Recent criticism concerning extension of black out period

INTRODUCTION

1. To strengthen Hong Kong's position as a leading international finance and capital formation centre, we are committed to improving and maintaining market quality. The Listing Rules are one of the most effective means by which we can achieve this objective. Therefore, in conjunction with the Securities and Futures Commission ("SFC"), we regularly review the Listing Rules to help ensure that they address developments in the market and international best practice and represent acceptable standards so that investors can continue to have confidence in the market.

2. On 11 January 2008, we published a Combined Consultation Paper ("CCP") inviting comments on proposed Listing Rule amendments relating to 18 substantive policy issues, together with some minor Rule amendments.

3. A three-month consultation period ended on 7 April 2008 and, on 28 November 2008, we published its Consultation Conclusions ("Conclusions") on 15 of the issues together with the final versions of the Rule changes.

4. Included in the 15 issues was the proposal to extend the black out period in the Model Code (Appendix 10 to the Main Board Rules and its GEM equivalent).

5. The Model Code currently provides for a black out period, during which a director is prohibited from dealing in securities of the issuer. The period starts one month immediately before the earlier of: (a) the date of the board meeting for the approval of the issuer's annual, half-year or quarterly results; and (b) the deadline for the issuer to publish its annual, half-year or quarterly results, and ends on the date of the results announcement ("old 30-day black out period"). The new Rule will extend the black out period so that it starts from the financial period end and ends on the date of the relevant results announcement.

6. The new Rule was to have been implemented, along with the other Rule changes in the Conclusions, on 1 January 2009.

7. However, since mid-December 2008, we have received about 240 letters from listed issuers, individual directors and other interested parties objecting to the new Rule. We have also received 13 communications supporting the Rule change.

8. On 30 December 2008, concerns raised about the new Rule were the subject of a Special Meeting of the Legislative Council Financial Affairs Panel. The Financial Affairs Panel approved, by a majority, a non-binding motion requesting "the authorities concerned not to effect the amended Rules as scheduled on 1 January 2009 and launch a six-month consultation on the issue afresh, so as to address properly the market concerns".

9. After the Special Meeting, and on the same day, the Listing Committee considered the comments from listed issuers, the media and Legislative Councillors on the Financial Affairs Panel, together with views from the SFC. In particular, the Listing Committee noted that the scale of the change to the length of the black out

period had been perceived as dramatic and that the change had been introduced at too short notice. In response to these concerns, the Listing Committee decided to defer implementation of the Rule until 1 April 2009.

10. The purpose of this statement is to summarise the main issues and concerns raised in the letters and the submissions ("Submissions") and to set out the relevant facts.

BACKGROUND

11. Before addressing the Submissions, it is appropriate to comment on the background context in which the Rule change and other related proposals recently put forward by us have developed. This is because the Rule change relating to the black out periods should not be looked at in isolation and detached from the broader picture concerning disclosure (or lack of it) among Hong Kong listed companies.

12. Over the past 18 months, we have publicly recommended two policy measures which we believe will make a significant contribution to market integrity and compensate to varying degrees for any absence of a culture of disclosure and the consequential concerns that arise: namely, shortening the reporting time limits for periodic reporting and the introduction of quarterly reporting. Lastly, we published a proposal to extend the black out period for dealings by directors. This is related to the other two in that it deals with investor perception of misuse of privileged information and, arguably, provides directors with an incentive to publish accounts earlier. We set out below the background and more details on each of these three initiatives.

Continuous disclosure

13. A successful continuous disclosure regime is one which supports the integrity of the market and maintains investors' confidence that the market is fully informed and that no investor is prejudiced by unequal access to material information. Listing Rule 13.09(1) and its GEM equivalent Rule is the cornerstone of the continuous disclosure regime in Hong Kong. It requires listed issuers to make, among other things, ad hoc disclosures concerning potentially price sensitive changes in the listed issuer's financial performance, expectations of its financial performance or the financial condition of listed issuers and their subsidiary and other operations.

14. Analysis we have performed in mid-2008 on the frequency of disclosures under Listing Rule 13.09(1) suggests that Hong Kong listed issuers, as a whole, do not have a well developed practice of regularly updating the market on their financial performance, prospects and financial condition.

15. Staff of the SFC has also recently observed that the lack of timely disclosure of price sensitive information by Hong Kong listed companies is a significant regulatory issue.

16. Some argue that enforcement is the solution to the problems associated with poor disclosure practices. However, we believe that for all its importance, enforcement

is not a substitute for a culture of transparency and engagement with stakeholders. Further, enforcement in this area is seen by some to be weak. Over recent years, market commentators and the investing public have raised concerns about the limited range of disciplinary sanctions available to us. There is a perception that the sanctions currently available do not act as a sufficient deterrent and are being treated by some as a minor cost of doing business in the manner preferred by those parties.

