



Hong Kong

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SFC RELEASES CONSULTATION CONCLUSIONS ON THE PROPOSED CODE OF CONDUCT ON HONG KONG BOOKBUILDING AND PLACING ACTIVITIES AND HKEX SPONSOR COUPLING

On 29 October 2021, Hong Kong's Securities and Futures Commission (the "SFC") released its consultation conclusions¹ (the "Consultation Conclusions") on (i) the conduct requirements for Hong Kong bookbuilding and placing activities in equity capital market and debt capital market transactions; and (ii) the HKEx "sponsor coupling" rules to require at least one overall coordinator to also act as a sponsor (together, the "Bookbuilding Conduct Requirements").

The Consultation Conclusions follow the SFC's February 2021 consultation paper² (the "Consultation Paper") in which the SFC proposed requirements designed to clarify the roles played by intermediaries in equity capital market and debt capital market transactions and set out the standards of conduct expected of them in Hong Kong bookbuilding, pricing, allocation and placing activities.

For an overview of the SFC's Consultation Paper on the proposed Code of Conduct on Hong Kong bookbuilding and placing activities and the "sponsor coupling" proposal, please see Charltons' February 2021 newsletter.³

During the consultation period, the SFC received 41 written submissions from various industry associations, intermediaries,

professional bodies and individuals, in which the respondents were generally supportive of the proposals.

The new Bookbuilding Conduct Requirements together with key discussions of the consultation will be examined in detail in this newsletter.

The key features of the new Bookbuilding Conduct Requirements are summarised below:

- introduction of a new paragraph 21 in the Code of Conduct for Persons Licensed by or Registered with the SFC (the "SFC Code of Conduct"), which will set out the obligations and expected standards of conduct for intermediaries involved in bookbuilding and placing activities. These intermediaries will be defined as "capital market intermediaries" ("CMIs");
- the obligations and expected standards of conduct for CMIs will cover, among others, (i) ensuring transparency in the bookbuilding process and implementing an allocation policy to ensure a fair allocation of securities to investor clients; (ii) prohibition on offering rebates to investor clients or enabling any investor clients to pay at a price lower than that disclosed in the listing documents; and (iii) maintaining policies and procedures to identify, manage and disclose conflicts of interest and giving priority to satisfying investor clients' orders over the CMI's own proprietary orders;
- prior to conducting any bookbuilding or placing activities, intermediaries will be required to be formally appointed under

1 <https://apps.sfc.hk/edistributionWeb/api/consultation/conclusion?lang=EN&refNo=21CP1>

2 <https://apps.sfc.hk/edistributionWeb/api/consultation/openFile?lang=EN&refNo=21CP1>

3 <https://www.charltonslaw.com/sfc-consults-on-proposed-code-of-conduct-on-hong-kong-bookbuilding-and-placing-activities-and-proposal-on-hkex-sponsor-coupling/>

- written agreements setting out their roles, responsibilities, fee arrangements and fee payment schedules;
- introduction of a “sponsor coupling” requirement for Main Board IPOs, so that at least one overall coordinator (“OC”) must also be appointed as a sponsor (or be a member of the sponsor’s group of companies) and this sponsor must be independent of the issuer. OCs are the heads of syndicates and are a type of CMI. They must also provide advice to the issuer client on marketing strategy, pricing and allocation, and ensure transparency in the price discovery process; and
- introduction of requirements for fee arrangements to be determined at an early stage and OCs to be appointed at an early stage.

The SFC will also update its guideline to sponsors, underwriters and placing agents involved in the listing and placing of GEM stocks, which was issued in January 2017. The revised guidelines, “Guidelines to capital market intermediaries involved in placing activities for GEM stocks”, will provide general guidance for OCs and guidance for CMIs when placing shares to their investor clients.

The new Bookbuilding Conduct Requirements will come into effect on 5 August 2022.

1. SFC Bookbuilding Conduct Requirements for Hong Kong Bookbuilding and Placing Activities in Equity Capital Market and Debt Capital Market Transactions

The new Bookbuilding Conduct Requirements were developed to address problems identified by the SFC in intermediary behaviours observed in the market and to codify good industry practices by setting out expected standards of conduct and systems and controls for intermediaries in the following areas:

- assessment of the issuer and the offering;
- appointment of CMIs and OCs;
- advice to the issuer;
- marketing;
- rebates and preferential treatment;

- assessment of investors;
- bookbuilding, pricing and allocation;
- conflicts of interest; and
- disclosures to the issuer, other CMIs and investors.

Scope of coverage (new paragraph 21.1.1 of the SFC Code of Conduct)

The new Bookbuilding Conduct Requirements will regulate the conduct of intermediaries that engage in providing services to issuers and/or investors and involve the following capital market activities conducted in Hong Kong:

- a) bookbuilding activities – collating investors’ orders (including indications of interest) in an offering in order to facilitate (i) the price determination and the allocation of shares or debt securities to investors; or (ii) the process of assessing demand and making allocations;
- b) placing activities – marketing or distributing shares or debt securities to investors pursuant to bookbuilding activities; and
- c) advising, guiding and assisting the issuer client in Hong Kong bookbuilding and placing activities.

Hong Kong intermediaries engaged in any of the above capital market activities will be referred to as “capital market intermediaries”. CMIs will not include financial advisers or other professionals who only provide advice to the issuer but do not participate in any bookbuilding or placing activities.

A non-syndicate CMI which is not appointed by a syndicate CMI (and therefore does not receive remuneration, directly or indirectly, from the issuer client) and is only responsible for relaying investor clients’ orders to the CMI for placing into the order book will not be subject to the full set of obligations applicable to CMIs under new Paragraph 21. In particular, such execution-only non-syndicate CMIs will only be required to comply with the following obligations: (a) new Paragraph 21.3.3 of the SFC Code of Conduct (i.e. assessment of investor clients); (b) new Paragraph 21.3.5 (i.e. transparency of the order book); and (c) new Paragraph 21.3.7 (i.e. disclosure of any rebates offered to CMIs and any other preferential treatments of CMIs/targeted investors and prohibition on offering rebates to investor clients). These obligations are discussed further below.

Key discussions during the consultation

The proposed definition of “placing activities” in the Consultation Paper did not include “marketing”. Many consultation respondents sought to clarify whether placing activities includes settlement and market sounding. The SFC decided to include “marketing” into the final definition as it would prevent firms without mandates from “swarming” the order book at the last minute with orders of unknown quality.

The SFC also agreed with various respondents that execution-only non-syndicate CMI’s often play a passive role in the placing process and thus many of the new requirements should not apply to them. Therefore, the SFC has included in a note to new paragraph 21 of the SFC Code of Conduct (note 7) that execution-only non-syndicate CMI’s, for the purposes of paragraph 21, are only required to comply with specified provisions.

