The statutory regime for listed companies' disclosure of inside information

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Introduction

- New statutory regime for disclosure of price sensitive information (PSI) (called **inside information** under the new regime) came into effect on **1 January 2013**
- PSI disclosure long governed by non-statutory obligations under Listing Rules (Ch.13 Main Board Rules/Ch.17 GEM Rules)
- New statutory regime set out in new Part XIVA SFO
- Breach of statutory obligation is a civil offence subject to a maximum fine of HK$8 million for listed companies and their directors

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Background to Proposal for Statutory PSI Disclosure Obligation

- Companies' Listing Rule obligations are contractual
- Exchange has limited disciplinary powers (e.g. can publicly or privately censure or suspend/cancel listing in extreme cases) – no power to fine
- Other international markets moved from non-statutory to statutory approach empowering statutory agencies and courts to take statutory action against those breaching rules (e.g. UK transferred listing regulatory role from London Stock Exchange to FSA)
- In Hong Kong – concerns that Listing Rules lack "regulatory teeth" led to calls for Listing Rules to be given statutory backing
- 2003, Dual Filing Regime established under Securities and Futures (Stock Market Listing) Rules under SFO – imposes criminal liability on applicants/issuers intentionally or recklessly disclosing materially false or misleading information to the public

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Background to Proposal for Statutory PSI Disclosure Obligation

- January 2005: SFC Consultation Paper on Proposed Amendments to Securities and Futures (Stock Market Listing) Rules Published
- Proposed statutory codification of 3 key areas of issuers' Listing Rule obligations
  - Disclosure of Price Sensitive Information
  - Publication of Annual and Interim Financial Reports
  - Disclosure and Shareholders' Approval Requirements for Notifiable and Connected Transactions
- February 2007: SFC Consultation Conclusions proposed alternative approach – statutory listing requirements would comprise set of general principles representing issuers' fundamental obligations. Details would be set out in ancillary provisions contained in a schedule to the SFO
- Non-compliance with new general principles would be "market misconduct" within Parts XIII and XIV SFO subject to SFC disciplinary action, civil proceedings before the Market Misconduct Tribunal or criminal prosecution
- Consultation Conclusions never implemented. SFC claimed widespread support for proposals but there were serious misgivings re. making disclosure of PSI a statutory obligation due to uncertainty surrounding meaning of PSI

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Background to Proposal for Statutory PSI Disclosure Obligation

- Exchange amendments to Listing Rules to avoid overlap with new Part XIVA SFO came into effect on 1 January 2013
- In March 2013, Exchange published its consultation conclusions on allowing release of PSI during trading hours subject to implementation of short trading halts. The implementation date will be announced in due course but will not be earlier than mid-2014.
- New definition of "inside information" same as current definition of "relevant information" under s245 SFO for insider dealing offence under Parts XIII and XIV SFO
- Information to be disclosed = same information which prohibits directors'/insiders' dealing in issuer's listed securities

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Agenda

- New statutory regime for disclosure of price sensitive information
- Listing Rule amendments resulting from the new statutory disclosure obligation
- Proposal to implement trading halts
- Insider dealing cases in Hong Kong
- Insider information cases in the UK
- Geltl v Daimler: an ECJ ruling from June 2012

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New Statutory Regime for Disclosure of Price Sensitive Information

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New Statutory Regime for PSI - Highlights

- 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 are dealt with by the **MMT**;
- A number of civil sanctions may be imposed incl. **a maximum fine of HK$ 8 million** on the corporation, its directors/chief executive;

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New Statutory Regime for PSI – Highlights (Cont'd)

- SFC can institute proceedings directly before the MMT (without referral to the Financial Secretary);
- The SFC has published **Guidelines on Disclosure of Inside Information (SFC Guidelines)** to assist compliance with the new requirements;
- The SFC provides an **informal consultation service** to assist corporations to understand the new requirements; and
- Other consequential amendments to the SFO – e.g. definition of "business day" excludes Saturdays.

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New Statutory Regime for PSI – Key Features

- The adoption of the concept of **"relevant information"** used under the insider dealing regime to define PSI.
- 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.
- Statutory obligation to disclose inside information **as soon as reasonably practicable** upon knowledge.
- An obligation on directors and officers to take reasonable measures to ensure **proper safeguards** exist to prevent corporations' breach of statutory requirements.
- Individual liability on directors/officers for corporation's breach of the requirement if such breach is a result of their intentional, reckless or negligent conduct or failure to ensure proper safeguards.

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New Statutory Regime for PSI – Key Features (Cont'd)

- The provision of "**safe harbours**" for legitimate circumstances where non-disclosure or late disclosure is permitted.
- The SFC can **investigate** suspected breaches and **institute proceedings** before the MMT.
- Civil sanctions: a **fine** up to **HKD 8 million** or **disqualification** order up to **5 years**.
- Liability to pay compensation to persons who suffer financial loss as a result of the breach.

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Definition of "Inside Information"

Section 307A SFO

Specific information that is about:

- the corporation;
- a shareholder or officer of the corporation; or
- the listed securities of the corporation or their derivatives; **and**
- 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 corporation's securities.

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Definition of "Inside Information" (Cont'd)

3 key elements to the definition

The information:

- must be **specific**;
- must **not be generally known** to that segment of the market which deals or would likely deal in the corporation's securities; and
- would, if so known **be likely to have a material effect on the price of the listed securities**.

The SFC Guidelines give guidance on how these terms have been interpreted by the MMT in the past.

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Definition of "Inside Information" (Cont'd)

Specificity of Information

- The information must be capable of being identified, defined and unequivocally expressed
- The information need not be precise; information may be specific even though the particulars or details are not precisely known
- Information on a transaction that is only contemplated or under negotiation, while not yet subject to a final agreement, can be specific information
- Mere rumours, vague hopes, or worries, wishful thinking and unsubstantiated conjecture are not specific information

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Definition of "Inside Information" (Cont'd)

Information must not be generally known to the market

- Rumours, media speculation and market expectation about an event cannot be equated with information generally known to the market.
- Clear distinction drawn between market having actual knowledge through proper disclosure and speculation/expectation on an event which require proof.
- Where information is the subject of media comments/analysts' reports, the corporation should consider the accuracy/completeness/reliability of the information in determining whether it is "generally known to the market".
- Should material omissions/doubts as to its bona fides exist, the information is not generally known to the market and requires full disclosure.

Definition of "Inside Information" (Cont'd)

Likely to have a material effect on the price of listed securities

- Test: 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 to buy or sell the securities.
- The test is necessarily a hypothetical one since it must be applied at the time the information becomes available.

