



Enforcement Bulletin

Welcome to the March 2023 edition of HKEX's Enforcement Bulletin. This bulletin covers our latest learnings and actions from our enforcement work to keep listed issuers, directors and others involved in Listing Rules compliance abreast of important developments.

In this edition of the Enforcement Bulletin, we focus on the important topic of good disclosures. Accurate and meaningful disclosures are an essential part of providing investors with the information they need, and ensuring a high-quality, fair, and orderly market.

Listing Rule 2.13 sets out the Exchange's expectations on the presentation of information. This states that information must be clearly presented and in plain language; and that the information provided must be accurate, complete in all material respects, and not be misleading or deceptive.

Here, we first look more closely at expectations around disclosure of information and then look at some disclosure issues that have emerged among newly-listed issuers. We then discuss some concerns we have identified in relation to "partial truth" disclosures and end the Bulletin with a round-up of our recent enforcement cases.

What is disclosure of information?

Disclosure is at the foundation of the regulatory framework of Hong Kong's capital markets. In the Listing Rules, the General Principles (in Rule 2.03) emphasise the particular importance of giving investors sufficient information to make an assessment of the issuer, and keeping them fully informed of material factors which might affect their interests. The Listing Rules also mandate disclosure in many specific scenarios, all to help ensure that the market remains orderly, informed, and fair.

Disclosure must be done properly to be effective from a regulatory perspective, and of value to the investing public. Any information to be disclosed must be provided

on a timely basis, but it is also essential that it is presented in a complete and accurate manner. If this is not done, then the disclosure will not be effective or meaningful, and may even be deceptive.

Given the importance of proper disclosure to the market, we will not hesitate to take regulatory action if we detect failings in this regard. Recent cases in which disciplinary action was taken in connection with misleading announcements include [Enterprise Development Holdings Limited](#) and certain directors of [Inno-Tech Holdings Limited](#).

Disclosure misconduct by newly-listed issuers

We have been conducting several investigations in relation to disclosures made by newly-listed issuers, covering the issuer's prospectus, listing application documents, and activities in the period leading up to and shortly after listing. We have also been liaising closely with the SFC on these matters. In some cases, we have had concerns around significant changes in the use of IPO proceeds or outflows of money that were not properly disclosed, and which could have been material to the investing public.

In May 2021, the SFC and HKEX issued a [joint statement on IPO-related misconduct](#). This noted concerns that we and the SFC had identified including in relation to unusually high underwriting commissions or other listing expenses, and material amounts of discretionary listing expenses being paid by the listing applicant or its connected persons. We reiterated the need for disclosure of relevant information, and that regulatory action may follow if a listing document may have included false, incomplete or misleading information or there is evidence of other misconduct.

Further concerns were also highlighted in [the Review of Issuers' Annual Reports 2022](#) published by the Exchange in January 2023 (see paragraphs 60 to 63). These included questionable investments of a material part of IPO proceeds, and seemingly disproportionate payments for consultancy arrangements. Sometimes these payments were fully made in advance. We had concerns that these arrangements lacked commercial rationale and appeared unfavourable to the issuers, particularly as in some cases they resulted in the issuer incurring substantial losses.

Two recent cases described below demonstrate the Exchange's continued focus on the use of IPO proceeds, or other significant expenditures, by newly-listed issuers. In both of these cases, serious sanctions were imposed against the issuers and the directors responsible.

The case of [China Bright Culture Group](#) concerned the issuer's use of a significant portion of its IPO proceeds to enter into an asset management agreement with one of the parties involved in the issuer's IPO. This party in turn invested the entire amount into a promissory note issued by its affiliated party. There was no disclosure of this arrangement in the issuer's prospectus, and the issuer further failed to comply with the disclosure and shareholders' approval requirements for major transactions which were applicable to its investment. The investment was unwound about a year later without any interest or return. An upfront fee of US\$3.5 million paid by the issuer under the asset management agreement was incurred as a loss.

In the case of [Raffles Interior Limited](#), the issuer entered into a number of agreements for professional and consultancy services around the time of its listing, as well as an investment management agreement. There was no disclosure of these agreements in the prospectus, even though they involved advance payments of substantial service fees to the service providers, amounting to 40% of the issuer's net IPO proceeds. The Exchange considered that the commercial rationale for the agreements was doubtful. The discovery of the agreements by the auditor led to a delay in the publication of the company's financial information, and to a prolonged suspension of trading being implemented just 11 months after the company's listing.

