

# May/June 2023 Legal and Regulatory Update

## Top stories

### HKEX Listed Issuer Newsletter; new global ISSB sustainability standards

(i) HKEX published its latest [Listed Issuer Newsletter](#), with useful observations on **disclosure of business valuations in transactions**, and **compliance with new Listing Rules on share schemes**. It also addresses issues relating to change in auditors.

**Firstly**, as regards **disclosure of business valuation in transactions**:

*(Background: in a “notifiable transaction”, issuers are required to disclose the basis for the consideration and the terms of the transaction. Under [FAQ Series 7 No. 21](#), where the valuation of a target is a primary factor in forming the basis for the consideration or other material terms, **disclosure of the valuation** would need to be made in the announcement/circular).*

HKEX **observed** that valuation disclosure in some issuer documents fell short of information “necessary for investors to understand the **underlying valuation methods and assumptions, bases** for adopting them, and **how the valued amount was derived**”. **Useful guidance and examples** are given.

**Secondly**, as regards **compliance with new rules on share schemes**:

*(Background: amended rules on (a) “12-month vesting period” (unless justified; see [FAQ No. 092-2022](#) for examples; (b) description of performance targets).*

HKEX’s observed **pitfalls** include **generic description**.

### **What you should know/do:**

**HKEX observations and guidance:**

#### **Disclosure on valuation**

- **Selection of valuation methods**
  - Describe the selected **valuation models** and explain why they are selected, in particular why the methods were **appropriate** for the transactions/target company
  - E.g. use of “**discounted cash flows**” **method** to value a start-up target company
  - Should explain how it is **appropriate** in the absence of a historical track record to substantiate the forecasts

- **More than one valuation method** is used: disclose the process in analysing the values derived from different valuation methods

- **Valuation assumptions and inputs**

- Explain these with **detail** and in **specific terms**
- E.g. “**market approach valuation**”: criteria and process for selecting comparable companies; why the selected market comparables are appropriate

### **Compliance with new rules on share schemes**

- **Examples of generic justification**

- E.g. (*justification for shorter vesting period*) “any circumstances as the board at the time of grant”: lacked **specific criterion**

(ii) [ISSB \(The International Sustainability Standards Board\) issued new global standards](#)

(IFRS S1 and IFRS S2), which create a global baseline of sustainability-related disclosures. **HKEX** had already issued a consultation paper to revise its ESG framework aligning with this.

(See our [April legal update](#))

## **Hot Trends**

### *Nasdaq*

### *2023 ESG & Climate Survey*

What you should note:

- Most widely- followed ESG ratings/rankings
- ESG team partners most with finance function
- Enhanced disclosure: data collection as key challenge
- Digitalisation strategy and trends

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## Also in this issue

### Regulators

#### (i) Notable HKEX enforcement cases

**(A) (New money lending business) HKEX imposes a Director Unsuitability Statement against 4 former executive directors of Arta Techfin Corporation Limited.**

[\(Announcement\)](#); [Statement of Disciplinary Action](#))

During 9 months (*Jul 2017 to Apr 2018*), the company (*through its **wholly-owned subsidiary***) **significantly expanded its money lending business** and granted loans in the total amount of \$2.28 billion. The borrowers defaulted on the loans and significant impairment losses were incurred by the company.

HKEX was concerned as to the **commercial rationale** of granting such loans. All loans were unsecured, the majority of the borrowers were based in the PRC, and over 93% of the loans were paid to third party nominees. Despite the fact that the loans which matured in Jan and Mar 2018 went into default, the company continued to grant more loans.

There were **limited or minimal level of discussions** or considerations among the relevant directors regarding the **expansion of money lending business, due diligence and credit assessments** on the borrowers/loans, and **monitoring** of the status of the loans.

**Directors** must fulfil their **fiduciary duties** and apply a **reasonable level of skill, care and diligence**. They are expected to **critically assess the commercial rationale** for the business, and to play an **active role in safeguarding the assets of the issuer**.

