



Enforcement Bulletin

Welcome to the April 2024 edition of HKEX's Enforcement Bulletin.

This bulletin covers our latest learnings and actions from our enforcement work to keep listed issuers, directors and others involved in Listing Rules compliance abreast of important developments.

Loans, advances and other similar arrangements

In the last few years, we have seen an increase in the number of cases involving listed issuers granting loans, advances or other similar arrangements without proper due consideration and risk assessment, without subsequent monitoring, and in some cases, without a clear commercial rationale. The listed issuers often suffer significant impairment losses as a result of this.

The Exchange takes these cases very seriously because they are putting public investors' funds at risk. Directors of listed issuers do not have unrestricted freedom as to how to deploy the company's assets. In making any business or investment decisions, directors must be mindful of their obligations under the Listing Rules, which include a duty to safeguard the issuer's assets.

In this Bulletin, we examine issues relating to ill-considered loans, advances and similar arrangements made by listed issuers, and provide practical tips to help directors and issuers better understand what is expected of them and how they can fulfil their duties. We hope this Bulletin will serve as a useful reminder to all issuers and directors.

In the second section of this Bulletin, we round up our enforcement cases from the second half of 2023.

We would also like to share that we have enhanced the Disciplinary Sanctions section of our webpage by creating [a digital index](#). We hope the new layout and filter functions will enhance your and the wider public's experience in viewing and searching our published disciplinary sanctions.

Rising misconduct related to loans and lending activity

In recent years, we have seen an increase in the number of investigations involving loans, advances and other similar arrangements made by listed issuers. Sometimes, the loans are part of the listed issuer's money lending business. Other times, the issuers have decided to venture into money lending alongside or as an alternative to their main business, particularly if that business is underperforming. There are also cases where issuers decided to use their idle cash to grant loans to earn interest income.

These cases often come to our attention once the listed issuers have suffered a significant impairment, or because the auditors raised questions about the arrangements.

The lending arrangements often contain one or more of the following red flags in different stages of the loan arrangement:

Pre-loan stage:

- Questionable commercial merits of loan terms, for example: loans that are granted interest-free or at an interest rate that is lower than the company's cost of financing
- Unreasonably large lending granted to individuals or borrowers that are connected to the issuer; lending to parties connected to the directors or senior management
- Lack of evidence of a considered business and risk management plan regarding the lending portfolio, for example: analysis of risk appetite against potential return and the risk of default, and monitoring of overall exposure
- Lack of measures to safeguard assets, for example: insufficient security/collateral, or the absence of legally-enforceable contractual documentation
- Lack of records of due diligence and credit assessments performed by management before loans are granted, during monitoring of each credit, and before any extension or renewal

Post-loan stage:

- Repeated renewal, extension or rolling-over of loans on the same terms despite minimal or no repayment from borrowers
- Loans, advances or prepayments which were unauthorised, or of which the board was not aware, or which have bypassed some or all of the usual pre-lending controls and assessments
- Lack of evidence of the loan portfolio being monitored in light of the status of each individual loan and changing risk factors

Recovery stage:

- Minimal efforts to recover overdue payments, or to properly consider strategy in respect of potential bad debts
- Impairment of all or most of the loans, sometimes shortly after granting

We will take enforcement action and impose sanctions against the responsible parties in appropriate cases. We take an interest in these cases even when there is no breach of any of the disclosure or shareholders' approval requirements in Chapter 13 or 14 of the Listing Rules.

When we investigate, we look closely at the directors' decision-making process and whether appropriate care has been taken in conducting the business.

As mentioned in the Listing Division's publications,¹ the Exchange has been reviewing issuers' material lending transactions and material asset impairments in our thematic review of issuers' annual reports since 2021. The Exchange has published market education materials and disciplinary sanctions relating to this theme in the last three years. While we have observed heightened market awareness of the matter, we continue to see cases involving loans, advances and other similar arrangements made by listed issuers (for example those set out in the section named "Examples of misconduct relating to lending activities" below).

