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

SFC
證監會

Consultation Conclusions on the Regulatory Framework for Pre-deal Research

June 2011

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Executive summary

1. On 30 September 2010 the Securities and Futures Commission ("**SFC**") issued a Consultation Paper inviting public comment on proposals to:

   (a) extend the scope of the SFC requirements governing analysts responsible for investment research:

      (i) research about companies about to be listed; and

      (ii) research about REITS whether listed or about to be listed; and

   (b) to require sponsors to take steps to ensure that all material information or forward looking information (whether quantitative or qualitative), disclosed or provided to analysts in connection with a new listing, is contained in the relevant prospectus or listing document, offering circular or other similar document.

Changes to the original proposals

2. Respondents generally agreed with the proposals except that one respondent representing a group of banks argued that the proposed prohibition on providing analysts with any qualitative forward-looking information not contained in the prospectus or listing document was unduly restrictive. In response to these comments we have refined the proposal and will limit the exclusion to material information not contained in the prospectus or listing document. Material information would encompass both historical and forward-looking information.

3. Recently we have received enquiries about listing of business operations in the form of a business trust. Without prejudging whether such listings are appropriate for the Hong Kong market, we consider that investment research by analysts relating to business operations that are constituted in a form other than that of a company, such as a trust, should be subject to the same SFC requirements as investment research about a listed company or listing applicant. The logic for expanding the scope of these SFC requirements to listed REITS calls for the scope to cover any business operations that are proposed to be listed or are listed.

4. We further consulted the respondents to the original consultation paper. All those who responded unanimously agreed that the requirements for analysts should be extended to business operations that are constituted in forms other than as a corporation. We have decided to include analysts reports on business operations that are listed and established in a form other than a corporation in the scope of the SFC requirements governing analysts responsible for investment research.

5. We would emphasise that in doing this we are not prejudging the merits of whether a particular form is suitable for listing business operations.

Introduction

6. On 30 September 2010, we issued a Consultation Paper inviting public comment on a number of proposed amendments to the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission ("**Code of Conduct**"); and the Corporate Finance Adviser Code of Conduct ("**CFA Code**") intended to :

   (a) extend the scope of the SFC requirements governing analysts responsible for investment research to:

      (i) research about companies about to be listed; and

      (ii) research about REITS whether listed or about to be listed; and

   (b) require sponsors to take steps to ensure that all material information or forward looking information (whether quantitative or qualitative), disclosed or provided to analysts in connection with a new listing is contained in the relevant prospectus or listing document, offering circular or other similar document.

Market consultation

7. The consultation period ended on 30 November 2010. We received six responses. The list of respondents is set out in **Appendix 3** paper, and the full text of the submissions can be viewed at the SFC's website at https://www.sfc.hk/sfcConsultation/EN/sfcConsultCommentServlet?name=predealresearch. In addition, we also consulted a number of market practitioners after the close of the consultation period on the proposals. We welcome these responses and are grateful to those who have participated. Their comments and the SFC's responses to those comments are discussed in this paper.

8. Respondents generally agreed with the proposed amendments outlined in the Consultation Paper which will be implemented, subject to the modifications as set out in this paper, with effect from 1 September 2011 except for the requirements in relation to new listings. In the case of a new listing applicant, the new requirements will apply to any new listing where the listing application (i.e. the A1 Form) is submitted to the Stock Exchange of Hong Kong on or after 1 August 2011. Our responses are based on both the submissions we received on the Consultation Paper as well as other comments provided by members of the industry.

9. Unless otherwise stated, we have used defined terms in the Consultation Paper.

10. The marked up text of the amendments to the Code of Conduct and the CFA arising from the consultation is set out in **Appendix 1** and **Appendix 2** respectively.

Comments received and the SFC's responses

11. The respondents generally supported the proposals. There were views that the proposals did not go far enough. One group response representing banks generally supported the proposals but argued that disallowing provision of forward-looking qualitative information to analysts may cause HK to lose its competitive edge as a preferred market in Asia (and globally) for listings to other Asian (or global) markets.

12. In addition to the responses received in the course of the public consultation, we also met with market practitioners to understand their concerns and views.

13. The substantive comments are discussed below in the same order in which the issues were presented in the Consultation Paper.

Extending the SFC requirements governing analysts responsible for investment research

The SFC's proposal in the Consultation Paper:

14. We proposed to expand the scope of the existing requirements in Paragraph 16 of the Code of Conduct in relation to analyst conduct, so that they apply not just to analysts covering companies listed in Hong Kong but also analysts covering:

    (a) companies that are about to list their equity securities on the Exchange for the first time and are required to issue a prospectus; and

    (b) proposed listings of and listed SFC-authorized REITs in Hong Kong.

