

## HKEx GUIDANCE LETTER

Cite as HKEx-GL4-06 (April 2006) (updated in July 2013) – effective for applications submitted on or after 1 October 2013

Summary	
<b>Listing Rule</b>	Main Board Listing Rule 3A.07(9)(c)
<b>Subject</b>	Guidance on assessment of a sponsor's independence
<b>Contents</b>	Extracts of a letter from the authorised signatory of the Stock Exchange of Hong Kong

**Important note:** *This letter does not override the Listing Rules and is not a substitute for advice from qualified professional advisers. If there is any conflict or inconsistency between this letter and the Listing Rules, the Listing Rules prevail. You may consult the Listing Division on a confidential basis for an interpretation of the Listing Rules or this letter.*

[\*] May 2005

*[Name and Address of Sponsor A]*

Dear Sirs

Re: Enquiry of a Main Board sponsor (“Sponsor A”) regarding the interpretation of Main Board Listing Rule 3A.07(9)(c) (the “Listing Rules”)

I write in response to your letter dated [\*day\*month\*year] to *[the Head of the Listing Division]*. We appreciate the attention you have given to the matters set forth in your letter.

### **Background**

We understand from your letter that during the course of the routine internal compliance check of *[name of sponsor]* (“Sponsor A”) before accepting an engagement for a proposed new listing (the “Listing”) on the Main Board of the Exchange, *[Sponsor A]* came to notice that an employee of *[Sponsor A]* (the “Employee”), who may participate in the Listing exercise should the engagement of *[Sponsor A]* be finalised, has a sibling (the “Employee’s Associate”) who is an executive director of one of the principal bankers (the “Bank”) of the Applicant Group. Following a preliminary review, your letter indicated that notwithstanding that the Employee’s Associate is an executive director of one of the principal bankers of the Applicant Group, *[Sponsor A]* considered that such relationship would not be reasonably considered to affect *[Sponsor A]*’s independence as sponsor to the Applicant in performing its duties, and should not reasonably give rise to a perception that *[Sponsor A]*’s independence would be so affected for the following reasons:

- (a) The current business relationship in question is one between the Bank and the Applicant Group, and not a personal relationship between the Employees' Associate and the Applicant Group. Your letter stated that, in fact, the Employee's Associate does not control the board of directors, or 30% or more of the voting rights, of the bank, and the aforesaid business relationship has been in existence for more than 10 years, long before the Employee's Associate joined the Bank in December 2004. It appeared to *[Sponsor A]* that the wording of Rule 3A.07(9)(c) does not go so far as to catch the genuine business relationship between the employer (i.e. the Bank) of the Employee's Associate and the Applicant Group;
- (b) The Applicant was sourced by *[Sponsor A]* through its own marketing efforts and not through the referral by the Bank or the Employee's Associate;
- (c) The current business relationship in question between the Bank and the Applicant Group, or the repayment of any outstanding borrowings by the Applicant Group to the Bank, does not and will not depend on the successful Listing of the Applicant. There is no incentive or motive whatsoever on the part of *[Sponsor A]* to compromise its independence in acting as sponsor to the Applicant in respect of the Listing;
- (d) Apart from the Bank, the Applicant Group also has 6 other principal bankers, granting approximately 76% in aggregate of the total amount of banking facilities available to the Applicant Group. Based on the latest audited financial statements of the Bank for the year ended 31 December 2004, it is anticipated that the banking facility limit of HK\$[\*] million granted by the Bank to the Applicant Group shall represent only approximately 0.04% of the total advances to customers of the Bank. In fact, the Bank was ranked one of the largest listed companies on the Stock Exchange in terms of market capitalisation as of a recent date in 2005. In the opinion of *[Sponsor A]*, the current business relationship in question between the Bank and the Applicant Group can be considered quite insignificant from the perspective of the Bank. *[Sponsor A]* is also of the view that the concept of "materiality" of the current business relationship in question should also be taken into consideration for the purposes of Rule 3A.07(9)(c), as such concept has been consistently applied for the purposes of other provisions under Rule 3A.07(1),(2),(4),(5),(6) and (7). In the opinion of *[Sponsor A]*, the application of such concept to Rule 3A.07(9)(c) would ensure that the Listing Rules would not be perceived to be more stringent on a relationship reasonably considered to be remoter (being one between the employer of the Employee's Associate and the Applicant Group) than on those direct relationships between the sponsor group (as defined in Chapter 3A of the Listing Rules) and the Applicant Group contemplated under Rules 3A.07(1),(2),(4),(5) and (6); and
- (e) Catching current business relationship(s) between the employer of an associate of an employee of the sponsor and the new listing applicant or its connected persons (like the current business relationship in question between the Bank and the Applicant Group) may be unduly burdensome on the part of the sponsor, as more often than not, such associate is just an employee of the organisation that he/she is working with and he/she cannot dictate what his/her employer does in its ordinary course of business. If the current business relationship in question between the Bank and the Applicant Group were caught under Rule 3A.07(9)(c), by the same token, it would follow that all employees of a sponsor firm, who have close relatives working in large companies

