



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

## **Consultation Paper on the Regulation of Sponsors and Compliance Advisers**

《有關監管保薦人及合規顧問的諮詢文件》

**Hong Kong  
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## Table of Contents

	Page
Foreword.....	1
Executive summary.....	4
Introduction.....	7
Background.....	8
Current regulatory regime on corporate finance advisers.....	10
Regulatory approach.....	12
Proposals on the eligibility criteria and on-going compliance requirements for sponsors.....	13
Compliance advisers.....	20
IFAs.....	21
Proposed transitional arrangements for sponsors.....	21
Regulatory supervision and enforcement.....	22
<b>Annex 1</b>	
Proposals on eligibility criteria and on-going compliance requirements for sponsors and compliance advisers .....	24

## Foreword

The Securities and Futures Commission (the “Commission”) 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 **no later than 31 August 2005**. Any person wishing to submit comments on behalf of any organization should provide details of the organization whose views they represent.

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

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

Written comments may be sent

By mail to: Intermediaries and Investment Products Division  
Securities and Futures Commission  
8/F Chater House  
8 Connaught Road Central  
Hong Kong  
Attn: Sponsor Consultation

By fax to: (852) 2526 5304

By on-line submission to: <http://www.sfc.hk>  
(Please enter into the subsection “Consultation Papers & Conclusions” under the section “Speeches, Publications & Consultations” on the website <http://www.sfc.hk>)

By e-mail to: [sponsorconsult@sfc.hk](mailto:sponsorconsult@sfc.hk)

For further information, please contact the Intermediaries and Investment Products Division at (852) 2283 6128.

Additional copies of the consultation paper may be obtained from the above address of the Commission. This consultation paper is also available at the Commission’s website at <http://www.sfc.hk>.

## **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 Data<sup>1</sup> will be used following collection, what you are agreeing to with respect to the Commission’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 Commission in response to the Consultation Paper on the Regulation of Sponsors and Compliance Advisers may be used by the Commission for one or more of the following purposes:
  - to administer the relevant provisions<sup>2</sup> of the Ordinances, rules, regulations, codes and guidelines made or promulgated pursuant to the powers vested in the Commission;
  - for the purpose of performing the Commission’s statutory functions under the relevant provisions of the Ordinances;
  - for research and statistical purposes;
  - other purposes permitted by law.

### *Transfer of Personal Data*

3. Personal Data may be disclosed by the Commission to the 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 the consultation paper together with the whole or part of their submission may be disclosed to members of the public. This will be done by publishing this information on the Commission website and in documents to be published by the Commission throughout and at the conclusion of the consultation period.

### *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 the Consultation Paper. The

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<sup>1</sup> Personal Data means personal data as defined in the Personal Data (Privacy) Ordinance, Cap. 486 (“PDPO”).

<sup>2</sup> Defined in Schedule 1 to the Securities and Futures Ordinance (Cap. 571) (“SFO”) to mean provisions of the SFO and subsidiary legislation made under it; and provisions of Parts II and XII of the Companies Ordinance (Cap. 32) insofar as those Parts relate, directly or indirectly, to the performance of functions relating to prospectuses; the purchase by a corporation of its own shares or a corporation giving financial assistance for the acquisition of its own shares, etc.

Commission has the right to charge a reasonable fee for processing any data access request.

*Retention*

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

*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  
8/F Chater House  
8 Connaught Road Central  
Hong Kong

**A copy of the Privacy Policy Statement adopted by the Commission is available upon request.**

## **CONSULTATION PAPER ON THE REGULATION OF SPONSORS AND COMPLIANCE ADVISERS**

### **EXECUTIVE SUMMARY**

1. Hong Kong, as one of the leading fund-raising centres in the world, has a unique market in which a significant number of listing applicants are incorporated in overseas jurisdictions and/or have the bulk of their operations and assets in Mainland China. Given this special characteristic, sponsors, who act as corporate finance advisers to listing applicants, play a pivotal role in bringing listing applicants to the Hong Kong market and providing investors with information about these companies.
2. Over the past few years, there have been increasing concerns about the standards of sponsors in view of the corporate scandals related to initial public offerings and sponsors' failure to carry out proper due diligence on listing applicants. The market and the investing public have, on various occasions, called for effective measures to raise the overall standard of professionalism in the market, and to take action against sponsors that have failed in their duties.
3. The Commission has therefore embarked on a two-stage course of action for the overall enhancement of the sponsor regulatory regime. The first stage, conducted jointly by the Commission and the Hong Kong Exchanges and Clearing Limited ("HKEx") ("Joint Consultation"), was concluded with the release of the revised Listing Rules and the introduction of the Practice Notes on Due Diligence by sponsors in respect of initial listing applications ("Practice Note") in October 2004. The revised Listing Rules and the Practice Notes came into effect on 1 January 2005.
4. The second stage is conducted by the Commission. The SFC proposes to implement a specific regulatory regime for sponsors. The demand for a specific regulatory regime is evident from the market responses to previous consultation, the general public's expectation gauged from the Investor Survey and the feedback from our recent soft consultation with the market. They all take the view that given their specialist role in advising corporations on their listing applications, sponsors need to meet a set of specific requirements before they are licensed to act as sponsors.
5. Under the current licensing regime, sponsors are one type of corporate finance advisers. All corporate finance advisers are licensed under Type 6 Regulated Activity of the SFO. However, the relevant codes and guidelines for corporate finance advisers only cover competence and conduct requirements general to all types of corporate finance advisers.

They do not address issues that are unique to sponsors in their role of bringing companies to the market and ensuring that proper due diligence is conducted on these companies and that the related prospectuses are accurate and contain all relevant information.

6. The proposal is to add to the current licensing regime a set of additional requirements specific to sponsors. This means that to be entitled to act as a sponsor, a firm must satisfy current licensing qualifications and the proposed additional requirements. These requirements are: (i) the initial eligibility criteria that sponsors must satisfy before they are licensed to act as sponsors, and (ii) on-going compliance obligations that sponsors, their management and staff must satisfy.
7. The proposed additional requirements are tailor-made to tackle commonly observed deficiencies among sponsors. In formulating these proposed requirements, our objectives are to raise the standards of sponsors and to make them responsible for the quality of their work. These objectives are also shared by investors. The proposals aim to strengthen the following four key aspects of a sponsor's operations:

*Organisational structure, internal controls and resources:* A sponsor should ensure that it maintains effective systems and internal controls within the firm, including effective reporting lines between staff and the management. A sponsor should ensure that there are sufficient resources to handle the sponsor work it undertakes. While these principles are already set out in the existing regime regulating corporate finance advisers, the additional requirements seek to elaborate on these principles so that they can be more specifically applied in the case of a sponsor.

