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

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CHARLTONS
易周律師行
Solicitors

Hong Kong **Shanghai** **Beijing** **Yangon**

www.charltonslaw.com

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On 1 January 2013, the statutory regime for the disclosure of price sensitive information (**PSI**), called "inside information" under the new regime, took effect. Disclosure of PSI had 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 has been be 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.

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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 are contractual obligations that they undertake to the Exchange to fulfill. They do not have the force of statute and do not give the Exchange statutory regulatory powers. Accordingly, the Exchange's disciplinary powers are limited: it has no power to impose fines, but may publicly or privately

censure firms in breach, and in extreme cases may 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.

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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 was intent upon codifying the obligation to disclose PSI.

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With the introduction of the statutory obligation to disclose price sensitive information, the Exchange's Listing Rules were amended with effect from 1 January 2013 to avoid overlap with Part XIVA SFO. In March 2013, the Exchange published its consultation conclusions on proposals to allow 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 implementation date of the proposals will be announced in due course, although the Exchange has said that implementation will not occur before mid-2014.

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. Previously, an error of judgement attracted, at worst, disciplinary actions from the Exchange. Under the new regime, it could cost up to HK$ 8 million.

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Over the nexthour, I will endeavour to cover:

- The key features of the new statutory disclosure regime;
- The amendments to the Listing Rules aimed 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", I 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 European Court of Justice ruling in the case of Geltl v Daimler (June 2012).

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NEW STATUTORY REGIME FOR DISCLOSURE OF PRICE SENSITIVE INFORMATION

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1. INTRODUCTION

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 are 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 Listing Rules' framework lacks "regulatory teeth" and reflects developments in other international markets.

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Under the amended SFO, the Securities and Futures Commission (the **SFC**) can directly institute proceedings before the MMT to enforce the PSI disclosure requirement and 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 in complying 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.

[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.

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.

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2. KEY FEATURES OF THE PSI DISCLOSURE REGIME

The key features of the new regime include:

- 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

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

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;

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- The provision of safe harbours for legitimate circumstances where non-disclosure or late disclosure is permitted;
- The SFC can rely on its powers under the SFO to investigate suspected breaches and to institute proceedings directly before the MMT;
- The MMT can 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).

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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.

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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.

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Specificity of Information

According to the SFC Guidelines, "specific information" is information which has the following characteristics:

- 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 described and 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, whether described as under contemplation or at a preliminary stage of negotiation, 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.

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Information not generally known

To constitute "inside information" the information must not be "generally known" to the persons who are accustomed or would be likely to deal in

the securities of the relevant listed corporation. 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.

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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.

Management Accounts

The SFC Guidelines state that knowledge of the content of draft annual or interim accounts will not generally be specific information. However, knowledge of substantial losses or profits made by a corporation, even though the exact figures are not yet available, would be specific information and thus may be inside information. Whether or not it is inside information depends on the facts and figures in each case. Generally, in order to constitute inside information, there must be a substantial difference between the results which the market might predict and the results known to the corporation's directors or officers.

In assessing the results the market might predict, the corporation should take into account information previously disclosed by the corporation including past results, statements and any profit forecasts issued. However, corporations should not normally regard profit projections made by analysts and information in financial journals or publications to

be information which is generally known to the market and disclosure of any inside information will be required.

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

The SFC Guidelines include at paragraph 35 a list of common examples of events or circumstances where a corporation should consider whether a disclosure obligation arises. The list given is non-exhaustive and indicative only and includes the following examples:

- Changes in performance, or the expectation of the performance, of the business;
- 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, 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;
- Changes to memorandum and articles of association 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;

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- 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

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- 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.

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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).

In determining whether information is discloseable as "inside information", the test is an objective one – i.e. would a "reasonable officer", based on his knowledge of all relevant facts and circumstances at the relevant time, consider the information to be inside information. 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 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.

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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.

It was clarified in the FSTB's Consultation Conclusions on the amendments to the SFO, that the formulation "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 his/her capacity as an officer of a listed corporation. 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.