listed on the Exchange may not be allowed to participate in new listing projects in Hong Kong so as to maintain the independence of their firm, as it is very likely or even inevitable that either the new listing applicants or their directors or substantial shareholders have “business relationships” with these large corporations on a daily basis or from time to time.

### **Public Consultation Process (*updated in July 2013*)**

As you know, the new requirements of Chapter 3A that took effect in January 2005 were the result of an extensive public consultation process undertaken by the Exchange and the SFC. The Consultation Conclusions on the Regulation of Sponsors and Independent Financial Advisers (“Consultation Conclusions”) published on 19 October 2004 represented a significant step forward in implementing the Government’s more general goal of improving the quality of Hong Kong’s financial market. The Exchange and the SFC view the role of sponsors as a critical element in maintaining market quality and this importance is reflected in the now more stringent requirements of Chapter 3A of the Listing Rules. While all of the desires of the various constituencies that commented on the proposals are not accommodated in the current standards, in our view the revised Chapter 3A represents a balanced and fair approach to regulating sponsors under the Listing Rules <sup>1</sup>.

### **Listing Rules and Consultation Materials**

The content of Rule 3A.07 is self evident, and is correctly referenced in your letter. In addition we consider the following passages from the Consultation Paper on the Regulation of Sponsors and Independent Financial Advisers (“**Consultation Paper**”) published in May 2003 and the Consultation Conclusions to be relevant to our analysis of issues of independence.

Paragraph 118 of the Consultation Paper states that:-

*“We consider independence of a sponsor to be of utmost importance. Investors rely on the information disclosed in a prospectus in arriving at their investment decision and the Exchange also relies on the due diligence performed by sponsors. We believe any material shareholding or relationship may affect independence and, for greater clarity, consider it desirable to list out some specific circumstances that may give rise to concerns about a sponsor’s independence.”*

Paragraph 28(a) of the Consultation Conclusions states that:-

*“We note respondents’ concerns regarding the proposed independence criteria. We also recognise that there will always be diverse views on appropriate independence thresholds or tests. But the principle underlying the proposed independence criteria, which to a large extent represents current Exchange practice, is to ensure a level playing field. To that end, we consider that the Consultation Proposals are generally appropriate.”*

Paragraph 28(c) of the Consultation Conclusions states that:-

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<sup>1</sup> In May 2012, the Securities and Futures Commission issued a Consultation Paper inviting public comment on various proposals designed to enhance Hong Kong’s sponsor regulatory regime. The SFC published the Consultation Conclusions in December 2012. The new sponsor regulation will be effective on 1 October 2013.

