

# OTHER RECENT RULE AMENDMENTS AND PRACTICAL COMPLIANCE ISSUES FOR LISTED ISSUERS

Janet Chiu

Listing Division, HKEx

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# Agenda

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## **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

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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

Day 1	<ul style="list-style-type: none"> <li>• A trademark license agreement between Listco and Entity A signed (subject to confidentiality)</li> </ul>
Day 8	<ul style="list-style-type: none"> <li>• Widely reported news on Mainland government's approval of Entity A's project</li> </ul>
Days 8 and 9	<ul style="list-style-type: none"> <li>• Substantial increase in Listco's share price</li> <li>• Market rumor on cooperation between Listco and Entity A</li> <li>• Media report on Listco's denial of market rumor</li> </ul>
Day 9	<ul style="list-style-type: none"> <li>• Standard denial announcement by Listco to clarify share price movements</li> </ul>
Day 13 (after market close)	<ul style="list-style-type: none"> <li>• Announcement of the license agreement by Listco (Entity A's consent obtained)</li> </ul>
Day 14	<ul style="list-style-type: none"> <li>• Further increase in Listco's share price</li> </ul>

- Breach of Rules 13.09(1) and 2.13(2)

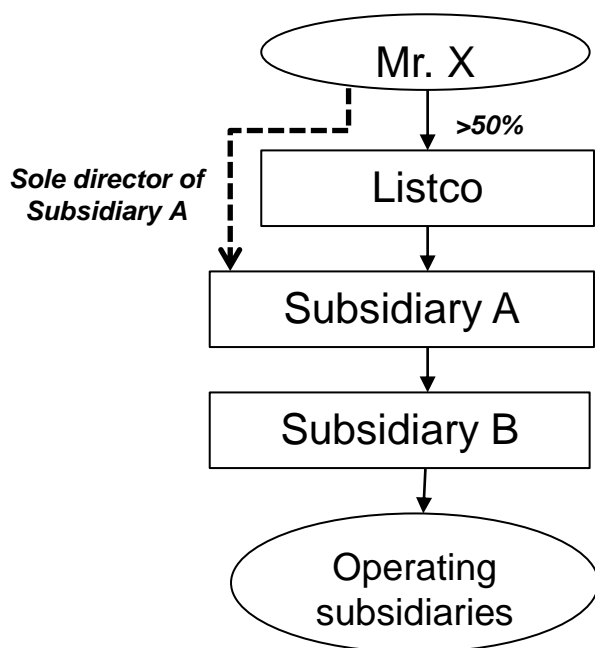
## Case study (2) : Handling PSI and market rumor

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

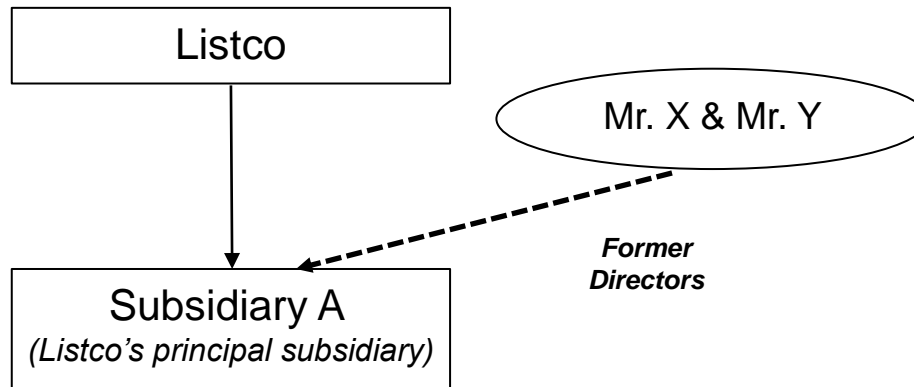
## Case study (3) : Transactions without proper approval

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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

