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# Hong Kong Regulatory Update

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This update primarily provides an overview of key regulatory developments in the second 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.

## New Proposals for Corporate Governance Reforms

In a consultation paper issued in June 2024, HKEx proposed amendments to the Listing Rules to improve corporate governance of listed companies, with a focus on the areas of board effectiveness and independence, diversity, risk management and capital management.

Key proposed amendments include:

- Where the chairman of the board is not an independent non-executive director (**INED**), the company must appoint a "lead INED."
- An INED must not concurrently hold more than six listed-company directorships.
- An INED will no longer be considered independent after serving as an INED for a company for nine years.
- At least one director of a different gender must be appointed to the nomination committee.
- All directors must participate in mandatory continuous professional training, with details of the training disclosed in the corporate governance report.
- First-time directors (those who have not been a director of an HKEx-listed company in the three years or more prior to their appointment) will be required to undertake a total of 24 hours of training within the first 18 months of their appointment.
- A board performance review should be conducted at least every two years and details of the review disclosed in the corporate governance report.
- The nomination committee must annually assess and disclose each director's time commitment and contribution to the board.
- The company must disclose gender ratios of senior management and its workforce (excluding senior management).
- The company must disclose its dividend policy, or disclose reasons for not having a dividend policy, and disclose reasons for any variations in dividend rate or for not paying a dividend.

For more details on the proposals, see our 4 July 2024 client alert "HKEX Consults on New Corporate Governance Reforms."

## Trading in Securities and Derivative Markets To Continue in Severe Weather

Currently, HKEx will delay market opening or suspend trading in the event that a typhoon signal No. 8 or above or a black rainstorm warning are issued by the Hong Kong Observatory.

In recent conclusions to a consultation process held in November 2023, HKEx announced it will change this practice such that trading, post-trade and listing arrangements in its securities and derivatives markets will continue uninterrupted during a severe weather event. To ensure safety, remote working and the use of online services are strongly encouraged on a severe weather trading day, and no public-facing physical outlets will provide services.

Severe weather trading will be effective from 23 September 2024, subject to regulatory approval.

## Listed Issuer Regulation Newsletter: Highlights

HKEx identified the following key areas in its regulation newsletter published in May 2024.

### Guidance on Preparing Spin-Off Proposals

When a listed company wishes to make an application to undertake a spin-off listing under Practice Note 15 (PN15) of the Listing Rules, sufficient and well-organised information on the following matters should be presented to expedite the regulatory process:

| | |
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| ***Pro forma* financial information of the remaining group** | To demonstrate that the remaining group could independently satisfy the financial track record requirements for an initial listing under Listing Rule 8.05, the *pro forma* information must be reviewed by the auditors and presented in reasonable detail, and show how the figures are derived. In particular, issuers should:<br>- Provide a line-by-line reconciliation showing its own financial information together with figures of the spin-off entity (**Spinco**), as well as adjustments (with explanations) for any intragroup transactions and costs allocation.<br>- Adequately describe and explain the nature of major financial statement line items in the *pro forma* financial statements to demonstrate that they are generated by activities within the remaining group's ordinary and usual course of business. |
| **Estimated market capitalization of the remaining group** | This is assessed on a case-by-case basis with reference to reasonableness. For example, issuers with a market capitalization significantly above the minimum requirement that spin off a small portion of their business can simply subtract the valuation of Spinco from their market capitalization. Conversely, marginal cases should provide more holistic analysis and anticipate heavier regulatory scrutiny on the appropriateness of inputs and methodologies, and incorporate all necessary supporting information in the first draft of proposals. |
| **Business delineation and independence** | - **Business delineation:** Issuers should explain and differentiate the business models of both the remaining group and the Spinco group. This is particularly important when the two businesses overlap in terms of products, technologies, brands, customers and suppliers. Issuers should give sufficient details supported by appropriate industry-specific parameters or metrics, such as the applications of the products, market segments and geographical locations, and use diagrams and flow charts to simplify transaction structures.<br>- **Spinco group's independence:** Material business dealings between the remaining group and Spinco group raise questions as to the Spinco group's ability to operate independently. Issuers should highlight historical and future transactions between the Spinco group and remaining group, and explain whether and how Spinco's independence may be impacted. |

As approval of a PN15 application is based on the issuer's circumstances at the relevant time the application is approved, if there is delay in the timetable rendering the track record period of the relevant entities in the approved proposal stale, issuers should reassess whether their spin-off proposal still complies with the PN15 requirements.

