

ENHANCED LISTING RULES RELATING TO DISCIPLINARY POWERS AND SANCTIONS

THE EXCHANGE PUBLISHES CONSULTATION CONCLUSIONS ON REVIEW OF DISCIPLINARY POWERS AND SANCTIONS

Background

On 20 May 2021, The Stock Exchange of Hong Kong Limited (**Exchange**) published **conclusions** (**Conclusions**) to its consultation on review of the Rules Governing the Listing of Securities on the Exchange (**Listing Rules**) relating to disciplinary powers and sanctions. Having considered comments from a broad range of respondents, the Exchange concluded that the proposed changes to its disciplinary regime as well as related amendments to the Listing Rules as set out in the earlier **consultation paper** will be implemented with minor modifications, effective from 3 July 2021.

This client briefing discusses some of the significant enhancements to the Exchange's disciplinary powers in terms of the circumstances where sanctions can be imposed, the parties on which sanctions may be imposed, and the range of reputational sanctions available.

Circumstances where sanctions can be imposed

The current Listing Rules provide that the Exchange may impose sanctions if there has been a breach of the Listing Rules by any of the Relevant Parties (defined below). The revised Listing Rules will specifically refer to three additional circumstances where sanctions can be imposed:

1. **Where a Relevant Party has failed to comply with a requirement imposed by the Exchange:** This extends to cover, for example, failure by listed issuers to appoint a compliance adviser as directed by the Listing Division, and failure by directors to undergo training as directed by the Listing Committee upon conclusion of a disciplinary action. While disciplinary proceedings in these circumstances currently occur, the revised Listing Rules will explicitly permit the Exchange to impose sanctions.
2. **Where a Relevant Party has contravened an undertaking given to or breached an agreement with the Exchange in relation to a listing matter:** Currently, undertakings given to or agreements with the Exchange are enforceable in court. The revised Listing Rules will allow the Exchange to impose

sanctions in the event of a breach. For example, if a substantial shareholder has given an undertaking to take appropriate steps to ensure that a sufficient public float exists, the Exchange will be able to impose sanctions (e.g. a private reprimand) if the substantial shareholder fails to take those steps.

3. **Where a Relevant Party has caused by action or omission or knowingly participated in a contravention of the Listing Rules or a requirement imposed by the Exchange:** This is perhaps one of the most debated amendments to the Listing Rules, especially in light of the amendments to the scope of "Relevant Parties" (see below). Secondary liability for all Relevant Parties will be introduced.

Examples where secondary liability may arise include:

- a. where the chief financial officer disregarded comments made by the auditors, causing the listed issuer's failure to obtain its auditors' agreement before the publication of its results announcement;
- b. where the board secretary, who was in charge of reviewing and approving corporate announcements, failed to identify missing material information in an announcement, contributing to the listed issuer's failure to make proper disclosure; and
- c. where the financial adviser, which was engaged to advise on an acquisition and prepare the requisite circular, agreed with the listed issuer and its directors to withhold material information from disclosure.

In assessing whether a person should bear secondary liability for the breach by the primary wrongdoer, the Exchange will take into account the facts and circumstances of each case, including the roles and responsibilities of the person in question.

Parties on which sanctions may be imposed

The Exchange's ability to hold certain parties accountable has been limited where the Listing Rules do not clearly set out obligations or standards of compliance for parties such as senior management members and substantial shareholders, or do not expressly allow those parties to be disciplined (e.g. employees of professional advisers). As a result of the additional circumstances where sanctions can be imposed as discussed above and changes to the scope of parties on which sanctions may be imposed, the revised Listing Rules will enable the Exchange to take disciplinary action against any of the following parties (**Relevant Parties**):

1. listed issuers (and/or their subsidiaries);
2. directors of listed issuers (and/or their subsidiaries) (and/or alternate directors);
3. senior management members of listed issuers (and/or their subsidiaries);
4. substantial shareholders of listed issuers;
5. professional advisers (and/or their employees) of listed issuers (and/or their subsidiaries) (including independent financial advisers of listed issuers);
6. authorised representatives of listed issuers;
7. supervisors of PRC-incorporated issuers;
8. guarantors of debt securities or structured products; and
9. parties who give an undertaking to or enter into an agreement with the Exchange.

It is helpful that the Exchange has clarified that 'senior management' will include specific senior office holders (e.g. chief executive, company secretary, chief operating officer), those who perform managerial functions one level below the board of directors, and those designated as 'senior management' in the listed issuer's corporate communication or any other publications. This provides more certainty as to who within the organisation of a listed issuer could be held secondarily liable.

