Hong Kong Legal & Regulatory Digest

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A Compendium of Charltons' Hong Kong Legal and Regulatory Newsletters

Charltons
易周律師行

HONG KONG LEGAL & REGULATORY DIGEST 2024

A compendium of Charltons' Hong Kong legal and regulatory newsletters issued during 2024

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SFC issues guidance for tokenisation of SFC-authorised investment products and intermediaries engaging in Hong Kong tokenised securities-related activities

Hong Kong Law – 651 – 09 January 2024

On 2 November 2023, the Hong Kong Securities and Futures Commission (*SFC*) issued two circulars providing guidance on the tokenisation of SFC-authorised investment products (*Hong Kong Tokenised Investment Products Circular*) and conduct-related guidance to intermediaries engaging in tokenisation of securities-related activities (*Hong Kong Tokenised Securities Circular*). The widely anticipated circulars were issued during the 2023 Hong Kong FinTech Week. With the growing interest in tokenisation of traditional products, the circulars provide guidance on how intermediaries should disclose and manage risks when engaging in any Hong Kong based tokenisation of securities-related activities.

Hong Kong tokenised securities

Tokenisation of investment products refers to the creation of blockchain-based tokens that represent (or aim to represent) ownership in the form of investment products. Such tokenised products can then be recorded digitally on the blockchain, offered directly to end-investors with the use of distributed technology (*DLT*) and distributed by SFC-licensed intermediaries or traded among blockchain participants where allowed.

The Hong Kong tokenisation circulars supersede The Statement on Securities Token Offerings published by the SFC in March 2019 which classified tokenised securities as complex products requiring the imposition of extra investment protection measures and restricting offerings to professional investors only. Please refer to our previous newsletter in relation to the SFC's previous position.

The SFC is now of the view that it is appropriate to adopt a "see-through" approach whereby it will assess whether the underlying product can meet all the applicable product authorisation requirements given that the SFC's view is that the nature of tokenised securities is that they are "*fundamentally traditional securities with a token-*

isation wrapper". In essence, tokenised securities are securities as defined in section 1 Part 1 of Schedule 1 to the Securities and Futures Ordinance (Cap. 571) (*SFO*) which uses DLT or similar technology as the underlying technology. The SFC is therefore of the view that there is no need to impose mandatory professional investors only restrictions and that the existing rules, codes and guidelines applicable to traditional securities apply, including the prospectus regime under the Companies (Winding up and Miscellaneous Provisions) Ordinance (Cap. 32) as well as the offers of investments regime under Part IV of the SFO.

Accordingly, Hong Kong intermediaries should determine whether a tokenised security would be considered complex by assessing the underlying traditional security having regard to the factors set out in Chapter 6 of the Guidelines on Online Distribution and Advisory Platforms[1] and paragraph 5.5 of the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission.[2] Hong Kong intermediaries distributing a tokenised security which is a complex product should comply with the requirements governing the sale of complex products including ensuring suitability irrespective of whether there has been any solicitation or recommendation.

New risks in connection with Hong Kong tokenisation

The SFC has clarified that the existing legal and regulatory requirements for traditional securities and investment products apply to tokenised securities, which is consistent with the SFC's overarching regulatory approach of "*same business, same risks, same rules*". The SFC is of the view that tokenisation will create new risks for Hong Kong intermediaries including ownership risks, technology risks, cybersecurity risks, anti-money laundering risks and business continuity risks. In particular, the SFC has noted their concerns relating to how ownership interests in tokenised securities are transferred and recorded, and other forms of technology risks (such as forking, blockchain network outages and related cybersecurity risks).

The significance and probability of such risks may vary depending on the type of DLT network. A typical categorisation of the DLT network includes private-permissioned, public-permissioned and public-permissionless. Given the open nature of public-permissionless networks, the lack of restrictions for public access may lead to such networks being more likely to experience theft, hacking and cyberattacks.

Considerations for intermediaries engaging in activities relating to Hong Kong tokenised securities

Given the risks that may arise, the SFC has indicated that Hong Kong intermediaries engaging in tokenised security activities should have the necessary manpower,

1 Guidelines on Online Distribution and Advisory Platforms
2 Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission

resources and expertise to understand and manage the nature of, and new risks associated with the business. Intermediaries should also perform due diligence on the tokenised securities and the use of the underlying tokenisation technology as well as implement appropriate measures to mitigate relevant ownership and technology risks accordingly.

Issuance of tokenised securities in Hong Kong

When Hong Kong intermediaries issue or are substantially involved in the issuance of tokenised securities in Hong Kong which they intend to deal in or advise on, they remain responsible for the overall operation of the tokenisation arrangement regardless of any outsourcing arrangement with third-party vendors or service providers, such as platform providers and technology developers.

The SFC has also noted that such Hong Kong intermediaries should take into account the features and risks of the tokenised securities when considering the most appropriate custodial arrangements to manage the relevant ownership and technology risks.

Dealing in, advising on or managing portfolios investing in tokenised securities in Hong Kong

When Hong Kong intermediaries deal in, advise on or manage portfolios investing in tokenised securities in Hong Kong, they should conduct due diligence on the issuers and their third-party vendors or service providers involved in the relevant tokenisation arrangements.

The SFC has indicated that, prior to engaging in any tokenised securities-related activities, Hong Kong intermediaries should understand and be satisfied with the measures implemented by the issuer and their third-party vendors or service providers to manage relevant ownership and technology risks.

Tokenisation disclosures in Hong Kong

The SFC has provided a non-exhaustive list of information that Hong Kong intermediaries engaging in any tokenised securities-related activities should provide to clients in relation to the tokenisation arrangement in Hong Kong. These include:

- whether off-chain or on-chain settlement is final;
- the limitations imposed on transfers of the tokenised securities;
- whether a smart contract audit has been conducted before deployment of the smart contract;
- key administrative controls and business continuity planning for DLT-related events; and

- the custodial arrangements.

Requirements for primary dealing of tokenised investment products in Hong Kong

Hong Kong tokenisation arrangements

In addition to the above regulatory requirements, the SFC has set out additional requirements with which providers of the tokenised investment products (*Hong Kong Product Providers*) must comply in the Hong Kong Tokenised Investment Product Circular. These include:

- ensuring that the Hong Kong Product Providers remain and are ultimately responsible for the management and operational soundness of the Hong Kong tokenisation arrangement adopted and record keeping of ownership, regardless of any outsourcing arrangement;

- ensuring that proper records of token holders' ownership interests in the product are maintained and the Hong Kong tokenisation arrangement is operationally compatible with the service providers involved;

- ensuring that appropriate measures are in place to manage and mitigate cybersecurity risks, data privacy, system outages and recovery and to maintain a comprehensive and robust business continuity plan;

- not using public-permissionless blockchain networks without additional and proper controls;

- upon the SFC's request, confirming and demonstrating to the SFC's satisfaction the management and operational soundness of the tokenisation arrangement, record keeping of ownership and integrity of the smart contracts;

- upon the SFC's request, obtaining third party audit or verification on the management and operational soundness of the tokenisation arrangement, record keeping of ownership and integrity of the smart contracts; and

- upon the SFC's request, obtaining satisfactory legal opinion(s) to support its application.

Hong Kong tokenisation disclosures for Hong Kong Product Providers

Hong Kong Product Providers should disclose the following information in the offering documents of a tokenised investment product in Hong Kong:

- "the tokenisation arrangement, in particular as to whether off-chain or on-chain settlement is final";[3]
- "the ownership representation of tokens";[4] and
- "the associated risks with the tokenisation arrangement, such as cybersecurity, system outages, the possibility of undiscovered technical flaws, the evolving regulatory landscape and potential challenges in application of existing laws."[5]

Hong Kong intermediaries

Hong Kong Product Providers or distributors of the tokenised investment products should be regulated by Hong Kong intermediaries (i.e. SFC-licensed corporations or registered institutions) and comply with the applicable requirements under the existing Hong Kong rules, codes and guidelines.

Hong Kong tokenisation – Staff competence

Hong Kong Product Providers are required to have at least one competent staff worker with relevant experience and expertise to operate and/or supervise the tokenisation arrangement and to manage the aforementioned new risks. This should be confirmed to the SFC.

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[3] See paragraph 17(a) of the Hong Kong Tokenised Investment Products Circular.
[4] See paragraph 17(b) of the Hong Kong Tokenised Investment Products Circular.
[5] See paragraph 17(c) of the Hong Kong Tokenised Investment Products Circular.

FSTB Consults on Regulating OTC Virtual Asset Trading

Hong Kong Law – 652 – 26 February 2024

On 8 February 2024, the Financial Services and the Treasury Bureau (*FSTB*) published a Consultation Paper seeking views on proposals to regulate over-the-counter (*OTC*) trading of virtual assets (*VA*) under a new licensing regime for providers of VA OTC services under the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (Cap.615) (the *AMLO*).

The FSTB welcomes public feedback on its proposals and the deadline for responding to the Consultation Paper is 12 April 2024.

Background

The Government initiated the development of a comprehensive framework to regulate VA in its Policy Statement on Development of VA in Hong Kong back in October 2022.[1] In June 2023, a licensing regime for operators of VA trading platforms (*VATPs*) came into effect under amendments to the AMLO requiring VATP operators to be licensed by the Securities and Futures Commissions (the *SFC*) and to comply with the anti-money laundering and counter-terrorist financing (*AML/CTF*) provisions set out in Schedule 2 to the AMLO. Currently, only two VATPs have been licensed by the SFC.[2]

In 2023, several cases emerged involving shops providing OTC VA trading services to retail investors making false or misleading claims as to their licensed status. This has prompted the Government to regulate VA OTC services.

The FSTB estimates that there are approximately 200 physical VA OTC shops (including ATMs) operating in Hong Kong and about 250 digital platforms or active online posts on VA trading services in Hong Kong.

[1] Policy statement on the development of virtual assets (VA) in Hong Kong. Available at P2022103000454_404805_1_1667173469522.pdf (info.gov.hk)

[2] List of virtual asset trading platforms. Available at www.sfc.hk/en/Welcome-to-the-Fintech-Contact-Point/Virtual-assets/Virtual-asset-trading-platforms-operators/Lists-of-virtual-asset-trading-platforms.

Hong Kong Proposed Regulation of VA OTC Service Providers

Licensing Requirement

The FSTB proposes that any person operating a VA OTC business in Hong Kong, or actively marketing the provision of VA OTC services to the Hong Kong public, will have to obtain a licence issued by the Commissioner of Customs and Excise (the *CCE*).

A VA OTC business will be defined as: (a) by way of business, provision of service of spot trade of any VA; (b) irrespective of whether the service is provided through a physical outlet (i.e. including ATMs) or other (e.g. digital) platforms; and (c) explicitly excluding the operation of a VATP as already covered under the VATP licensing regime.

The definition will exclude peer-to-peer trading between individuals, unless the trade constitutes the business activity of either party.

Applicants for VA OTC licensing will need to be:

- a Hong Kong incorporated company with a permanent place of business in Hong Kong; or
- a company incorporated overseas but registered in Hong Kong under the Companies Ordinance (Cap. 622).

Permitted Activities

Under the proposed regime, licensed VA OTC operators will be allowed to engage in spot trade of any VA for any money, or vice versa. However, licensees will be prohibited from providing VA-to-VA trading services which require a VATP licence. To remit fiat money to clients, the OTC will need to apply for a money service operator licence. If the licensee will transfer VA to clients after sale, it must transfer the VA from its wallet registered with the CCE to a wallet for which the client provides proof of ownership and/or control. Other services such as VA advisory or referral services, and offering VA derivatives or other financial products (including staking, lending and margin trading), will not be permitted.

Types of VA Allowed to be Offered for VA OTC Trading

VA OTC licensees will only be allowed to offer spot trading in:

- VA that can be traded by retail investors on at least one SFC-licensed VATP; and
- Stablecoins issued by issuers licensed by the Hong Kong Monetary Authority.

This will restrict considerably the types of VA that can be the subject of VA OTC licensees' spot trading.

Under the SFC's VATP Guidelines, licensed VATP operators can only offer retail trading in VA that are "highly liquid".[3] For a virtual asset to be considered "highly liquid", it must be an "eligible large-cap virtual asset", which is defined as a virtual asset that is included in a minimum of two acceptable indices issued by at least two independent index providers. An "acceptable index" is an index with a clearly defined objective to measure the performance of the largest virtual assets in the global market (for example, an index which measures the top 10 largest virtual assets) which is: (i) investible, meaning that the constituent virtual assets should be sufficiently liquid; and (ii) objectively calculated and rules-based. In practice, only the very largest VA, such as Bitcoin and Ethereum meet the definition.

The FSTB is currently consulting on a proposed licensing regime for issuers of fiat-referenced stablecoins. The proposed licensing regime will not apply to issuers of stablecoins referencing other assets (e.g. gold). Nor will it apply to algorithmic stablecoins which will not satisfy the requirement that the stablecoins are fully backed by reserve assets.

Proposed Requirements for VA OTC Licensees

The proposed regime will require an OTC licensee to:

- observe the AML/CTF requirements set out in Schedule 2 to the AMLO;
- appoint a competent Compliance Officer and a Money Laundering Reporting Officer
- have a proper corporate governance structure;
- operate its business in a prudent and sound manner
- act honestly, fairly, with due skill, care and diligence and in the best interest of its clients and the integrity of the market;
- have appropriate risk management policies and procedures to manage ML/TF, cybersecurity and other risks; and
- to keep records of transactions and fund flows.

Licensing period

To adjust for the ever changing VA market, the FSTB proposes an initial licence period of two years, with the possibility of renewal for an additional two years upon application to and approval from the CCE. This will enable the CCE to regularly monitor the licensee's competence and its capacity to effectively conduct business

[3] Paragraph 7.7(b) of the VATP Guidelines.

Transitional Period Options

The FSTB is proposing a six-month transitional period before the commencement of the new licensing regime for VA OTC businesses already operating in Hong Kong. It is seeking comments on two alternative options:

Option 1 – No Deeming Arrangement

Under Option 1, existing VA OTC service providers will be allowed to continue operating during the six-month transitional period, but will need to apply to CCE for a licence within the first three months of that period. If they fail to do so, they will need to shut down their business before the end of the fourth month of the transitional period

Option 2 – With Deeming Arrangement

As under Option 1, existing VA OTC service providers will be allowed to continue operating during the six-month transitional period and will need to apply to CCE for a licence within the first three months of that period. Applicants meeting the licensing requirements will be granted a "deemed licence" allowing them to continue operating after the end of the transitional period until the CCE determines to grant or refuse a licence.

Prohibition on Marketing Activities

Similar to the VATP licensing regime, the FSTB proposes to prohibit the active marketing of VA OTC services, in Hong Kong or elsewhere, to the Hong Kong public, unless the person hold a valid licence as a VA OTC service provider.

Powers of the CCE

The CCE will act as the VA OTC licensing authority and will have powers to:

- impose licensing conditions, including add to, vary or modify existing conditions;
- supervise the AML/CTF conduct of VA OTC licensees;
- enforce the statutory and regulatory requirements;
- enter licensees' business premises to conduct routine inspections;
- investigate suspected non-compliances and remove evidence of the commission of an offence;
- carry out arrest and search; and
- impose disciplinary sanctions for non-compliance.

Sanctions

The following outlines the proposed penalties, which will depend on the nature and severity of the offence:

Offence	**Proposed fines**
Any person conducting regulated activities without a licence	Fine of HK$1 million and imprisonment for two years
Knowingly issuing an advertisement relating to an unlicensed person's provision of VA OTC services	Level 5 fine of HK$50,000 and imprisonment for six months
Non-compliance with the statutory AML/CTF requirements	Fine of HK$1 million and imprisonment for two years
Misconduct (e.g. contravening any other regulatory requirements)	Suspension or revocation of licence, reprimand, remedial order and/or pecuniary penalty (not exceeding HK$500,000)
Engaging in fraudulent or deceptive behaviour in transactions involving VA	Fine of HK$10 million and imprisonment for 10 years
Any person to make a fraudulent or reckless misrepresentation for the purpose of inducing another person to engage in a transaction involving	Fine of HK$1 million and imprisonment for seven years

Responding to the FSTB Consultation

Interested parties can respond to the consultation by submitting a written submission to vaotc-consult@fstb.gov.hk or by mail to Division 5, Financial Services Branch, Financial Services and the Treasury Bureau, 24/F, Central Government Offices, Tim Mei Avenue, Tamar Central, Hong Kong by 12 April 2024.

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SFC Warns Public of Allegedly Fraudulent Crypto-related Activities

Hong Kong Law – 653 – 11 April 2024

Hong Kong's Securities and Futures Commission (*SFC*) is closely monitoring unauthorised crypto products being offered to the Hong Kong public and crypto-related activities conducted by entities that are not regulated by the SFC as is evident from its listing of 27 crypto products and businesses on its Suspicious Virtual Asset Trading Platforms Alert List as at 8 April 2024. The SFC has issued warning statements to the public relating to each business listed setting out the virtual asset-related fraud and/or false claims of regulated virtual asset trading platform (*VATP*) status allegedly involved. The SFC advises investors to check its List of Licensed Virtual Asset Trading Platforms, available on the SFC website, to ascertain whether trading platforms are in fact regulated and monitored by the SFC.

The following provides a summary of the SFC's allegations regarding the following entities.

1. EDY: Suspected virtual asset-related fraud

According to the SFC, a VATP operating under the name "EDY" has falsely claimed to be affiliated with a Hong Kong financial institution and the digital token system developed by another financial institution. The SFC's announcement of 25 March 2024 warns that investors have been unable to withdraw funds deposited with the platform.

2. HKCEXP/ HKCEXP-MAX/ HKCEXP OTC Holdings Co., Ltd – Suspicious VATP

HKCEXP, HKCEXP-MAX and HKCEXP OTC Holdings Co., Ltd (together, *HKCEXP*) is suspected of conducting fraudulent activities in claiming to operate a regulated VATP business through two Hong Kong websites, misleading investors as to the regu-

lated status of the platform. Investors also reported having to pay an excessive "tax" in order to withdraw their funds from the platform.

The Hong Kong address provided on HKCEXP's website is false, and the SFC alleges that its intention was to mislead investors by holding itself out as a regulated firm.

3. Aramex and DIFX – suspected virtual asset-related fraud

The SFC and the Police issued a joint announcement warning the public about suspected fraudulent activities conducted by "Aramex" and "DIFX" which purport to be VATPs and have adopted names similar to those of other entities, despite there being no apparent connection.

Aramex allegedly encouraged investors to join social media chat groups by claiming to offer free investment advice. Investors were allegedly persuaded to invest in cryptocurrencies through websites operated by Aramex and were required to deposit the purchase monies in designated bank accounts. Subsequently, investors were unable to withdraw their funds.

Similarly, individuals representing DIFX claimed to be investment experts and used instant messaging apps to refer unsuspecting investors to websites associated with DIFX. Like Aramex, victims were instructed to deposit funds into specific bank accounts, only to find that they could not withdraw their funds.

4. Floki and TokenFi Staking Programmes

The SFC issued a public warning regarding two suspicious investment products – "Floki Staking Program" and "TokenFi Staking Program" – cryptocurrency staking services purporting to offer annualised returns from 30% to over 100%. Information relating to the products and the products themselves are reportedly accessible to the Hong Kong public via the internet, despite neither product having been authorised by the SFC for retail offering in Hong Kong. Furthermore, the administrator of the products has apparently failed to provide satisfactory evidence to the SFC as to the feasibility of achieving the annualised rates of return.

As already highlighted in the SFC's Statement on virtual asset arrangements claiming to offer returns to investors of December 2022, the SFC considers that "staking" arrangements in relation to virtual assets could constitute collective investment schemes, the public offering of which requires authorisation from the SFC in the absence of an applicable exemption (such as where the product is offered in Hong Kong only to professional investors (as defined in the Securities and Futures Ordinance (the *SFO*)). The offer of these products may also amount to "dealing in securities" under

Part V of the SFO, which would require the platform operator to be licensed by the SFC for Regulated Activity Type 1.

5. MEXC: unlicensed VATP

On 13 March 2024, the SFC issued a warning statement regarding unlicensed VATP "MEXC" which operates and conducts marketing through its website, Facebook, Telegram groups, X page, Reddit and YouTube.

According to the SFC, MEXC actively promotes its services to Hong Kong investors, despite not being licensed by the SFC and not having applied for a VATP licence. It is an offence to operate a virtual asset exchange, or actively market the services of a virtual asset exchange to Hong Kong investors, without a licence under the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (the *AMLO*).

6. KKR Global

On 19 March 2024, the SFC issued a warning to the public regarding suspicious websites operating under the name "KKR Global". The websites are allegedly involved in virtual asset-related fraud and masquerading as a corporation licensed by the SFC. Victims have reported being solicited through instant messaging apps and had difficulties in withdrawing funds from the websites. They were also asked to pay excessive fees to verify their wallets. The SFC has included the websites on the Suspicious Virtual Asset Trading Platforms Alert List, cautioning the public to be aware of similar domain names that may continue to be created.

7. Sure X: Unlicensed VATP

The SFC has warned the public about an unlicensed VATP operating under the name of "Sure X", which is also known as "Sure Bit International Pte Ltd", "Sure Bit International Ltd" and "Sure 9". The SFC suspects if of actively marketing virtual asset exchange services to Hong Kong investors without being licensed under the pretext of offering education and training on blockchain and cryptocurrencies. This is an offence under the AMLO.

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HKEX Listing Rule Amendments Allowing Treasury Shares Effective 11 June 2024

Hong Kong Law – 654 – 25 April 2024

The Stock Exchange of Hong Kong Limited (*HKEX*) has published amendments to the Main Board (*MB Rules*) and GEM Listing Rules (*GEM Rules*) which will allow HKEX-listed companies to issue and hold treasury shares, provided this is allowed by the laws of their country of incorporation and their constitutional documents. The Listing Rule amendments will take effect on 11 June 2024 and are set out in Appendix IV (Main Board) and Appendix V (GEM) of the HKEX's Consultation Conclusions – Proposed Amendments to Listing Rules Relating to Treasury Shares, published on 12 April 2024. HKEX-listed companies that are incorporated overseas that have been granted waivers from compliance with the requirement to cancel repurchased shares will be allowed a transition period from 11 June 2024 until their second annual general meeting after 11 June 2024. The HKEX is implementing all its proposed Listing Rule amendments with some changes to reflect comments received from respondents to the consultation.

The HKEX also published a new Guidance Letter HKEX-GL119-24 (*GL119-24*) explaining the treasury share arrangements on the Central Clearing and Settlement System (*CCASS*) and frequently asked questions about treasury shares. For a summary of the original Consultation Paper's proposals, please see Charltons' November 2023 newsletter.

Key Listing Rule Amendments

The following amendments will be made to the Listing Rules to implement the treasury share regime.

1. Removal of the requirement to cancel repurchased shares

The requirement to cancel repurchased shares will be removed and listed companies will be able to hold repurchased shares in treasury; the shares will retain their status as listed shares. Respondents to the consultation generally supported this

change since it will give listed companies greater flexibility to adjust their capital structure, although some expressed concerns about increased risks of market manipulation, insider dealing, and the dilution impact. The HKEX reminds companies to make any necessary amendments to their constitutional documents to allow them to hold treasury shares, e.g. to remove any restriction on the holding and use of treasury shares.

Some of the key amendments to the Listing Rules to implement the treasury share regime are as follows:

Relevant Rules or requirements	**Listing Rule Amendments**
"treasury shares" definition (MB Rule 1.01[1])	The definition of treasury shares under Rule 1.01 will be: *"shares repurchased and held by an issuer in treasury, as authorised by the laws of the issuer's place of incorporation and its articles of association or equivalent constitutional documents which, for the purpose of the Rules, include shares repurchased by an issuer and held or deposited in CCASS for sale on the Exchange* Notes: (1) For the purpose of the Rules, a holder of treasury shares shall abstain from voting on matters that require shareholders' approval under the Rules. (2) Treasury shares may be held by an issuer's subsidiary or an agent or nominee on behalf of the issuer or its subsidiary, if this is permitted by the laws of the issuer's place of incorporation and its articles of association or equivalent constitutional documents. References to sales or transfers of treasury shares include sales or transfers by agents or nominees on behalf of the issuer or subsidiary of the issuer, as the case may be." The above definition modifies the definition proposed in the Consultation Paper to clarify that: • treasury shares can be held by a listed company's subsidiary, or an agent or nominee of the listed company or its subsidiary, if this is permitted by the laws of the company's jurisdiction of incorporation and its constitutional documents. For example, under Bermuda or Cayman laws, repurchased shares must be held in the company's own name in order to be classified as treasury shares. PRC laws, on the other hand, do not require treasury H shares to be held in the name of the listed company; although shareholders' rights attached to shares repurchased by the listed company will be suspended, irrespective of whether they are held by the listed company or a nominee. • as regards ADSs of companies dual-listed on the HKEX and an overseas stock exchange, repurchased ADSs must be converted into ordinary shares before they can be held as treasury shares. • the use of treasury shares will not be restricted by the HKEX Listing Rules. However, listed companies must ensure that their treasury shares are used only for purposes allowed under the laws of their jurisdiction of incorporation and their constitutional documents.
Removal of requirement to cancel repurchased shares (MB Rule 10.06(5), 19.16 and 19A.24[2])	The amendments remove the requirement to cancel repurchased shares and allow listed companies to hold them as treasury shares; the repurchased shares will retain their status as listed shares.
MB Rule 10.06(5)[3]	Listed companies must ensure that treasury shares are clearly identified and segregated.[4]

[1] GEM Rule 1.01
[2] GEM Rules 13.14, 24.07 and 25.18
[3] GEM Rule 13.14
[4] HKEX GL119-24 at paragraph 1

Holding Treasury Shares in CCASS

GL119-24 notes that listed companies can hold treasury shares that they intend to resell with CCASS registered in the name of HKSCC Nominees Limited (*HKSCCN*) as a common nominee. To enable treasury shares held in CCASS to be identified, listed companies are required to hold their treasury shares in a segregated CCASS account (which can be opened by a broker or custodian for the listed company).[5]

Jurisdictions requiring treasury shares to be held in listed companies' own names

Where the listed company is incorporated in a jurisdiction which requires repurchased shares to be held in the listed company's own name (such as Bermuda or the Cayman Islands), the company should withdraw the repurchased shares from CCASS and register them in the company's own name in its register of members. The listed company can only re-deposit the treasury shares into CCASS if it plans to resell them on HKEX imminently.

Although repurchased shares will no longer be classified as treasury shares under the relevant laws once legal title is transferred to HKSCCN on deposit of the shares into CCASS, the repurchased shares will be treated in the same way as treasury shares under the HKEX Listing Rules because they are beneficially owned by the listed company. On depositing repurchased shares into CCASS, the listed company is required to give clear written instructions to its broker and share registrar that the repurchased shares are to be treated as treasury shares under the HKEX Listing Rules.[6]

Jurisdictions allowing treasury shares to be held by nominees

If the laws of the listed issuer's place of incorporation (e.g. the PRC) do not require treasury shares to be held in the listed company's name, shareholders' rights attached to the shares will be suspended under the relevant laws once the shares are repurchased by the listed company, regardless of whether they are held in its own name or that of a nominee. In this case, the listed company can choose to hold the repurchased shares as treasury shares in a segregated account in CCASS. After completing the share repurchase, the listed company must provide clear written instructions to its share registrar and the relevant broker to update the record and identify the repurchased shares held in CCASS as treasury shares.[7]

Pending resale of the treasury shares on the HKEX, listed companies need to have measures in place to ensure that they will not exercise any shareholders' rights or receive any entitlements as shareholders. Examples of these measures given by the HKEX are board approvals that:

[5] Ibid. at paragraph 8
[6] Ibid. at paragraph 10
[7] Ibid. at paragraph 14

- the listed company should procure its broker not to instruct Hong Kong Securities Clearing Company Limited (HKSCC) to vote at general meetings for the treasury shares deposited with CCASS; and
- in the case of dividends or distributions, the listed company should withdraw the treasury shares from CCASS, and either re-register them in its own name as treasury shares or cancel them, in each case before the record date for the dividends or distributions.

2. Resale of Treasury Shares Treated as New Share Issue

The HKEX will extend the requirements for the issue of new shares to the resale of treasury shares.

Relevant Rules or requirements	**Listing Rule Amendments**
Resale of Treasury shares	
MB Rules 2.03(6), 13.36(1A), 13.36(20(b) and 13.36(8)[8]	The resale of treasury shares must be conducted on a pre-emptive basis and offered to all shareholders on a pro-rata basis, or be approved by a specific or general shareholder mandate. The number of shares repurchased in the year under a repurchase mandate is added to the general mandate limit. The general mandate limit and repurchase mandate limit are calculated based on the number of issued shares excluding treasury shares held by the listed company at the given time.
MB Rule 13.36(5A)[9]	An on-market resale of treasury shares under the general mandate is subject to a maximum price discount of 20% of the higher of: • the closing price on the trading day immediately before the resale; and • the average closing price in the five trading days immediately before the resale.
MB Rules 13.36(1A) and 13.36(5)[10]	All off-market resales of treasury shares under a general mandate for cash consideration are subject to the same price discount limit of 20% as new share issues.
PRC issuers	For listed companies incorporated in the PRC, Listing Rules 10.05 and 10.06 govern repurchases of shares listed on the HKEX. PRC issuers' repurchases of A shares are not therefore covered by Listing Rule 13.36. Under PRC law, A+H issuers do not need to cancel their treasury A shares and can hold and use repurchased A shares to satisfy employee share schemes, for the conversion of convertible securities or for resale in the open market to stabilise the share price. The holding and use of treasury A shares only requires board approval. The resale of treasury A shares will not be subject to the HKEX Listing Rules' shareholders' mandate requirement since A shares are not listed on the HKEX and should therefore only be subject to the listing requirements of their home jurisdiction.
Share Schemes	
MB Rules 17.01(4) and 17.02(2)	Share schemes can use treasury shares to satisfy share grants and will be treated as share schemes funded by new shares under Chapter 17 of the MB Listing Rules. Grants of shares under the scheme will be subject to the scheme mandate limit approved by shareholders under Chapter 17.

[8] GEM Rules 2.06(6), 17.39A and 17.42E
[9] GEM Rule 17.42BB
[10] GEM Rules 17.39A and 17.42B

Other requirements applicable to the resale of treasury shares	
	Relevant sections will be amended to reflect application of the existing requirements for the issue of new shares to the treasury share regime: • Chapter 14 (connected transactions) • MB Rule 13.28 (announcement) • MB Rule 11.04 (listing document) • MB Rule 13.25A (next day disclosure return) • MB Rule 13.25B (monthly return) • Paragraphs 11 and 11A to Appendix D2 of the MB Rules (annual report), • MB Rules 9.18 to 9.23 (documentary requirements such as a working capital comfort letter for resales with a listing document)[11]
Resale to connected persons	The resale of treasury shares to connected persons will be subject to the same connected transaction requirements as a new issue of shares under Chapter 14A. Resale will therefore require independent shareholders' approval unless exempted under MB Rule 14.92.
Disclosure	**Announcement**: Listed companies will not be required to announce a resale of treasury shares and any movement in the number of their treasury shares under MB Rule 13.28. They will instead need to disclose the same in a next day disclosure return (MB Rule 13.25A) and their next monthly return (MB Rule 13.25B). **Next day disclosure**: In the next day disclosure return, listed companies must disclose the highest and lowest prices, total funds raised and the mandate used for an on-market sale of treasury shares. **Annual return disclosure**: Under paragraphs 11 and 11A to Appendix D2[12], listed companies must disclose details of their sales of treasury shares for cash in their annual reports. Annual reports must also include a monthly breakdown of all on-market sales, the amount of funds raised, use of proceeds, the current balance of treasury shares held and their intended use.
Chapter 17 Share Schemes	The annual or interim report disclosure requirements under Paragraphs 11, 11A and 41A of Appendix D2[13] to the MB Rules do not apply to the issue of equity securities or resale of treasury shares if the share scheme complies with Chapter 17.
Listing document requirement	Although listed issuers do not need to submit a listing application for the resale of treasury shares, they are subject to the documentary requirements of MB Rules 9.18 to 9.23 as if they were an application for the listing of the newly listed shares and will need to produce a listing document under MB Rule 11.04.

[11] GEM Rules Chapter 20, Rules 17.30, 14.06, 17.27A, 17.27B, 18.32 and 18.32A
[12] GEM Rules 18.32 and 18.32A
[13] GEM Rules 18.55A

The HKEX also clarified in the Consultation Conclusions in relation to MB Rule 13.36 that:

- the maximum price discount allowed on a resale of treasury shares applies equally to dual-listed companies and the 20% discount price limit will be calculated based on the closing prices of the shares traded on the HKEX;

- the resale of treasury shares repurchased in other circumstances such as off-market share buy-backs are also subject to the general mandate limit;

- shareholders' approval is not required for the transfer of shares out of treasury for distributing scrip dividends or for satisfying share grants under share schemes; and

- the general mandate and share schemes must specifically state that the shares in question are treasury shares. However, if amendments to the share scheme are required, this will not constitute a material alteration that would require shareholders' approval under MB Chapter 17.

3. Proposals on mitigating market manipulation risks and insider dealing

(a) Moratorium periods for share repurchases and resales of treasury shares

The HKEX will impose a 30-day moratorium under MB Rule 10.6(3)(a)[14] on:

- a resale of treasury shares after an on- or off-market share repurchase; and

- an on-Exchange share repurchase after an on-Exchange resale of treasury shares.

The moratorium on resales of treasury shares will be subject to a carve-out for:

- resales of shares under capitalisation issues (e.g. bonus issues and scrip dividends); and

- grants of share awards or options under a share scheme that complies with Chapter 17 and a new issue of shares or a transfer of treasury shares upon vesting or exercise of share awards or options under the share scheme.

The HKEX has also clarified that the carve-out applies to new share issues and transfers of treasury shares by a listed company on the conversion of convertible securities which were issued with subscription monies settled in full before the share repurchase.

The carve-out to this 30-day moratorium requirement is where the issue or resale is made to fulfill warrants, shares options or other instruments outstanding before the share repurchase. As suggested by various respondents, further amendments will be made to extend the above carve-out for issues or resales of shares to include the following situations:

- capitalisation issues, such as bonus issues and scrip dividends;

- grants of share awards or options under a share scheme under Chapter 17 or a new issue of shares or a transfer of treasury shares when vesting or exercising the share awards or options under the share scheme; or

- the issuance of new shares and transfer of treasury shares by an issuer upon conversion of convertible securities, if they were the subscription monies has been fully settled before the share repurchase.

[14] GEM Rule 13.12

The HKEX also clarified that the 30-day moratorium also applies to dual-listed companies. However, the moratorium requirement does not apply to the resale of treasury shares A by a PRC company with H and A shares listed on the HKEX and a PRC stock exchange, respectively.

