

## HKCGI Securities Law and Regulation Guidance Note (Sixth Issue) - The Exchange's new Cooperation Guidance and updated Sanctions Statement

### Introduction

On 25 October 2022, The Stock Exchange of Hong Kong Limited (the **Exchange**) published a new Guidance Note on Cooperation (**Cooperation Guidance**) that clarifies the Exchange's expectations regarding cooperation. The Cooperation Guidance includes helpful examples of what constitutes good cooperation and describes what is regarded as uncooperative conduct. The Exchange has also updated its Enforcement Sanctions Statement (**Sanctions Statement**). In this Guidance Note we will provide some context to the Exchange's new Cooperation Guidance and amendments to the Sanctions Statement, which should be considered by listed issuers, directors and governance professionals

when handling the Exchange's investigations going forward.

### The Exchange's Latest Enforcement Guidance

Given the evolving regulatory landscape in recent years, it is not uncommon for Hong Kong-listed issuers and their directors to find themselves in the unenviable position of being the subject of an investigation by the Exchange for potential breaches of the Hong Kong Main Board Listing Rules (**Listing Rules**) or the GEM Listing Rules.

The Exchange's new Cooperation Guidance<sup>1</sup> provides helpful clarifications on what is and is not deemed to be cooperation from the Exchange's perspective. It

<sup>1</sup> Guidance Note on Cooperation dated 25 October 2022 ([https://www.hkex.com.hk/-/media/HKEX-Market/Listing/Rules-and-Guidance/Disciplinary-and-Enforcement/Disciplinary-Procedures-and-Enforcement-Guidance-Materials/guidance\\_cooperation.pdf](https://www.hkex.com.hk/-/media/HKEX-Market/Listing/Rules-and-Guidance/Disciplinary-and-Enforcement/Disciplinary-Procedures-and-Enforcement-Guidance-Materials/guidance_cooperation.pdf))

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also specifically highlights the importance of timely engagement with the Exchange. The Cooperation Guidance also appears to draw much of its inspiration from the Guidance Note on Cooperation with the Securities and Futures Commission (SFC) issued in December 2017.<sup>2</sup> The Cooperation Guidance also bears many similarities with the Guidance Note on Cooperation with the Accounting and Financial Reporting Council.<sup>3</sup> While the various guidance notes are customised specifically for the different regulated sectors, the common theme is that the regulators promote and recognise cooperation in investigations and enforcement actions as it assists the regulators to achieve their regulatory and enforcement objectives, and facilitates early resolution of investigations and enforcement actions to ensure effective and efficient use of the regulators' manpower and other resources.

In parallel, the Exchange has also updated its Sanctions Statement<sup>4</sup> to provide further guidance on its enforcement approach with a specific focus on the Exchange's expectations in respect of a listed issuer's internal controls. The Enforcement Policy Statement<sup>5</sup> has also been updated to include links to these documents. The governance professionals of listed issuers should familiarise themselves with the updated guidance to ensure they take appropriate steps and make informed decisions when handling an investigation and avoid potentially uncooperative conduct.

### What constitutes cooperation and non-cooperation in the context of the Exchange's investigations and disciplinary actions?

The Exchange considers cooperation from listed issuers and directors to be essential for maintaining an orderly, informed and fair market. Listing Rule

2.12A provides that issuers are required to provide any information as the Exchange reasonably considers appropriate to protect investors or ensure the smooth operation of the market, and any other information or explanation that the Exchange may reasonably require for the purpose of investigating a suspected breach of or verifying compliance with the Listing Rules. Directors are also required to provide an undertaking that they will cooperate with any investigations of the Exchange. Against this backdrop, there is a clear regulatory expectation for listed issuers, directors and governance professionals to cooperate in the context of an investigation.

As there is a general expectation that parties will cooperate, mere compliance with a listed issuer's or a director's statutory or regulatory obligations will not amount to cooperation. The level of a party's cooperation needs to be "exceptional".

### What is considered "cooperation"?

Some examples of cooperation include:

1. **Providing true and complete information and documents regarding the suspected breach or misconduct.** This includes taking early and proactive steps to preserve evidence, providing full disclosure of relevant information (even if it has not been specifically requested by the Exchange) and assisting with obtaining relevant evidence from third parties.
2. **Taking a proactive approach by devoting resources to investigating the matter and responding to the Exchange's enquiries.** This may involve engaging professional parties, such as auditors, forensic investigators, legal or financial advisers and internal

2 Guidance Note on Cooperation with the Securities and Futures Commission issued in December 2017 (<https://www.sfc.hk/-/media/EN/assets/components/codes/files-current/web/guidelines/guidance-note-on-cooperation-with-the-sfc/guidance-note-on-cooperation-with-the-sfc.pdf>)