Public comments:

15. All the respondents supported the proposal to extend the requirements in Paragraph 16 of the Code of Conduct to cover research analysts in relation to Pre-deal Research and proposed listings of and listed SFC-authorized REITs in Hong Kong.

16. However, a number of the respondents asked us to:

    (a) revisit the decision that it is inappropriate to completely ban Pre-deal Research in the Consultation Conclusion Paper of 2006; and

    (b) consider establishing a quiet period of at least 1 month for investment banks acting as sponsors so that they cannot release Pre-deal Research for a period of time before the IPO takes place.

17. One respondent suggested that when a firm who is involved in an IPO as a sponsor publishes Pre-deal Research reports, it should fully explain their potential benefits from the IPO deal prominently in the prospectus.

The SFC's response:

18. We do not consider it appropriate to review the issue whether to completely ban Pre-deal Research nor to establish a quiet period at this moment. Pre-deal Research should be an impartial analysis of an Applicant, its business and prospects based on the Applicant's prospectus or offering document. A firm that employs analysts should establish processes and procedures to ensure that its analysts' Pre-deal Research are not prejudiced by its financial interests and business relationships, particularly its work as sponsor or underwriter in an IPO.

19. To address potential conflicts of interest issues that its Pre-deal Research contains favourable recommendations about an Applicant as a marketing tool to sell and ensure a successful IPO, the firm's conflicts of interest policy should contain restrictions on the time of the publication of its Pre-deal Research. Many firms impose a quiet period of at

least two weeks after they issue a Pre-deal Research report. We believe that the length of a quiet period should be a matter for firms to consider and implement in light of the nature, complexity and scale of its business.

20. We intend to proceed with the proposed amendments subject to modifications discussed below.

21. The requirement in Paragraph 16.5(d) of the Code of Conduct for a firm which has an investment banking relationship with listed corporations to disclose this in its research report will be extended to investment banking relationships with Applicants. We are of the view that an investment banking relationship includes when the firm is involved in an IPO as a sponsor or when the firm acts as a corporate finance adviser. When they publish Pre-deal Research reports, they should disclose their relationship. As a matter of good practice, they should also explain their conflict of interest, including potential benefits from their investment banking relationship.

Listing of business operations that are constituted in a form other than a corporation

22. After we issued the consultation paper, we received enquiries about listing of business operations in the form of a business trust. Without prejudging whether such listings are appropriate for the Hong Kong market, we consider that investment research by analysts relating to business operations that are constituted in a form other than that of a company, such as a trust, should be subject to the same SFC requirements as investment research about a listed company or listing applicant. The logic for expanding the scope of these SFC requirements to listed REITS calls for the scope to cover any business operations that are proposed to be listed or listed.

23. We further consulted the respondents to the original consultation paper, of which seven responded and unanimously agreed that the requirements for analysts should be extended to business operations that are constituted in forms other than as a corporation. We consider it appropriate to expand the scope of the existing requirements in Paragraph 16 of the Code of Conduct to cover research analysts covering any business operations that are proposed to be listed and are listed regardless of the way in which the business is constituted or established.

24. We would emphasise that in doing this we are not prejudging the merits of whether a particular form other than that of a corporation is suitable for listing business operations.

25. We have amended Paragraph 16 of the Code of Conduct to extend the requirements to include business operations constituted in a form other than that of a corporation or a REIT. We have also replaced references to “listed corporation” with an “issuer” to reflect that the business operations may be constituted in forms other than a corporation.

Codifying existing practice for firms to establish, maintain and enforce independence and impartiality between investment function and research function

The SFC's proposal in the Consultation Paper:

26. We proposed to codify the existing practice that firms employing research analysts preparing Pre-deal Research on an Applicant should be required to establish, maintain and enforce a set of written policies and control procedures to ensure that these analysts are not provided by the firm with any material information or forward looking information (whether qualitative or quantitative) concerning the Applicant that is not reasonably expected to be included in the prospectus or publicly available.

Public comments:

27. The respondents supported this proposal. One respondent commented that appropriate monitoring and supervision practices of sponsor and underwriter firms must be part of the control procedures. The design of these policies and control procedures should be considered in the context of the firm's nature, scale and complexity of its business. Another respondent suggested that these policies and control procedures should be reviewed annually for effectiveness.

28. One respondent suggested that the SFC encourage Applicants to release more important and accurate information to the general public. Another respondent suggested that the SFC provide further explanation or guidance as to how the "reasonably expected" test will be applied.