Issuers, directors, and professional advisers are reminded that they must ensure there is adequate and timely disclosure of material commitments and expenditures, particularly those that occur around the time of or shortly after listing.

The Exchange will continue to scrutinise unusually high fees or other listing expenses, monitor the use of proceeds after listing, and take enforcement action if failures are identified.

Problems with “partial truth” disclosures

Issuers must ensure that any announcements they put out are not “passively” or indirectly misleading. This can happen, for example, if a disclosure omits, buries, or downplays material facts of an unfavourable nature, or if favourable possibilities are presented as more probable than they really are.

In this section, we highlight a particular area of concern regarding announcements which only tell part of the story. We have seen a number of instances in which an announcement refers only to positive (or bland and neutral) matters, but does not mention other potentially sensitive but material issues. In these announcements, the facts and information that are given are not necessarily false, but the omission of other relevant information means that the announcement gives a misleading picture to investors.

Examples include:

- Painting a rosy picture of the future prospects of a newly acquired business, whilst failing to disclose that the operation of the new business would be contingent upon obtaining certain governmental approvals which were known to be difficult to obtain.
- Attributing a delay in the publication of audited results to the Covid-19 pandemic, when the issuer is also aware, but does not disclose, that serious audit issues have been raised by the auditors, which would likely have resulted in delayed publication irrespective of the pandemic.

When we have identified announcements of this nature, we have sometimes had concerns that those responsible – particularly the directors – have got themselves comfortable with the announcement on the basis that what it contains is “true”, in the sense that the facts it contains are correct. But this is a false comfort. An announcement which is misleading by omission can be just as damaging as an announcement which states something which is incorrect or untrue. A specific area in which this “partial truth” can be problematic relates to resignations of directors and auditors.



Resignation announcements

It is common to see resignation announcements which state simply that a director is resigning for personal reasons or to pursue other endeavours, or that an auditor has resigned because of an inability to agree an audit fee.

Although in many cases this disclosure is appropriate, there is sometimes meaningful information for investors that exists a step deeper. For example, a director may have decided to spend time on other endeavours because there has been an unresolved breakdown in his or her relationship with the rest of the board over a corporate governance issue. The impossibility of agreeing an audit fee may have arisen because the auditor has identified high-risk, problematic areas of concern in the audit which the issuer appears reluctant to address.

In such cases, a resignation announcement referring only to the superficial reason is at best unhelpful, and may – by virtue of the important information that has not been disclosed – be misleading or deceptive.

Directors

In relation to director resignations, the issuer is required under the Listing Rules to announce the resignation and to disclose the reasons for it (Rule 13.51). There is an obligation to assess whether there are any matters that need to be brought to the attention of investors. The directors are required to assist in this regard and to ensure the disclosure is accurate and meaningful (Rule 13.51C).

Issuers and directors are reminded of the [joint news release](#), published by the Exchange and the Hong Kong Institute of Directors in 2007, which addresses the unhelpful practice of referring to “personal reasons” and states these should only encompass reasons such as illness, bereavement or other genuine personal difficulties that change the director’s circumstances. “Personal reasons” do not appropriately describe reasons such as work-related schedules, disqualification of the director, detainment by the police or other authorities (including imprisonment) or change in the issuer’s circumstances.

When any director resigns, but particularly if the resignation comes during a time of sensitivity, pressure (financial or otherwise), or disagreement for the listed issuer, the board, or the director personally, then careful attention must be paid to ensuring that appropriate disclosures are made. Issuers and directors should not satisfy themselves with a “partial truth” disclosure either to avoid addressing sensitive matters, or to buy time. If the resulting disclosure is deficient, we may bring disciplinary action and seek public sanctions against those responsible.

Finally, if any resigning director notes that the issuer has published an announcement regarding his or her resignation, but which does not adequately reflect the

director’s own understanding of the situation, or the reasons that the director had given on resignation, then this should be raised with the issuer or, if concerns persist, the director should not hesitate to contact the Exchange directly. We remind individual directors of the importance of good record-keeping (covered in our August 2022 Enforcement Bulletin). Good record-keeping will help to demonstrate how duties have been individually discharged, and this may be particularly important for a director who has resigned, or if there has been a disagreement amongst the board.

