

# SFC INVITES CONSULTATION ON CONDUCT REQUIREMENTS FOR BOOKBUILDING AND PLACING ACTIVITIES

## Summary

In February 2021, the Securities and Futures Commission (the **SFC**) published a **consultation paper** (the **Consultation Paper**) seeking input on a proposed code of conduct (the **Proposed Code**) that will govern licensed market intermediaries' bookbuilding and placing activities as well as a "sponsor coupling" proposal (the **Sponsor Coupling Proposal**). The Proposed Code and Sponsor Coupling Proposal are intended to address potential conflicts of interest and related conduct risks faced by intermediaries when engaging in equity and debt capital raising.

## Key Takeaways

The Proposed Code is intended to regulate intermediaries involved in bookbuilding and placing activities relating to both the shares of issuers listed (or shares to be listed, in the case of an initial public offering (**IPO**)) on the Hong Kong Stock Exchange (the **HKEX**) and all types of listed and unlisted debt offerings in Hong Kong. Intermediaries that are subject to the Proposed Code are classified as "capital market intermediaries" (**CMIs**) and "overall coordinators" (**OCs**) in the Proposed Code depending on the activities the intermediaries undertake.

Key changes to the bookbuilding and placing process proposed under the Consultation Paper include:

- **Requirement to have engagement and fees documented at the outset** - Each CMI and OC will be required to obtain a written appointment from their issuer client at the start of their engagement; the appointment must set out the intermediary's role, and the base fee arrangement payable to the intermediary.
- **Additional standards of conduct** - CMIs will be required to adhere to additional standards of conduct in respect of bookbuilding and securities allocation, including the requirement to prioritise their clients' orders over their own proprietary orders during the bookbuilding process.
- **Duty to act with due skill, care and diligence** - OCs will be expected to act with due skill, care and diligence throughout the offering process; this duty will also cover advising the issuer client and its directors as to their responsibilities under the HKEX Listing Rules.
- **Concurrent OC and sponsor appointment for IPOs** - Under the Sponsor Coupling Proposal, intermediaries will be required to have at least one sponsor to an IPO be appointed as a head of the underwriting syndicate concurrently with such sponsor's appointment (both appointments must occur at least two months before the listing application is filed).

## Background

The Proposed Code and Sponsor Coupling Proposal are being introduced to align Hong Kong's regulatory standards with the latest findings from the International Organisation of Securities Commissions on addressing conduct risk in capital raising activities, and reflect the SFC's focus following its recent thematic review of licensed intermediaries. If adopted, the Proposed Code and Sponsor Coupling Proposal would amend the existing *Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission*.

## Who does the Proposed Code apply to?

Firstly, the Proposed Code is designed to regulate the conduct of CMI. The Proposed Code defines CMI as intermediaries involved in, or advising on, the following activities as they relate to share or debt offerings:

- **Bookbuilding activities** - Collating investors' orders (including indications of interest) in a share or debt offering in order to facilitate: (i) the price determination and the allocation of securities to investors; or (ii) the process of assessing demand and making allocations; and
- **Placing activities** - Distributing shares or debt securities to investors pursuant to bookbuilding activities.

The Proposed Code covers CMI engaged in the offerings of shares of issuers listed on the HKEX (or issuers about to be listed via an IPO), and all types of listed and unlisted debt offerings, provided that the offering involves bookbuilding or placing activities conducted by intermediaries in Hong Kong. The Proposed Code will also apply to any placing of listed shares by a shareholder to third-party investors if the placing is followed by a top-up subscription and an intermediary is involved in the bookbuilding process.

Secondly, the Proposed Code also subjects any OC that leads a share or debt offering to additional requirements. The Proposed Code defines the role of an OC as the head of syndicate which conducts any of the following activities:

1. Act as the overall manager of the offering, coordinate bookbuilding or placing activities, exercise control over bookbuilding activities and make allocation recommendations to the issuer;
2. Advise the issuer on the offer price;
3. Exercise discretion to reallocate shares between the placing tranche and public subscription tranche in an offering, or overallotment option; or
4. Act as the stabilising manager.

