detailed in paragraphs 135 to 136 aims to provide a reasonable framework for the determination of fees by issuers. Apart from instilling discipline in the market, this also allows the SFC to make enquiries where there are material changes in the information previously submitted or the ratio between fixed and discretionary fees deviates substantially from market norms.

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

138. We propose that a confirmation should be provided to the SFC no later than listing that the issuer has determined allocations of any discretionary fees to each syndicate CMI as well as the fee payment schedule. Total monetary benefits, including fixed and discretionary fees and any bonuses, paid to each syndicate CMI by the issuer should be provided to the SFC within two weeks after the first day of dealings. The objective, again, is to encourage greater discipline in the market; issuers would need to determine discretionary fees and the fee payment schedule within specific timeframes.

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

139. Separately, some market participants are in favour of issuers making the following public disclosures:
- (a) at any early stage, the syndicate membership and the names of the OCs in order to assist market participants to identify who they should approach when they have questions about an IPO;
 - (b) all underwriting fees for IPO transactions. Underwriting fees for the Hong Kong public offer tranche are disclosed in the prospectus, but only infrequently for the international placing tranche. In some smaller and recent IPOs, over 20% of the funds raised from the international placing tranche have been paid to the underwriting syndicate as fees; this may amount to material information of relevance to investment decisions; and
 - (c) the total monetary benefits, including fixed and discretionary fees and any bonuses paid to each syndicate CMI after the completion of the IPO: Buy-side market participants commented that syndicate CMIs which receive higher fees are generally expected to be more senior in the syndicate and shoulder greater responsibilities. It is envisaged that CMIs rewarded with higher fees are generally expected to be more senior and in a position to exercise more influence over the bookbuilding process; the fee allocation information assists the market to assess who may be the dominant voice in the syndicate and take that into account in attributing success or failure of an IPO to the relevant CMIs. This, in turn, should encourage the relevant CMIs to be careful in providing advice.

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

“Sponsor coupling” proposal

140. During the course of our discussions with market participants, we learned that:

- (a) where an IPO transaction is led by a large group of syndicate CMI with a variety of titles, and the heads of syndicate are not clearly identified, buy-side participants are often faced with a confusing situation. Many are of the view that an IPO transaction should be led by one or a small group of clearly identified senior syndicate members from the outset (ie, from the due diligence stage) as this would ensure consistency in the advice provided to the issuer and allow market participants to know who is in a position to provide accurate and reliable answers to their questions and who, apart from the issuer, is primarily accountable for the transaction;
- (b) there appears to be increased interest on the part of CMIs to be appointed as heads of syndicate for IPOs. This is supported by our analysis²⁹ of the 205 IPOs in 2018 and 99 IPOs in the first nine months of 2020, which showed that the average number of heads of syndicate³⁰ per IPO transaction increased by 33.7% (from 2.11 to 2.82);
- (c) when heads of syndicate also act as sponsors for an IPO, either through the same legal entity or within the same group of companies, advantages can accrue for the overall offering. Sponsors have a deep knowledge of the listing applicant and its industry as a result of their responsibility to conduct due diligence work. Moreover, sponsors are usually responsible for preparing market-comparable analysis and valuations based on financial models. Sponsors also advise listing applicants about their ability to meet requirements under the Listing Rules. The ability of a sponsor to combine these responsibilities with those of an OC as described elsewhere in this paper enhances the ability of the OC to manage the overall offering in the interests of investor clients and the issuer;
- (d) however, an increasing proportion of the heads of syndicate did not act as sponsors (or did not have a group company that acted as a sponsor) during the nine months ended 30 September 2020 as compared to the year 2018; and
- (e) underwriting fees are substantially higher than sponsor fees. Based on our analysis of the 99 IPOs listed during the nine months ended 30 September 2020, the average sponsor fee was \$6.3 million and the average underwriting fixed fee was \$43.9 million³¹. In one IPO, it was disclosed that the sponsor fee was around \$12 million whilst the underwriting fixed fee was close to \$350 million. This indicates a misalignment between fees and sponsor costs and responsibilities, especially in larger IPOs where sponsors typically incur substantial costs and where the potential consequences of regulatory breach can be severe. When sponsors also act as the head of syndicate, the total fees may properly compensate the additional sponsor resource commitments and responsibilities.

²⁹ Based on disclosures in IPO prospectuses.

³⁰ In our analysis, heads of syndicate refers to the sole or joint global coordinator or the sole or joint representative, and for IPOs where these titles were not used, it refers to the sole or joint bookrunner or the sole or joint lead manager.

³¹ The average was calculated based on the disclosed total sponsor fees payable to all sponsors involved. The calculation of the fixed fee portion of the underwriting fee assumes that the fixed fee rate for Hong Kong offer shares is also applicable to international offer shares, unless stated otherwise.

However, if sponsors are not appointed as head of syndicate from the outset, there are concerns that they may be incentivised to compromise due diligence to secure the appointment.

141. In our soft consultations, there was resistance to proposals to require all OCs to be sponsors to address these concerns. Some market participants were of the view that this would limit flexibility for the issuer to appoint OCs whose strengths mainly lie in marketing. There were also concerns that this proposal might prejudice standalone boutique sponsor firms with no marketing capabilities³². Taking these concerns into account, we propose the following:

- (a) The listing applicant should appoint at least one sponsor³³ which is independent³⁴ of the listing applicant who should also be appointed as an OC for the IPO, or have a Group Company which is also appointed as an OC for the IPO.

This role is hereafter referred to as “Sponsor OC”.

- (b) The Sponsor OC should be appointed as OC and sponsor at the same time and at least two months before filing the listing application³⁵.
- (c) The listing applicant can appoint other OCs (which may or may not be sponsors of the IPO) no later than two weeks after the submission of the listing application.

142. In this way:

- (a) at least one sponsor would be free of potential incentives to limit due diligence in order to secure an OC role;
- (b) the Sponsor OC should be in a position to give comprehensive advice to the listing applicant throughout the transaction;
- (c) buy-side participants can look to the Sponsor OC to provide well informed and authoritative answers to their questions;
- (d) listing applicants could appoint additional OCs at a later stage; such flexibility is especially important for very large IPOs; and
- (e) non-sponsor OCs would still be appointed relatively early in the process so that they can perform key functions such as advising the listing applicant, coordinating the activities conducted by other CMLs and overall management of the offering.

³² Notwithstanding this, we observe that of the 127 sponsors licensed by the SFC as at 30 September 2020, approximately 94% either were licensed for Type 1 regulated activity (ie, dealing in securities) or had a group company which was licensed or registered for this activity. Of the 127 sponsors, 72% engaged in IPO transactions as a syndicate member in the year ended 30 September 2020.

³³ Reference to “sponsor” in this section of the consultation paper shall include the listing agent in the context of a REIT seeking the SFC’s authorisation.

³⁴ The circumstances under which a sponsor is considered not to be independent of the listing applicant are set out under the Listing Rules.

³⁵ This is to ensure compliance with Main Board Listing Rule 3A.02B and GEM Listing Rule 6A.02B which require all sponsors to be appointed no later than two months before the submission of the listing application.

