

CHARLTONS
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HKEX LISTING RULE CHANGES ON DISCIPLINARY POWERS AND SANCTIONS



STRUCTURE OF THE EXCHANGE

The Stock Exchange of Hong Kong Limited
(SEHK)



Listing committee



Listing division

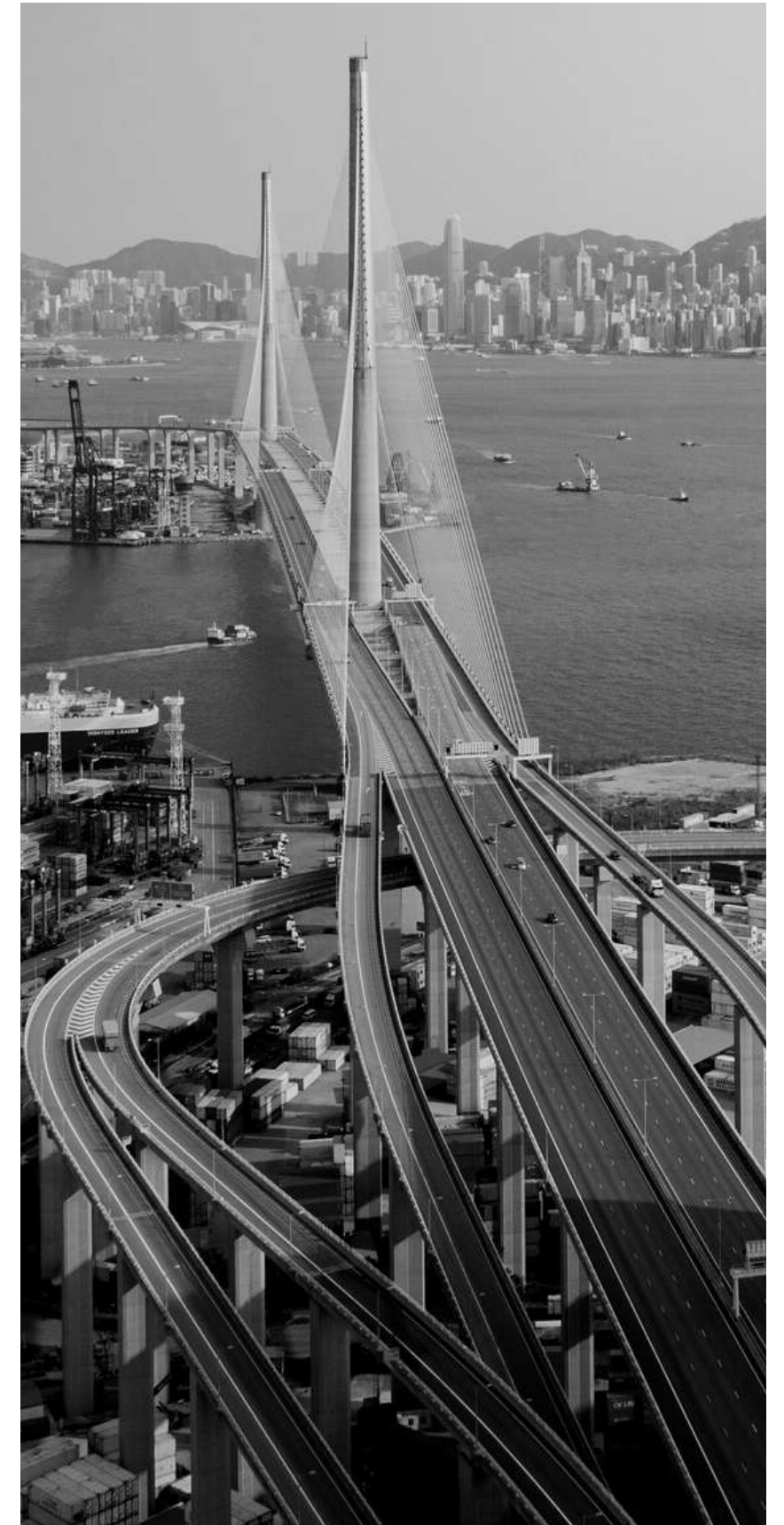
The SEHK is the formal decision making body on any amendments to the HKEX Listing Rules and has delegated certain functions and powers to the listing committee