*Formation of transaction teams and proper supervision:* A transaction team should be set up to prepare a client for its public offering and listing. Each transaction team should have at least one Principal (a team may have more than one if the circumstances require) and other staff qualified to advise on corporate finance work. The Principal(s) of a team should properly supervise the work carried out by the team. He/She should take full responsibility for the work of the team.

*Appointment of Principals:* A Principal should be a responsible officer ("RO") of a sponsor. He/She should have at least five years' relevant corporate finance experience and have played a substantial role in at least two completed IPOs in the 5-year period immediately before he/she applies to be a Principal. However, it should be noted that not all ROs of a sponsor have to be appointed as Principals.

*Management responsibility:* The management of a sponsor is ultimately responsible for the supervision of the sponsor work. It also bears the

overall responsibility of ensuring that each IPO transaction is at all times adequately supported by the firm's resources and staffed with the right mix of skills, experience and expertise to advise on the IPO in question.

*On-going compliance:* A sponsor and individuals working for it should ensure that they continue to comply with the on-going requirements on resources, management, supervision and other applicable conduct regulations. The management of a sponsor will be required to conduct a self-assessment of the firm's internal controls and systems annually. On the financial resources side, it is proposed that a sponsor has to maintain a minimum level of capital requirement of HK\$10 million.

8. To give the firms sufficient time to prepare for compliance with the additional requirements, the Commission proposes that the effective date of the proposed requirements takes place on the expiry of a 12-month period from the release of the consultation conclusions (referred to in this consultation paper as "the Effective Date").
9. Between now and the Effective Date, licensed corporate finance firms wishing to do or continue to do sponsor work will continue to be subject to the current regime, including the standards and requirements set out under the codes and guidelines issued by the Commission and the rules of HKEx.
10. On the Effective Date, the Commission proposes that a licensed corporate finance firm that can meet the additional requirements may conduct sponsor work without having to make a fresh licensing application. Specific requirements that a firm is expected to meet include the obligation to maintain sufficient resources and proper internal controls, as well as the appointment of at least two Principals<sup>3</sup>.
11. In order to facilitate the administrative arrangements for transition, we propose that a licensed corporate finance firm wishing to do or continue to do sponsor work may take one of the two routes below to transit to the new regime:
  - (1) A firm that has a track record in IPOs, i.e. it has advised on at least one completed IPO transaction during the 5-year period immediately prior to the Effective Date, only needs to file a confirmation with the Commission to the effect that it meets the additional requirements on the Effective Date. The confirmation should include the names of the Principals;

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<sup>3</sup> See paragraphs 50 to 52 of this consultation paper and paragraphs 1.3 and 1.4 of Annex 1 to this consultation paper.

- (2) A firm that has no track record in IPOs as explained above needs to file a confirmation to the Commission to the effect that it meets the new requirements on the Effective Date. The confirmation needs to be supported by evidence demonstrating its compliance with the new requirements, e.g. details of the Principals' experience.
12. Licensed corporate finance firms that do not wish to do sponsor work or who otherwise do not comply with the new requirements on the Effective Date will not be entitled to carry out sponsor work under the new regime. They may, in the absence of other restrictive conditions, continue to conduct all other corporate finance work under their Type 6 licence. They may also apply for the right to act as sponsor anytime provided they can satisfy the new requirements.
13. In addition to the above proposals, which specifically address issues regarding sponsors and their work, the Commission takes this opportunity to remind sponsors that they are also required to comply with all other general regulatory requirements on intermediaries' conduct.
14. The Commission will utilize its broad range of regulatory tools to ensure sponsors' compliance with these specific requirements, as well as all other relevant codes and regulations. The Commission will conduct inspections both on a routine and ad-hoc basis to ensure compliance. If any sponsor fails to meet the regulatory requirements, the Commission may impose measures such as licensing conditions and/or issue restriction notices that would effectively curtail a sponsor's operations.
15. In order to maintain Hong Kong's reputation as a leading fund-raising centre and protect Hong Kong investors, the Commission will not hesitate to take appropriate regulatory and disciplinary action against sponsors who have failed to meet the relevant regulatory requirements.

## **INTRODUCTION**

16. The Commission invites comments from the public on a set of specific eligibility criteria and on-going compliance requirements proposed for the regulation of sponsors and compliance advisers.
17. The proposals aim to introduce a set of specific eligibility criteria and on-going requirements for sponsors within the parameters of the Securities and Futures Ordinance ("SFO"), and the relevant codes and guidelines published by the Commission. In formulating the proposals for consultation, we have taken into account the responses to the Joint Consultation, the findings of the Investor Survey on Sponsors released by the Commission in March 2005, and feedback from discussions with a

spectrum of sponsor firms during our soft consultation, and the SFC's Public Shareholders' Group.

18. The scope of this consultation does not cover a review of the Corporate Finance Adviser Code of Conduct ("CFA Code"). The CFA Code applies to a broad range of corporate finance advisers and not just sponsors, e.g. advisers in takeovers and mergers. This consultation only focuses on sponsors in relation to their admission criteria and on-going compliance requirements.
19. All comments received from this consultation will be carefully considered. Consultation conclusions will be published after the consultation period, which is due to end on 31 August 2005.

## **BACKGROUND**

### **Joint Consultation**

20. In 2003 and 2004, the Commission and the HKEx conducted the Joint Consultation. The conclusions to the Joint Consultation were released in October 2004.
21. In the Joint Consultation, HKEx proposed to regulate sponsors and independent financial advisers ("IFAs") by imposing a set of eligibility criteria and implementing a code of conduct on sponsors through amendments to the Listing Rules. Respondents to the Joint Consultation were concerned about the possible duplication in regulatory oversight by the HKEx and the Commission on the same types of corporate finance activities, and thus were not supportive of the proposal. Given that the Commission already licenses and supervises corporate finance advisers who carry out Type 6 Regulated Activity under the SFO, and given the variety of enforcement powers of the Commission and its accountability in the exercise of such powers, respondents generally preferred a simple regulatory regime, with the Commission being the single statutory regulator overseeing the conduct of sponsors and IFAs.
22. In light of the respondents' views, the Commission and the HKEx agreed on a two-stage approach to enhance sponsor and IFA regulation. The first stage focused on the clarification of the standards for due diligence work undertaken by sponsors, and the responsibilities of sponsors and IFAs. The HKEx concluded the first stage with the release of the amendments to the Listing Rules relating to sponsors and IFAs and the introduction of the Practice Note in October 2004. The revised Listing Rules and the Practice Note came into effect on 1 January 2005. As the issues relating to sponsors' responsibilities and the standards of sponsors' due diligence

work have been addressed at the first stage, these issues are not revisited in this consultation paper.

