



Cultivating independence of mind

ACRU 2017 review: part one





The importance of cultivating an independent mindset for both independent non-executive directors and the company secretary emerged as a central theme of this year's Annual Corporate and Regulatory Update seminar, held last month at the Hong Kong Convention and Exhibition Centre.

Every year, the Institute's Annual Corporate and Regulatory Update (ACRU) seminar provides an ideal opportunity for practitioners, senior managers and directors to enter into a direct dialogue with Hong Kong's major regulatory bodies about the issues at the top of both regulators' and regulatees' agendas.

The 18th ACRU, held on 2 June at the Hong Kong Convention and Exhibition Centre, did not disappoint. Our review of the event will first focus on the main themes to emerge from the presentations and Q&A discussions, and then turn (see the following cover story on pages 18–22) to look in more detail at the specific governance and compliance issues that regulators highlighted at the event.

The role of the board

'Issues are run by people,' Kenneth Chan, Senior Vice-President, Compliance and Monitoring, Listing, Hong Kong Exchanges

and Clearing Ltd (the Exchange), pointed out in his ACRU presentation, 'and we expect them to have a good character, integrity and competence, and we expect them to fulfil their duties of skill, care and diligence. In short, we have high expectations of directors.'

Kenneth Chan's presentation focused on 'directors' suitability' – the need for the individuals in these roles to have the requisite integrity and skills. He cited a recent case where the Exchange opposed the appointment of a director to a company listed on the Exchange since he had, only one year previously, been found to be actively involved in market manipulation activities and sanctioned with a heavy fine by an overseas securities regulator.

Stephen Jamieson, Senior Vice-President, Head of Enforcement, Listing, the Exchange, focused his ACRU presentation on the need for directors to understand

Highlights

- company secretaries should be prepared to resign and state why they are resigning if their attempts to alert the board to fraud or breaches of the rules go unheeded
- company secretaries should not be intimidated by overbearing or dominant directors trying to push something through
- independent non-executive directors need to have an independence of mind and a willingness to challenge management

“ we don’t expect company secretaries to be saints, but we do expect you to fulfil your obligations and that includes the duty to speak up if breaches of the rules have been discovered

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Eugène Goyne, Senior Director, Enforcement, SFC



and fulfil their duties. 'It is quite surprising the number of cases where directors do not understand their obligations to comply with the listing rules,' Mr Jamieson said. In fact, directors' duties has been the single most common theme of the Exchange's enforcement activities over the last year (see 'Top enforcement themes for the Exchange' on page 17).

As an example he cited the case of Mei Ping, former Executive Director of China Nonferrous Metals Company Ltd. Mr Mei executed a number of guarantees as a legal representative of the issuer's subsidiaries for loans borrowed by another company of which he, together with his brother, were directors and substantial shareholders. The guarantees therefore constituted a major and connected transaction, but Mr Mei did not inform the board of the transaction, nor did he obtain board approval. His actions contravened almost every GEM listing rule relating to directors' duties, failing to:

- act honestly in good faith in the interests of the issuer as a whole and for proper purpose

- properly apply the issuer's assets
- avoid conflict of interest and duty
- fully disclose his interest, and
- apply the skill, care and diligence expected of him given his knowledge, experience and his role as compliance officer of the issuer.

Speakers from both the Exchange and the Securities and Futures Commission (SFC) emphasised that directors will be held personally liable for any failure to fulfil their duties. 'We will hold directors personally liable for any loss they cause their companies by breaching their duties,' Eugène Goyne, Senior Director, Enforcement, SFC, stated.

Mr Goyne discussed the SFC's new enforcement priorities, pointing out that listed company corporate fraud and director misconduct are priority areas of focus. The SFC now has two specialised teams focused on these areas. The teams will be focusing on high-impact cases and grouping cases together to assess multiple

breaches within the same corporate group as a whole. This new approach by the SFC to enforcement is mirrored at the Exchange. Stephen Jamieson explained that the Exchange will be focusing resources on pursuing the most blatant and serious misconduct in order to get the maximum regulatory effect from their existing resources.

