

Hong Kong Regulatory Update

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This update provides an overview of key regulatory developments in the fourth quarter of 2023 relevant to companies listed, or planning to list, on The Stock Exchange of Hong Kong Limited (**HKEx**) and their advisers. 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**). Other recent market developments may also be included. We do not intend to cover all updates that may be relevant, but we welcome feedback, so please contact us if you would like to see analysis of other topics in the future.

Comprehensive Guide for New Listing Applicants Replaces Guidance Letters, Listing Decisions

HKEx has published a new “[Guide for New Listing Applicants](#),” consolidating its guidance letters and listing decisions into a single, user-friendly handbook to assist new listing applicants. The guide will be updated regularly, helping new listing applicants and their advisers to better understand the HKEx’s interpretation of rules and requirements, as well as the expected standards and quality of listing document disclosure.

The guide is divided into six main sections:

1. Eligibility and suitability for listing.
2. Special listing regimes.
3. Listing document disclosure.
4. Specific topics relating to a new listing application, including guidance related to variable interest entities (**VI**Es), pre-IPO investments, particular business models and other matters.
5. Other listing structures.
6. Other matters.

The guide also has an annex of listing decisions. The guide as a whole replaces all previous HKEx guidance letters and listing decisions relating to new listing applications. Submissions made to HKEx should refer to the relevant sections of this guide.

Going forward, HKEx will update the guide as necessary. It will no longer issue new guidance letters or listing decisions on these topics.

IPO ‘Double Dipping’ Reforms Implemented

HKEx has historically maintained strict limits on the subscription for additional shares by an existing shareholder, or purchase of further shares by a cornerstone investor, in a listing applicant in its IPO, a practice commonly referred to as “double dipping.”

However, HKEx has recently revised its [guidance letter on double dipping](#) to allow existing shareholders and their close associates, and cornerstone investors who have a guaranteed allocation of shares under the placing tranche, to subscribe for further securities in an IPO as places if the following conditions are met:

- Minimum offer size is at least HK\$1 billion.
- Allocations to all existing shareholders and their close associates (whether as cornerstone investors and/or as places) do not exceed 30% of the offering.

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- There are no allocations to any director, chief executive or controlling shareholder (and, for People's Republic of China (PRC) issuers, supervisor) of the listing applicant or their close associates under the exemption.

These relaxations will be welcomed by issuers and underwriters as providing flexibility to ensure IPO order books are filled and deals can be successfully completed, notwithstanding ongoing challenging IPO market conditions.

HKEx Introduces Paperless Regime

Following the conclusion of a market consultation process, effective 31 December 2023, HKEx amended the Listing Rules to implement its new paperless regime.

Under the new arrangement, which is intended to address environmental concerns by reducing paper usage as well as streamlining processes for listed companies:

- HKEx-listed companies must distribute their corporate communications to shareholders electronically, as further discussed below.
- Most documents required to be submitted to HKEx must be submitted by electronic means.
- Certain documentary submission requirements have been abolished entirely, with the relevant obligations now codified into the Listing Rules or disclosed in issuers' published documents. (Examples include the director's declaration and undertaking, independence confirmation from independent financial advisor and independent nonexecutive directors, and annual confirmation by auditors on continuing connected transactions.)

Previously, listed companies were required to distribute corporate communications in printed form unless they had obtained shareholder consent to adopt electronic communications (which may have been by way of a "deemed consent" mechanism whereby shareholders were asked to "opt in" to receive printed communications).

Under the new rules, commencing 1 January 2024:

- Listed companies must disseminate corporate communications to their shareholders electronically, without the need to seek shareholder consent and instead relying on implied consent from shareholders, where that is permitted by the laws of their jurisdiction of incorporation (*e.g.*, the Cayman Islands, Bermuda, PRC or Singapore). For companies where implied consent is not permitted (which is the case for companies incorporated in Hong Kong), they must adopt the previous deemed consent approach.
- If a company's constitutional documents do not permit it to disseminate corporate communications electronically, the company must amend its constitutional documents by the first annual general meeting following 31 December 2023.

