OTHER RECENT RULE AMENDMENTS AND PRACTICAL COMPLIANCE ISSUES FOR LISTED ISSUERS

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Listing Division, HKEx
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Agenda

Practical compliance issues
1) Corporate governance and internal control issues
2) Exchange’s monitoring activities

Other recent Rule amendments and guidance materials
3) Property valuation
4) Trading ex-entitlement after shareholder approval
5) Overseas regulatory announcements
6) Share trading suspension
CORPORATE GOVERNANCE
AND INTERNAL CONTROL ISSUES
Corporate governance and internal control issues

• Non-compliance scenarios:
  − issuer failing to timely disclose material information or financial results
  − material transactions effected by subsidiaries without the approval of issuer’s board and shareholders

• Indications of significant internal control deficiencies, e.g.
  − lack of reliable financial reporting and disclosure system
  − lack of effective controls to safeguard the group’s assets
Case Study (1) : Change in financial trend

Listco published interim results for 30 Jun

- Substantial deterioration in Listco group’s performance:
  - turnover dropped by 20%
  - gross profit ratio reduced from 30% to 10%
  - operating loss & net loss

- No prior disclosure about poor performance

- Disclosure in last year’s annual results:
  - described challenges ahead
  - outlined positive steps taken
  - management confidence in meeting the challenges

Listco failed to issue profit warning announcement → Breach of Rule 13.09(1)
Case Study (1): Change in financial trend

Issuer should have:

• periodic financial reporting procedures to ensure flow of financial and operational data to all directors (e.g. monthly management updates – New CG Code C.1.2)
• procedures to identify and escalate reliable information to board on a timely basis
• authorization and vetting processes to ensure that profit warning / alert announcements are timely
## Case study (2): Handling PSI and market rumor

<table>
<thead>
<tr>
<th>Day 1</th>
<th>A trademark license agreement between Listco and Entity A signed (subject to confidentiality)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Day 8</td>
<td>Widely reported news on Mainland government’s approval of Entity A’s project</td>
</tr>
<tr>
<td>Days 8 and 9</td>
<td>Substantial increase in Listco’s share price</td>
</tr>
<tr>
<td></td>
<td>Market rumor on cooperation between Listco and Entity A</td>
</tr>
<tr>
<td></td>
<td>Media report on Listco’s denial of market rumor</td>
</tr>
<tr>
<td>Day 9</td>
<td>Standard denial announcement by Listco to clarify share price movements</td>
</tr>
<tr>
<td>Day 13 (after market close)</td>
<td>Announcement of the license agreement by Listco (Entity A’s consent obtained)</td>
</tr>
<tr>
<td>Day 14</td>
<td>Further increase in Listco’s share price</td>
</tr>
</tbody>
</table>

- Breach of Rules 13.09(1) and 2.13(2)
Case study (2) : Handling PSI and market rumor

Issuer should have effective systems and procedures:

- for the management to monitor media news and share trading, and timely escalate issues to the board
- for the board to assess potential price sensitivity of information and publish announcements in a timely manner
- for designated officers to communicate with media, investors and analysts
- to ensure authorised representatives
  - are in a position to promptly and accurately respond to our enquiry
  - have the delegated authority to request trading suspension if necessary
Case study (3) : Transactions without proper approval

- Subsidiary A pledged all Subsidiary B’s shares as a security for certain bank loans granted to entities controlled by Mr. X
- The share pledge was executed by Subsidiary A without the knowledge of Listco’s board
- Breach of notifiable and connected transaction requirements, deprived shareholders of their rights to vote on material transactions
Case study (3) : Transactions without proper approval

Issuers should have:

• appropriate organisational and management structure
• effective controls to safeguard group’s assets
Case study (4): Uncooperative outgoing management

- Loss of books and records of Subsidiary A after Mr. X and Mr. Y left the group
- Auditors disclaimed opinion of Listco group’s accounts due to incomplete books and records
Case study (4): Uncooperative outgoing management

Issuer should:

• set up formal hand over procedures for change of directors of subsidiaries
• change authorised signatories for bank accounts after directors of subsidiaries left the group
• conduct physical count and inspection of assets after change in subsidiaries’ management
• appoint common directors for issuer and principal subsidiaries
Case study (5) : Loss of control over acquisition target