The role of INEDs

Corporate governance systems around the world, including in Hong Kong, have been vesting increasing importance in the role of independent non-executive directors (INEDs) on boards as a way to bring objectivity and a wider perspective to board discussions. Trevor Keen, Head, Financial Market Infrastructure Oversight & Licensing, and Sarah Kwok, Head, Banking Conduct, at the Hong Kong Monetary Authority (HKMA), addressed the theme of 'INED empowerment and bank culture' in their ACRI presentations.

The HKMA has been promoting best practice for INEDs for some time, working closely with banks in Hong Kong to ensure that individuals taking up INED

roles have the right combination of skills and qualities. Ms Kwok stressed that, in addition to the appropriate experience and expertise, INEDs need to have integrity and the right personal qualities for the role. These qualities are essentially an independence of mind and a willingness to challenge management. 'INEDs need to constructively challenge management,' she said. 'They also need to have the ability to exercise objective, independent judgement after fair consideration of all relevant information and views, without undue influence from executives or from external parties.'

She added that this 'independence of mind' is crucial since INEDs need to protect the interests of all shareholders, depositors and customers and ensure that the company conducts its business in the wider public interest.

Mr Keen discussed the time commitment required for an INED position. The INED role is demanding, Mr Keen pointed out, and prospective INEDs may underestimate the time they will have to commit. 'Board and committee meetings, reading and preparation, understanding the business of the bank, keeping up with regulatory and industry developments all take time, especially for non-bankers,' he said.

Stephanie Lau, Senior Vice-President, Compliance and Monitoring, Listing, the Exchange, focused on the critical role played by INEDs in ensuring that connected transactions are conducted in compliance with the listing rules. 'The Exchange is concerned that INEDs all too often simply rely on information supplied by management when performing their connected transaction reviews,' she said, 'and that some issuers fail to provide reliable information on the fairness and

reasonableness of connected transactions to their INEDs.'

The Exchange recommends INEDs to exercise independent and objective judgement and recommends issuers to provide their INEDs with better quality information in order for them to monitor and perform their review of connected transactions.

The role of the company secretary

This year's ACRU saw an increased focus on the role of the company secretary, in particular the company secretary's role in providing governance advice and board support. 'How company secretaries can support directors' was the theme of the presentation by Katherine Ng, Senior Vice-President and Head of Policy, Listing,

the Exchange, in the first session of the day (see pages 6–11 of this month's journal for her insights on this topic).

Her colleague at the Exchange, Stephen Jamieson, made the point that company secretaries should not neglect their critical role in advising directors on their obligations under the listing rules and their obligation to cooperate with the Exchange's investigations.

Eugene Goynes of the SFC pointed out that the new focus of regulators in Hong Kong on enforcing individual accountability of both directors and senior management will be particularly relevant to company secretaries, not only due to their own

Keeping the dialogue open

Many speakers at ACRU 2017 commented on the usefulness of the ACRU seminar as a means for regulators to get the governance message out to the market. Both Hong Kong Exchanges and Clearing Ltd (the Exchange) and the Securities and Futures Commission (SFC) speakers emphasised the need for regulators to improve communication with market participants to ensure the governance message is heard and understood and thereby head off potential future governance and compliance problems.

'We tend to come in when the dead bodies are already on the floor,' said Eugène Goynes, Senior Director, Enforcement, SFC, 'but we recognise that we cannot rely on enforcement alone.' He added that companies can expect to see more preventative interventions in the future to achieve better governance and compliance outcomes. 'You can expect to see a much more active SFC getting involved at an earlier stage,' he said.

This approach, which has been dubbed 'front-loaded' regulation by SFC Chairman Carlson Tong SBS JP, will also mean a more extensive use of existing communication channels (for example via the SFC's *Enforcement Reporter*), and early warnings of enforcement priorities. The new approach will also involve a closer collaboration between different SFC divisions – aiming to achieve a better integration of the supervisory and enforcement sides of the SFC's work.

higher liability, but as a highly persuasive tool they can use to get the governance message across to board directors.