- Issuers already disseminating shareholder communications in electronic form should continue electronic dissemination by either maintaining their existing consent mechanism or adopting an implied consent mechanism by the first annual general meeting following 31 December 2023 if permitted by the laws and regulations and their articles of association.

Actionable corporate communications (*i.e.*, those seeking instructions from shareholders on how they wish to exercise their rights or make an election as the shareholders, such as provisional allotment letters or excess application forms of a rights issue) must be sent to shareholders individually.

Making such communications generally available on the websites will not meet the Listing Rules requirement. Issuers must send corporate communications in printed form to shareholders free of charge if their shareholders so request it. Issuers should disclose on their websites the arrangements for making such requests, and these arrangements must not be unduly burdensome for shareholders.

Other communications that are not considered actionable corporate communications must be sent to shareholders either:

- electronically (*e.g.*, by email, with the relevant document or weblink to that document on the issuer's website), or
- by making the document available on its and HKEx's websites.

Key Findings From Analysis of Corporate Governance Practice Disclosure

In November 2023, HKEx released its [report on companies' compliance with the Corporate Governance Code \(CG Code\)](#) for the 2022 financial year, based on an analysis of 400 corporate governance reports. The report focuses on compliance with the updates to the CG Code that took effect on 1 January 2022.

Key findings of the report are as follows:

Corporate Culture (CP A.1.1)

- Detailed disclosure on companies' desired corporate culture is required. Disclosure should include details on (i) the link between corporate culture and the issuer's business objectives, (ii) the implementation of the desired corporate culture into the issuer's daily operations, and (iii) an assessment of the progress and success of such implementation.

Long-Serving INEDs (CP B.2.3 and B.2.4)

- HKEx noted a meaningful reduction in the number of long-serving independent nonexecutive directors (INEDs).
- Board composition should be regularly assessed in line with changes to an issuer's business environment and other challenges. HKEx encourages periodic board refreshment to foster the sharing of diverse perspectives.

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- Where a long-serving INED is retained, sufficient details should be disclosed regarding the suitability of such individual for reelection, including the process undertaken by the nomination committee and the board to confirm their continued independence. The board should focus on the INED's mindset and whether the INED remains capable of continuing to provide an independent and objective contribution.

Diversity (Rule 13.92; CP B.1.3; MDR Para J)

- Existing single-gender board issuers (around 550 issuers) should proactively seek to appoint at least one director of a different gender by 31 December 2024.
- It is important that board composition reflects a suitable balance of skills, experience and diversity of perspectives. Issuers should formulate long-term targets and timelines to further progress gender diversity on their boards beyond the required minimum and within their wider workforce.
- Disclosures on diversity objectives should include details of (i) the steps and programmes implemented by the issuer, and (ii) a discussion as to whether the issuer is on track to meet its numerical targets and timelines (and if not, what additional actions the issuer is taking to enable it to achieve its diversity goals).

Risk Management and Internal Controls (CP D.2.1; MDR Para H)

- Conducting appropriate risk assessment and implementing internal controls that help manage such risks is key to good corporate governance. It is equally important to regularly monitor the existing internal controls and review their effectiveness at least annually.
- Companies should disclose sufficient details of their internal control reviews to support their findings that they remain effective.

Guidance Details Independent Nonexecutive Directors' Roles and Responsibilities

HKEx recently published "[A Snapshot of INEDs' Roles and Responsibilities](#)," which provides guidance to assist INEDs in understanding their roles and obligations.

The guide emphasizes that an INED is expected to exercise independent judgment and explains the role of INEDs' own expertise and experience in contributing to the company's success.

HKEx recommends that newly elected INEDs take the following actions:

- Understand the company's businesses.
- Comment objectively and exercise independent judgment on the existing framework and documentation for internal controls.

