



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

Consultation Paper on the Regulatory Framework for Pre-deal Research

September 2010



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Consultation Paper on the Regulatory Framework for Pre-deal Research

Part A – Executive Summary

Introduction

1. The Securities and Futures Commission (“**SFC**” or “**Commission**”) invites comments from the public on the proposals described in this Consultation Paper, including the proposed amendments to:
 - (a) the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (“**Code of Conduct**”); and
 - (b) the Corporate Finance Adviser Code of Conduct (“**CFA Code**”)

set out in Appendices 1 and 2 respectively. The proposals aim to enhance the regulatory framework governing analyst conduct in the context of investment research reports issued before a first listing of equity securities¹ on the Exchange (“**Pre-deal Research**”).

Background

2. The flow of timely and accurate information about companies and securities is fundamental to achieving fairness, efficiency and transparency in a capital market.
3. Analysts play an important role in the relationship between companies and investors, both retail and institutional, by providing valuable insights to investors in trying to make sense of a wide range of information. They provide investors with research and their analysis and views regarding the securities of public issuers.
4. However, analysts can face a conflict of interest insofar as their analysis and views influence the decisions investors make. An analyst whose research and opinions are widely respected can affect the price of a security through his or her analysis and views. If an analyst or the firm that employs him has a financial interest in an issuer that he or she reviews, this interest may conflict with the analyst’s ability to provide clear and unbiased research accurately reflecting what the analyst believes is the issuer’s true financial prospects.
5. Paragraph 16 of the Code of Conduct provides the framework to address analysts’ conflicts of interest and deals with the conduct of analysts and their employers in respect of investment research on securities that are traded in Hong Kong, and investment research which has an influence on such securities. Analysts and firms issuing research reports are expected to ensure there are process and procedures in place to address conflicts of interest concerns between their trading and financial interests, the firms’ financial interests and business relationships, the analysts’ reporting lines and compensation and the firms’ compliance systems. There should also be process and procedures to address undue influence by outside parties upon analysts, disclosure about any actual or potential conflicts of interests and the analysts’ integrity and ethical behaviour.

¹ For the purposes of this Consultation Paper, the words “equity security” and “equity securities” refer to shares, depositary receipts or units issued or to be issued by a new listing applicant, which includes SFC-authorized Real Estate Investment Trusts



6. Concerns about analysts' conflicts of interest equally apply to analysts covering a company or SFC-authorised real estate investment trusts ("REITs") that is about to list on the Exchange and listed REITs. We therefore propose to extend 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 prospectus²; and
 - (b) listings of and listed REITs in Hong Kong.
7. Professional investors, who have access to Pre-deal Research reports, may be provided with more material information than retail investors to the extent that research reports prepared by connected analysts contain or are derived from non-prospectus information. In order to ensure equality of source information and to prevent Pre-deal Research reports produced by "connected analysts"³ from being used as a vehicle for the Applicant to disseminate material information relating to an offer without formal prospectus liability, Pre-deal Research reports should be prepared by reference only to information reasonably expected to be contained in the prospectus and information in the public domain. To ensure that this is adhered to, we intend to impose an obligation on sponsors⁴ in relation to a new listing of equity securities by amending the existing CFA Code.
8. This Consultation Paper seeks the views of market participants and other interested parties on the details and the implementation of the proposals relating to the regulatory framework governing analyst conduct in the context of Pre-deal Research.
9. The purpose of this Consultation Paper is not to review the existing requirements relating to analyst conduct as set out in paragraph 16 of the Code of Conduct, but is merely to extend the existing requirements to apply to Pre-deal Research.

Next Steps

10. We welcome any comments from the public and the industry on the proposals made and issues raised in this Consultation Paper. Please submit your comments to the SFC in writing by no later than 30 November 2010.
11. A consultation conclusions paper will be published after the end of the consultation period and careful consideration of all public comments received.

² For the purposes of this Consultation Paper, the term "prospectus" means a prospectus, listing document, offering circular or similar document issued by an Applicant in connection with the first listing of its equity securities on the Exchange.

