

SECURITIES & FUTURES COMMISSION

Corporate Finance Adviser

Code of Conduct

Consultation Conclusions

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Introduction

In May 2000, the Securities and Futures Commission (the “SFC”) issued a Consultation Paper on a proposed Corporate Finance Adviser Code of Conduct (the “Code”). The SFC invited the public to comment on the proposals, which were aimed at setting standards and guidelines for advisers who advise on corporate finance transactions in Hong Kong.

The consultation period, which was originally scheduled to end on 31 May 2000, was extended to 30 June 2000 in response to market requests. A total of 23 responses were received. Consistent with previous consultations of this nature, comments varied considerably in range and depth, with some respondents focusing on the broad principles behind the proposals and others on specific questions raised in the Consultation Paper.

To ensure that the proposed guidelines and conduct requirements laid down in the Code are not unduly burdensome and difficult to achieve, the SFC sent the draft consultation conclusions and an advanced draft of the Code to all respondents to the public consultation for their further comments on 16 February 2001. This consultation period ended on 15 March and eight responses were received.

This paper summarises the results of the consultations and describes how the public comments have been taken into account in the amendment and refinement of the Code. It should be read in conjunction with the Consultation Paper. The Code is also released today and will be effective on 1 December 2001.

The SFC wishes to thank the public for providing its views on the proposed provisions in the Consultation Paper.

Background to formulating the Code

“... market intermediaries should conduct themselves in a way that protects the interests of their clients and helps to preserve the integrity of the market.”

The above statement is an extract from a document titled “Objectives and Principles of Securities Regulation” released by the International Organization of Securities Commission in September 1998, which, in our view, is one of the fundamental principles guiding the conduct of market intermediaries. As professionals providing corporate finance advice to listed issuers and market participants, corporate finance advisers play a key role in contributing to the success of a securities market. The provision of quality advice and the fitness and properness of corporate finance advisers are of paramount importance to the market.

Under section 4(1) of the Securities and Futures Commission Ordinance, the SFC is charged with the responsibility of promoting and maintaining the integrity of registered persons in the securities and futures market. In discharging its responsibilities, the SFC has produced a number of codes and guidelines providing guidance to the market on the expectations of the SFC.

The SFC released policy statements on *Fit and Proper Criteria* and *Code of Conduct for persons registered with the SFC* (the “*Registered Persons Code*”) in 1990 and 1994 respectively. These statements were last updated in July and November 1999 respectively. The *Fit and Proper Criteria* set out the SFC’s general expectation of the fitness and properness of registrants. The *Registered Persons Code* introduces the general principles fundamental to the undertaking of a registered person’s business, and outlines how the SFC ensures that all registered persons are fit and proper. Since these codes are intended to apply to all registered entities, the guidelines are general and not industry specific.

In 1997, the SFC issued the *Management, Supervision and Internal Control Guidelines* that are applicable to all licensed intermediaries. Later that year, a *Fund Manager Code of Conduct* was released, marking the first time the SFC provided guidance to a specific industry on how the licensed entities should conduct themselves in meeting the licensing requirements.

In June 1999, the SFC issued a consultation paper on a review of the licensing regime and proposed a new “single licence” concept that allows existing registrants to provide a range of specified services. These regulated activities, as reflected in Securities and Futures Bill (the “Bill”) relate to, among others, “*dealing in securities*”, “*advising on securities*”, and “*advising on corporate finance*”. Comments received during the public consultation, which ended in September 1999, had been carefully considered. General acceptance for the proposed regime was obtained from the industry. On 2 April 2000, the Government and

the SFC jointly announced the consultation of the Bill in the form of a White Bill. The consultation closed on 30 June 2000 and comments from the public had been considered. On 29 November 2000, the Government introduced the Bill before the Legislative Council.

Following public consultation in September 2000, the SFC issued a revised *Registered Persons Code* in April 2001. In addition to new conduct rules, the revised *Registered Persons Code* embodies the provisions of the existing code and specific rules of The Stock Exchange of Hong Kong Limited (“SEHK”) and Hong Kong Futures Exchange Ltd (collectively, the “Exchanges”). The rationale for the revised *Registered Persons Code* is to facilitate market reforms and the rationalisation of market regulatory functions following the merger of the Exchanges. The provisions proposed in this Code harmonise with those contained in the revised *Registered Persons Code*. Like the *Fund Manager Code of Conduct*, this Code will be an industry-specific code which seeks to provide guidance on how corporate finance advisers should conduct themselves in meeting the licensing requirements.

Need to have the Code now

The number of licensed investment advisers and investment adviser representatives has burgeoned rapidly in the recent years. The total number of entities in the securities and commodities industry licensed by the SFC has increased over three-fold during the past 10 years, from 8,584 as at 31 March 1992 to 27,154 as at 31 March 2001. Of the total number of registrants as at 31 March 2001, 14,898 were licensed as securities dealers or representatives, and 6,316 were licensed as investment advisers or representatives. They represent 54.9% and 23.3% respectively of the total number of licensed entities.

