



HKEX Publishes March 2023 Enforcement Bulletin with Focus on Disclosure

On 20 March 2023, the Stock Exchange of Hong Kong Limited (**HKEX**) published the [March 2023 edition of its Enforcement Bulletin](#), emphasising the importance of proper disclosure by listed issuers and their directors and the consequences of providing misleading or incomplete information. The bulletin provides guidance on the HKEX Listing Rules' disclosure requirements and the HKEX's expectations relating to disclosure. The HKEX highlights concerns in relation to disclosures by newly-listed issuers (including non-disclosure of changes in the use of IPO proceeds and expenditure incurred shortly after listing) and announcements rendered misleading by the omission of information, examples of which often include announcements of directors' and auditors' resignations.

HKEX Listing Rules' Disclosure Requirements

Timely disclosure of accurate information is a key obligation of companies listed on the HKEX. The general principles set out in HKEX Listing Rule 2.03 stress the importance of ensuring that investors receive sufficient information to make an assessment of an issuer and are kept informed of material factors that may affect their interests. The HKEX Listing Rules also require disclosures to be made in a number of specific situations. HKEX Listing Rule 2.13 sets out the HKEX's requirements for the presentation of information in issuers' announcements and corporate communications. Information must be presented clearly and in plain language and must be accurate and complete in all material respects, and not misleading or deceptive.

The HKEX warns that non-compliance with the disclosure requirements may result in regulatory action against listed issuers and their directors, as demonstrated by recent cases involving [Enterprise Development Holdings Limited](#) and certain directors of [Inno-Tech Holdings Limited](#).

HKEX Disciplinary Action against Enterprise Development Holdings Limited (Enterprise Development)

The HKEX censured Enterprise Development and censured and issued a prejudice to investors' interests statement against a former executive director of the company, Ms Mao Jun Jie (**Ms Mao**). Enterprise Development was found to have breached HKEX Listing Rule 2.13(2) by publishing inaccurate biographical information about Ms Mao in its announcement of her appointment as a director and in its notice of the company's AGM. The inaccurate information was given to Enterprise Development by Ms Mao, but the company failed to conduct due diligence on the information.

HKEX Disciplinary Action against Three Directors of Inno-Tech Holdings Limited (Innotech) (delisted)

The HKEX censured and imposed prejudice to investors' interests statements against three directors of Innotech. The case involved (among others) an announcement by Innotech of its appointment of a new auditor to replace

its former auditor (**Elite**). The announcement was inaccurate and misleading because it included a statement that Elite had confirmed that there were no matters or circumstances in respect of the change of auditor that needed to be brought to the attention of the company's shareholders, when no such confirmation had been given by Elite.

Disclosure Misconduct by Newly-listed Issuers

The HKEX has conducted several investigations into newly-listed issuers' disclosures, covering their prospectuses, listing application documents, and activities before and shortly after listing. The Enforcement Bulletin highlights particular concerns relating to significant changes in the use of IPO proceeds and outflows of money that were not properly disclosed, and which could have been material to the investing public.

The HKEX's latest Enforcement Bulletin makes reference to the SFC and HKEX's [joint statement on IPO-related misconduct](#) published in May 2021 which raised concerns regarding unusually high underwriting commissions or other listing expenses, and material amounts of discretionary listing expenses, being paid to underwriters by the listing applicant or its connected persons. The regulators suspected that, in some cases, these were used to artificially satisfy the HKEX's initial listing requirements (e.g. in relation to sufficient investor interest, minimum market capitalisation and adequate spread of shareholders). The HKEX reminded issuers to disclose all relevant information, warning that regulatory action may be taken if there is evidence of false, incomplete or misleading information in the listing document.

In addition, [the Review of Issuers' Annual Reports 2022](#) published by the HKEX in January 2023 raised further concerns about questionable investments of a material part of IPO proceeds, and seemingly disproportionate payments for consultancy arrangements, some of which lacked commercial rationale and resulted in substantial losses to the issuers.

The HKEX's latest Enforcement Bulletin cites two recent cases demonstrating its continued focus on the use of IPO proceeds, or other significant expenditures, by newly-listed issuers.

HKEX Disciplinary Action against China Bright Culture Group

In the case of [China Bright Culture Group \(China Bright\)](#), on the first day of the company's listing, China Bright used a significant portion of its IPO proceeds to enter into an undisclosed asset management agreement with a party that had been involved in its IPO as joint global coordinator, joint bookrunner and joint lead manager. This party then invested the entire amount in a promissory note issued by its affiliated party. China Bright terminated the asset management agreement about a year later. Although it redeemed the investment amount, it received no interest or return on the investment and the upfront fee of US\$3.5 million was incurred as a loss.

China Bright failed to disclose its intention to enter into the asset management agreement and acquire the promissory note in its prospectus in breach of HKEX Listing Rule 2.13(2) (the requirement for all information contained in a listed company's announcement or corporate communication to be accurate and complete in all material respects and not be misleading or deceptive). Alternatively, China Bright had failed to disclose the change in the use of its IPO proceeds under the then prevailing HKEx Guidance Letter GL86-16 (Part 1). At the time, paragraph 3.13 of that Guidance Letter stated that any material change in the use of IPO proceeds is generally price sensitive and must be announced after listing if information regarding the change is not disclosed in the prospectus. China Bright also failed to:

- comply with the announcement and shareholders' approval requirements with respect to the asset management agreement and promissory note (which constituted a major transaction of China Bright); and
- reflect the change in use of its IPO proceeds in its 2020 annual results announcement, 2020 annual report and 2021 interim results announcement in breach of paragraph 11(8) of Appendix 16 to the HKEX Listing Rules.

