COVID-19: LEGAL IMPLICATIONS FOR HONG KONG LISTED COMPANIES AND THEIR OFFICERS

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Regulators remind of need to make accurate and timely disclosures of inside information

As governments and organizations continue to attempt to stop the spread of COVID-19, the containment measures such as border closures, travel bans, office / factory closures, and cancellation of events have started to impact businesses and operations in Greater China and abroad.

On 4 February 2020, the Securities and Futures Commission ("SFC") and The Stock Exchange of Hong Kong Limited (the "Exchange") issued a joint statement providing guidance to listed companies on, amongst other things, the disclosure of financial information. Listed companies were reminded that if their *"business operations, reporting controls, systems, processes or procedures are materially disrupted by the [COVID-19] outbreak and/or the related travel restrictions, management should assess whether any inside information has arisen and, if so, make a separate announcement as soon as reasonably practicable, independent of any applicable Listing Rule requirement."*

Since the statutory regime for disclosure of price sensitive information (**"inside information"**) came into effect on 1 January 2013, the SFC has been proactively monitoring corporate information and disclosures to detect and investigate issues and taken enforcement action where appropriate.

Under s.307B(1) of the SFO, a listed company must as soon as reasonably practicable disclose any inside information after it has come to its knowledge (the **"Disclosure Requirements"**), while under s.307G(1) of the SFO, officers of a listed company must take all reasonable measures from time to time to ensure proper safeguards exist to prevent a breach of the Disclosure Requirements by the listed company (the **"Proper Safeguards Obligation"**). Breaches could result in the SFC initiating enforcement action before the Market Misconduct Tribunal (the **"MMT"**), and penalties, including fines of up to HKD8 million being imposed on the listed company and its directors or chief executive, and order the liable person not to be or continue to be "a director, liquidator or receiver or manager of the property or business, of a listed corporation or any other specified corporation", for up to 5 years. Additionally, a listed company or its officer that has been found

in breach of the Disclosure Requirements may be liable to pay compensation to persons who have suffered financial loss as a result of such breach under s. 307Z of the SFO.

Over the last 7 years, a number of enforcement actions have been initiated against listed companies and officers, with fines of up to HKD1.6 million being imposed on listed companies and their officers, and directors being disqualified.

We set out below a summary of some relevant enforcement actions to highlight the types of inside information not disclosed, the delay in disclosure and the sanctions imposed.

Company Name	Commencement of proceedings date (Decision date)	Summary of disclosure failure	Summary of penalties imposed[1]
In the matter of COMPANY A	July 2015 (November 2016)	COMPANY A, its Chairman and CEO failed to make timely disclosure of ***the insolvency related proceedings***. The delay was approximately 1 week.	Fines ▶ COMPANY A was fined HKD600,000 ▶ COMPANY A's Chairman was fined HKD800,000 ▶ COMPANY A's Chief Executive Officer was fined HKD600,000 Other orders ▶ The 2 officers were ordered to complete a training programme approved by the SFC
In the matter of COMPANY B	March 2016 (April 2017)	COMPANY B, its Financial Controller and 8 of its Directors failed to make timely disclosure of ***the resignation of its auditors and various transactions*** (including a disposal of a wholly-owned subsidiary for HKD15.5 million and substantial prepayments of USD4-10 million without security by COMPANY B's subsidiaries to suppliers). The delay was approximately 3 weeks.	Fines ▶ COMPANY B, its Financial Controller and 8 of its Directors were fined between HKD900,000 to HKD1.5 million each Disqualification ▶ The Financial Controller and 8 Directors of COMPANY B were disqualified from being a director or involved in the management of a listed corporation or any other specified corporation for periods between 12 - 20 months Disciplinary actions ▶ The MMT recommended the HKICPA to take disciplinary action against the Financial Controller Other orders ▶ COMPANY B was ordered to appoint an independent professional adviser to review its procedures for compliance with the corporate disclosure regime. COMPANY B's Financial Controller and its 8

[1] The contravening company and officers will usually be ordered to jointly and severally pay the costs of SFC's investigations and legal fees as well as the costs of the MMT proceedings.

			Directors were ordered to complete a training programme approved by the SFC.
In the matter of COMPANY C	April 2016 (February 2017)	COMPANY C, its CEO and Financial Controller failed to make timely disclosure of ***the material losses of COMPANY C in the second half of 2012***. The delay was approximately 13 weeks.	Fines ▶ COMPANY C and its CEO were fined between HKD1 million each Disqualification ▶ The CEO and Financial Controller of COMPANY C were disqualified from being a director or involved in the management of a listed corporation or any other specified corporation for 18 and 15 months respectively Disciplinary actions ▶ The MMT recommended the HKICPA to take disciplinary action against the Financial Controller Other orders ▶ COMPANY C was ordered to appoint an independent professional adviser to review its procedures for compliance with the corporate disclosure regime. Both the CEO and Financial Controller were ordered to complete a training programme approved by the SF
In the matter of COMPANY D	October 2019	COMPANY D and its 6 directors allegedly failed to disclose COMPANY D's ***significant gains in securities trading*** as soon as reasonably practicable. The alleged delay was approximately 4.5 months.	Case is still in progress