³ For the purposes of this Consultation Paper, the term "connected analysts" means analysts who are employed by a sponsor, manager, placing agent or underwriter to the offering (or by a related company).

⁴ For the purposes of this Consultation Paper, the term "sponsor" also refers to listing agents in the case of new listings of REITs.



Part B – Regulatory Framework for Pre-deal Research

Introduction

12. The issue of Pre-deal Research by connected analysts has been a feature of the Hong Kong securities market for many years. However, Hong Kong securities regulation does not expressly deal with Pre-deal Research reports.
13. In August 2005, the SFC released a Consultation Paper on Possible Reforms to the Prospectus Regime in the Companies Ordinance (“**Phase 3 Consultation Paper**”). As part of the review of the regulatory framework for public offers of shares and debentures, the SFC considered the practice of Pre-deal Research publication and initially proposed to prohibit the issue of written Pre-deal Research reports by analysts connected with the sponsors, managers or underwriters of the public offer, coupled with the requirement to publish leaked Pre-deal Research reports by connected analysts and commentary on such leaked research reports in the relevant prospectus by the listing applicant (“**Applicant**”).
14. After considering of the feedback from the market, the SFC published the Phase 3 Consultation Conclusions. The SFC recognised the role Pre-deal Research reports play in price discovery in the IPO process and noted comments from market participants that the requirement to publish leaked Pre-deal Research reports would be very disruptive to the IPO process and of little value to prospective investors. In response to comments from market participants, the SFC decided not to impose a ban on Pre-deal Research reports (whether oral or written), but rather to address concerns regarding inequality of information and inaccurate information in Pre-deal Research. We propose to extend, and expand where appropriate, the requirements in the Code of Conduct and CFA Code to ensure independence and objectivity of analysts in relation to Pre-deal Research.

Existing Market Practice

15. In response to regulatory and investor concerns as to the independence of connected analysts, we understand that many sponsors have for several years implemented detailed internal controls and other measures to safeguard analyst independence and to address potential conflicts of interest arising from the analyst’s function in the IPO process. These internal compliance procedures are supplemented by measures to restrict dissemination of Pre-deal Research reports to professional investors and to prevent the leakage of information in research reports in order to minimize the risk that research reports may technically be prospectuses.
16. The proposed amendments therefore, should not present insurmountable challenges. It is envisaged that codification of the principles behind these internal compliance procedures will create a minimum standard among sponsors and intermediaries involved in the IPO process to govern the role and conduct of Pre-deal Research analysts and their relationship with the sponsor team arranging the IPO. Maintenance of appropriate and adequate conflicts management arrangements is vital to the integrity of Pre-deal Research reports, which in turn impacts directly on the integrity of our financial markets and Hong Kong’s continuing role as an international financial centre.
17. We understand that “pre-marketing” or “investor education” activities of connected analysts normally take place after the Applicant receives from the Exchange a letter setting out the Listing Committee’s comments and any conditions to the listing approval.



In the case of REIT listing applicants, we understand that this process ordinarily commences after the REIT listing applicants and their listing agents receive the SFC's approval-in-principle letter. The "pre-marketing" or "investor education" process is ordinarily preceded by the connected analysts distributing Pre-deal Research to professional and institutional investors under the placing tranche.

18. Following the "pre-marketing" or "investor education" process, the underwriters commence the "book-building" process, where the underwriters approach potential institutional investors to obtain expressions of interest to purchase securities in the offering at various prices. This book-building process is usually conducted contemporaneously with a management road show and normally commences about two to three weeks before the start of the public offer period. Applicants will generally issue and distribute a "red herring" to assist in the book-building and management road show process.
19. Since January 2008 Applicants have posted a near final prospectus (or near final offering circular in the case of a public offering of SFC authorised CISs, including REITs) on the HKEx Website at around the same time as the "red herring" is made available to institutional investors. This allows the public access to substantially the same information as that provided to institutional investors by the Applicant.
20. The prospectus which contains all relevant information relating to the offering and the accompanying share application form will only be issued later when it is registered with the Registrar of Companies in Hong Kong or authorised by the SFC in the case of a REIT. A large majority of IPOs allow an offer period of three and a half days between the issue of the prospectus and the close of the offer.

