THE LAW SOCIETY OF HONG KONG 香港律師會

Submissions on a Consultation Paper on

(1) the Proposed Code of Conduct on Bookbuilding and Placing Activities in Equity Capital Market and Debt Capital Market Transactions and

(2) the "Sponsor Coupling" Proposal

The Securities and Futures Commission ("SFC") on 8 February 2021 issued a consultation paper on (1) the Proposed Code of Conduct on Bookbuilding and Placing Activities in Equity Capital Market and Debt Capital Market Transactions and (2) the "Sponsor Coupling" Proposal ("Consultation Paper"). In response thereto, the Law Society provides the following comments on the questions posed.

Question 1. Do you consider the definitions of "bookbuilding activities" and "placing activities" to be clear and sufficient to cover key capital raising activities? If not, please explain.

Law Society's response:

We note that the new Chapter 21 of the Code of Conduct[1] sets out the definitions of the "bookbuilding activities" and "placing activities" in paragraph 21.1.1.

In paragraph 43 and paragraph 44 of the Consultation Paper, the SFC states that it will grant certain exclusions to the following scenarios that are common in some bookbuilding and placing transactions:-

(a) financial advisers or other professionals who only provide advice to the issuer (e.g., on pricing or marketing strategy) but do not participate in any bookbuilding or placing activities; and

(b) "club deals", direct discussion and pre-determined allocations as defined in paragraph 44 of the Consultation Paper.

[1] Code of Conduct – Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission

For the sake of completeness and clarity, these exclusions should clearly and expressly be set out and defined in the definitions of "bookbuilding activities" and "placing activities" in paragraph 21.1.1 of the new Chapter 21 of the Code of Conduct so that regulators, lawyers and bankers will not have to refer to the Consultation Paper again for these exclusions in the future.

Question 2. Do you agree with the proposed scope of coverage for both ECM[2] and DCM[3] activities?

Law Society's response:

Hong Kong is an international financial city. For many global investment banks with presence in Hong Kong, very often their ECM/DCM teams in Hong Kong take part in regional/global transactions which are subject to different laws and regulations, such as the initial public offering ("IPO") on Singapore Stock Exchange/New York Stock Exchange/NASDAQ, Top-Up placing of US-listed companies and Mainland Chinese A-Share IPO.

The relevant transactions are already governed by the laws of their respective jurisdictions (e.g. Singaporean, Mainland Chinese and US laws) and these laws are notably different from some of the new requirements proposed in the Consultation Paper. Potentially, there are areas in which conflicts in laws and regulations between that of the relevant jurisdiction and those suggested in the Consultation Paper could arise.

We therefore suggest the draft Code of Conduct should clarify and state expressly that:-

(a) ECM - only applicable to Hong Kong IPOs and Hong Kong top-up transactions.

(b) DCM - only applicable to the debt offers made to investors that are based in Hong Kong.

Question 3. Do you consider the role of an OC[4] to be properly defined? If not, please explain.

Law Society's response:

We have no comment on the definition of OC.

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[2] ECM – equity capital market
[3] DCM – debt capital market
[4] OC – overall coordinator

Question 4. Do you agree that the appointments of OCs and other CMIs[5] and the determination of their roles, responsibilities and fee arrangements, should all take place at an early stage? If not, please explain.

Law Society's response:

We understand that typically in an IPO transaction, the roles, responsibilities and distribution of civil liabilities are set out in underwriting agreement(s) to be signed between all underwriters of the transaction close to listing.

The current proposal suggests to bring forward the finalisation of certain arrangements to 2 weeks after A1 submission (which is usually 2 to 3 months before the signing of the underwriting agreement(s), "**relevant date**"). This raises the following concerns from the perspective of general contract law and these concerns are substantial:-

- The market dynamics in ECM and DCM internationally is that the underwriters agree to the underwriting terms close to listing when (a) there is factual certainty as to market environment and (b) identity of all fellow contract counterparties are confirmed (i.e. fellow underwriters/CMIs).