17. In response to these concerns the Government has recommended the creation of statutory obligations for compliance with the most important listing requirements, including the continuous disclosure obligations for potentially price sensitive information. Breaches of these statutory listing requirements would attract a graduated range of proportionate civil and criminal sanctions. These proposals remain an important area of work in progress in the enhancement of the overall listing regulatory regime.

Financial Reporting

18. The disclosure requirements of the Rules seek to promote a high standard of financial disclosure. Obviously, disclosure of financial information is only useful to shareholders and potential investors if it is communicated to them on a timely basis. Main Board issuers are currently required to announce and publish their half-year results announcements and reports within three months and their annual results announcements and reports within four months of the relevant period end.

19. These reporting deadlines are more lax than standards in a majority of other international markets as can be illustrated by the comparison of the deadlines for the publication of periodic financial information of listed issuers in overseas markets which was set out as Table 3 to our Consultation Paper on Periodic Financial Reporting, published in August 2007. We reproduce as **Annexure I** this table of comparisons.

20. In addition, unlike in certain other international markets, there does not seem to be a widespread desire to meet investor expectations for timelier information or a more extensive culture of disclosure which results in a greater number of listed issuers reporting voluntarily on a timelier basis.

21. Table A[1] below profiles the reporting practices of Hong Kong listed issuers during 2008 which we believe shows a pattern consistent with earlier years.

[1] Data from HKEx sources.

Table A

Summary on timing of publication of financial results

Average (Mean) number of days

Annual results

	Overall		Main Board		GEM	
	Number	Average(days)	Number	Average(days)	Number	Average(days)
HSI companies	42	80.3	42	80.3		
Non-HSI companies	1200	99.9	1014	102.4	186	86.5
ALL listed companies	1242	99.3	1056	101.5	186	86.5

Interim results

	Overall		Main Board		GEM	
	Number	Average(days)	Number	Average(days)	Number	Average(days)
HSI companies	42	54.2	42	54.2		
Non-HSI companies	1223	68.7	1036	73.0	187	44.5
ALL listed companies	1265	68.2	1078	72.3	187	44.5

Quarter results

			Main Board				GEM			
	Overall		Q1		Q3		Q1		Q3	
	Number	Average(days)	Number	Average(days)	Number	Average(days)	Number	Average(days)	Number	Average(days)
HSI companies	33	33.9	16	33.9	17	33.9				
Non-HSI companies	537	41.9	81	38.5	88	36.1	187	44.5	181	43.5
ALL listed companies	570	41.4	97	37.7	105	35.8	187	44.5	181	43.5

Note : Annual Results' reporting deadlines - Main Board : 4 months, GEM : 3 months.
Interim Results' reporting deadlines - Main Board : 3 months, GEM : 45 days.
Quarter Results' reporting deadlines - Main Board : NA, GEM : 45 days.

Table B

Summary on timing of publication of financial results

Average (Mean) number of days - by market capitalisation

Annual results

	Main Board		GEM	
Market Cap	Number	Average(days)	Number	Average(days)
<100 million	109	110.9	82	93.0
>=100 million and <400 million	330	108.9	65	82.1
>=400 million and < 1 billion	204	104.1	24	82.2
>=1 billion and <4 billion	202	95.0	13	76.3
>=4 billion and <10 billion	89	94.6	2	77.0
>=10 billion	122	84.8		
Grand Total	1056	101.5	186	86.5

Interim results

	Main Board		GEM	
Market Cap	Number	Average(days)	Number	Average(days)
<100 million	108	80.0	84	48.3
>=100 million and <400 million	332	79.4	67	41.3
>=400 million and < 1 billion	207	75.6	23	42.4
>=1 billion and <4 billion	214	67.5	12	39.5
>=4 billion and <10 billion	94	62.6	1	43.0
>=10 billion	123	56.5		
Grand Total	1078	72.3	187	44.5

Quarter results

	Main Board				GEM			
	Q1		Q3		Q1		Q3	
	Number	Average(days)	Number	Average(days)	Number	Average(days)	Number	Average(days)
<100 million	6	69.0	3	56.7	83	48.2	84	46.4
>=100 million and <400 million	12	44.4	15	45.0	65	41.9	64	40.7
>=400 million and < 1 billion	9	29.7	12	31.1	24	41.7	22	40.5
>=1 billion and <4 billion	19	36.8	21	37.3	13	39.3	10	43.5
>=4 billion and <10 billion	16	35.0	18	31.2	2	43.5	1	41.0
>=10 billion	35	33.9	36	33.1				
Grand Total	97	37.7	105	35.8	187	44.5	181	43.5

22. The results from Table B[2] support the pattern as profiled in Table A and illustrate that issuers with larger capitalisation reported their financial results earlier than those with smaller capitalisation. For example, Main Board issuers with market capitalisation of less than $100 million took on average 110.9 days to announce their annual results, compared with 84.8 days for Main Board issuers with market capitalisation of over $10 billion. This pattern is also applicable to GEM issuers in that those with market capitalisation of less than $100 million took on average 93 days to announce their annual results and those with market capitalisation of between $4 to 10 billion took on average 77 days to do so. The pattern is less significant with respect to announcement of quarterly results.