Management Accounts

- According to the SFC Guidelines, knowledge of the content of draft annual or interim accounts will not generally be specific information.
- Knowledge of substantial losses or profits of a corporation would however be specific information, even if the exact figures are not yet known, and thus may be inside information.
- Generally, to constitute inside information there must be a substantial difference between the results the market might predict and the results known to the directors/officers.
- In assessing the results the market might predict, account should be taken of information previously published by the corporation (e.g. past results, statements & profit forecasts). But analysts' profit projections and information in financial publications is not normally information which is generally known to the market and disclosure of inside information will generally still be required.

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Examples of Possible Inside Information (Non-Exhaustive) (set out in the SFC Guidelines at para 35) include

- Changes in performance, or the expectation of performance, of the business;
- Changes in financial conditions: e.g. cash flow crisis, credit crunch;
- Changes in directors and their service contracts;
- Changes in auditors or any information related to their activity;
- Changes in the share capital, e.g. new share placing, bonus issue, rights issue, share split etc.;
- Issue of debt securities, convertible instruments, options or warrants to subscribe for shares;
- Takeovers and mergers;
- Purchase or disposal of equity interests or other major assets etc.;
- Formation of a joint venture;
- Changes to memorandum & articles of assoc. (or equivalents)
- Filing of winding up petitions, the issuing of winding up orders or the appointment of provisional receivers or liquidators;
- Legal disputes and proceedings;

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Examples of Possible Inside Information (Non-Exhaustive) (as set out in the SFC Guidelines) (Cont'd)

- 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;
- Decrease in value of patents or rights or intangible assets due to market innovation;

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Examples of Possible Inside Information (Non-Exhaustive) (as set out in the SFC Guidelines) (Cont'd)

- Receiving acquisition bids for relevant assets;
- 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 investment policy;
- Changes in 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.

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Timing of Disclosure

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.

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Meaning of "as soon as is reasonably practicable"

According to SFC Guidelines, the corporation should immediately take all steps necessary to disclose the information to the public, which may include:

- Ascertaining sufficient details;
- Internal assessment of the matter and its impact;
- Seeking professional advice; and
- Verification of the facts

The corporation must ensure that the information is kept strictly confidential until it is publicly disclosed. If the corporation believes that confidentiality cannot be maintained or has been breached, it should immediately disclose the information.

SFC also raises the possibility for corporation to issue "holding announcement" to give the corporation time to clarify the details and likely impact of an event before full announcement.

Who Is An "Officer"?

- Officer: a director, manager or company secretary of a corporation or any other person involved in its management (Part 1 of Schedule 1 to the SFO).

- For the purpose of the new PSI regime, "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.

- The formulation "in course of performing functions as an officer of the corporation" implies that only information being known in situations **where the officer is acting in capacity as an officer** is subject to the new PSI disclosure requirement.

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Manner of Disclosure

- Disclosure must be made in a manner that can provide equal, timely and effective access by the public (s307C(1) SFO).
- Publication via the electronic publication system operated by the Exchange will meet the above requirements (s307C(2)).
- On top of publication via the Exchange, press releases issued through news, wire services, press conferences in HK and/or posting an announcement on the corporation's own websites are also allowed.
- If a corporation is listed on more than one stock exchange, the corporation must ensure information disclosed in overseas markets is simultaneously disclosed in HK. If the HK market is closed, the corporation must issue an announcement in HK before the HK market opens.
- The information contained in the disclosure announcement must be complete and accurate in all material respects and not be misleading or deceptive.

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Safe harbours

- Safe Harbours: 4 situations where corporations are permitted not to disclosure or delay disclosing inside information (s307D SFO).
- 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

Corporations are granted safe harbour if disclosure would **breach an order by a HK court or any provisions of a HK statute** (s307D(1) SFO).

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Safe harbours (Cont'd)

Safe Harbour B

Corporations are granted safe harbour for information relating to an **incomplete proposal or negotiation** (s307D(2)(c)(i) SFO).

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.

Where a corporation is in financial difficulty and is negotiating with third parties for funding, the negotiations may be covered by the safe harbour and need not be disclosed. 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, if this is inside information, it must be announced.

Safe harbours (Cont'd)

Safe Harbour C

Corporations are granted safe harbour for information concerning a **trade secret** (s307D(2)(c)(ii) SFO). Trade secret generally refers to proprietary information owned by a corporation:

- used in a trade or business of the corporation;
- which is confidential (i.e. not already in the public domain);
- which, if disclosed to a competitor, would be liable to cause real or significant harm to the corporation's business interests; and
- 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.

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Safe harbours (Cont'd)

Safe Harbour D

Corporations are granted safe harbour for information concerning the provision of **liquidity support** from the Government's Exchange Fund or a Central Bank (or institution performing such functions, inside or outside HK).

The purpose of this safe harbour is to ward off financial contagion.

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Safe harbours (Cont'd)

Safe Harbour condition of confidentiality:

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

- Reasonable precautions for preserving confidentiality are taken; and
- The confidentiality is preserved.

If confidentiality is lost or information leaked, the safe harbour will cease to be available and disclosure is required as soon as practicable.

There is no breach of the duty to preserve confidentiality if information is given to a person who needs the information to fulfil the person's duties and functions in relation to the corporation provided the person owes the corporation a duty of confidentiality (s307D(3) SFO). Persons who may receive information include the corporation's advisers and advisers to other parties, parties to negotiations, lenders, major shareholders, government departments or statutory bodies.

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:

- Has taken reasonable measures to monitor the confidentiality of information in question; and
- Made disclosure as soon as reasonably practicable after becoming aware of the loss of confidentiality (Section 307D(4) SFO).

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Dealing with Media Speculation, Rumours and Analysts' Reports

According to SFC Guidelines:

- Generally corporations are not required to respond;
- If confidentiality of information under safe harbour protection is likely to have been lost, public disclosure is needed. For example, when media speculation, market rumours or analysts' reports about the corporation are largely accurate and based on the inside information, confidentiality is likely to have been lost;
- Accurate and extensive rumours and media speculation, even if included in analysts' reports, are unlikely to represent information that is "generally known" and accordingly, disclosure by the corporation will be required;
- If the corporation does not have inside information, and media reports/speculation/rumours carry false or untrue information, the corporation is not required under the SFO to make any further disclosure. The Exchange may however require it. A corporation wishing to respond should do so by publication of an announcement rather than by a remark to a single publication or press release; and
- Corporations should ensure no inside information is provided when responding to analysts' questions or reviewing analysts' reports.

