



# Hong Kong Regulatory Update

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This update provides an overview of key regulatory developments in the past three months relevant to companies listed, or planning to list, on The Stock Exchange of Hong Kong Limited (**HKEx**), and their advisers. In particular, it covers amendments to the Rules Governing the Listing of Securities on HKEx (**Listing Rules**) as well as announcements, guidance and enforcement-related news from HKEx and the Securities and Futures Commission (**SFC**). From time to time it may also cover other recent market developments. Our intention is not to cover every update that may be relevant, but we welcome feedback and if you'd like to see analysis of other topics in future updates, please contact us.

## Environmental, Social and Governance (ESG) Reporting

### HKEx consultation conclusions on ESG reporting<sup>1</sup>

HKEx has adopted a number of enhancements to the existing ESG reporting regime, which will take effect for financial years commencing on or after 1 July 2020.

The new rules seek to strengthen board involvement in managing ESG issues, including by mandating disclosure of a statement setting out the board's consideration of ESG issues. This statement should include details of the board's oversight of ESG issues, its approach and strategy to manage them, and how progress on relevant ESG-related goals and targets is reviewed.

Other key changes include:

- mandatory disclosure requirements to include application of relevant reporting principles (materiality, quantitative and consistency) and boundaries in the ESG report;
- disclosure (subject to "comply or explain") of significant climate-related issues that have impacted and may impact the company;
- disclosure (subject to "comply or explain") of relevant targets for "environmental" key performance indicators (**KPIs**) and steps taken to achieve them (rather than just results achieved as currently disclosed);
- disclosure (subject to "comply or explain") of "social" KPIs;
- a requirement to publish ESG reports within five months of the financial year-end;<sup>2</sup>

<sup>1</sup> See our 3 July 2019 client alert "[Hong Kong Regulatory Update — July 2019](#)" for details of the consultation.

<sup>2</sup> By contrast, the annual report and corporate governance report are required to be published within four months of financial year-end.

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- obligation to notify shareholders of the online location of each ESG report and to produce a printed ESG report only in response to shareholders' specific request for one;
  - permission for companies to seek independent assurance to strengthen the credibility of their ESG disclosures (and where such independent assurance is obtained, the issuer should describe the level, scope and processes adopted for assurance clearly in the ESG report).

In response to queries raised during the consultation process regarding the scope and application of the revised ESG reporting regime, HKEx has indicated it will update old guidance, provide further training, and publish new guidelines on the ESG reporting procedures.

The SFC has also placed increasing emphasis and developed guidance on ESG reporting, particularly climate-related disclosure as part of its strategy to develop green finance in Hong Kong. The momentum toward enhanced ESG disclosures is a global trend and a reflection of their increasing importance to institutional investors, regulators and other stakeholders. Listed companies should consider making preparations to position themselves to meet these heightened requirements during the course of 2020.

## HKEx review of 2018 ESG reports

HKEx recently published its second review of ESG reports, covering 400 ESG reports issued for financial years ended in 2018. HKEx reported the following as key areas with room for improvement in ESG reporting:

- **Materiality:** A lack of detail appeared regarding the existence and thoroughness of materiality assessments of the process of identifying and engaging with key stakeholders, and the criteria for assessing materiality, despite two-thirds of sampled reports disclosing that an assessment had occurred.
- **Board involvement:** Notwithstanding that disclosure of board involvement is not required for financial years beginning before 1 July 2020, HKEx noted that a majority of listed companies provided little or no description of board involvement in assessing and addressing ESG-related risks.
- **Preference to comply and reluctance to explain:** Among ESG comply-or-explain requirements, only 3% were explained, suggesting that listed companies did not sufficiently consider what is material or were reluctant to explain their determination of immaterial provisions. Moreover, even if a provision is immaterial, a statement of such is still necessary, as an omission or failure to address a comply-or-explain provision is itself technically a breach of the Listing Rules.

- **Poor disclosures regarding laws and regulations:** Not surprisingly, disclosures on compliance with relevant laws and regulations that have a significant impact on listed companies were generally less thoroughly reported than were disclosures about company policies or disclosure of key performance indicators.

The emphasis on materiality and relevance to a listed company's business and operations, and encouragement to use explanations (rather than compliance), are particularly relevant in light of market concerns, expressed in the process of HKEx's 2019 consultation on ESG matters, that the enhanced requirements may be burdensome and overly prescriptive for listed companies.

Mandatory disclosure on materiality (how a company determines material ESG factors) and reporting boundaries (details to identify entities or operations included in an ESG report) are expected to help companies focus their ESG reporting.

