



SFC and HKEx Disciplinary Actions in April 2022

The Hong Kong regulatory enforcement actions concluded in April 2022 included the Takeovers Executive's public criticism of two former directors for breach of the SFC Takeovers Code's no frustrating actions rule. In a separate action, the SFC banned a licensed representative for 20 months for trades conducted without client authorisation and non-compliance with client account opening requirements.

The Stock Exchange of Hong Kong Limited (the **HKEx**) disciplined Hsin Chong Group Holdings Limited (**Hsin Chong**) and seven of its former directors in relation to agreements entered into between the company and related companies of an executive director of Hsin Chong.

Directors Public Criticism of Directors for Breach of the SFC Takeovers Code's No Frustrating Action Rule 4

The Takeovers Executive of the SFC has publicly criticised two directors, Mr Gao Yunhong (**Mr Gao**) and Ms Feng Xuelian (**Ms Feng**) for disposing of material assets of Steering Holdings Limited (**Steering**) during an offer period in respect of the company, in breach of Rule 4 of the SFC's [Code on Takeovers and Mergers](#) (the **SFC Takeovers Code**) - the no frustrating action rule. The SFC's Executive Statement of 7 April 2022 is available [here](#).

Frustrating Action in Breach of Rule 4 of the SFC Takeovers Code

Masterveyor Holdings Limited (the **Offeror**), a company wholly-owned by Mr Ng, an executive director of Steering, acquired 49% of Steering's shares in April 2021 from CMBC Capital Finance Limited (**CMBC**). The CMBC shares had been provided as security for a loan made by CMBC to Gentle Soar Limited (**Gentle Soar**), a company wholly-owned by a non-executive director of Steering, Mr Gao. CMBC sold the shares in enforcing the security for the loan. The share acquisition resulted in the interest in Steering of Mr Ng and parties acting in concert with him increasing from 4.62% to 53.62%, triggering an obligation on the part of the Offeror to make an unconditional mandatory offer for Steering under Rule 26.1 of the Takeovers Code.

Following the acquisition, and while the SFC's Takeovers Executive was vetting the Offeror's draft offer announcement, Steering announced that Mr Ng and all the independent non-executive directors (**INEDs**) had been removed from Steering's board. Only Mr Gao and Ms Feng remained as directors. On the day after the announcement, Steering announced that Mr Gao had informed the board that Gentle Soar had commenced legal proceedings against the Offeror, CMBC and Mr Ng in relation to CMBC's enforcement of its security over the Steering shares and the sale of those shares to the Offeror.

Two days later, Steering announced that a new executive director and three new INEDs had been appointed to its board of directors, which then consisted of Mr Gao, Ms Feng and the new directors. The new board met the next day and approved the disposal of 137,740,000 shares in CMBC Capital Holdings Limited (the **CMBCCH Shares**)

held by a wholly-owned subsidiary of Steering, Jet Speed Asia Pacific Limited (**Jet Speed**), of which Ms Feng was the sole director.

One week later, on 13 May 2021, the Offeror announced its firm intention to make an offer for the shares of Steering under Rule 3.5 of the Takeovers Code, and an offer period in respect of Steering commenced on the same day. On 14 May 2021, the Offeror's legal advisers wrote to the legal advisers of Gentle Soar, Mr Gao and Ms Feng reminding them that any disposal of Steering's assets (including the disposal of the CMBCCH Shares) may result in a breach of the frustrating action provisions of Rule 4 of the Takeovers Code.

On 17 May 2021, Gentle Soar's legal advisers wrote to the Takeovers Executive to consult on whether a general offer obligation under Rule 26.1 of the Takeovers Code was in fact triggered by the Offeror given the dispute over the share sale. The Takeovers Executive replied that regardless of the dispute, since the transfer of the Steering shares to the Offeror had been completed, the Offeror's obligation to make a general offer had been triggered under the Takeovers Code. Four days later on 21 May 2021, Steering published an announcement in response to the offer announcement in compliance with Rule 3.2 of the Takeovers Code. The announcement was issued under the authority of the new board.

On 1 June 2021, Steering announced that the CMBCCH Shares had been disposed of between 27 May and 1 June 2021 and that the disposal constituted a discloseable transaction under the HKEx Listing Rules. Ms Feng instructed a broker to sell the CMBCCH Shares on-market and informed Mr Gao of the sale.

On 15 June 2021, Steering announced the new board's resolutions that the previous resolutions approving the removal of Mr Ng and the previous INEDs and the appointment of a new executive director and INEDs were suspended as if they had not been effected. Consequently, Mr Ng and the original three INEDs of Steering were reinstated to its board.

