



## HKEx and SFC Disciplinary Actions of October 2022

In October 2022, the Stock Exchange of Hong Kong Limited (the **HKEx**) published two disciplinary actions. The first involved the imposition of a Director Unsuitability Statement against a former executive director and chairman of Good Resources Holdings Limited and the censure of the company for breaches of the HKEx Listing Rules relating to transactions entered into by the company's subsidiary.

The second HKEx disciplinary action related to the issuance of a public censure and Director Unsuitability Statement against two directors of Biosino Bio-Technology and Science Incorporation for their failure to cooperate in an investigation by the HKEx.

The Securities and Futures Commission of Hong Kong (the **SFC**) published the results of actions against individuals for securities fraud, obstruction of the SFC's search operation, illegal short selling, non-compliance with the European Union's short selling requirements and securities dealing conducted in breach of the licensed corporation's staff dealing policy. It also published a public criticism against a company for its breaches of the Hong Kong Takeovers Code.

A further disciplinary action resulted in the making of an order by the Court of First Instance under section 214 of the Securities and Futures Ordinance (the **SFO**) for the chairman and executive director of Sound Global Ltd. to purchase the shares of the company's other shareholders. This was the first order of its kind made under section 214 and is the subject of a separate newsletter. See [Court Orders Sound Global Chairman to Purchase Investors' Shares](#).

## HKEx's Disciplinary Action against Good Resources Holding Limited (Delisted)

On 5 October 2022, the HKEx publically censured and imposed a Director Unsuitability Statement against Mr Chen Chuanjin (**Chen**), the former executive director and chairman of Good Resources Holdings Limited (**Good Resources**) a company listed on the Hong Kong Stock Exchange, now delisted. The Listing Committee found that:

- Good Resources had breached the HKEx Listing Rules relating to notifiable transactions; and
- Chen had breached his director's duties under HKEx Listing Rule 3.08 and his Director's Undertaking.

### Breach of HKEx Notifiable Transactions Rules

The HKEx Listing Committee determined that Good Resources' subsidiary (the **Subsidiary**) had engaged in several transactions and practices of concern between 2019 and 2020, having:

- entered into loan agreements (the **Loan Agreements**) with, and pledge contracts (the **Pledge Contracts**) to secure the loan obligations of, companies connected with Good Resources' controlling

shareholder. The pledges were enforced in September-November 2019 and the beneficiary bank deducted the pledged deposits of approximately RMB 981.6 million; and

- conducted circular payments of RMB 378 million on either side of Good Resources' end of year financial reporting point. The sum was transferred from one of the companies connected with the controlling shareholder on 30 June 2020 to the Subsidiary and returned one day later (the **Immediate Remittances**). The Subsidiary had claimed the Immediate Remittances were an operation error but the forensic reviewer found this to be unlikely.

In addition, provision of the Subsidiary's financial statements as at 30 June 2020 showed a subscription for certain wealth management products with a reported value of RMB 602.98 million (the **Purported Subscription**). Upon independent forensic review, it was discovered that the Purported Subscription never occurred. The forensic reviewer did not accept the Subsidiary's explanation of a misunderstanding and doubted the authenticity of certain purported subscription records. It was also suspected that the Purported Subscription and the Immediate Remittances were carried out to hide the enforcement of the Pledge Contracts as the sum of the Purported Subscription and Immediate Remittances added up to RMB 980.98 million.

The HKEx Listing Committee determined that Good Resources had, in relation to the Loan Agreements, failed to:

- publish an announcement as soon as possible after the terms of a notifiable transaction had been finalised in accordance with HKEx Listing Rule 14:34;
- publish and send a circular to its shareholders and the HKEx with regards to major transactions in accordance with HKEx Listing Rule 14:38A; and
- ensure that major transaction was made conditional upon shareholder approval in accordance with HKEx Listing Rule 14.40.

### **Chen's breach of Director Duties and Director's undertaking**

Chen was found to be in breach of his director's duties under HKEx Listing Rule 3.08 and his Director's Undertaking in:

- failing to report the Loan Agreements and Pledge Contracts to Good Resources and take steps to ensure Good Resources' rule compliance, despite his knowledge of the same. The fact that his failure to report was due to personal matters at the material time was not a valid reason to excuse himself from his director's duties. His role as Chairman and Executive Director of Good Resources and Chairman and Legal Representative of the Subsidiary aggravated his breaches. His failures caused Good Resources' belated discovery of the Loan Agreements, Pledge Contracts, Immediate Remittance and Purported Subscription;
- failing to protect Good Resources' assets, especially the deposits pledged as security; and
- failing to cooperate with the HKEx's investigation.