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SFC Guidance on companies listed on more than one exchange

If a corporation's securities are listed on more than one exchange, the corporation should :

- synchronise disclosure of inside information as closely as possible in all markets;
- ensure inside information is publicly released in Hong Kong at the same time it's released in other markets;
- if the HK market is closed when information is released in another market, issue an announcement before the HK market opens for trading;
- if necessary, request a suspension of trading pending issue of the announcement.

SFC Guidance on 3rd Party Publications and External Developments

- If publications by 3rd parties such as industry regulators, govt. departments, rating agencies or other bodies are expected to have significant consequences for a corporation when they become public knowledge, this may constitute inside information which should be disclosed with an assessment of the likely impact.
- General external developments (e.g. commodity price changes or tax regime changes) are not generally discloseable. But if the information has a particular impact on the corporation, this may be discloseable inside information. Disclosure should include an assessment of the likely impact of the events.

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SFC Guidance on Inside Information becoming known in course of preparing periodic or other disclosures

- Corporations may become aware of inside information previously unknown to the directors/officers in the course of preparing periodic financial information or other required disclosures (e.g. circulars).
- Disclosure of the inside information should be made immediately – disclosure cannot be deferred until the issue of the relevant document (e.g. periodic financial report).

SFC's Power of Waiver

- 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 is HK$24,000.

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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:

- the breach resulted from the officer's intentional, reckless or negligent conduct; or
- the officer has not taken all reasonable measures to ensure that proper safeguards exist to prevent the breach (section 307G(2) SFO).

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.

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Examples of Reasonable Measures to Prevent Breach (Non-Exhaustive)(as set out in the SFC Guidelines)

- Establish controls for monitoring business and corporate developments and events;
- Establish periodic financial reporting procedures;
- Maintain and regularly review a sensitivity list identifying factors or developments which are likely to give rise to inside information;
- Authorize one or more officer(s) or an internal committee to be notified of any potential inside information and to escalate such information to the board;
- Maintain an audit trail of meetings and discussions concerning the assessment of inside information;
- Restrict access to inside information to a limited number of employees on a need-to-know basis. Ensure such employees are aware of their obligations to preserve confidentiality;
- Ensure appropriate confidentiality agreements are in place when corporation enters significant negotiations;
- Develop procedures to review presentation materials in advance before they are released at analysts' or media briefings;

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Examples of Reasonable Measures to Prevent Breach (Non-Exhaustive)(as set out in the SFC Guidelines) (Cont'd)

- Record briefings and discussions with analysts or the media;
- Develop procedures for responding to market rumours, leaks and inadvertent disclosures;
- 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.

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Investigation and Enforcement

The SFC's powers of investigation under section 182 SFO were 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.

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Sanctions

Possible penalties imposed by the MMT:

- a fine of up to HK$8 million on the corporation, a director or chief executive (but not officer);
- disqualification of the director or officer for up to 5 years;
- a "cold shoulder" order on the director or an officer for up to 5 years;
- a "cease and desist" order on the corporation, director or officer;
- an order that any body of which the director or officer is a member be recommended to take disciplinary action against him; and
- payment of costs of the civil inquiry and/or the SFC investigation by the corporation, director or officer.

To prevent the occurrence of further breaches, the MMT may require:

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

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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.

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New Listing Rule Provisions

- **Inside Information** is the term now used in the Listing Rules to refer to PSI, while "**Inside Information Provisions**" is used to refer to the statutory disclosure regime under Part XIVA of the SFO;

- Main Board Rule 13.05 has been amended to state that the SFC is responsible for the enforcement of the statutory PSI disclosure regime; the Exchange has no jurisdiction over disclosure of PSI;

- The Exchange will not give any guidance as to the interpretation or operation of Part XIVA of the SFO or the Guidelines on Disclosure of Inside Information published by the SFC;

- The guiding principle is that enforcement of the law must take priority over that of the Rules;

- An issuer will not face enforcement action by the SFC and the Exchange at the same time, in respect of the same set of facts

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New Listing Rule Provisions (Cont'd)

- The Exchange will refer cases of possible breach of the statutory disclosure obligation to the SFC;
- The Exchange will not take disciplinary action unless the SFC considers it inappropriate to pursue the matter under the SFO;
- 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));
- Main Board Rule 13.10B: information released to any other stock exchange must be announced;
- This includes information released by an overseas listed subsidiary to another stock exchange, if the information is discloseable by the issuer under the Listing Rules.

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General Obligation of Disclosure Deleted

- To avoid overlap with the statutory disclosure requirements of the SFO, most of Main Board Rule 13.09 has been removed;

- 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.

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The Exchange Continues to Monitor the Market

- The Exchange continues to be responsible for maintaining an orderly, informed and fair market;
- Under Main Board Rule 13.10, the Exchange continues to be able to make enquiries of listed issuers regarding unusual movements in price or trading volume, the possible development of a false market and other matters;
- Main Board Rule 13.10: an issuer that receives an enquiry from the Exchange must respond promptly in one of two ways:
  - provide (and announce, if so required by the Exchange) any information it has that is relevant to the subject matter of the enquiry, so as to inform the market or to clarify the situation; or
  - if appropriate and if requested by the Exchange, issue a standard announcement confirming that the directors, **having made such enquiry with respect to the issuer as may be reasonable in the circumstances**, are not aware of any information that is or may be relevant to the subject matter of the enquiry or of any inside information that needs to be disclosed under the SFO.
- The latter response should be made in a standard form that is set out in Note 1 to the revised Main Board 13.10.

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The Exchange Continues to Monitor the Market (Cont'd)

"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 such enquiry with respect to the Company as is reasonable in the circumstances, we confirm that we are not aware of [any reasons for these price [or volume] movements] or of any information which must be announced to avoid a false market in the Company's securities or of any information which must be announced to avoid a false market in the Company's securities or of any inside information that needs to be disclosed under Part XIVA of the Securities and Futures Ordinance.

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

- Note 2 to Rule 13.10 – an issuer does not need to disclose inside information under the Rules if disclosure of the information is exempted under the Inside Information Provisions

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The Exchange Continues to Monitor the Market (Cont'd)

- Directors are required to make "**such enquiry as may be reasonable in the circumstances**" into the matter;

- It is no longer necessary to confirm that there are no negotiations or agreements relating to intended acquisitions or realisations that are discloseable under the Listing Rules on notifiable transactions or connected transactions;

- As previously under Rule 13.09, Exchange can enquire and require an announcement re. unusual movements in price or trading volume of listed securities or any other matters;

- Under revised Rule 13.10, Exchange can additionally enquire and require announcement re. "**the possible development of a false market in listed securities**"

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The Exchange Continues to Monitor the Market (Cont'd)

- under revised standard announcement directors must confirm that, **having made such enquiry** with respect to the Company **as is reasonable in the circumstances**, they are not aware of:

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

  (b) any inside information that needs to be disclosed under Part XIVA of the SFO.

