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## Hong Kong Securities and Futures Commission Publishes Consultation Paper on Bookbuilding, Placing Activities and Sponsor Coupling

*The paper proposes standards of conduct for intermediaries involved in bookbuilding and placing activities in ECM and DCM transactions.*

On 8 February 2021, the Securities and Futures Commission of Hong Kong (SFC) published a consultation paper on (i) the Proposed Code of Conduct on Bookbuilding and Placing Activities in Equity Capital Market (ECM) and Debt Capital Market (DCM) Transactions and (ii) the “sponsor coupling” Proposal (Consultation Paper).

### Bookbuilding and Placing Activities in ECM and DCM Transactions

The conduct of bookbuilding or placing activities by intermediaries in either the equity capital or debt capital markets is not currently governed by any specific requirements, in contrast to the onerous regulatory obligations that apply to investment banks acting as listing sponsors on Hong Kong initial public offerings (IPOs).

In the SFC’s view, the lack of a specific governance framework had in the past hampered the price discovery process for some offerings and can impact the fairness and orderliness of Hong Kong’s capital markets and may affect investor confidence and future market development.

Accordingly the SFC has taken into account reports issued by The International Organization of Securities Commissions (IOSCO) on ECM and DCM activities as well as observations noted during a thematic review to formulate a new section in the Code of Conduct for Persons Licensed by or Registered with the SFC (Code of Conduct) setting out specific conduct obligations in relation to Bookbuilding and Placing Activities in Equity Capital Market and Debt Capital Market Transactions (Proposed Code).

### Key features of the Proposed Code and consequences for investment banks:

The Proposed Code introduces the following three key features:

1. Defining the intermediaries involved in in-scope capital market activities as capital market intermediaries (CMIs) and defining the overall coordinator (OC) as the head of syndicate by reference

to the activities it conducts (i.e., the OC title is not simply window dressing but rather it is based on the substance of the activities that are carried out by the entity occupying the OC role)

2. Setting out the specific standards of conduct expected of CMI and OCs
3. Requiring (i) that syndicate membership and fee arrangements be determined at an early stage and (ii) formal appointments of CMI and OCs through written agreements specifying their roles and responsibilities and fee arrangements

The new requirements set **out** in the Proposed Code represent meaningful changes to the existing practices, roles and obligations of investment banks acting on ECM and DCM transactions. As a result, investment banks will need to review and update their internal controls, policies and procedures, standard form documentation and workflows in order to comply with the Proposed Code.

### Scope of Coverage

The Proposed Code is designed to regulate the conduct of intermediaries involved in:

- (i) bookbuilding activities;
- (ii) placing activities; and
- (iii) advising, guiding, and assisting the issuer in bookbuilding and placing activities.

Intermediaries engaged in any of these capital market activities are referred to as CMIs. CMIs do not include 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. The table below sets out the in scope and out of scope activities:

Proposed Code – Scope of Coverage		
Type of Activity	In scope	Out of scope
	<ul style="list-style-type: none"> <li>• Bookbuilding activities</li> <li>• Placing activities</li> <li>• Advising, guiding and assisting the issuer in bookbuilding and placing activities</li> </ul>	<ul style="list-style-type: none"> <li>• Bilateral agreements or arrangements between the issuer and the investors (such as “club deals”)</li> <li>• Transactions in which only one or several investors are involved and the terms of the offering are negotiated and agreed directly between the issuer and the investors</li> <li>• Transactions in which shares or debt securities are allocated to investors on a pre-determined basis</li> </ul>
<b>ECM</b>	<ul style="list-style-type: none"> <li>• Shares to be listed on the Stock Exchange of Hong Kong (SEHK) issued by a listing applicant or a listed company via (i) IPOs; (ii) offerings of shares of a class new to listing; or (iii) offerings of new shares of a class already listed</li> </ul>	A share offering that has been subscribed by an intermediary as principal deploying its own balance sheet for onward selling to investors or otherwise

Proposed Code – Scope of Coverage		
	In scope	Out of scope
	under a general or special mandate <ul style="list-style-type: none"> <li>• Units or interests in SFC- authorised real estate investment trusts (REITs) listed or to be listed on SEHK</li> <li>• Shares listed on SEHK when a shareholder places its existing shares to third-party investors followed by a top-up subscription of new shares by the shareholder</li> </ul>	
<b>DCM</b>	All types of debt offerings, provided that the offering involves bookbuilding or placing activities conducted by intermediaries in Hong Kong	N/A

