



Jeffrey Mak Law Firm
麦振兴律师事务所
www.jmaklegal.com

Changes to Hong Kong's Sponsor Regime under the Revised Bookbuilding and Placing Rules

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Introduction

The Hong Kong Securities and Futures Commission (“SFC”) published its Consultation Conclusions on (i) the Proposed Code of Conduct on Bookbuilding and Placing Activities in Equity Capital Market and Debt Capital Market Transactions and (ii) the “Sponsor Coupling” Proposal on 29 October 2021, which finalized on the amendments on the Code of Conduct for Persons Licensed by or Registered with the Securities and Future Commission (“**Code of Conduct**”), setting out the new requirements that apply to bookbuilding and placing activities in ECM and DCM transactions (the “**Revised Bookbuilding and Placing Rules**”). Such new requirements came into force from 5 August 2022. The Stock Exchange of Hong Kong Limited (the “**Stock Exchange**”) have also made consequential amendments to the Rules Governing the Listing of Securities on the Stock Exchange (“**Main Board Listing Rules**”) and the Rules Governing the Listing of Securities on the GEM of the Stock Exchange (“**GEM Listing Rules**”, together with the Main Board Listing Rules, “**HKEX Listing Rules**”) to complement the new provisions of the Code of Conduct.

The requirements under the Revised Bookbuilding and Placing Rules include appointment of ‘Capital Market Intermediaries’ (“**CMI**”), which are the intermediaries involved with the bookbuilding and placing activities for the issuer, and ‘Overall Coordinators’ (“**OC**”) which are responsible for the overall management of the offering and the lead syndicate members that coordinates the bookbuilding and placing activities, in share or debt offerings, respectively, and there are various new rules setting out their obligations and expected standards of conduct. In the context of IPOs for Main Board, the new ‘Sponsor Coupling’ requirement mandates that at least one independent sponsor is appointed as an OC and such appointment has to be confirmed shortly after the listing application.

For the purposes of this article, we will focus on the new requirements that relate to sponsor’s responsibilities in IPO.

The ‘Sponsor Coupling’ Requirement (Main Board)

The sponsor coupling requirement was a response to the fact that there had been an increasing number of the heads of syndicate not acting as sponsors for IPO, and this could be detrimental to the sponsors carrying out their due diligence work in two ways:

- While sponsors normally incur substantial costs in their due diligence work, underwriting fees are usually substantially higher than sponsor fees, but if sponsors also act as the head of syndicate, the total fees may properly compensate the additional sponsor resource commitments and responsibilities. However, with the increasing proportion of the heads of syndicate not being appointed as sponsors before the sponsor coupling requirement coming into force, this means that there was a misalignment between fees and sponsor costs and responsibilities and this would be detrimental to the comprehensiveness of the due diligence work carried out by sponsors.
- If sponsors are not appointed as head of syndicate from the outset, they may be pressurized to compromise due diligence to secure the appointment.

The sponsor coupling arrangement will ensure that at least one sponsor will be free of potential incentives to limit due diligence in order to secure an OC role. It would be advantageous when resources of the sponsor and the lead underwriter are combined to ensure sufficient due diligence can be done. The early appointment of the sponsor to also acts as an OC (“**Sponsor-OC**”) will discourage sponsors from compromising their due diligence obligations.

Appointment and termination of sponsor-OCs under new requirements

Under paragraph 17.1A of the Code of Conduct, 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:

- 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
- 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 same goes for appointment of OCs, whereby the OCs are required to either be appointed as an independent sponsor or obtain written confirmation from the issuer client that at least one independent sponsor has been appointed as an OC. The circumstances under which a sponsor is considered not to be independent of the listing applicant are specified in Chapter 3A of the Main Board Listing Rules.

Under Main Board Listing Rule 3A.43, a listing applicant must ensure that at least one OC (or one of the companies within its group of companies) appointed for the bookbuilding and placing activities:

- is also appointed as an independent sponsor (i.e. a sponsor-OC); and
- both appointments have to be made at the same time and no less than two months before submission of the listing application (or re-filing thereof).