Types of offerings (new paragraph 21.1.2 of the SFC Code of Conduct)

The new Bookbuilding Conduct Requirements will only cover the following types of share and debt offerings that involve Hong Kong bookbuilding activities:

a) **Equity Capital Market (“ECM”) – share offerings**

An offering of shares listed or to be listed on The Stock Exchange of Hong Kong Limited (“HKEx”).

Offerings of shares that are already listed on the HKEx will cover the placing of listed shares to third-party investors by an existing shareholder if it is accompanied by a top-up subscription by the existing shareholder for new shares in the issuer.

In respect of shares to be listed on the HKEx, this includes (i) initial public offerings (“IPOs”), which include share offerings in connection with a secondary listing and offer of existing shares by way of IPO; (ii) offerings of a class new to listing; and (iii) offerings of new shares of a class already listed under a general or special mandate.

All references to “shares” in new paragraph 21 of the SFC Code of Conduct also include depositary receipts and units of interests in SFC-authorized real estate investment trusts (“REITs”) listed or to be listed in Hong Kong.

b) **Debt Capital Market (“DCM”) – debt offerings**

An offering of debt securities listed or unlisted, and offered in Hong Kong or otherwise.

The SFC states in its Consultation Conclusions that offerings which do not involve bookbuilding activities are not within the scope of the new Bookbuilding Conduct Requirements and are thus not covered. Examples of such offerings are:

- a) bilateral agreements or arrangements between the issuer and the investors (sometimes referred to as “club deals”);
- b) transactions where only one or several investors are involved and the terms of the offering are negotiated and agreed directly between the issuer and the investors (sometimes referred to as “private placements”); and
- c) transactions where shares or debt securities are allocated to investors on a pre-determined basis at a pre-determined price.

Key discussions during the consultation

Consultation respondents were of the view that the scope of DCM activities (which covers listed or unlisted debt securities offered in Hong Kong or otherwise) is unnecessarily wide compared to the scope of ECM activities (which only covers shares listed or to be listed on the HKEx). The SFC explained that they recognise that there are significant differences between DCM and ECM activities and noted that a relatively high percentage of debt offerings in Hong Kong are executed over-the-counter. Thus, the SFC considered that the scope for DCM activities should not be limited to debt securities listed in Hong Kong.

Some respondents sought to clarify whether equity-linked convertible bonds and exchangeable bonds should be considered equities or debt securities under the new Bookbuilding Conduct Requirements. The SFC stated that it is of the view that convertible or exchangeable bond offerings are generally structured in the form of debt securities which may not always be converted into equity securities. This means that offerings of convertible or exchangeable bonds where the bookbuilding or placing activities are carried out in Hong Kong would be within the scope of DCM activities for the purposes of the new Bookbuilding Conduct Requirements.

Types of Hong Kong Capital Market Intermediaries (CMIs)

Hong Kong Syndicate CMIs and Non-Syndicate CMIs

A CMI will be classified as either a syndicate CMI or a non-syndicate CMI, depending on whether it has a mandate and a direct relationship with the issuer:

a) *Syndicate Capital Market Intermediaries (CMIs) (new paragraph 21.2.1 of the SFC Code of Conduct)*

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

The SFC provided in its Consultation Paper examples of titles/roles currently associated with syndicate CMIs – bookrunners or lead managers (in the case of other senior syndicate CMIs) and co-managers and placing agents (in the case of less senior syndicate CMIs).

b) *Non-syndicate Capital Market Intermediaries (CMIs) (new paragraph 21.2.2 of the SFC Code of Conduct)*

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

The SFC provided in its Consultation Paper examples of titles/roles currently associated with non-syndicate CMIs – (a) sub-placing agents engaged by syndicate CMIs or other non-syndicate CMIs for the placing of shares or debt securities; or (b) brokers which only collate orders received from their investor clients, place them with the syndicate CMIs and distribute the securities to their clients if they receive allocations from the syndicate CMIs.

As set out in new paragraph 21.1.4 of the SFC Code of Conduct, there are many types of share and debt offerings, which vary in nature and complexity, and a CMI may play different roles in different offerings. The CMI's senior management will be responsible for establishing and implementing adequate and effective policies, procedures and controls to ensure compliance with the regulations and rules which apply to the roles they play in an offering.

Hong Kong Overall Coordinators ("OCs")

Heads of syndicates for offerings will be referred to as overall coordinators ("OCs") and they will be identified solely by reference to the activities they carry out rather than by their titles.

a) *Share offerings (new paragraph 21.2.3 of the SFC Code of Conduct)*

A syndicate CMI which, solely or jointly, conducts any of the following activities in relation to a share offering will be an OC:

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

b) *Debt offerings (new paragraph 21.2.4 of the SFC Code of Conduct)*

A syndicate CMI which, solely or jointly, conducts the following activities in relation to a debt offering will be an OC:

- i) conducting the overall management of the offering;
- ii) coordinating the bookbuilding or placing activities conducted by other CMIs;
- iii) exercising control over bookbuilding activities; and
- iv) making pricing or allocation recommendations to the issuer client.

OCs will be required to comply with the obligations and expected standards of conduct that apply to OCs under new paragraph 21.4 of the SFC Code of Conduct in addition to the obligations

and expected standards of conduct that apply to CMIs under new paragraph 21.3 of the SFC Code of Conduct.

Key discussions during the consultation

The proposed definition of OCs in relation to share offerings in the Consultation Paper also included the activity “acting as a stabilising manager”, which a few respondents argued should be removed. The SFC agreed to remove “acting as a stabilising manager” as one of the activities set out in new paragraph 21.2.3 of the SFC Code of Conduct as it considers that a stabilising manager’s role is not central to the functions of an OC.

For debt offerings, some respondents suggested to remove the concept of OCs and referred to regulatory regimes in other jurisdictions. The SFC rejected this suggestion, explaining that it considers that additional conduct requirements should apply to syndicate members with greater influence.

Some respondents suggested removing the concept of OC for non-IPO transactions as OCs would find it difficult to comply with the new requirements due to the compressed timeframe and the fact that the SFC had not identified significant issues in relation to non-IPO transactions. In response, the SFC noted that there are many types of share and debt offerings that vary in nature and complexity, and made reference to new paragraph 21.1.4 of the SFC Code of Conduct which makes it clear that CMIs should implement policies, procedures and controls commensurate with the transaction’s nature and complexity. The SFC also noted that for transactions which only take a few hours to complete, CMIs may not conduct in-depth discussions with and provide detailed advice to the issuer client. In such cases, OCs should, at a minimum, document the basis for determining the final offer price and allocation.

Obligations and expected standards of conduct of OCs and CMIs in Hong Kong

Assessment of issuer client and offering (new paragraph 21.3.1 of the SFC Code of Conduct)

The SFC stated in its Consultation Paper that it considers that a proper understanding of the issuer and the offering is necessary for CMIs to market the shares or debt securities to their investor clients and for the OC to provide appropriate advice to the issuer.