29. However, one group respondent representing banks did not agree that analysts should be prevented from obtaining *qualitative forward-looking information* from listing applicants. This respondent agreed that financial projections that are not included in a prospectus should not be provided to research analysts. However, it believed that it is appropriate and useful for analysts to discuss forward-looking qualitative information that does not comprise of financial projections. It asked for clarification regarding the meaning of "material information or forward-looking information".

30. The group respondent submitted that analysts should be allowed to discuss with the Applicant management their views on future industry trends, assumptions about future growth or demand, and assumptions about the costs of oil or other commodities. It argued that such information cannot be included in the prospectus because this information cannot be verified nor subjected to a due diligence exercise. This information is not material information upon which investors can make their investment decision. Such information may be subjective and uncertain.

The SFC's response:

31. It is up to the Applicants to disclose all relevant and material information in its prospectus or offering document. The prospectus or offering document should contain sufficient information to enable a reasonable person to form as a result thereof a valid and justifiable opinion of the Applicant and its financial condition and profitability at the time of the issue of the prospectus.

32. We do not agree that only information that can be verified or subjected to a due diligence exercise can be included in a prospectus or listing document, especially if such information is material to enable investors to make an informed decision. The prospectus, offering circulars or listing documents should not omit any material information.

33. We had originally intended that the phrase "material information or forward-looking information" should refer to:

    (a) any material information which enables a reasonable person to form as a result thereof a valid and justifiable opinion of the shares and the financial condition and profitability of the company at the time of the issue of the prospectus; and

    (b) any forward-looking information, whether such information is quantitative or qualitative in nature. We did not intend to qualify forward-looking information with a materiality concept.

34. All respondents agreed that analysts should not be provided with information not in the prospectus that is material.

35. There were divergent views on forward-looking information. It was common ground that analysts should not be provided with financial projections for the Applicant where these are not included in the prospectus. However, one group respondent representing banks argued against prohibiting provision of information not in the prospectus that was qualitative forward-looking information, such as general industry trends, and future growth of the industry or section in which the listing applicant operates.

36. This group respondent argued that analysts needed such information to critically assess the intention of the listing applicant's management and confirm assumptions made about the Applicant's business model in preparing the Pre-deal Research, but investors would not find such information useful. Including them in the prospectus could be confusing and misleading.

37. We recognise that some forward-looking information whether qualitative or quantitative may not be necessary for investors to form a valid and justifiable opinion of the Applicant and its financial condition and profitability. However, we cannot agree that all qualitative forward-looking information is not necessary for investors to form a valid and justifiable opinion. Nor can we agree that all quantitative forward-looking information that does not relate to the Applicant directly is not necessary for investors to form a valid and justifiable opinion.

38. Rather than seek to define the characteristics of forward-looking information that can be given to analysts when not included in the prospectuses, we believe it would be more appropriate to apply a single test to all types of information, whether or not it is forward-looking information that can be provided to analysts when it is not included in the prospectuses. The test that should be applied is whether the information is material to an investor in forming a valid and justifiable opinion of the Applicant and its financial condition and profitability.

39. We note that few Applicants include financial projections in their prospectus notwithstanding the fact that most applicants will have forecasts and budgets for their operational purposes. In addition, listing applicants are required under the Listing Rules to submit their profit forecasts and cash flow forecasts to The Stock Exchange of Hong

Kong Limited. The fact that forecasts and budgets exist but are not included in a prospectus should not be taken as indicating that these are not material information.

40. In judging whether any information, particularly any forward-looking information, is material and thus falls within the prohibition consideration has to be given as to whether, if included in a prospectus, it is likely to significantly influence a reasonable person's opinion of the Applicant and its financial condition and profitability.

Analysts should not seek non-prospectus information

The SFC's proposal in the Consultation Paper:

41. We proposed to prohibit research analysts preparing Pre-deal Research reports on an Applicant from seeking from the Applicant or its advisers, either directly or indirectly, any material information or forward looking information (whether qualitative or quantitative) concerning the Applicant that is not reasonably expected to be included in the prospectus or publicly available by amending Paragraph 16.11 in the Code of Conduct.

Public comments:

42. Most of the respondents supported the proposal. It was agreed that research analysts should always perform independent due diligence to arrive at their own forecasts and recommendations.

43. One respondent distinguished between information or view that analysts:

    (a) formulated from information they obtained from their own independent due diligence. Analysts should be permitted to seek such information; and

    (b) obtained from the Applicant without further analysis. Analysts should not be permitted to seek such information and publish it as their own view.

