

September 2017 Legal and Regulatory Update

Top stories

New COSO ERM Framework

The Committee of Sponsoring Organizations of the Treadway Commission (“COSO”) published a new framework - “**Enterprise Risk Management—Aligning Risk With Strategy and Performance**”, updating its widely-followed “Enterprise Risk Management (“ERM”) — Integrated Framework” (2004).

A key theme is to better “**integrate**” risk management. As reflected in the document title, risk management should be aligned with **strategy** and **performance**. It should also be **embedded throughout an organization**, including its governance, culture, decision-making, systems and processes.

Thus, the framework is written from the “**perspectives of businesses**” — its document structure and graphics are based on a “**business model**” approach, instead of being isolated risk process and concepts. Some concepts, like “**risk appetite**” and “**risk tolerance**” are also refined.

(Click: [COSO press release](#); (COSO site) [\(free\) executive summary](#); [\(free\) frequently asked questions](#); [purchase full document](#); [summary by PwC](#) (engaged by COSO in the update project)

What you should know:

- Introduces **5 “components”** to assist organizations in designing and implementing ERM practices (see **new COSO graphics**: [P.6, COSO executive summary](#)):
 - (i) **Governance and culture**
 - (ii) **Strategy and objective-setting**
 - (iii) **Performance**
 - (iv) **Review and revision**
 - (v) **Information, communication, and reporting**
- **20 key principles** under the 5 components ([P.7, COSO executive summary](#))
- The **2004 “ERM cube”** is replaced by **new graphics** based on the “business model”

- **Linking strategy** with risk management in 3 ways:
 - (i) Possibility of strategy not aligning with mission, vision, and values
 - (ii) Implications from strategy chosen
 - (iii) Risks in strategy execution
- **Internal controls are part of ERM.** This update has a **different focus and does not replace the separate framework on Internal Controls (2013)**

What you should do:

- COSO stated that it is **not mandatory to adopt** the updated framework. The 2004 framework can continue to be used, though COSO may retire it in the future ([P.3-4, frequently asked questions](#))
- COSO also acknowledged that it is **up to management to decide on “how” to implement** ([P.3, frequently asked questions](#))
- We regard **“integration”** as the key. It is important to focus on the **overarching principles**, instead of treating it as a technical checklist
- A compendium with case studies is expected to be published during Q4 — we shall provide further updates generally

Also in this issue

Regulators

(i) **SFC successfully obtained**, in the Court of First Instance, **disqualification orders** against the **former chairman/executive director (8 years)**, and **four current independent directors (ranging from 3-4 years)** of Hanergy Thin Film Power Group (the “Company”). (Under s.214, Securities and Futures Ordinance) (Click: [press release](#))

In addition, SFC also obtained a **court order** requiring the **former chairman** (being the controlling shareholder of such entities) to procure that the Company’s parent and/or affiliates pay all outstanding receivables due to the Company.

These actions followed SFC’s investigation into various very substantial connected transactions between the Company and its parent and/or affiliates since 2010. The Company relied on sales to these parties as a main source of revenue. In July 2015, SFC suspended the Company’s share trading.

What you should know:

- the **former Chairman's** breaches of directors' duties found to **be very serious**:
 - (i) **Serious conflicts of interest**: his position as chairman/ executive director of the Company, and ultimate controller of both the Company and its parent
 - (ii) Very **substantial amounts, and time** involved
- The **independent directors** found to be **incompetent**, as well as showing a marked indifference to their **directors' duties**:
 - (i) Failed to make appropriate disclosure as to the viability of the Company's business model, which **a reasonable director should have questioned**
 - (ii) Failed to properly assess the financial positions of the connected parties and hence the recoverability of the receivables due
 - (iii) Failed to take proper steps to recover these receivables, and so **did not act in the Company's best interest**
- For share trading resumption, SFC would require publication of a disclosure document with detailed information (on the Company, its activities, business, assets, liabilities, financial performance and prospects) to address SFC's concerns

What you should do/watch out for:

- SFC stated that it will continue to take action to **"hold listed company directors accountable for corporate misconduct"**
- SFC's active enforcement and use of various powers — including the power for mandatory suspension of share trading (Click: [our July 17 legal update](#), for SFC's **"early intervention" approach**)

(ii) **HKEX published two consultation papers** on (1) Capital Raisings by Listed Issuers and (2) Delisting and other Rule Amendments. (Click: [press release](#); consultation papers: [capital raisings](#); [delisting](#))

The first consultation seeks to address potential abuses related to **large scale deeply discounted capital raising activities**, including rights issues, open offers, specific mandate placings. The second consultation aims to improve the effectiveness of the delisting framework and address the issue of **prolonged suspension of trading** in listed securities. **These concerns have been addressed in our previous updates.**

What you should do/watch out for:

- The proposals should **not** affect genuine capital raisings
- Some key proposals:
 - (i) Prohibition of capital raisings with a **material value dilution (25%** or more within a rolling **12-month** period when aggregated)
 - (ii) Mandatory minority shareholders' approval for open offers
 - (iii) Specific proposals to address potential abuse where a **connected person acts as the underwriter** of rights issues and open offers
 - (iv) **Automatic delisting** for issuers where share trading has been suspended continuously for a prescribed period (proposed: 12,18, or 24 months)

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