The presentations by Trevor Keen and Sarah Kwok of the HKMA also provided useful insights into the board support role of company secretaries. They made the point that one of the key factors in improving the effectiveness of directors generally, and INEDs in particular, is the level of support they receive from the company secretary.

Since INEDs will rarely have the same level of knowledge as executive directors of the company's business, Ms Kwok stressed that the induction and ongoing training facilitated by the company secretary is a crucial part of making INEDs effective members of the board. She recommended that company secretaries provide regular briefings on operations and risk management, as well as briefings on

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Sarah Kwok, Head, Banking Conduct, Hong Kong Monetary Authority

wider developments in the industry and regulatory requirements.

Mr Keen stressed the importance of good practices in the management of board meetings, such as:

- planning meeting schedules well

ahead and avoiding making changes unless really necessary

- providing clear board papers that avoid overly technical language
- providing briefings ahead of meetings where required
- facilitating tele- or video-conferencing where physical attendance is impossible
- facilitating access to professional advice, and
- ensuring that board and individual evaluations are carried out at least once a year.

He also emphasised the importance of preparing proper minutes. This issue surfaced in the Q&A at the end of the HKMA session. The chair of the session, Paul Stafford FCIS FCS(PE), Institute Vice-President and Chairman of the Professional Development Committee, asked what would be the appropriate level of detail in the minutes. Mr Keen said that, while they should not be verbatim, they should cover what was said. Most

ACRU in quotation

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Eugène Goyne, Senior Director, Enforcement, SFC

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Stephanie Lau, Senior Vice-President, Compliance and Monitoring, Listing, the Exchange

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importantly, the minutes should name who said what. 'If I held a dissenting view, I would want that noted,' he said.

The Q&A at the end of the SFC session raised another important issue for company secretaries – what should they do if their advice against a proposal that would, in their view, compromise governance or ethical standards was not heeded by the board. Eugene Goyne

said that company secretaries should be prepared to resign and state why they are resigning if their attempts to alert the board to fraud or breaches of the rules go unheeded.

The chair of the SFC session, Gillian Meller FCIS FCS, Institute Council member, asked whether the resignation should only be the last resort – that is, company secretaries should try to work with INEDs

to remedy the situation first before considering resigning. 'We recognise that you are in a difficult position,' said Mr Goyne, 'and we don't expect company secretaries to be saints, but we do expect you to fulfil your obligations and that includes the duty to speak up if breaches of the rules have been discovered. I urge you not to be intimidated by excessively overbearing or dominant directors trying to push something through.'

He added that company secretaries should also be prepared to report criminal behaviour to the SFC. 'If you detect fraud, please come forward – without the cooperation of the people in this room our job is more difficult. Your identity will be kept confidential. Often coming to us may be the best thing you can do.'

The 18th Annual Corporate and Regulatory Update (ACRU) took place at the Hong Kong Convention and Exhibition Centre, Hong Kong on 2 June 2017.

Top enforcement themes for the Exchange

	MB	GEM	TOTAL
CORE THEMES			
(1) Directors' duties	15	2	17
(2) Failure to cooperate with the Exchange's investigation	4	0	4
(3) Delayed trading resumption	1	0	1
(4) Financial reporting – delays, internal controls and corporate governance issues	1	0	1
(5) Inaccurate, incomplete and/or misleading disclosure in corporate communication	1	0	1
(6) Failure to comply with procedural requirements in respect of notifiable/connected transactions	6	1	7
(7) Repeated breaches of the listing rules	-	-	-
MULTIPLE THEMES	23	10	33
OTHERS: not falling into the scope of any themes	6	1	7

Compliance update

ACRU 2017 review: part two

CSj highlights the main compliance issues raised by regulators at the Institute's latest Annual Corporate and Regulatory Update.

The Institute's Annual Corporate and Regulatory Update (ACRU) provides attendees with first-hand knowledge of the emerging trends and areas of concern for Hong Kong's leading regulatory bodies. There was no shortage of compliance and governance issues to be discussed in the latest ACRU.