HKEX Disciplinary Action against Raffles Interior Limited

In the case involving [Raffles Interior Limited \(Raffles\)](#), the company entered into several agreements for professional and consultancy services and an investment management agreement around the time of listing. The company's intention to enter into these agreements was not disclosed in its prospectus, despite involving advance payments of substantial service fees amounting to 40% of the company's net IPO proceeds. The HKEX considered the commercial rationale for entering into the agreements to be doubtful, particularly as the fees charged by the service providers were excessive, and the services provided were limited and/or dubious. The auditor's subsequent discovery of the agreements resulted in a delay in the company's financial reporting and a trading suspension being implemented only 11 months after the company's listing.

Raffles was found to have breached HKEX Listing Rule 2.13(2) and/or 11.07 by failing to disclose in its prospectus its intention to enter into the service agreements and/or its investment plans. It also breached the HKEX Listing

Rules' requirements for the publication of its annual and interim results and the dispatch of its annual and interim reports.

In the Enforcement Bulletin, the HKEX reiterates the importance of adequate and timely disclosure of material commitments and expenditures by newly-listed issuers, particularly of those occurring around the time of or shortly after listing.

“Partial Truth” Disclosures

The HKEX underscores the importance of disclosures not being “passively” or indirectly misleading. An announcement could be regarded as “passively” or indirectly misleading when it omits, buries or downplays material facts of an unfavourable nature, or when favourable possibilities are presented as more probable than they really are. The HKEX gives the following examples of situations in which the omission of information could result in an announcement giving a misleading picture to investors:

- an announcement presenting only the promising future of a newly acquired business, without mentioning the need for certain government approvals that are known to be difficult to obtain; and
- an announcement attributing a delay in publishing audited results to external factors, e.g. the Covid-19 pandemic, while concealing serious audit issues raised by the auditors, which would have likely caused a delay regardless of external events.

The HKEX reminds issuers and directors to avoid including information in announcements which is misleading by omission. It highlights announcements of resignations of issuers' directors and auditors as one example of announcements that are often misleading by omission.

Directors' and Auditors' Resignation Announcements

The HKEX observes that it is common practice for directors' resignation announcements to cite personal reasons or the pursuit of other endeavours as the reason for resignation. Similarly, announcements of auditors' resignation often give an inability to agree on the audit fees as the reason for resignation. While these disclosures are sometimes appropriate, they sometimes conceal important information that investors should be aware of. For example, a director's resignation might stem from unresolved disputes with the board over a corporate governance matter, or an inability to agree on the audit fee may be due to the issuer's unwillingness to address high-risk, problematic areas of concern in the audit. In these situations, announcements that only disclose the superficial reasons for resignation may be misleading or deceptive.

Directors' Resignation

The HKEX Listing Rules require issuers to announce the resignation of a director and to disclose in the announcement the reasons for the resignation and a statement as to whether or not there are any matters that need to be brought to the attention of the holders of the issuer's securities (HKEX Listing Rule 13.51). Directors also have an obligation to ensure that the information disclosed is both accurate and meaningful (HKEX Listing Rule 13.51C).

The HKEX reminds issuers and directors of the [joint news release](#) published by the HKEX and the Hong Kong Institute of Directors in 2007, which clarified that the term “personal reasons” should be strictly limited to illness, bereavement or other genuine personal difficulties that change the director's circumstances. The term should not be used to refer to work-related schedules, disqualification of the director, detainment by the police or other authorities (including imprisonment) or change in the issuer's circumstances.

The HKEX stresses that issuers and directors should not resort to partial truth disclosures as a means to avoid addressing sensitive issues or as a delaying tactic. Incomplete disclosures may result in disciplinary action and public sanctions being imposed by the HKEX. Resigning directors should also raise any concerns they have if the issuer's announcement does not align with their understanding of the situation or the reasons provided for their resignation. These concerns should be raised with the issuer in the first instance, and if they remain unresolved, with the HKEX.

Auditors' Resignation

Similarly, the HKEX notes that an announcement of the resignation of an issuer's auditors should not simply cite disagreement over audit procedures or audit fees as the reason for resignation if there are other material issues that led to the auditors' resignation.

The HKEX refers to its [Listed Issuer Regulation Newsletter](#) published in December 2022 which reminded audit committees of their responsibility to ensure that auditors' resignation letters clearly reflect the reasons behind the resignation. The HKEX expects the audit committee to fully understand the reasons for the auditors' resignation

and to hold a meeting with the outgoing auditors in private to discuss various matters including any contentious issues raised during the audit. The audit committee is also required to ensure that the issuer discloses in the auditors' resignation announcement anything that may need to be brought to shareholders' attention in relation to issues or matters affecting the audit process or fees, or the issuer's relationship with the auditor.

The HKEX also refers in the Enforcement Bulletin to the concerns raised by the Accounting and Financial Reporting Council (**AFRC**) in its [open letter](#) regarding the misuse of "disagreement over audit fees" as a generic reason for resignation to obscure the real reason behind it. The AFRC's letter sets out its expectations that audit committees should engage in discussions with resigning auditors to understand the reasons for their resignation and ensure that the disclosure of the circumstances leading to the resignation in issuers' announcements is accurate and not misleading.

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