The new Bookbuilding Conduct Requirements will require CMIs to

conduct an adequate assessment of an issuer before engaging in an offering for that issuer client. This will include:

- a) taking reasonable steps to obtain an accurate understanding of the issuer client’s history, background, business and performance, financial conditions and prospects, operations and structure. Where the CMI for a debt offering had been the CMI for a previous debt offering made by the same issuer, the CMI will instead be required to ascertain whether there have been any material changes in the issuer client’s circumstances of relevance to its role as CMI;
- b) establishing a formal governance process for the review and assessment of the offering, including any (actual or potential) conflicts of interest between the CMI and the issuer client and the associated risks.

Appointment of CMIs and OCs in Hong Kong

The SFC considers that establishing clearly defined roles and responsibilities of CMIs from the outset will allow for better management of the offering and less confusion for buy-side participants, and will address potential concerns regarding reliability of information provided by an intermediary.

The new Bookbuilding Conduct Requirements set out requirements for the appointment of CMIs and OCs which are summarised below.

a) *CMIs (new paragraph 21.3.2 of the SFC Code of Conduct)*

Before a CMI starts carrying out any bookbuilding or placing activities, it will be required to ensure that:

- i) it has been formally appointed by the issuer client (or another CMI in the case of a non-syndicate CMI) under a written agreement to conduct such activities; and
- ii) the written agreement should clearly specify the roles and responsibilities of the CMI, the fee arrangements and the fee payment schedule. The fee arrangements in the agreement should include fixed fees as a percentage of the total fees to be paid to all syndicate CMIs participating in the offering (including fees for providing advice to the issuer, marketing, bookbuilding, making pricing and allocation recommendations and placing these securities with investor clients – often referred to as “underwriting fees” by the industry).

b) *OCs (new paragraph 21.4.1(a) of the SFC Code of Conduct)*

Before an OC conducts any activities set out in paragraph 21.2.3 of the SFC Code of Conduct for a share offering or participates in any bookbuilding or placing activities for a debt offering, it will be required to ensure that:

- i) it has been formally appointed by the issuer under a written agreement to conduct such activities; and
- ii) the written agreement should clearly specify the roles and responsibilities, fee arrangements (including fixed fees as a percentage of the total fees to be paid to all syndicate CMLs participating in the offering) and the fee payment schedule.

For Main Board IPOs, an OC should ensure that it is appointed as OC:

- i) if it (or one of its group companies) is also an independent sponsor (see discussion further below on HKEx “sponsor coupling”), at the same time as the sponsor appointment and at least two months before the listing application submission; or
- ii) if it (or one of its group companies) is not also an independent sponsor, no later than two weeks after the listing application submission.

For GEM IPOs, an OC should ensure that it is appointed as an OC no later than two weeks after the listing application submission.

Under new paragraph 21.4.8(b) of the SFC Code of Conduct, for an IPO, an OC should provide certain information to the SFC at least four clear business days prior to the Listing Committee Hearing, including the name of each OC participating in the offering. New paragraph 21.4.8(b) of the SFC Code of Conduct is discussed further below in respect of fee arrangements.

Key discussions during the consultation

Given the importance that OCs be given sufficient time to understand the issuer, develop marketing, pricing and allocation strategies, properly coordinate the activities of other CMLs and manage the offering, the requirement for the early appointment of OCs remains unchanged from the Consultation Paper proposals; additionally, the SFC has included a requirement under paragraph 21.4.8(b) that the list of all OCs, the fixed fee payable to each OC,

the total fees and the fee split ratio be submitted to the SFC no later than four clear business days before the Listing Committee Hearing to enable the SFC to make enquiries.

Respondents raised concerns that issuers may need to appoint additional syndicate CMLs at a later stage. To provide flexibility, the SFC therefore removed the requirement proposed in the Consultation Paper for the appointment of non-OC syndicate CMLs and the determination of their fees to be reported to the SFC. However, the SFC noted that all CMLs will still be required to be appointed before carrying out any bookbuilding or placing activities. The SFC considered that this will enable CMLs to assess whether they wish to accept the appointment based on their fixed fee entitlement and determine the resources they should utilise.

One respondent suggested to amend the requirements to permit frequent issuers to appoint CMLs for debt offerings at a later stage because issuers’ commercial decisions around fees would impose constraints at the early stage. However, the SFC considered that requirements already provide for sufficient flexibility and considered that no changes are necessary.

Advice to the issuer client (OCs) (new paragraph 21.4.2 of the SFC Code of Conduct)

The new Bookbuilding Conduct Requirements will require OCs to provide advice to the issuer client on marketing strategy, pricing and allocation.

In particular, OCs will be required under new paragraph 21.4.2(a) of the SFC Code of Conduct to act with due skill, care and diligence when providing advice, recommendations and guidance to the issuer client, and should:

- a) ensure that its advice and recommendations are balanced and based on thorough analysis and are compliant with all legal and regulatory requirements;
- b) engage the issuer client to understand its preferences and objectives on price and the desired shareholder or investor base so that the OC is in a position to advise/develop/revise a marketing and investor targeting strategy with a view to attaining these objectives in light of prevailing market conditions and sentiment;
- c) explain the basis of its advice and recommendations to the issuer client, including any advantages and disadvantages;

- d) provide advice to the issuer client in a timely fashion of key factors for consideration and how these factors could influence the pricing outcome, allocation and future shareholder or investor base; and
 - e) advise the issuer client on the information that should be provided to syndicate CMI's to enable them to satisfy their obligations and responsibilities under the SFC Code of Conduct (such as information about the issuer client to facilitate a reasonable assessment of the issuer client required under paragraph 21.3.1).
- the issuer client decides not to adopt an OC's advice or recommendations in respect of pricing or allocation of shares or debt securities; or
 - for a share offering, its decisions may lead to a lack of open market, an inadequate spread of investors or may negatively affect the orderly and fair trading of such shares in the secondary market.

OCs which participate in share offerings will be required under new paragraph 21.4.2(b) of the SFC Code of Conduct to:

- a) provide guidance to the issuer client on the market's practice on the ratio of fixed and discretionary fees to be paid to syndicate CMI's participating in an IPO, i.e. the fee split ratio. Discretionary fees are the portion of the total fees to be paid to all syndicate CMI's at the absolute discretion of the issuer client; and
- b) advise and guide the issuer client and its directors as to their responsibilities under the HKEx Requirements (i.e. the Listing Rules and other regulatory requirements or guidance issued by the HKEx) which apply to placing activities and take reasonable steps to ensure that they understand and meet these responsibilities.

In addition, there will be a requirement under new paragraph 21.4.8(b)(iii) of the SFC Code of Conduct for the ratio between the fixed and discretionary to be reported to the SFC no later than four clear business days before the Listing Committee Hearing.