23. The findings show that on average Main Board issuers took 101.5 days to report their annual results within a reporting deadline of 120 days and 72.3 days to report their interim results within a reporting deadline of 90 days. In other words, on average they reported about 18 days before the deadline. GEM issuers took on average 86.5 days to report their annual results within a reporting deadline of 90 days and 44.5 days to report their interim results within a deadline of 45 days. By contrast, companies within the Hang Seng Index reported earlier with an average of 80.3 days and 54.2 days for annual and interim results respectively.

24. Experience in Hong Kong is that 35% of all listed companies report their final results in the last fortnight and a further 25% report within one month of the deadline in the Listing Rules. Putting this another way, 40% of companies report at least one month before the deadline, 25% in the next two weeks and 35% in the last two weeks.

25. Against this background and as one of the three policy measures mentioned above, we consulted the market on the shortening of financial reporting deadlines.

26. On 18 July 2008 we announced our consultation conclusions on the shortening of the deadlines for half-yearly and annual reporting by Main Board issuers and published Rule changes to shorten the reporting deadlines for the release of half-year results announcements (from three months to two months) and the reporting deadlines for the release of annual results announcements (from four months to three months). The new requirements will provide more timely disclosure, and will come into effect for half-year and annual results announcements covering accounting periods ending on or after 30 June 2010 and 31 December 2010 respectively. The long grace period is to allow issuers, their finance departments and their external auditors sufficient time to adapt to the new regime.

Impact of trading by insiders

27. The impact of trading by directors and other insiders has been the subject of academic studies in the US, UK and also in Hong Kong. A Hong Kong study published in 2005[3], which analysed data from January 1993 to December 1998, concluded that, even though legislation exists to regulate transactions by corporate

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[2] Data from HKEx sources.

[3] "Insider trading in Hong Kong: Some stylized facts" by Cheuk, Fan and So, Department of Finance, Chinese University of Hong Kong, published in Pacific-Basin Finance Journal 14 (2006) 73-90

insiders, listed issuers, their directors and substantial shareholders are still able to make "abnormal" profits from trading in their own companies' shares. What the report does not acknowledge is that directors, by virtue of their experience and expertise in a particular industry or business sector, are naturally in a better position to benefit from the investment decisions they make within that sector.

28. The findings of this and other academic studies provide a useful insight into why trading by insiders which, generally, yield higher profits for the insiders, can be seen at certain times of the financial year to be particularly sensitive and raise suspicions about whether information available to those insiders has been improperly used. Without measures to reduce concerns, these suspicions potentially have a significant adverse effect on investor confidence and perceptions of market integrity.

29. The establishment of trading black out rules to supplement the statutory insider dealing prohibitions is one regulatory measure which has been adopted in Hong Kong (through the Model Code) and other jurisdictions to promote investor confidence by creating requirements to mitigate any perception of abuse by company insiders of price sensitive information that they may be thought to have, especially during periods leading up to an announcement of result.

30. The measures in the Model Code have the primary purpose of promoting greater investor confidence by tackling the perception of abuse by company insiders. Given the gravity of any wrongdoing in this area, compared to the sanctions available to the Exchange, the Securities and Futures Ordinance ("SFO"), rather than the Listing Rules, should be used as the most effective means of enforcing insider dealing and market misconduct.

Directors' dealings in sensitive periods in 2008

31. We have reviewed the patterns of reported directors' dealings during 2008, based on the disclosure of interests forms filed by the directors under the SFO. Our review shows that, of the forms filed by directors, approximately 3% of the reported transactions occurred within the old 30-day black out period, while a further approximately 33% occurred within the period between the financial period end and 30 days before the financial results' announcement (i.e. the effective new black out period excluding the old 30-day black out period). Many of the transactions reported within the old 30-day black out period were exempt dealings under the Model Code. That leaves 64% of the trading outside the new black out periods.

Table C[4]

Analysis of full year 2008 DI forms - Buy & Sell (include code 121 and 122)

(Exclude Unit Trust, REITS)

Number of DI forms

	Year Total		Main Board	GEM
(1) Fall within original blackout period (1 month)	251		195	56
(2) Fall outside original blackout period but within notional blackout period	3274	Annual	1867	105
		Interim	1210	18
		Quarter	36	38
(3) Fall outside original and notional blackout period	6315		5987	328
Grand Total	9840		9295	545

Column % of DI forms

	Year Total		Main Board	GEM
(1) Fall within original blackout period (1 month)	3%		2%	10%
(2) Fall outside original blackout period but within notional blackout period	33%	Annual	20%	19%
		Interim	13%	3%
		Quarter	0%	7%
(3) Fall outside original and notional blackout period	64%		64%	60%
Grand Total	100%		100%	100%

32. In addition we have compared statistics on the daily average number of dealings during these three periods and also the average value of "on exchange" dealings.

