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# **SFC CONSULTS ON PROPOSED CODE OF CONDUCT ON BOOKBUILDING AND PLACING ACTIVITIES AND PROPOSAL ON SPONSOR COUPLING**

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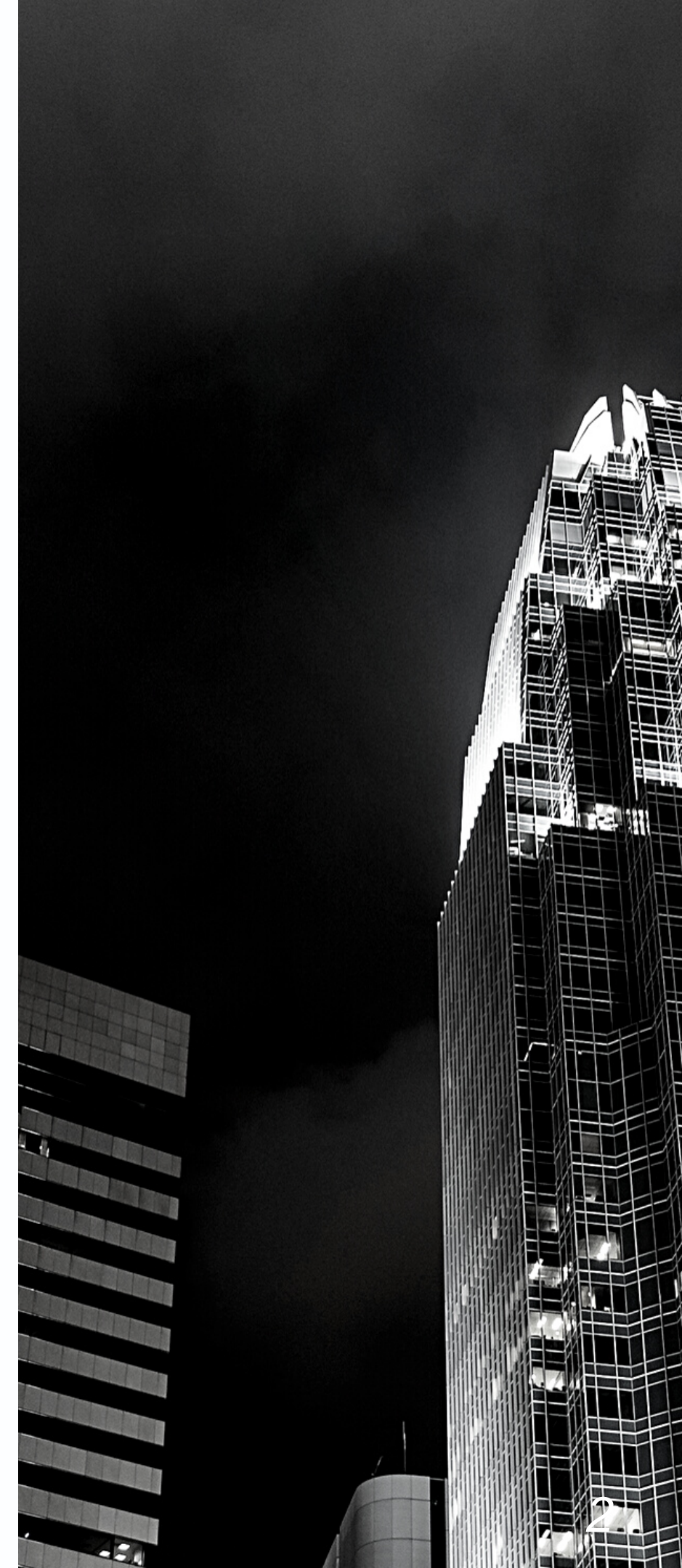
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**CHARLTONS**  
易周律师行