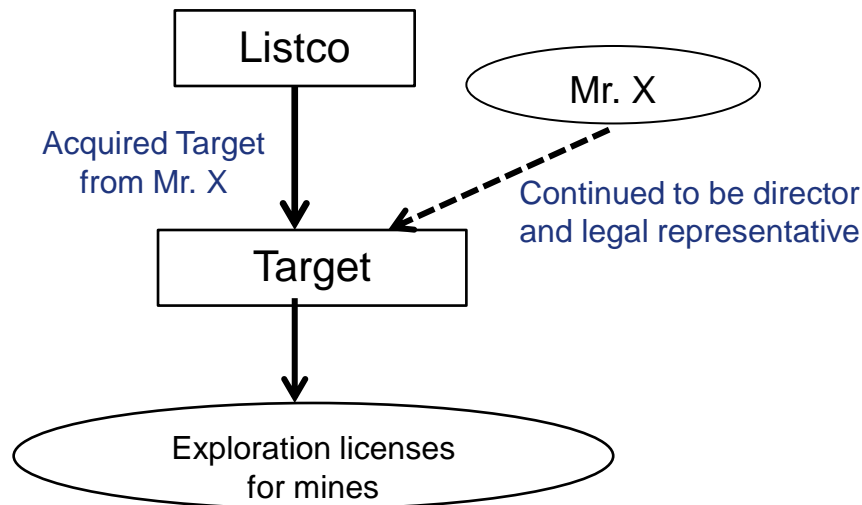
## Case study (4): Uncooperative outgoing management

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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

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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 interests in the issuer's affairs and obtain a general understanding of its business and follow up anything untoward.

## Other corporate governance issues

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- 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

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- 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

	2010	2009
Total	8,738 (100%)	6,365 (100%)
Fell within black out periods	507 (5.8%)	253 (4.0%)
- Exempt dealings / non-dealings	452 (5.2%)	219 (3.4%)
- Potential non-compliance cases	55 (0.6%)	34 (0.5%)

# Monitoring directors' dealings

## Common non-compliance cases

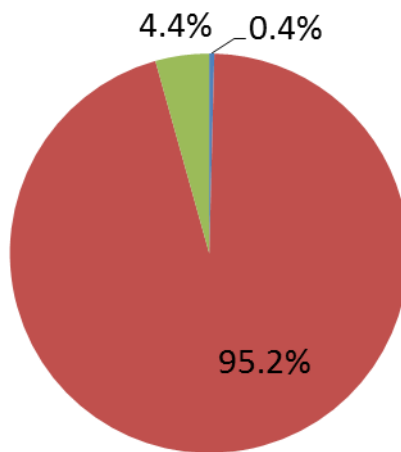
1. Dealings in shares:
  - on result publication day
  - during the first 30 days of the 60-day black out period
2. Granting share options / share awards during black out period
3. Postpone results publication date after identifying dealings during the original black out period
  - Commencement date of black out period would not change