Rule 4 of the SFC Takeovers Code

Rule 4 of the Takeovers Code aims to prevent an offeree company from taking any action which could result in an offer being frustrated or its shareholders being denied an opportunity to decide on the merits of an offer from the time when a bona fide offer has been made to the board of the offeree or the offeree's board has reason to believe that a bona fide offer may be imminent. The Rule applies irrespective of whether the offer is welcomed by the offeree. Rule 4 also serves to provide a level playing field for parties in an offer.

Rule 4 of the Takeovers Code provides that:

"Once a bona fide offer has been communicated to the board of an offeree company or the board of an offeree company has reason to believe that a bona fide offer may be imminent, no action which could effectively result in an offer being frustrated, or in the shareholders of the offeree company being denied an opportunity to decide on the merits of an offer, shall be taken by the board of the offeree company in relation to the affairs of the company without the approval of the shareholders of the offeree company in general meeting. In particular the offeree company's board must not, without such approval, do or agree to... (c) sell, dispose of or acquire assets of a material amount..."

Note 1 to Rule 4 provides that:

"The requirement of a shareholders' meeting may be waived by the Executive if the offeror ... agrees."

Note 6 to Rule 4 further provides that:

"For the purpose of determining whether a disposal or acquisition is of a "material amount" the Executive will, in general, apply the same tests as those set out in the Listing Rules to determine whether a transaction is a "discloseable transaction".

If several transactions relevant to this Rule 4, but not individually material, occur or are intended, the Executive will aggregate such transactions to determine whether the requirements of this Rule 4 are applicable to any of them.

The Executive should be consulted in advance where there may be any doubt as to the application of the above."

SFC Disciplinary Action: Public Criticism of Directors

Since the disposal of the CMBCCH Shares was a discloseable transaction under the HKEx Listing Rules carried out during an offer period, it constituted a frustrating action subject to the requirements of Rule 4 of the SFC Takeovers Code. However, Steering had failed to obtain its shareholders' approval of the frustrating action as required by Rule 4, nor did it seek a waiver of the requirement from the Takeovers Executive. This was a clear breach of the requirements of Rule 4.

The SFC viewed the failure to comply with the fundamental principle represented by Rule 4 of the SFC Takeovers Code as meriting disciplinary action. It took into account that Mr Gao and Ms Feng were the only directors on the board throughout the relevant period and that Ms Feng was the sole director of Jet Speed. The Takeovers Executive took disciplinary action against each of Mr Gao and Ms Feng because of their substantial involvement in the share disposal and their position as directors who owed duties to Steering.

Mr Gao and Ms Feng admitted the breaches of the requirements of Rule 4 of the SFC Takeovers Code, which they said were due to oversight and their misunderstanding of the SFC Takeovers Code requirements. As noted in the Takeovers Executive's disciplinary statement, the case illustrates the importance of listed company directors seeking professional advice where their actions may have implications under the SFC Takeovers Code. If there is uncertainty as to the Takeovers Code's application, the Takeovers Executive should be consulted at the earliest opportunity.

SFC Bans Licensed Representative for 20 Months for Trading without Client Authorisation

On 12 April 2022, the SFC banned licensed representative Mr Poon Choi Yung (**Mr Poon**) from re-entering the industry for 20 months in disciplinary proceedings under section 194 of the Securities and Futures Ordinance. The ban was imposed for breaches of the SFC's [Code of Conduct for Persons Licensed by or Registered with the SFC](#) (the **SFC Code of Conduct**) committed when Mr Poon:

- traded in clients' accounts without their specific authorisation of the trades and/or their written authorisation to effect the trades on a discretionary basis; and
- failed to exercise due skill, care and diligence in assisting clients to complete their account opening forms, and failed to take reasonable steps to establish their financial situations and investment experience during account opening.

The SFC's Statement of Disciplinary Action is available [here](#).

Mr Poon was a licensed representative of China Tonghai Securities Limited (**CTSL**) where he was responsible for client account opening and placing orders for clients. The SFC investigated Mr Poon after receiving a complaint from a CTSL client who claimed that Mr Poon had been irresponsible in operating her accounts.

Breach of SFC Code of Conduct Requirements

The SFC found that Mr Poon had breached General Principle 2 and paragraphs 5.1(a) and 7.1(a) of the SFC Code of Conduct.

General Principle 2 requires licensed persons to act with due skill, care and diligence, in the best interests of their clients and the integrity of the market.

Paragraph 7.1(a) provides that a licensed person should not effect a transaction for a client unless before the transaction is effected: (i) the client (or a person designated in writing by the client) has specifically authorised the transaction; or (ii) the client has authorised in writing the licensed person (or any person employed by the licensed person, who must in turn be a licensed person) to effect transactions for the client without the client's specific authorisation.

Paragraph 5.1(a) requires a licensed person to take all reasonable steps to establish the true and full identity of each of its clients, and each client's financial situation, investment experience and investment objectives. Where an account opening procedure other than a face-to-face approach is used, it should be one that satisfactorily ensures the identity of the client.