- Review compliance history and understand any causes of noncompliance.
- Ensure there are mechanisms for a regular flow of information and timely reporting of important information to directors.
- Devote sufficient time and attention to the company's affairs.
- Proactively attend training.
- Adopt good practices of documenting their own contributions to the board and keep important records circulated and produced.

In reviewing and approving business decisions, HKEx highlights the INEDs' role to act as a check to the board. The guide outlines several significant roles of INEDs, including:

- Ensure information is sufficient to make informed decisions.
- Ask questions proactively and exercise independent judgment.
- Independently assess professional advice and the reasonableness of valuations.
- Ensure there is a mechanism to follow up on the proper conduct of the business.
- Ensure contributions and concerns are properly recorded.

In terms of the INED's role in internal controls, HKEx states that board members are both collectively and individually responsible for ensuring the establishment of effective internal control and risk management systems. HKEx also reminds INEDs to be proactive in ensuring compliance with financial reporting obligations and that the company presents an authentic and objective view of its financial position in financial statements.

The guide also includes several case studies and gives advice on what the appropriate and inappropriate actions are for a director under particular circumstances.

HKEx Publishes Guidance on Internal Controls and Planning for Upcoming Audits

HKEx's latest *Listed Issuer Regulation Newsletter* addresses internal control issues and provides a number of reminders for companies as they begin to prepare their 2023 audits.

HKEx identified the following common internal control weaknesses based on their review of issuers who failed to publish financial results on time or received a modified audit opinion on their financial statements:

- During periods of economic/industry downturn or material changes in the issuers' financial performance, issuers lacked internal guidelines to assess and document such impact (e.g., going concern assumption, recoverability of receivables from customers and valuation of properties).
- Some issuers lacked policies and control procedures on origination and execution of corporate transactions (such as acquisitions and disposals of assets), and on provisions of

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financial assistance. This led to insufficient due diligence, approvals and documentation to substantiate their commercial substance and business rationale.

- Some issuers failed to exercise sufficient control or supervision over acquisition targets, leading to failures such as lack of access to targets' books and records or inadequate approval process over targets' activities, or even to the dissipation of assets.
- Some issuers failed to arrange for audit work on a subsidiary in the year of its disposal, resulting in qualification in the audit report due to lack of access to books and records.

HKEx recommends issuers to adopt sound financial reporting controls and processes, including:

- **A continuous review of principal risks and adequacy of the internal controls.** Issuers should consider whether its market, operational and compliance risks may be impacted by changes in economic conditions, regulations, industry landscape and competition, mergers and acquisitions or other corporate actions. Issuers should develop risk-mitigating controls and review their effectiveness on an ongoing basis.
- **Effective planning of the audit process, taking into account the principal risks identified and material changes during the year.** If issuers identify material changes in their principal risks that may impact the financial statements and/or the auditing process, they should discuss with the auditors at the planning stage to agree on the audit approach. Experts such as valuers should be engaged before the audit begins to align with the audit timetable.
- **Effective monitoring of the audit progress.** If there is any material departure from the timetable or substantial audit issues, management should timely escalate the matters to the audit committee.
- **Reporting.** Issuers should disclose details of the risk management and internal control systems, including the process used to identify and manage significant risks, the main features of the systems and that management is responsible for reviewing its effectiveness.

Proposal Would Keep Trading Open in Severe Weather

HKEx is proposing that Hong Kong's securities and derivative markets remain operational during severe weather conditions (such as typhoons) in a [consultation paper published in November 2023](#).

HKEx intends for its securities and derivatives markets, including Southbound and Northbound Stock Connect, derivatives holiday trading and after-hours trading, to be open and available to all local, regional and international investors during severe weather conditions.

The aim is to keep trading, post-trade and listing arrangements substantially the same as those during regular trading days, with some necessary adjustments to ensure the market's operational resilience and the safety of market participants.

