Statutory Regime for the Disclosure of Price Sensitive Information – The Implications for Listed Companies and their Directors

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THE STATUTORY PSI REGIME: IMPLICATIONS FOR LISTED COMPANIES AND THEIR DIRECTORS AND OFFICERS

I. INTRODUCTION

The statutory regime for the disclosure of price sensitive information (**PSI**), called "inside information" under the new regime, takes effect since 1 January 2013. Disclosure of PSI has long been governed by the non-statutory Listing Rules (under Chapter 13 of the Main Board Rules and Chapter 17 of the GEM Rules). Since 1 January this year, the obligation to disclose PSI becomes a statutory obligation under the new Part XIVA of the SFO. Breach of this obligation is a civil offence for which listed companies and their directors may be liable on conviction to a fine of up to HK$8 million.

By way of background, this statutory backing for listed companies' obligation to disclose PSI has been a long time in the making. Companies' obligations under the Listing Rules used to be contractual obligations that they undertook to the Exchange to fulfill. They did not have the force of statute and did not give the Exchange statutory regulatory powers. Accordingly, the Exchange's disciplinary powers were limited: it had no power to impose fines, but might publicly or privately censure firms in breach, and in extreme cases might suspend or cancel the listing of an issuer's securities.

A number of major jurisdictions which previously followed the non-statutory approach moved to a statutory approach in recent years and empowered their statutory agencies and courts to take statutory action against those breaching the rules. The UK transferred its listing regulatory role from the London Stock Exchange to the Financial Services Authority (**FSA**) which recast the listing requirements as statutory rules with statutory enforcement. Likewise Australia and Singapore have given their listing rules "statutory backing".

In Hong Kong, concerns were expressed about the lack of "regulatory teeth" in the Listing Rules. The Government and the SFC have already taken a number of initiatives aimed at strengthening regulation of listed companies. In 2003, the "dual filing" regime was established under the Securities and Futures (Stock Market Listing) Rules (**SMLR**) under the Securities and Futures Ordinance. This imposes criminal liability on listing applicants and listed issuers who intentionally or recklessly disclose materially false or misleading information to the public.

In 2004, proposals were put forward to build on the dual filing regime and codify the most important Listing Rule obligations into subsidiary legislation. The SFC would then be responsible for enforcing those provisions while the Exchange would continue to receive listing applications and administer the listing process as the frontline regulator of listed companies.

To that end, the SFC published a consultation paper in January 2005 (the Consultation Paper on Proposed Amendments to the Securities and Futures (Stock Market Listing) Rules) proposing the statutory codification of the following 3 areas of issuers' obligations under the Listing Rules:

- Disclosure of **price-sensitive** information;
- Publication of annual and interim **financial reports**

- Disclosure and shareholders' approval requirements for **Notifiable and Connected Transactions**

Respondents to the consultation had concerns that importing the detailed requirements of the listing rules into Statute could reduce flexibility making it difficult for the rules to be amended expeditiously in response to market needs. There were also concerns that an unintentional breach of the detailed requirements could be subject to severe statutory sanctions. As a result, the Consultation Conclusions published in February 2007 put forward an alternative approach: the statutory listing requirements would comprise a set of general principles representing issuers' fundamental obligations. These would be supplemented by ancillary provisions set out in a schedule to the SFC facilitating easier amendment of the requirements if and when necessary. Non-compliance with the new general principles was proposed to constitute "market misconduct' under Parts XIII and XIV SFO and subject to one of three types of sanction in serious cases: SFC disciplinary action, civil proceedings before the Market Misconduct Tribunal or criminal prosecution.

In the event, the Consultation Conclusions were not implemented. Although the SFC claimed to have received widespread support for the proposals, there were certainly concerns with making the disclosure of PSI a statutory obligation. The perceived difficulty arises from the lack of certainty as to the definition of what constitutes PSI: what is PSI is a matter of professional judgment in the particular circumstances of any given case. Thus, of the 3 areas proposed for statutory codification, disclosure of PSI was probably the most problematic and controversial.

Nevertheless, while there have not yet been any further moves to codify issuers' financial reporting and notifiable and connected transaction disclosure obligations, the SFC seems intent upon codifying the obligation to disclose PSI.

The Exchange conducted two consultations: one on amending the Listing Rules to avoid overlap with Part XIVA; the other on allowing the publication of PSI during trading hours subject to the implementation of short trading halts to allow the market to digest the information disclosed.

The definition of "inside information" under the new statutory regime is the same as the definition of "relevant information" – which forms the basis of the offence of insider dealing under Parts XIII and XIV of the SFO. Hence the information which listed companies are required to announce under the new statutory disclosure obligation is the same information which, if possessed by a listed company's directors and other insiders, prohibits them from dealing in the company's securities under the insider dealing offences in Parts XIII and XIV SFO.

Probably the greatest difficulty facing listed companies, their directors and advisers resulting from the transition to a statutory disclosure regime, is the difficulty of determining with certainty whether any given information falls within the definition of inside information. This is a matter of judgement. An error of judgement used to attract, at worst, disciplinary actions from the Exchange. Under the new regime, it could cost up to HK$ 8 million.

This note covers:

- The key features of the new statutory disclosure regime;
- The amendments to the Listing Rules aims at avoiding overlap with the new statutory disclosure obligation; and

- The Exchange's proposal to allow disclosure of PSI during trading hours.

By way of illustration of the difficulty of determining whether information constitutes "price sensitive information", we will also be looking at:

- Insider dealing cases in Hong Kong and the circumstances in which information has been considered to constitute PSI (or relevant information the term currently used in the SFO);
- Cases in the UK and the EU on information deemed to constitute "inside information" for the purposes of the EU disclosure requirements, embodied in the UK in the FSA's Disclosure and Transparency Rules; and
- A recent European Court of Justice ruling in the case of Geltl v Daimler (June 2012).

II. NEW STATUTORY REGIME FOR DISCLOSURE OF PRICE SENSITIVE INFORMATION

1. Highlights of the PSI Disclosure Regime

The new regime creates a statutory obligation on corporations to disclose PSI to the public, **as soon as reasonably practicable after** PSI has come to their knowledge. Breaches of the PSI disclosure requirement will be dealt with by the Market Misconduct Tribunal (**MMT**) which is able to impose a number of civil sanctions including a maximum fine of HK$8 million on the corporation and on its directors and chief executive in certain circumstances. The new statutory regime seeks to counter allegations that the existing Listing Rules' framework lacks "regulatory teeth" and reflects developments in other international markets.

Under the amended SFO, the Securities and Futures Commission (the **SFC**) will be able to directly institute proceedings before the MMT to enforce the PSI disclosure requirement and to deal with the six types of market misconduct under Part XIII SFO[1] with effect from 4 May 2012. Previously only the Financial Secretary could institute proceedings before the MMT.

The SFC has published Guidelines on Disclosure of Inside Information (**SFC Guidelines**) to assist corporations to comply with the new disclosure obligation. These were published in June 2012 and are available on the SFC website.

The SFC also provides an informal consultation service to assist corporations in understanding the new requirements for an initial period of 24 months.

The Amendment Ordinance also made certain consequential amendments to the SFO. These include amending the definition of "business day"[2] to exclude Saturdays. This affects (among others) the timing of giving notices of interests under the disclosure of interests regime in Part XV SFO.

2. Key Features of the PSI Disclosure Regime

The key features of the new regime include:

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[1] The six types of market misconduct are insider dealing, false trading, price rigging, disclosure of information about prohibited transactions, disclosure of false or misleading information inducing transactions and stock market manipulation.

[2] "Business day" is defined in Part 1 of Schedule 1 to the SFO.

- The adoption of the concept of “relevant information” used under the insider dealing regime to define PSI (called "inside information" in the SFO);

- The application of an objective test in determining whether information is “inside information” - whether a reasonable person, acting as an officer of the corporation, would consider that the information is inside information in relation to the corporation;

- An obligation on a corporation to disclose “inside information” as soon as reasonably practicable after it comes to the knowledge of the corporation (i.e. after the information has, or ought reasonably to have, come to the knowledge of an officer of the corporation in the course of performing functions as an officer of the corporation);

- An obligation on the directors and officers of a corporation to take all reasonable measures to ensure that proper safeguards exist to prevent the corporation breaching the statutory disclosure requirement;

- For directors and officers of a corporation to be individually liable for the corporation’s breach of the statutory disclosure obligation, if they are in breach of the obligation referred to above or if the corporation’s breach is a result of any intentional, reckless or negligent conduct on their part;

- The provision of safe harbours for legitimate circumstances where non-disclosure or late disclosure is permitted;

- The SFC is able to rely on its powers under the SFO to investigate suspected breaches and to institute proceedings directly before the MMT;

- The MMT is able to impose a range of civil sanctions, including a fine of up to HK$8 million on the corporation, a director or chief executive of the corporation and disqualification of a director or officer for up to 5 years; and

- A corporation or officer found to have breached the statutory disclosure requirement may be liable to pay compensation to any person who has suffered financial loss as a result of the breach (provided it is fair, just and reasonable that it/he should do so).

3. Definition of Inside Information

The amended SFO uses the term “inside information” to refer to the PSI which a corporation must disclose. “Inside information” is defined in Section 307A SFO as:

“specific information” that:

(a) is about:

  i. the corporation;

  ii. a shareholder or officer of the corporation; or

  iii. the listed securities of the corporation or their derivatives; **and**

(b) is not generally known to the persons who are accustomed or would be likely to deal in the listed securities of the corporation but would if generally known to them be

likely to materially affect the price of the listed securities.

Key elements of the definition

The three key elements of the definition are that:

(a) the information must be **specific;**

(b) the information **must not be generally known** to that segment of the market which deals or which would likely deal in the corporation's securities; and

(c) the information would, if generally known be **likely to have a material effect on the price of the corporation's securities**.

The SFC Guidelines provide guidance as to how these terms have been interpreted by the MMT in the past.

Specificity of Information

- The information must be capable of being identified, defined and unequivocally expressed.

  Information regarding a corporation's affairs will be sufficiently specific if "it carries with it such particulars as to a transaction, event or matter, or proposed transaction, event or matter, so as to allow that transaction, event or matter to be identified and its nature to be coherently understood".

- The information need not be precise.

  Information may be specific even though the particulars or details are not precisely known. For example, information that a corporation is in financial difficulty or proposes to conduct a share placing would be regarded as specific even if the details are not known.

- Information on a transaction that is only contemplated or under negotiation (and not yet subject to a final agreement (formal or informal)) can be specific information.

  To constitute specific information, a proposal should be beyond the stage of a vague exchange of ideas or a "fishing expedition". If negotiations or contracts have occurred, there should be a substantial commercial reality to the negotiations which should be at the stage where the parties intend to negotiate with a realistic view to achieving an identifiable goal.

- Mere rumours, vague hopes or worries, wishful thinking and unsubstantiated conjecture are not specific information.

Information not generally known

The SFC Guidelines note that rumours, media speculation and market expectation about an event or circumstances of a corporation cannot be equated with information which is generally known to the market. There is a clear distinction between the market having actual knowledge of a hard fact which has been properly disclosed by the corporation and speculation or expectation as to an event or circumstances which will require proof.

In determining whether information the subject of media comments or analysts' reports or carried by news service providers is generally known, the corporation should consider the accuracy, completeness and reliability of the information disseminated and not only how widely the information has been disseminated. Where the information disseminated is incomplete or there are material omissions or there are doubts as to its bona fides, the information cannot be regarded as generally known and the corporation is required to make full disclosure.

Information that is likely to have a material effect on the price of the listed securities

Whether inside information is likely to materially affect the price of a corporation's securities is judged based on whether the inside information would influence persons who are accustomed to or would be likely to deal in the corporation's shares, in deciding whether or not to buy or sell such shares. The test is necessarily a hypothetical one since it must be applied at the time the information becomes available.

The SFC Guidelines set out the following non-exhaustive list of possible examples of inside information

- Changes in performance, or the expectation of the performance, of the business or its financial condition;
- Changes in financial condition, e.g. cashflow crisis, credit crunch;
- Changes in directors and (if applicable) supervisors and their service contracts;
- Changes in auditors or any other information related to the auditors' activity;
- Changes in the share capital, e.g. new share placing, bonus issue, right issue, share split, share consolidation and capital reduction;
- Takeovers and mergers (corporations will also need to comply with the Takeovers Codes that include specific disclosure obligations);
- Purchase or disposal of equity interests or other major assets or business operations;
- Filing of winding up petitions, the issuing of winding up orders or the appointment of provisional receivers or liquidators';
- Legal disputes and proceedings;
- Revocation or cancellation of credit lines by one or more banks;
- Changes in value of assets (including advances, loans, debts or other forms of financial assistance);
- Insolvency of relevant debtors;
- Reduction of real properties' values;
- Physical destruction of uninsured goods;
- New licences, patents, registered trademarks;
- Decrease or increase in value of financial instruments in portfolio which include financial assets or liabilities arising from futures contracts, derivatives, warrants, swaps protective hedges, credit default swaps;
- Decrease in value of patents or rights or intangible assets due to market innovation
- Receiving acquisition bids for relevant assets;

- Innovative products or processes;
- Changes in expected earnings or losses;
- Orders received from customers, their cancellation or important changes;
- Withdrawal from or entry into new core business area;
- Changes in the investment policy;
- Changes in the accounting policy;
- Ex-dividend date, changes in dividend payment date and amount of dividend, changes in dividend policy;
- Pledge of the corporation's shares by controlling shareholders; or
- Changes in a matter which was the subject of a previous announcement.

4. Timing of disclosure

A corporation must disclose PSI to the public **as soon as reasonably practicable** after any inside information has come to its knowledge (section 307B(1) SFO). Inside information has come to the corporation's knowledge if:

(a) the inside information has, or ought reasonably to have, come to the knowledge of an officer of the corporation in the course of performing functions as an officer of the corporation; **and**

(b) a reasonable person, acting as an officer of the corporation, would consider that the information is inside information in relation to the corporation (section 307B(2) SFO).

Corporations must therefore have effective systems and procedures in place to ensure that any material information which comes to the knowledge of any of their officers is promptly identified and escalated to the board to determine whether it needs to be disclosed.

Meaning of "as soon as reasonably practicable"

According to the SFC Guidelines, "as soon as reasonably practicable" means that the corporation should immediately take all steps that are necessary in the circumstances to disclose the information to the public. The necessary steps that the corporation should immediately take before the publication of an announcement may include: ascertaining sufficient details; internal assessment of the matter and its likely impact; seeking professional advice where required and verification of the facts (paragraph 40 of the SFC Guidelines).

The corporation must ensure that the information is kept strictly confidential until it is publicly disclosed. If the corporation believes that the required degree of confidentiality cannot be maintained or that there may have been a breach of confidentiality, it should immediately disclose the information to the public (paragraph 41 of the SFC Guidelines). The SFC Guidelines also raise the possibility of a corporation issuing a "holding announcement" to give the corporation time to clarify the details and likely impact of an event before issuing a full announcement.

