



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

## **Investor survey on sponsors**

### **《關於保薦人的投資者調查》**

**Hong Kong  
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## **EXECUTIVE SUMMARY**

In October 2004, the Securities and Futures Commission (“SFC”) engaged an independent research centre to conduct a survey to solicit investors’ views on the standards and regulation of sponsors (the “Survey”).

### **Background and purpose**

The Survey is part of the second stage of the Commission’s initiatives for the enhancement of sponsor standards. The Commission appointed the Social Sciences Research Centre of the University of Hong Kong (“SSRC”), an independent research centre, to carry out an investor survey in order to gather a comprehensive picture of the investing public’s view on the topic of sponsor regulation. The Survey asked investors about their understanding of a sponsor’s role in the listing process, their views on current sponsor standards and possible means to enhance the standards of sponsors.

The first stage of the enhancement initiatives started with the SFC/HKEx Joint Consultation Paper on the Regulation of Sponsors and Independent Financial Advisers (the “Joint Consultation”) that was concluded with the release of a conclusions paper and a set of Listing Rules amendments in October 2004. The focus of the first stage is on setting standards for due diligence work undertaken by sponsors and clarification of the responsibilities of sponsors and independent financial advisers (“IFAs”) under the Listing Rules.

Results of the Joint Consultation clearly endorsed the SFC’s role, as the statutory regulator, to be responsible for the assessment of eligibility, on-going supervision and the taking of disciplinary action in relation to the conduct of corporate finance advisers who discharge the work of sponsors and IFAs. However, despite this general endorsement, respondents to the Joint Consultation, being mostly firms and other institutions involved in sponsor or IPO advisory work, overwhelmingly rejected the eligibility criteria requirements proposed in the Joint Consultation, which were intended to help raise sponsor standards.

As a statutory regulator overseeing the conduct of intermediaries, the Commission can apply all its statutory powers set out in the Securities and Futures Ordinance to deal with the fitness and properness, competence and conduct of sponsors and IFAs. The Commission is able to impose a variety of sanctions (such as public reprimands, fines, suspension or revocation of licence) on intermediaries that have failed to meet the required standards.

Continuing with the second stage of the Commission’s initiatives to enhance sponsor regulation, the Commission will be consulting the market in the first half of 2005 on eligibility criteria requirements of sponsors and IFAs and related regulatory issues. In preparation of the consultation, the Commission will take into account findings of the Survey and responses gathered in the Joint Consultation.

## Investors' understanding of sponsors

Survey findings indicate that both investors and potential investors have a fair understanding of a sponsor's role in the listing process, as well as the work undertaken by a sponsor during listing.

	<i>Retail investors</i>		<i>Potential investors</i>		<i>Institutional investors</i>	
	<i>Aware</i>	<i>Not aware</i>	<i>Aware</i>	<i>Not aware</i>	<i>Aware</i>	<i>Not aware</i>
<i>It is mandatory for a listing applicant to appoint a sponsor to advise it in preparation for listing.</i>	83.9%	16.1%	55.2%	44.8%	100%	0%
<i>Due diligence work is one of the duties of a sponsor.</i>	88.5%	11.5%	89.9%	10.1%	100%	0%
<i>Assisting in the preparation of an issuer's IPO prospectus is one of the duties of a sponsor.</i>	66.1%	33.9%	52.1%	47.9%	100%	0%
<i>Management of the listing process is one of the duties of a sponsor.</i>	70.7%	29.3%	62.1%	37.9%	90%	10%

Results of the Survey also suggest that the investing public has a relatively high level of cognisance of the duties and functions of sponsors, which is quite contrary to commonly held market belief.

## The need to raise sponsor standards in Hong Kong and possible measures to raise sponsor standards

Survey findings show that Hong Kong investors are in unison in their views that sponsor standards have to be raised. Investors are asked to consider a number of possible measures that may be employed to enhance sponsor standards. Findings of the Survey show that the investors consider the following as key factors for assessing the eligibility of sponsors:

- (a) Relevant IPO sponsor experience, and competence of firms and professional staff in carrying out sponsor work.
- (b) Firms' internal system and control that can deliver an effective management and organisational structure to oversee the quality of sponsor work.
- (c) Sufficient human and organisational resources to carry out sponsor work.
- (d) Sufficient financial resources including professional indemnity of sponsor firms.

Retail investors and institutional investors have a slightly different focus on the above key elements. Institutional investors place more emphasis on the organisational competence and resourcefulness of a sponsor firm, while retail investors are more concerned with the competence and experience of professional staff working in a sponsor firm.

## **Way forward**

In order to conduct an overall review of the sponsor regulatory regime for the purpose of raising the standards of sponsors, the SFC plans to conduct a public consultation on sponsor regulation in the first half of 2005. The Survey findings will be useful to our formulation of proposals on how to enhance sponsor standards.

Following the implementation of the revised Listing Rules regarding sponsors and the practice notes on due diligence on 1 January 2005, the Intermediaries and Investment Products Division of the SFC will conduct a theme inspection on sponsors' compliance with the revised Listing Rules and the new practice notes in the second half of 2005.

## INTRODUCTION

The SFC and the HKEx jointly issued the Consultation Conclusions Paper on the Regulation of Sponsors and IFAs (“Conclusions Paper”) in October 2004. The Conclusions Paper stated that there was a general consensus supporting the SFC to be the single regulator responsible for the assessment of eligibility, on-going supervision, and the taking of disciplinary action in relation to the conduct of corporate finance advisers who discharge the work of sponsors and IFAs. A majority of the respondents to that consultation was corporate finance practitioners, who had diverse views on the appropriate standards for regulating sponsors and the assessment criteria for the eligibility of sponsors under the SFC’s regulatory regime.

As mentioned in the Conclusions Paper, the SFC would conduct an investor survey to obtain an overall picture of public views on sponsor standards and sponsor regulation as part of its preparation for a focused public consultation on specific eligibility criteria requirements applicable to sponsors, Compliance Advisers and IFAs.

