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Listed Issuer Regulation Newsletter

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Welcome to the November 2023 edition of HKEX's Listed Issuer Regulation Newsletter. As a market regulator, we are committed to enhancing market transparency, quality, and governance standards, as well as increasing the vibrancy, competitiveness and attractiveness of our markets. Published on a semi-annual basis, this newsletter keeps you updated on our regulatory developments and supports you on your compliance journey.

The paperless listing regime

In June 2023, we published a conclusion to our consultation on **Proposals to Expand the Paperless Listing Regime and other Rule Amendments**. We will amend our Rules with effect from **31 December 2023** to streamline issuers' communications with us and their shareholders.

Under the amended Rules:

- Issuers must submit documents to the Exchange **by electronic means**, unless otherwise stated in the Rules[1] or required by us;
- Certain documents and undertakings are no longer required to be submitted to the Exchange, as the obligations will be codified into the Rules or disclosed in issuers' published documents. See examples in the box below; and
- Issuers **must** distribute their corporate communications to shareholders electronically, as further discussed below.

Codification of undertakings in the Rules:

- Declaration and Undertaking with regard to Directors form[2] (the **DU form**).
- Declarations and undertakings by financial advisers[3] and independence confirmation by independent financial advisers[4].

Disclosure in issuers' documents in lieu of submission to the Exchange:

- Disclosure in annual reports of annual confirmation by auditors on continuing connected transactions[5] and by independent directors on their independence[6];
- Disclosure in transaction announcements or circulars of matters relating to profit forecast (e.g. letters from auditors and financial advisers and confirmations by the board that they have made the forecast after due and careful enquiry)[7];
- Disclosure in directors' appointment announcements of the independent directors' confirmation of independence with reasons[8];
- Disclosure in next day returns of notification to the Exchange on changes in listed securities of issuers[9];

[1] For example, submission of documents for prospectus authorisation and registration until digitalisation of the processes.
[2] MB Rule 13.51(2) and Appendix 5B / GEM Rule 17.50(2) and Appendix 6.
[3] Appendices 29 and 30 to MB Rules / Appendices 21 and 22 to GEM Rules.
[4] MB Rule 13.85(1) and (2), Appendices 21 and 22 / GEM Rule 17.97(1) and (2), Appendices 13 and 14.
[5] MB Rule 14A.57 / GEM Rule 20.55.
[6] MB Rules 3.13 and 3.14 / GEM Rules 5.09 and 5.10.
[7] MB Rule 14.62 / GEM Rule 19.62.
[8] MB Rules 3.13 and 3.14 / GEM Rules 5.09 and 5.10.
[9] MB Rule 13.31 / GEM Rule 17.35.

Corporate communications with shareholders to be distributed electronically

Currently, issuers may distribute corporate communications (i) in printed form or (ii) electronically, provided that they have sought and obtained a consent from shareholders. This can be in the form of (a) an express and positive confirmation in writing (**Express Consent**); or (b) a **Deemed Consent** after the issuers have asked each shareholder individually for a consent to communicate through their websites and not received an objection within 28 days.

Under the amended Rules and subject to the laws and regulations of their places of incorporation, issuers **must** disseminate corporate communications to their shareholders electronically and **may do so without the need to seek individual shareholder consent**, i.e. by relying on an **Implied Consent** from shareholders.

In other words, commencing next year:

- Issuers currently disseminating corporate communications in **printed form** must convert to electronic communication. They may rely on an Implied Consent if such consent mechanism is permitted by laws and regulations (e.g. applicable to issuers incorporated in the Cayman Island, Bermuda, PRC or Singapore) or obtain an Express or Deemed Consent from shareholders to disseminate electronically if an Implied Consent mechanism is prohibited by laws and regulations (e.g. Hong Kong)*.

  As a transitional arrangement, if an issuer's constitutional documents contain provisions restricting its ability to disseminate corporate communications electronically, it must amend its constitutional documents by the first annual general meeting following 31 December 2023[10].

- Issuers already disseminating in **electronic form** (under Express or Deemed Consent) should continue electronic dissemination by either maintaining their existing consent mechanism (i.e. Express or Deemed Consent) or adopting an Implied Consent mechanism if permitted by laws and regulations*.

