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# FSTB & SFC Consultations On Proposals To Give Statutory Backing To Listed Companies' Obligation To Disclose Price Sensitive Information

## Introduction

The Financial Services and the Treasury Bureau ("**FSTB**") and the Securities and Futures Commission ("**SFC**") have published consultation papers in relation to the FSTB's proposal to create a statutory obligation under the Securities and Futures Ordinance ("**SFO**") on listed companies to disclose price sensitive information ("**PSI**") on a timely basis. The FSTB's Consultation Paper on the Proposed Statutory Codification of Certain Requirements to Disclose Price Sensitive Information by Listed Corporations (the "**FSTB Consultation Paper**") includes the following principal proposals:

* To adopt the concept of "relevant information" currently used under the insider dealing regime to define PSI (to be called "inside information" in the SFO);
* To create an obligation under the SFO on a listed company to disclose "inside information" as soon as practicable after it comes to the knowledge of the listed company (i.e. after the information has come into the possession of a director or officer of the company in the course of performing of his duties);
* To provide safe harbours for legitimate circumstances where non-disclosure or late disclosure would be permitted;
* To impose an obligation under the SFO on the directors and officers of a listed company to take all reasonable measures to ensure that proper safeguards exist to prevent the listed company breaching the statutory disclosure requirements;
* For directors and officers of a listed company to be individually liable for the company's breach of the statutory disclosure obligation if he is in breach of the obligation referred to above or if the company's breach is a result of any intentional, reckless or negligent act or omission on his part;
* For the SFC to enforce the statutory disclosure requirements. The SFC would be able to rely on powers under the SFO to investigate suspected breaches and to institute proceedings directly before the Market Misconduct Tribunal ("**MMT**");
* To provide a range of civil sanctions, including a fine up to HK$8 million on the listed company and/or the director and disqualification of a director or officer for up to 5 years; and
* To allow persons suffering pecuniary loss as a result of a breach of the new disclosure requirement to rely on the results of MMT proceedings to take civil actions seeking compensation from those in breach.

The FSTB proposals take into account the latest developments in major markets and aim to address the lack of "regulatory teeth" of the existing non-statutory Listing Rules administered by the Stock Exchange of Hong Kong ("**HKEx**"). The Listing Committee of the HKEx has shown its support for PSI disclosure in its press release of 12 February 2009[[1]](#footnote-24).

To assist companies in complying with the proposed disclosure obligations, the SFC has published draft Guidelines on Disclosure of Inside Information (the "Guidelines") providing guidance on what constitutes "inside information", the availability of the safe harbours and on a number of specific situations and issues. The draft Guidelines are set out in the SFC's Consultation Paper on the Draft Guidelines on Disclosure of Inside Information (the "**SFC Consultation Paper**").

The FSTB Consultation Paper is available on [the FSTB website](http://www.fstb.gov.hk/fsb/ppr/consult/doc/consult_psi_e.pdf) and Frequently Asked Questions are available [here](http://www.fstb.gov.hk/fsb/ppr/consult/doc/consult_psi_faq_e.pdf). A copy of the SFC Consultation Paper is attached as Annex 2 to the FSTB Consultation Paper. Alternatively, the SFC Consultation Paper is available on [the SFC website](http://www.sfc.hk/sfcConsultation/EN/sfcConsultFileServlet?name=dii&type=1&docno=1). The cut off date for responding to both consultation papers is **28 June 2010**.

## FSTB Proposals

### 1. Inside Information - Disclosure

The FSTB proposes to include the new disclosure obligations in a new Part IIIA of the SFO, a draft or which is attached as Annex 1 to the FSTB Consultation Paper.

#### Definition of inside information

The FSTB proposes that the term "inside information" should be used to refer to the "price sensitive information" which a listed company needs to disclose. The definition of "inside information" will be the same as the definition of "relevant information" in section 245 of the SFO, being the information which the insider dealing regime prohibits a person from using when dealing in the shares of a listed company. The proposed definition of "inside information" is specific information that:

(a) is about:

1. the corporation;
2. a shareholder or officer of the corporation; or
3. 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.

Inside information which listed companies will have to disclose will therefore be the same information that is currently prohibited from being used for dealing in the securities of the listed company. This approach follows that adopted in the United Kingdom and other European Union countries.

#### Timing of disclosure

There will be a new statutory obligation on listed companies to disclose to the public as soon as practicable any inside information which has come to their knowledge. A listed company will be taken to have knowledge of inside information if a director or an officer has come into possession of that information in the course of the performance of his duties. The term "officer" is defined widely to include a director, manager or secretary of a listed company or any other person involved in its management (Part 1 of Schedule 1 to the SFO).

Disclosure will be required to be made in a manner that provides the public with equal, timely and effective access to the information. Publication of the information via the Electronic Publication System operated by the Hong Kong Exchanges and Clearing Limited ("HKEx-EPS") will meet this requirement. Any disclosure made to the public must not be false or misleading as to a material fact, or false or misleading through the omission of a material fact.