The HKEx also noted that his failure to discharge his Listing Rule responsibilities was serious and/or repeated.

### **Delisting of Good Resources from HKEx**

Good Resources' suspension of trading was due to the delayed publication of its annual results for its 2020 year end brought about by the aforementioned forensic review.

Good Resources' listing was cancelled in May 2022 due to the company's failure to fulfil all the resumption guidance imposed by the HKEx, including its failure to complete investigations in relation to the Pledge Contracts, the Loan Agreements, the Purported Subscription and other material unauthorised financial assistance.

The HKEx's Statement of Disciplinary Action is available on the HKEx website [here](#).

### **HKEx's Disciplinary Action against Two Former Directors of Biosino Bio-Technology and Science Incorporation**

On 24 October 2022, the HKEx issued public censures and imposed Director Unsuitability Statements against the former vice-chairman and executive director, Mr Chen Jintian, and former executive director, Mr Chen Jianhua (collectively the **Directors**), of Biosino Bio-Technology and Science Incorporation (**Biosino**).

The disciplinary action serves as a reminder that directors are under an obligation to cooperate with the HKEx in its enquiries, even after they have ceased to be directors.

The HKEx had sent investigation letters and reminder letters to the Directors' correspondence and email addresses in relation to an investigation into whether the Directors had breached the GEM Listing Rules (the **Investigation**). However, neither Director responded to the HKEx's letters.

Both Directors were subsequently placed on the Request for Assistance List (**RFA**) on 25 February 2022, requesting that the Directors and persons having information about them contact the HKEx urgently. There was no response to the RFA from the Directors or other persons.

The Directors' failure to cooperate with the HKEx with regards to the Investigation was determined to constitute a breach of their Director's Undertaking and the GEM Listing Rules. Under the terms of their Director's Undertakings, the Directors were under an obligation (among others) to:

- a) cooperate in any investigation conducted by the Listing Division or the Listing Committee of the HKEx;
- b) promptly and openly answer any questions addressed to them; and
- c) provide the HKEx with their up-to-date contact details for three years after the date they ceased to be directors of the company.

These obligations do not lapse after a person ceases to be a director of a listed company.

The HKEx also emphasised that the Directors' breach of their Undertakings was serious.

The HKEx's Statement of Disciplinary Action is available on the HKEx website [here](#).

## **SFC Reprimands and Fines Asia Research & Capital Management Limited HK\$1.75 million and bans Former Senior Executive Billy Wong Yim Chi for Two Months**

On 31 October 2022, the SFC reprimanded and fined Asia Research & Capital Management (**ARCM**), a Type 9 licensed corporation, HK\$ 1.75 million for its failures in relation to its non-compliance with the European Union's short selling reporting requirements (the **EU Regulation**) and its obligation to promptly notify the SFC of its material regulatory breach. ARCM's former Head of Compliance and Operation and Manager-In-Charge for Compliance, Mr Wong Billy Yim Chi (**Wong**), was also banned for two months.

The reprimand and fine was preceded by an enforcement action, issued in October 2020, against ARCM for its breach of the EU Regulation between February 2017 and December 2019. During this period, ARCM failed to make a total of 155 notifications and 153 public disclosures of its net short position in a company listed on the London Stock Exchange, Premier Oil plc (**Premier Oil**), in breach of the EU Regulation. ARCM was fined GBP 873,118 by the Financial Conduct Authority (**FCA**) for the aforementioned breach.

### **Compliance Failures and Internal Control deficiencies**

The SFC found ARCM to have failed to implement adequate measures to ensure compliance with the EU Regulation by:

- failing to put a formal process in place for its compliance framework to:
  - o require its staff members to analyse and understand applicable shareholding and short position reporting requirements when ARCM invests in a new jurisdiction; and
  - o incorporate additional controls to ensure compliance with those obligations in new jurisdiction(s); and
- failing to "implement any systems and controls in its compliance framework to monitor and ensure its portfolio positions in the EU markets complied with the reporting obligations under the EU Regulation".

The SFC also noted that ARCM had, in spite of its unfamiliarity with the EU market, failed to seek legal advice on its reporting obligations under EU regulations before entering into swap transactions and establishing a short position in Premier Oil. It determined that had ARCM taken steps to check the EU regulations or sought legal advice on the matter, instead of relying on reference materials provided by its prime brokers, it would have been aware of the reporting obligations for short positions held through swap transactions under the EU Regulation.