An issuer may disseminate electronically under the Rules by:

- sending the document to its shareholders using electronic means (e.g. by email with the relevant document or weblink to that document on the issuer's website); or
- making the document available on its and the Exchange's websites.

For **Actionable Corporate Communication**[11], however, issuers must send the communication to shareholders **individually**. Making them generally available on the websites will not meet the Rules requirement.

Issuers must send corporate communications in **printed form** to shareholders free of charge if their shareholders so request. They should disclose on their websites the arrangements for making such requests, and these arrangements must not be unduly burdensome for shareholders[12].

Note(*): The laws and regulations of Hong Kong, the UK and US prohibit the use of an Implied Consent for electronic dissemination. Issuers incorporated in these jurisdictions can adopt or continue to adopt an Express or a Deemed Consent mechanism.

[10] In the circumstances where the company law in the issuer's jurisdiction of incorporation restricts electronic dissemination,the issuer must amend its constitutional documents by the first annual general meeting after the legal or regulatory restriction is removed.

[11] These are communications which seek instructions from shareholders on how they wish to exercise their rights or make an election as the shareholders, such as provisional allotment letters or excess application forms of a rights issue.

[12] For example, the need to request printed form communications on a per document basis would be considered unduly burdensome to shareholders.

Other matters to note

- **Change of dissemination arrangements** – An issuer desiring to make a change (e.g. from Deemed Consent to Implied Consent, or from printed form to electronic communication) should send a one-time notification to its shareholders individually and by the method that the shareholders have opted for (electronic or printed). It should also ask shareholders for their functional electronic contact details (if not already received) and explain the purpose of such request.

  Issuers are reminded that a change in consent mechanism in electronic dissemination will not make the existing requests for printed communications invalid. For example, if an issuer changes from Deemed Consent to Implied Consent, it should continue sending printed corporate communications to shareholders who have made these requests previously, until these requests are revoked, suspended or expired.

- **Handling unsuccessful deliveries** – If an issuer attempts to send a corporate communication electronically and receives a non-delivery message, it should send the document to the shareholder using other electronic means or in printed form. In the case of an Actionable Corporate Communication, the issuer must send the document in printed form together with a request for functional electronic communication details of the shareholder.

We have recently published **FAQs No119-2023 to 134-2023** to provide further guidance to issuers on the new requirements.

Guide on internal controls and planning for upcoming audit

This year, we conducted a thematic review of issuers that failed to publish financial results on time or received a modified audit opinion on their financial statements. Our review also covered issuers against which we had taken disciplinary actions for their failure to maintain proper internal controls[13].

From our review we noted that poor internal controls and audit planning were often the culprit of these issues. Issuers should have sound financial reporting controls and processes including (i) a continuous review of the issuers' principal risks and assessment of the adequacy of the internal controls; (ii) effective planning of the audit process, taking into account the principal risks identified and material changes during the year; (iii) effective monitoring of the audit progress; and (iv) reporting. We set out our observations below.

Identifying and managing principal risks

In today's dynamic business environment, issuers face challenges arising from changes in economic conditions, regulations, industry landscape and competition; or in their own operations as a result of mergers and acquisitions or other corporate actions. These changes may have a material impact on the issuers' market, operational and compliance risks. Management should establish a risk management policy to identify these risks, develop risk-mitigating controls, and review the control effectiveness on an ongoing basis to provide for timely and accurate reporting of issuers' financial statements.

In our review, we identified some common internal control weaknesses:

- During periods of economic/ industry downturns or material changes in the issuers' financial performance, issuers lacked internal guidelines to assess and document such impacts (e.g. going concern assumption, recoverability of receivables from customers, and valuation of properties).
- Some issuers lacked policies and control procedures on origination and execution of corporate transactions (such as acquisitions and disposals of assets) and provisions of financial assistance. This led to insufficient due diligence, approvals and documentation to substantiate their commercial substance and business rationale.
- Some issuers failed to exercise sufficient control or supervision over acquisition targets, leading to failures such as lack of access to targets' books and records and inadequate approval process over targets' activities, leading to dissipation of assets.
- Some issuers failed to arrange for audit work on the subsidiary in the year of its disposal, resulting in audit qualification due to lack of access to its books and records.

[13] As of 31 October 2023, the Listing Division has issued statement of disciplinary action against 9 issuers and/or their directors for material internal control deficiencies (2022: 11).