As for the termination of a sponsor-OC, Main Board Listing Rule 3A.45 stipulates that, if the outgoing sponsor-OC was the only sponsor-OC that fulfills the eligibility criteria for appointment as a sponsor-OC, the new applicant will have to file a new listing application with payment of listing fee not less than two months from the date of the formal appointment of a replacement sponsor-OC if it intends to continue with the listing application process, regardless of whether the outgoing sponsor-OC or one of its group companies remains as a sponsor to the new applicant.

Transitional arrangements

The sponsor coupling arrangement comes into effect on 5 August 2022, listing applications submitted before 5 August 2022 are unaffected. However, for a listing application submitted by a Main Board listing applicant before 5 August 2022 that will be re-filed on or after 5 August 2022, the existing sponsor applicant must satisfy

the following conditions to discharge its role of a sponsor-OC:

- the existing independent sponsor has been appointed before 5 August 2022 and at least two months before the re-filing, the Stock Exchange has been notified of the sponsor engagement before 5 August 2022;
- the independent sponsor or its group company has also been appointed as an OC before 5 August 2022 and at least two months before the re-filing;
- the engagements of the sponsor and OC remain valid and effective as at the time of the re-filing; and
- the re-filing is made within three months from the lapse of the last listing application

If the new applicant has formally appointed a sponsor before 22 April 2022 but has not appointed the sponsor (or its group company) as an OC at that time, and intends to submit its listing application on or after 5 August 2022, the existing sponsor applicant will discharge its role of a sponsor-OC if the following conditions are satisfied:

- the new applicant has appointed an independent sponsor before 22 April 2022, and has submitted a sponsor appointment notice to the Exchange before 22 April 2022;
- the abovementioned independent sponsor or its group company has also been appointed as the OC before August 5, 2022 and at least two months before the first submission or resubmission of the listing application; and
- the appointment of the sponsor and OC are still in effect at the time of the initial or resubmission of the listing application.

GEM IPOs

“Sponsor coupling” is only required for IPOs on the Main Board of the Stock Exchange.

In the case of an IPO on GEM of SEHK, an OC should ensure that it is appointed as an OC no later than two weeks after the submission of the listing application to SEHK by or on behalf of the issuer client.

Declarations and documents to be provided by sponsor/OC for IPO

Under the Revised Bookbuilding and Placing Rules, responsibilities of an OC (including sponsor-OC) will include advising and guiding the company and its directors as to their responsibilities under the regulatory requirements and taking reasonable steps to ensure that they understand those responsibilities. In particular, an OC is required to ensure that directors, existing shareholders, their close associates and nominees will only be allocated equity interests in accordance with the applicable requirements under the HKEX Listing Rules. The OC will also be required to take all reasonable steps to ensure that the price discovery process is credible and transparent, the order book has been properly managed and the allocation recommendations made to the company and the final allocation have a proper basis.

The new Main Board Listing Rule 3A.40 (GEM Listing Rule 6A.45) requires OCs engaged in connection with an IPO to provide a declaration in the form of new Form E in Appendix 5 (Form I in Appendix 7 for GEM) in respect of the issuer's compliance with Main Board Listing Rules 8.08, 10.03 and 10.04 (GEM Listing Rules 11.23 and 13.02(1)) relating to placing and allocations, as soon as practicable after the issue of the prospectus but before dealings commence.

Fee arrangements

Fee arrangements, including the ratios of fixed fees to discretionary fees and allocations of fixed fees to syndicate members, should be agreed at an early stage under the Revised Bookbuilding and Placing Rules.

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. OCs should also 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. There is no specific time limit for the appointment of a syndicated CMI who is not an OC in relation to any transaction as long as the CMI has been appointed by the issuer pursuant to a written agreement prior to any book-building or placement activities.

Under Main Board Listing Rule 9.11(23a) (GEM Listing Rule 12.23AA), a sponsor-OC (for a Main Board IPO) or an OC (for a GEM IPO) must submit the following information to the SFC *no less than four clear business days prior to the Listing Committee Hearing*:

- the name of each OC;

- the fixed fees to be paid by the issuer to each OC;
- the total fees (as a percentage of the gross proceeds to be raised from the IPO) in respect of both the public subscription and the placing tranches to be paid to all syndicate CMIs, and
- the ratio of *fixed* and *discretionary* fees to be paid to the syndicate CMIs (in percentage terms).

