

July 2021 Legal and Regulatory Update

Top stories: new HKEX enforcement policy

HKEX published revised [Enforcement Policy Statement](#) and [Enforcement Sanctions Statement](#), which have come into effect. In addition to the [press release](#), HKEX's latest [Enforcement Bulletin](#) also elaborates on the new statements.

By way of background, the Enforcement Bulletin noted that there was a **notable rise in disciplinary cases** during 1H 2021.

The **Enforcement Policy Statement** sets out HKEX's **latest enforcement priorities**, namely the **3 concepts of responsibility, controls and culture**, and **cooperation**. HKEX takes a broader approach, and these priority concepts will replace the enforcement themes in place since 2017. It is also important to note that **“culture” goes beyond controls**.

The press release explains that the new priorities reflect HKEX's **focus on individuals**, and the critical importance of **proactivity** and **vigilance**. Having both the **right attitude** and **framework** towards Listing Rule compliance is essential for good corporate governance.

The **Sanctions Statement** sets out the **general principles and factors** in determining sanctions. It has been updated to reflect the new enforcement policy, and revised disciplinary regime (*effective from 3 July 2021; read our [May legal update](#)*). For instance, the **list of factors** (*P.1, para 6*) elaborates on some new enforcement priorities, notably **culture, controls, and cooperation**.

What you should know:

New Enforcement Priorities

- **“Responsibility”**
 - **Directors’ primary responsibility** (*under companies’ law, Listing Rules, HKEX Directors’ Undertaking*)
 - **Collective and individual responsibility** (*executive + non-executive directors*)
 - **Non-executive directors** (*including independent directors*) must take an **active interest** and **follow up** anything untoward
 - Despite **“delegation”**, directors have a **continuing supervisory role**
 - **Professional advice** - should apply an **enquiring mind** using own wisdom, experience and independent judgement
 - **Senior management** also responsible

- **Controls and culture**
 - (As a *minimum*) adequate and effective **internal controls + risk management**
 - **Regular review** of such systems
 - “**Culture**”: **attitude towards compliance + corporate governance**
 - E.g. HKEX will consider if directors/ staff are **informed, competent, and kept up to date** via **ongoing training and professional development**
 - **Directors, senior management**, and those with a **responsibility for compliance** should **keep abreast of Listing Rules changes** through **regular training**
 - Regular **director briefings** on **business/operations**
 - Expect **documentary evidence** of steps taken to discharge (*individual/corporate*) duties
- **Cooperation**

What you should do/watch out for:

- **Update your board and senior management** on the developments
- **Directors’ duties**
 - Reinforces themes of taking an “**active interest**” in company; continuing supervisory role **despite “delegation”**; apply an “enquiring mind” re: **professional advice**
- **Senior management responsibility**
- **Internal controls + risk management systems**
 - Assess your compliance-related systems
 - E.g. regular updates
- **Culture**
 - **Beyond adequate controls** (*which are a minimum only*)
 - Implement necessary actions e.g. **regular briefings/training on Listing Rule changes** to **directors/senior management/those responsible** for compliance
- **Keep documentary evidence of steps in place**
- **Co-operate in investigations**
- While the **3 new enforcement priorities** reflect a **broader HKEX approach**, ensuring compliance with **specific procedural requirements** (e.g. “*notifiable and “connected transactions”*”) **remain important**

Also in this issue

Regulators

Listing decision on Longrun Tea Group Limited and its current directors. ([Press release](#); [Statement of Disciplinary Action](#))

Two named executive directors (“EDs”) procured the company’s subsidiary to enter into a **loan agreement** with a borrower (around RMB 140m), **without informing the two boards**. Loan proceeds were transferred to a **supplier owned** by the 2 EDs. The loan constituted a **major and connected transaction**. The company failed to comply with the **procedural requirements** (*announcement; independent shareholder approval, etc.*).

The **directors** failed to ensure the company had an **adequate and effective internal controls system** to procure its **Listing Rule compliance** regarding the loan, and to protect the interests of the company and its shareholders. There were also findings of inaccuracy and delay in relation to the company’s **financial results**.

HKEX also made a **public statement** that in its opinion, by reason of the two EDs’ persistent and/or wilful failure to discharge their responsibilities under the Listing Rules, their “**retention of office is prejudicial to the interests of investors**”. (*Note: “persistent and/or wilful failure” is no longer required under the new disciplinary regime for this sanction.*)

What you should know/watch out for:

Breaches by all directors

- No effective system in place for the senior management to **declare their material interests in transactions** with the group
- (*For audit purposes*) **auditors advised the audit committee and/or the board** to undertake a forensic investigation
 - instead of “agreed-upon-procedures” (“AUP”)
 - to involve the auditors in settling the scope
- The company only engaged consultants to perform AUP, **without involving the auditors** in settling its scope.

Legislation

The Competition Commission published an [Advisory Bulletin](#) to advise on the potential risks under the Competition Ordinance related to the membership admission criteria and procedures of trade associations. [FQ+As](#) were also issued. ([Press release](#))

The bulletin applies to **all trade, sporting, professional and industry associations or bodies** and their **members** in Hong Kong. Where membership of a trade association is an essential pre-condition for competing in a market, exclusion from membership can significantly impact an undertaking's effectiveness as a competitor.

The Commission's **Guideline on the First Conduct Rule** sets out that the rules for admission to membership should be: **transparent; proportionate; non-discriminatory**; based on **objective standards**; and subject to **appeal**.

The FQ+As are useful and provide some scenarios to illustrate these principles.

The Commission **calls on all trade associations to actively review their admission practices** in accordance with the guidance and to **make changes** where needed to ensure compliance with the Ordinance.

Published by Practising Governance Limited

August 2021