

Hong Kong Regulatory Update

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This update primarily provides an overview of key regulatory developments in the first quarter of 2024 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.

HKEx Publishes Summaries of Private Reprimands in Disciplinary Matters

HKEx recently published summaries of certain private reprimands it had issued to listed companies in the areas of:

- Insufficient oversight.
- Conflicts of interest.
- Duties in respect of internal controls.

HKEx's enforcement actions remind directors, whether executive or non-executive, to be proactive in discharging their duties, including understanding the company's business, applying sufficient oversight, avoiding conflicts of interest, and ensuring that the company has appropriate and effective internal controls.

Insufficient Oversight

Private reprimands for insufficient oversight of a listed company's business by its directors were issued in the following circumstances:

- A company entered into agreements to pay out over half of its IPO proceeds to third parties within one week of listing, without disclosing such payments in its prospectus. The relevant directors (one non-executive director and two independent non-executive directors) later claimed they were not aware of the payments at the time they were made. HKEx reprimanded the directors for breach of directors' duties, claiming the directors had not requested monthly financial and business updates.
- A company transferred funds to another company controlled by a director and his spouse without the board's knowledge. HKEx reprimanded the executive director responsible for the transaction for solely relying on information supplied to him by other directors and senior management, and failing to take an active interest in and make independent enquiries about the company's business and operations.
- Two executive directors delegated to another director the responsibilities to enter into certain arrangements, which were later found to have circumvented the connected transaction rules. HKEx reprimanded the two directors for failing to ensure that the delegated duties were properly discharged, actively follow up with the delegate and provide clear directions as to when matters should be reported back for further board consideration and approval.

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The cases illustrate that:

- Directors should regularly be provided with information regarding the issuer's business and financial position, and actively request such information if it is not provided.
- Delegation must be managed carefully and with appropriate oversight. Unquestioning reliance on others is unlikely to be sufficient to discharge directors' duties, even if those relied upon are other directors or senior management.

Conflict of Interest

HKEx reprimanded the directors for conflicts of interest in the following cases:

- A listed company's placing agent appointed a sub-placing agent controlled by two executive directors, which received more than 90% of the placing fees.
- A company entered into an undisclosed arrangement that conferred benefits on a connected person without disclosure.

Directors are reminded that the threshold for conflicts of interest is very low, and disclosure must be made even if there is only a potential for conflict.

Duties Relating to Internal Controls

HKEx emphasized the need for directors and senior management to take proactive steps and exercise independent judgment to ensure appropriate and effective internal controls are in place for Listing Rules compliance.

In one case, a company's subsidiary entered into an acquisition that required shareholders' approval under the Listing Rules. Three independent non-executive directors were reprimanded for lack of involvement in the acquisition and for undue reliance on others as they failed to take meaningful measures to ensure the adequacy and effectiveness of internal controls related to the acquired business.

HKEx Announces Consultation Conclusions for New Treasury Share Rules

In its conclusions to a market consultation process held in late 2023, HKEx announced it will permit listed companies to hold their own shares as treasury shares and introduced rules for companies' resale of treasury shares. The new rules will be effective 11 June 2024.

Highlights of the conclusions include:

- The new rules abolish the requirement to cancel repurchased shares and permit listed companies to hold their own shares as treasury shares.

- Resales of treasury shares will be governed by the rules applicable to the issuance and sales of new shares.
- Treasury shares may also be used to satisfy award grants under share schemes.
- There will be no restriction on the number of treasury shares a company may hold.
- Certain restrictions on resales of treasury shares apply, to prevent companies from repeatedly repurchasing and reselling their own shares on the market with the intention of manipulating the share price or making a trading profit.

For more on the new rules, see our [26 April 2024 client alert](#).

HKEx Publishes Consultation Conclusions on Enhancing Climate-Related Disclosure

On 19 April 2024, HKEx published conclusions to its consultation on the enhancement of climate-related disclosures.