The market has for some time called for guidelines and directions to help assist the planning and execution of transactions. There are concerns that as the number of market participants increases, their standards vary considerably across a spectrum of firms of diverse size and corporate culture. Given that the corporate finance industry in Hong Kong is still at a developing stage compared to some of the more advanced markets in the United States and Europe, it is the SFC’s observation that local investors are generally less demanding of the quality of advice given by the corporate finance advisers and disclosure of information by companies. One unfortunate consequence is that some corporate finance advisers may have the tendency not to perform beyond the minimum required.

The SFC considers it timely and appropriate to formulate a code of conduct specifically for practitioners engaging in advising on corporate finance in Hong Kong. The Code is aimed at providing guidance of the standard of conduct expected of corporate finance advisers.

The urgency for the Code became more apparent after the initial public offering of the shares of *tom.com limited* when it was generally felt that sponsors should assume greater responsibility in ensuring a fair and orderly market during such offers. There was also general expectation from the market that the SFC would tighten the rules governing the conduct of sponsors. In response to market needs and to support the continued

development of Hong Kong as a recognised international financial centre, the SFC believes it is vital to set proper standards amongst this group of market participants who are at the core of the securities market.

Basis for the Code

The guidance as set out in the Code was developed from practices adopted by local corporate finance advisers and the existing practices of the SFC and the SEHK, and is consistent with the internal compliance manuals of a number of major investment banks. The SFC also aims to ensure that the provisions of the Code conform with international standards and codes of practice, for example those observed by the Securities and Futures Authority (“SFA”) - the predecessor of the Financial Services Authority (“FSA”), the European Union and the Association for Investment Management and Research.

Prior to releasing the Consultation Paper, the SFC conducted a private consultation in February 2000 with a group of 17 corporate finance advisers who are considered to be active in the market and forming a representative sample of industry participants. Of these, seven responses were received. The proposed Code that was released for consultation was modified to take into account the various comments received.

The SFC is grateful for the 23 responses received during the public consultation. Further meetings and discussions held between the SFC and some of the respondents to the Consultation Paper have been helpful in the refinement of the provisions of the Code.

In February 2001, the SFC sent the draft consultation conclusions and an advanced draft of the Code to all respondents to the public consultation for their further comment. This was considered necessary to ensure that the proposed guidelines and conduct requirements laid down in the Code are not unduly burdensome and difficult to achieve. Of these, eight responses were received.

In finalising the Code, the SFC has been careful in weighing the benefits to investors and the market as a whole against the costs to the corporate finance advisers. In particular, the SFC seeks to ensure that the Code:

- promotes professional and ethical business conduct amongst corporate finance advisers in Hong Kong;
- sets out the recommended best practice and business conduct requirements, without stipulating unnecessarily stringent or unachievable standards;
- codifies current practices of corporate finance advisers, the Corporate Finance Division of the SFC and the Listing Division of the SEHK; therefore most of the advisers should be familiar with the provisions and requirements of the Code;

- accords with the relevant international practices and standards, in particular, the FSA in the UK and the European Union.

Applicability of the Code

The Code sets out the expected conduct requirements for advisers engaged in corporate finance advisory work in Hong Kong. Once adopted, it will be used as a benchmark, along with other SFC codes and guidelines, against which a licensed corporate finance adviser's fitness and properness will be measured. Therefore, in assessing its registration status, consideration will be given to how a corporate finance adviser has been discharging its responsibilities as provided for by the Code.

The Code aims to supplement related laws, legislation, codes, regulations or guidelines applicable to corporate finance advisers, and does not replace any existing codes, rules and regulations.

Date on which the Code will come into effect

The Code will become effective on 1 December 2001. Given that the corporate finance industry is typically fast moving and constantly evolving, it is the SFC's intention to review the provisions of the Code on a regular basis to ensure their applicability and appropriateness.

Summary of results of the consultation

Approximately 70 copies of the Consultation Paper were posted to a cross-section of the market participants engaging in the activity of advising on corporate finance in Hong Kong, including investment banks, accountants, lawyers and professional representative bodies. Several hundred further copies were collected in person from the SFC's offices. The Consultation Paper was also published on the SFC Web site. Most respondents addressed only specific provisions in the proposed Code where they wish to see further clarification or relaxation, sometimes with accompanying general comments.

Profile of respondents

The SFC received 23 responses to the Consultation Paper. Below is a profile of the respondents.

	<u><i>No of respondents in the category</i></u>
Investment banks (<i>Note</i>)	17
Lawyers	1
Other regulatory bodies	1
Professional representative bodies	2
Political parties	1
Individuals	1
Total	<hr/> 23 <hr/>

Note:

There was one submission by a firm of lawyers representing a group of 12 investment banks.

General comments

The market generally supported the Code and welcomed the SFC's initiative in providing guidance on the standard of conduct expected of corporate finance advisers in Hong Kong. There was general agreement that the Code is an important step towards promoting and maintaining fairness, integrity and ethical conduct in the market. This notwithstanding, respondents to the Consultation Paper have sought clarification on a number of the provisions contained in the Code. The comments dealing with general concepts and principles are summarised below.