# OVERVIEW OF SFC PROPOSALS

1. New Code of Conduct requirements for intermediaries conducting bookbuilding and placing activities in equity and debt capital market transactions
2. "Sponsor Coupling" - require at least one head of the underwriting syndicate or a company within the same group to also act as an independent sponsor





# SFC THEMATIC REVIEW

1

Price discovery process  
hampered by various factors

2

Instances of "undesirable  
intermediary conduct"

3

Sponsors' fees and costs and  
liabilities often misaligned



# SFC PROPOSALS

- Impose various obligations on intermediaries in a new paragraph 21 of the SFC Code of Conduct for Persons Licensed by or Registered with the SFC (**CMIs**)
- Syndicate membership and fee arrangements determined at an early stage
- CMIs and overall coordinators (**OCs**) appointed under written agreements setting out their roles, responsibilities and fee arrangements
- **On IPOs**, at least one OC must be appointed as a sponsor and this sponsor must be independent of the issuer



# SFC CONCERNS

## Roles and functions of intermediaries:

- written agreements do not clearly set out roles and functions
- intermediaries' titles have little bearing on their seniority or responsibilities in relation to the transactions

## Syndicate membership:

- late determination of syndicate membership and fee arrangements



# SFC CONCERNS (CONT.)

## **Incentive structures:**

- significantly more allocated to discretionary fees
- SFC concerned that price-insensitive demand can drive up share price to a level that cannot be sustained in secondary market trading

## **Inflated orders and overstated demand:**

- knowingly placing inflated orders
- overstating demand which undermines price discovery process and can mislead investors



# SFC CONCERNS (CONT.)

## Lack of transparency:

- use of "X-orders" in debt capital market transactions
  - (1) may result in unusual, duplicated or potentially fictitious orders not being identified;
  - (2) inflate "market-driven demand"
  - (3) prevent other syndicate members from poaching clients
  - (4) conceal participation in a debt capital market transaction





# SFC CONCERNS (CONT.)

## Conflicts of interest:

- not giving priority to orders placed by investor clients over proprietary orders
- syndicate members with access to the order book are privy to non-public information which could be used to increase chances of allocation in popular deals

## Preferential treatment or rebates:

- rebates passed on to private banks' clients
- brokerage fees rebated to IPO investors



# SFC CONCERNS (CONT.)

## Records:

- insufficient or inadequate records of incoming client orders, discussions with issuer and syndicate members or basis of allocation recommendations

## Breach of HKEx requirements:

- potential breaches of the HKEx requirements identified



# SFC PROPOSED CODE OF CONDUCT

## Scope of Coverage

### *BOOKBUILDING ACTIVITIES*

"collating investors' orders in a share or debt offering to facilitate:

- (i) price determination and allocation of shares / debt securities to investors; or
- (ii) process of assessing demand and making allocations"

### *PLACING ACTIVITIES*

"distributing shares or debt securities to investors pursuant to bookbuilding activities"



# SFC PROPOSED CODE OF CONDUCT

## Types of Offerings

### *ECM*

- shares to be listed on the HKEx issued by a listing applicant in an IPO (including share offerings in secondary listings)
- offerings of shares of a class new to listing
- offerings of new shares of a class already listed under a general or special mandate
- units or interests in SFC-authorised REITs listed or to be listed on the HKEx
- shares listed on the HKEx when a shareholder places its existing listed shares to third party investors followed by a top-up subscription of new shares by the shareholder, to the extent that these offerings involve bookbuilding activities

### *DCM*

- all types of debt offerings involving bookbuilding or placing activities conducted by intermediaries in Hong Kong

### *OUT OF SCOPE*

- bilateral agreements of arrangements between issuers and investors
- transactions involving only one or several investors where the terms of the offering are negotiated and agreed directly between the issuer and the investors
- transactions where shares or debt securities are allocated to investors on a pre-determined basis
- share offerings which have been subscribed by an intermediary as principal deploying its own balance sheet, for onward selling to investors or otherwise