The Exchange will continue its surveillance and enforcement efforts in this area and we encourage all issuers to critically consider any lending arrangements in light of the Exchange's published materials and the key areas described below.

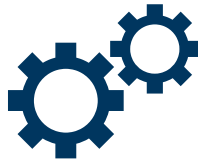
¹ See, for example, the [Review of Issuers' Annual Reports – 2023](#) published in January 2024

Our loan-related investigations focus on three areas

In our investigation of any loans, advances and other similar arrangements, we typically focus on the following key areas:



Directors' duties;



Internal controls; and



Disclosure obligations.

Directors' duties include a thorough evaluation of lending activities

Directors are expected to critically assess the commercial rationale for entering into money lending. This includes assessing whether the terms are fair and reasonable, and whether the use of issuers' funds is in the best interest of the company.

Entry into or expansion of a business, particularly one which is high risk, must be properly considered by the board. For money lending, proper steps must be taken to assess and manage the exposure of the issuer. This includes:

- Before granting any loans or making advances to a party, proper due diligence, background check and credit assessment should be conducted on both the borrower and any assets purportedly owned by the borrower which are used as security for the loan. Care should also be taken to assess the enforceability of any pledges offered by borrowers. We have seen cases where issuers experienced difficulties in taking possession of pledged properties, or faced challenges in court as the pledge agreement was not in the correct form or properly registered.
- After loans are granted, there should be regular review and monitoring of the loan portfolio including the status of any payments due (whether principal or interest). In the event of any issues, there should be a procedure for escalation for further consideration and management.
- In the event of a default or delay in payment, proactive and appropriate measures should be considered to minimise risks. This may include sending demand letters, requesting additional security, having recourse to guarantors, disposing of collateral or pledges, and in appropriate situations, taking legal action. There should be evidence that the issuer's management has given proper consideration of the options available, has carefully formulated its strategy, and has sound reasons for its decisions.
- Before granting any renewal or extension of a loan, the company should renew its risk assessment both against the individual borrower (such as reviewing credit history, income and asset proof, updating background checks) and in the context of its overall exposure.
- Issuers should develop appropriate and supporting estimates to assess the recoverability of loans to support the impairment assessment under the relevant accounting standards.

Directors must use their best endeavours to ensure contemplated loans or advances are in the interests of the issuer and its shareholders, and the terms are fair and reasonable.

Effective lending-related internal controls must be in place

Issuers and directors should also ensure that they have appropriate and effective internal control systems to assess and manage their credit risk exposure, identify the need for any impairment, and perform timely and accurate internal and external reporting, including announcements and financial statements.

In the context of provision of advances and loans, there should be adequate checks and balances, such as an approval system for payments by the company. There should be segregation of duties and a monitoring system, so that no one individual has unfettered decision-making power over the grant of loans or advances. If the relevant money lending business is operated by a subsidiary of the issuer, there should be sufficient reporting to the board to enable the board to exercise oversight. There should also be appropriate internal control measures to assess the enforceability of any pledges offered.

Another important part of internal control is record keeping. In the context of loans and advances, issuers are expected to keep records of the commercial assessment and approval process. The absence of contemporaneous documentation evidencing appropriate risk management will cast doubt as to its adequacy, cause issues of concern and could lead to adverse inferences being drawn in an investigation or disciplinary action.

The Hong Kong Companies Registry has published in June 2023 [a guideline for licensed money lenders on compliance of anti-money laundering and counter-terrorist financing requirements](#) which notes that money lenders should keep the original/a copy of the

documents, a record of the data and information obtained in the course of identifying and verifying the customers' identities, including information obtained for the purposes of enhanced due diligence or ongoing monitoring, for at least five years after the end of the licensed money lenders' business relationship with the borrowers/after the completion date of the relevant transactions.

Disclosure obligations apply to loans too, including when renewing and extending

Issuers must always remember their obligations under Chapters 14 and 14A of the Listing Rules to make timely disclosures and, if necessary, obtain shareholders' approval, especially when the loans are material, or where the advances are being made to connected parties. Provision of advances or financial assistance may also trigger obligations under Chapter 13 of the Listing Rules.