The aim of the Survey is to solicit responses from investors, both retail and institutional, on their views on the current standards of the work done by sponsors in connection with the listing of companies in Hong Kong, possible means to enhance the standards of sponsors and any general comments on the topic.

The Survey was carried out by the SSRC. 1,600 survey targets were reached. Respondents to the Survey include individuals and institutions. The individuals are divided into the following categories: non-investors<sup>1</sup>, retail investors<sup>2</sup>, and potential investors<sup>3</sup>. The group of institutions comprises ten international and Hong Kong fund management companies which together accounted for approximately 85% of Hong Kong’s total retail fund market and 58% of the pension fund market, including Mandatory Provident Funds<sup>4</sup>.

The SFC would like to thank all the participants in the Survey, including the SSRC and the survey respondents.

## METHODOLOGY

The SFC commissioned the SSRC to conduct a survey to collect investors’ views on sponsors and sponsor regulation. The Survey was conducted through telephone between 19 October 2004 to 5 November 2004, and self-administered questionnaires between 27 October 2004 to 6 November 2004. The questionnaires for the ten institutional investors were administered between 1 November 2004 and 12 November 2004. All questionnaires were administered on an anonymous basis.

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<sup>1</sup> “*Non-investors*” include respondents who had not traded any Hong Kong stocks during the past 5 years and did not plan to trade in the future.

<sup>2</sup> “*Retail investors*” include respondents who had traded Hong Kong stocks during the past 5 years.

<sup>3</sup> “*Potential investors*” include respondents who had not traded any Hong Kong stocks during the past 5 years, but indicated that they would trade in the future.

<sup>4</sup> The percentages are based on the total asset under management of these 10 fund managers obtained via the Fund Management Activities Survey 2003.

All individual respondents are Hong Kong adults aged 18 or above. For telephone interviews, a random sample of 9,715 residential telephone numbers was drawn. 1,714 households were reached, of which 1,122 respondents were successfully interviewed. The questionnaire used during telephone interviews was also administered to 501 students who were enrolled in various finance courses at a tertiary institution.

## **STRUCTURE OF THE SURVEY**

The Survey is broadly divided into two parts. Part one is focused on collecting information about the background of the respondents and the level of their awareness of market knowledge about sponsors. Individuals who were ascertained as non-investors at the beginning of the Survey were not asked to continue with the rest of the Survey.

The second part of the Survey is focused on possible measures that may enhance sponsor standards. Findings from this part are based on replies from retail investors (including potential investors) and institutional investors.

## **KEY FINDINGS OF THE SURVEY**

### **Part I: Investors' awareness of sponsors and their responsibilities**

#### **Key observations**

Part one of the Survey asked respondents about their IPO investment experience, information that they would consider important when deciding whether to subscribe to an IPO, and their awareness of sponsors and their responsibilities.

The Survey findings show that most retail investors had experience investing in IPOs. Almost all respondents considered information about the business nature of the company as the most important source of information when making their IPO investment decisions. A large portion of the potential investors and institutional investors considered prospectus an important source of information.

The majority of respondents was aware of the mandatory Listing Rule requirement that every listing applicant is required to have a sponsor to assist them with the listing process. When asked further about a sponsor's responsibilities, over 70% of the retail investors and 90% of the institutional investors, as well as over half of the potential investors, were able to identify correctly the responsibilities of a sponsor.

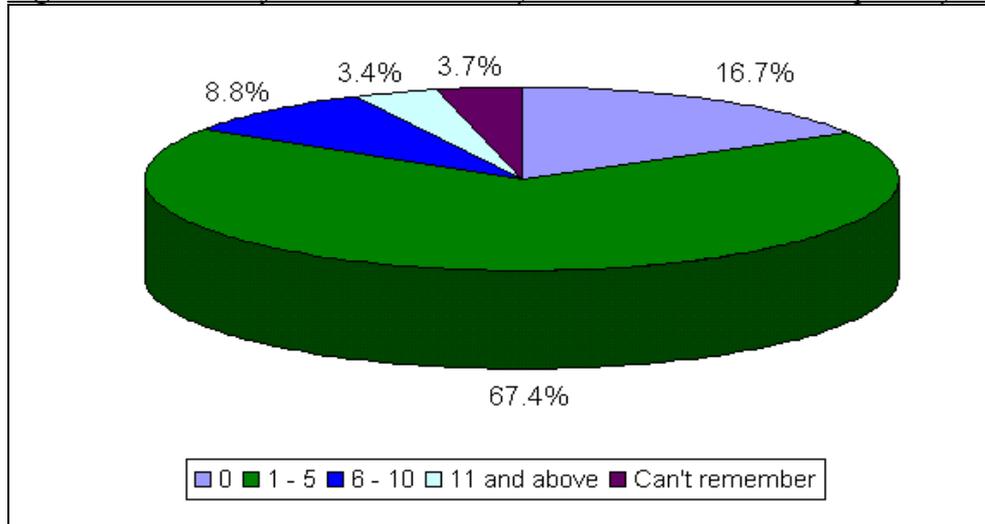
#### **Retail investors and potential investors**

A total of 1,623 individuals aged 18 years or above were successfully interviewed, of which 937 (57.7%) were identified as either retail or potential investors (specifically, 765 (47.1%) retail investors and 172 (10.6%) potential investors), and 686 (42.3%) non-investors. As mentioned previously, questionnaires were successfully administered to 10 institutional investors.