The listing committee has the power and authority to act in relation to all listing matters

The listing division deals with matters relating to the HKEX Listing Rules in the first instance, including interpretation, administration and enforcement of the HKEX Listing Rules

SOURCES OF DIRECTORS' DUTIES

- The responsibilities and obligations of directors of Hong Kong-listed companies are derived from Hong Kong laws, the laws of the company's place of incorporation, and non-statutory regulations which include:
 - common law and applicable Hong Kong legislation, including the Companies Ordinance and the Securities and Futures Ordinance (**SFO**)
 - the HKEX Listing Rules
 - the SFC Takeovers Code
 - the HKEX director's undertaking
 - the Hong Kong Companies Registry Guide on Directors' Duties



SOURCES OF DIRECTORS' DUTIES (CONT'D)

Directors of HKEX listed companies:

- collective responsibility of the board for the listed company's **management and operations** (HKEX Listing Rule 3.08)
- collective and individual responsibility for ensuring that the listed company **complies fully with the HKEX Listing Rules** (HKEX Listing Rule 13.04)
- undertake to comply with the HKEX Listing Rules, Parts XIVA (disclosure of inside information) and XV (disclosure of interests in securities of the listed company and its associated companies) of the SFO and to cooperate with investigations



DIRECTORS' DUTIES

- Listing Rule 3.08 - requires directors, both collectively and individually, to fulfill fiduciary duties and duties of skill care and diligence to a standard at least commensurate with the standard established by Hong Kong law.
- Every director must in the performance of his duties as a director:
 - act honestly and in good faith in the interests of the listed company as a whole;
 - act for a proper purpose;
 - be answerable to the listed company for the application or misapplication of its assets;
 - avoid actual and potential conflicts of interest and duty;
 - disclose fully and fairly his interests in contracts with the listed company; and
 - apply such degree of skill, care and diligence as may reasonably be expected of a person of his knowledge and experience and holding office within the listed company.

SUMMARY OF THE PREVIOUS DISCIPLINARY SANCTIONS UNDER CHAPTER 2A OF THE LISTING RULES

- Chapter 2A of the HKEX Listing Rules is the source of the Exchange's disciplinary and sanctioning powers
- The Exchange may halt trading or suspend dealings in a listed company's shares or cancel its listing where necessary for investor protection or maintenance of an orderly market (HKEX Listing Rule 6.01)
- The Exchange has the power to impose sanctions which include:
 - censures
 - reprimands
 - public statements involving criticism



DISCIPLINARY ACTION TAKEN IN 2020 UNDER CHAPTER 2A

- The Exchange brought 20 disciplinary proceedings during 2020 of which 13 were concluded by the year end
- Sanctions were imposed on 59 listed company directors of whom 30 were executive directors, 20 were INEDs and 9 were non-executive directors
- Sanctions imposed included public censures, public statements involving criticism, private reprimands, and statements that a director's retention of office was considered prejudicial to investors' interests