# POST-VETTING ISSUERS' ANNOUNCEMENTS

## Pre and post-vetting of announcements

1 - 9 / 2011

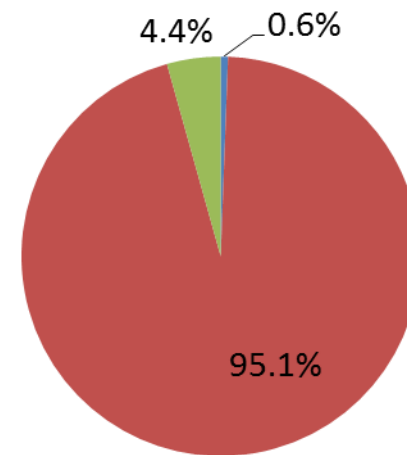


■ Pre-vetted

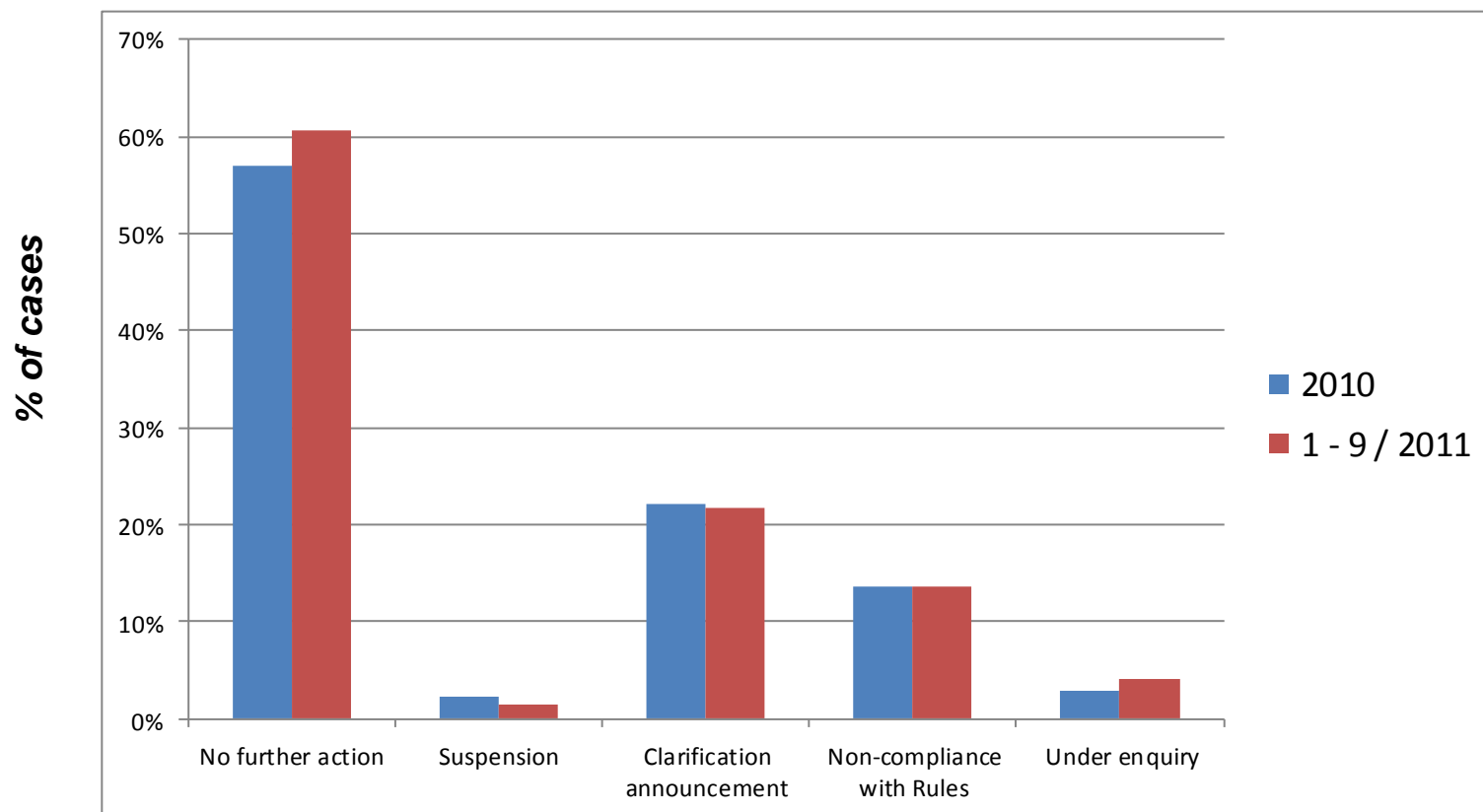
■ Post-vetted - without follow up

■ Post-vetted - with follow up

2010



## Results of follow up actions for post-vetted announcements



## Post-vetting

### – Handling of non-compliance with disclosure requirements

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- 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

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- 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

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- 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

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# **RULE AMENDMENTS – PROPERTY VALUATION REQUIREMENTS FOR LISTED ISSUERS**



## Property valuation – Current Rules

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

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

Transaction Type		Is property valuation required?	
		<i>Property interests to be acquired or disposed of</i>	<i>Property interests of the issuer group</i>
Notifiable Transaction*	Major / VSD	Yes	No
	VSA	Yes	Yes
Connected transaction subject to shareholders' approval		Yes	No

Rule change to **remove** this requirement

\* Reverse takeovers are subject to new listing requirements

# Property valuation

## - Rule amendments: New exemptions

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

Target company to be acquired or disposed of	Target company's property interests	Is property valuation required?	Disclosure in circular	Remarks
<b>Listed</b> “property company”	All property interests	No	Overview of property interests not valued	<i>New Rule (exempt property valuation)</i>
<b>Unlisted</b> “property company”	Immaterial property interests <ul style="list-style-type: none"> <li>• Each property interest's carrying amount &lt; 1% of issuer's total assets</li> <li>• Subject to a <b>10%</b> limit on total carrying amount for property interests not valued</li> </ul>	No	Overview of property interests not valued	<i>New Rule (exempt property valuation)</i>
	Other property interests	Yes	Summary disclosure of valuations for smaller property interests <ul style="list-style-type: none"> <li>• Each property interest's value &lt; 5% of all property interests required to be valued</li> </ul>	<i>New Rule (exempt disclosure of full text valuation report)</i>
			Full text of valuation reports for other property interests	<i>No change</i>