Who is an "officer"?

The term "officer" is defined widely to include a director, manager or secretary of a corporation or any other person involved in its management (Part 1 of Schedule 1 to the SFO).

In the context of the PSI disclosure regime, a "manager" generally connotes a person who, under the immediate authority of the board, is charged with management responsibility affecting the whole or a substantial part of the corporation. A secretary refers to a company secretary.

Also, it is clarified that the formulation that "in the course of performing functions as an officer of the corporation" confines discloseable PSI to that which becomes known in situations where the officer is acting in capacity as an officer. In other words, information known in circumstances outside the course of performing functions as an officer of the corporation will not be caught under the new regime.

5. Manner of Disclosure

Disclosure of inside information must be made in a manner that can provide for equal, timely and effective access by the public to the information disclosed (section 307C(1) SFO). Section 307C(2) provides that publication of inside information via the electronic publication system operated by HKEx will meet the requirements for provision of equal, timely and effective access.

The SFC Guidelines also provide that corporations can use additional means to disseminate the information such as press releases issued through news or wire services, press conferences in Hong Kong and/or posting an announcement on their own websites. Such measures are however of themselves unlikely to satisfy the requirements of section 307C(1) SFO.

The SFC Guidelines further provide that where a corporation is listed on more than one stock exchange, it should ensure that inside information is disclosed to the public in Hong Kong at the same time as it is released to the overseas markets. If inside information is released to an overseas market while the Hong Kong market is closed, the corporation should issue an announcement in Hong Kong before the Hong Kong market opens for trading.

The information contained in an announcement of inside information must be complete and accurate in all material respects and not be misleading or deceptive (whether by omission or otherwise).

6. The Safe Harbours

Section 307D SFO provides four safe harbours to permit corporations to not disclose or delay disclosing inside information. Except for Safe Harbour A, corporations may only rely on the safe harbours if they have taken reasonable precautions to preserve the confidentiality of the inside information and the inside information has not been leaked.

Safe Harbour A: When disclosure would breach an order by a Hong Kong court or any provisions of other Hong Kong statutes

This grants a safe harbour to corporations if they are prohibited from disclosing inside information under a Hong Kong court order or any Hong Kong statute.

Safe Harbour B: When the information relates to an incomplete proposal or negotiation

The SFC Guidelines give the following examples:

- when a contract is being negotiated but has not been finalised;

- when a corporation decides to sell a major holding in another corporation;
- when a corporation is negotiating a share placing with a financial institution; or
- when a corporation is negotiating the provision of financing with a creditor.

The SFC Guidelines note that where a corporation is in financial difficulty and is negotiating with third parties for funding, reliance on this safe harbour will mean that it will not be necessary to disclose the negotiations. The safe harbour does not however allow the corporation to withhold disclosure of any material change in its financial position or performance which led to the funding negotiations and, to the extent that this is inside information, should be the subject of an announcement.

Safe Harbour C: Where the information is a trade secret

There is no statutory definition of trade secret. However the SFC Guidelines provide that a "trade secret" generally refers to proprietary information owned by a corporation:

(a) used in a trade or business of the corporation;

(b) which is confidential (i.e. not already in the public domain);

(c) which, if disclosed to a competitor, would be liable to cause real or significant harm to the corporation's business interests; and

(d) the circulation of which is confined to a limited number of persons on a need-to-know basis.

Trade secrets may concern inventions, manufacturing processes or customer lists. However a trade secret does not cover the commercial terms and conditions of a contractual agreement or the financial information of a corporation, which cannot be regarded as proprietary information or rights owned by the corporation.

Safe Harbour D: When the Government's Exchange Fund or a Central Bank provides liquidity support to the corporation

Under this safe harbour, no disclosure is required for information concerning the provision of liquidity support from the Exchange Fund of the Government or from an institution which performs the functions of a central bank (including one located outside Hong Kong) to the corporation or any member of its group. The purpose of this safe harbour is to ward off financial contagion. It resembles a similar stability ensuring liquidity support mechanism employed in the UK.

Safe Harbour Condition of Confidentiality

Except for Safe Harbour A, the safe harbours are only available if and so long as:

(a) the corporation takes reasonable precautions for preserving the confidentiality of the information; and

(b) the confidentiality of the information is preserved.

If confidentiality is lost or the information is leaked, the safe harbour will cease to be available and the corporation must disclose the inside information as soon as practicable.

However, if confidentiality is lost, the corporation will not be regarded as in breach of the disclosure requirement in respect of inside information if it can show that it:

(a) has taken reasonable measures to monitor the confidentiality of the information in question; and

(b) made disclosure as soon as reasonably practicable, once it became aware that the confidentiality of the information had not been preserved.

Guidance on dealing with media speculation, market rumours and analysts' reports

The guidance on dealing with media speculation, market rumours and analysts' reports set out in the SFC Guidelines includes the following:

- Generally, corporations are not obliged to respond to media speculation, market rumours or analysts' reports;

- If, however, a corporation has inside information and relies on a safe harbour to withhold disclosure, media speculation, market rumours or analysts' reports about the corporation that are largely accurate and based on the inside information, make it likely that confidentiality has been lost. In that case, the safe harbour will no longer be available and the corporation must make the inside information publicly available;

- If a corporation does not have inside information, but media reports or market rumours carry false or untrue information, the corporation is not required to make any further disclosure under the SFO. The Stock Exchange may however require a corporation to provide disclosure or clarification which is not required under the SFO. If a corporation wishes to respond to market rumours, it should do so by publication of an announcement rather than by a remark to a single publication or press release; and

- Corporations should ensure that no inside information is provided when responding to analysts' questions or reviewing analysts' reports.

7. SFC's Power to Grant Waivers

The SFC is empowered to grant waivers where the disclosure of PSI in Hong Kong would be prohibited under a court order or legislation of another jurisdiction or would contravene a restriction imposed by a law enforcement agency or government authority in another jurisdiction (section 307E(1) SFO). The SFC will grant waivers on a case-by-case basis and may attach conditions.

During an application for a waiver, confidentiality must be maintained. Should an information leakage occur, the corporation would be obliged to suspend trading prior to making a disclosure. The waiver application fee will be HK$24,000.

8. Liability of Officers under the New Regime

The officers of a corporation are required to take all reasonable measures to ensure that proper safeguards exist to prevent the corporation's breach of the PSI disclosure requirement (section 307G(1)). Although an officer's breach of this provision is not actionable of itself, an officer will be regarded as having breached the PSI disclosure obligation if the listed corporation has breached such obligation and either:

(a) the breach resulted from the officer's intentional, reckless or negligent conduct; or

(b) the officer has not taken all reasonable measures to ensure that proper safeguards exist to prevent the breach (section 307G(2) SFO).

In relation to officers' obligation to take all reasonable measures to ensure the existence of proper safeguards, the SFC Guidelines focus on the responsibility of officers, including non-executive directors, to ensure that appropriate systems and procedures are put in place and reviewed periodically to enable the corporation to comply with the disclosure requirement. Officers with an executive role will also have a duty to oversee the proper implementation and functioning of the procedures and to ensure the detection and remedy of material deficiencies in a timely manner. The particular needs and circumstances of the listed corporation should be taken into account in establishing appropriate systems and procedures. The SFC Guidelines provide a non-exhaustive list of examples of systems and procedures which listed corporations should consider implementing.

Key examples of reasonable measures to prevent breach of the disclosure requirement (non-exhaustive) (as set out in the SFC Guidelines)

(a) Establish controls for monitoring business and corporate developments and events so that any potential inside information is promptly identified and escalated.

(b) Establish periodic financial reporting procedures so that key financial and operating data is identified and escalated in a structured and timely manner.

(c) Maintain and regularly review a sensitivity list identifying factors or developments which are likely to give rise to the emergence of inside information.

(d) Authorize one or more officer(s) or an internal committee to be notified of any potential inside information and to escalate any such information to the attention of the board.

(e) Restrict access to inside information to a limited number of employees on a need-to-know basis. Ensure employees who are in possession of inside information are fully conversant with their obligations to preserve confidentiality.

(f) Ensure appropriate confidentiality agreements are in place when the corporation enters into significant negotiations.

(g) Develop procedures to review presentation materials in advance before they are released at analysts' or media briefings.

(h) Record briefings and discussions with analysts or the media afterwards to check whether any inside information has been inadvertently disclosed.

(i) Develop procedures for responding to market rumours, leaks and inadvertent disclosures.

(j) Provide regular training to relevant employees to help them understand the corporation's policies and procedures as well as their relevant disclosure duties and obligations.

9. Investigation and enforcement

The SFC's powers of investigation under section 182 SFO has been extended to allow it to investigate any suspected breach of the statutory disclosure requirement. The SFC can also institute enforcement proceedings before the MMT directly without referring the matter to the Financial Secretary in respect of suspected breaches of the statutory disclosure requirement and in cases of civil market misconduct offences under Part XIII SFO.

10. Sanctions

The MMT is able to impose one or more of the following penalties:

(a) a fine of up to HK$8 million on the corporation, a director or chief executive (but not officers) of the corporation;

(b) disqualification of the director or officer from being a director or otherwise involved in the management of a corporation for up to five years;

(c) a "cold shoulder" order on the director or an officer (i.e. the person is deprived of access to market facilities for dealing in securities, futures contracts and other investments) for up to five years;

(d) a "cease and desist" order on the corporation, director or officer (i.e. an order not to breach the statutory disclosure requirement again);

(e) an order that any body of which the director or officer is a member be recommended to take disciplinary action against him; and

(f) payment of costs of the civil inquiry and/or the SFC investigation by the corporation, director or officer.

To try and prevent the occurrence of further breaches of the disclosure requirement, the MMT may additionally require:

(a) the appointment of an independent professional adviser to review the corporation's procedures for disclosure of PSI and advise it on matters relating to compliance; and

(b) the officer to undertake a training programme approved by the SFC on compliance with Part XIVA SFO, directors' duties and corporate governance.

11. Civil Liability – Private Right of Action

A corporation or officer found to be in breach of the statutory disclosure obligation may be found liable to pay compensation to any person who has suffered financial loss as a result of the breach in separate proceedings brought by such person under Section 307Z SFO. The corporation or officer will be liable to pay damages provided that it is fair, just and reasonable that it/he should do so. A determination by the MMT that a breach of the disclosure requirement has taken place or identifying a person as being in breach of the requirement will be admissible in evidence in any such proceedings to prove that the disclosure requirement has been breached or that the person in question has breached that requirement. The courts may also impose an injunction in addition to or in substitution for damages.

III. PROPOSED LISTING RULE AMENDMENTS RESULTING FROM THE NEW STATUTORY DISCLOSURE OBLIGATION

1. Introduction

Following the enactment of the Securities and Futures (Amendment) Ordinance 2012, the Exchange consulted on proposed amendments to the Listing Rules. The purpose of the proposed Rule amendments was to eliminate overlap between the new statutory disclosure obligation and the Listing Rule requirements.

The SFC has the power to enforce the new statutory disclosure regime set out in new Part XIVA of the amended SFO. The Exchange remains responsible for maintaining an orderly, informed and fair market. In short, the Exchange ceases to have jurisdiction over disclosure of PSI.

2. Jurisdiction over PSI vests with the SFC

MB Rule 13.05 has been amended to state that the SFC is responsible for enforcement of the new statutory disclosure regime. The Rule refers to the Guidelines on Disclosure of Inside Information (the Guidelines) published by the SFC and note that the Exchange will not give any guidance as to the interpretation or operation of the statutory disclosure obligations under Part IVA SFO or the Guidelines.

However, where the Exchange is aware of a possible breach of the statutory disclosure obligation, it will refer it to the SFC. The Exchange will not take any disciplinary action itself unless the SFC considers it inappropriate to pursue the matter under the SFO and the Exchange considers action under the Rules for a possible breach of the Rules to be appropriate.

Listed issuers are required to announce PSI which is required to be disclosed under the SFO. They must also copy to the Exchange any application to the SFC for a waiver from the requirement to disclose PSI and the copy of the SFC's decision whether to grant such waiver (MB Rule 13.09(2)(b)).

The amended Rule moves to MB Rule 13.10B the previous obligation to announce information released by the issuer to any other stock exchange on which its securities are listed and information released by an issuer's overseas listed subsidiary to another stock exchange which is discloseable by the issuer under the Rules.

3. General obligation of disclosure to be deleted

To avoid overlap with the statutory disclosure requirements of the SFO, most of Main Board Rule 13.09 has been removed. The former Main Board Rule 13.09 related to the disclosure of information necessary to enable the Exchange, shareholders and the public to appraise the position of an issuer group or which might be reasonably expected materially to affect the market activity in and the price of its securities.

4. The Exchange will continue to monitor the market

Although responsibility for the enforcement of the disclosure regime rests with the SFC, the Exchange remains responsible under Section 21 SFO for maintaining an orderly, informed and fair market in securities that are traded on the Exchange. Accordingly, the Exchange continues to monitor the market and media and where necessary, will require trading

suspensions under the Rules. Accordingly, the mechanism to monitor the market by making enquiries of listed issuers regarding unusual trading movements, the possible development of a false market in the trading of an issuer's securities and of any other matters under MB Rule 13.10 remains.

Under the revised version of these Rules, if the Exchange makes an enquiry, an issuer will be required to respond promptly to the Exchange's enquiries in one of the following two ways:

1. provide to the Exchange and, if requested by the Exchange, announce any information relevant to the subject matter(s) of the enquiries available to it; or

2. if appropriate, and if requested by the Exchange, confirm with an announcement that, the directors, having made due enquiry, are not aware of any information that is or may be relevant to the subject matter(s) of the enquiries, or of any inside information which needs to be disclosed under the SFO.

The standard form of the announcement in response to an enquiry has been revised and is set out in Note 1 to Main Board Rule 13.10. The revised form reads as follows:

"*This announcement is made at the request of The Stock Exchange of Hong Kong Limited.*

We have noted [the recent increases/decreases in the price [or trading volume] of the [shares/warrants] of the Company] or [We refer to the subject matter of the Exchange's enquiry]. Having made due enquiry, we confirm that we are not aware of [any reasons for these price [or volume] movements] or [relevant information concerning the subject matter of the Exchange's enquiry] or of any information which must be announced to correct or to prevent a false market in the Company's securities or of any information which must be announced to correct or to prevent a false market in the Company's securities or of any inside information under Part XIVA of the Securities and Futures Ordinance that needs to be disclosed.

This announcement is made by the order of the Company. The Company's Board of Directors collectively and individually accept responsibility for the accuracy of this announcement."