Particular care must be taken to ensure compliance with the Rule obligations when renewing or extending loans. We have seen cases where issuers mistakenly assume that the renewal of loans is not subject to the Rule obligations. Issuers are reminded that each renewal/extension of a loan is regarded as a new transaction. Accordingly, issuers must comply with all applicable requirements under the Listing Rules, including performing a fresh size test calculation and making any necessary disclosures.

Care must be taken when assessing recoverability and impairment of loan receivables to ensure that any disclosures in financial statements and corporate announcements are accurate and complete in all material respects and are not misleading or deceptive (Rule 2.13).



Examples of misconduct relating to lending activities

In this section, we set out examples of recent cases involving loans, advances or other similar arrangements which resulted in public disciplinary sanctions.

Hong Kong Resources Holdings Company Limited:

The issuer's subsidiary granted loans to borrowers totaling HK\$74.4 million during a 10-month period. Within months, some interest repayments in respect of the loans had become overdue. The issuer's auditors raised concerns regarding the loans, noting that there were inadequate controls in place for the money lending business, and that the due diligence on the borrowers' ability to repay was insufficient. The auditors were also concerned about, and disagreed with, the issuer's expected credit loss assessment. After these concerns were raised, the issuer published its interim report, but the report did not say anything about the auditors' concerns. No expected credit loss provision was made by the issuer. A few months later, during the audit process for financial year end, the auditors continued to raise concerns regarding the loans. The auditors questioned their commercial rationale and the lack of follow-up action when sums had become overdue. In the end, all the borrowers defaulted on the loans. The issuer recorded a 100 per cent impairment loss of around HK\$86 million.

The Exchange took disciplinary action and sanctions were imposed against the issuer and the responsible directors, for, among other things, their failure to procure the issuer to disclose accurate and complete information in the interim report, and for failing to procure the issuer to have in place an adequate and effective internal control system in the money lending business.

Arta TechFin Corporation Limited: The issuer significantly expanded its money lending business and granted loans in the total amount of HK\$2.28 billion during a 9-month

period. All of the borrowers defaulted on the loans and significant impairment losses of over HK\$1.9 billion were incurred by the issuer. The commercial rationale for granting the loans was questionable, as all of the loans were unsecured and made to individual borrowers, all of whom were referred to the issuer by the same director. Further, most of the borrowers requested that their loans be paid to third-party nominees, with some borrowers nominating the same nominee. Inadequate due diligence and credit assessment had been conducted, and the relevant directors had only conducted limited follow-up or monitoring regarding the status of the loans. There was also no evidence of anti-money laundering procedures or any other checks conducted against the third-party nominees, even where the same nominee was designated by different borrowers to receive their loan proceeds. The relevant directors were publicly sanctioned for their breach of directors' duties, including, among other things, their failure to apply the levels of skill, care and diligence required in supervising the business, and to take sufficient steps to safeguard the company's interests.

China Saite Group Company Limited: A former chairman was found to have continuously withdrawn cash from the issuer totaling around RMB113 million in the form of advances. The interest-free advances were booked as "other receivables" in the issuer's annual reports. Upon the Exchange's enquiry, the issuer initially submitted that these sums comprised interest-bearing loans granted by the issuer to the former chairman and provided loan agreements and minutes purporting to show their existence. However, it was later discovered that the alleged discussions and loan agreements about the advances never existed. The issuer and relevant directors, including the former chairman, faced public sanctions in this case.



Cooperation with other regulators

Many outflows of funds give rise to concerns of corporate misconduct, misappropriation of funds, or false and misleading financial statements. When necessary, we will refer our findings and may cooperate with other regulators or law enforcement agencies, such as the Securities and Futures Commission (**SFC**), the Accounting and Financial Reporting Council (**AFRC**) and the Commercial Crime Bureau of the Hong Kong Police, in our investigation. See for example a recent press release concerning

[China Ecotourism Group Limited](#), where we collaborated with the SFC in an enforcement action concerning granting of loans. The SFC and AFRC have also published a [joint statement](#) in July 2023 in relation to their observations on loans, advances, prepayments and similar arrangements made by listed issuers. The Exchange continues to work closely with other regulatory and enforcement authorities to maintain market quality and investor confidence.