### Standards of conduct

The SFC has taken measures to rectify specific problems in intermediary behaviours identified in the recent thematic review and to codify good industry practices by setting out specific standards of conduct and systems and controls. All CMIs are subject to a set of baseline requirements, while additional requirements apply to OCs. The key requirements applicable to CMIs and OCs from the Proposed Code are set out below:

Proposed Code – Standards of Conduct for CMIs and OCs		
	CMI	OC
<b>Assessment of the issuer and the offering</b>	Before engaging an offering, a CMI should: <ul style="list-style-type: none"> <li>• Take reasonable steps to obtain an accurate understanding of the issuer</li> <li>• Establish a formal governance process to review and assess the offering</li> </ul> <p><u>Key takeaway:</u> CMIs will need to undertake diligence on the issuer and will need to create a governance framework staffed with appropriately experienced personnel for the purposes of assessing the offering. This will need to be factored into the deal timetable</p>	An OC should share information about the issuer with syndicate CMIs, or take reasonable steps to ensure that the issuer provides this information to them, which should, in turn be shared with non-syndicate CMIs <p><u>Key takeaway:</u> OCs will need to create a suitable control framework to comply with this requirement</p>
<b>Appointment of CMIs and OCs</b>	Before a CMI starts any bookbuilding or placing activities, it should ensure that it has been formally appointed by the issuer under a written	Before an OC provides any services to the issuer client for a share offering or participates in any bookbuilding or placing activities for a debt offering, it

Proposed Code – Standards of Conduct for CMI and OCs		
	CMI	OC
	<p>agreement that clearly specifies the roles and responsibilities of the CMI and describes fee arrangements</p> <p><u>Key takeaway:</u> CMIs to review engagement letter templates and ensure they are amended to comply with this requirement and that they are signed and copies retained for record keeping purposes</p>	<p>should ensure that it has been formally appointed by the issuer under a written agreement that clearly specifies the roles and responsibilities of the OC and describes fee arrangements</p> <p><u>Key takeaway:</u> OCs to review engagement letter templates and ensure they are amended to comply with this requirement and that they are signed and copies retained for record keeping purposes</p>
<b>Advice to the issuer</b>	N/A	An OC should provide balanced advice that is aligned with all legal and regulatory requirements to the issuer on syndicate membership, fee arrangements, marketing strategy, and pricing and allocation
<b>Marketing</b>	<ul style="list-style-type: none"> <li>• Syndicate CMIs are required to inform CMIs they engage of the marketing and investor targeting strategy</li> <li>• CMI should not market to investor clients who fall outside the strategy</li> </ul> <p><u>Key takeaway:</u> CMIs to create a suitable control framework to comply with this requirement</p>	OC should advise and assist the issuer in developing an appropriate marketing and investor targeting strategy and inform other syndicate CMIs of the strategy so that they can carry out their own activities accordingly
<b>Rebates and preferential treatment</b>	<ul style="list-style-type: none"> <li>• CMIs should not offer any rebates to their investor clients or pass on any rebates provided by the issuer</li> <li>• IPO: a CMI should not enable any investor clients to pay, for each of the shares allocated, less than the total consideration as disclosed in the listing documents (including the 1% brokerage fee)</li> <li>• Debt offering: a CMI should not enter into any arrangements that may result in investor clients paying different prices for the debt securities allocated</li> <li>• A CMI should disclose to the issuer, the OCs, all of its targeted investors and the non-syndicate CMIs it appoints, any rebates offered by the issuer to</li> </ul>	<p>An OC should:</p> <ul style="list-style-type: none"> <li>• Disseminate information relating to rebates and preferential treatment to all syndicate CMIs</li> <li>• Advise the issuer against providing any arrangements whereby, in the case of an IPO, the investor clients would pay less than the total consideration as disclosed in the listing documents for each of the shares allocated and, in the case of a debt offering, the investor clients would pay different prices for the debt securities allocated</li> <li>• Provide advice and guidance to the issuer on the relevant disclosures</li> </ul> <p><u>Key takeaway:</u> OCs to create new workflows and procedures with appropriate record keeping standards to evidence compliance with these requirements</p>

