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13 February 2012

Ms Anita Sit
Clerk to Bills Committee on
Securities and Futures (Amendment) Bill 2011
Legislative Council Secretariat
Legislative Council Complex
1 Legislative Council Road
Central
Hong Kong

Dear Ms Sit,

Bills Committee on Securities and Futures (Amendment) Bill 2011
Follow-up to meeting on 31 January 2012

We refer to your letter of 2 February 2012 on the follow-up actions to the meeting held on 31 January 2012.

On item 1(a), the response of this Bureau and the Securities and Futures Commission (SFC) regarding the safe harbour proposed by Hong Kong Institute of Certified Public Accounts is at **Appendix A**.

On item 1(b), we have reviewed the Chinese wording of the proposed amendments to section 109 of the Securities and Futures Ordinance (Cap 571) (SFO) under clause 36 and decided to revise it. Our proposed revised clause 36 is at **Appendix B**.

The first part of item 1(c) is about whether a modification or waiver granted by the SFC under section 134(1) of SFO is subsidiary legislation. It is clear from section 134(1) and (2) that a grant by the SFC of a modification or waiver is not subsidiary legislation. Such a waiver is

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granted on an individual basis and communicated to the applicant by notice in writing. All that the proposed amendments would do is to require publication of the modification or waiver by the SFC on the internet, rather than in the Gazette. In contrast, class waivers, which are subsidiary legislation, are dealt with in section 134(8) which is not engaged by the proposed amendment. We have also reviewed the proposed amendments under clause 37 (i.e., amendments to section 134(6) and (7)) and agreed that the term "on-line medium" should be replaced by "internet". We will propose Committee Stage Amendments in this regard.

Yours sincerely,



(Miss Sara Tse)
for Secretary for Financial Services
and the Treasury

c.c. SFC (Attn: Mr Donald Lai)
 DoJ (Attn: Ms Karmen Kwok)

Bills Committee on Securities and Futures (Amendment) Bill 2011

**Proposed safe harbour by the
Hong Kong Institute of Certified Public Accountants**

Purpose

At the meeting of 31 January 2012, the Administration was requested to confirm whether it would further consider the additional safe harbour proposed by the Hong Kong Institute of Certified Public Accountants (HKICPA). This paper sets out the response of the Administration and the Securities and Futures Commission (SFC).

Response

2. We have further considered the proposed safe harbour having regard to the views expressed by Members at the Bills Committee meeting on 31 January 2012. We consider that a safe harbour based on “good faith” and the other grounds proposed by HKICPA is inappropriate for the proposed regime for the disclosure of price-sensitive information (PSI). The introduction of such a safe harbour, which is in a number of important respects a subjective test, would render the proposed PSI regime ineffective because disclosure could be withheld as long as a listed corporation believes “in good faith” that the information is not PSI. In effect, the proposed PSI regime risks becoming a voluntary scheme where it would be up to the listed corporation and its officers to decide whether a piece of information is PSI and needed to be disclosed. This would defeat the purpose of the proposed legislation and we note that such safe harbour is not found in the PSI regimes of other jurisdictions.

3. To limit the circumstances wherein a listed corporation would have a disclosure obligation, the Bill has specified “a reasonable person” test. A listed corporation would not have breached the disclosure requirement unless it can be proved that –

- (a) 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; 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.

4. As for individual officers, an officer will not be held liable unless it can be proved that –

- (a) the listed corporation has breached the disclosure requirement; and
- (b) the officer’s intentional, reckless or negligent conduct resulted in the breach; or the officer has not taken all reasonable measures from time to time to ensure that proper safeguards exist to prevent the breach.

SFC to issue additional guidance

5. In view of Members’ concerns, the SFC will revise its guidelines to set out clearly that assuming a corporation has implemented reasonable measures to prevent a breach, an officer (including Non-Executive Directors (NEDs)) who **acts in good faith** and in accordance with all his fiduciary duties **without actual knowledge** of the information or involvement in the corporation’s breach is unlikely to be personally liable on ground of intentional, reckless or negligent conduct.

6. On the requirement for officers to take all reasonable measures from time to time to ensure that proper safeguards exist to prevent breach of the disclosure requirement, to facilitate compliance, the SFC will provide in its guidelines **a list of examples of such measures**, including those at **Annex A**, and additional guidance on officers’ liability and obligations of NEDs at **Annex B**.

7. These are in addition to what we have proposed in our letter to the Bills Committee dated 18 January 2012. As set out in that letter, the SFC would also set out in its guidelines relevant precedent cases in the Insider Dealing Tribunal and now the Market Misconduct Tribunal in respect of the concept of material change for listed corporations’ reference in deciding whether a particular piece of information is price sensitive.

8. Pursuant to section 399(6) of the SFO, the SFC's **guidelines shall be admissible in evidence** in court and any relevant provision set out in the guidelines may be taken into account by the court in deciding a relevant question arising in the proceedings under the SFO.

9. We would also like to reiterate that when considering whether an officer has taken all "reasonable measures" and whether an officer had been negligent, the SFC will take into account the roles of the officers concerned in the listed corporation. Insofar as NEDs are concerned, in the event of a breach of the disclosure requirement by a listed corporation, an NED is unlikely to be held liable if proper internal control procedures for monitoring and reporting potential inside information to the board have been established and reviewed periodically, and the NED concerned has no knowledge of the PSI in question because other officers or employees of the listed corporations do not comply with the established internal control procedures.

10. We believe that the additional measures to be taken by the SFC, together with our clarifications above, would facilitate compliance with the disclosure requirement and help address Members' concerns about the liability of officers.