3 Guidance Note on Cooperation with the Accounting and Financial Reporting Council (<https://www.afrc.org.hk/en-hk/publications/guidelines/discipline/guidance-note-on-cooperation-with-the-afrc.pdf>)

4 Enforcement Sanctions Statement dated 25 October 2022 ([https://www.hkex.com.hk/-/media/HKEX-Market/Listing/Rules-and-Guidance/Disciplinary-and-Enforcement/Disciplinary-Procedures-and-Enforcement-Guidance-Materials/enf\\_sanctions.pdf](https://www.hkex.com.hk/-/media/HKEX-Market/Listing/Rules-and-Guidance/Disciplinary-and-Enforcement/Disciplinary-Procedures-and-Enforcement-Guidance-Materials/enf_sanctions.pdf))

5 Enforcement of the Listing Rules – Policy Statement dated 8 July 2021, with links to the Cooperation Guidance and the updated Sanctions Statement added on 25 October 2022 ([https://www.hkex.com.hk/-/media/HKEX-Market/Listing/Rules-and-Guidance/Disciplinary-and-Enforcement/Disciplinary-Procedures-and-Enforcement-Guidance-Materials/enf\\_policy.pdf](https://www.hkex.com.hk/-/media/HKEX-Market/Listing/Rules-and-Guidance/Disciplinary-and-Enforcement/Disciplinary-Procedures-and-Enforcement-Guidance-Materials/enf_policy.pdf))

control reviewers, as necessary to assist with fact-finding and proactively reporting to the Exchange any breaches or misconduct. The Exchange also expects early and proactive reporting of any breaches or misconduct.

3. **Admitting to breaches or misconduct at an early stage.** This demonstrates a proactive attitude and willingness to take responsibility for breaches. Such admissions should be submitted to the Exchange in writing, with sufficient details of the relevant Listing Rule(s), relevant events related to the breach, the identity of the parties involved, a clear admission of breach, the reasons for the breach and any remedial actions taken or to be taken.
4. **Initiating settlement or accepting sanctions.** Should parties intend to settle, they should approach the Exchange as early as possible. The Exchange clearly states that it is less likely to be amenable to settlement the further the enforcement action progresses.

### What is considered “uncooperative conduct”?

Some examples of uncooperative conduct include:

1. Failing to respond to the Exchange's enquiries.
2. Providing inaccurate, incomplete or misleading information.
3. Unnecessarily prolonging the Exchange's investigation.
4. Failing to attend an interview or disciplinary hearing where a party's presence has been requested.
5. Providing late submissions, evidence or documents.

The Exchange expressly states that any failure to provide relevant information or submissions at the appropriate time could result in adverse consequences. In particular, less weight may be attached to late submissions or adverse inferences may be drawn. Failure to provide information and submissions in a

timely manner may also be considered an aggravating factor, and the relevant party may, in appropriate cases, be found to be in breach of their obligation to cooperate with the Exchange.

The Exchange takes a holistic view when considering the appropriate regulatory response to the breach in question, and in appropriate cases, where cooperation should be recognised, there may be a reduction in the sanction and/or the inclusion of a statement to reflect the parties' cooperation in the news release or statement of disciplinary action. Conversely, uncooperative conduct may result in a separate breach of a party's obligations and result in a more severe sanction.

### Legal professional privilege: Would a refusal to disclose privileged materials be seen as uncooperative conduct?

Similar to the position of the SFC, as stated in the Guidance Note on Cooperation with the SFC, the Exchange makes clear that it fully respects the parties' right to legal professional privilege, and if privilege is asserted on a bona fide basis, it will not be regarded as uncooperative conduct. Parties voluntarily waiving legal professional privilege, on a limited basis, over certain documents to assist the Exchange's investigation may also contribute to the Exchange's assessment of their degree of cooperation.

### What substantive updates have been included in the Exchange's latest Sanctions Statement?

As well as publishing the Cooperation Guidance, the Exchange has updated its Sanctions Statement. The Sanctions Statement added an appendix setting out the primary disciplinary sanctions available following the revisions of the Exchange's disciplinary powers and sanctions in July 2021. Other substantive updates include:

1. **Passive misconduct** - The Exchange draws attention to “passive misconduct”, whereby directors may be found in breach by failing to take sufficient steps to discharge a duty, such as to

address control environment failings (e.g., internal control deficiencies or lack of oversight) for which they are responsible, even if such failings do not lead to other breaches of the Listing Rules or loss (see paragraph 5(c) of the Sanctions Statement).