Effective audit planning and communication with auditors and experts involved

A good audit starts with proper planning, including early engagement with auditors to agree on audit fees and audit plans. If issuers identify material changes in their principal risks that may impact the financial statements and/or the auditing process, they should draw them to the auditors' attention at the planning stage. Both parties should agree on the audit approach and the supporting documents required. They should also agree on a timetable, which should be detailed with key milestones on addressing major risk areas. The Audit committee should oversee this process.

If new auditors are appointed, issuers should be mindful of possible requirements for additional resources and time while developing their audit plans, noting that the new auditors may not be familiar with the issuers' operations, and may also adopt audit approaches and methodologies different from the former auditors and perform extra audit procedures on the issuers' historical financial statements (e.g. opening balances).

Before commencement of the audit, issuers should engage experts (e.g. valuers), if necessary, and agree with them on a work schedule that aligns with the audit timetable.

Active monitoring of audit progress

Issuers' management and audit committee should closely monitor the audit progress. If there are material departure from the timetable and/or substantial audit issues identified, management should timely escalate the matters to the audit committee. The audit committee should proactively facilitate the resolution of the audit issues.

Disclosure in issuers' annual and corporate governance reports

In the corporate governance reports, issuers should disclose details of the risk management and internal control systems, including the process used to identify and manage significant risks; the main features of the systems; and that management is responsible for reviewing its effectiveness.

Note on disclosure:

We highly recommend issuers disclose their principal risks, internal control deficiencies identified and measures taken to address the deficiencies. Issuers are also encouraged to confirm in the reports that they have reviewed the effectiveness of the issuers' risk management and internal control systems and highlight any issues identified and how they were addressed[14].

When an auditor issues a modified audit opinion and discloses its basis of audit modifications, the issuer should, for transparency, disclose in the annual report (i) details of the modifications and their impact on the issuer's financial position; (ii) management's position and basis on major judgmental areas and how it is different from that of the auditor; (iii) the audit committee's view including whether it agrees with the management's view; and (iv) the issuer's plans to address the modifications[15].

[14] Code Provision D.2.8 of Appendix 14 to MB Rules / Appendix 15 to GEM Rules.

[15] These recommended disclosures are highlighted in our **Review of Issuers' Annual Report Disclosure Report 2017** and reports for subsequent years.

Review of issuers' corporate governance practices and new INED guide

As part of our continuous efforts to promote high corporate governance standards amongst issuers, we published the findings from our latest review of issuers' corporate governance **(CG)** practices and a new guide for independent non-executive directors **(INEDs)** earlier this month.

Review of issuers' corporate governance practices

Our review focused on compliance with the requirements introduced to the Corporate Governance Code in 2022. We encourage issuers to read the **review report**, which sets out our findings and provides guidance to issuers on the improvements they could make to their CG practices.

Key recommendations:

- **Corporate culture**: Comprehensive disclosure should include details on how corporate culture has been implemented and supports an issuer's long-term business objectives.
- **INEDs who have served more than nine years**: Periodic board refreshment fosters sharing of diverse perspectives, and issuers should regularly assess their board composition in response to change. Where a long-serving INED is retained, sufficient details regarding that individual's suitability for re-appointment should be disclosed.
- **Diversity**: Issuers should formulate long-term targets and timelines to further progress gender diversity on their boards and within the wider workforce. Existing single gender board issuers should proactively seek to appoint at least one director of a different gender before the deadline of **31 December 2024**.
- **Risk management and internal control**: Regular monitoring and (at least) annual reviews of the systems are key to proper risk management. Issuers should provide sufficient details of the reviews they have conducted to support their findings that those systems remain effective.

New INED guide

INEDs play a crucial role in effective governance. Our new guide, **A Snapshot of INEDs' Roles and Responsibilities**, provides a quick and easy-to-follow overview of INEDs' key responsibilities and obligations. INEDs are encouraged to familiarize themselves with the guide to better understand what is expected of them and how they can fulfill their duties under the Rules.

Guidance letter on disclosure of consideration basis and business valuations in transactions

In vetting issuers' transaction circulars, we identified from time to time cases where the disclosure made by issuers on the basis for the consideration paid in a transaction was inadequate. Against this background, we published guidance letter **GL116-23** last month to set out the disclosure gaps identified from our vetting and our guidance. In particular,

- Where the consideration paid in a transaction is primarily based on an independent business valuation, the shareholder circular should disclose details of the valuation (including valuation approaches and methods, key inputs and assumptions); and
- In other cases, the issuer should make relevant disclosure (both in quantitative and qualitative terms) to explain the consideration basis, regardless of whether an independent business valuation is disclosed.

