THE LAW SOCIETY OF HONG KONG 香港律師會

SECURITIES AND FUTURES (AMENDMENT) BILL 2011
Law Society's Submissions

The Law Society has considered the contents of the Securities and Futures (Amendment) Bill 2011 and has the following comments:

We consider the disclosure of information provisions stand out as the most important feature of the Bill in terms of market impact.

There remain significant concerns among many members as to the appropriateness of statutory codification of requirements for the disclosure of Price Sensitive Information (PSI), for a number of reasons: the potential for over-disclosure (and as a result flooding of the market with extraneous and potentially confusing information); the various other remedies in the market designed to tackle this general area, including the insider dealing provisions of the Securities and Futures Ordinance (SFO); the recognised increase in compliance costs, particularly for smaller listed companies at a difficult time in the economic cycle, and the arguably draconian level and nature of potential personal liability for directors and other officers which may affect hiring and retention of senior figures in listed companies, when combined with other aspects of the tightening regulatory regime. Some strong views were expressed on these aspects in the Law Society's original submission. It seems the Consultation Conclusions tended to stress views where parts of the legal sector supported the original proposals, rather than contrary views.

While we understand the desire to ensure as level a playing field as possible for the various market participants in the Hong Kong listed market, particularly given the need to maintain Hong Kong's attractiveness as a listing and investment centre at the forefront of the APAC markets, the proposed approach clearly conflicts with the significant concerns expressed above.

We would note that the Guidelines and the willingness of the Securities and Futures Commission (SFC) to provide at least two years' guidance to the market are of course no substitute for clarity in the legislation. We have concentrated on the Bill, rather than dwelling on the Guidelines, for the purposes of this submission.

In the light of the above, the following comments are intended to highlight the specific issues that arise in respect of the Bill, through our analysis of the specific provisions.

We have also set out comments on the other provisions contained in the Bill for your consideration. As regards the Investor Education Council, we see its establishment as a healthy addition to the Hong Kong financial markets provided that it is sufficiently

resourced, the scope of its activities is sufficiently clear and its activities are sufficiently widely disseminated, and it stands independent of its parent as far as possible, with its own voice.

Part 2 of the Bill - DISCLOSURE OF INFORMATION

Part XIVA, Division 1, SFO

Clause 307A

1. We agree that, assuming the underlying principle of statute-backed disclosure of information holds good, it is important that the equivalent definition used in the civil and criminal provisions for PSI in relation to insider dealing is mirrored here. Similar decisions would accordingly need to be made as at present, in practice, by the directors of listed corporations, needing to grapple with the treatment of PSI under the Listing Rules and otherwise under the regulatory regime.

2. While we note the comments made in the Consultation Conclusions, we remain of the view that the definition of "officer" for the purposes of the disclosure of information provisions needs to be refined and narrowed. At present, it is as follows (our emphasis added):

"officer" (T)-

(a) in relation to a corporation, means a director, manager or secretary of, or any other person involved in the management of, the corporation; or
(b) in relation to an unincorporated body, means any member of the governing body of the unincorporated body.

The highlighted wording in our view is insufficiently targeted at those persons who are responsible for the ongoing management of the business. Instead, we suggest the following amended wording:

"officer" (T)-

(a) in relation to a corporation, means a director, or a senior manager directly responsible for supervision of the management of, the corporation; or
(b) in relation to an unincorporated body, means any member of the governing body of the unincorporated body.

The amended wording broadly mirrors the concept of executive officer/responsible officer under the SFO and the Banking Ordinance. "Director" already expressly incorporates the concept of persons equivalent to a director and shadow directors, and our proposed amendment would clearly not limit the obligations merely to directors, which as pointed out in the Consultation Conclusions would be inappropriate.

3. In our view, the definition of "securities" for the purposes of this Part needs to incorporate most securities and other instruments listed on the Hong Kong Stock Exchange in line with the revised definition of securities under the SFO. Disclosure obligations should include (without limitation):

(a) for collective investment schemes, specific information will include information relating to the affairs of the trustees, the fund/investment managers and, where relevant, material counterparties and collateral providers;

(b) for REITs, specific information will include information relating to the affairs of the trustees and the property managers;

(c) for debt securities, specific information will include information relating to the affairs of the guarantors in case of guaranteed debt issues; and

(d) for warrants and other structured products, specific information will include information relating to the affairs of guarantors, market makers and liquidity providers etc.

Possible exemption should be given for exchange traded options.

To the extent that this results in the scope of obligations being extended to directors of managers, trustees/custodians and other parties as well as directors of listed companies, such extension is both necessary and fair to ensure a level playing field.

The definition of "listed corporation" should be expanded to include an issuer, for example, a REIT, which is not a corporation. Also, the definition of "inside information" should include specific information relating to unit holders pari passu with shareholders.

Part XIVA, Division 2

307B - knowledge of inside information

The amendments made to the provisions, as set out in the Bill, are welcome clarifications.

Reasonableness Test

We remain of the view that any decision by a listed corporation on whether any specific information constitutes "inside information" should have the benefit of the test of reasonableness as provided in "*Wednesbury*. Thus, a listed corporation should not be held liable if a reasonable board of directors, by reference to the circumstances existing at the relevant time of making the disclosure, could have come to the conclusion that the specific information does not amount to "inside information", even if another reasonable board of directors could have come to a contrary conclusion. This can operate either as an additional safe harbour or as a separate provision.