PROPOSALS TO BE IMPLEMENTED UNDER THE REVISED DISCIPLINARY REGIME

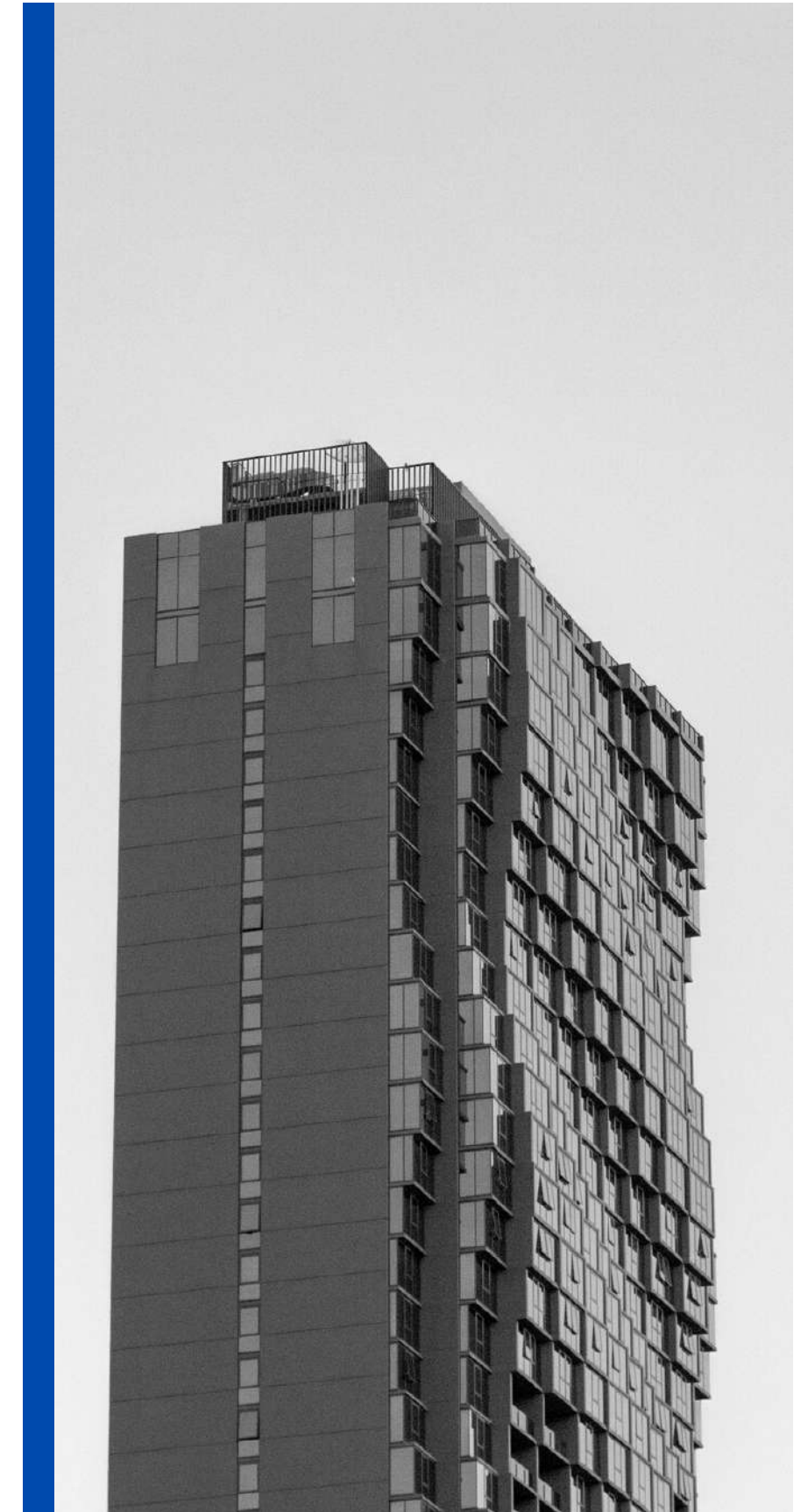
- The Exchange's proposals to revise its disciplinary powers and sanctions were set out in its consultation paper published on 7 August 2020
- Changes to the HKEX Listing Rules effective from 3 July 2021
- The HKEX is able to take disciplinary action against members of senior management of a listed company, if they cause or knowingly participate in a breach of the Listing Rules or a requirement imposed by the Listing Division or Listing Committee.



CHANGES TO THE EXCHANGE'S DISCIPLINARY POWERS

1. Amendments relating to a public statement that an individual's continued holding office of director of a listed company prejudices investors' interests