23. The second stage involves the setting out of specific eligibility criteria and on-going compliance requirements applicable to sponsors licensed by the SFC, which is the subject of this consultation paper. At this stage, the Commission makes no proposals in respect of specific or further requirements for IFAs (see paragraph 80).

### **Investor Survey**

24. While there was a great number of responses to the Joint Consultation, they were almost exclusively from industry players and issuers. In order to obtain a more comprehensive picture of the views of the investing public, the Commission appointed the Social Sciences Research Centre of the University of Hong Kong, an independent research centre, to conduct a survey to solicit the opinions of both retail and institutional investors on the standards of sponsors in connection with the listing of companies in Hong Kong. 1,623 individuals and ten fund managers were surveyed. The survey report was released in March 2005.
25. The survey findings showed that Hong Kong retail and institutional investors are in agreement that sponsor standards must be raised (94.2% and 100% respectively). The survey also showed that retail investors have a fair understanding of a sponsor's role in the listing process. Generally, investors consider the following four criteria to be key to the enhancement of sponsor standards:
  - Relevant IPO sponsor experience and competence of a sponsor firm and professional staff in carrying out sponsor work;
  - A sponsor firm's internal system and controls that deliver an effective management and organisational structure to oversee the quality of sponsor work;
  - Sufficient human and organisational resources of a sponsor firm in carrying out sponsor work; and
  - Sufficient financial resources of a sponsor firm including professional indemnity of sponsor firms.

## **Sponsors' activities in Hong Kong**

26. Hong Kong was the largest fund-raising market in Asia and the 3<sup>rd</sup> largest fund-raising market in the world in 2004, raising a total US\$36 billion.<sup>4</sup> Over the past 5 years, there have been a total of 438 initial public offerings in Hong Kong, including 70 in 2004.
27. The Hong Kong market plays a vital role in bringing together international capital and Mainland Chinese companies and assets through the efficient and transparent allocation of international and domestic investment monies to Mainland Chinese enterprises seeking funds for development and growth. Sponsors are key players in this process, performing the important role of bringing listing applicants from Mainland China to the Hong Kong market and providing investors of the Hong Kong equity market with information about these companies.
28. Besides its interaction with Mainland Chinese enterprises, the Hong Kong market also provides an efficient capital raising platform for a wide range of international institutional investors from other leading markets. There is no doubt that Hong Kong needs the presence of listed corporations with good corporate governance and intermediaries with high standards of professionalism in order to maintain its position as a financial capital-raising centre in the region. Therefore, in the process of examining possible options to develop a set of specific regulation for sponsors, we do recognise and take into account the need to develop a regulatory framework that is able to both cater for local market characteristics and meet international standards.

## **CURRENT REGULATORY REGIME ON CORPORATE FINANCE ADVISERS**

### **The Commission**

29. In order to carry out their respective corporate finance activities, corporate finance advisers including sponsors and IFAs must be licensed under Type 6 Regulated Activity of the SFO. As of 1 April 2005, there are 291 corporations licensed for Type 6 Regulated Activity. As SFC licensees, these corporate finance advisers must remain fit and proper to be licensed, and comply with the relevant codes and guidelines, which include:
  - Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (“Code of Conduct”)

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<sup>4</sup> The figure includes both IPOs and subsequent new issues by listed companies.

- Management, Supervision and Internal Control Guidelines for Persons Licensed by or Registered with the Securities and Futures Commission (“Internal Control Guidelines”)
  - Fit and Proper Guidelines
  - CFA Code
30. In order to monitor the compliance of licensed corporate finance advisers, including sponsors, with the relevant codes and guidelines, the SFC may exercise its statutory powers of inspection and investigation. Where regulatory breaches are found, the SFC is able to impose a range of sanctions on the corporate finance adviser pursuant to the SFO as appropriate. These sanctions include reprimands, fines, suspension and revocation. The Commission may also impose licensing conditions and issue restriction notices that could effectively curtail a sponsor's operations or specific part thereof.
31. These codes and guidelines contain basic competence requirements and general principles for licensed persons to comply with as they carry out advisory work on corporate finance. They are not intended to address specific issues such as the eligibility, resources and management supervision of sponsors and their role and functions in public offerings<sup>5</sup>. This is because sponsors are a special category of intermediaries who have the duty to help and advise prospective issuers to comply with the requirements in the Listing Rules in relation to IPOs. When sponsors fail to meet these requirements, the HKEx may refuse their admission as sponsors for listing applicants on the Main Board and/or GEM Board. Sponsors are currently subject to specific admission criteria set out in the Listing Rules which are administered and enforced by the HKEx.
32. However, the comments received from the respondents to the Joint Consultation, the results of the Investor Survey and the feedback in our soft consultation, show that the general public supports a set of focused criteria to be established and enforced by the Commission and tailored for the sole purpose of regulating sponsors under the statutory regulatory framework of the SFO.

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<sup>5</sup> Transactions for which sponsors are required to be appointed pursuant to the requirements of the listing rules of the HKEx shall be referred to as “IPOs” in this paper. This term is intended to be used generally and is not intended to have any bearing on the interpretation of similar terms in the HKEx listing rules, or any rules, regulations, codes and guidelines issued by the HKEx or the Commission. This term may include offers for sale and offers for subscriptions by listing applicants, as the case may be.

## **Listing Rules requirements on sponsors**

### *Main Board*

33. The Main Board Listing Rules provide that sponsors must be acceptable to HKEx. Where the HKEx finds a sponsor unacceptable, prospective issuers have to select other sponsors that are acceptable to the HKEx.

### *GEM*

34. Corporate finance advisers who act as sponsors of listing applicants of the Growth Enterprise Market (“GEM”) must obtain prior approval from the HKEx and be admitted to a list of sponsors maintained and published by HKEx from time to time. Currently, there are 54 corporate finance advisers under the GEM list of sponsors. The GEM Listing Rules set out the minimum admission requirements, which include requirements on the firm’s experience, its minimum capital<sup>6</sup>, the number of experienced staff and appropriate internal control procedures. Sponsors must continue to satisfy these criteria in order to remain on the list.