(b) Dealing restrictions for on Exchange treasury share resales

The following dealing restrictions on on-market share repurchases and on-market resales of treasury shares will apply:

Relevant Rules or requirements	**Listing Rule Amendments**
MB Rules 10.06(2)(e) and 10.06A[15]	The restriction on share repurchases when there is undisclosed inside information or during the 30-day period preceding any results announcement, will also apply to resales of treasury shares. • The original proposal for the restriction period to be set at one month prior to any results announcement has been amended to 30 days to ensure that the same restriction period applies to all listed companies regardless of their financial year-end.
MB Rule 10.06A[16]	Brokers appointed to effect the resale of treasury shares must inform the HKEX of the resale of treasury shares.
MB Rules 14A.73(3), 14A.92B and Note 1 to Rule 13.36(2)(b)[17]	Under MB Chapter 14A, an on-market resale of treasury shares to a connected person is fully exempt from the connected transaction requirements if the connected person does not know that they are buying from the listed company.

[15] GEM Rule 13.11(4) and 13.14A
[16] GEM Rule 13.14A
[17] GEM Rules 20.71(3), 20.90B and Note 1 to Rule 17.41

(c) Other proposals for on-market resale

The disclosure and documentary requirements for resale of treasury shares also apply to on-market resales. In particular, the next day return should include key information and separate announcements would be required if the size of the resale exceeds the threshold of 5% of the listed company's shares. This requirement is subject to the exception that no announcement is required under MB Rule 13.28.[18] and submission of placee information under MB Rule 9.23(2) is not required either.[19] Nor are listed companies required to submit placee information under MB Rule 9.23(2).20[20] Disclosure of listed companies' on-market resales must instead be disclosed in a next day disclosure return.

4. Proposals relating to new listing applicants

For new listing applicants who wish to keep their existing treasury shares after listing, the following amendments to the Listing Rules must be observed:

[18] MB Rule 13.27A, GEM Rule 17.29A
[19] MB Rules 9.23(2), GEM Rules 12.27(6)
[20] MB Rules 9.23(2), GEM Rules 12.27(6)

Relevant Rules or requirements	**Listing Rule Amendments**
MB Paragraph 23(1A) of Appendix D1A and Paragraph 23(1A) of Appendix D1E[21]	Relevant disclosures on the treasury shares must be included in the prospectus: • All intentions or plans to exercise a material repurchase must be fully explained and disclosed in the prospectus and cash flow forecasts to enable investors to make an informed assessment on the operations, management, financial position and future prospects of the new listing applicant
MB Rule 10.08	The resale of treasury shares (or agreeing to resell) is not allowed within six months of a new listing.
MB Rule 10.08(5)[22]	An exception from the six-month lock-up on resales of treasury shares is available for companies that have transferred their listing from GEM to the Main Board.

[21] MB Paragraph 23(1A) of Appendix D1A and Paragraph 23(1A) of Appendix D1E / GEM Paragraph 23(1A) of Appendix D1A
[22] GEM Rule 17.29

Some respondents raised questions on whether a new listing applicant could issue new shares to a trust before listing and use these shares to satisfy any future share grants under its share scheme after listing. Referencing a previous FAQ 091-2022 published by the HKEX subsequent to the amendments to the Listing Rules on share schemes in 2022, this will only be allowed if the arrangements benefit specified participants. If a new applicant proposes to issue new shares to the trustee before listing and use them to satisfy any future share grants after listing, this will be regarded as a non-compliant circumvention of Chapter 17 as no specified participants can be designated at the time the new shares are issued to the trustee.

5. Other consequential Listing Rule amendments

(a) Voting rights attached to treasury shares

Amendments to MB Rule 1.01[23] clarify that listed companies that hold treasury shares must abstain from voting on matters that require shareholders' approval under the HKEX Listing Rules.

The HKEX will also amend MB Rules 14.44 and 14A.37[24] to clarify that for the purposes of these rules, the definition of "shareholder" refers to a "shareholder other than the holder of treasury shares".

The HKEX also clarified that voting rights attached to treasury shares will not be "voting rights" under the Takeovers Code and Share Buy-backs Code ("*Codes*").

(b) Excluding treasury shares when calculating issued shares

Shares held in treasury will be excluded when calculating the listed company's issued shares to determine matters such as public float, market capitalisation, man-

[23] GEM Rule 1.01
[24] GEM Rules 19.44 and 20.35

date limits and size tests for transactions. The HKEX reminds listed companies to adhere to the public float requirement at all times and refrain from repurchasing their shares if the company will not meet the public float requirement after the share repurchase.

In response to concerns regarding weighted voting rights, the HKEX will modify the rules to clarify that MB Rule 8A.15, which requires weighted voting rights beneficiaries to reduce their weighted voting rights proportionately if the repurchase would otherwise increase the proportion of their weighted voting rights, will apply when the shares are either cancelled or held in treasury.

Regarding the difference in treatment of voting rights under the Listing Rules and the Securities and Futures Ordinance (Cap. 571) (*SFO*), after reviewing the responses, the Securities and Futures Commission (*SFC*) has decided to maintain the current position. As a result, treasury shares will remain part of an issuer's issued voting shares, according to the definition under section 308(1) of the SFO, on the basis that voting rights attached to treasury shares are temporarily suspended.

(c) Disclosure of the listed company's intention to hold treasury shares

MB Rule 10.06(1)(b)[25] will be amended to state that listed companies must include their intention to cancel the repurchased shares or hold them in treasury in the explanatory statement for the proposed repurchase mandate.

A majority of respondents opined that more flexibility should be given to listed companies to decide whether to cancel the repurchased shares or hold them in treasury depending on the actual circumstances at the time of the repurchase. The HKEX clarified in the consultation conclusions that disclosure of the intention statement would not preclude the listed company from subsequently changing its decision and the HKEX will make the following amendments to the proposed Listing Rule changes:

- under MB Rule 10.06(4)(a)[26], in the relevant disclosure in the next day disclosure return, the listed company will be required to disclose the respective number of shares to be cancelled or held in treasury after the repurchase. If applicable, listed companies should also disclose reasons for any discrepancies between the new arrangements and those already disclosed in the explanatory statement;
- amendments to MB Rule 13.25A(2)(b)(iv)[27] will oblige listed companies to report the cancellation of treasury shares in the next day disclosure return in certain situations; and
- the number of treasury shares held as of the year end date and their intended use must be disclosed in listed companies' annual reports.

[25] GEM Rule 13.08(12)
[26] GEM Rule 13.13(1)
[27] GEM Rule 17.27A(2)(b)(vi)

(d) Resale of treasury shares through agents or nominees

The HKEX will amend MB Rule 1.01[28] to make clear that a resale of treasury shares by a listed company or its subsidiary includes resale of treasury shares through their agents or nominees, irrespective of whether they are aware of any material non-public information.

The HKEX has also clarified that this will not apply to a sale of shares by the trustee of a share scheme upon cancellation, expiry or lapse of a listed company's share scheme if the relevant shares are not treasury shares under the laws of the listed company's place of incorporation and its constitutional documents.

(e) Other consequential amendments to the Listing Rules

The HKEX will amend MB Rule 19C.11 to allow listed companies with secondary listings on the HKEX to be exempted from MB Rules 10.06A(1), 10.06A(3) and 10.06B in order to align with the existing exemptions.

The SFC will also issue further guidance on treasury units of real estate investment trusts authorised by the SFC under the Code on Real Estate Investment Trusts. Consequentially, the next day disclosure return and monthly return requirements to record the movement of the treasury units of real estate investment trusts under Paragraphs 7 and 8 of Appendix E3 to the MB Rules will be amended to cover treasury units of real estate investment trusts.

6. Other Housekeeping amendments

Other housekeeping amendments to the Listing Rules include:

- Paragraphs 11, 11A and 41A of Appendix D2 of the MB Rules[29] – clarifications that the reporting requirements for issues of securities for cash consideration do not apply to new shares issued or treasury shares resold under share schemes will be added. Rules 17.07 to 17.09[30] would apply instead;
- MB Rule 13.25A31[31] – listed companies will be allowed to file a next day disclosure return for the new shares issued or treasury shares transferred to grantees under a share scheme on passing the threshold under MB Rule 13.25A(3). Listed companies are not required to file separate returns upon vesting of these awards.
- MB Rule 17.05 – the restricted period for grants of options or awards under share schemes will be amended from one month to 30 days preceding the results announcement. This is to align with the restricted period amendments for on-Exchange share repurchases and on-Exchange resales of treasury shares as stated above.

[28] GEM Rule 1.01
[29] GEM Rules 18.32, 18.32A and 18.55A
[30] GEM Rules 23.07 and 23.09
[31] GEM Rule 17.27A

Implications on other laws and regulations in Hong Kong

The Hong Kong Government is currently considering amending the Companies Ordinance to coincide with the amendments to the HKEX Listing Rules to allow companies incorporated in Hong Kong to also benefit from the treasury share regime in the same manner as overseas-incorporated companies.

Regarding the Codes, the voting rights attached to treasury shares are explicitly excluded from the definition of "voting rights". This would impact the interpretation of disinterested shares in the calculation of certain thresholds such as the 30% trigger of a general mandatory offer, the 2% creeper or the acceptance threshold. Also, an offer is not required for treasury shares during a general offer or partial offer. The Takeovers Executive of the SFC will issue a practice note to clarify the implications of the treasury share regime on the Codes when the treasury share regime comes into effect

As already noted, the treatment of treasury units of real estate investment trusts will largely mirror that of the resale of treasury shares by listed companies. Further guidance will be issued by the SFC specifically pertaining to real estate investment trusts.

Lastly, a resale of treasury shares in the secondary market will constitute a disposal of the shares for valuable consideration. Therefore, the contract notes must be stamped in accordance with the Stamp Duty Ordinance and are subject to ad valorem stamp duty.

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HKEX Disciplinary Actions in Q1 2024

Hong Kong Law – 655 – 26 April 2024

In the first quarter of 2024, the Stock Exchange of Hong Kong Limited (*HKEx*) continued its clamp down on corporate misconduct by Hong Kong-listed companies, disciplining Global Uin Intelligence Holdings Limited for misappropriation of company assets, China Gas Industry Investment Holdings Co Ltd in relation to unauthorised lending and Xinming China Holdings Limited for unauthorised borrowing arrangements. Certain directors of the companies were also disciplined for breaches of their directors' duties including, in the case of Global Uin Intelligence Holdings Limited, misappropriation of company assets.

The actions demonstrate the HKEx's continued determination to improve the corporate governance of listed companies. While the HKEx's sanctioning powers are limited to the issue of reputational sanctions, such as reprimands and criticism, the Securities and Futures Commission (*SFC*) may also intervene in certain cases of misconduct, as seen in the case of Global Uin Intelligence Holdings Limited.

1. Misconduct by Former Directors of Global Uin Intelligence Holdings Limited

The HKEx and the SFC brought a joint disciplinary action against two former directors of GEM-listed Global Uin Intelligence Holdings Limited (formerly Global Dining Holdings Limited) for breaches of their fiduciary duties as company directors. The company's two former executive directors and controlling shareholders misappropriated the company's listing proceeds for their personal use through sham arrangements.

The company's first annual report after its 2020 listing reported listing expenses that were materially higher than disclosed in its listing document. The increase in listing expenses was due to a Singapore dollar 1 million fee and discre-

tionary bonus paid to an IPO consultant in Singapore. The related service agreement was not disclosed in the listing document, nor was the payment notified to the professional parties and other board members.

The payment was re-routed to the two former directors who used the funds to repay amounts they owed to the company. The GEM Listing Committee found that the directors had committed serious breaches of the fiduciary duties they owed to the company, GEM List Rules 5.01 and 17.55B and their director's undertakings.

- *Breaches of directors' fiduciary duties under GEM Listing Rule 5.01*

In misappropriating the company's assets, the two directors breached their fiduciary duties under GEM Listing Rule 5.01 which includes duties to: act honestly and in good faith in the interests of the company as a whole; act for a proper purpose; be answerable to the issuer for the application or misapplication of its assets; and avoid actual and potential conflicts of interest and duty.

The directors acted dishonestly and contrary to the company's interests. They failed to avoid an obvious conflict between their interests and those of the company and abused their position as directors. They also misled the company's shareholders and the public.

- *Breach of GEM Listing Rule 17.55B*

The directors were also found to have breached the requirement under GEM Listing Rule 17.55B to provide accurate, complete and up-to-date information in responding to enquiries and investigations by the SEHK and SFC. They intentionally avoided providing evidence, including information about their bank accounts and bank statements, and deliberately obstructed the investigation by providing false or misleading information to prevent the detection of their misconduct.

- *Breach of Director's Undertaking (then Appendix 6A to the GEM Listing Rules)*

Both directors were additionally in breach of their director's undertakings to (among others) comply with the GEM Listing Rules to the best of their ability, procure the company's compliance with the Listing Rules, and cooperate in any investigation conducted by the Division, including by answering promptly and openly any questions addressed to them, and promptly producing the originals or copies of any relevant documents.

The HKEX publicly censured both directors and subjected them to director unsuitability statements – that is a statement that the individuals are unsuitable to occupy a position as a director or within senior management of the company or any of its subsidiaries.

The SFC's investigation into the alleged misappropriation continues.

2. Disciplinary Action against China Gas Industry Investment Holdings Co Ltd. and a Former Director

The HKEx has criticised China Gas Industry Investment Holdings Co Ltd (*China Gas*) and criticised and publicly reprimanded one of its former directors, for using the company's funds to make loans without disclosing this as a proposed use of its IPO funds, nor the risks involved, in its prospectus. The former director had also conducted four transactions on behalf of the company without obtaining board approval or consulting the company's sponsor and compliance adviser. Please see the HKEX's statements of disciplinary action against China Gas and the former director, Mr. David Chen.

Shortly before and after listing on the HKEx, China Gas used a significant proportion of its funds to provide three unsecured loans and subscribe for a loan note (together, the *Transactions*). None of the Transactions were disclosed in the prospectus, which the former director had signed off on before the listing date. The director had entered into all the Transactions without seeking the approval of the board or the advice of the China Gas' sponsor and compliance adviser. He approved the Transactions after conducting only cursory due diligence. According to the company's auditor, China Gas did not receive any amounts due in the year ended 31 December 2020, and the auditor's request that the board commission an independent investigation into the matter led to a delay in the company publishing its annual results and reports for that financial year and the subsequent half-year. Ultimately, China Gas made a full loss allowance on the receivables arising from the Transaction in the aggregate sum of approximately RMB184.4 million.

The former director was found to have breached:

- *HKEx Listing Rule 2.13(2)* – the requirement for information provided in any announcement or corporate communication (which includes a prospectus) to be accurate and complete in all material respects and not misleading or deceptive.

- *HKEx Listing Rule 3.08* – directors' obligation (collectively and individually) to fulfil fiduciary duties and duties of skill, care and diligence to a standard at least commensurate with the standard established by Hong Kong law; and

- *Director's Declaration and Undertaking (then Appendix 5B)* – directors' obligation to comply with the HKEx Listing Rules and use best endeavours to procure the company's Listing Rule compliance.

China Gas was in breach of:

- *HKEx Listing Rules 13.46(2)(a), 13.48(1), 13.49(1) and 13.49(6)* given the late publication and dispatch its annual and interim results and reports; and

- *HKEx Listing Rules 2.13(2) and 11.07* for failing to provide sufficient, true and accurate information in the prospectus to enable investors to make an informed assessment of the company's financial assets, financial position, potential risk and future cash requirements.

A settlement was reached between China Gas, Mr. Chen and the Listing Division in this matter.

3. Disciplinary Action against Three Directors of Xinming China Holdings Limited

The HKEx disciplined three current directors of XinMing China Holdings Limited (*XinMing*), executive director, chairman and chief executive officer, Mr. Chen Cheng-shou (*Mr. Chen*); executive director, Mr. Feng Cizhao (*Mr. Feng*); and non-executive director, Ms Gao Qiaoqin (*Ms. Gao*), (together, the *Directors*). The disciplinary actions related to an impairment loss resulting from a number of loans made to one of Xinming's subsidiaries, Chongqing Xinming Property Company Limited (*Chongqing Xinming*).

When Chongqing Xinming had cash flow problems and was unable to secure funding, Mr. Chen, XinMing's controlling shareholder, chairman, CEO and executive director, offered to borrow funds on its behalf from private investors (*Lenders*) through a company he owned with his wife outside the listed group, Xinming Group Limited (*XGL*). XGL was named as the borrower in the loan agreements, although the intention was that Chongqing Xinming would use the funds and repay the loans.

XGL borrowed a total of RMB 501.5 million on behalf of Chongqing Xinming, of which it repaid RMB 283 million. The loans were originally made interest free, but in 2017, the Lenders demanded annual default interest of 24% to be charged retroactively as a condition of extending the outstanding loans' repayment date. To avoid disruption to Chongqing Xinming's business, Mr. Chen agreed to pay the default interest demanded by the Lenders without informing Xinming's board of directors. XGL then repaid the outstanding principal and default interest on Chongqing Xinming's behalf. Chongqing Xinming repaid the principal of the loans to XGL, but not the amount of default interest.

At Mr. Chen's suggestion, Mr. Feng recorded the paid default interest paid by XGL to the Lenders as "other receivables" in Chongqing Xinming accounts on the assumption that a refund of the default interest would be negotiated later. In 2020, Xinming recorded an impairment loss of RMB 49.4 million on its "other receivables". The Directors did not inform the rest of the board about the loans or the Lenders' demand for default interest. Information on the loans was not circulated to the board in board updates and the loans were not recorded in Xinming's accounts for the years ended 31 December 2016 and 2017.

HKEx Listing Rule Breaches

The Listing Committee found the three Directors to be in breach of the following:

- *HKEx Listing Rule 3.08* – Each of the three directors was found to have breached their obligations as directors under Rule 3.08 to exercise due care, skill and diligence in respect of the loans entered into on behalf of Chongqing Xinming. Mr. Chen was also considered to have failed to avoid conflicts of interest and duty. The conduct highlighted by the Listing Committee as constituting breaches of the Listing Rules included the directors' failure to:
    - bring the loans to the attention of the board and obtain board approval;
    - ensure compliance with the company's internal controls; and
    - obtain proper documentation of the loans.

Mr. Chen additionally failed to avoid his conflict of interest as a director of the company and the owner of XGL. He did not inform the board of the Lenders' demand for default interest and agreed to pay it without informing the board. This prevented the company from acting to protect its interests.

HKEx Sanctions Imposed

The HKEx censured the directors and required them to attend training on regulatory and legal topics and HKEx Listing Rule compliance, directors' duties and the Corporate Governance Code's requirements.

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SFC Consults on Enhancements to Hong Kong REIT and Listed CIS Statutory Regimes

Hong Kong Law – 656 – 29 May 2024

The Securities and Futures Commission's (the *SFC*) March Consultation Paper proposes to introduce a statutory scheme of arrangement and compulsory acquisition mechanism for real estate investment trusts (*REITs*) similar to those applicable to Hong Kong-incorporated companies. It also proposes extending the market misconduct, disclosure of inside information and disclosure of interests regimes applicable to Hong Kong-listed companies to listed collective investment schemes (*CISs*). The aim is to boost Hong Kong's attractiveness as an investment destination and its status as an international financial hub. The cut-off date for responding to the Consultation Paper is 27 May 2024.

Proposed improvements to Hong Kong REIT and Listed CIS Statutory Regimes

The proposed statutory scheme of arrangement and compulsory acquisition scheme for REITs under the Securities and Futures Ordinance (Cap. 571 of the laws of Hong Kong) (the *SFO*) would allow REITs to conduct privatisation and corporate restructuring in a similar way to listed companies. REIT unitholders would be given various safeguards and protections. As regards listed collective investment schemes, including REITs, the SFC is proposing to extend to them the following regimes under the SFO: the market misconduct regime under Parts XIII and XIV; the disclosure of inside information regime under Part XIVA; and the disclosure of interests regime under Part XV.

Prior to publishing the Consultation Paper, the SFC consulted market participants and stakeholders and apparently received positive feedback on the proposals.

Proposed Statutory Scheme of Arrangement and Compulsory Acquisition Mechanism for Hong Kong REITs

The first proposal is to introduce a statutory framework to enable a court-supervised scheme of arrangement and compulsory acquisitions for SFC –authorised REITs in Hong Kong.

Hong Kong provides a statutory mechanism for companies formed and registered under Part 13 of the Companies Ordinance (Cap. 622 of the laws of Hong Kong) (the *Companies Ordinance*) to carry out a corporate restructuring by way of a scheme of arrangement. However, REITs are constituted as trusts, not companies, and thus cannot rely on the Companies Ordinance's scheme of arrangement and compulsory acquisitions mechanism.

REITs can only achieve privatisation indirectly by first disposing of all or a substantial part of their assets and then delisting from the Hong Kong Stock Exchange and de-authorisation under the SFC's Codes on Takeovers and Mergers and Shares Buy-backs (the *Takeovers Code*) and the Code on Real Estate Investment Trusts (the *Hong Kong REIT Code*).

Current Position in Hong Kong

Part 13 of the Companies Ordinance contains detailed procedures for companies incorporated or registered in Hong Kong to undertake schemes of arrangement as part of corporate restructuring and to compulsorily acquire shares after a takeover offer or a general offer for a share buy-back.

Under section 670 of the Companies Ordinance, on application by the relevant parties, the court can direct a meeting of members or creditors to consider a proposed scheme. If a meeting is called, the relevant parties must convene the meeting in accordance with section 671 of the Companies Ordinance and its notice and content requirements. Meetings must be held in compliance with these requirements which ensure that meeting notices are comprehensive and issued in a timely manner to ensure that parties receive accurate and adequate information to make informed decisions. Once the arrangement or compromise is approved, the court can sanction it, and a copy of the court order must be registered with the Registrar of Companies.

These statutory restructuring mechanisms are not available to REITs because they are established as trusts. If a REIT manager wishes to privatise the REIT or undertake a corporate restructuring, it generally has to do so by way of asset disposal followed by delisting and deauthorisation of the Hong Kong REIT under paragraph 11.13 of the Hong Kong REIT Code and Note 7 to Rule 2 of the Takeovers Code, subject to obtaining sufficient votes under Rule 2.10 of the Takeovers Code. After the asset disposal, the REIT will no longer meet the investment requirements of paragraph 3.2 of the Hong

Kong REIT Code and its listing can no longer be maintained, rendering it ineligible for authorisation under the SFO.

Calls for Change for Hong Kong REITs

The industry had been calling for a direct exit option similar to the statutory scheme of arrangement and compulsory acquisition regime for listed companies. Although REITs and listed companies operate as different legal forms, units and shares are similar in terms of their rights and the interests attached to them. Merger and acquisition activities involving REITs and listed companies also have similar commercial characteristics. Despite the SFC extending the Takeovers Code to REITs, it does not provide for a "squeeze out" provision on a REIT takeover or for the privatisation of REITs.

Without a "squeeze out" mechanism, a general offer to take over a REIT entirely would not be achievable. Obtaining acceptance from all unitholders is impossible, and accepting less than 100% acceptance risks leaving the offeror with minority unitholders. Unlike listed companies, the Hong Kong REIT Code lacks a mechanism for the offeror to remove resistant minority unitholders, regardless of their size. Australia and Singapore adopted a compulsory acquisition mechanism in 2000 and 2009, respectively.

It is common for Hong Kong companies to privatise by way of a scheme of arrangement. A scheme of arrangement is binding on all shareholders after the scheme is approved in a meeting by shareholders and/or creditors and sanctioned by the court. There is, however, no equivalent mechanism for REITs to privatise. Australia and Singapore have a scheme of arrangement that allows REITs to be privatised.

The Financial Service Development Council (*FSDC*) issued a paper in 2013 suggesting a statutory scheme of arrangement and compulsory acquisition regime for REITs to promote liquidity and revitalise Hong Kong's REIT market. Although Hong Kong was one of the earlier markets to allow the trading of REITs under the Hong Kong REIT Code, its regime lags that of other financial products. The FSDC paper revisited the two main issues: the absence of: (i) squeeze-out provisions to facilitate REIT takeovers; and (ii) a scheme of arrangement provision to allow REITs to privatise.

Proposed Changes to the Hong Kong SFO

The SFC proposes introducing a new Part to the SFO which would allow REITS to conduct an arrangement or compromise similar to that available to companies under the Companies Ordinance.

The proposed statutory framework would include the following features which are similar to those available under the Companies Ordinance, with adjustments tailored to the characteristics of REITs:

1. For a scheme entered into with creditors (or a class of creditors), the scheme's terms would need to be approved by a majority in number representing at least 75% in value of the creditors (or a class of creditors) present and voting at the relevant meeting.

2. For a scheme entered into with unitholders (or a class of unitholders), the scheme's terms would be subject to the approval of:

    ◦ unitholders representing at least 75% in value of the voting rights present and voting; and

    ◦ unless otherwise ordered by the court, a majority in number of unitholders' rights present and voting.

3. If a general offer or takeover offer is involved in a scheme entered into with unitholders (or a class of unitholders), it:

    ◦ must be approved by unitholders representing at least 75% in value of the voting rights present and voting; and

    ◦ must not be voted against by 10% or more of the voting rights of disinterested unitholders or disinterested unitholders of that class.

4. The REIT's management company, trustee, unitholders or creditors may apply to the court to order a meeting and sanction the scheme.

5. The REIT's management company, trustee and all its directors must disclose all material interests in the arrangement or compromise in an explanatory statement sent prior to the court-ordered meeting.

6. An arrangement or compromise of a REIT sanctioned by the court is binding on the relevant parties including the REIT's trustee and management company, its unitholders and creditors.

7. The court order sanctioning the arrangement or compromise has no effect until a copy of the court order is delivered to the SFC for filing.

Current Position on Compulsory Acquisition of Hong Kong REITs

For companies registered under the Companies Ordinance, the provisions relating to the compulsory acquisition of shares following a takeover offer or general offer are found in sections 687 to 704 of the Companies Ordinance.

Section 689(1) defines a takeover as an offer to acquire all the shares in the company except those held by the offeror at the date of the offer. The terms of the offer must be the same for all the shares to which the offer relates (or all the shares of the class to which the offer relates).

Section 689(3) provides that "shares that are held by an offeror" include shares that the offeror has contracted, unconditionally or conditionally to acquire, but exclude shares that are subject to a contract is that is intended to secure that the shareholder will accept the offer when it is made and entered into for no consideration and by deed, for consideration of negligible value, or for consideration consisting of a promise by the offeror to make the offer.

Sections 689 and 691 state that a takeover offer may relate to:

- shares that are allotted after the date of the offer but before a date specified in the offer as set out in Section 689(6);
- shares that the offeror acquires or contracted to acquire other than by virtue of acceptances of the offer during the offer period, unless the acquisition consideration exceeds the consideration specified in the terms of the offer as set out in section 691(2); and
- shares which a nominee or an associate of the offeror has contracted to acquire after a takeover offer is made but before the end of the offer period, unless the acquisition consideration exceeds the consideration specified in the offer as set out in section 691(4).

The Companies Ordinance includes mechanisms that allow for the mandatory acquisition or "squeeze-out" of minority shareholdings if the acquiring company or offeror obtains acceptances exceeding 90% of the total shares or a specific class of shares in a takeover or general offer. When the majority shareholding reaches that threshold, the offeror can require the minority shareholders to sell their shares. The minority shareholders can obtain a court order to prevent the acquisition if the compulsory acquisition would result in their unfair treatment. Minority shareholders also have a "sell-out" right, which means that they can require the acquiring company or offeror to purchase their remaining shares if it achieves a 90% acceptance rate and control of the company in a takeover or general offer.

Proposed Compulsory Acquisition Mechanism to the Hong Kong SFO

The SFC is proposing that the Companies Ordinance's compulsory acquisition provisions are mirrored in the SFO. The key elements of the proposal are that:

1. "Squeeze-out" and "sell-out" provisions would apply after a takeover offer or general offer for a unit buy-back. These would be based on the provisions under Divisions 4 and 5 of Part 13 of the Companies Ordinance;
2. The provisions for the procedures and timelines for giving an acquisition notice will be similar to those under the Companies Ordinance, with certain modifications:

- the offeror or repurchaser in a "squeeze out" would have to provide notice to minority holders within the earlier of: (i) three months from the day after the offer period of the takeover offer or general offer ends; or (ii) six months from the date of the takeover offer or general offer. A disinterested unitholder could apply to the court to determine whether the "squeeze out" can be carried out or not; and

- notice to minority unitholders regarding their rights to a "sell-out" would have to be given within one month after the first day on which the unitholders become entitled to a sell-out. Those rights would be exercisable by minority unitholders within three months after the later of: (i) the end of the offer period; or (ii) the date notice is given by the offeror or repurchaser. Notices issued before the expiry of an offer period would be required to state that the offer is still open for acceptance;

3. If the offeror or the repurchaser has acquired acceptances of at least 90% of the number of units in the offer, the management company or the trustee of the offeror or the repurchaser could apply to the court to authorise the issue of an acquisition notice to buy out the remaining units upon satisfying the court that: (i) the consideration is fair and reasonable; and (ii) the buy-out is fair;

4. The time and manner for the issue of an acquisition notice will be similar to that under the Companies Ordinance;

5. Where a unitholder's address is not available from the register of holders, the management company or the trustee of the offeror or the repurchaser could apply to the SFC for directions on delivery of the acquisition notice;

6. The SFC would be able to issue directions as to the form of an acquisition notice;

7. Similar to sections 698, 699, 716, and 717 of the Companies Ordinance, the trustee of the REIT would be required to hold the consideration monies on trust for the entitled unitholders pending completion of the acquisition; and

8. On a takeover offer and compulsory acquisition, the REIT's trustee would be responsible for updating the unitholders' register to show the offeror as the holder of the acquired units. Conversely, in a general offer for a unit buy-back, the REIT's trustee would be required to cancel the relevant units.

Proposed Modifications to Cater for Hong Kong REIT Capital Characteristics

Given the specific features of REITs, new definitions will be added into the interpretation section of the new part of the SFO which will largely follow the definitions used in the Companies Ordinance sections 666 and 667, namely the definitions of

"Child", "Cohabitation Relationship", "Offer Period", "Repurchase Company" and "Associate". It would also include new terms such as "Management Company" and "REITs".

One of the main differences between a REIT and a company is that a REIT lacks legal personality. The proposals would therefore introduce new provisions to deem the acts and powers of a REIT's trustees, management company and directors as being exercised on behalf of the REIT. Obligations and powers imposed or conferred on the REIT would be deemed to be imposed or conferred on the REIT's trustee or management company.

Similarly, (i) voting rights owned, controlled, or held by a trustee or a management company and/or any of the management company's directors; and (ii) property, undertaking or liabilities or rights attached, held or exercised by a REIT's trustees and/or its management company or directors, would be considered to be owned or held etc. on behalf of the REIT.

Creditors to whom the trustee and/or the management company incur liability on behalf of the REIT will be deemed to be creditors of the REIT.

Finally, the definition of "responsible person" of a company under section 3 of the Companies Ordinance will be extended to include officers of the management company, and the officers of the management company will be deemed to have committed an offence if it fails to comply with the new provisions.

Other Notable Amendments for Hong Kong REITs

Section 675 of the Companies Ordinance caters for a court-free regime for amalgamations. However, this regime is limited to amalgamations of wholly-owned intra-group companies limited by shares and is not used in other jurisdictions such as Australia, Singapore or the United Kingdom. Therefore, the SFC will not extend these provisions to REITs.

Housekeeping amendments include amendments to section 400 of the SFO so that service of notices will include references to REITs. Although the new proposals will be inserted into the SFO, certain provisions and interpretations are set out in the Schedule IX (REIT Guidance Note) of the Takeovers and Buy-back Codes.

Extension of SFO Market Misconduct Statutory Regime to Hong Kong Listed CISs

The SFC's second proposal would amend the SFO to explicitly apply the market conduct regimes to listed CISs. Parts XIII to XV of the SFO set out the statutory frameworks governing market misconduct, offences relating to dealings in securities and futures contracts, the disclosure of inside information and disclosure of interests listed securities and listed corporations.

Some of the SFO's market misconduct provisions, such as section 270 on insider dealing, apply only to listed corporations. To ensure that all listed CISs are subject to appropriate market conduct and transparency standards, the SFC will refine its previous proposals.

Previous SFC proposals

To ensure certainty with respect to listed CISs and to align with the approach in countries like Australia, Singapore and the United Kingdom, the SFC has proposed amending the SFO to expand the market conduct regimes to REITs and non-corporate listed entities.

Two consultations were held previously. The first was a January 2010 consultation paper on proposals to:

- extend the application of the Codes on Takeovers and Mergers and Share Repurchases to SFC-authorised REITs and related amendments; and
- extend Parts XIII to XV of the SFO to listed collective investment schemes.

A subsequent consultation paper in November 2012 proposed enhancing the regulatory regime for non-corporate listed entities. Both received positive feedback. After publishing consultation conclusions to these two consultation papers on 25 June 2010 and 27 March 2013, respectively, the SFC and the Hong Kong Government started preparing legislative amendments based on the two consultation papers. However, the process was stalled by technical difficulties. It was considered that more discussions would be required. Meanwhile, the SFC has imposed other measures to supervise REITs and other listed CISs, including:

- close surveillance of any untoward price or volume movements;
- imposing disclosure obligations on REITs to include requirements in their trust deeds similar to those in Part XV of the SFO, and
- close supervision of SFC licensed managers and their management of listed CIS.

The 2024 proposals will fine tune the technical difficulties and implement the two consultation conclusions. Based on the two previous consultation conclusions, the proposed legislative amendments would include the following:

- As regards the Part XIII provisions on the Market Misconduct Tribunal, the objective of the market misconduct regime is to promote fairness in the market and minimise crime and misconduct. Currently, some defined terms such as "associate" and "controller" cater only for corporations. In view of the CIS market in Hong Kong, amendments will be made to explicitly confer powers on the SFC to initiate civil proceedings in the Market Misconduct Tribunal in relation to listed CISs. The

Courts and the Secretary for Justice will have the power to handle proceedings and make orders in relation to a listed CIS. This will eliminate any doubt in the legislation and provide investors with the same protections against market misconduct as investors in listed corporations;

- Part XIV of the SFO is the criminal market misconduct regime. Similar amendments to those made to Part XIII will be made. Any contravention of Part XIV by a listed CIS will lead to criminal liability;

- Part XIVA relates to public disclosure of inside information. Currently, Part XIVA requires listed corporations to disclose price sensitive or inside information on a timely basis. However, this statutory disclosure obligation does not apply to listed CISs. From investors' point of view, investments in listed CISs and listed companies are very similar economically and in terms of the fundamental rights and interests attaching to units in CISs and shares in a listed company. It would therefore be expected that the statutory disclosure obligations are similar. Accordingly, amendments will be made to oblige listed CISs and their officers, including management companies and their officers, to promptly disclose inside information. Otherwise, the SFC will be able to bring Market Misconduct Tribunal proceedings. The Courts and Secretary for Justice will be able to bring proceedings and make orders if there is a breach of the disclosure obligation by the officers of a listed CIS. The general principles and guidance set out in the Guidelines on Disclosure of Inside Information will also be modified accordingly. The safe harbours under the price sensitive information regime for listed corporations would also apply to listed CISs; and

- Part XV on Disclosure of Interests explicitly refers to shares and debentures of a listed corporation. Part XV currently provides investors in listed corporations with more complete and quality information to allow investors to make informed investment decisions. This regime also allows investors to identify the persons who control, or are in a position to control, interests in shares in listed corporations and those who may benefit from transactions involving associated corporations of listed corporations. However, currently it does not apply to CIS which are constituted in the form of trusts or other non-corporate form.