Auditors

We have similar concerns regarding announcements of resignations of auditors. Simply citing disagreement over audit procedures or audit fees, without disclosing more, is of limited value to the investing public. In some cases, our further enquiries or investigation have established that there were material, undisclosed, issues that led to the auditors’ resignation.

In the Exchange’s [Listed Issuer Regulation Newsletter](#) published in December 2022, we reminded audit committees that they are expected to ensure that the auditors’ resignation letter clearly reflects the reasons for their resignation, and to procure the issuer to announce anything that needs to be brought to shareholders’ attention regarding any issues or matters affecting the audit process or fee, or the issuer’s relationship with the auditors, in the auditors’ resignation announcement.

The Accounting and Financial Reporting Council (AFRC), in a January 2023 [open letter](#) to public interest entity auditors and members of audit committees, also noted its concern that the use of “disagreement over audit fees” was sometimes being used as a generic reason for resignation to hide deeper underlying issues which were the real root cause of the resignation. The AFRC’s letter set out their expectation that audit committees understand, and make appropriate disclosure of, the reasons for an auditor’s resignation.

The resignation or replacement of an auditor is an important matter for a listed issuer and the audit committee has particular responsibilities in this regard. Each director must ensure they take care to fully discharge all their duties.

Conclusion

Directors should not content themselves with a “partial truth” announcement. If the announcement is misleading as a result of omission of material information, then disciplinary action may follow against those responsible. It will be no defence to say that the limited information which was disclosed was not factually wrong.

Recent enforcement cases

We have published sanctions in 13 cases in the second half of 2022.

These include the first cases in which a director unsuitability statement has been imposed: these statements were made against 13 directors. Prejudice to investors' interests statements were made against a further 12 directors.

Five of the cases involved settlements with issuers and directors, reflecting an encouraging increase in early engagement in settlement negotiations by parties who are subject to disciplinary action. Parties are reminded that settlement can result in the saving of costs, time and resources. Please read our [Settlement Statement](#) for more details.

A number of cases covered in this Bulletin involve breaches of duty by directors who have failed to safeguard an issuer's assets or interests.

In [Ping An Securities Group \(Holdings\) Limited](#), two directors granted loans in excess of their powers, and made a number of arrangements which resulted in the issuer losing control of its subsidiaries. In [Good Resources Holdings Limited](#), a director failed both to report pledge contracts and loan agreements entered into by the issuer's subsidiary and to take steps to protect the issuer in respect of them. The pledges were enforced, and the loans were not recovered, resulting in substantial losses.

In [Xinyuan Property Management Service \(Cayman\) Ltd](#), the issuer entered into a number of transactions, involving significant sums, which were conducted mainly for the benefit of the issuer's parent. The relevant directors failed to protect the issuer's interest by putting the issuer at risk of the parent's default, and by entering into transactions which lacked business substance. In the case involving directors of [Christine International Holdings Limited](#), the chairman procured the issuer to provide financial assistance to his sister's business through an equipment purchase and a food processing service agreement, but the sister's business failed and a significant balance was written off as a result. The other directors failed to proactively enquire with management about the agreement, and monitor or follow up on the status of the same. In [REXLot Holdings Limited](#), the directors failed to adequately safeguard the issuer's investment in the PRC, being an online lottery sales platform. The directors failed to put in place arrangements to ensure the issuer's power to control the PRC investment, which resulted in a loss of control of the business.

All directors are reminded that they have an important role to play in safeguarding the issuer's assets and interests. This includes ensuring that transactions have a proper commercial rationale, are discussed with the board as appropriate, and that adequate care is taken to manage risk on entry into transactions and in monitoring them thereafter.