An OC will be required to timely report various information to the SFC under new paragraph 21.4.8(a) of the SFC Code of Conduct, including (a) any instances of material non-compliance with the HKEx Requirements related to, for example, the placing activities conducted by itself or the issuer client; and (b) any material changes to the information it previously provided to the SFC and HKEx. This reporting requirement would include, in the case of a share offering, any decisions made by the issuer client that amounts to any material non-compliance with the HKEx Requirements.

New paragraph 21.4.2(c) of the SFC Code of Conduct provides that an OC should explain the potential concerns and advise the issuer client against making decisions where:

Under new paragraph 21.4.7(d), the OC should document any final decisions of the issuer client which deviates materially from the advice or recommendations provided by the OC, including the OC's explanation to the issuer client of any concerns associated with the decisions and advice provided.

Key discussions during the consultation

Some consultation respondents suggested that advice should be given by the whole syndicate or, in certain circumstances, by non-OC syndicate CMI's rather than only by the OC. The SFC disagreed and explained that OCs, being overall-in-charge, are in the best position to advise the issuer and should be held accountable accordingly. Some consultation respondents submitted that the issuer, in the case of share offerings, should be advised by an independent financial adviser. The SFC considers that an independent financial advisers (which is not a member of the syndicate) is not able to properly gauge investor sentiment and interest in the transaction.

It was proposed in the Consultation Paper that OCs should provide advice and guidance to the issuer client on syndicate membership and fee arrangements. Many respondents, including representatives from both the buy-side and the sell-side, had reservations about this proposed requirement, expressing concerns about potential conflicts of interest and that this proposal could go against issuers' interests. In light of the concerns, the SFC removed this requirement.

The requirement to provide guidance on the market's practice on the fee split ratio was not included in the initial proposals as set out in the Consultation Paper. Some consultation respondents suggested that OCs should be required to provide transparent market information and comparable transactions as references for the issuer client's consideration. The SFC stated that, although the OC is no longer required to advise on fee arrangements they agreed that the issuer client should at least be informed of the market's fee split practice.

In addition, the SFC has included a requirement under new paragraph 21.4.8(b)(iii) of the SFC Code of Conduct for the ratio between the fixed and discretionary to be reported to the SFC no later than four clear business days before the Listing Committee Hearing.

Marketing

a) *CMIs (new paragraph 21.3.4 of the SFC Code of Conduct)*

Under new paragraph 21.3.4 of the SFC Code of Conduct, CMIs will be required to only market the shares or debt securities to its investor clients which are targeted investors. For a share offering, where the shares are only marketed to selected investor clients, the CMI should be satisfied that the shares have been marketed to a sufficient number of clients and the likelihood of undue concentration of holdings is reasonably low.

A CMI should also allow all of its investor clients which are targeted investors and have indicated an interest in an offering to participate in that offering.

New paragraph 21.3.3 defines targeted investors as investors that fall within the types of investors targeted in the marketing and investor targeting strategy.

b) *OCs (new paragraph 21.4.3(a)-(b) of the SFC Code of Conduct)*

OCs will be required under new paragraph 21.4.3(a) to, in consultation with the issuer client, formulate a marketing and investor targeting strategy for order generation, taking into consideration the issuer client's objectives and preferences. The strategy may specify the types of investors targeted and the proportion of an offering to be allocated to each type of investors to establish the desired shareholder or investor base. In the case of IPOs, the strategy should also include the types of investors who may be appropriate to be cornerstone investors, and should seek to achieve an open market and adequate spread of shareholders and promote the orderly and fair trading of shares.

OCs will also be required by new paragraph 21.4.3(b) to advise the issuer to adjust the strategy as appropriate in response to changing market conditions and sentiment.

In addition, OCs will be required under new paragraph 21.4.6(a) to inform other syndicate CMIs of the marketing and investor targeting strategy.

Rebates and preferential treatment

The new Bookbuilding Conduct Requirements include provisions prohibiting CMIs from offering any rebates to investor clients or enabling any investor clients to pay at a price lower than that offered to other investors.

a) *CMIs (new paragraph 21.3.7 of the SFC Code of Conduct)*

CMIs will be required to:

i) not offer any rebates to an investor client or pass any rebates provided by the issuer to an investor client, and:

1) for an IPO, not enable any investor clients to pay, for each of the shares allocated, less than the total consideration as disclosed in the listing documents; and

2) for a debt offering, not enter into any arrangements which may result in investor clients paying different prices for the debt securities allocated; and

ii) disclose to the issuer client, the OCs, all of its targeted investors and the non-syndicate CMIs it appoints, any rebates offered to CMIs and any other preferential treatment of any CMIs or targeted investors, and:

1) for a share offering, disclosure should be made by a CMI upon becoming aware of any such rebates or preferential treatment; and

2) for a debt offering, disclosure should be made no later than at the dissemination of the deal "launch message" to targeted investors.

b) *OCs (paragraphs 21.4.3(c) and 21.4.4(b)(ii) of the SFC Code of Conduct)*

OCs will be required under new paragraph 21.4.4(b)(ii) of the SFC Code of Conduct to advise the issuer against providing any arrangements whereby:

1) for an IPO, the investor clients would pay, for each of the shares allocated, less than the total

consideration as disclosed in the listing documents;
and

- 2) for a debt offering, the investor clients would pay different prices for the debt securities allocated.

New paragraph 21.4.3(c) will provide that OCs must advise the issuer of the disclosure of any rebates and preferential treatment.

OCs will also be required to disseminate information on rebates and preferential treatment to all syndicate CMIs (for the CMI's onward disclosure to targeted investors and the non-syndicate CMIs they appoint) in accordance with the general requirement under new paragraph 21.4.6 of the SFC Code of Conduct to disseminate material information related to the offering to all syndicate CMIs.

Key discussions during the consultation

Some respondents submitted that rebates in whatever form, including rebates to private banks and investor clients, should be banned entirely so as to maintain a level playing field. The SFC disagreed and explained that they consider that rebates offered by issuers to intermediaries as incentives for their selling efforts should remain, provided that they are not passed on to investor clients and are properly disclosed in accordance with the new Bookbuilding Conduct Requirements.

Assessment of investor clients

- a) *CMIs (new paragraph 21.3.3 of the SFC Code of Conduct)*

The new Bookbuilding Conduct Requirements will require CMIs to take reasonable steps to assess whether its investor clients, based on their profiles, are targeted investors.

For share offerings, CMIs will be required to take all reasonable steps to identify the investor clients to whom the allocation of shares will be subject to restrictions or require the prior consent of the HKEx under the HKEx Requirements ("**Restricted Investors**") and inform the OC prior to placing an order on behalf of such clients.