Accordingly, the disclosure of interests regime will be modified to extend to substantial unitholders and relevant personnel of listed close-ended CISs (that is CISs other than a listed open-ended CIS consisting mostly of exchange-traded funds).

The consultation paper published in 2012 also proposed complementary amendments to the SFC's investigation and intervention powers under Parts VIII and X of the SFO. Currently, Part VIII of the SFO gives the SFC with supervisory and investigative powers. The SFC intends to clarify that the powers of the SFC under this part will allow it to investigate and intervene in misconduct on the part of listed CISs. Part X allows

the SFC to apply to court for injunctions and other orders to remedy or regulate misconduct or oppression in the way a listed company's affairs are conducted. The proposed amendments would empower the SFC to apply for court orders to remedy market misconduct on the part of listed CISs.

The proposed amendments would provide greater consistency in the regulation of Hong Kong listed entities and align Hong Kong's regulatory regime for listed entities more closely with standards used in other overseas jurisdictions.

Proposed refinements

Given the technical challenges previously encountered in the drafting process and to support effective enforcement, the Consultation Paper proposes further refinements to the previous proposed legislative amendments to the SFO discussed in the 2010 and 2012 consultation papers. The amendments will ensure that the provisions operate appropriately in the context of listed CISs. The SFC is proposing to fine-tune its proposals based on the 2024 consultation:

1. Limiting the scope of the extension to Hong Kong listed CISs only

Currently, the only type of non-corporate entities listed on the Hong Kong Stock Exchange are listed CIS, including REITS. Hence the legislative amendments will specifically target listed CISs and their management companies. The amendments will not apply to all forms of non-corporate entities. If any new form of non-corporate listed entity appears in the market, the consultation paper provides that the SFC will consider then whether the market conduct regimes would be applicable to those entities.

2. Streamlining the proposed legislative amendments

The legislative amendments will impose relevant obligations under the market conduct regime on the management company of a listed CIS and the CIS directors in the case of a corporate CIS. Trustees and custodians are responsible for overseeing the operations of listed CISs. However, management companies and CIS directors carry out the executive and managerial functions of a listed CIS. Their functions are comparable to that of directors of listed companies. Consequentially, trustees and custodians will not be referred to in some definitions such as "associate", "controller", "persons connected with a corporation", "inside information", "subsidiary" and "related corporation" under Parts XIII to XV of the SFO. However, the trustee or custodian of a listed CIS will be retained under Parts VIII and X of the SFO. Parts VIII and X of the SFO relate to the SFC's supervisory and investigative powers over trustees or custodians of a listed CIS since they can act on behalf of the CIS. For instance, trustees and custodians will be required to provide all information relevant to an investigation under section 179 of the SFO. The court can also order trustees and custodians to bring proceedings in the name of the listed CIS against such persons as the court may see fit under section 214 of the SFO.

Additionally, as the duty to provide information pursuant to the listed CIS's constitutive documents, the duty to keep a register of unitholders and other investigative powers have already been provided for under existing similar regulations, the consultation proposal will not extend to listed CIS the equivalent provisions under Divisions 5, 6, 10, 11 and 12 of Part XV of the SFO.

Other consequential amendments include clarifications as to the scope of application of the market conduct regimes to listed CISs. All listed CISs, including those structured in corporate form, open-ended fund companies or other corporate funds established overseas, will be subject to the market conduct regime. This however excludes overlapping provisions applicable to listed corporations. Further, various definitions will be added to Part 1 of Schedule 1 of the SFO including:

- the definition of "officer" will be expanded to include the management company of a CIS and its manager, director or secretary; and
- definitions for "fund subsidiary", "fund-holding entity" and "fund-related entity" will be included. They will bear similar meanings to "subsidiary", "holding company" and "related corporation". However, modifications to these definitions will be made as a holding entity and subsidiary of a listed CIS may or may not be a listed CIS, and voting rights of a listed CIS may be exercised by its trustee or management company (or its directors) on behalf of a listed CIS.

Subject to the legislative process, consequential amendments may be made to existing subsidiary legislation under the SFO. An enabling power will be included in the proposed legislation to enable amendments to be made correspondingly. The amendments will also include changes to the provisions on insider dealing as set out in the consultation conclusions on proposed amendments to enforcement related provisions of the SFO published in August 2023.

The proposals regarding listed CISs aims to apply aspects of the SFO's market conduct regime to listed CIS.

Implementation Timeline

The proposal is subject to a two-month public consultation which will end on 27 May 2024. The SFC aims to complete the legislative process before December 2025. The SFC does not consider a transition period to be necessary.

Exchange Publishes Consultation Conclusions on New Climate Disclosure Requirements Effective 1 January 2025

Hong Kong Law – 657 – 04 June 2024

On 19 April 2024, The Stock Exchange of Hong Kong Limited (the *Exchange*) published the Consultation Conclusions on enhanced requirements for climate-related disclosures under the Environmental, Social and Governance Framework as proposed in its Consultation Paper with a consultation period that had ended on 14 July 2023. For a summary of the Consultation Paper, please see Charltons' May 2023 newsletter.

From 1 January 2025, the additional requirements will be set out in Appendix C2 to the Main Board and GEM Listing Rules, which will be renamed the "Environmental, Social and Governance Reporting Code" (*ESG Code*). To facilitate implementation and understanding of the new requirements, the Exchange has also issued the Implementation Guidance incorporating the International Sustainability Standards Board's (*ISSB*) reporting principles and setting out illustrative examples and step-by-step workflows for listed companies.

Adoption of ISSB standards

Since the publication of the Consultation Paper, significant advancements in Environmental, Social and Governance (*ESG*) reporting and climate-related disclosure have been made. In June 2023, the ISSB finalised the ISSB Climate Standard and the ISSB General Standard (together with the ISSB Climate Standard, the *ISSB Standards*), which were endorsed by the International Organisation of Securities Commissions in July 2023 urging its member jurisdictions to consider adopting these standards. Additionally, the International Auditing and Assurance Standards Board initiated a consultation on the International Standard on Sustainability Assurance 5000 in August 2023, which is aimed at boosting investors' confidence in sustainability reporting. In February 2024, the International Financial Reporting Standards (*IFRS*) Foundation published an ISSB Adoption Guide Preview, suggesting enhanced climate disclosures and phased implementation based on market tiers and milestones.

Since the announcement of the Green and Sustainable Finance Cross-Agency Steering Group1[1] and the Chief Executive's 2023 Policy Address, Hong Kong has sought to strengthen its sustainable finance ecosystem by adopting the ISSB Standards published in June 2023 with suitable amendments to cater for Hong Kong's green finance landscape. In March 2024, the Hong Kong Government's Financial Services and the Treasury Bureau published a statement designating the Hong Kong Institute of Certified Public Accountants (*HKICPA*) as the sustainability reporting standard setter in Hong Kong. Following the ISSB's recommendations on proportionality, phasing-in of the ISSB Standard and its proposed focus on publicly accountable entities, the Exchange's Consultation Conclusions will be the first step in enhancing ESG reporting regulations for listed companies in Hong Kong pending the HKICPA's development of local sustainability disclosure standards.

The Exchange urges listed companies to reference the Implementation Guidance as well as the definitions and application guidance set out in Appendices A and B to the ISSB Climate Standard. These guides provide in-depth explanations of the new climate requirements, relevant measurement approaches and applicable implementation reliefs. In paragraph 8 of the ESG Code, the Exchange clarifies that listed companies can also follow other international ESG reporting guidance provided that the ESG Code's mandatory disclosures have been made. ESG reports following the ISSB Standards will be deemed to be in compliance with Part D of the ESG Code, which will contain the new climate-related disclosures.[2] Listed companies are required to indicate where the ESG Code disclosure requirements have been incorporated, for instance by way of a reference table.

For a direct comparison between the climate-related disclosures under the ISSB Climate Standards and the enhanced disclosure requirements in Part C of the ESG Code, please see Appendix V to the Consultation Conclusions.

Implementation Timeline

Considering the responses received and the ISSB Adoption Guide Preview recommending a phased implementation according to the size, trading volume and liquidity of listed companies, the Exchange has decided to adopt the following phased approach to implement the requirements under Part D of the ESG Code. References to "Large-Cap listed companies" are to listed companies that are Hang Seng Composite LargCap Index constituents throughout the year immediately prior to the reporting year of the ESG report in question.

[1] The Steering Group was established in May 2020 and co-chaired by the Hong Kong Monetary Authority and the SFC, with members including the Environment Bureau, the Financial Services and the Treasury Bureau, the Accounting and Financial Reporting Council, Exchange, the Insurance Authority and the Mandatory Provident Fund Schemes Authority.

[2] Paragraph 2 of the ESG Code.

	Disclosure of scope 1 and scope 2 greenhouse gas emissions	**Disclosure other than scope 1 and scope 2 greenhouse gas emissions**
LargeCap Listed Companies	**Mandatory disclosure** (Financial years commencing on or after 1 January 2025)	• "**Comply or explain**": Financial years commencing on or after 1 January 2025 • **Mandatory disclosure**: Financial years commencing on or after 1 January 2026
Main Board Listed Companies (other than LargeCap Listed Companies)		"**Comply or explain**"(Financial years commencing on or after 1 January 2025)
GEM Listed Companies		**Voluntary disclosure** (Financial years commencing on or after 1 January 2025)

Given that LargeCap listed companies (which do not include secondary listed companies which are not required to publish ESG reports under the ESG Code), contributed to around 64.05% of the total market capitalisation, and 46.41% of the total year-to-date average daily trading volume of all listed companies in Hong Kong as at 31 December 2023, the Exchange believes that LargeCap listed companies have sufficient resources to lead compliance with the new disclosure requirements under the amended ESG Code. LargeCap-listed companies should note that under paragraph 17(2) and the corresponding note in the ESG Code, they are required to comply with the mandatory disclosure requirements even if they subsequently cease to qualify as a LargeCap-listed company.

Definition of Materiality

Currently, matters that the board determine to be important to investors and stakeholders could be regarded as passing the "materiality" threshold. Some respondents opined that the "materiality" threshold should be confined to financial materiality to align with the position under the ISSB Standards, or alternatively adopt a double materiality approach including the impact on the company's financial value and operational activities. The Exchange rejects suggestions to amend the scope of "materiality" on the basis that it considers the current definition to be sufficiently broad to encompass the financial materiality threshold. However, the Exchange clarifies that listed companies must disclose information on climate-related risks and opportunities that may reasonably affect their cash flows, access to finance or cost of capital over the short, medium or long term. The Exchange also invites listed companies to adopt the double materiality approach to meet the needs of their investors.

Consultation proposals and responses

To implement the following proposals, relevant amendments and additions to the ESG Code will be made under the enhanced climate-related disclosures regime.

1. Upgrading climate-related disclosures to mandatory

The Exchange received broad support for the proposal to make listed companies' climate-related disclosures mandatory, rather than subject to "comply or explain". As explained above, the Exchange will adopt phased implementation to facilitate a smooth transition to the new requirements and any future Hong Kong Standards. This approach may also alleviate concerns about the enhanced climate-related disclosures being too burdensome in terms of time and resources for small- to medium-sized listed companies. The "comply or explain" basis allows listed companies more time to prepare for the relevant disclosures. However, the Exchange strongly urges listed companies to provide as much information and disclosures as possible and to start reviewing their current systems to prepare for the future Hong Kong standards.

The Exchange will also put in place certain implementation reliefs as summarised in the table below:

	Reasonable Information Relief	**Capabilities Relief**	**Commercial Sensitivity Relief**	**Financial Effects Relief**
All paragraphs with respect to climate-related opportunities			note 2 to paragraph 20 of Appendix C2	
Identification of climate-related risks and opportunities	note 1(a) to paragraph 20 of Appendix C2			
Determination of the scope of the value chain	note to paragraph 21 of Appendix C2			
Quantification of current and anticipated financial effects		note 4 to paragraph 25 of Appendix C2 (for anticipated financial effects only)		notes 3 and 5 to paragraph 25 of Appendix C2
Preparation of disclosures on anticipated financial effects	note 2 to paragraph 25 of Appendix C2	note 2 to paragraph 25 of Appendix C2		
Use of climate-related scenario analysis	note to paragraph 26 of Appendix C2	note to paragraph 26 of Appendix C2		
Measurement approach, inputs and assumptions of Scope 3 greenhouse gas emissions	note 1 to paragraph 29 of Appendix C2			
Calculation of metrics in particular cross-industry metric categories with respect to climate-related transition risks, climate-related physical risks and climate-related opportunities		note to paragraph 32 of Appendix C2		

- *Reasonable Information Relief* – under this relief, listed companies are only required to make disclosures if the information is reasonably accessible and supportable, and if the information is available at the reporting date without undue cost or effort.

- *Capabilities Relief* – listed companies are permitted to limit their disclosures based on the available skills, capabilities and resources at a particular point in time in preparing disclosures on a climate-related scenario analysis and anticipated financial effects.

- *Commercial Sensitivity Relief* – full compliance with the disclosure requirements is not mandatory if (i) the information about the climate-related opportunity is not already publicly available; (ii) disclosure of such would seriously prejudice the economic benefits the listed company would otherwise be able to realise in pursuing the opportunity; and (iii) it is not possible to disclose such information in a manner that would enable the listed company to meet the objectives of the disclosure requirements without seriously prejudicing the above mentioned economic benefits.[3]

Under paragraph 16 of the ESG Code, the Exchange encourages listed companies who have opted for the “explain” option or one of the implementation reliefs above to also make disclosures on its work plan, including the progress of preparing relevant information and the timetable.

Governance

2. Introducing new climate-related governance disclosures (Governance)

A large majority of respondents supported the Exchange’s proposal to add provisions in the ESG Code to address the roles of the board of directors, committees and management. This aims to help focus the management on climate issues in relation to the listed company and thus allow investors to evaluate whether the listed company has the ability to deal with significant climate-related risks and opportunities. The Exchange will implement in the ESG Code wordings similar to that under the ISSB Climate Standard, which specifies that governance bodies and management are responsible for oversight of climate-related risks and opportunities. These responsibilities should also be set out in the applicable terms of reference, mandates, role descriptions or other related policies.[4] The Exchange notes that under paragraph 13 of the ESG Code, listed companies are already required to issue a statement from the board in relation to the listed company’s ESG disclosures, to avoid duplication, the Exchange states that only one integrated set of disclosures would be required to comply with paragraphs 13 and 19 of the ESG Code.

[3] Please see the Implementation Guidance for more details
[4] note to paragraph 19(a) of the ESG Code

Strategy

3. Disclosure of climate-related risks and opportunities

The Exchange will also include requirements on disclosures of climate-related risks and opportunities as they may have a material effect on the listed company's business model, strategy and cash flows, access to finance and cost of capital, all of which are essential for investors to make investment and voting decisions. The Exchange considers that this will also enhance the sustainable growth of listed companies and that they will be able to amend their business model and development plan according to the identified risks and opportunities.

Considering the feedback received, the Exchange will also make certain modifications to the original proposal on climate-related risk disclosure:

- *Paragraph 20(a) of the ESG Code* – risks that could "reasonably be expected to affect the issuer's cash flows, its access to finance or cost of capital over the short, medium or long term" must be disclosed. The industry-based disclosure topics under IFRS S2 Industry-based Guidance on implementing Climate-related Disclosures should be adopted, if applicable.

- *Paragraph 21 of the ESG Code* – listed companies must also disclose the impact on the listed company's "business model and value chain", and a description of where in the listed company's business model and value chain such risks and opportunities are concentrated at. According to the implementation guide, value chain generally means the full range of interactions, resources and relationships related to a reporting entity's business model and the external environment in which it operates.

- *Note to paragraphs 20 and 21 of the ESG Code* – as mentioned above, the Exchange will also provide Reasonable Information Relief in relation to disclosures on identifying climate-related risks and determining the scope of the value chain.

On the other hand, the Exchange will also mandate disclosures of the actual and potential effects of climate-related opportunities subject to the following amendments:

- *Paragraph 20(a) of the ESG Code* – instead of only requiring disclosure of climate opportunities that correspond to climate risks, disclosure must be made of potential climate-related opportunities which may affect the listed company's cash flows, its access to finance or cost of capital over the short, medium or long term. The industry-based disclosure topics under the IFRS S2 Industry-based Guidance on implementing Climate-related Disclosures should be adopted if applicable.

- *Paragraph 21(b) of the ESG Code* – a description of where in the listed company's business model and value chain climate-related risks and opportunities are concentrated at will be required.

- *Note 1 to paragraph 20 of the ESG Code* – the Reasonable Information Relief will also be available for climate-related opportunities disclosures.

- *Note 2 to paragraph 20 of the ESG Code* – the Commercial Sensitivity Relief will also be available to information that is not publicly available and is commercially sensitive.

4. Disclosure of cross-industry metrics and industry-based metrics when disclosing climate-related risks and opportunities

As mentioned under paragraph 41 of the ESG Code, listed companies are required to consider adopting cross-industry metrics and industry-based metrics as they serve as indicators to reflect the listed company's ability to address climate-related risks or opportunities. Disclosures based on these metrics coupled with qualitative information such as the percentage of business activities or assets vulnerable to a climate-related risk when discussing the relevant climate-related risk, would allow better visualisation of the risk or opportunity in question. As set out in paragraphs 28 to 35 of the ESG Code, it will be mandatory to report on certain cross-industry metrics such as greenhouse gas emissions and internal carbon prices, while paragraph 36 of the ESG Code states that the applicability of the industry-based metrics associated with disclosure topics defined in the IFRS S2 Industry-based Guidance on implementing Climate-related Disclosures must be considered.

5. Transition plans – climate-related risks and opportunities

The ESG Code will require disclosures on the listed company's response to climate-related risks and opportunities including disclosures on the:

i. current or anticipated changes to the listed company's business model, strategy and resource allocation;

ii. adaption and mitigation efforts; and

iii. whether the plan aims to achieve any climate-related targets.

The Exchange notes that not all listed companies would have comprehensive plans in place, therefore, only an overall strategic plan laying out its targets, actions or resources is required. This is crucial to allow investors to evaluate the credibility and feasibility of the listed company's climate change commitments.

To further mirror the ISSB Climate Standard, the Exchange will amend the section heading in the ESG Code from "Transition plans" to "Strategy and decision-making" as well as implementing the following amendments to the previous proposals:

- *Paragraph 22(a) of the ESG Code* – disclosure of how the listed company has responded to and plans to respond to, any climate-related risks and opportunities in its strategy and decision-making.

- *Paragraph 22(a)(iii) of the ESG Code* – disclosure of any climate-related transition plan or alternatively a negative statement. The plan should include information about the key assumptions used in developing its transition plan and the dependencies used in formulating the plan.

- *Paragraph 22(a)(iv) of the ESG Code* – disclosure on the plans to achieve any climate-related targets. This is in line with the requirements under paragraph 39 of the ESG Code where listed companies are required to disclose their progress towards targets set in future ESG reports.

6. Climate-related targets

In furtherance of the above, under paragraphs 39 and 71 to 76 of the ESG Code, listed companies will be required to disclose their climate-related targets as well as any mandatory greenhouse gas emission targets in accordance with local legislation. In particular, if listed companies wish to apply carbon credits, information such as the intended use, their gross and net greenhouse gas emissions targets must be disclosed separately. The Exchange clarifies that these climate-related targets are not confined to KPIs A1.5 (emission targets), A1.6 (waste reduction targets), A2.3 (energy use efficiency targets) and A2.4 (water efficiency targets), as referred to in Part C of the ESG Code.

Additionally, the Exchange will amend the ESG Code to explicitly require disclosure of certain particulars essential for investors to evaluate the listed company's climate-related targets and performance in achieving these targets. These include:

- *Paragraphs 37(h) and 40(d) of the ESG Code* – disclosures on whether the climate-related target was (i) set based on the latest international agreement on climate change; or (ii) derived using a sectoral decarbonisation approach.

- *Paragraph 38 of the ESG Code* – disclosure of (i) whether the target and methodology for setting the target has been validated by a third party; (ii) the processes used by the listed company for reviewing the target; (iii) the metrics used to monitor the progress towards reaching the target; and (iv) any revisions to the target with corresponding explanations.

- *Paragraph 39 of the ESG Code* – disclosure of an analysis of trends or changes in the listed company's performance of each climate-related target.

- *Paragraph 40(e)(iv) of the ESG Code* – if listed companies wish to apply carbon credits, information on the intended use, their gross and net greenhouse gas emissions targets must also be disclosed separately (for example, assumptions regarding the permanence of the carbon offset).

The Exchange reminds listed companies that under the "comply or explain" regime, the reasons for any non-disclosure of the climate-related targets must be

disclosed and alternative disclosures in the work plan, progress and timetable would not be sufficient.

7. Progress of the transition plans disclosed

Listed companies are required to disclose in their ESG reports their progress on reaching the climate-related targets and also the implementation status of previously set plans. This will allow investors and management of listed companies to evaluate the effectiveness of their climate-related measures. Regarding amendments to the proposals, the disclosure of progress requirements will be moved to the "Strategy" section, while the requirements for disclosure of the performance, and analysis of the trends or changes of the listed company will be set out under the "Metrics and Targets" pillar. The Exchange's original proposal that listed companies are not required to make such disclosures during the first reporting period will be discarded as well.

8. Climate resilience

Under the revised requirements, listed companies will be required to conduct climate-related scenario analysis to disclose how climate change may affect their business operations, how their strategies and business models are resilient to climate change and clearly identify significant areas of uncertainty. The Exchange has revised its proposal to adhere to the ISSB Climate Standard under paragraph 26 of the ESG Code and the Exchange clarifies that disclosure of a single amount or a range are both acceptable for quantitative data.

The Exchange will also introduce requirements for listed companies to conduct a climate-related scenario analysis with sufficient detail proportionate to their circumstances. However, some respondents are concerned that given the lack of a common agreed methodology and the lack of resources, such requirements may be overly burdensome for some listed companies. In response, the Exchange's view is that it is essential for listed companies to start using quantitative information to illustrate potential pathways and outcomes and this would enhance the ability of listed companies to respond efficiently to climate-related risks and opportunities. As such, the Exchange will make the following amendments allowing for more flexibility while ensuring the adequacy of the disclosure requirements:

- *Paragraph 26 of the ESG Code* – listed companies can opt for the Reasonable Information Relief and the Capabilities Relief, which is determined by assessing a listed company's exposure to climate-related risks and opportunities, and its available skills, capabilities and resources.

- *Paragraph 26(b)(i)(2) of the ESG Code* – disclosure of whether the analysis included a diverse range of climate-related scenarios.

- *Paragraph 26(b)(i)(4) of the ESG Code* – disclosure of whether a climate-related scenario aligned with the latest international agreement on climate change was used.

- *Paragraph 26(b)(iii) of the ESG Code* – disclosure of the reporting period in which the climate-related scenario analysis is carried out, as such analysis is not required every year;

- *Paragraph 26(b)(i)(7) of the ESG Code* – disclosure of the scope of operations covered by the analysis, such as the operation locations and business units covered.

To provide further guidance on the standard for climate-related scenario analysis disclosures, the Exchange has included detailed information on the preparation workflow, certain commonly used publicly available scenarios, recommendations that listed companies should select scenarios with higher contrast, and illustrative examples on how a scenario analysis should be performed in the Implementation Guidance.

9. Financial effects of climate-related risks and opportunities

Current financial effects

The Exchange will adopt the proposal to require the disclosure of the current financial effects of climate-related risks and opportunities while the proposed interim disclosure requirements will be removed. To ensure that the impact of climate-related risks and opportunities on listed companies are more vividly presented to investors and stakeholders, under paragraph 24 of the ESG Code, listed companies must disclose both quantitative and qualitative (expressed in a single amount or range) financial effects. Financial Effects Relief will also be available to listed companies who meet certain conditions, such as when the financial effects are not separately identifiable and the uncertainties in compiling such disclosures are so high that the information disclosed would not be useful.[5] If such relief is adopted, adequate explanations, qualitative information about the relevant financial effects and quantitative information about the combined financial effects as a whole must be disclosed.[6]

To clarify, such financial effects should be disclosed in the ESG report, however where the effect of the climate-related risks or opportunities on the listed company's financials is material, such information should also be addressed in the financial statements prepared according to applicable accounting standards,[7] as well as in the management commentary sections of annual reports and ESG reports.

[5] Note 3 to Paragraph 25 of the ESG Code
[6] Note 5 to Paragraph 25 of the ESG Code
[7] Note 1 to paragraph 24 of Appendix C2

Anticipated financial effects

In addition to the original proposal to require qualitative disclosure of anticipated financial effects, quantitative disclosure (expressed as a single amount or range) will be required. To address concerns that there may be great uncertainties, challenges and potential commercial sensitivities in disclosing anticipated financial effects, the Reasonable Information Relief, the Capabilities Relief, and the Financial Effects Relief are available for the disclosure of anticipated financial effects.[8] The Exchange also clarifies that a listed company is excused from providing quantitative information if it does not possess sufficient skills, capabilities and resources to provide such information. The Exchange notes that since most listed companies will be reporting on a “comply or explain” basis during the first phase, the above requirements would not place unnecessary burdens on less-resourced listed companies.

Risk management

10. The risk management process for climate-related risks and opportunities

Concerning climate-related risks, listed companies should disclose in detail the risk management process including measures taken to identify, assess and manage climate-related risks. In particular, paragraph 27 of the ESG Code sets out the list of information that should be disclosed, which includes (i) the inputs and parameters used; (ii) whether and how climate-related scenario analysis is utilised in the risk identification stage; (iii) how the nature, likelihood and magnitude of the effects of those risks are assessed; (iv) how climate-related risks are monitored; and (v) whether the risk management processes have been changed compared with the previous reporting period. Additionally, the Exchange will amend the ESG Code to state that only one set of integrated risk management disclosure that comply with the relevant requirements under both Parts B and D of the ESG Code is required. Listed companies can reference the Implementation Guidance for a detailed explanation on a proper risk management process with illustrative disclosure examples.

To align with the disclosure requirements of climate-related opportunities, under paragraph 27(b) of the ESG Code, it will be mandatory for all listed companies to disclose the risk management processes mentioned above in respect of climate-related opportunities. This requirement is subject to the “comply or explain” phase.

Metrics and targets

11. Disclosure of Greenhouse gas emissions

As explained in the Implementation Guidance, greenhouse gas emissions are divided into 3 scopes:

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[8] Notes 2, 3, and 5 of Paragraph 25 of the ESG Code

- *scope 1 greenhouse gas emissions* – direct emissions from sources owned or controlled by the listed company;
- *scope 2 greenhouse gas emissions* – emissions resulting from the generation of purchased or acquired electricity, heating, cooling and steam consumed within the listed company; and
- *scope 3 greenhouse gas emissions* – all other types of indirect emissions consequential to the activities of the listed company but are released from sources not owned or controlled by the listed company.

For scope 1 and scope 2 greenhouse gas emissions, it will be mandatory for all Main Board and GEM listed companies to disclose the absolute gross greenhouse gas emissions generated during each financial year commencing from 1 January 2025 under paragraphs 16 and 17 of the ESG Code. These disclosures should adhere to the Greenhouse Gas Protocol: A Corporate Accounting and Reporting Standard (2004) unless otherwise required by the relevant exchange on which the company is listed.[9] As required under paragraph 29(b) of the ESG Code, the (i) measurement approach; (ii) the inputs; and (iii) the assumptions used when measuring greenhouse gas emissions must be disclosed. For scope 2 greenhouse gas in particular, the location-based method,[10] which should be used, and contractual instruments in relation to the listed company's scope 2 greenhouse gas emissions should be explained as well.

Detailed disclosure on the absolute gross emission figures of scope 3 greenhouse gases is also required. As further explained in the Implementation Guidance, the Greenhouse Gas Protocol Corporate Value Chain (Scope 3) Accounting and Reporting Standard (2011) sets out 15 scope 3 greenhouse gas emission categories and listed companies must disclose the categories that are included within its measurement of scope 3 greenhouse gas emissions,[11] the basis of such selection and all significant changes in the value chain which may affect the categories chosen. Noting feedback from stakeholders that this disclosure may be challenging in terms of data collection and verification, the Exchange will make available the Reasonable Information Relief and allow listed companies to use information that is available to it without undue cost or effort.[12] If there are different reporting periods for different value chain entities, data from different reporting periods can be cited if (i) the recent data available from those other entities can be used without undue cost or effort to measure and disclose its greenhouse gas emissions; (ii) the reporting periods of the two companies are of the same length; and (iii) significant events and change in circumstances occurred between the reporting dates of the two companies.[13] The originally proposed interim

[9] Paragraph 29(a) of the ESG Code
[10] See the Implementation Guidance for details on the calculation scope under the location-based method
[11] Paragraph 29(d) of the ESG Code
[12] Note 1 to paragraph 29 of the ESG Code
[13] Note 2 to paragraph 29 of the ESG Code

provision requiring disclosures to be made during the first and second reporting periods following the effective date of the amendments will be removed given the adoption of the phased approach.

The Exchange acknowledges that scope 3 greenhouse gas emissions account for a significant portion of a company's carbon footprint. Given that data in relation to scope 1 and scope 2 greenhouse gases are prerequisites for scope 3 greenhouse gas emission data, this approach coupled with the phased approach should enable listed companies to acquire a deeper understanding of their carbon emissions and achieve sustainability. The Exchange will continue to monitor the disclosures of listed companies and will consider increasing the disclosure obligations especially when the Hong Kong Standards are available.

12. Cross-industry metrics

Cross-industry metrics are metrics relevant to all listed companies regardless of what industry and business section they are in. Stakeholders generally support the implementation of these disclosures as they will allow them to better assess the extent to which the listed company is vulnerable to climate change, enhance transparency around how capital is utilised for climate-related opportunities, and indicate the listed company's commitment to execute their climate-related transition plan. To address concerns as to difficulties in measurement, quantification and disclosure, listed companies would be required to disclose the following cross-industry metrics subject to various reliefs:

Paragraph 30 of the ESG Code	Amount and percentage of assets or business activities vulnerable to transition risks • the Reasonable Information Relief will be available
Paragraph 31 of the ESG Code	Amount and percentage of assets or business activities vulnerable to physical risks • the Reasonable Information Relief will be available
Paragraph 32 of the ESG Code	Amount and percentage of assets or business activities aligned with climate-related opportunities • the Reasonable Information Relief and Commercial Sensitivity Relief will be available
Paragraph 33 of the ESG Code	Amount of capital expenditure, financing or investment deployed toward climate-related risks and opportunities • the Commercial Sensitivity Relief will be available

The original proposal for interim disclosure of cross-industry metrics before the listed company can make quantitative disclosures will be removed as well given the current phased approach.

13. Internal carbon prices

Pursuant to paragraph 34 of the ESG Code, listed companies must disclose (i) the price for each metric tonne of greenhouse gas emissions that they use to assess the

costs of their emissions; and (ii) an explanation of how the listed company is applying the carbon price in decision-making (for instance capital expenditure decisions, research and development decisions, investment decisions, transfer pricing and scenario analysis). As the current ESG Code does not mandate all listed companies to maintain an internal carbon price, listed companies who have yet to maintain such a measure will be required to make a negative statement explaining that an internal carbon prices has not been used in decision-making. Given that internal carbon prices are useful tools to measure the financial implications of the carbon footprint and enhance transparency and accountability, the Exchange encourages listed companies to consider maintaining an internal carbon price. The Implementation Guidance also explains the 4-step workflow of developing an internal carbon price: (1) business engagement; (2) approach design; (3) rollout; and (4) monitoring and evaluation.

14. Remuneration

Disclosures on whether and how climate-related considerations are factored into remuneration policy, or otherwise an appropriate negative statement will be required under Paragraph 35 of the ESG Code. The Exchange clarifies that it is not compulsory for listed companies to consider climate-related factors when formulating their remuneration policy and the Exchange does not intend to interfere with the absolute discretion of the board of directors on whether to include these factors, and the scope of persons covered by this policy. However, the Exchange encourages listed companies to set climate-related KPIs such as performance, investment, product, rating and climate-related targets to incentivise senior management in achieving climate-related goals. Although not required, quantitative disclosure on the percentage of the remuneration that is tied to climate-related considerations is also encouraged.

15. Industry-based metrics

Although optional, the Exchange strongly encourages listed companies to disclose industry-based metrics that are relevant to one or more of their business models, activities or other common features that characterise participation in an industry.[14] The IFRS S2 Industry-based Guidance on implementing Climate-related Disclosures and other industry-based disclosure requirements prescribed under other international ESG reporting frameworks provide for various industry-based metrics for consideration.

Other Matters

Implementation Guidance

Considering that many respondents voiced requests for practical guidance on the format of the disclosures, how to set and disclose climate-related targets, methods of conducting climate-related scenario analysis, guidance on the quantification of financial effects, calculation of scope 3 greenhouse gas emissions and suggested steps to

[14] Paragraph 36 of the ESG Code

make the requisite qualitative disclosures, the Exchange has published the Implementation Guidance alongside the Consultation Conclusions. The Implementation Guidance contains useful details on each new climate-related disclosure and incorporates the ISSB Standards. Listed companies should reference the Implementation Guidance to ensure consistent and accurate disclosures.

Feedback on latest ISSB developments

Regarding the impact of the final ISSB Standards published on 26 June 2023 on the proposals made by the Exchange, a respondent expressed concerns over whether the flexibility for listed companies to determine their own reporting boundary under paragraph 15 of the ESG Code will be applicable as this is not provided for in the ISSB Standards. The Exchange's response is that the current requirements under the existing Listing Rules will not be amended, however, listed companies are encouraged to follow international standards to prepare for the future Hong Kong Standards.

Additional comments

Some respondents suggested the addition of the ESG assurance requirements subject to a limited assurance within the coming two to three years in light of the recent consultation on independent sustainability assurance published by the International Auditing and Assurance Standards Board. The Exchange notes that since a globally accepted assurance standard has yet to be developed, there is no need for mandatory independent assurance at this stage. However, paragraph 9 of the ESG Code encourages seeking independent assurance to strengthen the credibility of the ESG information disclosed. As further explained in question 23 of FAQ Series 18, listed companies should ensure that the assurance provider (i) is an independent third party; (ii) is competent in the subject matter and assurance practices; and (iii) will issue a thorough written report setting out the items such as their opinion and summary of work performed. The Exchange also suggests referring to the International Standard on Assurance Engagements 3000 standard for assurance over non-financial information.