Table D[5]

Daily Average of Dealing Volume by (DI forms/by value)

	Average daily "on" and "off" exchange dealing volume by number of DI forms			Average daily "on- exchange" dealing volume by value (in HKD million)		
Average number of days :-	Total	MB	GEM	Total	MB	GEM
(1) Fall within original blackout period (1 month)	3.4	2.9	0.5	1.2	0.8	0.3
(2) Fall outside original blackout period but within notional blackout period	29.3	27.3	1.7	50.0	48.4	0.6
(3) Fall outside original and notional blackout period	35.4	32.5	2.2	82.4	79.4	0.6
Averages in period (2) as a proportion of averages in period (3)	**82.9%**	**83.8%**	**73.7%**	**60.7%**	**60.9%**	**100.2%**

33. The above statistics show that the average daily transactions within period (2) (i.e. the new black out period excluding the old 30-day black out period) was 29.3 which is 82.9% of those in period (3) (i.e. the period outside the new black out period) with an average daily transactions of 35.4. In terms of dealing value, the daily average was $50 million which is 60.7% of that in period (3) with a daily average of $82.4 million.

[4] Data from HKEx sources.

[5] Data from HKEx sources.

34. However, what causes some concern is that many of the directors' dealings appear clustered around the commencement date of the old black out period. A closer examination of the data set out in Table E below shows that, of the directors' dealings that took place during the effective new black out period but excluding the old black out period, a majority (57%) of the dealings occurred in the 30 days before the start of the old 30-day black out period. A further 36% took place within 31 to 60 days from the start of the old 30-day black out period. Only 7% occurred in the first 30 days of the new black out period.[6]

35. One possible explanation for the concentration of dealings shortly before the old 30-day black out period is that directors may have been adjusting their positions in the companies just before the black out periods. Nevertheless, investors could draw the inference from this trading behaviour that the old 30-day black out period has failed to adequately address the adverse perception held that company insiders like directors and employees may take advantage of information in their possession in the period leading up to the publication of the listed issuer's results.

Table E

Number of days to original blackout period start date (No. of DI forms)

	Year Total
0-10 days	627
11-20 days	647
21-30 days	575
31-40 days	502
41-50 days	377
51-60 days	293
61-70 days	146
71-80 days	79
81-90 days	28
Grand Total	3274

Main Board			GEM			Year Total
Annual	Interim	Quarter	Annual	Interim	Quarter	
236	302	20	19	17	33	627
323	297	10	11	1	5	647
292	267	5	11			575
257	220		25			502
244	102	1	30			377
264	20		9			293
146						146
79						79
26	2					28
1867	1210	36	105	18	38	3274

Column %

	Year Total
0-10 days	19%
11-20 days	20%
21-30 days	18%
31-40 days	15%
41-50 days	12%
51-60 days	9%
61-70 days	4%
71-80 days	2%
81-90 days	1%
Grand Total	100%

Main Board			GEM			Year Total
Annual	Interim	Quarter	Annual	Interim	Quarter	
13%	25%	56%	18%	94%	87%	19%
17%	25%	28%	10%	6%	13%	20%
16%	22%	14%	10%	0%	0%	18%
14%	18%	0%	24%	0%	0%	15%
13%	8%	3%	29%	0%	0%	12%
14%	2%	0%	9%	0%	0%	9%
8%	0%	0%	0%	0%	0%	4%
4%	0%	0%	0%	0%	0%	2%
1%	0%	0%	0%	0%	0%	1%
100%	100%	100%	100%	100%	100%	100%

[6] Data extracted from HKEx sources.

36. The results noted above suggest that the insider dealing laws and existing Model Code are effective to at least some extent, since there is a rightful fall in the rate at which directors' trade during restrictive periods and a more significant reduction in the value of dealing conducted in these periods. Nevertheless the rate of dealing remains reasonably significant.

Mandatory quarterly reporting

37. The proposal to introduce mandatory quarterly reporting was the subject of public consultation in August 2007. The Listing Rule changes to implement the proposal have yet to be formally adopted.

38. The regulatory intent of requiring mandatory quarterly reporting is to increase transparency and market efficiency, bring Hong Kong reporting standards into line with international best practices, help ensure timely disclosure and achieve better shareholder protection.

39. It has been our intention that the proposal for mandatory quarterly reporting should take effect for quarterly financial periods ending on or after 31 December 2011. The proposed deadlines for publishing quarterly reports are 1.5 months for each of the first and the third quarters.

40. The Listing Rule changes to implement the proposal have yet to be formally adopted by us. [When the Listing Committee is invited to approve the Listing Rule changes they will also consider whether or not there should be any modification of the black out period requirements.]

41. [When adopted, the Rule changes to introduce mandatory quarterly reporting for Main Board issuers will be forwarded to the SFC for approval. If the SFC approves the Listing Rule changes, we will release a consultation conclusions document in due course.]

