Part B Consultation Questions

Please reply to the questions below that are raised in the Consultation Paper downloadable from the HKEX website at: https://www.hkex.com.hk/-/media/HKEX-Market/News/Market-Consultations/2016-Present/August-2020-Disciplinary-Powers/Consultation-Paper/cp202008.pdf. Please indicate your preference by ticking the appropriate boxes.

Where there is insufficient space provided for your comments, please attach additional pages.

We encourage you to read all of the following questions before responding.

1. We propose to amend the existing threshold for imposing a PII Statement and to make it clear that a PII Statement can be made whether or not an individual continues in office at the time of the PII Statement. Do you agree?

   ☐ Yes

   ☒ No

   If your answer to the above question is "no", please provide reasons for your views.

We do not agree with the proposed amended threshold for imposing a PII Statement (the "**Enhanced PII Statement**"). Under the current LR 2A.09(7), a PII Statement would be issued against a director for his wilful or persistent failure to discharge his responsibilities under the Listing Rules. The Enhanced PII Statement, based on paragraph 32(a) on page 9 of the Consultation Paper, is intended to lower the threshold of LR 2A.09(7) by deleting any references to the director's wilful or persistent failure to discharge his responsibilities under the Listing Rules, so that the Stock Exchange need not prove such failure on the part of the director before imposing a PII Statement on him. See the proposed LR 2A.10(4) on Appendix I-3 of the Consultation Paper.

We consider that the Enhanced PII Statement would unnecessarily increase concern of listed issuers' directors or senior management over whether any perceived failure on their part to discharge duties under the Listing Rules, in the absence of the more qualitative yardstick of "persistent failure" (wilful is hard to prove objectively in any event), might attract arbitrary imposition of the Enhanced PII Statement on them.

Moreover, if the proposed amendment is adopted, there is little practical difference, in our view, between an Enhanced PII Statement and a public censure under LR 2A.09(3). We fail to see how the purposes of the Enhanced PII Statement would not be equally achieved by a public censure enhanced with additional details and information which would otherwise appear in the Enhanced PII Statement including the Stock Exchange's proposal of using the Enhanced PII Statement to make clear disciplinary sanctions can be imposed on a wrongdoing individual, whether or not he or she remains in office at the time of the disciplinary action (see paragraphs 31 and 32(b) on page 9 of the Consultation Paper). Accordingly, it is our view that the Enhanced PII Statement would not advance the Stock Exchange's disciplinary cause to any greater extent than would an expanded public censure. Hence, we are in doubt of the need to introduce the proposed Enhanced PII Statement.

For the above reasons, it is submitted that (i) there is little need for the Stock Exchange to propose the Enhanced PII Statement; and (ii) the current scope of public censure should be expanded to incorporate information in the Enhanced PII Statement.

2. We propose to extend the scope of a PII Statement to include directors and senior management of the relevant listed issuer and any of its subsidiaries. Do you agree?

☐ Yes

☒ No

If your answer to the above question is "no", please provide reasons for your views.

Please refer to our response to Q1 in respect of the Enhanced PII Statement. That said, we have no objection to the inclusion of members of senior management as subjects of an enhanced public censure regime.

3. We propose to enhance follow-on actions where an individual continues to be a director or senior management member of the named listed issuer after a PII Statement has been made against him. Do you agree?

☒ Yes (Please refer to our comments in the box below)

☐ No

If your answer to the above question is "no", please provide reasons for your views.

Please see our response to Q1. We agree that enhanced follow-on actions as described in paragraphs 48-59 of the Consultation Paper should be imposed on an individual who continues to be a director or senior management of the named listed issuer after an enhanced public censure on him is published.

4. We propose that, after a PII Statement with follow-on actions has been made against an individual, the named listed issuer must include a reference to the PII Statement in all its announcements and corporate communications unless and until that individual is no longer its director or senior management member. Do you agree?

☒ Yes (Please refer to our comments in the box below)

☐ No

If your answer to the above question is "no", please provide reasons for your views.

Please see our response in Q1 in relation to the Enhanced PII Statement. We agree, however, that after an enhanced public censure with follow-on actions has been made against an individual, the named listed issuer must include a reference to the public censure in all its announcements and corporate communications unless and until that individual is no longer the listed issuer's director or a member of its senior management.

5. We propose to extend the current express scope of disclosure in listing applicants' listing documents and listed issuers' annual reports in respect of their directors and members of senior management (current and/or proposed, as the case may be) by requiring provision of full particulars of any public sanctions made against those individuals. Do you agree?