    The respondent suggested the SFC draws a clear line between this information and asked the SFC to develop clear guidelines on what type of information is allowed and what is not.

44. Another respondent suggested analysts be allowed to immediately disclose to the sponsor or listing intermediary non-prospectus information acquired indirectly (not actively solicited) which may compromise their integrity and ethics.

45. One response representing a group of banks did not support the proposal. They submitted that prospectuses and research reports are fundamentally different and are for different purposes. Not all information that is provided to research analysts is suitable for inclusion in a prospectus. The SFC's proposal to disallow provision of qualitative forward-looking information to analysts would prevent them from seeking some forward-looking information from Applicants and remove one of the more valuable data points analysts currently have. They considered it inappropriate to impose on analysts the obligation to:

    (a) suppress their line of questioning that is industry standard (both in Hong Kong and abroad) for the preparation of both pre-deal research and on-going research; and

(b) determine whether any material information or forward-looking information which would not be reasonably be expected to be included in the prospectus or made public has been provided to them.

46. The group respondent argued that it should be the Applicant's responsibility to control the information flow to the analysts. It suggested that there should be a corresponding obligation for Applicants to not actively provide this information to analysts and for them take steps to ensure that all material information provided to analysts is contained in the relevant prospectus.

The SFC's response:

47. We agree that analysts should not be permitted to ask an Applicant for information about the Applicants' business and include such information in their Pre-deal Research reports as their own. Analysts should always perform independent due diligence to arrive at their own views, forecasts and recommendations.

48. The Code of Conduct and the CFA Code do not prohibit analysts from disclosing to the sponsor or listing intermediary non-prospectus information acquired indirectly (not actively solicited) which may compromise their integrity and ethics. As a matter of good practice, a firm's conflicts of interest policy should require its analysts to disclose instances when they have been provided with information not contained in the prospectus that may compromise their integrity and ethics. Sponsors and other listing intermediaries should be sensitive to attempts to provide analysts with information not contained in the prospectus and influence the analysts' views and recommendations.

49. During our discussion with the market participants, it was generally agreed that research analysts should know where to draw the line as to what questions they can reasonably ask Applicants and their advisers. We do not consider it necessary to develop guidelines to clarify what questions analysts can and should not ask Applicants and their advisers.

50. We understand that analysts are generally provided with information by the sponsors ("analysts briefing papers"). As such, the sponsor firms are in the best position to ensure that any material information they provide analysts is included in the prospectus. Analysts are uniquely qualified to determine whether the information they request that is not in the analysts briefing papers is material for investors to reach an informed view and should refrain from seeking material information that is not reasonably expected to be included in the prospectus or are not publicly available. If analysts receive information not included in the analysts briefing papers that could be material they should advise the sponsor and the Applicant. It is then up to the sponsor and Applicant to consider whether this information is material, and if so, ensure that it is included in the prospectus. See further discussion in paragraphs 58 to 59 below.

51. We will revise Paragraphs 16.7(b) and 16.11(c) of the Code of Conduct to require firms to establish written policies and control procedures to ensure analysts responsible for preparing a research report on an Applicant are not provided with material information.

Codifying existing practice for sponsors in relation to a new listing of equity securities to maintain integrity of flow of information to analysts

The SFC's proposal in the Consultation Paper:

52. We proposed to impose an obligation on sponsors in relation to a new listing of equity securities to take steps to ensure that all material information or forward looking information (whether qualitative or quantitative), disclosed or provided to analysts is contained in the relevant prospectus or where the proposed listing does not involve a prospectus, the relevant listing document, offering circular or similar document, by amending Paragraph 5.10 in the CFA Code.

Public comments:

53. Almost all the respondents agreed that sponsors have an obligation to ensure that information provided to analysts are included in the prospectus or listing document. In an IPO, sponsor or underwriter firms acts as intermediary between the Applicant and the connected analysts. They would be in the best position to ensure that their clients, the Applicants are properly briefed and advised on how to deal with research analysts.

54. Only the group respondent did not agree. It submitted that it is not reasonable to expect the sponsors to be responsible for:

    (a) syndicate members whose research analysts do not comply with the Research Guidelines, the Code of Conduct for Persons Licensed by or Registered with the SFC or the CFA Code of Conduct, and

    (b) any consequences arising from such non-compliance by syndicate members.

    This is particularly so given that the sponsors may not even be involved in the selection of syndicate members and do not know nor want to interfere with the internal measures taken by such syndicate members in relation to the research independence.