ARCM was thus determined to be in breach of General Principle 2 (Diligence) of the Code of Conduct for Persons Licensed by or Registered with the SFC (the **SFC Code of Conduct**) which requires licensed corporations to "act with due skill, care and diligence in the integrity of the market", and General Principle 7 (Compliance), and paragraph 12.1 (Compliance: in general) of the SFC Code of Conduct, requiring licensed corporations to comply with, implement and maintain measures appropriate to ensure compliance with, relevant regulatory requirements.

### **Delays in SFC Notification**

The SFC found ARCM to be in breach of Paragraph 12.5 (Notifications to the Commission) of the SFC Code of Conduct in having delayed its reporting of the material breach of the EU Regulation to the SFC.

In November 2019, ARCM was alerted to the EU Regulation by its legal adviser and became aware of its obligation to make disclosures to the FCA. It subsequently focused on the preparation of remedial filings and ensuring the accuracy of the data, notifying the FCA of the breach and submitted its remedial filings in late November 2019 and early December 2019, respectively. However, the SFC was not notified until 16 January 2020 and a written notification was not submitted until the day after.

## Wong's Breach of SFC Code of Conduct

Wong was ARCM's Head of Compliance and Operations, Manager-In-Charge for Compliance, and a member of its senior management during the relevant period. He was found to be neglectful in the discharge of his responsibilities, in particular he had failed:

- to implement adequate systems and controls to ensure ARCM's compliance with the EU Regulation; and
- to seek legal advice on the reporting obligations for ARCM in relation to the short position in Premier Oil, or to instruct the compliance and operations team to do so, despite the investment being in a new jurisdiction and Wong and his team's unfamiliarity with the reporting regime in the EU.

Wong had thus breached General Principle 9 (Responsibility of senior management) of the SFC Code of Conduct which requires senior management of a licensed corporation to bear primary responsibility for ensuring the maintenance of appropriate standards of conduct and adherence to proper procedures by the firm, and Paragraph 14.1 (Responsibility of senior management) of the SFC Code of Conduct which requires senior management of a licensed corporation to properly manage the risks associated with the firm's business.

The SFC determined that the fitness and properness of ARCM and Wong to carry on regulated activities had been called into question.

In reaching its decision to reprimand and fine ARCM and suspend Wong, the SFC took into account the following relevant circumstances:

- a) ARCM's and Wong's clean SFC disciplinary record;
- b) the cooperation of ARCM and Wong in resolving the SFC's concerns;
- c) the FCA penalty imposed on ARCM for its breaches of the EU Regulation; and
- d) ARCM had itself taken remedial steps to enhance internal controls to avoid recurrence of a similar breach.

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

## SFC Bans Tang Shiyi for 10 months

On 31 October 2022, the SFC announced that it had suspended Ms Tang Shiyi (**Tang**), a Type 1 licensed representative of China Galaxy International Securities (Hong Kong) Co., Limited and China Galaxy International Futures (Hong Kong) Co., Limited, both subsidiaries of China Galaxy International Financial Holdings Limited (collectively, **China Galaxy**) for ten months from 29 October 2022.

The SFC found that between July 2019 and February 2021, Tang had breached China Galaxy's staff dealing policy in:

- failing to obtain China Galaxy's approval before opening two securities trading accounts with an external broker (the **Accounts**) and conducting 148 personal trades in those Accounts. Under China Galaxy's staff dealing policy (the **Policy**), all employees had to:
  - o seek China Galaxy's approval before opening and maintaining securities trading accounts with other licensed corporations or registered instructions and before conducting trades in any external accounts; and
  - o forward duplicates of their trade confirmations and monthly statements of external accounts to China Galaxy within one month from the date of the trade confirmation or monthly statement.

The fact Tang only held a client-facing role in the office in August 2020 did not preclude the applicability of the Policy;

- concealing the opening and maintenance of the Accounts by making false declarations to China Galaxy. Tang, contrary to the Policy, did not disclose the Accounts until December 2020 and she did not disclose her personal trades at the time nor did she produce any relevant statements. She only disclosed her personal trades when China Galaxy conducted an internal investigation in February 2021. The SFC subsequently discovered she conducted further personal trades without approval even after she informed China Galaxy she would close the Accounts; and

- conducting securities transactions that were prohibited by the Policy, namely dealing in a stock on China Galaxy's restricted list and engaging in day trading on two occasions.

China Galaxy's Policy reflected the requirements of paragraph 12.2 of the SFC Code of Conduct, which requires licensed corporations to implement procedures and policies on employee trading and to actively monitor trading activities in their employees' accounts and their related accounts. The SFC determined that Tang's failure to disclose and obtain China Galaxy's prior approval for opening and maintaining the Accounts enabled her to circumvent China Galaxy's internal controls and evade its monitoring of her trading activities. This, together with her false and misleading declaration and disregard of the Policy, formed the basis of the SFC's determination that her conduct was "wilful and dishonest". It thus reached the view that Tang was not a fit and proper person to be licensed.

