



Hong Kong Regulatory Update

Contacts

Christopher W. Betts

Partner / Hong Kong
852.3740.4827
christopher.betts@skadden.com

Paloma Wang

Partner / Hong Kong
852.3740.6888
paloma.wang@skadden.com

Anthony Pang

Counsel / Hong Kong
852.3740.4831
anthony.pang@skadden.com

The update was prepared with the assistance of associates Johanna Yau, Steven Lee and Paul Lau.

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One Manhattan West
New York, NY 10001
212.735.3000

42/F, Edinburgh Tower, The Landmark
15 Queen's Road Central
Hong Kong
852.3740.4700

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 also may cover other recent market developments. It is not our intention to cover all updates that may be relevant, but we welcome feedback, and if there are any other topics of interest that you'd like us to cover in the future, please contact us.

HKEx and SFC Issue Joint Statements on Results Announcements and Annual Reports in Light of the Coronavirus/COVID-19

According to the joint statements issued by HKEx and SFC in February and March 2020:

- Inside information announcement, if COVID-19 is having a material adverse effect:

If the business operations, reporting controls, systems, processes or procedures are materially disrupted by the outbreak and/or the related travel restrictions, an inside information announcement must be made as soon as possible.

- Publication of annual results announcements, as required by the Listing Rules:

If a company believes that there is a real possibility that it will be unable to publish a preliminary results announcement/audited financial statements as required by the Listing Rules, it should contact the HKEx as early as possible with the following information: (i) a description of the travel and other restrictions that have affected its auditing or reporting process, (ii) why these restrictions rendered it unable to comply with the relevant reporting requirements set out in the Listing Rules, (iii) the financial information that it is nevertheless still able to report on, and (iv) an explanation of whether the accuracy, completeness and presentation of the financial information available is believed to have been adversely affected and, if so, to what extent.

If a company is unable to obtain agreement from its auditors but is otherwise able to publish its preliminary results in full compliance with the other reporting requirements, it should publish such preliminary results (without the agreement with its auditors) on or before the deadline. In such cases, the HKEx will not normally require a trading suspension.

Hong Kong Regulatory Update

If a company has management accounts available but is uncertain as to the potential adjustments to the financial figures, it should publish such accounts by 31 March 2020, providing the investing public with sufficient information to make investment decisions. No trading suspension will be required if the issuer can highlight the details of the uncertainties.

If a company's operations are severely affected by the outbreak of COVID-19 and cannot prepare its management accounts, trading of its shares can continue if the following information (**Material Financial Information**) is disclosed:

(i) key financial figures, such as assets, liabilities, income and expenses, and changes in shareholders' equity; and (ii) narrative discussions of its financial position and performance during the year to supplement the financial figures provided, including the impact of any material events and any material transactions that have taken place.

- Publication of annual reports:

Publication of the annual report can be delayed for up to 60 days after 16 March 2020, if a company has issued on or before 30 March 2020:

- its final results with its auditors' agreement;
- its final results without its auditors' agreement but has explained (i) the lack of agreement with auditors, (ii) the expected date that the results may be agreed with auditors, and (iii) whether the results have been agreed with the audit committee and details of such disagreement (if any);
- its management account highlighting the area of uncertainties on the financial items; or
- its Material Financial Information (see above).

However, if delayed publication of their annual reports companies must (i) announce an estimate of when they expect to publish their annual report with an explanation of the factors considered in arriving at such estimate, (ii) keep the market informed of the expected publication date along with other updates as appropriate, and (iii) check whether the delay in publishing the annual report is in compliance with the laws and regulations of their place of incorporation and its articles of association.

Convening a Shareholder Meeting by Webcast, Video Conference or Other Electronic Means

In light of the pandemic and travel bans imposed by different jurisdictions, listed companies should plan ahead for their upcoming annual general meetings, given that the pandemic is expected to continue to have a global impact for the foreseeable future. HKEx stated in its latest "frequently asked questions" that the Listing Rules do not impose any requirements on the format for general meetings. If listed companies comply with the requirements of the laws of their place of incorporation and their articles of association, they may use webcast or video conference in lieu of a physical meeting.