## **REGULATORY APPROACH**

35. The role of sponsors is particularly important in Hong Kong due to the fact that a large number of listed companies in Hong Kong are incorporated and/or have the whole or bulk of their operations and assets in other jurisdictions, such as Mainland China. As investors are, understandably, not familiar with and lack information regarding these overseas companies, investors have to rely on information disclosed in the prospectus in order to make informed investment decisions. Sponsors carry out the vital role of conducting due diligence on these companies before bringing them to the market, and ensuring that the prospectus is accurate and contains all relevant information, so that it is not misleading. Thus, the Commission strongly believes that only those firms that are fit and proper may act as sponsors.
36. The importance of a sponsor’s role and the increasingly complex cross-border listing issues in the Hong Kong market necessitate the formulation of a set of licensing criteria for sponsors, which includes eligibility

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<sup>6</sup> Among other requirements, the GEM Listing Rules require that a prospective sponsor must have acted as a lead sponsor on at least 2 completed IPO transactions over a 5-year period, or acted as a co-sponsor on at least 3 completed IPO transactions over the same period. Similarly, an individual must have played a substantial role on at least 2 completed IPO transactions over the 5-year period in order to be eligible to become a Principal Supervisor, and 3 years of relevant corporate finance experience to be eligible to become an Assistant Supervisor. A prospective sponsor must also have a paid up share capital and/or non-distributable reserves of not less than HK\$10 million, and a net tangible asset value after minority interests of not less than HK\$10 million represented by unencumbered assets.

criteria and on-going compliance requirements that are specific to the role and functions of a sponsor.

37. The implementation of a set of specific criteria will help raise sponsors' standards in two ways:
  - it will clarify, from a compliance perspective, the standards and qualifications required of sponsors, including specific areas such as internal supervision and sufficiency of resources; and
  - it will set the benchmarks for determining a sponsor's fitness and properness, and establish the basis on which regulatory actions may be taken against those who fall short of the requisite standards.
38. The specific criteria provide the Commission with a clear and transparent set of benchmarks, such as a sponsor's actual transactional experience, sufficiency of resources, effectiveness of its internal controls and systems and the level of its management supervision. The Commission may then use these benchmarks to measure and supervise a sponsor's eligibility and performance, and where necessary take regulatory actions against sponsors when and where they fail to measure up to these benchmarks.
39. As a statutory regulator of intermediaries, the Commission is empowered to employ a wide spectrum of regulatory tools on licensed individuals and firms, including imposing licensing conditions, issuing restriction notices, taking disciplinary action, and imposing sanctions that range from private and public reprimands, suspension of licences, to the imposition of fines and revocation of licences. Such sanctions serve to deter intermediaries from falling below the standards required of them. More importantly, these sanctions have the ultimate effect of protecting the investing public.

#### **PROPOSALS ON THE ELIGIBILITY CRITERIA AND ON-GOING COMPLIANCE REQUIREMENTS FOR SPONSORS ("PROPOSALS")**

40. There are three main aspects to the Proposals:
  - A sponsor should have proper internal controls and adequate supervision to ensure compliance with relevant regulatory requirements;
  - The management, including the ROs has the ultimate responsibility for the work conducted by the sponsor; and
  - The sponsor should have competent staff and sufficient resources to carry out its work.

41. The Proposals will become an integral part of the general framework for the regulation of sponsors (see paragraph 29 for particulars).
42. The Proposals, including a set of draft clarification notes, are attached to this consultation paper as **Annex I**.

### **Initial Eligibility Criteria and Structural Requirements**

43. We propose that a corporate finance adviser must satisfy certain initial eligibility criteria and on-going compliance standards before it can carry out and continue to carry out the work of a sponsor. The overriding principle is that a sponsor must demonstrate that it is fit and proper to carry out sponsor work.
44. In determining whether a corporate finance adviser is fit and proper as a sponsor, the Commission will take into account the factors in paragraphs 45 to 79 in addition to the basic requirements applicable to a Type 6 licensed person. Under the new proposed regime, while a sponsor will continue to be subject to all current codes and guidelines relevant to corporate finance advisers licensed under Type 6, it must also satisfy additional requirements.

#### *Management's overall responsibilities*

45. In taking up new sponsorship engagements, the management, including the ROs, has to take into account the sponsor's capacity, resources and expertise. The management is also responsible for the staffing of each of the transaction teams undertaking sponsor work ("transaction team"). The management must also ensure that the deployment of resources and composition of the teams are commensurate with the nature, complexity and size of the relevant IPO.
46. This clarification is made based on the general observation of the operations of a typical sponsor. It is common that within a sponsor, various teams are set up to carry out sponsor work. A typical transaction team is made up of staff with different levels of experience and expertise including senior supervisory staff, who are referred to as "Principals" in this paper, and other corporate finance executives.

#### *Supervision and reporting lines*

47. It is very important that a sponsor maintains effective reporting lines and internal controls. The management of a sponsor must closely supervise the work of transaction teams. There should be clear and effective reporting lines between a transaction team and the sponsor's management.

It is expected that key issues about a transaction and/or the related sponsor work should be brought to the attention of the Principals and the management so that decisions can be made in a timely manner and by those having the experience, skill and competence to make them. For example, where fraud or the provision or perpetuation of false or misleading information is suspected during the course of due diligence, the management must be alerted of this fact as soon as possible so that it can take appropriate measures to address these issues promptly.

#### *Sufficient expertise and resources*

48. As a general principle under the Code of Conduct, licensed persons should have, and should effectively employ, the resources and procedures that are necessary for the proper performance of their business activities and obligations. In the case of a sponsor, this means that it must have sufficient expertise and human resources to carry out its work throughout each IPO transaction, and in respect of the sponsor work undertaken by the firm as a whole.
49. Previously, a number of respondents did not agree with the Joint Consultation's proposals to mandate a fixed number or ratio of senior and junior staff within a sponsor firm. Having considered the basis for these submissions, we decided that there are merits in leaving the actual operational decisions (such as the number and ratio of senior and junior staff) to the management of a sponsor. However, we maintain the view that it is the management's duty to have sufficient staff that are competent in discharging a sponsor's job. In our Proposals, we have not prescribed any particular ratio of members within a transaction team for carrying out IPO work. However, the management and the ROs have the overarching obligation and responsibility to ensure that the team is properly and adequately resourced and in possession of the necessary skill and competence to work on a relevant IPO project.

#### *Principals*

50. We propose that a sponsor must have sufficient Principals and the minimum requirement is to appoint at least two Principals. The management is responsible for deciding the sufficient number of Principals for its firm, taking into account the volume, nature, complexity and size of sponsor work that the firm is or will be engaged in. While every team formed for a particular sponsor engagement must be led by at least one Principal, a Principal may oversee more than one transaction team provided that the Principal has the capability and competence to directly and properly supervise each team.