55. One respondent suggested sponsors should be required to ensure that a compliance adviser is present at presentations to prevent listing applicants from using it as a platform for disseminating material information without formal liability. Another respondent foresaw some difficulties, for instance when independent analysts pick up comments by an Applicant's chairman about the Applicant's business prospects in a certain market shortly before listing. The respondent suggested that the SFC should provide further guidance on the expected minimum steps a sponsor should take and on the expected consequences.

56. Another respondent suggested that the CFA Code also include a similar note as Paragraph 16.11(c) to make clear that analysts' views, forecasts through their own due diligence need not be included in the prospectus.

57. Another respondent suggested that Paragraph 5.10 of the CFA Code should be amended to include a REIT.

The SFC's response:

58. In a syndicate where there is more than one sponsor, sponsors in the syndicate are jointly responsible for compliance with the CFA Code. We do not agree that the proposed amendment imposes an unreasonable obligation when sponsors act in a group. Therefore, we intend to proceed with the proposal.

59. The sponsor or underwriter firm generally acts as intermediary between the Applicant and analysts. One of their responsibilities is the overall management of the public offer[1]. This includes putting in place sufficient arrangement to ensure that their clients are properly briefed and advised on how to deal with research analysts. To monitor the flow of information, as a matter of good practice, some firms require a chaperone to be present at meetings between the Applicant and analysts, while others require all communication between the Applicant and analysts to be made through a designated person. It is up to the sponsor to decide what steps are appropriate in the circumstances.

60. We agree with one of the respondents' submission that appropriate monitoring and supervision practices of sponsor and underwriter firms must be part of the control procedures. The design of these policies and control procedures should be considered in the context of the firm's nature, scale and complexity of its business. One respondent suggested that these policies and control procedures should be reviewed annually for effectiveness. We do not consider it necessary to provide further guidance on this matter.

61. The note to Paragraph 5.12 of the Code on Real Estate Investment Trusts makes it clear the listing agents appointed by the management company of a REIT should comply with all the requirements under the SFC codes and guidelines including the CFA Code. We do not agree it is necessary to amend the CFA Code to include REIT.

62. We will proceed with the proposed amendments to the CFA Code to require sponsors to take reasonable steps to ensure that all material information provided to analysts is included in the prospectus or offering document.

[1] Paragraph 5.3(a) of the CFA Code

Appendix 1

Paragraph 16 of the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission

Analysts

16.1 Application

(a) This paragraph applies to:

(i) an analyst;

(ii) a firm that employs any analyst; and

(iii) a firm that issues any investment research.

(b) This paragraph covers:

(i) investment research on securities that are traded in Hong Kong; and

(ii) investment research on securities that are issued or to be issued by a new listing applicant which are to be traded in Hong Kong,

and investment research that has an influence on such securities.

16.2 Interpretation

(a) "Analyst" for the purposes of this paragraph means any individual within a firm who prepares and/or publishes investment research or the substance of investment research. The term does not include an individual:

(i) giving investment advice or comments wholly incidental to his dealing or broking function;

(ii) conducting research solely for the firm's internal consumption and not for distribution to clients; or

(iii) giving personal (one-to-one) investment advice.

In respect of paragraph 16.2(a)(ii), the firm's internal consumption includes consumption by all companies in the group and not just those specified in paragraph 16.2(d).

(b) "Associate" for the purposes of this paragraph means:

Note: The changes to the existing Code of Conduct and the CFA Code are underlined. Modifications to the proposed amendments discussed in the Consultation Paper are highlighted in yellow.

(i) the spouse, or any minor child (natural or adopted) or minor step-child, of the analyst;

(ii) the trustee of a trust of which the analyst, his spouse, minor child (natural or adopted) or minor step-child, is a beneficiary or a discretionary object; or

(iii) another person accustomed or obliged to act in accordance with the directions or instructions of the analyst.

(c) "Financial interest" for the purposes of this paragraph means any commonly known financial interest, such as investment in the securities in respect of an issuer~~listed corporation~~ or a new listing applicant, or financial accommodation arrangement between the issuer~~listed corporation~~ or the new listing applicant and the firm or analyst.

This term does not include commercial lending conducted at arm's length, or investments in any collective investment scheme other than an issuer or new listing applicant ~~REIT~~ notwithstanding the fact that the scheme has investments in securities in respect of an issuer~~listed corporation~~ or a new listing applicant.

(d) "Firm" for the purposes of this paragraph means any intermediary and its group of companies. A company will only be regarded as a group company if it carries on a business in Hong Kong in:

(i) investment banking;

(ii) proprietary trading or market making; or

(iii) agency broking,

in relation to securities.