The revised standard announcement requires directors to make "due enquiry" into the relevant matter before issuing the announcement and require inclusion of that confirmation in the announcements. The revised standard form announcement also excludes the confirmation previously required that there are no negotiations or agreements relating to intended acquisitions or realisations which are discloseable under the Rules on notifiable transactions or connected transactions.

A couple of points to note about the revised form Rule 13.10:

- as under the former Rule 13.09, the Exchange can make enquiries of an issuer and require the publication of an announcement, with respect to any unusual movements in the price or trading volume of its listed securities or any other matters;

- under revised Rule 13.10, the Exchange is able, additionally, to make enquiries and require an announcement to be published in relation to "the possible development of a false market" in listed securities;

- Under revised Rule 13.10 directors have to confirm in any announcement that, *having made due enquiry*, they are not aware of:

(a) any information that is or may be relevant to the subject matter of the Exchange's enquiry;

(b) any information which must be announced to correct or to prevent a false market in the Company's securities; or

(c) any inside information under Part XIVA of the SFO.

The confirmations in (b) and (c) as to the absence of information necessary to correct or prevent a false market and the non-existence of discloseable inside information do not appear to require that the relevant information is relevant to the subject matter of the Exchange's enquiry. In the case of (b) in particular, this raises a question as to the expected scope of directors' "due enquiry" – for example how far does the Rule require directors to "search" for incorrect information with the potential to create a false market which may be circulating in the media or market?

The Exchange also reserves the right to direct a trading halt of an issuer's securities if an announcement (as set out in Rule 13.10) cannot be made promptly (new Note 2 to MB Rule 13.10).

If any confirmation in the standard announcement is discovered to be false, the Exchange will refer the matter to the SFC.

Regardless of whether the Exchange has made an enquiry, listed issuers are required to disclose information to correct or prevent a false market. The obligation to disclose PSI has been amended to clarify that the obligation requires disclosure not only of information necessary to avoid the creation of a false market but also of information necessary to correct a false market (as set out in MB Rule 13.09(1)(b)). The requirement to publish periodic announcements of developments during the suspension of trading in a listed issuer's securities on the Main Board are kept as set out in the new MB Rule 13.24A.

The following provisions which exist previously as notes to Rules are kept and escalated to become full-fledged Rules:

- MB Rule 13.06A / GEM Rule 17.07A – the requirement to maintain strict confidentiality of inside information until it is announced;
- MB Rule 13.06B / GEM Rule 17.07B – the requirement not to divulge information so as to privilege the dealing position(s) of any person(s); and
- MB Rule 13.24B / GEM Rule 17.26A – the requirement that an issuer must make an announcement if:
  - o an event occurs that would have caused any assumptions of a profit forecast to have been materially different; or
  - o income or loss generated by some previously undisclosed activity outside the issuer's ordinary and usual course of business contributes materially to the profits for the period of the profit forecast.

5. Other changes

Changes in terms

The terms "inside information", "Inside Information Provisions" and "trading halt" are added as new defined terms in the Interpretation sections of the Rules. References to "price sensitive information" are replaced by the term "inside information" to be consistent with the SFO. "Inside Information Provisions" refers to Part XIVA of the SFO. Trading halts are a new concept on which the Exchange has concluded its consultation.

Additionally, "Exchange Listing Rules" are known as "Listing Rules" or "Rules" on the Main Board and "GEM Listing Rules" are known as "GLR" or "Rules" on the GEM. The SFO is known as the "Ordinance" on both the Main Board and the GEM. The term "general disclosure obligation" is no longer used.

Debt issues

According to the former MB Rule 37.44, where debt securities are guaranteed, the guarantor must announce immediately any information that is necessary for investors to appraise the position of the guarantor which may have a material effect on its ability to meet its obligations. The new statutory disclosure obligation under the SFO only imposes an obligation on the issuer. The Exchange therefore clarified in the Listing Rules and the Listing Agreement that a guarantor has an obligation to announce any information which may have a material effect on its ability to meet its obligations under the debt securities (see new MB Rule 37.47A, paragraph 2A in MB Appendices 7C to 7E and 7H).

Guidance materials

The Exchange has published guidance materials in respect of the obligation to disclose price sensitive information under the Listing Rules which are available on its website. These include the Guide on Disclosure of Price Sensitive Information (January 2002), the letter of 31 October 2008 in respect of recent economic developments and the disclosure obligations of listed issuers, and some of the no further disciplinary action (guidance) letters published in 2008 and 2009. Given the deletion of MB Rules 13.09(1)(a) and (c) and the related notes, these guidance materials were repealed with effect from 1 January 2013.

Trading halts

The SFO does not specify whether a trading halt is required pending the disclosure of PSI. Therefore, new Rules require listed issuers to request a trading halt if (i) there is PSI to be disclosed and an announcement cannot be made promptly; or (ii) PSI may have been leaked where it is the subject of an application to the SFC for a waiver to comply with the statutory disclosure obligation or where it is exempt from the statutory disclosure obligation (except if the exemption concerns disclosure prohibited by foreign law or court order). The new requirement is set out under MB Rule 13.10A.

The term "trading halts" in the revised Rules refers to an interruption of trading in an issuer's securities requested or directed pending disclosure of information under the Rules and extending for no more than two trading days.

IV. STOCK EXCHANGE PROPOSALS TO ALLOW THE RELEASE OF PSI DURING TRADING HOURS SUBJECT TO TRADING HALT IMPLEMENTATION

1. Background

The Exchange has consulted previously on the possible implementation of trading halts. In a 2002 consultation on a proposal to publish announcements on the Exchange website, a majority of respondents supported the release of PSI during trading halts in trading hours. The Exchange conducted a consultation on this proposal in 2007, but decided to study the effectiveness of the morning/lunch time publication windows system (which was newly implemented by the Exchange then) before pursuing the proposal.

In 2009, The Exchange considered again allowing the release of PSI during trading halts, but concluded that its implementation would leave investors with insufficient time to react to PSI disclosures. Additionally, the Exchange's trading system would need to be upgraded to handle trading halts of securities that have many related derivative products. This upgrade occurred following a criminal hacking incident in August 2011, which caused a suspension in the trading of seven equity securities and related derivative products. The market can now operate continuously in the event of a disruption of news dissemination.

The Exchange has several reasons in support of the implementation of trading halts for PSI disclosures. The proposals would:

- bring Hong Kong into line with international market practices. Appendix II to the Consultation Paper provides the Exchange's summary of comparable arrangements in Australia, Germany, Singapore and the United States;
- help investors in derivative products to close out the opening position rather than bear risk overnight;
- provide more accurate intraday prices in securities as price discovery would occur soon after the halt; and
- avoid putting Hong Kong investors at a disadvantage by providing PSI in a more timely manner and keeping the duration of any trading halt to a minimum. Presently, an investor at a market that has implemented trading halts is able to respond more quickly to PSI as it would be released during trading hours in that market and trading would resume shortly after the release.

2. Arrangements under the former Rules

Under the former Rules, PSI may be published on the Exchange's website only during three publication windows:

- from 6:00 am to 8:30 am;
- from 12:00 pm to 12:30 pm; and
- from 4:15 pm to 11:00 pm (6:00 pm to 8:00 pm on a public holiday before the next business day).

If an issuer failed to publish PSI when a disclosure obligation is triggered, trading in its securities (and related options, futures and structured products) would be suspended until the trading session following the publication of the PSI announcement. Mid-trading session

suspensions were possible, but would be usually avoided and reserved for unexpected events. Most trading suspensions lasted over half a day.

There is a 30 minute period between the close of the publication window and the beginning of the trading session to allow investors to process the published PSI. The vast majority of PSI releases occurred in the evening publication window. In the securities market, orders entered before a suspension of trading remained in the order book and could be cancelled during the suspension period, but if trading did not resume on the same day, the outstanding orders would be cancelled automatically after market close. In the options and futures market, all outstanding orders would be cancelled automatically once trading in the underlying securities was suspended.

3. New arrangements

The Exchange adopts a trading halt regime. PSI announcements can be published on the Exchange's website during trading hours subject to a short trading halt. Trading halts has a minimum duration of 30 minutes and a maximum duration of two days. The Exchange believes that 30 minutes provides a balance between allowing investors to digest the published PSI and allowing them the opportunity to trade accordingly. Trading resumes only on the quarter hour or the half hour.

The Exchange will notify investors of any upcoming trading halts through various Exchange system channels. These will include the Exchange website, where a separate information page will inform investors of such information as the time of commencement of the halt, its duration and when it will be lifted.

The Exchange has stated that they will take market readiness into account (particularly any necessary changes to the trading systems of Exchange participants) before implementing a trading halt regime. One of the questions in the Exchange's consultation was on the amount of lead time that would be necessary after the relevant system specifications are available to prepare for the implementation of trading halts.

The Exchange believes that 30 minutes provides a balance between allowing investors to digest the published PSI and allowing them the opportunity to trade accordingly. Trading will resume only on the quarter hour or the half hour. A minimum of 30 minutes of trading will occur after the resumption of trading, including a 10 minute single price auction session. This means that resumption of trading will never occur after 3:30 pm on a normal trading day or after 11:30 am on a half-day; resumption of trading will occur at the beginning of the following trading day instead.

Listed issuers who request trading halts are expected to have their PSI announcements ready for publication as soon as practicable. If the issuer fails to publish the PSI announcement within the two days, the trading halt will lapse and the halt will become a suspension of trading. The former rules on PSI announcements and suspensions will then apply until the PSI announcement is made. Trading will then resume in the next trading session.

<u>Results announcements</u>

Board meeting dates are currently required to be published at least seven clear business days before the meeting so that investors would know when to expect results announcements. Suspensions are thus not generally necessary for the publication of results announcements under the existing arrangements.

Due to the large volume of results announcements, particularly during certain periods of the year, the Exchange proposes that results announcements should be published during the publication windows under the former Rules as far as possible. The Exchange may however grant a trading halt for the publication of a results announcement in special circumstances.

Issuers dually listed on the London Stock Exchange

Five issuers that are dually listed on the London Stock Exchange have obtained waivers to publish PSI on the Exchange website during trading hours without a trading halt. The purpose of these waivers is to avoid restricting Hong Kong investors from trading in the securities of those issuers while investors in London are able to do so; there is no trading halt regime in the UK. The Exchange maintains these waivers for those five issuers.

Outstanding orders

All outstanding orders for the securities and their related derivative warrants and callable bull and bear contracts will be cancelled upon a trading halt. The Exchange sees this arrangement as preferable, since retail investors do not usually keep track of the publication of announcements constantly. Cancelling all outstanding orders will serve as a precautionary measure to avoid situations where uninformed retail investors would keep orders based on a price that does not take the published PSI into account while other more informed investors would be able to cancel their orders. This will help minimise market disputes.

Price discovery

To facilitate price discovery, a 10-minute single price auction will occur once a trading halt is lifted. Where a PSI announcement is made during the lunch publication window (i.e. between 12:00 pm and 12:30 pm), the single price auction will occur at the beginning of the afternoon trading session, regardless of whether the issuer requested a trading halt.
The mid-session auction applies to the securities market only and comprise:

- 7 minutes of order input (when at-auction orders and at-auction limit orders may be inputted);
- 1 minute of pre-order matching (when only at-auction orders may be inputted);
- 1 minute of order matching (when orders would be matched in type, price and priority); and
- 1 minute of blocking (when all unmatched at-auction orders are cancelled and unmatched at-auction limit orders are converted into limit orders and carried into the trading session).

Structured products will also trade in the mid-session auction once a trading halt of the underlying stock is lifted. Liquidity providers of structured products will be exempted from providing quotes during the auction session upon lifting of a trading halt.

Market makers of the Exchange's stock options and futures who have been consulted indicated that they will make a market upon completion of the price determination of the underlying stocks. Accordingly, the mid-session auction mechanism will not apply to the Exchange's stock options/futures market. Continuous trading of related stock options and stock futures will be resumed only upon completion of the mid-session auction of underlying stock.

V. INSIDER DEALING CASES IN HONG KONG

When is information likely to have a material effect on the price of listed securities?

The SFC Guidelines on Disclosure of Inside Information (as set out in the Annex to this note) include in Annex B, a summary of information which Hong Kong tribunals (the Insider Dealing Tribunal and the Market Misconduct Tribunal which replaced it) have found in the past to constitute information likely to have a material effect on the price of relevant companies' listed securities. Please see page 29 below.

VI. INSIDER INFORMATION CASES IN THE UK

1. UK Provisions

"Inside information" is information that is not generally available and that:

(i) is likely to have a significant effect on the price of the company's shares or other securities

(ii) a reasonable investor would be likely to use as part of the basis of any investment decision.

Under the Financial Services Authority's ("**FSA**") Disclosure and Transparency Rules ("**DTRs**") an issuer must notify a Regulatory Information Service as soon as possible of any inside information which directly concerns it without delay (DTR 2.2.1R) unless certain exceptions apply, which are outlined in DTR 2.5R.

Listing Principle 4 of the Listing Rules states that a listed company must communicate information to holders and potential holders of listed equity securities in such a way as to avoid the creation or continuation of a false market in such securities.

There have been a number of instances of the FSA imposing fines for a failure to announce inside information without delay, pointing to a growing restlessness on the part of the FSA with issuers who breach the disclosure requirements and demonstrating that the circumstances justifying delay in disclosure are extremely few (see DTR 2.5R).

2. Recent UK FSA rulings

<u>Wolfson Microelectronics PLC (January 2009)</u>

On 10 March 2008 a key customer decided it would not be pursuing certain orders, representing a loss to Wolfson's forecast revenue of 8%. It was expected this would be made up by additional orders for existing products from the same customer. It was also considered that the market would overreact and that a confidentiality agreement with the customer would prevent disclosure. Initially, investor relations advisers thought no announcement was needed. The company's lawyers and brokers were eventually consulted and both disagreed. Wolfson was fined £140,000 for the 16 day delay.

<u>Entertainment Rights PLC (January 2009)</u>

Entertainment Rights and a subsidiary had entered into a distributorship agreement in the USA. A variation to the agreement, which came into effect on 10 July 2008, would impact on

the company's estimated 2008 profits by US$13.9 million. The company considered that there would be future opportunities to remove the impact of the variation and delayed disclosure accordingly. It was fined £245,000 for a 78-day delay.

Woolworths Group PLC (June 2008)

Woolworths was fined £350,000 for a 29-day delay in announcing inside information. A Woolworths subsidiary had renegotiated a supply contract with Tesco in 2005 and the retrospective discount agreed caused a reduction of £8 million in its 2006/07 profits. The FSA said that there was no percentage threshold below which an effect on the price of a company's shares could not be regarded as a "significant effect".