More generally, given the greater number of comply-or-explain items in the HKEx ESG reporting guide, listed companies should carefully consider when it is sufficient to explain why certain factors are not material or relevant, rather than to unnecessarily comply with the reporting guide.

## SFC Reminds Companies To Consider Disclosing Actual Controllers or Beneficial Owners of Counterparties in Corporate Transactions

The SFC recently released a statement to remind listed companies to ensure that their announcements, statements, circulars and other documents do not include false, incomplete or misleading information about their counterparties in pending corporate transactions.

The statement noted that disclosure of counterparties often was limited to the names of the entities to be used to consummate the transaction without disclosure of the controllers or beneficial owners of the entities, even though the identity of a counterparty appeared to be necessary for the investing public to make an informed assessment of the listed company or its activities, assets and liabilities, or financial position.

This expectation expands on the recent extension of the requirement to disclose the identities, ultimate beneficial owner(s) and a description of the principal business activities of the parties to a connected transaction in circulars and all connected transaction announcements.

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Some examples of circumstances where the SFC noted that the identities of the actual controllers or beneficial owners of a counterparty to a transaction may be required include:

- in acquisitions, disposals, capital injections, and formation of joint ventures where details of the counterparties illustrate or clarify the background, experience, resources or strategy of the parties with whom the listed company is entering into a long-term business arrangement;
- in acquisitions, disposals, capital injections, and formation of joint ventures where the controller or beneficial owner is a prominent business or political figure or entity, or a person who has close business dealings with the listed company, its controlling shareholder or management;
- in lending of a material loan amount (or series of related loans) where the borrower is a privately held entity not generally known to the market, and the counterparty's background and financial standing are necessary for an assessment of the listed company's activities;
- in issuance of shares, convertible bonds and options where the Listing Rules require disclosure of the names of the allottees if there are fewer than six allottees;
- in grants of stock options where generic descriptions of grantees (such as "eligible participants") are unsatisfactory (given the incredibly broad definition of such terms).

## HKEx Enhances Guidance for Overseas Companies Seeking To List in Hong Kong

In addition to the four "Recognised Jurisdictions" (namely, the People's Republic of China, Hong Kong, Bermuda and Cayman Islands), HKEx currently accepts listings from entities incorporated in 27 "Acceptable Jurisdictions" under the Joint Policy Statement Regarding the Listing of Overseas Companies (**JPS**) issued by the SFC and HKEx.

HKEx has now issued a standardised template for new jurisdictions to demonstrate they meet key shareholder protection standards for recognition as an Acceptable Jurisdiction under the JPS. The Hong Kong Securities Clearing Company Limited (**HKSCC**) also issued guidance to introduce overseas applicants to its Central Clearing and Settlement System (**CCASS**).

For U.S. "domestic issuers" listing securities in Hong Kong under safe harbour exemptions for offshore transactions, HKEx introduced technical alternative procedures to enable securities traded in Hong Kong to satisfy Regulation S Category 3 requirements.

As HKEx completes its current review of the regime for listing of overseas entities, further changes are expected in this area.

## HKEx Consults on Updating Listing Regime for Debt Issues to Professional Investors Only

The HKEx is now consulting on changes to Chapter 37 of the Listing Rules, which provides for listing of debt securities and is limited to professional investors only. The limitation to professional investors drives the general 'light-touch approach' adopted to provide an expedient and streamlined listing process for debt securities. As a result, no prescribed disclosure requirements exist and HKEx vetting examines only fulfilment of eligibility requirements and inclusion of the prescribed disclaimer and warnings. This overall approach remains unchanged.

Key proposals being consulted include:

- raising the existing issuer's minimum net assets requirement from HK\$100 million to HK\$1 billion and introducing a minimum issuance size of HK\$100 million (as proxy indicators) to enhance the quality of listed debts;
- requiring issuers to state explicitly in the listing document that the intended investor market in Hong Kong includes only professional investors and requiring publication of the listing documents on the HKEx website on the listing date to increase transparency and indirectly tackle off-exchange secondary sales of debt to non-professional investors;
- while avoiding prescriptive disclosure requirements, HKEx will issue guidance on what it considers "appropriate disclosure" on various special features and on other disclosure-related matters;
- codifying a general waiver that for the purposes of Chapter 37 of the Listing Rules, "professional investors" includes high-net-worth corporate entities and individuals (prescribed under section 397 of the Securities and Futures Ordinance); and
- expressly extending certain continuing obligations to guarantors in addition to the issuer of the debt securities.

The deadline for responding to the consultation paper is 7 February 2020.