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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).

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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 (section 307D(1) SFO)

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.

For example, under section 30 of the Prevention of Bribery Ordinance, it is unlawful for a person to disclose details of any investigation by the Independent Commission Against Corruption ("ICAC"). Accordingly a listed corporation would not be required to disclose the fact that one of its officers is under investigation by the ICAC.

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Safe Harbour B: When the information relates to an incomplete proposal or negotiation (section 307D(2)(c)(i) SFO)

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.

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Safe Harbour C: Where the information is a trade secret (section 307D(2)(c)(ii) SFO)

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.

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Safe Harbour D: When the Government's Exchange Fund or a Central Bank provides liquidity support to the corporation (section 307D(2)(c)(iii) SFO)

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.

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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.

Knowledge of inside information of a corporation must therefore be restricted to those who need to have access to it and any recipients of the information must be made aware that the information is confidential and of their obligations to maintain confidentiality. 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.

There will be no breach of the requirement to preserve confidentiality under subsection 307D(2)(a) if information is given to another person who needs the information to fulfill the person's duties and functions in relation to the corporation and provided that the person owes the corporation a duty of confidentiality. This is provided for by Section 307D(3). According to the SFC Guidelines, the categories of persons who may receive the information include:

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

(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 corporation's securities);

(c) the corporation's lenders;

(d) the corporation's major shareholders; and

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

The SFC Guidelines recommend that information should be provided to any relevant persons on the basis that restricts its use to the stated purpose and the recipient should recognise its obligation to keep the information confidential.

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 (Section 307D(4) SFO).

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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. 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 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, e.g. the issue of a negative announcement to confirm that a rumour is false. 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' draft reports.

Guidance on Internal Matters

According to the SFC Guidelines, where internal issues involved in a corporation's day-to-day running involve supposition or are of an indefinite nature, the information is not specific. The Guidelines give as examples, the development of 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 would not normally constitute inside information. However, once these matters become specific or definite, they may constitute inside information.

Another example given is where an internal marketing research report indicates something needs to be done to address a competitor's launch of a new product, since this might result in a significant loss of sales. The mere possibility that without doing something to address this, the corporation could face a substantial decline in profits does not automatically trigger a disclosure obligation. However if the competitor's new product in fact results in substantially reduced sales, then the fact of the change in the corporation's trading performance may constitute discloseable inside information.

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SFC Guidance on corporations listed on more than one exchange

Where the securities of a corporation are listed on more than one exchange, the corporation should try to synchronise disclosure of inside information as closely as possible in all markets in which the securities are listed. It should try to ensure that inside information is released to the public in Hong Kong at the same time as it is released to overseas markets. If the Hong Kong market is closed when information is released to an overseas market, the corporation should issue an announcement in

Hong Kong before the market opens for trading. If necessary, a suspension of trading in the corporation's securities can be requested pending the issue of an announcement in Hong Kong.

SFC Guidance on Third Party Publications

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. Disclosure should include an assessment of the likely impact of the events.

SFC Guidance on External Developments

Corporations are not generally expected to disclose general external developments such as foreign currency rates, changes in commodity prices or changes in the tax regime. However if the information has a particular impact on the corporation, this may constitute inside information which should be disclosed together with an assessment of the likely impact of the events.

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Information arising in the course of preparation of periodic or

structured disclosures

Corporations are required to make disclosures in prescribed structured formats under the Listing Rules and relevant laws, e.g. to prepare periodic financial reports, circulars and listing documents. A corporation may become aware of inside information in the course of preparing these disclosure documents which was previously unknown to its directors and officers. Where inside information emerges during the preparation of other disclosures (such as periodic financial information), the corporation cannot defer releasing the inside information until the relevant document is issued. Instead, immediate separate disclosure of the inside information will be required.

7. SFC'S POWER TO GRANT WAIVERS

The SFC is empowered to grant waivers where the disclosure of PSI in Hong Kong is prohibited under a court order or legislation of another jurisdiction or contravenes a restriction imposed by a law enforcement agency or government authority in another jurisdiction (section 307E(1) SFO). The SFC grants 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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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 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.