Listed company governance issues were the focus of the Hong Kong Exchanges and Clearing Ltd (the Exchange) and Securities and Futures Commission (SFC) sessions. The Companies Registry session was devoted to the government's proposed new legislative amendments designed to upgrade Hong Kong's anti-money laundering and counter-terrorism financing (AML/CTF) regime, as well as an introduction to the Registry's electronic services. The Privacy Commissioner for Personal Data discussed effective privacy management and, in the final session of the day, the Hong Kong Monetary Authority addressed the empowerment of independent non-executive directors and improving governance culture.

Regulation of trust and company service providers

Ellen Chan, Deputy Principal Solicitor, Companies Registry, addressed a topic highly relevant to the company secretaries in the ACRU audience – the government's proposed licensing regime

for trust or company service providers (TCSPs). She gave an account of how the Companies Registry, which will be the regulator responsible for implementing the new regime, intends to enforce the new requirements.

Under the licensing scheme, TCSPs will be required to apply for a licence from the Registrar of Companies (the Registrar) before they can carry on a trust or company service business in Hong Kong. 'A person who carries on a trust or company service business without a licence commits an offence, and is liable to a fine and imprisonment. The Registrar will keep a register of all TCSP licensees, which will be open for public inspection,' Ms Chan said.

This is designed to fulfil the requirements of the Financial Action Task Force (FATF). FATF recommends that 'designated non-financial businesses and professions' (DNFBPs), which includes TCSPs, should be subject to effective systems for monitoring to ensure their compliance with AML/CFT requirements.

FATF also requires DNFBPs to be subject to customer due diligence (CDD) and record-keeping requirements. Currently, these are only prescribed for financial institutions (as set out in Schedule 2 of the Anti-Money Laundering and



Counter-Terrorist Financing (Financial Institutions) Ordinance). The government proposes to extend Schedule 2 of the Ordinance to cover, among others, TCSP licensees.

This would mean TCSPs would need to, among other things: verify their customers' identities and identify any beneficial owners. They would also be required to keep, in relation to each transaction and each customer, the original or a copy of the documents and a record of the data and information obtained (such as identification data, account files, business correspondence and records of transactions) for a period of six years.

The Registrar will be empowered to carry out inspections for the purposes of ascertaining whether a TCSP licensee is complying with the licensing and statutory CDD/record-keeping requirements. A TCSP licensee in contravention of the statutory requirements, or any conditions of the



licence, may be disciplined and subject to a range of civil sanctions, including: a public reprimand, a remedial order to remedy the contravention, and payment of a pecuniary penalty.

There will be a review tribunal to which any person aggrieved by the Registrar's decisions in implementing the licensing and disciplinary regime for TCSPs may appeal.

Beneficial ownership disclosure

FATF also requires member jurisdictions, which includes Hong Kong, to take measures to prevent the misuse of legal structures for money laundering and terrorist financing by ensuring that adequate and accurate information on the beneficial owners and control of such structures can be obtained or accessed in a timely fashion by competent authorities. Accordingly, the government's proposes to amend the Companies Ordinance to require disclosure of beneficial ownership information by Hong Kong companies.

Francis Mok, Senior Solicitor, Companies Registry, highlighted the main components of the new beneficial ownership regime in Hong Kong for the ACRU audience. He pointed out that the Companies Ordinance currently has no requirement for the disclosure of beneficial ownership information. Under the Securities and Futures Ordinance (SFO), however, listed corporations are required to keep a register of those individuals or entities owning 5% or

more interests in any class of shares (including any beneficial owner of such shares). Listed companies will therefore be exempted from the new regime since they are subject to a more stringent disclosure requirement under the SFO.

Under the proposed new beneficial ownership regime, companies incorporated in Hong Kong would be required to:

- maintain a register of people with significant control (PSC register) over the company, containing required particulars of their identities, and
- take reasonable steps to ascertain the individuals who (and legal entities which) have significant control over a company, give notice to them, and obtain accurate and up-to-date information about their identities.