For debt offerings, CMIs will be required to take all reasonable steps to identify whether its investor clients may have any associations with the issuer client, the CMI or a company in the same group of companies as the CMI, as well as provide

sufficient information to an OC to enable it to assess whether any orders may negatively impact the price discovery process.

CMIs must comply with the existing know-your-client ("**KYC**") requirements under the SFC Code of Conduct).

- b) *OCs (new paragraph 21.4.5 of the SFC Code of Conduct)*

For IPOs, OCs will be required to:

- i) advise the issuer client to provide to all syndicate CMIs a list of its directors, existing shareholders and their respective close associates, and any of their respective nominees appointed for the subscription or purchase of IPO shares; and
- ii) take all reasonable steps to identify investors on such list and ensure that they will only be allocated shares in accordance with the HKEx Requirements.

For debt offerings, OCs will be required to:

- i) advise the issuer client to provide adequate information to all syndicate CMIs to allow them to reasonably identify whether investor clients have any associations with the issuer client; and
- ii) take all reasonable steps to identify whether investors clients have any associations with the issuer client, CMIs or their group companies.

Key discussions during the consultation

It was proposed in the Consultation Paper that OCs should provide relevant information about the issuer directly to the other syndicate CMIs to facilitate their identification of Restricted Investors (for IPOs) or investors that have any relevant associations (for debt offerings). Some consultation respondents commented that this would impose an onerous burden on OCs and had concerns relating to OCs' liability for the accuracy and completeness of the information provided. The SFC agreed, noting that it would be more direct and efficient for the issuer itself to disseminate the relevant information to all syndicate CMIs. The revised provisions require an OC to advise the issuer client to provide the information to syndicate CMIs. The SFC stated in the Consultation Conclusions that it will work with the HKEx to reflect in the Listing Rules or appropriate guidance letters the role of the issuer in these matters.

Bookbuilding in Hong Kong

The bookbuilding process comprises the collation of client orders and the determination of pricing and allocation.

Order book

The SFC is particularly concerned about the market practice of “X-orders” (i.e. orders where the identities of investors are concealed). As set out in the Consultation Paper, the SFC considers that issuers may request CMIs to use “X-orders” to conceal the identities of prospective investors with whom they are closely associated, so as to hide the fact that the orders are not market-driven or for other purposes. The new Bookbuilding Conduct Requirements prohibit the use of “X-orders”.

a) CMIs (new paragraph 21.3.5 of the SFC Code of Conduct)

CMIs will be required to ensure transparency in the bookbuilding process. They should disclose the identities of all investor clients in an order book. There will be an exception for orders placed on an omnibus basis, and in such cases:

- i) CMIs will only be required to provide information about the underlying investors (i.e., the investor client’s name and unique identification number) to the OC and the issuer client when placing orders; and
- ii) CMIs which receive information about the investor clients will only be permitted to use the information for placing orders in that specific offering transaction.

CMIs should also take reasonable steps to ensure that all orders (including indications of interest) in the order book represent bona fide demand on behalf of its investor clients, itself and its group companies. They should make enquiries with investor clients about orders which appear unusual prior to placing the order.

b) OCs (new paragraph 21.4.4(a) of the SFC Code of Conduct)

OCs will be required to take reasonable steps to properly manage an order book and ensure the book’s transparency, including:

- i) ensuring that the identities of all investor clients are disclosed in the order book, apart from orders placed on an omnibus basis;

- ii) properly consolidating orders in the order book by taking reasonable steps to identify and eliminate duplicated orders, inconsistencies or errors;
- iii) segregating and clearly identifying in the order book and book messages any proprietary orders of CMIs and their group companies; and
- iv) making enquiries with CMIs which have placed orders on behalf of their investor clients, themselves or their group companies which appear unusual or irregular, such as orders which appear to be related to the issuer client.

Key discussions during the consultation

It was proposed in the Consultation Paper that in respect of orders placed on an omnibus basis, CMIs should provide information about the underlying investor clients to the OC and the issuer. Acknowledging the concerns of many consultation respondents relating to the commercial secrecy of client information and that disclosing it to competitors may lead to client poaching, the SFC in its Consultation Conclusions modified the requirement relating to orders placed on an omnibus basis (as set above).

The majority of respondents supported prohibiting the use of “X-orders” in the order book. Some respondents suggested that exemptions should be granted to entities with a legitimate reason including sovereigns, central banks and state-owned companies. The SFC disagreed with granting any exemptions as they consider disclosing the identities of investor clients in an order book is fundamental to ensuring transparency during the bookbuilding process.

Pricing and allocation

As discussed in the Consultation Paper, conflicts of interests between the issuer and the CMI or its investor clients could lead to under-pricing or over-pricing. In order to address these concerns, the new Bookbuilding Conduct Requirements include the following provisions:

a) CMIs (new paragraph 21.3.6 of the SFC Code of Conduct)

CMIs will be required to establish and implement an allocation policy to ensure a fair allocation of shares or debt securities to its investor clients. The allocation policy should:

- i) address or take into account the principles and requirements under paragraph 21.3.10 of the SFC Code

of Conduct (i.e. the provisions on conflicts of interest and proprietary orders) as well as the following factors:

- 1) the marketing and investor targeting strategy;
 - 2) the order sizes and circumstances of the investor client;
 - 3) the price limits for the investor clients' orders;
 - 4) any minimum allocation amounts indicated by investor clients; and
 - 5) any applicable legal and regulatory requirements; and
- ii) prevent any practices which may result in the unfair treatment of investor clients or knowingly distort the demand for other share or debt offerings.
- b) *OCs (new paragraphs 21.4.4 and 21.4.2(a)(iii) of the SFC Code of Conduct)*

OCs will be required to:

- i) take all reasonable steps to ensure that the price discovery process is credible and transparent and that the allocation recommendations made to the issuer client as well as the final allocation have a proper basis;
- ii) advise the issuer client on the pricing with reference to, for example, the results of the bookbuilding activities, the issuer client's characteristics, prevailing market conditions and the relevant authorities' sentiment and requirements;
- iii) advise the issuer client against providing any arrangements whereby the investor clients would pay:
 - 1) for an IPO, for each of the shares allocated, less than the total consideration as disclosed in the listing document; and
 - 2) for a debt offering, different prices for the debt securities allocated;
- iv) ensure that the proprietary orders of CMIs or their group companies (and for debt offerings, the orders placed by investor clients which have associations with the issuer

client, CMIs or their group companies) will not negatively impact the price discovery process;

- v) develop and maintain an allocation policy which specifies the criteria for making allocation recommendations to the issuer client, which should address or take into account the following factors:
 - 1) the issuer client's objectives, preferences and recommendations;
 - 2) the prevailing market conditions and sentiment;
 - 3) the types, characteristics and circumstances of targeted investors;
 - 4) the spread of investors (such as the sizes and number of large holdings); and
 - 5) the overall subscription rate for the offer;
- vi) make allocation recommendations in accordance with its allocation policy;
- vii) ensure that recommendations regarding the allocation of securities to the OC's investor clients take into account the CMI allocation policy;
- viii) for an IPO, ensure that allocation recommendations (a) are made with a view to achieving an open market, an adequate spread of shareholders and the orderly and fair trading of the shares in the secondary market and (b) should ensure that any allocations to Restricted Investors comply with the HKEx Requirements;
- ix) if the allocation recommendations materially deviate from the OC or CMI allocation policy, explain to the issuer client the reasons for the deviation; and
- x) explain to the issuer client the basis of its advice and recommendations, including any advantages and disadvantages. For example, it should communicate its allocation policy to ensure that the issuer client understands the factors underlying the allocation recommendations.