- Setting a deadline to finalise the identities of the OC by the relevant date would affect the visibility of an OC to give regard to (a) and (b) above.

- Contract laws protect the rights of parties by giving them the freedom to enter into commercial obligations if and when they see fit, subject to mutual agreement by all joining parties. Having certain contract terms finalised (e.g. payment terms) and other terms not finalised (e.g. civil liability, termination terms) on the relevant date may create uncertainty in deals. Very often parties will have to consider the whole package of the underwriting agreement (e.g. payment date, currency, right to terminate) in deciding fees/payment terms.

- The SFC should compare its proposals with the equivalent regulations of other comparable financial market (e.g. Singapore, UK, US, Australia) as to the relevant date to ensure that Hong Kong will be able to stay competitive with our relevant date.

We have not been advised as to whether the SFC would allow certain excepted scenarios to permit a firm to join as OC after the relevant date. There can be scenarios with particular hardships, for example, the hospitality industry has been dramatically hit by the COVID-19 pandemic, where it would be in the benefit for the listing applicant and the existing OC to allow a "late-join" OC to participate to

[5] CMIs – capital market intermediaries

mitigate the underwriting risk and to increase the spread of potential international investors.

Question 5. Do you agree that an OC should provide advice to the issuer on: (i) syndicate membership and fee arrangements; (ii) marketing strategy; and (iii) pricing and allocation? If not, please explain. What else should the OC advise the issuer about?

Law Society's response:

We have no comment.

Question 6. Do you agree that a private bank should not pass on to investor clients any rebates provided by the issuer? If not, please explain.

Law Society's response:

We agree with this proposal. This ensures fairness among the subscribing investors.

Question 7. Do you agree that an OC should provide relevant information to CMIs to enable them to identify investor clients which are Restricted Investors in share offerings or have associations with the issuer in debt offerings? If not, please explain.

Law Society's response:

We agree with this proposal.

Question 8. Do you agree that information about the underlying investors should be provided to an OC by CMIs placing orders on an omnibus basis when they place orders in the order book? If not, please explain.

Law Society's response:

We agree with the draft rule as set out in paragraph 21.3.5 of the new Code of Conduct.

Question 9. Do you think there would be difficulties in a large IPO or debt offering for OCs to remove duplicated orders and identify irregular or unusual orders in the order book? If so, please provide examples.

Law Society's response:

We have no comment.

Question 10. Do you agree that OCs and CMIs should not accept knowingly inflated orders? If not, please explain.

Law Society's response:

We agree with the proposal.

Question 11. Do you agree that OCs should ensure the transparency of the order book? If not, please explain.

Law Society's response:

The primary responsibility to ensure the transparency of the order book should be taken up by those who receive the order, i.e. the individual CMIs. The OCs do not have the first hand client order information.

Should there be any regulatory burden or civil liability be imposed, such burden/liability should attach to the party with the primary information.

Question 12. Do you agree that "X-orders" should be prohibited? If not, please explain.

Law Society's response:

"X-orders" (as referred to in the Consultation Paper) should be regulated by express regulations but not be prohibited in their entirety. On one hand, it is true that CMIs may be reluctant to disclose the names of investors for fear that other CMIs will poach their clients.

On the other hand, there are sovereign entities / national pension funds / international religious bodies who have adopted an international industry practice to place order in an anonymous capacity. Notably, the laws and regulations on this may be different in other legal jurisdictions. The proposal to prohibit "X orders" in Hong Kong would cause substantial concerns to these global governmental/religious entities (that usually place orders of rather large size) when they look at investment opportunities globally in different markets in Asia and globally.

Question 13. Do you agree that OCs and CMIs should be required to establish and implement allocation policies? If not, please explain.

Law Society's response:

We agree with the proposal.

Question 14. Do you agree that client orders must have priority over proprietary orders at all times? If not, please explain.

Law Society's response:

We do not fully agree to this proposal.