Some services that are provided via physical outlets would be unavailable. For example, a buy-in exemption may be granted to clearing participants who are unable to deposit physical securities to HKEx's clearinghouse for settlement purposes under severe weather conditions. In addition, the last registration date for some corporate actions would be postponed if that day fell on a severe weather event, as participation in corporate actions by physical certificate holders would be impacted due to the closure of physical outlets, including those of share registrars.

HKEx will make appropriate announcements on its website and systems to alert participants and investors that, whilst a severe weather event is taking place in Hong Kong, market trading remains normal, with alternative arrangements in place for certain functions.

Mandatory Climate Disclosures Delayed to 2025

In April 2023, HKEx published a [consultation paper on enhanced climate-related disclosures for listed companies](#) (covered in our [August 2023 update](#)), with the intention of implementing the Listing Rule amendments by 1 January 2024. HKEx has now postponed the implementation date to 1 January 2025, thereby allowing market participants more time to prepare for the new climate-related disclosure obligations.

The International Sustainability Standards Board (ISSB) published the final IFRS Sustainability Disclosure Standards in June 2023. The ISSB will also develop an adoption guide to help regulators implement IFRS S2 Climate-Related Disclosures and to advise on scalability and phasing-in measures.

HKEx will consider both the final IFRS Sustainability Disclosure Standards and the adoption guide (which has not yet been released) when finalizing its amendments to the Listing Rules.

New Privacy Protection Measures for Company Directors in Hong Kong

Under traditional standard protocols at the Hong Kong Companies Registry, the full residential address and identification document numbers of the directors and company secretary of any company registered in Hong Kong — including both Hong Kong-incorporated companies and overseas companies registered as non-Hong Kong companies with the Companies Registry — are available to the general public and may be readily accessed through a Companies Registry search.

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However, a new inspection regime implemented at the end of 2023 at the Companies Registry permits company directors and company secretaries to withhold their residential addresses and identification document numbers from public inspection. Under the regime, the register will make available for public inspection correspondence (rather than residential) addresses and partial (rather than full) ID numbers. This will alleviate concerns about privacy and identity theft that arose under the previous arrangements. Note that a post office box is not permitted to be used as correspondence address.

As of 27 December 2023, directors and company secretaries whose data appears in the Companies Register may apply to the Companies Registry to protect their personal information from public inspection. To apply, affected persons should:

- Complete the [Companies Registry Form MPI](#), available at the Companies Registry website.
- To submit by post: post the Form MPI together with a certified copy of their identification document (Hong Kong ID card or passport) to: Public Search Section, Companies Registry, 13th Floor, Queensway Government Offices, 66 Queensway, Hong Kong.
- To submit in person: submit the Form MPI at the e-Services Centre of the Companies Registry at the above address and present their original identification document for inspection.

Registered users of the Companies Registry's e-filing services may also apply through the e-filing system. No identification document is required in such case.

No fee is required for the application.

Following approval, the Companies Registry will notify applicants by email.

Enforcement Matters

HKEx Takes Disciplinary Action Over Lending Transactions

Listed companies engaging in lending transactions outside the ordinary course of their business have been a concern for HKEx. A recent disciplinary case illustrates the risks that may arise in connection with these transactions.

Between June 2018 and March 2019, Hong Kong Resources Holdings Company Limited granted loans to borrowers totaling HK\$74.4 million. The company's auditors raised concerns over the inadequate internal controls in respect of loan approval, insufficient due diligence assessments on the borrowers' repayment ability and disagreement over the expected credit loss assessment.

However, Hong Kong Resources proceeded to publish its interim report with no mention of these concerns, thereby giving investors a wrongful impression of the company's

financial condition. During the subsequent fiscal year, the auditors continued to raise the above concerns and further questioned the commercial rationale of the loans given, the lack of follow-up actions when sums became overdue and the questionable relationship between the company and the borrowers. All the borrowers defaulted on the loans, resulting in an impairment loss of around HK\$86 million.

