



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 Hong Kong Securities and Futures Commission (**SFC**). We do not intend to cover all updates that may be relevant, but we welcome feedback, so please contact us if you'd like to see analysis of other topics in the future.

HKEx Consults on SPAC Listings

HKEx are proposing to introduce a new regime to permit the listing of Special Purpose Acquisition Companies (**SPACs**) in Hong Kong.

A SPAC is a company which undertakes an IPO to raise a cash fund, and then seeks to acquire or merge with another company (usually unlisted) within a set time limit (a **De-SPAC** transaction). If it is not able to identify a target and complete a transaction within that time limit, the money raised is refunded to investors and the SPAC is de-listed and liquidated. SPACs have proved extremely popular in the US in recent years, and other markets including the UK and Singapore have also introduced rules to permit SPAC listings.

In a consultation paper released in September, HKEx stated that they “have not attempted to replicate the US SPAC regime”, but is proposing instead “a regime tailored to the particular risks and requirements of the Hong Kong market”. The aim is to create a regulatory system that ensures “the listing of SPACs that have experienced and reputable SPAC promoters that seek good quality De-SPAC targets”.

The proposed rules are heavy on investor protection measures, and present fairly significant hurdles for SPAC promoters and De-SPAC targets compared to other jurisdictions.

Among the key features to protect investors:

- HKEx proposes a “professionals only” SPAC market: Only certified professional investors will be permitted to subscribe for or trade SPAC securities. To avoid undue speculation in SPAC shares, they will be required to trade in board lots of at least HK\$1 million per lot.
- SPACs will be required to ring-fence 100% of SPAC IPO proceeds, and upon redemption, refund investors their pro rata share of the full amount, plus accrued interest, effectively creating a risk-free investment environment for SPAC investors. Interest on IPO proceeds will not be accessible to the SPAC until completion of a De-SPAC transaction.

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- SPACs will be required to offer investors redemption opportunities, including upon any vote for a De-SPAC transaction. However, only shares voted against the De-SPAC transaction could be redeemed.

There will be a high bar for SPAC promoters, including the requirement that at least one promoter be a firm licensed by the SFC for asset management (type 9) or corporate finance advisory (type 6) regulated activity and hold 10% of SPAC promoter shares. HKEx will retain broad discretion to approve the suitability of SPAC promoters, based on their experience, character and integrity. Various restrictions apply to SPAC promoter shares and warrants, limiting the potential upside for promoters, while the 100% ring-fencing requirement means that SPAC promoters must bear all of the expenses in connection with the SPAC's IPO and operations (including underwriting commissions and taxes) out of their own pockets.

SPAC IPOs will be subject to stringent fundraising and distribution requirements, including:

- a minimum IPO fund-raise of HK\$1 billion;
- distribution to at least 75 professional investors, of which at least 30 must be institutional (as opposed to individual) professional investors;
- at least 75% of SPAC shares and warrants distributed to institutional professional investors; and
- the usual public float rules (25% public float, and not more than 50% of public float in hands of 3 largest shareholders) to apply.

SPACs will be required to announce a proposed De-SPAC transaction within 24 months of its IPO, and complete its De-SPAC transaction within 36 months of IPO, subject to a six-month extension of either deadline with shareholder and HKEx approval.

From the point-of-view of De-SPAC targets, the regime also presents hurdles which, in the highly competitive market for De-SPAC targets, may make Hong Kong-listed SPACs less attractive to targets than SPACs listed elsewhere.

De-SPAC targets must have a fair market value of at least 80% of funds raised by the SPAC. In combination with the SPAC minimum fund raise requirement, this means that the De-SPAC route in Hong Kong will only be available to targets with a valuation of upwards of HK\$800 million.

HKEx will treat any De-SPAC transaction as a new listing application: The newly merged company must meet all listing requirements, a sponsor must be appointed and conduct due diligence to IPO-standard, the listing document must meet the

prospectus standards and the offering will be fully vetted by the HKEx. The time and steps required for a target to go public via a De-SPAC transaction will therefore be comparable to that required for a traditional IPO.

SPACs will also be required to conduct a PIPE (private investment in public equity) share placing to institutional investors simultaneous with any De-SPAC transaction. The simultaneous PIPE transaction must constitute at least 25% of the market capitalization of the successor company (*i.e.*, comparable in size to a standard IPO transaction in the Hong Kong market), and at least 5% of the issued shares of the successor company must be placed with one independent PIPE investor which is an asset management firm or fund with HK\$1 billion in assets under management. The requirement to undertake this sizeable PIPE transaction may undermine deal certainty, because any De-SPAC transaction will be conditioned on the ability to price and sell the PIPE deal to external investors.