Respondents also suggested that the Exchange cooperate with the Hong Kong Government and other stakeholders to improve market infrastructure and wider capacity building by compiling a central database, providing training, developing sustainability taxonomy and exploring relevant certification of professionals. The Exchange notes that various capacity-building initiatives are in effect in Hong Kong, including the (i) digitalised Climate and Environmental Risk Questionnaire for Non-listed companies;[15] (ii) greenhouse gas emissions calculation and estimation tools;[16] (iii) a cross-sector re-

[15] See the questionnaire at https://sustainablefinance.org.hk/en/data-technology/casg-non-listed-company-questionnaire-on-climate-and-environmental-risk

[16] See the greenhouse gas emission calculator at https://sustainablefinance.org.hk/en/data-technology/calculator-for-scope-1-and-scope-2-greenhouse-gas-emissions-of-a-corporation and see the greenhouse gas emission estimation tools at https://sustainablefinance.org.hk/en/data-technology/estimator-for-scope-1-and-scope-2-greenhouse-gas-emissions-of-a-corporation

pository for green and sustainability-related resources; and (iv) a sustainable finance internship program to train ESG talent in Hong Kong. In addition, the Hong Kong Monetary Authority has released a discussion paper on a local green classification framework to gather feedback from stakeholders on its development and application in Hong Kong.[17] The Exchange will continue to work with other stakeholders to further perfect Hong Kong's sustainability framework, nurture ESG talent and include further requirements on liability protection and mandatory climate training for directors when necessary.

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[17] See the discussion paper at https://www.hkma.gov.hk/media/eng/doc/key-information/guidelines-and-circular/2023/20230530e1a1.pdf

Hong Kong SFC Broadens Exemption for Master-Feeder ETFs

Hong Kong Law – 658 – 26 June 2024

The Securities and Futures Commission (*SFC*) has published a revised Circular on streamlined requirements for eligible exchange-traded funds adopting a master-feeder structure to allow SFC-authorised feeder Exchange-traded funds (*ETFs*) to invest in overseas-listed master ETFs – including actively managed ETFs – subject to meeting specified conditions. The changes extend the streamlined requirements for master ETFs to actively managed ETFs and are aimed at broadening the range of investment products available to Hong Kong investors and boosting Hong Kong's status as an international fund management hub.

Position under the SFC's Code on Unit Trusts and Mutual Funds

Previously, paragraph 7.12 of the SFC's Code on Unit Trusts and Mutual Funds (*UT Code*) allowed a feeder fund to invest 90% or more of its total net asset value in a master fund provided that both the feeder ETF and the master ETF were authorised by the SFC.[1] However, this prevented SFC-authorised feeder ETFs from investing in overseas-listed master ETFs, limiting the investment products available. Additionally, the procedures for obtaining SFC authorisation are onerous and expensive, especially when the master ETF is listed offshore.

With the increased popularity of ETFs, the SFC received a number of requests to allow SFC-authorised feeders to invest in overseas-listed master ETFs without SFC authorisation. According to the SFC, the global ETF market's assets under management increased to US$12.7 trillion at the end of the first quarter of 2024, while actively managed ETFs have grown much faster than ETFs generally since 2019.

In December 2019, the SFC implemented a Circular on streamlined requirements for eligible exchange-traded funds adopting a master-feeder structure (*2019 Circular*)

[1] SFC. Code on Unit Trusts and Mutual Funds, paragraph 7.12

allowing passively managed SFC-authorised feeder ETFs to invest in eligible overseas-listed master ETFs without the master ETF needing separate SFC authorisation. This framework was updated in February 2022 by the SFC's Supplemental Circular on streamlined requirements for eligible exchange traded funds adopting a master-feeder structure (*Supplemental Circular*), which relaxed the fund size and track record requirements for eligible master ETFs.

Revisions to the Circular on Streamlined Requirements for Eligible ETFs adopting a Master-Feeder Structure

Under the revised Circular, the SFC will authorise a feeder ETF that invests in an overseas-listed master ETF, whether the master ETF is passively or actively managed, on a case-by-case basis. The key requirements are that the master ETF must:

a. have satisfactory safeguards and measures in place to provide investor protection that is substantially the same as for SFC-authorised ETFs, taking into account its underlying assets, investment strategy, applicable rules and regulations in home jurisdiction;

b. have sizeable assets under management – the SFC has removed the limitation on the application of the streamlined requirements to particular types of schemes (essentially recognised jurisdiction schemes managed by a management company in an acceptable inspection regime or schemes eligible under a mutual recognition of funds arrangement); and

c. together with its management company and trustee/custodian, have a good compliance record with the rules and regulations of its home jurisdiction and, in the case of the master ETF, its listing venue.

The revised Circular also removes the specific fund size and track record requirements of the 2019 Circular and Supplemental Circular.

Feeder ETF Requirements

Feeder ETFs seeking SFC authorisation for public offering in Hong Kong need to meet the following requirements:

a. the feeder ETF must be a Hong Kong-domiciled ETF authorised by the SFC;

b. the feeder ETF must be managed by a management company which is licensed or registered for Type 9 regulated activity and have a good compliance record;

c. the management company of the feeder ETF should report to the SFC as soon as practicable if the master ETF ceases to comply with the requirements set out in the circular and take appropriate remedial action to promptly rectify the situation; and

d. the management company of the feeder ETF should put in place appropriate arrangements to inform Hong Kong investors of any material changes to, or events that have a significant adverse impact on, the master ETF in a timely manner.

The SFC may consider introducing additional requirements or conditions if it deems it necessary or appropriate.

Feeder ETFs must also comply with the relevant requirements in the Overarching Principles Section and the UT Code of the SFC Handbook for Unit Trusts and Mutual Funds, Investment-Linked Assurance Schemes and Unlisted Structured Investment Products, and all other applicable SFC regulatory requirements and guidelines.

The SFC has emphasised its intention to balance the needs for investor protection and market development in amending the master-feeder ETF requirements. It believes the relaxation will improve Hong Kong's competitiveness in attracting overseas ETFs.

The SFC's revised circular is available on the SFC website here.

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HKEx Consults on Corporate Governance Changes for January 2025

Hong Kong Law – 659 – 5 July 2024

The Hong Kong Exchanges and Clearing Limited (*HKEX*) is consulting on changes to its Corporate Governance Code and related Listing Rules to limit the number of INEDs' concurrent directorships and tenure and increase disclosure of board dividend decisions. The changes are planned for implementation from 1st January, 2025 with a proposed three-year transition period for the changes relating to INEDs. The cut-off date for responding to the Consultation Paper is 16th August, 2024.

Improving Board Effectiveness

Designation of Lead Independent Non-Executive Director (INED)

There is currently no concept of a Lead INED in the HKEX Listing Rules as there is, in some form, in Australia, Singapore and the UK. The HKEX is proposing to add a new Code Provision which would require listed companies without an independent board chair to designate one INED as a Lead INED. The role of a Lead INED would be to facilitate and improve communication among INEDs, and between INEDs and the rest of the board and investors. A board chair will not be considered independent if they are not an independent director. As a Code Provision, the obligation would apply on a "comply or explain" basis and companies not designating a Lead INED would need to provide reasons for their non-compliance, for example by specifying the shareholder communication channels they have to enable investors to communicate with the board.

Mandatory Director Training

Under the existing framework, director training is encouraged but is not compulsory: it is a Code Provision under the Corporate Governance Code that directors should participate in continuous professional development to develop and update their knowledge and skills.[1]

[1] Code Provision C.1.4

The HKEX is proposing to introduce a new Listing Rule requirement for:

- all directors to receive mandatory continuous professional training on specific topics but without setting a minimum number of training hours; and

- directors appointed as a listed company director for the first time and directors who have not served as a listed company director for three years or more (*First-time Directors*) to complete a minimum of 24 training hours within 18 months of their appointment.

The requirements would apply to directors appointed after January 1st, 2025 including the directors of companies listed on other exchanges. The requirements would apply to directors appointed to fill a casual vacancy from the start of the listed company's full financial year following the date of appointment. The format of the training (e.g. in person or online, or internal or external provision) is not mandated.

The areas to be covered by mandatory training are:

- the roles, functions and responsibilities of the board, its committees and directors, and board effectiveness;

- listed companies' obligations and directors' duties under Hong Kong law and the Listing Rules, including important legal and regulatory updates affecting the discharge of those obligations and duties;

- corporate governance and Environmental, Social and Governance matters, including developments related to sustainability and climate-related risks and opportunities relevant to the listed company and its business;

- risk management and internal controls; and

- updates on industry-specific developments, business trends and strategies relevant to the listed company.

Mandatory Disclosure of Director Training in Corporate Governance Report

It is proposed that a new Mandatory Disclosure Requirement should be added requiring listed companies to confirm in their Corporate Governance Reports that their directors have participated in training as required by the amended Listing Rules. That would include disclosure that First-time Directors have completed the required minimum 24 hours training during the 18 months after being appointed.

Disclosure would also be required of the details of each director's training including the number of hours; the topics covered; the format (e.g. physical attendance or remote); and the name of any external training provider.

Board Performance Review

The conduct of a board performance evaluation is currently a Recommended Best Practice only under the Corporate Governance Code. In contrast, listed companies in Australia, Singapore and the UK are required to conduct and disclose board performance reviews on a "comply or explain" basis.

The HKEX is proposing to upgrade the existing Recommended Best Practice to a Code Provision and to require listed companies to conduct a board performance review at least every two years. They would then have to disclose in the Corporate Governance Report details of the scope of the performance review carried out, the process and its finding, any areas identified for improvement and measures taken or proposed to address the findings. Listed companies will be free to determine the format of board performance reviews and to conduct the review internally or appoint external providers.

Disclosure of Board Skills Matrix

The HKEX Listing Rules do not currently require listed companies to disclose a board skills matrix. By way of comparison, Australia apparently requires listed companies to maintain and disclose a board skills matrix on a comply or explain basis, while Singapore requires companies to set out how the directors' skills, talents, experience and diversity serve the company's purpose, value, strategy and desired culture. The HKEX is proposing to implement a new Code Provision requiring listed companies to maintain a board skills matrix and to disclose information on: their boards' existing skills mix; how the combination of their directors' skills, experience and diversity serve the company's purpose, values, strategy and desired culture; and their plans to acquire further skills. The HKEX is encouraging companies to use the board skills matrix as a tool for identifying missing skills and increasing the board's skills and diversity.

New 6 Directorship Cap for INEDs

The Corporate Governance Code currently requires that if a proposed INED will be holding their seventh (or more) listed company directorship, the board should explain to shareholders voting on the appointment why it believes the individual would be able to devote sufficient time to the board. Code Provision B.2.1 of the Corporate Governance Code also requires directors to ensure they can devote enough time and attention to the listed company's affairs and to not accept a directorship if that is not the case. In vetting listing applications, the HKEX says it discourages applicants from appointing INEDs holding seven or more listed company directorships (*Overboarding INEDs*).[2] At the end of 2023, 23 Overboarding INEDs served on the boards of 181 companies listed on the HKEX (approximately 7% of all HKEX-listed companies), and five Overboarding INEDs held 10 or more listed company directorships.

[2] Chapter 3.10 (Directors, Supervisors and Senior Management) of HKEx's Guide for New Listing Applicants.

The Consultation Paper notes that Mainland China caps the number of concurrent INED directorships that can be held at three, while the UK Corporate Governance Code states that full-time executive directors should not have more than one non-executive director role in a FTSE 100 company or other significant commitments.[3]

The HKEX is proposing a new Listing Rule imposing a six-directorship cap on the number of Hong Kong listed company directorships an INED can hold. That cap will cover directorships as executive director, non-executive director and INED and will prevent an individual being appointed as an INED if they already hold six directorships of other Hong Kong-listed companies. The rule will take effect on January 1st, 2025, and the HKEX will no longer accept listing applications from companies with INEDs exceeding the maximum of six listed company directorships.

For listed company directors appointed before 1st January, 2025, a three-year transition period will be implemented to facilitate the phasing out of INEDs with more than six directorships. INEDs holding more than six Hong Kong-listed company directorships will have to comply with the six directorship limit by the conclusion of the first AGM occurring after December 31st, 2027 held by any issuer of which they are a director (that is the first AGM held by the companies of which the person is a director).

New Mandatory Disclosure Requirement

A new mandatory disclosure requirement will require the nomination committee of listed companies to annually assess and disclose its assessment of each director's time commitment and contribution to the board, taking into account their professional qualifications, work experience, listed company directorships and other significant time commitments, and other factors or circumstances relevant to their character, integrity, independence and experience. The nomination committee will be expected to consider the varying levels of time commitment for different board and board committee positions and to evaluate each director's significant external time commitments according to their nature and complexity. The HKEX refers to the European Central Bank's Guide to Fit and Proper Assessments as a useful reference for assessing time commitments.

INEDs' Independence

There is currently no limit on INEDs' tenure under the Listing Rules, although the Corporate Governance Code requires that the further appointment of an INED who has served nine years must be approved by shareholders and that the resolution must give reasons for the board's belief that the director remains independent and should be re-elected.[4] At the end of 2023, around 31% of Hong Kong-listed companies had INEDs who had served for over nine years and around 1.3% of Hong Kong-listed companies only had INEDs with more than nine years' service. The HKEX notes that many

[3] Provision 15 of the UK Corporate Governance Code
[4] Code Provision B.2.3

listed companies continue to cite meeting the independence criteria of Listing Rule 3.13 as a reason for supporting an INED's independence, when those criteria do not address whether the individual thinks independently and can contribute independently and objectively to the board. The Hong Kong Monetary Authority's guidance for the INEDs of Hong Kong authorised institutions calls into question the independence of an INED who has served on the same board for more than nine years. The corporate governance codes of the UK and Australia recognise that long directorship tenures can impair, or appear to impair, directors' independence while the Singapore and Malaysian Stock Exchanges cap independent directors' tenure at nine years[5] and 12 years,[6] respectively.

9-year cap on INEDs' Tenure

The HKEX is proposing a new HKEX Listing Rule setting a hard cap of nine years on the tenure of INEDs. A person will not be considered independent if they have been an INED of an issuer for nine years or more, but they may continue to contribute to the board in a re-designated capacity as non-executive directors (*NEDs*).

The nine-year tenure will be counted from the date of the company's listing if the INED was appointed before then, or from the date of their appointment after the company was listed. If a listed company is restructured after listing, INEDs' tenure will continue to accrue notwithstanding any transfer from another company in the same listed group.

If an INED ceases to be an INED for less than two years and is then reappointed as an INED, the period of non-appointment as an INED will still be counted in their period of tenure.

An INED who reaches the nine-year limit can serve as an INED of the same issuer after a cooling-off period of two years. During the cooling-off period, the individual must not serve as a director of the relevant issuer, its holding company or any of their respective subsidiaries or any core connected persons of the issuer.

The HKEX is proposing a three-year transition period for implementing the new Listing Rule which will take effect on January 1st, 2028. An INED who has served continuously for more than nine years will no longer be considered independent after the first AGM of the listed company held after December 31st, 2027. During the transition period, the current requirements will continue to apply in relation to: re-electing INEDs that have served more than nine years, the disclosure of new INEDs' appointment and INEDs' tenure where all the company's INEDs have served on the board for more than nine years.

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5 SGX Group Announcement of January 11th, 2023
6 Bursa Malaysia Amendments of January 19th, 2022

The requirement to disclose length of tenure currently applies only to INEDs of companies that only have INEDs who have served as INEDs of the company for more than nine years.

The HKEX is proposing to change the relevant mandatory disclosure requirement[7] so that listed companies will have to disclose the length of tenure and current period of appointment for all their directors.

Board Diversity Proposals

Currently, the nomination committee (or the board) must have a board diversity policy and disclose that policy, or a summary of it, in the Corporate Governance Report. A single gender board will not be considered diverse[8] and listed companies with single gender boards are required to appoint at least one different gender director by December 31st, 2024. Mandatory disclosures are required to be included in listed companies' Corporate Governance Reports on board and workforce diversity and Code Provision B.1.3 requires an annual board review of the implementation and effectiveness of a listed company's diversity policy.

At the end of 2023, around 19% of Hong Kong-listed companies still had single gender boards while women made up around 17% of listed company directors. The HKEX notes in the Consultation Paper that more disclosure of numerical targets and timelines for the achievement of board diversity is warranted.

As to the situation in other major listing jurisdictions, the HKEX notes that Australia requires listed companies to set measurable objectives for achieving gender diversity on the board, among senior executives and across the workforce on a "comply or explain" basis. It also insists on disclosure of the proportions of men and women on the board, in senior executive positions and across the workforce. The UK requires disclosure of the gender identity of the board and executive management, and the gender balance of senior management and their direct reports.

One different gender director on Nomination Committees

The proposals would introduce a new Code Provision requiring listed companies to have at least one director of a different gender on their nomination committee.

Annual review of board diversity policy

The HKEX proposes to upgrade the current Code Provision requiring an annual review of listed companies' board diversity policy to a mandatory disclosure requirement. Proposed new mandatory disclosure requirement J would require:

"*(a) The issuer's policy on board diversity or a summary of the policy, which should include information on measurable objectives (e.g. numerical targets and timelines) that*

[7] Revised Mandatory Disclosure Requirement paragraph B(a)
[8] Note to Main Board Listing Rule 13.92 and GEM Listing Rule 17.104

it has set for the promotion of gender diversity on its board and the measures the issuer has adopted to develop a pipeline of potential successors to the board to achieve gender diversity; and (ii) the results of issuer's review of the implementation of its board diversity policy conducted during the year (including progress towards the issuer's objectives and how the issuer has arrived at its conclusion);

(b) the issuer's policy on diversity in the workforce (including senior management) or a summary of the policy, including any plans or measureable objectives (e.g. numerical targets and timelines) the issuer has set for achieving gender diversity, and progress on achieving those objectives. Where applicable, issuers may disclose any mitigating factors or circumstances which make achieving gender diversity across the workforce (including senior management) more challenging or less relevant; and

(c) the gender ratio of: (i) senior management; and (ii) the workforce (excluding senior management)."

Workforce diversity policy

Main Board Listing Rule 13.92 and GEM Listing Rule 17.104(1) would be amended to require listed companies to have a diversity policy for their workforce and related disclosures would be required under the amendments to mandatory disclosure requirement J. The HKEX notes in the Consultation Paper that different diversity considerations may apply at the board and workforce levels and that the demographics of particular industries or geographic locations may make the setting of diversity targets at the workforce level more challenging. Accordingly, listed companies will only have to disclose "*any plans or measurable objectives*" for achieving gender diversity at the workforce level.

Gender ratio disclosure

Revised mandatory disclosure requirement J(c) would require the gender ratio of senior management and the workforce (excluding senior management) to be separately disclosed.

Arrangements during temporary deviations

New Listing Rules would codify the HKEX's existing guidance on the arrangements during temporary deviations from the requirement for listed companies to have directors of different genders on the board. From January 1st, 2025, a listed company will have to publish an announcement if it has a single gender board giving the reasons why it does not have directors of a different gender and appoint director(s) to ensure its compliance with the board gender diversity requirement within three months of failing to meet that requirement.

Risk Management and Internal Control (RMIC)

Although the current Corporate Governance Code mandates that boards oversee the company's RMIC system and requires an annual review and a report to shareholders in the Corporate Governance Report, the HKEX has observed failures in establishing effective RMIC systems. It also notes the developments in the UK and Singapore suggesting a trend in tightening requirements on the RMIC review process and confirmation of its effectiveness.

Proposed emphasis on the board's responsibility for RMIC

The HKEX is proposing to emphasise in Principle D.2 the board's responsibility for a listed company's RMIC system and the annual review of its effectiveness.

Mandatory annual review of RMIC Systems

The HKEX also proposes upgrading to a mandatory requirement the requirement to conduct (at least) annual reviews of RMIC systems' effectiveness under revised mandatory disclosure requirement paragraph H. It will also require detailed disclosures on: (i) the RMIC systems in place (including any significant changes made); (ii) the process through which the review of the RMIC systems was conducted; (iii) a board confirmation on the appropriateness and effectiveness of the RMIC systems, and information supporting the board's conclusion (including confirmations from management, the relevant board committee(s) with responsibility for the RMIC systems, other internal departments, the company's independent auditors and other external providers (as applicable); and (iv) details of any significant control failings or weaknesses identified during the review and/or previously reported but unresolved, and any remedial steps taken or proposed.

It will also revise the Code Provision on the required scope of a listed company's review of the effectiveness of its RMIC systems and set out the areas expected to be included in that review. HKICPA's "AATB 1 Assistance Options to New Applicants and Sponsors in connection with Internal Controls over Financial Reporting" provides guidance on the scope and depth of matters which a comprehensive internal controls assessment should consider. Appendix 3 of AATB 1 also contains illustrative areas of focus for a review of internal controls.

The HKEX proposes to provide guidance on its website for listed companies to refer to when determining the scope of the review of their RMIC systems.

Dividend Proposals

The Corporate Governance Code currently requires listed companies to have a dividend policy and to disclose it in their annual reports. Issuers must also report dividend rates paid on each share class and any dividend waivers in their financial statements and reports. While compliance with the current disclosure requirements is

high (99.5%), the HKEX notes that other jurisdictions have implemented broader measures aimed at improving listed companies' capital management. It notes that Japan and South Korea have introduced initiatives to improve listed companies' capital efficiency and encourage disclosure of their efforts to enhance value. Other jurisdictions, such as Singapore and Mainland China have required listed companies to disclose their reasons for not declaring dividends, and Mainland China additionally requires companies that do not declare dividends to disclose the measures they are taking to enhance investor returns.[9]

Upgrade dividend policy disclosure requirement to mandatory and require enhanced disclosure

The HKEX is proposing to upgrade the current dividend policy disclosure requirement from a Code Provision to a mandatory disclosure requirement. Listed companies with a dividend policy will be required to: (i) disclose the aim or objective of the policy and the key factors that the board takes into account when deciding whether to declare, recommend or pay a dividend; and (ii) confirm that all dividend decisions made by the board during the reporting period were made in accordance with the company's dividend policy or, if not, explain any deviations from the dividend policy.

Listed companies not having a dividend policy will have to state this and disclose the reasons for not having one.

All listed companies, irrespective of whether they have a dividend policy or not, will have to make the following disclosures with respect to the board's decisions on dividends: (i) an explanation of the reason(s) for any material variation in the dividend rate between a dividend declared during the reporting period compared to that for the previous corresponding period; and (ii) where the board decided not to declare a dividend, the reasons for its decision and the measures the company proposes to enhance investors' return (if any).

If earnings are retained, listed companies are expected to explain how they will be used and link that to the company's business model, strategy and objectives. Reasons should be based on companies' particular circumstances and boilerplate language should be avoided.

Other Listing Rule Changes

New requirement to set a record date

The Listing Rules set a deadline for listed companies' announcement of a book closure. If a company sets a record date without book closure, the book closure requirements apply to the record date. However, the Listing Rules do not require listed companies to set a record date: the HKEX's expectation for companies to set a record

[9] For example, Article 8 of the CSRC Cash Dividend Guidelines

date for general meetings and entitlements is contained only in its guidance materials which are not binding on listed companies.

The HKEX is therefore proposing to amend Main Board Listing Rule 13.66(1) and GEM Listing Rule 17.78(1) to require listed companies to set a record date for general meetings and receiving entitlements. The current announcement and minimum trading period requirements for book closures will be revised accordingly.

Disclosure of modified auditors' opinions

The Listing Rules require listed companies to give more detailed and/or further information if their financial statements do not give a true and fair view of their affairs, results of operations and cashflows. However, the Listing Rules do not set out any specific requirements as to the information to be disclosed.

In its "Review of Issuers' Annual Reports", the HKEX recommends that companies receiving a modified auditors' opinion should disclose in their annual reports: (i) details of the modifications and their impact on the company's financial position; (ii) the management's position and basis on major judgmental areas (e.g. the basis for impairment or valuation of assets) and how it differs from that of the auditors; (iii) the audit committee's view of the modifications and whether it has reviewed and agrees with management's position on the major judgmental area(s); and (iv) the listed company's proposals to address the modifications.

The HKEX is proposing to codify these recommended disclosures in the Listing Rules.

Provision of monthly financial information to the board

Code Provision D.1.2 requires listed companies' management to provide the board with monthly updates giving a balanced and understandable assessment of the company's performance, position and prospects and explains the information expected to be included in those updates. The HKEX is now proposing to revise that Code Provision to clarify that management should provide these monthly updates to the board of a listed company and that directors should request monthly updates if they are not provided with them.

Alignment of nomination committee requirements with audit and remuneration committee requirements

Listed companies are required to establish a nomination committee chaired by the chairman of the board or an INED and made up of a majority of INEDs (Main Board Listing Rule 3.27A and GEM Listing Rule 5.36A). Listed companies with weighted voting rights structures must establish a nomination committee that complies with the Principle and Code Provisions that apply to the nomination committee in the Corporate Governance Code (section B.3 in Part 2 of Appendix C1 of the Main Board Rules)

and is chaired by an INED and made up of a majority of INEDs (Main Board Rules 8A.27 and 8A.28).

The HKEX is proposing to revise the Listing Rules to align the requirements on establishing written terms of reference for the committee and the arrangements during temporary deviations from requirements so that these are the same for the nomination committee, the audit committee and the remuneration committee. This will involve revising Main Board Listing Rules 3.23 and 3.27 and GEM Listing Rules 5.33 and 5.36 and adding new Main Board Listing Rules 3.27B and 3.27C and GEM Listing Rules 5.36B and 5.36C (for all companies except those with a weighted voting rights structure), and new Main Board Rule 8A.28A (for companies with weighted voting rights structures).

Implementation and Transitional Arrangements

Implementation of the proposed Corporate Governance Code and related Listing Rule amendments is intended to come into effect on January 1st, 2025 and will apply to Corporate Governance Reports and annual reports for financial years commencing on or after that date. As detailed above, a three-year transition period is proposed for the proposed six directorship cap and the proposed cap on INEDs' tenure. These proposed Listing Rules will take effect on January 1st, 2028 with compliance required by the conclusion of the first AGM occurring after that date.

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HKEX Consults on Reducing Minimum Spreads for Hong Kong Securities

Hong Kong Law – 660 – 12 July 2024

The Hong Kong Stock Exchange (*HKEX*) has published a Consultation Paper seeking feedback on proposals to reduce the minimum spreads – or tick sizes – of certain Hong Kong securities, including equities, REITs and equity warrants, in two phases. Suggested by the Hong Kong Government-appointed Task Force on Enhancing Stock Market Liquidity, the proposals aim to improve Hong Kong market liquidity and the global competitiveness of the Hong Kong market by lowering bid-ask spreads and transaction costs.

The HKEX is requesting feedback on the proposals and has set a cut-off date for comments of September 20, 2024.

Rationale for Proposed Minimum Spread Reductions

Minimum spread is the smallest price change for stocks traded on an exchange. It determines the bid-ask spread – the difference between the highest bid price and the lowest ask price for a security – which is a transaction cost and impacts trading liquidity. The current spread cost when trading securities on the HKEX is apparently higher than in many other major markets, and reducing minimum spreads could help lower this cost. However, these reductions could potentially thin the order book depth and deter trading in less liquid stocks, causing a net decrease in liquidity. Thus, the HKEX's proposals seek to maintain a balance between spread cost reduction and overall trading quality and liquidity.

The HKEX recognises that minimum spreads affect the bid-ask spread and, consequently, the trading liquidity of stocks, particularly those that are "tick constrained" or trading at or near the minimum spread. A stock is considered to be "tick constrained" if trading of the stock is restricted by its minimum spread, which is indicated by its bid-ask spread almost always being at or very close to the minimum spread. The Consultation Paper warns that too small a minimum spread could fragment orders

across multiple price points, thereby thinning the order book depth and reducing execution efficiency. This could deter various investor groups, such as active traders who seek prompt execution, block investors who aim for fewer price points to limit slippage, and retail investors who might prefer wider spreads for economic benefits from passive round-trip trades.

Hong Kong Equities Market Liquidity Profile

Average Daily Turnover (*ADT*) is used as a measure of liquidity and generally provides an indication of the level of market interest in a stock. The Consultation Paper notes that stocks priced at or below HK$0.5, which constitute over 34% of the Hong Kong market by number, have minimal ADT and are therefore less liquid. These low-priced stocks are therefore not ideal candidates for spread reduction given their already thin order books.

Stocks priced between HK$0.5 and HK$500, however, account for a significant portion of ADT and have better trading liquidity, making them more suitable for spread reduction. The HKEX emphasises the importance of selecting stocks with sufficient order book depth for spread reduction, to avoid compromising net trading liquidity. Higher-priced stocks above HK$0.5 are noted to generally have deeper order book depth, suggesting they are better equipped to handle the potential negative effects of spread reduction and may be ideal candidates for spread reduction.

The Consultation Paper notes the diversity of investors in the Hong Kong market which includes institutional investors, market makers and retail investors which each exhibit different trading behaviours and preferences regarding minimum spreads. The HKEX has considered these varying needs and behaviours in proposing changes to minimum spreads, acknowledging that different investor groups have distinct interests in various types of stocks. Retail investors, for example, tend to prioritise overall trading profit over spread cost when making investment decisions about specific stocks.

Transaction Costs and Minimum Spread Models on Other International Exchanges

The bid-ask spread in the Hong Kong market is comparatively higher than that on other major exchanges like Japan, Mainland China, the UK and the US. The HKEX considers that there is potential to reduce transaction costs in Hong Kong by lowering the minimum spread, although this is just one of several factors influencing costs, with others including the inherent liquidity of stocks. Current transaction costs in Hong Kong also include stamp duty, exchange and regulatory fees, levies and broker commissions, all of which affect trading behaviour.

Globally, exchanges typically follow one of three minimum spread arrangements:

- a uniform spread at all price levels, as seen in Mainland China and the US, where a standardised minimum spread and board lot size apply across all stocks;
- a single spread table for all stocks, which uses a tiered approach to set minimum spreads that increase by price band, as used by the HKEX and the Australian, Korean, Singapore and Taiwanese stock exchanges; and
- multiple spread tables, as used by the London and Japanese stock exchanges, which group stocks based on specific liquidity measures, such as trading volume or ADT, and assign stocks with higher liquidity or ADT to spread tables with smaller minimum spreads.

Several of these exchanges have reduced their minimum spreads or adjusted their spread arrangements over the last 20 years. The Japanese stock exchange, for example, introduced a tighter spread table for certain stocks twice, in 2014 and again in 2023, with an assessment in 2024 indicating success in reducing investor execution costs, but a decrease in order book depth at individual price points due to order dispersion.

Past Minimum Spread Review in ETPs Conducted by the Exchange

On June 1, 2020, the HKEX implemented reduced minimum spreads for Exchange Traded Products (*ETPs*) by 50% to 90% across various price bands to enhance trading flexibility and decrease transaction costs for investors. This change led to a narrowing of bid-ask spreads for over 70% of listed ETPs in Hong Kong, with a notable average reduction of 54% among highly traded ETPs with an ADT exceeding HK$100 million. The HKEX also improved the market-making regime for ETPs, which likely contributed to the reduced spreads.

Application of HKEX's Proposed Minimum Spread Reductions

The Consultation Paper's proposals are based on its reviews of the liquidity profile of the Hong Kong securities market, international practices, recent reductions in minimum spreads in the ETP market and initial market feedback. The proposed changes would apply to equities, REITs, and equity warrants (*Applicable Securities*), while the minimum spreads for debt securities, Exchange Traded Options, ETPs and structured products would remain unchanged. This is because minimum spreads for ETPs were reduced in 2020 and are trading efficiently, while structured products and debt securities exhibit different trading behaviours and characteristics, for example, structured products are typically priced below HK$2.

Proposed Minimum Spread Reductions

The HKEX proposal includes a phased approach to reduce minimum spreads.

In Phase 1, it proposes:

- a 50% cut in minimum spreads for securities priced between HK$10 and HK$20; and
- a 60% cut in minimum spreads for securities priced between HK$20 and HK$50.

This group represents a significant portion of ADT and has both relatively high tick-to-price ratios and sufficient order book depth to absorb the change. The HKEX plans to observe the effects of phase 1 for six months before considering the implementation of phase 2, with its decision informed by the results of phase 1 and feedback from the market and regulators.

Phase 2, if implemented, would:

- introduce a 50% reduction in minimum spreads for securities priced between HK$0.5 and HK$10, which currently have high tick-to-price ratios and reasonable order book depth; and
- exclude the most liquid stocks to avoid impacting visible liquidity.

Price Bands Excluded from Spread Reductions

Certain price bands are not included in the proposed spread reductions:

- stocks priced between HK$0.01 and HK$0.25, and HK$0.25 and HK$0.5, which represent a small portion of equity ADT and are favoured by retail investors for their larger spread, will keep their current minimum spreads; and
- stocks priced above HK$50 will also not change as their tick-to-price ratios already align with the targeted range and international practices.

The proposed changes to minimum spreads under phases 1 and 2 are summarised in the tables below.

PROPOSED MINIMUM SPREADS FOR PHASE 1				
Price Band in HK$	*Original minimum spread*	*Proposed minimum spread*	*Original tick-to-price ratio (bps)*	*Proposed tick-to-price ratio (bps)*
From 0.01 to 0.25	0.001		40-1000	
Over 0.25 to 0.50	0.005		100-200	
Over 0.50 to 10.00	0.010		10-200	
0.50 to 1.00	0.010		100-200	
1.00 to 2.00	0.010		50-100	
2.00 to 5.00	0.010		20-50	
5.00 to 10.00	0.010		10-20	
Over 10.00 to 20.00	*0.020*	*0.010 (-50%)*	*10-20*	*5-10 (-50%)*
Over 20.00 to 100.00	*0.050*	*0.020 (-60%) / 0.050*	*5-25*	*4-10 (-60%) / 5-10*
20.00 to 50.00	*0.050*	*0.020 (-60%)*	*10-25*	*4-10 (-80%)*
50.00 to 100.00	0.050		5-10	
Over 100.00 to 200.00	0.100		5-10	
Over 200.00 to 500.00	0.200		4-10	
Over 500.00 to 1,000.00	0.500		5-10	
Over 1,000.00 to 2,000.00	1.000		5-10	
Over 2,000.00 to 5,000.00	2.000		4-10	
Over 5,000.00 to 9,995.00	5.000		5-10	

PROPOSED MINIMUM SPREADS FOR PHASE 2				
Price Band in HK$	*Original minimum spread*	*Proposed minimum spread*	*Original tick-to-price ratio (bps)*	*Proposed tick-to-price ratio (bps)*
From 0.01 to 0.25	0.001		40-1000	
Over 0.25 to 0.50	0.005		100-200	
Over 0.50 to 10.00	*0.010*	*0.005*	*10-200*	*5-100*
0.50 to 1.00	0.010	0.005 (-50%)	50-100 (-50%)	
1.00 to 2.00	0.010	0.005 (-50%)	25-100 (-50%)	
2.00 to 5.00	0.010	0.005 (-50%)	10-25 (-50%)	
5.00 to 10.00	0.010	0.005 (-50%)	10-20 (-50%)	
Over 10.00 to 20.00	0.010		5-10	
Over 20.00 to 50.00	0.020		4-10	
Over 50.00 to 100.00	0.050		5-10	
Over 100.00 to 200.00	0.100		5-10	
Over 200.00 to 500.00	0.200		4-10	
Over 500.00 to 1,000.00	0.500		5-10	
Over 1,000.00 to 2,000.00	1.000		5-10	
Over 2,000.00 to 5,000.00	2.000		4-10	
Over 5,000.00 to 9,995.00	5.000		5-10	

Impact of Minimum Spread Reductions

The proposed changes are quantified as follows:

- Phase 1 would affect 283 securities (about 11% of Applicable Securities, representing 29% of ADT); and

- Phase 2 would impact 1,345 securities (about 51% of Applicable Securities, accounting for 24% of ADT).