Key discussions during the consultation

A couple of consultation respondents were concerned that the proposed requirements would create disincentives for CMIs to work hard to secure adequate demand to support a higher price (e.g. CMIs may seek a lower offering price to favour their own investor clients, which would be contrary to the issuer's interests). The SFC explained that the risk of under-pricing would be a problem if issuers were in a weak bargaining position, but it considers that this is not the case in Hong Kong.

The SFC considers that these requirements are essential in order to balance the interests of different parties in an offering and promote transparent and effective price discovery. Further, the issuer has the final say on price and allocation, and the OC will only be required to explain any potential concerns and advise the issuer appropriately.

Conflicts of interest and proprietary orders of CMIs and their group companies (new paragraph 21.3.10 of the SFC Code of Conduct)

The new Bookbuilding Conduct Requirements will include provisions to address conflicts of interest and the potential for CMIs to take advantage of non-public information in the order book when placing proprietary orders.

CMIs will be required under new paragraph 21.3.10(a) of the SFC Code of Conduct to establish, implement and maintain policies and procedures to:

- a) identify, manage and disclose actual and potential conflicts of interest which may, for instance, arise when a CMI:
 - i) serves the interests of both its issuer client and investor clients;
 - ii) serves the interests of its investor clients when having a proprietary interest (including a proprietary interest of its group companies) in an offering; or
 - iii) has full discretion over allocations to investor clients or a proprietary order; and
- b) govern the process for generating proprietary orders and making allocations to such orders.

CMIs will also be required under new paragraph 21.3.10(b) of the SFC Code of Conduct to:

- a) always give priority to fulfilling investor clients' orders over its own proprietary orders (and proprietary orders of its group companies);
- b) only be the price taker in respect of its proprietary orders (and proprietary orders of its group companies) and ensure that these orders would not negatively impact the price discovery process; and
- c) segregate and clearly identify its own proprietary orders (and proprietary orders of its group companies), whether directly or indirectly, in the order book and book messages.

A note to new paragraph 21.3.10(b) will provide that proprietary orders placed by a group company will not include orders placed on behalf of the group company's clients or funds and portfolios under its management, but will include orders placed on behalf of funds and portfolios in which the CMI or the group company has a substantial interest.

For a debt offering, CMIs will be required under new paragraph 21.3.10(c) of the SFC Code of Conduct to take reasonable steps to disclose to the issuer client how any risk management transactions it intends to conduct for itself, the issuer client or its investor clients will not impact the debt securities' pricing.

Key discussions during the consultation

Some consultation respondents sought clarification as to the definition of "proprietary order", noting that there are three types of intra-group orders which raise concerns – orders from syndicate members' (i) asset management arms, (ii) treasury functions and (iii) trading desks.

The majority of respondents commented that orders from syndicate members' trading desks should be considered proprietary orders. The SFC agreed.

Most respondents considered that orders from syndicate members' asset management arms and treasury functions should not be treated as proprietary orders.

The SFC agreed that orders from syndicate members' asset management arms should be classified as client orders (and not proprietary orders), provided that the orders are placed on an arm's length basis and there are effective Chinese Wall controls in place.

The SFC disagreed that orders from syndicate members' treasury functions should be treated as client orders, explaining that the treasury function is responsible for managing the firm's capital and making investment decisions. A potential conflict of interest may arise when the firm is committing its capital in a debt offering and the syndicate desk of the firm is exercising control over bookbuilding activities and making pricing and allocation recommendations to the issuer client. Thus, orders placed by the treasury function of a CMI should be treated as the CMI's proprietary orders.

The SFC has included a note to paragraph 21.3.10(b) in the final version of the new paragraph 21 of the SFC Code of Conduct as to the meaning of proprietary orders.

Some respondents stated that client orders should not have priority over proprietary orders and that proprietary orders should only be price takers in debt offerings. The SFC disagreed and explained that the requirements are consistent with the fundamental principle of the existing SFC Code of Conduct and the IOSCO DCM Report.

Review and approval of orders and allocations (new paragraph 21.3.11(b) of the SFC Code of Conduct)

Senior management of CMIs will be required under new paragraph 21.3.11(b) of the SFC Code of Conduct to review and approve certain types of orders and allocations, including:

- a) proprietary orders of the CMI and any of its group companies;
- b) orders from its investor clients which may appear unusual (e.g., orders which might appear to be related to the issuer); and
- c) allocations to Restricted Investors in the case of share offerings.

Communications with issuers, other CMIs and targeted investors

Throughout the offering, CMIs will receive information from the issuer, OCs, other CMIs and its investor clients which would materially affect the offering, including information about the offer price and the ways in which the OC and CMIs should discharge their responsibilities. The new Bookbuilding Conduct Requirements include provisions on communications with issuers, other CMIs and targeted investors.

a) *CMIs (new paragraph 21.3.8 of the SFC Code of Conduct)*

CMIs will be required under paragraph 21.3.8 of the SFC Code of Conduct to disclose complete and accurate information in a timely fashion on the status of the order book and other relevant information it receives to:

- i) the OC (whether directly or indirectly) and non-syndicate CMIs it appoints so that they can perform their duties; and
- ii) its targeted investors so that they can make an informed decision.

b) *OCs (new paragraph 21.4.6 of the SFC Code of Conduct)*

OCs will be required under paragraph 21.4.6 of the SFC Code of Conduct to:

- i) inform other syndicate CMIs of the issuer client's marketing and investor targeting strategy; and
- ii) disseminate material information related to the offering as included in, for example, the launch term sheet and book messages, in a timely fashion to all syndicate CMIs and ensure that the disseminated information is complete and accurate and has a proper basis. Material information related to the offering includes, for example, information which may affect the prices, orders received per investor type, proprietary orders of CMIs and their group companies, and known preferential treatments and rebates.