  Confirmations in (a) and (b) don't seem to require information to be relevant to subject matter of Exchange enquiry.

  The scope of "enquiry" will reflect the individual circumstances of each issuer but also introduces an element of objectivity to the extent of enquiries necessary.

- If Rule 13.10 announcement cannot be made promptly, the Exchange may direct that **a trading halt** be imposed; and

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

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The Exchange Continues to Monitor the Market (Cont'd)

- Main Board Rule 13.09(1) – if in the view of the Exchange there is or is likely to be a false market, as soon as reasonably practicable after consultation with the Exchange, the listed issuer must announce information necessary to avoid a false market.

- This obligation exists whether or not the Exchange makes enquiries under Rule 13.10.

- A note to Rule 13.09(1) also states that if an issuer believes that there is likely to be a false market in its listed securities, it must contact the Exchange as soon as reasonably practicable.

- The requirement to publish periodic announcements of developments during the suspension of trading in a listed issuer's securities on the Main Board is set out in new MB Rule 13.24A.

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The Exchange Continues to Monitor the Market (Cont'd)

The following provisions have been upgraded from notes to fully-fledged Rules:

- MB Rule 13.06A (GEM Rule 17.07A) – the requirement to take all reasonable steps 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:

  - an event occurs that would have caused any assumptions of a profit forecast to have been materially different; or

  - 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.

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Other Changes

Changes in terms in the Listing Rules:

- "Exchange Listing Rules" will be known as "Listing Rules" or "Rules" on the Main Board;
- "GEM Listing Rules" will be known as "GLR" or "Rules" on the GEM;
- The SFO will be known as the "Ordinance" on both the Main Board and the GEM;
- The term "general disclosure obligation" will no longer be used

Debt issues:

- The new Main Board Rule 37.47A clarifies that a guarantor of a debt security has an obligation to announce any information which may have a material effect on its ability to meet its obligations under the debt security..

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Other Changes (Cont'd)

Guidance materials repealed with effect from 1 Jan. 2013:

- the Guide on Disclosure of Price Sensitive Information;
- 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.

TRADING HALTS or TRADING SUSPENSION (Rule 13.10A)

New Rule 13.10A was adopted to require a listed issuer to request a trading halt or trading suspension where an announcement cannot be made promptly if:

- the issuer has information discloseable under amended Rule 13.09;
- it reasonably believes that there is PSI to be disclosed under Part XIVA SFO; or
- circumstances exist where it reasonably believes or it is reasonably likely that confidentiality may have been lost in respect of PSI which is : (a) the subject of an application to the SFC for a waiver; or (b) exempt from the statutory disclosure obligation.

❖ *"Trading halts" are defined as an interruption of trading in an issuer's securities requested or directed pending disclosure of information under the Rules*

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Increased Inside Information Announcements

- The implementation of the new statutory disclosure regime for price sensitive information has resulted in a significant increase in **corporate announcements on inside information**;

- Inside information announcements in 2013 **increased by 52%,** profit alerts and warnings **went up 16%** from 2012, while updates on trading information **rose by 48%**;

- Most enquiries handled by the SFC's consultation service on the new regime were general in nature and were generally processed within the same day;

- The enquiries covered a broad range of issues such as the interpretation of inside information, the application of safe harbours and confidentiality requirements, the liability provisions and other general administrative matters.

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FAQ ON STATUTORY INSIDE INFORMATION DISCLOSURE REGIME AND REGULATORY ACTION FOR NON-DISCLOSURE UNDER PREVIOUS LR REGIME

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Publication of Frequently-Asked-Questions

- The SFC has published an FAQ on disclosure of Inside Information to provide guidance to listed issuers on the application of the statutory regime and the SFC Guidelines on Disclosure of Inside Information;

Avoid issuing an announcement with "Voluntary Announcement"

- The use of the heading exposes issuers to the risk of failing to comply with the requirement to disclose inside information that is accurate, complete and not misleading;
- The heading "voluntary announcement" is not helpful for investors to understand the significance of the information contained in the announcements;
- The announcement heading selected should be that which most accurately reflects the substance of the relevant information

Content requirements

- Factual, clear and expressed in a balanced and objective manner;
- Convey key messages that are visible to and understandable by investors;
- Contain sufficient background information to facilitate reading without undue reference to other documents;
- Avoid boilerplate statements without providing meaningful information;
- Contain sufficient quantitative information which has come to the knowledge of the listed corporation (s307B(3) of the SFO)

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Publication of Frequently-Asked-Questions (Cont'd)

Disclosing inside information in an "overseas regulatory announcement"

- An issuer dually listed in HK and an overseas exchange must announce in HK all information released to any other exchanges at the same time as it is released to that other exchange (MB 13.10B/GEM 17.12);

- Publications on the Exchange website must normally be made in both Chinese and English (MB 2.07C/GEM 16.18(3)(b));

- In practice, Exchange has allowed overseas regulatory announcements to be published in one language only (or assumption they rarely contain price sensitive information);

- It was noted by the SFC and Exchange that some overseas regulatory announcements contain information which could be inside information under HK law (e.g. periodic results);

- If an issuer discloses inside information in an overseas regulatory announcement in one language only, the issuer has not fully discharged its statutory obligation to disclose inside information in a manner that can provide for equal, timely and effective access by the public to the information (s 307C(1) of the SFO);

- Thus, if information which a dually listed issuer is required to disclose to an overseas exchange in fact contains inside information, the announcement to the Hong Kong market must be published in **both Chinese and English**

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Publication of Frequently-Asked-Questions (Cont'd)

Stock Exchange Enquiries re. unusual movement in securities price or trading volume

- If the Exchange makes an enquiry under LR13.10 concerning unusual movements in the price or trading volume of a listed corporation's securities, the corporation should consider all relevant matters.
- A director's trading in listco's securities, particularly if the trading volume is significant, is likely to lead to a sudden increase in trading volume and possibly an unusual change in share price;
- If a listed corporation is aware of any material dealings by its directors shortly before or at the time of the Exchange's enquiry and it is requested by the Exchange to issue an announcement, information about such dealings should be disclosed

Disclosure of a statutory enquiry or an investigation by the SFC

- The following should be considered when deciding whether or not to disclose such information:

a) Statutory enquiry or an investigation concerning a corporation is confidential non-public information;

b) An SFC statutory enquiry or investigation is unlikely to be inside information;

c) Sometimes, the mere fact of an enquiry or investigation may be inside information (rare);

d) But it is for the corporation to decide whether such information is inside information. If it is discloseable under s307B SFO, disclosure will not breach statutory secrecy provisions under **s 378 of the SFO** since 378(2)(e) permits disclosure in accordance with a legal requirement;

e) None of the above removes the obligation to disclose inside information. If the circumstances giving rise to, or the subject of, an SFC enquiry or investigation (as opposed to the fact of the SFC enquiry/investigation) are discloseable under the inside information disclosure regime, they should be disclosed

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Frequently-Asked-Questions on Listing Rule Changes

- The Exchange published Frequently-Asked-Questions Series 22 (the FAQs) in relation to the listing rules changes implemented in connection with the statutory regime for disclosure of inside information (i.e. price sensitive information)

- The FAQs clarify certain concepts or elements in the amended Listing Rules in relation to disclosure of inside information.