A round-up of recent enforcement cases

We have published sanctions in 14 cases in the second half of 2023, set out in the index below.

Among these cases, director unsuitability statements were made against 12 directors, and prejudice to investors' interests statements were made against eight directors. Five of these cases involved settlements with issuers and directors.

A common theme shared by these cases is that the directors and senior management of a listed company should take active steps to safeguard the company's assets.

In [Hope Life International Holdings Limited](#), the then chairman and executive director caused the company's group to enter into a joint venture proposed by her new acquaintance, who was later discovered to have misappropriated all the monies paid for this new business, and the company suffered a loss of over USD 1 million as a result. The director in this case undertook no or very limited due diligence, and did not conduct any commercial or risk assessment in respect of the joint venture business. In [Global Mastermind Holdings Limited](#), the then executive director did not obtain information about the acquisitions despite their questionable legitimacy, which led to an impairment loss of around HK\$58.7 million. The director in this case appeared to have actively concealed the acquisitions, and allowed the cash withdrawals to occur without supporting documents normally required for such payments.

While executive directors have a crucial role to play in procuring the listed issuer's Listing Rule compliance, non-executive directors and independent non-executive directors (INED) – although not involved in day-to-day operations and management – also have a key role to play. In [China Saite Group Company Limited](#), where a former chairman was found to have caused the company to provide him with financial assistance through loans and advances, the INEDs were found to have breached directors' duties for, among other things, their failure to

raise enquiries and to take substantive steps to address the company's internal control deficiencies for an extended period of time.

We have published [A Snapshot of INEDs' Roles and Responsibilities](#) in November 2023, which seeks to provide a quick and easy-to-follow overview of INEDs' key responsibilities and obligations to help directors in Hong Kong better understand what is expected of them and how they can fulfill their duties. We encourage all directors and interested parties to read it.



Date of News Release	Issuers and summary of conduct
<u>5 July 2023</u>	<p>E&P Global Holdings Limited</p> <ul style="list-style-type: none"> Listed issuer’s failure to comply with the announcement, circular and shareholders’ approval requirements in relation to certain transactions including acquisition and conversion of convertible bonds, and disposal of shares The Division reached a settlement with the party in this disciplinary action
<u>19 July 2023</u>	<p>Lisi Group (Holdings) Limited</p> <ul style="list-style-type: none"> Listed issuer’s repeated failure to comply with the procedural requirements in relation to various discloseable, major and continuing connected transactions Listed issuer’s failure to timely publish its annual results and report Listed issuer’s failure to maintain adequate and effective internal controls The Division reached a settlement with the party in this disciplinary action
<u>17 August 2023</u>	<p>Two directors of Ourgame International Holdings Limited</p> <ul style="list-style-type: none"> Breach of directors’ duties by failing to (a) ensure proper due diligence was conducted in respect of certain loans, (b) exercise due care in arranging and handling the loans, and (c) make reasonable enquiry into certain arrangements relating to the loans Failure to cooperate by one of the directors The Division reached a settlement with one of the two directors in this disciplinary action
<u>24 August 2023</u>	<p>China Saite Group Company Limited and ten directors</p> <ul style="list-style-type: none"> Listed issuer’s failure to (a) comply with the notifiable and connected transaction requirements in relation to certain loans, advances and subscription of shares, (b) ensure its submissions to the Exchange are true, accurate and not misleading, (c) inform the Exchange and publish an announcement after the presentation of winding-up petitions as soon as it comes to its attention, (d) timely despatch its annual report and financial statements, and (e) ensure the announcements published are accurate and complete in all material respects and not misleading or deceptive Breach of directors’ duties by (a) failing to discharge fiduciary duties, (b) failing to procure the issuer’s Listing Rule compliance, (c) endorsing misleading submissions to the Exchange, (d) failing to ensure adequate and effective internal controls, and/or (e) failing to apply independent judgement to audit issuers
<u>30 August 2023</u>	<p>A director of Global Mastermind Holdings Limited</p> <ul style="list-style-type: none"> Breach of director’s duties by failing to exercise reasonable skill, care and diligence to safeguard the assets and interests of the issuer and its shareholders in relation to certain unauthorised investments and cash withdrawals Director’s failure to cooperate in the Exchange’s investigation
<u>5 September 2023</u>	<p>Two directors of Hope Life International Holdings Limited</p> <ul style="list-style-type: none"> Breach of directors’ duties by failing to conduct proper due diligence and assessment before causing the issuer group to enter into joint venture and relevant transactions Directors’ failure to cooperate in the Exchange’s investigation
<u>5 October 2023</u>	<p>C-Link Squared Limited and two directors</p> <ul style="list-style-type: none"> Listed issuer’s failure to (a) disclose its potential engagement of consultants in the prospectus and profit and cash flow forecast memorandum, (b) fully assist the sponsor to perform its due diligence work, and (c) consult its compliance adviser before making advance payment to consultants Breach of directors’ duties by failing to apply sufficient care, skill and diligence and use their best endeavours to procure the issuer’s Listing Rule compliance and protect the issuer’s assets The Division reached a settlement with the relevant parties in this disciplinary action