51. Each Principal must be a licensed RO for Type 6 Regulated Activity. This is to ensure that the management, through the ROs, has a direct supervisory relationship with each transaction team. Under this arrangement, the ROs will have first hand knowledge of, and direct responsibility for, the standards of sponsor work within the firm. A similar model is already practised under the GEM sponsor regime where each GEM sponsor must appoint at least two Principal Supervisors, who must be ROs of the firm. For the avoidance of doubt, not all ROs need to be Principals if the minimum requirement of 2 Principals is met.
52. Apart from being qualified as a RO in a corporation licensed to carry out Type 6 Regulated Activity, a Principal must also meet the specific initial eligibility criteria as discussed below.

*Specific eligibility criteria for Principals*

53. We propose that a Principal must have a minimum of 5 years' relevant corporate finance experience (see paragraphs 54 and 55) and have played a substantial role in at least two completed GEM and/or Main Board IPOs in the 5 year-period immediately before s/he applies to become a Principal.
54. Corporate finance experience generally refers to a broad spectrum of skills and experience which a corporate finance adviser must possess in order to properly advise its clients and to structure deals. However, we consider it appropriate to lay down, at the outset, the parameters of what would constitute "relevant corporate finance experience", so that upon application to become a Principal, there are objective benchmarks against which the applicant can be assessed.
55. In assessing whether a person has the 5 years' relevant corporate finance experience, we propose that where the person has experience in one or more of the following activities, s/he would generally be considered as having met the requirement:
  - IPOs;
  - Notifiable Transactions under the Listing Rules;
  - A rights issue or open offer by a listed company; and
  - Takeovers subject to the Takeovers Code.
56. We generally expect a Principal to have gained a substantial amount of the relevant corporate finance experience and specific IPO experience in the Hong Kong market. However, we are prepared to consider

comparable experience acquired in other well-established securities markets, especially in the jurisdictions that have broad regulatory equivalence with Hong Kong.

57. In the Joint Consultation, it was proposed that individual supervisory staff must demonstrate that s/he has completed a fixed number of IPOs continually. Market practitioners considered this proposal to be unduly burdensome and made the point that whether an individual is able to meet that requirement on a continuous basis could be a consequence of market conditions and might have no direct correlation to the individual's competence to carry out sponsor work.
58. While we see the merits of this argument, we maintain the view that staff engaged in sponsor work should be conversant with the latest market practices and regulatory requirements in the Hong Kong market. We therefore propose that, instead of imposing an on-going experience requirement to demonstrate active participation in IPOs over a fixed period, there should be an on-going requirement for continuous training of the staff of sponsors, which we will discuss further in this consultation paper.

*Transaction team's local regulatory knowledge*

59. Apart from corporate finance experience, we propose that at the firm level, the management of a sponsor should ensure that in each transaction team, there is a sufficient number of staff familiar with Hong Kong regulatory requirements and practice in securities offerings in order to properly advise a company for listing. We believe this requirement is a balanced way forward which takes into account the open architecture of the Hong Kong market where transactions often involve cross or multi-jurisdictional offerings. There is a need to ensure that while the Hong Kong market benefits from the depth and breadth of experience brought by corporate finance advisers involved in overseas and cross-jurisdictional offerings, the transaction team as a whole must be able to provide proper advice on compliance with Hong Kong regulatory requirements.

*Additional on-going compliance requirements*

60. Apart from the entry criteria and the obligations to ensure that there are competent and properly staffed transaction teams, a sponsor should meet the following on-going compliance requirements:
  - A sponsor should carry out an assessment on the internal controls and systems of the firm annually to ensure the relevant regulatory requirements are complied with;

- A sponsor should submit an annual return to the Commission to confirm that it has completed the internal assessment mentioned above; and
- A sponsor should ensure that its staff, being licensed individuals carrying out the work of sponsor, undertake corporate finance related training as part of the existing continuous professional training requirement.

*Compliance with other SFC codes and guidelines*

61. In our soft consultation with market practitioners, we note that some sponsors have recently taken an increasingly liberal reading of the relevant codes and regulations and have moved away from compliance with these regulations. The Commission reminds sponsors that as SFC licensees, all corporate finance advisers are subject to all the relevant codes and guidelines of the Commission, and not just the CFA Code.

*Internal assessment*

62. We propose that a sponsor should carry out an annual assessment regarding its compliance with the specific requirements in the Proposals for maintaining appropriate internal systems and controls as a sponsor. The management, in conducting the assessment, should take into account the activities of the transaction teams, their members and the Principals.
63. As a reminder, all SFC licensed intermediaries are required to have systems and controls in place to ensure that the firm, among other things, has adequate supervision over its employees. These requirements apply equally to sponsors.

*Filing confirmation of internal assessment with the SFC*

64. We propose that a sponsor is required to submit a confirmation that the management has conducted the required internal assessments on the firm's internal controls and systems as described in paragraph 62. This confirmation will form an additional part of the annual return that SFC licensees are currently required to file with the Commission under the SFO. A sponsor must keep proper records of internal assessments performed.

*General obligation of notification of material breaches*

65. The general obligations under paragraphs 12.1 and 12.5 of the Code of Conduct are equally applicable to sponsors. In short, a sponsor is

required to ensure that it continues to comply with the applicable rules, regulations, codes and guidelines and upon becoming aware or suspicious of any material breaches of these regulatory requirements, it is under a duty to report the details of breach(es) to the Commission.

66. It follows that where the management is aware of any material non-compliance with the requirements in Annex I by a sponsor or its staff, it should promptly report such failure to the Commission.
67. This obligation is an existing requirement in the Code of Conduct, hence, a sponsor should have implemented mechanisms/systems to ensure that any material breaches are brought to the attention of the management and reported to the Commission in a timely manner. A sponsor is not expected to encounter particular difficulties in adhering to the notification requirement in paragraph 12.5 of the Code of Conduct.

#### *Continuous Professional Training (“CPT”)*

68. We propose that for individuals working in sponsor firms, at least 50% of the 5 CPT hours that they are required to undertake should consist of training that is related to the subject of corporate finance, particularly IPO matters, and on Hong Kong listing practice and regulatory knowledge.
69. This proposal is made having regard to our discussions during soft consultation with market practitioners, who opined that in a rapidly developing market like Hong Kong, corporate finance advisers are facing increasing challenges to keep their practice and regulatory knowledge up-to-date. Continuous professional training can help bridge this gap. This proposal is also backed by the findings of the Investor Survey, which indicated that professional training is an important element in enhancing overall sponsor standards.

#### *Minimum capital requirement and professional indemnity*

70. Under the current GEM Listing Rules, a sponsor must have a minimum paid-up capital of HK\$10 million. Alternatively, this capital requirement can be satisfied by way of adequate financial backing in the form of an unconditional and irrevocable guarantee from a company within the sponsor group or an authorised institution of not less than HK\$10 million.
71. One of the proposals in the Joint Consultation was to impose a minimum capital requirement (equivalent to that currently required for GEM sponsors) on all sponsors including those sponsoring Main Board listings. Respondents were divided on this issue.