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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) 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.

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

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

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

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

(k) 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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9. INVESTIGATION AND ENFORCEMENT

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

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10. SANCTIONS

The MMT can 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.

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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.

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THE LISTING RULE AMENDMENTS

The Listing Rules were amended with effect from 1 January 2013 to avoid overlap with the statutory regime for disclosure of price sensitive information under the SFO.

The Listing Rules now use the term **Inside Information** to refer to price sensitive information in line with the SFO's requirement for disclosure of such information, while "**Inside Information Provisions**" is used to refer to the statutory disclosure regime under Part XIVA of the SFO.

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 SFC Guidelines) published by the SFC and notes 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 SFC Guidelines. The Exchange however remains responsible for maintaining an orderly, informed and fair market. In short, the Exchange's jurisdiction over disclosure of PSI has ceased.

The guiding principle is that enforcement of the law must take priority over that of the Rules. An issuer will not therefore 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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Jurisdiction over PSI vests with the SFC (Cont'd)

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)).

MB Rule 13.10B sets out an issuer's 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.

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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 previously set out the general obligation to disclose 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

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 Listing Rules, if the Exchange makes an enquiry concerning unusual movements in the price or trading volume of an issuer's listed securities, the possible development of a false market in its securities, or any other matters, an issuer is 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, so as to inform the market or to clarify the situation; or
2. 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(s) of the enquiries, or of any inside information which needs to be disclosed under the SFO.

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

The standard form of the announcement in response to an enquiry is revised and 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 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 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."

There is a note to Rule 13.10 that an issuer does not need to disclose inside information under the Rules if disclosure of the information is exempted under the Inside Information Provisions (which is defined as Part XIVA of the SFO).

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

The revised standard announcement requires directors to make "such enquiry with respect to the Company as is reasonable in the circumstances" before issuing the announcement and requires inclusion

of that confirmation in the announcements. The revised standard 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 previously under 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 can additionally make enquiries and require an announcement to be published in relation to "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 Rule 13.10 directors have to confirm in any announcement that, *having made such enquiry 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.

The confirmations in (a) and (b) as to the absence of information necessary to avoid 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. 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.

The Exchange also reserves the right to direct a trading halt of an issuer's securities if an announcement under Rule 13.10(1) or (2) cannot be made promptly (Note 3 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.

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

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. (as set out in the revised MB Rule 13.09(1)).

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 remains and is set out in the new MB Rule 13.24A.

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

The following provisions which existed previously as notes to Rules have been escalated to become fully-fledged Rules:

- MB Rule 13.06A / GEM Rule 17.07A – the requirement for an issuer and its directors 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 and "GEM Listing Rules" will be known as "GLR" or "Rules" on the GEM. The SFO will be known as the "Ordinance" in both the Main Board and the GEM Listing Rules. The term "general disclosure obligation" is no longer used.

Debt issues

MB Listing Rule 37.47A and corresponding amendments to the Listing Agreement clarify that where debt securities are guaranteed, the guarantor must announce immediately any information which may have a material

effect on its ability to meet its obligations under the debt securities (see also paragraph 2A in MB Appendices 7C to 7E and 7H).

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Other Changes (Cont'd)

Guidance materials

The Exchange previously published guidance materials in respect of the obligation to disclose price sensitive information under the Listing Rules which were available on its website. These included 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. These guidance materials were repealed with effect from 1 January 2013.

Trading halts

"Trading halt" is a new concept in the Listing Rules. The term 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.

The SFO does not specify whether a trading halt is required pending the disclosure of PSI. Therefore, new Rules were adopted to require a listed issuer to request a trading halt or trading suspension where an announcement cannot be made promptly: (i) if the issuer has information discloseable under amended Rule 13.09; (ii) if it reasonably believes that there is PSI to be disclosed under Part XIVA SFO; or (iii) circumstances exist where it reasonably believes or it is reasonably likely that confidentiality of PSI may have been lost 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.