- They also explain how listed issuers should comply with the Listing Rule requirements in certain hypothetical situations.

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Frequently-Asked-Questions on Listing Rule Changes (Cont'd)

"False market"

- "False market" refers to a situation where there is material misinformation or materially incomplete information in the market which is compromising proper price discovery.

Examples:

- An issuer has made a **false or misleading announcement;**
- There is **other false or misleading information**, including a false rumour, circulating in the market;
- An issuer has inside information that needs to be disclosed under the Inside Information Provisions (**Part XIVA of the SFO**) but it has not announced the information (e.g. the issuer signed a material contract during trading hours but has not announced the information); or
- A segment of the market is trading on the basis of inside information that is **not available to the market as a whole**

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Frequently-Asked-Questions on Listing Rule Changes (Cont'd)

Media or analyst reports

- Regardless of whether the information is accurate or not, where a media or analyst report appears to contain information from a credible source, the issuer must announce information necessary to avoid a false market in its securities in the following situations:
  - There is a material change in the market price or trading volume of the issuer's securities which appears to be **referrable to the report** (in the sense that it is not readily explicable by any other event or circumstance); or
  - Where the market is not trading at the time but the report is of a character that when the market starts trading, it is **likely to have a material effect** on the market price or trading volume of the issuer's securities.
- Note that in such case, the information is required to be disclosed to avoid the development of a false market **under the Listing Rules.**
- The information may not be inside information discloseable under the statutory regime.

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Frequently-Asked-Questions on Listing Rule Changes (Cont'd)

No need to consult the Exchange

- An issuer does not need to "consult" the Exchange before announcing the information necessary to avoid a false market. However, it must contact the Exchange as soon as reasonably practicable if it believes that there is likely to be a false market in its securities.

"Such enquiry with respect to the issuer as may be reasonable in the circumstances"

- In response to the Exchange's enquiries, an issuer is required to make the standard announcement in the form of Note 1 to Listing Rule 13.10 after having made "*such enquiry with respect to the issuer as may be reasonable in the circumstances*" if it is not aware of any discloseable matters to avoid a false market (**Standard Announcement**)

- The Exchange clarifies that the facts and circumstances giving rise to each of its enquiries are different. What enquiry should be made by the issuer depends on the circumstances and the test is one of **reasonableness**.

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Frequently-Asked-Questions on Listing Rule Changes (Cont'd)

Controlling shareholders which are not directors or officers

- When making enquiries with respect to the company, an issuer is generally not expected to contact,
  - Its controlling shareholders when they are not directors or officers of the issuer, or
  - Counterparties to a transaction
- **except** if there is information available to the issuer suggesting that the subject matter of the enquiry is related to the controlling shareholders or the counterparties to a transaction.

Example 1

- Where the issuer is aware of its controlling shareholder's plan to dispose of its interests in the issuer, and there is an unusual increase in the trading volume of the issuer's shares.

Example 2

- Where there are press articles suggesting that the counterparty to a disclosed transaction may not be able to complete the transaction due to difficulties raising finance.

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Frequently-Asked-Questions on Listing Rule Changes (Cont'd)

Inside information exempted from disclosure

- Where an issuer has inside information which is exempted from disclosure under the safe harbours of the Inside Information Provisions, and there are market rumours which are unrelated to this information but have resulted in unusual trading movements, the Exchange clarifies that if the issuer publishes a **Standard Announcement, it would not be inaccurate** as information that is exempted from disclosure does not fall within the term "*any inside information that needs to be disclosed under Part XIVA of the SFO*" in the Standard Announcement.

Subsequent disclosure of inside information and market uncertainty

- If an issuer made a Standard Announcement stating that there was no discloseable inside information due to an exemption under the Inside Information Provisions, and the issuer subsequently (**e.g. 1 month later**) discloses the information, the Exchange states that the issuer can clarify in the disclosure announcement that the information was exempted from disclosure when the Standard Announcement was first issued, so as to avoid market uncertainty that might arise from the subsequent disclosure.

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Frequently-Asked-Questions on Listing Rule Changes (Cont'd)

Listed structured products

- For the obligations of listed issuers of structured products to make an announcement to avoid a false market, to respond to the Exchange's enquiries and to apply for a trading halt, the obligations do not cover information **relating to the underlying securities** but are confined to information relating to the listed structured products, structured products issuers and/or guarantors.

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Regulatory Decision for Breach of Old Rule 13.09

- March 2013, the Exchange published its decision to censure a listed issuer and four of its directors for breach of Rule 13.09 as in force prior to 1 January 2013;

Facts

- **Year-End 31 Dec 2010**: 49% increase in net profit compared to the previous year;
- **Six months-End 30 Jun 2011**: The Company's performance deteriorated significantly;
- The Company's monthly consolidated management accounts were brought to the directors' notice in the first week of successive months **from February 2011**

- Percentage changes to the monthly net profit compared to the same period in 2010:

	Jan 11	Feb 11	Mar 11	Apr 11	May 11	Jun 11
% Change	+178.6%	-173.2%	-94.9%	-112.4%	-91.3%	-78.4%

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Regulatory Decision for Breach of Old Rule 13.09 (Cont'd)

Facts

- **11 Jul 2011**: profit warning announcement "*the financial results of the Group for the six months ended 30 June 2011 are expected to decrease significantly as compared with that for the corresponding period in 2010*";

- **The next trading day**: share price fell by **30.3%** at the maximum and closed with **a decrease of 28.7%**; trading volume was **19 times the 10-day average**;

- **29 Aug 2011**: the Company announced its 2011 interim results which reported **a 78% decrease in net profit** compared to the same period in 2010

Rule 13.09 prior to 1 Jan 2013

Issuers were required to disclose, **as soon as reasonably practicable**, any information which:

- is necessary to enable shareholders and the public to appraise the position of the group;

- is necessary to avoid the establishment of a false market in the company's securities; or
- which might be reasonably expected **materially to affect market activity in and the price of its securities**.