The consultation period ends on 31 October 2021.

HKEx Updates Policies on Enforcement and Sanctions

HKEx has updated the market on its enforcement priorities and approach to determining sanctions for breaches of the Listing Rules, with the publication of a revised Enforcement Policy Statement (**Policy Statement**) and Enforcement Sanctions Statement (**Sanctions Statement**) in July.

The revised Policy Statement sets out three enforcement priorities: (i) responsibility; (ii) controls and culture; and (iii) cooperation. Listed companies and their advisors should take note of these priorities, as they will underlie many of HKEx's enforcement decisions:

Responsibility

Individuals responsible for compliance with the Listing Rules include, amongst others, directors and senior management of the listed company. HKEx will take enforcement action in appropriate cases if such individuals cause or knowingly participate in a contravention of the Listing Rules.

These individuals are reminded that delegation to, or unquestioning reliance on, others will often not be sufficient to discharge their duties. Such individuals are normally expected:

- to play at least a continuing supervisory role for, and demonstrate sufficient continuing interest in, matters delegated to others, and
- to apply an enquiring mind to any professional advice received, and to have used their wisdom, experience and independent judgement.

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Controls and Culture

Appropriate conditions for compliance should be created and maintained within listed companies, such as the implementation of effective internal controls, and the establishment of a culture or attitude towards compliance and corporate governance.

The appropriate conditions for compliance include the following:

- Directors and senior management must take steps to ensure that their company has effective systems in place to achieve Listing Rule compliance. Risk management and internal control systems should be reviewed regularly.
- Directors should regularly receive briefings and professional development to ensure that they have a good understanding of their company's operations and responsibilities under the Listing Rules. Directors should also have sound knowledge of all relevant legal and regulatory requirements, as well as the company's business and governance policies.
- Directors, senior management and any others who are responsible for Listing Rule compliance should keep abreast of changes to the Listing Rules through regular training.
- Companies must keep proper books and records regarding any steps taken to discharge their duties in compliance with the Listing Rules. Such documentary evidence will often be requested during enforcement investigations.

Cooperation

Listed companies and directors should cooperate with HKEx and provide complete, accurate and up-to-date information in response to HKEx requests.

Any non-cooperation, failure to respond, or provision of misleading information will be viewed as a serious misconduct, warranting the imposition of some of the most severe sanctions available.

The revised Sanctions Statement sets out the general principles and factors that HKEx (through its Disciplinary Committee or Listing Review Committee) will take into account when determining sanctions for breaches of the Listing Rules.

Key action items for listed companies and their advisors to ensure that HKEx will look favourably upon any misconduct issues that may arise include the following:

- evidence of a culture conducive to compliance with the Listing Rules and the promotion of good corporate governance;
- appropriate supervisory, risk management, operational or technical procedures and/or controls for ensuring compliance with the Listing Rules;

- independent professional accounting or legal advice;
- self-reporting misconduct in a timely and comprehensive manner, and not attempting to conceal any misconduct;
- fully assisting and cooperating with HKEx during an investigation, to an extent that minimises the time and costs of the investigation;
- making an early decision not to contest any case brought against them, thereby assisting HKEx in the efficient administration of the disciplinary process;
- taking steps to remediate the breaches, and/or to redress any risk, loss or injury caused;
- subsequent to the breach, taking steps or measures to prevent any recurrence of the contravening conduct; and
- participating in the disciplinary proceedings in person (rather than simply by filing written submissions).

Other factors the HKEx will consider include the following:

- the compliance history of the respondent;
- sanctions previously applied in relation to similar types of breach;
- whether the misconduct was unintentional, negligent, wilful, reckless, intentional, deceptive, manipulative and/or fraudulent;
- whether the misconduct was an isolated instance or occurred over an extended period of time;
- whether the relevant misconduct was systemic or indicative of a pattern of non-compliance with the Listing Rules;
- the size of any commercial advantage or financial benefit obtained as a result of the misconduct;
- whether the misconduct resulted in, or had the potential to result in, loss or injury to other parties (*e.g.*, shareholders, the investing public, other market participants, creditors, etc.), and if so, the nature and extent of that actual or potential loss or injury; and
- whether the relevant conduct damaged, or had the potential to damage, the reputation of HKEx or the integrity of the market and facilities it operates.