☒ Yes

☐ No

If your answer to the above question is "no", please provide reasons for your views.

6. We propose to remove the existing threshold for ordering the denial of facilities of the market. Do you agree?

☒ Yes

☐ No

If your answer to the above question is "no", please provide reasons for your views.

7. We propose to include fulfilment of specified conditions in respect of the denial of facilities of the market. Do you agree?

☒ Yes

☐ No

If your answer to the above question is "no", please provide reasons for your views.

8. We propose to introduce the Director Unsuitability Statement as a new sanction. Do you agree?

☒ Yes (Please refer to our additional views below)

☐ No

If your answer to the above question is "no", please provide reasons for your views.

We agree that the Director Unsuitability Statement (the "**DUS**"), which is proposed to be issued to a director in circumstances where his or her misconduct is at the most serious end of the spectrum, e.g. entering into unauthorised transactions in which the director has a clear conflict of interest or which does not appear to be in the interests of the listed issuer or its shareholders (see paragraphs 71-72 of the Consultation Paper), would give the general public a clearer picture of the director's misconduct which warrants the imposition of disciplinary actions against the director.

However, with reference to the trigger for the issuance of DUS in the proposed LR 2A.10(5) on Appendix I-3 of the Consultation Paper, the Stock Exchange may consider setting out clearly, e.g. by providing more examples in the form of a guidance letter accompanying the amendments to the Listing Rules, what constitutes in its view "serious or repeated failure by a director to discharge his responsibilities under the Listing Rules" to trigger the issuance of a DUS. Another suggested circumstance in which the Stock Exchange may consider including as a trigger for the publication of the DUS is where the director involved was convicted by a criminal court for criminal offence(s) he/she had committed.

Furthermore, if it is considered that a DUS should be a new sanction for more serious cases of director's misconduct, so as to distinguish it from other sanctions dealing with less serious misconduct of the director, it is all the more necessary for the Stock Exchange to avoid confusion or misunderstanding to the market by proposing a sanction such as the Enhanced PII Statement which does not fall on either side of the disciplinary spectrum. It is therefore suggested that public censure incorporating information of the Enhanced PII Statement should deal with less serious cases of directors' misconduct whereas DUS is issued against directors involved in more serious cases of misconduct.

As a further deterrent in respect to those directors to whom the DUS is issued, the Stock Exchange may consider adding a statement that such person may not act as a director or chief executive officer of a listed issuer or any of its subsidiaries without the permission of the Stock Exchange.

9. We propose that the follow-on actions and publication requirement in respect of PII Statements also apply to Director Unsuitability Statements. Do you agree?

☒ Yes

☐ No

If your answer to the above question is "no", please provide reasons for your views.

10. We propose to impose secondary liability on Relevant Parties if they have 'caused by action or omission or knowingly participated in a contravention of the Listing Rules'. Do you agree?

☐ Yes

☒ No

If your answer to the above question is "no", please provide reasons for your views.

Please refer to the Attachment for our response.

11. We propose to include an explicit provision permitting the imposition of a sanction in circumstances where there has been a failure to comply with a requirement imposed by the Listing Division, the Listing Committee or the Listing Review Committee of the Exchange. Do you agree?

☒ Yes

☐ No

If your answer to the above question is "no", please provide reasons for your views.

12. We propose that sanctions may be imposed on all Relevant Parties through secondary liability where a party has failed to comply with a requirement imposed by the Listing Division, the Listing Committee or the Listing Review Committee. Do you agree?

☐ Yes

☒ No

If your answer to the above question is "no", please provide reasons for your views.

Please refer to our response to Q10. For the reasons mentioned there, some of the proposed RPs are considered to be too remote to be in a position to exert control on a listed issuer (and its directors) in compliance with requirements imposed by regulators. Hence, they should not be sanctioned. We also believe that the Stock Exchange should observe principles of equity and rules of natural justice and be discerning and prudent in reviewing and assessing individual cases before considering imposition of sanctions on the RPs.

13. We propose to explicitly provide in the Rules the obligation to provide complete, accurate and up-to-date information when interacting with the Exchange in respect of its enquiries or investigations. Do you agree?

☒ Yes

☐ No

If your answer to the above question is "no", please provide reasons for your views.

14. Do you agree with the proposed definition of 'senior management'?

☐ Yes

☒ No

If your answer to the above question is "no", please provide reasons for your views.

For the reasons stated below, we do not agree that there is sufficient force in the Stock Exchange's arguments for a proposed definition of 'senior management', which is set out in paragraphs 115 and 116 on pages 32 and 33 of the Consultation Paper, respectively.