Pace Micro Technology PLC (January 2005)

On 8 January 2002, Pace announced its interim results but failed to reveal that its trade credit insurance for future deliveries to one of its largest customers had been withdrawn. The regulator held that because two annual reports had previously stated that a credit insurance programme existed, the loss of cover was material and did affect "the import" of the interim results announcement. Moreover, on 4 February, Pace revised its previous revenue forecast for the year to 1 June 2002 from £524m to £455m but failed to inform the market. The company argued that its earnings expectations had not changed as the lost sales would have produced little or no profit. On 5 March a statement was made – by which time expectations had fallen to £350m. The share price fell by 67% .The Company was fined £450,000 for breaching the two rules.

Universal Salvage PLC (May 2004)

Universal Salvage had a rolling contract which was responsible for 40% of turnover and could be terminated on three months' notice. The board was told on 20 March 2002 that the contract was to end. The company thought this was a negotiating ploy and raised a number of arguments against the decision. After consideration by the contractee, confirmation of the loss was received on 16 April. It took four working days to receive advice from the company's financial adviser. On the adviser's recommendation, an announcement followed the next day and the share price fell by 55%. For the delay of five working days, the company was fined £90,000 whilst the Chief Executive was fined £10,000 as he was 'knowingly concerned' in the breach and was best placed to take the required steps notify the market yet failed to do so.

3. Implications of the rulings

Good news cannot offset bad news

All inside information, both good and bad, must be disclosed to the market as soon as possible (subject to the limited ability to delay disclosure under DTR 2.5.1R) and considered independently. Good and bad information cannot be offset against one another in any circumstance to justify non-disclosure. In particular, bad news cannot be offset against "a mere hope of positive news in the future". The market not the issuer should determine the effect of the information. Any activity to this effect on behalf of a company hampers an investor's ability to make informed decisions and risks distorting the market value of a company's shares.

The cases of Wolfson Microelectronics and Entertainment Rights illustrate such a point. Both were fined: £140,000 and £245,000 respectively. Wolfson had learned from its customer that they expected increased demand for the existing products which had not been terminated,

offsetting some of the loss of revenue. Yet Entertainment Rights had no such reassurances or mitigating positive news and merely expected future opportunities to arise. This may have contributed to the larger fine levied upon Entertainment Rights.

Fall in share price away from its "true value" does not excuse non-disclosure

The market's reaction to information should not be a primary concern of the issuer in considering whether or not to release that information. An issuer's refusal to disclose price sensitive information on the basis that it could cause the issuer's share price to fall or that a diminished share price would not represent the true value of a company does not excuse a delay. Any failure to notify the market of material information creates a false market for a company's shares for that period, regardless of whether or not the company regards the pre-disclosure share price as reflecting the "true market value".

Such behaviour was highlighted by the FSA in the Wolfson case. Wolfson believed there would be an overreaction in the market to the terminated contracts and not enough focus on the expected rise in demand for those remaining. Investors would fail to understand the true value of the company if the information was released and this would create a false market. The FSA ruled that the value of a company is up to the market to decide and not the company itself. The suspicion that the share price would fall only serves to highlight that such information would be used by a reasonable investor as part of his investment decision and therefore constitutes inside information. It was the failure to disclose such information that resulted in a false market for a company's shares, not the actual disclosure.

Confidentiality agreements cannot justify non-disclosure

An issuer cannot use confidentiality agreements with their clients as a reason to avoid disclosing inside information. The disclosure obligations contained in the DTRs overrule any contractual requirements in agreements with third parties. A well-drafted contract should in any event allow for announcements required by law or by a regulator; names can always be anonymised and the text agreed with the other party.

Wolfson was again criticised by the FSA for such an excuse. The company argued that the non-disclosure agreement with the customer prohibited it from releasing the news. Such an argument simply does not hold up against the authorities and steps must be taken when drafting contracts to avoid follow-on actions from business partners.

There is no set figure that can define a "significant effect"

Whether the inside information is likely to have a "significant effect" on the share price is not determined by any set percentage or figure. It will vary from issuer to issuer and must be assessed according to the test of whether the information is of a kind which a reasonable investor would be likely to use as part of the basis of his investment decision.

Woolworths believed that the renegotiated contract with Tesco and the accompanying reduction in projected profits of £8 million was too low to be significant with respect to the share price. The FSA disagreed and such a ruling makes it very difficult for companies to gauge how much is "significant". Issuers must err on the side of caution and consult professional advisers immediately if there is any doubt.

All material information must be released

Developments which some would not consider price-sensitive could still be seen as inside information by the FSA. Any information released or previously released cannot be misleading. Thus a company must disclose any developments likely to affect the import of information already released.

Pace Micro Technology was judged by the FSA to have omitted material information. The regulator held that because two annual reports had previously stated that a credit insurance programme existed for large customers, the loss of cover was material and did affect "the import" of the interim results announcement. The decision not to disclose to the market that revenue, but not profit, forecasts had been revised downwards was also deemed to be inside information. The FSA accepted that Pace had not acted recklessly or deliberately but had simply come to the wrong conclusion about what was material. The regulator still issued a large fine of £450,000.

An issuer must seek timely professional advice

If there is any doubt over whether information should be released, professional advice should be sought as a matter of urgency. There is no excuse for any delay in seeking this advice and therefore no excuse in withholding material information from the market due to impediments in liaising with advisors. Professional advice must be from legal advisers and corporate brokers or sponsors, not investment relations personnel. An issuer, not their advisers, is primarily responsible for complying with the rules.

Not only did Universal Salvage wait two days after the contract termination was confirmed to seek professional advice but, due their usual contact not being available and a lack of urgency, a meeting to discuss the matter was scheduled two business days after contact was made. It was only then that advice was given to disclose to the market and the statement was made twenty four hours later. Such delays were deemed unacceptable by the FSA, regardless of why they were caused. Entertainment Rights and Photo-Me International received similar criticism for not seeking legal and/or broker advice immediately whilst Wolfson Electronics were condemned for substituting appropriate professional consultation for advice from investor relations personnel who wrongly recommended not to disclose.

VII. GELTL V DAIMLER: ECJ RULING OF JUNE 2012

1. Geltl v Daimler AG

In April 2005, Mr Schrempp, Chairman of the Board of Management of Daimler AG, began considering the possibility of resigning his appointment before 2008, the date then fixed for his resignation. Over a period of two months Mr Schrempp informed other board members and employees of this desire. On 10 July, the head of communications began preparing a press release, a public statement and a letter to employees. On 18 July, Mr Schrempp and the Chairman of the Supervisory Board agreed to propose the early retirement at the meeting of the Supervisory Board on 28 July. At this meeting at approximately 9:50 am, it was resolved that Mr Schrempp would step down at the end of the year. By 10.32 am the market was informed and the company's share price rose roughly 17.6%. Numerous investors who had sold shares prior to the announcement initiated proceedings for damages.

2. Relevant Provisions

Article 1(1) of Directive 2003/6/EC of the European Parliament and of the Council provides that:

"Inside information" shall mean information of a precise nature which has not been made public, relating, directly or indirectly, to one or more issuers of financial instruments or to one or more financial instruments and which, if it were made public, would be likely to have a significant effect on the prices of those financial instruments or on the price of related derivative financial instruments.

Article 1 of Commission Directive 2003/124 provides that:

1. **For the purposes of applying point 1 of Article 1 of Directive 2003/6/EC**, information shall be deemed to be of a precise nature if it indicates a set of circumstances which exists or may reasonably be expected to come into existence or an event which has occurred or may reasonably be expected to do so and if it is specific enough to enable a conclusion to be drawn as to the possible effect of that set of circumstances or event on the prices of financial instruments or related derivative financial instruments.

2. **For the purposes of applying point 1 of Article 1 of Directive 2003/6/EC,** "information which, if it were made public, would be likely to have a significant effect on the prices of financial instruments or related derivative financial instruments" shall mean information a reasonable investor would be likely to use as part of the basis of his investment decisions.

The German version of Article 1 of Directive 2003/124, based on which the reference to the ECJ was made, refers to "sufficient probability" rather than reasonable expectation.

3. Legal Process

The Higher Regional Court, Stuttgart, ruled in favour of Daimler. On appeal, the German Federal Court of Justice referred to Court of Justice of the European Union ("**ECJ**") two questions on the interpretation of inside information, namely:

(i) Can intermediate steps which have already been taken and which are connected with bringing about a future set of circumstances or future event constitute precise information for the purposes of applying Article 1(1) of Directive 2003/6 and Article 1(1) of Directive 2003/124?

(ii) For the purposes of Article 1(1) of Directive 2003/124:

- does "reasonable expectation" require that the probability be assessed as preponderant or significant?; and

- does the reference to "set of circumstances which ... may reasonably be expected to come into existence or an event which... may reasonably be expected" to occur, imply that the degree of probability required depends on the extent of the consequences for the issuer and that, where the likelihood of their affecting share prices is significant, it is sufficient that the occurrence of the future circumstance or event be uncertain but not improbable?

4. ECJ Ruling and Interpretation

The ECJ replied that, in the case of a protracted process intended to bring about a particular circumstance or event, not only may that future circumstance or event be regarded as precise information, but also *the intermediate steps* of the process connected to bringing it about. An intermediate step in a protracted process may in itself constitute a set of circumstances or an event in the meaning normally attributed to those terms. This interpretation does not hold true only for those steps which have already occurred, but also concerns steps which may reasonably be expected to occur.

The ECJ also held that the notion of a set of circumstances or event which exists or occurred or may reasonably be expected to come into existence or occur refers to future circumstances or events from which it appears, on the basis of an assessment of the factors at the time, that there is a realistic prospect that they will come into existence or occur. It is, accordingly, not necessary that proof be made out of a high probability of the circumstances or events in question coming into existence or occurring. The magnitude of their possible effect on the prices of the financial instruments concerned is immaterial in the interpretation of that notion.

Adopting a strict application of the definition of inside information to all possible, including intermediate, events which may fall subject to the regime is not surprising. If the information would be likely to be used by a "reasonable investor" as part of the basis of the investor's investment decision it must be disclosed.

VIII. RECENT HONG KONG CASES INVOLVING DISCLOSURE OF INFORMATION REGARDED AS "STATE SECRETS" UNDER PRC LAW

1. SFC Proceedings Against Ernst & Young for failure to hand over audit working papers due to potential breach of PRC law on Guarding State Secrets

The SFC recently commenced proceedings against Ernst & Young in the Court of First Instance for failing to produce specified accounting record relating to its work on the listing of Standard Water Limited. Standard Water withdrew its application for listing after Ernst & Young resigned as reporting accountants upon the discovery of inconsistencies in some of the company's documents.

Ernst & Young did not comply with the SFC's request because it claimed that the relevant records were held in Mainland China by Ernst & Young Hua Ming, its joint venture partner, and were unavailable. They then claimed that they were prevented by PRC legal restrictions from producing the documents. Specifically, Ernst & Young claimed that the documents in question may be the subject of claims based on the PRC law on state secrecy, meaning they required the consent of certain Mainland authorities first before giving the relevant documents to the SFC.

The SFC requested the assistance of the Mainland authorities but Ernst & Young did not produce the required documents to the Mainland authority. The case is still being heard in the High Court.

2. Suspension of Trading in shares of China High Precision Automation due to non-disclosure on grounds of information constituting State Secrets

The SFC suspended the shares of China High Precision Automation Group Limited from trading on 22 August 2012. China High Precision had refused to provide certain information

to KPMG, its former reporting accountants, after they discovered inconsistencies in their records. The SFC is concerned that if Mainland companies are allowed to withhold information and documents from scrutiny by citing restrictions imposed by state secrecy laws in the PRC, auditing and regulatory functions cannot be carried out. If such companies are allowed into the Hong Kong market it could harm Hong Kong's reputation for corporate transparency. Now that the statutory disclosure regime is to come into effect, there may be future conflicts between Hong Kong law and PRC law in this area of disclosure of information. It is hoped that the outcome of the Ernst & Young case will help resolve the uncertainty surrounding the conflict between disclosure requirements set out in the SFO and the PRC law on state secrets. The case is still being heard in the High Court.

It's worth noting that the new statutory regime provides an exemption from the disclosure obligation where this would breach provisions of Hong Kong laws and regulations, but not those of any overseas jurisdiction. In the latter case, however, the SFC will have the power to waive potential breaches of the obligation if disclosure would result in a breach of overseas laws and regulations.

AUGUST 2013

This note is provided for information purposes only and does not constitute legal advice. Specific advice should be sought in relation to any particular situation. This note has been prepared based on the laws and regulations in force at the date of this note which may be subsequently amended, modified, re-enacted, restated or replaced.

ANNEXURE

SECURITIES AND FUTURES COMMISSION
證券及期貨事務監察委員會

Guidelines on Disclosure of Inside Information

June 2012

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Introduction

1. On 1 January 2013 ("**Commencement Date**"), amendments to the Securities and Futures Ordinance ("**SFO**") (Cap. 571) come into effect to provide for a new Part XIVA under the SFO giving statutory backing to one of the most important principles in the Rules Governing the Listing of Securities ("**Listing Rules**") on the Stock Exchange of Hong Kong Limited ("**Stock Exchange**"). The provisions under Part XIVA impose a general obligation of disclosure of price sensitive, or "inside" information by listed corporations ("**corporations**")[1].

2. These Guidelines are published by the Securities and Futures Commission ("**SFC**") under section 399 of the SFO to assist corporations to comply with their obligations to disclose inside information under Part XIVA of the SFO. However, they are not an exhaustive examination of the disclosure obligations as set out in the SFO nor can they be relied upon as an authoritative legal opinion. The obligations to disclose inside information depend upon the facts of each case.

3. These Guidelines provide examples and discuss issues on particular situations to illustrate the SFC's views on the operation of the provisions as set out in the SFO. They do not have the force of law.

4. As the definition of the new term "inside information" in Part XIVA of the SFO is the same as that of "relevant information" used in section 245 in Part XIII of the SFO in connection with insider dealing, the Guidelines have quoted the decisions of the tribunals in Hong Kong with regard to the meaning of "relevant information". The decisions of the tribunals in relation to insider dealing, and "relevant information" are relevant for the purposes of determining what constitutes "inside information" and may assist in determining when an obligation to disclose information arises under the SFO. For the avoidance of doubt, the Guidelines are intended to assist listed corporations and their officers to fulfil their obligations under Part XIVA. As the Guidelines do not concern the provisions of Part XIII and Part XIV other than the definition of "relevant information", they have no application to the operation of Part XIII and Part XIV of the SFO.

5. Although the Guidelines summarise the key aspects of what has been viewed by the tribunals in Hong Kong as constituting "relevant information", it is important to recognise that the set of circumstances or events will not be the same in each case and every case turns on its own facts. Understanding the principles underlying the obligations will help listed corporations and their officers to comply with the disclosure requirements. This summary is not intended to be exhaustive, is included for guidance only, and may not represent the latest legal authority.

6. The term "inside information" is used in the legislation because the provisions are concerned with information that is known to an officer, or "insider", of a corporation but not generally known to the market. The term "inside information" is also used in a similar context in the securities regulations of the European Union.