- Commercial disputes between Listco and Mr. X after acquisition
- Failure to obtain Target’s corporate seal and legal documents → Unable to remove Mr. X from Target
- Target’s exploration licenses transferred to Mr. X’s company without Listco’s approval
- Deconsolidation of Target from Listco group’s accounts due to loss of control over Target
Case study (5) : Loss of control over acquisition target

Issuer should review the management structure and internal control systems of the acquired subsidiary

- ensure the subsidiary’s books and records and corporate seal are properly kept
- effect any necessary change to the subsidiary’s management in a timely manner
Corporate governance and internal control issues

Directors should:

– ensure the issuer maintain sound and effective internal controls to safeguard shareholders’ investment and group assets (CG Principle C.2)
– review (at least annually) effectiveness of internal controls (CG Code C.2)
– ensure proper delegation of authority (CG Code D.1.1)

Recent Rule amendments include:

– management to provide “monthly management updates” to all members of the board (new CG Code C.1.2)
– the board of directors (or a corporate governance committee) be responsible for corporate governance duties (new CG Code D.3.1)

Amended Rule 3.08 emphasizes that directors must take an active interest in the issuer’s affairs and obtain a general understanding of its business and follow up anything untoward.
Other corporate governance issues

- Independence of proposed INEDs
- Eligibility of company secretaries
Case study (6) : Re-designation of NED to INED

• Mr. A’s relationship with Listco:
  2009 – now:  NED of Listco
  1999 – 2008:  ED of Listco

• Mr. A does not meet the independence guideline under Rule 3.13(7)

• Rule 3.14 requires Exchange’s consent

• Our view:  Mr. A has long association with Listco
  → a perceived lack of independence from Listco’s management
    and controlling shareholder
Case study (7): Eligibility of company secretary

- Mr. B is not member of HKICS, solicitor or barrister, or CPA (as defined in the PAO)
- Mr. B’s “relevant experience”:
  - Working experience: Since 2003: CFO of Listco
    (oversees financial reporting, internal control, and compliance with Listing Rules and other regulations)
    1995 – 2002: Manager of accounting department
  - Training: About 35 hours of relevant professional training in the last 2 years
  - Academic qualification: Senior accountant qualified in the Mainland
- Our view: Mr. B can act as Listco’s secretary
EXCHANGE’S MONITORING ACTIVITIES
Exchange’s monitoring activities

a) Monitoring directors’ dealings under Model Code
b) Post-vetting issuers’ announcements
c) Publication on issuers’ websites
d) Annual reporting of continuing connected transactions
MONITORING DIRECTORS’ DEALINGS UNDER MODEL CODE
Model Code on directors’ dealings

• Dealing restrictions for director
  – when he is in possession of unpublished PSI
  – in a black out period
    ➢ the day on which financial results are published
    ➢ 30 days before publication of half-year/ quarterly results
    ➢ 60 days before publication of annual results
## Monitoring directors’ dealings

- Findings from our review of DI forms filed by directors

<table>
<thead>
<tr>
<th></th>
<th>2010</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>8,738 (100%)</td>
<td>6,365 (100%)</td>
</tr>
<tr>
<td>Fell within black out periods</td>
<td>507 (5.8%)</td>
<td>253 (4.0%)</td>
</tr>
<tr>
<td>- Exempt dealings / non-dealings</td>
<td>452 (5.2%)</td>
<td>219 (3.4%)</td>
</tr>
<tr>
<td>- Potential non-compliance cases</td>
<td>55 (0.6%)</td>
<td>34 (0.5%)</td>
</tr>
</tbody>
</table>
Monitoring directors’ dealings

Common non-compliance cases

1. Dealings in shares:
   - on result publication day
   - during the first 30 days of the 60-day black out period

2. Granting share options / share awards during black out period

3. Postpone results publication date after identifying dealings during the original black out period
   - Commencement date of black out period would not change
POST-VETTING ISSUERS’ ANNOUNCEMENTS
Pre and post-vetting of announcements

1 - 9 / 2011
- 4.4% Pre-vetted
- 0.4% Post-vetted - without follow up
- 95.2% Post-vetted - with follow up

2010
- 4.4% Pre-vetted
- 0.6% Post-vetted - without follow up
- 95.1% Post-vetted - with follow up
Results of follow up actions for post-vetted announcements
Post-vetting
– Handling of non-compliance with disclosure requirements