Issuers should read this guidance letter and ensure that their disclosure meet the disclosure standard set out in our Rules[16], and would assist investors in understanding the basis for the consideration paid and more generally, whether the transaction is in the interest of the issuer and its shareholders.

[16] MB Rule 2.13 / GEM Rule 2.18 requires that information contained in issuers' circulars must be accurate and complete in all material respects and not be misleading or deceptive.

Streamlined listing regime for PRC issuers

Rule amendments consequential to the repeal of the Mandatory Provisions

Since 31 March 2023, the China Securities Regulatory Commission (CSRC) implemented a new regulatory framework for the overseas listing of Mainland-based companies and repealed the Mandatory Provisions[17]. The new PRC regulations no longer require PRC issuers to deem their domestic shares and H shares as different classes and use arbitration to resolve disputes involving H shareholders.

To reflect the PRC regulatory changes, we have amended the Rules with effect from 1 August 2023, under which PRC issuers are no longer required to (i) hold separate class meetings for issuance or repurchase of shares; (ii) settle disputes involving H shareholders through arbitration; and (iii) include in their articles of association the Mandatory Provisions and other ancillary provisions.

Points to note:

PRC issuers must still adhere to their existing articles of association concerning class meetings and other provisions originally formulated based on the Mandatory Provisions where applicable, until and unless they amend their articles of association to remove such provisions.

In general, where PRC issuers propose to amend their articles of association to remove the class meeting requirements, they should (i) hold separate class meetings based on their existing articles of association, and (ii) explain in shareholder circulars the differences between the provisions of the existing articles of association and the proposed articles of association and any impact on measures relating to shareholder protection.

Other Rule amendments to align the requirements for PRC issuers with those applicable to other issuers

PRC incorporated issuers are subject to a separate chapter[18] under the Rules that imposes additional requirements on these issuers. These requirements have been in place since 1993, and impose additional requirements in light of the then PRC laws and regulation regime. Currently, there are 328 PRC issuers listed on the Exchange, including 143 A+H issuers and 185 H-share issuers.

In light of developments in PRC laws and the PRC financial markets and as part of our efforts to provide a consistent investor protection framework for all issuers regardless of their places of incorporation, we have removed or modified certain Rule requirements specific to PRC issuers that we consider no longer necessary. These Rule amendments aligned the requirements for PRC issuers with those applicable to other issuers listed on the Exchange and took effect on 1 August 2023. Under the amended Rules:

- The mandate limits on issuance of new shares under general mandate (of up to 20%) and share scheme mandate (of up to 10%) are based on a PRC issuer's total issued shares (both A and H shares), rather than requiring mandates for H shares and A shares separately;
- PRC issuers are no longer obligated to publish their annual returns for online display and open their branch registers of members in the PRC for physical inspection; and
- Directors, officers and supervisors of PRC issuers are no longer required to provide undertakings to the issuers and their shareholders on compliance with PRC laws.

For details of the Rule amendments, please refer to the **consultation conclusions** published in July 2023.

[17] The Mandatory Provisions for Companies Listing Overseas set forth in Zheng Wei Fa (1994) No. 21 issued on 27 August 1994 by the State Council Securities Policy Committee and the State Commission for Restructuring the Economic System.

[18] Chapter 19A of the MB Rules/ Chapter 25 of the GEM Rules.

Administrative reminder on filing listing application for placing of new shares

Recently, we received enquiries about the time required for the Exchange to approve new shares after a listed issuer conducts a placing to independent placees.