*“However, taking into account respondents’ submissions, we have modified certain of the factors proposed in the Consultation Paper impacting on independence. We have also made the proposed criteria a bright-line test, which should assist with its application in practice.”*

## **Analysis**

Whether or not a sponsor is independent under Rule 3A.07 is a question of fact. Generally, it is the responsibility of new listing applicants and each of their directors to accept responsibility for factual information contained in or omitted from a listing document, including a prospectus, under Listing Rules 2.13 and 11.12. The listing document is also specifically required to disclose whether each sponsor satisfies the independence test set forth in Listing Rule 3A.07 and, if not, then how the lack of independence arises under Listing Rule 3A.10(2). Given this background, it is not the practice of the Exchange to provide affirmative comfort to new listing applicants or sponsors regarding any factual matter, including but not limited to the independence or non-independence of a sponsor, at any stage of the listing application process. Listing Rule 11.20 requires all listing documents to carry a statement on the front cover specifically disclaiming the Exchange’s responsibility for the accuracy or completeness of the document.

Listing Rule 9.03(3) requires an applicant to submit an Application Proof to the Exchange with its listing application form. The information prescribed in the listing application and the Application Proof must be substantially complete except in relation to information that by its nature can only be finalised and incorporated at a later date. If the Exchange decides this information is not substantially complete, the Exchange will not continue to review any documents relating to the application. All documents, including the Form A1 (except for the retention of a copy of these documents for record) submitted to the Exchange will be returned to the sponsor(s). When reviewing questions of fact identified during the vetting process it is the established practice of the Exchange to consider all relevant facts and circumstances. In connection with requests for guidance relating to new listing applications that have not yet been received the Division’s practice is different. In those instances, it is ordinarily the practice of the Division to assume all facts presented are true and confine our guidance to interpretations of the relevant Listing Rules in light of the facts submitted. The Division will ordinarily decline to provide guidance where it is found that the nature of the enquiry requires the more complete information ordinarily found in a listing application to be considered in order for a reasonable judgement to be made. In such cases the Division may confirm the circumstances under which it would accept a listing application for vetting to ensure that all relevant information is available for purposes of its review pursuant to Chapter 9.

### *Current Business Relationship*

Based on the representations in your letter that [*Sponsor A*] has actual knowledge that the Employee’s Associate is an executive director of one of the principal bankers of the Applicant Group, in our view the relationship does fall under the parameters of Rule 3A.07. We therefore disagree with [*Sponsor A*]’s assertions that:

- Rule 3A.07(9)(c) does not go so far as to catch a genuine business relationship between the Bank, the Employee’s Associate and the Applicant Group. In our view, such a conclusion is inconsistent with the stated intention of the Exchange that the sponsor’s independence criteria be bright-line tests.

- The concept of “materiality” of the current business relationship in question should be taken into consideration when determining whether Rule 3A.07 applies in the first instance. Again, in our view such a conclusion is inconsistent with the stated intention of the Exchange that the sponsors independence criteria be bright-line tests. Rather, as described in more detail below, in our view the materiality of the business relationship is one factor among many to be taken into account when considering the reasonableness of an existing relationship which falls within the scope of Rule 3A.07(9).
- Catching current business relationship(s) between the employer of an associate of an employee of a sponsor and the new applicant may be unduly burdensome for sponsors. Sponsors undertake under Appendix 17(1)(a) to comply with the Listing Rules applicable to sponsors. In the context of Rule 3A.07, the Listing Division is generally aware that many sponsor firms and related institutions invest considerable time and effort to establish comprehensive systems for reviewing conflicts of interest for purposes of assessing independence in various circumstances. Such market practice is to be commended as representing a good faith effort to meet the highest standards of professional responsibility reasonable under the circumstances. In the event such systems are available the Listing Division may not consider it reasonable to limit an independence review to a small group of persons, given the fundamental importance of the independence of sponsors under Chapter 3A. Such an artificial limitation might result in an actual conflict that is readily discoverable being disregarded by a sponsor. In our view such a result would clearly conflict with the underlying rationale of Chapter 3A.