## IPO investment experience

The Survey shows that the majority (79.7%) of the retail investors had subscribed for shares in IPOs, with 12.2% of these investors having subscribed for shares in 6 or more IPOs over the past 5 years. There are also some retail investors (3.4%) who had subscribed for shares in 11 or more IPOs over the past 5 years. (See Figure 1)

*Figure 1: Number of IPOs subscribed by retail investors over the past 5 years*



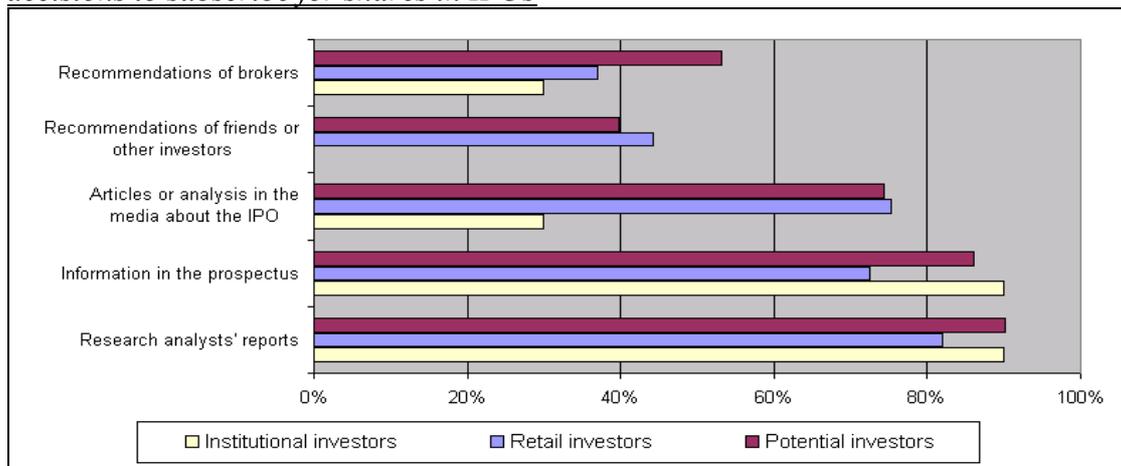
## Information relied on to make IPO subscription decisions

Nearly all respondents (93.9% of retail investors, 91.9% of potential investors, 100% institutional investors) considered information about the business nature of a listed company important for them to decide whether to subscribe for shares in an IPO.

Respondents were further invited to rate five types of information according to the level of importance such information might bear on their decisions to subscribe for IPOs:

- (a) *Prospectuses and Research Reports:* Despite the market's general belief that retail investors and potential investors pay little attention to information in prospectus, the Survey shows that 72.4% of retail investors and 86.1% of potential investors considered prospectus an important source of information for making investment decisions.
- (b) *Other sources of information:* Findings of the Survey suggest that other sources of information such as articles or analyses relating to IPOs that are generally available in the media are also important to retail investors. Over 70% of retail investors and potential investors believed that articles and analysis in the media about the IPO is an important source of information whereas less than 35% of institutional investors considered this important. As expected, given their professional background, none of the institutional investors considered recommendations of friends and other investors to be important. Interestingly, retail and potential investors also considered this type of information to be the least important (at 44% and 40% respectively). (See Figure 2)

*Figure 2: Information sources which investors deemed important when making decisions to subscribe for shares in IPOs*

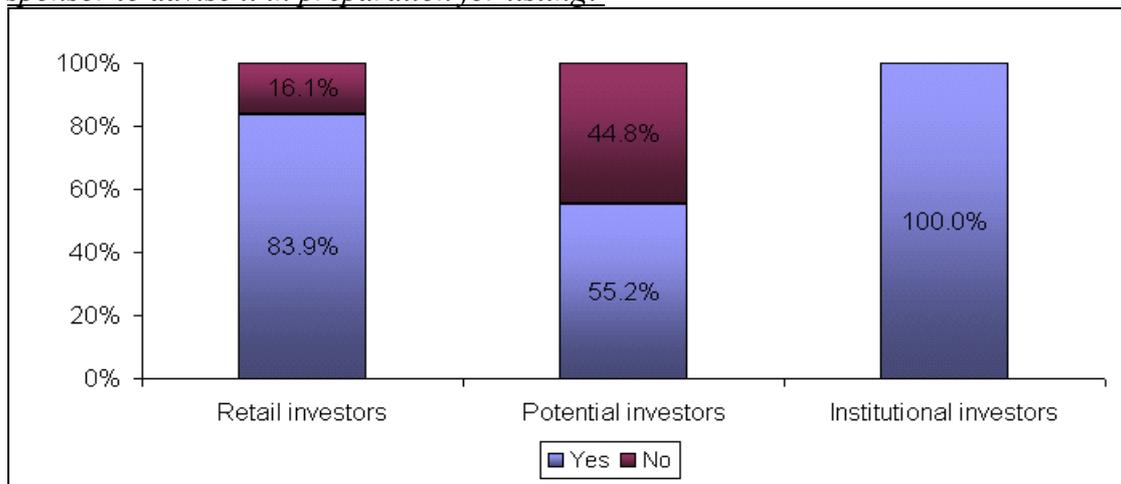


### **Understanding the concept of sponsor and investors' views on sponsor work**

Despite the fact that sponsors work “behind the scenes” as corporate finance advisers to listing applicants during the listing process, and generally receive little media exposure, a large portion of respondents was familiar with the concept of sponsors and was able to differentiate between the work done by the sponsors and the listed company itself.