**Financial Services and the Treasury Bureau
Securities and Futures Commission
February 2012**

Examples of reasonable measures to ensure proper safeguards exist to prevent breach of the disclosure requirement

- (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) Disseminate inside information through the electronic publication system operated by the Stock Exchange before the information is released via other channels, such as the press, wire services or posting on the corporation's website
- (i) Designate a small number of officers or executives with the appropriate skills and training to speak on behalf of the corporation when communicating with external parties such as the media, analysts or investors.

- (j) Develop procedures to review the presentation materials in advance before they are released at analysts' or media briefings.
- (k) Record briefings and discussions with analysts or the media afterwards to check whether any inside information has been inadvertently disclosed.
- (l) Develop procedures for responding to market rumours, leaks and inadvertent disclosures.
- (m) Provide regular training to the employees to help them understand the corporation's policies and procedures as well as their relevant disclosure duties and obligations.
- (n) Document the disclosure policies and procedures of the corporation in writing and keep the documentation up to date.
- (o) Publish the disclosure policies and procedures of the corporation so that the media and other stakeholders understand the corporation's statutory disclosure obligations.

Officers' liability and obligations of non-executive directors

Officers' liability

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

In the situation where an officer has actual knowledge of information which should have been disclosed the meaning of "intentional", "reckless" and "negligent" can be summarised as follows. The requirement for conduct to be intentional means that there must be evidence that the officer intended the corporation not to disclose information that was required to be disclosed under a disclosure requirement. The requirement for conduct to be reckless means that the officer was aware that there was a risk that by not disclosing the information the corporation may breach a disclosure requirement and it was in the circumstances known to him unreasonable to take the risk. The requirement for conduct to be negligent means the officer failed to exercise such care, skill or foresight as a reasonable officer in his situation would exercise to ensure or cause the corporation to comply with a disclosure requirement.

Obligations of non-executive directors

Given the unitary nature of a board and the indivisible legal duties of all directors, both executive directors and non-executive directors should exercise due care, skill and diligence to fulfil their roles and obligations. However, as acknowledged in the Code of Corporate Governance Practices issued by the Stock Exchange¹, non-executive directors normally are not involved in the daily operations of a corporation and would usually rely on a corporation's internal controls and reporting procedures to ensure that, where appropriate, material information is identified and escalated to the board as a whole. It is for this reason that the board's responsibility for establishing and monitoring key internal control procedures is of particular significance for non-executive

¹ See Listing Rule Appendix 14 - A.5.2. The functions of non-executive directors should include, but should not be limited to (a) participating in board meetings of a corporation to bring an independent judgement to bear on issues of strategy, policy, performance, accountability, resources, key appointments and standards of conduct; (b) taking the lead where potential conflicts of interest arise; (c) serving on the audit, remuneration and other governance committees, if invited; and (d) scrutinising the corporation's performance in achieving agreed corporate goals and objectives, and monitoring the reporting of performance.

directors as this is an area where they are more likely to be directly involved. It is therefore more likely that sections 307G(1) and 307G(2)(b) will be of direct relevance to them.

Under section 307G(1) and section 307G(2)(b) officers must take all reasonable measures from time to time to ensure that proper safeguards exist to prevent a breach of a disclosure requirement. In this respect, officers, including non-executive directors, are responsible to ensure that appropriate systems and procedures are put in place and reviewed periodically to enable the corporation to comply with the disclosure requirements. Officers with an executive role would also have a duty to ensure the proper implementation and functioning of the mechanisms and that any material deficiencies are detected and resolved in a timely manner. In developing the systems and procedures, boards should take into account the particular needs and circumstances of the corporation.

English Version (英文文本)

Chapter:	571	SECURITIES AND FUTURES ORDINANCE	Gazette Number	Version Date
Section:	109	Offence to issue advertisements relating to carrying on of regulated activities, etc.	L.N. 12 of 2003	01/04/2003

(1) Subject to subsections (3) to (6), a person commits an offence if he issues, or has in his possession for the purposes of issue-

- (a) an advertisement in which to his knowledge-
 - (i) a person holds himself out as being prepared to carry on Type 4, Type 5, Type 6 or Type 9 regulated activity; and
 - (ii) the person is not licensed or registered for such regulated activity as required under this Ordinance; or
- (b) any document which to his knowledge contains such advertisement.

Chinese Version in the Bill (條例草案中文文本)

章：	571	證券及期貨條例	憲報編號	版本日期
條：	109	發出關於進行受規管活動等的廣告的罪行	L.N. 12 of 2003	01/04/2003

(1) 除第(3)至(6)款另有規定外，任何人(該人)作出以下作為，即屬犯罪—

- (a) 發出或為發出而管有任何廣告，而該人知道—
 - (i) 另一某人在該廣告中顯示自己準備進行第4、5、6或9類受規管活動；及
 - (ii) 該第(i)節所指的另一人沒有根據本條例的規定就該等活動獲發牌或獲註冊；或
- (b) 發出或為發出而管有該人知道載有上述廣告的文件。

Revised Chinese Version (修訂中文文本)

(1) 除第(3)至(6)款另有規定外，~~任何人作出以下作為，即屬犯罪—~~

- (a) ~~凡發出或為發出而管有任何廣告，而該人知道—~~
 - (i) ~~某另一~~人在該任何廣告中顯示自己準備進行第4、5、6或9類受規管活動；~~及而~~
 - (ii) 該另一人沒有根據按本條例的規定就該等活動獲發牌或獲註冊，~~；或~~
則明知有第(i)及(ii)節所述情況而發出該廣告或為發出而管有該廣告的人，即屬犯罪；或
- (b) ~~任何人~~發出其本身知道載有上述廣告的文件，或為發出而管有該人其本身知道載有上述廣告的文件，即屬犯罪。