#### *Actual / Perceived Effect on Sponsor’s Independence*

Rule 3A.07(9) establishes two alternative tests, one of which must be satisfied before an associate of an employee of the sponsor who is directly engaged in providing sponsorship services to a new applicant will be considered to cause the sponsor to lack independence:

- (i) the relationship would be reasonably considered to affect the sponsor’s independence in performing its duties; or
- (ii) the relationship might reasonably give rise to a perception that the sponsor’s independence would be so affected.

The Listing Division does not consider the first limb of Rule 3A.07(9) to be a subjective standard. It is well established that in the context of the Listing Rules that a “reasonable” belief or consideration is one which an ordinarily prudent person of like knowledge and experience would reach in the same or similar circumstances. In our view, while not as well established, the plain meaning of “consider” is equivalent to that of belief, namely: a conclusion arrived at from external sources after weighing probability. While knowledge is an assurance of fact or propositions founded on direct perception by the senses (or intuition), a belief or consideration is confidence in a proposition gained by evidence and from other persons.

There is no well established definition of what would or would not “reasonably give rise to a perception” for purposes of the Listing Rules, and the Listing Division will not attempt to

propose one in this case. Nevertheless, it is clear to the Listing Division that the alternative tests of Rule 3A.07(9) are not equivalent - they are intended to cover different scenarios. It is also clear that the second limb of Rule 3A.07(9) is the broader more comprehensive standard, given the use of the conditional term “might” as compared to the more definitive term “would” in the first limb of Rule 3A.07(9).

### *Guidance*

The Listing Division agrees with the premise of your letter that many of the factors cited are relevant when considering whether the requirements of Rule 3A.07(9) are satisfied. Such factors include, but are not limited to:

- the nature of the relationship between the Bank and the Applicant Group;
- the nature of the relationship, if any between the Employee’s Associate and the Applicant Group;
- the nature of the relationship between the Employee’s Associate and the Bank, including seniority, shareholding, length of service etc.;
- whether the business relationship in question pre-dated the Employee’s Associate joining the Bank;
- whether the Employee or the Employee’s Associate was involved, directly or indirectly, in sourcing the engagement; and
- the nature and materiality of other relevant business relationships of both the Bank and the Applicant Group.

Nevertheless, it is the view of the Listing Division that the assessment of independence is a fundamental responsibility of the sponsor, together with the directors of the new listing applicant. It is not the practice of the Exchange to provide affirmative comfort regarding any factual matter, including the independence of a sponsor or the reasonableness of a belief, at any stage of the listing application process, nor will the listing of a particular applicant preclude the Exchange from taking action against a sponsor for failure to comply with Listing Rule 3A.07 in the event concerns arise based on information identified at a later date. The strongest affirmative position the Exchange ordinarily takes with respect to any factual matter prior to listing is to conclude the vetting process without further comment.

In the present case, the Listing Division is able to confirm that we would accept an application for vetting without requiring an additional independent sponsor in the event that the application is made under the circumstances described in your letter, including [*Sponsor A*]’s concluding to its own satisfaction that such relationship would not be reasonably considered to affect [*Sponsor A*]’s independence as sponsor to the Applicant in performing its duties, and should not reasonably give rise to a perception that [*Sponsor A*]’s independence would be so affected. We are also hopeful that our guidance set forth above will provide a basis for [*Sponsor A*] to understand our views on these matters for purposes of reaching its own conclusions regarding independence both in this case and in the future.

We wish to emphasise that our views set forth above are made based on the information

provided in your letter. We reserve the right to alter our views should additional information come to light or the information provided in your letter change. Please note that the views set forth above are the views of the Listing Division, and are subject to endorsement by the Listing Committee.

*[Portion of Letter Purposefully Omitted]*

Yours faithfully  
For and on behalf of  
The Stock Exchange of Hong Kong Limited

*[signed]*

*[Authorised Signatory]*