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# HONG KONG REGULATORY UPDATE

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This Hong Kong regulatory update is intended to provide a brief overview of the principal Hong Kong regulatory developments in the preceding three months relevant to companies listed or proposed to be listed on The Stock Exchange of Hong Kong Limited (the **HKEx**) and their advisers, including HKEx announcements and rule changes, Securities and Futures Commission (**SFC**) decisions and updates, and both HKEx and SFC enforcement-related news. In this update we cover:

- Commencement of trading under the Shanghai – Hong Kong Stock Connect program
- Updates to the disclosure requirements for acquisitions prior to listing
- The decision by the Takeovers Panel regarding China Oriental
- Results of the SFC annual review of the performance of the HKEx
- HKEx's guidance letter on placing shares to "connected clients"
- SFC's consultation conclusions on amendments to professional investor regime
- Recent enforcement actions and penalties against listed companies and their directors

## Commencement of Trade Under the Shanghai – Hong Kong Stock Connect Program

17 November 2014 marked the first day of trading under the Shanghai-Hong Kong Stock Connect (**the Shanghai-HK Connect**), a mutual market access program that effectively opens the Hong Kong market to mainland Chinese investors. The Shanghai-HK Connect enables mainland Chinese investors to trade in securities listed on the HKEx in Renminbi (**RMB**) through broker members of the Shanghai Stock Exchange (**SSE**), and Hong Kong investors to trade in securities listed on the SSE through their HKEx brokers.

At least initially, the scope of the Shanghai-HK Connect is limited by an initial RMB250 billion cap on the aggregate quota of HKEx-listed securities that may be purchased under the program by mainland Chinese investors (together with a daily cap of RMB10.5 billion). A rise in average daily trade on the Hong Kong exchange during recent months had been widely attributed to the impending commencement of the program. Daily turnover for the HKEx throughout the month of November 2014 was approximately HK\$78.2 billion, an increase of over 25 per cent from the same month in 2013. Within the program's first three weeks, shares in 263 HKEx-listed entities (out of a total of 266 eligible for trading under the program) had been traded by mainland Chinese investors.

While still in its early days, the Shanghai-HK Connect is an important step in the liberalization of China's capital markets. The program boosts the appeal of Hong Kong as a listing venue for companies looking to tap Chinese investor demand. Both the Hong Kong and mainland Chinese sides have publicly stated that if it is successful in its initial pilot phase, it may be broadened in terms of the quotas, markets and securities covered.

## Updates to the Disclosure Requirements for Acquisitions Prior to Listing

The HKEx recently updated two guidance letters governing the disclosure requirements for acquisitions of subsidiaries and businesses (**the Target**) conducted during or after a company's requisite three-year trading record period, namely HKEx-GL32-12 and HKEx-GL6-09A. A brief summary of these letters and current HKEx practice is set out below:

*For acquisitions that occur during the final trading record period as set out in a company's published prospectus:*

- Disclosure of the financial information of the Target from commencement of the three-year trading record period up to the date of acquisition is required if the size of the acquisition exceeds any of the 25 per cent thresholds in the Hong Kong Listing Rules calculated by comparing the total assets, profits and revenue of the Target for the most recent financial year of the trading record period against those of the company for the same financial year.
- If any of the 25 per cent thresholds are met, disclosure of the Target's financial information up to the date of acquisition is required in the proof of the prospectus submitted at the time of the listing application (the **Application Proof**) even if the acquisition took place after the latest balance sheet date (*e.g.*, the company is seeking to benefit from HKEEx-GL6-09A by filing with two years and nine months of accounts and the acquisition was in the final three months of the third year). However, if the size test results are all below 25 per cent, the Application Proof prospectus does not need to include the pre-acquisition financial information of the Target provided the company updates the prospectus before the listing hearing to cover the final three months of the trading record period that includes the acquisition.