83.9% of retail investors, 55.2% of potential investors, and 100% institutional investors were aware that it is mandatory for a listing applicant to appoint a sponsor to advise it in preparation for listing. Given that the question is intended to find out investors' awareness of the mandatory Listing Rule requirement for a sponsor, it is not out of expectation that potential investors would be less familiar with this aspect. (See Figure 3)

*Figure 3: Are you aware that it is mandatory for a listing applicant to appoint a sponsor to advise it in preparation for listing?*



Respondents were also asked to identify the duties of a sponsor. The findings from this question show that the majority of the respondents had a general understanding of the sponsor’s duties during the listing process. (See Table 1)

<i>(Table 1)</i>	<i>Retail investors</i>		<i>Potential investors</i>		<i>Institutional investors</i>	
	<i>Aware</i>	<i>Not aware</i>	<i>Aware</i>	<i>Not aware</i>	<i>Aware</i>	<i>Not aware</i>
<i>Due diligence work is one of the duties of a sponsor.</i>	88.5%	11.5%	89.9%	10.1%	100%	0%
<i>Assisting in the preparation of an issuer’s IPO prospectus is one of the duties of a sponsor.</i>	66.1%	33.9%	52.1%	47.9%	100%	0%
<i>Management of the listing process is one of the duties of a sponsor.</i>	70.7%	29.3%	62.1%	37.9%	90%	10%

## **Part II: Investors' views on sponsor standards and regulation**

### **Key observations**

Part two of the Survey gauged the views of respondents on specific measures that may help enhance the standards of sponsors. In general, an overwhelming majority of respondents took the view that raising the standards of sponsors was necessary. The Survey also shows that institutional investors and retail investors had a slightly different focus with respect to the effectiveness of these measures in enhancing standards.

Institutional investors were inclined to place more emphasis on the organisational competence and resourcefulness of a sponsor firm in carrying out its sponsor's functions. They were unanimous in their views that the following are key factors for assessing the sponsors' eligibility:

- (a) proper system within sponsors' firms and internal control to oversee the quality of their work; and
- (b) firms possess sufficient IPO experience in order to become a sponsor.

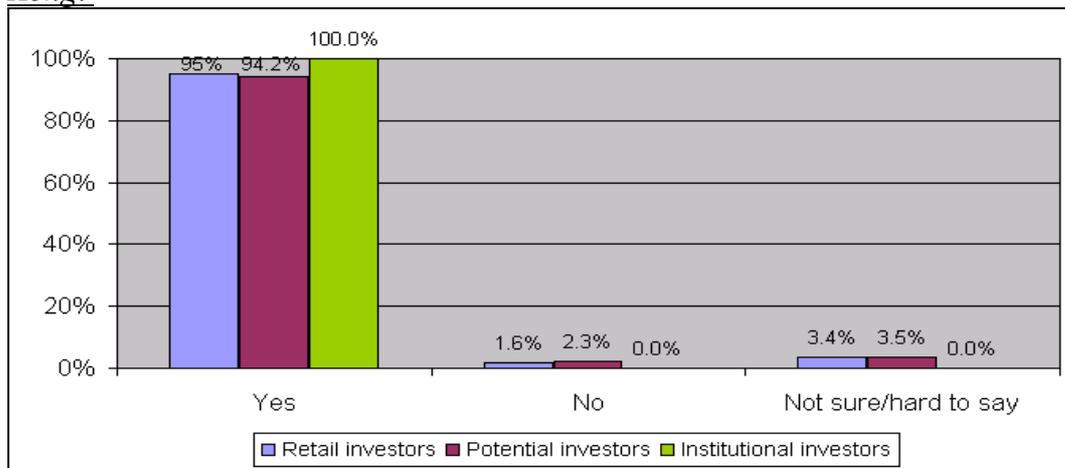
On the other hand, individual investors including retail investors and potential investors placed more importance on the competence and experience of professional staff employed by sponsor firms in carrying out the sponsors' role. The three most important factors ranked by retail and potential investors, in descending order of importance, are:

- (a) stringent assessment of the senior management experience of sponsor firms in IPO work;
- (b) sufficiency of qualified staff employed by sponsor firms; and
- (c) sufficient sponsorship experience of professional staff in sponsor firms.

### **The need to raise sponsor standards in Hong Kong**

Institutional investors, retail investors and potential investors reached an almost unanimous view that there is a need to raise sponsor standards in order to raise the quality of the Hong Kong stock market. It is interesting to note that institutional investors, being professionals in the financial services industry, were in unison that the standards of Hong Kong sponsors need improvement. (See Figure 4a)

*Figure 4a: Do you agree that there is a need to raise sponsor standards in Hong Kong?*



**Possible measures to enhance sponsor standards**

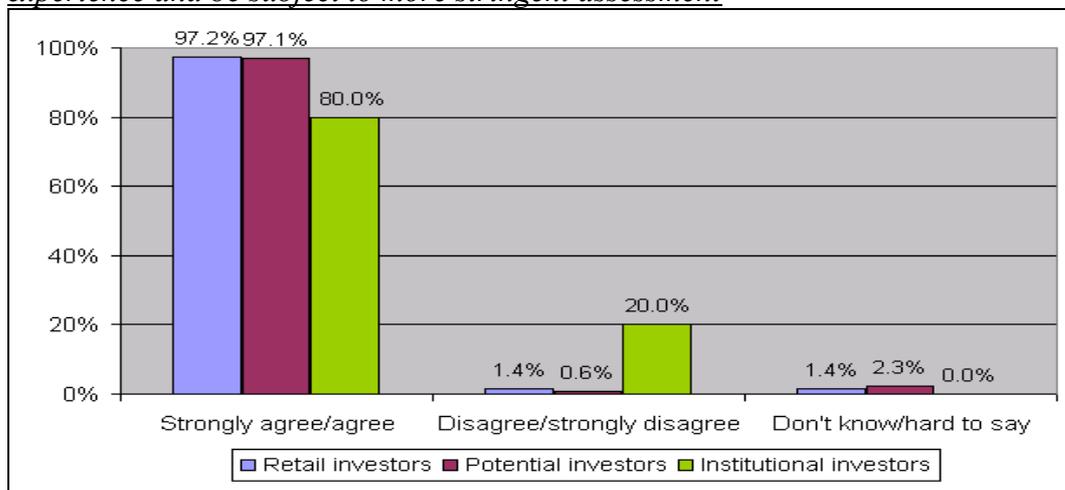
Respondents were invited to consider ten possible factors for assessing the sponsors’ eligibility and give their views on whether they should be adopted. These ten criteria fall broadly into three categories: (a) competence and experience of professional staff of a sponsor firm; (b) competence and experience of the firm itself; and (c) organisational and financial resources. Findings are stated below.