Disclosure of Interests under Part XV of the SFO

42. A prohibition against dealings by directors during sensitive periods in a listed issuer's annual financial reporting cycle merely constitutes one aspect of the regulatory framework. In order for any perceptions of abuse by company insiders to be avoided, a high degree of transparency regarding dealings in the securities of the listed issuer is also required. It is therefore equally important for an adequate disclosure of interests regime to be in place so that these dealings can be promptly monitored by any member of the public.

43. The Listing Rules require listed issuers to let us have a Next Day Disclosure Return on changes in issued share capital, in some cases by 9:00 a.m. the next business day and in other cases subject to a 5% de minimis threshold and certain other criteria (e.g. aggregation).

44. Part XV of the SFO requires directors, chief executives and holders of 5% or more in the listed issuer to file, with us and the listed issuer, disclosures of certain changes in interests within three business days.

45. Filings under Part XV of the SFO are published on our website. However, electronic filing is not mandatory and mailing in hard copies is equally acceptable, so there are possibilities for delay.

46. Enhancement of the disclosure regime under the SFO may be conducive to the regulatory objective of enhancing the transparency of trading by certain key company insiders which may help to avoid the perceptions of abuse and provides investors with a timely indication of certain key company insiders' own investment decisions regarding their companies.

ISSUES

47. The Rule change to extend the black out period for directors attracted the following comments and criticism:

(i) The length of the extended black out is too long, especially if and when the proposed mandatory quarterly reporting is implemented.

(ii) It will reduce market liquidity.

(iii) It will remove a defensive ploy to fend off "corporate snipers".

(iv) It will impact on issuers' fund raising ability under the current difficult market conditions.

(v) It will deter independent investors from having a presence on the issuer's board.

(vi) It will discourage directors from holding shares of the companies on whose boards they sit.

(vii) It is unfair to directors and will discourage individuals from becoming directors, INEDs and NEDs.

(viii) The current Rules and insider dealing law are enough.

(ix) It is more restrictive than other comparable overseas jurisdictions.

(x) The Rule change is detrimental to Hong Kong's competitiveness.

(xi) It will have a negative impact on the flow of information.

(xii) The consultation process was flawed.

(xiii) The arguments put forward to support extending the black out period are flawed.

(xiv) Directors do not necessarily possess unpublished price sensitive information just because a financial period has ended. There is no justification for the proposed length of the extension.

(xv) It should be reconsidered together with the proposals to shorten the reporting deadlines and mandatory quarterly reporting.

(xvi) It will add to the administrative burden of issuers and deter listing in Hong Kong.

(xvii) It may lead to a high concentration of transactions during certain periods in a calendar year, and may result in market instability.

48. A majority of the above comments were absent from the responses to the CCP.

COMMENTS RECEIVED AND THE RELEVANT FACTORS

(i) The length of the extended black out is too long, especially if and when the proposed mandatory quarterly reporting is implemented

Comments

49. The Submissions criticise the extended black out period as too long with some adding that the problems associated with the extended black out period would be exacerbated when quarterly reporting becomes mandatory. Directors of companies that report on a quarterly basis are in a worse position in terms of their freedom to deal.

Relevant Factors

Black out too lengthy

50. The proposal for this Rule change was made against the background discussed above, in particular, that the old 30-day black out period was seen as inadequate to mitigate perceptions of abuse and that directors appeared to have a propensity to deal as the time draws closer to the start date of the old black out period.

51. Those in support of the Rule change have stated that the present-day use of modern information technology means that directors in some cases become aware of their companies' financial performance well in advance of the old 30-day black out period.

Impact of quarterly reporting

52. It is worth noting that all GEM issuers and approximately one hundred Main Board issuers already report on a quarterly basis, with the latter doing so voluntarily primarily as a good corporate governance measure.

53. If the extended black out period due to start on 1 April 2009 continues to apply upon the implementation of mandatory quarterly reporting, the black out period will cover all periods starting from the end of annual, half-year, quarterly financial periods until the announcement of the results for the relevant period. The black out periods for each of the first and third quarters will therefore start from the end of the quarterly period and end on the date of the results announcements.

54. The extent of the impact on directors' dealings will vary depending upon when the relevant listed issuer reports the relevant results. If a listed issuer chooses to report on the deadlines of the quarterly reporting periods, the total additional black out period will be 90 days.

(ii) It will reduce market liquidity

Comments

55. Most of the Submissions consider that:

    (a) barring directors (and possibly majority shareholders) from trading for a long time will curtail liquidity and be detrimental to Hong Kong listed companies; and

    (b) the extended black out period reduces trading volume (because major shareholders account for a considerable portion of the total market capitalisation), an important source of market liquidity and stable support for shareholder value.

Relevant Factors

56. The data below suggests that directors' trading does not contribute significantly to market turnover in most companies.

57. Table F[7] below shows that, from 2 January to 18 December 2008, shares purchased and sold by directors (and their associates) of the 42 Hang Seng Index companies, applying their HSI weightings, contributed to only 0.12% of all transactions. For 32 of these companies (or 76% of all HSI companies) the level of trading by directors and their associates contributed to less than 0.1% of the market turnover in this period. Only one HSI company experienced more than 2% of its trading by its directors during this period.