Proposed amendments

Extending the requirements under paragraph 16 of the Code of Conduct to Pre-deal Research

21. As discussed above, in the Phase 3 Consultation Conclusions, the SFC concluded that it would not be appropriate to ban Pre-deal Research reports as such research plays a role in price discovery during the IPO process. One of the recommendations in the Phase 3 Consultation Conclusions was to extend "the scope of paragraph 16 of the Code of Conduct to ensure independence and objectivity of analysts in relation to pre-IPO research." Concerns about analysts' conflicts of interest equally apply to analysts covering a company that is about to list on the Exchange. It is proposed that the existing conflicts of interest requirements for analysts writing research reports on listed corporations in paragraph 16 of the Code of Conduct be extended to apply to Pre-deal Research reports to ensure analysts' independence and objectivity in relation to Pre-deal Research reports.
22. We are of the view that the concerns about analysts' conflicts of interest and the general principles underlying paragraph 16 of the Code of Conduct are also equally applicable to proposed listings of and listed REITs in Hong Kong. It is therefore proposed that the requirements in paragraph 16 of the Code of Conduct (as amended from time to time) be explicitly extended to cover proposed listings of and listed SFC-authorized REITs in Hong Kong.



Question 1

Do you agree that the requirements in paragraph 16 of the Code of Conduct should be extended to cover research analysts in relation to Pre-deal Research reports?

Please explain your views.

Question 2

Do you agree that the requirements in paragraph 16 of the Code of Conduct should be extended to cover research analysts covering proposed listings of and listed SFC-authorized REITs in Hong Kong?

Please explain your views.

Integrity of information provided to research analysts

23. One of the areas of concern when considering the issue of Pre-deal Research reports is how to reduce or eliminate dissemination to the public of non-prospectus information prior to and during the offer period.
24. There is also a concern that Applicants and their advisers may seek to influence the formulation of analysis and views in the Pre-deal Research reports by providing analysts with information about the Applicant that is not contained in the prospectus. There have been criticisms that research reports issued by analysts from the firms actively involved in the public offering, especially sponsors or underwriters, may be seen as providing a mechanism for the Applicant to issue a forecast or other information that avoided the rigorous verification process applicable to information in a prospectus. There are also concerns that analysts from firms connected to the listing could be put at an advantage by being provided with information that is not made available to other analysts.
25. We intend to address this issue in three ways:
 - (a) codify the existing practice that firms employing research analysts preparing Pre-deal Research reports 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;
 - (b) require that research analysts preparing Pre-deal Research reports on an Applicant should not seek 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; and



- (c) require 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.

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

26. We understand that the sponsors generally prepare materials for, coordinate and manage the analysts' briefings. The sponsors will normally advise and guide the Applicant's management when they meet with research analysts. The sponsors and intermediaries involved in the listing process will normally have control measures over such briefing process so that the management will not give any material information, including forward looking information, that is not contained in the prospectus and will not provide connected analysts with any information that is not provided to other analysts. Measures will usually be put in place to ensure that analysts from the firms involved with proposed listings are only provided with information in the briefings arranged and supervised by the sponsors.
27. We consider that the established control measures described in paragraph 26 above should be codified. We propose to amend paragraph 16.7 of the Code of Conduct to require firms employing an analyst to be responsible for ensuring that the firm does not pass to analysts responsible for preparing a Pre-deal Research report on an Applicant any material information or forward looking information (whether qualitative or quantitative) not reasonably expected to be included in the prospectus or is otherwise publicly available.

Question 3

Do you agree that the firm employing research analysts preparing Pre-deal Research reports on a 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 are not:

- (a) reasonably expected to be included in the prospectus; or
- (b) publicly available?

Please explain your views.

