

# Nov/Dec 2020 Legal and Regulatory Update

## Top stories

### (i) HKEX review: corporate governance disclosure

HKEX published its latest review of issuers' corporate governance reports **for financial year ended between Jan to Dec 2019**. ([Press release](#); [full report](#))

It focuses on (i) **re-election** of independent non-executive directors (“INEDs”) who **served more than nine years**, (ii) election of **overboarding INEDs** (*i.e. holding their 7th or more directorship*), and (iii) **board diversity, nomination of and selection criteria** for directors.

In terms of the “technical” compliance with the relevant Code Provisions, there is a high degree and improving compliance. One of the “least complied” areas is the separation of chairman and chief executive roles.

In its press release, HKEX stressed that a **strong independent element**, INED’s availability/**time commitment** and **board diversity** are all crucial to an effective board. The report suggests improvement areas in these themes.

It is noteworthy that HKEX is currently conducting a review of the **corporate governance framework** and expects to put forward **proposals for public consultation**.

#### *What you should know:*

- **Long-serving INEDs** (*para 29, P.7*)
  - Some **common explanations rejected**
  - E.g. cite satisfying **Rule 3.13 independence** criteria; which do not address mindset issues
  - **Should balance the benefit** of having long-serving INEDs
  - Against their **ability to stay independent**, and the **necessity of board refreshment / succession planning**
  - Should demonstrate the **rigour** and **transparency** of the **nomination process**
  - E.g. from **identifying** candidates; how they can bring **fresh perspectives** despite long tenure; how **succession planning** ensured; and the board’s **evaluation**
- **“Overboarding”** (*para 36, P.8*)
  - Some common **explanations rejected**

- E.g. citing good attendance (*but INEDs should be **fully engaged**, both inside and outside the boardroom*)
- Should provide **details** of the **board’s assessment**, including **balancing various factors**
- **Board diversity** (*para 46, P.10*)
  - Should set “**measurable objectives**” so that shareholders can **track progress**
  - **Information on development of a diverse pipeline for succession**
  - E.g. programmes to prepare selected employees for senior management/board positions

*What you should do:*

- Your forthcoming **corporate governance report** — note HKEX specific disclosure suggestions summarised above
- In anticipation of **HKEX’s forthcoming consultation proposals**, should note its continuing focus on **board independence**, **INED time commitment**, and **board diversity**

(ii) [HKEX’s latest Listed Issuer Regulation Newsletter](#) covers **various themes relevant to listed issuers**, e.g. further guidance on the disclosure of counterparties in transactions. In particular, it addresses **planning for the upcoming financial year-end amidst Covid-19**.

There is a useful reminder of various planning aspects (*P.7*), including **audit committee**, communications with **auditors and valuers**, and **disclosure in annual reports**.

*What you should know/do:*

- **Audit committee**
  - Review **internal control on financial reporting systems** to ensure adequacy
  - **Proactively** discuss with **management/auditors** the plan for the upcoming audit
  - Ensure **sufficient resources**: both issuer and auditors
- **Audit planning process**
  - Discuss with auditors as to **significant accounting matters**
- **Engage professional parties (e.g. valuers)** at the earliest instance; discuss plans + timetable
- Special points for **companies anticipating audit issues**
- Covid 19 **disclosure in annual reports**
  - **Qualitative** disclosures: effect on **operations; risks** for future performance

- **Quantitative: financial impact**
- **Liquidity** positions, **working capital** sufficiency, **capital commitments**
- **Actions:** e.g. cost control, funding and business plans

## Other Stories

### Legislation

(i) **The Competition Commission** filed a case in the **Competition Tribunal** against Linde GmbH and a group company, for “**abusing its substantial degree of market power**” in the **HK medical gases supply market** to the detriment of competition in the (“*downstream*”) medical gas pipeline system maintenance market. ([Press release](#))

This is the **first case brought under the “Second Conduct” rule**, as regards abuse of substantial market power.

It is alleged that (*between Oct 15 and Jan18*) Linde ceased/ limited supply of medical gases, which are essential inputs, to the only other medical gas maintenance service provider. E.g. by denying supply of medical gases, imposition of arbitrary/unreasonable terms so that the provider could not compete/perform such maintenance contracts. These **harmed competition and affected the interest of the consumers**, which are mostly **public hospitals in HK**.