### Board Diversity

Issuers with single-gender boards are reminded to appoint at least one director of another gender to the board before 31 December 2024 to avoid a breach of the Listing Rules. Additionally, if noncompliance arises after an issuer already had a board of directors including both genders on or after 1 January 2022, the issuers must make an announcement and appoint a replacement within three months.

### Timely Financial Reporting

HKEx noted that delays in timely financial reporting have been attributed to companies' inability to provide timely information or evidence necessary for auditors to assess the fairness of the reported financial statement line items amid changes in the external environment, as well as internal factors such as material acquisitions and unusual transactions conducted during the year.

HKEx reminded companies to establish policies to identify emerging risks, develop risk-mitigating controls and review the control effectiveness continuously to facilitate timely and accurate financial reporting.

Announcements of a delay in publication of results should disclose adequate reasons for the delay (*e.g.*, the financial statement line items involved and their materiality, specific documents or information outstanding and/or areas of disagreement with the auditors, and the underlying reasons) to allow investors to make informed trading decisions.

HKEx further reminded companies that they must publish financial results no later than three months after the end of a financial year. If the intended publication date falls on a nonbusiness day where the publication window of the e-submission system is closed, the issuer must schedule the announcement date earlier (*i.e.*, prior to the close of the last available publication window prior to the reporting deadline) to avoid inadvertently missing the reporting deadline.

### Caution on Selective Disclosure in External Meetings

Companies are reminded that they must be careful not disclose inside information via channels accessible only to restricted groups. They must ensure that any meeting materials given to analysts, investors or the media to provide updates on their recent financial performance do not contain inside information not otherwise already disclosed by the company in an announcement published on the HKEx website in both English and Chinese, to avoid selective disclosure or unequal dissemination of information.

## Guidance on Loans and Lending Activities

In its April 2024 Enforcement Bulletin, HKEx highlighted the importance of handling loans and lending activities effectively in light of the rise in loan-related misconduct among listed companies.

The bulletin calls on companies and directors to ensure strict compliance with the Listing Rules and identifies common red flags of poor lending decisions, such as questionable loan terms, excessive lending to connected parties and repeated renewal of loans on the same terms despite minimal or no repayment from borrowers.

The bulletin emphasizes that directors' duties include a thorough evaluation of lending activities. They should diligently assess and monitor lending activities to ensure that these activities align with due diligence standards and shareholder interests, and that the terms are fair and reasonable.

Issuers must establish and strictly adhere to robust internal control systems for managing credit risks, identifying the need for any impairment, and performing accurate internal and external reporting.

In addition, issuers are required to make timely disclosures in accordance with the Listing Rules and obtain shareholders' approval for material loans or loans made to connected parties.

HKEx reiterated that loan-related misconduct can risk investors' funds and corporate assets. To minimize such risks, directors should apply a questioning mind and exercise independent judgment throughout the different stages of loan arrangements, and ensure compliance with the Listing Rules.

HKEx will take enforcement action and impose sanctions against issuers and directors for misconduct related to loans and lending activities.

## Enforcement Matters

### HKEx Takes Disciplinary Action Against China Ecotourism and Its Directors for Problematic Lending Practices and Poor Governance

Directors of listed companies are responsible for safeguarding the company's interests and assets. This includes conducting proper due diligence and risk assessment prior to granting loans.

Recently, HKEx took disciplinary action against China Ecotourism Group Limited (formerly known as China LotSynergy Holdings Limited) and its directors for problematic lending practices and poor governance.

From 2014 to 2018, China Ecotourism issued loans totaling approximately HK$363 million and RMB 91 million to various corporate borrowers without conducting proper due diligence or credit risk assessment. The majority of these loans were unsecured, and all borrowers eventually defaulted.

During this period, repeated management representations were made to auditors that all loan receivables were fully recoverable. However, there was insufficient scrutiny of these representations, and the members of the audit committee should have questioned the representations to ensure the integrity of the company's financial statements.

By 2020, China Ecotourism had lost contact with most of the borrowers, resulting in significant financial losses and impairment charges. China Ecotourism later found that some loans had become connected transactions of the company.