72. Practitioners who did not support the imposition of a minimum capital requirement questioned the rationale behind the proposal. They argued that corporate finance advisory work is not capital intensive, and in any event, the amount of HK\$10 million would not be sufficient to fund compensation to investors. Some argued that this amount should be lowered in order to provide incentives to firms with less resources to enter the industry.
73. Others respondents believed that the minimum capital requirement has its merits. In practice, there is usually a time gap between a sponsor taking up a new sponsor engagement and payment for its work. This gap may range from several months to a year or even longer. In the meantime, a sponsor is expected to keep a group of qualified staff to continue work on IPOs. In the circumstances, the requirement to maintain a certain level of capital requirement is justified to demonstrate that a sponsor appointed to advise on an IPO is a firm with substance and commitment, and not just a “two-dollar capital company”. Given the time it takes to complete a sponsorship, a prospective issuer may also want to ensure that its sponsor has sufficient resources to remain in business for a period of time before deciding to appoint the firm as the issuer’s sponsor.
74. On balance, we propose that a sponsor should be subject to minimum capital requirements and the reference threshold should be the same as the current GEM Listing Rules requirements where the minimum paid-up capital is HK\$10 million. If it is finally concluded that a minimum paid up capital requirement is the preferred course, legislative amendments will have to be made to the Financial Resources Rules to incorporate such changes. Before these changes are reflected in the law, it is proposed that the minimum capital requirement be maintained in the Listing Rules regime until replaced by the statutory requirement.
75. In light of the findings of the Investors Survey, we also propose that sponsors should have professional indemnity insurance coverage for possible liabilities arising out of its sponsor work. The amount of insurance coverage should be commensurate with the size of the sponsor’s business, subject to a minimum amount of coverage. We would like to hear the market’s views regarding the amount of minimum coverage that would be prudent and not overly burdensome.

## **COMPLIANCE ADVISERS**

76. Under current Listing Rules, issuers listed on the Main or GEM Board must appoint a compliance adviser for the period commencing on its listing until the publication of financial results for the first/second full financial year after its listing.

77. A compliance adviser need only provide advice and guidance when requested by the listed issuer. A listed issuer must consult with and, if necessary, seek advice from its compliance adviser on a timely basis in prescribed circumstances, e.g. before publication of any regulatory announcement, circular or financial report.
78. We believe that the role of compliance advisers is an extension of corporate finance advisory work conducted by a sponsor during the listing application. As such, we propose that any firm that qualifies to work as a sponsor can act as a compliance adviser.
79. The management, including the ROs, and the firm must ensure that sufficient resources are assigned to each engagement/transaction. The Commission appreciates that the types of engagement/transaction on which a compliance adviser may be asked to advise may vary in complexity and its demand on resources. The Commission is therefore prepared to adopt a flexible approach when considering whether sufficient resources are employed.

## **IFAs**

80. The Commission notes that the revised Listing Rules have incorporated specific requirements on IFAs and their obligations under the Listing Rules. Furthermore, the existing codes and guidelines issued by the Commission are in general applicable to IFAs, where relevant. As such, we believe these existing requirements, together with our on-going monitoring and enforcement of standards, should be sufficient for the purpose of regulating IFAs. Having analysed the costs and benefits, we do not believe it would be beneficial to propose any additional regulations on IFAs at this stage.

## **PROPOSED TRANSITIONAL ARRANGEMENTS FOR SPONSORS**

81. To give the firms sufficient time to prepare for compliance with the proposed requirements, the Commission suggests that the Effective Date of the proposed requirements takes place on the expiry of a 12-month period from the release of the consultation conclusions.
82. Between now and the Effective Date, licensed corporate finance firms wishing to do or continue to do sponsor work will continue to be subject to the current regime, including the standards and requirements set out under the codes and guidelines issued by the Commission and the rules of HKEx.

83. The Commission proposes that a licensed corporate finance firm that can meet the new requirements on or before the Effective Date may conduct sponsor work after the Effective Date without having to make a fresh licensing application. Specific requirements that a firm is expected to meet on the Effective Date include the obligation to maintain sufficient resources and proper internal controls, as well as the appointment of at least two Principals.
84. In order to facilitate the administrative arrangements for transition, we propose that the licensed corporate finance firms wishing to do or continue to do sponsor work may take one of the two routes below to transit to the new regime:
- (1) A firm that has a track record in IPOs, i.e. it has advised on at least one completed IPO transaction during the 5-year period immediately prior to the Effective Date, only needs to file a confirmation with the Commission to the effect that it meets the additional requirements on the Effective Date. The confirmation should include the names of its Principals.
  - (2) A firm that has no track record in IPOs as explained above needs to file a confirmation to the Commission to the effect that it meets the new requirements on the Effective Date. Given that it is not in the business of acting as sponsors, it may not have the requisite resources, and systems and controls in place. The confirmation that it files with the Commission therefore needs to be supported by evidence demonstrating its compliance with all the new requirements, e.g. details of the Principals' experience.
85. As from the effective date, those firms holding a Type 6 corporate finance adviser licence that have not transited using either of the two routes will not be entitled to carry out sponsor work. They may, in the absence of other restrictive conditions, continue to do all other corporate finance work under their licence. Should they wish to apply for a licence to do sponsor work in the future, they may also do so as soon as they meet the new requirements.

## **REGULATORY SUPERVISION AND ENFORCEMENT**

86. The Commission believes there are distinct advantages in subjecting sponsors to a focused regulatory regime in which they are required to comply with specific admission criteria and on-going compliance requirements.

87. Under the licensing regime, sponsors are subject to on-going supervision by the Commission. The Commission also has the power to carry out enquiries and to investigate the activities of sponsors in respect of breaches of the relevant regulatory requirements. In addition, the Commission has the power to fine them and to revoke the licences of sponsors, depending on the severity and nature of the breaches.
88. As part of our on-going supervision, we inspect the operations of sponsors both on a routine and an ad-hoc basis. Inspections help identify problematic conduct issues. Where necessary, we can take appropriate measures, including imposing licensing conditions or restrictions on the business or operations of sponsors having regard to the nature of the regulatory issues concerned.
89. Once the specific admission criteria and on-going compliance requirements are in place, the Commission will have a set of clear and transparent benchmarks against which the assessment of sponsors can be made. Appropriate regulatory action can be taken and disciplinary sanctions can be imposed to deter breaches and failures, and to encourage compliance and better standards.
90. As failings of sponsors may result in listing applicants being inadequately prepared for listing, we take a serious stance towards such failings. In view of the grave consequences such conduct may bring to the market, the Commission will not hesitate to take any necessary action to enforce the required standards, including the possibility of imposing heavy fines and other sanctions.
91. The Commission will co-operate with the HKEx in carrying out enforcement actions against sponsors and will seek to avoid duplication of regulatory actions on the same entity. Together with HKEx, we will also coordinate our initiatives to help raise the awareness of maintaining high professional standards of sponsors in the market.