### 2. SAFE HARBOURS

To strike a reasonable balance between market transparency and fairness and safeguarding the legitimate interests of listed companies in keeping certain information confidential to facilitate their operations and business development, four safe harbours will allow listed companies to not disclose or delay disclosing inside information. Reliance on the safe harbours is conditional upon the listed company having taken reasonable precautions for preserving the confidentiality of the inside information and the inside information not having been leaked. The proposed safe harbours are set out below.

**Safe Harbour A** - when disclosure would breach an order by a Hong Kong court or any provisions of other Hong Kong statutes.

It is proposed that the SFC be empowered to grant a waiver to listed companies if they are prohibited from disclosing inside information under a court order or the legislation of another jurisdiction. The SFC would also be empowered to impose appropriate conditions on any such waiver.

Applications for a waiver will be dealt with by the SFC and would be considered by an SFC internal committee that would make the first instance decision. Should the waiver be rejected by the committee, a request may be made by the listed company within 2 business day after the refusal for the decision to be reviewed by the Board of the SFC. The "user pays" principle will apply so that the listed company will be charged a fee for the SFC to process the waiver application.

**Safe Harbour B** - when the information relates to impending negotiations or incomplete proposals the outcome of which may be prejudiced if the information is disclosed prematurely.

Under this safe harbour, listed companies will not be required to disclose negotiations or proposals for say, mergers and acquisitions which have not been concluded. However, if market rumours indicate that inside information has been leaked, the listed company would need to disclose the inside information.

**Safe Harbour C** - when the information is a trade secret.

**Safe Harbour D** - when the information concerns the provision of liquidity support by the Government's Exchange Fund or by a central bank (including overseas central banks) to the listed company or to a member of its group.

#### Additional Safe Harbours

It is proposed that the SFC should, after consulting the Financial Secretary, be empowered to make rules under the SFO prescribing further safe harbours if it considers it to be in the public interest.

### 3. Liability Of Officers And Directors

It is proposed that there should be a new statutory obligation on directors and officers to take all reasonable measures to ensure that proper safeguards exist to prevent the listed company breaching the statutory disclosure requirements. If a listed company is in breach of the statutory disclosure requirements, a director or officer of the company will also be taken to be in breach of such requirements if: (i) the breach resulted from his intentional, reckless or negligent act or omission; or (ii) he has not taken all reasonable measures to prevent the breach.

As set out in the SFC Consultation Paper, listed companies will need to ensure that they have effective systems and procedures to ensure that any material information which comes to the knowledge of their officers is promptly identified and brought to the attention of the board of directors to determine whether it is required to be disclosed. In the context of context of ensuring compliance with the obligation to disclose inside information relating to material changes in the company's financial condition, the board should ensure that it has in place effective reporting procedures providing a structured flow of financial and operational data necessary for such appraisal.

### 4. Sanctions

The following civil sanctions are proposed for listed companies and individual directors or officers breaching the statutory disclosure requirements:

1. a regulatory fine up to $8 million on the listed company and/or the director;
2. disqualification of the director or officer from being a director or otherwise involved in the management of a listed company for up to five years;
3. a "cold should" order on the director or an officer (i.e. the person is deprived of access to market facilities) for up to five years;
4. a "cease and desist" order on the listed company, director or officer (i.e. an order not to breach the statutory disclosure requirements again);
5. an order that any body of which the director or officer is a member be recommended to take disciplinary action against him; and
6. payment of costs of the civil inquiry and/or the SFC investigation by the listed company, director or officer.

The FSTB proposes to review the effectiveness of the new disclosure regime and may consider creating additional and/or criminal sanctions should it be required.

### 5. Extending The Jurisdiction Of The Market Misconduct Tribunal ("MMT")

Given the MMT's experience in handling "inside information" cases and in considering the orders referred to at (b) to (f) above, the FSTB proposes to extend the jurisdiction of the MMT to cover breaches of the statutory disclosure requirements.

The MMT will be required to apply the principle of proportionality when determining the amount of regulatory fines by reference to the facts and circumstances of each case. The FSTB proposes that the MMT should only order the payment of a fine if, under the circumstances, it is proportionate and reasonable in relation to the conduct of the listed company and/or director breaching the disclosure requirements. The MMT may take into account the following factors:

1. the seriousness of the conduct of the listed company/director breaching the disclosure requirements;
2. whether the conduct was intentional, reckless or negligent;
3. whether the conduct may have damaged the integrity of the securities and futures market;
4. whether the conduct may have damaged the interest of the investing public;
5. whether the conduct has resulted in a benefit to the person or any other person;
6. the financial resources of the one breaching the disclosure requirements;
7. whether the breach has resulted in any gain or loss avoided to the person in breach; and
8. any conduct by the listed company/director breaching the disclosure requirements which-
9. previously resulted in it/him being convicted of an offence in Hong Kong;
10. previously resulted in it/him being identified by the MMT as having engaged in any market misconduct;
11. previously resulted in it/him being identified as an insider dealer.

The FSTB proposes to empower the SFC to institute proceedings on such breaches before the MMT directly rather than have to report the matter to the Financial Secretary for him to determine whether to institute proceedings, as is currently required.