## Enforcement Matters

### HKEx intervenes after Yashili failed to announce and seek shareholder approval of connected transactions

A listed company is expected to monitor any transactions entered into by it and its subsidiaries to ensure compliance with the Listing Rule requirements to announce and secure shareholder approval of such transactions where necessary. This is especially the case for connected transactions, which trigger an announcement obligation at a much lower threshold.

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Spotlighting these expectations, HKEx criticised Yashili International Holdings Limited (**Yashili**) for failing to secure proper approval, particularly after Yashili had already received caution letters from HKEx in 2014 and 2017 regarding its late announcement of connected transactions. More specifically, HKEx found that Yashili failed to comply with the similar connected transaction requirements in Chapter 14A of the Listing Rules in seven connected transactions conducted in the first nine months in 2017.

During the course of preparing interim and annual results for financial year 2017, Yashili discovered further non-compliance and issued announcements of four connected transactions (six to eight months late), having failed to seek independent shareholder approval for a continuing connected transaction that should have been aggregated with another three prior connected transactions.

HKEx noted a number of internal control deficiencies, including:

- failure to maintain a list of connected persons to Yashili for the responsible personnel's reference, by which connected transactions could be identified and escalated to its board of directors for Listing Rule compliance consideration;
- a lack of systems to equip staff charged with reporting responsibility with relevant knowledge on Listing Rule compliance; and
- an absence of training on compliance with the connected transaction requirements.

In addition to the public censure, Yashili was required to retain an independent professional advisor to conduct an internal controls report and make recommendations in such report to HKEx. Additionally, relevant directors were required to attend 24 hours of training, with a further 4 hours of training for key reporting staff.

## **HKEx censures Artini for delayed publication of annual results and annual report**

HKEx censured Artini Holdings Limited (**Artini**) for its delay in the publication of its annual results and annual report for the year ended 31 March 2017. The delay stemmed from material deficiencies in its internal controls, including a failure to maintain adequate supporting documents or records of its revenue or expenditures in certain businesses, which an independent internal control consultant found to be of high- to medium-risk.

HKEX found the lack of or limited supporting information and documents prevented Artini's auditors from carrying out satisfactory audit procedures, resulting in both a disclaimer of opinion on Artini's annual results and annual report for the year ended 31 March 2017 and a delay in the publication of the same.

Artini commissioned an internal control review following discovery of the deficiencies and implemented measures to improve its internal control systems and financial reporting procedures.

## **SFC seeks compensation and disqualification of Perfect Optronics' directors in relation to financial performance guarantee**

The SFC has sought disqualification and compensation orders against various Perfect Optronics Limited (**Perfect Optronics**) directors in relation to a financial performance guarantee.

The underlying transaction involved the sale to Perfect Optronics of a group of companies in April 2015 by Mr. Cheng Wai Tak, the chairman and executive director of Perfect Optronics. Mr. Cheng had guaranteed that if the group of companies failed to meet a minimum profit for the two years ended 31 December 2016, he would compensate a sum equivalent to 9.513 times the shortfall in the guaranteed minimum profit.

However, on 22 December 2016, just nine days before the expiry of the minimum profit guarantee period, Perfect Optronics sold part of the group of companies. This boosted the group of companies' profits by HK\$26.5 million and reduced the compensation payable by Mr. Cheng under the guarantee by HK\$251.9 million.

The SFC therefore alleged that despite Mr. Cheng's apparent material interest, he failed to excuse himself from negotiations, to properly disclose his interest to other directors or to abstain from voting on the proposal. Additionally the SFC sought disqualification against and compensation by other directors for their failure to properly investigate the transaction and/or evaluate the pros and cons of postponing the transaction to after 31 December 2016.

## **Former staff of Hong Kong Television Network Limited jailed for insider dealing**

Mr. Ken Yiu Ka Lun, a former senior regulatory affairs manager of Hong Kong Television Network Limited (**HKTV**), was convicted of insider dealing in HKTV shares after pleading

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guilty. Mr. Yiu was sentenced to two and a half months of imprisonment and ordered to pay a fine and the SFC's investigation costs.

The SFC alleged that between 19 and 20 December 2013, Mr. Yiu purchased 101,000 HKTV shares while he was involved in HKTV's acquisition of a mobile television licence in his capacity as senior regulatory affairs manager. After disposing of his shares on 20 December 2013 after the acquisition was announced, Mr. Yiu was alleged to have made a profit of HK\$163,810.

## **SFC commences MMT proceedings against China Medical & Healthcare and its senior management for alleged late disclosure of inside information**

The SFC has initiated proceedings before the Market Misconduct Tribunal (MMT) against China Medical & Healthcare Group Limited (formerly known as COL Capital Limited (COL)) and COL's directors for failure to disclose information in relation to its significant gains in securities trading in 2014.