Takeovers Bulletin: Undesirable Conduct of Practitioners in Consultations

The SFC has reminded practitioners to act honestly and in utmost good faith when consulting SFC and act professionally in all dealings with SFC. The reminder came in the SFC's most recent Takeovers Bulletin, and noted that any person dealing with SFC must do so in an open and cooperative manner and disclose all information known to him/her and relevant to the matter considered.

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The SFC highlighted that they will not answer purely hypothetical questions or give provisional rulings, and that the SFC's views expressed in a consultation are preliminary and non-binding.

In particular, the SFC called out advisors who ask the same hypothetical question of multiple SFC officers within a short period of time, effectively "shopping" for their preferred answer. The SFC noted that this not only disrupts the operation of SFC, but amounts to an abuse of the consultation process. Where a case team has been assigned to a transaction, practitioners should not approach other officers on matters related to that transaction.

In appropriate circumstances, SFC may report a person to regulatory authorities or professional bodies where the conduct of that person may have contravened an authority's or body's rules, regulations or standards of professional conduct.

Enforcement Matters

SFC Censures BIT for Breaching Takeovers Code on "Special Deals"

The SFC has censured BIT Mining Limited, a company listed on the New York Stock Exchange and formerly known as 500.com Limited, for breaching Rule 25 of the Takeovers Code regarding special deals, in a case that reminds companies engaging in transactions in the Hong Kong markets to seek proper professional advice.

On January 28, 2021, Loto Interactive Limited announced a proposed share subscription by BIT that would increase the shareholding of BIT and its concert parties in Loto from 33.82% to 54.26%, triggering a mandatory general offer under the Takeovers Code. Mr. Law was a director and shareholder of BIT and also a shareholder of Loto. Discussion about the Loto subscription took place on December 22, 2020. On a date prior, an agreement was entered into between BIT and a company wholly-owned by Mr. Law whereby BIT agreed to issue shares increasing Mr. Law's interest in BIT from 3.78% to 19.9%. This subscription was completed after commencement of the offer period for the Loto subscription.

On April 5, 2021, BIT agreed to issue class A preference shares (which contain special voting rights) to Mr. Law, further increasing his voting rights from 19.9% to 61.7%. As a result, Mr. Law acquired statutory control of BIT and consolidated control of Loto upon completion of the Loto Subscription.

BIT did not request SFC consent for either of these share subscriptions. Moreover, BIT did not obtain advice from its professional advisers on the Takeovers Code implications of these deals prior to their completion.

In both instances, the issue of shares to Mr. Law constituted special deals under Rule 25 of the Takeovers Code as they were arrangements between BIT and a shareholder of Loto with favourable conditions not extended to all other shareholders of Loto. Rule 25 generally prohibits transactions with favourable conditions between an offeror or its concert parties and a shareholder of the offeree company except with the SFC's consent.

If BIT had sought SFC consent as required under the Takeovers Code, the SFC would have requested BIT either (a) to extend the benefit of the special deal to other shareholders of Loto, or (b) if such benefit were not capable of being so extended, to have an independent financial advisor provide a fairness opinion on the terms of the transaction, and obtain the approval of Loto's independent shareholders for the special deals.

The SFC reminded practitioners and parties who wish to take advantage of the securities markets in Hong Kong that they should conduct themselves in accordance with the Takeovers Code which includes seeking professional advice as needed and consulting SFC at the earliest opportunity.

SFC Obtains Disqualification and Compensation Orders Against EHL Former Directors

The SFC has obtained disqualification and compensation orders from Hong Kong's courts against former directors of EganaGoldpfeil (Holdings) Ltd (EHL).

The conduct prompting the penalties arose from a series of transactions entered into by subsidiaries of EHL which were not genuine commercial transactions and were used to cover up the transfer of HK\$622 million from EHL to a company owned by the family of EHL's then-chairman. In the same series of transaction, one of the directors caused EHL to lend money to or invest in companies he controlled under commercially unfavourable or unrealistic terms.

All of the relevant directors failed to carry out proper enquiries or perform appropriate due diligence on these transactions. As a result, the former directors were found to have breached their fiduciary duty to act in good faith and in the best interests of EHL, the duty of care at common law to exercise reasonable skill, care and diligence, and Rules 3.08 and 3.09 of the Listing Rules, which regulate directors' duties.