Competence, experience and sufficiency of sponsor’s staff

(1) *Whether a sponsor’s senior management should possess substantial IPO experience and be subject to more stringent assessment*

97.2% of retail investors, 97.1% of potential investors and 80% of institutional investors agreed that a sponsor’s senior management should possess substantial IPO experience and be subject to more stringent assessment. (See Figure 4b)

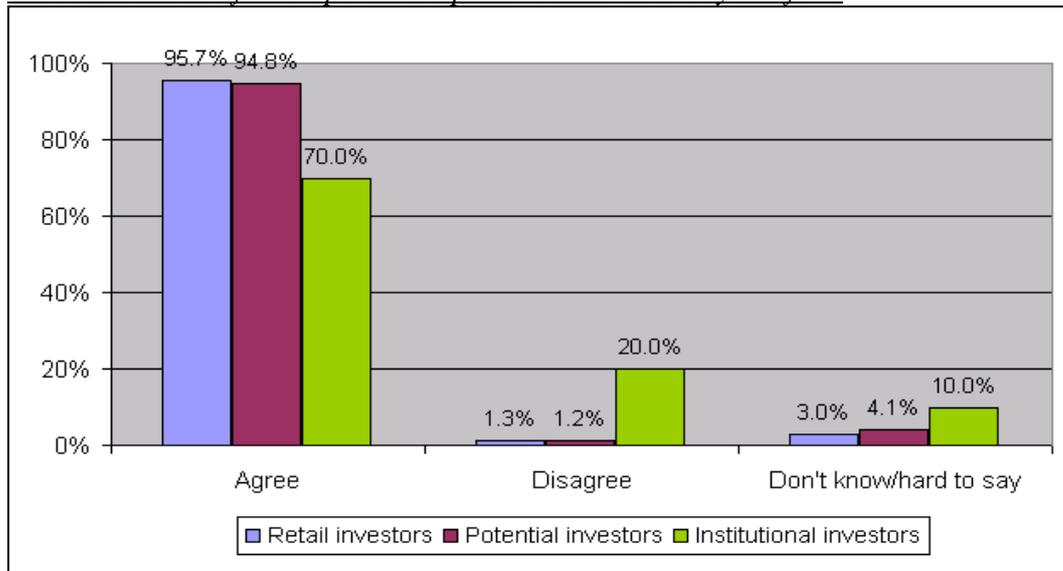
*Figure 4b: A sponsor’s senior management should possess substantial IPO experience and be subject to more stringent assessment*



(2) *Sponsors to employ sufficient qualified professional staff to keep up with the volume of IPO sponsorship work undertaken by the firm*

95.7% of retail investors, 94.8% of potential investors and 70% of institutional investors agreed that sponsors should employ sufficient qualified professional staff to keep up with the volume of IPO sponsorship work undertaken by the firm. (See Figure 4c)

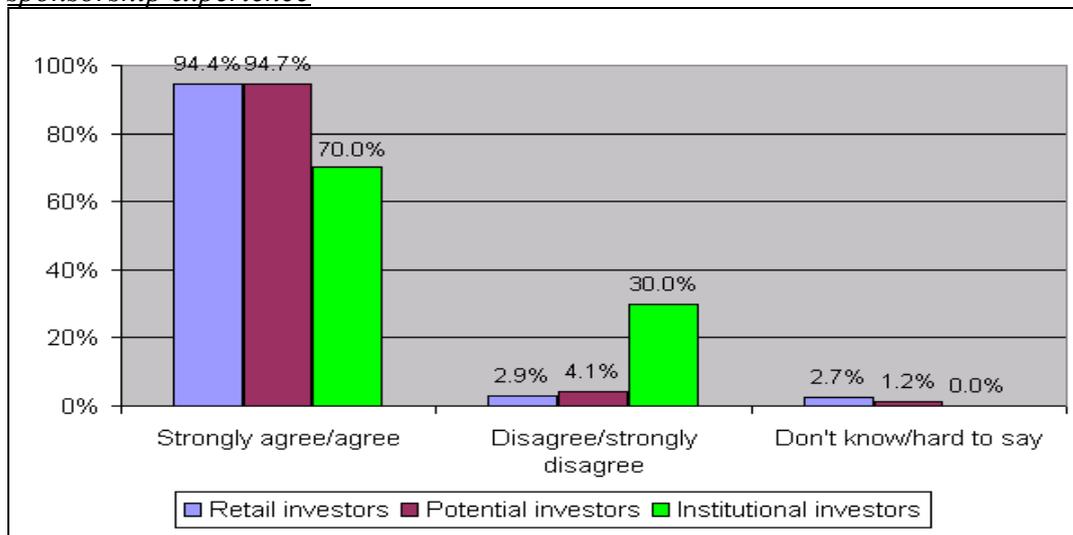
*Figure 4c: Sponsors should employ sufficient qualified professional staff to keep up with the volume of IPO sponsorship work undertaken by the firm*



(3) *Professional staff working for sponsor firms should have sufficient sponsorship experience*

94.4% of retail investors, 94.7% of potential investors and 70% of institutional investors agreed that professional staff working for sponsors should also have sufficient sponsorship experience. (See Figure 4d)