First, the SFC alleged that COL's directors had learned by April 2014 that COL's profit for March 2014 came to HK\$360 million, bringing COL's profit for the nine months ended 31 March 2014 to around HK\$894 million (a significant uptake compared to a loss of around HK\$33 million for the same period in 2013). However, this inside information was not disclosed until a profit alert for the year ended 30 June 2014 was issued in September 2014.

Second, the SFC noted that the gains were primarily attributable to COL's March 2014 investment in the shares of ChinaVision Media Group Limited, now known as Alibaba Pictures Group Limited. However, this inside information was again not disclosed until the September 2014 profit alert.

## **The SFC obtains court orders against former chairman and directors of Minth Group Limited**

The SFC expects listed companies to carefully evaluate acquisitions, ensuring they are truly arm's-length transactions, and to fully disclose directors' conflicts of interest.

The agency enforced this expectation when a wholly-owned subsidiary of Minth Group Limited (**Minth**) disclosed its acquisition of two companies in 2008 purportedly from independent third parties. The two sellers were in fact the nephew and niece of Mr. Chin Jong Hwa, who then served as the chairman and executive director of Minth and had significant control over the two companies acquired through his relatives.

Mr. Chin admitted he had failed to negotiate for the lowest possible price, to fully disclose his conflict of interest to Minth's board or shareholders, and to prevent Minth from making false and/or misleading representations and material non-disclosures to the SFC, to HKEx and in public announcements. Three other executive directors also admitted their failure to make inquiries that would have revealed Mr. Chin's conflict of interest.

The SFC has obtained a compensation order against Mr. Chin, ordering him to pay a sum of RMB 20.3 million in compensation. In addition Mr. Chin and three former executive directors were disqualified from being directors or involved in management of any companies for periods of three to six years.

## **HKEx criticizes Ding He Mining and its directors for failure to cooperate with investigation**

HKEx has taken the rare step of publicly stating that it considers the retention of office by three directors of Ding He Mining Holdings Limited (**Ding He Mining**) to be prejudicial to the interests of investors, in addition to censuring Ding He Mining and the three directors for their failure to cooperate with HKEx investigations.

Trading of Ding He Mining's shares had been suspended since April 2018, and HKEx placed the company in the delisting process beginning in May 2018 due to a failure to maintain sufficient operations or assets. The second delisting stage commenced in November 2018, shortly before the Listing Department of HKEx sought information from the three directors as part of its ongoing investigation in January 2019. HKEx sent three subsequent reminder letters before moving the company to the third delisting stage in June 2019.

Although Ding He Mining's receipt of the letters and its board's awareness of the ongoing investigations were both confirmed, neither Ding He Mining nor the three directors provided a submission or applied for a time extension to provide a submission. The HKEx concluded that the failure to cooperate was willful and serious, and warranted a statement under Rule 2A.09(7) that in its opinion, the retention of office by the three directors is prejudicial to the interests of investors.

Shortly before its third delisting stage expired on 19 December 2019, Ding He Mining was ordered by the Hong Kong court of first instance to be wound-up and placed under control of a provisional liquidator.

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## **HKEx censured former executive director for serious breach of the Model Code on Securities Transactions by Directors of Listed Issuers**

HKEx's recent censure and public statement against Mr. Hu Guo An, the former executive director of Future Bright Mining Holdings Limited (**Future Bright Mining**), highlights the importance of directors' strict compliance with restrictions on their dealing of listed companies shares.

Mr. Hu's secretary, on his behalf, repeatedly traded in the shares of Future Bright Mining between 7 December 2017 and 27 February 2018, which transactions were conducted without first obtaining the written acknowledgement of the chairman or designated director as required under the Model Code on Securities Transactions by Directors of Listed Issuers (the **Model Code**). Moreover, a number of these trades took place during the prescribed 60-day blackout period prior to Future Bright Mining announcement of its 2017 financial results on 28 March 2018.

Although Mr. Hu sought to explain the breaches as resulting from his negligence in giving a general power to his secretary to deal in Future Bright Mining shares on his behalf, HKEx noted that his ultimate responsibility to comply with the Listing Rules could not be delegated, and he was still obligated to adequately supervise the delegated function. A director's ignorance or unfamiliarity with the rules, or the failure to observe a blackout period through a representative, are not acceptable justifications for breaches of the Model Code.

HKEx took the rare step of stating that in its opinion, a willful and persistent failure to comply with the Listing Rules meant that had Mr. Hu remained in office, his position would have been prejudicial to the interests of investors.