*For acquisitions that occur after the final trading record period:*

- Disclosure of the financial information of the Target during the trading record period (including any stub period) is required regardless of the results of the size test calculation.
- All acquisitions or proposed acquisitions since the date the latest audited accounts of the applicant were made should be aggregated. If the aggregate total assets, profits or revenue represents 5 per cent or more under any of the threshold tests, a pro forma statement of assets and liabilities of the enlarged group is required. If any of the tests yield 100 per cent or more, a pro forma balance sheet, pro forma income statement and pro forma cash flow statement of the enlarged group are required.

### **The Decision of the Takeovers Panel on China Oriental**

On 14 October 2014, the Hong Kong Takeovers and Mergers Panel (the **Panel**) issued a ruling that the completion of certain transactions between Mittal Steel Holdings AG (**ArcelorMittal**), a substantial shareholder of China Oriental Group Company Limited (**China Oriental**), and counterparties involving shares of China Oriental on 30 April 2014 did not give rise to a mandatory general offer obligation under the Code on Takeovers and Mergers (**Takeovers Code**) by ArcelorMittal to acquire all the shares of China Oriental. Under the Takeovers Code, a mandatory offer is normally triggered when a person or persons acting in concert (a) hold less than 30 per cent and acquire voting rights that result in them going above 30 per cent, or (b) hold between 30 per cent and 50 per cent and increase that interest by more than 2 per cent in any 12-month period.

Following a general offer by ArcelorMittal for all the shares of China Oriental in 2008, ArcelorMittal and Mr. Han Jingyuan, chairman of China Oriental, held 47 per cent and 45 per cent of the shares of China Oriental, respectively. As a result, the minimum 25 per cent public float requirement under the Listing Rules was not satisfied. To rectify this, ArcelorMittal subsequently sold 9.9 per cent and 7.5 per cent of shares it owned in China Oriental to ING Bank (**ING**) and Deutsche Bank (**DB**). As part of the transactions at the time, Arcelor-Mittal granted ING and DB options entitling them to put their shares to ArcelorMittal at the original purchase price (subject to certain adjustments). The put options expired on 30 April 2014 and ArcelorMittal proposed to extend the put option arrangement with ING for one year on amended terms. It also proposed closing the arrangement with DB and enter into an arrangement with Macquarie Bank Limited (**Macquarie**) that was similar to the amended arrangement with ING. These transactions were to be completed simultaneously.

The Panel ruled that (i) the completion of the agreements between DB and ArcelorMittal on the one hand and ArcelorMittal and Macquarie on the other did not result in ArcelorMittal

acquiring additional voting rights as these voting rights passed directly from DB to Macquarie, (ii) Macquarie and ArcelorMittal are presumed to be acting in concert by virtue of the financial arrangements between them and the presumption had not been rebutted, and (iii) both ING and DB were parties presumed to be acting in concert with ArcelorMittal given the similarity of the arrangements. Since ArcelorMittal and its concert parties, *i.e.*, DB, ING and Macquarie, held a combined 47 per cent stake in China Oriental throughout the existence of such arrangements, the arrangements did not increase the concert parties' aggregate holding. They also did not cause any member of the concert party group to cross a mandatory offer trigger threshold or cause any significant change to the concert party with the substitution of Macquarie for DB. As a consequence, a mandatory offer obligation was not required.

### Results of the SFC Annual Review of the Performance of the HKEx

The SFC, as the regulator overseeing the HKEx, recently issued its annual review of the performance of the HKEx. The SFC found that the HKEx had exercised its functions well, with its principal recommendation being that the HKEx should adopt a higher degree of scrutiny of listings involving companies transferring from the Growth Enterprise Market (**GEM**) board to the Main Board. Market perception of the HKEx's consistency in rule interpretation, impartiality and timeliness of responses all improved, with the HKEx generally receiving an average score of between 4.1 and 4.3 on a scale of 5 (with 5 being the best possible score) from respondents on such matters. We set out below some brief highlights of the report that may be of interest to companies looking to list on, or are already listed on, the HKEx:

#### *For companies seeking a listing:*

- Vetting times had improved significantly. The median time between the filing of a listing application and the issue by the HKEx of the first comment letter had decreased from 21 days for the period October 2012 to April 2013 to 14 days for October 2013 to April 2014. The median time between the filing of a listing application and the Listing Committee hearing dropped from 117 days to 59 days over the same periods.
- In 2013, 54 per cent of applications were reviewed by the Listing Committee of the HKEx within 120 days. (Based on our experience, we believe this has likely reduced further in 2014, as borne out by the October 2013 to April 2014 median time above.)