First, we note in paragraph 116(b) on page 33 of the Consultation Paper that the Stock Exchange intends the proposed definition of 'senior management' to capture those company's officers who perform managerial functions one level below the board of directors. However, there is case authority in the UK and Hong Kong (see, e.g., *Re Copyright Ltd* [2004] 2 HKLRD 113) to the effect that directors have a continuing duty to know and understand the company's business and that delegation of functions does not absolve a director from supervising how the functions are discharged. Hence, directors of listed issuers are held ultimately responsible for the issuers' actions and wrongdoings. Any employee of the listed issuer including members of the proposed 'senior management' who are involved in the commission of fraudulent schemes against the issuer and its shareholders could be subject to criminal sanctions for their involvement in such schemes, either in their own right and/or aiding or abetting the directors. Civil and regulatory penalties against the wrongdoing employees could also follow if the fraudulent schemes are referred to the MMT by the SFC. See, e.g., the MMT's sanctions against directors and senior management of Mayer Holdings Limited in July 2017 for late disclosure of inside information.

Second, members of senior management of a listed issuer is one of the parties (other parties that could likewise be disciplined include, e.g., the listed issuer and its PA) subject to disciplinary actions by the Stock Exchange under the current LR 2A.10(c), which has been in existence for at least the past 13 years. LR 2A.10 defines who a listed issuer and its PA are, but does not define members of senior management. This may partly explain why the Stock Exchange wishes to propose a LR definition of 'senior management' now in order to determine, as explained in paragraph 116(c) on page 33 of the Consultation Paper, who should be subject to its regulatory purview. However, we are not aware of any evidence to date which suggests that listed issuers and market participants have been confused by or considered it unsatisfactory over the lack of a definition of 'senior management' insofar as the exercise of disciplinary power by the Stock Exchange is concerned. Hence, we are doubtful of the need for the proposed definition of 'senior management'.

Finally, even if there is a need for introducing a LR definition of 'senior management', the definition in the proposed LR 2A.09(2)(c) on Appendix I-2 of the Consultation Paper, which has three limbs, is in our view unsatisfactory. Under this proposed LR, whether or not a person is a member of 'senior management' is determined by (i) the position he or she holds in the issuer such as CEO, CFO, company secretary; (ii) the reference to him or her as senior management in the issuer's corporate communication or other publications on the Stock Exchange's or the issuer's website; or (iii) the catch-all definition of a person who performs managerial functions. While the individuals subject to limbs (i) and (ii) can be identified with relatively little difficulty, we, however, consider that limb (iii) to be too general. The Stock Exchange may find it difficult to clearly demonstrate that the targeted individual is performing managerial functions under the directors' immediate authority in respect of certain circumstances. For example, is a junior staff member of the issuer who is asked by a director to manage and then fabricate accounting records to perpetrate a fraudulent scheme regarded as a member performing management functions under limb (iii), hence be penalised by disciplinary sanctions? Accordingly, it could be helpful to listed issuers if the Stock Exchange could comprehensively define what constitutes management functions in a new guidance note.

15. We propose to include employees of professional advisers of listed issuers and their subsidiaries as a Relevant Party under the Rules. Do you agree?

☐ Yes

☒ No

If your answer to the above question is "no", please provide reasons for your views.

Please refer to our response to Q14, in particular the second paragraph. For the reasons mentioned there, we believe that the currently available sanctions are sufficient to penalise wrongdoing employees of PAs. Hence, there is no need to include PAs' employees as RPs.

16. We propose to include guarantors of structured products as a Relevant Party under the Rules. Do you agree?

☒ Yes

☐ No

If your answer to the above question is "no", please provide reasons for your views.

17. We propose to include guarantors for an issue of debt securities as a Relevant Party under the MB Rules. Do you agree?

☒ Yes

☐ No

If your answer to the above question is "no", please provide reasons for your views.

18. We propose to include parties who give an undertaking to, or enter into an agreement with, the Exchange as Relevant Parties under the Rules. Do you agree?

☒ Yes

☐ No

If your answer to the above question is "no", please provide reasons for your views.

19. We propose to extend the ban on professional advisers to cover banning of representation of any or a specified party. Do you agree?

☐ Yes

☒ No

If your answer to the above question is "no", please provide reasons for your views.