143. In order to achieve the outcomes mentioned in paragraph 142, we propose the following requirements:

- (a) under the Proposed Code, before accepting an appointment by the issuer to act as an OC, an OC should either:
 - (i) ensure that it (or one of its Group Companies) is also appointed as a sponsor, which is independent of the issuer client, and that both appointments are made at the same time at least two months before the submission of the listing application to SEHK by or on behalf of the issuer; or
 - (ii) obtain a written confirmation from the issuer that at least one sponsor, which is independent of the issuer client, or one of the Group Companies of that sponsor, has been appointed as an OC for that IPO, in which case its appointment as an OC should be made no later than two weeks after the submission of the listing application to SEHK by or on behalf of the issuer; and
- (b) under paragraph 17 of the Code of Conduct, before accepting an appointment by a listing applicant to act as a sponsor, a sponsor should either:
 - (i) be independent of the listing applicant and ensure that it or one of its Group Companies is also appointed at the same time as an OC in connection with that listing application; or
 - (ii) obtain written confirmation from the listing applicant that at least one sponsor, which is independent of the listing applicant, or one of the Group Companies of that sponsor, has been appointed as an OC in connection with that listing application.

144. In addition, we consider that it would be appropriate for the Sponsor OC to submit to the SFC the information discussed in paragraphs 135, 136 and 138, including the membership of the syndicate, the total fees to be paid to all syndicate CMLs participating in the offering and the allocation of fixed fees to syndicate CMLs within the prescribed timeframe. If more than one intermediary is appointed as a Sponsor OC, they should arrange for one of them to provide this information to the SFC. Notwithstanding this, each Sponsor OC is jointly and severally liable for ensuring that the information is accurate and complete and has been provided to the SFC within the stipulated timeline.

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

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

Seeking comments and implementation timetable

145. The SFC welcomes comments from the public and the industry on the proposals made in this paper and the indicative drafts of the Proposed Code, paragraph 17 of the Code of Conduct and the GEM Placing Guidelines set out in the Appendices. Please submit your comments to the SFC in writing no later than 7 May 2021.
146. Taking into account the respondents' comments, a consultation conclusions paper will be issued together with the revised Proposed Code, proposed amendments to paragraph 17 of the Code of Conduct and the GEM Placing Guidelines as appropriate. The SFC appreciates that the industry may need to update their internal procedures and controls to implement the Proposed Code. We propose to provide a six-month transition period for the industry to comply after the gazettal of the above.

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

Draft Paragraph 21 of the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission

Bookbuilding and placing activities in equity capital market and debt capital market transactions

21.1 Introduction

21.1.1 Paragraph 21 applies to a licensed or registered person engaged in providing services involving the following activities which are conducted in Hong Kong in respect of an offering of shares¹ listed² or to be listed³ on The Stock Exchange of Hong Kong Limited (“SEHK”) (“share offering”) or an offering of debt securities listed or unlisted, and offered in Hong Kong or otherwise (“debt offering”) to issuers, investors or both:

- (a) collating investors’ orders (including indications of interest) in a share or debt offering in order to facilitate:
 - (i) the price determination and the allocation of shares or debt securities to investors; or
 - (ii) the process of assessing demand and making allocations (“bookbuilding activities”);
- (b) distributing shares or debt securities to investors pursuant to those bookbuilding activities (“placing activities”); or
- (c) advising, guiding and assisting the issuer client⁴ in those bookbuilding and placing activities.

A licensed or registered person engaged in any of the above-mentioned capital market activities is referred to as a “capital market intermediary” (“CMI”).

21.1.2 Paragraph 21 sets out the standards of conduct expected of a CMI in a share or debt offering. CMIs are also reminded to fulfil their obligations under applicable laws, rules and regulations, including properly addressing actual and potential conflicts of interest, ensuring the fair treatment of both their issuer client and investor clients, and upholding the integrity of the market at all times. In the case of a share offering, these include the Listing Rules⁵ and other regulatory requirements or guidance issued by SEHK from time to time (“SEHK Requirements”). In the case of a debt

¹ References to “shares” in paragraph 21 also include depository receipts and units or interests in SFC- authorised real estate investment trusts (“REITs”) listed or to be listed in Hong Kong.

² This only covers situations where a shareholder places its existing listed shares to third-party investors followed by a top-up subscription of new shares by the shareholder.

³ This can be an initial public offering of shares (including a public offer conducted in connection with a secondary listing in Hong Kong) (“IPO”) or placing of new shares to be listed.

⁴ In the case of an IPO, “issuer client” includes “listing applicant”.

⁵ The Rules Governing the Listing of Securities on the SEHK and Rules Governing the Listing of Securities on GEM of SEHK.

offering where the debt securities are listed on SEHK, CMI is also reminded to ensure compliance with the applicable rules and regulations issued by SEHK.

21.1.3 There are many types of share and debt offerings, which vary in nature and complexity, and a CMI may play different roles in different offerings. It is the responsibility of the senior management of a CMI to establish and implement adequate and effective policies, procedures and controls to ensure compliance with the rules and regulations which are applicable to the roles they play in an offering.

21.2 Types of CMIs

21.2.1 A CMI which is engaged by the issuer of a share or debt offering is referred to as a syndicate CMI.

21.2.2 A CMI which is not engaged by the issuer⁶ of a share or debt offering is referred to as a non-syndicate CMI.

21.2.3 In the case of a share offering, an “Overall Coordinator” (“OC”) of the offering is a syndicate CMI which, solely or jointly, conducts any of the following activities:

- (a) overall management of the offering, coordinating the bookbuilding or placing activities conducted by other CMIs, exercising control over bookbuilding activities and making allocation recommendations to the issuer client;
- (b) advising the issuer client of the offer price and being a party to the price determination agreement with the issuer client;
- (c) exercising the discretion to reallocate shares between the placing tranche and public subscription tranche, reduce the number of offer shares, or exercise an upsize option or over-allotment option; or
- (d) acting as the stabilising manager.

21.2.4 In the case of a debt offering, an OC of the offering is a syndicate CMI which, solely or jointly, conducts the overall management of the offering, coordinates the bookbuilding or placing activities conducted by other CMIs, exercises control over bookbuilding activities and makes pricing or allocation recommendations to the issuer client.

21.2.5 For the avoidance of doubt, irrespective of whether or not a CMI has been formally appointed by, or has entered into a written agreement with, the issuer client, a CMI which conducts any of the activities in paragraphs 21.2.3 or 21.2.4 will be an OC and is required to comply with this paragraph.

⁶ Given that a non-syndicate CMI is not engaged by the issuer, the issuer is not its client and hence not an “issuer client”. The above notwithstanding, references to “issuer client” in this paragraph include references to “issuer” in the case of a non-syndicate CMI.

21.3 CMI - Obligations and expected standards of conduct

A CMI should uphold market integrity and ensure compliance with all applicable legal and regulatory requirements.

21.3.1 Assessment of issuer client and offering

A CMI should conduct an adequate assessment of an issuer client before engaging in a share or debt offering for that issuer client. This includes:

- (a) taking reasonable steps to obtain an accurate understanding of the history and background, business and performance, financial condition and prospects, operations and structure of the issuer client, except for a repeated issuer of debt offerings where a CMI acted as the CMI for previous offerings made by the same issuer. In this case, the CMI should ascertain whether there have been any material changes in the circumstances of the issuer client of relevance to its role as CMI; and
- (b) establishing a formal governance process to review and assess the share or debt offering, including any actual or potential conflicts of interest between the CMI and the issuer client as well as the associated risks.