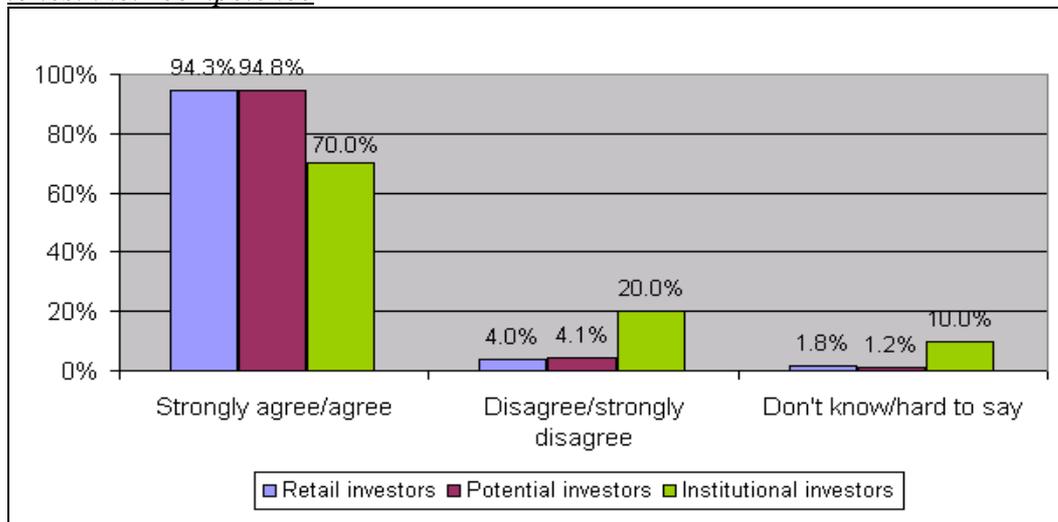
*Figure 4d: Professional staff working for sponsor firms should have sufficient sponsorship experience*



(4) *Professional staff working for sponsors should pass specific examinations to test their competence*

94.3% of retail investors, 94.8% of potential investors and 70% of institutional investors agreed that professional staff working for sponsors should pass specific examinations to test their competence. (See Figure 4e)

Figure 4e: Professional staff working for sponsors should pass specific examinations to test their competence

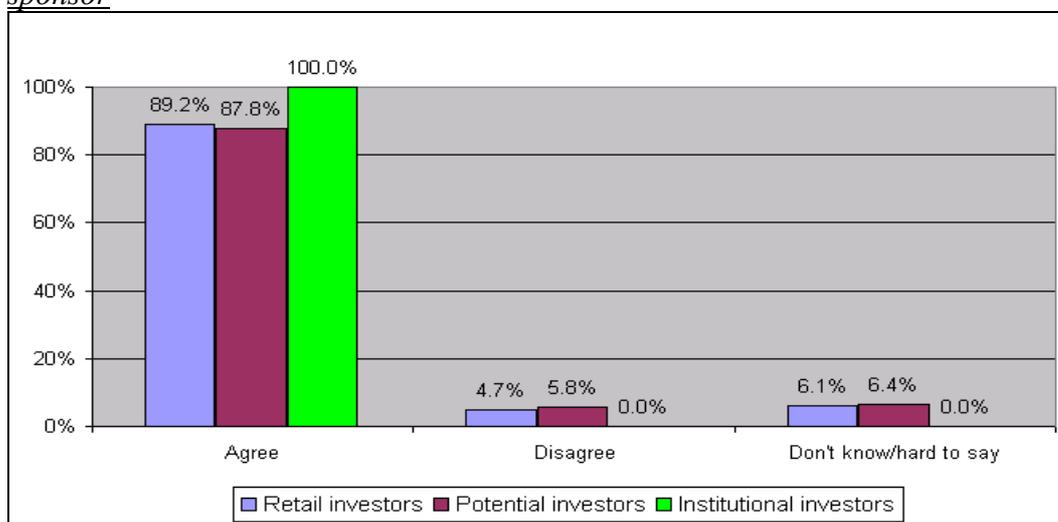


Competence and experience of the sponsor firms

(5) *Firms should have sufficient IPO sponsor experience in order to become a sponsor*

89.2% of retail investors, 87.8% of potential investors, and all of the institutional investors agreed that firms should have sufficient IPO sponsor experience in order to become a sponsor. (See Figure 4f)

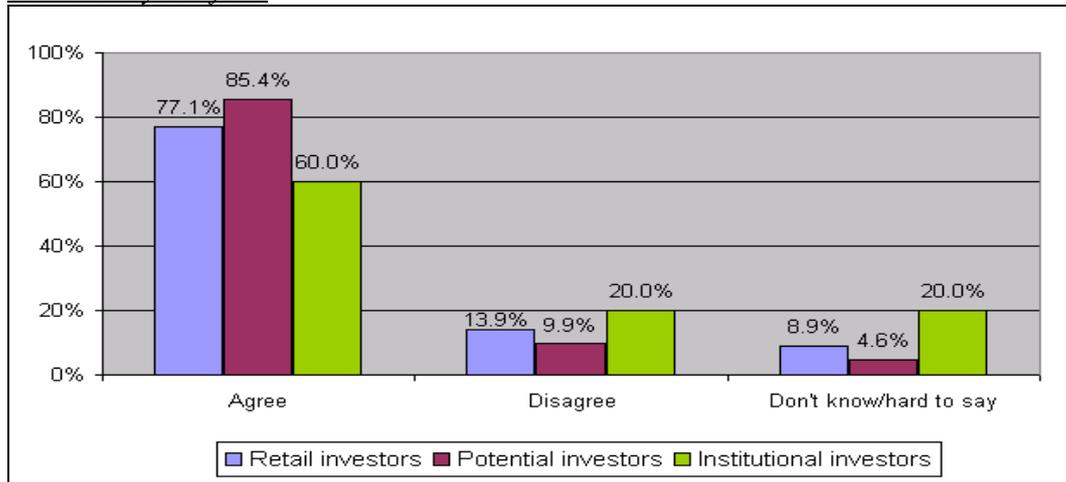
Figure 4f: Firms should have sufficient IPO sponsor experience in order to become a sponsor



(6) Overseas IPO experience should count towards the overall experience obtained by the firm

