KPMG
cutting through complexity

# Hong Kong Capital Markets Update

Issue 2 – April 2015


**In this issue, we highlight the latest key regulatory developments affecting the Hong Kong capital markets with a focus on regulatory reporting and compliance matters.**

## Key Regulatory Developments

### Topics

- Consultation conclusions on review of Listing Rules on disclosure of financial Information with reference to the new Companies Ordinance and Hong Kong Financial Reporting Standards and proposed minor/housekeeping rule amendments
- China's Draft Foreign Investment Law
- Findings and recommendations pursuant to the Exchange's review of disclosure in issuers' annual reports to monitor rule compliance

### Consultation conclusions on review of Listing Rules on disclosure of financial Information with reference to the new Companies Ordinance and Hong Kong Financial Reporting Standards and proposed minor/housekeeping rule amendments

On 6 February 2015, The Stock Exchange of Hong Kong Limited ("the Exchange") published their Consultation Conclusions on Review of Listing Rules on Disclosure of Financial Information with Reference to the New Companies Ordinance and Hong Kong Financial Reporting Standards and Proposed Minor/Housekeeping Rule Amendments. The proposed amendments on the Main Board Listing Rules ("MB Rule") and GEM Listing Rules ("GEM Rule") (collectively, "Listing Rules") were approved by the Board of the Exchange and the Securities and Futures Commission ("SFC").

Please refer to our *Hong Kong Capital Markets Update published in July 2014* for a summary of the objectives and the proposals.

The following provides a summary of the consultation conclusions:

#### I. Rule amendments relating to financial information disclosure

1. Align the requirements under the Listing Rules with the disclosure provisions in the new Hong Kong Companies Ordinance ("New CO")

   The amendment is based on the principle of maintaining a level playing field for all issuers, irrespective of whether they are incorporated in Hong Kong, to include disclosures under provisions of the New CO. The additional disclosures include:

   - a new Business Review section. The Exchange, however, will not dictate where issuers should present the business review under the New CO as long as the information required is provided in the annual reports and complies with the disclosure requirements under the New CO and the Listing Rules;

- names of the directors of the non-Hong Kong incorporated issuers (disclosures of the names of subsidiaries' directors are not required);
- directors' interest on transactions and arrangements with the issuer;
- permitted indemnity provisions;
- equity-linked agreements; and
- reasons for a director resigning or not seeking re-appointment.

2. Streamline the disclosure requirements of financial information under the Listing Rules with reference to the requirements under Hong Kong Financial Reporting Standards

   The amendments:

   - remove disclosure requirements already included under International Financial Reporting Standards ("IFRSs") or Hong Kong Financial Reporting Standards ("HKFRSs");
   - align accounting terms in order to be consistent with the IFRSs or HKFRSs;
   - repeal the disclosure requirements in relation to financial conglomerates; and
   - repeal Appendix 15 of the MB Rule and GEM Rule equivalent in relation to "Bank Reporting".

3. Introduce new requirements when an issuer decides to revise its published financial report or make prior period adjustments due to correction of material errors in the results announcement

   Issuers are required to:

   - publish an announcement under the headline "Revision of Published Financial Statements and Reports" when the board of directors decides to revise its published financial statements, including published summary financial report and quarterly report. The date of publication of the original financial reports, the reason(s) leading to the revision of published financial statements and the financial impact, if any, are expected to be disclosed in the announcement.
   - alert the public on prior period adjustments due to correction of material errors in the results announcements through disclosure under separate "Prior Period Adjustments due to Correction of Material Errors" headline category. Issuers are not required to select this new headline category if a prior period adjustment was made due to the adoption of a new accounting standard.
   - inform the Companies Registry when the financial statements and reports (including summary financial reports and quarterly reports) are revised.