A majority of companies listed on HKEx are incorporated in the Cayman Islands. We understand that the Cayman Companies Law does not specify the format for convening general meetings, but the common law position is that the meeting cannot be entirely virtual. Listed companies should therefore check with their Cayman counsel and articles of association to ascertain the extent to which webcast, video conference or other electronic means can be used. If they can be used, there must still be a physical venue for the meeting where the chairman of the meeting will be present and the shareholders can attend in person, if they so wish.

Listed companies also may consider amending their articles of association at their upcoming annual general meetings to provide them with the flexibility to convene general meetings with the aid of webcast, video conference or other electronic means in the future. They also may consider convening the general meeting in a location where the chairman of the meeting and other directors can attend in person and encourage shareholders to submit their proxy forms in advance if they cannot attend in person.

HKEx Issues Consultation Paper on Corporate WVR Beneficiaries

In January 2020, HKEx issued a consultation paper to solicit market feedback on a proposal to extend the current weighted voting rights (**WVR**) regime to permit corporates to benefit from WVRs. In order to benefit from WVRs, it is proposed that a prospective corporate WVR beneficiary:

- must either be an eligible entity itself or a wholly owned subsidiary of an eligible entity;
- must have had an underlying economic interest of **10%** or more and material involvement in the listing applicant for at least two financial years prior to the date of listing application;
- must own at least **30%** of the underlying economic interest of the listing applicant's total issued share capital and be the single largest shareholder in the applicant at the time of listing (save for any individual WVR beneficiary); and
- can have shares that carry no more than **five times** the voting power of ordinary shares.

In addition, HKEx proposes the following ring-fencing measures to reduce the risk of corporate WVR beneficiaries proliferating in Hong Kong:

- existence of an ecosystem of meaningful scale between the listing applicant and the prospective corporate WVR beneficiary that is comprised of a community of companies having grown and co-evolved around a technology or know-how platform or a set of core products or services, owned or operated by the prospective corporate WVR beneficiary;

Hong Kong Regulatory Update

- an expected market capitalisation of the corporate WVR beneficiary of not less than HK\$200 billion both (i) on the day of the listing; and (ii) based on its average market capitalisation over the preceding three months;
- the corporate WVR beneficiary is either an innovative company (as defined by Guidance Letter HKEX-GL-93-18) itself or having a track record of investment in, or contributions to, innovative companies;
- the corporate WVR beneficiary has a primary listing on HKEx or a qualifying exchange (*i.e.*, the New York Stock Exchange, Nasdaq or the Main Market of the London Stock Exchange (and belonging to the U.K. FCA's "Premium Listing" segment));
- the listing applicant represents not more than 30% of the corporate WVR beneficiary in terms of market capitalisation at the time of listing; and
- at least one representative was appointed by the corporate WVR beneficiary to the board of directors of the listing applicant (the Corporate Representative).

It is further proposed that:

- the WVR attached to a corporate WVR beneficiary's shares shall lapse permanently if (i) the corporate WVR beneficiary no longer has a Corporate Representative on the issuer's board of directors for a continuous period of 30 days; (ii) the Corporate Representative is disqualified by a court or tribunal of competent jurisdiction or found by HKEx to be unsuitable as a director; or (iii) the corporate WVR beneficiary has been convicted of an offence involving fraud and dishonesty;
- a corporate WVR beneficiary shall be subject to a time-defined sunset of not more than 10 years, subject to renewal, by way of independent shareholders' approval, for further periods of five years following the expiry of the previous term; and
- a listing applicant is permitted to concurrently have a corporate WVR beneficiary and individual WVR beneficiaries.

The deadline for submission of responses to the consultation paper is 1 May 2020.

Latest Update on SFC's Front-Loaded Regulatory Approach

In February 2020, the SFC issued a special edition of the *SFC Regulatory Bulletin* to provide an update on its front-loaded regulatory approach. IPO sponsors have been identified as an area of concern due to deficiencies identified in their due diligence exercises, over-reliance on third parties' work and lack of oversight of their junior staff. The SFC raised concerns over sponsors' work in the following cases:

- A sponsor failed to adhere to the due diligence plan prepared by its lawyers and did not document the reasons for not completing the work.