# SFC PROPOSED CODE OF CONDUCT

## *Types of CMIs*

***Share offering*** - OC is a syndicate CMI which, solely or jointly, conducts any of the following activities:

- (1) overall management of the share offering, coordinating bookbuilding or placing activities conducted by other CMIs, exercising control over bookbuilding activities and making allocation recommendations to the issuer;
- (2) advising the issuer of offer price and being party to the price determination agreement with the issuer;
- (3) exercising discretion to reallocate shares between placing tranche and public subscription tranche; reducing number of offer shares; or exercising an upsize option or over-allotment option; or
- (4) acting as stabilising manager

***Debt offering*** - OC is a syndicate CMI which, solely or jointly, conducts the overall management of the debt offering, coordinates bookbuilding or placing activities conducted by other CMIs, exercises control over bookbuilding activities and makes pricing or allocation recommendations to the issuer



# SFC PROPOSED CODE OF CONDUCT

## *Types of CMIs*

### Syndicate CMIs and Non-syndicate CMIs:

- all other CMIs will fall within the category of (1) syndicate CMIs or (2) non-syndicate CMIs, depending on whether they have a mandate and direct relationship with the issuer



# SFC PROPOSED CODE OF CONDUCT

## Standards of Conduct Expected of OCs and CMIs

### 1. Assessment of the issuer and the offering (para. 21.3.1 & 21.4.7(a))

- before engaging in an offering, take reasonable steps to obtain an accurate understanding of the issuer (issuer's history, background, business and performance, financial conditions and prospects, operations and structure)
  - **exception** for CMI for a debt offering which has been a CMI for a previous debt offering by the same issuer - CMI should assess whether there are any material changes in the issuer's circumstances of relevance to its role as CMI
  - OC should share information about the issuer with syndicate CMIs or take reasonable steps to ensure that the issuer provides this information to them. The information should then be shared with non-syndicate CMIs
- Establish a formal governance process to review and assess the offering before entering into an offering
  - review the offering and assess any actual or potential conflicts or interest between the CMI and issuer and associated risks
  - CMIs must maintain sufficient resources and have effective systems and controls in place to ensure that it can properly discharge these obligations





## 2. Appointment of CMIs and OCs (para. 21.3.2 & 21.4.1)

- Before a CMI (other than an OC) starts any bookbuilding or placing activities, it must have been formally appointed by the issuer (or another CMI in the case of a non-syndicate CMI) to conduct those activities under a written agreement
- Written agreement must clearly set out the roles and responsibilities of the CMI, fee arrangements and the fee schedule
- ***On a share offering***, the OC must be appointed before it provides any services as OC and in any event no later than two weeks after the listing application is submitted to the HKEx
- ***On a debt offering***, the OC must be appointed before it conducts any bookbuilding or placing activities
- OCs must be appointed under a written agreement which specifies the OC's roles and responsibilities, fee arrangements and fee schedules



### 3. Advice to the issuer (para. 21.4.2 and 21.4.3)

- OC should advise the issuer on syndicate membership, fee arrangements, marketing strategy and pricing and allocation
- OC must ensure its advice and recommendations are balanced and take into account the issuer's preferences and objectives with respect to pricing and prevailing market conditions and sentiment
- OCs must ensure that their advice is aligned with all legal and regulatory requirements
- ***On a share offering***, an OC will need to advise and guide the issuer and its directors on the HKEx's requirements for placings under Appendix 6 to the Main Board Listing Rules and Chapter 10 of the GEM Rules and take reasonable steps to ensure that they understand and meet those requirements
- ***On a debt offering***, OCs will also need to ensure compliance with the specific requirements for an offering of debt securities listed on the HKEx
- OCs will be required to explain the basis of their advice and recommendations including any advantages and disadvantages and advice should be provided in a timely manner