21.3.2 Appointment of CMI

Subject to paragraph 21.4.1 of the Code, before a CMI conducts any bookbuilding or placing activities, it should ensure that it has been formally appointed under a written agreement to conduct such activities by an issuer client in the case of a syndicate CMI or another CMI in the case of a non-syndicate CMI. The written agreement should clearly specify the roles and responsibilities of a CMI, the fee arrangements (including fixed fees as a percentage of the total fees to be paid to all syndicate CMIs participating in the offering⁷) and the fee payment schedule.

21.3.3 Assessment of investor clients

- (a) A CMI should take reasonable steps to assess whether its investor clients, based on their profiles, such as investment preferences and past investment histories, fall within the types of investors targeted in a marketing and investor targeting strategy (“targeted investors”) as referred to under paragraph 21.4.4.
- (b) In the case of a share offering, a CMI should take all reasonable steps to identify investor clients to whom the allocation of shares will be subject to restrictions or require prior consent from SEHK under the SEHK Requirements (“Restricted Investors”) and inform the OC (whether directly or indirectly) before placing an order on behalf of such clients.

⁷ This includes fees for providing advice to the issuer, marketing, bookbuilding, making pricing and allocation recommendations and placing these securities with investor clients. This is also commonly referred to as “underwriting fees” by the industry.

- (c) In the case of a debt offering, a CMI should take all reasonable steps to identify whether its investor clients may have any associations with the issuer client, the CMI or a company in the same group of companies⁸ as the CMI (“group company”) and provide sufficient information to an OC to enable it to assess whether orders placed by these investor clients may negatively impact the price discovery process.

21.3.4 Marketing

- (a) A CMI should only market the shares or debt securities to its investor clients which are targeted investors. In the case of a share offering, where the shares are only marketed to selected investor clients, the CMI should be satisfied that the shares have been marketed to a sufficient number of clients and the likelihood of undue concentration of holdings is reasonably low.
- (b) A CMI should allow all of its investor clients which are targeted investors and have indicated an interest in an offering to participate in that offering.

21.3.5 Order book

- (a) A CMI should take reasonable steps to ensure that all orders (including indications of interest) placed in an order book represent bona fide demand of its investor clients, itself and its group companies. A CMI should also make enquiries with its investor clients about orders which appear unusual, for example, an order which is not commensurate with the investor client’s financial profile, before placing the order.
- (b) A CMI should ensure transparency in the bookbuilding process. It should disclose (whether directly or indirectly) the identities of all investor clients in an order book, except for orders placed on an omnibus basis. For orders placed on an omnibus basis, a CMI should provide information about the underlying investor clients (whether directly or indirectly) to the OC and the issuer when placing the orders.

21.3.6 Allocation

A CMI should establish and implement an allocation policy to ensure a fair allocation of shares or debt securities to its investor clients. This policy should:

- (a) address or take into account the principles and requirements under paragraph 21.3.10 and the following factors:
 - (i) the marketing and investor targeting strategy;
 - (ii) the order size and circumstances of the investor client;
 - (iii) the price limits for the investor client’s orders;

⁸ For the purposes of this paragraph, “group of companies” has the same meaning as in section 1 of Part 1 of Schedule 1 to the SFO.

- (iv) any minimum allocation amounts indicated by investor clients; and
 - (v) any applicable legal and regulatory requirements; and
- (b) prevent any practices which may result in the unfair treatment of investor clients or knowingly distort the demand for other share or debt offerings.

21.3.7 Rebates and preferential treatment offered

- (a) A CMI should not offer any rebates to an investor client or pass on any rebates provided by the issuer client. In addition:
- (i) in the case of an IPO, a CMI should not enable any of its investor clients to pay, for each of the shares allocated, less than the total consideration as disclosed in the listing documents; and
 - (ii) in the case of a debt offering, a CMI should not enter into any arrangements which may result in investor clients paying different prices for the debt securities allocated.
- (b) A CMI should disclose (whether directly or indirectly) to the issuer client, OC, all of its targeted investors and the non-syndicate CMIs it appoints:
- (i) any rebates offered (such as those offered by the issuer client of a debt offering) to CMIs. The disclosure should specify, for example:
 - the targeted recipients of the rebates;
 - the terms and conditions under which the targeted recipients may receive the rebates; and
 - the timing for the payment of the rebates; and
 - (ii) any other preferential treatment of any CMIs or targeted investors (such as guaranteed allocations).

In the case of a share offering, a CMI should make the above disclosure upon becoming aware of any such rebates or preferential treatment. In the case of a debt offering, the disclosure should be made no later than the time of the dissemination of the deal “launch message” to targeted investors.

21.3.8 Disclosure of information to OC, non-syndicate CMIs and targeted investors

A CMI should disclose complete and accurate information in a timely manner on the status of the order book and other relevant information it received to:

- (i) the OC (whether directly or indirectly) and non-syndicate CMIs it appoints for them to carry out their duties; and

- (ii) its targeted investors for them to make an informed decision⁹.

21.3.9 Record keeping

A CMI should maintain books and records which are sufficient to demonstrate its compliance with all applicable requirements in this paragraph. In particular, a CMI should document:

- (i) assessments of the issuer client, share or debt offering and investor clients;
- (ii) audit trails from the receipt of orders (i.e. including indications of interest), the placing of orders in the order book (whether directly or indirectly) through to the final order allocation (including changes in the orders received, details of the rejected orders and the reasons thereof, order confirmations with each investor client or CMI prior to the final allocation decisions and records of the allocation decisions made with a special focus on large or unusual allocations);
- (iii) all key communications with, and information provided to, the OC, other CMIs or investor clients, including information about the status of the order book (such as the launch term sheet and book messages);
- (iv) where a CMI's order is placed on an omnibus basis, the intended basis of allocation for all orders with justifications as well as any material deviations from its allocation policy as referred to in paragraph 21.3.6;
- (v) all key communications with the issuer client, such as disclosures made to the issuer client in relation to actual or potential conflicts of interest;
- (vi) rebates offered by the issuer client and the payment details;
- (vii) any other preferential treatment offered to itself, non-syndicate CMIs it appoints or its investor clients; and
- (viii) information forming the basis of all submissions made to SEHK and the SFC.

Except for records mentioned in sub-paragraph (ii), which should be kept for a period of not less than two years, a CMI should maintain the above records for a period of not less than seven years.

21.3.10 Conflicts of interest

- (a) A CMI should establish, implement and maintain policies and procedures to:
 - (i) identify, manage and disclose actual and potential conflicts of interest which may, for example, arise when a CMI:
 - serves both the interests of its issuer client and investor clients;

⁹ Where a CMI is a non-syndicate CMI (such as a sub-placing agent), it should disclose information received from syndicate CMIs or non-syndicate CMIs (such as a distributor).