#### *For companies that are already listed:*

- The enforcement department conducted 69 investigations in 2013, down from 91 in 2012.
- There were eight disciplinary cases involving sanctions (such as a public censure), 16 companies were issued warning / caution letters and eight cases were closed by way of "no further action." This was in part due to the responsibility for enforcement shifting to the SFC and the 2012 implementation of a statutory obligation to disclose inside information in a timely manner in the Securities and Futures Ordinance.

### HKEx's Guidance Letter on Placing Shares to "Connected Clients"

Currently, the "placing guidelines" in Appendix 6 to the Hong Kong Listing Rules prevent IPO underwriters from placing shares to "connected clients" without the consent of the HKEx. HKEx guidance letter HKEx-GL75-14 clarifies that the HKEx will ordinarily give its written consent for allocation of shares to connected clients of the lead broker or any distributors subject to the conditions below, which may be modified if required:

- The shares are held by the connected client on behalf of independent third parties.
- The sponsor(s) and the bookrunner(s) confirm that the shares will not be offered to the connected clients on a preferential basis or, for connected clients who will hold shares on behalf of a cornerstone investor, that material terms of the agreement with the relevant investor are substantially the same as other cornerstone investors participating in the offering.



- Details of the allocation to the connected clients, including the name of the connected clients and their relationship with the lead broker or distributor(s), and number and percentage of shares allocated to each connected client and lock-up arrangement (if any), will be disclosed in the allotment result announcement.

The HKEx has made it clear that no consent will be given for an allocation of shares to a connected client for its proprietary account other than in exceptional circumstances that will be considered on a case-by-case basis.

### **SFC's Consultation Conclusions on Amendments to Professional Investor Regime**

The concept of "professional investors" plays an important role in Hong Kong's securities market. Among other things, once a person or entity's status as a "professional investor" has been established, an intermediary can dispense with the following:

- Ensuring that a recommendation or solicitation is reasonable in all the circumstances (the **Suitability Requirement**).
- The need to establish a client's financial situation, investment experience and investment objectives.
- The need to assess a client's knowledge of derivatives and characterise the client based on his knowledge of derivatives.
- The need to disclose certain transaction-related information.
- The need to enter into a written agreement and the provision of relevant risk disclosure statements.
- For discretionary accounts, the need to obtain from the client an authority in written form prior to effecting transactions for the client without his specific authority, the need to explain the authority and the need to confirm it on an annual basis.
- The need to inform the client about itself and the identity and status of its employees and others acting on its behalf.
- The need to confirm promptly with the client the essential features of a transaction after effecting a transaction for a client.

The SFC had sought views on whether individual and corporate professional investors (namely, individuals with portfolios of HK\$8 million or more, or corporations with total assets of HK\$40 million or more) should be prevented from participating in private placements, and whether the dispensations noted above should be removed in relation to individual professional investors. Based on feedback received, the SFC decided to continue to allow individual and corporate professional investors to participate in private placements but decided that intermediaries should be required to comply with the Suitability Requirement and the remainder of the first six requirements noted above when dealing with individual professional investors. The SFC also adopted a number of other proposals, including amendments to the requirements for the terms of client contracts. The proposed amendments will come into effect in early 2016.