In reaching its decision to suspend Tang, the SFC took into account the following:

- a) Tang's clean SFC disciplinary record;
- b) the need for a deterrent message to be sent to the market that the SFC will not tolerate deliberate circumvention of internal control policies by licensed individuals;
- c) the duration of Tang's breaches, which lasted over one and a half years, involved 148 transactions made between February 2020 and 2021 and totalled over HK\$1.7 million; and
- d) the fact that her trading activities in the Accounts prejudiced neither the interest of China Galaxy's clients nor market integrity.

The SFC's Statement of Disciplinary Action against Tang can be found on the SFC website [here](#).

## Former Account Executive of Fulbright Securities Limited Jailed for Securities Fraud

On 14 October 2022, a former account executive of Fulbright Securities Limited, Mr Danny Fung Kwok Shing (**Fung**), was convicted in the Eastern Magistrates' Court of employing a fraudulent scheme to effect securities transactions in eight stocks between two securities trading accounts under his control (the **Fraudulent Scheme**). He was determined to have effected the transactions by dishonestly using his client's fund and securities without authorisation. Under section 300, it is an offence to engage in any act, practice or course of business which is fraudulent or deceptive in a transaction involving securities. The Fraudulent Scheme involved the use of a client's funds to purchase shares at high prices from the market and selling the shares at low prices to his friend's account, or using the client's funds to purchase shares at high prices from his friend's account.

The Eastern Magistrates' Court sentenced Fung on 27 October 2022 to two and a half month's imprisonment. Fung is appealing the sentence and has been granted bail in the interim.

The October conviction and sentence followed an SFC disciplinary action which resulted in the SFC fining him HK\$ 542,071 and banning him from re-entering the industry for life on 23 November. The SFC's Statement of Disciplinary Action against Fung in 2017 can be found on the SFC website [here](#).

## Retail Investor Convicted and Fined for Illegal Short Selling

Mr Lau Chi Ho (**Lau**) was convicted of illegal short selling after having pleaded guilty to the charge of breaching section 170(1) of the SFO, for placing orders to sell shares of two listed companies on the Hong Kong Stock Exchange when he did not have any of those shares.

Section 170(1) of the SFO prohibits the sales of securities when the person does not have, or does not believe or does not have reasonable grounds to believe that he has, a presently exercisable and unconditional right to vest the securities in the purchaser of them.

Lau was ordered to pay the SFC's investigation costs and fined HK\$20,000.

## Court Convicted Wong King Hoi for Obstruction of SFC's Search Operation

Mr Wong King Hoi (**Wong**) was convicted of obstructing employees of the SFC in the execution of a search warrant under Section 382 of the SFO on 27 October 2022, after pleading guilty to the offence. He was sentenced to two weeks' imprisonment on 10 November 2022. This is the first conviction of an individual under section 382 for obstructing the SFC's employees in the performance of their functions under the SFO

It is an offence under section 382 of the SFO for a person, without reasonable excuse, to obstruct any specified person (i.e. the SFC and its employees or any person appointed to investigate any matter under Section 182(1) of the SFO) in performing a function under the SFO.

The SFC had obtained a search warrant to search for, seize and remove from Wong's residence records and documents relating to the SFC's investigation into suspected market manipulation in the shares of a Hong Kong-listed company. Wong had delayed the SFC search team's access to his residence and attempted to dispose of two mobile phones and two notebooks.

## SFC publicly criticises Gold Dragon Worldwide Asset Management Limited for breaches of Hong Kong Takeovers Code

On 28 October 2022, the SFC publicly criticised Gold Dragon Worldwide Asset Management Limited (**Gold Dragon**) for its failure to disclose its dealings in the shares of Shanghai Dongzheng Automotive Finance Co., Limited (**Shanghai Dongzheng**) contravening Rule 22 and General Principle 6 of the SFC's Code on Takeovers and Mergers (the **Hong Kong Takeovers Code**).

On 3 February 2021, an offer period commenced for Shanghai Dongzheng when it announced a possible sale of 71.04% of its issued share capital held by its controlling shareholder to a potential buyer under Rule 3.7 of the Hong Kong Takeovers Code. The announcement contained a clear reminder to its "associates" of their obligation to disclose their dealings in Shanghai Dongzheng's relevant securities under Rule 22 of the Hong Kong Takeovers Code.