Spread table arrangement

In Hong Kong, a uniform spread table is applied to all securities, which sets minimum spreads that escalate with price bands but does not differentiate based on liquidity. This system maintains a consistent tick-to-price ratio, which is considered beneficial for executing strategies within a particular product segment.

However, a significant drawback of the single spread table approach is that it does not account for the liquidity of individual stocks. Highly liquid stocks may be limited by large minimum spreads (tick constrained), while the orders for less liquid stocks may be scattered across numerous price levels, which can dilute visible liquidity and hinder effective price discovery.

A multiple spread table model for setting minimum spreads in equity markets based on both price and liquidity can mitigate the issues of dispersed liquidity in less liquid stocks. This model is complex, however, and requires regular updates to account for changes in stock liquidity, and demands greater engagement from market participants to incorporate data into their systems and test algorithmic trading strategies.

Initial market feedback showed a preference among market participants for a single spread table, favouring simplicity, consistency and lower costs in the Hong Kong equities market. The Consultation Paper therefore proposes maintaining the single spread table model for Applicable Securities.

Other Matters Affected by the Proposed Minimum Spread Reductions

Quotation Rules

The proposed reduction of minimum spreads for Applicable Securities will result in tighter price limits for order input, which will be governed by the quotation rules in terms of number of minimum spreads. In view of this, the HKEX considers that there needs to be a review of the quotation rules in conjunction with the proposed minimum spread review.

Order input prices during the Continuous Trading Session are governed by the relevant quotation rules under the Rules of the HKEX. The quotation rules are intended to ensure that only orders priced within a specific range are entered into the HKEX's trading system to allow smooth price discovery and manage the trading system's capacity.

The allowable price limits for Applicable Securities are currently set within ±24 spreads, but with the proposed reduction of minimum spreads, these limits could be reduced by 50% to 60%. To mitigate the impact of this reduction, the HKEX is considering adjusting the quotation rules for Applicable Securities. It is looking to adopt a dual structure price limit system, which is already in use for ETPs and would additionally adopt a percentage-based quotation limit which is adopted by other exchanges such as the Shanghai, Shenzhen and Korean stock exchanges.

The proposal would involve setting order input price limits based on a fixed number of spreads or a percentage of the reference price, whichever is greater. The HKEX is proposing to adopt the same quotation rules as apply to ETPs. The price limits for Applicable Securities would then be the greater of ±24 spreads or ±3.5% from the reference price. This approach aims to address the narrowing price limits issue and align the quotation rules across all securities, facilitating easier adoption and technical implementation by market participants.

The HKEX also proposes to align the rules for opening quotations and transactions concluded outside the HKEX's trading system.

Market System Adaptability

If the HKEX expands the minimum spread reduction to price bands below HK$10, the minimum spread could be reduced to HK$0.005 for securities in the HK$0.05 to HK$10 price band. Initial feedback from some market participants suggested that some systems may need upgrades to handle more than two decimal places, for example for Exchange Traded Option trades, indicating that some market participants may need additional time to adjust to these changes.

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HKEX and SFC Announce Temporary Modifications to Requirements for Specialist Technology Companies and De-SPAC Transactions

Hong Kong Law – 661 – 24 August 2024

On 23 August 2024, the Stock Exchange of Hong Kong Limited (*HKEX*) and the Securities and Futures Commission (*SFC*) announced temporary modifications to the requirements for Specialist Technology Companies and Hong Kong De-SPAC Transactions.

In summary, the modifications include reduced initial market capitalisation thresholds for listing, independence requirements for third-party investors in De-SPAC Transactions, temporary modifications to certain listing requirements, and clarification of the definition of a "sophisticated investor." These changes aim to reinforce Hong Kong's position as a leading listing venue for tech firms, and maintain high regulatory standards. The updates also align third-party investment requirements for De-SPAC Transactions with the Chapter 18C Independence Test. The SFC has officially approved these modifications in accordance with Main Board Listing Rule 2.04.

Reduction in initial market capitalisation thresholds for Specialist Technology Companies listing in Hong Kong

The minimum initial market capitalisation requirements for Specialist Technology Companies to list on the Main Board have been lowered. For Commercial Companies, the requirement has decreased from HK$6 billion to HK$4 billion, and for Pre-Commercial Companies, it has been reduced from HK$10 billion to HK$8 billion. This change relates to the requirements in Main Board Listing Rule 18C.03(3).

Reduction in minimum independent third party investment for a Hong Kong De-SPAC Transaction

The minimum independent third party investment required for a Hong Kong De-Spac Transaction will now be set at the lower of either: (i) the amount calculated based

on specified percentages in the table set out in the Main Board Listing Rules 18B.41; or (ii) HK$500 million in value.

Independence requirements for third party investors in Hong Kong De-SPAC Transactions

The criteria for determining the independence of third-party investors in a Hong Kong De-SPAC Transaction as per the Main Board Listing Rule 18B.40, will be aligned with the independence test for sophisticated independent investors in Specialist Technology Companies.

Key points include:

1. An investor's independence is assessed at the time of signing the definitive agreement for the investment and continues up to the listing of the Successor Company, the listed issuer resulting from the completion of the Hong Kong De-SPAC Transaction.

2. Certain individuals or entities are excluded from being considered independent third-party investors: (i) Core connected persons of the SPAC or the De-SPAC Target, except for substantial shareholders who are only considered connected due to their shareholding size; (ii) Controlling shareholders of the SPAC or the De-SPAC Target; or (iii) Founders of the De-SPAC Target and their close associates.

3. The HKEX retains the discretion to determine independence based on specific case facts and circumstances. For instance, individuals or entities with acting-in-concert agreements with SPAC Promoters, controlling shareholders, or founders of the De-SPAC Target are generally not viewed as independent.

Time limit for the Modifications

These temporary modifications to certain listing requirements will be effective for a three-year period from 1 September 2024, to 31 August 2027, known as the Implementation Period. The HKEX may reassess these requirements before 31 August 2027, potentially involving public consultation. For Specialist Technology Companies aiming to list under Hong Kong Main Board Chapter 18C, the modified initial market capitalisation thresholds will only apply if their expected listing date is within the Implementation Period and their listing applications are submitted by the end of this period. In the case of Hong Kong De-SPAC Transactions, altered investment threshold and independence criteria for third-party investors will be in effect for transactions announced during the Implementation Period.

Clarification of the Hong Kong definition of a "sophisticated investor" for independent third party investment

The HKEX has updated its guidance materials to refine the definition of a "sophisticated investor" to match more closely with the criteria used for identifying qualified Strategic Investors in Specialist Technology Companies. These updates will be reflected in the revised Guide for New Listing Applicants, guidance letter HKEX-GL113-22, and the updated FAQ on SPACs, which will take effect from 1 September 2024.

Hong Kong De-SPAC Transactions

The rationale behind introducing mandatory independent third-party investment for De-SPAC Transactions is to reduce the risk of inflated valuations. The new investment requirements are meant to ensure a substantial amount of "capital at risk," supporting the legitimacy of the valuation of the target company in a Hong Kong De-SPAC Transaction. Additionally, the section draws parallels between these investment requirements and the Chapter 18C Independence Test, which was established to address valuation challenges specifically for Specialist Technology Companies. The alignment of third-party investment requirements with the Chapter 18C Independence Test aims in part to solve problems SPACs apparently faced when applying the independent financial adviser test, which was not originally designed for Hong Kong De-SPAC Transactions.

HKEX definition of Specialist Technology Companies

A Specialist Technology Company under the HKEX Listing Rules is a company which focuses on R&D, commercialization, and sales of products or services that utilize science and technology in approved sectors as outlined in the Guide for New Listing Applicants. For such companies that do not fulfill the eligibility criteria of Chapter 8 of the Main Board Listing Rules, Chapter 18C offers an alternative listing route on the Main Board.

HKEX definition of a SPAC

A SPAC (Special Purpose Acquisition Company) is essentially a blank-cheque company established to raise capital through an IPO with the intention of acquiring an existing company or business referred to as a De-SPAC Target, within a specified timeframe. Chapter 18B of the Main Board Listing Rules and Chapter 2.4 of the Guide for New Listing Applicants outlines the regulatory framework for SPAC listings in Hong Kong, including the criteria they must meet for De-SPAC Transactions.

The Hong Kong Chief Executive's 2024 Hong Kong Policy Address – Key Business Points

Hong Kong Law – 662 – 18 October 2024

Hong Kong's Chief Executive, John Lee, delivered his third Policy Address on 16 October 2024 (2024 Hong Kong Policy Address), "Reform for Enhancing Development and Building Our Future Together", focused on Hong Kong's competitiveness and strengthening sustainable economic growth in Hong Kong. Also on 16 October 2024, Hong Kong was ranked as the world's freest economy among 165 economies by The Fraser Institute of Canada's Economic Freedom of the World 2024 Annual Report. Of the five areas of assessment in the 2024 Economic Freedom Report, Hong Kong ranks top in "Freedom to trade internationally" and "Regulation", and third in "Sound money".

In brief, the 2024 Hong Kong Policy Address included the following:

The Hong Kong Securities Market

- Introducing Exchange Traded Funds (*ETFs*) for Hong Kong stock indices in the Middle East.

- Encouraging large-scale Mainland enterprises to list in Hong Kong, optimising Hong Kong's mutual access with the Mainland's financial markets.

- Enhancing market efficiency and reducing transaction costs.

- The Hong Kong Securities and Futures Commission (*SFC*) and the Hong Kong Stock Exchange (*HKEX*) will introduce new measures to expedite the vetting process for companies applying to list on the HKEX.

New Fintech Innovation Ecosystem in Hong Kong

- The Hong Kong Government will continue to promote the development of innovative financial services including Central Bank Digital Currencies (*CBDCs*),

mobile payment, virtual banks, virtual insurance and virtual asset (*VA*) transactions.

- FSTB shortly to issue a policy statement on the application of AI in the financial market.

- Promoting the use of CBDCs for cross boundary payments – the Hong Kong Monetary Authority (*HKMA*) is actively testing and exploring more add on technology solutions and use cases related to cross boundary trade settlement on the mBridge platform, and will further widen the participation of both the public and private sectors.

- Enhancing the regulation of Virtual Assets trading, the FSTB will:

  - Complete the second round public consultation on the regulatory proposals for over the counter trading of VA.

  - Put forward a proposed licensing regime for Virtual Assets custodian service providers.

  - Promote real world asset tokenisation and develop a digital money ecosystem – the HKMA is taking forward Project Ensemble, a financial market infrastructure project, to explore the application of real world asset tokenisation and the use of digital money for interbank settlement, facilitating the development of the relevant asset trading. The HKMA will continue to collaborate with different jurisdictions to formulate a mechanism for trade information transmission, promoting cross-boundary data transfer and the digitalisation of international trade.

  - The HKMA already allows potential stablecoin issuers to test business plans and use cases through the stablecoin issuer sandbox, and will work with the FSTB to introduce a bill on the regulation of fiat referenced stablecoin issuers in 2024.

  - Promote the development of the digital securities market – the HKMA is to launch the Digital Bond Grant Scheme to encourage more financial institutions and issuers to adopt tokenization technology in capital market transactions.

Internationalisation of the RMB under the 2024 Hong Kong Policy Address

- Improving Hong Kong's infrastructure and upgrading the Central Moneymarkets Unit to aid the settlement in various assets and various currencies globally.

- Enhancing offshore RMB liquidity by making "good use" of the currency swap agreement between Hong Kong and China. The HKMA will explore measures such as night-time cross-boundary service capabilities of Hong Kong's RMB Real Time

Gross Settlement System to facilitate global settlements in offshore RMB markets and explore a range of diversified channels for obtaining offshore RMB financing.

- Making available additional RMB-denominated investment products such as increasing issuance of RMB bonds and supporting the issuance of green and sustainable offshore RMB bonds in Hong Kong.

- The HKEX will encourage more listed companies to have their shares listed in the RMB stock trading counter and to expand the range of RMB-denominated equities available.

Hong Kong as an International Financial, Shipping and Trade Centre Under the 2024 Hong Kong Policy Address

- Establish a global marketplace for gold trading and develop gold storage facilities. The Hong Kong Government views the growth of the gold industry in Hong Kong as also driving the demand for related services such as collateral and loan businesses, thereby creating new areas of growth.

- The Insurance Authority will conduct a review of their risk management system, including capital requirements for infrastructure investment, enriching insurance companies' assets allocation for risk diversification and boosting investment in infrastructure such as the Northern Metropolis of Hong Kong.

- To enhance the New Capital Investment Entrant Scheme, with immediate effect, investments in residential properties are permitted, provided the transaction price is at least HK$50 million, while the amount of real estate investment to be counted towards the total capital investment capped at HK$10 million. Additionally, starting from 1 March 2025, investments made through an eligible private company wholly owned by the applicant will count towards the applicant's eligible investments.

- Further to the launch of the international carbon market (*Core Climate*) by the HKEX, the HKMA will announce a Sustainable Finance Action Agenda, which will target the full adoption of the International Financial Reporting Standards – Sustainability Disclosures Standards (*ISSB Standard*) by 2024.

- Strengthening Hong Kong's maritime industry including providing tax concessions, promoting maritime services enterprises to establish a presence in Hong Kong and advancing development of a Green Maritime Centre through promoting the green transformation of registered ships, developing a green maritime fuel bunkering centre and offering green fuel bunkering facilities. The Hong Kong Government will complete the installation of a port community system in 2025 which will provide real-time data to the relevant industries.

- Lowering the duty on imported liquor (with alcohol strength of more than 30%) priced over HK$200 from 100% to 10% for the portion exceeding HK$200, effective immediately. The duty for such liquor imports priced below HK$200 will remain unchanged.

Aim to Become the World's Largest Cross-Border Wealth Management Centre under the 2024 Hong Kong Policy Address

- Partnering with sovereign wealth funds in areas connected by Mainland China's Belt and Road initiative and establish funds to invest in assets in Mainland China and other regions.

- The Hong Kong Government will explore avenues to provide tax concessions on qualifying transactions for funds and single-family offices.

Hong Kong Small and Medium Enterprises (SMEs)

- Loans under the SME Financing Guarantee Scheme (launched by HKMC Insurance Limited) are eligible for a principal moratorium for up to 12 months to alleviate financial hardships faced by the SMEs.

- An injection of HK$1 billion into the Dedicated Fund on Branding, Upgrading and Domestic Sales (*the BUD Fund*) to enable SMEs to enhance their businesses development and pursue international expansion.

- The Hong Kong Government plans to support SMEs through various promotional events aimed at strengthening brand development, facilitating connections with Mainland enterprises, and providing opportunities for SMEs to participate in tendering processes for contractors.

Research and Innovation and Technology (I.T.) Sector in Hong Kong

To support the I.T. sector in Hong Kong, the Hong Kong Government will:

- Establish a Research Matching Grant Scheme of HK$1.5 billion to support organisations with research.

- Establish a HK$10 billion I.T. Industry-Oriented Fund to invest in specific industries with strategic importance, such as life and health technology, AI and robotics, semi-conductors and smart devices, advance materials and new energy.

- Establish a HK$1.5 billion fund to invest in start-ups in strategic industries.

- Establish an I.T. Accelerator Pilot Scheme with a funding allocation of HK$180 million to attract professional start-up services from both local and overseas to set up accelerator bases in Hong Kong.

Hong Kong as a Regional Centre for International Legal and Dispute Resolution Services

- The "Hong Kong International Legal Talents Training Academy" is set to launch in 2024, aimed at developing legal professionals proficient in various legal systems, with the support from the Department of Justice.

- After the relevant international convention is adopted, the International Organisation for Mediation will establish its headquarters in Hong Kong. The Hong Kong Government aims to improve local mediation accreditation and disciplinary systems, promote mediation clauses in government contracts, and encourage private organizations to adopt these clauses. Additionally, a Pilot Scheme on Community Mediation will be launched to foster a mediation culture.

- A sports dispute resolution system will be introduced.

Low-altitude Economy

- The development of a Low-altitude Economy in Hong Kong which will concentrate on economic activities within the airspace below 1000 metres. The Hong Kong Government will explore the economic potential of this low-altitude airspace in sectors such as telecommunications, AI, and the digital industry. A working group will be established to implement relevant measures, including formulating regulations, enhancing collaboration with the Mainland China, and developing low-altitude infrastructure.

Legislative Framework for Intellectual Property under the 2024 Hong Kong Policy Address

- The Hong Kong Government plans to enhance Hong Kong's legislative framework for intellectual property in 2025. This includes extending the Copyright Ordinance to protect AI technology development, conducting a consultation on the registered design regime, and proposing amendments to streamline the IP litigation process for greater efficiency.

- The Trade Marks Registry will introduce a new AI-assisted image search service for users to conduct public searches in the trademark database.

Attracting High-Calibre Talent to Hong Kong under the 2024 Hong Kong Policy Address

- Include 13 additional universities to the Top Talent Pass Scheme.

- Attract students from outside Hong Kong to study in Hong Kong via the pilot arrangement for graduates from the GBA to work in Hong Kong, offering scholarships and other incentives.
- Increase the number of quotas for young families to purchase flats under the Home Ownership Scheme in the forthcoming White Form Secondary Market Scheme.

Housing under the 2024 Hong Kong Policy Address

- Adjust the maximum loan-to-value ratio for residential property mortgage loans to 70% of the property's value for all buyers.
- Increase the supply of public housing to 189,000 units over the next five years.
- Legislate for a regulatory framework governing the rental of subdivided units in residential buildings, incorporating prescribed requirements.

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Hong Kong's Proposed Company Re-domiciliation Regime

Hong Kong Law – 663 – 23 October 2024

In July 2024, Hong Kong's Financial Services and Treasury Bureau (*FSTB*) published its Consultation Conclusions[1] on its proposed introduction of an inward re-domiciliation regime to allow companies incorporated outside Hong Kong to re-domicile to Hong Kong as set out in its March 2023 Consultation Paper.[2]

Chief Executive, John Lee, has since announced in his 2024 Policy Address[3] delivered on 16 October 2024 that the FSTB will introduce a bill this year to implement the Hong Kong re-domiciliation regime as part of the Hong Kong Government's efforts to attract more offshore companies to establish headquarters or corporate divisions in Hong Kong. For further details of the Chief Executive's 2024 Policy Address, please see our October 2024 newsletter and for details of the FSTB's Consultation Paper on Proposed Company Re-domiciliation Regime in Hong Kong, please see our June 2023 newsletter.

Following its introduction of fund re-domiciliation regimes to allow offshore funds established as companies or limited partnerships to re-domicile to Hong Kong as open-ended fund companies or limited partnership funds, the Hong Kong Government is proposing a legislative regime to allow companies incorporated in overseas jurisdictions to migrate their place of incorporation to Hong Kong while maintaining their legal identity and the validity of their corporate actions prior to the re-domiciliation. The intention is to provide a streamlined and cost-effective way for overseas companies to move their place of incorporation to Hong Kong which avoids the need to wind-up the company in its original domicile and set up a new company in Hong Kong.

[1] *FSTB. Consultation Conclusions and Legislative Proposals – Proposed Company Re-domiciliation Regime in Hong Kong, July 2024*

[2] *FSTB. Public Consultation on Proposed Company Re-domiciliation Regime in Hong Kong, March 2023*

[3] *The Chief Executive's 2024 Policy Address, October 2024*

The proposed regime will be administered by the Hong Kong Registrar of Companies, who will approve or reject applications for re-domiciliation to Hong Kong.

Legal Effect after Re-domiciliation to Hong Kong

Under the proposed regime, the legal identity, property, rights, obligations and contracts of re-domiciled companies will be preserved. Additionally, re-domiciled companies will benefit from the same rights and be subject to the same obligations under Hong Kong company laws as other Hong Kong-incorporated companies. The FSTB has clarified that these obligations include appointing a company secretary under section 474 of the Hong Kong Companies Ordinance (Cap. 622 of the Laws of Hong Kong) (*Hong Kong Companies Ordinance*) which may not be required under the law of the company's original jurisdiction of incorporation.

Inward Re-domiciliation only

The FSTB confirmed in its Consultation Conclusions that an outward re-domiciliation regime to allow Hong Kong-incorporated companies to re-domicile out of Hong Kong will not be introduced at this stage given the lack of demand for an outward re-domiciliation regime.

No Economic Substance Test for Hong Kong Company Re-domiciliation

Applicant companies will not be subject to an economic substance test under the proposed regime. The FSTB intends the re-domiciliation regime to be accessible to a wide range of companies in terms of size and hierarchies, including holding companies.

Eligibility Requirements for Companies Re-domiciling to Hong Kong

The key eligibility criteria for companies re-domiciling to Hong Kong are summarised below.

Company Type

The company will need to be in the same or substantially the same form as one of the following types of companies that can be incorporated under the Companies Ordinance:

- private companies limited by shares;
- public companies limited by shares;
- private unlimited companies with a share capital; and
- public unlimited companies with a share capital.

Companies limited by guarantee without a share capital, which are typically non-profit making organisations, will not be eligible to re-domicile to Hong Kong.

Given the aim of preserving the legal identity of the re-domiciled company, the FSTB has clarified that companies will not be allowed to change their company type during the re-domiciliation process.

Re-Domiciling Company's Compliance with the Laws of its Jurisdiction of Incorporation

The law of the company's original place of incorporation must allow outward re-domiciliation to other jurisdictions. For example, companies originally incorporated in the Cayman Islands may be eligible to re-domicile to Hong Kong as the Cayman Limited Liability Companies Act permits outward re-domiciliation, whereas Singapore does not have an outward re-domiciliation regime. Some other jurisdictions allow outward re-domiciliation to specified jurisdictions. For example, Bermuda permits outward re-domiciliation to "appointed jurisdictions", which do not currently include Hong Kong.

Re-domiciling companies will have to fulfil all the requirements for outward re-domiciliation under the laws of the original place of incorporation. These may include shareholder approval, creditor notification and other approval requirements.

Company Age

The company must have been incorporated for at least one financial year before submitting an application for re-domiciliation to Hong Kong.

Integrity Requirement

There must be no intention to use the re-domiciled company for unlawful purposes, or for engaging in activities that are against the public interest or would endanger national security in Hong Kong. Under the proposed regime, re-domiciling companies will have to comply with the requirements of the Hong Kong Companies Ordinance relating to re-domiciliation, which will be substantially the same as the registration requirements for locally incorporated companies.

Solvency

A company will need to be solvent and not in liquidation to apply for re-domiciliation. As discussed further below, the company will be required to submit financial statements and other documents to prove the company's solvency.

Creditor Protection and Shareholders' Consent to Re-domiciliation to Hong Kong

Under the proposed regime, the application for re-domiciliation must be made in good faith and the arrangement must not be intended to defraud the company's creditors.

The company's re-domiciliation will need to be approved by its shareholders. If neither the law of the original jurisdiction of incorporation nor the constitutional documents of the company require shareholders to approve the company's re-domiciliation, then the re-domiciliation must be approved by way of a special resolution passed by at least 75% of the shareholders entitled to vote. Otherwise, shareholders' approval must be given in accordance with the requirements of the company's jurisdiction of incorporation and/or constitutional documents.

Application Documents for Company Re-domiciliation to Hong Kong

In order to apply for re-domiciliation to Hong Kong, a company will need to submit the following documents to the Hong Kong Registrar of Companies:

- Application form setting out: (i) the company's original and proposed name; (ii) the company's original place of incorporation; (iii) whether the company is a registered non-Hong Kong company under Part 16 of the Hong Kong Companies Ordinance; (iv) the company type; (v) the proposed registered office address; (vi) particulars of the proposed directors and company secretary; and (vii) details of the share capital and shareholders;

- A copy of the Articles of Association that the re-domiciled company proposes to adopt;

- A certified copy of the company's certificate of incorporation issued under the law of its original place of incorporation. If the company has undergone re-domiciliation before, a certified copy of its certificate of registration will also be required;

- A certified copy of the company's constitutional documents in its original place of incorporation;

- A certified copy of the resolution approving the company's re-domiciliation passed by at least 75% of the eligible shareholders. This can be a resolution passed at a meeting or a written resolution. The FSTB has said that this document is required only if neither the law of the original place of jurisdiction nor the constitutional documents of the company require shareholders' approval of the company's re-domiciliation;

- ◦ A legal opinion from a legal practitioner qualified in the original place of jurisdiction confirming, among others:
- ◦ that the company is duly registered in its original place of jurisdiction;
- ◦ that the proposed re-domiciliation is allowed under the law of the original place of jurisdiction;
- ◦ the company type in the original place of jurisdiction and the proposed company type subsequent to re-domiciliation;
- ◦ the company's solvency;
- ◦ that the company has obtained shareholders' approval for the re-domiciliation;
- ◦ the intended name of the re-domiciled company; and
- ◦ adoption of the proposed articles of association submitted with the application;

- The company's latest financial statements or audited financial statements containing financial information up to a date that is not more than 12 months before the application date. In the Consultation Conclusions, the FSTB relaxed the requirement for the financial statements to be audited if the laws of the original place of jurisdiction, the rules of the relevant stock exchange, or other similar regulatory rules do not require audited financial statements to be prepared;
- A certificate signed by a director confirming that the company is duly registered in its original place of jurisdiction and its solvency. The certificate should also confirm that the company's shareholders have approved the re-domiciliation and explain the reasons for the re-domiciliation.

The list of documents required to be submitted as set out in the Consultation Paper also includes other documents such as the notice to the Business Registration Office, business registration fee and an application fee. The FSTB also noted in the Consultation Conclusions that the one-stop business registration arrangement between the Hong Kong Companies Registry and the Inland Revenue Department will apply to re-domiciliation applications.

Application Procedures for Company Re-domiciliation to Hong Kong

All application documents should be addressed to the Hong Kong Registrar of Companies. Although the processing time for applications will vary according to the type and circumstances of the company, the FSTB expects that approvals will generally be granted within two weeks of receipt of all the required application documents.

Tax Arrangements for Companies Re-domiciling to Hong Kong

According to the Consultation Conclusions, the tax obligations of the company in its original place of domiciliation will not be affected by the re-domiciliation process. This will prevent companies from using the company re-domiciliation regime as a means of tax evasion. The re-domiciled company's liability to Hong Kong profits tax will also remain unchanged. This is because the position under the Inland Revenue Ordinance (Cap. 112 of the Laws of Hong Kong) (*Inland Revenue Ordinance*) is that, irrespective of the place of incorporation or tax residency, profits tax is charged on profits arising in or derived from Hong Kong from a trade, profession or business carried on in Hong Kong.

However, the FSTB is proposing to amend the Inland Revenue Ordinance to allow the Inland Revenue Department to address transitional tax matters such as fair deduction for trading stock, specified types of expenditures and depreciation allowances. The FSTB has said that it will propose comprehensive amendments in due course and will reference the arrangements adopted by other jurisdictions during the drafting process.

To eliminate double taxation, the FSTB proposes to provide re-domiciled companies with unilateral tax credits for tax payable on actual profits derived in Hong Kong after re-domiciliation, if similar profits have been taxed in an unrealised form in the original jurisdiction of incorporation at the time of exit.

As regards stamp duty implications, the FSTB has said that since the re-domiciliation process will not generally involve the transfer of the company's assets, it should not give rise to a charge to Hong Kong stamp duty. The FSTB has not however addressed whether, after re-domiciliation, a transfer of the re-domiciled company's shares will attract Hong Kong stamp duty.

Preservation of Business Continuity

The FSTB expects that many of the companies that will apply to re-domicile to Hong Kong will be non-Hong Kong companies with an established place of business in Hong Kong that are already registered as non-Hong Kong companies under Part 16 of the Hong Kong Companies Ordinance. One of the stated aims of the proposed re-domiciliation regime is to allow companies to preserve their business and legal identity after migrating their place of domiciliation to Hong Kong. In line with this policy intent, the FSTB is proposing to make arrangements under the Hong Kong Companies Ordinance and the Business Registration Ordinance (Cap. 310 of the Laws of Hong Kong) to allow registered non-Hong Kong companies applying to re-domicile to Hong Kong to keep their existing company name and business registration number after the re-domiciliation process.

For re-domiciliation applicant companies that are not registered non-Hong Kong companies, the filings and records of the company prior to re-domiciliation will be regulated by the law of its original place of jurisdiction. The company will only be required to observe the record-keeping and filing requirements under the Hong Kong Companies Ordinance from the date of its re-domiciliation.

Deregistration Period

A company will be regarded as having re-domiciled to Hong Kong on the date the certificate of re-domiciliation is issued by the Hong Kong Registrar of Companies. Re-domiciled companies must then provide evidence of deregistration in their original place of domicile to the Companies Registry within 120 days from the date of re-domiciliation. If a company fails to do so within that timeframe, the registration in Hong Kong will be revoked and the re-domiciliation application will be deemed unsuccessful. The FSTB will also allow companies to apply for a time extension where necessary.

Arrangements for Overseas Financial Institutions Re-domiciling to Hong Kong

Regarding companies with business operations in regulated sectors in Hong Kong, such as banks and insurance companies, the FSTB will also propose amendments to the Insurance Ordinance (Cap. 41 of the Laws of Hong Kong) and the Banking Ordinance (Cap. 155 of the Laws of Hong Kong) to include re-domiciled insurance companies and authorised institutions in their regulatory frameworks. The intention is to ensure that insurance companies and authorised institutions that re-domicile to Hong Kong will be subject to the same rules and regulations as insurance companies and authorised institutions incorporated in Hong Kong. In the Consultation Conclusions, the FSTB also advises insurance companies and authorised institutions looking to re-domicile to Hong Kong to consult the Insurance Authority or the Hong Kong Monetary Authority to ascertain whether they meet the requirements for locally incorporated insurance companies or authorised institutions before submitting their re-domiciliation application. The FSTB noted in the Consultation Conclusions that it will look into administrative arrangements to enhance coordination between the Companies Registry and the financial regulators in relation to the authorisation process of financial institutions.

Safeguarding National Security

The Safeguarding National Security Ordinance (Instrument A305 of the Laws of Hong Kong) that came into effect on 23 March 2024 gives the Chief Executive the power to order companies incorporated in Hong Kong to be struck off if the company is believed to engage in activities that may endanger national security in Hong Kong. The FSTB will propose amendments to the relevant provisions to extend that power to cover re-domiciled companies in addition to Hong Kong incorporated companies.

Next Steps

The FSTB is preparing an amendment bill to amend the Hong Kong Companies Ordinance and other ordinances mentioned in the Consultation Conclusions and aims to submit the bill to the Legco by the end of this year.

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Hong Kong's Proposed Regulation of Fiat-referenced Stablecoin Issuers

Hong Kong Law – 664 – 28 October 2024

On 17 July 2024, the Financial Services and the Treasury Bureau (*FSTB*) and the Hong Kong Monetary Authority (*HKMA*) jointly published the Consultation Conclusions[1] on their legislative proposal to implement a regulatory regime for fiat-referenced stablecoin issuers in Hong Kong (*Proposed Fiat-referenced Stablecoin Regulatory Regime*) as proposed in their December 2023 Consultation Paper.[2]

Chief Executive, John Lee, has since announced in his 2024 Policy Address[3] delivered on 16 October 2024 that the HKMA and FSTB are planning to introduce a bill to the Legislative Council this year to implement the proposed regulatory regime. For further details of the Chief Executive's 2024 Policy Address, please see our October 2024 newsletter.

Background to Hong Kong's Proposed Fiat-referenced Stablecoin Regulatory Regime

In line with Hong Kong's development as a virtual asset hub, the FSTB and HKMA are collaborating with other Hong Kong financial regulators to provide a comprehensive framework regulating a wide-range of virtual asset related activities. The FSTB and HKMA are of the view that stablecoins, and fiat-referenced stablecoins in particular, present a potential risk to monetary and financial stability due to the potential for them to serve as a channel for risks to spill over from the virtual asset sector to the traditional financial system and vice versa. The initiative to regulate fiat-referenced stablecoins was first muted in the HKMA's January 2022 Discussion Paper on Crypto-

[1] *Financial Services and the Treasury Bureau/ Hong Kong Monetary Authority. July 2024. Legislative Proposal to Implement the Regulatory Regime for Stablecoin Issuers in Hong Kong – Consultation Conclusions*

[2] *Financial Services and the Treasury Bureau/ Hong Kong Monetary Authority. December 2023. Legislative Proposal to Implement the Regulatory Regime for Stablecoin Issuers in Hong Kong – Consultation Paper*

[3] *The Chief Executive's 2024 Policy Address, October 2024*

assets and Stablecoins[4] and the January 2023 Conclusion Paper.[5] The December 2023 Consultation Paper and July 2024 Consultation Conclusions referred to above give further details of the proposed regulatory regime.

Current Regulatory Framework in Hong Kong

Under the current regulatory framework in Hong Kong, the licensing regime:

- for virtual asset service providers (*VASPs*) is overseen by the Securities and Futures Commission (*SFC*) under the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (*AMLO*); and
- for stored value facilities (*SVF*) is overseen by the HKMA under the Payment Systems and Stored Value Facilities Ordinance (*PSSVFO*).

Rationale for Hong Kong's Proposed Fiat-referenced Stablecoin Regulatory Regime

The FSTB and HKMA are proposing to introduce a stand-alone new piece of Hong Kong legislation to establish the Hong Kong regulatory regime for fiat-referenced stablecoin issuers in Hong Kong, rather than amending existing legislation such as the AMLO or the PSSVFO. The FSTB and HKMA made this decision based on the recognition that stablecoins and stored value facilities may have different features and a new ordinance is considered more suitable given the complex nature of the virtual asset market. They are also of the view that the new legislation can serve as the foundation for extending the regulatory regime to cover other virtual asset-related activities as necessary and appropriate in the future.

According to the FSTB and HKMA, the key policy objectives of Hong Kong's Proposed Fiat-referenced Stablecoin Regulatory Regime are to:

- put in place appropriate safeguards to address potential monetary and financial stability risks posed by fiat-referenced stablecoins;
- provide adequate protection to fiat-referenced stablecoin users;
- maintain Hong Kong's status as an international financial centre by putting in place an appropriate regulatory regime for fiat-referenced stablecoin issuers that is in line with international regulatory recommendations; and
- foster sustainable and responsible development of the virtual asset ecosystem in Hong Kong by providing legal and regulatory clarity.