7. The obligations to disclose inside information under Part XIVA of the SFO are separate and distinct from the disclosure requirements under the Listing Rules and those under the Codes on Takeovers and Mergers and Share Repurchases ("**Takeovers Codes**").

[1] Where depositary receipts are issued, the corporation whose shares in respect of which the depositary receipts are issued is the listed corporation for the purposes of Part XIVA of the SFO.

Background

8. The statutory requirements to disclose inside information are central to the orderly operation and integrity of the market and underpin the maintenance of a fair and informed market.

9. To comply with the obligations, corporations should consider their own circumstances when deciding whether any inside information arises and how it should be disclosed properly to the public. Disclosure should be made in a manner that provides for equal, timely and effective access by the public to the information disclosed.

10. To strike an appropriate balance between encouraging timely disclosure of inside information and preventing premature disclosure which might prejudice a corporation's legitimate interests, the SFO provides for appropriate Safe Harbours to permit a corporation to withhold the disclosure of inside information in specified circumstances.

11. From one month before the Commencement Date, the SFC will provide a consultation service to assist corporations to understand how to apply the disclosure provisions. We will provide the consultation service initially for a period of 2 years and will then review whether it is necessary to continue the service for an additional period. We envisage that most questions will relate to the application of the Safe Harbours. The SFC is not in a position to judge whether in the circumstances of a particular corporation certain information is likely to materially affect the price of a corporation's listed securities, and accordingly, is not able to offer advice to a corporation on whether a particular piece of information is inside information.

12. In case of doubt, listed corporations are encouraged to consult the SFC, the contact details of which are available on the SFC website at www.sfc.hk.

What may constitute inside information?

13. Section 307A(1) of the SFO states that " 'inside information', in relation to a listed corporation, means specific information that –

(a) is about –

(i) the corporation;

(ii) a shareholder or officer of the corporation; or

(iii) the listed securities of the corporation or their derivatives; and

(b) is not generally known to the persons who are accustomed or would be likely to deal in the listed securities of the corporation but would if generally known to them be likely to materially affect the price of the listed securities."

14. The definition of **inside information** is the same as that of "relevant information" used in section 245 of the SFO which applies to insider dealing. The term "relevant information" has been the subject of consistent and definitive interpretation by tribunals in Hong Kong over many years and those decisions will continue to offer guidance as to the meaning of the new term **inside information**.

15. Paragraphs 16 to 34 below summarise the key aspects of what has been viewed by tribunals as constituting "relevant information". A list of cases handled by the Insider Dealing Tribunal and the Market Misconduct Tribunal relevant to the interpretation of "relevant information" is set out in **Appendix A**. It is important to recognise that the set of factual circumstances or events will not be the same in each case. In particular, the circumstances in which insider dealings are regarded to have taken place would be different from the context in which the obligation to disclose may arise and thus the interpretative guidance available from these decisions may not apply. Nevertheless, understanding the principles underlying the obligations should help listed corporations and their officers to comply with the disclosure requirements. This summary is not intended to be exhaustive.

16. There are three key elements comprised in the concept of **inside information**. They are –

    (a) the information about the particular corporation must be **specific**;

    (b) the **information must not be generally known** to that segment of the market which deals or which would likely deal in the corporation's securities; and

    (c) the information would, if so known be **likely to have a material effect on the price of the corporation's securities**[2].

Inside information must be specific information

17. Inside information must be specific information. Specific information is information which has the following characteristics –

    (a) The information is capable of being identified, defined and unequivocally expressed.

    Information concerning a company's affairs is sufficiently specific if it carries with it such particulars as to a transaction, event or matter, or proposed transaction, event or matter, so as to allow that transaction, event or matter to be identified and its nature to be coherently described and understood.[3]

    (b) The information may not be precise.

    It is not necessary that all particulars or details of the transaction, event or matter be precisely known. Information may still be specific even though it has a vague quality and may be broad which allows room, even substantial room, for further particulars[4]. For instance, information that a company is having a financial crisis would be regarded to be specific, as would contemplation of a forthcoming share placing even if the details are not known. However, specific information is to be contrasted with mere rumours, vague hopes and worries, and with unsubstantiated conjecture.[5]

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[2] See p.34 of the IDT report dated 6 August 2009 on Harbour Ring International Holdings Limited

[3] See p.58-59 of the IDT report dated 2 April 2004 and 8 July 2004 on Firstone International Holdings Limited

[4] See p.235-236 of the IDT report dated 5 August 1995 on Public International Investments Ltd

[5] See p.20-21 of the IDT report dated 8 September 2006 and 14 December 2006 on Asia Orient Holdings Limited

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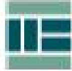

(c) Information on a transaction contemplated or at a preliminary state of negotiation can be specific information but vague hopes and wishful thinking may not be specific information.

The fact that a transaction is only contemplated or under negotiation and has not yet been subjected to any formal or informal final agreement does not necessarily cause the information concerning that contemplated course of action or negotiation to be non-specific. However, a vague hope or wishful thinking that a transaction will occur or come to fruition does not amount to sufficient contemplation or preliminary negotiation of that transaction.

To constitute specific information, a proposal, whether described as under contemplation or at a preliminary stage of negotiation, should have more substance than merely being at the stage of a vague exchange of ideas or a "fishing expedition". Where negotiations or contacts have occurred, for these to be considered specific information there should be a substantial commercial reality to such negotiations which goes beyond a merely exploratory testing of the waters and which is at a more concrete stage where the parties intend to negotiate with a realistic view to achieving an identifiable goal.[6]

Inside information must be information that is not generally known

18. By its very nature, inside information is information which is known only to a few and not generally known to the market, the market being defined as those persons who are accustomed or would be likely to deal in the listed securities of that corporation.[7] In some instances, the investor group or class who are accustomed or would be likely to deal in the listed securities of that corporation may be a large one, comprising not only professional dealers and investors with elaborate networks for obtaining information, but also those of the investing public including small investors who deal in the particular category of stocks to which the corporation belongs.[8]

19. Even though there might be rumours, media speculation or market expectation as to an event or a set of circumstances of a corporation, these cannot be equated with information which is generally known to the market. There is a clear distinction between actual knowledge of the market about a hard fact which is properly disclosed by the corporation and speculation or expectation of what might have happened about a corporation which obviously requires proof.[9]

20. It is not uncommon that information relating to a corporation is found in media comments, analyst research reports or electronic subscription databases, which may consist of published historical information, market commentary, speculation, rumour or even information leaked from various sources. However, press speculation, reports and rumours in the market cannot be automatically taken to be information generally known to the market, even though in some cases the media reports might have a wide circulation.[10]

[6] See p.60-61 of the IDT report dated 2 April 2004 and 8 July 2004 on Firstone International Holdings Limited
[7] See p.70 of the IDT report dated 10 April 2000 and 15 June 2000 on Hanny Holdings Limited
[8] See p.237-238 of the IDT report dated 5 August 1995 on Public International Investments Ltd
[9] See p.258 of the IDT report dated 5 August 1995 on Public International Investments Ltd
[10] See p.57-58 of the IDT report dated 22 February 1990 on Lafe Holdings Limited

21. In deciding whether information is generally known by virtue of being the subject of media comments, covered in analysts' reports or carried on news service providers, a corporation should consider not only how widely the information has been disseminated but also the accuracy and completeness of the information disseminated and the reliance that the market can place on such information. A corporation should consider in particular whether –

    (a) these sources contain the full information that would need to be disclosed as required under section 307B(3) so that there are no material omissions which may make the disclosure false or misleading (see paragraphs 39 and 43);

    (b) the market will realise that the information in these sources reflects the information known to the corporation; and

    (c) the information will be regarded as speculation or opinion of persons outside the corporation.

    Where the information known to the market is incomplete or there are material omissions or there are doubts as to its bona fides, such information cannot be regarded as generally known and accordingly full disclosure by the corporation is necessary.

22. Notwithstanding the above, a piece of information is regarded as generally known if it consists of readily observable matter such as general external developments e.g. changes in commodity prices, foreign exchange rates and interest rates, outbreak of pandemic diseases and occurrence of natural disasters or general public information e.g. disclosure of interests by directors and shareholders pursuant to Part XV of the SFO.

Inside information is information that is likely to have a material effect on the price of the listed securities

23. Corporations with potential inside information need to assess promptly whether or not the information is likely to have a material price effect. It would not be sufficient to meet the test of "likely to have a material price effect" if the information is likely to cause a mere fluctuation or slight change in price. For information to constitute inside information, there must be likelihood that the information would cause a change in the price of sufficient degree to amount to a material change.[11]

24. Generally information that is likely to have a material effect on the price of the listed securities is important information concerning a corporation. But the converse is not necessarily true. Some important information or information of great interest concerning a corporation may excite comment but may not be information that would be likely to have a material effect on the price of the securities. Similarly, some important information may be of a neutral or mixed nature that may influence some investors to buy and others to sell, but which would not be likely to affect the price either up or down to a material degree.[12]

25. Information that is *likely* materially to affect the price is information which *may well* materially affect the price. Put another way, it is more likely than less likely that the price will be affected materially. The further element of the statutory test concerns materiality.

[11] See p.58-59 of the IDT report dated 22 February 1990 on Lafe Holdings Limited

[12] See p.20 of the IDT report dated 10 March 2005 on HKCB Holding Company Ltd & Hong Kong China Ltd

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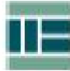

It may be that what is a material price increase in one case may not necessarily be a material price increase in another case. It all depends on the share and the circumstances obtaining at the time.[13]

26. The standard by which materiality is to be judged is whether the information on the particular share is such as would influence persons who are accustomed or would be likely to deal in the share, in deciding whether or not to buy or whether or not to sell that share. A movement in price which would not influence such an investor may be termed immaterial. Price is, after all, to a large extent determined by what investors do. If generally known, it is the impact of the information on persons who are accustomed or would be likely to deal in the share, and thus on price, which has to be judged.[14]

27. The test of whether the information is likely to materially affect the price is a hypothetical one in that it has to be applied at the time the information becomes available. The exercise in determining how the general investor would behave if he was in possession of that piece of information has necessarily to be an assessment at the time the disclosure was to take place.[15]

28. It is clear that fixed thresholds of price movements or quantitative criteria alone are not a suitable means of determining the materiality of a price movement. For example, the volatility of "blue-chip" securities is typically less than that of small, less liquid stocks and "blue-chip" securities usually move within ranges narrower than those of small stocks. While a certain percentage movement for a small company stock might be seen immaterial, the same (or even lower) percentage movement if applied to a large company stock might be considered material by virtue of the stock's nature and size. In determining whether a material effect is likely to occur, the following factors should be taken into consideration –

    (a) the anticipated magnitude of the event or the set of circumstances in question in the context of the totality of the corporation's activity;

    (b) the relevance of the information as regards the main determinants of the price of the listed securities;

    (c) the reliability of the source;

    (d) market variables that affect the price of the listed securities in question (These variables could include prices, returns, volatilities, liquidity, price relationships among securities, volume, supply, demand, etc.).

29. Whilst the actual magnitude of the share movement once the information becomes publicly known indicates the extent of probable change the information might have brought about was it known to the market at the time, this evaluation is by no means conclusive. It is possible that the actual price change on the day the information is released is moderate because of the mixed impact arising from the information released and other extraneous factors or considerations. It is possible that a material price movement may have been pre-empted by the fact that the share price has already declined substantially in the period leading up to the release of the information. Care

[13] See p.41 of the IDT report dated 5 March 1997 on Hong Kong Parkview Group Limited

[14] See p.41 of the IDT report dated 5 March 1997 on Hong Kong Parkview Group Limited (the terminology of which is adjusted to reflect the terminology used in Part XIVA)

[15] See p.19-20 of the IDT report dated 10 March 2005 on HKCB Holding Company Ltd & Hong Kong China Ltd

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must be taken to ascertain whether and how the investors' response once the information is stripped of its confidentiality and becomes public knowledge is attributable to the information released and / or affected by other events or considerations.[16]

Management accounts

30. In the ordinary course of running the business, directors and officers are likely to possess information concerning the corporation not generally known to the market. It is therefore necessary to distinguish between information about day-to-day activities, and on the other hand, significant events and matters which are likely to change a corporation's course or indicate that there has been a change in its course.[17]

31. Generally the mere knowledge of the content of draft annual or interim accounts prior to their publication or internal management accounts would not be specific information. However, knowledge of substantial losses or profits made by a corporation even though the precise magnitude is not yet clear would be specific information and accordingly may be inside information. The facts and figures in every case will be different and every case turns on its own facts. To constitute inside information the difference between the results which the market might predict and the results the directors or officers know must be significant.[18]

32. As stated by the Insider Dealing Tribunal in Chevalier (OA) International Limited, "what percentage is deemed to be "material" or "significant" or "substantial" in an insider dealing case may vary and it would be dangerous to lay down any hard and fast or arithmetic test[19]". Examples of relevant facts and key aspects which have been viewed by tribunals as constituting "material" in some insider dealing cases are set out in **Appendix** B.

33. In assessing what results the market might predict for a corporation, account must be taken of information previously disclosed by the corporation including past results, statements and any forecasts issued by the corporation. Reference should also be made to profit projections by analysts and the availability of data and information about the corporation in financial journals and publications from which a sophisticated investor may logically deduce the corporation's results. However, it would be inadvisable to consider these research reports or financial publications to be information generally known to the market because the market means "the persons who are accustomed or would be likely to deal in the listed securities of the corporation" which might include smaller investors who are unable to perform or follow professional analyses.[20]

34. Although there might be a substantial amount of financial and economic information circulated in the market, it is not unusual that profit forecasts made by different analysts vary considerably and media reports contain inconsistencies. As such analysts' reports, financial journals and media reports often fall short of providing information which is accurate, complete and not misleading or deceptive. Accordingly, a corporation should not normally treat these as information that is generally known and disclosure of any inside information would be necessary.

[16] See p.59-60 of the IDT report dated 22 February 1990 on Lafe Holdings Limited

[17] See p.72-73 of the IDT report dated 10 April 2000 and 15 June 2000 on Hanny Holdings Limited

[18] See p.35-36 of the IDT report dated 23 July 1998 of Ngai Hing Hong Company Limited

[19] See p.73 of the IDT report dated 10 July 1997 on Chevalier (OA) International Limited

[20] See p.62-70 of the IDT report dated 10 July 1997 on Chevalier (OA) International Limited

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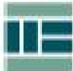


Examples of possible inside information concerning the corporation

35. There are many events and circumstances which may affect the price of the listed securities of a corporation. It is vital for the corporation to make a prompt assessment of the likely impact of these events and circumstances on its share price and decide consciously whether the event or the set of circumstances constitutes inside information that needs to be disclosed. The following are common examples of such events or circumstances where a corporation should consider whether a disclosure obligation arises.