Analysts should not seek non-prospectus information

28. In response to the concerns described in paragraphs 23 and 24 above, the Phase 3 Consultation Conclusions proposed to prohibit analysts from obtaining any forward looking information (both qualitative and quantitative forecasts) from the Applicant and any other material information not reasonably expected to be contained in the prospectus or in the public domain. We propose to implement this recommendation by amending paragraph 16.11 of the Code of Conduct.



29. We expect analysts will wish to conduct their own due diligence when preparing their Pre-deal Research reports such as making site visits to the Applicant's factories. The proposed amendments are not intended to prohibit analysts from undertaking their own due diligence such as site visits, nor to prohibit the Applicant and its advisers from assisting analysts in performing their own due diligence, for example, by arranging site visits.
30. We would like to stress that the prohibition on the Applicant and its advisers to pass forward looking information that is not in the prospectus to analysts should not be taken as seeking in any way to limit the inclusion in the Pre-deal Research reports of forward looking information developed by analysts. Indeed we understand that the market benefits greatly from such information. Our concern is to ensure that forward looking information in Pre-deal Research reports is not, and is not perceived to be, information prepared by the Applicant. Analysts should not seek from the Applicant or its advisers feedback in any form or manner on the analysts' forward looking information or guidance as to the Applicant's anticipated profit forecasts, future operating results or projected performance.
31. Please refer to Appendix 1 for the proposed amendments to Paragraph 16 of the Code of Conduct.

Question 4

Do you agree that a research analyst preparing a research report on an Applicant should not seek to obtain from the Applicant or its advisers, any material information or forward looking information (whether qualitative or quantitative), that are:

- (a) not reasonably expected to be included in the prospectus; or
- (b) publicly available?

Please explain your views.

Question 5

Do you agree that the proposed amendments to Paragraph 16 of the Code of Conduct set out in Appendix 1 implement the above proposals?

Please explain your views.

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

32. One of the functions and responsibilities of sponsors who advise and guide Applicants in their listing applications is to coordinate and manage the IPO process, from advising the Applicant on the appropriate business structure and how it should re-organise its business in order to meet the listing eligibility criteria to marketing the Applicant's IPO and ensuring there is sufficient copies of prospectuses and application forms. This expectation of the sponsors' duties and obligations is reflected in paragraph 5.3 of the



CFA Code. Paragraph 5.3(a) of the CFA Code provides that sponsors should be responsible for the overall management of the public offer.

33. As discussed above in paragraph 26, sponsors prepare materials for, coordinate and manage the analysts' briefing. One of the key considerations in this process is to ensure that analysts are not provided with information that is not reasonably expected to be included in the prospectus. Where material information or forward looking information (whether qualitative or quantitative) is inadvertently disclosed, the sponsor should advise the Applicant as to what changes are needed to the draft prospectus to ensure that the prospectus includes all material information provided to analysts.
34. Sponsors are expected to set up appropriate measures to ensure that analysts are not provided with information that is not reasonably expected to be included in the prospectus. Whilst we do not expect sponsors to be present at each and every meeting (whether physical meetings, telephone exchanges or other means of communication) between an Applicant and analysts, we expect sponsors or their representatives (for example, a chaperone or a compliance officer) would, at the very least, be present at the main analyst briefings.
35. We therefore intend to impose an obligation on sponsors in relation to a new listing of equity securities (by amending the CFA Code) to ensure that this is adhered to by requiring sponsors 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. If adopted, this obligation would equally apply to listing agents in the case of REITs. The Commission expects any listing agent or financial adviser appointed by the management company of a REIT shall at all times perform its functions and duties and conduct its activities in accordance with the standards and requirements under the Commission's codes and guidelines including the CFA Code (please see note 1 to Paragraph 5.12 of the Code on Real Estate Investment Trusts).
36. Please refer to Appendix 2 for the proposed amendments to the CFA Code.

Question 6

Do you agree that sponsors should 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?

Please explain your views.

Question 7

Do you agree that the proposed amendments to the CFA Code of Conduct set out in Appendix 2 implement the above proposal?

Please explain your views.