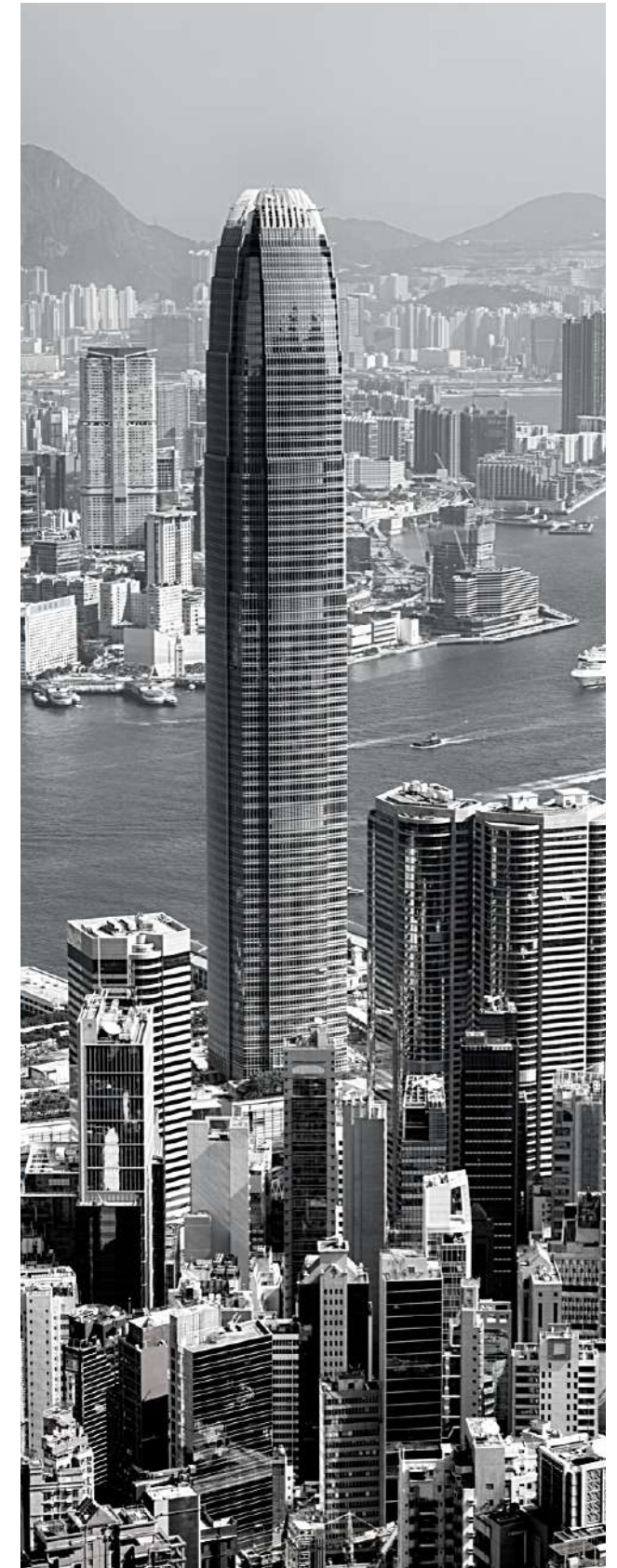
- Prior to the changes, where there was a “wilful” or “persistent” failure by a director to discharge his responsibilities under the HKEX Listing Rules, the Exchange could issue a Prejudice Statement
- Under revised HKEX Listing Rule 2A.10(4), the Exchange is able to issue a public statement that:
 - *“in the Exchange’s opinion the occupying of the position of director or senior management of a named listed issuer or any of its subsidiaries by an individual may cause prejudice to the interests of investors.”*



CHANGES TO THE EXCHANGE'S DISCIPLINARY POWERS (CONT'D)

The revised HKEX Listing Rule implements three changes:

1. Lowering threshold for issuing the Prejudice Statement by removing the requirement for there to be a “wilful” or “persistent” failure
2. Extending the scope of the Prejudice Statement to cover senior managers and officers of subsidiaries
3. Clarifying that Prejudice Statements can be imposed on persons no longer in office



CHANGES TO THE EXCHANGE'S DISCIPLINARY POWERS (CONT'D)

2. Exchange follow-on actions after making a Prejudice Statement

- Prior to the amendments, the Exchange had no power to remove from office an individual who was the subject of a Prejudice Statement
- Under the revised HKEX Listing Rules, in cases involving more serious misconduct, the Exchange is able to direct follow-on actions at the same time as making a Prejudice Statement against an individual
- In certain circumstances, the follow-on actions may include denying the listed company "*the facilities of the market*" - i.e. Exchange will withhold its approval