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Regulatory Decision for Breach of Old Rule 13.09 (Cont'd)

Analysis

The deterioration in the Company's performance:

- Was not information in the public domain;
- Was outside market expectation;
- Was price-sensitive;
- Required disclosure as soon as possible under the old LR 13.09

Company's obligation to disclosure

- **1st week of May 11** – the directors had possession of the April accounts showing a 112% drop in net profit;
- **31 May 11** – the April accounts were discussed at a board meeting;
- **1st week of Jun 11** – the directors had possession of the May accounts showing a 91% drop in net profit

"As soon as reasonably practicable"

- Publication of the profit warning announcement on **11 July 2011** was not "*as soon as reasonably practicable*" under the old LR13.09;
- It is not clear why the obligation to disclose was not considered by the Exchange to have arisen earlier **in the first week of March and April**, when the Directors had possession of the monthly management accounts for February and March, both showing a significant decrease in the Company's net profit

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Regulatory Decision for Breach of Old Rule 13.09 (Cont'd)

Inadequate and ineffective internal control measures

- Did not have any **written internal procedures** for compliance with the provisions;
- No **guidelines** for senior management and directors to determine whether certain information was PSI;
- No **internal procedures and mechanism** to gauge and monitor market expectation of the Company's performance and share price movements

The new statutory regime

- An issuer must disclose PSI to the public **as soon as reasonably practicable** after any inside information has come to its knowledge (s307B(1) SFO);
- "Come to the company's knowledge":
  - 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
  - a reasonable person, acting as an officer of the corporation, would consider that the information is inside information in relation to the corporation (s307B(2) SFO)

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Regulatory Decision for Breach of Old Rule 13.09 (Cont'd)

The new statutory regime

- "**as soon as reasonably practicable**" – all necessary steps:
  - ascertaining sufficient details;
  - internal assessment of the matter and its likely impact;
  - seeking professional advice where required and verification of the facts
- Issuers should 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
- In the regulatory decision, the Exchange's interpretation of the key concepts such as "**as soon as reasonably practicable**" and "**effective systems and procedures**" may help illustrate how listed issuers should comply with the new statutory regime.

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Insider Dealing Cases in Hong Kong

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Insider Dealing Cases: Hong Kong

WHEN IS INFORMATION LIKELY TO HAVE A MATERIAL EFFECT ON PRICE OF LISTED SECURITIES?

Case	Relevant Facts	Factors relevant to materiality
China Apollo Holdings Limited (IDT report dated 31 Jan 2002 & 6 June 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 31Dec 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.	• 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.

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Insider Dealing Cases: Hong Kong

Case	Relevant Facts	Factors relevant to materiality
China Apollo Holdings Limited (IDT report dated 31 Jan 2002 & 6 June 2002)	• 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 to 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.	• 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.

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Insider Dealing Cases: Hong Kong

Case	Relevant Facts	Factors relevant to materiality
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 year ended 31 Mar 1994 were in fact facing a significant loss.	• 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 Company's reversal of fortunes makes that obvious.

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Insider Dealing Cases: Hong Kong

Case	Relevant Facts	Factors relevant to materiality
Hanny Holdings Limited (IDT report dated 10 Apr 2000 & 15 Jun 2000)	• 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%.	• 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.

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Insider Dealing Cases: Hong Kong

Case	Relevant Facts	Factors relevant to materiality
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: o The Company's consolidated accounts for the 9 months up to 31 Mar 1995 showed a total profit of approximately $47.1 million. o The Company's management accounts for 11 months up to 31 May 1995 showed a profit before adjustments of approximately $71.4 million.	• The facts and figures in every case will be different and every case turns on its own facts. • 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. • 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.

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Insider Dealing Cases: Hong Kong

Case	Relevant Facts	Factors relevant to materiality
Ngai Hing Hong Company Limited (IDT report dated 23 Jul 1998)	• Information in the public domain at that time was limited to knowledge that: o The interim results for the first 6 months of the year showed a profit of approximately $20.8 million. o The annual result for the previously year 1993/94 showed a profit of approximately $35 million.	• 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 material to constitute relevant information.

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Insider Dealing Cases: Hong Kong

Case	Relevant Facts	Factors relevant to materiality
Ngai Hing Hong Company Limited (IDT report dated 23 Jul 1998)	• If the public had 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%)	

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Insider Dealing Cases: Hong Kong

Case	Relevant Facts	Factors relevant to materiality
Chevalier (OA) International Limited (IDT report dated 10 Jul 1997)	• 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.	• At the end of the day the tribunal can only hazard an educated guess as to how the market would have reacted.

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Insider Dealing Cases: Hong Kong

Case	Relevant Facts	Factors relevant to materiality
Chevalier (OA) International Limited (IDT report dated 10 Jul 1997)	• The share price of the Company fell from 40 cents at the close on 11 Aug 1993 to 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".	

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Insider Dealing Cases: Hong Kong

Case	Relevant Facts	Factors relevant to materiality
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.	• 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.

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Insider Dealing Cases: Hong Kong

Case	Relevant facts	Factors relevant to materiality
Lafe Holdings Limited (IDT report dated 22 Feb 1990)	• 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 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.

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Insider Information Cases in the UK

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UK Provisions

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

- is likely to have a significant effect on the price of the company's shares or other securities; and
- a reasonable investor would be likely to use as part of the basis of any investment decision
- Under DTR 2.2.1R an issuer must notify a Regulatory Information Service as soon as possible of any inside information which directly concerns it without delay unless certain exceptions apply.
- Under Listing Principle 4 of the Listing Rules in the UK, an issuer 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 for such securities.

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Recent UK FSA Rulings

The case of Wolfson Microelectronics (Jan 2009)

- A customer decided not to pursue certain orders, representing a loss of 8% of Wolfson's forecasted revenue.
- Wolfson believed that increased demand for remaining orders would mitigate loss and that 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. It was decided that a disclosure would take the share price away from its "true value".
- Wolfson consulted investor relations advisers initially who advised wrongly not to disclose bad news, expecting it to be offset by good news. Legal and broker advice sought later disagreed strongly.
- Wolfson argued that the non-disclosure agreement with its customer prohibited it from releasing the news
- Wolfson was fined £140,000.