Proposed Code – Standards of Conduct for CMIs and OCs		
	CMI	OC
	<p>CMIs and any preferential treatment of any CMIs or targeted investors</p> <p><u>Key takeaway:</u> CMIs to review and amend existing workflows and procedures to comply with these requirements</p>	
<b>Assessment of investors</b>	<ul style="list-style-type: none"> <li>A CMI should take reasonable steps to assess each investor client's profile, including investment preferences and past investment history</li> <li>IPO: Identify groups of investors that are subject to restrictions or require consent from SEHK, and inform the OC before placing an order on behalf of such clients</li> <li>Debt offerings: A CMI should identify whether its investor clients may have any associations with the issuer, the CMI, or a company in the same group of companies as the CMI and should inform the OC of these investors to enable the OC to assess whether any orders may negatively impact the price discovery process</li> </ul> <p><u>Key takeaway:</u> Additional diligence on investors required and suitable workflows / procedures and timetables established to comply with this requirement</p>	<p>An OC is expected to obtain from the issuer a list of persons or entities as required to enable it to provide information to CMIs to facilitate their identification of investors related to the issuer</p> <p><u>Key takeaway:</u> OC to do additional work with the issuer to obtain the relevant information and handle the data in compliance with applicable data privacy laws and regulations</p>
<b>Bookbuilding, including order placement and order book management, pricing, and allocation</b>  <b>Conflicts of interest</b>	<ul style="list-style-type: none"> <li>A CMI is responsible for ensuring that the price discovery process is credible and that the order book is transparent and incorporates only bona fide orders</li> <li>CMIs need to establish and implement policies and procedures as necessary (e.g., a policy to disclose actual and potential conflicts of interest as well as an allocation policy to ensure a fair allocation of shares or debt securities to their investor clients if they place an order on an omnibus basis and</li> </ul>	<p>An OC should:</p> <ul style="list-style-type: none"> <li>Ensure that the identities of all investor clients are disclosed in the order book, except for orders placed on an omnibus basis</li> <li>Make enquiries with CMIs if any orders appear to be unusual or irregular</li> <li>Consolidate the order book by taking reasonable steps to identify and eliminate duplicated orders, inconsistencies, and errors</li> <li>Segregate and clearly identify in the order book any proprietary orders of</li> </ul>

Proposed Code – Standards of Conduct for CMIs and OCs		
	CMI	OC
	<p>an OC gives them an overall allocation)</p> <ul style="list-style-type: none"> <li>CMI senior management should review and approve certain types of orders and allocations including (i) proprietary orders of the CMI and any of its group companies; (ii) orders from investor clients that may appear unusual; and (iii) allocations to restricted investors in the case of share offerings</li> </ul> <p><u>Key takeaway:</u> CMIs to establish and implement suitable policies and procedures, and ensure that senior management review / approvals are incorporated into workflows</p>	<p>CMIs and their group companies</p> <ul style="list-style-type: none"> <li>Discuss with and advise the issuer on the final offer price, taking into account the results of bookbuilding activities, the issuer's characteristics, and prevailing market conditions and sentiment</li> <li>Develop and maintain an allocation policy that sets out the criteria for making recommendations to the issuer and make allocation recommendations in accordance with the allocation policy</li> </ul> <p><u>Key takeaway:</u> OCs to develop operational procedures to improve monitoring/verification of orders and to satisfy the order book segregation requirement</p>
<p><b>Disclosures to the issuer, other CMIs, and investors</b></p> <p><b>Record keeping</b></p>	<ul style="list-style-type: none"> <li>A CMI should disseminate material information related to the offering to all stakeholders in a timely manner and ensure that such information is complete, accurate, and has a proper basis</li> <li>A CMI should maintain books and records that are sufficient to evidence work done through the entire transaction</li> <li>A CMI should establish and maintain effective information barriers and wall-crossing policies and procedures</li> <li>A CMI should conduct independent surveillance and monitoring on a regular basis to detect irregularities, conflicts of interest, and leakage of price-sensitive or confidential information as well as non-compliance with legal and regulatory requirements or its own internal policies and procedures</li> </ul> <p><u>Key takeaway:</u> CMIs to review existing policies and procedures to verify whether they are already fit for purpose and to consider whether</p>	<ul style="list-style-type: none"> <li>An OC should disseminate information in a timely manner to all syndicate CMIs and ensure that such information is complete, accurate, and has a proper basis</li> <li>An OC should document all changes in the orders in the order book through the bookbuilding process and all key discussions with, and key advice or recommendations provided to, the issuer</li> </ul> <p><u>Key takeaway:</u> OCs to review existing policies and procedures to verify whether they are already fit for purpose and to consider whether enhancements to internal controls are required</p>

