

# Feb 19 Legal and Regulatory Update

## Top stories

**Latest SFC Regulatory Bulletin: “front-loaded” approach** (Click: [press release](#); [full report](#))

Useful cases illustrate how the SFC **intervenes at an early stage** (“front-loaded” approach), where it has serious concerns about IPO applications or post-IPO corporate transactions.

We focus on the post-IPO cases. SFC is devoting more resources to transactions which appear to be **“oppressive or unfairly prejudicial” to shareholders**, or where fraud/other serious misconduct is suspected.

**Directors** are reminded to **act in good faith in the interests of the company** and **exercise due and reasonable care, skill and diligence** when **evaluating, proposing or approving corporate transactions**. Directors have a **duty to exercise their own judgement** and should not **“over-rely” on third party opinions or advice**.

**SFC tools** used are also noteworthy — including exercising its **power to require production of books and records** under specified circumstances (**s.179**, Securities and Futures Ordinance); issuing **“letter of concern”**.

### *What you should know:*

Noteworthy post-IPO cases:

- **Post-IPO cases 1 and 2 (P. 2): valuation in acquisitions**
  - Both cases: proposed acquisitions
  - Case 1
    - (i) target engaged in research and development for the use of artificial intelligence; no revenue, loss making
    - (ii) **SFC** concerned whether acquisition was “fair and reasonable”; issued **“s.179 enquiries”**
    - (iii) findings: vendor related to chairman; **no independent financial advice or valuation** obtained
  - Case 2
    - (i) target: loss-making; producing robotics
    - (ii) vendor provided a profit guarantee

- (iii) **SFC issued “s.179 enquiries”**
  - (iv) findings: **material issues with draft valuation report** on target, **cash flow forecast report**
  - (v) company unable to give explanations for basis and assumptions used to determine target’s projected revenue, profit margin, and valuation
  - In both cases, **SFC issued a letter of concern** requesting an explanation
  - Neither company addressed the concerns; deals lapsed
- **Post-IPO case 4 (P. 3): rationale of acquisition**
    - (i) Proposed acquisition of interest in a target involved in financial leasing
    - (ii) Target: one-year old; only minimal revenue; only conducted business with vendor
    - (iii) **SFC issued “s.179 enquiries”**; concerned that transaction might be **“unfairly prejudicial” to shareholders**
    - (iv) Requested company to **explain rationale of acquisition**: low entry barrier in financial leasing industry, could have directly solicited business organically
    - (v) Company did not address the concerns and announced termination of deal

*What you should do/watch out for:*

- **SFC focus on “fair and reasonable valuation” in transactions**, and the otherwise adverse impact on public shareholders
- Reference to [SFC Guidance Note](#). Higher expectations on **boards’ role in valuations**, including the need to obtain **independent valuation reports, and exercise judgment in reviewing the underlying assumptions etc.** (Click: our [May 17 legal update](#))

## Also in this issue

### Regulators

- (i) **HKEX published consultation conclusions on “Proposed changes to documentary requirements relating to listed issuers and other minor Rule amendments”**. (Click: [full report](#); [press release](#)). The proposed changes, effective 1 March 19, aim to simplify and streamline administrative procedures in the submission of documents, to enhance efficiency. There are no changes in policy direction.

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

- **Company Secretaries** should watch out for the proposed simplified procedures
  - For details in Listing Rules changes: Appendix I of full document
  - [Revised checklists and forms](#)
- Declaration and undertaking by directors (for PRC companies) supervisors (Forms B, H, I of Appendix 5)
  - Require (by 31 March) submission of personal details by directors/supervisors (e.g. mobile telephone number); grant HKEX the power to gather information from supervisors
  - Disclosure of former names/alias of directors in appointment announcements
  - [New FAQ](#)
- Issue of securities: simplified filings
  - (E.g.) abolish listed issuer's declaration (Form F, Appendix 5) and submission of board resolutions
  - Instead, the issuer to make a confirmation in the relevant next day disclosure return and/or monthly return, as to proper authorization, and satisfaction of applicable conditions
- Remove filing requirements for (i) documents that are submitted to HKEX for record only; and (ii) documents whose contents are already disclosed to the public
- Other minor amendments (e.g. reflect updated accounting terminology) and housekeeping amendments

**(ii) HKEX updated and withdrew some FAQs, Guidance Letters, and Listing Decisions** as a result of the proposed changes to documentary requirements summarized in (i) above.

- [FAQ Series 8](#)
- [GL 58-13/ GL66-13/ GL95-18](#)
- [LD 74-1/ LD112-1/ LD6-2011/ LD114-2017](#)

It also updated [FAQ](#) in light of updates in accounting terminology.

## Legislation

[The Financial Reporting Council \(Amendment\) Ordinance 2019](#) was enacted by the Legislative Council, to become effective on a date to be announced. The Financial Reporting Council (“FRC”), a statutory body, will 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 potential impact on listed companies. (Click: [press release](#))

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