# Property valuation

## - Rule amendments: New exemptions

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

- Target company has 20 property interests:

Property No.	Carrying amount (% to Listco's total asset)	Is property valuation required?	Valuation (% to total property interests valued)	Disclosure in circular
1 ... 15	< 1% each (Total < 10%)	<b>No</b>	N/A	<b>Overview of property interests</b>
16	< 1% (Total for 1 to 16 > 10%)	<b>Yes</b>	1%	<b>Summary disclosure of valuations</b>
17	2%	<b>Yes</b>	3%	
18	4%	<b>Yes</b>	7%	<b>Full text of valuation reports</b>
19	20%	<b>Yes</b>	40%	
20	25%	<b>Yes</b>	49%	
			----- 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

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To require:

- 1) Additional disclosure in property valuation reports
- 2) General disclosure for material property interests in circulars

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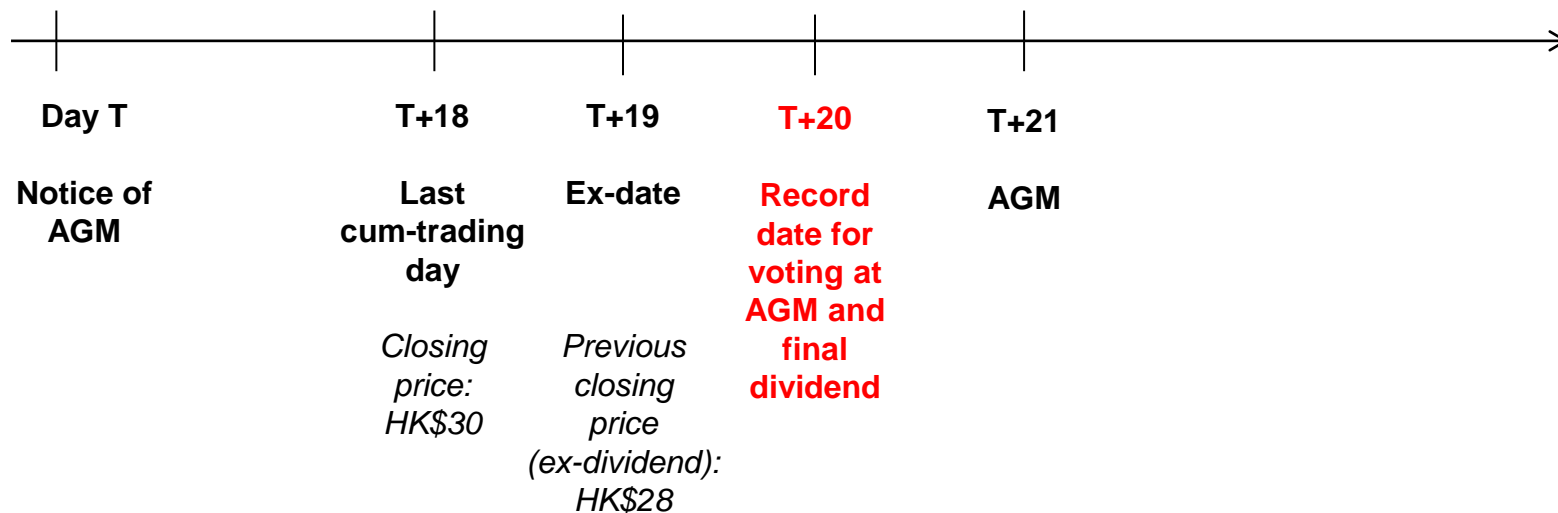
## **RULE AMENDMENTS – TRADING EX-ENTITLEMENT AFTER SHAREHOLDER APPROVAL**

