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Hong Kong regulatory oversight on money lending transactions by listed companies

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NEWSLETTER

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In recent years, money lending transactions by listed companies have attracted the attention of Hong Kong regulators, who are particularly concerned with misconduct related to money lending transactions by listed companies due to their ineffective internal control systems and lack of adequate public disclosures. The visible increase in cases of suspected money lending transactions in dubious circumstances, sometimes to misappropriate or fraudulently misuse company assets, has sparked the regulators to more closely review such transactions.

As a measure to facilitate compliance, the regulators have published guidances recommending and requiring compliance practices for listed companies dealing with money lending transactions. In July 2023, the Securities and Futures Commission (SFC) and the Accounting and Financial Reporting Council (AFRC) issued their first joint statement in relation to loans, advances, prepayments and similar arrangements made by listed companies. Further, in January 2024, The Stock Exchange of Hong Kong Limited (HKEx) published its review of listed issuers' annual reports for the 2023 financial year, followed by its April 2024 edition of the enforcement bulletin.

The above guidelines highlight the regulatory expectations on managements of listed companies when assessing and entering into money lending transactions. The guidelines suggest that internal control systems for money lending transactions should cover the assessment, approval, monitoring, recovery and documentation of money lending transactions, as follows:

- **Assessment:** conduct adequate due diligence and credit assessment on the borrower
- **Approval:** establish clear levels of internal approvals with designated authorised persons for money lending transactions with different amounts
- **Monitoring:** closely monitor the repayment status and the fulfilment of financial covenants by the borrower during the life of the money lending transaction

- **Recovery:** promptly follow-up on late repayments or settlements and take enforcement actions for overdue debts if necessary
- **Documentation:** maintain proper records of the money lending transaction.

Directors of listed companies are ultimately responsible for ensuring that effective internal control systems for money lending transactions are established and implemented by listed companies. They are also expected to thoroughly evaluate the commercial rationale for entering into money lending transactions, critically assess whether transaction terms are fair and reasonable, clearly ascertain borrower identity and credibility, and use their best endeavours to determine whether a transaction is in the best interest of the listed company and its shareholders as a whole.

In addition, the audit committee of a listed company should oversee the effective operation of the listed company's internal control systems, and ensure that money lending transactions are appropriately accounted for and adequately disclosed in financial statements. The audit committee should also maintain active dialogue with the listed company's external auditor so that auditor's questions about money lending transactions, such as their commercial rationale and any material recoverability issues, are duly addressed by the listed company.

The guidelines also remind listed companies of their public disclosure obligations when dealing with money lending transactions. In general, listed companies should disclose in their annual reports the details and major terms of money lending transactions, the reasons for entering into those transactions and the alignment of those transactions with the listed company's business strategies. In addition, annual reports should also discuss any material impairments or write-offs of money lending transactions and the basis of impairment assessments.

For any listed company that conducts money lending transactions as its principal activity, it should further disclose in its annual reports its business model, its breakdown of its money lending portfolio, and its discussions of the movements of impairments or write-offs of money lending transactions.

In addition to regular disclosures in their annual reports, listed companies and their directors are also reminded by the guidelines that money lending transactions are a form of "financial assistance" under the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited ("**Hong Kong Listing Rules**"). Therefore, when dealing with a proposed money lending transaction, the directors of a listed company should fully consider the implications of Chapters 14 (*notifiable transactions*) and 14A (*connected transactions*) of the Hong Kong Listing Rules from a corporate governance perspective. Furthermore, both the listed company and its directors should closely monitor any ongoing money lending transaction as part of their continuing obligations under Chapter 13 of the Hong Kong Listing Rules, and make a timely public disclosure in the event of a material change in the money lending transaction.

Since 2023, we have observed multiple cases where regulators have investigated and publicly censured listed companies and/or its directors for engaging in dubious money lending transactions. The publication of the guidelines is a reminder that listed companies should enhance their existing internal control systems to comprehensively address potential compliance risks during different stages of money lending transactions. In the event that issues arise surrounding money lending transactions, listed companies should also consider the implication of the Hong Kong Listing Rules and make timely disclosures and announcements when and where necessary. To best protect their assets and their shareholders' interests, listed companies are strongly encouraged to seek professional advice on how to handle money lending transactions before making any lending decisions.

Fangda Partners' Hong Kong Contentious Regulatory Practice Group (HKCRP) will continue to closely monitor these and other regulatory developments so that we are prepared to advise clients on any of their regulatory concerns.