37. In developing the proposals in this Consultation Paper, we discussed various options with market practitioners. Some practitioners argued that the sole responsibility for



ensuring that no material information or forward looking information (whether qualitative or quantitative) that is not reasonably expected to be included in the prospectus is provided to analysts should rest with the Applicant and its directors as the Applicant and its directors are responsible for the contents of its prospectus. They argued that sponsors should not have this responsibility.

38. Accordingly, it is suggested that it may be appropriate to require Applicants 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.
39. As discussed in paragraph 26 above, the sponsors will normally advise and guide the Applicant's management when they meet with research analysts. Sponsors have a responsibility, under paragraph 5.3 of the CFA Code of Conduct, for the overall management of the public offer and putting in place sufficient arrangements and resources to ensure that the public offer is conducted in a fair, timely and orderly manner. As part of their responsibility under paragraph 5.3, sponsors should ensure that their clients are properly briefed and advised on how to deal with analysts and what information can and cannot be disclosed to analysts. The Applicant's management is usually the party with the least experience and knowledge as to the IPO process (compared with sponsors and analysts), and the legal and regulatory requirements regarding what type of information can and should not be disclosed to analysts.
40. We consider that the preparation of the information given to analysts and the briefings of the Applicant's management as to what they can say at the analyst briefings is, and for sometime has been, a key task for the sponsor. Thus, as described in paragraphs 32 to 35 above we have proposed amendments to the CFA Code to codify the existing practice.



Consolidated list of questions

Questions No.	Questions	See paragraphs for discussion
1	<p>Do you agree that the requirements in paragraph 16 of the Code of Conduct should be extended to cover research analysts in relation to Pre-deal Research reports?</p> <p>Please explain your views.</p>	21-22
2	<p>Do you agree that the requirements of paragraph 16 of the Code of Conduct should be extended to cover research analysts covering proposed listings of and listed SFC-authorized REITs in Hong Kong?</p> <p>Please explain your views.</p>	21-22
3	<p>Do you agree that the firm employing research analysts preparing Pre-deal Research reports on a 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 are not:</p> <p style="padding-left: 40px;">(a) reasonably expected to be included in the prospectus; or</p> <p style="padding-left: 40px;">(b) publicly available?</p> <p>Please explain your views.</p>	23-27
4	<p>Do you agree that a research analyst preparing a research report on an Applicant should not seek to obtain from the Applicant or its advisers, any material information or forward looking information (whether qualitative or quantitative), that are:</p> <p style="padding-left: 40px;">(a) not reasonably expected to be included in the prospectus; or</p> <p style="padding-left: 40px;">(b) publicly available?</p> <p>Please explain your views.</p>	28-30
5	<p>Do you agree that the proposed amendments to Paragraph 16 of the Code of Conduct set out in Appendix 1 implement the above proposals?</p> <p>Please explain your views.</p>	21-30, Appendix 1



Questions No.	Questions	See paragraphs for discussion
6	Do you agree that sponsors should 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? Please explain your views.	32-35
7	Do you agree that the proposed amendments to the CFA Code of Conduct set out in Appendix 2 implement the above proposal? Please explain your views.	32-35, Appendix 2



How to respond

The consultation will last for two months until 30 November 2010. Any person wishing to submit comments on behalf of an organisation should provide details of that organisation. In addition, any respondents who wish to suggest alternative approaches are encouraged to submit the proposed text of possible amendments that would be necessary to incorporate their suggestions into the Code of Conduct and the CFA Code.

All changes to the Codes will be set out in a Consultation Conclusions Paper which will be published after the end of the consultation period.

Written comments may be sent to the SFC:

By mail to: Corporate Finance Division
Securities and Futures Commission
8th Floor, Chater House
8 Connaught Road Central
Hong Kong

Re: Consultation on the Regulatory Framework for Pre-deal Research

By fax to: (852) 2810 5385

By online submission at: <http://www.sfc.hk/sfc/html/EN/speeches/consult/consult.html>
(or, enter into the subsection "Consultation papers and Conclusions" under the section "Speeches & Publications" on the SFC's website at <http://www.sfc.hk>)

By e-mail to: cficonsult@sfc.hk

Please note that the names of the commentators and the contents of their submissions may be published on the SFC's website and in other documents to be published by the SFC. Please read the Personal Information Collection Statement of the SFC.