(e) "Individual employed by or associated with…the firm" for the purposes of paragraph 16.5(c) means any individual:

(i) employed by the firm in accordance with whose directions or instructions the analyst is accustomed or obliged to act;

(ii) employed by the firm who has influence on the subject matter or content, or the timing of distribution, of investment research; or

(iii) who is responsible for determining the remuneration of the analyst.

(f) "Investment research" for the purposes of this paragraph includes documentation containing any one of the following:

(i) result of investment analysis of securities;

(ii) investment analysis of factors likely to influence the future performance of securities, not including any analysis on macro economic or strategic issue; or

(iii) advice or recommendation based on any of the foregoing result or investment analysis,

and an investment/research report shall be construed accordingly.

(g) "Issuer~~Listed corporation~~" for the purposes of this paragraph means:

(i) a corporation;

(ii) a REIT; and

(iii) an entity that is established to conduct business operations and constituted in a form other than that of a corporation or REIT,

the securities of which are listed on The Stock Exchange of Hong Kong Limited ~~and includes a REIT~~.

(h) "New listing applicant" for the purposes of this paragraph means:

(i) a corporation;

(ii) a REIT; and

(iii) an entity that is established to conduct business operations and constituted in a form other than that of a corporation or REIT

~~an entity, including a REIT~~, applying for listing of and permission to deal in securities on The Stock Exchange of Hong Kong Limited, none of whose securities~~, including interests in the REIT,~~ are already listed on The Stock Exchange of Hong Kong Limited.

(i) "Prospectus" for the purposes of this paragraph means a prospectus, listing document, offering circular or similar document issued by a new listing applicant.

(j) "REIT" for the purposes of this paragraph means a real estate investment trust which is authorized or applying for authorization by the Commission under section 104 of the SFO.

(k) "Securities" for the purposes of this paragraph means:

(i) shares, depositary receipts, interests or units issued by an issuer~~listed corporation~~ and any warrants or options on these shares, depositary receipts, interests or units which are listed or traded on The Stock Exchange of Hong Kong Limited; and

(ii) shares, depositary receipts, interests or units issued or to be issued by a new listing applicant and any warrants or options on these shares, depositary receipts, interests or units which are to be listed or traded on The Stock Exchange of Hong Kong Limited.

Note: The changes to the existing Code of Conduct and the CFA Code are underlined. Modifications to the proposed amendments discussed in the Consultation Paper are highlighted in yellow.

16.3 Principles

The Commission believes the following principles[2] are of fundamental importance to the business undertaken by all analysts and firms to which this Paragraph applies.

(a) Analyst trading and financial interests

Mechanisms should exist so that analysts' trading activities or financial interests do not prejudice their investment research and recommendations.

(b) Firm financial interests and business relationships

Mechanisms should exist so that analysts' investment research and recommendations are not prejudiced by the trading activities, financial interests or business relationships of the firms that employ them.

(c) Analyst reporting lines and compensation

Reporting lines for analysts and their compensation arrangements should be structured to eliminate or severely limit actual and potential conflicts of interest.

(d) Firm compliance systems

Firms that employ analysts should establish written internal procedures or controls to identify and eliminate, avoid, manage or disclose actual and potential analyst conflicts of interest.

(e) Outside influence

The undue influence of securities issuers, institutional investors and other outside parties upon analysts should be eliminated or managed.

(f) Clarity, specificity and prominence of disclosure

Disclosures of actual and potential conflicts of interest should be complete, timely, clear, concise, specific and prominent.

(g) Integrity and ethical behaviour

Analysts should be held to high integrity standards.

16.4 Analyst trading and financial interests

(a) Firms to establish dealing policies for analysts

A firm that employs any analyst should establish and maintain written policies and control procedures governing the dealings and tradings by any such analyst with

[2] These principles generally replicate those published by the International Organisation of Securities Commissions ("IOSCO") on 25 September 2003 in the Statement of Principles for Addressing Sellside Securities Analyst Conflicts of Interest ("Statement of Principles"). Aside from these principles, analysts and firms are encouraged to adopt the measures specified in the Statement of Principles as best practices. The Statement of Principles is available at the IOSCO website at www.iosco.org.

Note: The changes to the existing Code of Conduct and the CFA Code are underlined. Modifications to the proposed amendments discussed in the Consultation Paper are highlighted in yellow.

a view to eliminating, avoiding, managing or disclosing actual or potential conflicts of interest arising from such dealings or tradings.