- serves the interests of its investor clients when having a proprietary interest (including a proprietary interest of its group companies) in an offering; or
 - has full discretion over allocations to investor clients or a proprietary order; and
- (ii) govern the process for generating proprietary orders as well as making allocations to such orders.
- (b) A CMI should:
- (i) always give priority to satisfying investor clients' orders over its own proprietary orders¹⁰ and those of its group companies;
 - (ii) only be the price taker in relation to its proprietary orders and those of its group companies and ensure that these orders would not negatively impact the price discovery process; and
 - (iii) segregate and clearly identify its own proprietary orders and those of its group companies (whether directly or indirectly) in the order book and book messages.
- Note: For the purposes of this paragraph, proprietary orders of a group company exclude orders placed by the group company on behalf of its investor clients or funds and portfolios under its management, but include orders placed on behalf of funds and portfolios in which a CMI or its group company has a substantial interest.*
- (c) In relation to a debt offering, a CMI should take reasonable steps to disclose (whether directly or indirectly) to the issuer client how any risk management transactions it intends to carry out for itself, the issuer client or its investor clients will not affect the pricing of the debt securities.

21.3.11 Resources, systems and controls

A CMI should maintain sufficient resources and effective systems and controls to ensure that it can discharge its obligations and responsibilities.

Chinese walls

- (a) Where a CMI is a company or is part of a group of companies undertaking multiple activities in relation to an offering, for example, it or its group company is involved in the preparation and issuance of research reports, sponsor work, bookbuilding activities, placing activities and other related business activities, the CMI should take adequate measures to prevent the flow of information which may be confidential or price sensitive between staff performing different

¹⁰ Subject to the SEHK Requirements.

activities and to prevent and manage any conflicts of interest which may arise. In particular, the CMI should establish and maintain:

- (i) an effective system of functional barriers (Chinese walls) which should include having physical separation between, and different staff employed for, the various business activities; and
- (ii) appropriate policies and procedures which cover:
 - the procedures (including approval procedures) for bringing staff over the wall;
 - the standards of conduct expected of staff brought over the wall; and
 - the records to be kept on wall-crossing activities.

Review and approval of orders and allocations

- (b) The placing of orders for, or the allocation of shares or debt securities to, any of the following types of account by a CMI should be subject to appropriate risk assessments (taking into consideration, for instance, a CMI's financial capability and exposure to associated risks) and management review and approval:
 - (i) proprietary orders for the CMI and any of its group companies;
 - (ii) orders from its investor clients which may appear unusual, for example, orders which might appear to be related to the issuer client; and
 - (iii) in the case of a share offering, allocations which are subject to restrictions or require the prior consent of SEHK under the SEHK Requirements.

Appointment of non-syndicate CMIs

- (c) Where a CMI appoints a non-syndicate CMI to assist it in distributing shares or debt securities, it should exercise due skill, care and diligence in the selection and appointment.

Surveillance and monitoring

- (d) A CMI should conduct independent surveillance and monitoring on a regular basis to detect irregularities, conflicts of interest, leakage of price sensitive or confidential information about the issuer client and the offering, and potential non-compliance with applicable regulatory requirements or its own policies and procedures. For example, a CMI should:

- (i) review the book messages it prepares and disseminates to ensure that there are no misleading messages;
- (ii) perform surveillance of electronic communications; and
- (iii) select debt or share offerings for post-deal reviews to ensure that the pricing or allocation is adequately justified.

This should be supplemented by an effective incident management and reporting mechanism to ensure that any issues identified are reported to independent control functions for follow-up action and escalated to senior management as appropriate.

21.3.12 Communication with the SFC and SEHK

A CMI should deal with the SFC and SEHK in an open and cooperative manner and promptly provide all relevant information and explanations in accordance with applicable legal or regulatory requirements or upon request.

21.4 OC - Obligations and expected standards of conduct

In addition to the requirements specified in paragraph 21.3, an OC should comply with the following requirements.

21.4.1 Terms of appointment

- (a) Before an OC conducts any activities specified in paragraph 21.2.3 for a share offering or participates in any bookbuilding or placing activities for a debt offering, it should ensure that:
 - (i) it has been formally appointed by the issuer under a written agreement to conduct such activities; and
 - (ii) the written agreement should clearly specify its roles and responsibilities, fee arrangements (including fixed fees as a percentage of the total fees to be paid to all syndicate CMIs participating in the offering) and the fee payment schedule.
- (b) In the case of an IPO, an OC should, before accepting an appointment, either:
 - (i) ensure that it (or one of its group companies) is also appointed as a sponsor¹¹, which is independent¹² of the issuer client, and that both appointments are made at the same time and at least two months before the submission of the listing application to SEHK by or on behalf of the issuer client; or

¹¹ Reference to "sponsor" in this paragraph 21 shall include the listing agent in the context of a REIT seeking the SFC's authorisation.

¹² The circumstances under which a sponsor is considered not to be independent of the issuer client are set out under the Listing Rules.

- (ii) obtain a written confirmation from the issuer client that for that IPO at least one sponsor, which is independent of the issuer client, or a group company of that sponsor, has been appointed as an OC, in which case its appointment as an OC should be made no later than two weeks after the submission of the listing application to SEHK by or on behalf of the issuer client.

The sponsor which is also appointed as the OC under subparagraphs (i) or (ii) is referred to as a “Sponsor OC”.

21.4.2 Advice to issuer client

- (a) An OC should act with due skill, care and diligence when providing advice, recommendations and guidance to the issuer client. In particular, an OC should:
 - (i) ensure that its advice and recommendations are balanced and based on thorough analysis and are compliant with all applicable legal and regulatory requirements;
 - (ii) engage the issuer client at various stages during the offering process to understand the issuer client’s preferences and objectives with respect to pricing and the desired shareholder or investor base so that the OC is in a position to advise, develop or revise a marketing and investor targeting strategy with a view to achieving these objectives given prevailing market conditions and sentiment;
 - (iii) explain the basis of its advice and recommendations to the issuer client, including any advantages and disadvantages. For example, it should communicate its allocation policy to the issuer client to ensure that the issuer client understands the factors underlying the allocation recommendations; and
 - (iv) advise the issuer client in a timely manner, throughout the period of engagement, of key factors for consideration and how these could influence the pricing outcome, allocation and future shareholder or investor base.
- (b) An OC which participates in a share offering should advise and guide the issuer client and its directors as to their responsibilities under the SEHK Requirements which apply to placing activities and take reasonable steps to ensure that they understand and meet these responsibilities.
- (c) Where the issuer client decides not to adopt an OC’s advice or recommendations in relation to pricing or allocation of shares or debt securities or, in the case of a share offering, its decisions may lead to a lack of open market, an inadequate spread of investors or may negatively affect the orderly and fair trading of such shares in the secondary market, the OC should explain

the potential concerns and advise the issuer clients against making these decisions.

21.4.3 Syndicate composition & fee arrangements

An OC should advise and guide the issuer client in:

- (a) the selection and appointment of syndicate CMI^s to ensure that they have appropriate seniority and responsibilities; and
- (b) the determination of:
 - (i) the ratio of fixed and discretionary¹³ fees to be paid to all syndicate CMI^s participating in the offering;
 - (ii) the basis of allocation of fixed fees to syndicate CMI^s;
 - (iii) the basis of allocation of discretionary fees to syndicate CMI^s. In the case of a debt offering, this allocation should be determined no later than at the time of pricing¹⁴ the debt securities; and
 - (iv) the fee payment schedule.