You may not wish your name and/or submission to be published by the SFC. If this is the case, please state that you wish your name and/or submission to be withheld from publication when you make your submission.



SFC's Personal Information Collection Statement

1. This Personal Information Collection Statement (“**PICS**”) is made in accordance with the guidelines issued by the Privacy Commissioner for Personal Data. The PICS sets out the purposes for which your Personal Data⁵ will be used following collection, what you are agreeing to with respect to the SFC's use of your Personal Data, and your rights under the Personal Data (Privacy) Ordinance, Cap. 486 (“**PDPO**”).

Purpose of Collection

2. The Personal Data provided in your submission to the SFC in response to this Consultation Paper may be used by the SFC for one or more of the following purposes:
 - to administer the relevant provisions⁶ and codes and guidelines published pursuant to the powers vested in the SFC;
 - in performing the SFC's statutory functions under the relevant provisions;
 - for research and statistical purposes; and
 - for other purposes permitted by law.

Transfer of Personal Data

3. Personal Data may be disclosed by the SFC to members of the public in Hong Kong and elsewhere, as part of the public consultation which is the subject of this Consultation Paper. The names of persons who submit comments on this Consultation Paper together with the whole or part of their submission may be disclosed to members of the public. This will be done by publishing this information on the SFC's website and in documents to be published by the SFC during the consultation period or following its conclusion.

Access to Data

4. You have the right to request access to and correction of your Personal Data in accordance with the provisions of the PDPO. Your right of access includes the right to obtain a copy of your Personal Data provided in your submission on this Consultation Paper. The SFC has the right to charge a reasonable fee for processing any data access request.

Retention

5. Personal Data provided to the SFC in response to this Consultation Paper will be retained for such period as may be necessary for the proper discharge of functions of the SFC.

⁵ Personal Data means personal data as defined in the Personal Data (Privacy) Ordinance.

⁶ Defined in Schedule 1 to the SFO to mean provisions of the SFO and subsidiary legislation made under it; and provisions of Parts II and XII of the Companies Ordinance (Cap.32) so far as those Parts relate directly or indirectly to the performance of functions relating to prospectuses, the purchase by a corporation of its own shares, or a corporation giving financial assistance for the acquisition of its own shares etc.



Enquiries

6. Any enquiries regarding the Personal Data provided in your submission on this Consultation Paper, or requests for access to Personal Data or correction of Personal Data, should be addressed in writing to:

The Data Privacy Officer
Securities and Futures Commission
8th Floor, Chater House
8 Connaught Road Central
Hong Kong

A copy of the Privacy Policy Statement adopted by the SFC is available upon request.



Draft amendments to paragraph 16 of the Code of Conduct

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:



- (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 a listed corporation or a new listing applicant, or financial accommodation arrangement between the 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 a REIT notwithstanding the fact that the scheme has investments in securities in respect of a 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) “Listed corporation” for the purposes of this paragraph means a corporation 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 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.
- ~~(h)~~(k) “Securities” for the purposes of this paragraph means:
 - (i) shares, depositary receipts, interests or units issued by a 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.

16.3 Principles

The Commission believes the following principles² 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.

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.



(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 behavior

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 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 a 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 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 a listed corporation if he or his associate had dealt in or traded the securities in respect of the 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 listed corporation or the new listing applicant (which includes in the case of a REIT, an officer of the management company of such REIT) 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 a 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 a 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 1% of the listed corporation's market capitalization or 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, the firm should disclose that fact in the research report.

(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 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 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 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 listed corporation which its investment research covers.



(f) Firms not to provide certain assurances to listed corporations or new listing applicants

A firm should not, with a view to commencing or influencing a business relationship with a 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 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 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 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 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.

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 a 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 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 behavior

- (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 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

Draft 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 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.