(i) High Benchmark

Public comments: While respondents were generally supportive of the proposed guidelines to set a higher standard of conduct for corporate finance advisers, some expressed concern that the benchmark is too high and unachievable.

SFC's response: The SFC is mindful of its duties and functions to protect investors and ensure an orderly market by developing clear and fair rules for listed companies and promoting sound business practices. In light of this, the quality and standard of corporate finance advisers and their conduct are of paramount importance. The rapid development of the Hong Kong securities market has led to an increase in the number of corporate finance advisers with varied experience and expertise. The SFC believes that a code of conduct of this nature will help uphold and improve standards amongst advisers, which will in turn, benefit investors in the market. The SFC believes that the provisions of the Code are appropriate and are not unduly onerous, and can be achieved by corporate finance advisers consistently.

The SFC has ensured that the Code accords with relevant international standards, in particular, those in the United Kingdom and the European Union. Many of the important provisions in this Code are adopted from the practices of major investment banks that are active in corporate finance advisory work in Hong Kong. The SFC has always been conscious about whether the standard set in the Code would in fact be unachievable. In less important areas which do not directly relate to the interest of public investors, the standard in the Code is not as high as those set out in the compliance manuals of the major investment banks.

(ii) Onerous and Legal Implications

Public comments: Some respondents envisaged that under the Code, apart from their traditional advisory role, corporate finance advisers would be required to assume a supervisory and enforcement function with respect to their clients and others professionals. This could be onerous. They were also concerned that this would impose on them responsibility for the actions of others that could lead to serious risk of prosecution or civil actions from investors.

SFC's response: The intention of the Code is not to hold corporate finance advisers accountable for non-compliance or breaches by their clients or other professionals. Instead, it is aimed at promoting professional and ethical conduct between the advisers and their clients or other professionals and amongst themselves. The SFC believes that in helping Hong Kong maintain its place as one of the world's premier markets, advisers, principals, and professional firms alike have a vital role to play. Ultimately, if the principals do not comply with the rules and regulations, the entire system of regulation would be undermined. Corporate finance advisers, who have a close professional relationship with their clients and who are expected to be conversant in the rules and regulations, play a crucial role in bridging the gap between principals and the investing public and ensuring that regulatory standards are met.

In instances where corporate finance advisers are providing advice to the public at large or are involved in the preparation of a document that is to be disseminated to the public, they are expected to review and consider the bases and assumptions adopted by a listed company's directors and other professionals in arriving at their expert opinion before reliance can be placed on the opinion. However, in responding to market concerns, the SFC has exempted legal advisers, accountants and property valuers in respect of the valuation of real property from this requirement. Please see specific comments on paragraphs 5.6 and 5.7 of the Code below.

(iii) **Overlapping jurisdiction**

Public comments: Some respondents questioned the rationale behind producing a code where the provisions overlap with those contained in the other codes and guidelines issued by the SFC, e.g., the Code of Conduct for Registered Persons, the Fit and Proper Criteria, the Management, Supervision and Internal Control Guidelines and the Guidelines on Money Laundering. The Code also contains provisions that duplicate those in the Rules Governing the Listing of Securities on the SEHK (the "Listing Rules") and the Code on Takeovers and Mergers (the "Takeovers Code").

SFC's response: The Code was originally intended to be a self-contained guide for corporate finance advisers, addressing all aspects of corporate finance and other advisory transactions. This typically permeates different areas of investment banking, for instance, financial analysis and share dealings. Therefore overlap is inevitable and the fact that the provisions are included in other codes should not preclude the SFC from repeating them in this Code. This notwithstanding, the SFC has removed some of the duplication in certain areas, for instance, compliance with guidelines on money laundering (paragraph 2.9 of the draft Code in the Consultation Paper), confirmation of financial resources (paragraph 5.3) and opinion of the independent financial adviser (paragraphs 5.9 and 5.10).

In time, the SFC aims to alleviate the inconvenience faced by licensees of having to refer to a number of different codes and guidelines by consolidating all published codes and guidelines in a single regulatory handbook.

On the issue of overlapping jurisdiction in the course of instituting disciplinary proceedings, the SFC considers that breaches of different guidelines, codes or regulations will have different consequences. Due consideration to give effect to natural justice will be taken.

Comments on specific provisions of the Code

This section summarises public comments received in response to the specific provisions of the Code that are considered to be more salient. The numbering of the paragraphs follows that in the draft Code contained in the Consultation Paper.

Introduction (paragraph 1)

The Code seeks to govern the conduct of licensed or exempt persons who are engaged in “*advising on corporate finance*” in Hong Kong. For this purpose, the definition of “*advising on corporate finance*” emulates the definition in the latest draft of the Bill. If the Securities and Futures Ordinance is implemented in the future, this definition will be amended to follow the definition contained in the Ordinance.

The Code does not replace any existing codes, rules or regulations. The SFC will use the Code as a benchmark against which a licensed corporate finance adviser’s fitness and properness will be measured.