Many global investment banking conglomerates provide a full spectrum of financial service to their clients, e.g. brokerage, investment banking, money lending, asset management, wealth management, custodian services. There are existing Code of Conduct provisions and SFC circulars requiring the establishment of Chinese walls and certain specific physical/information segregation between (a) a firm's asset management arm(s) and proprietary desk(s) and (b) the rest of a firm's business. In reality, most global firms have set up very stringent internal policies on physical segregation that their asset management arms and proprietary desks are located in isolated business premises (very often a different building, or a different floor), and to ensure that there is no duplication of front-office staff function.

Having orders from asset management arm, proprietary desk and group companies in an OC/CMI conglomerate ("entities") ranking lower to other orders would have the following negative impacts:-

1. Such entities would unfairly lose out in priority in bookbuilding to the other asset managers, in spite of the fact that they have maintained intact Chinese walls and possess no unfair price sensitive information.

2. The non-conglomerate asset management companies will have an unfair advantage in getting priority allocation or larger allocation. The intention of the Consultation Paper to safeguard a fair market would not be met.

3. This goes against the principle of freedom of investment, when the freedom to invest of the conglomerate asset managers are restricted to invest in deals.

4. Many conglomerate asset managers have very high AUM[6]. If they choose to invest elsewhere than Hong Kong, it would reduce the total market capital of

[6] AUM – asset under management

Hong Kong and the attractiveness of Hong Kong as a place for listing and capital raising.

Question 15. Do you agree that proprietary orders can only be price takers? If not, please explain.

Law Society's response:

See our comments in Question 14.

Question 16. Do you agree that a CMI's proprietary orders and those of its Group Companies should also include orders placed on behalf of funds and portfolios in which a CMI or its Group Companies have a substantial interest? If not, please explain.

Law Society's response:

See our comments in Question 14.

Question 17. Orders received and entries placed in the order book are subject to constant amendments and updates throughout the bookbuilding process. Do you think it is feasible for the OC and CMIs to maintain records which evidence every change? If not, please explain.

Law Society's response:

We have no comment.

Question 18. Do you agree with the scope of fee-related advice to be provided by an OC to an issuer? If not, please explain.

Law Society's response:

We have no comment.

Question 19. Would you envisage substantial practical difficulties in an issuer determining the syndicate membership, the ratio between the fixed and discretionary portions of the fees to be paid to all syndicate CMIs and fixed fees allocation four clear business days before the Listing Committee Hearing? If yes, please cite examples.

Law Society's response:

We have no comment.

Question 20. Would you envisage substantial difficulties in issuers determining the allocation of discretionary fees and the fee payment schedule no later than listing? If yes, please cite examples.

Law Society's response:

We have no comment.

Question 21. Do you agree that (i) the syndicate membership (including the names of OCs) should be disclosed at an early stage; (ii) the total fees to be paid to all syndicate CMIs participating in the offering for the international placing tranche should be disclosed in the prospectus; and (iii) the total monetary benefits paid to each syndicate CMI should be disclosed after listing? If not, please explain.

Law Society's response:

We have no comment.

Question 22. Do you agree with the "sponsor coupling" proposal? If not, please explain.

Law Society's response:

We agree with the proposal.

Question 23. Do you think one Sponsor OC is adequate or should more OCs be required to act as sponsors? For example, should the majority of OCs be required to act as sponsors (i.e., if the issuer appoints three OCs, two must also act as sponsor)? Please explain.

Law Society's response:

We have no comment.

Question 24. Do you have any comments on the proposed implementation timeline?

Law Society's response:

We envisage that:-

- there is substantial work to be conducted by firms, such as the preparation of allocation policy, compliance manuals and many internal workflow revamping/ new workforce arrangements;

- a main bulk of the policy drafting work will be assigned to law firms and accounting firms;

- in-house lawyers, accountants and compliance professionals will need time to implement rules and new workflow internally, and to provide staff training.

We suggest that a 1 year to 1.5 year time period would be more appropriate to ensure that the market is ready for the new rules.

The Law Society of Hong Kong
21 April 2021