[4] *Hong Kong Monetary Authority. January 2022. Discussion Paper on Crypto-assets and Stablecoins*

[5] *Hong Kong Monetary Authority. January 2023. Conclusion of Discussion Paper on Crypto-assets and Stablecoins*

Definition of "stablecoin" under Hong Kong's Proposed Stablecoin Regulatory Regime

Under Hong Kong's Proposed Fiat-referenced Stablecoin Regulatory Regime, a "stablecoin" will be defined as a cryptographically secured digital representation of value that, among other things:

- is expressed as a unit of account or a store of economic value;
- is used, or is intended to be used, as a medium of exchange accepted by the public, for the purpose of payment for goods or services; discharge of a debt; and/or investment;
- can be transferred, stored or traded electronically;
- is operated on a decentralised distributed ledger (defined as "a distributed ledger in which no person has the unilateral authority to control or materially alter its functionality or operation") or similar technology; and
- purports to maintain a stable value with reference to a specified asset, or a pool or basket of assets.

Deposits, securities and futures contracts, float stored in stored value facilities (*SVF*) and SVF deposits, digital representations of fiat currencies issued by central banks and digital representations of value with limited purposes will be excluded from the definition.

Definition of "fiat-referenced stablecoin" under Hong Kong's Proposed Stablecoin Regulatory Regime

Fiat-referenced stablecoins ("*Hong Kong fiat-referenced stablecoins*") will be defined as stablecoins where the referenced asset is one or more fiat currencies. The FSTB and HKMA have proposed that the issuance of a fiat-referenced stablecoin in Hong Kong will be a regulated stablecoin activity given that a Hong Kong fiat-referenced stablecoin could potentially become a commonly acceptable means of payment, which, in their view, would pose more imminent monetary and financial stability risks as compared to other types of stablecoins, such as commodity-referenced stablecoins.

Scope of regulated activity under Hong Kong's Proposed Stablecoin Regulatory Regime

The Proposed Fiat-referenced Stablecoin Regulatory Regime will prioritise the regulation of fiat-referenced stablecoin issuance in Hong Kong. The question of what will be considered an "issuance" activity will generally be decided on a case-by-case basis according to the specific facts and circumstances. The regulators are intending to

provide guidance to the industry on this issue when the licensing regime is implemented.

Some respondents to the consultation commented that the regulatory regime should also cover other activities such as private key storage and the provision of wallet services. In response, the FSTB and HKMA said that these activities will not be covered by the proposed regime. They are exploring their approach to regulating these activities in terms of risk management and user protection, and will engage the public and relevant stakeholders in the process in due course.

Summary of the Licensing Regime under Hong Kong's Proposed Fiat-referenced Stablecoin Regulatory Regime

Under Hong Kong's Proposed Stablecoin Regulatory Regime, a licence from the HKMA will be required in order to:

- issue, or hold oneself out as issuing, a fiat-referenced stablecoin in Hong Kong;
- issue, or hold oneself out as issuing, a stablecoin purporting to maintain a stable value with reference to the value of the Hong Kong dollar; or
- actively market the issuance of fiat-referenced stablecoins to the public of Hong Kong.

During the consultation period, some respondents sought clarity around the concept of "actively marketing its issuance of fiat-referenced stablecoins to the public of Hong Kong" as they were unclear whether this is intended to cover only unlicensed fiat-referenced stablecoin issuers who actively market their own issuance in Hong Kong, but not agents or intermediaries engaged by the issuers. The consultation conclusions confirmed that any person, including issuers, agents and intermediaries, promoting the issuance of fiat-referenced stablecoins in Hong Kong by an unlicensed issuer will commit an offence. However, agents or intermediaries who actively market a licensed entity's issuance of fiat-referenced stablecoins to the Hong Kong public will not be regarded as issuing fiat-referenced stablecoins themselves, and will not require a licence to issue fiat-referenced stablecoins in Hong Kong. When determining whether a person is "actively marketing" an issuance of fiat-referenced stablecoins to the Hong Kong public, the HKMA will consider various factors similar to the approach adopted by the SFC including, among others, the language used in the marketing messages; whether the message is targeted at a group of people that resides in Hong Kong; and whether a Hong Kong domain name is used for its website.

Similarly, whether a fiat-referenced stablecoin is issued in Hong Kong will depend on the facts and circumstances of each case. The factors to be considered will include: the fiat-referenced stablecoin issuer's place of incorporation; the location of its operations; the provision of subsequent customer services to users of the fiat-referenced

stablecoin; and whether a Hong Kong bank account is used to process issuance and redemption requests. The regulators will provide guidelines on these matters.

Licensing Criteria and Conditions under Hong Kong's Proposed Stablecoin Regulatory Regime

The key licensing criteria and conditions under Hong Kong's Proposed Fiat-referenced Stablecoin Regulatory Regime are set out below:

(a) *Management of reserves and stabilisation mechanisms*

(i) *Full backing:*

Issuers of fiat-referenced stablecoins in Hong Kong will have to ensure that the fiat-referenced stablecoins are backed by reserve assets with a value equal to or greater than the par value of the fiat-referenced stablecoins in circulation at all times. Issuers of fiat-referenced stablecoins in Hong Kong will also be required to demonstrate to the HKMA's satisfaction that they have put in place sufficient measures to comply with this requirement, for example, over-collateralisation arrangements. Issuers of fiat-referenced stablecoins that derive their value solely from arbitrage or algorithm will not be licensed in Hong Kong because the stablecoins are not backed by reserves.

(ii) *Investment limitations:*

Reserve assets will need to be of high quality and liquidity, with minimal market, credit and concentration risks. The regulators have said that high quality and high liquidity reserve assets may include coins and banknotes, deposits placed with licensed banks, marketable securities representing claims on or guaranteed by governments, central banks or qualified international organisations with high credit quality, overnight reverse repurchase agreements with minimal counterparty risk backed by these securities and tokenised versions of any of these assets. Issuers of fiat-referenced stablecoins in Hong Kong will be required to demonstrate to the HKMA that their proposed investments are suitable and have an investment policy for reserve assets that undergoes regular review.

(iii) *Segregation and safekeeping of reserve assets:*

Issuers of fiat-referenced stablecoins in Hong Kong will be required to put in place an effective trust arrangement to ensure the reserve assets are segregated and available to satisfy redemption requests and legal claims. The appointment of an independent trustee or a declaration of trust over the reserve assets will be considered as an acceptable trust arrangement. The HKMA should be given a draft of the relevant trust deed together with a draft of an independent legal opinion before implementation of the trust arrangement. Is-

suers of fiat-referenced stablecoins in Hong Kong will need to set up segregated accounts for the reserve assets with licensed banks in Hong Kong or, if approved by the HKMA, with other custodians. The FSTB and HKMA consider that safekeeping reserve assets with licensed banks in Hong Kong provides greater user protection in the case of business disruptions or failures. However, the HKMA will consider individual proposals from fiat-referenced stablecoins issuers on placing reserve assets in other jurisdictions on a case-by-case basis if they can demonstrate the need for the alternative arrangement, address any additional risks and show that the interests of fiat-referenced stablecoin users are not compromised. Issuers of fiat-referenced stablecoins in Hong Kong will also need to implement an internal control policy to safeguard reserve assets against operational risks, such as theft, fraud and misappropriation.

(iv) *Risk management and controls:*

Hong Kong fiat-referenced stablecoin issuers will need to have policies and controls to properly manage all their investment activities related to the reserve assets to ensure that sufficient funds and liquid assets will be available to satisfy redemption requests. They will also need to implement comprehensive liquidity risk management practices which should set out the strategy and tools for handling large-scale redemptions. Issuers of fiat-referenced stablecoins in Hong Kong will also be expected to conduct periodic stress testing to monitor the adequacy and liquidity of their reserve assets. They will also be required to formulate a reserve management policy to deal with both financial and operational risks in the course of managing their reserves.

(v) *Disclosure and reporting:*

Hong Kong fiat-referenced stablecoin issuers will be required to regularly disclose the total amount of fiat-referenced stablecoins in circulation, the mark-to-market value of reserve assets and the composition of reserve assets. The exact frequency of these disclosure has yet to be set, but the FSTB and HKMA have stated that they will strike a balance between the operational burden on issuers and the need for transparency. Issuers of fiat-referenced stablecoins in Hong Kong will also be required to appoint an independent auditor to attest to: the composition and market value of the reserve assets; the par value of fiat-referenced stablecoins in circulation; whether the reserve assets are adequate to fully back the value of fiat-referenced stablecoins in circulation and sufficiently liquid, as of the last business day of the period covered by the attestation; and the fulfilment of the HKMA's conditions on the management of reserves. The independent auditor's attestation will be required at least monthly.

(vi) *Prohibition on paying interest:*

Issuers of fiat-referenced stablecoins in Hong Kong will not be permitted to pay interest to stablecoin users and any income or loss from the reserve assets will have to be attributed to the fiat-referenced stablecoin issuer. Issuers will also be prohibited from making arrangements with third parties to provide interest to fiat-referenced stablecoin users, but the offering of marketing incentives will be allowed provided that they do not amount to interest payments.

(vii) Effective stabilisation:

Hong Kong issuers of fiat-referenced stablecoins will be ultimately responsible for ensuring the effective functioning of the stabilisation mechanism of the stablecoins they issue notwithstanding their engagement of third parties to conduct stabilisation-related activities.

(b) *Redemption requirements*

Fiat-referenced stablecoin users will have the right to redeem their stablecoins at par value from the issuer without undue costs or unreasonable conditions. Fiat-referenced stablecoins must be redeemed at par in the fiat currency or currencies they reference. In normal circumstances, fiat-referenced stablecoin issuers will be required to fulfil redemption requests within one business day after the day on which a redemption request is received. Where issuers foresee difficulty in fulfilling redemption requests within that time frame, they will need to seek the HKMA's prior approval.

(c) *Restrictions on business activities*

Issuers of fiat-referenced stablecoins in Hong Kong will be required to obtain approval from the HKMA before starting new business lines and should conduct a risk assessment and avoid introducing significant risks or impairing its role as an issuer of fiat-referenced stablecoins. The HKMA will assess the proposed business activities on a case-by-case basis giving consideration to the risks involved and the effectiveness of measures to mitigate those risks. Issuers of fiat-referenced stablecoins will be permitted to provide ancillary services such as wallet services for the stablecoins they issue, provided they implement procedures for segregating and safekeeping users' stablecoins and handling their deposit and withdrawal requests. However, they will need to avoid activities such as lending, financial intermediation or other regulated activities such as activities regulated under the Securities and Futures Ordinance (SFO), the Mandatory Provident Fund Schemes Ordinance or the Insurance Ordinance.

(d) *Physical presence in Hong Kong*

An issuer of fiat-referenced stablecoins in Hong Kong will need to be a company incorporated in Hong Kong with a registered office in Hong Kong. Its chief execut-

ive, senior management team and key personnel must be based in Hong Kong and exercise effective management and control of its fiat-referenced stablecoin issuance and related activities. Key personnel include the functional heads of operations, IT systems, financial management, control and risk management, compliance and internal audit. Companies incorporated in other jurisdictions, other than authorised institutions, will need to establish a subsidiary in Hong Kong in order to apply for a licence as a fiat-referenced stablecoin issuer. The rationale for the local incorporation requirement is that it will allow the HKMA to supervise issuers more effectively and provide greater protection to fiat-referenced stablecoin users in the event of an issuer's insolvency.

(e) *Financial resources requirements*

Issuers of fiat-referenced stablecoins in Hong Kong will be required to have adequate financial resources, including a minimum paid-up share capital, to enable them to sustain their operations and absorb any losses. The minimum paid-up share capital will be the higher of HK$25 million or 1% of the par value of the fiat-referenced stablecoins in circulation. The HKMA may also impose a higher paid-up share capital requirement where it considers it appropriate.

(f) *Disclosure requirements*

Hong Kong issuers of fiat-referenced stablecoins will be required to publish a white paper which should include, among others, general information about the fiat-referenced stablecoin issuer; the rights and obligations of fiat-referenced stablecoin users; the relevant stabilisation mechanisms; the arrangements for managing reserves; information on the underlying technology; the risks associated with using the fiat-referenced stablecoin; and the mechanism and procedures for issuance, distribution and redemption. The white paper will need to be ready when the licence application is submitted to the HKMA and will need to be published on the website of the issuer of the fiat-referenced stablecoin.

(g) *Governance, knowledge and experience*

The senior management, including controllers, chief executives and directors, of an issuer of Hong Kong fiat-referenced stablecoins, will need to be fit and proper persons. Any appointment or changes in ownership or management of the issuer will require the prior consent of the HKMA. Applications regarding senior management will be reviewed individually by the HKMA taking into account the applicant's previous supervising and financial experience, financial status and solvency as well as educational qualifications. Issuers of fiat-referenced stablecoins will need to ensure that they have in place systems of controls sufficient for the appointment of senior management and other personnel that have the necessary knowledge and experience to perform their roles effectively.

(h) *Risk management requirements*

Hong Kong issuers of fiat-referenced stablecoins will need to have appropriate risk management processes and measures for their operations including, among others; (i) adequate security and internal controls to ensure data and systems security; (ii) effective detection measures for fraud and technological risks; (iii) robust contingency arrangements to address operational disruptions; and (iv) other operational and security safeguards. Incident management should also include establishing management policies and monitoring incident response mechanisms. Despite cost concerns, the FSTB and HKMA are of the view that fiat-referenced stablecoin issuers should conduct risk assessments at least annually, regardless of their business size or the risk level of the stablecoin operation. The purpose is to identify any internal weaknesses that may undermine the effectiveness of fiat-referenced stablecoin issuers' internal controls, risk management and governance on an ongoing basis.

(i) *Audit requirements*

Issuers will be required to submit annual audited financial statements to the HKMA. When appointing an auditor, Hong Kong issuers of fiat-referenced stablecoins will be required to consider the auditor's knowledge, expertise, resources and independence regarding relevant audit areas. The FSTB and the HKMA will provide further guidance on the scope of the audit in future guidelines. As and when required by the HKMA, issuers of fiat-referenced stablecoins will also need to submit reports prepared by external independent auditors and assessors confirming the management and operational soundness of their stablecoin issuance.

(j) *Anti-money laundering and counter-financing of terrorism requirements*

Issuers of fiat-referenced stablecoins in Hong Kong will be required to adopt a risk-based approach and suitable measures to mitigate and manage risks related to money laundering and terrorist financing, including those related to transactions with intermediaries. Issuers will also need to ensure that they have in place adequate and appropriate systems of control for the purpose of ensuring compliance with the applicable provisions of the AMLO and other relevant regulations and guidelines. In particular, fiat-referenced stablecoin issuers will need to observe the AMLO's requirements pertaining to customer due diligence, transaction monitoring and wire transfers in relation to stablecoin issuance and redemption.

(k) *Complaints handling*

Issuers of fiat-referenced stablecoins in Hong Kong will be required to provide stablecoin users with effective complaint handling and dispute resolution systems. These mechanisms should be accessible, affordable, independent, fair, accountable, timely and efficient.

Other Licensing Matters for Hong Kong Fiat-referenced Stablecoin Issuers

(a) *Eligibility for a licence*

The FSTB and HKMA have noted that all entities would be eligible to apply for a licence as an issuer of fiat-referenced stablecoins if they can satisfy the same set of licensing and regulatory requirements. Although there are certain exemptions for authorised institutions, these only pertain to licensing criteria regarding restrictions of business activities, physical presence in Hong Kong and financial resources requirements. The FSTB and HKMA explained that these exemptions are intended to prevent regulatory inconsistencies and overlaps with existing banking regulations. The regulators consider that authorised institutions are already subject to stringent prudential requirements and ongoing supervision by the HKMA. When evaluating a licence application from an authorised institution, the HKMA will consider the risk profile of the authorised institution to determine if a separate entity should be set up.

(b) *Ongoing licensing conditions*

The HKMA will be empowered to impose ongoing conditions on the licences of Hong Kong fiat-referenced stablecoin issuers. Conditions could relate, for example, to requirements for reserve assets or restrictions on the types of service an issuer is permitted to provide. This power will allow the HKMA to address matters regarding specific fiat-referenced stablecoin issuers, such as operational risks, risk management effectiveness and operation size. Issuers will be notified of the HKMA's intention to impose licensing conditions and will have the chance to make representations in response before the HKMA finalises a decision to proceed with attaching licensing conditions.

(c) *Issuing more than one fiat-referenced stablecoin*

HKMA-licensed stablecoin issuers will be allowed to issue more than one fiat-referenced stablecoin in Hong Kong without needing to set up a separate entity or apply for a separate licence. To issue a new additional fiat-referenced stablecoin in Hong Kong, the issuer will be required to provide reasons for the further issue, justify the use cases for the fiat-referenced stablecoin, and obtain the HKMA's prior consent.

(d) *Open-ended licence*

Fiat-referenced stablecoin issuer licences will be open-ended and remain valid until revoked by the HKMA. Licences may be revoked due to non-compliance with the regulatory requirements or if the fiat-referenced stablecoin issuer ceases to operate.

(e) *Register of licensees*

In terms of licensing visibility, issuers of fiat-referenced stablecoins in Hong Kong will be expected to display their licence number in a prominent place on advertisements and in accessible locations on their websites and mobile applications. There will not be any specific format or mode of display for the licence number. The HKMA will also maintain a central register of fiat-referenced stablecoin issuer licences that will be accessible by the public.

Offering Fiat-referenced Stablecoins in Hong Kong

Only HKMA-licensed issuers of fiat-referenced stablecoins, authorised institutions, SFC-licensed corporations and SFC-licensed virtual asset trading platforms will be able to offer fiat-referenced stablecoins in Hong Kong or actively market such an offering to the Hong Kong public. A licensed fiat-referenced stablecoin issuer will only be permitted to offer fiat-referenced stablecoins that it issues itself and not those issued by other issuers. Authorised institutions, licensed corporations and licensed virtual asset trading platforms will only be allowed to offer fiat-referenced stablecoins issued by HKMA-licensed issuers to retail investors. They will only be able to offer fiat-referenced stablecoins issued by unlicensed entities to professional investors as defined in Schedule 1 to the SFO and will need to indicate clearly that the stablecoins are not issued by a licensed fiat-referenced stablecoin issuer. Authorised institutions, licensed corporations and licensed virtual asset trading platforms will not need to obtain a fiat-referenced stablecoin issuer licence to offer fiat-referenced stablecoins, but will need to comply with the relevant regulatory requirements applicable under their respective regimes and obtain the necessary approvals from their regulating authority before offering fiat-referenced stablecoins.

The term “offer” will be defined to mean a public communication in any form that provides sufficient information about the terms of the offer and how the fiat-referenced stablecoin can be obtained to enable individuals to decide whether to acquire it. This proposed definition of “offer” references the regulatory regimes of other jurisdictions.

The FSTB and HKMA are working with relevant authorities on the possibility of allowing licensed virtual asset over-the-counter service providers to offer fiat-referenced stablecoins, subject to the finalisation and implementation of the licensing regime for virtual asset over-the-counter trading.

Authorities’ power to modify Hong Kong’s Proposed Fiat-referenced Stablecoin Regulatory Regime

Given the fast-evolving nature of the industry, the HKMA will be given flexibility to address new risks arising from emerging types of stablecoins, activities or entities by giving it the power to adjust the parameters of in-scope stablecoins and activities. In exercising this power, the HKMA would have regard to any risks to the Hong Kong

market or the investing public. In assessing the materiality of the situation and the severity of the risks involved, the HKMA would take into account factors such as: the number and type of users; the number and value of transactions; the size and type of reserve assets; the value in circulation; market share; the interconnectedness with the financial systems; and the business, structural and operational complexity.

Supervisory and investigation powers of the HKMA

The HKMA will be given the power to intervene in the operations of a fiat-referenced stablecoin issuer licensee when, in consultation with the Financial Secretary, it is of the opinion that the licensee:

- is or is likely to become insolvent or unable to meet its obligations;
- is carrying on its business in a manner detrimental to the interests of its users or creditors; or
- has contravened any of its licensing conditions or the applicable regulations.

The HKMA will also be given powers to gather information, give directions, make regulations and issue guidelines. It will be empowered to conduct investigations where there is reasonable cause to believe that an offence may have been committed. Its powers would include the ability to direct an investigator to conduct an investigation and to apply to a Hong Kong Magistrate for search warrants and seizures. Given the importance of ensuring protection of fiat-referenced stablecoin users, the HKMA will issue press releases and reminders to the general public from time to time to alert them of suspicious fiat-referenced stablecoin issuers and websites, and highlight the importance of exercising caution and vigilance.

Offences and Sanctions under Hong Kong's Proposed Fiat-referenced Stablecoin Regulatory Regime

The proposed criminal offences and sanctions have been formulated by the FSTB and HKMA with reference to the AMLO and other relevant regulations and will be further refined in consultation with the Department of Justice. The conduct of any activity for which a fiat-referenced stablecoin issuer licence is required without a licence will be a criminal offence. An issuer of fiat-referenced stablecoins will need to be licensed by the HKMA in order to: issue a fiat-referenced stablecoin in Hong Kong; issue a Hong Kong dollar-referenced stablecoin; or actively market its issuance of fiat-referenced stablecoins to the Hong Kong public.

It will also be an offence to advertise an issuance of fiat-referenced stablecoins by an unlicensed issuer. Since only specified entities – that is HKMA-licensed issuers of fiat-referenced stablecoins, authorised institutions and SFC-licensed corporations and virtual asset trading platforms – will be allowed to offer fiat-referenced stablecoins in Hong Kong, it will be an offence for any other person to offer, or advertise an offering

of, fiat-referenced stablecoins. Additional offences will include: providing false information to the HKMA and failing to produce documents required by the HKMA. The penalties for the various offences will be aligned with those under comparable legislation such as the AMLO and the SFO.

The HKMA will also be empowered to impose various civil and supervisory sanctions for breach of the regulatory requirements including suspension or revocation of licence, warnings, reprimands or a pecuniary penalty not exceeding the higher of HK$10 million or three times the amount of profit gained or loss avoided as a result of the contravention. An appeal tribunal mechanism will be set up to allow appeals against HKMA decisions.

Transitional arrangements under Hong Kong's Proposed Fiat-referenced Stablecoin Regulatory Regime

Under the transitional arrangements, existing fiat-referenced stablecoin issuers with a meaningful and substantial presence in Hong Kong before the implementation of the new licensing regime will be allowed to continue to operate for a 6-month non-contravention period on the condition that they apply to the HKMA for a fiat-referenced stablecoin issuer licence within the first 3 months. Those that do not submit a licence application in the first three months will have to close down their business in an orderly manner by the end of the fourth month.

What will be considered "meaningful and substantial operations in Hong Kong" will be evaluated by the HKMA with reference to factors such as whether the entity operating the fiat-referenced stablecoin issuance is incorporated in Hong Kong, whether it has a physical office in Hong Kong with staff exercising central management and control over the fiat-referenced stablecoin issuance and whether the fiat-referenced stablecoin(s) it issues have been circulated to independent users and not just to its own associated entities.

Implementation timeline

The FSTB and HKMA are currently drafting a bill to implement the regulatory regime for fiat-referenced stablecoins, which they plan to introduce to the Legislative Council this year. Additionally, the HKMA will issue licensing and supervisory guidelines in due course to aid the applicants' understanding of the relevant requirements.

HKMA Stablecoin Issuer Sandbox

When the FSTB and HKMA issued their consultation paper in December 2023, it was also announced that the HKMA would introduce a sandbox arrangement for stablecoin issuers. The sandbox arrangement allows participants to test the feasibility of their intended business models and communicate with the HKMA to understand

how to comply with future regulatory requirements. The HKMA can communicate supervisory expectations and guidance to parties planning to issue fiat-referenced stablecoins in Hong Kong and obtain feedback on the proposed regulatory regime. Participation in the sandbox is not a prerequisite for applying for a stablecoin issuer licence when the new regime takes effect.

To be eligible for the sandbox, applicants must be able to demonstrate that: they have a genuine interest in and a reasonable plan for issuing fiat-referenced stablecoins in Hong Kong, a concrete plan for participating in the sandbox, and have a reasonable prospect of complying with the proposed regulatory requirements. In determining an applicant's eligibility, the HKMA will take into account a range of factors such as the proposed use case, stabilisation mechanism, management of reserve assets and user protection. Applicants are expected to explain how their network, supply chain or major partners can drive long-term demand for the stablecoin they issue and must include specific plans on using the sandbox to demonstrate the robust processes to be put in place for the issuance, distribution and redemption of the stablecoin, in full compliance with the future regulatory requirements.

On 18 July 2024, the HKMA announced the first batch of 3 participants admitted to the sandbox – being (1) JINGDONG Coinlink Technology Hong Kong Limited; (2) RD InnoTech Limited; and (3) a coalition of Standard Chartered Bank (Hong Kong) Limited, Animoca Brands Limited, and Hong Kong Telecommunications (HKT) Limited. These participants are now able to test their proposed business models within a limited scope as specified by the HKMA. The primary use cases proposed by the first batch of sandbox participants include payments, supply chain management and applications in capital markets. They are designed to target pain points in the movement of funds across financial institutions, payment services companies and settlement systems in different time zones. The sandbox participants have also proposed applications of their stablecoins in other areas such as Web3, gaming and virtual asset trading.

Depending on the participants' plans, testing progress and sophistication of risk management, the HKMA may fine-tune the permitted operational parameters and testing scope for a sandbox participant as appropriate.

For further information on the requirements for participation in the HKMA sandbox for fiat-referenced stablecoin issuers, please see Details of the Sandbox Arrangements for Stablecoin Issuers as attached to the HKMA's press release of 12 March 2024[6] and the HKMA's press release of 18 July 2024.[7]

[6] *HKMA. March 2024. HKMA launches the stablecoin issuer sandbox arrangement*
[7] *HKMA. July 2024. HKMA announces stablecoin issuer sandbox participants*

Growing Hong Kong's Virtual Asset Market: HK Fintech Week 2024

Hong Kong Law – 665 – 1 November 2024

Dr. Eric Yip, Executive Director, Intermediaries at the SFC, outlined the current landscape and the future direction of the virtual assets market in Hong Kong in his opening speech, Charting a Regulatory Roadmap for Hong Kong's Virtual Asset Market, at Hong Kong FinTech Week 2024, held on 28-29 October 2024 at the AsiaWorld-Expo, Hong Kong. Noting the unprecedented year-on-year growth in Hong Kong virtual asset trade volumes, Dr. Yip stressed the need for a robust regulatory framework to protect investors and market participants while fostering innovation and further developing Hong Kong's virtual asset market. The SFC's key initiatives, as described by Dr. Yip, are also the subject of the SFC's publication "SFC sets out vision to foster a vibrant fintech ecosystem in Hong Kong" of 28 October 2024.

The Current Licensing Regime for Virtual Asset Trading Platforms (VATPs) in Hong Kong

There are currently three SFC-licensed VATPs in Hong Kong and 14 licence applicants undergoing the vetting process. The SFC's main focus now are the 11 so-called "deemed to be licensed" applicants. These are VATP licence applicants that operated in Hong Kong before the implementation of the VATP licensing regime in June 2023 that are "deemed to be licensed" under the regime's transitional provisions until their licence application is approved, rejected or withdrawn.

As highlighted by Dr. Yip, the SFC has changed its vetting approach for these "deemed to be licensed" applicants, replacing a document-based vetting process with risk-based on-site inspections, concentrating on specific areas such as safe keeping of client virtual assets, cybersecurity and the applicants' anti-money laundering (AML) and know-your-client (KYC) procedures. The SFC has now conducted on-site inspections for all 11 "deemed to be licensed" applicants and given them feedback.

For new applications, the SFC is adopting a three-pronged approach:

1. the VATP licence applicant agrees to rectify issues raised in the SFC's feedback following its on-site inspection;

2. the SFC grants a licence permitting the applicant to operate a restricted scope of business after rectification of the identified issues; and

3. completion of a review by a third party after which the restrictions on the scope of business will be lifted.

Establishment of Consultative Panel for Licensed VATPs

Dr. Yip's speech also noted the SFC's plan to set up an official consultative panel for licensed VATPs in early 2025. The panel will include senior management members from all SFC-licensed VATPs whose perspectives will be taken into account in the SFC's policy making. The consultative panel will contribute to a virtual asset white paper to be published by the SFC outlining a development roadmap for virtual asset products and services and potential improvements to compliance and risk management.

Hong Kong's Virtual Asset Market Development

Dr. Yip identified three key drivers behind the rapid development of Hong Kong's virtual asset market, namely:

- *Talent Pool*: A wealth of talent and expertise is driving the virtual asset market's growth.

- *Economic Potential*: The sector's high economic potential.

- *Younger Demographics*: Studies show that market participants involved in trading crypto assets are younger on average than those trading traditional stocks, highlighting the shift in investor demographics.

The SFC has also noted two emerging trends supporting the SFC's drive to regulate virtual asset-related activities: (i) virtual asset practitioners are facing increasing scrutiny from law enforcement agencies and regulators globally, prompting many market participants to reassess their previously unregulated operations; and (ii) the increasing participation of traditional finance (Tradfi) in the virtual asset market has introduced valuable compliance concepts such as anti-money laundering and conflict checks, client suitability assessment and measures to ensure the safe custody of assets.

Establishing a Robust Virtual Asset Regulatory Regime in Hong Kong

As noted by Dr. Yip, the SFC is working with the Hong Kong Government and other regulators in developing further regulation for the provision of virtual asset trading

services and virtual asset custody services and public consultations on new licensing regimes for these activities will be conducted in due course. To this end, the SFC has been working with Hong Kong's virtual asset community to understand their business models and operating procedures for ensuring efficient and AML-compliant on- and off-ramping.

More generally, the SFC and Hong Kong Government are seeking to put in place a comprehensive regulatory framework for virtual assets in Hong Kong to assure Hong Kong's status as an international crypto hub. Hong Kong's Chief Executive, John Lee, announced in his 2024 Policy Address delivered on 16 October 2024 a range of virtual asset-related initiatives including the promotion of real-world asset tokenisation and development of a digital money ecosystem and digital securities market. For further details of the Chief Executive's 2024 Policy Address, please see our October 2024 newsletter.

Tokenisation, Project Ensemble and Stablecoins

Hong Kong is seeing progress in the implementation of tokenisation-related initiatives. The SFC issued two circulars – the Circular on Tokenisation of SFC-authorised Investment Products and Circular on Intermediaries Engaging in Tokenised Securities-related Activities in November 2023, and is co-leading tokenisation initiatives for the asset management industry with the Hong Kong Monetary Authority (*HKMA*) through Project Ensemble. In August 2024, the HKMA launched the Project Ensemble Sandbox which allows participating financial institutions to trial interbank settlement of tokenised asset transactions using tokenised money.

Hong Kong is additionally planning to implement a new regulatory regime for fiat-referenced stablecoin issuers in Hong Kong. According to the Consultation Conclusions published jointly by the Financial Services and the Treasury Bureau (*FSTB*) and the HKMA on 17 July 2024, a stand-alone piece of Hong Kong legislation implementing a Hong Kong regulatory regime for fiat-referenced stablecoin issuers in Hong Kong will be introduced, and the bill to implement that regime will be presented to the Legislative Council this year. For further details of the proposed regulation of fiat-referenced stablecoin issuers, please see our October 2024 newsletter.

Commitment to Investor Protection

The SFC considers "education" to be a key focus area in its efforts to enhance investor protection. The SFC has invested in multiple initiatives to educate investors about virtual assets, which include expedited information dissemination, developing a proactive alert system, promoting via TV drama series, commercials and other media outlets to raise awareness of scams and unregulated platforms.

International Collaboration on Virtual Asset Regulation

In closing, Dr. Yip highlighted the importance of international collaboration when establishing a robust regulatory framework, noting the SFC's continued collaboration with other international regulators in monitoring trends and sharing best practices and experiences.

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HKEX Consults on Further Expansion of its Paperless Listing Regime

Hong Kong Law – 666 – 12 November 2024

In August 2024, the Hong Kong Exchanges and Clearing Limited (*HKEX*) issued a Consultation Paper on further expanding its paperless listing regime to improve operational efficiencies and reduce the use of paper. This follows the implementation of two earlier rounds of paperless listing reforms and other market modernisation and digitalisation initiatives including the introduction of FINI, proposals for the implementation of an uncertificated securities market (*USM*), and arrangements for Hong Kong's securities and derivatives markets to remain open during severe weather conditions.

Paperless and Digitalisation Initiatives in Hong Kong Listing in Recent Years

The HKEX's first paperless initiative was implemented in July 2021 to require:

- listing documents for new listings of equities, debt securities and collective investment schemes to be published only in electronic form;
- subscriptions for new listings to be made electronically, except in the case of mixed media offers; and
- listing applicants and listed issuers to publish certain documents electronically on their own and the HKEX websites instead of putting them on physical display.

The paperless listing regime was expanded in December 2023 with the introduction of requirements:

- to submit electronically many of the documents previously required to be submitted in paper form to the HKEX; and

- for listed issuers to disseminate their corporate communications to securities holders electronically if allowed under the laws of their jurisdiction of incorporation.

For details of the paperless regime's expansion in December 2023, please see our December 2023 newsletter.

In addition, the HKEX and the Securities and Future Commission (*SFC*) introduced a series of improvements to digitise and modernise the market structure, which include:

- *Fast Interface for New Issuance* (*FINI*): FINI was launched by the HKEX in November 2023 to streamline the initial public offering (*IPO*) settlement process and reduced the time between IPO pricing and the start of trading from five to two business days;
- *Uncertificated Securities Market*: Hong Kong's uncertificated securities market is scheduled for implementation at the end of 2025 and will allow investors to hold certain securities in their own names without the need for paper documents; and
- *Severe Weather Trading*: following the publication of the HKEX's Consultation Conclusions in June 2024, arrangements enabling Hong Kong's securities and derivatives markets to remain open for trading during severe weather conditions were implemented in September 2024.

Proposals for further expansion of HKEX's Paperless Listing Regime

1. Allowing Electronic Instructions from Securities Holders

Following the December 2023 expansion of the paperless listing regime, issuers are required to send corporate communications to their securities holders electronically provided this is allowed under the laws of their jurisdiction of incorporation. Actionable corporate communications (being corporate communications that seek instructions from securities holders on how they want to exercise their rights or make an election) must be sent to securities holders individually in electronic form. However, issuers are under no obligation to put mechanisms in place for securities holders to respond electronically to corporate communications which means that issuers can require securities holders to submit their instructions in paper form only.

The HKEX now proposes to require issuers to implement mechanisms to give securities holders the option of returning the following instructions to issuers electronically:

- instructions relating to a meeting of securities holders which require an indication as to attendance at the meeting and Proxy-related instructions (*Meeting Instructions*); and

- instructions sent in response to actionable corporate communications other than instructions responding to a provisional allotment letter issued in connection with a rights issue (*Non-meeting Instructions*).

Securities holders will then have the option to submit their response electronically or in hard copy forms. Issuers will not be restricted in their choice of mechanism for receiving electronic instructions. They could, for example, receive instructions by email or via a bespoke online platform.