CHANGES TO THE EXCHANGE'S DISCIPLINARY POWERS (CONT'D)

3. Reference to Prejudice Statements with follow-on actions in Exchange announcements and corporate communications

- Where an individual is the subject of a Prejudice Statement - the listed company or its subsidiary will have to refer to the Prejudice Statement in announcements and corporate communications
- This will be required until the individual ceases to be a director or member of senior management of the listed company or the subsidiary named in the Prejudice Statement (new Listing Rule 2A.10A(1))



CHANGES TO THE EXCHANGE'S DISCIPLINARY POWERS (CONT'D)

4. Exchange extends disclosure in listing documents and annual reports

- The Exchange requires full particulars of any public sanctions made by statutory or regulatory authorities against their directors or members of senior management (whether current or proposed) be disclosed in a listing applicant's listing documents and a listed company's annual reports

5. Exchange removed the previous threshold for the denial of market facilities

- The threshold for ordering the denial of market facilities to be lowered by removing the requirement for a listed company's "wilful" or "persistent" failure in fulfilling its responsibilities



CHANGES TO THE EXCHANGE'S DISCIPLINARY POWERS (CONT'D)

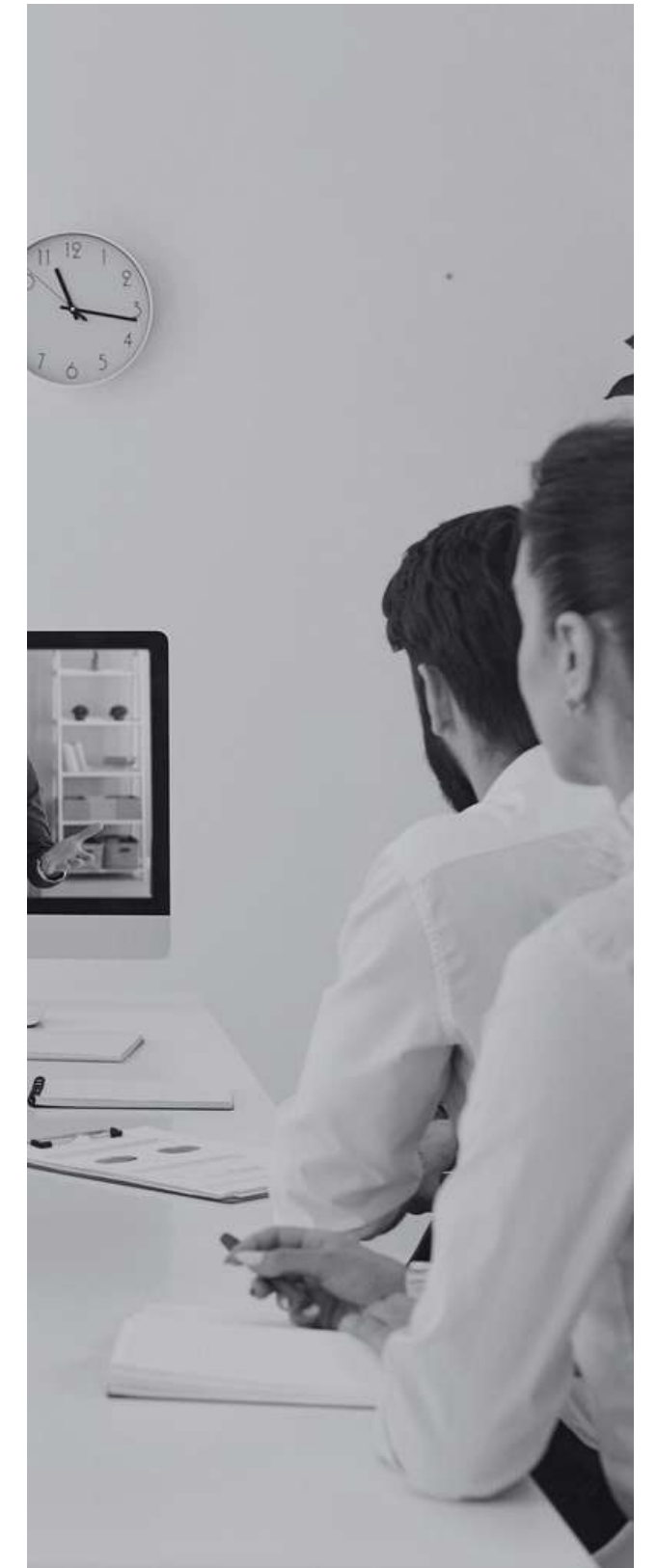
6. Exchange to include fulfilment of specified conditions in respect of the denial of market facilities