The fundamental issue remains: in what circumstances should the listed corporation be viewed as being aware of the inside information, and (see below) how far relevant individual officers should have any liability for any failure to disclose.

Taking the corporate level first, a listed corporation would be treated as having that knowledge if (firstly) an officer knows the information "in the course of performing functions as an officer of the corporation" and a reasonable officer would view that information as being inside information. We agree with that position.

Secondly, a listed corporation would be treated as having that knowledge if an officer ought reasonably to have known the information "in the course of performing functions as an officer of the corporation" and a reasonable officer would view that information as being

inside information. We disagree with that position. That is more troublesome. This is tantamount to imposing strict liability on the operating systems and structure of the listed corporation, since it would not matter that those systems, including reporting systems, had been reasonably designed or monitored: provided that the information had come into the corporation and one of the officers in carrying out his normal duties would normally be expected to have picked up that information and recognised its importance, then the listed corporation would be in breach of the disclosure requirements.

We recommend that Clause 307B should be amended to treat the information as not having come to an officer's knowledge where the safeguards referred to in Clause 307G(1) have been put in place. That would remove the strict liability element and focus the need for proper systems and controls to be put in place and monitored.

We also note that liability may not be covered by typical directors and officers liability insurance contracts and, even if liability is covered, it would not be surprising to see policies being modified going forward to exclude liability arising under the new regime. In our view, it would be unfortunate for coverage to be excluded for liability arising from what, in practice, may often amount to an error of judgment rather than a deliberate wrongdoing.

Clause 307D - safe harbours

Subsection (1) - court order or enactment. We note the comments and changes made in the Consultation Conclusions.

Subsection (2) - the reference to "incomplete proposal or negotiation" needs to be clarified in the legislation rather than relying upon the Guidelines to flesh it out. In our view, "incomplete proposal" is more confusing than "incomplete negotiation" (particularly bearing in mind the comment in the Consultation Conclusions, which we agree with, regarding the effect of a binding legal agreement, which would cause that safe harbour to fall away).

Reference to an incomplete proposal is arguably otiose (and potentially misleading), since any proposal would normally form part of (the first step in) a negotiation, so "negotiation" should be sufficient here.

The reference to a "trade secret" is a good example of where in our view, notwithstanding the instances of other jurisdictions not clarifying the point, the Guidelines should not be used as effectively subsidiary legislation.

There is the potential for inconsistencies to arise between the new statutory disclosure regime and the provisions of the Takeovers Code (especially if recent amendments to the UK Takeovers Code are also adopted in Hong Kong). Accordingly, we recommend that information which falls to be regulated under the Takeovers Code should be disclosed (or kept confidential) in accordance with the Takeovers Code and that compliance with such disclosure (or confidentiality) obligations should fall within a safe harbour under the new regime.

Suspension of trading
We also believe that a safe harbour should be available for corporations which have applied for a suspension of trading of its shares pending the release of the PSI.

Clause 307E - waivers

We note, and have sympathy for, the reservations set out in the Consultation Conclusions regarding a "carte blanche" waiver process for the SFC. However, we trust that the position will be carefully monitored to ensure that when a sufficient critical mass of need is demonstrated in relation to a specific category of situation, then the list would be suitably expanded accordingly.

We suggest, as a form of compromise, that further canvassing of the market is carried out in say six months after the new provisions come into effect to assess whether a broader range of waivers should be introduced.

Clause 307G(2) - safeguards

If the word "all" is to be retained, we would suggest that "proper" be replaced with the words "reasonably adequate", in this provision with a view to arriving at a more balanced test.

Part XIVA, Division 3, SFO

MMT disclosure proceedings / civil liability for breach

Part 3 of the Bill - DIRECT ACCESS TO MMT

We disagree that the SFC, with the role of investigator, should be empowered to institute proceedings directly before the MMT (or any other tribunal or court established to handle PSI cases), without the approval of the Financial Secretary. We believe this filter is appropriate.

Part 4 of the Bill - INVESTOR EDUCATION COUNCIL (IEC)

While we remain generally supportive of the creation of an IEC, this is only on the basis that the existing investment education functions performed by the SFC will be entirely transferred to the IEC (otherwise wasteful duplication will occur).

We refer to section 5(1)(k) of the SFO, which as amended refers to the importance of the public "*taking responsibility for the informed decisions regarding purchases of financial services*." We suggest inserting the word "*appropriate*" before "*responsibility*".

Part 5 of the Bill - MISCELLANEOUS

In relation to the proposed amendment to the definition of "business day", we note that the amendment was first proposed in the May 2005 "*Consultation Conclusions on the Review of the Disclosure of Interests Regime under Part XV of the Securities and Futures Ordinance*" issued by the SFC and repeated in its April 2008 "*Consultation Conclusions on the Proposal to Make Electronic Submission of Disclosure of Interests Notice Mandatory*".

As mentioned in the Financial Services Bureau's Legislative Council Brief on the Bill, the proposed technical amendments are straightforward and uncontroversial. We are concerned it has taken more the six years before such a non-controversial amendment is put before the legislature. Other than this, we have no comment on the proposals in Part 5.

Law Society of Hong Kong
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