- Changes in performance, or the expectation of the performance, of the business;
- Changes in financial condition, e.g. cashflow crisis, credit crunch;
- Changes in control and control agreements;
- Changes in directors and (if applicable) supervisors;
- Changes in directors' service contracts;
- Changes in auditors or any other information related to the auditors' activity;
- Changes in the share capital, e.g. new share placing, bonus issue, rights issue, share split, share consolidation and capital reduction;
- Issue of debt securities, convertible instruments, options or warrants to acquire or subscribe for securities;
- Takeovers and mergers (corporations will also need to comply with the Takeovers Codes that include specific disclosure obligations);
- Purchase or disposal of equity interests or other major assets or business operations;
- Formation of a joint venture;
- Restructurings, reorganizations and spin-offs that have an effect on the corporation's assets, liabilities, financial position or profits and losses;
- Decisions concerning buy-back programmes or transactions in other listed financial instruments;
- Changes to the memorandum and articles (or equivalent constitutional documents);
- Filing of winding up petitions, the issuing of winding up orders or the appointment of provisional receivers or liquidators;
- Legal disputes and proceedings;
- Revocation or cancellation of credit lines by one or more banks;

- Changes in value of assets (including advances, loans, debts or other forms of financial assistance);
- Insolvency of relevant debtors;
- Reduction of real properties' values;
- Physical destruction of uninsured goods;
- New licenses, patents, registered trademarks;
- Decrease or increase in value of financial instruments in portfolio which include financial assets or liabilities arising from futures contracts, derivatives, warrants, swaps protective hedges, credit default swaps;
- Decrease in value of patents or rights or intangible assets due to market innovation;
- Receiving acquisition bids for relevant assets;
- Innovative products or processes;
- Changes in expected earnings or losses;
- Orders received from customers, their cancellation or important changes;
- Withdrawal from or entry into new core business areas;
- Changes in the investment policy;
- Changes in the accounting policy;
- Ex-dividend date, changes in dividend payment date and amount of dividend; changes in dividend policy;
- Pledge of the corporation's shares by controlling shareholders; or
- Changes in a matter which was the subject of a previous announcement.

36. However, the above list of events or circumstances should not be treated as definitive in terms of meaning that the information in question, if disclosed, will have a material price effect. It is a *non-exhaustive and purely indicative* list of the type of events or circumstances which might constitute inside information. The fact that an event or a set of circumstances does not appear on the list does not mean it cannot be inside information. Nor does inclusion in the list mean that it automatically is inside information. It is the materiality of the information in question that needs to be considered. Information which is likely to materially affect the price of the securities should be disclosed.

37. Moreover, corporations should take into account that the materiality of the information in question will vary widely from entity to entity, depending on a variety of factors such as the entity's size, its course of business and recent developments, the market sentiment about the entity and the sector in which it operates. For example, what may constitute material information to one party to a contract may be immaterial to another party.

Similarly, cancellation of a credit line by a bank which is material to an entity facing liquidity problems may be immaterial to another entity which is highly liquid.

When and how should inside information be disclosed?

38. Section 307B(1) of the SFO states that –

"A listed corporation must, as soon as reasonably practicable after any inside information has come to its knowledge, disclose the information to the public."

39. Section 307B(3) of the SFO states that –

"Without limiting subsection (1), a listed corporation fails to disclose the inside information required under that subsection if –

(a) the information disclosed is false or misleading as to a material fact, or is false or misleading through the omission of a material fact; and

(b) an officer of the corporation knows or ought reasonably to have known that, or is reckless or negligent as to whether, the information disclosed is false or misleading as to a material fact, or is false or misleading through the omission of a material fact."

40. A corporation must disclose any inside information to the public *"as soon as reasonably practicable"* unless the information falls within any of the Safe Harbours as provided in the SFO. For this purpose, "as soon as reasonably practicable" means that the corporation should immediately take all steps that are necessary in the circumstances to disclose the information to the public. For example, if a corporation faces an event that might significantly affect its business and operations, the necessary steps which the corporation should immediately take prior to the issue of a public announcement may include ascertaining sufficient details, internal assessment of the matter and its likely impact, seeking professional advice where required and verification of the facts.

41. Before the information is fully disclosed to the public, the corporation should ensure that the information is kept strictly confidential. Where the corporation believes that the necessary degree of confidentiality cannot be maintained or that confidentiality may have been breached, it should immediately disclose the information to the public.

42. If a corporation needs time to clarify the details of, and the impact arising from, an event or a set of circumstances before it is in a position to issue a full announcement to properly inform the public, the corporation should consider issuing a "holding announcement" which –

(a) details as much of the subject matter as possible; and

(b) sets out reasons why a fuller announcement cannot be made.

The corporation should make a full announcement as soon as reasonably practicable.

43. The information contained in an announcement must not be false or misleading as to a material fact, or false or misleading through the omission of a material fact. To comply with this requirement, the information must be accurate and complete in all material respects and not be misleading or deceptive, and there are no omissions that would

make the information misleading. The information must be presented in a clear and balanced way, which requires equal disclosure of both positive and negative facts.

44. There are circumstances where confidentiality has not been maintained and the corporation is not able to make an announcement, be it a full announcement or a holding announcement. In such cases, the corporation should consider applying for a suspension of trading in its securities until disclosure can be made. The fact that trading in the securities of the corporation is suspended in no way lessens the obligations of a corporation to disclose inside information to the public as soon as reasonably practicable.

45. Section 307C(1) of the SFO states that –

"A disclosure under section 307B must be made in a manner that can provide for equal, timely and effective access by the public to the inside information disclosed."

46. Section 307C(2) of the SFO states that –

"Without limiting the manner of disclosure permitted under subsection (1), a listed corporation complies with that subsection if it has disseminated the inside information required to be disclosed under section 307B through an electronic publication system operated by a recognized exchange company for disseminating information to the public."

47. To fulfil the obligation to disclose to the public, a corporation should disclose inside information to the market as a whole so that all users of the market have equal and simultaneous access to the same information.

48. Section 307C(2) provides a corporation with certainty that disclosure by way of the electronic publication system operated by the Stock Exchange meets its obligation to ensure that the public has equal, timely and effective access to the inside information it discloses. Accordingly the SFC would expect a corporation to use this channel for dissemination of inside information. In addition, under the Listing Rules, a corporation is required to publish announcements of inside information through the electronic publication system of the Stock Exchange.

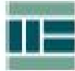
49. A corporation may implement additional means to disseminate information such as issuing a press release through news or wire services, holding a press conference in Hong Kong and / or posting an announcement on its own website; however, using such means of themselves are unlikely to be sufficient to satisfy the obligation to ensure equal, timely and effective access by the public to the information.

Responsibility for compliance and management controls

50. Section 307B(2) of the SFO states that –

"For the purposes of subsection (1), inside information has come to the knowledge of a listed corporation if –

(a) information has, or ought reasonably to have, come to the knowledge of an officer of the corporation in the course of performing functions as an officer of the corporation; and



> *(b) a reasonable person, acting as an officer of the corporation, would consider that the information is inside information in relation to the corporation."*

51. Section 307G of the SFO states that –

> *"(1) Every officer of a listed corporation must take all reasonable measures from time to time to ensure that proper safeguards exist to prevent a breach of a disclosure requirement in relation to the corporation.*
>
> *(2) If a listed corporation is in breach of a disclosure requirement, an officer of the corporation –*
>
> *(a) whose intentional, reckless or negligent conduct has resulted in the breach; or*
>
> *(b) who has not taken all reasonable measures from time to time to ensure that proper safeguards exist to prevent the breach,*
>
> *is also in breach of the disclosure requirement."*

52. Although the disclosure obligation rests with the corporation, the corporation is a legal entity which cannot act on its own. The corporation can only act through its "controlling mind", which encompasses its officers. Therefore, under section 307B(2), the corporation is considered to have knowledge of the inside information when (a) one or more of its officers knows or ought reasonably to have known that information in the course of performing functions as officers of the corporation **and** (b) a reasonable person, acting as an officer of the corporation, would consider that the information is inside information in relation to the corporation. In applying the test under subsection 307B(2)(b), a reasonable officer would consider whether the information is inside information based on his knowledge of all relevant facts and circumstances at the time; such information cannot be judged in hindsight taking account of factors that were not reasonably known at the time.

53. According to Part 1 Schedule 1 of the SFO, an "officer", in relation to a corporation, means "a director, manager or secretary of, or any other person involved in the management of, the corporation". As a general principle, one must look to the object of the legislation and the context to determine the meaning of the term "manager". In the context of Part XIVA, in considering whether a person is a "manager", the person's actual responsibilities are more important than the person's formal title. A "manager" normally refers to a person who, under the immediate authority of the board, is charged with management responsibility affecting the whole of the corporation or a substantial part of the corporation. A person is normally regarded to be "involved in the management of the corporation" if the person discharges the role of a "manager". A "secretary" means a company secretary which has the meaning ascribed to it under the Companies Ordinance (Cap. 32).

54. The corporation should establish and maintain appropriate and effective systems and procedures to ensure any material information which comes to the knowledge of one or more of its officers be promptly identified, assessed and escalated for the attention of the Board of directors to decide about the need for disclosure. This would require a timely and structured flow to the Board of information arising from the development or occurrence of events and circumstances so that the Board can decide whether disclosure is necessary.

55. In ensuring compliance with the obligation to disclose inside information in relation to any material changes in the corporation's financial condition, in the performance of its business or in its expectation as to its performance, the Board should establish and maintain appropriate and effective reporting procedures which ensure a timely and structured flow of relevant financial and operational data.

56. It is ultimately the responsibility of the corporation's officers to ensure that the corporation complies with the disclosure obligation. Officers are obliged to take all reasonable measures to ensure proper safeguards exist to prevent the corporation from breaching the statutory disclosure requirement, which would include the creation and maintenance of appropriate internal control and reporting systems. If a breach on the part of the corporation is attributable to the failure to take all reasonable measures to ensure that proper safeguards exist by, or to any intentional, reckless or negligent conduct of, any officers, the officers concerned would also be liable.

Officers' liability

57. An officer would only have liability under section 307G(2)(a) **if** (i) the listed corporation is in breach of a disclosure requirement; **and** (ii) the officer's intentional, reckless or negligent conduct resulted in the breach.

58. In the situation where an officer has actual knowledge of information which should have been disclosed the meaning of "intentional", "reckless" and "negligent" can be summarised as follows –

    (a) The requirement for conduct to be intentional means that there must be evidence that the officer intended the corporation not to disclose information that was required to be disclosed under a disclosure requirement.

    (b) The requirement for conduct to be reckless means that the officer was aware that there was a risk that by not disclosing the information the corporation may breach a disclosure requirement and it was in the circumstances known to him unreasonable to take the risk.

    (c) The requirement for conduct to be negligent means the officer failed to exercise such care, skill or foresight as a reasonable officer in his situation would exercise to ensure or cause the corporation to comply with a disclosure requirement.

    Assuming a corporation has implemented reasonable measures to prevent a breach, an officer who acts in good faith and in accordance with all his fiduciary duties without actual knowledge of the information or involvement in the corporation's breach is unlikely to be personally liable under any of the elements discussed above.

Obligations of non-executive directors

59. Given the unitary nature of a board and the indivisible legal duties of all directors, both executive directors and non-executive directors should exercise due care, skill and diligence to fulfil their roles and obligations. However, as acknowledged in the

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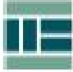

Corporate Governance Code issued by the Stock Exchange[21], non-executive directors normally are not involved in the daily operations of a corporation and would usually rely on a corporation's internal controls and reporting procedures to ensure that, where appropriate, material information is identified and escalated to the board as a whole. It is for this reason that the board's responsibility for establishing and monitoring key internal control procedures is of particular significance for non-executive directors as this is an area where they are more likely to be directly involved. It is therefore more likely that sections 307G(1) and 307G(2)(b) will be of direct relevance to them.

Reasonable measures

60. Under sections 307G(1) and 307G(2)(b), officers must take all reasonable measures from time to time to ensure that proper safeguards exist to prevent a breach of a disclosure requirement. In this respect, officers, including non-executive directors, are responsible to ensure that appropriate systems and procedures are put in place and reviewed periodically to enable the corporation to comply with the disclosure requirements. Officers with an executive role would also have a duty to oversee the proper implementation and functioning of the mechanisms and ensure that any material deficiencies are detected and resolved in a timely manner. In developing the systems and procedures, boards should take into account the particular needs and circumstances of the corporation. The following provides examples of measures which should be considered when establishing systems and procedures. These are not hard and fast rules and should not be taken as a definitive or exhaustive list. It would depend on the specific circumstances to determine whether there was a breach of section 307G(1) or section 307G(2)(b) and the absence of some of the examples below would not be conclusive.

(a) Establish controls for monitoring business and corporate developments and events so that any potential inside information is promptly identified and escalated.

(b) Establish periodic financial reporting procedures so that key financial and operating data is identified and escalated in a structured and timely manner.

(c) Maintain and regularly review a sensitivity list identifying factors or developments which are likely to give rise to the emergence of inside information.

(d) Authorize one or more officer(s) or an internal committee to be notified of any potential inside information and to escalate any such information to the attention of the board.

(e) Maintain an audit trail of meetings and discussions concerning the assessment of inside information.

(f) Restrict access to inside information to a limited number of employees on a need-to-know basis. Ensure employees who are in possession of inside information are fully conversant with their obligations to preserve confidentiality.

[21] See Listing Rule Appendix 14 - A.6.2. The functions of non-executive directors should include: (a) participating in board meetings to bring an independent judgement to bear on issues of strategy, policy, performance, accountability, resources, key appointments and standards of conduct; (b) taking the lead where potential conflicts of interests arise; (c) serving on the audit, remuneration and other governance committees, if invited; and (d) scrutinising the corporation's performance in achieving agreed corporate goals and objectives, and monitoring performance reporting.

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(g) Ensure appropriate confidentiality agreements are in place when the corporation enters into significant negotiations.

(h) Disseminate inside information via the electronic publication system operated by the Stock Exchange before the information is released via other channels, such as the press, wire services or posting on the corporation's website.

(i) Designate a small number of officers or executives with the appropriate skills and training to speak on behalf of the corporation when communicating with external parties such as the media, analysts or investors.

(j) Develop procedures to review presentation materials in advance before they are released at analysts' or media briefings.

(k) Record briefings and discussions with analysts or the media afterwards to check whether any inside information has been inadvertently disclosed.

(l) Develop procedures for responding to market rumours, leaks and inadvertent disclosures.

(m) Provide regular training to relevant employees to help them understand the corporation's policies and procedures as well as their relevant disclosure duties and obligations.

(n) Document the disclosure policies and procedures of the corporation in writing and keep the documentation up to date.

(o) Publish the disclosure policies and procedures of the corporation so that the media and other stakeholders understand the corporation's statutory disclosure obligations.