• Encourage issuer to clarify and disclose omitted information (normally items specified in Listing Rules)

• Issuer’s discretion on further action, e.g. – issuing further announcement – disclosing in circular (if any)
Post-vetting
– Non-compliance with disclosure requirements

Examples:

• Notifiable/ connected transactions
  – Principal business activities of the counterparty (MB R14.58(2)/ GEM R19.58(3))
  – Basis of consideration (MB R14.58(5)/ GEM R19.58(6))
  – Value of subject assets (MB R14.58(6)/ GEM R19.58(7))
  – Net profits attributable to the target asset (MB R14.58(7)/ GEM R19.58(8))
  – A statement whether any director has material interest in the transaction (MB R14A.56(5)/ GEM R20.56(5))
  – Connected person’s original acquisition cost (MB R14A.56(9)/ GEM R20.56(9))

• Issue of securities
  – Total fund to be raised and proposed use of proceeds (MB R13.28(3)/ GEM R17.30(3))
  – Net price of securities to be issued (MB R13.28(5)/ GEM R17.30(5))
  – Fund raising history in previous 12 months (MB R13.28(9)/ GEM R17.30(9))
Post-vetting
– Results announcements

• Review all results announcements

• Matters requiring follow up:
  ➢ no profit warning/ alert announcement, or timeliness of announcement
  ➢ undisclosed notifiable or connected transaction
  ➢ inconsistent information relating to transactions announced or completed during the year
  ➢ insufficient level of operations/ cash company concerns
Issuers’ announcements and circulars

• Information contained in issuers’ documents must be:
  – clearly presented, and in plain language format
  – accurate and complete in all material respects and not be misleading or deceptive
  – sufficient for shareholders to make voting decision

(Rule 2.13)

• Issuers should:
  – highlight important information
  – avoid using lengthy sentences or paragraphs, or legalistic style of writing
PUBLICATION ON ISSUERS’ WEBSITES
Publication on issuers’ websites

• Issuers to publish on their own websites announcements and other documents submitted for publication on HKExnews website:
  – within 1 hour after submission to the Exchange
  – by 8:30 a.m. on next business day if submitted to Exchange after 7:00 p.m.

• Issuers’ websites
  – channel for information dissemination in the unlikely event that services of HKExnews website are disrupted
Publication on issuers’ websites

• Periodic review of issuers’ websites

• Non-compliance scenarios:

  1. Timeliness – 19% of issuers’ documents published in the review period were not posted on issuers’ websites before the deadline

    2. Website/webpage accessibility problems

    3. Publication in single language
Publication on issuers’ website

Points to note:

• Arrange internal staff/ external service providers to upload documents on issuer’s website in a timely manner

• Ensure issuer’s website is available at all times (except for downtime required for essential maintenance)

• Issuer’s website shows clearly where its documents are accessible and provide hyperlinks to direct readers to the documents

• Update the Exchange for change of issuer’s website address

• Ensure documents published on issuer’s website are the same as those published on HKExnews website
ANNUAL REPORTING OF CONTINUING CONNECTED TRANSACTIONS
Annual reporting of CCTs

Non-compliance issues include:

- annual caps exceeded
- transactions not conducted in accordance with agreements
- issuers failed to engage auditors to review CCTs
- auditors’ letters not copied to the Exchange
- omission of information in annual reports
  - details of CCTs undertaken during the year
  - confirmation from INEDs / auditors on their review of CCTs
  - a statement on whether related party transactions reported under accounting standards constituted connected transactions
Annual reporting of CCTs

Points to note:

• Issuer to maintain appropriate internal controls to identify, record, authorise and report all CCTs

• Directors to provide necessary information to auditors for reviewing CCTs before deadline

• If auditors cannot provide an unqualified confirmation letter
  − issuer to promptly notify the Exchange and announce the facts
  − directors to discuss the issues with auditors and put in place appropriate remedial internal controls
OTHER RECENT RULE AMENDMENTS AND GUIDANCE MATERIALS
RULE AMENDMENTS –
PROPERTY VALUATION REQUIREMENTS
FOR LISTED ISSUERS
Property valuation – Current Rules

- Requirements apply to listed issuer buying or selling:
  1. **property**; or
  2. “**property company**” i.e. a company whose assets consist solely or mainly of property