Anyone claiming pecuniary loss as a result of others breaching the disclosure requirements could rely on the MMT findings to take civil actions seeking compensation from those who have breached the disclosure requirements. No person would be liable to pay such compensation unless it is fair, just and reasonable in the circumstances of the case that he should be so liable.

Additional civil remedies would include enabling the SFC to seek injunctive and disqualification orders under the current sections 213 and 214 of the SFO.

### 6. REGULATORY STRUCTURE AND ENFORCEMENT

The FSTB proposes maintaining the division of duties between the SFC and HKEx established under the Memorandum of Understanding Governing Listing Matters between the SFC and HKEx[[2]](#footnote-39). Accordingly, HKEx would remain the frontline regulator for listing-related matters while the SFC would remain responsible for ensuring compliance with the provisions of the SFO and for investigating breaches. The SFC will be responsible for the enforcement of the statutory disclosure obligation.

#### Modifications to the Listing Rules' general disclosure obligation

It is proposed that the general obligation of disclosure under Rule 13.09(1) of the Main Board Listing Rules and Rule 17.10(3) of the GEM Listing Rules will be modified to dovetail with the new statutory provisions. HKEx will consult separately on the changes to the Listing Rules. If HKEx detects a possible breach of the statutory disclosure requirement, it will inform the SFC for follow-up action.

#### Filing of materials

Listed companies will continue to file disclosure materials with HKEx: there will be no need to file materials with the SFC. The obligation to disclose inside information will be satisfied by its distribution through HKEx-EPS.

#### Informal consultation with the SFC

It is proposed that the SFC should provide an informal consultation service for listed companies on the statutory disclosure requirements for an initial 12-month period starting one month before the statutory regime comes into effect. It is expected that this would relate to the availability of the safe harbours rather than determining whether specific information is required to be disclosed.

#### Enforcement of the statutory disclosure obligation

The SFC will be responsible for the investigation and enforcement of any possible breaches of the statutory PSI disclosure requirements. It will be given the power under the SFO to conduct investigation where it has reasonable cause to believe that a breach of the statutory disclosure requirement has taken place. While the SFC will handle possible breaches of the statutory disclosure obligation, if there are also breaches of other requirements under the Listing Rules, these will be dealt with by HKEx which may take disciplinary action.

## SFC Consultation Paper On The Draft Guidelines On Disclosure Of Inside Information

### Introduction

As mentioned above, the SFC is consulting on the draft Guidelines which provide guidance to listed companies to assist them in complying with the proposed statutory disclosure obligation in relation to inside information. As the definition of "inside information" will be the same as the definition of "relevant information", the Guidelines summarise the key aspects of what has been viewed by tribunals in Hong Kong as constituting "relevant information". A list of cases handled by the Insider Dealing Tribunal and the Market Misconduct Tribunal is set out in Appendix A of the SFC Consultation Paper. The draft Guidelines also include information on the timing and manner of disclosure of inside information, the importance of establishing systems and procedures to ensure compliance with the disclosure obligations and the circumstances in which the safe harbours will be available.

The Guidelines aim to assist listed companies and their officers in understanding the principles underlining the compliance obligations. They are not however exhaustive and do not have the force of law.

The Guidelines provide information on the following areas:

* A breakdown of the three key elements of "inside information", namely:
  1. the information about the particular company must be specific;
  2. the information must not be generally known to that segment of the market which deals or which would likely deal in the company's securities; and
  3. the information would, if so known be likely to have a material effect on the price of the company's securities;
* Management accounts - a consideration of the factors relevant to determining whether knowledge of financial results constitutes inside information;
* A non-exhaustive list of examples of possible inside information;
* When and how inside information should be disclosed (under proposed sections 101C(1) and 101C(2) SFO);
* Responsibility for compliance and management controls (under proposed sections 101B(2) and 101G(1) SFO);
* Safe harbours that allow non-disclosure of inside information (proposed section 101D(1) SFO); and
* Guidance on particular situations and issues, such as:
  1. Dealing with rumours
  2. Internal matters
  3. Companies listed on more than one exchange
  4. Analysts' reports
  5. Publications by third parties
  6. External developments
  7. Disclosure of information discovered in the course of preparing periodic and other structured disclosures.

*The purpose of this newsletter is to provide a summary only of information included in the FSTB's "Consultation Paper on the Proposed Statutory Codification of Certain Requirements to Disclose Price Sensitive Information by Listed Corporations" (March 2010) and the SFC's "Consultation Paper on the Draft Guidelines on Disclosure of Inside Information" (March 2010). Its contents do not constitute legal advice and specific advice should be sought in relation to any particular situation.*

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1. [HKEx News Release, 12 February 2009](http://www.hkex.com.hk/eng/newsconsul/hkexnews/2009/090212news.htm) [↑](#footnote-ref-24)
2. [Memorandum of Understanding Governing Listing Matters between the SFC and HKEx, signed on 28 January 2003](http://www.hkex.com.hk/eng/rulesreg/regdoc/documents/mou_28jan03.pdf). [↑](#footnote-ref-39)