

Jan 2018 Legal and Regulatory Update

Top stories

HKEX review: annual reports + annual review of Connected Transactions

HKEX published a **report** on its review of issuers' **annual reports for year 2016**.

Regarding “**annual review of continuing connected transactions**” by independent directors, HKEX gave very useful examples of internal controls procedures that should be in place, and the type of information that should be provided to independent directors for such review.

For **disclosure in annual reports**, recommendations in certain areas, like MD+A, auditors' modified opinions, were **similar to last year's**. (Click here: [press release](#), [full report](#), our [Jan 16 update](#) for last review)

What you should know:

HKEX's specific recommendations include:

- “**Business review**” in MD&A: a majority of companies inspected continued to give generic description; specific HKEX recommendations for:
 - (i) “**Principal risks and uncertainties**”
 - (ii) “**Environmental policies and compliance with relevant laws and regulations**”
 - (iii) “**Key relationships with employees, customers and suppliers**”
 - (iv) “**Financial key performance indicators**”
- Better disclosure of **significant securities investments in MD&A**: issuers with significant securities investments should note
- “**Continuing connected transactions**” (“CCTs”) (para 32-42)
 - (i) **Internal control procedures**
 - **Pricing policies** (specific and measurable) in relevant “framework agreements”
 - **Internal procedures of operating teams to ensure transactions are conducted in accordance with framework agreements and Listing Rules** (within annual cap; normal commercial terms; or multi-level/cross department internal approvals to ensure independent assessment)
 - (ii) **Review by internal audit and/or designated teams**
 - Assessment of appropriateness and effectiveness of **internal controls**
 - Regarding **underlying transactions** (e.g. sample checking of vouchers, quotations, invoices, receipts of transactions; **comparable price/market trend data**)

- (iii) **Information to independent directors** ((i) and (ii) above)
- **Financial statements with auditors' modified opinions** (P.3, para (b)) — issuers should also give shareholders progress update on remedial action plans

What you should do:

- Your forthcoming annual review of CCTs by independent directors — review your list of information to be provided
- Your forthcoming annual results announcement/annual reports — take into consideration HKEX's specific recommendations, e.g. for MD+A
- Better disclosure in periodic reports also **helps reduce the need to make “inside information” disclosure**. E.g. more detailed disclosure regarding “significant securities investments” means that investors already have more background information to assess the impact of market volatilities

Also in this issue

Regulators

SFC launched a three-month consultation on proposed amendments to the Codes on Takeovers and Mergers and Share Buy-backs. (Click: [press release](#), [Consultation](#))

These include raising the **independent shareholder approval** threshold for “**whitewash waivers**” from a simple majority to **75 %**. This is in line with the regulatory theme of combating “shell companies”.

It is also proposed to empower the Takeovers Panel to require compensation to be paid to shareholders who have suffered as a result of a breach of the Codes.

What you should know:

- Background: currently, SFC may waive (a “whitewash waiver”) an obligation to make a general offer if a change of control is achieved (among others) as a result of the issue of new shares, subject to a number of conditions including approval by independent shareholders

Legislation

(i) **The Companies (Amendment) Ordinance 2018** will become **effective on 1 March**. Companies incorporated in Hong Kong will need to maintain **beneficial ownership information** which may be **inspected by law enforcement officers**. As previously reported in our updates (Click: [June 17 legal update](#)), this reflects HK's **anti-money laundering** efforts in line with international standards.

There is a useful dedicated thematic section on the [Companies Registry's website](#), with [Guideline \(with sample register/notices\)](#), FQ+A, and CR filing form. Listed companies are exempted, but their HK-incorporated subsidiaries need to comply. The new measures are not expected to impose heavy burden for listed groups, as the identities of "significant controllers" of group companies should be known already.

What you should know/do:

- Scope: all companies formed and registered under the Companies Ordinance ("CO"), including companies limited by guarantee, unlimited companies, dormant companies, etc. **except listed companies**. It does not apply to foreign companies registered under the CO
- A natural person or specified entity (e.g. a corporation) has "**significant control**" over a company if one or more of these conditions are met:
 - holds, directly or indirectly, more than **25%** of its issued shares OR voting rights
 - holds, directly or indirectly, the right to appoint or remove a **majority of its directors**
 - has the right to exercise, or actually exercises, **significant influence or control**
 - has the right to exercise, or actually exercises, significant influence or control over the activities of a **trust or a firm that is not a legal person**, but whose trustees or members satisfy any of the above
- The company has to:
 - keep a "**Significant Controllers Register**" ("SCR") at its registered office or a prescribed place (for the latter case only- file CR Form to give notice of its location)
 - "**take reasonable steps**" to identify its significant controllers; if it knows or has reasonable cause to believe that a registrable person is a significant controller — give **notice** within 7 days and obtain the required particulars
 - such "reasonable steps" include reviewing documents readily available, like articles of association, shareholder agreements
 - enter the required particulars of its significant controllers in the SCR
 - keep such particulars in the SCR up-to-date
 - make the SCR available for **inspection by a "law enforcement officer"** (includes the Police, Inland Revenue, HK Monetary Authority, SFC, Companies Registry; see P.21 of the Guideline for a complete list)

- A company is not required to give the notices if it has been informed of a registrable person's status as its significant controller, and all required particulars have been provided

(ii) **The Financial Reporting Council (Amendment) Bill 2018** was gazetted. The Financial Reporting Council ("FRC"), a statutory body, is proposed to become HK's independent regulator with powers of investigation and discipline concerning auditors of listed companies. This will replace the current system of self-regulation by the Hong Kong Institute of Certified Public Accountants.

We shall monitor further developments, including funding arrangements and potential impact on listed companies. (Click: [press release](#))

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