Between 12 March 2021 and 14 April 2022 (**Relevant Period**), Gold Dragon, acting as the investment manager of Seahawk China Dynamic Fund (**Seahawk Fund**), executed 53 trades in Shanghai Dongzheng's H shares (**Relevant Dealings**) resulting in a decrease in the percentage of shares Seahawk Fund held in Shanghai Dongzheng from 6.45% to 4.75%. Both Gold Dragon and Seahawk Fund made the relevant disclosures of interest under Part XV of the SFO but failed to disclose the dealings as required by Rule 22 of the Hong Kong Takeovers Code.

### Rule 22 and General Principle 6 of the Hong Kong Takeovers Code

Rule 22.1(a) of the Hong Kong Takeovers Code requires that all dealings in relevant securities by an offeror or the offeree company and their associates for their own account during an offer period must be publicly disclosed. Associates include any person who owns or controls 5% or more of any class of relevant securities issued by an offeror or the offeree company, including a person who as a result of any transaction owns or controls 5% or more.

General Principle 6 of the Hong Kong Takeovers Code states that "All persons concerned with offers should make full and prompt disclosure of all relevant information and take every precaution to avoid the creation or continuance of a false market. Parties involved in offers must take care that statements are not made which may mislead shareholders or the market."

### Breach of the Hong Kong Takeover Code

The Takeovers Executive of the SFC (the **Executive**) determined that Gold Dragon had breached Rule 22.1(a) of the Hong Kong Takeovers Code in failing to disclose the Relevant Dealings. Gold Dragon, as Seahawk Fund's investment manager, owned or controlled more than 5% of Shanghai Dongzheng's H shares immediately before the commencement of the offer period in relation to Shanghai Dongzheng. It was thus an associate of Shanghai Dongzheng and required to disclose the Relevant Dealings which occurred during the offer period.

Whilst recognising Gold Dragon's cooperation in the matter, the Executive, nonetheless, made the decision to take disciplinary action given the "material deficiencies in Gold Dragon's compliance systems" and its failure to put in place adequate systems to prevent the breaches. Its explanation of stretched resources (the focus of Gold Dragon's resources and manpower during the Relevant Period was on an investigation and civil proceedings against its former executive director, CEO and chief investment officer for their wrongdoings) for its failure to disclose under Rule 22.1(a) of the Hong Kong Takeovers Code was not accepted by the Executive.

The Executive noted that the disclosure rules under Rule 22.1(a) of the Hong Kong Takeovers Code are particularly onerous to reflect the high degree of transparency that is essential for the efficient functioning of the market in an offeree company's shares (and an offeror company's shares in the case of a securities exchange offer) during the critical period of an offer or possible offer. Further, in line with General Principle 6 of the Hong Kong Takeovers Code, timely and accurate disclosure of information relating to dealings by associates play a fundamental role in ensuring takeovers take place under an orderly framework and market integrity is maintained.

### Gold Dragon's Remedial Actions

Gold Dragon apologised for its breach of the Hong Kong Takeovers Code and, in light of the disciplinary action, it implemented a number of enhancements and remedial measures to ensure future compliance with the Hong Kong Takeovers Code. These included:

- a) assigning staff to regularly review:
  - all stock positions of all securities under its existing portfolio;
  - whether any of its stock positions would render it an associate of any Hong Kong-listed company;
  - announcements published on Stock Exchange of Hong Kong's website for all securities under its portfolio to see whether an announcement has been issued by, or in relation to, a relevant company that has commenced an offer period; and

- the offer period tables published on the SFC's website;
- b) assigning its Manager-in-Charge, together with other competent staff, to review:
  - all existing positions in its fund portfolio, and confirm that at the time of review, it did not hold more than 5% of the issued share capital of any Hong Kong-listed companies; and
  - all internal compliance and procedural manuals, and confirm they are adequate in view of its asset management business and are in line with industry standards; and
- c) regularly reviewing the procedures referred to under paragraph (b) above for as long as it continues its asset management business; and
- d) subscribing to relevant alerts from the SFC, including the Takeovers Bulletin.

The SFC reminded practitioners and parties who wish to take advantage of the securities markets in Hong Kong to conduct themselves in accordance with the Hong Kong Takeovers Code on matters relating to takeovers and mergers.

The Executive's Statement can be viewed [here](#).

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CHARLTONS  
易周律師行

Hong Kong Office

Dominion Centre 12th Floor  
43-59 Queen's Road East Hong Kong

[enquiries@charltonslaw.com](mailto:enquiries@charltonslaw.com)

[www.charltonslaw.com](http://www.charltonslaw.com)  
Tel: + (852) 2905 7888  
Fax: + (852) 2854 9596