To facilitate this proposal, the HKEX advises issuers:

- to check whether the laws and regulations of their jurisdiction of incorporation require them to amend their constitutional documents to comply with this proposal (e.g. where those laws and regulations require an issuer's constitutional documents to expressly allow the electronic receipt of security holders' instructions);

- of the need to put in place mechanisms to verify the authenticity of instructions received.

The HKEX is proposing that the requirements in relation to Meeting Instructions will apply to issuers of equity securities and public debt issuers. The requirements for Non-Meeting Instructions will apply to issuers of equity securities and issuers of structured products. The requirements will not apply to issuers of collective investment schemes or professional debt.

In line with these proposals, the HKEX would also revise the template proxy form attached to its general meeting guide to allow proxy appointments to be sent electronically. Additionally, the Form Filling Guide for the Meeting Notification e-Form would be modified to require issuers to give instructions on how securities holders can give instructions electronically.

The proposed implementation date for this proposal is the same as the implementation date for Hong Kong's uncertificated securities market, which is currently scheduled for the end of 2025. Issuers will then have a one-year transitional period to make any necessary changes to their constitutional documents.

2. Real-time Electronic Payment of Corporate Action Proceeds

HKEX's Listing Rules do not specify how issuers should distribute corporate action proceeds to their securities holders. The distribution of paper cheques by post is currently the predominant method. "Corporate action proceeds" include dividends and

other entitlements, refunds relating to applications for rights issues and open offers and payments relating to takeovers and privatisations. However, the current process often results in a delay in payment beyond the announced payment date due to the time required for cheque deposit and clearance at banks.

To improve efficiency and enable shareholders to access corporate action proceeds as close to the announced payment date as possible, the HKEX proposes that listed issuers provide an option for securities holders to receive corporate action proceeds electronically via Clearing House Automated Transfer System (*CHATS*) by the announced payment date. CHATS is a Hong Kong inter-bank payment system for settling transactions in local or foreign currencies. However, the HKEX will permit issuers to provide additional methods of payment, including by cheque, autopay and FPS as alternatives to provide greater flexibility for stakeholders.

The HKEX would require listed issuers to inform securities holders of the available payment options and seek their instructions on their choice. Issuers would need to obtain functional electronic payment information for securities holders electing to receive payment via CHATS. If a securities holder fails to indicate a choice of payment method or does not provide its functional electronic payment information, the issuer could adopt any payment method (including a non-electronic method) previously used to pay corporate action proceeds to the securities holder.

Issuers would be required to bear outward charges, e.g. bank charges, arising on payments made to securities holders through CHATS. Securities holders opting to receive corporate action proceeds via CHATS would be subject to any inward charges imposed by their banks and issuers would be required to inform them of the possibility of incurring these charges in the relevant announcement or corporate communication.

This proposal would apply to issuers of equity securities and collective investment schemes only. The proposed implementation date is the date the uncertificated securities market takes effect.

3. Electronic Payment of Subscription Monies

Since the launch of FINI, all IPO subscriptions and subscriptions for public offers by listed issuers of equity securities take place electronically via the FINI platform. The HKEX Listing Rules do not, however, stipulate how subscription monies must be paid to listed issuers for offers made to their existing securities holders. The HKEX is proposing to require listed issuers to offer the option to pay subscription monies electronically for offers made to their existing securities holders. These offers would include, open offers, rights issues, preferential offers and bonus issues of securities. The HKEX will not mandate that securities holders pay subscription monies electronically and they would still have the option to pay subscription monies either by paper cheque or cashier order.

The proposal also offers listed issuers the flexibility to elect their electronic payment method (such as autopay or FPS): they would not be required to use CHATS. Issuers would be required to disclose instructions on how to pay subscription monies and give details of their electronic payment details in the relevant announcement or corporate communication. The HKEX expects securities holders to continue to bear any charges incurred on their payment of subscription monies electronically, which is in line with the current practice.

The proposal will not apply to placings, including top-up placings, as the method of payment of subscription monies is generally determined among the placing agent, the placee(s) and the issuer.

The proposed requirements will apply only to issuers of equity securities and collective investment schemes, as alternative payment methods for debt securities and structured products are already in place.

4. Abolishing Mixed Media Offers ("MMOs")

Mixed media offers were introduced in 2011 to allow paper application forms to be made available with electronic versions of prospectuses for public offerings of shares and debentures listed on the HKEX.

Under the first phase of its paperless listing reforms implemented in July 2021, the HKEX introduced requirements for listing documents to published only in electronic form and for IPO subscriptions to be made electronically, except for those involving a mixed media offer. FINI was launched in November 2023 and requires all IPO subscriptions and subscriptions for public offers conducted by listed issuers of equity securities to be conducted via the FINI platform.

The HKEX is proposing to fully abolish MMOs, thereby removing the option to issue application forms in printed form for a public offer of equity securities, collective investment schemes and debt securities. Applications for public offers of equity securities and collective investment schemes would instead be required to be made by online subscription. Subscriptions for public offers of debt securities will continue to be conducted through channels such as placing banks and/or HKSCC.

The implementation date for this proposal will be specified in the HKEX's consultation conclusions. In any event, it will be no earlier than that date of repeal of the 2011 class exemption notice that allows mixed media offers.

5. Hybrid General Meetings and E-Voting for HKEX-listed Issuers

The HKEX Listing Rules do not currently specify the format of general meetings or the method of voting that must be used. HKEX proposes to require listed issuers to amend their constitutional documents to allow them to hold hybrid general meetings and provide E-voting, to the extent allowed under the laws or regulations of their jur-

isdiction of incorporation. To comply with the proposed requirements, listed issuers may need to revise their constitutional documents to:

- remove any provision that prevents the holding of hybrid general meetings and/or the use of E-voting; and/or
- include express provisions allowing the holding of hybrid general meetings and the use of E-voting.

However, the HKEX will not mandate the use of hybrid meetings and E-voting. Listed issuers will retain the flexibility to choose the methods of hosting general meetings and voting that best align with their operational needs and the interests of their shareholders. Where issuers opt to hold hybrid general meetings, they must comply with the requirements of the core shareholder protection standards set out in Appendix A1 to the Main Board and GEM Listing Rules and adopt measures to ensure that securities holders have the right to speak and vote at general meetings.[1] The HKEX suggests that this could be achieved by allowing securities holders to ask questions orally or electronically by typing them into a dedicated platform and to cast their votes electronically.

The proposal would only apply to issuers of equity securities. The HKEX will specify the proposed implementation date for this proposal and details of a short transitional period in the consultation conclusions.

6. Applicability of the Paperless Regime Proposals by Issuer Type

The following table summarises the applicability of the paperless regime proposals by Issuer Type:

	Electronic Instructions from Securities Holders	*Real-time Electronic Payment of Corporate Action Proceeds*	*Subscription Monies via Electronic Means*	*Abolishing MMOs*	*Hybrid General Meetings and E-Voting*
Issuer of equity securities	Yes	Yes	Yes	Yes	Yes
CIS	No	Yes	Yes	Yes	No
Issuer of structured products	Non-Meeting Instructions only	No	No	No	No
Public Debt Issuers	Meeting Instructions only	No	No		No
Professional Debt Issuers	No	No	No	No	No

[1] *Under paragraphs 14(3) and 19 of Appendix A1 to the Main Board and GEM Listing Rules*

HKEX Seeks Feedback on Web Accessibility of HKEX-listed Issuers' Corporate Communications

The HKEX received suggestions in response to an earlier consultation that the HKEX Listing Rules or the Corporate Governance Code should refer to web accessibility guidelines, such as the Web Content Accessibility Guidelines. These are an international standard for web content accessibility developed by the World Wide Web Consortium which aim to assist persons with disabilities in gaining better access to web content.

The HKEX is now seeking feedback on whether it should incorporate or refer to web accessibility guidelines in the HKEX Listing Rules (including in the Corporate Governance Code) or the HKEX's guidance so that corporate communications made available on listed issuers' websites in accordance with the HKEX Listing Rules will conform with those guidelines.

HKEX's Other Proposed Rule Amendments

The HKEX is also proposing various minor HKEX Listing Rule amendments that would not involve any change in the HKEX's policy.

Clarification of Conditions for Waivers from Annual Results/Reports Publication Requirements

Note 4 to Main Board Listing Rule 13.46(2) sets out the conditions for the HKEX to grant waivers from the requirements to publish and distribute annual results and reports. Currently, these conditions only apply to waivers granted to overseas issuers and PRC issuers, despite originally being intended to apply to all newly listed issuers.[2] The HKEX therefore proposes to clarify the Main Board Listing Rules by adding a new note to Main Board Listing Rule 13.46(1) to apply the same waiver conditions to other issuers.

Alignment of Requirements

The HKEX proposes the following amendments to the HKEX Listing Rules:

- *Removal of independent non-executive director's annual confirmation*

The requirement for independent non-executive directors to file annual confirmations of their independence with listed issuers was removed from Main Board Listing Rule 3.13 and GEM Listing Rule 5.09 in December 2023. The HKEX is now proposing to remove the requirement for listed issuers to confirm in their annual reports whether they have received annual confirmations of independence from

[2] *See proposal 7 in the Consultation Paper on Codification of General Waivers and Principles relating to IPOs and Listed Issuers and Minor Rule Amendments (August 2019) at:* https://www.hkex.com.hk/-/media/HKEX-Market/News/Market-Consultations/2016-Present/August-2019-Codification-of-General-Waivers/Consultation-Paper/cp201908.pdf

their independent non-executive directors under paragraph 12B of Appendix D2 of the Main Board Listing Rules and GEM Listing Rule 18.39B to align with Main Board Listing Rule 3.13 and GEM Listing Rule 5.09.

- *Documentary requirements for listing applications*

The HKEX is proposing to amend Main Board Listing Rule 9.22(2)(c) to align the documentary requirements for listing applications made by listed issuers (namely, the requirements for translations of prospectuses) with the documentary requirements for new listing applicants under Listing Rule 9.11(33)(c).

- *Alignment of Main Board and GEM Listing Rule Requirements*

  - As there is no comparable requirement under the Main Board Listing Rules, the HKEX is proposing to remove the requirement under GEM Rule 18.50C for listed issuers to submit a copy of their annual report to the HKEX for publication on the HKEX's website no later than three months after the end of their financial year. Both Main Board and GEM issuers are required to issue their annual reports no later than four months after the end of the financial year under Main Board Listing Rule 13.46 and GEM Listing Rule 18.03.

  - The HKEX proposes to require GEM listing applicants to provide the estimated market capital of the total equity of the GEM issuer in their listing application forms (Form A published in GEM Regulatory Forms). This proposed amendment will align the market capitalisation information requirement for Main Board and GEM Board listing applicants.

Amendments relating to Debt Securities

The HKEX is also proposing the following amendments to the Listing Rules relating to debt securities.

- *Publication window for prescribed announcements*

Main Board Listing Rule 2.07C(4) allows the issuers of debt securities to the public (Public Debt Issuers) to publish certain prescribed announcements during trading hours in certain circumstances. The HKEX proposes to amend Main Board Listing Rule 2.07C(4)(a) to allow issuers of debt securities to professional investors under Chapter 37 of the Main Board Listing Rules (Professional Debt Issuers) to publish during trading hours the same prescribed announcements in specific circumstances as currently provided for Public Debt Issuers.

- *Audited interim financial statements for eligibility assessment*

The HKEX is proposing to clarify that the requirement for listing applicants to have produced "audited accounts for two years" under Main Board Listing Rule 37.06 requires audited accounts for "two financial years" rather than two calendar years.

The HKEX notes that Main Board Listing Rule 37.06, which also requires that the two financial years' audited accounts are made up to a date no later than 15 months before the intended date of the listing document, may create a blackout period for certain applicants. The HKEX is therefore proposing an amendment so that applicants can be eligible to list under Chapter 37 of the Main Board Listing Rules if they can provide audited accounts for two financial years as well as audited interim financial statements covering at least the first six months of the financial year that ends not more than 15 months before the intended date of the listing document.

- *Professional Debt Issuers' continuing obligations*

    - The HKEX proposes to expand the coverage of the continuing obligation for Professional Debt Issuers under Main Board Listing Rule 37.49(b) (GEM Listing Rule 3042(b)) so that their obligation to notify the HKEX in advance of any proposal to amend the trust deed also applies to any proposal to amend any other document that secures or constitutes the debt securities.

    - It also proposes to revise the continuing obligation for Professional Debt Issuers under Main Board Listing Rule 37.53 to require the submission of interim financial statements to the HKEX rather than interim financial reports.

- *Public Debt Issuers' continuing obligations*

The HKEX is proposing to revise the continuing obligations of Public Debt Issuers under paragraphs 12(1) and 19(2) of Appendix E4 to the Main Board Listing Rules and GEM Listing Rules 31.15(1) and 31.19(2) to require them to notify the HKEX of any proposal to amend a trust deed or other document securing or constituting listed debt securities and to provide the HKEX with a draft of the proposed amendment.

- *Validity period of a debt programme*

The HKEX is proposing to amend Main Board Listing Rule 37.41 (GEM Listing Rule 30.34) to clarify that the validity period for a debt programme is one year after the date of the listing document rather than the date of publication.

- *Definition of supranationals*

The HKEX proposes to amend the definition of "supranationals" in the Main Board Listing Rules to include the list of multilateral agencies set out in Part 4 of Schedule 1 to the Securities and Future Ordinance.

- *Bilingual publication of financial statements*

Amendments are proposed to require all Public Debt Issuers, other than States and supranationals, to publish English and Chinese versions of their financial

statements as set out in paragraph 20(1) of Appendix E4 to the Main Board Listing Rules.

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Hong Kong SFC's Guidelines for Market Soundings to take effect on 2 May 2025

Hong Kong Law – 667 – 18 November 2024

The Securities and Futures Commission (*SFC*) has published the Guidelines for Market Soundings (*Hong Kong Market Sounding Guidelines*) which will take effect on 2 May 2025, six months after their gazettal on 1 November 2024. SFC-licensed and registered intermediaries that conduct market soundings need to ensure that they comply with the Hong Kong Market Sounding Guidelines' requirements by that date. The SFC has also published Frequently Asked Questions on Guidelines for Market Soundings containing practical guidance and examples. This follows the publication of the SFC's Consultation Conclusions on the Proposed Market Guidelines for Market Soundings on 31 October 2024. For a summary of the SFC's original consultation proposals set out in its October 2023 Consultation Paper,[1] please see Charltons' November 2023 Newsletter.

While respondents to the consultation generally supported the setting of standards for market soundings, many objected to their proposed scope, in particular their proposed application to the disclosure of any non-public information during the course of market sounding, subject to various carve-outs. The final version of the Hong Kong Market Sounding Guidelines has scaled back many of the SFC's original proposals, including restricting their scope to confidential information disclosed during the course of market soundings.

The following provides a summary of the key provisions of the Hong Kong Market Sounding Guidelines.

[1] *SFC. Consultation Paper on the Proposed Guidelines for Market Soundings. October 2023*

Hong Kong Market Sounding Guidelines: Scope of Application

The Hong Kong Market Sounding Guidelines will apply to SFC-licensed or registered persons who disclose or receive "Market Sounding Information" in the course of a "Market Sounding" conducted in connection with a possible transaction in:

1. shares that are listed on a stock exchange (whether in Hong Kong or elsewhere[2]); and

2. any other securities (as defined in Part 1 of Schedule 1 to the Securities and Futures Ordinance) which is likely to have a material effect on the price of shares that are listed on a stock exchange (whether in Hong Kong or elsewhere).

SFC-licensed or registered persons who disclose or receive Market Sounding Information in these circumstances are defined as "Disclosing Persons" and "Recipient Persons", which are referred to collectively as "Market Sounding Intermediaries".

"Market Sounding Information" is defined as confidential information that is entrusted to an SFC-licensed or registered person by its client, an issuer, or an existing shareholder selling or buying in the secondary market (a "Market Sounding Beneficiary"). Confidential information will be "entrusted" to an SFC-licensed or registered person where that person owes a duty of confidentiality to the provider of the information. The following are non-exhaustive examples of Market Sounding Information:

- the name of the relevant security or specific information that would enable its name to be deduced;

- the Market Sounding Beneficiary's identity;

- the Market Sounding Beneficiary's intention to undertake a possible transaction; and

- the terms or details of the possible transaction, for example its potential size, timing, pricing structure or trading method.

Market Sounding Information does not include routine conversations between SFC-licensed or registered persons and investors that are not connected with market soundings, such as:

- generic discussions about public information, market trends and sentiments, or other anecdotal or unverified information; and

- trade ideas put forward by a sell-side broker or reverse enquiries from a buy-side firm or investor without any indication (such as an acknowledgement, con-

[2] *See the response to Question 3 of the SFC's Frequently Asked Questions on Guidelines for Market Soundings ("Market Sounding FAQs") and paragraph 51 of the Consultation Conclusions on the Proposed Guidelines for Market Soundings*

sent, confirmation or mandate) from a Market Sounding Beneficiary that they want to engage potential investors for feedback on a possible transaction.[3]

"Market Sounding" is defined as the communication of information with potential investors, prior to the announcement (if any) of a transaction, to gauge their interest in a possible transaction and assist in determining the terms and specifications related to it, such as its potential timing, size, pricing, structure and trading method.

The Hong Kong Market Sounding Guidelines set out four Core Principles that both Disclosing Persons and Recipient Persons are required to observe and additional obligations that apply separately to Disclosing Persons and Recipient Persons.

Hong Kong Market Sounding Guidelines – The Core Principles

Core Principle 1 – Handling of Information

A Market Sounding Intermediary will be required to protect and safeguard the confidentiality of Market Sounding Information, and ensure that it has in place an effective system of barriers to prevent inappropriate disclosures, leakage and misuse of this information. To this end, Market Sound Intermediaries should implement and maintain, among other measures:

- appropriate standards of conduct for staff handling Market Sounding Information, which should reflect the requirements under General Principles 1 (Honesty and fairness), 2 (Diligence) and 6 (Conflicts of Interest) and paragraph 9.3 (Front-running) of the SFC's Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission and paragraph 1.3 (Functional Barriers) of the SFC's Fund Manager Code of Conduct;
- clear and robust information sharing principles and processes for their staff; and
- physical and functional segregation of incompatible duties (e.g. between staff on the public and private sides of a transaction) and associated system user access controls in compliance with the "need-to-know" principle.

Core Principle 2 – Governance

A Market Sounding Intermediary will be required to have in place robust governance and oversight arrangements to ensure that its management effectively supervises its market sounding activities. These should include, without limitation:

- senior management assuming overall responsibility for overseeing market soundings;

[3] *See the response to Question 4 of the SFCís Market Sounding FAQs*

- adopting governance arrangements for market soundings that are appropriate for the size and complexity of the Market Sounding Intermediary's business;
- designating a committee or person(s) to monitor its market soundings to support senior management's oversight. The committee or person(s) so designated should have defined roles, responsibilities and reporting lines and adequate knowledge of the Market Sounding Intermediary's policies and procedures on market sounding; and
- implementing processes, procedures and controls to ensure that matters related to market soundings are promptly escalated to senior management and the designated committee or person(s) for review and follow-up, where necessary.

Core Principle 3 – Policies and procedures

A Market Sounding Intermediary should establish, maintain and periodically review and update effective written policies and procedures specifying how market soundings are to be conducted. These will need to cover, among others:

- the timing and prescribed procedures for market soundings;
- the roles and responsibilities of staff engaged in market sounding and ensuring that they are properly trained;
- firm and staff dealing policies and procedures to prevent inappropriate disclosure, misuse or leakage of Market Sounding Information for benefit or financial advantage;
- circumstances and protocols for escalating market sounding-related matters to senior management or other independent functions, such as legal and compliance;
- sanctions or disciplinary measures for non-compliance with market sounding requirements;
- identifying and handling Market Sounding Information; and
- the record keeping requirements for market soundings.

Core Principle 4 – Review and monitoring controls

Market Sounding Intermediaries should have in place effective procedures and controls to monitor and detect suspicious behaviour, suspected misconduct, inappropriate or unauthorised disclosure, misuse or leakage of Market Sounding Information, and breach of their internal guidelines on market sounding. These should include, without limitation, periodic reviews of:

- firm and staff personal trading activities;
- voice and electronic communications; and

- unauthorised access to Market Sounding Information.

Hong Kong Market Sounding Guidelines – Specific Requirements for Disclosing Persons

Procedures before conducting market soundings

Before conducting market sounding, a Disclosing Person is required to obtain agreement or consent from the Market Sounding Beneficiary to conduct market soundings regarding their possible transaction and to determine:

- a standard set of information to be disclosed in each market sounding;
- appropriate timing for conducting market soundings (e.g. close to the launch of the possible transaction and outside the trading hours for the securities associated with the market sounding); and
- an appropriate number of Recipient Persons or other potential investors to contact, such that market soundings are restricted to as few investors as necessary to gauge their interest in the possible transaction.

Use of authorised communication channels

A Disclosing Person should:

- only use recorded communication channels (e.g. telephone, video or text) authorised by its senior management or independent functions (such as legal and compliance) to conduct market sounding;
- keep recorded market sounding conversations as part of its records; and
- only use other methods (e.g. written minutes) to record market sounding conversations if its telephone recording system or other recorded communications channels are not available.

Standardised scripts for Hong Kong market soundings

Disclosing Persons must use a standardised script approved by their senior management or independent functions during market soundings. The minimum content and required sequencing for standardised scripts are as follows:

- an opening statement that the purpose of the communication is market sounding and a confirmation that the individual is the person authorised by the Recipient Person to receive market soundings; and
- a request for consent from the Recipient Person or other potential investor to:
    - record the conversation if it is being recorded; and

   ◦ receive the Market Sounding Information, safeguard its confidentiality and prevent its inappropriate disclosure, misuse or leakage.

The SFC clarifies in the notes to the Standardised Script requirements that a Disclosing Person should not proceed with a market sounding if it has not received the required consents. Further, a Disclosing Person should only provide preliminary information to a Recipient Person or other investor before receiving the required consents (e.g. to enable them to decide if they want to consent) if the preliminary information is provided on a "no-name" basis and is sufficiently broad, limited, vague and anonymised to prevent the identification of the relevant security.

Following receipt of the required consents, Disclosing Persons are required to provide a written summary of the market sounding conversation to the Recipient Person or other potential investor.

Record keeping

A Disclosing Person is required to keep records of its market soundings for at least two years. These need to include:

- the Market Sounding Beneficiary's agreement or consent to the Disclosing Person's conduct of market soundings with respect to the possible transaction;
- a list of Recipient Persons or other potential investors who have rejected a market sounding request;
- audio, video or text records of market soundings conducted through recorded communication channels;
- written minutes of market soundings conducted through unrecorded communication channels; and
- a list of all internal and external persons (including legal and natural persons) who possess Market Sounding Information, including details of the date and time of market sounding, the name and contact details of persons sounded, information and materials disclosed and all relevant consents obtained.

Hong Kong Market Sounding Guidelines – Specific Requirements for Recipient Persons

Handling Requests for Market Sounding

A Recipient Person is required to:

- authorise an individual who has adequate knowledge of its internal policies on the receipt and handling of Market Sounding Information to receive market soundings;

- inform Disclosing Persons of the person authorised to receive market soundings on being contacted for the purpose of market sounding; and
- inform Disclosing Persons of whether or not it wants to receive market soundings in relation to all or only specified types of transactions.

If a Disclosing Person does not specify whether a communication is a market sounding, the Recipient Person is required to use reasonable efforts to verify whether it is in possession of Market Sounding Information.

Implementation Timeline

The Hong Kong Market Sounding Guidelines will take effect on 2 May 2025 which means that SFC-licensed and registered intermediaries that engage in market sounding need to comply with them by that date.

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Hong Kong Court Orders JPEX to Return 247,498 USDT to Customers

Hong Kong Law – 668 – 21 November 2024

The Hong Kong District Court has granted a default judgment[1] against the operators of unlicensed crypto exchange, JPEX, in the first civil action against the JPEX platform brought by two plaintiffs who could not withdraw 247,498 USDT (Tether) they had deposited with the platform. The case involves seven defendants, including the operators of the JPEX platform, JP-EX Crypto Asset Platform Pty Ltd and Hong Kong-incorporated Web3.0 Technical Support Limited (together, *JPEX*). In a judgment that is likely to be significant for other investors seeking to recover losses incurred on the JPEX platform, the Court ordered JPEX to deliver the USDT deposits to the plaintiffs or otherwise pay them equitable compensation.

The events involved in the case occurred between July and September 2023. In September, 2023, Hong Kong's Securities and Futures Commission (*SFC*) published two statements warning investors of suspicious activities on the part of JPEX and others. The statements also warned that JPEX was not, and had not applied to be, licensed to operate a virtual asset trading platform in Hong Kong and, contrary to its claims, it was not licensed by Dubai's Virtual Assets Regulatory Authority. As of April 2024, the Hong Kong police had reportedly arrested more than 70 people allegedly involved in the JPEX scandal allegedly involving more than 2,600 victims and losses of more than HK$1.6 billion.[2] For further information on the SFC's warnings regarding JPEX, please see our newsletter, Hong Kong Police Arrest Suspects in JPEX Scandal.

JPEX: The Facts

The plaintiffs in the case were registered users of the JPEX platform and had deposited 247,498 USDT into wallets they believed were assigned to their accounts registered on the JPEX platform. Despite having access to the accounts, the plaintiffs

[1] *Chan Wing Yan and Another v. JP-EX Crypto Asset Platform Pty Ltd and Others [2024] HKDC 1628*

[2] *South China Morning Post. "Hong Kong JPEX cryptocurrency scandal: 72 arrested, HK$228 million in assets frozen so far". April 2024*

were not provided with the private keys to the wallets. The plaintiffs submitted applications to JPEX to urgently withdraw their USDT on 15 and 27 September 2023, but JPEX failed to return their USDT. It transpired that JPEX had transferred the USDT deposited to the plaintiffs' wallets within five minutes of the deposits being made without seeking authorisation from the plaintiffs. The plaintiffs claimed that JPEX held the USDT in an express trust and had breached its duties as trustee by transferring the USDT without their consent. JPEX did not attend the hearing and did not file a defence.

JPEX: A Question of Trust

The primary question addressed by the judgment was whether JPEX held the USDT under an express trust for the plaintiffs. The judge referred to Re Gatecoin Ltd (in Liq) [2023] 2 HKLRD 1079 (*Re. Gatecoin Ltd*) as authority for the fact that cryptocurrency is "property" capable of forming the subject matter of a trust, and also cited Feng Bo v Dela Cruz Anabelle-Gamoso [2024] HKCFI 1819 (*Feng Bo*) which ruled that USDT specifically is property capable of forming the subject matter of a trust.

In Re. Gatecoin Ltd, the judge held that to create an express trust, "three certainties must be present" – certainty of subject matter, certainty of object and certainty of intention. On the basis of the pleaded facts in the JPEX case, the judge was satisfied that the three certainties were present. The principal factors taken into account were as follows:

Certainty of subject matter (i.e. the property subject to the trust)

- USDT is property capable of forming the subject matter of a trust;
- JPEX held itself out as operating a cryptocurrency exchange platform;
- As a cryptocurrency exchange, JPEX recorded and documented the balance of and transactions in cryptocurrencies in each account;
- The plaintiffs' USDT deposits were clearly segregated and held in their wallets before being transferred out; and
- Even if the USDT deposits had been transferred out and stored in JPEX's cold wallets, there can still be certainty of subject matter in the case of a trust of part of a fungible mass provided the beneficiary's proportionate share is not uncertain.

Certainty of object (i.e. the beneficiaries of the trust)

- There was certainty as to the trust's beneficiaries, and the extent of the plaintiffs' claim was clearly apparent from the balance in their accounts recorded on the JPEX platform.

Certainty of intention (i.e. the existence of a mutual intention to create a trust)

- In creating the exchange without allocating private keys to users of the platform, JPEX demonstrated that it intended to hold cryptocurrencies deposited by its users on trust;
- Representations made by JPEX on its website and the words used – "client funds", "customer funds", "user's property", "all users' assets", "customers' assets" and "your account's security and assets" – properly construed, acknowledged that the beneficial ownership of cryptocurrencies deposited in wallets belonged to users of the JPEX platform;
- JPEX held itself out as a cryptocurrency exchange providing a platform for users to trade cryptocurrencies, rather than a platform through which JPEX sold cryptocurrencies for profit; and
- In depositing 247,498 USDT into their wallets, the plaintiffs intended to entrust, and entrusted, the USDT to JPEX for the purpose of depositing, trading and investing in cryptocurrencies for profit.

JPEX: The Ruling

The Court found that JPEX held the 247,498 USDT on express trust for the plaintiffs. It referred to the New Zealand case of Ruscoe v Cryptopia Ltd (in Liquidation) [2020] NZCH 935, which likewise found that Cryptopia Ltd, a cryptocurrency trading exchange, held cryptocurrencies on express trust for the accountholders, and described the principal duties of the cryptocurrency trading exchange as trustee as being to "*hold each group of digital assets as trustee for the accountholders, to follow their instructions, and to let individual accountholders then increase or reduce their beneficial interest in the relevant trusts in accordance with the system Cryptopia had created for that purpose*".[3]

The Court was satisfied that JPEX had breached its duties as trustee in:

- transferring the plaintiffs' USDT without their authorisation; and
- failing to and/or refusing to return the USDT to the plaintiffs despite their request to withdraw them.

The Court granted default judgment against JPEX and ordered it to deliver up the 247,498 USDT to the plaintiffs, or if the USDT have become untraceable, to pay equitable compensation to the plaintiffs. It also granted an injunction to prevent JPEX from disposing of or dealing with the USDT deposits without the plaintiffs' consent.

[3] *Ruscoe v Cryptopia Ltd (in Liquidation) at paragraph 196*

HKEX Disciplinary Actions September to November 2024

Hong Kong Law – 669 – 3 December 2024

The Hong Kong Stock Exchange (*HKEX*) published the results of eight disciplinary actions against listed issuers and/or their directors between September and November 2024. The cases involved, among others, issuers granting loans or making investments without conducting proper due diligence, risk assessment and on-going monitoring, failure to avoid or properly manage directors' conflicts of interest, and directors' failure to exercise independent judgement in determining whether transactions were in the issuer's best interest. Three cases involved directors' failure to cooperate in HKEX investigations – an obligation which continues after a person ceases to be a director and after the issuer's delisting. The cases are summarised below.

1. HKEX Disciplinary Action against Sunshine 100 China Holdings Ltd and Eight Directors

HKEX issuers' obligations: notifiable and connected transactions and financial reporting

The case involved Sunshine 100 China Holdings Ltd (*Sunshine 100*) and the conduct of Mr. Yi Xiaodi (*Mr. Xiaodi*), its executive director and chairman, Mr. Fan Xiaochong (*Mr. Xiaochong*), its executive director and vice chairman, two non-executive directors, three independent non-executive directors and one former independent non-executive director (together, the *Relevant Directors*).

Between 2020 and 2021, Sunshine 100 granted three loans amounting to RMB1.05 billion in total to borrowers with financial difficulties who were themselves the creditors of the debts of other ultimate borrowers. Those debts were secured primarily by a property in Beijing. Despite their awareness of the significant credit risks presented by the loans, the Relevant Directors envisioned that if the borrowers and ultimate borrowers defaulted, the company would be able to acquire the Beijing property at a

substantial price discount as a distressed asset in a judicial auction (*Fire Sale Opportunity*).

Despite knowing that the poor financial creditworthiness of the borrowers and ultimate borrowers presented significant risks, the Relevant Directors failed to conduct adequate due diligence before making the loans, did not obtain legal advice, and lacked a strategy to recover the amount owed if the Fire Sale Opportunity was not successful.

In November 2022, Sunshine 100 made a further loan to one of the borrowers, which, when aggregated with the earlier loans, constituted a major transaction under Chapter 14 of the HKEX Listing Rules with a total outstanding amount of RMB1.11 billion. However, Sunshine 100 failed to comply with the announcement, circular and shareholders' approval requirements.

Mr. Xiaodi and Mr. Xiaochong were responsible for procuring due diligence and executing the transactions.

The borrowers failed to repay the loans, resulting in Sunshine 100 making Expected Credit Loss provisions that increased annually, reaching a total of RMB 619.9 million in 2023, more than half of the loans' principal amount. By April 2024, the Relevant Directors had not devised a strategy for recovering the outstanding loans or acquiring the Beijing property, despite two borrowers successfully obtaining judgments in PRC courts on accounts receivables arising from the ultimate borrowers' debts.

Sunshine 100 had additionally provided financial assistance on two other occasions in 2022. One transaction was a discloseable transaction under Chapter 14 of the HKEX Listing Rules, and the other was a major transaction under Chapter 14 and a connected transaction under Chapter 14A of the HKEX Listing Rules. The company failed to comply with the announcement, circular and shareholders' approval requirements.

Sunshine 100 also failed to publish certain interim and annual results and reports as required under Chapter 13 of the HKEX Listing Rules in 2022 and 2023 due to its failure to keep proper records of the loans.

Sunshine 100 conceded that there were deficiencies in its internal controls which contributed to the company's breaches of the requirements of Chapters 13, 14 and 14A of the HKEX Listing Rules described above.

Breaches of the HKEX Listing Rules

Sunshine 100 was found to have breached:

- HKEX Listing Rules 13.46(2)(a), 13.48, 13.49(1) and 13.49(6) in failing to publish its annual and interim results and despatch its annual and interim reports within the prescribed time limits; and
- HKEX Listing Rules 14.34, 14.38A, 14.40 and 14A.35 in failing to comply with the announcement, circular and/or shareholders' approval requirements applicable to the loans and its provision of financial assistance on two occasions in 2022.

The Relevant Directors were found to have breached:

- HKEX Listing Rule 3.08 in failing to exercise due skill, care and diligence in relation to the grant and enforcement of the loans; and
- HKEX Listing Rule 3.08 and their obligations as now set out in HKEX Listing Rule 3.09B(2) to use their best endeavours to procure the company's compliance with the HKEX Listing Rules.

Sanctions imposed by HKEX Listing Committee under Chapter 2A of the HKEX Listing Rules

The HKEX Listing Committee criticised Sunshine 100 and censured Mr. Xiaodi and Mr. Xiaochong. It also criticised the six other directors involved and directed them, as well as Mr. Xiaodi and Mr. Xiaochong, to attend directors' training.

The Statement of Disciplinary Action is available here.

2. HKEX Disciplinary Action against a Director of Tenfu (Cayman) Holdings Company Limited

HKEX listed issuer: director's conflict of duty

In December 2023, Tenfu (Cayman) Holdings Company Limited (*Tenfu*) authorised a non-executive director, Mr. Tseng Ming-Sung (*Mr. Tseng*), to purchase its shares on its behalf under the company's share repurchase scheme. At the same time, Mr. Tseng agreed with two substantial shareholders of Tenfu that he would also buy Tenfu shares on their behalf. Mr. Tseng then made a number of purchases of Tenfu shares on behalf of the company and the two substantial shareholders.