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Recent UK FSA Rulings

The case of Entertainment Rights PLC (Jan 2009)

- Variation to a distributorship agreement reduced profits by US$13.9 million.
- Entertainment Rights considered that future opportunities to remove impact of variation would occur and delayed accordingly.
- Entertainment Rights was fined £245,000.

The case of Woolworths Group PLC (June 2008)

- Subsidiary had renegotiated a supply contract.
- Retrospective discount caused reduction of £8 million in its 2006/07 profits.
- Woolworths thought this would cause insignificant effect on share price.
- Woolworths was fined £350,000

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Recent UK FSA Rulings

The case of Pace Micro Technology (Jan 2005)

- Pace Micro announced interim results but failed to reveal that trade credit insurance for future deliveries to larger customers had been withdrawn.
- Two previous annual reports stated credit insurance programme existed.
- Pace Micro also failed to inform market when revising revenue expectations downward from £524m to £455m.
- Pace Micro argued that earning expectations had not changed as the lost sales volume would have produced little profit.
- Pace Micro was fined £450,000.

The case of Universal Salvage PLC (May 2004)

- A contract responsible for 40% of revenue was terminated.
- Universal Salvage waited two working days to contact the financial adviser to ask for advice, then another two working days to receive the advice.
- Announcement of inside information was made 24 hours after the advice was given.
- Universal Salvage was fined £90,000. The chief executive was fined £10,000.

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Implications of the Rulings

Good news cannot offset bad news

- All inside information, both good and bad, must be disclosed as soon as possible and considered independently.
- Good and bad news cannot be offset against each other to justify non-disclosure.
- The market, not the issuer, should determine the effect of the information.

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 to disclose.
- Any failure to notify the market of material information creates a false market, regardless of whether the company regards the pre-disclosure price as reflecting the "true market value".

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Implications of the Rulings

Confidentiality agreements cannot justify non-disclosure

- Disclosure obligations contained in the DTRs overrule any contractual requirements in agreements with third parties.
- A well drafted contract should allow for announcements required by law or by a regulator.

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

- Whether inside information is likely to have a 'significant effect' will vary from issuer to issuer
- Must be assessed according to "reasonable investor test"
- Issuers must err on side of caution and consult professional advisers when in doubt

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Implications of the Rulings

All material information must be released

- Developments that may seem to have an insignificant effect on share price can still be seen as inside information by regulators.
- Any information released or previously released cannot be misleading.
- Company must disclose any developments likely to affect the import of information already available to market

Issuers must seek timely professional advice

- Advice must be from legal and broker professionals and not from investor relations personnel.
- Any delay in receiving advice is not an excuse for delayed disclosure.
- Issuers, not their advisers, are responsible for complying with the rules.

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Geltl v. Daimler: ECJ Ruling of June 2012

- In April 2005, the CEO of Daimler AG began to consider resigning early.
- Over a period of two months he informed other board members and employees of his decision.
- Early retirement was proposed at a meeting of the Supervisory Board on 28 July 2005.
- After the board confirmed that the CEO would be replaced, an announcement to the market was made on the same day.

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Relevant Provisions

Article 1(1) of Directive 2003/6/EC:

""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:

"1. For the purposes of applying point 1 of Article 1 of Directive 2003/6/EC [MAD], 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."

Article 1 of Commission Directive 2003/124 (Cont'd):

"2. For the purposes of applying point 1 of Article 1 of Directive 2003/6/EC [MAD], "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."

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Legal Process

On appeal, the German Federal Court of Justice referred to the ECJ two questions:

1. 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?

2. 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?

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ECJ Ruling and Interpretation

Answer to Question One:

- 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.

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ECJ Ruling and Interpretation

Answer to Question Two:

- It is not sufficient that there is a high probability of the circumstances or events in question coming into existence or occurring; there must be a realistic prospect of the occurrence

- The magnitude of their possible effect on the prices of the financial instruments concerned is immaterial in the interpretation of that notion.

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SFC Commences Legal Proceedings Against Ernst & Young

- SFC press release of 28.07.2012 announced commencement of Court of First Instance Proceedings against Ernst & Young Hong Kong for failure to produce specified accounting records
- Records relate to its work as reporting accountant and auditor for Standard Water Limited **(Standard Water)**
- Standard Water withdrew its application to list on Exchange shortly after Ernst & Young's resignation as reporting accountants and auditor in March 2010, upon discovery of inconsistencies in documents provided by company
- Ernst & Young claim audit working papers and underlying accounting documents relating to Standard Water cannot be produced because of restrictions under PRC law
- As a result of a joint statement issued by PRC authorities in October 2009, accounting records, including audit working papers, may be the subject of claims of state secrecy under PRC law and all Hong Kong accountants are required to obtain consent from relevant Mainland authorities before handing over accounting records to regulators like the SFC, even if records are kept in Hong Kong

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SFC Orders Suspension of Dealings in Shares in China High Precision

- On 22 August 2012, SFC ordered suspension of trading in shares of China High Precision Automation Group Limited
- Followed the company's use of state secrecy as the reason for not providing information to its former auditor, KPMG
- SFC concern that citing PRC state secrecy laws as grounds for non-disclosure will tarnish corporate transparency and enforcement in HK
- Possible implications under new statutory PSI disclosure regime for PRC businesses listed on HK Exchange

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PROPOSAL TO ALLOW THE RELEASE OF PSI DURING TRADING HOURS SUBJECT TO TRADING HALT IMPLEMENTATION

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Background

Trading halts for the purpose of disclosing PSI were suggested as early on as 2002. The Exchange has several reasons for wanting to implement trading halts:

- to bring Hong Kong into line with international market practices (see Appendix II to the Consultation Paper in 2012);
- to help investors in derivative products to close out the opening position rather than bear risk overnight;
- to provide more accurate intraday prices in securities as price discovery would occur soon after the halt; and
- to 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.

Current Arrangements

- PSI may be published during only three 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).
- Failure to publish PSI when the disclosure obligation is triggered will result in suspension of trading in the security until the trading session after the PSI has been announced;
- Mid-trading suspensions are usually avoided. Therefore most PSI announcements are published in the evening window;
- 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.