Effective 1 January 2025, a new set of rules mandating climate-related disclosures will be added to the exchange's Environmental, Social and Governance Reporting Code. New disclosure requirements will cover an issuer's governance, strategy, risk management, and metrics and targets in relation to climate-related risks and opportunities. The new requirements will be implemented in phases and subject to certain implementation relief.

Listed companies should consider:

- Familiarizing themselves with the new rules and the underlying International Sustainability Standards Board (ISSB) standards for sustainability disclosure.
- Identifying any gaps in their internal procedures and systems.
- Establishing necessary measures as soon as possible to position themselves to comply with the new reporting requirements.

For more on the new rules, see our [13 May 2024 client alert](#).

New Greenhouse Gas Emissions Calculation and Estimation Tools Launched

In February 2024, The Green and Sustainable Finance Cross-Agency Steering Group and the Hong Kong University of Science and Technology launched two [greenhouse gas emissions \(GHG\) calculation and estimation tools](#) to facilitate sustainability reporting by corporates and financial institutions in Hong Kong.

The new tools include a calculation tool for users to compute their GHG emissions based on activity levels and an estimation tool for financial institutions to assess the GHG emissions of their investees or borrowers.

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Enforcement Matters

HKEx Censures Directors for Failure To Highlight Material Matters to the Board

A recent HKEx disciplinary case focused on directors' failure to ensure appropriate internal control policies and procedures were in place to enable them to monitor material transactions entered into by the company.

In February 2016, Chongqing Xinming China Holding Limited had cash flow difficulties and sought funding through a company outside of the group that was privately owned by the controlling shareholder (who was also that company's chairman and CEO) and his wife. That company acted as a borrower of loans from certain private investors.

Chongqing Xinming soon started to struggle with repayments and eventually requested a time extension for the repayment of the outstanding amounts. Disagreements arose between the parties over the lenders' demand for a 24% annual default interest rate.

The relevant directors did not inform the rest of the board about the loans or the lenders' demand for default interest, and the regular updates circulated to the board did not contain any information about the loans. Chongqing Xinming did not retain a copy of the agreement for the loans. The loans were also not reflected in the financial statements for the 2016 and 2017 financial years.

Chongqing Xinming repaid the loan principal but not the default interest charged by the lenders. The chairman paid the default interest without informing the board, and the amount was recorded as "other receivables" in Chongqing Xinming's financial statements with the aim of negotiating a refund with the lender later. The basis for such accounting treatment was unclear, as was the basis for the company's belief that it would be able to recover such amounts from the lenders. The refund negotiations were unsuccessful, resulting in a RMB 49.4 million impairment loss.

HKEx found the directors breached their duties by failing to:

- Properly retain documentation in respect of the loans.
- Follow internal control policies.
- Disclose the loans for board approval.

The chairman also failed to avoid conflict of interest given his dual role as a director of the company and the owner of the counterparty in this transaction. He did not inform the board about the lender's demand for default interest and paid the default interest without reporting to the board. Consequently, the relevant directors were censured and directed to attend training.

Directors are reminded to ensure that transactions carried out by a listed issuer are compliant with internal control policies, and that material matters are brought to the attention of the board for consideration and approval. A director of a listed issuer should also take active steps to manage actual or potential conflicts of interest, such as when acting in another capacity in a transaction involving the listed issuer.

HKEx Censures China Gas for Undisclosed Use of Funds

HKEx's recent action against China Gas Industry Investment Holdings emphasizes that sufficient and accurate information must be disclosed in a company's listing prospectus, including information relating to the use of proceeds, financial information and risks. When entering into significant transactions, directors must ensure sufficient information and related risks are brought to the board's attention and appropriate due diligence and risk assessments are conducted.

China Gas used a substantial portion of its funds shortly before and after listing to provide three unsecured loans at an interest rate much lower than the effective interest rates the company was paying its lenders, and subscribed for one loan note. The chairman entered into all four transactions on the company's behalf without seeking the board's approval or consulting the company's sponsor and compliance adviser.

The transactions were entered into in breach of the company's internal control policy and without commercial rationale. The company did not disclose the transactions and their potential risks in the prospectus and subsequently made a full loss allowance of more than RMB 180 million on the loans.