### 3. Advice to the issuer (para. 21.4.2 & 21.4.3) (cont.)

- Where an issuer decides not to adopt an OC's advice / recommendations in relation to pricing or allocation, or where an issuer's decision on a share offering may lead to a lack of an open market, an inadequate spread of investors or may significantly and negatively affect the trading of shares in the secondary market, the OC should explain its concerns and advise the issuer against making a decision
- Any final decisions which materially deviate from the OC's advice / recommendations should be documented by the OC and in the case of a share offering, the OC should report to the SFC any issuer decisions that amount to material non-compliance with the HKEx's requirements on placings





#### 4. Marketing and investor targeting strategy (para. 21.3.4, 21.4.4 and 21.4.7(b))

- OC will be required to advise and assist the issuer in developing an appropriate marketing and investor targeting strategy which should take into account the issuer's objectives and preferences
- OC should advise the issuer to adjust the strategy as appropriate in response to changing market conditions and sentiment
- OCs should inform other syndicate CMLs of the marketing and investor targeting strategy and syndicate CMLs would be required to inform CMLs they engage of the strategy
- CMLs should not market to investor clients falling outside the strategy
- ***On a share offering***, where the shares are only marketed to selected investor clients, CMLs should be satisfied that the shares are marketed to a sufficient number of investor clients to minimise the likelihood of an undue concentration of shareholdings



## 5. Rebates and preferential treatment (para. 21.3.7, 21.3.8, 21.4.4(c), 21.4.5(b) & 21.4.7(c))

- CMIs should not offer any rebates to their investor clients or pass on any rebates provided by the issuer
- **On IPOs**, CMIs should not enable investor clients to pay less for their shares than the total consideration disclosed in the listing document (including the 1% brokerage fee)
- **On debt offerings**, CMIs should not enter into any arrangements which may result in investor clients paying different prices for the debt securities
- A CMI will be required to disclose to the issuer, the OCs, all of its targeted investors and the non-syndicate CMIs it appoints, any rebates offered by the issuer to CMIs and any preferential treatment of any CMIs or targeted investors
- **On a share offering**, a CMI should make this disclosure upon becoming aware of any rebate or preferential treatment
- **On a debt offering**, disclosure should be made no later than the dissemination of the deal “launch message” to targeted investors
- OCs will be obliged to disseminate the information they receive about rebates or preferential treatment to all syndicate CMIs for their onward disclosure to targeted investors and the non-syndicate CMIs they appoint
- The OC will be required to advise IPO issuers against providing any arrangements which would allow investor clients to pay less than the total consideration disclosed in the listing documents
- **On a debt offering**, the OC should advise issuers against providing any arrangements which would allow investor clients to pay different prices for the debt securities. The OC should also advise and guide the issuer in relation to the necessary disclosures.





## 6. Assessment of investor clients

- CMIs will be required to take reasonable steps to assess each investor client's profile, including their investment preferences and past investment history
- a CMI will be required to take reasonable steps to identify Restricted Investors and inform the OC before placing an order on behalf of a Restricted Investor
- OCs will be required to provide more information to CMIs in respect of persons and entities related to the issuer
- OCs should take reasonable steps to identify Restricted Investors so that they will only be allocated shares in accordance with the HKEx requirements
- ***On a debt offering***, a CMI should identify whether its investor clients may have any associations with the issuer, the CMI or a company in the same group of companies as the CMI. OCs will be expected to provide sufficient information to CMIs to enable them to identify these investors. The CMI should inform the OC of these investors to enable the OC to assess whether any orders may negatively impact the price discovery process



An aerial photograph of a long, multi-lane bridge spanning a large body of water. The bridge has multiple support pillars and is surrounded by a body of water. In the background, there are mountains and some industrial structures on the left side. The sky is clear and blue.