HKEx found that Hong Kong Resources had breached the Listing Rules by failing to:

- Disclose accurate and complete information in its interim report.
- Give due consideration to issues raised by the company auditors.
- Include unfavorable material facts, which thereby misled its investors.

HKEx found that the directors had failed to procure adequate internal controls for the company's money-lending business and to disclose accurate and complete information on the interim report. HKEx highlighted that two directors with prior experience in operating a money-lending business should have ensured sufficient due diligence, proper credit checks and assessments.

The audit committee was also found to be notably ineffective by failing to make meaningful enquiry as to the overdue payments and failing to exercise a lack of independent and critical assessment of the company's financial statements.

HKEx censured the company and eight of its directors. The exchange also issued a prejudice of investors' interests statements against two directors, indicating HKEx's opinion that the retention of office by these directors would have been prejudicial to the interests of investors.

The case highlights the importance of a company having robust internal controls and risk management framework, and of directors remaining vigilant, proactive and exercising independent judgment when auditors raise questions or concerns. Failures in this regard can lead to misleading disclosures and an increased risk of loss to investors.

HKEx Censures C-Link for Material Transactions Made Shortly After Its Listing

A recent case involving a company making substantial payments shortly after listing without proper disclosure has led to disciplinary action from HKEx.

C-Link Squared Limited entered into certain service agreements on the day of, and very shortly after, its listing, involving refundable payments of HK\$38.5 million made to service providers within a week of listing. The payments were equivalent to more than half of C-Link's IPO proceeds and heavily contributed to a material shortfall in C-Link's net profit and loss.

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These transactions and payments were not disclosed in its prospectus or cash flow memorandum submitted at the time of listing. C-Link also did not consult its compliance adviser before paying such service fees. This resulted in insufficient information being provided to the investing public at the time of listing and exposed the company to significant financial risk.

C-Link and two former executive directors were censured by HKEx. As a result, the former directors agreed to resign from all directorships and senior management positions in C-Link and its subsidiaries, and not to take up any directorship or senior management positions in any listed issuer in Hong Kong in the future.

SFC Continues To Take Action on Breaches of Directors' Duties

The SFC continues to take action in courts against directors for breach of their directors' duties under Section 214 of the SFO, which empowers the SFC to apply to the courts for a wide variety of orders in cases of fraud, misfeasance or unfair prejudice in relation to a listed company.

First Credit Finance Group Limited. In this case, the SFC has sought disqualification orders against five former directors and a former *de facto* director of First Credit for allegedly breaching their fiduciary duties. The SFC found an individual to have acted as the *de facto* director of First Credit between December 2015 and June 2017 by taking part in the company's business management and making decisions of a directorial nature.

In early 2016, First Credit conducted a share placement in which the *de facto* director was a placee, and later he and his brother were subscribers of untaken rights shares in First Credit's rights issue. However, First Credit wrongfully stated in the related announcements that all the placees and subscribers were independent third parties.

The SFC claimed that the former directors breached their duties by:

- Failing to disclose the *de facto* directorship.
- Including false and/or misleading information in their company announcements regarding the placee's independence.
- Failing to consider the dilution impact of the placing on the company's shareholders when approving the placing proposal.

China Candy Holdings Limited. In a successful application under Section 214 of the SFO, a former independent non-executive director of the company was disqualified from being a director and from being involved in the management of any listed or unlisted corporation in Hong Kong for a period of three years. SFC investigations found that China Candy's 2016 interim and annual reports falsely portrayed its financial strength, particularly through the overstatements of the company's cash and bank balances.

Although he was not involved in the company's daily operations, the former INED admitted his negligence and his lack of attention when red flags were raised by the internal control consultant about China Candy's treasury, cash management and financial reporting functions. As an INED and audit committee member, he also admitted to his failure to monitor the company's financial position.

