



Hong Kong

June 2017

SFC ELABORATES ON THE LIABILITIES OF DIRECTORS AND SENIOR EXECUTIVES

In the May 2017 issue of its newsletter, Enforcement Reporter¹, the Securities and Futures Commission (SFC) discussed director and senior executive liabilities and senior management accountability in listed companies, particularly in relation to corporate fraud and misfeasance. The regulator also listed some of its enforcement powers that could be used to pursue directors and senior executives who are responsible for misconduct, and reminded readers of a recent guidance in relation to valuations in corporate transactions.

Liabilities of Directors and Senior Executives of Listed Companies

The SFC identified corporate fraud and misfeasance as the greatest risk to Hong Kong's markets and investors. To protect the reputation of Hong Kong's financial markets, the regulator has been conducting investigations into such cases, including (i) outright fraud by directors and senior executives, (ii) company controllers putting their own interests before those of the company, (iii) directors or senior executives deferring to company controllers by relinquishing responsibilities or accepting compromised roles, (iv) non-executive directors failing to act as a check and balance on executive directors and (v) boards and senior executives who lack proper controls to ensure the board's awareness of inside information and the proper disclosure thereof.

Directors and senior executives of listed companies are reminded to pay attention to minority shareholder interests in addition to ensuring that the company is profitable. They

¹ http://www.sfc.hk/web/EN/files/ER/Reports/Enforcement%20Reporter/Enforcement%20Reporter_ENG_24%20May%202017_final.pdf

should also ensure the implementation of proper internal controls and build a culture of good corporate governance. Company directors and officers have duties to:

- act in good faith and in the best interests of the company and its shareholders as a whole;
- exercise due and reasonable care, skill and diligence;
- exercise independent judgement;
- exercise their powers for proper purposes;
- avoid actual or potential conflicts of interest; and
- refrain from making undisclosed profits.

The following are some of the steps that the newsletter recommended for directors and senior management of listed companies to safeguard against corporate misconduct:

- establish effective whistleblowing policies;
- ensure the integrity of the company's financial statements and assets;
- review the effectiveness of internal control systems regularly;
- take the lead to discuss matters of governance regularly;

- get regular updates on management accounts and corporate performance;
- attend board meetings regularly;
- abstain from discussions and involvement in situations where a conflict of interests exists; and
- encourage good practices that go beyond the requirements according to the letter of the law.

Although they do not take part in the daily management of companies, independent non-executive directors in listed companies should voice their opinions to all shareholders when they disagree with the board or believe that shareholder interests are not being served. If an independent non-executive director resigns, substantive reasons for the resignation should be provided.

Senior Management Accountability

The SFC has established specialised teams to investigate cases of fraud, misleading financial statements and serious conflicts of interests taken strong action against infringers.

Under Section 213 of the Securities and Futures Ordinance (SFO), the SFC may seek injunctive and other orders for restitution or damages against anyone, including a director or senior officer, who has contravened, or aided, abetted, induced or been involved in a contravention of, any provision of the SFO. The SFC may take action and obtain court orders for breaches by current and former directors and executives of listed companies which resulted in losses to listed companies under Section 214 of the SFO.

Sections 258 and 307N of the SFO provide for civil action against officers who failed to take reasonable measures to establish proper safeguards to prevent market misconduct, even if the officer did not personally engage in the misconduct. This liability is not limited to civil action, but to criminal action as well. Under Section 390 of the SFO, officers who committed offences such as disclosing false or misleading information likely to induce others to deal in securities or using deceptive or fraudulent conduct, devices or schemes with the intention to defraud are liable to a maximum of 10 years' imprisonment and a fine of up to \$10 million.

Recent Cases of Enforcement

The SFC has exercised its powers under the SFO to take action cases of fraud and misleading financial statements, conflicts of interest, and late disclosure of inside information. For example, they commenced proceedings last December against Greencool Technology Holdings Limited for inflating its net assets by 80% (RMB 904 million) in its annual reports. The SFC pursued the company executives responsible for the fraud as well as the group financial controller (who was also the company secretary and "qualified accountant") whose negligence allowed the fraud to occur.

Another example occurred this January, when the SFC commenced proceedings against five directors of Hanergy Thin Film Power Group Limited. They alleged that the directors failed to act in the company's best interests by not questioning the company's business model of relying heavily on sales to its parent company and affiliates. It was also alleged that the directors did not assess the recoverability of receivables owed to the company by its connected parties. The SFC is seeking a court order to require the controlling shareholder to guarantee the settlement of the outstanding receivables.

The SFC took action against the directors and senior executives of Yorkey Optical International (Cayman) Limited, AcrossAsia Limited and Mayer Holdings Limited for late disclosure of inside information. The SFC's Market Misconduct Tribunal imposed sanctions and fines of up to \$1 million against the individual directors and senior executives of those companies. These actions are the first cases the SFC has pursued for breach of corporate disclosure obligations under Part XIVA of the SFO.

Valuations in Corporate Transactions

Lastly, the Enforcement Reporter mentioned the issuance of a new guidance on the duties of directors and senior executives in relation to valuations in corporate transactions². In particular, they have the duty to determine whether the terms of a corporate transaction are fair and reasonable. The SFC has indicated that valuers cannot be used as a substitute to shoulder this responsibility. It is likely that directors and senior executives of listed companies who do not follow the guidance will be investigated by the SFC, which may seek disqualification, compensation and other orders against them.

² <http://www.sfc.hk/web/EN/assets/components/codes/files-current/web/guidance-note-on-directors'-duties-in-the-context-of-valuations-in-corporate-transactions/guidance-note-on-directors'-duties-in-the-context-of-valuations-in-corporate-transactions.pdf>

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