The chairman later sought the board's endorsement of a proposed put option arrangement to repay the loans, under which the company could be obliged to buy its own shares from a vendor. He neither knew of, nor had he performed any background or credit assessment on, the proposed vendor.

HKEx found that the chairman had failed to discharge his directors' duties in approving the four transactions and in proposing the draft put option agreement. He also failed to protect the company's interests and to use his best endeavours to procure the company's compliance with the Listing Rules in respect of the transactions.

HKEx censured the company and imposed a statement that retention of the chairman as a director would be prejudicial to the interests of investors.

SFC Takes Action on Breaches of Directors' Duties

The SFC has successfully obtained disqualification orders against the former chief financial officer (CFO) and company secretary of Fuguiniao Co. Limited.

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Fuguiniao failed to disclose several deposit pledges amounting to approximately RMB 5.3 billion that were used as security for bank credit facilities extended to a substantial shareholder and other external parties without proper disclosure. Ultimately, RMB 1.79 billion worth of pledges were withheld by the banks after the loans defaulted. The non-disclosed pledges rendered Fuguiniao's annual and interim reports for the financial years from 2013 to 2015 false and misleading.

The SFC investigation found that Fuguiniao's CFO failed to:

- Ascertain whether the company's deposits were pledged to banks.
- Monitor the company's financial affairs (including its material transactions and significant deposit pledges).
- Follow up on the matter even after the issue of undisclosed deposits was uncovered.

The CFO also failed to ensure or verify the accuracy of the company's financial statements and announcement to ensure compliance with Listing Rule requirements, indicating a serious dereliction of his duties and a lack of understanding of his role and responsibility.

The CFO was disqualified for two years from being a director of any corporation in Hong Kong and directly or indirectly taking part in the management of any corporation there. He was also ordered to pay HK\$500,000 for SFC's costs in the proceedings.

SFC Orders Shares To Be Suspended Pending Investigation

The SFC has directed HKEx to suspend dealings in the shares of LET Group Holdings Limited and Summit Ascent Holdings Limited under the Securities and Futures (Stock Market Listing) Rules in order to maintain market order and protect the interest of the investing public, due to serious concerns surrounding a substantial disposal of a major asset.

The transaction involved the disposal of US\$1.16 billion worth of assets in Russia, held by Summit Ascent through a 77.5% owned subsidiary. LET in turn holds a 69.66% stake in Summit

Ascent. Since there was a change in control of LET in May 2022, any material disposal is restricted for 36 months from the change in control unless the remaining group after the change in control can meet the listing eligibility requirements under Listing Rule 8.05.

The SFC observed that after the disposal, LET and Summit Ascent may lack sufficient value of assets to support their operations for continued listing under the Listing Rules. The SFC also noted that LET and Summit Ascent should have consulted the SFC under Note 7 to Rule 2 of the Code on Takeovers and Mergers. That code requires shareholders' super-majority approvals (*i.e.*, 75% of the votes cast by disinterested shareholders at the meeting and the disapproving votes representing not more than 10% of the votes attached to all disinterested shares) if a company proposes to dispose of its assets and/or operations and, as a result of such proposal, may not be regarded as suitable for listing.

The SFC's investigation is ongoing.

SFC Takes Action on Market Manipulation

The SFC has started proceedings in the market misconduct tribunal against the former chairman of Ding Yi Feng Holdings Group International Limited and 20 other individuals for alleged share manipulation between 1 March 2018 and 14 September 2018.

The SFC alleges that the group conducted manipulative trading and a significant number of matched trades (trades in a similar quantity of shares conducted at the same time and at similar prices) in Ding Yi Feng shares to, among other things, create a false or misleading appearance of active trading in the shares. By doing so, the overall trading volume was significantly increased, thereby creating a false impression of larger market liquidity of Ding Yi Feng shares and misleading other market participants.

The SFC is seeking orders to restore the affected counterparties to their pre-transaction position and restraining the defendants from dealing with any assets related to the claim.