Paragraph 1.1 – Entities to which this Code applies

Public comments: Respondents generally welcomed a code of conduct for corporate finance advisers. They believed that the Code would help raise the standard of conduct and integrity amongst advisers in Hong Kong. Nevertheless, many respondents sought clarification on whether the Code is only intended to govern the conduct of registered persons engaged in advising corporate finance in Hong Kong and whether it would be applicable in the case where a corporate finance mandate involves a client based outside Hong Kong.

SFC’s response: Clarification has been inserted into the definition of “corporate finance advisers” in the Code to identify the persons to whom the Code applies. The Code would apply in situations where a corporate finance adviser located in Hong Kong advises a client based overseas.

Paragraph 1.2 – Corporate finance advice

Public comments: Specific comments on the definition of “advising on corporate finance” are as follows:

- (i) *paragraph 1.2(b)(iii), which refers to advice concerning acceptance of a general offer, should apply to advice given generally to shareholders. Otherwise, the definition may be too wide and may extend to a stockbroker giving advice to his individual client on whether to accept an offer.*

SFC’s response: The SFC agrees with this comment and the appropriate amendment has been made in the Code. A similar amendment has been made to the Bill.

- (ii) *paragraph 1.2(c) extends to any advice concerning the restructuring of a corporation or any of its assets or liabilities. Clarification is required on whether matters unrelated to the securities issued by a company, e.g. rescheduling of debt obligations, would be covered under this definition.*

SFC’s response: The SFC agrees with this comment and the appropriate clarification has been made in the Code. A similar amendment has been made to the Bill.

- (iii) *paragraph 1.2(c)(i) should be amended to exclude affiliates.*

SFC’s response: The SFC does not agree. Affiliates include non-wholly owned subsidiaries and where there are minority shareholders in a company, they should be afforded protection under the Code.

Conduct of Business (paragraph 2)

A corporate finance adviser should be fit and proper to conduct its business. Paragraph 2 prescribes guidelines and the standard of conduct expected of an adviser in the discharge of its obligation. It stresses the importance of maintaining an effective compliance function to monitor adherence with internal procedures and all applicable legal and regulatory requirements.

It is noteworthy that most major international investment banks have robust compliance functions monitored by a designated compliance officer, and detailed compliance manuals for internal use. The Code recommends that for the smaller adviser firms where manpower resources are limited, the compliance function could be directly undertaken by the Senior Management, which has been defined to include the managing director, the board of directors, or the chief executive officer of a corporation or other senior operating management personnel in a position of authority over the corporation’s business decisions.

Public comments: Some respondents felt that the provisions in paragraph 2 have been adequately covered by other SFC codes and guidelines, which also apply to corporate finance advisers, and need not therefore be repeated in the Code. As an alternative measure, it was proposed that paragraph 2 should be restricted to apply only to the corporation in the course of advising on corporate finance and not be extended to the representatives of the corporation.

SFC's response: The SFC accepts that generally, it may not be appropriate to hold the registered representatives of a corporate finance adviser responsible for how its business is being conducted. Nonetheless, the SFC remains of the view that the persons who are ultimately responsible for ensuring the integrity of the compliance function, or have any influence over the way the corporation is operated, would be the Senior Management itself. Accordingly, the SFC has inserted a note in the preface to paragraph 2 to clarify that the provisions contained therein apply to all corporate finance advisers other than individuals and that the Senior Management should be responsible for ensuring compliance with those provisions.

Paragraph 2.4 – Books and records

Public comments: Some respondents commented that as corporate finance transactions move or change at a rapid pace, the advice may often be provided to clients verbally and not in writing. Accordingly, there is concern that it may be difficult to provide an audit trail of work done and that such a requirement might impede the provision of advice.

SFC's response: The SFC finds this remark cause for concern. This means that in the event of a breach of duty on the part of the corporate finance adviser, it would not be possible to trace the file records to accurately ascertain the actual situation. This is unacceptable. The SFC would like to stress the importance of allocating adequate resources to ensure that the functions of a firm can be performed properly.

Paragraph 2.6 - Compliance

Public comments: Respondents generally agreed that it is important to have a robust compliance function. However, some comments were raised on the practical application of the provisions in paragraph 2.6:

- (i) *Where corporate finance advisory activities are carried out as part of a wider business, the firm need not have a separate compliance personnel or a Designated Compliance Officer, to be dedicated exclusively to corporate finance;*

SFC's response: The SFC agrees that the sophistication of the compliance function should depend on the size and complexity of the firm. Therefore, the SFC will not insist that the compliance function be headed by a Designated Compliance Officer provided there are proper arrangements in place to monitor compliance with the

firm's internal policies and procedures. In most cases, it would be acceptable for the compliance function to be managed by Senior Management as defined in the definition section of the Code.

- (ii) *Some of the respondents considered that the requirement of an annual confirmation of compliance with the corporation's policies and procedures in writing is bureaucratic and time consuming;*

SFC's response: The SFC agrees to delete this requirement from the Code.