## 7. Bookbuilding

- The SFC considers CMIs to be responsible for ensuring that the price discovery process is credible and that the order book is transparent and incorporates only bona fide orders
- An OC should ensure that the pricing and allocation recommendations made to the issuer fully take into account the principles and factors stipulated under the Proposed Code



## 7. Bookbuilding - Order book (para. 21.3.5 & 21.4.5(a))

- Identities of all investors must be disclosed in the order book, except for orders placed on an omnibus basis
- ***In the case of omnibus orders***, the identity of the underlying investors will need to be provided to the OC and the issuer, but need not appear in the order book
- CMIs will be required to take reasonable steps to ensure that all orders placed in the order book on behalf of their investor clients, the CMI itself and its group companies represent bona fide demand
- CMIs must not place "knowingly inflated" orders
- CMIs should also make enquiries with their investor clients about orders which appear unusual and will be required to maintain adequate records of orders placed by its investor clients to substantiate that there are no fictitious or knowingly inflated orders placed in the order book
- The OC will be required to ensure that the identities of all investor clients are disclosed in the order book, except for orders placed on an omnibus basis. If any orders appear to be unusual or irregular, the OC should make enquiries with the CMIs
- The OC is required to consolidate the order book by taking reasonable steps to identify and eliminate duplicated orders, inconsistencies and errors
- The OC should segregate and clearly identify in the order book any proprietary orders of CMIs and their group companies





## 7. Bookbuilding - Pricing and allocation (para. 21.3.6, 21.4.2(a)(iii), 21.4.5(b) & (c) & 21.4.6(a)(ii))

- An OC should discuss with and advise the issuer on the final offer price taking into account the results of bookbuilding activities, the issuer's characteristics and prevailing market conditions and sentiment
- ***On a debt offering***, the OC should ensure that the orders placed by investors which have associations with the issuer, CMI and their group companies will not negatively impact the price discovery process
- An OC should develop and maintain an allocation policy which sets out the criteria for making allocation recommendations to the issuer
  - must take into account the issuer's objectives, preferences or recommendations; prevailing market conditions and sentiment; and targeted investors' type, characteristics and circumstances (such as clients' financial profiles, investment experience and objectives) and must address the spread of investors
  - should communicate allocation policy to the issuer early
  - ***in the case of an IPO***, recommendations should ensure that allocations to Restricted Investors comply with the HKEx's requirements and be made with a view to achieving an open market, an adequate spread of shareholders and promoting the orderly and fair trading of shares in the secondary market
  - OC should document allocation recommendations provided to the issuer, including its rationale





## **7. Bookbuilding - Pricing and allocation (para. 21.3.6, 21.4.2(a)(iii), 21.4.5(b) & (c) & 21.4.6(a)(ii)) (cont.)**

- CMI should establish and implement an allocation policy to ensure a fair allocation of shares or debt securities to their investor clients where they place an order on an omnibus basis and an OC gives them an overall allocation
  - CMIs should allocate shares or debt securities to investor clients in accordance with the allocation policy and document any reasons for material deviations from the allocation policy
  - when allocating shares or debt securities, a CMI is expected to assess whether the investor client has the ability to take up the allocation and whether the size of the order appears unusual



## 8. Conflicts of interest and proprietary orders of CMI and their Group Companies (para. 21.3.10)

- CMIs must establish and implement policies and procedures to identify, manage and disclose actual and potential conflicts of interest with investor clients which may arise when the CMI has a proprietary interest in an offering
- A CMI will be required to implement policies governing the process for generating its own proprietary orders and making allocations to those orders
- CMIs must give priority to investor clients' orders over their own proprietary orders and those of their group companies
- A CMI will be required to be a "price taker" in relation to its proprietary orders and those of its group companies and should ensure that these orders are based on market-driven demand and would not materially influence the pricing of the offering
- The OC and CMI should also segregate and clearly identify in the order book and "book messages" its own proprietary orders and those of its group companies, other CMIs and their group companies
- ***On a debt offering***, a CMI should take reasonable steps to disclose to the issuer why any risk management transactions it intends to carry out for itself, the issuer or its investor clients would not affect the pricing of the new offering