## 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

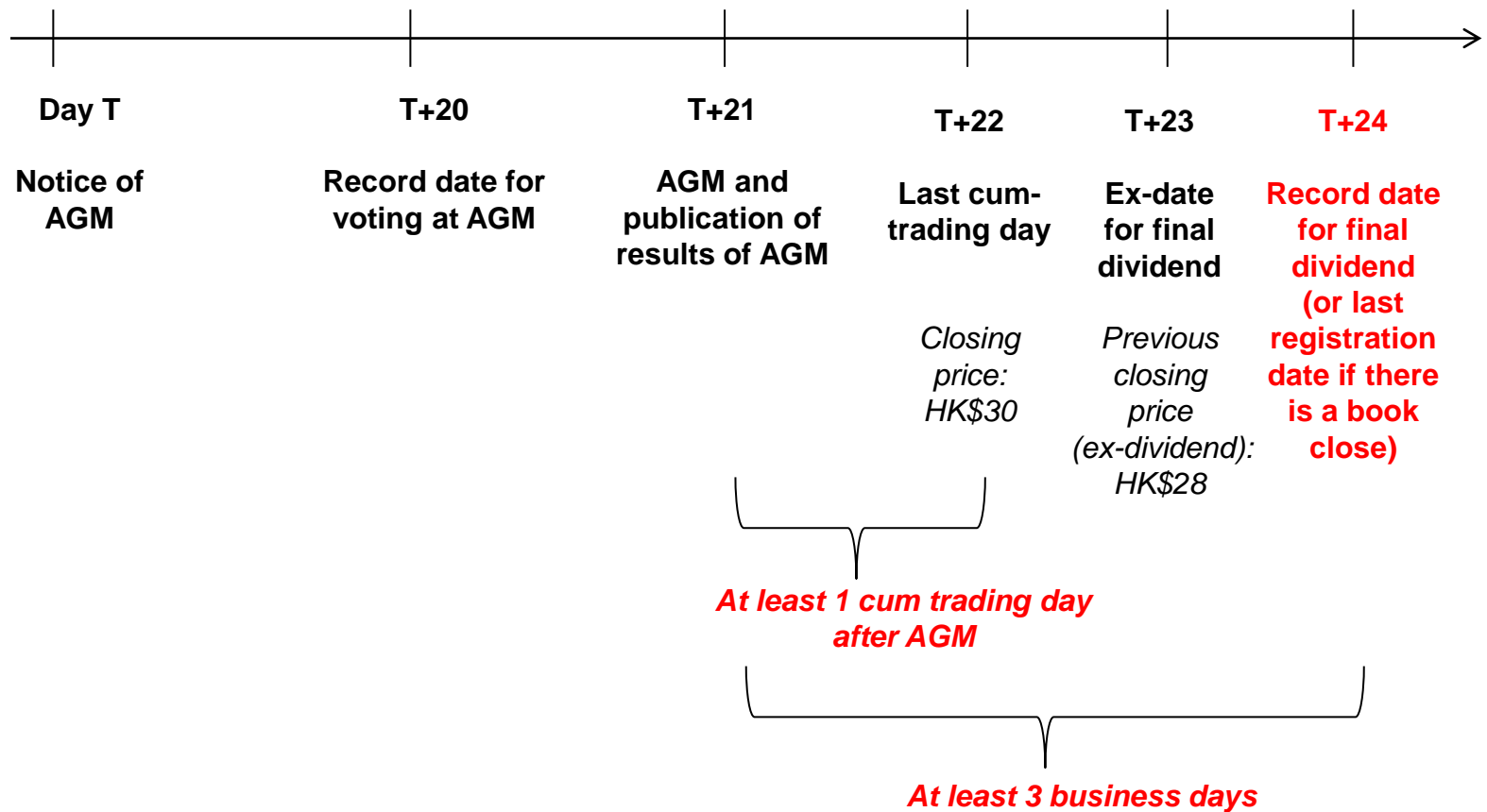
Approval of final dividend (e.g. HK\$2 per share) at AGM (before Rule amendments)





# Trading ex-entitlement - Example

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



# **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

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# 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

Day 1 (after 5:00 pm)	<ul style="list-style-type: none"><li>• Placing agent approached Listco for a placing</li></ul>
Day 2 (at 8:00 am)	<ul style="list-style-type: none"><li>• Placing agreement expected to be signed on Day 2</li><li>• Listco requested trading suspension</li></ul>