Range of reputational sanctions available

The reputational sanctions currently provided under the Listing Rules, in ascending order of seriousness, are as follows: a private reprimand, a public statement involving criticism, a public censure, and a public statement that the retention of office by a director is prejudicial to the interests of investors (**PII Statement**). The revised Listing Rules will make available a wider range of reputational sanctions:

1. **A PII Statement will be subject to a lower threshold and will cover both directors and senior management members:** The existing threshold for making a PII Statement (i.e. wilful or persistent failure to discharge one's responsibilities under the

Listing Rules) will be removed to enable the Exchange to make a PII Statement where the occupying of office *may* cause prejudice to the interests of investors. The scope of a PII Statement will also be extended to include not only directors of listed issuers, but also directors of listed issuers' subsidiaries as well as senior management members of listed issuers and/or their subsidiaries. The changes will also make clear that a PII Statement can be made whether or not an individual is still in office at the time of the statement.

2. **A Director Unsuitability Statement will be made in circumstances falling at the most serious end of the spectrum of misconduct:** The Exchange will have the power to make a public statement that a director is unsuitable to occupy a position as director or within the senior management of a named listed issuer or any of its subsidiaries (**Director Unsuitability Statement**) in the case of serious or repeated failure by the director to discharge his/her responsibilities under the Listing Rules. A Director Unsuitability Statement applies to more severe breaches than a PII Statement in that the conduct of the director may not only be prejudicial to the interests of investors but also may not meet the requirements of a director. Therefore, where a director, for example, has entered into unauthorised transactions notwithstanding a clear conflict of interest, or repeatedly failed to procure the listed issuer's compliance with the Listing Rules despite previous public sanction, the Exchange may impose a Director Unsuitability Statement.
3. **Additional follow-on actions and publication requirements may be imposed with a PII Statement or Director Unsuitability Statement:** If the Exchange issues a PII Statement or Director Unsuitability Statement against an individual, all listed issuers of which the individual is a director or senior management member will be required to disclose such sanction in their annual reports. If the director or senior management member concerned intends to take a similar role in a listing applicant, the prospectus will have to disclose the sanction imposed.

The Exchange has the power to direct follow-on actions where an individual subject to a PII Statement or Director Unsuitability Statement remains in office of the named listed issuer. Apart from suspension or cancellation of listing of the issuer's securities which is currently available under the Listing Rules, the Exchange will be able to direct the denial of facilities of the market to the issuer (by withholding approval of any matters that require the

approval from the Exchange). Where follow-on actions are directed, the named listed issuer will be required to refer to the PII Statement or Director Unsuitability Statement in all its announcements and corporate communications as long as the person concerned in the PII Statement or Director Unsuitability Statement remains in office.

Comments

Overall, the enhanced spectrum of graduated sanctions will enable a more effective regulatory response to different types of misconduct. It remains to be seen how the Exchange will differentiate the sanctions depending on the seriousness of the misconduct involved. In particular, it is envisaged that some of the more egregious or severe cases where a PII Statement would have been imposed in the past will in the future lead to the imposition of a Director Unsuitability Statement. Given the similarities in the consequences of a PII Statement and a Director Unsuitability Statement, further guidance and clarity on the imposition of such sanctions would be welcomed. In this regard, the

Exchange has mentioned in the Conclusions that it will consider publishing guidance to provide further clarity as to the application of a PII Statement.

Given the introduction of secondary liability and the expanded scope of “Relevant Parties”, those who were previously not specifically caught by the Listing Rules should be more vigilant in ensuring compliance with the Listing Rules as a corporate as they may have to bear consequences if their acts or omissions cause the non-compliance.

Listed issuers and listing applicants should pay heed to the ramifications of a PII Statement or Director Unsuitability Statement. In particular, whilst a PII Statement or Director Unsuitability Statement does not prevent an individual from being a director or senior management member, the burden will also be on the named listed issuer and any other listed issuers of which the individual is or will be a director or senior management member to assess his/her suitability and appropriateness for the role in question.

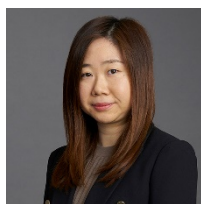
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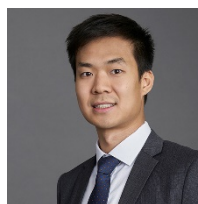
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