[7] Data provided by the SFC.

Table F

Of the 42 HSI Constituents:	Number of HSI Constituents	% of HSI companies
No trading by directors	15	35.7
Trading level below 0.1%	17	40.5
Trading level between 0.1% and 0.5%	3	7.1
Trading level between 0.5% and 1.0%	3	7.1
Trading level between 1.0% and 2.0%	3	7.1
Trading level above 2.0%	1	2.4

58. Looking at the broader picture, Table G[8] below profiles trading by directors (and their associates) of the Main Board and GEM companies in 2008. In 2008, 62% of the companies, directors and their associates did not trade in the companies' shares at all. Of the 38% of the companies which had directors trading, 27% traded at a level below 3%. Only 11% of the companies had directors trading at a level in excess of 3% of the market turnover in their companies' shares.

Table G

	Number			Column %		
Of all companies traded in 2008 :	MB	GEM	Total	MB	GEM	Total
No trading by directors	652	153	805	59%	78%	62%
Trading level below 0.1%	73	3	76	7%	2%	6%
Trading level between 0.1% and 0.5%	85	8	93	8%	4%	7%
Trading level between 0.5% and 1.0%	61	7	68	6%	4%	5%
Trading level between 1.0% and 2.0%	63	9	72	6%	5%	6%
Trading level between 2.0% and 3.0%	31	4	35	3%	2%	3%
Trading level between 3.0% and 10.0%	51	6	57	5%	3%	4%
Trading level above 10.0%	87	5	92	8%	3%	7%
Total	1103	195	1298	100%	100%	100%

[8] Data extracted from HKEx sources.

Table H

Of all companies traded in 2008 :	HKD in million MB	HKD in million GEM	HKD in million Total	Column % (HKD in million) MB	Column % (HKD in million) GEM	Column % (HKD in million) Total
No trading by directors	0	0	0	0%	0%	0%
Trading level below 0.1%	476	0	476	2%	0%	2%
Trading level between 0.1% and 0.5%	2497	14	2511	12%	7%	12%
Trading level between 0.5% and 1.0%	2832	8	2840	14%	4%	14%
Trading level between 1.0% and 2.0%	4828	10	4838	24%	5%	24%
Trading level between 2.0% and 3.0%	1653	95	1747	8%	49%	9%
Trading level between 3.0% and 10.0%	1223	45	1268	6%	23%	6%
Trading level above 10.0%	6690	19	6709	33%	10%	33%
Total	20197	192	20389	100%	100%	100%

59. Table H above shows that directors' trading at a level below 3% represented $12,412 million in monetary value or 61% of the total trading in their companies' shares and directors' trading at a level above 3% represented $7,977 million in monetary value or 39% of the total trading in their companies shares.

60. Further, Main Board Rule 8.08 (and its GEM equivalent) requires a listed issuer to keep at all times a minimum public float, which in most cases is 25% of its issued share capital. The shareholdings of directors and their associates are excluded from the calculation of the minimum public float. In other words, the shares constituting the public float cannot be held by the directors or their associates and therefore are never subject to the black out restriction on dealings. Therefore, if there are no other factors, a large portion of the shares in the listed issuer always remains freely transferable and liquid.

61. At the same time, we recognise the potential role which a controlling shareholder can play in providing market liquidity for his company's shares, in particular in the case of a so-called "third or fourth liner", by legitimately standing in the market to accept buy or sell orders. That this role will be further curtailed by any extension of the black out period may be considered by advocates of an extension as a necessary concession in the quest for a higher standard of corporate governance in Hong Kong and greater investor confidence in the market as a whole.

(iii) It will remove a defensive ploy to fend off "corporate snipers"

Comments

62. It has been submitted that the extended black out period will prevent directors from doing anything in the face of "attacks" during the black out periods so that "corporate snipers" can destroy value for both major and small shareholders and that the inability of major or significant shareholders to trade may give rise to market disruptions, e.g. possible hostile takeovers.

Relevant Factors

63. A controlling shareholder may understandably experience negative emotions and a sense of frustration if, during a black out period, he believes that the value of his company's shares is being driven down with malicious intent by others who have designs on or harbour ill intent towards his company. He may feel unable to "defend" the share price as he may otherwise wish to do. Further, if he has pledged his shares as security, the falling share price may subject him to a series of margin calls from the lender although, as we understand it, a bank may not necessarily wish to call in a margin loan as it will typically yield a forced sale value. In this connection, it is acknowledged that restrictions in a director's ability to deal freely with his assets may render a bank less willing to lend, demand more collateral or charge a premium on a loan to him.

64. Another response that companies adopt when facing similar circumstances is to buy back shares. Rules applying to company buy backs have not been amended. There have been no changes to Listing Rule 10.06(2)(e) that prohibits buybacks for 30 days before results are announced.