FingerTango Inc. The SFC has sought disqualification orders against eight current or former directors of the company, as well as compensation orders against six directors, for alleged corporate misconduct and breach of their directors' duties. Shortly after its listing, FingerTango used its IPO proceeds to invest HK\$450 million into a fund without conducting proper due diligence about the fund itself, such as its track record and portfolio. Furthermore, after partially redeeming the fund, FingerTango invested another HK\$250 million in loan notes issued by a small-scale private company that subsequently defaulted, leading to losses of HK\$258.75 million. The SFC alleged that the loss and damage was caused by the directors' failure to carry out proper inquiries about the issuer of the notes and assessing the investment risks.

Tech Pro Technology Development Limited. The SFC has sought disqualification orders against former Tech Pro directors for alleged breach of their duties of care, skill and diligence, as well as their duty to act in the best interest of the company. An investigation had revealed that the directors had failed to manage the company's assets prudently or maintain sufficient control and supervision over one of the company's PRC joint ventures. As a result, the joint venture partner misappropriated funds of more than RMB300 million and failed to settle outstanding rent, resulting in a PRC court order to terminate Tech Pro's subleasing right to the building and therefore wiping out Tech Pro's investment in the joint venture.

These cases serve to highlight the SFC's continued attention on listed company directors' duties and demonstrate the SFC's willingness to make use of the powers given to it and the courts under Section 214 of the SFO to take action against recalcitrant directors.

SFC Acts on Fraudulent Share Placement Scheme

The SFC successfully obtained disqualification and compensation orders against the former chairman and executive director of Kong Sun Holdings Limited and China Sandi Holdings Limited in connection with a fraudulent share placement scheme.

The SFC found that the chairman had directed a nominee company to make false and misleading representations purporting its independence to apply for shares placed by Kong Sun and China Sandi. He also brought about false and misleading declarations by Kong Sun and China Sandi to HKEx to induce the exchange to grant the listing approval relating to these placing shares.

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The chairman further brought about false announcements by both companies to the public with respect to the compliance of the independent places requirements under the Listing Rules. After the share allotment was secured, the nominee company disposed of all the shares on the open market, making an aggregate profit of approximately HK\$2 million.

The chairman was disqualified for 10 years from being a director of any corporation in Hong Kong and directly or indirectly taking part in the management of any corporation in Hong Kong. He was also ordered to pay Kong Sun the secret profit made in breach of his fiduciary duty and SFC's costs in the proceedings.

SFC Restrains Former Director of SMI Culture From Disposing Personal Properties

In another example of the flexible nature of remedies available to the SFC under Section 214 of the SFO, the SFC has applied to the courts for an injunction to prevent disposal of local and overseas assets by a former CEO and executive director of SMI Culture & Travel Group Holdings Limited in order to preserve assets to satisfy a potential adverse compensation order.

Pending final determination of the SFC's application, an interim injunction was obtained requiring the director to provide notice in relation to any agreement to sell her specified properties in Hong Kong, Shanghai and Canada. The director subsequently

notified the SFC about sale agreements for two of her properties in Shanghai and Canada; the SFC believed there was a real risk of asset dissipation and therefore applied to the court to restrain completion of the sales. The director agreed not to complete the transactions without the SFC's consent or the court's approval.

Personal Assistant to Listed Company's Chairman Convicted of Insider Dealing

In a recent successful prosecution, the personal assistant to the chairman and executive director of Kingboard Holdings Limited was convicted of insider dealing and sentenced to 240 hours of community service and ordered to pay a HK\$25,000 fine and the costs for the SFC's investigation of HK\$38,277.

The personal assistant had obtained insider knowledge of a potential privatization of a target company from a meeting and proceeded to purchase shares of the target company. He subsequently sold the shares after announcement of the privatization, for a total profit of HK\$19,080.

The usual sentence for insider dealing would involve imprisonment, but a community service order was considered appropriate in this case, considering the relatively small profit gained and the offender's early guilty plea. However, the case highlights that the SFC takes a zero-tolerance approach to insider dealing and will prosecute all cases accordingly.