- A sponsor changed its due diligence interview plan due to pressure from the listing applicant. Other interviews were arranged by the listing applicant or conducted in the presence of the applicant's representatives. Some sponsors failed to independently verify customers' identities, enquire into key areas or follow up on discrepancies.
- A sponsor relied on PRC lawyers to verify certificates of legal title to the listing applicant's assets in the PRC without enquiring into the reasonableness of the steps taken to verify actual ownership.
- Various sponsors failed to provide satisfactory explanations for apparent red flags on financial information, such as cost of inventories, increases in revenue (after years of accumulated losses), change of major suppliers, short-term loans to customers guaranteed by connected persons and third-party payment arrangements.
- One sponsor principal acted as a "signing responsible officer" for a listing application but was involved neither in the due diligence nor the correspondence with the HKEx.

Another area of concern identified is corporate transactions undertaken by listed companies. In particular, the SFC is concerned about transactions with elements of concealed share ownership and control, suspect valuations, warehousing of shares and nominee arrangements, and highly dilutive rights issues. Examples of corporate transactions recently scrutinised by the SFC include:

- a proposed acquisition of a majority interest in a target with minimal net profit and assets with a profit guarantee from the vendor for 2019 that was 20 times higher than the net profit realised in 2017;
- a proposed acquisition of a stake in a target that recorded losses for two consecutive years on the assumption that the target's estimated revenue growth rates would exceed 40% and its profit margin would turn positive; and
- a proposed placing of new shares at steep discounts to net asset value and cash while having no imminent need for funds.

HKEx Publishes Results of Its Latest Review of Annual Report Disclosure

On 31 January 2020, HKEx published a report setting out findings and recommendations from its review of issuers' annual reports for financial years ended between January and December 2018.

Among other things, HKEx noted the following:

- **Amended rules on annual report disclosure:** Some recommended disclosures from HKEx's previous reports have now been codified into the Listing Rules. These include disclosures relating to (i) information about any performance guarantees given in relation to acquired businesses; (ii) a breakdown of significant investments; and (iii) use of proceeds from fundraising activities.

Hong Kong Regulatory Update

- **Business review in Management Discussion and Analysis (MD&A):** Companies should make clear disclosure about any risk areas, such as major regulatory or governmental policy changes (e.g., in the pharmaceutical or education industries) and an assessment of the impact of those changes on their business operations and previously announced business plans. Where applicable, companies also should discuss the impact of the policy changes on their financial performance during the financial year.
- **Financial statements with auditors' modified opinions:** Companies with audit modifications should actively engage with their auditors to discuss their action plans with a view towards taking appropriate and effective actions to remove the modifications. On asset valuations of receivables and deposits, companies should maintain a credit loss policy supported by historical loss information and adjusted by forward-looking economic factors and make impairments according to such policy.
- **Disclosure on material "other expenses":** Companies should provide an appropriate breakdown of their "other expenses".
- **Material intangible assets, including goodwill:** Companies should ensure that the key assumptions applied in impairment testing are not overly optimistic and provide sufficient information for investors to understand how companies assess the reasonableness of key assumptions.
- **Using non-GAAP financial measures:** Companies should ensure that the non-GAAP financial measures are unbiased, presented with no greater prominence than GAAP measures, clearly defined, reconciled to the relevant amounts in the financial statements with sufficient explanation on adjusted items and presented consistently over time.

Please also refer to our January 2020 client alert entitled "[Guide for Annual Reporting on Fiscal Year 2019 for Companies Listed on the Hong Kong Stock Exchange](#)," which may be useful to issuers when preparing for their annual reporting.

HKEx Launches E-Training and Publishes Guidance Materials on ESG Reporting

HKEx published the following updated guidance materials on environmental, social and governance (ESG) reporting (links included):

- [E-training](#);
- Guidance for board and directors, "[Leadership Role and Accountability in ESG](#)";
- Step-by-step ESG reporting guidance, "[How to Prepare an ESG Report](#)"; and
- Frequently Asked Questions [Series 18](#).

HKEx determined to amend the ESG Reporting Guide and related Listing Rules in December 2019, following a consultation process in May 2019. The key changes taking effect for financial years commencing on or after 1 July 2020 include:

- Introducing the following mandatory disclosure requirements:
 - a board statement setting out the board's consideration of ESG matters;
 - application of Reporting Principles "materiality", "quantitative" and "consistency"; and
 - explanation of reporting boundaries of ESG reports.
- Requiring disclosure of significant climate-related issues that have impacted and may impact the issuer;
- Amending the "Environmental" key performance indicators (KPIs) to require disclosure of relevant targets;
- Upgrading the disclosure obligation of all "Social" KPIs to "comply or explain"; and
- Shortening the deadline for publication of ESG reports to within five months after the financial year-end.