It is important to note that under the Proposed Code, CMI and OCs are classified by reference to the activities they carry out, rather than their respective titles in an offering. This means that, for example, a joint bookrunner in an offering may not necessarily advise on the offering beyond placing shares and would therefore not likely be considered an OC.

## Key Requirements under the Proposed Code

### Standard of Conduct

- **Assessing the issuer and the offering** - Before engaging in an offering, a CMI will be expected to gain an understanding of the issuer, and have in place a formal governance process to review and assess the offering. The assessment of the issuer should include a sufficient understanding of the history and background, business and performance and financial conditions of the issuer.
- **Formal appointment agreement** - After the assessment, but before an OC or a CMI provides any services stipulated in the Proposed Code, it must ensure that there is a written agreement between it and the issuer. The written agreement should specify the roles and responsibilities of the OC or CMI as well as the fee arrangements (see also *Fee Arrangements* below).
- **Role of the OC** - CMI acting as OCs will be subjected to additional requirements. They are expected to act with due skill, care and diligence when providing advice to the issuer client. The expected scope of advice includes syndicate composition, fee arrangement, marketing strategy, and pricing and allocation. In respect of marketing advice, the OC should assist the issuer in developing a marketing and investor targeting strategy and inform the CMI of the same. In addition, the OC should also advise the issuer and its directors on their responsibilities under the requirements of the HKEX and ensure that they understand and meet these responsibilities.

- **Record keeping** - A CMI should maintain books and records which are sufficient to demonstrate its compliance with legal and regulatory requirements. An OC is expected to thoroughly document its key advice given to the issuer client and all changes in the order book. If the issuer takes any action which would amount to material non-compliance with the requirements of the HKEX, the OC is expected to notify the SFC.

### Bookbuilding

- **Rebates** - CMIs will be restricted from offering to their investor clients or passing on any rebates (e.g. brokerage fee rebates) provided by the issuer and will have an obligation to disclose any such rebates offered by the issuer. In addition, CMIs should not permit any of its investor clients to pay for shares at a price that is less than the consideration disclosed in a listing document.
- **Investor assessment** - CMIs are expected to identify investors who may be restricted from subscribing for shares in any offering as prescribed by the rules of the HKEX (e.g. connected clients and core connected persons of an issuer) (**Restricted Investors**) and inform the OC before placing an order on behalf of such clients. To assist CMIs with identifying Restricted Investors in an offering, the OCs will be expected to obtain from the issuer a list of persons related to it and share the list with the CMIs.
- **Order book disclosure** - To ensure that the OCs can identify duplicate orders in an offering, CMIs will be required to disclose the identities of all investors to the OCs and the issuer.
- **Allocation policies** - CMIs and OCs are expected to develop policies on allocation and placing. In addition, OCs will be expected to advise the issuer to allocate shares such that an open market and adequate spread of shareholders can be achieved. When allocating securities to its investor clients, CMIs will be expected to consider the ability for their clients to take up their allocation and monitor whether any order size appears unusual. The implementation of these rules will impose additional duties on CMIs and OCs.
- **Prioritise client orders** - To minimise conflicts of interest that arise when a CMI (or its affiliate) places orders for both its own proprietary trading as well as for its investor clients, CMIs will be expected to give priority to investor clients' orders over their own proprietary orders when allocating securities. Furthermore, CMIs will be expected to execute proprietary orders as "price taker" orders, so that proprietary orders from CMIs would not influence the pricing of an offering.