→ No suspension unless confidentiality cannot be maintained

→ Listco should plan the signing of agreement outside trading hours

## Share trading suspension - Example 2

Day 1 (at 9:00 pm)	<ul style="list-style-type: none"><li>• Agreement on major transaction signed</li></ul>
Day 2 (morning session)	<ul style="list-style-type: none"><li>• Trading suspended</li></ul>
Day 2 (lunch break)	<ul style="list-style-type: none"><li>• Major transaction announcement published</li><li>• A block-trade of Listco's shares commenced</li><li>• Listco requested continued suspension</li></ul>

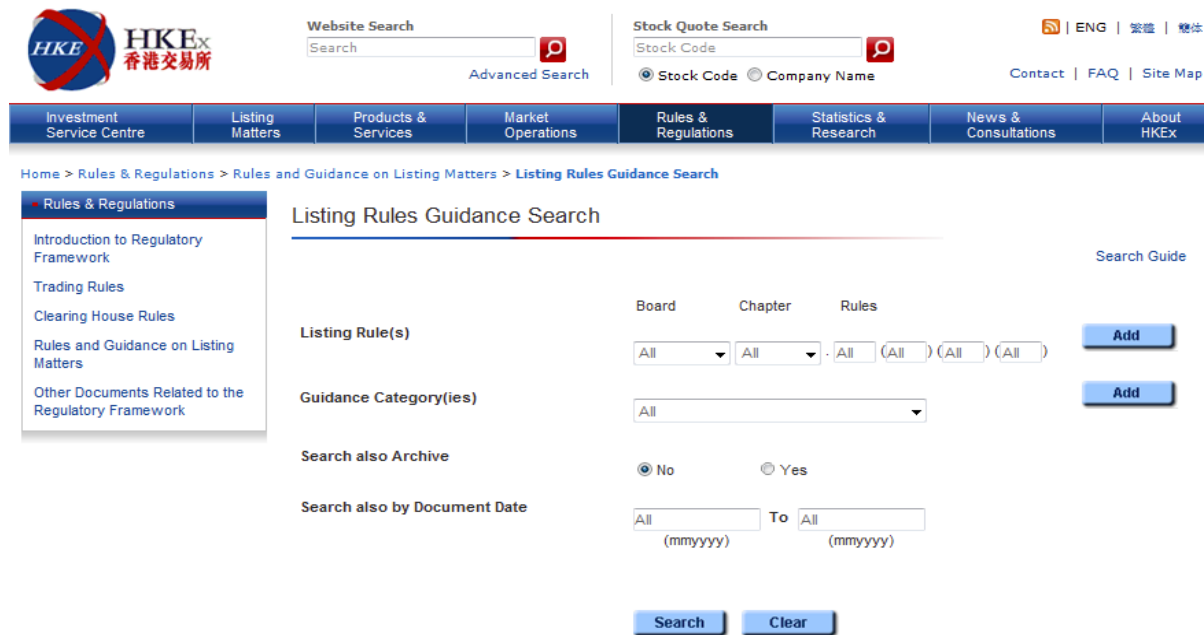
→ Continued suspension allowed to avoid a disorderly market

→ 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



The screenshot shows the HKEx website's search interface for Listing Rules and Guidance. At the top, there are search boxes for 'Website Search' and 'Stock Quote Search'. Below these is a navigation menu with categories like 'Investment Service Centre', 'Listing Matters', 'Products & Services', 'Market Operations', 'Rules & Regulations', 'Statistics & Research', 'News & Consultations', and 'About HKEx'. The 'Rules & Regulations' section is expanded, showing a sidebar with sub-categories such as 'Introduction to Regulatory Framework', 'Trading Rules', 'Clearing House Rules', 'Rules and Guidance on Listing Matters', and 'Other Documents Related to the Regulatory Framework'. The main content area is titled 'Listing Rules Guidance Search' and includes a 'Search Guide' link. It features several search filters: 'Board', 'Chapter', and 'Rules' (each with a dropdown menu set to 'All'); 'Listing Rule(s)' (with an 'Add' button); 'Guidance Category(ies)' (with a dropdown menu set to 'All' and an 'Add' button); 'Search also Archive' (with radio buttons for 'No' and 'Yes', where 'No' is selected); and 'Search also by Document Date' (with two date input fields set to 'All' and '(mmyyyy)' format). At the bottom, there are 'Search' and 'Clear' buttons.

**THANK YOU**