HKEx has stated that the board should take leadership and be accountable for:

- Overseeing the assessment of the company's environmental and social impacts;
- Understanding the potential impact and related risks of ESG issues on the company's operating model;
- Aligning with what investors and regulators expect and require with regard to ESG matters;
- Enforcing a materiality assessment and reporting process to ensure actions are properly followed through and implemented; and
- Promoting a culture from the top down to ensure ESG considerations are part of the business decision-making process.

ESG matters should therefore be an agenda item for upcoming board meetings.

Enforcement Matters

MMT Finds Magic Holdings and Its Directors Culpable of Late Disclosure of Inside Information

This case highlights the obligations of listed companies to disclose inside information in a timely manner and ensure proper safeguards are established to ensure such compliance. Magic Holdings International Limited (**Magic**) and L'Oréal S.A. (**L'Oréal**) engaged in discussions regarding a proposal by L'Oréal to acquire Magic in early March 2013. On 27 April

Hong Kong Regulatory Update

2013, L'Oréal and Magic's founders agreed that an offer price of not less than \$5.5 per share would be put before Magic's board of directors for their consideration. Magic's founders indicated to L'Oréal that they would contact Magic's institutional investors to gauge their support for the acquisition proposal and also would recommend that Magic's board of directors agree to L'Oréal's request to carry out due diligence. However, Magic did not disclose the information relating to L'Oréal's acquisition proposal to the public until August 2013.

The Market Misconduct Tribunal (**MMT**) found that there was a commercial reality to the negotiations between Magic and L'Oréal, such negotiations had gone beyond testing the waters and Magic had failed to disclose inside information to the public as soon as reasonably practicable. In the MMT's view, Magic's breach of the disclosure requirements was due to the fact that its directors were not informed in a timely manner of all information relevant to the determination of whether it was necessary to make disclosure about the potential acquisition by L'Oréal to the public.

The MMT therefore found that Magic's chairman and company secretary had failed to carry out their functions, which resulted in Magic's breach of the corporate disclosure requirements. It also found that the five directors had failed to take all reasonable measures to ensure that proper safeguards existed within Magic to prevent it from breaching its disclosure obligation. The MMT will hold a hearing on the making of the consequential orders on 25 April 2020.

HKEx Criticises Directors of Asia Resources for Failure To Conduct Proper Investigation and Due Diligence of an Acquisition

Asia Resources Holdings Limited (**Asia Resources**) announced in May 2017 the acquisition of 67% of a spring water mine business in Hunan, China. At the time, the business had not yet commenced, and even as of the end of 2019, the production facilities in Hunan remain under construction.

HKEx criticised the then directors of Asia Resources for a failure to properly evaluate the acquisition. The directors were found to have both placed excessive reliance on professional parties and failed to procure sufficient professional advice. This case demonstrated the importance of conducting proper investigation and due diligence on a target company that is the subject of a proposed acquisition in order to discharge directors' fiduciary duties of skill, care and diligence.

The following aspects were noteworthy:

- **Heightened scrutiny of new businesses:** The acquisition was part of Asia Resources' diversification strategy to expand into water mining and production and sales of bottled water. However, the target had not yet commenced business, and none of Asia Resources' directors had relevant experience in this new business. Heightened scrutiny should be warranted for investments in a business new to the company or a newly set-up target.

- **Valuation reports cannot be blindly relied on:** Although the directors obtained a valuation report, they failed to assess the reasonableness of the report or its underlying assumptions. For example, the valuation was based upon the quantity of water guaranteed by the vendor but which exceeded the maximum amount permitted under the existing mining permit. Moreover, when using a market approach, the valuation did not explain the selection of comparable transactions, which were very different in nature from the water mine business. Whether the directors had taken steps to assess the reasonableness of the valuation report and the assumptions adopted was called into question.
- **Professional advice should be procured on matters of expert knowledge:** The existing mining permit would expire in 2022 and needs to be extended. However, the directors relied only on verbal reassurance obtained from PRC authorities regarding such extension and did not obtain a formal PRC legal opinion on when and how it could apply for an expanded permit.
- **Scepticism of vendor-provided information:** The vendor provided a feasibility study with a recommended service life of five years for the mine. However, the valuation report was based upon a service life of 10 years. As such, HKEx considered that the directors should have taken steps to further verify the documents provided by the vendor.
- **Need to keep detailed record and evidence of directors' considerations:** HKEx noted the lack of records evidencing whether the directors had either considered if it was necessary to retain professional advisers to counsel on the merits or impact of the acquisition, given that it was a new business, or discussed the valuation assumptions at any board meetings.