Date of news release	Issuer/name – summary of conduct
<u>14 July 2022</u>	<p>Five directors of China Creative Global Holdings Limited</p> <ul style="list-style-type: none"> • Directors’ breach of undertakings to cooperate with the Division’s investigation
<u>18 July 2022</u>	<p>Enterprise Development Holdings Limited and one director</p> <ul style="list-style-type: none"> • Inaccurate, incomplete and/or misleading disclosure by the listed issuer in relation to the biographical details of a newly appointed executive director • Breach of director’s duties in relation to the inaccurate, incomplete and/or misleading information provided by the newly appointed director
<u>5 August 2022</u>	<p>Three directors of Inno-Tech Holdings Limited (delisted)</p> <ul style="list-style-type: none"> • Breach of directors’ duties and/or undertakings in relation to (a) the listed issuer’s failure to comply with the Listing Committee’s direction to appoint a compliance advisor for two years; (b) the listed issuer’s publication of an inaccurate and/or misleading announcement; and (c) their failure to use their best endeavours to procure the listed issuer’s timely response to the Division’s enquiries • Three directors’ breach of undertakings to cooperate with the Division’s investigation
<u>10 August 2022</u>	<p>Ping An Securities Group (Holdings) Limited (delisted) and two directors</p> <ul style="list-style-type: none"> • Listed issuer’s failure to comply with the procedural requirements applicable to loans and disposals which constituted major and discloseable transactions • Breach of directors’ duties in relation to the listed issuer’s breaches of the Listing Rules and failure to use their best endeavours to procure compliance with the Listing Rules • Two directors’ breach of undertakings to cooperate with the Division’s investigation
<u>26 September 2022</u>	<p>Four directors of National Investments Fund Limited (delisted)</p> <ul style="list-style-type: none"> • Directors’ breach of undertakings to cooperate with the Division’s investigation
<u>5 October 2022</u>	<p>Good Resources Holdings Limited (delisted) and one director</p> <ul style="list-style-type: none"> • Listed issuer’s failure to disclose loan agreements which constituted major transactions • Breach of director’s duties and/or undertaking in relation to a director’s failure to (a) procure the Company’s Listing Rule compliance, (b) protect the Company’s assets, and (c) cooperate with the Exchange’s investigation
<u>24 October 2022</u>	<p>Two directors of Biosino Bio-Technology and Science Incorporation</p> <ul style="list-style-type: none"> • Directors’ breach of undertakings to cooperate with the Division’s investigation
<u>21 November 2022</u>	<p>China Bright Culture Group and two directors</p> <ul style="list-style-type: none"> • Listed issuer’s failure to disclose an asset management agreement in its prospectus and to comply with Listing Rule requirements for a major transaction • Breach of directors’ duties in relation to the commercial rationale for entering into the asset management agreement
<u>28 November 2022</u>	<p>Xinyuan Property Management Service (Cayman) Ltd and four directors</p> <ul style="list-style-type: none"> • Listed issuer’s failure to disclose and/or seek shareholder approval for loan transactions which constituted (a) major and/or discloseable and (b) connected transactions • Breach of directors’ duties and/or undertakings in relation to their failure to (a) procure the Company’s Listing Rule compliance, (b) protect the Company’s interests as a whole, and/or (c) avoid or properly address their conflict of interest in the transactions

Date of news release	Issuer/name – summary of conduct
<u>1 December 2022</u>	Seven directors of Christine International Holdings Limited <ul style="list-style-type: none">• Breach of director’s duties by the chairman for procuring the listed issuer to provide financial assistance to his sister’s business through an equipment purchase and a food processing service agreement• Breach of directors’ duties by other directors for failing to monitor and follow up on the relevant transactions
<u>5 December 2022</u>	REXLot Holdings Limited and five directors <ul style="list-style-type: none">• Listed issuer’s failure to (a) publish accurate information in its financial statements, (b) disclose financial assistance provided by it, (c) publish its financial results in a timely manner, and (d) comply or explain its deviation from a Code Provision• Breaches of directors’ duties for failing to oversee the listed issuer’s business and operations and to ensure that the issuer’s interests were properly safeguarded
<u>12 December 2022</u>	Raffles Interior Limited and three directors <ul style="list-style-type: none">• Listed issuer’s failure to disclose its intention to enter into a number of service agreements and an investment management agreement around the time of listing• Breach of directors’ duties in relation to the commercial rationale for the agreements and the due diligence conducted on the service providers
<u>28 December 2022</u>	China New City Commercial Development Limited and four directors <ul style="list-style-type: none">• Listed issuer’s failure to comply with the procedural requirements applicable to certain advances provided to its controlling shareholder’s group, which constituted connected transactions, and major transactions or very substantial acquisitions.• Breach of directors’ duties in relation to their failure to use their best endeavours to procure Listing Rule compliance