Additionally, in 2018, a significant investment made by a subsidiary of China Ecotourism was mishandled. The investment funds were not paid to the vendor but to a third party, and the promised business developments did not materialize, resulting in a full impairment of the HK$35 million invested. The investment was not disclosed until two years later. It was found that part of the funds ended up in the personal account of a director's husband.

HKEx found that China Ecotourism did not have adequate internal controls and failed to ensure Listing Rules compliance. It censured the directors involved and required three of them to attend additional training. HKEx also issued a Prejudice to Investors' Interests Statement against three directors, indicating that their retention of office would have been prejudicial to the interests of investors.

Furthermore, HKEx directed an independent review of the company's internal controls.

### HKEx Censures a Former Director of Suchuang Gas for Failure To Disclose a Guarantee and Breach of Director Duties

Directors of listed companies must ensure that all material transactions, especially those involving significant financial exposure and risk, are promptly brought to the board's attention. Issuers must also maintain effective internal controls to ensure Listing Rules compliance.

In a recent disciplinary case, HKEx censured a former executive director of Suchuang Gas Corporation Limited who failed to disclose to the board a guarantee involving RMB 137.5 million that she arranged for a subsidiary of the company, which constituted a discloseable transaction that was not announced. The guarantee and subsequent transactions were only discovered later by the auditors, resulting in a substantial delay in the publication of the company's interim report.

HKEx censured the director and required her to undergo training on regulatory and legal compliance before she could serve as a director of any listed company in future.

### HKEx Takes Disciplinary Action Against Link Holdings and Two Former Directors for Failure To Discharge Directors' Duties and Handle Conflicts of Interest

Directors of listed companies are responsible for ensuring proper use of funds and compliance with the Listing Rules. If funds are raised for a stated purpose, and circumstances change, then this should be properly considered by the board, and investors should be informed of any proposed change in use.

Recently, HKEx took disciplinary action against Link Holdings Limited and two of its former directors. Link Holdings raised approximately HK$25 million of funds through issuing new convertible bonds, the proceeds of which were to be used to repay maturing bonds. However, the two former directors used the funds predominantly to settle shareholder loans provided by one of them, resulting in a default of the maturing bonds due to insufficient funds for redemption.

A conflict of interest arose as the payment involved the former director personally, and the directors are brothers-in-law. They also failed to disclose the change in use of funds, the default on the maturing bonds, and the conflict of interest to other board members and investors in a timely manner.

As a result, HKEx censured Link Holdings and the directors involved, and issued a Prejudice to Investors' Interests Statement against them, indicating that their retention of office would have been prejudicial to the interests of investors.

Additionally, HKEx directed an independent review of the company's internal controls.

### HKEx Censures Haisheng Juice and Its Directors for Compliance Failure for Major Transactions and Issue of Misleading Announcement

HKEx's recent action against China Haisheng Juice Holdings Co., Ltd. reminds directors of the importance of complying with the Listing Rules in major transactions and of their obligation to (i) provide accurate and complete information in a timely manner, and (ii) ensure the accuracy and completeness of the information contained in announcements.

In October 2021, Haisheng Juice announced that its subsidiary has entered into an agreement to dispose of an entity, which constituted a major transaction. The company completed the transaction after a week without obtaining shareholders' approval.

In November 2021, the company announced the steps to be taken to obtain the requisite shareholders' approval, but the announcement was considered misleading or deceptive, as it did not mention that the transaction had already been completed.

In December 2021, the company announced that the transaction was completed and that it would take remedial steps to seek shareholders' ratification. However, the announcement was once again determined to be misleading or deceptive, as the company was experiencing serious financial problems and therefore unable to pay the fees of intermediaries to provide Listing Rules compliance services to the company.

The company did not issue a circular nor seek approval from shareholders.

HKEx censured the company and five directors for failure to comply with the Listing Rules and failure to ensure the accuracy and completeness of the information in the announcements. The directors were ordered to attend further training.

# Hong Kong Regulatory Update

## HKEx Censures Former Directors of Enviro Energy for Failure To Manage Conflicts of Interest and Breach of Directors' Duties

HKEx's recent action against former directors of Enviro Energy International Holdings Ltd reminds directors to take active steps to manage conflicts of interest (including conflicts of other directors) and to keep the company informed of material information to ensure that the company can make timely and accurate disclosures as required under the Listing Rules.