### **Proposals on eligibility criteria and on-going compliance requirements for sponsors and compliance advisers**

*This Annex sets out the Commission's proposals on the initial eligibility criteria and on-going compliance requirements for corporate finance advisers who wish to carry out the work of sponsors and/or compliance advisers.*

*Sponsors and compliance advisers are reminded to continue to comply with SFC's codes and guidelines that apply to licensed or registered persons generally, including the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission ("Code of Conduct"), the Management, Supervision and Internal Control Guidelines for Persons Licensed by or Registered with the Securities and Futures Commission ("Internal Control Guidelines") and the Corporate Finance Adviser Code of Conduct, and such other regulations, codes and guidelines applicable to them from time to time.*

#### ***Application of this Annex***

*This Annex is applicable where appropriate to the following persons who are licensed or registered as corporate finance advisers:*

- (a) an individual who applies for a licence or is licensed as a representative;*
- (b) a licensed representative who applies for approval or is approved as a responsible officer ("RO");*
- (c) a corporate which applies for licence or is licensed as a licensed corporation; and*
- (d) an authorized financial institution which applies for registration or is registered as a registered institution.*

*An individual whose name is to be or is entered in the register maintained by the Hong Kong Monetary Authority ("HKMA") under section 20 of the Banking Ordinance ("relevant individual") has to meet the same requirements as a representative. It is the responsibility of a registered institution to ensure that a relevant individual meets the same requirements as those applicable to a representative before submission of his name to the HKMA for the purpose of entering in the register.*

*An individual who applies to the HKMA for consent or who has been given consent to act as an executive officer of a registered institution under section 71C of the Banking Ordinance has to meet the same requirements as those applicable to a RO.*

*Throughout this Annex, unless otherwise stated, where reference to “RO” is made, the term covers executive officer of a registered institution, and the term “representative” covers relevant individual (other than an executive officer of a registered institution).*

## **I. SPONSORS**

### **1. Competence**

The SFO requires that all licensed or registered persons must be fit and proper. In assessing whether a person is fit and proper as a licensed or registered person or to be licensed or registered with the Commission, the person’s competence is one of the factors that should be taken into account. Specific competence requirements on sponsors and certain staff employed by them are set out below.

#### **1.1 Sufficient expertise and resources**

1.1.1 *The Code of Conduct provides that licensed or registered persons should have, and employ effectively, the resources and procedures that are needed for the proper performance of its business activities.<sup>1</sup> The Code of Conduct further provides that a licensed or registered person should ensure that its employees are fit and proper and otherwise qualified to act in the capacity so employed (including having relevant professional training or experience)<sup>2</sup>.*

1.1.2 In the context of the work of sponsors, a corporate finance firm that conducts sponsor work should have sufficient expertise and resources to carry out its work. A sponsor should not undertake sponsor work and other corporate finance advisory work beyond its capacity and expertise. The Management<sup>3</sup> should ensure that the firm has the relevant expertise and adequate resources to perform its role as a sponsor properly.

1.1.3 Whenever a firm takes up an appointment as a sponsor pursuant to the requirements under the Listing Rules<sup>4</sup>, the Management should appoint a team comprising of corporate finance staff (hereinafter “transaction team”). Members of the transaction team should be competent, and the team should have the manpower and resources to carry out the sponsor work to the standards expected of it under the relevant rules, regulations, codes and guidelines. A transaction team should have sufficient Hong

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<sup>1</sup> Code of Conduct General Principle 3.

<sup>2</sup> Paragraph 4.1 of Code of Conduct.

<sup>3</sup> Management includes the firm’s Board of Directors, managing director, Chief Executive Officer, RO or other senior management personnel.

<sup>4</sup> “Listing Rules” means the Listing Rules for the Main Board and GEM Board.

Kong regulatory knowledge of the relevant rules, regulations, codes and guidelines so that it can properly discharge its duty as a sponsor.

1.1.4 Members in one transaction team of a sponsor may work in other transaction teams of the same sponsor provided that

- (i) the Management and the Principals<sup>5</sup> of the respective transaction teams are satisfied on reasonable grounds that the sponsor can properly discharge its responsibilities in all the sponsor work that it undertakes;
- (ii) the Principals have the capability and competence to directly and properly supervise each team; and
- (iii) the sponsor complies with General Principle 6 and paragraph 10.1 of the Code of Conduct in respect of conflicts of interest.

1.1.5 The Management has the overall responsibility to ensure that there are sufficient staff to carry out the work throughout the period when the firm acts as a sponsor.

1.1.6 The level of sufficiency in relation to human resources and expertise should be commensurate with the volume, size, complexity and nature of the sponsor work that is undertaken by a sponsor.

## **1.2 Management's responsibility**

1.2.1 *The Code of Conduct provides that the senior management of a licensed or registered person should bear primary responsibility for ensuring the maintenance of appropriate standards of conduct and adherence to proper procedures by the firm<sup>6</sup>.*

1.2.2 *The Internal Control Guidelines<sup>7</sup> provide that the Management should ensure that there is an effective management and organisational structure, which ensures that the operations of the business are conducted in a sound, efficient and effective manner. The Management should assume full responsibility for the firm's operations including the development, implementation and on-going effectiveness of the firm's internal controls and the adherence thereto by its directors and employees. Reporting lines should be clearly identified, with supervisory and reporting responsibilities assigned to the appropriate staff members.*

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<sup>5</sup> See 1.3 of this Annex.

<sup>6</sup> General Principle 9.

<sup>7</sup> Part I.

1.2.3 *The Code of Conduct<sup>8</sup> further provides that a licensed or registered person should ensure that it has adequate resources to supervise diligently and does supervise diligently persons employed by it to conduct business on its behalf.*

1.2.4 In applying the above principles to a sponsor, the Management of a sponsor is ultimately responsible for the supervision of the sponsor work undertaken by the firm, as well as the compliance of all relevant rules, regulations, codes and guidelines. This responsibility cannot be delegated by the Management.

1.2.5 The Management should appoint a transaction team to carry out each sponsor engagement, taking into account the considerations for the appointment and composition of the team set out in 1.1.3 and 1.1.6. The transaction team should include at least one Principal who acts as the leader and supervisor of the team.