Date of news release	Issuers and summary of conduct
<u>26 October 2023</u>	A director of China Tian Yuan Healthcare Group Limited <ul style="list-style-type: none">• A director's failure to cooperate in the Exchange's investigation
<u>31 October 2023</u>	China Fortune Holdings Limited and eight directors <ul style="list-style-type: none">• Listed issuer's failure to comply with the disclosure and procedural requirements under the Listing Rules for notifiable and connected transactions• Breach of directors' duties in relation to their failure to (a) procure the issuer's Listing Rule compliance, (b) ensure adequate and effective internal controls, and (c) review and monitor the training and continuous professional development of directors and senior management of the issuer• A director's failure to cooperate in the Exchange's investigation• The Division reached a settlement with the relevant parties in this disciplinary action
<u>9 November 2023</u>	A director of China Fortune Investments (Holding) Limited <ul style="list-style-type: none">• Breach of director's duties in relation to the failure to (a) comply with training direction, and (b) update his contact details with the Exchange as soon as reasonably practicable
<u>21 November 2023</u>	Sun Cheong Creative Development Holdings Limited and eight directors <ul style="list-style-type: none">• Listed issuer's failure in relation to (a) misleading communications with the Exchange, and (b) inaccurate, incomplete, misleading and/or deceptive disclosure in the annual report and the announcements• Breach of directors' duties in relation to their failure to (a) take reasonable steps to maintain the issuer's operation, and (b) procure the issuer's Listing Rule compliance• Three directors' failure to cooperate in the Exchange's investigation
<u>4 December 2023</u>	Hong Kong Resources Holdings Company Limited and eight directors <ul style="list-style-type: none">• Listed issuer's failure in relation to (a) inaccurate and incomplete disclosure in its interim report, and (b) delays in publishing and dispatching its interim results, interim report, annual results and annual report• Breach of directors' duties in relation to their failure to (a) comply with Listing Rules, (b) procure the issuer's Listing Rule compliance, and (c) ensure adequate and effective internal controls• Two directors' failure to cooperate in the Exchange's investigation
<u>12 December 2023</u>	A director of Xinjiang La Chapelle Fashion Co., Ltd <ul style="list-style-type: none">• Breach of director's duties in relation to the failure to (a) act honestly and in good faith in the interests of the company as a whole, act for proper purpose, be answerable to the company for the misapplication of its assets, (b) avoid conflict of interest, (c) exercise reasonable skill, care and diligence to safeguard the interests of the company, and (d) use best endeavours to comply with Listing Rules and applicable laws, rules and regulations• A director's failure to cooperate in the Exchange's investigation
<u>19 December 2023</u>	A director of Brilliance China Automotive Holdings Limited <ul style="list-style-type: none">• A director's failure to cooperate in the Exchange's investigation