Conducting Discretionary Trades without Clients' Written Authorisation

The SFC investigation found that between June 2019 and March 2020, Mr Poon conducted 1,089 trades in six clients' stock options accounts at CTSL. The six clients had only agreed for Mr Poon to conduct 87 trades (approximately 8% of the total number of trades). He had no specific authorisations for the other 1,002 trades (around 92% of the total trades), nor had the clients authorised him in writing to effect the trades on a discretionary basis.

The SFC investigation revealed that:

- a) Mr Poon generally used CTSL's recorded telephone line to call each of the six clients once on each trading day to indicate that he would trade in the client's stock options account later that day;

- b) Mr Poon initiated all the recorded calls and the clients always agreed with his trading suggestions. The clients never initiated order instructions themselves;
- c) Mr Poon gave details of the 87 trades agreed to by clients during the recorded calls, but never specified any details (e.g. order size and price) of the other 1,002 trades;
- d) although the six clients had agreed that Mr Poon could trade in their stock options accounts at his discretion, the arrangements were never put into writing and CTSL was not informed of the discretionary trading arrangements. This breached CTSL's internal policies which required: (i) clients authorising CTSL and/or its representatives to effect transactions on their behalf on a discretionary basis to enter into a discretionary client mandate; and (ii) CTSL's senior management to approve the opening of a discretionary account by signing off on the discretionary client mandate. None of the clients had signed a discretionary client mandate.

Mr Poon clearly effected the 1,002 discretionary trades without the clients' specific authorisation for the trades and/or their written authorisation for him to effect the trades on a discretionary basis. This breached the requirements of paragraph 7.1(a) of the SFC Code of Conduct.

CTSL was not aware that the clients had agreed that Mr Poon could trade in their stock options accounts at his discretion, and the clients' stock options accounts were not designated as discretionary accounts by CTSL. The SFC considered this to be prejudicial to the clients' interests since CTSL was prevented from monitoring and supervising the operation of the accounts and clients were thus deprived of protection against the risk of unauthorised trades being carried out in their accounts. Mr Poon was found to have failed to act with due skill, care and diligence and in the best interests of the clients when conducting business activities, in breach of General Principle 2 of the SFC Code of Conduct.

Incorrect Information on Clients' Account Opening Forms

Mr Poon assisted three clients in completing their account opening forms between May 2019 and February 2020. However, he took no steps to establish and/or verify their financial situations and investment experience. This resulted in some of the answers relating to three clients' financial situations and investment experience in the account opening forms being incorrect.

Mr Poon also failed to properly conduct the risk disclosure procedures required by the account opening forms. He nevertheless signed the account opening forms, confirming that he had completed the relevant procedures for two of the three clients. It appeared that Mr Poon's only concern was to ensure that the account opening forms were completed in a way that would enable the clients to satisfy CTSL's suitability requirements for clients who wished to invest in its equity-linked notes.

It was therefore the SFC's view that Mr Poon had failed to act with due skill, care and diligence, and had failed to take all reasonable steps to establish the true and full identity of the three clients and their financial situations and investment experience. His conduct breached paragraph 5.1(a) and General Principle 2 of the SFC Code of Conduct.

HKEx Disciplinary Action against Hsin Chong and seven former Directors

On 11 April 2022, the HKEx sanctioned de-listed Hsin Chong and seven of its former directors for various breaches of the HKEx Listing Rules, including the requirements for notifiable and connected transactions, and of the directors' undertakings, including the undertaking to avoid conflicts of interest.

The HKEx:

- censured Hsin Chong and Mr Zhou Wei (**Mr Zhou**), a former executive director of the company;
- criticised the other six Hsin Chong directors and directed them to attend directors' training; and
- made a prejudice to investors' interests statement against Mr Zhou – due to his wilful failure to discharge his responsibilities under the HKEx Listing Rules, the HKEx issued a statement that if he had remained in office and Hsin Chong had remained listed, his retention of office would have been prejudicial to the interests of investors.

The HKEx suspended trading in Hsin Chong's shares in April 2017 and **delisted Hsin Chong** under HKEx Listing Rule 6.01A on 31 December 2019, after the company failed to resume trading by the required date. The HKEx's Statement of Disciplinary Action is available [here](#).

Discloseable and Connected Transactions

In 2016, Hsin Chong entered into: (i) a sale and leaseback agreement to acquire two properties for RMB500 million from a related company of Mr Zhou under which Hsin Chong paid RMB129 million as the first instalment; and (ii) a renovation cooperation agreement with another related company of Mr Zhou to renovate the properties under which Hsin Chong would pay consideration of RMB247.5 million. Both agreements were subsequently terminated and the sums paid by Hsin Chong were then treated as loans to Mr Zhou's related companies.