(b) Limitations on dealing by analysts

An analyst or his associate should not deal in or trade any securities in respect of an issuer~~listed corporation~~ that the analyst reviews:

(i) in a manner contrary to his outstanding recommendation ; or

(ii) within 30 days prior to and 3 business days after the issue of investment research on the issuer~~listed corporation~~,

except in special circumstances outlined in the firm's policy and pre-approved by the relevant legal or compliance function.

In respect of paragraph 16.4(b)(ii), an analyst should not issue any investment research on an issuer~~listed corporation~~ if he or his associate had dealt in or traded the securities in respect of the issuer~~listed corporation~~ within the previous 30 days, except on occurrences of major events that would affect the price of the securities and the events are known to the public.

(c) Disclosure of relevant relationships

If an analyst or his associate serves as an officer of the issuer~~listed corporation~~ or the new listing applicant (which includes in the case of a REIT, an officer of the management company of such REIT; and in the case of any other entity, an officer or its equivalent counterpart of the entity who is responsible for the management of the issuer or the new listing applicant) that the analyst reviews, the analyst should disclose that fact in the research report.

(d) Disclosure of relevant financial interests

If an analyst or his associate has any financial interests in relation to an issuer~~listed corporation~~ or a new listing applicant that the analyst reviews, he should disclose that fact in the research report.

16.5 Firm financial interests and business relationships

(a) Disclosure by firms of relevant financial interests

Where a firm has any financial interests in relation to an issuer~~listed corporation~~ or a new listing applicant the securities in respect of which are reviewed in a research report, and such interests aggregate to an amount equal to or more than:

(i) in the case of an issuer, 1% of the issuer~~listed corporation~~'s market capitalization; ~~or~~

(ii) in the case of a new listing applicant, an amount equal to or more than 1% of the new listing applicant's issued share capital, or issued units, as applicable,

the firm should disclose that fact in the research report.

Note: The changes to the existing Code of Conduct and the CFA Code are underlined. Modifications to the proposed amendments discussed in the Consultation Paper are highlighted in yellow.

(b) Disclosure by firms of relevant market making activities

A firm that makes, or will make, a market in the securities in respect of the issuer~~listed corporation~~ or the new listing applicant should disclose that fact in the research report.

(c) Disclosure by firms of relevant relationships

A firm having an individual employed by or associated with the firm serving as an officer of the issuer~~listed corporation~~ or the new listing applicant should disclose that fact in the research report.

(d) Disclosure by firms of relevant business relationships

A firm that has an investment banking relationship with the issuer~~listed corporation~~ or the new listing applicant should disclose that fact in the research report. Any compensation or mandate for investment banking services received within the preceding 12 months would constitute an investment banking relationship.

(e) Improper dealing by firms ahead of issue of investment research

A firm should not improperly deal or trade ahead in the securities in respect of the issuer~~listed corporation~~ which its investment research covers.

(f) Firms not to provide certain assurances to issuers~~listed corporation~~ or new listing applicants

A firm should not, with a view to commencing or influencing a business relationship with an issuer~~listed corporation~~ or a new listing applicant, provide any promise or assurance of favourable review or change of coverage or rating in its investment research.

(g) Quiet periods

A firm that acts as a manager, sponsor, listing agent or underwriter of a public offering should not issue any investment research covering the issuer~~listed corporation~~ or the new listing applicant at any time falling within a period of:

(i) 40 days immediately following the day on which the securities are priced if the offering is an initial public offering; or

(ii) 10 days immediately following the day on which the securities are priced if the offering is a secondary public offering,

unless the firm has been issuing investment research on the an issuer~~listed corporation~~ or the new listing applicant with reasonable regularity in its normal course of business, or on occurrences of major events that would affect the price of the securities and the events are known to the public.

The day on which the securities are priced refers to the day when the specific price of the offering is determined.

16.6 Analyst reporting lines, compensation and participation in other functions

(a) Analyst reporting lines and compensation

A firm that has an investment banking function should not:

(i) arrange for its analysts to report to such function; or

(ii) directly link its analysts' compensation to any specific investment banking transaction.

(b) Pre-approval of investment research by investment banking function

A firm that has an investment banking function should not allow such function to pre-approve analyst reports or recommendations, except in circumstances subject to oversight by compliance or legal function where investment banking function reviews a research report for factual accuracy prior to publication.

(c) Analysts not to solicit investment banking business

An analyst should not participate in business activities designed to solicit investment banking business, such as sales pitches and deal road shows.

