

Client Alert.

December 13, 2012

Consultation Conclusions on the Regulation of Hong Kong IPO Sponsors – The Top Five Things You Need to Know

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Jun-Min Tang provided valuable assistance in preparing this article.

On December 12, 2012, the Securities and Futures Commission (SFC) published its eagerly anticipated consultation conclusions concerning the regulation of IPO sponsors (the “Consultation Conclusions”). While a more detailed Client Alert analyzing the Consultation Conclusions will be forthcoming, we have highlighted below the top five things you need to know now about the Consultation Conclusions.

1. PROSPECTUS LIABILITY

One of the most closely watched aspects of the SFC’s consultation paper published in May of this year was the proposal relating to civil and criminal prospectus liability for sponsors. In the Consultation Conclusions, the SFC reiterated its view that the existing prospectus liability provisions in the Companies Ordinance (Cap. 32) already apply to sponsors, but acknowledged that there were diverging views and a lack of case law on the issue. Accordingly, the SFC will recommend to the Hong Kong Government that the applicable provisions in the Companies Ordinance with respect to civil liability (Section 40) and criminal liability (Sections 40A and 342F) be clarified so that sponsor firms have civil and criminal liability for untrue statements in prospectuses.

However, the SFC agreed with certain concerns raised by the sponsor community about the existing criminal liability provisions of the Companies Ordinance, under which the prosecution need only prove that a prospectus contains an untrue statement, and in response the defendant must establish that it had reasonable grounds to believe and did believe at the time of issue of the prospectus that the untrue statement was either true or immaterial. In order to address this concern, the SFC will recommend that criminal liability should depend on the prosecution proving that a sponsor firm knowingly or recklessly approved a prospectus containing an untrue statement (including an omission) which was materially adverse from an investor’s perspective. The current maximum fine for criminal prospectus liability under the Companies Ordinance is HK\$700,000 and three years’ imprisonment.

2. PUBLICATION OF A1 PROOF ONLINE

In an effort to “encourage the submission of a quality first draft” of the prospectus, the advanced draft prospectus submitted with each listing application will be published on the Hong Kong Stock Exchange’s website. The SFC envisions that this will result in fewer regulatory comments and require a minimal number of amendments in subsequent proofs, thereby facilitating a shorter listing timetable, as well as enhancing transparency for investors. The SFC intends that ultimately all successive amended drafts, regulatory comments and responses will similarly be made public.

Client Alert.

3. SUPPORT FOR SPONSOR'S ROLE

During the comment process, certain sponsor firms emphasized the importance of being given adequate authority and appropriate support in order to enable sponsors to discharge their role effectively, and the sponsor community put forward various proposals intended to help sponsors perform their role as gatekeepers of market quality in IPOs. The SFC agreed with a number of these proposals and decided to adopt the following provisions:

- a listing applicant must formally appoint a sponsor at least two months before submission of a listing application;
- a sponsor is obliged to notify the regulators of any instances of material non-compliance in a timely manner and provide an explanation if and when it ceases to act for a listing applicant;
- a listing applicant must commit that it and all professional advisers involved in the IPO will fully cooperate with the sponsor in discharging the sponsor's duties;
- a financial adviser appointed to advise a listing applicant must fully cooperate with, and should not adversely affect, the sponsor in discharging its duties; and
- sponsor fees, including the basis, payment structure and timing, must be specified in a sponsor's terms of engagement and must be based solely on a sponsor's role.

4. RELIANCE ON EXPERTS AND PROVISION OF MEANINGFUL MANAGEMENT DISCUSSION AND ANALYSIS (MD&A)

In order to clarify the extent to which sponsors can rely on expert reports such as those provided by accountants or valuers, the SFC has explained that while a sponsor is not expected to re-perform the work of an expert, it should ensure that the scope of the expert's work adequately covers reviewing the reliability of the information provided to the expert. If not, the sponsor should request that the scope be expanded, seek assistance from a qualified person to check the information or extend the scope of its own due diligence. Sponsors must assess any expert report critically against the totality of its knowledge of the company and its industry sector, to ensure that overall disclosure to the public is coherent and consistent.

In addition, the Code of Conduct will be revised to provide guidance on the preparation of the MD&A section in the prospectus, and sponsors will need to work closely with company management and other advisers to produce a relevant, adequate and comprehensible MD&A section.

5. EXPANDED ELIGIBILITY CRITERIA FOR PRINCIPALS

The SFC has introduced additional options whereby individuals may qualify as Principals if they, among other things: (i) are highly experienced in the area of due diligence through leading IPOs in Australia, the United Kingdom or the United States or (ii) have participated actively and substantially in due diligence work in at least four IPOs in Hong Kong within the preceding five years.

The new requirements will apply to listing applications submitted on or after October 1, 2013. Revised versions of the Code of Conduct, the Corporate Finance Advisers Code and the Sponsor Guidelines will also become effective on October 1, 2013. Revisions to the prospectus liability provisions of the Companies Ordinance will be subject to further consultation with the Hong Kong Government and will need to go through the normal legislative process, and so they will be on a slower timetable.

Client Alert.

We will publish a more detailed analysis of the Consultation Conclusions in due course.

For a copy of the Consultation Conclusions, please click [here](#).

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