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Revised Arrangements

- The Exchange decided in March 2013 to adopt the proposals for a trading halt regime but no earlier than mid-2014

Summary of Proposals to be Implemented

- Issuers will be able to announce Inside Information on the Exchange's news website during trading hours subject to a short trading halt;
- All trading halts will have a minimum duration of 30 minutes. Resumptions in trading will occur on the quarter hour;
- Trading halts will lapse automatically after two days, at which time all rules on trading suspensions will apply;
- Trading halts will not apply to issuers that are dually listed in Hong Kong and the UK and have obtained a waiver to publish Inside Information announcements during trading hours;
- After a trading halt is lifted, there will be at least 30 minutes of trading;
- The 30 minutes after the lifting of a trading halt will include a 10-minute auction session and 20 minutes of continuous trading;

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Revised Arrangements (Cont'd)

Summary of Proposals to be Implemented

- All outstanding orders entered before a trading halt or suspension will be cancelled automatically;
- Results announcements must be published during the current publication windows and trading halts would be granted if the issuer can justify doing so;
- Current rules on the release of non-Inside Information outside trading hours and the automatic purging of outstanding stock options/futures orders at the time of suspension will remain the same;
- The Exchange will notify investors of any upcoming trading halts through various Exchange system channels, including the Exchange website;
- The Exchange will not implement the trading halts proposals **until after mid-2014** (possibly coinciding with the Orion Trading Platform infrastructure) in order to provide sufficient lead time for the market to prepare for the new regime.

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Revised Arrangements (Cont'd)

Trading Halts Regime

- The minimum duration and the maximum duration of a trading halt will be set at **30 minutes** and **2 trading days** respectively; the approximate duration of most trading suspensions currently and in line with the maximum duration in Australia and Singapore;

- There will be **at least 30 minutes of trading time** after a trading halt is lifted;

- Trading would never resume **after 3:30 pm** on a normal trading day (or after 11:30 am on a half-day); trading would resume at the beginning of the following trading day instead;

- Listed issuers who request trading halts would be expected to have their PSI announcements ready for publication as soon as practicable;

- If a PSI announcement is not published within two days after trading has halted, the trading halt would lapse and **become a suspension of trading** (i.e. trading would resume on the trading day following the PSI announcement rather than 30 minutes afterwards).

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Revised Arrangements (Cont'd)

Results announcements

- Results announcements are to be published in the **existing three publication windows** in the morning, afternoon and evening as far as possible (a trading halt will only be granted if the issuer justifies doing so).

Issuers dually listed on the London Stock Exchange

- There are five issuers dually listed on the HKSE and the London Exchange who have waivers to publish PSI during Hong Kong trading hours without a trading halt because there is no trading halt regime in the UK; **the waivers will be maintained in the new trading halts regime**;

Outstanding orders

- When a trading halt is imposed, all outstanding orders for the securities and their related derivative warrants and callable bull and bear contracts would be cancelled.

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Revised Arrangements (Cont'd)

Price discovery

- In the first 10 minutes of trading immediately after a trading halt is lifted, a single price auction would occur. If the PSI announcement was made between 12:00 pm and 12:30 pm, the single price auction would occur at the beginning of the afternoon trading session.

The single price auction is composed of:

- 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 would be cancelled and unmatched at-auction limit orders would be converted into limit orders and carried into the trading session).

- *Structured products would also trade in the single price auction, during which liquidity providers of structured products would be exempted from providing quotes.*
- *The auction will not apply to the stock options and stock futures market; trading in those products will resume only after the auction.*

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Revised Arrangements (Cont'd)

Non-Inside Information Announcements

- The release of non-Inside Information will continue to be restricted to the current publication windows (**outside trading hours**);
- There will be a risk that issuers may accidentally select a non-Inside Information headline for an announcement that contains Inside Information;
- There is generally no urgency in releasing non-Inside Information, there is no need to release it during trading hours.

A + H Shares

- Mid-session trading halts are not yet available in stock exchanges in PRC, suspensions in trading in A shares cannot be lifted until the beginning of the next trading day;
- Therefore, A+H shares companies will not be able to participate in the new trading halts regime.

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Implementation and Future Plans

- The Exchange intends to implement trading halts along with other major market infrastructure initiatives such as the Orion Trading Platform infrastructure;
- The Exchange will be responsible for system changes to AMS terminals and MWS provided by the Exchange;
- Assistance will be provided for changes to in-house trading systems and trading systems provided by system vendors;
- In addition to its news website, the Exchange may also use market data feed to notify the public of trading halts and resumptions in the future;
- The Exchange will review the experience of allowing Inside Information announcements during trading hours before considering allowing non-Inside Information announcements during trading hours;
- Once again, the Exchange will implement the trading halts regime **no earlier than mid-2014**.

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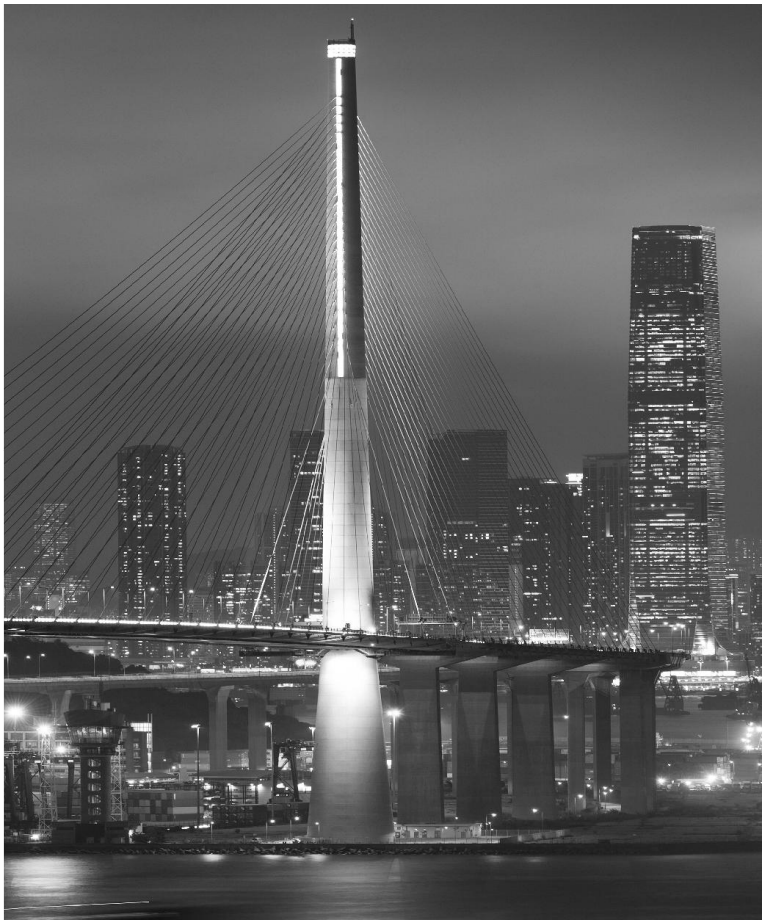

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