We believe that the impact of the proposed banning of PAs to act for <u>any</u> party (the "**Enhanced Ban**") is too draconian. Such ban, if exercised, would render the PA being unable to conduct any advisory business in relation to Listing Rules matters during the period of the ban, which would significantly affect the PA's income if the length of the ban is a long one. Moreover, if the banning of PA acting for a specified party, as described in paragraph 138 of the Consultation Paper, is a reputational sanction, the fact that it is currently confined to barring the PA from further acting for the specified party (see LR 2A.09(5)), and issued together with a press release or public statement involving criticism, would already serve such purpose. Hence, we do not agree with the Stock Exchange's claim that the deterrent value of the current scope of the ban is limited.

In addition, if the PA has committed only a single incident of breaching the Listing Rules in the course of acting for a specified party in respect of a particular transaction, the imposition of the Enhanced Ban on the PA to act for any other issuer is grossly unfair to it causing significant loss of income, as described above, and is likely to subject the Stock Exchange to possible legal challenge such as judicial review. If, however, the ban is imposed on the PA based on the cumulative effect of its breaches and/or misconduct in respect of a few transactions for a number of specified parties over a period of time, the Stock Exchange, it is submitted, should set out specifically what kind of breaches/misconduct and the number of specified parties and stipulated matters involved would warrant the imposition of the Enhanced Ban.

For the above reasons, we do not believe that there is sufficient basis for the Stock Exchange to propose the Enhanced Ban. Instead, the Stock Exchange may retain the current ban under LR 2A.09(5) and consider publishing a 'black list' of PAs whose conduct is below market expectations, which helps deter listed issuers and market participants to engage such firms.

In the event that the Stock Exchange insists on imposing the Enhanced Ban, it is our view and submission that since the Stock Exchange possesses extensive power under LR 2A.09(4) to refer breaches of the Listing Rules and other misconduct by SFC's licensees and members of professional bodies to their respective regulators for possible disciplinary actions, it would only be appropriate, not to mention fair, that the Enhanced Ban should be imposed on the PA **<u>after</u>** disciplinary actions having been taken against it by the SFC / professional bodies.

It is further submitted that the Stock Exchange should confirm, either in the Consultation Conclusions or other related documents, whether or not the Enhanced Ban would be imposed on the whole PA firm as a result of breaching the Listing Rules by, say, its corporate finance practice. If the Enhanced Ban applies to the entire firm, this would be in our view disproportionate to the seriousness of the charges laid against the PA, and is likely subject the Stock Exchange to legal challenge.

20. We propose to include express obligations on professional advisers when acting in connection with Rule matters. Do you agree?

☒ Yes

☐ No

If your answer to the above question is "no", please provide reasons for your views.

21. We propose that 'business day' be used as the benchmark for counting the periods for filing review applications, and for requesting or providing written reasons for decisions. Do you agree?

☒ Yes

☐ No

If your answer to the above question is "no", please provide reasons for your views.

22. We propose that all review applications must be served on the Secretary. Do you agree?

☒ Yes

☐ No

If your answer to the above question is "no", please provide reasons for your views.

23. We propose that the counting of the period for filing review applications be from the date of issue of the decision or the written reasons. Do you agree?

☒ Yes

☐ No

If your answer to the above question is "no", please provide reasons for your views.

24. We propose that the counting of the period for requesting written reasons be from the date of issue of the decision. Do you agree?

☒ Yes

☐ No

If your answer to the above question is "no", please provide reasons for your views.

25. We propose that the counting of the period for providing written reasons be from the date of receipt of the request. Do you agree?

☒ Yes

☐ No

If your answer to the above question is "no", please provide reasons for your views.

- End -

Attachment

Response to Q10

In our opinion, the proposed definition of Relevant Parties (the "**RPs**") in the Consultation Paper is too board and all-embracing It is noted that the relevant parties defined in all the securities rules which the Stock Exchange cited in footnote 28 on page 24 of the Consultation Paper, such as the Financial Conduct Authority's DTR 1.5.3G, the Singapore Exchange's Main Board Rules, paragraph 1401, and Catalist Rules 301 as well as Bursa Malaysia Main Market Listing Requirement, paragraph 16.13 (collectively the "**Securities Rules**"), to justify the imposition of secondary liability are primarily those parties directly involved in the day-to-day running of the issuer's business such as directors, executive officers and persons discharging managerial functions in the issuer.