The fact that one is **not a director of the subsidiary** does **not absolve** him / her from the **collective responsibility to safeguard the assets of the group**.

**HKEX's announcement** states **useful lessons learnt for entry/expansion of a business** (*summarised below*).

#### **What you should know/do:**

- **Entry into or expansion** of a business, particularly one which is **high risk**, must be **properly considered by the board**
- **For money lending business**
  - Proper steps to **assess and manage the exposure** to the issuer
  - E.g. **due diligence, thorough analysis of the risks, ongoing oversight** of loan portfolio
  - **Comprehensive records** of these steps must be kept

**(B) (Conflicts of interest) HKEX criticises a non-executive director of Agile Group Holdings Limited** for failing to disclose his interests in his son's competing business. ([Announcement; Statement of Disciplinary Action](#))

Before the company was listed, each member of the founding family, including the director, undertook not to be interested or involved in any business that would likely compete with the company group.

In late 2013, the director **personally provided initial funding** of \$180M to his son to set up his own property development business in China. Between 2014 – 19, he **provided** nearly \$2 billion **funding and financial guarantees** for his son's business. **The son's business potentially competed with that of the company.** He also **acted as a director of companies** within his son's group.

**Throughout that time**, the director did **not disclose** to the board **his interests** in, and **financial support** to, his son's business. This included a failure to disclose when the company considered and ultimately entered into a release of the family members from the non-competition undertaking.

**HKEX's announcement** states **useful lessons learnt for conflicts of interest** (*summarised below*).

***What you should know/do:***

- **Proper handling of potential conflicts of interest** is a fundamental element of good corporate governance
- Directors are under **broad-ranging obligations to avoid or transparently manage** even an **indirect risk of conflict**
- Directors should ensure they are **fully aware of the expectations** on them regarding **potential conflicts of interest**
- Directors should **make open and early disclosure** of anything which **might be considered a conflict**, even if the **possibility of an actual conflict is considered remote**

(ii) HKEX published consultation conclusions on proposed expansion of its paperless listing regime ([Press release](#), [Consultation conclusions](#))

*(Background: for a summary of consultation proposals, see our [Dec 22 legal update](#)).*

**HKEX will adopt the 3 key proposals** with a number of minor modifications. Most new requirements are to take effect on **31 Dec 2023** (“effective date”), with **transitional arrangements**. *(For details, see para 8, P.4 of consultation conclusions)*

**Firstly, the number of documents required to be submitted** to HKEX will be reduced, with **mandatory submission by electronic means**. E.g. by “**codifying**” obligations currently contained in various undertakings *(e.g. directors’ undertaking in DU Form)*.

**Secondly, mandatory electronic dissemination of corporate communications** to securities holders by listed issuers, to the extent **permitted by the laws and regulations** applicable to them and their **constitutional documents**.

If permitted by applicable laws, issuers should **check** if their **constitutional documents contain any restriction**. If so, they need to **amend** the same **by the first annual general meeting** following the effective date.

For **issuers incorporated in HK**, **HK Companies Ordinance does not currently permit shareholders’ consent to be “implied” for receiving communications by electronic means**. **HKEX** stated that it **will work with relevant parties** to consider the issue of implied consent for the corporate communications of Hong Kong-incorporated listed issuers.

However, **issuers must still send “Actionable Corporate Communications”** *(definition refined, see below)* to securities holders **individually in electronic form**, or *(where email details not provided)* by **hard copy**. **HKEX will provide a list of items** on what constitutes the same *(e.g. provisional allotment letter in connection with a rights issue)*.

**Thirdly, Listing Rule appendices will be simplified**. E.g. by moving fee-related appendices to HKEX website.

### **What you should know:**

#### **Definition of “Actionable Corporate Communications”**

- *Any corporate communication that seeks instructions from issuer’s securities holders on how they wish to exercise their rights or make an election as the issuer’s securities holders*

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