- (iii) *One of the respondents emphasised the importance of the compliance function in providing employees with a valuable reference tool and in identifying both acceptable and unacceptable behaviour. The respondent in question encouraged the SFC to further develop the concept of compliance.*

SFC's response: While the SFC agrees that the proposals by this respondent will further enhance the compliance function, the SFC believes it is necessary to strike a balance between setting a high standard for market practitioners and ensuring that the requirements are not too rigid. The SFC trusts that the proposed provisions of this paragraph are a step towards achieving the intentions of this respondent.

Competence (paragraph 3)

A corporate finance adviser should act with competence in the performance of its duties. He should be honest, of good repute and character, and maintain a high standard of integrity and fair dealing in the conduct of his business.

The Code states that in addition to being suitably licensed for the various types of businesses, the Regulators may require licensed persons, who are new to the market, to demonstrate their resources, competence and suitability before they undertake an assignment. This would entail submitting, to the Regulators¹, a list of the directors' or representatives' qualifications, together with details of their relevant corporate finance experience. This procedure is a codification of the existing practices of the Regulators.

It is envisaged that the relevant corporate finance experience is not only limited to experience gained in the local market. In the administration of this requirement, the SFC would consider favourably experience from overseas market where the standard of regulation commensurates with that in Hong Kong.

¹ "Regulators" are defined to include the SFC and/or the SEHK as appropriate.

Paragraph 3.2 – Demonstration of competence

Public comments: Respondents queried whether, in assessing the standard of competence, credit will be given to corporate finance experience gained from overseas markets, and not only specific experience of transactions governed by the Takeovers Code.

SFC's response: It is stated in the Consultation Paper that relevant corporate finance experience is not only limited to experience gained in the Hong Kong market. The SFC would consider favourably experience from overseas markets where the specific rules that apply to the relevant corporate finance transactions and the standard of regulation commensurates with those in Hong Kong.

Conflicts of interest (paragraph 4)

Paragraph 4 states that a corporate finance adviser should avoid engaging in work that may give rise to conflicts of interest and should also take all reasonable steps to avoid such situations. An adviser should not unfairly place its interests above those of its clients. Where a conflict of interest cannot be removed, it should decline to act.

Specifically, where the matter concerned relates to the issue of independence of a financial adviser in a transaction involving the Listing Rules, the Takeovers Code or the Code on Share Repurchases, such matter should be dealt with in accordance with the respective codes or regulations. The Code does not attempt to lay down any guidance under such circumstances as they fall under the respective jurisdictions of the Listing Committee of the SEHK and the Takeovers and Mergers Panel, as appropriate.

Chinese walls, which serve as an effective functional barrier preventing the flow of information, should be set up between the corporate finance adviser and other group companies or divisions engaging in other financial activities. There should also be segregation of key duties and functions between staff members of the corporate finance adviser.

Paragraph 4.2 – Conflicts of interest

Public comments: Some respondents sought clarification of the term “opinion-shopping”.

SFC's response: This provision aims to address situations where a client shops around for an opinion from an independent financial adviser that accords with its own. If an independent financial adviser is appointed on this basis, it may be difficult for the independent financial adviser to convince independent shareholders that its impartiality has not been impaired. However, the SFC considers that is unnecessary to specifically address the issue of opinion-shopping in the Code and has therefore deleted references to it in the Code.

Paragraph 4.3 – Maintaining independence

Public comments: Most respondents agree that independence is an important attribute for an independent financial adviser. However, several of the respondents were concerned that there appears to be inconsistency in the period over which the Regulators would normally consider in establishing an adviser's independence. While the SFC normally considers relationships over a two-year period, this exceeds the SEHK's current practice of looking at the six-month period following the sponsorship of an initial public offer and one year in other situations. Given that the requirement for an independent financial adviser arises in a number of different contexts already governed by the Takeovers Code and the Listing Rules, they suggested that the issue should not be addressed in the Code.

SFC's response: The SFC agrees that there may be a disparity in the period of time considered by the Corporate Finance Division of the SFC and the Listing Division of the SEHK when assessing the independence of an adviser, which stems from the practices of the individual Regulators. To eradicate any confusion that the market may face in complying with this provision and in view of the fact that the issue relating to the independence of independent financial advisers is more suitably addressed in the relevant Takeovers Code or Listing Rules, paragraph 4.3 has been deleted.

Paragraph 4.4 – Chinese walls

Public comments: One of the respondents expressed concern that there appears to be inconsistency in the way the SFC regards Chinese walls. On one hand the Code prescribes that Chinese walls are effective means for a multifunctional group to segregate different business areas, however, in practice, the Executive² nowadays does not recognise the effectiveness of Chinese walls between business divisions in takeover transactions.

SFC's response: The SFC generally thinks that Chinese walls provide an important and effective means for the segregation of operations in a multifunctional group. It is only in respect of certain circumstances during an offer period under the Takeovers Code where the SFC, in following the practice in London, does not recognise Chinese walls, e.g. with respect to disclosure of share dealings and distribution of research materials.

Public comments: One of the respondents maintained that in smaller houses, where the various operations are typically headed by one person, i.e., the managing director, he should be able to override the Chinese walls to enable him to manage the various activities effectively.