**Quick summary on the requirements for Hong Kong vs. Non-Hong Kong incorporated issuers**

| | Hong Kong incorporated issuers | Non-Hong Kong incorporated issuers |
|---|---|---|
| **Business review** | • Within the scope of the directors' report, i.e. included either in full or by explicit cross reference to elsewhere in the annual report | • Same as Hong Kong incorporated issuers |
| **Disclosure of directors' names on a consolidated basis** | • Disclose directors' names on a consolidated basis in the directors' report<br>• Disclosure of the names of directors of subsidiary undertaking by way of inclusion by reference, for example, by providing a link to the relevant website(s) which contains a full list of the names to prevent inclusion of excessive information in the directors' report | • Disclose names of the directors on their own board<br>• Disclosure of subsidiaries' directors not required |

## II. Rule amendments unrelated to disclosure of financial information

1. Consequential rule amendments due to enactment of new HKCO

   The amendments:

   - align the notice periods required for Bermuda or Cayman Islands incorporated issuers with the relevant requirement for general meetings under the New CO, i.e. 21 days for AGMs and 14 days for any other general meetings

     The intention is to ensure that issuers incorporated in Bermuda or the Cayman Islands and listing listed in Hong Kong are subject to the same notice requirements as Hong Kong incorporated issuers. Bermuda and Cayman Islands incorporated issuers, however, have an option to convene meeting on shorter notice on the same terms as Hong Kong incorporated companies.
   - replace "nominal value" or "issued share capital" under various parts of the Listing Rules with the number of, or the voting rights attaching to, issued shares.

2. Other rule amendments

   These include:

   - requirements to announce the expected payment dates for dividends or other distributions and codify the practice to require changes to be updated to shareholders.
   - clarification on the requirement of property valuation for the circular of any connected transactions that involve acquisitions or disposals of any property interest or property company.
   - removal of the requirement for disclosure of competing interests of directors of the issuer's subsidiaries and their close associates in circulars for notifiable and/or connected transactions.
   - codification of the existing practice to require trading suspension for GEM board issuers that fail to publish their financial results announcements.

### Quick summary on amendments and new requirements

**Related** to financial information disclosure

- Align the requirements under the Listing Rules with the disclosure provisions in the new Hong Kong Companies Ordinance
- Streamline the disclosure requirements that are already required under Hong Kong Financial Reporting Standards
- Introduce new requirements when an issuer decides to revise its published financial report or make prior period adjustments due to correction of material errors in the results announcement

Effective for accounting periods ending on or after 31 December 2015.

★ Early adoption permitted

**Unrelated** to financial information disclosure:

- Consequential rule amendments due to enactment of new Hong Kong Companies Ordinance
- Other rule amendments

Takes effect on 1 April 2015

Following the release of the Draft Law, the latest version of the Catalog for the Guidance of Industries for Foreign Investment (the "Catalog") came into force on 10 April 2015. According to the Catalog, the number of restricted sectors reduced from 79 to 38 and foreign investments in the service and manufacturing sectors become more accessible.

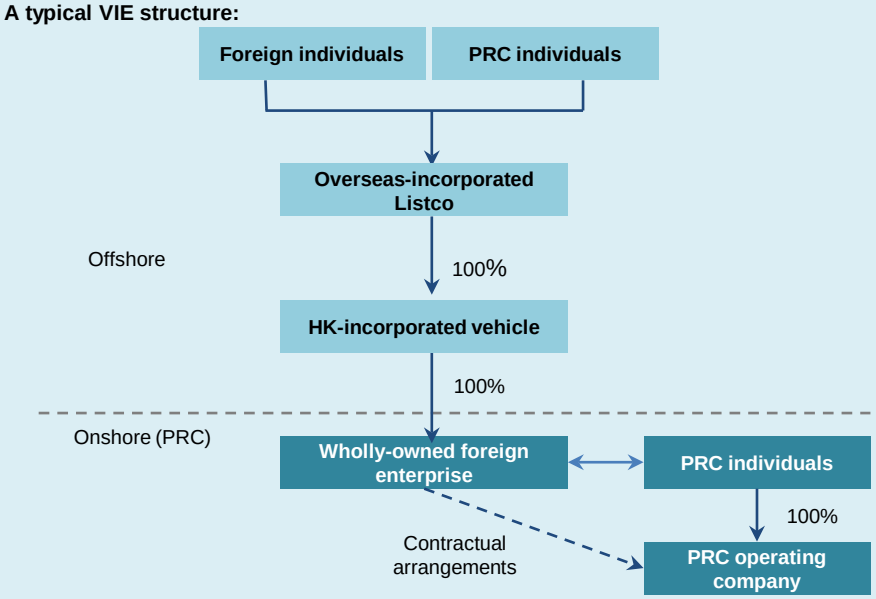
## China's draft Foreign Investment Law on VIE