From 2018 to 2019, the former chairman and the former CEO were involved in problematic transactions without the board's knowledge. They included entering into loan agreements that constituted major and connected transactions without complying with the Listing Rules requirements, and subsidiaries entering into a guarantee provided for the directors' personal benefit.

In additional, the former chairman engaged in the following misconduct from 2019 to 2020:

- Failed to disclose his history of prosecution in the People's Republic of China for suspected misappropriation of public funds, which is required to be disclosed under the Listing Rules.
- Transferred his shareholding as a result of the enforcement of a share charge. During the board meeting to discuss whether this information should be disclosed, he did not abstain from voting, despite the clear conflict of interest, but rather voted not to disclose.
- His directorship was suspended by the board after his prosecution was discovered, but he immediately caused the company to publish unauthorized and misleading announcements — including one to postpone the annual general meeting — resulting in the company having to take immediate action, including a suspension of trading to remedy the situation.

A former executive director and a former independent non-executive director were aware of the former chairman's conflict of interest in relation to the enforcement of the share charge but did not manage the situation. Instead, HKEx determined they blindly followed the former chairman's lead to vote for nondisclosure of the matter.

The directors were found to have breached their directors' duties by failing to:

- Avoid and manage conflicts of interest.
- Act for proper purpose and in the interests of the company as a whole.
- Cooperate in the investigation.

A director unsuitability statement was issued against the directors stating that they are not fit to occupy a position as director or within senior management of the company or any of its subsidiaries. A Prejudice to Investors' Interests Statement was also issued against one director that had he remained on the board of directors, his retention of office would have been prejudicial to the interests of investors.

## HKEx Criticizes Orient Victory and Its Chairman for Selective Disclosure

HKEx's recent action against Orient Victory Smart Urban Services and its chairman reminds directors that they should make timely disclosure of relevant information to the investing public and ensure equal dissemination of information.

Prior to two top-up placings of the company in 2019, the chairman disclosed to selected participants in online meetings that the controlling shareholder would give them one free additional share for every placing share they took up. However, the arrangement — notwithstanding its importance and nature — was not publicly disclosed by way of an announcement.

The HKEx criticized the chairman for his failure to take steps to procure the company's compliance with its disclosure obligations. He was further ordered to attend training covering regulatory and legal topics, and Listing Rule compliance.

## Court Disqualifies Changgang Dunxin's Former Director and CFO for Serious Misconduct in Concealing Misappropriation of Funds

The SFC has successfully obtained compensation and disqualification orders in the Court of First Instance against the former director and chief financial officer (CFO) of Changgang Dunxin Enterprise Company Limited.

The SFC found that the former CFO:

- Allowed proceeds of share and bond placements amounting to approximately HK$163 million to be misappropriated by the former chairman and executive director of the Company.
- Further concealed the misappropriation from the auditors, the audit committee and the board by providing falsified records purporting to show that the chairman had returned the net proceeds raised.
- Overstated the cash and bank balances in the financial statements.
- Provided false or misleading information regarding the intended use of the net proceeds in the share and bond placement announcements.

The former CFO was disqualified for 10 years from acting as a director, liquidator, receiver or manager, and from being involved in the management of any listed or unlisted corporation. He was also ordered to pay the SFC's costs in the proceedings, as well as a sum of HK$163 million with interest as compensation to the company.

## Recent Prosecutions Over Suspected Insider Dealing

The SFC recently announced developments in two cases concerning suspected insider dealing.

**Dan Form Holdings Company Limited.** The Market Misconduct Tribunal (**MMT**) is investigating the company secretary and three others over suspected insider dealing between 8 and 22 September 2016. Along with other entities, Dan Form made a joint announcement of a conditional agreement for another company to acquire a controlling interest of Dan Form from the then-chairman. The SFC alleges that, prior to issuance of the announcement, Dan Form's company secretary and the driver who provided services to the family members of the chairman of the acquirer possessed inside information regarding the acquisition. The company secretary allegedly counselled her relative, whilst the chairman's driver allegedly counselled his wife to purchase Dan Form shares. Upon disposing of their entire holdings, the parties profited HK$218,593 and HK$106,968, respectively.

**Segantii Capital Management Limited.** The SFC has commenced criminal proceedings in the Eastern Magistrates' Court against the company, its director and chief investment officer, and a former trader for insider dealing in the shares of a listed company prior to its block trade (a privately negotiated deal through investment banks executed off-market) in June 2017.

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.