Keeping of records

a) *CMIs (new paragraph 21.3.9 of the SFC Code of Conduct)*

CMIs will be required to maintain books and records sufficient to demonstrate compliance with all applicable requirements of new paragraph 21 of the SFC Code of Conduct, including among others: (i) assessments of the issuer client, the offering and investor clients; (ii) audit trails; (iii) all key communications with the issuer client, investor clients and other CMIs; and (iv) where a CMI's order is placed on an omnibus basis, the intended basis of allocation for all orders with justifications and any material deviations from the CMIs allocation policy. CMIs must maintain records of the documented information for at least seven years (this requirement will be reduced to only two years for audit trails).

b) *OCs (new paragraph 21.4.7 of the SFC Code of Conduct)*

OCs will be required to document various matters, including, among others, all changes in the order book throughout the bookbuilding process and all key discussions with, and key advice or recommendations provided to, the issuer client. OCs must maintain records of the documented information for at least seven years.

Key discussions during the consultation

Although some respondents commented that it would be burdensome to require OCs and CMIs to maintain records which evidence every change in the order book throughout the bookbuilding process, over half of the respondents considered it to be feasible. The SFC agreed with the majority that these requirements are feasible, particularly in light of the proliferation of electronic means which intermediaries can adopt when conducting bookbuilding activities. The SFC also noted that setting a quantifiable range of the records which should be kept would be arbitrary and therefore undesirable.

Resources, systems and controls

General Principle 3 of the SFC Code of Conduct provides that an intermediary should have and effectively employ the resources and procedures which are needed for the proper performance of its business activities. The new Bookbuilding Conduct Requirements builds upon this principle by including the following provisions.

New paragraph 21.3.11 of the SFC Code of Conduct stipulates that a CMI should maintain sufficient resources and effective systems and controls to ensure that it can discharge its obligations and responsibilities. In addition:

a) *Chinese walls (new paragraph 21.3.11(a) of the SFC Code of Conduct)*

CMIs should take adequate measures to prevent the flow of information which may be confidential or price sensitive amongst staff performing different activities relating to an offering (e.g. research report preparation, sponsor work, bookbuilding activities and placing activities) and to prevent and manage any conflicts of interest. In particular, CMIs should establish and maintain effective Chinese walls and wall-crossing policies and procedures.

b) *Appointment of non-syndicate CMIs (new paragraph 21.3.11(c) of the SFC Code of Conduct)*

CMIs should exercise due skill, care and diligence in the selection and appointment of any non-syndicate CMIs to assist it in distributing shares or debt securities.

c) *Surveillance and monitoring (new paragraph 21.3.11(d) of the SFC Code of Conduct)*

CMIs should regularly carry out independent surveillance and monitoring to detect any irregularities, conflicts of interest, leakage of price sensitive or confidential information, and potential non-compliance with regulatory requirements or its own internal policies and procedures.

Fee arrangements (new paragraphs 21.3.2, 21.4.1(a)(ii), 21.4.2(b)(i) and 21.4.8(b) of the SFC Code of Conduct)

The SFC considers that fee arrangements (particularly, the ratios of (i) fixed fees to discretionary fees and (ii) allocations of fixed fees to syndicate members) should be agreed at an early stage.

Under new paragraphs 21.3.2 and 21.4.1(a)(ii) of the SFC Code of Conduct, each written agreement to be entered by a CMI or OC will be required to specify the fee arrangements (including the allocation of fixed fees to the particular CMI as a percentage of the total fees to be paid to all syndicate CMIs) and the fee payment schedule.

Under new paragraph 21.4.2(b)(i) of the SFC Code of Conduct, OCs which participate in a share offering should provide guidance to the issuer client in relation to the market's practice on the ratio of fixed and discretionary fees to be paid to syndicate CMIs participating in an IPO, i.e. the fee split ratio.

The SFC stated in its October 2021 Consultation Conclusions that the market practice for the fee split ratio is currently approximately 75% fixed fees and 25% discretionary fees, i.e. 75:25 ratio.

The SFC also provided in the Consultation Conclusions that post-IPO price performance should not be a consideration in determining the allocation of discretionary fees.

Additionally, in order to assist with the identification of arrangements that substantially differ from market norms, OCs will be required under new paragraph 21.4.8(b) of the SFC Code of Conduct to provide the following to the SFC by no later than four clear business days prior to the Listing Committee Hearing for an IPO:

- a) the name of each OC participating in the IPO;
- b) the allocation of the fixed portion of the fees paid by the issuer to each OC;
- c) the total fees (as a percentage of the gross amount of funds raised) of both the public offer and the international tranche to be paid to all syndicate CMIs; and
- d) the fee split ratio – the ratio between the fixed and discretionary portions of the total fees to be paid to all syndicate CMIs (in percentage terms).

The OC should notify the SFC as soon as practicable of any material changes to any of the above information.

Key discussions during the consultation

A couple of respondents submitted that there should be provisions requiring fees to be paid at settlement and one respondent suggested that a breach of the payment schedule should be reported to the SFC. However, the SFC considers that the timing for fee payment and the enforcement of the fee payment schedule are commercial issues which the SFC is not in a position to intervene.

As the SFC will not require OCs to advise issuers on fee arrangements (as proposed in the Consultation Paper), it will also not require OCs to confirm to the SFC that the issuer has determined the allocation of discretionary fees to each syndicate CMI and the fee payment schedule no later than listing (as also proposed in the Consultation Paper).

The SFC and HKEx will explore the possibility of introducing a requirement for issuers to confirm directly that they have determined the allocation of discretionary fees to each syndicate CMI and the fee payment schedule no later than listing.

In regards to disclosure of syndicate membership, some respondents commented that disclosure should be made at the time of the A1 submission to enhance market transparency at an early stage and lock in all syndicate CMIs. However, the SFC considers that prescribing a timeframe for the appointment of syndicate CMIs for all IPO transactions is not feasible. As the definition of “placing activities” includes “marketing”, firms without mandates approaching potential investors would be in breach of the new Bookbuilding Conduct Requirements;

and therefore, the buy side should reasonably assume that it would only be approached by CMIs appointed by the issuer. As is the existing practice, the composition of the syndicate will be disclosed at the time of the publication of prospectus. The SFC provided in the Consultation Conclusions that it will work with the HKEx to introduce a requirement under the Listing Rules or appropriate guidance letters for the public disclosure of OCs at an early stage of the offering.

Currently, underwriting fees for the Hong Kong public offer tranche are disclosed in the prospectus, whilst underwriting fees for the international placing tranche are disclosed infrequently. Consultation respondents, in general, supported requiring disclosure of the total fees to be paid to all syndicate CMIs participating in the international placing tranche. The SFC in the Consultation Conclusions stated that it considers that the total fees payable to all syndicate CMIs covering both tranches should be disclosed in the prospectus, and if the issuer also appoints an overseas firm to conduct underwriting, bookbuilding or placing of shares in an IPO, the prospectus should disclose the fees payable to the overseas firm covering both tranches.