In addition, under Rule 3A.38 of the Main Board Listing Rules, an OC (including sponsor-OC) is liable for ensuring that the information provided by it to the Stock Exchange is accurate and complete and will be provided to the Stock Exchange within the required timeframe. Where more than one OC is appointed, all OCs are jointly and severally liable for ensuring the same.

Obligations and expected standards of conduct required of OCs and CMIs

The Revised Bookbuilding and Placing Rules applies to share offering (i.e. an offering of shares listed or to be listed on the Stock Exchange), and following the sponsor coupling requirement, sponsors will usually also be OC for a listing applicant in an IPO, therefore sponsors should take note of the obligations and expected standards of conduct of OCs and CMIs under the paragraph 21 of the Code of Conduct as well.

The Revised Bookbuilding and Placing Rules under paragraph 21 of the Code of Conduct seek to improve governance and enhance market standards by targeting regulatory certain shortcomings in bookbuilding and placing activities in Hong Kong, such as:

- lack of transparency in the order book;
- preferential treatment or rebates paid to some investors;
- conflicts of interest between intermediaries and its investor clients; and
- a lack of documentation and record keeping processes.

The following tables summarises certain key obligations and expected standards of conduct of CMIs and OCs:

Obligations and expected standards of conduct for CMIs

Assessment of Issuer and offering	Conduct an adequate assessment of an issuer client before engaging in a share or debt offering for that issuer client. This would include obtaining an accurate understanding of the history
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	and background, business and performance, financial condition and prospects, operations and structure of the issuer client.
Appointment	Enter into a formal written appointment agreement as CMI before carrying out any bookbuilding and placing activities.
Assessment of investor clients	Assess whether investor clients are "targeted investors" (investors which are targeted in a marketing and investor targeting strategy). Identify whether investor clients have any associations with the Issuer, the CMI or a company in the same group of companies as the CMI.
Marketing	Market only to the targeted investors, and ensure that the shares have been marketed to a sufficient number of clients and the likelihood of undue concentration of holdings is reasonably low.
Rebates and preferential treatment	CMIs are not permitted to offer or pass on any rebates to an investor client.
Assessment of investor clients	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 Stock Exchange under the requirements of the Stock Exchange and inform the OC prior to placing an order on behalf of such clients.
Bookbuilding	Ensure all orders placed in an order book represent bona fide demand of its investor clients, itself and its group companies. Enquiries should be made of any unusual orders. Disclose the identities of all investor clients in an order book (except omnibus orders).
Pricing and allocation	Establish and implement an allocation policy to ensure fair allocation of debt securities to investor clients.
Conflict of interests and proprietary orders of CMIs	Establish and maintain policies and procedures to identify, manage and disclose any actual and potential conflicts of interest and govern the

and their group companies	process for generating proprietary orders and making allocations to such orders. Ensure priority is given to satisfying investor clients' orders over its own proprietary orders and those of its group companies. In respect of its (and its group companies') proprietary orders, it should be a price taker. Segregate and clearly identify its (and its group companies) proprietary orders in the order book.
Communication with issuers, other CMIs and targeted investors	Disclose, in a timely manner, complete and accurate information on the status of the order book to the OC, its appointed non-syndicate CMIs and its targeted investors.
Record keeping	Maintain books and records to demonstrate compliance with all applicable requirements of new paragraph 21 of the SFC Code of Conduct, for example audit trails from the receipt of orders, order confirmations, all key correspondence with the Issuer as to actual or potential conflicts of interest, rebates etc., and must maintain records for at least seven years (two years for audit trails).
Resources, systems and controls	Maintain sufficient resources and effective systems and controls to ensure it can discharge its obligations and responsibilities.

Obligations and expected standards of conduct for OCs

In addition to those obligations and expected standards of conduct applicable to CMIs as set out above, OCs are also required to comply with the following:

Appointment	Enter into a formal written appointment agreement as OC with the issuer. For Main Board IPO: ensure it is also appointed as an independent sponsor and that both appointments (OC and sponsor) are made at least two months before submission of listing application; or obtain written confirmation from issuer that at least one independent sponsor has been appointed as OC For GEM IPO: ensure it is appointed as OC no later than two weeks after listing
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	application.
Advice to Issuer	Act with due skill, care and diligence when providing advice, recommendations and guidance to the issuer client. Provide guidance to the issuer client on the market's practice on the ratio of fixed and discretionary fees to be paid to syndicate CMLs 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 CMLs at the absolute discretion of the issuer client
Marketing	Consult with the Issuer, formulate a marketing and investor targeting strategy for order generation, taking into account the objectives/preferences of the Issuer.
Rebates and preferential treatment	Advise the issuer against providing any arrangements whereby, 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. Advise the issuer of the disclosure of any rebates and preferential treatment.
Assessment of investor clients	For IPOs, OCs are required to advise the issuer client to provide to all syndicate CMLs 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 take all reasonable steps to identify investors on such list and ensure that they will only be allocated shares in accordance with the requirements of the Stock Exchange.
Bookbuilding	Take reasonable steps to properly manage an order book and ensure the book's transparency and ensure that the identities of all investor clients are disclosed in the order book
Pricing and allocation	Take all reasonable steps to ensure price discovery is credible and transparent and that allocation recommendations made to the Issuer

	and the final allocation have a proper basis. For IPO, advise the issuer client against providing any arrangements whereby the investor clients would pay less than the total consideration for each of the shares allocated as disclosed in the listing document.
Communication with issuers, other CMLs and targeted investors	Inform other syndicate CMLs of the Issuer's marketing and investor targeting strategy and disseminate material information (which is complete, accurate and has a proper basis) related to the offering in a timely manner to all syndicate CMLs.
Record keeping	Document all changes in the order book throughout the bookbuilding process; all key discussions, advice or recommendations provided to the Issuer; the final decisions of the Issuer which debate materially from advice or recommendations from the OC; and the rationale for decisions delegated to it by the Issuer. Records should be maintained for at least seven years.

For more detailed requirements, please refer to paragraph 21 of the latest version of the Code of Conduct (pages 50ii to 50bbb).

Important highlights in the Revised Bookbuilding and Placing Rules include the prohibition of "X-orders" and rebates and preferential treatment to investor clients.

SFC is particularly concerned about the market practice of "X-orders" (i.e. orders where the identities of investors are concealed), as issuers may request CMLs to use "X-orders" to conceal the identities of prospective investors with whom they are closely associated, in order to hide the fact that the orders are not market-driven or for other purposes. The Revised Bookbuilding and Placing Rules prohibit the use of "X-orders". For example, CMLs are now required to disclose the identities of all investor clients in an order book except omnibus orders, in which case information of the underlying investors will have to be provided, and OCs (including sponsor-OCs) are required to take reasonable steps to properly manage an order book and ensure the book's transparency.

CMLs are also prohibited from offering any rebates to investor clients or enabling any investor clients to pay at a price lower than that offered to other investors and OCs (including sponsor-OCs) should advise the issuer

client regarding such prohibition. On the other hand, rebates offered by issuers to intermediaries as incentives for their selling efforts are not banned, provided that they are not passed on to investor clients and are properly disclosed in accordance with the Revised Bookbuilding and Placing Rules.

Additional obligations of the issuer and its directors

In compliance with the Revised Bookbuilding and Placing Rules, the issuer must enter into written agreements with CMI's before the CMI's conduct any specified activities. The written agreement should specify the roles and responsibilities of the CMI, the fee arrangements, the fee payment schedule, etc.

Issuers should also note that, pursuant to the 'sponsor coupling' requirement, sponsor-OC has to be appointed at the outset when listing application is submitted and changes in the appointment of sponsor-OC may lead to suspending the listing application until replacement sponsor-OC is appointed.

For the purposes of an IPO, in order to enable the CMI's to identify investors to whom the allocation of equity securities or interests would be subject to restrictions under the HKEx Listing Rules (or require the Stock Exchange's prior consent), paragraph 21.4.5 of the Code of Conduct requires the OC to advise the new applicant to provide all syndicate CMI's with a list of the directors and existing shareholders of the listing applicant and their respective close associates and any nominees engaged by any of the foregoing persons for the subscription or purchase of equity securities or interests.

To assist CMI's in discharging their relevant obligations under the Revised Bookbuilding Placing Rules, Main Board Listing Rule 3A.46 (GEM Listing Rule 6A.48) requires the written engagement entered into by a listing applicant with each syndicate member to specify the obligations of the listing applicant and its directors to provide the relevant information as soon as practicable and in any event at least four clear business days before the date of the listing applicant's Listing Committee hearing. The listing applicant must also keep the syndicate member informed of any material changes to information provided as soon as it becomes known to the new applicant and its directors.