Bearing in mind COVID-19 and the possible economic consequences arising, we highlight below some key points to note from the enforcement actions:

- **Deterioration in financial performance:** significant deterioration in financial performance (even if such information is based only on internal accounts) would likely need to be disclosed. *In the matter of COMPANY C*, COMPANY C stated its expectations of "*significant growth*" and "*increasing profitability*" for the second half of 2012 in its unaudited interim result for the first half of 2012 released in August 2012. In fact, COMPANY C's financial performance further deteriorated and sustained material losses in the second half of 2012 ("**Deterioration**"). COMPANY C did not issue any profit warning between the interim result and the announcement of its audited annual results for 2012 on 25 March 2013. The MMT held COMPANY C, Mr. A (COMPANY C's CEO and Executive Director) and Mr. B (COMPANY C's Financial Controller and Company Secretary liable for breaching the Disclosure Requirements. In doing so, it found that COMPANY C had knowledge of the Deterioration

around mid-December 2012 when the monthly management accounts up to November 2012 were sent to Mr. A, and Mr. B had failed to take any steps to ensure timely disclosure when he received the draft consolidated financial statement from the auditor in February 2013. The MMT also found that Mr. A and Mr. B failed to ensure proper safeguards existed to prevent COMPANY C from breaching the Disclosure Requirement, noting that there was no system in place to ensure the Financial Controller would receive the monthly management accounts. Given the severity of the breach, the MMT disqualified Mr. A and Mr. B for 18 months and 15 months respectively.

- **Litigation involving the listed company:** such litigation, including if in a foreign jurisdiction, would likely need to be disclosed. *In the matter of COMPANY A*, COMPANY A's subsidiary filed a petition to the Courts in Indonesia to suspend COMPANY A's obligation to pay its debts and a court summons was issued against COMPANY A. Both documents were received by COMPANY A on 2 January 2013, English translations of the documents were sent to Mr. C, the former Chairman, and Mr. D, the former CEO, on 4 January 2013 and legal advice in relation to the documents was obtained on 8 January 2013. Disclosure was not, however, made until 17 January 2013. In finding that COMPANY A, Mr. C and Mr. D breached the Disclosure Requirements, the MMT found that Mr. C and Mr. D had behaved responsibly and diligently by attending the hearing, arranging the legal advice and obtaining translations. However, they had failed to share the information with the public in a more timely fashion i.e. once proper legal advice leading to rational and comprehensive understanding of the legal position in the foreign jurisdiction was obtained.

- **Officers' exposure:** Officers (i.e. directors, managers or secretaries of, or any other persons involved in the management of the listed company) who breach the Proper Safeguards Obligation and/or whose intentional, reckless or negligent conduct results in a listed company's breach of the Disclosure Requirement are also liable for the breach of the Disclosure Requirement. NEDs (whether independent or otherwise) who are not involved in management should be particularly vigilant. *In the matter of COMPANY B,* COMPANY B's NED argued that by the time he was informed of the inside information (i.e. 3 weeks after the event), the breach had already occurred and could not be undone. The MMT rejected this argument, and found the NED liable for breaching the Proper Safeguards Obligation on his admission that he was aware that COMPANY B had no written guidelines and/or internal control policies in relation to the Disclosure Requirement and he had never made any complaint about the failure of COMPANY B to set up systems to prevent a breach. It also observed that a breach continues so long as the default continues, and an officer whose intentional, reckless or negligent conduct causes the continuing default will also be liable for the continuing breach. *In the matter of COMPANY D,* which is currently pending determination, COMPANY D's INEDs are facing allegations that they recklessly or negligently caused COMPANY D's alleged failure to disclose information pertaining to the significant gains from securities trading as soon as reasonably practicable on the basis that they failed to ensure timely disclosure of the information after it had, or ought reasonably to have, come to their knowledge (by way of, among other things, an email to the board containing COMPANY D's own internal financial report).

Key steps for directors and senior management to consider:

Given that the Disclosure Requirements have been in place since 2013, listed companies are expected to have effective systems and procedures in place to meet these requirements, and in light of the joint statement from the SFC and the Exchange, we anticipate that both regulators will be keeping a close eye on listed companies' compliance with the Disclosure Requirements, and will not be slow to act if issues are detected.

We recommend directors and senior management:

- Remind themselves as to what constitutes "inside information" under the SFO (refer to SFC Guidelines on inside information (the **"SFC Disclosure Guidelines"**) - paragraphs 13 – 37);
- Check that appropriate systems and procedures are in place to ensure compliance with the Disclosure Requirement (refer to SFC Disclosure Guidelines - paragraph 60);
- Check that such systems and procedures have been properly implemented, in particular, an effective reporting system to ensure financial controllers receive financial information (e.g. monthly management accounts) in a timely manner, and all directors (including non-executive directors, independent or otherwise) are fully informed of the company's business and operation so as to ensure timely disclosure if the Disclosure Requirements have been triggered;
- Check that staff are properly trained on and understand the policies and procedures, and are responsive to them; and
- Seek independent professional legal advice if in doubt as to
    - whether the Disclosure Requirements have been triggered;
    - where there has been delay in identifying and/or making disclosure; and/or
    - whether it is advisable to make disclosure even if the Disclosure Requirements may not have been triggered.

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