21.4.4 Marketing, rebates and preferential treatment offered

- (a) An OC should, in consultation with the issuer client, devise a marketing and investor targeting strategy for order generation, taking into account the objectives and preferences of the issuer client. This may include specifying the types of investors targeted¹⁵ and the portion of an offering to be allocated to each type of investors to establish the desired shareholder or investor base. In the case of an IPO, the strategy should include which types of investors who may be appropriate to be cornerstone investors and aim to achieve an open market and an adequate spread of investors and promote the orderly and fair trading of the shares in the secondary market in accordance with the SEHK Requirements.
- (b) An OC should keep in view prevailing market conditions and sentiment and advise the issuer client to adjust the strategy as appropriate.
- (c) An OC should advise the issuer of the disclosure of any rebates and preferential treatment.

¹³ Discretionary fees refer to the portion of the deal economics to be paid to syndicate CMI^s at the absolute discretion of the issuer client.

¹⁴ In the case of a fixed price offering, the allocation of discretionary fees to syndicate CMI^s should be determined at or before the allocation of the debt securities.

¹⁵ These include institutional clients, sovereign wealth funds, pension funds, hedge funds, family offices, high net worth individuals and retail investors.

21.4.5 Bookbuilding

An OC should take all reasonable steps to ensure that the price discovery process is credible and transparent, the order book has been properly managed and the allocation recommendations made to the issuer client as well as the final allocation have a proper basis. An OC should use its best endeavours, when advising the issuer client or when making pricing and allocation decisions as delegated by the issuer client, to strike a balance between the interests of the issuer client and investor clients and to act in the best interests of the integrity of the market.

(a) Order generation and consolidation of an order book

An OC should take reasonable steps to properly manage an order book and ensure the transparency of the order book.

(i) In particular, an OC should:

- ensure that the identities of all investor clients are disclosed in the order book, except for orders placed on an omnibus basis;
- properly consolidate orders in the order book by taking reasonable steps to identify and eliminate duplicated orders, inconsistencies or errors;
- segregate and clearly identify in the order book and book messages any proprietary orders of CMI and their group companies; and
- make enquiries with CMI which have placed orders on behalf of their investor clients, themselves or their group companies which appear unusual or irregular, for example, orders which appear to be related to the issuer client.

(b) Pricing

An OC should:

- (i) advise the issuer client on the pricing with reference to, for instance, the results of the bookbuilding activities, the characteristics of the issuer client, prevailing market conditions and sentiment and the requirements of the relevant authorities;
- (ii) advise the issuer client against providing any arrangements whereby:
 - in the case of an IPO, the investor clients would pay, for each of the shares allocated, less than the total consideration as specified in the listing documents; and

- in the case of a debt offering, the investor clients would pay different prices for the debt securities allocated.
- (iii) ensure that the proprietary orders of CMI or their group companies and, for debt offering, the orders placed by investor clients which have associations with the issuer client, CMI or their group companies, will not negatively impact the price discovery process.
- (c) Allocation
- (i) An OC should develop and maintain an allocation policy which sets out the criteria for making allocation recommendations to the issuer client. The allocation policy should address or take into account the following factors:
- the issuer client's objectives, preferences and recommendations;
 - the prevailing market conditions and sentiment;
 - the types and characteristics as well as the circumstances of targeted investors;
 - the spread of investors (for example, the sizes and number of large holdings); and
 - the overall subscription rate for the offer.
- (ii) An OC should make allocation recommendations in accordance with an allocation policy as referred to in subparagraph (i) above. In addition:
- recommendations regarding the allocation of shares or debt securities to the investor clients of the OC should take into account the policy specified in paragraph 21.3.6; and
 - in the case of an IPO, allocation recommendations should also ensure that allocations to Restricted Investors comply with the SEHK Requirements and be made with a view to achieving an open market, an adequate spread of shareholders and the orderly and fair trading of the shares in the secondary market.

Should the allocation recommendations materially deviate from the allocation policy or the policy specified in paragraph 21.3.6, the OC should explain to the issuer client the reasons for the deviation.

21.4.6 Assessment of investors

- (a) In the case of an IPO, an OC should take all reasonable steps to:

- (i) ensure that sufficient information is available to enable itself and other CMI to reasonably identify Restricted Investors; and
 - (ii) identify Restricted Investors and ensure that they will only be allocated shares in accordance with applicable SEHK Requirements.
- (b) In the case of a debt offering, an OC should take all reasonable steps to ensure that sufficient information is available to enable itself and other CMI to reasonably identify whether investor clients have any associations with the issuer client, CMI or their group companies.

21.4.7 Disclosures to syndicate CMI and targeted investors

An OC should:

- (a) share, or take reasonable steps to ensure the issuer client to provide, information about the issuer client to other syndicate CMI which are involved in a share or debt offering for the conduct of the assessments of the issuer client required under paragraph 21.3.1 and identifying Restricted Investors in the case of an IPO and investor clients which have any associations with the issuer client in the case of a debt offering as required under paragraphs 21.3.3(b), 21.3.3(c) and 21.4.6;
- (b) inform other syndicate CMI of the issuer client's marketing and investor targeting strategy; and
- (c) disseminate material information related to the offering (for example, information which may affect the prices, orders received per investor type, proprietary orders of CMI and their group companies, and known preferential treatments and rebates) as included in, for example, the launch term sheet and book messages, in a timely manner to all syndicate CMI and ensure that such information is complete, accurate and has a proper basis.

21.4.8 Record keeping

An OC should document:

- (a) all changes in the order book throughout the bookbuilding process;
- (b) all key discussions with the issuer client on, for instance, the composition of the syndicate, fee arrangements, marketing and investor targeting strategy, pricing, allocation policy and disclosures of any actual or potential conflicts of interest;
- (c) key advice or recommendations provided to the issuer client (including the allocation rationale, advantages and disadvantages, and any material deviations from the allocation policy);



- (d) the final decisions of the issuer client which deviate materially from the advice or recommendations provided by the OC, including the OC's explanation to the issuer client on any potential concerns associated with these decisions and the advice provided; and
- (e) the rationale for any decisions delegated to it by the issuer client (such as pricing and allocation of shares).

An OC should maintain records of the above for a period of not less than seven years.

21.4.9 Communication with the SFC

An OC should report and provide the following information to the SFC in a timely manner:

- (a) any instances of material non-compliance with the SEHK Requirements related to, for example, the placing activities conducted by itself or the issuer client;
- (b) any material changes to the information it previously provided to the SFC and SEHK;
- (c) the reasons for ceasing to act as an OC in a share offering transaction;
- (d) in the case of an OC acting as a Sponsor OC, the information specified in Schedule 11 to the Code; and
- (e) other information as the SFC may require from time to time.