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Increase in number of announcements on inside information

The implementation of the new statutory disclosure regime for price sensitive information has resulted in a significant increase in corporate announcements on inside information. In a news release published on 9 Jan 2014, the Securities and Futures Commission ("SFC") noted that in 2013, corporate announcements about inside information increased by 52% and profit alerts and warnings went up 16% from 2012. Updates on

companies' trading information, including monthly sales figures, production volumes and other key performance indicators, also increased by 48%.

Most enquiries handled by its 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 ("FAQ")

The SFC published an FAQ on disclosure of inside information to provide guidance to listed issuers on the application of the provisions of the statutory regime and the SFC Guidelines. The following is a summary of the responses to the five questions raised by the FAQ.

1. Issuing an announcement with the heading "Voluntary Announcement" to disclose inside information

Listed issuers should avoid using the heading "voluntary announcement" to disclose inside information since it exposes issuers to the risk of failing to comply with the requirement to disclose inside information that is accurate, complete and not misleading which is set out in the SFC Guidelines on Disclosure of Inside Information of June 2012 (at paragraph 43). The SFC additionally commented that the heading "voluntary announcement" is not helpful for investors to understand the significance of the information contained in the announcements. Issuers should instead ensure that the heading chosen for the announcement is that which most accurately reflects the substance of the relevant information.

2. Content requirements for an inside information announcement

Announcements of inside information should enable investors to make well-informed decisions and should therefore:

i. be factual, clear and expressed in a balanced and objective manner;

ii. convey key messages that are clearly visible to and readily understandable by investors;

iii. contain sufficient background information so that an announcement can be read without undue reference to other documents;

iv. avoid boilerplate statements that tend to lengthen the document without providing meaningful information; and

v. contain sufficient quantitative information which has come to the knowledge of the listed corporation, the omission of which may cause the information disclosed to be false or misleading under section 307B(3) of the SFO.

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

3. Disclosing inside information in an "overseas regulatory announcement"

Under the Listing Rules (Main Board Rule 13.10B and GEM Rule 17.12), an issuer dually listed in Hong Kong and an overseas exchange must announce in Hong Kong all information released to any other exchanges at the same time as the information is released to that other exchange. Any publication on the Exchange website must be made in both Chinese and English unless otherwise

specified (Main Board Listing Rule 2.07C and GEM Rule 16.18(3)(b)).

The Exchange, in practice, allowed an "overseas regulatory announcement" to be published in one language only because they did not usually contain information reportable under the Listing Rules and it was assumed that they did not contain inside information.

The SFC and the Exchange have noticed, however, that there have been overseas regulatory announcements contain information which could constitute inside information under Hong Kong law (e.g. periodic results).

As a result, the practice described has been revisited. The SFC takes the view that 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 (section 307C(1) of the SFO). Thus if information which a dually listed issuer is required to disclose to an overseas exchange in fact contains

information which is inside information under Part XIVA SFO, the announcement to the Hong Kong market must be published in both Chinese and English.

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4. Stock Exchange enquiries concerning unusual movements in price or trading volume of securities

When the Stock Exchange makes an enquiry concerning unusual movements in the price or trading volume of a listed corporation's securities, the possible development of a false market in its securities or any other matters under Listing Rule 13.10, a listed company should consider all matters that are or may be relevant to the trading of its securities. A sudden increase in the trading volume of a company's listed securities, which may in turn trigger a change in the share price may be due to a director trading in the securities, particularly if the trading volume is significant or represents a significant portion of market turnover. Where a listed corporation is aware of any material dealings by its directors shortly before or at the time of the Exchange's enquiry and the Exchange requests the issue of an announcement, information about such dealings should be disclosed.