These transactions constituted discloseable and connected transactions under the HKEx Listing Rules. However, Hsin Chong did not comply with the applicable reporting, announcement, circular and shareholders' approval requirements. The transactions were not announced until 31 March 2017, and as at 31 December 2019 (when the company was delisted), Hsin Chong had not despatched a circular to its shareholders. The HKEx's Disciplinary Statement noted that there was no commercial rationale for the sale and leaseback agreement. In particular: (i) the eight-year leaseback allowed Mr Zhou's related company to lease the properties for an aggregate rent of RMB203.5 million (less than half the purchase price paid by Hsin Chong); and (ii) Hsin Chong was subject to a buy-back provision requiring it to sell the properties back to Mr Zhou's related company for RMB100 at the end of the eight-year lease.

Mr Zhou was the sole approver of the transactions. He did not notify Hsin Chong's board of directors, seek the board's approval of the transactions, or disclose his personal interests in them before the company entered into the transactions. The other six directors claimed they were not aware of the transactions until they were discovered by Hsin Chong's auditors when preparing its 2016 annual results. The transactions were raised as an audit issue and the annual reports for the three years ended 31 December 2016 were consequently subject to disclaimer opinions.

The loans remained outstanding as at the date of the 2017 Annual Report (23 March 2018).

Delays in Financial Reporting

Hsin Chong also failed to timely publish and/or despatch its 2016 annual results and 2017 annual report as required by the HKEx Listing Rules, with delays of 18 and 17 days, respectively.

Deficiencies in Listed Company's Internal Controls

Hsin Chong admitted that it lacked internal controls for, among other things, financial reporting, HKEx Listing Rule compliance for notifiable and connected transactions, approval and reporting of transactions, and avoidance of conflict of interest when it entered into the transactions. It admitted that the failure to report the transactions to the board of directors resulted from deficiencies in its internal controls at the time.

Hsin Chong's Listing Rule Breaches

The HKEx Listing Committee found that Hsin Chong had breached:

- HKEx Listing Rules 13.46(2) and 13.49(1) which set out the timing for the publication or despatch of a listed company's preliminary announcement of annual results and its annual reports; and
- HKEx Listing Rules 14.34, 14A.35, 14A.36 and 14A.46 which require a listed company to comply with the announcement, circular and/or independent shareholders' approval requirements for discloseable transactions and connected transactions.

Directors' Breaches of HKEx Listing Rules and Undertakings

Under HKEx Listing Rules 3.08, 3.16, and 13.04, the board of directors is collectively responsible for a listed company's management and operations. In particular, Listing Rule 3.08 provides that the directors must (among others) avoid potential and actual conflicts of interest and duty (HKEx Listing Rule 3.08(d)), and apply the degree of skill, care and diligence that may reasonably be expected of a person with his/her knowledge and experience and holding his/her office within the company (HKEx Listing Rule 3.08(f)). HKEx Listing Rule 3.08 also requires listed company directors to take an active interest in the company's affairs and acquire a general understanding of its business. They are also required to follow up anything untoward that comes to their attention.

Listed company directors are also under an obligation under the declaration and undertaking they give to the HKEx¹ to comply with the HKEx Listing Rules to the best of their ability and to use best endeavours to procure the company's compliance with the Listing Rules.

The Listing Committee found that Mr Zhou had breached HKEx Listing Rules 3.08(a), (b), (e) and (f) and his declaration and undertaking in:

- failing to avoid an actual conflict of interest;
- failing to disclose to Hsin Chong his personal interests in the transactions between his related companies and Hsin Chong;
- not acting honestly and in good faith in the interests of Hsin Chong and its shareholders;
- failing to conduct the business of Hsin Chong in accordance with applicable laws, rules and regulations, including the HKEx Listing Rules; and
- wilfully failing to exercise due skill, care and diligence in discharging his director's duties as indicated by the seriousness of the Listing Rule breaches.

The other six directors were found to have breached their duties of skill, care and diligence under Listing Rule 3.08(f) and their undertakings to comply with the HKEx Listing Rules to the best of their ability and to use their best endeavours to procure the company's compliance with the HKEx Listing Rules. The directors failed to:

- take an active interest in Hsin Chong's operations and use of its financial assets;
- ensure that adequate and effective internal controls were in place to safeguard the company's assets in relation to identifying and reporting material transactions and processing significant payments; and
- ensure that the company had adequate and effective internal controls for compliance with the HKEx Listing Rules' requirements for financial reporting and connected and notifiable transactions.

Where the company claimed that policies were in place, these were not properly implemented and no training was provided to the relevant staff.

The case acts as a reminder to directors of their obligations to take an active interest in the company's operations and the use of its financial assets, to safeguard company assets and ensure the company's compliance with the HKEx Listing Rules, and of their responsibility for implementing an appropriate control and risk management framework.

[1] in the form set out in Appendix 5B to the HKEx Listing Rules

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