Schedule 11 Information to be provided by Sponsors OCs to the SFC

- Under paragraph 21.4.9(d) of the Code, the SFC may require a Sponsor OC to provide information from time to time.
- This Schedule¹ sets out the information which a Sponsor OC is required to provide to the SFC for an IPO:

Information	Timeframe
The syndicate composition of the IPO, including the name of each syndicate CMI and its roles (i.e. whether appointed as an OC or not)	Four clear business days prior to the Listing Committee Hearing ²
The total fees (as a percentage of the gross amount of funds raised) of both the public offer and the international tranche to be paid to all syndicate CMIs participating in the offering	Four clear business days prior to the Listing Committee Hearing
The ratio between the fixed and discretionary portions of the fees to be paid to all syndicate CMIs participating in the offering (in percentage terms)	Four clear business days prior to the Listing Committee Hearing
The allocation of the fixed portion of the fees paid by the issuer to each syndicate CMI participating in the offering	Four clear business days prior to the Listing Committee Hearing
Any material changes from the previous disclosures to the SFC in the fixed fee allocation made by the issuer to syndicate CMIs and the corresponding justifications	As soon as they are agreed between the issuer client and syndicate CMIs
Confirmation that the issuer has determined the allocation of discretionary fees to each syndicate CMI and the fee payment schedule	No later than listing
Total monetary benefits (including fixed and discretionary fees and any bonuses) paid by the issuer to each syndicate CMI	Within two weeks after the first day of dealings

- If more than one intermediary is appointed as a Sponsor OC for an IPO, arrangements should be made for one of them to provide the information specified in paragraph 2 to the SFC. Notwithstanding this, each Sponsor OC is jointly and severally liable for

¹ The terms used in this Schedule are as defined in paragraph 21 of the Code

² Reference to "Listing Committee Hearing" in this Schedule 11 shall refer to the expected date of the issue of the approval-in-principle letter by the SFC in the context of a REIT seeking the SFC's authorisation.



ensuring that such information is accurate and complete and has been provided to the SFC within the timeframe stipulated above.

Draft Paragraph 17.1A of the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission

Paragraph 17 – Sponsors

17.1A Appointment

Before accepting an appointment by a listing applicant as a sponsor in relation to a listing application, a sponsor should either:

- (a) be independent¹ of the listing applicant and ensure that it or one of the companies within its group of companies² is appointed at the same time as an overall coordinator (“OC”) (as defined under paragraph 21.2.3 of the Code) in connection with that listing application; or
- (b) obtain written confirmation from the listing applicant that at least one sponsor, which is independent of the listing applicant, or one of the companies within the group of companies of that sponsor, has been appointed as an OC in connection with that listing application.

¹ The circumstances under which a sponsor is considered not to be independent of the listing applicant are set out under the Listing Rules.

² For the purposes of this paragraph, “group of companies” has the same meaning as in section 1 of Part 1 of Schedule 1 to the SFO.



**Guidelines to capital market intermediaries, sponsors,
underwriters and placing agents involved in the
listing and placing activities for GEM stocks**

[Date] 20 January 2017

Introduction

1. The Securities and Futures Commission (**SFC**) and The Stock Exchange of Hong Kong Limited (**Exchange**), a wholly-owned subsidiary of the Hong Kong Exchanges and Clearing Limited, today issued a joint statement (**Joint Statement**)¹ expressing grave concerns over the price volatility of stocks listed on the Growth Enterprise Market (**GEM**) of the Exchange. Almost all GEM initial public offerings (**IPOs**) were conducted by way of placing only. Placing practices in a significant number of cases indicate that rule 11.23 of the GEM Listing Rules (which provides that there must be an open market in the securities for which listing is sought) may have been undermined and may not enable an orderly, informed and efficient market for such securities to develop.
2. Although underwriters² and placing agents³ play an important role in GEM IPO placings, there are no specific requirements governing placing activities under the Code of Conduct⁴ or the CFA Code⁵. This guideline, which is published under section 399(1) of the Securities and Futures Ordinance, is designed to provide guidance to placing agents on the standards of conduct that is expected of them when conducting GEM IPO placings. This guideline also extends to sponsors given their obligation to declare to the Exchange that new applicants seeking to list on the GEM (**new applicants**) have complied with the relevant GEM Listing Rules.
3. A failure to comply with any of the requirements of this guideline by a sponsor or placing agent (and their representatives) may reflect adversely on its fitness and properness and may result in disciplinary action. The SFC will adopt a pragmatic approach taking into account each firm's particular circumstances when assessing a sponsor's or placing agent's compliance with this guideline.

Background

4. As set out in the Joint Statement,
 - (a) Share prices of recently listed GEM securities have exhibited unusually high volatility and substantially all of these GEM IPOs were conducted by way of placing only;
 - (b) A review of recent GEM IPO placings demonstrates that a substantial majority of the offered securities were allocated to a small number of placees (**top placees**), while the remainder were placed in small quantities (usually one or two board lots) to a large number of placees. Moreover, a handful of investors repeatedly appeared as top placees in otherwise unconnected GEM IPOs;

¹ A copy of the Joint Statement can be found on the SFC website (<http://www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/doc?refNo=17PR9>).

² This also includes sub-underwriters.

³ Based on industry practice, the underwriter of a GEM IPO placing usually acts as the placing agent as well. In addition, the underwriting agreement, which is usually entered into between the listing applicant, the sponsor(s) and the underwriters, usually specifies the obligations owed by the underwriters to the listing applicant in relation to the placing of the IPO shares. As such, reference to placing agents in this guideline will generally include underwriters as well.

⁴ Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (**Code of Conduct**)

⁵ Corporate Finance Adviser Code of Conduct (**CFA Code**)

- ~~(c) All new applicants should ensure compliance with all relevant GEM Listing Rules including ensuring that conditions exist for an open market as well as orderly, informed and fair trading to develop in the relevant securities at the time of listing. In this regard, the new applicant should assess, inter alia, the likely interest of different prospective investors in the offered securities and their profiles and determine an appropriate allocation basis in order to satisfy rule 11.23 and other relevant GEM Listing Rules. The new applicant should also ensure that any preferential treatment afforded to any placee is adequately disclosed in the listing document.~~

Regulatory principles and requirements

5. ~~An intermediary is required to conduct its activities in accordance with the general principles (GP) set out in the Code of Conduct, including:~~
- ~~(a) Acting honestly, fairly, and in the best interests of its clients and the integrity of the market (GP1 of the Code of Conduct);~~
 - ~~(b) Acting with due skill, care and diligence, in the best interests of its clients and the integrity of the market (GP2 of the Code of Conduct);~~
 - ~~(c) Having and employing effectively the resources and procedures which are needed for the proper performance of its business activities (GP3 of the Code of Conduct);~~
 - ~~(d) Complying with all regulatory requirements applicable to the conduct of its business activities so as to promote the best interests of clients and the integrity of the market (GP7 of the Code of Conduct); and~~
 - ~~(e) The senior management bearing primary responsibility for ensuring the maintenance of appropriate standards of conduct and adherence to proper procedures by the firm (GP9 of the Code of Conduct).~~

Specific requirements of sponsors

6. ~~Furthermore, a sponsor, in its capacity as corporate finance adviser, is required under the CFA Code to:~~
- ~~(a) Use all reasonable efforts to ensure that its client understands the relevant regulatory requirements and their implications at all stages of a transaction. Upon becoming aware that its client is not complying with the regulatory requirements, it should advise its client to bring the matter to the attention of the regulators at the earliest opportunity. If this is declined by the client without valid reasons, it should consider the need to cease to act (paragraph 6.3 of the CFA Code); and~~
 - ~~(b) Take all reasonable steps to give its client, in a comprehensive and timely manner, any information required (including advice on the Listing Rules⁶) to enable its client to make a balanced and informed decision (paragraph 6.4 (b) of the CFA Code).~~

⁶ Rules Governing the Listing of Securities on the Stock Exchange and the GEM Listing Rules (**Listing Rules**)