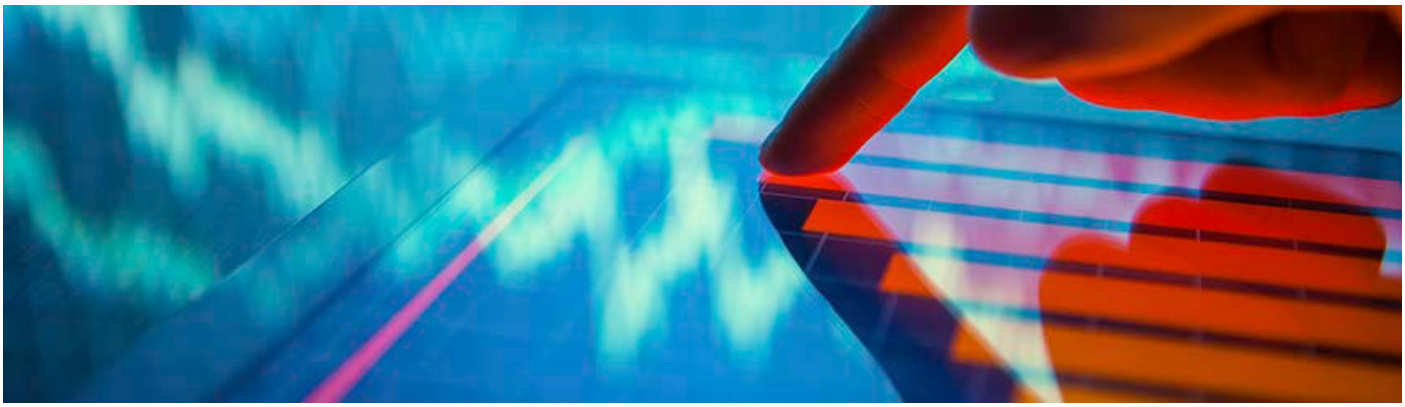
The People's Republic of China (PRC) Ministry of Commerce (MOFCOM) released the Draft Foreign Investment Law ("the Draft Law") on 19 January 2015. The new law will replace three existing laws related to foreign investment – the Law of the PRC on Foreign-capital Enterprises, the Law of the PRC on Chinese-foreign Contractual Joint Ventures and the Law of the PRC on Chinese-foreign Equity Joint Ventures.

The Draft Law, if adopted in its current form, would overhaul the foreign investment regime in the PRC. Among other proposals, the Draft Law introduces a more in-substance approach towards defining what is regarded as "foreign investment" and could have profound impact on variable interests entities ("VIE") structures, in the cases where foreign investors do not directly own equity interests in PRC businesses but obtain control through contractual arrangements.

The risks associated with a VIE structure are primarily regulatory and structural, i.e. whether the structure might be seen as a device to circumvent PRC laws and regulations that restrict or prohibit foreign investments in certain industries, and whether ownership via such structure is as secure as direct ownership of the PRC operating entity through equity investments for example when one or more parties decide not to perform their obligation under the contracts.

**A typical VIE structure:**



*Potential change impacting VIE structures*

The Draft Law introduces a more in-substance approach towards determining what constitutes a "foreign investment" in the following ways:

- It introduces a wider concept of "control" and clarifies that an investor may directly or indirectly control a PRC entity via trust or other contractual arrangements.
- It introduces a "look through" approach whereby a PRC entity would not be regarded as a foreign invested/controlled entity simply because its immediate (and any intermediate) parent was incorporated outside the PRC. Rather, any of these immediate and intermediate parents would be looked through to identify whether the PRC entity is ultimately controlled by a foreign or another PRC investor.

Under the proposal, it appears that an onshore PRC entity that is in-substance controlled by an immediate foreign parent via contractual arrangements, but that immediate foreign parent is controlled by a PRC national, might – at least in some cases – be considered to be controlled by a PRC investor for the purposes of investing in restricted industries. Although the Draft Law proposes some tests for assessing "control" for this purpose, these tests do not seem to be very clear and do not necessarily align with financial reporting standards; accordingly, identifying the controlling party could be challenging.