HKEx Censured Yorkshine and Its Former Directors for Inadequate Internal Control of Connected Transactions and Failure To Obtain Its Auditor's Agreement Prior to Release of Results

A subsidiary of Yorkshine Holdings Limited (Yorkshine, delisted since December 2019) provided interest-free loans to a connected party in the 2014-2016 financial years. However, Yorkshine failed to comply with the relevant requirements for disclosable and/or continuing connected transactions (under Chapters 14 and 14A of the Listing Rules), due to the following internal control deficiencies identified:

- It was unclear if there were written internal control procedures relating to compliance with Chapters 14 and 14A of the Listing Rules. Even if written procedures existed, they were not implemented, followed, updated or even communicated to staff, as most of the directors were not aware of their existence. Moreover, Yorkshine did not maintain a list of connected parties.
- The directors placed excessive reliance on the chief financial officer/company secretary to procure compliance with the Listing Rules, without adequate evidence of any supervision and/or regular reporting to the board of directors.

Hong Kong Regulatory Update

- None of the directors demonstrated that they took an active role in implementing, reviewing and monitoring the effectiveness of Yorkshire's internal control procedures.
- Certain directors were either aware that the counterparty was a connected person or ought to have identified the connected transactions, as they were noted in the financial statements. However, they ultimately failed to raise queries about the transactions, notify the board of directors of the connected transactions or seek advice from professional parties. This demonstrated a general disregard for compliance with the Listing Rules.

This case should remind directors of listed companies that they are ultimately responsible for the company's compliance with the Listing Rules. Delegation will not absolve them from their duty to supervise the discharge of the delegated functions, for which they, collectively and individually, retain ultimate responsibility.

HKEx Censured Great Wall and its Directors for Inaccurate, Incomplete and Misleading Disclosures and Inadequate Internal Control To Mitigate Potential Abuse of Power

A subsidiary of Great Wall Belt & Road Holdings Limited (formally known as e-Kong Group Limited) approved a disposal of certain listed investments to Mr. Yeung, who was an executive director, chairman and chief executive officer, at a price of HK\$4.65 per share (**Agreed Price**). Mr. Yeung executed the disposal on market on the same day at an average price of around HK\$7.316 per share (**Transaction Price**) without the board's knowledge. The Agreed Price represented a 36.47% discount on the Transaction Price, and Great Wall was therefore required to refund the price difference to Mr. Yeung. Great Wall subsequently sought independent shareholders' ratification for the disposal but was refused, as a result of which Mr. Yeung was required to return such listed investments to Great Wall.

HKEx censured Great Wall, noting that its announcements about the disposal were inaccurate, incomplete in all material respects and misleading. In particular, the announcements failed to disclose the reasons for the disposal at a discount, the refund mechanism, and why the Agreed Price was considered by the board to be fair and reasonable, on normal commercial terms, and in the interest of the company and the shareholders as a whole.

HKEx also censured Mr. Yeung for failing to exercise due skill, care and diligence because he (i) executed the disposal in haste and did not inform the board of the execution; (ii) failed to consult with Great Wall's legal advisers as to the Listing Rules requirements; and (iii) instructed his staff to replace the calculation of the size test by reference to the Agreed Price (instead of the Transaction Price, which was correct initially) without explanation, which resulted in the transaction being erroneously classified as not subject to independent shareholders' approval. HKEx also censured Mr. Yeung for failing to ensure all material information was set out in the announcements for investors to sufficiently appraise the circumstances of the disposal and failing to ensure Great Wall's compliance with the Listing Rules. HKEx also is of the view that Mr. Yeung's remaining in office would have been prejudicial to the interest of investors.

HKEx also criticised the other directors of Great Wall for failing to (i) properly review the announcements to ensure that they were accurate, complete in all material respects and not misleading; (ii) ensure Great Wall's compliance with the Listing Rules; and (iii) put in place adequate internal controls over the securities investment business and ensure checks and balances were in place to monitor Mr. Yeung's control and conduct over Great Wall.