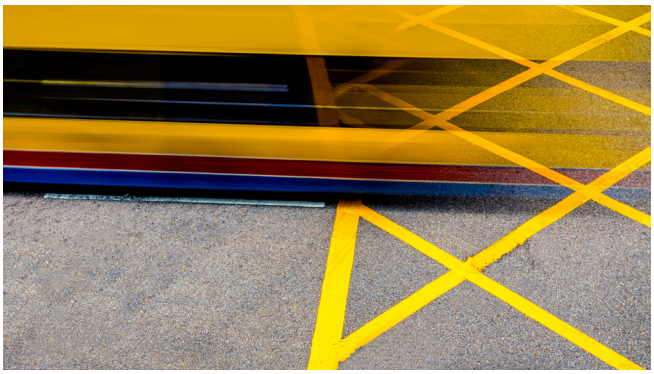
In our experience, our listing approvals may be delayed if information submitted by the issuer and its placing agents are incomplete. We have identified some common mistakes and omissions in the submissions, for example, where the placing involves multiple placing/ sub-placing agents, the placee lists and confirmations of placee independence are often submitted at different times by placing agents and the number of placing shares does not reconcile. Issuers should coordinate the submissions.

Other common omissions identified:

- Missing information on the beneficial owners of corporate placees in the placees list;
- Incomplete information related to the placees' addresses or missing identification numbers;
- Erroneous entry of placees' addresses, for example, copying address of another placee in the previous row of entry; and
- Errors in the number of placing shares.

In October, we updated the placee list template (Main Board issuers – **CI205M**/ GEM issuers – **CI205G**) to streamline data fields and added data validation in order to minimise manual input errors. **Placing agents should use the new template going forward.**

We normally grant listing approval **on or before the next business day** after receipt of all required information. Issuers requiring prompt listing approvals are recommended to contact our responsible officers to coordinate this process.



Reminder on making authorised representatives available

As part of our function to maintain a fair and orderly market in the trading of listed securities, we make enquiries with issuers from time to time. For example, we may seek clarifications on an issuer's published announcement before the market opens, or we may make enquiries on unusual share price or volume movements, market rumours or media reports. These enquiries are normally made with the authorised representatives by phone, and may be made before market opens or during trading hours. It is possible that trading in an issuer's securities may be halted pending a clarification announcement and in these cases, the trading halt must be promptly executed (and before the commencement of the trading session where possible) to avoid securities trading taking place in an unfair and/or disorderly market.

From time to time we experience difficulties in contacting the authorised representatives of some issuers, resulting in undue delays. We remind issuers that their **authorised representatives, as the principal channel of communications with the Exchange, should be contactable at all times, from 8:00 a.m. of any business day**. When an authorised representative is outside Hong Kong, the issuer should make available alternatives available and provide us with their contact information.

To facilitate prompt responses to our enquiries, **issuers should also put in place adequate arrangements to proactively monitor media coverage and make timely assessments of their disclosure obligations under the Inside Information Provisions.**

Other publications

We have recently published the following new guidance materials:

- **New e-learning Module** (4 August 2023) on requirements for share schemes (i) involving issuance of new shares of issuers; (ii) involving grants of existing shares; and (iii) of a subsidiary
- Updates of Guides (28 September 2023) on (i) practice and procedures for **Post-vetting Announcements** of listed issuers; (ii) selection on **Headlines and Title** of documents under electronic disclosure; and (iii) **Interpretation of the Rules** and requests for individual guidance.
- **Revised Listing e-Forms and Guidelines**
  - listing application forms for collective investment scheme and equity securities (Main Board issuers - FFD001M and GEM issuers – FF201G)
  - monthly return and next day disclosure return to reflect Rule changes relating to PRC issuers (FF301/FF304)
- **Revised GL95-18** (20 October 2023) to provide further guidance on exceptional circumstances in which the remedial period of a long suspended issuer may be extended.
- **GL117-23** (27 October 2023) to provide guidance on conducting automatic share buy-back programs on the Exchange and the framework for the Exchange's assessment in considering a waiver application.

We have also recently published:

- The information paper on **Rule Amendments Consequential to the Reforms to the IPO Settlement Process with the Launch of FINI and Housekeeping Rule Amendments** and **guidance materials** on the revised Rules (28 June 2023). The **FINI webpage**, a new digital platform modernizing the IPO settlement process, was launched on 22 November 2023.
- A consultation paper on **GEM Listing Reforms** (26 September 2023) to strike a balance between facilitating capital raising opportunities for issuers and protecting the interests of GEM investors.
- A consultation paper on **Proposed Amendments to the Rules relating to Treasury Shares** (27 October 2023) to remove the requirement to cancel repurchased shares and to adopt a framework in the Rules to govern the resale of treasury shares.

We welcome your feedback.
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