65. The high number of listed companies held by controlling shareholders, either state or family controlled, seems to have kept the incidence of aggressive third party action to a minimum in Hong Kong. In fact, there have only been one or two attempted hostile takeovers in the last two years. Furthermore, in recent years no takeover bid that was not supported by the management shareholder has succeeded.

66. We have performed an analysis based on information contained in annual reports and disclosures filed under Part XV of the SFO. Based on our analysis of the 1,261 companies listed on our Exchange as at 31 December 2008, approximately 65% of these companies appeared to be family-controlled (in that at least 20% of the company was held by an individual or a family, including ownership through a firm with controlling interests).

67. On one of the rare occasions where we saw a fund taking a significant position in a listed company that was not welcome by the incumbent management and controlling shareholder, the response was to launch a "best endeavours" placement of shares to raise further capital needed by the business and that would have resulted in a significant dilution of the fund's position. Because of the announcement of the planned placement, the fund sold its stake in the company. The extension of the black out period does not affect a company's ability to adopt a similar strategy although it is clearly necessary for company directors to be satisfied that there is a legitimate need for the fund raising.

68. In the unlikely event that a hostile bid is launched, the Takeovers Code sets a timetable that provides other shareholders enough time to respond, including enough time to make an opposing bid. If the results are due to be released during an offer, Rule 15.4 of the Takeovers Code requires the offeree company to publish the results before Day 39 of the hostile bidder's timetable. The black out period will end when the offeree company publishes its latest results. Alternatively, the listed issuer might ask us to consider granting a waiver or modification of the Model Code requirements. In the UK, where there are frequent hostile bids and

they have a similar takeover code and black out restrictions, similar concerns have not, to our knowledge, been raised.

(iv) It will impact on issuers' fund raising ability under the current difficult market conditions

Comments

69. A majority of the Submissions state that the extended black out period will undermine the normal fund raising ability of listed companies by depriving controlling shareholders (who are also directors) from underwriting rights issues which may constitute securities dealing in the black out period.

Relevant Factors

70. Analysis we have conducted indicates that this is not a particularly popular way for companies to raise funds. For all companies listed in Hong Kong, only 3% of the total fund raised in 2008 was by way of rights issues or open offers.

71. In considering whether the fund raising ability of listed companies will be unduly compromised as a result of the extended black out period, the following facts are relevant.

72. The Listing Rules do not subject listed issuers to a black out period like the one imposed on directors for a new issue of shares or securities by the issuer (although, if the new issue is to directors or their associates, it will be subject to the Rules governing connected transactions). It is also well understood that investors should not be asked to subscribe without up-to-date and accurate disclosure. Fund raising activities of this kind may enhance trading in the securities and help ensure liquidity.

73. The Listing Rules have been amended (effective 1 January 2009) to facilitate share issuance by adding an exception to the definition of "dealing" by a director or his associates. This newly codified exception allows an issuer to conduct fund raising by way of a "top-up" placing by directors or their associates during the black out period. Top-up placing is permitted as an exception because the director involved does not benefit from the exercise. It is a means for companies to raise funds at short notice and to avoid the market uncertainties introduced by the comparatively lengthy timetable for rights issues.

74. As regards the ability of directors to act as underwriters, we appreciate the difficulties faced by issuers in the current market. In particular, we note that issuers may find it difficult to raise funds and, in the case of a rights issue, they may encounter problems securing underwriters who are willing to face a prolonged underwriting exposure. In these circumstances, we are aware of occasions of controlling shareholders stepping in as the underwriter.

75. In response to enquiries on this issue, we have previously clarified that the completion or execution of an underwriter's obligations, by a director or an

associate of a director, under an underwriting agreement entered into outside the black out period would be regarded as falling outside the intended scope of the dealing restrictions. Nevertheless the listed issuer would need to take steps to ensure that investors invited to take up a rights issue would be in possession of enough up-to-date and accurate information concerning the listed company at the time they are invited to take up their entitlements. This is a general principle which applies equally to any circumstances where listed companies are contemplating any share issues whether during or outside a black out period.

(v) It will deter independent investors from having a presence on the issuer's board

Comments

76. A few of the Submissions have said that there is a growing trend for independent investors (e.g. long-term equity funds with a significant stake) to participate in management and have a presence on the board of directors. An extended black out period increases liquidity risks and discourages board representation and will eventually harm Hong Kong's growth as a financial market.

77. Extended black out periods render directors' shares highly illiquid assets which in turn discourages directors from acquiring shares in companies where they sit on the board in a representative capacity.

Relevant Factors

78. We have not discerned any significant trend for independent or institutional investors with a significant stake to participate in management and be represented on the board. At the same time, some large institutions, including long-term equity funds, have expressed views that they would prefer a longer black out period in the interest of investor protection. Institutional investors are most concerned with good governance and management with a strong record of performance.

79. Based on our understanding, most institutional investors prefer not to be represented on the board of a listed company since an institutional investor with a seat on the board will have to consider whether information provided to its representative director is price sensitive whenever it contemplates trading in the listed company's shares. Even when satisfied that it does not have price sensitive information, there remains a perception that the institutional investor is better informed than the market. Hence any dealing by the institutional investor can cause a perception that it has adopted less than the highest standards of corporate governance.

