Charltons - Hong Kong Law Newsletter - 11 May 2012

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# Statutory Regime For Disclosure Of Price Sensitive Information To Take Effect On 1 January 2013

## 1. Introduction

The new statutory regime governing listed corporations’ (**corporations**) disclosure of price sensitive information (referred to in the new legislation as "inside information") (**PSI**) will come into effect on 1 January 2013. The regime is set out in a new Part XIVA to the Securities and Futures Ordinance (**SFO**) which will be implemented under Part 2 of the Securities and Futures (Amendment) Ordinance 2012 (**Amendment Ordinance**) which was gazetted on 4 May 2012.

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

Under the amended SFO, the Securities and Futures Commission (the **SFC**) will be able to directly institute proceedings before the MMT to enforce the PSI disclosure requirement and to deal with the six types of market misconduct under Part XIII SFO[[1]](#footnote-24) with effect from 4 May 2012. Previously only the Financial Secretary could institute proceedings before the MMT.

The SFC will publish Guidelines on Disclosure of Inside Information (**SFC Guidelines**) to assist corporations to comply with the new disclosure obligation. These are expected to be published in June 2012. Hong Kong Exchanges and Clearing Limited (**HKEx**) will amend the Listing Rules to remove the existing continuing disclosure obligations relating to PSI and all existing HKEx guidelines on disclosure of PSI will be replaced by the SFC Guidelines. HKEx intends to conduct a public consultation on amendments to the Listing Rules later this year.

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

The Amendment Ordinance also makes certain consequential amendments to the SFO. These include amending the definition of “business day”[[2]](#footnote-25) to exclude Saturdays. This will affect (among others) the timing of giving notices of interests under the disclosure of interests regime in Part XV SFO.

A copy of the Amendment Ordinance can be viewed [here](http://www.gld.gov.hk/egazette/pdf/20121618/es1201216189.pdf).

A copy of the SFC’s draft Guidelines on Disclosure of Inside Information can be viewed [here](http://legco.gov.hk/yr10-11/english/bc/bc11/papers/bc11cb1-1325-1-e.pdf).

## 2. Key Features Of The PSI Disclosure Regime

The new regime is discussed in detail in this newsletter but key elements 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 course of performing functions as an officer of the corporation);
* An obligation on the directors and officers of a corporation to take all reasonable measures to ensure that proper safeguards exist to prevent the corporation breaching the statutory disclosure requirement;
* For directors and officers of a corporation to be individually liable for the corporation's breach of the statutory disclosure obligation, if they are in breach of the obligation referred to above or if the corporation's breach is a result of any intentional, reckless or negligent conduct on their part;
* The provision of safe harbours for legitimate circumstances where non-disclosure or late disclosure is permitted;
* The SFC will be able to rely on its powers under the SFO to investigate suspected breaches and to institute proceedings directly before the MMT;
* The MMT will be able to impose a range of civil sanctions, including a fine of up to HK$8 million on the corporation, a director or chief executive of the corporation and disqualification of a director or officer for up to 5 years; and
* A corporation or officer found to have breached the statutory disclosure requirement may be liable to pay compensation to any person who has suffered financial loss as a result of the breach (provided it is fair, just and reasonable that it/he should do so).

## 3. The New Regime: Background

The current regulatory regime governing disclosure of PSI is non-statutory, being located in the Listing Rules administered by the Listing Committee of the Stock Exchange of Hong Kong Limited (**SEHK**). Breach of the Listing Rules’ requirements may result in SEHK imposing disciplinary sanctions on the corporation and its directors. These include issuing a private reprimand or public censure and in extreme cases SEHK can cancel a corporation’s listing. This has led to a public perception of a set of rules lacking regulatory force. The new statutory framework is aimed at enhancing market transparency and quality and bringing the disclosure regime for corporations more in line with those of overseas jurisdictions.

## 4. Definition Of Insider Information

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

specific information that:

1. 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
2. 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.

This is the same as the definition of "relevant information" under the insider dealing regime in Parts XIII and XIV SFO. As the two definitions are identical, the definition of "relevant information" in Parts XIII and XIV SFO has been replaced by the definition of "inside information". The inside information which a corporation will have to disclose is therefore the same information that is prohibited from being used for dealing in the securities of the corporation. This approach follows that adopted in the United Kingdom and other European Union countries.

### Objective test

An objective test should be applied in considering whether a piece of information is inside information. The test is whether 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)(b) SFO).

### Key elements of the definition

The three key elements of the definition are that:

1. the information 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 corporation’s securities; and
3. the information would, if generally known be **likely to have a material effect on the price of the corporation’s securities**.

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

### Specificity of Information

* The information must be capable of being identified, defined and unequivocally expressed
* Information regarding a corporation’s affairs will be sufficiently specific if “it carries with it such particulars as to a transaction, event or matter, or proposed transaction, event or matter, so as to allow that transaction, event or matter to be identified and its nature to be coherently understood”.
* The information need not be precise
* Information may be specific even though the particulars or details are not precisely known. For example, information that a corporation is in financial difficulty or proposes to conduct a share placing would be regarded as specific even if the details are not known.
* Information on a transaction that is only contemplated or under negotiation (and not yet subject to a final agreement (formal or informal) can be specific information
* To constitute specific information, a proposal should be beyond the stage of a vague exchange of ideas or a “fishing expedition”. If negotiations or contracts have occurred, there should be a substantial commercial reality to the negotiations which should be at the stage where the parties intend to negotiate with a realistic view to achieving an identifiable goal.
* Mere rumours, vague hopes or worries, wishful thinking and unsubstantiated conjecture are not specific information.

### Information not generally known

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

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

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

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

The draft SFC Guidelines contain a non-exhaustive list of events or circumstances where a corporation should consider whether a disclosure obligation arises. That list can be viewed by clicking here.