## **8. Conflicts of interest and proprietary orders of CMI and their Group Companies (para. 21.3.10) - Review and approval of orders and allocations (para. 21.3.11(b))**

- senior management of a CMI should review and approve certain types of orders and allocations, including proprietary orders of the CMI and its group companies; orders from investor clients which appear unusual; and allocations to Restricted Investors in the case of share offerings





## 9. Communications with issuers, other CMIs and targeted investors (para. 21.3.8 & 21.4.7)

- A CMI should disseminate material information relating to the offering to the OC, its investor clients and the CMIs it appoints
- ***On a share offering***, CMIs should provide information about Restricted Investors
- ***On a debt offering***, CMIs should provide information about investor clients which have associations with the issuer, CMIs and their group companies
- CMIs will need to provide the information to the OC and non-syndicate CMIs appointed by them to enable them to properly discharge their duties
- CMIs must disseminate the marketing and investor targeting strategy to non-syndicate CMIs to facilitate their marketing of the shares or debt securities to investor clients
- CMIs should provide “book messages” and other information related to the offering (such as information on rebates offered to CMIs) to the OC, non-syndicate CMIs they appoint and to their targeted investors
- OCs and CMIs should disseminate information in a timely manner and ensure that it is complete, accurate and has a proper basis



## **10. Keeping of records (para. 21.3.9 & 21.4.8)**

- A CMI must maintain books and records to evidence the work done throughout the transaction and demonstrate compliance with the legal and regulatory requirements and the CMI's internal policies and procedures
- CMIs will be required to document key communications with the issuer, investors and other CMIs and the basis of allocation decisions with justifications for any material deviations from the CMI's allocation policy
- The records should also include an audit trail from the receipt of orders through to final order allocation
- OCs will be required to document all changes in the orders in the order book throughout the bookbuilding process and all key discussions with, and key advice or recommendations provided to the issuer



## 11. Resources, systems and controls (para. 21.3.11)

- Chinese walls:
  - take adequate measures to prevent the flow of information which may be confidential or price sensitive amongst staff performing different activities and to prevent and manage any conflicts of interest which may arise
  - maintain effective Chinese walls and wall-crossing policies and procedures
- ***When a CMI appoints a non-syndicate CMI***, it should exercise due skill, care and diligence in selecting and appointing the non-syndicate CMI which will require the CMI to take reasonable steps to ensure that the non-syndicate CMI is able to comply with the Proposed Code
  - review the non-syndicate CMI's process for assessing whether investor clients are independent from or associated with the issuer and its procedures and controls to ascertain whether all orders are bona fide
  - review the non-syndicate CMI's allocation policy to ensure that it addresses the requirements under the Proposed Code, and the procedures to ensure that allocation is made in compliance with that policy
- CMIs will be required to conduct independent surveillance and monitoring on a regular basis to detect irregularities, conflicts of interest and leakage of price sensitive or confidential information and any potential non-compliance with applicable legal and regulatory requirements or their own internal policies and procedures



## 12. Fee arrangements (para. 21.3.2, 21.4.1, 21.4.3 & 21.4.9)

- Fee arrangements must be specified in the written agreements with CMIs and OCs and OCs will be required to advise issuers on the fee arrangements
- **Fixed fees payable to the OCs** - should be determined at the time of their appointment and should cover the advisory services provided by an OC and proportions of shares or debt securities ordinarily expected to be sold by the OC. Issuers can still pay CMIs discretionary fees to incentivise sales outperformance
- Each written agreement to be entered by an OC or CMI should 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
- An OC will be required to advise and guide the issuer on:
  - fee-related matters and on determining the ratio of fixed to discretionary fees to be paid to syndicate CMIs and the basis of allocation of fixed fees to syndicate CMIs;
  - the basis of allocation of any discretionary fees to syndicate CMIs. ***In the case of a debt offering***, this allocation should be determined no later than at the time of pricing; and
  - the fee payment schedule