16.7 Firm compliance systems

(a) A firm should establish, maintain and enforce a set of written policies and control procedures to eliminate, avoid or manage actual and potential analyst conflicts of interest. These policies and procedures should be appropriately formulated having regard to the firm's particular structure and business model and the experience and investment profile of its clients.

(b) A firm should establish, maintain and enforce a set of written policies and control procedures to ensure that analysts responsible for preparing a research report on a new listing applicant are not provided by the firm with any material information, including ~~or~~ forward looking information (whether qualitative or quantitative) concerning the new listing applicant that is not:

(i) reasonably expected to be included in the prospectus; or

(ii) publicly available.

16.8 Outside influence

An analyst or his firm should disclose in the research report the fact where the issuer~~listed corporation~~, the new listing applicant or other third party has provided or agreed to provide any compensation or other benefits in connection with the investment research.

Note: The changes to the existing Code of Conduct and the CFA Code are underlined. Modifications to the proposed amendments discussed in the Consultation Paper are highlighted in yellow.

16.9 Making commentaries or recommendations through the mass media

When an analyst makes commentaries or recommendations through the mass media, all provisions in paragraph 16, as modified (where applicable) under paragraph 16.9(a) and (b) below, should apply.

(a) Analysts appearing in personal capacity in the mass media

When an analyst provides analyses or comments on securities in respect of an issuer~~listed corporation~~ or new listing applicant in the mass media in his personal capacity, including appearing in person, he should disclose the following at the time the analyses or comments are provided:

(i) his name;

(ii) his licence status; and

(iii) where he and/or his associate has a financial interest in the issuer~~listed corporation~~ or new listing applicant, the fact of having such an interest.

(b) Analysts responding in personal capacity to queries from audiences and journalists

When an analyst is asked by members of an audience, or otherwise by a journalist, for analyses or comments on specific securities, he may offer such analyses or comments, provided that he makes the disclosures set out in paragraph 16.9(a)(i) to (iii) notwithstanding the fact that he and/or his associates have traded in the relevant securities during the 30 days prior to giving such analyses or comments.

(c) Firms communicating their investment research through the mass media

For avoidance of doubt, when a firm communicates its investment research through the mass media, such as disseminating its research reports in whole or in part in a sponsored programme, all relevant provisions in paragraph 16 should apply.

16.10 Clarity, specificity and prominence of disclosure

(a) Quality of disclosure

Where any matter is required to be disclosed under this Paragraph, the disclosure should be:

(i) clear;

(ii) concise;

(iii) specific;

(iv) given adequate prominence; and

(v) released in a timely and fair manner.

(b) Methods of disclosure

Any disclosure required under this Paragraph should be made in a method that is commensurate with the medium through which the investment research, or analyst's advice or comments, is being delivered. The required disclosures are limited to the fact of the matter. Details such as the amount or its nature are not required.

(c) Disclosure responsibility

Where relevant disclosures have been made by analysts and/or firms, they will not be held responsible if their investment research, or recommendation is published or otherwise reproduced in whole or in part by the mass media without the relevant disclosures.

16.11 Integrity and ethical behaviour

(a) An analyst should have a reasonable basis for his analyses and recommendations.

(b) An analyst should define the terms used in making recommendations, and utilize such definitions consistently.

(c) An analyst should not seek to obtain from the new listing applicant or its advisers any material information, including ~~or~~ forward looking information (whether qualitative or quantitative) concerning the new listing applicant that is not:

(i) reasonably expected to be included in the prospectus; or

(ii) publicly available.

Note: The expectation that an analyst only uses information that is reasonably expected to be included in the prospectus or that is publicly available does not preclude an analyst from conducting his own due diligence such as undertaking site visits.

Appendix 2

Amendments to paragraph 5 of the CFA Code

Information to analysts in new listings	5.10	Where a Corporate Finance Adviser acts as a sponsor in relation to a listing of equity securities by a company on the Stock Exchange, the sponsor should take reasonable steps to ensure that all material information, including ~~or~~ forward-looking information (whether quantitative or qualitative) disclosed or provided to analysts is contained in the relevant prospectus or where the proposed listing does not involve a prospectus, the relevant listing document, offering circular or similar document.

Note: The changes to the existing Code of Conduct and the CFA Code are underlined. Modifications to the proposed amendments discussed in the Consultation Paper are highlighted in yellow.

Appendix 3

List of Respondents

1. CompliancePlus Consulting
2. Hong Kong Institute of Certified Public Accountants
3. Hong Kong Society of Financial Analysts
4. NortonRose Hong Kong
5. Skadden, Arps, Slate, Meagher & Flom
6. SUEN Chi Wai