OCs (including sponsor-OCs) should also advise the issuer client prohibition of "X-orders" and any rebates and preferential treatment to investors. In light of the heightened compliance obligations, issuers and its directors should be reminded to cooperate with the syndicate members and provide all the necessary information required.

PRACTICAL TIPS

The following sets out some important timeline requirements under the Revised Bookbuilding and Placing Rules and the new requirements under the HKEX Listing Rules:

1. Sponsors should discuss early on with the issuer client the appointment of OCs and CMI's and the fee arrangements regarding the fixed fees and discretionary fees to syndicate members, as appointment of sponsor-OC has to be finalised at least *two months* before submission of listing application and the appointment must be made in writing setting out the fee arrangements.
2. At the time of submitting listing application, the application proof prospectus shall include the names of the issuer's principal banks, sponsors, sponsor-OCs, OCs, any other syndicate members, authorised representatives, attorneys, registrar and counsels for the offering and their addresses, as well as the fee arrangement for the fees to be paid to the syndicate members. An application proof announcement for the appointment of OC ("**OC Announcement**") shall also be published on HKEXnews website together with the application proof prospectus on the date of submitting listing application.
3. The listing applicant must appoint all other members of the syndicate (OCs) within two weeks after submission of the listing application. The listing applicant should also publish an application proof OC Announcement notifying the public of the name(s) of its newly appointed OC as soon as possible after each appointment, but in any event no later than the first business day following the date of appointment.
4. In no less than four clear business days prior to the Listing Committee Hearing, a sponsor-OC (for a Main Board IPO) or an OC (for a GEM IPO) must submit information of each OC and the details of their fee arrangements to the SFC.
5. After the issue of the prospectus but before dealings commence, the following documents relating to pricing and distribution of shares are to be submitted to the Stock Exchange:
 - A placing letter and a Marketing Statement (Form D of Appendix 5 to the Main Board Listing Rules or the GEM Listing Rules) signed separately by each of the OCs, the CMI's and every exchange participant involved

- A list of places prepared by the above persons
- "Sponsor/Overall Coordinator's Statement" (Form E of Appendix 5 to the Listing Rules)
- "Issuer's Declaration" (Form F of Appendix 5 to the Main Board Listing Rules or Form E of Appendix 5 of the GEM Listing Rules)

[commission/Code_of_conduct_05082022_Eng.pdf?rev=0fd396c657bc46feb94f3367d7f97a05](https://www.sfc.gov.hk/commission/Code_of_conduct_05082022_Eng.pdf?rev=0fd396c657bc46feb94f3367d7f97a05)

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CONCLUSION

To implement the requirements under the Revised Bookbuilding and Placing Rules, sponsors and CMI's may consider the following measures:

- set up working teams to manage implementation of the requirements;
- update policies and document templates (e.g. appointment agreements) to address the requirements and govern processes to prevent conflict of interests;
- ensure timely disclosure of complete and accurate information to the OC, CMI's and targeted investors;
- formulate compliance checklists in relation to the bookbuilding and placing activities;
- conduct relevant training for senior management staff relating to the new requirements; and
- maintain books and records to comply with all applicable requirements.

The Revised Bookbuilding and Placing Rules in paragraph 21 of the Code of Conduct has undoubtedly brought about a positive change for the market as a whole since it further promotes transparency of bookbuilding and strives to maintain a level playing field among all investors. However, sponsors and market intermediaries are now faced with even more compliance obligations, and some also say that the sponsor coupling requirement may limit the issuer's flexibility in appointing OCs with strong marketing abilities and prejudice standalone boutique sponsor firms that lack marketing capabilities. Nevertheless, the new requirements solidifies the power of sponsors, creates a regulatory environment that encourages thorough due diligence to be performed on issuers and discourages any manipulation of the securities market, most importantly, helps to promote a fair and orderly market which has always been one of the core values that make Hong Kong stand out internationally.

Source:

- <https://www.sfc.gov.hk/media/EN/assets/components/codes/files-current/web/codes/code-of-conduct-for-persons-licensed-by-or-registered-with-the-securities-and-futures->

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