The relevant directors were ordered to pay, jointly and severally, compensation of HK\$622 million to EHL and are disqualified from being a director and taking part in the management of any listed or unlisted corporation in Hong Kong for a period of six to nine years.

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HKEx Censures IntelliCentrics and Its Directors for Changed Use of IPO Proceeds

Listed companies are reminded that any change in the use of IPO proceeds from that disclosed in the prospectus requires a company to consult with its compliance advisor, and may be subject to additional requirements under the Listing Rules. This will include the placement of cash in financial instruments or products other than those specified in the prospectus.

In a recent case, a change in the use of IPO proceeds, and failure to comply with the Listing Rules requirements on the related transactions, has led to HKEx censuring IntelliCentrics Global Holdings Ltd. The company used its IPO proceeds to acquire certain promissory notes issued by offshore private companies. These constituted major transactions and advances to the entities, and the relevant announcement and shareholder approval requirements were not complied with. In addition, the transactions involved the company using its IPO proceeds in a manner different from that stated in its prospectus.

IntelliCentrics also failed to consult its compliance adviser in relation to the transactions, as required by the Listing Rules.

HKEx also censured two executive directors of IntelliCentrics for breaches of their director's undertaking. By failing to correctly consider the Listing Rule implications of the company's acquisition of the promissory notes, obtain independent advice and conduct sufficient due diligence on the issuers of the promissory notes, the directors failed to comply with the Listing Rules to the best of their ability and to use their best endeavours to ensure the company's compliance with the Listing Rules.

HKEx Censures Longrun Tea For Breaching Connected Transaction Rules and Internal Control Deficiencies

HKEx has censured Longrun Tea Group Company Limited and its directors in relation to a major and connected transaction, in a case that serves as a reminder that directors must comply with the Listing Rules requirements relating to notifiable and connected transactions and maintain adequate and effective internal controls.

Two executive directors of Longrun Tea, Dr. Chiu and Mr. Jiao, arranged for a subsidiary of the company to enter into a loan agreement with a borrower, the proceeds of which were directed to a connected person owned by Dr. Chiu and Mr. Jiao. The loan transaction constituted a major and connected transaction and was approved by Dr. Chiu and Mr. Jiao without informing the board of Longrun Tea.

In addition to failing to comply with the connected transactions rules, HKEx identified a number of internal control deficiencies at the company, including the absence of an effective system for senior management to declare material interests in transactions. HKEx concluded that these deficiencies contributed to Longrun Tea's breaches of the Listing Rules.

HKEx censured Longrun Tea for failing to (i) comply with the reporting, announcement, circular and shareholders' approval requirements for a major and connected transaction, (ii) ensure that Longrun Tea's financial information was accurate and complete in all material respects, and not misleading or deceptive, (iii) timely publish and/or dispatch seven sets of financial results and/or reports, and (iv) explain its deviation from Code Provision C.1.2 of the Corporate Governance Code, which requires management to ensure the board are provided with monthly financial updates.

HKEx also censured the directors of Longrun Tea for failing to apply such degree of skill, care and diligence as may reasonably be expected of a person of their knowledge and experience and holding their offices within the issuer.

In addition, HKEx censured Dr. Chiu and Mr. Jiao for failing to (i) act honestly and in good faith in the interests of the company as a whole, (ii) act for proper purpose, (iii) avoid actual and potential conflicts of interest and duty, and (iv) disclose fully and fairly their interests in contracts with the issuer.

HKEx directed Longrun Tea to appoint an independent compliance adviser and the directors were required to attend 26 hours of training on Listing Rules compliance. HKEx further issued a prejudicial statement against Dr. Chiu and Mr. Jiao.

HKEx Censures Alltronics in Connection With Insufficient Due Diligence and Varying the Terms of a Transaction

The failed sale of a subsidiary by Alltronics Holdings Limited has led to a censure for the company and its directors from HKEx.

Alltronics had reached an agreement to dispose of a subsidiary group for RMB100 million. This constituted a very substantial disposal and a connected transaction under the Listing Rules, and accordingly was approved by the independent shareholders on terms which, among others, included that RMB30 million was to be received by the company before completion.

