



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

Guideline to sponsors, underwriters and placing agents involved in the listing and placing of GEM stocks

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;
 - (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,

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**)

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).
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);

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

- (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).

Guidance to sponsors and placing agents

10. Sponsors and placing agents all play an important role in the listing and placing of GEM IPO stocks, and should act both in the best interests of their clients (including the new applicant) and to assure the overall integrity of the market. Accordingly, sponsors and placing agents are expected to use their best efforts to assist new applicants to comply with the relevant GEM Listing Rules (as supplemented by the Joint Statement) as well as the obligations stipulated in the prospectus⁷, where applicable.

⁷ 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.

Guidance to sponsors

11. In light of the Joint Statement⁸ and other applicable regulatory principles and requirements, a sponsor is expected to use all reasonable efforts to:
- (a) Advise the new applicant on the following:
 - (i) The relevant regulatory requirements, including the relevant GEM Listing Rules (as supplemented by the Joint Statement) and the potential consequences⁹ 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;
 - (iii) The target investor type and placee mix (for example, the new applicant may indicate its preference for a percentage of shares to be allocated to long term investors rather than short term investors or institutional investors rather than retail investors);
 - (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 taking into account their client base, competence, resources and track record, as well as their allocation strategy;
 - (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
 - (vi) The retention of proper documentation by the new applicant as required under the Joint Statement.¹⁰
 - (b) Retain proper documentation to demonstrate that the sponsor has used all reasonable efforts to discharge all of its obligations.

Guidance to placing agents

12. The following guidance is provided to assist placing agents¹¹ to comply with the relevant regulatory principles and requirements as well as to fulfil their responsibilities to the new applicant (where applicable) when placing securities with their 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

⁸ 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.

⁹ Please see paragraphs 21 and 22 of the Joint Statement.

¹⁰ Please see paragraph 18 of the Joint Statement.

¹¹ This includes sub-placing agents appointed by the issuer or the underwriter.

meets the relevant requirements under the GEM Listing Rules (as supplemented by the Joint Statement). In particular:

- (a) Placings should be conducted with sufficient senior management oversight.
- (b) Placing agents should put in place appropriate policies and procedures to avoid any undue concentration of shareholdings and to maximize the likelihood of an open, fair and orderly market in the securities at the time of listing, which should include a marketing programme directed to a wide range of clients. For example:
 - (i) placing agents should promptly notify¹² their clients¹³ that they have been appointed as a placing agent for a GEM IPO¹⁴ with a brief description of the new applicant and a cautionary statement¹⁵;
 - (ii) placing agents should allocate a reasonable number of account executives to each placing transaction and the placing opportunity should not be offered to certain clients to the exclusion of other clients;
 - (iii) placing agents should endeavour to respond to enquiries from prospective clients who are interested in participating in the placing and to open accounts for these investors in good time for the placing; and
 - (iv) placing agents should not afford clients any preferential treatment¹⁶ unless this has already been properly disclosed in the listing document.
- (c) KYC procedures must be conducted properly. Placing agents are required to take reasonable steps to establish the identity of the client and to confirm whether a client intending to subscribe is the beneficial owner of the client's account (i.e. not a nominee of some other person) and is independent of the new applicant, its controlling shareholders and directors. For the avoidance of doubt, placing agents should exercise caution when relying on the client's declaration of the client's independence and should make further enquiries (by way of, for example, internet search) in cases of doubt. Placing agents are generally expected to pay special attention to the following "red flags":
 - (i) Clients subscribing for the placing are procured or introduced by the new applicant, its controlling shareholders or directors;

¹² This statement should provide factual, fair and balanced information about the GEM IPO placing. It does not need to recommend the particular GEM IPO placing to the clients.

¹³ A placing agent is generally expected to notify all of its active clients of each placing opportunity. However, where a placing agent opts to notify only selected clients when also meeting its suitability obligations (for details, please refer to footnote 14), based, for example, on clients' risk appetites and past investment preferences, this will be acceptable provided that senior management is satisfied that a sufficient number of clients are offered the placing opportunity and the chances of undue concentration of shareholdings is reasonably low.

¹⁴ Placing agents 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 clients.

¹⁵ Please refer to the cautionary statement included in the Joint Statement as a reminder to the public about the higher investment risks and susceptibility to high market volatility of GEM stocks.

¹⁶ 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 after listing or any other arrangement entered into on non-arm's length commercial terms in consideration for the placees taking up the securities.

- (ii) Clients subscribing for the placing have known business, financial or other relationships (e.g. employees, suppliers or customers) with the new applicant or any of its controlling shareholders or directors;
 - (iii) Clients subscribing for the placing have familial relationships or share the same address with other placees; and
 - (iv) Accounts of clients subscribing for the placing are operated by the same person.
- (d) Sources of funding for the subscription of placing shares should be established before any acceptance of the client's subscription using a risk-based approach. Placing agents are expected to ensure that subscriptions are commensurate with the client's financial position.
- (e) Save for nominee companies¹⁷, subscriptions should be rejected where there is a suspicion that the client may be a nominee of some other person whose identity the placing agent is unable to ascertain or the acceptance of subscriptions will result in an inadequate spread of shareholders.
- (f) Proper records must be kept so that the placing agents can demonstrate compliance with this guideline throughout the entire placing process. Sufficient details should be available covering, among others, (i) all notifications to clients, (ii) all orders received, (iii) the rationale for allocation of the securities as well as the reasons for rejection of orders and (iv) the list of placees submitted to the Exchange.

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¹⁷ Rule 10.12(1) 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.