## 5. 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:

1. 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
2. a reasonable person, acting as an officer of the corporation, would consider that the information is inside information in relation to the corporation (section 307B(2) SFO).

Corporations must therefore 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.

### Meaning of “as soon as reasonably practicable”

The word “reasonably” was not included in the original draft of the legislation. According to the draft 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 draft 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 draft SFC Guidelines). The draft SFC Guidelines also raise the possibility of a corporation issuing a “holding announcement” to give the corporation time to clarify the details and likely impact of an event before issuing a full announcement.

### Who is an “officer”?

The term "officer" is defined widely to include a director, manager or secretary of a corporation or any other person involved in its management (Part 1 of Schedule 1 to the SFO). This manner of attributing knowledge to the corporation was retained despite opposition from a majority of respondents to the consultation conducted by the Financial Services and Treasury Bureau (**FSTB**)[[3]](#footnote-39) (**Consultation**) who expressed concern that the definition of officer would catch middle managers. The draft SFC Guidelines place emphasis on the objective of the legislation, and the context at hand, to determine the meaning of the term “manager”. 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.

Some respondents to the Consultation questioned whether the Clause 307B(2) formulation “in the course of performing functions as an officer of the corporation” restricted the information which must be disclosed to that which becomes known in situations where the officer is acting in that capacity. The FSTB responded in its consultation conclusions[[4]](#footnote-40) that its intention was that information known in circumstances outside the course of performing functions as an officer of the corporation should not be caught.

## 6. 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 draft 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 draft 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).

## 7. The Safe Harbours

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

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

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

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

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

### Safe Harbour C: Where the information is a trade secret

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

1. used in a trade or business of the corporation;
2. which is confidential (i.e. not already in the public domain);
3. which, if disclosed to a competitor, would be liable to cause real or significant harm to the corporation’s business interests; and
4. the circulation of which is confined to a limited number of persons on a need-to-know basis.

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

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

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

### Safe Harbour Condition of Confidentiality

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

1. the corporation takes reasonable precautions for preserving the confidentiality of the information; and
2. the confidentiality of the information is preserved.

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

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:

1. has taken reasonable measures to monitor the confidentiality of the information in question; and
2. made disclosure as soon as reasonably practicable, once it became aware that the confidentiality of the information had not been preserved.

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

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

* Generally, corporations are not obliged to respond to media speculation, market rumours or analysts’ reports;
* If, however, a corporation has inside information and relies on a safe harbour to withhold disclosure, media speculation, market rumours or analysts’ reports about the corporation that are largely accurate and based on the inside information, make it likely that confidentiality has been lost. In that case, the safe harbour will no longer be available and the corporation must make the inside information publicly available;
* If a corporation does not have inside information, but media reports or market rumours carry false or untrue information, the corporation is not required to make any further disclosure under the SFO. The Stock Exchange may however require a corporation to provide disclosure or clarification which is not required under the SFO. If a corporation wishes to respond to market rumours, it should do so by publication of an announcement rather than by a remark to a single publication or press release; and
* Corporations should ensure that no inside information is provided when responding to analysts’ questions or reviewing analysts’ reports.

## 8. SFC’s Power To Grant Waivers

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

The FSTB’s consultation conclusions noted that during an application for a waiver, confidentiality must be maintained. Should an information leakage occur, the corporation would be obliged to suspend trading prior to making a disclosure. The waiver application fee will be HK$24,000.

## 9. 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:

1. the breach resulted from the officer’s intentional, reckless or negligent conduct; or
2. 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 draft SFC Guidelines focus on the responsibility of officers, including non-executive directors, to ensure that appropriate systems and procedures are put in place and reviewed periodically to enable the corporation to comply with the disclosure requirement. Officers with an executive role will also have a duty to oversee the proper implementation and functioning of the procedures and to ensure the detection and remedy of material deficiencies in a timely manner. The particular needs and circumstances of the listed corporation should be taken into account in establishing appropriate systems and procedures. The draft SFC Guidelines provide a non-exhaustive list of examples of systems and procedures which listed corporations should consider implementing. That list can be viewed by clicking here.

## 10. Investigation And Enforcement

The SFC’s existing powers of investigation under section 182 SFO will be 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.

## 11. Sanctions

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

1. a fine of up to HK$8 million on the corporation, a director or chief executive (but not officers) of the corporation;\*\*
2. disqualification of the director or officer from being a director or otherwise involved in the management of a corporation for up to five years;
3. 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;
4. a "cease and desist" order on the corporation, director or officer (i.e. an order not to breach the statutory disclosure requirement 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 corporation, director or officer.

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

1. 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
2. the officer to undertake a training programme approved by the SFC on compliance with Part XIVA SFO, directors’ duties and corporate governance.

## 12. 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 seperate 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.

## 13. Establishment Of An Investor Education Centre (IEC)

The Amendment Ordinance empowers the SFC to establish the IEC to promote the public’s understanding of the financial services sector. The SFC hopes to launch the IEC, a wholly-owned subsidiary of the SFC, in the fourth quarter of 2012.

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**Charltons - Hong Kong Law Newsletter - Issue 155 - 11 May 2012**

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. [↑](#footnote-ref-24)
2. “Business day” is defined in Part 1 of Schedule 1 to the SFO. [↑](#footnote-ref-25)
3. The Consultation Paper on the Proposed Statutory Codification of Certain Requirements to Disclose Price Sensitive Information by Listed Corporations published by the FSTB in March 2010. [↑](#footnote-ref-39)
4. Paragraph 22 of the FSTB’s Consultation Conclusions on the Proposed Statutory Codification of Certain Requirements to Disclose Price Sensitive Information by Listed Corporations published in February 2011. [↑](#footnote-ref-40)