#### *What you should watch out for:*

- “**Second Conduct Rule**” means — businesses with a **substantial degree of market power abuse that power** to prevent, restrict or distort competition in Hong Kong
- Previous cases concern the “**First Conduct Rule**” (parties “acting together with an **agreement**, and/or engaged in a **concerted practice**”)
- **Case triggered by a public complaint**, which channel is encouraged by the Competition Commission

### Regulators

#### (i) **New HKEX case on notifiable transactions**

HKEX’s Listing Committee criticised Wai Chi Holdings Company Limited, for breach of Listing Rule “**notifiable transactions**” announcement/shareholder approval requirements; and

an executive director (*who approved the transactions without board knowledge*) for breach of directors' undertaking. ([Press release](#))

It involved the subscription of 5 “**wealth management products**” (*namely index or asset linked deposits*) between Sept and Dec 2018. The total amount involved was around HK\$153m, being 9.8 % of the company total assets as at 2018 year-end.

These were NOT pure time deposits. They were classified as “**financial assets at fair value through profit or loss**” in the company's 2018 annual results, not as “bank balances and cash”.

A majority of these investments constituted a discloseable transaction. Additionally, **when aggregated**, subscriptions made in Dec 2018 constituted a “major transaction”, for which shareholder approval was needed. The other subscriptions made in Sept 2018 in aggregate constituted a “discloseable transaction”.

### ***What you should know/watch out for:***

- **Broad interpretation** of “transactions” (*Chapter 14*)
- **HKEX cited its guidance materials** on the acquisition of wealth management products
  - E.g. its Enforcement Newsletter, July 2018
- Application of “**aggregation**” principle

**(ii) HKEX published its Enforcement Bulletin**, featuring articles relevant to Listing Rule compliance and updates on its enforcement work. ([Report](#))

This issue addresses **director onboarding and continuing education**, and highlights some **enforcement cases** during 2020.

Some notable cases involving **breach of directors' duties**, namely in **acquisitions** ([Asia Resources case/ Jan 20](#); [Champion Technology case/ Apr 2020](#)), **loan transactions** ([Kong Sun case/ May 2020](#)) were also addressed in **our previous legal updates**.

**(iii) HKEX published a [FAQ](#) on calculation of adjustments in stock options** in light of corporate transactions like rights issue. The **overriding Listing Rule principle** is that no adjustments to the exercise price or number of shares should be made to the advantage of scheme participants without specific prior shareholder approval. It gave an **example** on adjustment calculations for a rights issue.

**(iv) HKEX published consultation conclusions on proposals to introduce a paperless listing and subscription regime, online display of documents and a reduction of the types of documents on display.** ([Press release](#); [full report](#))

Our focus is on listed issuers' **continuing obligations**; relevant proposals as summarised below:

Firstly, the current requirement for certain documents to be put on **physical display** will be replaced with a requirement for those documents to be **published online**. i.e. on HKEX's and the issuer's website. (e.g. *relevant contracts and valuation reports for "notifiable/connected transactions"*)

Secondly, **types of documents** that are mandatory to put on **display** for "**notifiable transactions**" and "**connected transactions**" will be **reduced**. (e.g. *no longer required: all material contracts entered into during the past 2 years, not directly related to the transactions*).

These proposals will become **effective on 4 Oct 2021**.

**(v) SFC launched a consultation on proposals to introduce investor identification** for the securities market in Hong Kong. ([Press release](#); [full document](#))

As proposed, licensed corporations and registered institutions would submit clients' names and identity document information to a data repository. This will allow **SFC to identify investors who place securities orders**. The proposed investor identification measures aim to make SFC's **market supervision** more robust and promote investor confidence which is essential for HK as a premier international financial centre.

**(vi) The Office of the Privacy Commissioner for Personal Data** issued 3 Guidance Notes under the series "**Protecting Personal Data under Work-from-Home Arrangements**". ([Press release](#))

They provide practical advice to (1) [employers](#); (2) [employees](#); and (3) [users of video conferencing software](#), to enhance data security and the protection of personal data privacy.

**Published by Practising Governance Limited**

**January 2021**