5. Disclosure of a statutory enquiry or an investigation by the SFC

A listed corporation should consider the following factors when deciding whether to disclose the fact that it is subject to a statutory enquiry or an investigation by the SFC:

a) The fact that the SFC is conducting a statutory enquiry or investigation concerning a corporation and/or its officers is confidential non-public information. The SFC will not ordinarily disclose or confirm the fact of such an enquiry or investigation to the public. Similarly, a corporation (and/or its officers) assisting the SFC in an enquiry or investigation is **obliged** to preserve secrecy with regard to any matter coming to its knowledge in the course of assisting the SFC, pursuant to s 378 of the SFO (relating to point (d)).

b) A disclosure obligation will seldom arise because such statutory enquiry or investigation by the SFC is normally not inside information, but merely an administrative information gathering processes and nothing is proven or alleged until the investigation is finished and proceedings started.

c) There may be rare cases where the mere fact of an enquiry or investigation is inside information and so will need to be disclosed. An example might be where the SFC is conducting an investigation into misconduct in office by the corporation's CEO who has stood down or stands down

pending the conclusion of the investigation. However, the SFC expects such cases to be rare, and that any corporation who decides to make such disclosure will inform the SFC beforehand.

d) It is for the corporation to decide whether such information is inside information, and if the answer is in the affirmative then such disclosure must be made under s 307B of the SFO. In this case, disclosure will not breach the statutory secrecy provisions under s 378 of the SFO as obligations made under the SFO will fall within s 378(2)(e) of the SFO which permits disclosure in accordance with a legal requirement.

e) It should be noted that points (a) to (d) concern disclosure of the fact that the SFC has started or is conducting a statutory enquiry or investigation. They do not remove the obligation of a corporation to disclose inside information. If the circumstances which have resulted in, or are the subject of, the enquiry or investigation (as opposed to the fact that the SFC has made a statutory enquiry or is undertaking an investigation) are discloseable inside information, then they should be disclosed. Similarly, the fact of a statutory enquiry or investigation should be distinguished from legal proceedings, including those commenced by the SFC. In the

case of legal proceedings commenced by the SFC, the corporation should consider points (a) to (d) in deciding whether a disclosure obligation exists.

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Frequently-Asked-Question on Listing Rule Changes

The Stock Exchange of Hong Kong 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) under new Part XIVA of the SFO which came into effect on 1 January 2013. With the introduction of the statutory regime, the Exchange remains responsible for maintaining an orderly, fair and informed market for the trading of securities. Listed issuers therefore continue to be subject to an obligation under the Listing Rules to disclose information necessary to avoid the development of a false market.

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-Question 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 of situations where this could arise include:

- 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-Question on Listing Rule Changes (Cont'd)

Media or analyst reports

The FAQ goes on to state that, 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 referable 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-Question 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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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 interest 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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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 (i.e. Part XIVA SFO), 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 containing the required confirmation that it is not aware of any inside information, 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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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

In March 2013, the Listing Committee of the Exchange published its decision to censure a listed issuer and four of its directors for breach of Rule 13.09 governing disclosure of price-sensitive information as in force prior to 1 January 2013.

Facts

The Company reported $104,977,000 net profit for the year ended 31 December 2010, a 49% increase compared to the previous year. The Company's performance then deteriorated significantly during the six months ended 30 June 2011 compared to the same period in 2010. The Company's monthly consolidated management accounts showing the deterioration were brought to the directors' notice in the first week of successive months from February 2011. The percentage changes to the monthly net profit compared to the same period in 2010 are as below:

	Jan	Feb	Mar	Apr	May	Jun
% 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)

On 11 July 2011, the Company published a profit warning announcement, disclosing that "*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*".

On the next trading day, the Company's 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.

On 29 August 2011, the Company announced its 2011 interim results which reported a 78% decrease in net profit compared to the same period in 2010.

Prior to January 2013, Listing Rule 13.09 required issuers to disclose, **as soon as reasonably practicable**, any information which:

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

ii. is necessary to avoid the establishment of a false market in the company's securities; or

iii. 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 Listing Division of the Exchange pointed out that the significant deterioration in the company's performance during the relevant period as indicated in the consolidated management accounts (i) was not information in the public domain, (ii) was outside market expectation, (iii) was price-sensitive and (iv) required disclosure as soon as reasonably practicable under the old Listing Rule 13.09.