SFC's response: The SFC does not agree. In this example, if the managing director is privy to confidential information, he should abstain from being actively involved in the day-to-day operations of the areas where conflicts of interest may conceivably arise.

² Executive has the meaning ascribed to it in the Takeovers Code, that is the Executive Director of the Corporate Finance Division of the SFC or any delegate of the Executive Director.

Paragraph 4.7 – Contingency fees

Public comments: Respondents had diverging views on the need and propriety of disclosing contingency fees. Supporters of this provision went further to suggest that corporate finance advisers should disclose such arrangements voluntarily. Those who disagreed thought that remuneration is a matter of commercial negotiation between the adviser and its client.

SFC's response: The need to disclose contingency fees is only likely to arise when there is a perceived conflict of interest. In such cases, in addition to a host of other corroborative factors, the Regulators may take into account the contingency fee negotiated between the two parties in determining whether there is a conflict of interest concern. Otherwise, disclosure would not normally be required. Notwithstanding proposals by some respondents to tighten this provision, the SFC will also not insist that such disclosures should be made customarily.

Paragraph 4.8 – No secret profit rule

Public comments: One of the respondents queried whether a case where an adviser legitimately holds a position in the shares of its client that may result in a profit would be regarded as making a secret profit. The requirement to disclose such profits to the public or to the client on a private basis is considered burdensome.

SFC's response: The SFC considers that it is difficult to set out the various circumstances that would be regarded as acts that would lead to the making of secret profit. The example given by the respondent in question is common in many multifunctional financial groups. We consider that if other parts of a multifunctional financial group hold a position in the shares of a client company that is affected by a corporate finance transaction, it should be disclosed to the client, especially if those shares are subject to a takeover offer by its client. Nevertheless, given that issues relating to secret profits are governed by the general law, the SFC has decided to delete this paragraph 4.8.

Standard of work (paragraph 5)

A corporate finance adviser should aim to deliver a high standard of work at all times. The Code expects that a corporate finance adviser should act with integrity, due skill, care and diligence in the execution of its duties and responsibilities.

In particular, clarification is given on the role and the conduct expected of sponsors in an initial public offering. The Code also recognises that a corporate finance adviser may, from time to time, rely on the work of independent experts or professionals before arriving at its opinion. The Code emphasises that an adviser should only rely on an expert's opinion after due and careful consideration.

Paragraph 5.2 – Engagement letter

Public comments: Some respondents expressed practical difficulties in ensuring that engagement letters are signed at the beginning of corporate finance transactions.

SFC's response: The SFC considers that it is good practice to have terms of engagement drawn up and agreed upon at the start of a transaction to minimise any disagreements at a later stage and should be encouraged. This requirement is also consistent with the practice of the major investment banks in Hong Kong. The SFC does not intend to make this a mandatory requirement but merely to promote it as good practice. Therefore this requirement has been relaxed in the Code.

Paragraph 5.3 – Confirmation of financial resources

Public comments: Some respondents commented that this requirement is already stated in the Takeovers Code and should not be repeated in the Code.

SFC's response: The SFC agrees to delete this requirement from the Code and the SFC will seek to clarify this issue in the revision of the Takeovers Code.

Paragraphs 5.4 and 5.5 – Role of sponsors in a public offer

Public comments: Some respondents commented that the provisions in paragraphs 5.4 and 5.5 duplicate the rules in the proposed Chapter 3A of the Listing Rules.

SFC's response: Following the recent case of *tom.com*, the SFC has expressly stated that the Code will contain certain provisions relating to the responsibility of sponsors in public offers. There was also a general expectation from the market that the SFC will regulate the conduct of sponsors during public offers. For this reason, these provisions relating to sponsors are repeated in the Code.

Public comments: One of the respondents commented that, in an initial public offer, if a receiving bank considers there is impropriety on the part of the sponsor in the share offering arrangement and instructions, it should bring these matters to the attention of the sponsor and the SFC.

SFC's response: Receiving banks report directly to the Hong Kong Monetary Authority and guidelines on the role of the receiving banks in new share issues were issued in May 2000.

Paragraphs 5.6 and 5.7 – Reliance on work by experts or other professionals

Public comments: Many respondents thought it was inappropriate for the corporate finance adviser to assess the credibility and integrity of the firm of experts or professionals.

SFC's response: The SFC believes that corporate finance advisers, particularly those acting as independent financial advisers, should not “hide” behind other experts in a transaction since they are the ones providing the overall advice to the independent board committee. Advisers are expected to be diligent in querying and assessing the opinions and valuations provided by experts before reliance could be placed on them. This is especially pertinent in cases involving valuation of internet or high technology ventures which constantly tests the limits of acceptable methodology. However, the SFC accepts that it may not be suitable for the adviser to judge the credibility and integrity of an expert and therefore agrees to amend this requirement. Nonetheless, corporate finance advisers would still be expected to assess whether the firm of experts or other professionals have *the relevant experience and expertise* to carry out the task that it is employed to do.

