

June 2021 Legal and Regulatory Update

Top stories: directors' duties

Notable HKEX enforcement cases reflect recurring themes on **directors' duties**, adequacy of **internal controls** in different context: **disposals**; **financial assistance**.

(A) *[Disposal]* Listing decision on Alltronics Holdings Limited and named directors (*executive, non-executive, independent*) ([Press release](#); [Statement of Disciplinary Action](#))

The company intended to **dispose** of a subsidiary for RMB100m, and obtained **independent shareholder approval** as required under the Listing Rules (*“very substantial disposal and connected transaction”*). Disposal terms included the repayment of debt owed by the subsidiary according to an agreed time schedule.

The purchaser was unable to meet the payment schedule. The company agreed to **extend the time**, and proceeded with **completion** of the disposal **without seeking independent shareholder approval** again.

What you should watch out for:

The company breached **Listing Rules**, which require **“re-compliance”** including obtaining independent shareholder approval for **material variations of terms previously announced**. (*Rules 14.36 and 14A.35*)

The directors breached **directors' duties and undertakings** given failure to: (i) conduct sufficient **due diligence** on the financial capability of the payment obligors before allowing time extension and completion; (ii) use their best endeavours to procure the company's **Listing Rule compliance**.

(B) *[Financial assistance + prepayments]* Listing decision on Tenwow International Holdings Limited and named directors (*executive, non-executive, independent*) ([Press release](#); [Statement of Disciplinary Action](#))

The company discovered some abnormal transactions including:

- (i) **financial assistance** — entered into a **credit line agreement with a bank**, allowing utilization by a company connected with (*then*) chairman and CEO (*up to RMB340m; hence a “connected transaction”*)
- (ii) **prepayments to suppliers (RMB1.7b)** — not conforming to relevant policies/ procedures; or where prepayment was not required

The company was found liable for lacking **adequate and effective internal controls**. The **directors** breached their **duties** and **directors' undertakings**, for failing to use their best endeavours to ensure that the company had **adequate and effective internal controls**.

What you should do/watch out for:

Internal controls deficiencies + failure in directors' duties *include*

- **Combined CEO and chairman role**
 - No clear **division of responsibilities** re: management of the board and day-to-day management of business; unfettered power over decision-making
 - No or insufficient **segregation of duties**; no proper **checks and balances**, to help ensure **policies/procedures** be followed, and **non-compliance identified/followed up**
- **Internal audit: lacked independence; inadequately resourced**
 - Only one employee who reported to senior management, resulting in certain transactions being excluded from audit scope
- **Policies and procedures not properly implemented, reviewed and updated, or were deficient**
 - E.g. policies re: company chops, provision of credit to third parties and related parties not strictly followed

Hot Trends

- Optimizing the Virtual Boardroom: A Guide to Planning and Executing Virtual Board Meetings (Nasdaq)

Useful ideas include:

- **Build a “virtual board table”**
- **“Virtual” seating arrangements?**
- **Meeting day glitches**
- **Safeguard confidentiality**

[Read more](#) **Practical! Actionable!**

Also in this issue

Regulators

(i) New HKEX case on “notifiable transactions”

HKEX Listing Committee censured IntelliCentrics Global Holdings Limited, for breach of “**notifiable transactions**” and “**advance to entities**” announcement/shareholder approval requirements; and named executive directors for breach of directors’ undertakings. ([Press release](#); [Statement of Disciplinary Action](#))

The company used part of its IPO proceeds (*US\$55m*) to acquire promissory notes issued by offshore private companies. These constitute “**major transactions**” (“*notifiable transactions*”, *Chapter 14*) and “**advances to entities**” (*Chapter 13*).

Issuers are reminded that acquisitions of promissory notes, as well as other **wealth management products**, are generally regarded as “**transactions**” for the purposes of the Listing Rules, even if they are **issued by licensed banks or authorised financial institutions**.

What you should know/watch out for:

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

(ii) HKEX published updated [FAQ 075-2021](#) re: on-line display of documents

It clarifies some practical issues under the new regime:

- E.g. duration of online display period
- E.g. if some documents on display contain sensitive information and issuers do not want such information be made public, they may apply for a specific relief (*to be considered by HKEX on a case-by-case basis*)

Legislation

Subsidiary legislation for implementing a new inspection regime under the Companies Ordinance was gazetted, to be followed by negative vetting by the Legislative Council. ([Press Release](#))

(Background: the Companies Ordinance (*passed in 2012*) contains provisions that the Companies Register (the “Register”) of the Companies Registry (“CR”) is to make available for public inspection **correspondence addresses** of directors instead of **usual residential addresses** (“URAs”), and **partial identification numbers** (“IDNs”) of directors/company secretaries/other relevant persons in place of full IDNs, but have not commenced. The above subsidiary legislation are made to implement the new inspection regime).

The Government has reviewed the situation and considered it appropriate to implement the new inspection regime, with a view to enhancing protection of personal information while ensuring that the public could continue to inspect the Register.

The new system will be implemented **in phases**, and "**Specified Persons**" may access the protected information.

What you should know/watch out for:

- **“Specified Persons”**: data subjects and their authorised persons; members of the company; public officers, public bodies and persons/organisations who need to use such information for statutory functions; lawyers practising in law firms and practising accountants; banks; and financial institutions and designated non-financial businesses and professions regulated under the Anti-Money Laundering and Counter-Terrorist Financing Ordinance
- **Phases**
 - **Phase 1 (from 23 Aug, 2021): companies may replace**, for public inspection on **their own registers**
 - (i) **URAs of directors** with their **correspondence addresses**
 - (ii) **full IDNs of directors and company secretaries** with **partial IDNs**
 - **Phase 2 (from 24 Oct, 2022):**
 - (i) protected information on the **index of directors on the Register** will be **replaced** with **correspondence addresses** and **partial IDNs** for **public inspection**
 - (ii) protected information contained in documents **filed after commencement** of this phase will **NOT** be available for **public inspection**
 - (iii) **“Specified Persons” could apply** to the CR for access

- **Phase 3** (*from 27 Dec, 2023*):
 - (i) **data subjects could apply** to the CR for protecting from public inspection their protected information in documents **filed before commencement of Phase 2**, and replace the same with correspondence addresses and partial IDNs
 - (ii) **“Specified Persons” could apply for access**

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