Mr. Tseng's dual roles involved a conflict of duty, but he failed to inform Tenfu that he was also trading its shares on behalf of the substantial shareholders or take any action to manage the conflict.

Breach of the HKEX Listing Rules

The HKEX Listing Committee found that Mr. Tseng had breached HKEX Listing Rule 3.08 in failing to take any action to avoid, manage or disclose to Tenfu the conflict of duty that arose on his agreeing to purchase the company's shares on behalf of the

two substantial shareholders at the same time as purchasing its shares on behalf of Tenfu. The fact that Mr. Tseng did not benefit personally from the transactions was irrelevant: he should have taken steps to avoid or properly manage the conflict.

Public statement involving criticism under HKEX Listing Rule 2A.10

The HKEX Listing Committee criticised Mr. Tseng and required him to undertake 15 hours of training.

The HKEX's Statement of Disciplinary Action is available here.

3. HKEX Disciplinary Action against a Former Director of Christine International Holdings Limited

Mr. Dun-Ching Hung (*Mr. Hung*), a former director of Christine International Holdings Limited (*Christine International*) had failed to undertake 15 hours of training as directed in a previous disciplinary action against Mr. Hung and other directors of the company. The HKEX Listing Committee found Mr. Hung's breach of its training direction to be intentional and egregious and determined that this demonstrated that he was not suitable to act as a director of the company.

Imposition of a director unsuitability statement with follow-on action under HKEX Listing Rule 2A.10A(2)(b)

The HKEX Listing Committee censured Mr. Hung and issued a director unsuitability statement directing that:

- it considered Mr. Hung to be unsuitable to act as a director or senior management member of Christine International or any of its subsidiaries; and
- Christine International's listing should be cancelled under HKEX Listing Rule 2A.10A(2)(b) if Mr. Hung continued as a director or senior management member of the company or its subsidiaries 14 days after the Listing Committee's statement of disciplinary action.

The HKEX's Statement of Disciplinary Action is available here.

4. HKEX Disciplinary Action against two Former Directors of Suchuang Gas Corporation Limited (Delisted)

The case involved Mr. Su A. Ping (*Mr. Su*), the former chairman and an executive director of Suchuang Gas Corporation Limited, and Mr. Du Shao Zhou (*Mr. Du*), a former executive director (together, the *Directors*). During an investigation into whether the Directors had fulfilled their duties and obligations under the HKEX List-

ing Rules, the HKEX Listing Division sent investigation and reminder letters to the Directors to which they failed to respond in time or at all.

Breach of the HKEX Listing Rules' obligation to cooperate in HKEX investigation

The HKEX Listing Committee found that the Directors had breached HKEX Listing Rule 3.09C in failing to cooperate in the investigation. It noted in particular that the Directors' obligation to provide information reasonably requested by the HKEX did not lapse after their resignation and after the issuer's delisting. The HKEX Listing Committee considered the Directors' failure to discharge their responsibilities under the HKEX Listing Rules to be a serious breach of the Listing Rules.

The HKEX Listing Committee censured the Directors and issued a statement directing that they were unsuitable to act as directors or senior management members of the company or its subsidiaries.

The HKEX's Statement of Disciplinary Action is available here.

5. HKEX Disciplinary Action against four Directors of China General Education Group Limited

The case involved Mr. Niu Sanping (*Mr. Niu S*) and his son, Mr. Niu Jian (*Mr. Niu J*), former executive directors of the company and the company's former chairman and CEO, respectively, and two other executive directors of the company, Mr. Niu X and Ms Zhang. The four individuals are referred to together as the *Relevant Directors*.

The disciplinary action related to problematic transactions conducted shortly before and after the company's listing in July 2021. Mr. Niu S and his son are the company's controlling shareholders. Shortly before the company listed and in order to shore up demand for its shares on listing, Mr. Niu S entered into a pre-IPO investment agreement on behalf of the company with a third party, Tai He International Group Limited (*Tai He*). Under the terms of the agreement, Tai He would subscribe for around HK$100 million of the company's shares in the IPO, and in return, the company would lend HK$25 million to Tai He and subscribe for HK$60 million of investment products designated by Tai He, although the company would not receive any return on those investments.

The pre-IPO investment agreement was allegedly rescinded three days before the company listed following the receipt of advice to do so. However, it was later discovered that the company had entered into two transactions on substantially the same terms as its obligations under the investment agreement: (i) a HK$25 million loan to a borrower designated by Tai He (*Loan A*) procured by Mr. Niu S and Mr. Niu J and approved by the Relevant Directors; and (ii) a HK$60 million investment in a fund introduced by Tai He (*Fund*). The company made a loss of HK5 million on Loan A. It received a repay-

ment of HK$54.45 of the amount invested in the Fund but received no return on its investment.

The company also lent HK$40 million interest free to a friend of Mr. Niu J (*Loan B*). No due diligence or risk assessment was conducted, apparently because Mr. Niu J was satisfied that the borrower could repay the loan. Loan B was made shortly before the company's listing and the amount was similar to the amount of the borrower's subscription in the company's IPO. The company denied that Loan B and the borrower's IPO subscription were related. Loan B was repaid in full.

An internal controls review revealed deficiencies in the company's internal controls: it lacked investment risk controls and a loan management mechanism. There were no internal control policies or procedures relating to the granting of loans and payments to third parties at the time of the transactions described above which prevented other board members detecting the problematic transactions.

Breaches of the directors' duties under HKEX Listing Rule 3.08

The Relevant Directors were found to have breached HKEX Listing Rule 3.08 in several ways:

- Mr. Niu S entered into the pre-IPO investment agreement without informing the rest of the board or obtaining professional advice. He and Mr. Niu J procured the company to grant Loan A. Mr. Niu X and Ms Zhang approved the grant of Loan A without questioning its rationale. The Relevant Directors failed to ensure the conduct of proper due diligence on the borrower and the recoverability of Loan A.

- The Relevant Directors failed to exercise due skill, care and diligence in approving the company's investment in the Fund. They could not demonstrate the commercial rationale for the company's investment in the Fund, especially since the pre-IPO investment agreement had been rescinded. They also failed to conduct proper due diligence on the Fund and the Fund manager and lacked even basic information as to its investment objective and assets. They did not consider any other investment products.

- Mr. Niu S and Mr. Niu J used the company's money to make Loan B to Mr. Niu J's friend. There was no commercial rationale for the grant of Loan B since it did not bear interest. Mr. Niu S and Mr. Niu J failed to: (i) act for proper purpose; (ii) be answerable to the company for the application of its assets; (iii) avoid actual and potential conflicts of duty; and (iv) exercise sufficient skill, care and diligence.

- The Relevant Directors did not ensure the company had an effective internal control system at the relevant time.

The HKEX Listing Committee censured Mr. Niu S and Mr. Niu J. It also censured two Mr. Niu X and Ms Zhang, and directed them to attend training.

The HKEX's Statement of Disciplinary Action is available here.

6. HKEX Disciplinary Action against three Former Directors of YNBY International Limited (Formerly Ban Loong Holdings Limited)

The HKEX Listing Committee censured and imposed a director unsuitability statement with respect to three former directors of the company for failing to cooperate with an HKEX Listing Division investigation into (among others) whether they had discharged their duties and obligations under the HKEX Listing Rules.

The HKEX Listing Committee noted that it considers failure to cooperate in an HKEX investigation to be a serious breach of the HKEX Listing Rules and that a director's obligation to cooperate does not lapse after a person ceases to be a director of an issuer.

The HKEX's Statement of Disciplinary Action is available here.

7. HKEX Disciplinary Action against three Former Directors of National Arts Group Holdings Limited (Delisted)

Three former directors of the company (*Directors*) approved the company's acquisitions of two target companies holding property units under construction in Malaysia. At the time of the acquisitions, the target companies had not paid the developers for the property units in full. Despite this, the company paid in full by issuing new shares valued at HK$108.8 million to the vendors. The vendors and/or their related parties agreed to be responsible for the target companies' outstanding payment obligations to the developer. A lock-up arrangement was put in place for the consideration shares allotted to one of the vendors, although the company later agreed to its partial release. The Directors failed to prevent the consideration shares being sold without the company's consent and both vendors sold the consideration shares shortly after the acquisitions. The company was wound up by the court without the property units having been delivered.

Breaches of directors' duties under GEM Listing Rule 5.01

The Directors were found to have breached their directors' duties under GEM Listing Rule 5.01 in failing to exercise reasonable skill, care and diligence to safeguard the company's interest in the acquisitions. In particular:

- the Directors should have been aware of the risks that the vendors might not honour their obligations to pay the outstanding amounts owed to the developers and that the developers might not complete construction. Before the second acquisition, the HKEX had warned the company of construction delays and difficulties in obtaining project updates experienced by another listed issuer on a similar project;
- the Directors failed in their duty to manage these risks despite having been told that another listed issuer had experienced problems on a very similar transaction;
- the Directors should have at least conducted due diligence on the vendors' and their related parties' financial capability to meet the outstanding payment obligations;
- the Directors should have taken steps to properly monitor the projects, including that the outstanding payments were made and that construction was progressing. They failed to ensure that the company received timely updates on these matters; and
- the Directors should have put arrangements in place to prevent the vendor in the first acquisition from selling the consideration shares.

The GEM Listing Committee criticised the Directors and made their future appointment as a director of any HKEX-listed company conditional upon their completion of directors' training.

The HKEX's Statement of Disciplinary Action is available here.

8. HKEX Disciplinary Action against China Zhengtong Auto Services Holdings Limited and Five Former Directors

In this case, the HKEX Listing Committee criticised the company and censured and imposed a director unsuitability statement with respect to Mr. Wang, the company's former chairman and executive director, and Mr. Shao, a former executive director of the company. It also censured three other former executive directors and made their future appointment as a director of any HKEX-listed company conditional upon their completion of directors' training.

A subsidiary of the company entered into an undertaking in 2016 to pay any shortfall if a company majority-owned by the son of the chairman failed to repay a loan and redeem two investments in a total amount of RMB1.8 billion. In 2020, the 2016 undertaking was replaced by three agreements. Each of the 2016 undertaking and the three 2020 agreements (together) were major and connected transactions of the company, although the company did not comply with the announcement, circular and independ-

ent shareholders' approval requirements under Chapters 14 and 14A of the HKEX Listing Rules.

In December 2021, the company was notified of PRC court judgments holding the subsidiary liable for amounts due under the loan and with respect to the two investments and announced the 2016 undertaking and 2020 agreements.

The company's chairman was an executive director and legal representative of the subsidiary when the 2016 undertaking and 2020 agreements were entered into. He approved both without declaring and avoiding his conflict of interest. Nor did he disclose to the other directors who approved the 2020 agreements the fact that they involved a company that was majority-controlled by his son. The company's other directors were unaware of the 2016 undertaking and 2020 agreements until the company was notified of the PRC court judgments in 2021.

Breaches of the HKEX Listing Rules

Listed issuer's breaches of notifiable and connected transaction requirements

The company was found to have breached the announcement, circular and independent shareholders' approval requirements under Chapters 14 and 14A of the HKEX Listing Rules in relation to the 2016 undertaking and the 2020 agreements.

Breaches by the company's former chairman

Mr. Wang, the company's former chairman, was found to have breached HKEX Listing Rule 3.08 and his obligations as now set out in HKEX Listing Rule 3.09 to comply with the HKEX Listing Rules and use best endeavours to ensure the company's compliance with the HKEX Listing Rules. The breaches on the part of Mr. Wang included:

- failure to declare and avoid his conflict of interest in the 2016 undertaking and 2020 agreements by disclosing that the company whose obligations were assumed was a connected person of the company and abstaining from approving them;

- in approving the subsidiary's entry into these transactions which were harmful to the company, Mr. Wang did not act in the interest of the company and for a proper purpose;

- failure to exercise his independent judgement in assessing whether the 2020 agreements were in the company's interest. In his submission to the company, he claimed that he had relied on the senior management's and relevant departments' approval of those agreements in deciding to approve them; and

- failure to procure the company's compliance with the HKEX Listing Rules. He did not raise the Listing Rules' implications of the 2016 undertaking and 2020 agreements with the board and failed to obtain compliance advice.

Mr. Wang additionally breached the HKEX Listing Rules by failing to cooperate in the HKEX's investigation.

Breaches by the three former executive directors who approved the 2020 agreements

The three former executive directors were found to have breached Listing Rule 3.08 by:

- failing to exercise their independent judgement in evaluating whether the three 2020 agreements were in the interest of the company. Even if the agreements were considered non-objectionable by other departments or staff of the company, the directors still had a duty to consider the potential risks for the company in entering into them. In approving the agreements, they failed to protect the company's interest;

- failing to inform the other board members of the 2020 agreements or discuss them with the board, in particular the independent non-executive directors; and

- failing to procure the company's compliance with the HKEX Listing Rules in relation to the 2020 agreements. They should not have placed unquestioning reliance on the company's compliance department and should instead have followed up with the department as to the company's Listing Rule compliance. The size of the transactions alone should have put the directors on notice that they likely triggered obligations under the HKEX Listing Rules, but they took no steps to determine whether this possibility had been considered.

Breach by Mr. Shao

- Mr. Shao was found to have committed a serious breach of the HKEX Listing Rules in failing to cooperate in the HKEX Listing Division's investigation.

- Directors must avoid conflicts of interest and must always put the issuer's interest before their own.

- Before approving transactions, directors must exercise independent judgement in determining whether the transaction is in the issuer's interest.

- Directors are responsible for ensuring the issuer's compliance with the HKEX Listing Rules. Excessive or unquestioning reliance on the issuer's staff can amount to failure on the part of directors to exercise due skill, care and diligence.

The HKEX's Statement of Disciplinary Action is available here.

Hong Kong Monetary Authority Launches Digital Bond Grant Scheme

Hong Kong Law – 670 – 6 December 2024

The Hong Kong Monetary Authority (*HKMA*) launched the Hong Kong Digital Bond Grant Scheme on 28 November 2024 to promote the development of Hong Kong's digital securities market. To incentivise issuers and financial institutions to issue digital bonds, the HKMA will offer grants of up to a maximum of HK$2.5 million to reimburse expenses incurred on eligible bond issues in Hong Kong. Details of the Hong Kong Digital Bond Grant Scheme, including the eligibility requirements, reimbursable expenses and application process, are set out in the HKMA's Guideline on the Digital Bond Grant Scheme. The scheme started accepting applications on 28 November 2024 and will continue for three years, unless extended. Applications can be made for digital bonds issued on or after 16 October 2024.

Grants Available for Hong Kong Digital Bond Issues

The Hong Kong Digital Bond Grant Scheme provides financial support for digital bond issues covering up to 50% of the issuer's eligible expenses. Digital bond issuers can apply for two levels of grant:

- up to HK$1.25 million (*Half Grant*) if they meet specified basic requirements (*Basic Requirements*); or
- up to HK$2.5 million (*Full Grant*) if they meet the Basic Requirements and specified additional requirements (*Additional Requirements*).

Whether a bond qualifies as a digital bond will be determined by the HKMA on a case-by-case basis. Generally speaking, however, the term "digital bond" means a bond that leverages distributed ledger technology (*DLT*) to digitally represent ownership, such as legal title and/or beneficial ownership.

An issuer and its associates can receive grants for a maximum of two digital bond issues under the scheme. The term “associates” includes: (i) a person or corporation over which the issuer has control; (ii) a person or corporation which has control over the issuer; and (iii) a person or corporation under the control of the same person or corporation as the issuer, excluding persons or corporations which are associated only because of common ownership by a central government, sovereign wealth fund or similar state-owned enterprises and operate independently as separate commercial entities in practice.

Eligibility Requirements for Hong Kong Digital Bond Issues

Basic Requirements

To qualify for a grant under the Hong Kong Digital Bond Grant Scheme, the digital bond must:

1. be issued in Hong Kong, i.e. at least half of the lead arranger(s) must be recognised arrangers; and
2. meet one of the following conditions:
    1. the team involved in the development and/or operations of the DLT platform and other aspects of the digital bond issue (*digital team*) must have a substantial Hong Kong presence; or
    2. be issued on a DLT platform operated by the Central Moneymarkets Unit (*CMU*).

“Recognised arrangers” are arrangers with substantial Hong Kong debt capital market operations. The Hong Kong Digital Bond Grant Scheme and the Green and Sustainable Finance Grant Scheme share the same list of recognised arrangers.

The “digital team” may include (without limitation) roles in project or business management, information technology, engineering, operations, legal and compliance, issuer services, securities services, etc. Whether a digital team has a substantial presence in Hong Kong will be determined on a case-by-case basis, taking into consideration factors such as the size and composition (including the seniority) of the Hong Kong team and other factors that demonstrate the DLT platform’s Hong Kong nexus.

Additional Requirements

To qualify for a Full Grant, the digital bond must additionally:

1. be issued on a DLT platform provided by an entity that is not an associate of the bond issuer;

2. have a minimum issue size of HK$1 billion or its equivalent (including all tranches);

3. be issued initially to a minimum of five investors that are not associates of the issuer or the DLT platform provider(s); and

4. be listed on the Stock Exchange of Hong Kong Limited (the *HKEX*) or one or more virtual asset trading platforms licensed by the Hong Kong Securities and Futures Commission (the *SFC*).

Eligible Expenses under the Hong Kong Digital Bond Grant Scheme

The following expenses incurred by the issuer of an eligible digital bond issue qualify for reimbursement:

1. fees paid to DLT platform providers that are not associates of the issuer;

2. fees paid to Hong Kong-based arrangers that are not associates of the issuer;

3. fees paid to Hong Kong-based legal advisers;

4. fees paid to Hong Kong-based auditors, accountants and rating agencies;

5. listing fees paid to the HKEX or virtual asset trading platforms licensed by the SFC; and

6. CMU lodging and clearing fees.

Expenses are not reimbursable under the scheme if they are covered under other grant schemes either in or outside Hong Kong. If a digital bond is also a green, social, sustainability, sustainability-linked or transition bond, subject to meeting the eligibility requirements under the applicable grant schemes:

1. the eligible general bond issue costs can be covered by either the Hong Kong Digital Bond Grant Scheme or Track 1 of the Green and Sustainable Finance Grant Scheme, up to HK$2.5 million, but not both; and

2. the external sustainability review costs can be covered by Track 2 of the Green and Sustainable Finance Grant Scheme, up to HK$800,000 for all pre-issue and post-issue external reviews combined.

How to Apply for the Hong Kong Digital Bond Grant Scheme

Optional Pre-Application Consultation

Before submitting a formal application, the issuer, lead arranger(s) and/or the DLT platform provider(s) can initiate a pre-application consultation with the HKMA via

dbgs@hkma.gov.hk either before or after the digital bond issue. If satisfied that the eligibility criteria are met, based on the preliminary information provided, the HKMA will issue a no-objection.

Formal Application

A formal application can be made by the issuer, lead arranger(s) and/or the DLT platform provider(s) within three months after the issue of the digital bond. The application form for the Hong Kong Digital Bond Grant Scheme can be obtained from the HKMA via dbgs@hkma.gov.hk.

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Summary of HKEX Corporate Governance Consultation Conclusions Effective 1 July 2025

Hong Kong Law - 671 - 20 December 2024

On 19 December 2024, The Stock Exchange of Hong Kong Limited (the HKEX) published the Consultation Conclusions on the Review of the Corporate Governance Code and related Listing Rules (the HKEX Corporate Governance Consultation Conclusions). For a summary of the Consultation Paper, please see Charltons' July 2024 newsletter.

From 1 July 2025, the proposed amendments will come into effect except for certain rules in relation to independent non-executive directors (INEDs). Rules concerning "overboarding" INEDs will be effective by the first annual general meeting held on or after 1 July 2028 except for new listing applicants, while a two-phased implementation over a six-year transition period will apply to the nine-year cap on tenures of INEDs. The HKEX will publish updated guidance on the HKEX's Corporate Governance Practice Portal in the first half of 2025 to assist listed companies in complying with the new requirements.

Key Amendments to HKEX corporate governance requirements

Set out below is a summary of the key amendments to the HKEX Corporate Governance Code and the Listing Rules, a more detailed newsletter outlining the details of the changes and the HKEX Corporate Governance Consultation Conclusions will be published on the Charltons' website shortly.

Improving Board Effectiveness for HKEX listed companies

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<tr><td>Designation of Lead INED</td><td>

- The new Recommended Best Practice C.1.8 will be introduced to encourage listed companies with a chairman who is not an INED to appoint a Lead INED who will serve as an intermediary for other directors and shareholders and act as an alternative communication channel when normal communication channels are inadequate.
- The HKEX clarified in the HKEX Corporate Governance Consultation Conclusions that the appointment of a Lead INED is not necessary when the board chairman is an INED.
- The HKEX also clarified that the designation of a Lead INED does not require an announcement to be made under HKEX Main Board Rule 13.51(2), however, listed companies should publish an updated list of directors and their roles and functions when there are changes in the designation of Lead INED.
- The amended Mandatory Disclosure Requirement B(a) will require listed companies to disclose the Lead INEDs of the company (if any) in the corporate governance report.
- The new Mandatory Disclosure Requirement L(d) and Code Provision F.1.1 will require disclosures of the board's engagement with shareholders in the corporate governance report. The enhanced disclosure requirements include:
  1. the nature and number or frequency of such engagements;
  2. the group(s) of shareholders involved;
  3. the representatives of the listed company involved; and
  4. the listed company's approach to following up on the outcomes of these engagements.

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<tr><td>Mandatory director training</td><td>

- The new HKEX Listing Rule provisions[1] will require all directors to receive mandatory continuous professional development that covers the topics specified under HKEX Main Board Rule 3.09G or GEM Rule 5.02G, which includes:
  1. the roles, functions and responsibilities of the board, its committees and its directors, and board effectiveness;
  2. the listed company's obligations and directors' duties under Hong Kong law and the HKEX Listing Rules, and key legal and regulatory developments (including HKEX Listing Rule updates) relevant to the discharge of these obligations and duties;
  3. corporate governance and environmental, social, and governance matters (including developments on sustainability or climate-related risks and opportunities relevant to the listed company and its business);
  4. risk management and internal controls; and
  5. updates on industry-specific developments, business trends and strategies relevant to the listed company.
- Principle C.1 and the Code Provisions under this section will also be amended to emphasise the requirements of continuous professional development.
- "First-time directors", meaning directors who have not been appointed as a director of a company listed on the HKEX or directors who have not served as a director of a company listed on the HKEX for the three preceding years, must complete at least 24 hours of training within the first 18 months of appointment on the specified topics listed above.[2]
- For "First-time directors" who have been appointed as a director of companies listed on the exchanges of other jurisdictions within the three preceding years, only 12 hours of training within the first 18 months of appointment will be required.
- The HKEX has also amended the original proposals to state that if a "First-time director" resigned before completing the minimum training hours, and is subsequently re-appointed as a director within three years, the number of training hours completed will still be counted towards fulfilling the minimum training requirements.

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[1] HKEX Main Board Rules 3.09F and 3.09G; GEM Rules 5.02F and 5.02G
[2] HKEX Main Board Rules 3.09H; GEM Rules 5.02H

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<tr><td>Board performance review</td><td>
• The new Code Provision B.1.4 will require listed companies to conduct a board performance review at least every two years to assess whether the performance of the board and the board's skills as a whole aligns with the business and strategic goals of the listed company.
• In the corporate governance report, listed companies must make the following disclosures:
1. whether the review was conducted internally or by external services providers;
2. the scope of the review and responsible persons involved in conducting the review;
3. if an external review is conducted, the relationship between the external provider and the listed company and/or its directors (if any);
4. the findings and results of the review, significant areas of improvement identified and the measures to be taken in response to the results of the review.
• The HKEX clarified in the HKEX Corporate Governance Consultation Conclusions that the review should be conducted on the board as a whole rather than on each director individually.
• The original Code Provision B.1.5 on conducting a regular evaluation of the board's performance will be removed.
• The HKEX will issue further guidance on the expected scope of the review and level of detail required in relevant disclosures.
• The amended Code Provision B.3.1 will also impose the duty to support the listed company's regular evaluation of the performance of the board on the nomination committee.
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<tr><td>Disclosure of board skills matrix</td><td>
• The new Code Provision B.1.5 will require listed companies to maintain and disclose a board skills matrix in its corporate governance report which should include:
1. details of the mix of skills the board currently possess;
2. explanations on how the said mix of skills, experience and diversity of the directors serves the purpose, values, long-term strategy, goals and desired culture of the listed company; and
3. the types of skills the board is looking to acquire, the plans to acquire these skills and the progress of achieving this type of plans made in the previous year.
• The HKEX will issue further guidance on the suggested format of the skills matrix and level of detail required in relevant disclosures.
• The amended Code Provision B.3.1 will also impose the duty to assist the board in maintaining a board skills matrix on the nomination committee.
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<tr><td>New cap on concurrent directorships for INEDs</td><td>
• The new HKEX Main Board Rule 3.12A and GEM Rule 5.07A will be added to impose a hard cap of six concurrent Hong Kong-listed company directorships on INEDs. Directorship positions will include both executive and non-executive director positions.
• For existing listed companies, a three-year transition period will be allowed and this rule will come into effect from the first AGM held on or after 1 July 2028. The current requirements under Code Provision B.3.4(b) for INEDs who will be holding their seventh or more listed company directorship will apply during the transition period up to 30 June 2028.
• On the other hand, new listing applicants submitting their listing applications on or after 1 July 2025 must ensure that their INEDs comply with the cap on concurrent directorships.
• Listed companies should note that the cap on concurrent directorships for INEDs does not apply to secondary listed overseas listed companies.[3]
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[3] HKEX Main Board Rule 19C.11

Disclosure requirements on assessment of the time commitment of directors	• The amended Mandatory Disclosure Requirement E(d)(iii) will include additional disclosure requirements in relation to the nomination committee's annual assessment of the time commitment and board contribution of each director. The assessment should consider circumstances such as the the nature of the director's involvement on the board, the professional qualifications and work experiences of the directors as well as other directorships and significant external time commitments. • "Significant external time commitments" under this requirement broadly includes directorships on companies listed on other exchanges, full-time occupations, major consultancy work, major public service commitments, as well as directorships of and involvement in statutory bodies or non-profit organisations. • The HKEX will issue further guidance on the assessment criteria and the level of detail required in relevant disclosures.

HKEX listed company INEDs' Independence

Nine-year cap on INEDs' Tenure	• The new HKEX Main Board Rule 3.13A and GEM Rule 5.09A will impose a hard cap of nine years on the tenure of INEDs. INEDs serving for more than nine years (Long-Serving INEDs) will not be considered as independent and can only continue to serve the listed company in the capacity of a non-executive director or executive director. • The HKEX Corporate Governance Consultation Conclusions also provides a lengthened cooling-off period, where Long-Serving INEDs can be re-appointed as INEDs by the same listed company only if the relevant Long-Serving INED has not been a director of the listed company, its holding company, any of their respective subsidiaries or core connected persons for three years and satisfies the independence guidelines under the Listing Rules. • The nine years will commence from the date of the appointment of the INED or the date of listing if the INED is appointed before the company is listed on the HKEX . If the INED ceases to serve as an INED for the relevant company for less than three years and is then re-appointed by the same listed company to serve as an INED, this period will also be counted towards the nine-year tenure. • This requirement will be implemented in two phases over a period of six years: 1. *Phase one* – listed companies must ensure that Long-Serving INEDs do not represent the majority of INEDs on the board by the first annual general meeting held on or after 1 July 2028; and 2. *Phase two* – nine-year cap on INEDs' tenure will be effective on all INEDs by the first annual general meeting held on or after 1 July 2031. • During the transition period, the current requirements on tenure disclosure and appointment of new INEDs when all of the INEDS are Long-Serving INEDs,[4] and current requirements on the re-election of Long-Serving INEDs will continue to apply.[5] • Listed companies should note that the cap on the tenure of INEDs does not apply to secondary listed overseas listed companies.[6]
Disclosure on the length of tenure of each director	• The amended Mandatory Disclosure Requirement B(a) will require listed companies to disclose the length of tenure and current period of appointment of all directors in the listed company's corporate governance report.

[4] Code Provision B.2.4
[5] Code Provision B.2.3
[6] HKEX Main Board Rule 19C.11

HKEX Board Diversity Proposals

At least one director of a different gender the nomination committee	• The new Code Provision B.3.5 will require listed companies to appoint at least one director of a different gender to serve on the nomination committee.
Workforce diversity policy	• The amended HKEX Main Board Rule 13.92(1), GEM Rule 17.104(1) and Mandatory Disclosure Requirement J(b) will impose a new requirement on all listed companies to maintain and disclose a workforce diversity policy in addition to a board diversity policy. • The full workforce diversity policy or a summary of it must be included in the listed company's corporate governance report. The disclosures should include at least: 1. the plans or measurable objectives, for example, numerical targets and timelines for achieving gender diversity (note that setting measurable objectives is not compulsory); 2. the progress on achieving these objectives; and 3. any mitigating factors which make achieving gender diversity in the workforce less relevant or more challenging (where applicable).
Annual review of board diversity policy	• The amended Mandatory Disclosure Requirement J(a) will require listed companies to review its board diversity policy annually and disclose the results of the review in the corporate governance report. The disclosure should also contain the progress towards achieving the board diversity objectives and how the listed company has arrived at the disclosed conclusion. • The HKEX also clarified in the HKEX Corporate Governance Consultation Conclusions that annual reviews will still be required even if the listed company has already achieved its current board diversity objectives.
Gender ratio disclosure	• The amended Mandatory Disclosure Requirement J(c) will require separate disclosures on the gender ratio of the workforce excluding senior management in addition to the gender ratio of senior management only.
Arrangements during temporary deviations	• The amended HKEX Main Board Rule 13.92(2) and GEM Rule 17.104(2) will codify the arrangements during temporary deviations from the requirement on listed companies to have directors of different genders on the board. • As all listed companies must have at least one director of a different gender on the board after 31 December 2024, listed companies that fail to comply with this rule must immediately publish an announcement explaining the details and reasons for this breach and must use all reasonably endeavours to re-comply with this requirement as soon as possible and in any case within three months of the breach.

HKEX Listed Company Risk Management and Internal Control

Proposed emphasis on the board's responsibility for risk management and internal control systems and mandatory annual review of these systems	• The requirement to conduct annual reviews on the effectiveness of the risk management and internal control systems of the listed company will be upgraded to a Mandatory Disclosure Requirement7 in addition to being a Code Provision8. • Under the amended Mandatory Disclosure Requirement H, listed companies must disclose: 1. a board statement acknowledging its responsibility for the listed company's risk management and internal control systems and confirming that the risk management and internal control systems are appropriate and effective; 2. the features of the risk management and internal control systems in place (such as the process used to identify, evaluate and manage significant risks, the procedures for ensuring timely and accurate disclosures); 3. significant changes in the assessment of risks and the risk management and internal control systems; 4. whether the listed company has an internal audit function; 5. the responsibilities of internal departments and external providers in the review; 6. the process through which the review of the risk management and internal control systems was conducted and the frequency; 7. confirmations from management, the relevant board committee(s), other internal departments, the company's independent auditors and other external providers to support the board's conclusion that the risk management and internal control systems are appropriate and effective; 8. the scope of the review; and 9. results of the review and details of any significant control failings or weaknesses identified during the review and/or previously reported but unresolved, and any remedial steps taken or proposed. • The amended Code Provision D.2.1 will also clarify that the review should cover all material controls of the listed companies and their subsidiaries. In addition to existing requirements on the scope of the review, under the new requirements, listed companies should also conduct reviews on the adequacy of various types of resources for designing, implementing and monitoring the risk management and internal control systems. • The HKEX will issue further guidance on the level of detail required in relevant disclosures and the scope of the reviews. • The amended Principle D.2 and the Code Provisions under this section will also be amended to emphasise the responsibility of the board to maintain and establish effective risk management and internal control systems on an ongoing basis.

HKEX Listed Company Dividend Proposals

Disclosure of dividend policy and board dividend decisions	• The new Mandatory Disclosure Requirement M will require listed companies with a dividend policy to disclose this policy or a summary of it in their corporate governance report. The disclosure shall include the aim or objective of the policy as well as the key considerations of the board when deciding on whether to recommend payment of dividends. The corporate governance report should also include either a confirmation that all dividend decisions made during the reporting period conform with the dividend policy or otherwise an explanation on any deviations from the dividend policy. • If the listed company does not have a dividend policy, the listed company must clearly state this in its corporate governance report and explain the reasons for not having a dividend policy. • In any case, all listed companies must disclose material variations in the dividend rate declared compared to that of the previous relevant period if the board has declared a dividend during the reporting period. Where the board has not declared any dividends, the corporate governance reports must contain reasons on the board's decision and any alternative measures to enhance investor's return.

Other HKEX Listing Rule Changes

New requirement to set a record date	• The amended HKEX Main Board Rule 13.66(1) and GEM Rule 17.78(1) will codify the existing guidance concerning requirements on setting a record date to determine the eligibility of shareholders to attend general meetings and receive corporate entitlements. • Consequential amendments will also be made to require the announcement of the record date as well as any alterations to the announced record date when there is no book closure.
Disclosure requirements in relation to modified auditors' opinions	• Paragraph 3.1 of Appendix D2 to the HKEX Main Board Rules and Note to GEM Rule 18.47 will also be amended to codify the disclosure requirements regarding modified auditor's opinion. Under this provision, listed companies must disclose: • details of the modifications and their actual or potential impact on the listed company's financial position; • the management's position and basis concerning major judgmental areas and how the management's view differs from that of the auditors; • the audit committee's view towards the modifications, and whether the audit committee has reviewed and is in agreement with management's position concerning major judgmental areas; and • the proposed plans to address the modifications.
Provision of monthly financial information to the board	• The amended Code Provision D.1.2 will allow directors to request for monthly updates on the listed company's financial and operating performance, provision and prospects if the management of the listed company fails to provide them to the directors. • This Code Provision will also clarify that the monthly updates should include monthly management accounts and management updates if they are available.
Alignment of nomination committee requirements with audit and remuneration committee requirements	• HKEX Main Board Rules 3.23 and 3.27 and GEM Listing Rules 5.33 and 5.36 will be amended to clarify that when a listed company is unable to set up an audit or remuneration committee or unable to provide their terms of reference, the listed company must issue an announcement with details and reasons for the breach and ensure re-compliance with the rule within three months from the breach. • New HKEX Main Board Rules 3.27B and 3.27C and GEM Listing Rules 5.36B and 5.36C (for all listed companies except those with a weighted voting rights structure), and new HKEX Main Board Rule 8A.28A (for listed companies with a weighted voting rights structure) will be added to align the requirements on the setting up committees, the requirements on the terms of reference and the arrangements in the case of temporary deviation from the rules that will be applicable to nomination committees with those in relation to audit and remuneration committees.

Other than the above key amendments, the HKEX Corporate Governance Consultation Conclusions also includes other consequential and relevant amendments to the Corporate Governance Code and the HKEX Listing Rules.

Disclaimer
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