As some respondents have raised the issue, it should be clarified here that the requirement for corporate finance advisers to review and discuss with its clients and other experts the qualification, bases and assumptions adopted should apply, not only when the adviser intends to rely on the opinion of another expert in rendering its advice to its client, but also whenever an opinion is rendered in connection with the relevant transaction (and whether or not the opinion is published). Clarification has been made to paragraph 5.5 of the final version of the Code.

Given that real property valuations are routine expert opinions that appear in most documents disseminated to shareholders in Hong Kong, the SFC has exempted property valuers (in respect of real property valuations) from the requirement of having their work scrutinised by a corporate finance adviser before reliance could be placed on their opinions. The opinions given by legal advisers in respect of legal advice rendered and by accountants in respect of the audit of results and accountants' reports derived therefrom would also be exempted from such a requirement.

Public comments: Some of the respondents felt that since experts are normally the authority in their respective fields, corporate finance advisers should be able to rely on their expert opinions without having to conduct further enquiries.

SFC's response: The SFC reiterates the view that corporate finance advisers should not simply accept the opinions or valuations of experts at face value. They are expected to bridge the gap between the experts or other professionals and the investing public. In doing so, if the opinions and valuations are to form the basis of their advice, the advisers would be required to review and be satisfied with the underlying bases and assumptions adopted by the experts were made with due care and objectivity. In any event, this will certainly form the basis upon which the advisers would “report on” the valuations. Without

distorting the essence of this requirement, the SFC has incorporated the provisions of this paragraph into paragraph 5.5 of the final Code.

Paragraph 5.8 – Reliance on information from clients

Public comments: Some respondents commented that the directors of a company are generally responsible for any misleading information. Further, they felt that any provision of false or misleading information would be governed by the Provision of False Information Ordinance.

SFC's response: The SFC considers that while the ultimate responsibility for the contents of documents rests with the directors of a company, corporate finance advisers, who are normally considered to be familiar with regulatory disclosures and are involved in the preparation of documents, play an important role in ensuring the truth, accuracy and completeness of information contained therein. Moreover, the directors would expect to be able to rely on the advisers for their professional advice. This notwithstanding, further elaboration has been added to the paragraph to clarify that the requirement only applies when the information and representations are provided for inclusion in a public document or submission to Regulators and in such cases, the corporate finance adviser is expected to *advise its client* to ensure that the required standard is achieved. To reinforce the message that corporate finance advisers are not held accountable for the action of its clients but that they have a duty to ensure the completeness and accuracy of published information, the SFC has inserted a clarification in paragraph 5.8 of the final Code, which deals with standard of documents, that the corporate finance adviser should *assist its client* to achieve this standard.

Although Regulators may rely on the Provision of False Information Ordinance to require accurate information, the SFC considers that given the time constraint in corporate finance transactions, it may not be efficient to rely on the Ordinance (as there are pre-conditions to be satisfied before a Regulator can rely on the Ordinance). The SFC believes that the Code could be applied more flexibly and expeditiously to obtain accurate and complete information from advisers and their clients.

Paragraph 5.9 – Opinion of an independent financial adviser

Public comments: Some respondents remarked that these provisions are too detailed and are not in line with international practice. Moreover, they commented that advisers are restricted in what they could discuss in a document given the limitation on analysis that may have profit forecast implications under the Takeovers Code.

SFC's response: The SFC considers that the work of an independent financial adviser is more appropriately addressed in the Takeovers Code or Listing Rules and therefore, paragraph 5.9 has been deleted.

Duties to the client (paragraph 6)

A corporate finance adviser should act in the best interests of its client at all times. In discharging this obligation, it is imperative that a corporate finance adviser should have a thorough understanding of its client's business. A corporate finance adviser should also safeguard the confidentiality of information provided to it by its client, and as far as possible, ensure that all other persons who receive the confidential information from the corporate finance adviser take the greatest care to prevent a leakage of the information to the market.

Paragraph 6.1 – Know your client

Public comments: Many respondents were silent on this requirement. However, one of the respondents suggested that in discharging its duty to protect the fairness of the markets, corporate finance advisers, when become aware of illegal activities by their clients, should advise their clients to cease such activities and to seek legal counsel to determine their responsibility to disclose such violations to the relevant regulatory body.

SFC's response: The requirement for corporate finance advisers to help their clients understand the relevant regulatory requirements is stated in paragraph 6.3. It also provides guidance on what the adviser should do when it becomes aware of non-compliance of the rules by its client.

Paragraph 6.3 – Client's behaviour

Public comments: Respondents generally resisted the concept that corporate finance advisers should be assigned the task of ensuring the good conduct of their clients.

SFC's response: As discussed under paragraph 5.8 above, the SFC does not envisage the situation where corporate finance advisers would be held accountable for the conduct of their clients. Rather, they are expected to perform an advisory role in helping their clients attain the required standard.

Duties to the market (paragraph 7)

The Code expects a corporate finance adviser to observe proper standards of market conduct and take every precaution to avoid misleading public shareholders, and the creation or continuance of a false market in securities.

Paragraph 7.1 – Duties to the market

Public comments: Respondents generally accepted that they should act in the interests of the integrity of the market. One of the respondents said that it should be made clear that the duty of care only arises when the adviser is advising a client on a transaction.