- Possible conditions to be fulfilled may include market facilities being denied until the listed company has:
 - carried out an independent internal controls review and implemented any relevant recommendations;
 - or sought and obtained independent shareholders' ratification of any relevant matter.

NEW EXCHANGE DISCIPLINARY SANCTION

1. Introduction of the Director Unsuitability Statement

- The Exchange has introduced a new disciplinary sanction which allows it, “in the case of serious or repeated failure by a director to discharge his responsibilities under the Listing Rules, [to] state publicly that in the Exchange’s opinion the director is unsuitable to occupy a position as director or within senior management of a named listed issuer or any of its subsidiaries” (**Director Unsuitability Statement**)
- Director Unsuitability Statement reserved for the most egregious cases of misconduct



NEW EXCHANGE DISCIPLINARY SANCTION (CONT'D)

2. Application of follow-on actions/publication for Director Unsuitability Statement

- follow-on actions (such as denying a listed company of market facilities), publication requirements and enhanced disclosures should apply to a director of a listed company who is the subject of a Director Unsuitability Statement.



ADDITIONAL CIRCUMSTANCES WHERE THE EXCHANGE CAN IMPOSE DISCIPLINARY SANCTIONS

1. Imposition of secondary liability for HKEX Listing Rule breaches

- Expansion of the scope of the parties whom the Exchange may sanction
- Relevant Parties to be subject to secondary liability in certain circumstances involving breach of the HKEX Listing Rules
- New HKEX Listing Rule 2A.10B imposes secondary liability on Relevant Parties who cause by action or omission or knowingly participate in a breach of the Listing Rules or a requirement imposed by the Listing Division or Listing Committee



ADDITIONAL CIRCUMSTANCES WHERE THE EXCHANGE CAN IMPOSE DISCIPLINARY SANCTIONS (CONT'D)



Legal basis

- The Exchange has broad powers to make rules on matters that are necessary or desirable for the proper regulation and efficient operation of the market
- The Exchange's authority was limited to solicitors or certified public accountants in private practice (the **Professional Parties**), except in certain circumstances specified in the arrangements between the Exchange and the regulatory bodies for the Professional Parties



ADDITIONAL CIRCUMSTANCES WHERE THE EXCHANGE CAN IMPOSE DISCIPLINARY SANCTIONS (CONT'D)

- the following note has been included in new Listing Rule 2A.10B:
 - *“In respect of parties covered by section 23(8) of the SFO, a sanction may be imposed under rule 2A.10B(3) in and only in the circumstances prescribed for disciplinary action in the arrangements agreed from time to time between the Exchange and the relevant professional regulatory body; and, in considering whether a party covered by section 23(8) of the SFO has breached rule 2A.10B(3), the Exchange will take into account, among other things, whether such party has knowingly or recklessly facilitated or participated in a breach of the Listing Rules or any undertaking given or any agreement with the Exchange.”*
- The Exchange notes that the amendments will not widen the scope for liability beyond those agreed arrangements





ADDITIONAL CIRCUMSTANCES WHERE THE EXCHANGE CAN IMPOSE DISCIPLINARY SANCTIONS (CONT'D)

Threshold for imposing secondary liability

- The Exchange will consider the Relevant Parties' roles and responsibilities in respect of the breach and also the listed company's compliance with the HKEX Listing Rules in determining whether secondary liability is established
- Liability for an omission will only apply to a person who has a duty to act
- Existence of knowledge relevant to "*knowing participation*"

ADDITIONAL CIRCUMSTANCES WHERE THE EXCHANGE CAN IMPOSE DISCIPLINARY SANCTIONS (CONT'D)