Safe Harbours that allow non-disclosure of inside information

61. To strike an appropriate balance between requiring timely disclosure of inside information and preventing premature disclosure which might prejudice a corporation's legitimate interests, the SFO provides for Safe Harbours which permit a corporation to withhold disclosure of inside information under specified circumstances. Section 307D of the SFO sets out the Safe Harbours –

"(1) A listed corporation is not required to disclose any inside information under section 307B if and so long as the disclosure is prohibited under, or would constitute a contravention of a restriction imposed by, an enactment or an order of a court.

(2) A listed corporation is not required to disclose any inside information under section 307B if and so long as –

(a) the corporation takes reasonable precautions for preserving the confidentiality of the information;

(b) the confidentiality of the information is preserved; and

(c) one or more of the following applies –

(i) *the information concerns an incomplete proposal or negotiation;*

(ii) *the information is a trade secret;*

(iii) *the information concerns the provision of liquidity support from the Exchange Fund established by the Exchange Fund Ordinance (Cap. 66) or from an institution which performs the functions of a central bank (including such an institution of a place outside Hong Kong) to the corporation or, if the corporation is a member of a group of companies, to any other member of the group;*

(iv) *the disclosure is waived by the Commission under section 307E(1), and any condition imposed under section 307E(2) in relation to the waiver is complied with."*

(3) *For the purposes of subsection (2) –*

(a) *a listed corporation has not failed to take reasonable precautions for preserving the confidentiality of any inside information only because the corporation has, in the ordinary course of business, disclosed the information to any person who –*

(i) *requires the information to perform the person's functions in relation to the corporation; and*

(ii) *by virtue of any enactment, rule of law, contract, or the articles of association of the corporation, is under a duty to the corporation not to disclose the information to any other person; and*

(b) *in those circumstances, the confidentiality of the information is to be regarded as having been preserved.*

(4) *Despite subsection (2)(b), a listed corporation is not in breach of a disclosure requirement in respect of inside information the confidentiality of which is not preserved if –*

(a) *the corporation has taken reasonable measures to monitor the confidentiality of the information; and*

(b) *the corporation discloses the information in accordance with section 307C as soon as reasonably practicable after the corporation becomes aware that the confidentiality of the information has not been preserved."*

Where disclosure is prohibited by law

62. By virtue of section 307D(1), no statutory disclosure is required for information where disclosure would breach an order made by a Hong Kong court or any provisions of other Hong Kong statutes. For example, under section 30 of the Prevention of Bribery Ordinance (Cap. 201), it is unlawful for a person to disclose details of an investigation of

the Independent Commission Against Corruption, except for disclosure matters which are carved out from that prohibition. If a corporation or any of its officers is subject to an investigation by the ICAC and such investigation constitutes inside information, disclosure would not be required to the extent that it is prohibited statutorily. Nonetheless, disclosure of other information which would not contravene the relevant statutory requirement is still required.

63. The Safe Harbour under section 307D(1) does not apply to information the disclosure of which is prevented by contract. A corporation cannot justify not making the disclosure by virtue of the terms of an agreement which require the parties entering into the agreement not to disclose information about the agreement or the transaction that is the subject of the agreement. The terms and conditions of a contract do not override the statutory requirement.

Where disclosure is withheld in other circumstances

64. To rely on a Safe Harbour under section 307D(2), a corporation must satisfy each of subsections (a) **and** (b) **and** one paragraph of subsection (c). We discuss subsections (a) and (b) first and deal with subsection (c) below at paragraph 71.

Preservation of confidentiality

65. The requirements of the Safe Harbour under subsections 307D(2)(a) and (b) are that the corporation must take reasonable measures to preserve the confidentiality of the information and that the confidentiality of the information is preserved. In this regard, the corporation needs to ensure that knowledge of information is restricted to those who need to have access to it and that recipients of the information are aware that the information is confidential and recognise their obligations to maintain the information confidential. Where the information has not been kept confidential or there has been a leak, whether intentionally or inadvertently, these conditions will not be fulfilled and any Safe Harbour will no longer apply.

66. If there are unexplained changes to the share price of the corporation's securities or if there are comments about the corporation in the media or analysts' reports, this may indicate that confidentiality has been lost. It would be more likely to indicate that confidentiality has been lost where comments about the corporation are significant and credible and the details are reasonably specific or the market moves in a way that appears to be referrable to such comments.

67. The requirement to preserve confidentiality under subsection 307D(2)(a) is not breached if information is given to another person who needs the information to fulfil the person's duties and functions in relation to the corporation and provided that the person owes the corporation a duty of confidentiality. The information should be given on the basis that restricts its use to the stated purpose and the recipient should recognise the resulting obligations. The categories of persons who may receive the information include the following –

(a) the corporation's advisers and advisers of other persons involved in the matter in question;

(b) persons with whom the corporation is negotiating, or intends to negotiate, any commercial, financial or investment transaction (including prospective underwriters or placees of the securities of the corporation);

(c) the corporation's lenders;

(d) the corporation's major shareholders; and

(e) any government department, statutory or regulatory body or authority (e.g. SFC, Stock Exchange).

68. A corporation should note that the wider the group of recipients of inside information the greater the likelihood of a leak. If, during the period in which the corporation has decided to withhold disclosure, any inside information is released from any source, however inadvertent, the Safe Harbour no longer applies and public disclosure by the corporation is required.

69. If a corporation has availed itself of any of the Safe Harbours, it should keep under review whether confidentiality of the information has been maintained. If confidentiality has been lost, the Safe Harbour no longer applies and the corporation must disclose the inside information as soon as reasonably practicable. The corporation should normally prepare a draft announcement (albeit a holding announcement) to be kept updated ready for publication if it becomes apparent that confidentiality has not been maintained. In addition, the corporation should consider recording the reasons for relying on the Safe Harbour and the steps taken in preserving and monitoring confidentiality.

70. Where confidentiality has been lost and hence the Safe Harbour under section 307D(2)(b) falls away, if a corporation proves that it has taken reasonable measures to monitor the confidentiality and that it has made disclosure as soon as reasonably practicable once it becomes aware of the leakage, the corporation shall not be regarded to be in breach of the disclosure requirement.

Categories of information

71. The requirement of the Safe Harbours under subsection 307D(2)(c) is that the information falls into one or more of the categories as prescribed in paragraphs (i) to (iv) of that subsection. If the information is not, or if it loses that character, then the requirement is not satisfied.

72. ***Where information concerns an incomplete proposal or negotiation.*** No statutory disclosure is required for information concerning incomplete proposals or negotiations. The following are examples –

- when a contract is being negotiated but has not been finalised;
- when a corporation decides to sell a major holding in another corporation;
- when a corporation is negotiating a share placing with a financial institution; or
- when a corporation is negotiating the provision of financing with a creditor.

73. Where a corporation in financial difficulty and is in negotiations with third parties for funding, the Safe Harbour provides relief from disclosure in respect of the negotiations and the status of progress of those negotiations. However the Safe Harbour does not allow the corporation to withhold disclosure of any material change in its financial

position or performance which led to the funding negotiations and, to the extent that this is inside information, should be the subject of an announcement.

74. *Where information concerns a trade secret*. No statutory disclosure is required for information that is a trade secret. A trade secret generally refers to proprietary information owned by a corporation –

(a) used in a trade or business of the corporation;

(b) which is confidential (i.e. not already in the public domain);

(c) which, if disclosed to a competitor, would be liable to cause real or significant harm to the corporation's business interests; and

(d) the circulation of which is confined to a limited number of persons on a need-to-know basis.

Trade secrets may concern inventions, manufacturing processes or customer lists. For example, a corporation with a new pharmaceutical product may withhold disclosure until after completing the registration of the patent for the product. However, a corporation cannot regard the commercial terms and conditions of a contractual agreement or the financial information of a company as trade secrets as these are not proprietary information or rights owned by the corporation.

75. *Where information concerns the provision of liquidity support*. No statutory disclosure is required for information concerning the provision of liquidity support from the Exchange Fund of the Government or from an institution which performs the functions of a central bank, including one located outside Hong Kong. The liquidity support may be provided to the corporation or, if the corporation is a member of a group of companies, to any other member of the group. The entity receiving the liquidity support is normally a banking institution which may be registered in or outside Hong Kong.

76. *Where disclosure is waived by the SFC*. There are circumstances where disclosure of the information is prohibited under or would constitute a contravention of a restriction imposed by –

(a) legislation of a place outside Hong Kong;

(b) an order of a court exercising jurisdiction under the law of a place outside Hong Kong;

(c) a law enforcement agency of a place outside Hong Kong; or

(d) a government authority of a place outside Hong Kong in the exercise of a power conferred by legislation of that place,

especially where the corporation or certain of its subsidiaries are incorporated or operate outside Hong Kong. In these cases, the SFC may, on application by a corporation, grant an exemption to waive disclosure of the information if it considers appropriate to do so. An exemption granted may be unconditional or subject to specified conditions. No statutory disclosure is required for information for which an

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exemption has been granted and any conditions imposed in relation to the exemption have been complied with.

77. An application to the SFC to exempt disclosure of the information must be made in writing. The application should contain a clear explanation of why the exemption is requested in the circumstances and include all relevant details and information necessary for the SFC to consider the matter. Where applicable, the application should include an appropriate legal opinion to set out all relevant issues. The application should be accompanied by a fee which is payable pursuant to the Securities and Futures (Fees) Rules.

78. The application would be considered by an SFC executive committee that would make a first instance decision after considering all relevant facts and circumstances. If the waiver is rejected by the executive committee, the corporation may request the decision be reviewed by a committee appointed by the Commission for the purposes of handling reviews (**"Review Committee"**). A request for such a review must be made by the applicant to the Review Committee within 2 business days after the refusal of the waiver. Any member of the SFC who was involved in the first instance decision will not participate in the deliberations of the Review Committee in considering the review. A decision made by the Review Committee will be final and binding.

Guidance on particular situations and issues

Dealing with media speculation, market rumours and analysts' reports

79. Corporations are generally under no obligation to respond to media speculation, market rumours or analysts' reports. However, if a corporation has inside information and relies on a Safe Harbour to withhold disclosure subject to the preservation of confidentiality, the existence of media speculation, market rumours or analysts' reports about the corporation might indicate that matters intended to be kept confidential have leaked. In particular, where media speculation, market rumours or analysts' reports are largely accurate and the information underlying the speculation, rumours or reports constitutes inside information, it is likely that confidentiality has been lost, thus the Safe Harbour falls away and public disclosure is required. Accurate and extensive rumours and media speculation, even where included in analysts' reports, are unlikely to represent information that is generally known and accordingly disclosure by the corporation is necessary.

80. If a corporation does not have inside information but media reports or market rumours carry false or untrue information, the corporation is not obliged to make further disclosure under the SFO. This notwithstanding, under the Listing Rules, the Stock Exchange may require a corporation to provide disclosure or clarification beyond that required by the SFO, for example the issue of a negative announcement to confirm that a rumour is false. The fact that the corporation issues an announcement as requested by the Stock Exchange for the purposes of the Listing Rules would not in itself imply that the corporation has failed to meet the disclosure obligation for inside information under the SFO. If a corporation wishes to respond to rumours, the corporation should do so by making a formal announcement, rather than making a remark to a single publication or by way of a press release. This will ensure that the whole market is equally and properly informed.

81. A corporation should ensure that no inside information is given when answering an analyst's questions or reviewing an analyst's draft report. It is inappropriate for a

question to be answered, or draft report corrected, if doing so involves providing inside information. When analysts visit the corporation, care should be taken to ensure they do not obtain inside information.

82. In some circumstances, a corporation does not have inside information but an analyst's report contains errors or misinterpretations by, for example, using out of date data, or misreading or misinterpreting historical information of the corporation especially where the corporation's business is complex and / or comprised of many different divisions. In such cases, unless the corporation knows of inside information relevant to the analyst's report which has not been disclosed, strictly speaking the corporation is not obliged to make a correction or clarification under the SFO. It may nevertheless be appropriate, as a matter of good practice, for the corporation to clarify historical information and correct any factual errors in the analyst's assumptions which are significant to the extent that they may mislead the market, provided any clarification is confined to drawing the analyst's attention to information that has already been made available to the market. If the corporation becomes aware of inside information that would correct a fundamental misconception in the report, public disclosure of such information would be necessary. Nonetheless, a corporation is under no legal obligation to track reports prepared by third parties.

83. No analyst, investor or journalist should receive a selective release of inside information.

Internal matters

84. A corporation may consider internal issues in its day-to-day running which may involve matters of supposition or of an indefinite nature and where premature disclosure of the information may be more misleading than informative. Such information is not specific information. This might include, for example, the development of a new technology, the planning of a major redundancy program or the possibility of a substantial price cut in its products. Consideration of these matters with hypotheses or scenarios would not normally constitute inside information. However, once these matters become specific or definite, they may constitute inside information.

85. Similarly, a corporation may from time to time generate internal reports for management purposes. For example, an internal marketing research report may indicate that a new product to be launched by a competitor may pose a significant challenge that needs to be addressed as one possible outcome could be a significant loss of sales. The mere possibility that without a successful response the corporation could face a serious decline in profits does not automatically trigger an obligation to disclose. However, if after time the competitor's new product has significantly reduced sales, then the fact of the change in trading performance, shown by regular performance monitoring, may constitute inside information.

Corporation listed on more than one exchange

86. If the securities of a corporation are listed on more than one stock exchange, the corporation should synchronise the disclosure of inside information as closely as possible in all markets in which the securities are listed. In general, the corporation should ensure that inside information is released to the public in Hong Kong at the same time it is given to the overseas markets. If inside information is released to another market when the market in Hong Kong is closed, the corporation should issue an announcement in Hong Kong before the Hong Kong market opens for trading.

87. If necessary, the corporation may request a suspension of trading in its securities pending the issue of the announcement in Hong Kong.

Publications by third parties

88. Publications by industry regulators, government departments, rating agencies or other bodies may affect the price of, or market activity in, the securities of the corporation. If such publications when they become public knowledge are expected to have significant consequences directly affecting the corporation this may be inside information that should be disclosed by the corporation with an assessment of the likely impact of those events.

External developments

89. Corporations are not expected to disclose general external developments, such as foreign currency rates, the market price of commodities or changes in a taxation regime. However, if the information has a particular impact on the corporation this may be inside information that should be disclosed by the corporation with an assessment of the likely impact of those events.

In the course of preparing periodic and other structured disclosures

90. A corporation may be required in a number of circumstances to prepare disclosure in prescribed structured formats pursuant to the relevant laws and listing rules, for example, regular periodic financial reports, circulars and listing documents. In the course of preparing these prescribed disclosure documents, a corporation may become aware of inside information previously unknown to the directors and officers, or information in respect of a matter or financial trend which may have crystallised into inside information.