77.1% of retail investors, 85.4% of potential investors and 60% of the institutional investors agreed that overseas IPO experience should count towards the overall experience obtained by the firm. (See Figure 4g)

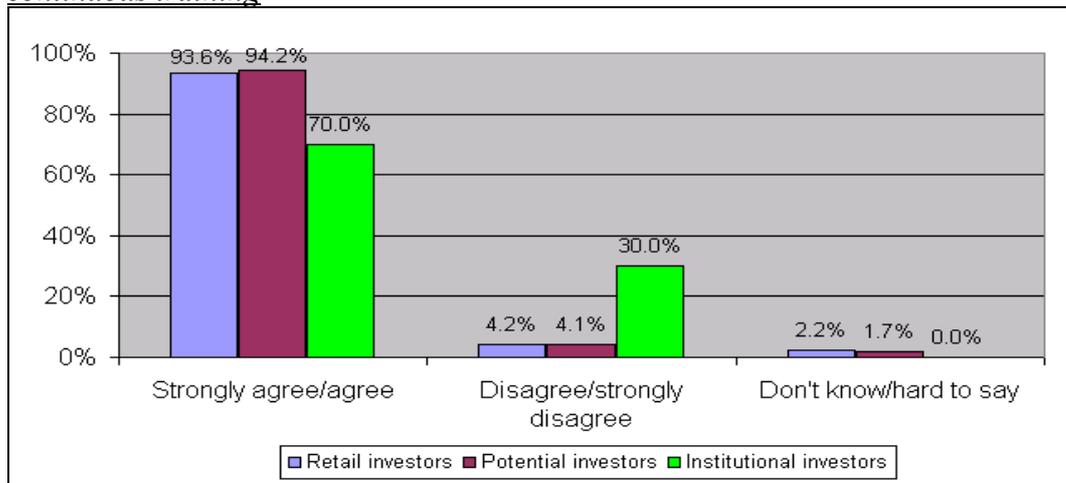
Figure 4g: Overseas IPO experience should count towards the overall experience obtained by the firm



(7) Professional staff working for sponsors should undertake compulsory continuous training

93.6% of retail investors, 94.2% of potential investors and 70% of institutional investors agreed that professional staff working for sponsors should undertake compulsory continuous training to keep up with the latest industry trends. (See Figure 4h)

Figure 4h: Professional staff working for sponsors should undertake compulsory continuous training

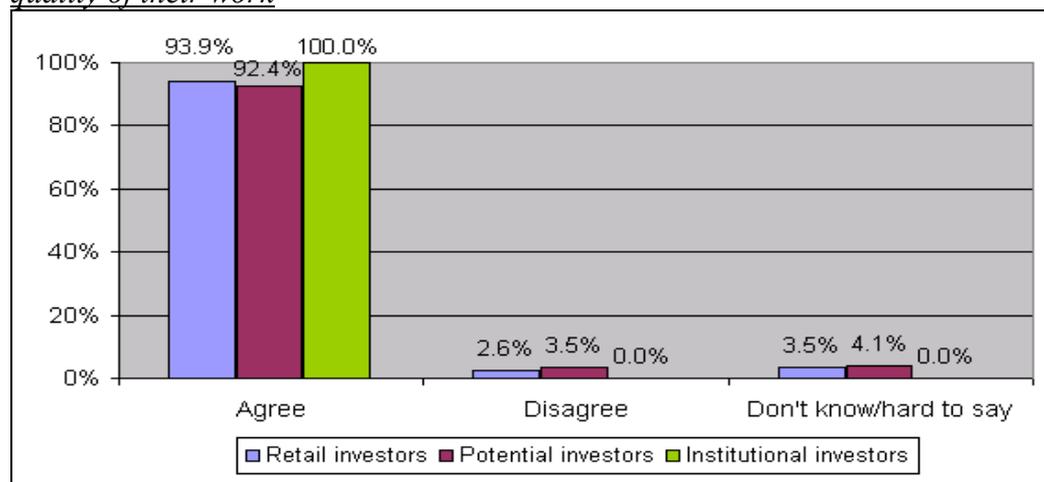


## Sponsor Firms – organisational resources and competence

(8) *Sponsors should have systems and internal controls in place to oversee the quality of their work*

93.9% of retail investors, 92.4% of potential investors and all institutional investors agreed that sponsors should have systems and internal controls in place to oversee the quality of their work. (See Figure 4i)

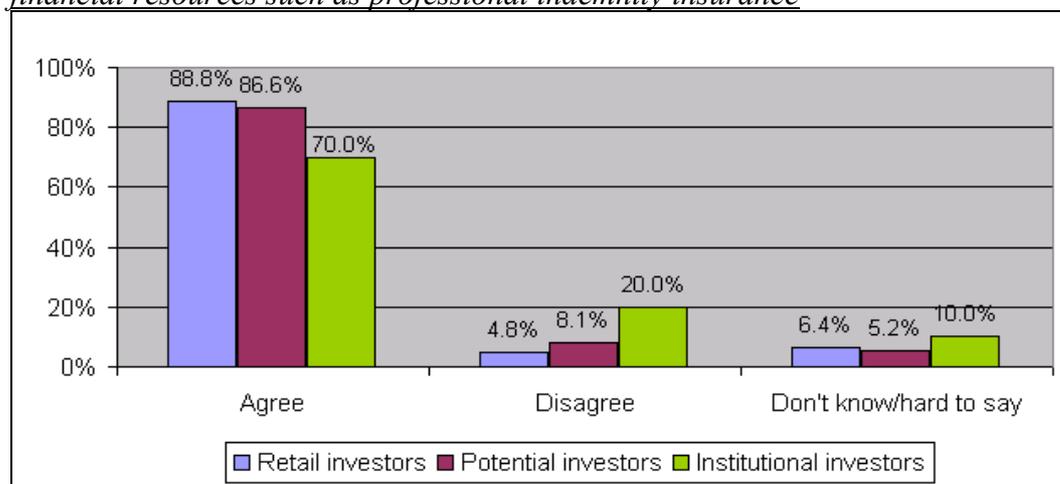
Figure 4i: Sponsors should have systems and internal controls in place to oversee the quality of their work