Scope / who is covered

(i) Substantial shareholders

(ii) Professional advisers

(iii) Senior management

- New Listing Rule 2A.09(2)(c)
- Company secretary is included in the definition of "Senior Management"



ADDITIONAL CIRCUMSTANCES WHERE THE EXCHANGE CAN IMPOSE DISCIPLINARY SANCTIONS (CONT'D)

2. Explicit sanction for failure to comply with requirements imposed

- The relevant requirements include those which are typically imposed on listed companies under specific provisions of the HKEX Listing Rules, or otherwise imposed on listed companies or individuals as a result of disciplinary actions taken

3. Secondary liability – failure to comply with a requirement imposed by the Exchange

- Secondary liability will only be imposed on those Relevant Parties which have caused by action or omission, or knowingly participated in, a breach of a requirement



ADDITIONAL CIRCUMSTANCES WHERE THE EXCHANGE CAN IMPOSE DISCIPLINARY SANCTIONS (CONT'D)

4. Obligation to provide complete, accurate and up-to-date information to the Exchange

- Express obligation to provide complete, accurate and up-to-date information when responding to Exchange enquiries or investigations

5. Inclusion of employees of professional advisers as Relevant Parties

- Employees of professional advisers to listed companies and their subsidiaries will be subject to disciplinary actions



ADDITIONAL CIRCUMSTANCES WHERE THE EXCHANGE CAN IMPOSE DISCIPLINARY SANCTIONS (CONT'D)

6. Inclusion of guarantors of structured products and debt securities as a Relevant Party

- Guarantors of structured products and guarantors for an issue of debt securities are regarded as Relevant Parties

7. Inclusion of a party giving an undertaking / entering into an agreement as a Relevant Party

- A clause in an undertaking or agreement will be included to alert the contracting parties and those who have provided an undertaking to the Exchange that they are all regarded as Relevant Parties



PROPOSED MINOR RULE AMENDMENTS CONCERNING THE EXCHANGE'S DISCIPLINARY POWERS AND PROCEDURAL MATTERS

1. Extending the ban on professional advisers to representation of any party

- the ban is a severe penalty and the Exchange will assess the circumstances for its imposition on a case-by-case basis

2. Listing Rules to impose express obligations on professional advisers

- professional advisers will be under an explicit duty:
 - to use all reasonable efforts to ensure that their clients understand and are advised on the scope of and their obligations under the HKEX Listing Rules; and
 - not to knowingly supply false or misleading information to the Exchange



PROPOSED MINOR RULE AMENDMENTS CONCERNING THE EXCHANGE'S DISCIPLINARY POWERS AND PROCEDURAL MATTERS (CONT'D)

3. Aligning the practices for filing review applications and requesting or providing written reasons for *decisions*

(i) Benchmark for counting relevant periods

- “business day” as defined in the Listing Rules to be used as the single unified counting benchmark for determining relevant periods for filing review applications, and for requesting or providing written reasons for decisions for both disciplinary and non-disciplinary review matters

PROPOSED MINOR RULE AMENDMENTS CONCERNING THE EXCHANGE'S DISCIPLINARY POWERS AND PROCEDURAL MATTERS (CONT'D)

(i) Review applications must be served on the secretary to the Exchange Listing Committee or the secretary to the Exchange Listing Review Committee

(ii) Counting of the period for filing review applications and requesting written reasons to start on the date of issue of the decision or written reasons (as applicable)

(iii) Counting of the period for providing written reasons to begin from the date of receipt of the request (i.e. within 14 business days)



PROPOSED MINOR RULE AMENDMENTS CONCERNING THE EXCHANGE'S DISCIPLINARY POWERS AND PROCEDURAL MATTERS (CONT'D)

4. Exchange housekeeping amendments without changes in policy direction

- Independent financial advisers to be included within the definition of “professional advisers”
- The HKEX Listing Rules in respect of the requirement to provide contact information for communication with regulators to be amended
- Relevant provisions of the HKEX Listing Rules and Directors’ Undertaking to be amended so that the SFC may also rely on them