However, on becoming aware that the purchaser was unable to meet the payment schedule, Alltronics agreed to extend the time for payment until after completion and proceeded with completion of the disposal, without obtaining additional independent shareholders' approval for this material change in the terms of the transaction. As of the date of HKEx's Statement of Disciplinary Action, Alltronics had still not received any payment for the disposal.

HKEx censured Alltronics for failing to obtain independent shareholders' approval again as the payment deferrals and the decision to complete without receipt of any consideration amounted to a material variation in the terms of the disposal. It also censured and criticized Alltronics's directors for breach-

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ing the Listing Rules by (i) failing to perform sufficient due diligence on the financial capability of the payment obligors, and (ii) failing to use their best endeavors to ensure Alltronics's compliance with the Listing Rules. HKEx directed each of the directors to attend training on regulatory and legal topics, including Listing Rule compliance.

HKEx Censures Winshine Science for Deficient Internal Control Reviews

The Listing Rules require issuers to conduct annual internal control reviews covering all material controls, including financial, operational and compliance controls. A recent case has shown how a failure to implement such reviews thoroughly can expose a company and its directors to both financial losses and regulatory risk.

The former executive director and chief executive officer of Winshine Science Company Limited arranged for Winshine Science's subsidiary to make transfers and advance loans without notification to or approval from Winshine Science's board. These undisclosed transactions contributed to Winshine Science's delay in its publication of financial results. Winshine Science also failed to (i) timely publish its financial results for the year ended 31 December 2018 and the six months ended 30 June 2019, and (ii) cover all material controls in its review of its internal control, thus failing to comply with Code Provision C2.1 of the Corporate Governance Code. An internal control review later conducted by Winshine Science identified significant and material deficiencies of the group's internal controls at the material time.

HKEx found two former executive directors to have breached (i) the Listing Rules by failing to comply with their directors' duties and (ii) their director's undertakings. HKEx concluded that the retention of office by the former executive directors would have been prejudicial to the interests of investors. Other relevant directors were directed to attend 18 hours of training on Listing Rules compliance.

HKEx reminds listed companies that conducting internal control reviews limited to certain business segments or on a rotational basis can lead to weaknesses in the control framework. This could in turn create an environment which enables unauthorised transactions.

HKEx Censures Coolpad and Its Directors for Ineffective Internal Controls

Another recent HKEx disciplinary case also illustrates the consequences of inadequate internal controls at a listed company, as well as the consequences of directors not being

directly involved in management, failing to exercise independent judgment and "turning a blind eye" to problematic transactions.

From July 2016 to March 2017, Coolpad Group Limited entered into transactions involving advances and/or financial assistance totalling more than RMB1.3 billion. These sums were for the benefit of a group of companies in which Mr. Jia, the former executive director and chairman of Coolpad, was the controlling shareholder or entities beneficially owned by an acquaintance of Mr. Jia and Mr. Liu Hong, former executive director of Coolpad.

Coolpad's auditors queried the transactions, which led to a delay in publishing four sets of Coolpad's financial results from the end of 2016 to the half year of 2018. Consequently, trading of Coolpad's shares was suspended for over two years. In this regard, the Listing Committee found that Coolpad (i) breached the disclosure and announcement requirements under the Listing Rules, and (ii) did not have adequate internal controls which contributed to Coolpad's breaches.

Further, the Listing Committee concluded that Coolpad's six former directors (including Mr. Jia and Mr. Liu) failed to discharge their duties under the Listing Rules. In particular, Mr. Jia failed to (i) comply with Coolpad's "Information Disclosure Management System" manual to identify the Listing Rules implications of one of the transactions and report them to Coolpad's board of directors for consideration and discussion, (ii) keep the board members informed that the borrowers in one of the transactions were related to each other, and (iii) ensure that Coolpad complied with the Listing Rules applicable to the transactions. Other former directors of Coolpad were found to have failed to exercise their independent judgment and turned a blind eye to potential Listing Rules implications arising from the transactions.

Therefore, the Listing Committee found that (i) there were material deficiencies in Coolpad's internal controls for Listing Rules compliance, and (ii) Coolpad's former directors failed to ensure that Coolpad notified shareholders and the market of the transactions, destroying the transparency, trust and confidence in the market. Accordingly, Coolpad's former directors who were not directors of any other company listed on the HKEx were directed to attend 24 hours of training on Listing Rule compliance and directors' duties. HKEx also made a public statement that the retention of office by two former directors would have been prejudicial to the interests of investors had they remained on the Board.