~~7. Under the Code of Conduct, a sponsor is required to:~~

- ~~(a) Provide assurance to the Exchange and the market generally that the listing applicant complies with the Listing Rules and other relevant legal and regulatory requirements (paragraph 17.1(b) of the Code of Conduct);~~
- ~~(b) Advise and guide the listing applicant as to the Listing Rules and other relevant regulatory requirements (paragraph 17.3(b) of the Code of Conduct); and~~
- ~~(c) Report to the Exchange in a timely manner where it becomes aware of any material information relating to a listing applicant or listing application which concerns non-compliance with the Listing Rules or other legal and regulatory requirements relevant to the listing (paragraph 17.9(c) of the Code of Conduct).~~

~~8. In addition, a sponsor is also required by the GEM Listing Rules to declare:~~

- ~~(a) That the new applicant is in compliance with all the conditions in Chapter 11 of the GEM Listing Rules (Appendix 7G). In this connection, pursuant to rule 6A.11(2), a sponsor must conduct reasonable due diligence enquiries to put itself in a position to be able to make such a declaration; and~~
- ~~(b) The number of holders of the shares in the hands of the public and the percentage of the shares that are in the hands of the public in accordance with rule 11.23 (Appendix 7I of the GEM Listing Rules).~~

Specific requirement of placing agents

~~9. Placing agents are required to conduct adequate “know your client” (KYC) procedures under the Code of Conduct, including:~~

- ~~(a) Take all reasonable steps to establish the true and full identity of each of its clients, and of each client’s financial situation, investment experience, and investment objectives (paragraph 5.1 of the Code of Conduct); and~~
- ~~(b) Be satisfied on reasonable grounds about the identity, address and contact details of:
 - ~~(i) The person or entity (legal or otherwise) ultimately responsible for originating the instruction in relation to a transaction; and~~
 - ~~(ii) The person or entity (legal or otherwise) that stands to gain the commercial or economic benefit of the transaction and / or bear its commercial or economic risk (paragraph 5.4(a)(i) of the Code of Conduct).~~~~

1. These Guidelines are published by the Securities and Futures Commission (SFC) under section 399 of the Securities and Futures Ordinance (SFO) for the purposes of supplementing the existing conduct requirements relating to equity capital market placing activities.

2. These Guidelines were first issued⁷ together with the Joint Statement regarding the price volatility of GEM stocks issued by the SFC and The Stock Exchange of Hong

⁷ These Guidelines were formerly known as the Guideline to sponsors, underwriters and placing agents involved in the listing and placing of GEM stocks.

Kong Limited (Exchange) (Joint Statement) on 20 January 2017 and were revised following the introduction of paragraph 21 of the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (Code of Conduct). These Guidelines should be read in conjunction with the Joint Statement and paragraph 21 of the Code of Conduct. If there are any conflicts between these Guidelines and paragraph 21 of the Code of Conduct, the more stringent requirements shall prevail. Unless otherwise stated, the terms used in these Guidelines are as defined in paragraph 21 of the Code of Conduct.

3. These Guidelines apply to capital market intermediaries (CMIs) engaged in placing activities conducted in Hong Kong in respect of GEM initial public offerings (IPOs).
4. Any failure by a CMI to comply with any applicable provisions of these Guidelines:
 - (a) shall not by itself render a CMI liable to any judicial or other proceedings, but these Guidelines shall be admissible in evidence in any proceedings under the SFO before any court, and if any provisions set out in these Guidelines appear to the court to be relevant to any questions arising in the proceedings, they shall be taken into account in determining the questions; and
 - (b) may cause the SFC to consider whether such failure adversely reflects on the CMI's fitness and properness and the need for regulatory action.

Guidance for overall coordinators (OCs) to sponsors and placing agents

~~10.5. Sponsors and placing agents all OCs play an important role in the listing and placing of GEM IPO stocks/shares, and They should act both in the best interests of their ensure the fair treatment of both the issuer client and investor clients (including the new applicant) and to assure uphold the overall integrity of the market. Accordingly, sponsors and placing agents they are expected to use their best efforts to assist their issuer clients in new applicants to complying with the Rules Governing the Listing of Securities on GEM (relevant GEM Listing Rules) (as supplemented by the Joint Statement) relevant to placing activities as well as the obligations stipulated in the prospectus⁸, where applicable.~~

Guidance to sponsors

~~11.6. In light of the Joint Statement⁹ and other applicable regulatory principles and requirements, a sponsor An OC is expected to use all reasonable efforts to advise the issuer client of the following in relation to placing activities:~~

- ~~(a) Advise the new applicant on the following:~~

⁸ For example, some prospectuses may stipulate that:

- ~~(i) Allocation of placing shares is to be based on a number of factors, including the level and timing of demand and whether or not it is expected that the relevant investor is likely to purchase further shares or hold or sell the shares after the listing; and~~
- ~~(ii) Such allocation is intended to result in a distribution of the placing shares which would lead to the establishment of a solid professional, institutional and individual shareholder base for the benefit of the new applicant and the shareholders as a whole.~~

⁹ In ensuring that the applicant has an open market in the securities for which listing is sought, paragraph 18(a) of the Joint Statement states that a new applicant should take due care in deciding the issues listed in that paragraph in consultation with its sponsor.

- ~~(a)(i)~~ The relevant regulatory requirements, including ~~the~~ relevant GEM Listing Rules (as supplemented by the Joint Statement) and ~~the~~ potential consequences¹⁰ for non-compliance;
- ~~(ii)~~ ~~The method of listing, in particular, whether the new applicant should adopt an offer for subscription by or sale to the public in addition to a placing tranche;~~
- ~~(b)(iii)~~ The targeted investor type and placee mix (for example, the ~~new applicant issuer client~~ may indicate its preference for a percentage of shares to be allocated to long-term investors rather than short-term investors or to institutional investors rather than retail investors);
- ~~(c)(iv)~~ The overall strategy and allocation basis with a view to achieving an open market and an adequate spread of shareholders, and to ensure that the percentage of shares in public hands meets the relevant requirements under the GEM Listing Rules (as supplemented by the Joint Statement). -This will generally include selecting an appropriate number of ~~underwriters or placing agents~~syndicate CMIs, taking into account their investor client base, competence, resources, and track record, ~~as well as their~~ and allocation strategy; and
- ~~(v)~~ ~~The proper disclosure of any preferential treatment (financial or otherwise) afforded to any placees in the new applicant's listing document, where applicable; and~~
- ~~(d)(vi)~~ The retention of proper documentation by the ~~new applicant~~issuer client as required under the Joint Statement.¹¹

~~7. (b) An OC is also expected to R~~retain proper documentation to demonstrate that ~~the sponsor~~it has used all reasonable efforts to discharge all of its obligations.

Guidance for CMIs when placing shares to their investor clients~~to placing agents~~

~~12.8.~~ The following guidance is provided to assist CMIs (including syndicate CMIs and non-syndicate CMIs) ~~placing agents~~¹² to comply with ~~the~~ relevant regulatory principles and requirements as well as to fulfil their responsibilities to the ~~new applicant~~issuer client¹³ (where applicable) when placing ~~securities with~~shares to their investor clients.