As set out in the Consultation Paper, the SFC considers that the early determination of syndicate membership and fee arrangements will allow OCs and CMIs to better focus their efforts and resources on providing advice to the issuer and conducting Hong Kong bookbuilding and placing activities, and as a result, will enhance the transparency and credibility of the price discovery and allocation process. The SFC also noted that the early agreement of fixed fees is consistent with international market practice.

2. HKEx “Sponsor Coupling” in Hong Kong

Under the new Bookbuilding Conduct Requirements, listing applicants will be required to adopt “sponsor coupling” for IPOs on the Main Board of the HKEx. “Sponsor coupling” is the requirement that for an IPO, at least one sponsor which is independent of the listing applicant is (or one of the sponsor’s group companies is) also appointed as an OC for the IPO. “Sponsor coupling” will not be required for GEM IPOs.

Background

As set out in the Consultation Paper, the SFC found from its pre-consultation discussions with market participants that:

- where an IPO transaction is led by a large group of syndicate CMIs with a variety of titles and the heads of syndicate are

not clearly identified, buy-side participants may be faced with a confusing situation. The SFC noted that many market participants indicated that preferably IPO transactions should be led by one or a small group of clearly identified senior syndicate members from the outset in order to ensure consistency in advice and allow participants to know who can provide accurate and reliable information and who is primarily accountable for the transaction;

- it appears that there is an increased interest by CMI's to be appointed as heads of syndicate for IPOs;
- when heads of syndicate also act as sponsors for an IPO, advantages can accrue for the overall offering. However, an increasing proportion of the heads of syndicate did not act as sponsors during the nine months ended 30 September 2020 as compared to 2018; and
- based on the SFC's analysis of the IPOs conducted in the first nine months of 2020, underwriting fees are substantially higher than sponsor fees. The SFC suggested that this indicates a misalignment between fees and sponsor costs and responsibilities, particularly in larger IPOs where sponsors normally incur substantial costs and any regulatory breaches could potentially result in severe consequences. The SFC further noted that where sponsors also act as the head of syndicate, the total fees may properly compensate the additional sponsor resource commitments and responsibilities. If sponsors are not appointed as head of syndicate from the outset, the SFC is concerned that they may be incentivised to compromise due diligence to secure the appointment.

In addition, the SFC also noted that market participants were resistant to proposals requiring all OCs to be sponsors based on concerns that it would limit the issuer's flexibility in appointing OCs with strong marketing abilities and may prejudice standalone boutique sponsor firms with no marketing capabilities.

The concept of "sponsor coupling" was developed to address the SFC's concerns that sponsors may compromise their standard of due diligence to secure an OC appointment and, by acting as both OC and sponsor, the intermediary should be in a better position to provide quality advice to the issuer. The SFC considers that "sponsor coupling" will ensure that at least one sponsor will be free of potential incentives to limit due diligence in order to secure an OC role. The early appointment of the Sponsor OC will discourage sponsors from compromising its due diligence obligations. This is important as the Sponsor OC is in a position to give comprehensive advice to the listing applicant throughout the

transaction and buy-side participants will be able to look to the Sponsor OC to provide well-informed and authoritative answers to their questions.

Hong Kong "sponsor coupling" requirements

Pursuant to new paragraph 21.4.1(b) of the SFC Code to Conduct, in relation to IPOs on the Main Board of the HKEx, prior to accepting an appointment, OCs will be required, to:

- a) ensure that it (or one of its group companies) is also appointed as a sponsor, which is independent of the issuer client (the "Sponsor OC"), and that both appointments are made at the same time and at least two months prior to the issuer client's listing application submission; or
- b) obtain a written confirmation from the issuer client that at least one sponsor, which is independent of the issuer client (or a group company of that sponsor) has been appointed as an OC for that IPO, in which case its appointment as an OC should be made no later than two weeks after the issuer client's listing application submission.

New paragraph 21.4.1(b) is mirrored in new paragraph 17.1A of the SFC Code of Conduct (paragraph 17 of the code sets out the standards and requirements for sponsors). Under paragraph 17.1A, before accepting an appointment by a listing applicant to act as a sponsor in respect of a Main Board IPO, the sponsor will be required to either:

- a) be independent of the listing applicant and ensure that it (or one of its group companies) is also appointed at the same time as an OC in connection with that listing application; or
- b) obtain written confirmation from the listing applicant that at least one sponsor, which is independent of the listing applicant (or a group company of that sponsor) has been appointed as an OC in connection with that listing application.

The circumstances under which a sponsor is considered not to be independent of the listing applicant are specified in Chapter 3A of the Listing Rules.

In order to be considered a group company of a sponsor, the definition of "group of companies" in section 1 of Part 1 of Schedule 1 to the SFO is applied.

"Sponsor coupling" will only be required for IPOs on the Main Board of the HKEx.

Key discussions during the consultation

The majority of consultation respondents supported the introduction of “sponsor coupling” as they considered that it will help ensure the transparency of offerings (which is in the best interest of investors) and ease concerns that sponsors which are not appointed as OCs at an early stage may compromise their due diligence standards to acquire an OC mandate.

On the other hand, some respondents commented that “sponsor coupling” might give too much bargaining power to the Sponsor OCs. The SFC disagreed with this view, explaining that fees are currently not aligned with sponsor costs and responsibilities which is putting sponsors under undue pressure to compromise their due diligence to secure their appointment as an OC. Therefore, the SFC considers that it appears that sponsors currently have too little bargaining power.

It was proposed in the Consultation Paper that the “sponsor coupling” requirement apply to all IPOs, both Main Board and GEM.

A few respondents were concerned that small boutique sponsors without underwriting or distribution capacity would be driven out of the market as issuers generally do not wish to appoint multiple sponsors, particularly in GEM IPOs. If “sponsor coupling” were introduced, many small but highly professional sponsors would no longer be able to act as sponsors. In response, the SFC stated that the impact on small boutique sponsors should be limited and referred to data that in the year ended 30 September 2020, 72% of the 127 sponsors were engaged as a syndicate member which indicates that they already have the necessary capabilities.

The SFC acknowledged that “sponsor coupling” is not as prevalent in GEM IPOs, where small boutique sponsors with limited underwriting or distribution capability tend to be more active. The SFC is of the view that sponsors compromising their standard of due diligence is less of a concern in GEM IPOs as the SFC considers that their sponsor fees are generally commensurate with their work. For these reasons, the “sponsor coupling” requirement will only apply to IPOs on the Main Board and not GEM.

3. Implementation timeline

The new Bookbuilding Conduct Requirements were gazetted on 5 November 2021 (see *G.N. 6935/2021* and *G.N. 6932/2021*) and will come into effect on 5 August 2022.

There is a nine months transition period so as to give reasonable time for CMLs to implement the requisite operational and system changes to comply with the new requirements.

The SFC will work with the HKEx to introduce appropriate amendments to the Listing Rules which will dovetail with the new Bookbuilding Conduct Requirements.

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