The PSC register should contain required particulars of registrable persons (that is natural persons) who ultimately have a controlling ownership interest in a company, or who are exercising control of the company through other means,

Highlights

- directors contemplating rights issues and open offers must act in the best interests of the company as a whole – meaning in the best interests of all of the shareholders
- the Registrar of Companies will be empowered to carry out inspections of trust and company service provider licensees to ensure that they are complying with their licensing and statutory requirements
- directors should not accept blindly or unquestioningly the facts or assumptions made in valuation reports – they have a duty to take all reasonable steps to check the accuracy of those facts or assumptions

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Ellen Chan, Deputy Principal Solicitor, Companies Registry



and registrable legal entities with significant control over the company to facilitate identification of PSC in a chain of ownership.

The PSC register must also include the name and contact details of a person designated by the company as its representative to provide assistance relating to the PSC register to a law enforcement officer. The designated representative must be a natural person resident in Hong Kong, or a DNFBP, that is an accountant, legal professional or a licensed trust or company service provider.

Persons whose names are entered in the register are entitled, on request made in the prescribed manner and without charge, to inspect the PSC register and to be provided with copies of the register (on payment of a prescribed fee). Law enforcement officers are also entitled, for the purposes of performing their functions under Hong Kong law, to inspect the PSC register at the place at

which it is kept and make copies of the whole or part of the register.

Rights issues

Since late last year, both the SFC and the Exchange have been closely monitoring rights issues and open offers that substantially dilute the interests of non-subscribing minority shareholders. A joint statement on highly dilutive rights issues and open offers was issued by both regulators in December 2016.

Stephanie Lau, Senior Vice-President, Compliance and Monitoring, Listing, the Exchange, raised this issue in her ACRU presentation. She warned that the Exchange will not grant approval to share issues where they would undermine minority shareholders' interest. 'We expect directors to act in the best interests of the company,' she said, 'and this means acting in the best interests of all of the shareholders.'

Ms Lau highlighted the factors considered by the Exchange when assessing rights

issues and open offers. These include the price discount; the dilution impact on the interests of non-participating shareholders; whether there has been any recent similar corporate actions; and whether there is a genuine funding need for the rights issue. Ms Lau emphasised that listed companies should be able to show that there is such a need and that the terms of the proposed fundraising are the best terms available.

Backdoor listings and shell activities

Stephanie Lau also discussed the Exchange's current review of its regulations relating to backdoor listing activities. She warned that the Exchange will intervene where the use of reverse takeover and shell activities are designed to circumvent the requirements for IPO applicants and avoid the IPO vetting process. She emphasised that, among the factors considered by the Exchange, would be whether there has been any fundamental change in the issuer's principal business, and other events and transactions (historical, proposed or intended) which, together with the

acquisition, form a series of arrangements to circumvent the reverse takeover rules.

Kenneth Chan, Senior Vice-President, Compliance and Monitoring, Listing, the Exchange, also looked at this issue in his presentation. He focused on the approach of the Exchange to shell activities, emphasising that a listed company needs to have a sufficient level of operations, or have tangible or intangible assets of sufficient value, to demonstrate to the Exchange that it is a viable concern. He urged attendees to look at the Exchange's published guidance on continuing listing criteria and how companies should comply with Rule 13.24 which requires sufficiency of operation. He also pointed out that, while issuers are normally given an opportunity to take remedial action, the Exchange may suspend the trading in the securities or cancel the listing of an issuer where it does not have a sufficient level of operations or assets under Rule 13.24.

Valuations

Another compliance issue that has been on regulators' radars over the last year is the due diligence needed when the board considers valuation reports in the

context of asset purchases or transfers. Mike Knight, Director, Corporate Finance, SFC, pointed out that directors are the guardians of listed company assets and they therefore must act in the interests of the company as a whole and exercise due care and skill when considering valuation reports.

He emphasised that directors need to exercise independent due diligence, rather than simply focusing on the bare minimum compliance with the approval process. 'Don't accept blindly or unquestioningly the facts or assumptions made in valuation reports,' he said. 'You need to take all reasonable steps to check the accuracy of those facts or assumptions.'