<table>
<thead>
<tr>
<th>Transaction Type</th>
<th>Is property valuation required?</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Property interests to be acquired or disposed of</td>
</tr>
<tr>
<td>Notifiable Transaction*</td>
<td>Yes</td>
</tr>
<tr>
<td></td>
<td>Major / VSD</td>
</tr>
<tr>
<td></td>
<td>VSA</td>
</tr>
<tr>
<td>Connected transaction subject to shareholders’ approval</td>
<td>Yes</td>
</tr>
</tbody>
</table>

*Reverse takeovers are subject to new listing requirements*

Rule changes to introduce **new exemptions** for buying or selling “property company”

Rule change to **remove** this requirement
## Property valuation

- **Rule amendments: New exemptions**

**New exemptions for buying or selling “property company” (Major/VSD/VSA)**

<table>
<thead>
<tr>
<th>Target company to be acquired or disposed of</th>
<th>Target company’s property interests</th>
<th>Is property valuation required?</th>
<th>Disclosure in circular</th>
<th>Remarks</th>
</tr>
</thead>
</table>
| **Listed**
  “property company”                      | All property interests            | No                             | Overview of property interests not valued | New Rule (exempt property valuation) |
| **Unlisted**
  “property company”                       | Immaterial property interests     | No                             | Overview of property interests not valued | New Rule (exempt property valuation) |
|                                            | - Each property interest’s carrying amount < 1% of issuer’s total assets |
|                                            | - Subject to a 10% limit on total carrying amount for property interests not valued |
|                                            | Other property interests          | Yes                            | Summary disclosure of valuations for smaller property interests |
|                                            |                                   |                                | - Each property interest’s value < 5% of all property interests required to be valued |
|                                            |                                   |                                | Full text of valuation reports for other property interests |
|                                            |                                   |                                | No change |

<table>
<thead>
<tr>
<th>Remarks</th>
<th>New Rule (exempt disclosure of full text valuation repot)</th>
</tr>
</thead>
</table>

- New Rule
- No change
Property valuation
- Rule amendments: New exemptions

Example – Acquisition of an *unlisted* “property company” (major transaction)

- Target company has 20 property interests:

<table>
<thead>
<tr>
<th>Property No.</th>
<th>Carrying amount (% to Listco’s total asset)</th>
<th>Is property valuation required?</th>
<th>Valuation (% to total property interests valued)</th>
<th>Disclosure in circular</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 ... 15</td>
<td>&lt; 1% each <em>(Total &lt; 10%)</em></td>
<td>No</td>
<td>N/A</td>
<td>Overview of property interests</td>
</tr>
<tr>
<td>16</td>
<td>&lt; 1% <em>(Total for 1 to 16 &gt; 10%)</em></td>
<td>Yes</td>
<td>1%</td>
<td>Summary disclosure of valuations</td>
</tr>
<tr>
<td>17</td>
<td>2%</td>
<td>Yes</td>
<td>3%</td>
<td>Full text of valuation reports</td>
</tr>
<tr>
<td>18</td>
<td>4%</td>
<td>Yes</td>
<td>7%</td>
<td></td>
</tr>
<tr>
<td>19</td>
<td>20%</td>
<td>Yes</td>
<td>40%</td>
<td></td>
</tr>
<tr>
<td>20</td>
<td>25%</td>
<td>Yes</td>
<td>49%</td>
<td></td>
</tr>
</tbody>
</table>

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100%
Property valuation
- Rule amendments: New exemptions

• New exemption for buying or selling a “property company” involving in mining activities (Major/VSD/VSA)
  
  - No property valuation required for property interests ancillary to mining activities

    *if* the circular includes a valuation that encompasses the natural resources and ancillary property interests, and together have been valued as a business or as an operating entity by a Competent Evaluator under Chapter 18
Property valuation
- Rule amendments: Disclosure requirements

To require:

1) Additional disclosure in property valuation reports

2) General disclosure for material property interests in circulars
RULE AMENDMENTS –
TRADING EX-ENTITLEMENT
AFTER SHAREHOLDER APPROVAL
Trading ex-entitlement

• Some entitlements are subject to shareholder approval
e.g. – final dividend
  – rights issue/ open offer with a material dilution effect
  – distribution in species conditional on shareholder approval of material transaction