*Note: The Management should have regard to the staff's expertise, corporate finance experience, capacity and other factors that may affect the standard of sponsor work in deciding the composition of the team.*

1.2.6 *The Internal Control Guidelines<sup>9</sup> provide that the Management should establish and maintain effective record retention policies which ensure that all relevant legal and regulatory requirements are complied with, and which enable the firm, its auditors and other interested parties, e.g. HKEx and the Commission, to carry out routine and ad hoc comprehensive reviews or investigation.*

### **1.3 Principals**

1.3.1 In making the appointment, the Management endorses the Principals' competence to act as a Principal as described in 1.3 and 1.4 of this Annex. The Management's endorsement should be filed with the SFC when the application is made to appoint an individual as a Principal.

1.3.2 A Principal should be a RO of a sponsor who is directly involved in and supervises the sponsor work undertaken by the firm. The Management should ensure that there are sufficient Principals engaged in a full time capacity to discharge the sponsor work it undertakes, taking into account the factors set out in 1.1.6. A sponsor should have at least two Principals at all times.

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<sup>8</sup> Paragraph 4.2.

<sup>9</sup> Part IV.6.

- 1.3.3 While the Principal may allocate work among the members of a transaction team, the Principal’s responsibility as a supervisor cannot be delegated.

*Note: A Principal is expected to be the decision maker on all key issues relating to the work carried out by the transaction team. For example, in respect of conducting due diligence on a listing applicant, the Principal should decide the breadth and depth of the review and the amount of resources to be deployed for carrying out such work. The Principal is also expected to be fully conversant with the key issues in each sponsorship appointment and be able to respond and react promptly to requests of the Regulators<sup>10</sup> on such issues and to properly advise the clients.*

## **1.4 Eligibility Criteria for Principals**

- 1.4.1 In order to qualify as a Principal, an individual should

- (1) be a RO of the licensed corporation that his licence is accredited to;
- (2) have a minimum of 5 years of relevant corporate finance experience in respect of companies listed on the Main Board and/or GEM Board; and

*Note: “Corporate finance experience” includes providing advice on the following matters:*

- (i) *IPOs*
  - (ii) *notifiable transaction*
  - (iii) *a rights issue or open offer by a listed company*
  - (iv) *takeovers and share repurchase subject to the Codes on Takeovers and Mergers and Share Repurchases*
- (3) in the five years immediately preceding his appointment, have played a substantial role in advising a listing applicant as a sponsor in at least two completed IPOs on the Main Board and/or GEM Board.

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<sup>10</sup> “Regulators” means the SFC and/or HKEx.

*Note to 1.4.1:*

- (1) *The requirements set out 1.4.1 may be varied if a sponsor can demonstrate there are valid and justifiable grounds for such variation, which will not prejudice the overall protection of investors' interest. Factors that may be considered as to whether a sponsor should be granted a variation from strict compliance with these requirements include, without limitation, the nature and complexity of the transactions commonly undertaken by the sponsor and the expertise required (e.g. industry expertise), the nature and structure of the business of the group companies to which the sponsor belongs, the governance of the sponsor and/or its group companies by securities regulators in other leading and well regulated markets, the compliance record of the sponsor in Hong Kong and other jurisdictions. Variation may be given to a sponsor subject to imposition of conditions on, or provision of undertakings by, the sponsor and/or its group companies.*
- (2) *For the avoidance of doubt, the requirements set out at 1.4.1(2) and (3) apply to Principals as initial eligibility criteria only, and are not continuing requirements.*

## **1.5 Systems and Controls and Internal Assessment**

1.5.1 A sponsor should have effective systems and controls in place to ensure

- (1) adequate supervision and management of its employees who perform the services of a sponsor;
- (2) that employees do not act beyond their proper authority; and
- (3) its compliance with all laws, regulations, codes and guidelines, including the Listing Rules, that are applicable to the work of a sponsor.

*Note: Employees carrying out any sponsor work should be adequately supervised and managed, and the Management should ensure that it is kept abreast of any material development and key issues relating to its sponsor work.*

1.5.2 A sponsor should keep a complete and up-to-date list of all the sponsor work that has been and is being undertaken. The list should include the composition of the teams designated for the sponsor work (including

any variations thereto) from start to finish. Such information should be made available to the Commission upon request.

- 1.5.3 A sponsor should carry out an assessment annually in order to ensure that its obligation to have effective systems and controls under 1.5.1 is complied with. Any material non-compliance issue should be reported to the Commission promptly.
- 1.5.4 Records of the following appointments and assessments made by the Management should be properly kept to demonstrate its compliance with this Annex:
  - (1) The appointment of the transaction team for each sponsor engagement under 1.1.3 and 1.2.5;
  - (2) The appointment of a RO as a Principal under 1.3.1; and
  - (3) The annual assessment of the sponsor's internal systems and controls under 1.5.3.

## **2. Minimum capital requirements/[Professional indemnity]**

A sponsor should have

- (1) a minimum paid-up capital of \$10 million, and
- (2) [professional indemnity insurance – to consult market and public – see Consultation Paper.]

## **3. Continuing professional education**

- 3.1 *The Internal Control Guidelines<sup>11</sup> provides, inter alia, that training policies shall be established with adequate consideration given to training needs to ensure compliance with the firm's operational and internal control policies and procedures, and all applicable legal and regulatory requirements to which the firm and its employees are subject. Adequate training should be provided both initially and on an on-going basis.*
- 3.2 All ROs and licensed representatives who engage in the sponsor work of a firm are required to attend training on topics that are relevant to their sponsor work, e.g. skills that are relevant to their role as sponsors and knowledge of the relevant regulatory rules and their changes. Training on these topics should constitute at least 50% of the 5 CPT hours (or any

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<sup>11</sup> Part III.

other amount of CPT hours as required by the Commission from time to time) that the ROs and licensed representatives are required to undertake as holders of a corporate finance adviser licence (Type 6).

#### **4. Annual return**

A sponsor should confirm with the SFC that it has carried out its internal assessment of its system and controls according to 1.5.3 in its annual return filed with the SFC under section 138 of the SFO.

## **II. COMPLIANCE ADVISERS**

1. In order for a corporate finance adviser to act as a compliance adviser, it is a pre-requisite that it must first be qualified to act as a sponsor under this Annex. Its management should ensure that it is in compliance with the applicable regulatory requirements issued by the Regulators from time to time.
2. The Management of a compliance adviser should appoint staff that are qualified to advise listed corporations on the application of the Listing Rules and related matters. Where the transactions warrant due diligence to be conducted, the compliance adviser should ensure that this is carried out with due care and skill.