(9) *Other than minimum financial capital, sponsor firms should have other financial resources such as professional indemnity insurance*

88.8% of retail investors, 86.6% of potential investors and 70% of institutional investors agreed that other than minimum financial capital, sponsor firms should have other financial resources, such as professional indemnity insurance. (See Figure 4j)

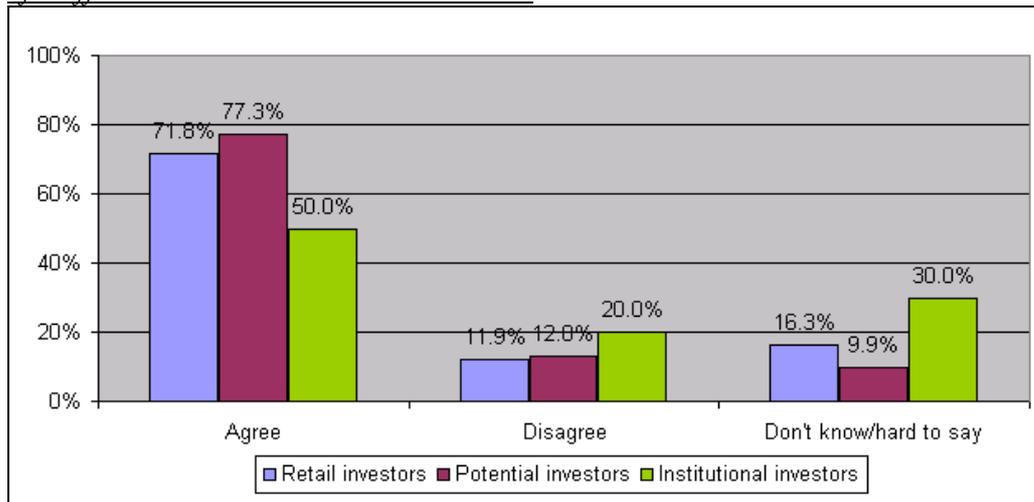
Figure 4j: Other than minimum financial capital, sponsor firms should have other financial resources such as professional indemnity insurance



(10) *The number of IPOs undertaken by a sponsor at any given time should be commensurate with the number of staff that can be dedicated to the work*

71.8% of retail investors, 77.3% of potential investors and half of the institutional investors agreed that the number of IPOs undertaken by a firm at any given time should be commensurate with the number of staff that can be dedicated to the work.(See Figure 4k)

*Figure 4k: The number of IPOs sponsored should be commensurate with the number of staff that can be dedicated to the work*



## **CONCLUSION**

The Survey findings show that despite their different backgrounds, the majority of individual respondents, whether retail or potential investors, has a fair understanding of the role and work of a sponsor. Responses from individual investors are, quite contrary to some market belief, in line with those of institutional investors. It is evident from the Survey that the investing public has a general expectation and demand on sponsors fulfilling their role in performing proper due diligence and in assisting the preparation of prospectus, which is regarded by the respondents as an important source of information for them to make investment decisions.

More importantly, all respondents, both retail and institutional investors, are in favour of raising the overall standards of sponsors in Hong Kong, and support adopting certain measures to enhance sponsor standards.

We appreciate that institutional investors, as professional investors, have a higher expectation of the internal controls and the capacity of sponsor firms in undertaking IPO work. As professionals in the financial services industry, institutional investors have a legitimate expectation that other professionals such as sponsors should only undertake jobs that are within their capacity, competence and resources to do so, and it is a sponsor's duty to exert overall control over the quality of the work and advice provided by its staff from a corporate governance and risk management perspective.

Both individual and institutional investors considered it important that sponsor firms have in place proper internal control systems and the experience, competence and quality of professional staff employed by sponsor firms. In fact, retail investors appeared to place an even greater emphasis on the latter requirement.

## **WAY FORWARD**

The Survey is part of the preparation for the SFC's public consultation on eligibility criteria requirements of sponsors and IFAs, which will be carried out in the first half of 2005. Findings of the Survey serve as useful reference for the market expectation on measures that should be engaged for enhancing standards.

In formulating our proposals in the coming public consultation for eligibility criteria requirements for sponsors and IFAs, we will take into account the four key elements that are indicated as important for assessing eligibility of sponsors from the findings of the Survey:

- Relevant IPO sponsor experience and competence of firms and professional staff engaged in carrying sponsor work.
- Firms' internal system and control that can deliver an effective management and organisational structure to oversee the quality of sponsor work.
- Sufficient human and organisational resources to carry out sponsor work.
- Sufficient financial resources including professional indemnity of sponsor firms.

The SFC notes that respondents to the Joint Consultation in May 2003, being mostly firms and other institutions involved in sponsor or IPO advisory work,

overwhelmingly rejected the specific eligibility criteria requirements proposed in that consultation, which were intended to help raise sponsor standards.

The Survey attempts to seek the views of investors, both retail and institutional. This group of stakeholders was not among the respondents to the Joint Consultation in 2003. Results of the Survey provide indicators for our formulation of a balanced response and action plan for carrying out the public consultation on sponsor regulation in the first half of 2005. The public consultation will cover various aspects of regulatory requirements and compliance oversight by the Commission on the work carried out by sponsors and IFAs.

The SFC plans to soft consult the market on the proposed sponsor regulatory regime, which will be followed by public consultation. The SFC aims to complete the soft consultation and the preparation for public consultation in the first half of 2005. In the meantime, the SFC plans to conduct a theme inspection in the second half of 2005 in relation to sponsors' compliance with the recently implemented Listing Rules and practice notes on due diligence.