~~13.~~ ~~Placing agents must have a robust marketing and placing strategy and allocation basis with a view to achieving an open market in the offered securities, including an adequate spread of shareholders, and must ensure that the percentage of securities in public hands meets the relevant requirements under the GEM Listing Rules (as supplemented by the Joint Statement).~~—In particular:

¹⁰ -Please see paragraphs 21 and 22 of the Joint Statement.

¹¹ Please see paragraph 18 of the Joint Statement.

¹² This includes sub-placing agents appointed by the issuer or the underwriter.

¹³ Given that a non-syndicate CMI is not engaged by the issuer, the issuer is not its client and hence not an “issuer client”. Notwithstanding this, references to “issuer client” in these Guidelines include references to “issuer” in the case of a non-syndicate CMI.

- (a) Placings should be conducted with sufficient senior management oversight by the CMI's senior management.
- (b) ~~Placing agents~~CMI~~s~~ should put in place appropriate policies and procedures to avoid any undue concentration of shareholdings and to ~~maximize~~ maximise the likelihood of an open market, ~~and a~~ fair and orderly trading of shares in the secondary market in the securities at the time of listing, which should include a marketing programme directed to a wide range of investor clients. -For example:
- (i) ~~placing agents~~CMI~~s~~ should ~~promptly~~ notify¹⁴ their investor clients¹⁵ as part of their marketing programmes that they have been appointed as a placing agent CMI for a GEM IPO¹⁶ ~~and provide~~with a brief description of the new applicant issuer client and a cautionary statement¹⁷;
- (ii) ~~placing agents~~CMI~~s~~ should allocate a reasonable number of account executives to each GEM IPO and allow all of its investor clients which are targeted investors and have indicated an interest in a GEM IPO to participate in it ~~placing transaction and the placing opportunity should not be offered to certain clients to the exclusion of other clients~~;
- (iii) ~~placing agents~~CMI~~s~~ should endeavour to respond to enquiries from prospective investor clients¹⁸ who are interested in participating in the placing a GEM IPO and to open accounts for these investors clients in good time for them to participate in the GEM IPO ~~the placing~~; and
- (iv) ~~placing agents~~CMI~~s~~ should not afford ~~clients~~ any preferential treatment¹⁹ to investor clients unless this has already been properly disclosed in the listing document. Practices which may result in the unfair treatment of investor clients and potentially manipulate the demand for other share offerings are prohibited. This includes the following types of preferential treatment:

¹⁴ This statement notification should provide factual, fair and balanced information about the GEM IPO placing. -It does not need to recommend ~~the particular that~~ GEM IPO placing to ~~the investor~~ clients.

¹⁵ A placing agent CMI is generally expected to notify all of its active investor clients of each GEM IPO to the extent that these clients fall within the targeted investor types specified in the marketing and investor targeting strategy (targeted investors) placing opportunity. -However, where a placing agent CMI opts to notify only selected investor clients when also meeting its suitability obligations (for details, please refer to footnote 4416), based, for example, on investor clients' risk appetites and past investment preferences, this ~~will~~ would be acceptable provided that senior management of the CMI is satisfied that a sufficient number of investor clients are offered the placing opportunity and the ~~chances~~ likelihood of undue concentration of shareholdings is reasonably low.

¹⁶ Placing agentsCMI~~s~~ are also required to observe the suitability obligations under paragraph 5.2 of the Code of Conduct (as supplemented by the Circular to Intermediaries - Frequently Asked Questions on Triggering of Suitability Obligations dated 23 December 2016 and Circular to Intermediaries - Frequently Asked Questions on Compliance with Suitability Obligations dated 23 December 2016) when placing shares with their investor clients.

¹⁷ Please refer to the cautionary statement included in the Joint Statement as a reminder to the public about the high investment risks and susceptibility to high market volatility of GEM stocks.

¹⁸ To the extent that these investor clients are targeted investors.

¹⁹ Preferential terms or treatment may include guaranteed allocation, unusually large allocation, ~~agreements to allocate securities in another IPO, waiver or rebate of brokerage commission,~~ put options or offers to repurchase placing securities shares after listing ~~or any other arrangement entered into on non-arm's length commercial terms in consideration for the placees taking up the securities.~~

- offering rebates by CMI to investor clients or passing on any rebates provided by the issuer to investor clients; and
 - making any arrangements which would result in investor clients paying, for each of the shares allocated, less than the total consideration as disclosed in the listing document.
- (c) “Know-your-client” KYC procedures must be conducted properly. ~~Placing agents~~ CMIs are required to take reasonable steps to establish the identity of ~~the an investor~~ client and to confirm whether a client person intending to subscribe is the beneficial owner of ~~the an investor~~ client’s account (i.e. not a nominee of some other person) and is independent of the ~~new applicant issuer client~~, its controlling shareholders and directors. For the avoidance of doubt, ~~placing agents~~ CMIs should exercise caution when relying on ~~the an investor~~ client’s declaration of ~~the client’s~~ sits independence and should make further enquiries (~~by way of~~, for example, by way of an internet search) ~~in cases of doubt~~. ~~Placing agents~~ CMIs are generally expected to pay special attention to the following “red flags”:
- (i) ~~Clients investor clients~~ investor clients subscribing for the ~~placing GEM IPO shares~~ GEM IPO shares are procured or introduced by the ~~new applicant issuer client~~, its controlling shareholders or directors;
 - (ii) ~~Clients investor clients~~ investor clients subscribing for the ~~placing GEM IPO shares~~ GEM IPO shares have known business, financial or other relationships (e.g. as employees, suppliers or customers) with the ~~new applicant issuer client~~ or any of its controlling shareholders or directors;
 - (iii) ~~Clients investor clients~~ investor clients subscribing for the ~~placing GEM IPO shares~~ GEM IPO shares have familial relationships or share the same address with other placees; and
 - (iv) ~~Accounts the accounts of investor~~ investor clients subscribing for the ~~placing GEM IPO shares~~ GEM IPO shares are operated by the same person.
- (d) ~~Sources The sources~~ of funding for the subscription of ~~placing GEM IPO shares~~ GEM IPO shares should be established ~~before any acceptance of the client’s subscription~~ using a risk-based approach ~~before any acceptance of an investor client’s subscription~~. ~~Placing agents~~ CMIs are expected to ensure that ~~the~~ subscriptions are commensurate with ~~the an investor~~ client’s financial position.
- (e) Save for nominee companies²⁰, subscriptions should be rejected where there ~~is~~ are any suspicions that ~~the an investor~~ client may be a nominee of some other person whose identity the ~~placing agent CMI~~ is unable to ascertain or the acceptance of subscriptions ~~will would~~ result in an inadequate spread of shareholders.
- (f) Proper records must be kept so that ~~the placing agents~~ CMIs can demonstrate ~~their~~ compliance with ~~this these guideline~~ Guidelines throughout the entire placing process. Sufficient details should be available, covering, ~~among others, for~~ example: (i) all notifications to investor clients; (ii) all orders received; (iii) the

²⁰ Rule 10.12(1A) of the GEM Listing Rules allows allocation to nominee companies ~~if the name of the ultimate beneficiary of the placing shares is disclosed or~~ with the written consent of the Exchange.



rationale for the allocation of ~~the securities-shares~~ as well as the reasons for the rejection of orders; and (iv) the list of places submitted to the Exchange.

~~Intermediaries Supervision~~

~~Intermediaries~~

~~Securities and Futures Commission~~