

September 2019 Legal and Regulatory Update

Top stories

Two notable enforcement cases

(i) HKEX criticizes Yashili International Holdings Limited for repeated breaches of the Listing Rules, and raised concerns on internal controls. (Click: [Press release](#)).

The case relates to **delay** in announcing 7 “**connected transactions**” (“CTs”) during Jan-Aug 2017. The issuer previously received two “caution letters” (in 2014, 2017) of similar breaches.

There were **no evidence** as to (i) intentional/wilful concealment; (ii) the transactions not on normal, commercial and arms-length terms; and (iii) benefits for any board members.

It was highlighted that issuers committing **repeated breaches** should expect appropriate regulatory action. **Directors should take active steps to avoid such repeated breaches.** The lack of adequate **internal controls** was stressed.

Similar messages were also communicated in **HKEX’s latest enforcement newsletter.** (Click: our [Aug 19 Legal Update](#))

This case also cited **useful measures for monitoring “connected transactions”.**

What you should know:

- **Delay** in announcing 7 transactions; over 6-8 months in some cases
- Some transactions, when **aggregated**, would have required independent shareholder approval
- Some cases involved **subsidiaries**
- **Measures for monitoring** connected transactions/aggregation
 - Keep a list of connected persons
 - Identify CTs/Continuing CTs potentially subject to aggregation rules
 - Determine if the transactions gave rise to any Listing Rule implications
 - Monitor reporting of CTs at subsidiary level
 - (If necessary) escalate to board and/or senior management for consideration
 - Consult HKEX or professional advisers
 - Training and/or written procedural manual to those responsible for reporting CTs

What you should watch out for:

- **Repeated breaches** likely to lead to regulatory actions
- **Assess adequacy of your internal controls system** against the measures cited
- **Directors' duties to avoid breaches, including for internal controls**

(ii) SFC obtains disqualification order against former executive director of Life Healthcare Group Limited, for a period of 6 years. (Click: [Press release](#)).

The defendant director did not benefit from the misconduct, and admitted that she had little experience/expertise in managing financial matters of the company and had relied on the other executive directors.

What you should know:

- **Relevant misconduct**
 - Signed documents pledging company assets for loans (\$98m), without making enquiries
 - Approved grant of stock options, without enquiring grantees' financial ability to pay
 - Signed attendance sheets of board meetings approving an overseas acquisition by a subsidiary; subsequently found to involve undisclosed related persons
- **Breach of directors' duties**
 - Exercise **reasonable care and diligence** in the management of the company, to act in **good faith and in its best interests**, and to implement a sound and prudent **system of financial control** to minimise the risk of misappropriation of assets

What you should watch out for:

- The **high standard** expected in directors' duties, including making the necessary enquiries
- **Directors' duties** being an enforcement focus

Also in this issue

Regulators

HKEX updated "continuing obligations" rules

Effective 1 Oct 2019, some rules in this area are updated, as part of HKEX's **concluded consultation on backdoor listing, continuing listing criteria and other Rule amendments**. (Background: our [June 18 legal update](#); [July 19 legal update](#)).

HKEX also published new FAQs, Guidance Letters; and updated many related FAQs, Guidance Letters, and Listing Decisions.

Backdoor listings is not our focus area. We shall focus on refinements in “continuing obligations” that may affect issuers generally, notably “**Notifiable/Connected transactions**” and **annual report disclosure**. (Summary: items 15-20, Appendix 1, [HKEX Consultation Conclusions](#))

What you should know:

Summary of changes

- **(Notifiable Transactions) confine “revenue” exemption for securities transactions**
Only where they are conducted by **banking companies, insurance companies and securities houses** within the **issuer’s group** (Also read [FAQ 057-2019](#))
- Disclose in **annual reports details** of each **securities investment** representing **5%** or more of **total assets**
- **Notifiable (“NT”) / Connected Transactions (“CTs”) disclosure**
 - Subsequent change/ outcome of any **financial performance guarantee** of a target acquired by the issuer
 - (NTs) **identities of both** parties, in announcements /circulars
 - (CTs) **identities and activities of both** parties; **ultimate beneficial owners** in announcements
- New FAQ for **H-share issuers** whose **domestic shares** are quoted on the National Equities Exchange and Quotations (**NEEQ**) (Also read [FAQ 068-2019 to 069-2019](#))

What you should do:

- Issuers with **substantial securities investment** should note the confined “revenue” exemption
- Update your internal checklists

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