In the Q&A concluding the SFC's session, a question was raised as to whether directors can rely on information supplied by others to whom they have delegated the task of assessing the valuation. 'You can delegate the technical aspects of the valuation,' Mr Knight said, 'but you can't delegate responsibility.'

These points were backed up by Eugène Goyne, Senior Director, Enforcement, SFC,

in his ACRU presentation. 'The message is very clear,' he said, 'directors have a duty to do all reasonable due diligence particularly if the valuation comes from the vendor, who obviously wants the best price,' he said.

Takeovers

The fair and equal treatment of all shareholders was a recurring theme throughout ACRU 2017. In her update on the takeovers regime in Hong Kong, Zarina Curreem, Director, Corporate Finance, SFC, emphasised that this is the most important principle to bear in mind in takeovers activities.

'The Takeovers Executive is not concerned with the commercial advantages of any proposed offer,' she said, 'this is for shareholders to decide. The Takeovers Executive is concerned to ensure the preservation of a fair market.'

In practical terms, this means that the SFC looks to ensure that there has been a full and timely disclosure of information. Ms Curreem reminded ACRU attendees that all documents related to takeover activities, except those designated for post-vetting, must be filed with Takeovers Executive for comment prior to release. Nevertheless, issuers have the ultimate responsibility for information disclosed and for compliance with the takeovers rules. Her final word of advice was to consult Takeovers Executive if in doubt.

Privacy management

Privacy management has been an issue of increasing concern for boards in Hong Kong as the regulations relating to privacy, both locally and overseas, have become more complex. Professor Stephen Kai-yi Wong, Privacy Commissioner for Personal Data, gave some practical and

The mobile registry

Wendy Ma, Deputy Registry Manager, Companies Registry, gave ACRU participants an update on the latest developments relating to the Companies Registry's electronic services. In 2015, the Registry launched its full-scale electronic filing service and last year it introduced its 'Company Search Mobile Service' which enables users to conduct company searches using smartphone and mobile devices. Ms Ma explained that this year the Registry is rolling out its 'eFiling Mobile App' which allows users to file an increasing number of forms with the Registry via smartphones and mobile devices. Stage one was launched on 6 February 2017, stage two is now available for a pilot run, and stage three is expected to be available by the end of the year.

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Professor Stephen Kai-yi Wong, Privacy Commissioner for Personal Data

useful tips to the ACRU audience on how to design and implement an effective privacy management programme.

He started his presentation with a look at the paradigm shift in privacy management from a purely compliance approach to one based on accountability (see 'Privacy management'). He pointed out that the 'accountability principle' under the *OECD Privacy Guideline*, for example, requires a data user to

be accountable for complying with measures which give effect to the data protection principles. Moreover, the EU General Data Protection Regulation (GDPR), due to be implemented in 2018, makes accountability a legal requirement.

Mr Wong emphasised that the key to successful privacy management is to ensure that privacy issues are handled by the board. 'Privacy issues should be discussed in the board room,' he



said. 'Organisations need to embrace personal data privacy protection as part of their corporate governance responsibilities and apply it as a top-down business imperative throughout the organisation.' He added that company secretaries can assist here by securing the buy-in from the board and top management.

He also urged all organisations in Hong Kong to adopt a formal privacy management programme, adding that organisations can make use of the *PMP Best Practice Guide* issued by the Office of the Privacy Commissioner for Personal Data, which provides direct guidance for compliance with specific provisions of the Personal Data (Privacy) Ordinance.

Privacy management

There has been a paradigm shift in privacy management from a compliance to accountability approach.

Compliance approach

- passive
- reactive
- remedial
- problem-based
- handled by the compliance team
- achieving the minimum legal requirement
- bottom-up

Accountability approach

- active
- proactive
- preventative
- based on customer expectations
- directed by top-management
- focused on reputation building
- top-down

The 18th Annual Corporate and Regulatory Update (ACRU) took place in the Hong Kong Convention and Exhibition Centre, Hong Kong, on 2 June 2017.

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