91. A corporation should be aware that inside information which requires disclosure may emerge during the preparation of these disclosures, in particular periodic financial information, and that the corporation cannot defer releasing inside information until the prescribed document is issued. Separate immediate disclosure of the information is necessary.

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Appendix A

List of cases handled by the Insider Dealing Tribunal and the Market Misconduct Tribunal

The following is a list of insider dealing cases handled and published by the Insider Dealing Tribunal and the Market Misconduct Tribunal as at 31 May 2012. Details of these cases can be found on the Insider Dealing Tribunal website at http://www.idt.gov.hk/ and the Market Misconduct Tribunal website at http://www.mmt.gov.hk/

Insider Dealing Tribunal

1) Founder Holdings Limited – Report of the IDT dated 5 Nov 2009

2) Harbour Ring International Holdings Limited (currently known as Hutchison Harbour Ring Limited) – Report of the IDT dated 6 Aug 2009

3) Vanda Systems and Communications Holdings Limited – Report of the IDT dated 26 Mar 2007

4) Tingyi (Cayman Islands) Holding Corp – Report of the IDT dated 11 Jan 2007

5) Dransfield Holdings Limited (later renamed China Merchants DiChan (Asia) Limited; now known as Pearl Orient Innovation Limited) – Report of the IDT dated 22 Dec 2006

6) Siu Fung Ceramics Holdings Limited – Report dated 18 Mar 2004 (1st Report), 25 Oct 2004 (2nd Report), 14 Mar 2006 (3rd Report) & 2 Nov 2006 (4th Report)

7) Asia Orient Holdings Limited – Report of the IDT dated 8 Sep 2006 & 14 Dec 2006

8) Cheong Ming Investments Limited (formerly Cheong Ming holdings Limited) – Report of the IDT dated 3 Aug 2006 & 14 Sep 2006

9) Easy Concepts International Holdings Limited (subsequently renamed as 21CN CyberNet Corporation Limited and known as CITIC 21CN Company Limited) and Easyknit International Holdings Limited – Report of the IDT dated 19 Jan 2006

10) Gilbert Holdings Limited – Report of the IDT dated 11 May 2005 & 15 Dec 2005

11) HKCB Holding Company Ltd & Hong Kong China Ltd (now renamed Lippo China Resources Ltd) – Report of the IDT dated 10 Mar 2005 (1st Part), 9 Aug 2005 (2nd Part) & 20 Mar 2008 (3rd Part)

12) Chinney Alliance Group Limited – Report of the IDT dated 24 Dec 2004

13) Firstone International Holdings Limited – Report of the IDT dated 2 Apr 2004 & 8 Jul 2004

14) Stime Watch International Holding Limited – Report of the IDT dated 6 Dec 2003 & 14 Feb 2003

15) China Apollo Holdings Limited – Report of the IDT dated 31 Jan 2002 & 6 Jun 2002

16) Indesen Industries Company Limited (now known as Central China Enterprises Limited) – Report of the IDT dated 2 Nov 2001

17) Hanny Holdings Limited (formerly known as Hanny Magnetics (Holdings) Limited) – Report of the IDT dated 10 Apr 2000 & 15 Jun 2000

18) Chinese Estates Holdings Limited – Report of the IDT dated 6 May 1999

19) Ngai Hing Hong Company Limited – Report of the IDT dated 23 Jul 1998

20) Chee Shing Holdings Limited – Report of the IDT dated 30 Mar 1998 & 21 Jun 2001

21) Emperor (China Concept) Investments Limited – Report of the IDT dated 8 Jun 1998

22) Hong Kong Worsted Mills Limited (now renamed as Beijing Development (H.K.) Limited) – Report of the IDT dated 18 Nov 1997 & 21 Jan 1998

23) Chevalier (OA) International Limited – Report of the IDT dated 10 Jul 1997

24) Hong Kong Parkview Group Limited – Report of the IDT dated 5 Mar 1997

25) Yanion International Holdings Limited – Report of the IDT dated 29 Oct 1996

26) Public International Investments Ltd – Report of the IDT dated 5 Aug 1995

27) Success Holdings Limited – Report of the IDT dated 24 Jun 1994

28) Lafe Holdings Limited – Report of the IDT dated 22 Feb 1990

29) International City Holdings Limited – Report of the IDT dated 27 Mar 1986 (Vols. I & II)

Market Misconduct Tribunal

30) Chaoda Modern Agriculture (Holdings) Limited – Report of the MMT dated 26 Apr 2012

31) ABC Communications (Holdings) Limited – Report of the MMT dated 20 Oct 2011

32) Mirabell International Holdings Limited – Report of the MMT dated 23 Jul 2010

33) China Overseas Land and Investment Limited – Report of the MMT dated 8 Jul 2009

34) Sunny Global Holdings Limited – Report of the MMT dated 21 Jul 2008

Appendix B

Examples of previous insider dealing cases: materiality

Case	Relevant facts	Factors relevant to materiality
China Apollo Holdings Limited (IDT report dated 31 Jan 2002 & 6 Jun 2002)	- On 7 Dec 1995, before the listing, the Company published a prospectus which included its actual business results to 30 Jun 1995 and a profit forecast for the year ended 31 Dec 1995 amounting to not less than $190 million. It was listed on 19 Dec 1995. - On 21 May 1996, the Company announced its final results to the year ending 31 Dec 1995 which disclosed a profit attributable to shareholders of $192 million. The figure included an exceptional gain of $15.8 million made on the sale of a long-term investment held by a major subsidiary pursuant to a sale and purchase agreement dated 26 Dec 1995. - Without the inclusion of the exceptional gain, the Company would not meet the profit forecast in the prospectus. The prospectus, however, had stated that the profit forecast did not include any exceptional items in the calculation and that the directors did not expect any exceptional items to arise during the year to 31 Dec 1995. - At the time of the issue of the prospectus, only the directors were in possession of information relating its results up to and including Oct 1995. It was apparent that sales deteriorated in the second half of 1995, rendering the attainment of profit forecast of not less than $190 million impossible.	- The tribunal accepted the evidence of the non-expert and expert witnesses. On the evidence, the investors' response was wholly attributable to the information released on 21 May 1996. The tribunal had no doubt that had the market known of the Company's poor trading results for the 2nd half of 1995 before that date, this information would have been likely to have had a material impact on the price of its shares, both on the flotation and in subsequent trading up to 21 May 1996.[1] - It was certainly information, which had it been known during the relevant time would have been likely to cause more than a mere fluctuation, or a slight change in the Company's share price.[2]
Hanny Holdings Limited (IDT report dated 10 Apr 2000 & 15 Jun 2000)	- On 3 Jan 1994, the Company published its interim results for the 6 months ended 30 Sep 1993 with an increased profit attributable to shareholders of $82.36 million, compared to $60.08 million for the same period in 1992. The announcement expressed a bullish sentiment on the Company's performance for the year ended 31 Mar 1994. - But, it was subsequently discovered from draft accounts that the year end results for	- The tribunal accepted the accuracy of the expert witness's evidence. The tribunal had no doubt that if the information of what was really happening at the Company from about 11 Jul 1994 onwards had been shared with the investing public it would have brought about a material drop in the value of the Company's shares. The very nature and extent of the

[1] See p.47 of the IDT report of China Apollo Holdings Limited dated 31 January 2002 & 6 June 2002

[2] *Ibid*

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Case	Relevant facts	Factors relevant to materiality
	the year ended 31 Mar 1994 were in fact facing a significant loss. - One of the earliest of these accounts (bearing a date of 11 Jul 1994) showed that just one company in the Group was looking at a loss of over HK$100 million compared to a profit of HK$18 million at the end of the previous year. - On 2 Sep 1994, the Company announced its year end results showing that the profit decreased by 76%.	Company's reversal of fortunes makes that obvious.[3] - If further proof was needed, the reaction to the Company's results when they were formally published on 2 Sep 1994 was sufficient. Despite a major fall in value over the previous weeks (share price dropped by 33% over 5 weeks from 13 Jul to 22 Aug 1994), when the Company's year-end position was spelt out in black and white the drop in value continued. Between 2 and 7 Sep 1994, share price dropped another 15% over 5 trading days.[4]
Ngai Hing Hong Company Limited (IDT report dated 23 Jul 1998)	- On 21 Jul 1995, the then financial controller of the Company (who was also the company secretary and an executive director) purchased 1 million shares of the Company. - At the time of his purchase, the financial controller possessed the following information which was not in public possession: • The Company's consolidated accounts for the 9 months up to 31 Mar 1995 showed a total profit of approximately $47.1 million. • The Company's management accounts for 11 months up to 31 May 1995 showed a profit before adjustments of approximately $71.4 million. - Information in the public domain at that time was limited to knowledge that: • The interim results for the first 6 months of the year showed a profit of approximately $20.8 million. • The annual result for the previously year 1993/94 showed a profit of approximately $35 million.	- The facts and figures in every case will be different and every case turns on its own facts.[5] - To constitute relevant information, the difference between the results which the public might predict and the results which the insider knows must be significant. If it were not significant the share price would not be materially affected.[6] - To arrive at a decision in each case the tribunal must make a judgement from the combined effect of the figures themselves, the expert evidence concerning those figures and the insider's own testimony either admitting or explaining those figures.[7] - Based on the totality of the evidence coupled with the absence of any submissions to the contrary the tribunal was satisfied that the difference between what the financial controller of the Company knew and the likely investors of the Company knew at the material time was sufficiently significant and

[3] See p.100 of the IDT report of Hanny Holdings Limited dated 10 April 2000 & 15 June 2000
[4] *Ibid*
[5] See p.36 of the IDT report of Ngai Hing Hong Company Limited dated 23 July 1998
[6] *Ibid*
[7] *Ibid*

Case	Relevant facts	Factors relevant to materiality
	- If the public wanted to estimate the final profit for year 1994/95, they would probably double the half yearly figure and arrive at a figure of about $40 million which represents an improvement over the 1993/94 figure of about 14% whereas the financial controller of the Company knew that the unaudited accounts for 11 months of the year in fact represented an improvement in profit over the previous year of about 105%. - Due to adjustments, the annual figure which was subsequently published on 18 Sep 1995 showed a profit of $60.9 million (an improvement of over 70%).	material to constitute relevant information.[8]
Chevalier (OA) International Limited (IDT report dated 10 Jul 1997)	- From the date of its incorporation in 1988 until the financial year 1992/93, the Company had always made a profit; however, the size of its profits got smaller each year from $45.9 million in 1989 to $4.5 million in 1992. - On 13 Jan 1993, the Company announced its half yearly loss of $16.9 million (up to 30 Sep 1992). - The Company's monthly management account showed the following accumulated losses in the subsequent months after the first half year – up to Oct 1992: $24.66 million; Nov 1992: $28.91 million; Dec 1992: $35.60 million; Jan 1993: $43.90 million (i.e. the half yearly loss of $16.9 million doubled in the space of 3 months and increased by a factor of 2.8 in 5 months). These monthly management accounts were circulated to the directors of the Company on a monthly basis from 16 Jan 1993 to 1 Apr 1993. - On 12 Aug 1993, the Company announced its final figures for the financial year 1992/93. For the year ended 31 Mar 1993, the Company incurred a total loss of $84.5 million. - The share price of the Company fell from 40 cents at the close on 11 Aug 1993 to	- What does "materially" mean? Synonyms include considerably, substantially, significantly. Authority on the meaning is sparse.[9] - When gauging materiality it is obviously more helpful to look at percentages than actual cents. In the accountancy profession a movement up or down of 5% or more is deemed to be material.[10] - What percentage is deemed to be "material" or "significant" or "substantial" in an insider dealing case may vary and it would be dangerous to lay down any hard and fast or arithmetic test.[11] - At the end of the day the tribunal can only hazard an educated guess as to how the market would have reacted.[12]

[8] *Ibid*, see p.38

[9] See p.72 of the IDT report of Chevalier (OA) International Limited dated 10 July 1997

[10] *Ibid*

[11] *Ibid*, see p.73

[12] *Ibid*

Case	Relevant facts	Factors relevant to materiality
	31 cents on 25 Aug 1993 (over 10 trading days). - As at early May 1993, the alleged insider would have known that the final loss for the year ended 31 Mar 1993 would be not less than $54 million, taking into consideration the previous trend, adjustments and other factors, before the announcement of the final figure. The question to be determined was whether this loss was "material".	
Lafe Holdings Limited (IDT report dated 22 Feb 1990)	- The Company reported a profit of $22.13 million for the half year ended 30 Jun 1988 in its interim report dated 22 Sep 1988. - The Company's internal management account revealed that the accumulated net profit for the year continued to rise to reach a peak of $28.7 million on 31 Aug 1988. However, beginning with September to the end of that year, the Company incurred losses – for Sep: $2.78 million; for Oct: $5.9 million; for Nov: $2.35 million and for Dec: $7.77 million, making a total loss of $18.8 million for the 4 months ended Dec 1988. - The effect of those losses was that the Company's net profits for the year dropped dramatically from the accumulated total of $28.7 million at the end of Aug 1988 to $9.9 million at the end of Dec 1988. - The then chairman (who was also the managing director and principal shareholder) of the Company possessed the information of the management accounts for Dec 1988 in the middle of Mar 1989. - In the period between 24 Nov 1988 and 5 May 1989, the chairman sold 99.3% of his shareholding (i.e. 175.13 million shares of the Company). In particular, 161.82 million shares were sold between 1 Mar 1989 and 5 May 1989. - The results for the year ended Dec 1988 were published on 5 May 1989.	- Thus information that would be likely to cause a mere fluctuation or a slight change in price would not be sufficient; there must be the likelihood of change of sufficient degree in any given circumstances to amount to a material change. [13] - The share price declined steeply from $0.94 to $0.53 i.e. almost 44% during the period from 1 Mar to 5 May 1989. It is perhaps not surprising, taking into account the overall decline from $1.10 in mid-Feb 1989, that when the results were actually released on 5 May 1989, they did not have a major impact and the price fell some 5 cents in the ensuing week, i.e. about 10%, which may nevertheless be thought by no means immaterial. However, had the results come out at the times the sales by the chairman were procured, the fall could have well been greater. [14] - Having regard to all the evidence and the foregoing considerations the tribunal was satisfied that both the information in the monthly accounts for Sep, Oct and Nov 1988 that losses had occurred in those months, and the information that the total losses for the last 4 months of 1988 amounted to 18.8 million, revealed by the Dec accounts, was each on its own likely to produce a material change, i.e. a substantial fall, in the

[13] See p.58-59 of the IDT report of Lafe Holdings Limited dated 22 February 1990

[14] *Ibid*, see p.59-60

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Case	Relevant facts	Factors relevant to materiality
		Company's share price, if it had become generally available during the period ending 5 May 1989 and beginning 1 Mar 1989 or even earlier.[15]

[15] *Ibid*, see p.62