### Fee Arrangements

- **Timing for determining fees** - To minimise potential conduct risk relating to bookbuilding, the Proposed Code will require that fees payable to OCs and CMIs be determined at the time of appointment. Specifically, OCs and CMIs must set out in their written appointment agreement their fee arrangement with the issuer, including fees as a percentage of the total fees to be paid to all syndicate members participating in the offering. However, the Proposed Code will not limit the ability for an issuer to pay CMIs discretionary fees to incentivise sales outperformance.
- **Disclosing fee information to the SFC for an IPO** - To assist the SFC in identifying arrangements which deviate from market norms, the OC appointed for an IPO will be required to provide the following information to the SFC no later than four business days before the HKEX Listing Committee hearing:
  - The name of each member of the IPO syndicate and their role(s);
  - The total fees (as a percentage of the gross amount of funds raised) of both the public offer and the international tranche to be paid to all syndicate CMIs;
  - The ratio between the fixed and discretionary portions of the fees to be paid to all syndicate CMIs; and
  - The allocation of the fixed portion of the fees paid by the issuer to each syndicate CMI participating in the offering.

The OC will also be required to confirm with the SFC by the listing date that all discretionary fees (if any) have been allocated to syndicate CMIs. In addition, the OC must, within two weeks after the first day of dealing, the OC must inform the SFC of the total monetary benefits (including discretionary fees and bonuses) paid by the issuer to each CMI. While issuers may alter their fee allocations during the course of an IPO, the SFC expects that it will be kept informed of any material changes together with the rationale for such changes.

## Sponsor Coupling

The Consultation Paper also includes the Sponsor Coupling Proposal, which will require a listing applicant to appoint at least one sponsor (or the sponsor's affiliate) as an OC for an IPO. The SFC takes the position that there are advantages to the overall IPO process when an OC, as the head of the syndicate, is also the sponsor (either directly or through another affiliate). It is thought that a sponsor's deep knowledge of the listing applicant and responsibility to conduct due diligence work, when combined with the responsibilities of an OC, would enhance the ability of the OC to manage the overall offering. The SFC also considers that the Sponsor Coupling Proposal would ensure that the work conducted by a sponsor (which typically involves substantial due diligence and advisory work) is reflected by the compensation payable to the sponsor, and would avoid instances where a sponsor may be incentivised to compromise due diligence in order to secure an appointment as the head of a syndicate for an IPO. Under the Sponsor Coupling Proposal, both the OC and sponsor appointments should be made concurrently and at least two months before a listing application is filed for an IPO.

## Considerations

Overall, the Proposed Code will likely have the effect of reducing instances where conflicts of interests may arise for market intermediaries. The Proposed Code will also provide intermediaries with certainty earlier on in the transaction as to the proportion of fees payable in an offering and the timing of payment. However, intermediaries, particularly those who take up the position of an OC in an offering, will need to be aware of the additional obligations imposed on them, including their duty to advise an issuer properly under the Proposed Code, record keeping and reporting obligations.

The SFC invites market participants to submit comments on the Consultation Paper no later than 7 May 2021.

## CONTACT



PETER BRIEN  
PARTNER  
T: +852 2901 7206  
E: [Peter.Brien@slaughterandmay.com](mailto:Peter.Brien@slaughterandmay.com)



WYNNE MOK  
PARTNER  
T: +852 2901 7201  
E: [Wynne.Mok@slaughterandmay.com](mailto:Wynne.Mok@slaughterandmay.com)



JACKY SIN  
ASSOCIATE  
T: +852 2901 7215  
E: [Jacky.Sin@slaughterandmay.com](mailto:Jacky.Sin@slaughterandmay.com)

**London**  
T +44 (0)20 7600 1200  
F +44 (0)20 7090 5000

**Brussels**  
T +32 (0)2 737 94 00  
F +32 (0)2 737 94 01

**Hong Kong**  
T +852 2521 0551  
F +852 2845 2125

**Beijing**  
T +86 10 5965 0600  
F +86 10 5965 0650

Published to provide general information and not as legal advice. © Slaughter and May, 2021.  
For further information, please speak to your usual Slaughter and May contact.

[www.slaughterandmay.com](http://www.slaughterandmay.com)