### **Recent Enforcement Actions and Penalties Involving HKEx-Listed Companies**

- The SFC commenced proceedings in the Hong Kong Court of First Instance against Mr. Tong Shek Lun (**Mr. Tong**) and two former executive directors of Sinogreen Energy International Group Limited (**Sinogreen**) seeking that all three be disqualified as acting as directors and be required to pay compensation to Sinogreen for the loss allegedly caused by their misconduct. Sinogreen had disposed of a subsidiary business to a third party at a price that represented a loss on investment to Sinogreen. Mr. Tong had received a secret profit of US\$1 million from the purchaser to facilitate the transaction that was not disclosed to shareholders of Sinogreen. The two other executive directors allegedly failed to make full and proper inquiries about the disposal before approving it.

- The freezing order over 107,290,000 shares in HKEx-listed Hisense Kelon Electrical Holdings Limited obtained by the SFC has been extended. The SFC alleges that the shares are held for the benefit of Mr. Gu Chujun (**Mr. Gu**), the former chairman and CEO of HKEx-listed Greencool Technology Holdings Limited (**Greencool**). Mr. Gu and other members of Greencool senior management are the subject of ongoing proceedings under Section 213 of the Securities and Futures Ordinance in relation to alleged gross overstatements of the financial position of Greencool. The Market Misconduct Tribunal (**MMT**) hearing is set to take place in September 2015.
- The SFC has obtained a disqualification order in the High Court of Hong Kong against Mr. Norman Ho Yik Kin (**Mr. Ho**), a former executive director of Tack Fat Group International Limited, now known as Tack Fiori International Group Limited (**TF**). Mr. Ho admitted to neglecting his duties as a director by, among other things, signing attendance sheets annexed to minutes of board meetings in which substantial transactions were purportedly agreed when he did not attend any such meetings. These meetings approved a number of transactions that turned out to be problematic for TF. In commenting on the order, the SFC's Executive Director of Enforcement said: "Directors cannot abdicate their duties to safeguard the company's interests and keep members properly informed. It is even worse if directors connive in records of meetings that have not taken place and in decisions that are detrimental to the company. The consequences will be serious as today's decision by the court demonstrates."
- The MMT has banned Tiger Asia and Mr. Bill Hwang from trading in securities in Hong Kong following their admission to having engaged in insider dealing. Tiger Asia had been given advance notice and was invited to participate in two placements of existing shares of Bank of China shares by UBS AG and RBS on 31 December 2008 and 13 January 2009 respectively and was provided with details of both placements after being told the information was confidential and price-sensitive. Tiger Asia had agreed not to deal in BOC shares after receiving the information, but short sold (a) 104 million BOC shares before the placement by UBS AG on 31 December 2008 making a notional profit of around HK\$9 million, and (b) 256 million BOC shares before the placement by RBS on 13 January 2009 making a notional loss of around HK\$10 million. Tiger Asia took similar actions in relation to a placing of China Construction Bank shares by Bank of America in January 2009. Tiger Asia also agreed to pay a total of HK\$45,266,610 to around 1,800 investors in Hong Kong and overseas who traded with Tiger Asia in the insider dealing transactions, representing the difference between the actual price of BOC and CCB shares sold by Tiger Asia and the value of those shares taking into account the inside information known to Tiger Asia (as assessed by expert evidence). Tiger Asia also admitted to having engaged in "market manipulation."
- The SFC suspended Mr. Eric Shum Kam Chi (**Mr. Shum**) from acting as a representative in all regulated activities and as a responsible officer for failures in his capacity as responsible officer and sponsor principal of Sun Hung Kai International Limited (**SHK**). The suspension arose from Mr. Shum and SHK's work on the listing of Sino-Life Group Limited (**Sino-Life**), in respect of which SHK had failed to (i) assess the accuracy and the completeness of the information submitted by Sino-Life to demonstrate that it satisfied the financial requirements to list, (ii) ascertain the existence of various encumbrances on the title of a major business deal of Sino-Life in Taiwan, (iii) properly assess the business of the Sino-Life's wholly-owned subsidiary in Taiwan, (iv) ensure true, accurate and complete disclosure was made to the HKEx and in Sino-Life's prospectus and breached the sponsor undertaking to the SEHK by filing untrue statements in the sponsor declaration, and (v) keep proper books and records in relation to the sponsor work conducted.