SFC's response: These requirements are a codification of current practices and are adopted from the SFA rules. Therefore they do not impose any new responsibilities on the advisers. Nonetheless, the SFC agrees to delete paragraph 7 and in accordance with the SFA rules, include a requirement for corporate finance advisers to *observe proper standards of market conduct* in paragraph 5.1.

Communication with Regulators (paragraph 8)

The Code encourages corporate finance advisers to develop a good working relationship with the Regulators; they should always be open and cooperative in dealing with the Regulators. The SFC believes that effective communication between the Regulators and the corporate finance adviser is important to facilitate frank and open exchanges of views.

Paragraph 8.2 – Co-operation with the Regulators

Public comments: Some respondents commented that from time to time, a corporate finance adviser may encounter difficulty in deciding between co-operating fully with the Regulators and acting in the best interest of its client. They considered that it should not be a regulatory breach to argue the client's case forcibly, as long as this does not involve misrepresentations to the Regulators or if the matter does not yet need to be disclosed or announced.

SFC's response: There is a similar requirement in the SFA rules. Corporate finance advisers are expected to provide Regulators with all relevant and significant information promptly to enable them to carry out their functions effectively. At times, an adviser may consider that a transaction has not reached the stage whereby it needs to be disclosed or announced, but because of a number of factors, including signs of leakage of information relating to that transaction to the market, the Regulators may make further enquiries to determine whether the transaction should in fact be announced. In such cases, it would be undesirable if the relevant information is withheld from the Regulators. For this reason, the SFC proposes to retain the essence of this requirement but will amend the wording to adopt the language used in the SFA rules, that is to require advisers to tell the Regulators promptly anything relating to the firm of which the Regulators would reasonably expect prompt notice.

Paragraph 8.6 - Documents

Public comments: Respondents generally did not support the inclusion of this requirement in a general code of conduct.

SFC's response: The SFC would like to encourage corporate finance advisers to strive for quality and completeness of disclosures in the drafting of documents that are to be released to shareholders. That is, without doubt, the intention of paragraph 8.6. This notwithstanding, the SFC agrees that this requirement need not be expressly stated in a general code of conduct and proposes to delete this paragraph.

Personal account dealings (paragraph 9)

A corporate finance adviser should ensure that all personal account dealings are properly conducted and monitored. The Code emphasises that a corporate finance adviser should avoid conflicts of interest when dealing in securities on its own account while discharging its duties as adviser to its client.

Paragraph 9.1 – Personal account dealings

Public comments: Many respondents were in favour of the broad guidelines on personal account dealings. However, several of the respondents raised the following specific comments on the provisions of paragraph 9.2:

- (i) *The provisions are too detailed and prescriptive.*

SFC's response: This paragraph aims to set out guidance of good practice in respect of personal account dealings and has been amended to adopt the wording in the revised *Registered Persons Code* that was issued in April 2001. It is the SFC's observation that most of the larger and well-run investment banks have similar, if not, more detailed policies and procedures on personal account dealings. Therefore, these firms are not expected to have any difficulty meeting the requirements of this paragraph and it is not envisaged that this paragraph would impose upon them, new or onerous requirements. For the smaller firms who do not already have similar procedures in place, these provisions may be used as a basis for adopting their own set of procedures on personal account dealings.

- (ii) *Government securities, derivatives on broad based market indices and mutual funds should not require pre-approval as these securities and investment products afford no opportunity for employees to use inside information gained as a result of corporate finance work undertaken by them.*

SFC's response: These financial products are excluded from the Code.

- (iii) *Corporate finance advisers in global investment banks should be permitted to adhere to a set of globally uniform policy on personal account trading.*

SFC's response: The SFC agrees that a set of globally uniform policy on personal account trading that is consistent with the provisions of this paragraph would be acceptable.

- (iv) *It is unfair and impractical to require prior approval for personal account dealings in companies in which the corporate finance adviser has no involvement.*

SFC's response: Given that the requirement to obtain prior approval for personal account dealings is not included in the revised *Registered Persons Code*, this requirement has been deleted from the Code.

Paragraph 9.2 – Prohibition of dealings

Public comments: *Some respondents queried whether, in large financial institutions, the dealing ban envisaged by a watchlist could be applied practically to ensure the propriety of personal account dealings. They expressed concern that an across-the-board dealing ban for staff on unannounced transactions could in fact give notice to any person seeking an approval to deal that something was being contemplated and increase the risk that an unannounced transaction would become the subject of speculation.*

SFC's response: It is worth reiterating that the watchlist is confidential and should be safeguarded by the Designated Compliance Officer. Due to its confidentiality, the SFC envisages that the Designated Compliance Officer would have to exercise a fair amount of tact and astuteness in carrying out this function. The Code aims to set out good practice and this provision is consistent with the current practice adopted by the major investment banks. However, the SFC considers that the guidance on how the watchlist and restricted lists should be maintained need not be expressly stated in a general code of conduct and proposes to delete reference to this from the Code.