The Company's obligation to disclose the information in relation to its deteriorating performance arose in:

i. **in the first week of May 2011**, when the directors had possession of the April monthly management accounts reporting a net loss representing a 112% drop compared to the same period in 2010;

ii. **on 31 May 2011**, when the April monthly management accounts were discussed at a board meeting; or

iii. **in the first week of June 2011**, when the directors had possession of the May monthly management accounts reporting a 91% decrease in net profit compared to the same period in 2010.

Publication of the profit warning announcement on **11 July 2011** was not "*as soon as reasonably practicable*" under the old Listing Rule 13.09.

However, 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)

Internal control measures

The Listing Division noted that the Company's internal control measures to ensure compliance with the price-sensitive information provisions were not adequate and effective:

i. The Company did not have any written internal procedures for compliance with the provisions;

ii. There were no guidelines for senior management and directors to determine whether certain information was price sensitive; and

iii. There were no internal procedures and mechanism for the Company to gauge and monitor market expectation of its performance and its share price movements.

The new statutory regime for the disclosure of price-sensitive information

The new statutory regime governing listed issuers' disclosure of price sensitive information (referred to in the new legislation as "inside information") (PSI) came into effect on 1 January 2013 to replace the non-statutory regime under the Listing Rules.

An issuer 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)

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

According to the SFC, "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.

"effective systems and procedures"

Issuers must therefore ensure that they 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 (paragraph 40 of the SFC Guidelines).

Although this regulatory decision was made in relation to the breach of the old Listing Rule 13.09 which has been replaced by the new statutory regime, 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

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

The SFC Guidelines on Disclosure of Inside Information 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 material effect on the price of relevant companies' listed securities.

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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	• The tribunal accepted the evidence of the non-expert and expert witnesses. On the evidence, the investors' response was wholly attributable to the

Case	Relevant Facts	Factors relevant to materiality
	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. **Slide 67** • 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.	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. • 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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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.
	Slide 69 • 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.
Slide 70		
Ngai Hing Hong Company Limited (IDT	• On 21 Jul 1995, the then financial controller of the Company (who was also the company secretary and an	• The facts and figures in every case will be different and every case turns on its own facts.

Case	Relevant Facts	Factors relevant to materiality
report dated 23 Jul 1998)	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. **Slide 71** • 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. **Slide 72**	• 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. • 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.

Case	Relevant Facts	Factors relevant to materiality
	• 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%)	
Slide 73		
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:	• What does "materially" mean? Synonyms include considerably, substantially, significantly. Authority on the meaning is sparse. • 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. • What percentage is deemed to be "material" or "significant" or "substantial" in an insider dealing case may vary and it would be

Case	Relevant Facts	Factors relevant to materiality
	\$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. **Slide 74** 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".	dangerous to lay down any hard and fast or arithmetic test. • At the end of the day the tribunal can only hazard an educated guess as to how the market would have reacted.
Slide 75		
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.	• 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

Case	Relevant Facts	Factors relevant to materiality
	• 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. **Slide 76** • 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	likelihood of change of sufficient degree in any given circumstances to amount to a material change. • 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. • 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 Company's share price, if it had become generally available during the period ending 5 May 1989 and

Case	Relevant Facts	Factors relevant to materiality
	May 1989	beginning 1 Mar 1989 or even earlier.

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INSIDER INFORMATION CASES IN THE UK

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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).

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2. RECENT UK FSA RULINGS

Wolfson Microelectronics PLC (January 2009)

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.

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Entertainment Rights PLC (January 2009)

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".

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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.

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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.

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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.

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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.

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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.

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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.

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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?

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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.

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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.

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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 proceedings are ongoing.

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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 proceedings are ongoing.

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.

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

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Background

The Exchange 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.