Proposed Code – Standards of Conduct for CMIs and OCs		
	CMI	OC
	enhancements to internal controls are required	

## Membership and fee arrangements

Due to concerns of fluid syndicate membership and fee arrangements and therefore the types of competitive pressures that can lead to undesirable intermediary behaviours (e.g., existing incentive structures may reward syndicate members who support aggressive pricing, which may lead to prices being artificially high and unsustainable in secondary market trading), the Proposed Code sets a timeframe within which fee arrangements should be determined and requires related disclosures be made to the SFC.

It is proposed that:

- A **written agreement** should be entered into by an OC or CMI that specifies the fee arrangement (including the allocation of fixed fees to that CMI as a percentage of the total fees to be paid to all syndicate CMIs participating in the offering) and the fee payment schedule
- **Fixed fees** should be paid to the OCs and such fees should be determined at the time of the OC's appointment to cover the advisory service they provide and proportions of shares or debt securities ordinarily expected to be sold by the OC
- **Fixed fees** should be paid to the syndicate CMIs and such fees should be determined at the time of their appointment based on the volumes they are expected to sell

Although the amount of fees to be paid to individual syndicate CMIs will remain a commercial decision, issuers should appoint syndicate CMIs and agree their fees early in the process.

The SFC's rationale for imposing this requirement is that if syndicate membership and fee arrangements are determined at an early stage, OCs and CMIs should be able to focus their efforts and devote their resources to providing advice to the issuer and conducting bookbuilding and placing activities in compliance with the proposed conduct requirements.

The fixed fee is generally expected to account for a larger portion of the total fees to the syndicate CMIs participating in an offering.

The SFC further clarified that the issuer will retain its discretion to pay CMIs discretionary fees in order to incentivise sales outperformance and such fees can only be determined when the selling process is complete or substantially complete.

## Sponsor Coupling

The SFC's "sponsor coupling" proposal would require that, for IPOs, at least one sponsor which is independent of the listing applicant who should also be appointed as an OC for the IPO or have a group company which is also appointed as a sponsor (Sponsor OC). The Sponsor OC should be appointed as OC and sponsor at the same time and at least two months before filing the listing application. The listing applicant can appoint other OCs (which may or may not be sponsors of the IPO) no later than two weeks after the listing application submission.

## Next Steps

The deadline for responding to the Consultation Paper is 7 May 2021.

In addition to the incorporation of the Proposed Code into the Code of Conduct, consequential changes also will be made to (i) the Guideline to sponsors, underwriters and placing agents involved in the listing and placing of GEM stocks; (ii) the Rules Governing the Listing of Securities on SEHK; and (iii) the Rules Governing the Listing of Securities on GEM of SEHK.

To allow market participants sufficient time to implement changes required by the Proposed Code, the SFC has indicated that there would be a six-month transition period for compliance after the Proposed Code is made effective.

In addition to reviewing and responding to the Consultation Paper, market participants that engage in in-scope activities also should consider starting the process of reviewing their internal controls, policies and procedures, standard form documentation and workflows to determine what changes need to be made in order to comply with the Proposed Code.

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If you have questions about this *Client Alert*, please contact one of the authors listed below or the Latham lawyer with whom you normally consult:

**Simon Hawkins**

simon.hawkins@lw.com  
+852.2912.2733  
Hong Kong

**Cathy Yeung**

cathy.yeung@lw.com  
+852.2912.2622  
Hong Kong

**Kenneth Hui**

kenneth.hui@lw.com  
+852.2912.2711  
Hong Kong

**Terris Tang**

terris.tang@lw.com  
+852.2912.2719  
Hong Kong

**Mandy Wong**

mandy.wong@lw.com  
+852.2912.2682  
Hong Kong

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