For ***new VIE structures***, the key implications of the above proposals appear to be that:

- a VIE structure that is ultimately not controlled (within the meaning of the Draft Law) by PRC investors would require market entry approval by the relevant foreign investment departments of the PRC State Council and hence might be prohibited in holding operating licences in certain restricted or prohibited industries in the PRC.
- a VIE structure that is ultimately controlled by PRC investors might be able to use such structure to invest in restricted or prohibited industries if such control could be demonstrated to the satisfaction of the relevant authorities.

For ***existing VIE structures***, the Draft Law is silent about the transitional arrangements; however, the explanatory note accompanying the Draft Law includes three proposals:

- The PRC entity that adopts a VIE structure would make a declaration to the relevant authorities that it is ultimately controlled by PRC investors, and continue with its VIE structure; or
- The PRC entity referred to above would have to specifically apply for a confirmation by the authorities (i.e. not simply making a declaration) that it is ultimately controlled by PRC investors, before it can continue with its VIE structure; or
- All PRC entities that adopt VIE structures, regardless of whether they are ultimately controlled by PRC or non-PRC investors, would have to obtain market entry approval by the relevant authorities, which would be granted on a case-by-case basis.

Although the Draft Law has yet to be finalised and the final law could be different, there is likely to be more scrutiny around VIE structures as a result. The proposals involve highly technical matters related to laws governing foreign investments in the PRC. Issuers or listing applicants whose VIE structures are significant to their businesses are advised to consult their legal advisors to determine the potential implications of the Draft Law to their businesses.

In addition, the entity should consider the related control assessment under the relevant financial reporting standards and the extent to which material VIE-related risks would necessitate additional disclosures in the financial statements or elsewhere in the annual report.

Listing applicants with VIE structures in place or that are considering putting in place VIE structures, in particular those that are not ultimately controlled by PRC investors, should carefully assess whether such structures would remain viable should the Draft Law be finalised as proposed, and the implications on their listing plans.

### Findings and recommendations pursuant to the Exchange's review of disclosure in issuers' annual reports to monitor rule compliance

On 27 March 2015, the Exchange published a report on the findings and recommendations for improvement from its review of certain issuers' annual reports for the financial years ended between December 2013 and November 2014 in respect of compliance with the Listing Rules and corporate conduct. The aim of the report is to improve transparency and promote a fair, orderly and informed market.

The focus of the Exchange's review covered the following topics:

- sufficiency of disclosure on issuer's adoption of IFRS 10/HKFRS 10 and the issuer's assessment on any financial impact to the company's financial statements;
- proposed and actual use of funds raised through issue of equity, convertible securities and subscription rights;
- updates on material changes after acquisitions;
- results of performance guarantees on acquisitions;
- significant changes to financial performance and material reliance on key customers;
- details of valuation methodology and assumptions of biological assets, including sensitivity analysis on changes in material inputs and full details of the issuer's licenses/rights/permits to carry out the agricultural activities; and
- details of exploration, development and mining production activities for mineral companies and a summary of expenditures incurred for the abovementioned activities and an annual update of resources and reserves as required under Chapter 18 of the MB Rule and Chapter 18A of the GEM Rule.

For newly listed issuers, the Exchange's review extended to cover the outcomes of profits forecasts and material changes in financial results after listing, changes in use of IPO proceeds and non-competition undertakings provided by the major shareholders in relation to the issuers' businesses.

The Exchange highlighted a new improvement point in relation to the profit warning announcements under the Inside Information Provisions. The Exchange has stated that issuers should ensure the information represents material developments subsequent to the date of the prospectus that has not been disclosed. Additional information about the newly listed issuers' financial position subsequent to its listing should be meaningful and specific, and not a restatement of information already available in the prospectus.

# Contact us

If you have any questions about the matters discussed in this publication, please feel free to contact Paul Lau or Katharine Wong of our Capital Markets Group ("CMG").

**Paul Lau**
Head of Capital Markets Group (Professional Practice)
Tel.: +852 2826 8010
paul.k.lau@kpmg.com

**Katharine Wong**
Partner
Tel.: +852 2978 8195
katharine.wong@kpmg.com

**kpmg.com/cn**