## 12. Fee arrangements (para. 21.3.2, 21.4.1, 21.4.3 & 21.4.9) (cont.)

- The following information should be submitted to the SFC four clear business days before the Listing Committee Hearing for an IPO:
  - information about the syndicate members indicating their roles;
  - the total fees to be paid to all syndicate CMIs;
  - the ratio between the fixed and discretionary portions of the fees to be paid to all syndicate CMIs (in percentage terms); and
  - the allocation of the fixed portion of the fees paid by the issuer to each syndicate CMI participating in the offering
- The SFC should be informed of any material changes once they are agreed between the issuer and syndicate CMIs and of the reasons for the change
- **Discretionary fees -**
  - a confirmation should be provided to the SFC no later than listing that the issuer has determined allocations of any discretionary fees to each syndicate CMI as well as the fee payment schedule
  - total monetary benefits, including fixed and discretionary fees and any bonuses, paid to each syndicate CMI by the issuer should be provided to the SFC within two weeks after the first day of dealings







# HKEX "SPONSOR COUPLING" PROPOSAL

## ***Motivations for Proposal:***

- SFC perceives advantages to heads of syndicate also acting as IPO sponsors
- Misalignment between fees paid to sponsors and sponsors' costs
- For the nine months ended 30 September 2020, average sponsor fee was HK\$6.3 million and average underwriting fixed fee was HK\$43.9 million

## ***SFC 2012 Consultation:***

- *"Sponsor fees should appropriately reflect the role and responsibilities to be discharged by a sponsor and should not be confused with other services, notably bookbuilding, pricing and similar functions governed by underwriting and related agreements"*

## ***Soft Consultations:***

- Market participants opposed proposals to require all OCs to be sponsors based on concerns that it would limit the issuer's flexibility in appointing OCs whose strengths are primarily in marketing rather than sponsor work; and
- The proposal could prejudice standalone boutique sponsor firms with no marketing capabilities





## **Proposed Requirements**

- Listing applicant must appoint at least one sponsor which is independent of the listing applicant who should also be appointed as an OC, or have a group company which is appointed as an OC for the IPO (the **Sponsor OC**)
- Sponsor OC must be appointed as OC and sponsor at the same time and at least two months before filing the listing application
- Listing applicant can appoint other OCs (which may or may not be sponsors of the IPO) no later than two weeks after the submission of the listing application





## **Proposed Requirements** **(cont.)**

- Before accepting an appointment by the issuer to act as an OC, an OC should either:
  - ensure that it (or one of its group companies) is also appointed as a sponsor, which is independent of the issuer client, and that both appointments are made at the same time at least two months before the submission of the listing application to the HKEX; or
  - obtain a written confirmation from the issuer that at least one sponsor, which is independent of the issuer client, or one of the group companies of that sponsor, has been appointed as an OC for that IPO. The OC's appointment should be made no later than two weeks after the submission of the listing application to the HKEX



## **Proposed Requirements** **(cont.)**

*Before accepting an appointment by a listing applicant to act as a sponsor*, a sponsor should either:

- 1 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
- 2 obtain written confirmation from the listing applicant that at least one sponsor, which is independent of the listing applicant, or one of the group companies of that sponsor, has been appointed as an OC in connection with that listing application



## **Proposed Requirements (cont.)**

- A Sponsor OC would also be expected to submit information on the syndicate membership, the total fees to be paid to all syndicate CMIs and the allocation of fixed fees within the prescribed time frame
- If more than one intermediary is appointed as a Sponsor OC, they should arrange for one of them to provide this information to the SFC
- Each Sponsor OC will be jointly and severally liable for ensuring that the information is accurate and complete and has been provided to the SFC within the stipulated timeline





## **Impact of Sponsor Coupling Proposal**

- Potential conflict of interest between the OC as the lead underwriter and the issuer
- Underpricing, particularly on smaller IPOs
- Listing delay if an OC which is the sole or sole independent sponsor decides it no longer wants to underwrite an IPO