The definition of RPs in the Consultation Paper is, however, much broader than those in the Securities Rules. Not only does the proposed definition of RPs include those parties commonly found in the Securities Rules (see the preceding paragraph) but also the listed issuer's professional adviser, which includes, e.g. any financial adviser, independent financial adviser, lawyer, accountant, property valuer, but does not include sponsors or Compliance Adviser" (see the proposed LR 2A.09(2)(b) on Appendix I-2 of the Consultation Paper), and a named individual employed by the professional adviser (see the proposed LR 2A.09(1)(f) on Appendix I-1 of Consultation Paper). None of whom is specified as relevant parties in any of the Securities Rules – Catalist Rule 301 mentions a sponsor or registered professional only. As the concept of secondary liability is a new one and based on the Securities Rules, we are of the view that the definition of RPs, who would potentially be attached with secondary liability, should not go beyond those set forth in the Securities Rules.

In particular, we draw the Stock Exchange's attention to the following RPs in the proposed LR 2A.09(1) on Appendix I-1 of the Consultation Paper. LR 2A.09(1)(b) refers to any director of a listed issuer or any alternative of such director as a RP. However, an alternate of a listed issuer's director may not assume the responsibility for previous breach of listing rules (i.e. they can only perform remedial actions). LR 2A.09(1)(d) categories a substantial shareholder of a listed issuer as RP, but he or she may not be in a position to exert management control over listed issuer's operation.

A professional adviser of a listed issuer and its employee (collectively "**Professional Adviser**" or "**PA**") are classified as RPs under LR 2A.09(1)(e) and (f) respectively. Since a Professional Adviser provide only advisory services to the issuer without any participation in its business and decision-making process, we believe that it would be too remote for it (i.e. Professional Adviser) to assume secondary liability. It is notable that of the six examples used by the Stock Exchange in the Consultation Paper to illustrate how secondary liability could be imposed on Relevant Parties for their LR breaches and misconduct in relation to the issuer (see paragraph 93 on pages 25-27 of the Consultation Paper), five of them are concerned with Relevant Parties who are

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parties closely involved in the issuer's business operations such as the CEO, CFO, COO, Board secretary and substantial shareholder, only example (f) is about the misconduct of the issuer's financial adviser (see page 27 of the Consultation Paper). The fact that it is the only example used by the Stock Exchange to justify the inclusion as a Relevant Party of a party not directly involved in the issuer's business arguably shows the lack of reasonable basis for attaching financial advisers with secondary liability as compared to the CEO, CFO etc. of the listed issuer.

Specifically, example (f) is concerned with the financial adviser's collusion with the issuer to withhold disclosure of material information on the acquisition target's deteriorating financial performance. We believe that existing sanctions are sufficient to penalise the possibly fraudulent conduct on the part of the financial adviser in such a case, namely, (i) criminal sanctions by a court of law; (ii) regulatory actions by the SFC (For example, in 2015 the SFC commenced proceedings in the Market Misconduct Tribunal (the "**MMT**") against AcrossAsia Limited (stock code 8061) for failing to disclose highly sensitive inside information as soon as reasonably practicable, which resulted in a fine of $60,000 for AcrossAsia and of $1.4 million in total against 2 directors) as well as (iii) the current LR 2A.09(5). Apart from the last sanction, both sanctions (i) and (ii) are imposed on the wrongdoing financial adviser and/or employee by a party independent of the Stock Exchange, which help ensure the objectiveness and appropriateness of the penalties arrived at. Given that there are already sufficient sanctions, we believe that it would be too onerous and repetitive, not to mention inappropriate and unfair, to attach financial advisers and its employees with the proposed secondary liability, which might, in turn, subject them to further penalties under the Listing Rules.

Another disciplinary sanction currently available to the Stock Exchange is the reporting of the offender's conduct to the SFC, Financial Secretary, the Banking Commissioner, any professional body or an overseas regulator under LR 2A.09(4). The Consultation Paper has a similar provision in the proposed LR 2A.10(10) on Appendix I-4. Section 23(8) of the Securities and Futures Ordinance (the "**SFO**") further stipulates that the Stock Exchange may refer breaches of the Listing Rules and other misconduct by a solicitor and a certified public accountant to the Law Society and the Hong Kong Institute of Certified Public Accountants for their respective follow-up actions.
Having regard to the current range of sanctions against financial advisers and its staff as described in the above 5th paragraph, which can similarly be imposed on other types of professional advisers, we submit that instead of including a RP which cannot be found in the Securities Rules (see the above 1st paragraph), the Stock Exchange might find it more fruitful to fully exercise the referral power vested in it by LR 2A.09(4) and/or seek an expansion of its section 23(8) power to refer Listing Rules breaches and other misconduct by other types of PAs (in addition to solicitors and accountants) to their respective professional bodies for possible disciplinary actions.

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