2. **Collective and individual responsibility** - The Exchange reinforces that directors have a collective and individual responsibility for Listing Rules compliance (see paragraph 5(d) of the Sanctions Statement).
3. **Reliance on others in the discharge of duties** - Where a party claims to have relied on others (such as other directors, senior management, staff members, governance professionals or professional advisers) to discharge their duties, in defence of a breach of duties, the Exchange will assess whether such reliance is reasonable in the context of whether the party has continued to (i) maintain adequate oversight, (ii) apply professional scepticism and (iii) exercise independent judgment (see paragraph 7(m) of the Sanctions Statement).
4. **Internal controls** - The Exchange will assess whether a party has appropriate supervisory, risk management, operational or technical procedures and/or controls in place for procuring compliance with the Listing Rules by reference to:
  - a. Effectiveness and robustness of the internal controls systems, policies, procedures and working practices;
  - b. The necessary skills, experience and resources of directors and staff, including any training on internal controls and risk management measures;
  - c. Any regular reviews and updates to the control environment to ensure compliance with the Corporate Governance Code; and
  - d. The existence of proper channels to escalate concerns regarding risks and Listing Rules compliance matters and procedures to properly

handle the escalated concerns (see paragraph 7(n) of the Sanctions Statement).

### What are some practical considerations for governance professionals when facing an investigation by the Exchange?

Based on recent experience in assisting listed issuers, directors and governance professionals in resolving investigations by the Exchange, it would be worthwhile for governance professionals to bear the following points in mind and provide timely reminders to directors:

1. All directors, including independent non-executive directors, should be mindful of the principle of individual and collective responsibility of directors in ensuring the listed issuer's Listing Rules compliance. This may include ensuring the listed issuer has devised, implemented and communicated appropriate policies to its staff to address potential compliance issues and confirming there is sufficient monitoring and supervision in place to achieve compliance. The Exchange expects the directors to exercise proactivity and independent judgment to identify and raise to the board any issues concerning Listing Rules compliance.
2. Directors should keep a proper record of their involvement in promoting good practices for internal control, risk management and corporate governance. This will serve as helpful supporting evidence of their track record in such areas. For example, board minutes or minutes of other internal meetings, such as those of the audit committee or corporate governance committee, should contain reasonably sufficient details to reflect the matters raised and discussed at the meetings.
3. Where it is necessary for directors to rely on the listed issuer's supporting function or employees, such as the listed issuer's internal audit department, there should not be any excessive reliance and the directors must still ensure they

maintain adequate oversight, apply professional scepticism and exercise independent judgment with supporting evidence. The listed issuer should maintain an effective internal reporting system for any Listing Rules compliance matters.

4. Timely engagement with the Exchange is the key. Where breaches are identified, directors should consult with the listed issuer's legal advisers as soon as possible to decide when and how the matter should be reported to the Exchange, whether admissions should be made and whether it is appropriate to initiate settlement at an early stage. The Exchange will consider possible settlement proposals at any stage of the enforcement action. It is also important to take active steps to implement appropriate remedial measures as soon as possible instead of waiting for directions from the Exchange. Sufficient resources should be allocated to handle the Exchange's investigation and any submissions or information provided to the Exchange should be made in a timely manner.
5. With respect to internal controls, it is important for directors to adopt a proactive approach to discharge their duties. As pointed out by the Exchange in its Enforcement Bulletin<sup>6</sup>, issued in February 2022 (**Feb 2022 Enforcement Bulletin**), the adequacy of the internal controls needs to be considered on an ongoing basis to ensure proper and effective implementation. It is important to note that engaging external auditors to conduct annual audits is not sufficient to ensure the

adequacy and effectiveness of internal controls as external auditors do not generally conduct a thorough internal control review within the scope of their annual audit work.

6. As clarified by the Exchange in the Feb 2022 Enforcement Bulletin, disciplinary sanctions may still be appropriate even if no loss is suffered or where any loss suffered was not attributable to internal controls deficiencies. The Exchange's expectation remains on listed issuers maintaining robust internal controls to properly manage risks and disciplinary action is not contingent on loss.

## Conclusion

It is generally recommended to adopt a cooperative approach when handling regulatory enquiries as it is in the interest of both regulators and listed issuers/directors to resolve the investigation effectively and efficiently, to identify and resolve the underlying issues, and to save time and costs. Uncooperative conduct often results in public criticism of the party's approach and increased severity of sanctions. With respect to regulatory breaches, prevention is usually better than cure. Governance professionals, acting as company secretaries, have an important role to play in assisting listed issuers and their directors to foster a pre-existing environment and culture of compliance and promote good corporate governance. Developing greater awareness of the regulatory expectations and requirements amongst staff members would be a proactive first step.

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6 Exchange February 2022 Enforcement Bulletin (<https://www.hkex.com.hk/-/media/HKEX-Market/Listing/Rules-and-Guidance/Disciplinary-and-Enforcement/Enforcement-Newsletter/newsletter202202.pdf>)