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Current Arrangements

Currently, 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 fails 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 are possible, but are usually avoided and reserved for unexpected events. Most trading suspensions last 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 occur in the evening publication window. In the securities market, orders entered before a suspension of trading remain in the order book and can be cancelled during the suspension period, but if trading does not resume on the same day, the outstanding orders are cancelled automatically after market close. In the options and futures market, all outstanding orders are cancelled automatically once trading in the underlying securities is suspended.

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Revised Arrangements (Cont'd)

In the Consultation Conclusions published in March 2013, the Exchange decided to adopt the following proposals to adopt a trading halt regime.

Summary of Proposals To Be Implemented

- Listed issuers will be able to announce Inside Information on the Exchange's news website during trading hours subject to a short trading halt to allow the public to digest the new information;
- 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 trading in the security is suspended and all current 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. Therefore the latest time to resume trading will be 3:30 pm on a normal trading day and 11:30 am on a half-day;
- 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)

- All outstanding orders entered before a trading halt or suspension will be cancelled automatically;
- Results announcements must be published during the current publication windows (trading halts would be granted only if the issuer can justify doing so); and
- 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. These would include the Exchange website, where a separate information page would 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. 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 of a trading halt will be set at 30 minutes, while the maximum duration of a trading halt will be set at 2 trading days as the Exchange considered that this is the approximate duration of most trading suspensions currently. It is also in line with the maximum duration in Australia and Singapore.

A minimum of 30 minutes of trading would occur after the resumption of trading, including a 10 minute single price auction session. This means that resumption of trading would never occur after 3:30 pm on a normal trading day or after 11:30 am on a half-day; resumption of trading would occur at the beginning of the following trading day instead. 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 would resume only on the quarter hour or the half hour.

Listed issuers who request trading halts would be 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 would lapse and the halt would automatically become a suspension of trading. The existing rules on PSI announcements and suspensions would then apply until the PSI announcement is made. Trading would then resume in the next trading session.

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Revised Arrangements (Cont'd)

Results announcements

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 decided that results announcements should be published during the existing publication windows as far as possible. The Exchange may only grant a trading halt for the publication of results announcement if it is justified by the issuer

in order to be consistent with the general principle that interruptions to trading should be kept to a minimum and only permitted for maintaining an orderly and informed market.

Issuers dually listed on the London Stock Exchange

Currently, 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 will maintain these waivers for those five issuers in the new trading halt regime.

Outstanding orders

The Exchange will adopt the proposal that all outstanding orders for the securities and their related derivative warrants and callable bull and bear contracts would be cancelled upon a trading halt. The Exchange sees this arrangement as preferable, since retail investors would not usually keep track of the publication of announcements constantly. Cancelling all outstanding orders would 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 would help minimise market disputes.

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Revised Arrangements (Cont'd)

Price discovery

To facilitate price discovery, the Exchange will implement a 10-minute single price auction 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 would occur at the beginning of the afternoon trading session, regardless of whether the issuer requested a trading halt.

The mid-session auction would apply 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 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 mid-session auction once a trading halt of the underlying stock is lifted. Liquidity providers of structured products would 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.

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Revised Arrangements (Cont'd)

Non-Inside Information Announcements

The Exchange will continue to restrict the release of non-Inside Information announcements to the current publication windows because

the Exchange believes that there is a risk that issuers may accidentally select a non-Inside Information headline for an announcement that contains Inside Information if both can be released during trading hours. Also, since there is generally no urgency in releasing non-Inside Information, there is no need to release it during trading hours. Nevertheless the Exchange will consider allowing the release of non-Inside Information during trading hours in the future.

A+H Shares

As mid-session trading halts are not yet available in stock exchanges in Mainland China (**PRC**), suspensions in trading in A shares cannot be lifted until the beginning of the next trading day. For this reason, A+H shares companies will not be able to take advantage of the trading halts regulations that will be implemented; such companies would likely continue to release Inside Information in the Hong Kong and Mainland markets at the same time after the market closes for the day. The Exchange stated in the consultation conclusions that it will continue to communicate and coordinate with PRC stock exchanges in relation to information disclosures and trading suspensions and resumptions.

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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.

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Q&A Session