• Before Rule amendments
  – No restriction on record date

• After Rule amendments
  – Record date: at least 3 business days after the date of shareholder approval
  – At least 1 cum-trading day after the general meeting
Trading ex-entitlement – Example

Approval of final dividend (e.g. HK$2 per share) at AGM (before Rule amendments)

<table>
<thead>
<tr>
<th>Day T</th>
<th>T+18</th>
<th>T+19</th>
<th>T+20</th>
<th>T+21</th>
</tr>
</thead>
<tbody>
<tr>
<td>Notice of AGM</td>
<td>Last cum-trading day</td>
<td>Ex-date</td>
<td>Record date for voting at AGM and final dividend</td>
<td>AGM</td>
</tr>
<tr>
<td></td>
<td>Closing price: HK$30</td>
<td>Previous closing price (ex-dividend): HK$28</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Trading ex-entitlement - Example

Approval of final dividend (e.g. HK$2 per share) at AGM (after Rule amendments)

- **Day T**: Notice of AGM
- **T+20**: Record date for voting at AGM
- **T+21**: AGM and publication of results of AGM
- **T+22**: Last cum-trading day
  - Closing price: HK$30
- **T+23**: Ex-date for final dividend
  - Previous closing price (ex-dividend): HK$28
- **T+24**: Record date for final dividend (or last registration date if there is a book close)

At least 1 cum trading day after AGM

At least 3 business days
NEW GUIDELINES ON PUBLICATION OF OVERSEAS REGULATORY ANNOUNCEMENTS ("ORAS")
ORA – Rules and guidelines

• Rule 13.09(2) applies to:
  1) Issuers with dual or multiple listings in other markets
  2) Issuers with overseas listed subsidiaries

• New guidelines (January 2011)
  1) Overseas regulatory information released by issuers *(No change)*
      → Require publication on Exchange’s website
  2) Overseas regulatory information released by subsidiaries *(New guideline)*
      → Require publication on Exchange’s website *only if* the information is discloseable under other Rules (e.g. 13.09(1), Chapter 14 or 14A)
ORA – Points to note

- ORA may be published on Exchange’s website
  - in single language
  - during trading hours

- If information is discloseable under Rule 13.09(2) and other Listing Rules (e.g. PSI under Rule 13.09(1))

  → full compliance with announcement publication requirements:
  - published in both English and Chinese
  - published outside trading hours

Example: Quarterly results required by overseas regulators
GUIDANCE ON POLICY OF SHARE TRADING SUSPENSION
Share trading suspension

• When required?
  – For investor protection or maintenance of an orderly market

• Common scenario:
  – Temporary suspension pending announcement of PSI

• Guidance letter issued in June 2011 to remind issuers to
  – manage and plan their affairs to avoid trading suspension
  – keep PSI confidential until announcement is made
  – provide reasons to support their requests for trading suspension
    (e.g. PSI cannot be timely released or to avoid a disorderly market)
  – keep suspension period as short as possible
### Share trading suspension - Example 1

<table>
<thead>
<tr>
<th>Day 1</th>
<th>Placing agent approached Listco for a placing</th>
</tr>
</thead>
<tbody>
<tr>
<td>(after 5:00 pm)</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Day 2</th>
<th>Placing agreement expected to be signed on Day 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>(at 8:00 am)</td>
<td>Listco requested trading suspension</td>
</tr>
</tbody>
</table>

- No suspension unless confidentiality cannot be maintained
- Listco should plan the signing of agreement outside trading hours
Share trading suspension - Example 2

<table>
<thead>
<tr>
<th>Day 1 (at 9:00 pm)</th>
<th>• Agreement on major transaction signed</th>
</tr>
</thead>
<tbody>
<tr>
<td>Day 2 (morning session)</td>
<td>• Trading suspended</td>
</tr>
</tbody>
</table>
| Day 2 (lunch break) | • Major transaction announcement published  
| | • A block-trade of Listco’s shares commenced  
| | • Listco requested continued suspension |

→ Continued suspension allowed to avoid a disorderly market

→ Listco to announce the block-trade as soon as possible to minimise suspension period
Listing Rules and Guidance Search Facilities

- Launched in Sep 2011
- To help users to locate information published on the HKEx corporate website
THANK YOU