80. However, it may be that the possession, or perceived possession, by institutional investors of price sensitive information does not constitute a major hurdle to trading. Institutional investors with board representation can use their influence on the board to ensure that the issuer concerned disseminates any unpublished price sensitive information to the market as soon as possible so that they become free to trade. If this is so, and if there is a trend for institutional investors to take board seats, the extension of the black out period may be a disincentive further to do so.

(vi) It will discourage directors from holding shares of the companies on whose boards they sit

Comments

81. The principle in Paragraph 3 of the Model Code encourages directors of a listed issuer to hold shares in listed companies to show confidence and to align their own interest with the company's long-term success. It is said that the extension of the black out periods goes against that principle because it discourages directors from acquiring shares in companies they represent on the board.

82. Some Submissions have raised the point that the inability of directors to trade in their companies' shares means that they cannot exercise share options freely and in a timely manner as desired. This may deprive directors of the chance to realise gains to which they are legitimately entitled.

Relevant Factors

83. One of the principles enunciated in the Model Code is that it is highly desirable that directors should hold shares in the listed issuer. This having been said and for the reasons detailed in this statement, it may not be desirable for them to trade frequently in these shares for short-term gains.

84. The Model Code also states that directors may sell or dispose of securities of their listed companies under exceptional circumstances. An example of exceptional circumstances would be a pressing financial commitment on the part of the director that cannot otherwise be satisfied. To the extent that current market conditions impose significant financial challenges for director shareholders, there is a means to grant relief.

85. The Model Code further provides an exception to the dealing restrictions to allow directors to exercise vested share options provided that the agreement for these share options was entered into before a period during which dealing is prohibited. The new Rule does not change this position. However, we appreciate that directors may not wish to be exposed to a fixed tax liability.

(vii) It is unfair to directors and will discourage individuals from becoming directors, INEDs and NEDs

Comments

86. Some of the Submissions say that the Rule change is unfair to directors, INEDs and NEDs because it penalises directors and discourages individuals from becoming listed companies' directors. Other criticism includes:

    (a) Directors of listed companies spend their time and employ their expertise seeking to maintain and improve returns to shareholders. The new black out period further restricts their freedom to deal in their listed issuers'

shares and will discourage talented individuals of the appropriate calibre from becoming directors of listed issuers;

(b) the inability of directors to trade for substantial periods of the year poses a significant liquidity risk on a major personal asset;

(c) the new black out period will prejudice the legitimate rights and functions of directors as investors;

(d) it is unfair to directors who have already held shares for many years. When the shares were bought, they believed they could trade them any time they wanted to subject to black out periods totally 2 months a year;

(e) INEDs and NEDs believe that the new black out period is harsh on them as they are not involved in the day-to-day management of the listed issuer. They may not have access to management accounts; and

(f) the spirit of the law and Rules should be to put everyone on a level playing field without bias towards any particular group of investors.

Relevant Factors

87. Directors owe a fiduciary duty to their companies. This means that they should not place their own interests in conflict or potential conflict with those of other shareholders. Directors ordinarily become aware of their companies' performance soon after the year/period end, sometimes even earlier. To permit trading during this sensitive period may be regarded as allowing directors to put their own interests potentially in conflict with those of the general investors.

88. Since a majority of listed issuers in Hong Kong are family-owned, one would expect the nature of family shareholdings, for the most part, to be long-term and that a conflict of interests of this kind would be unlikely to arise.

89. INEDs and NEDs owe the same fiduciary duty as any director and therefore should not put their interests in conflict or potential conflict with those of the other shareholders. Although, unlike outside investors, they may not be involved in the day-to-day management of the company, they too occupy a privileged position with possible access to unpublished information about the company.

(viii) The current Rules and insider dealing law are adequate and effective

Comments

90. The Submissions state that the Listing Rules already contain provisions which adequately provide transparency and protection for the market. Arguments submitted in support include:

(a) (i) the Listing Rules are effective with good and practicable measures providing the public with required information. Rule 13.09 requires continuous disclosure of price sensitive information and the Model

Code prohibits dealing when a director is in possession of unpublished price sensitive information;

(ii) the Model Code prohibits a director from dealing without first notifying the chairman or a director designated by the board for this specific purpose and receiving a dated written acknowledgment. The listed issuer is obliged to keep records of the notification;

(iii) there is a time limit for an issuer to respond to a request for clearance to deal and a time limit for dealing to take place once clearance is given. These time limits will serve as additional preventive hurdles to dealings taking place in a prohibited period and where price sensitive developments have occurred;

(b) regulating trading activities of directors is not the responsibility of the Listing Rules;

(c) the insider dealing provisions in the SFO are a sufficient safeguard against market misconduct;

(d) it would not be appropriate to extend the black out indiscriminately to cover all kinds of cases while the regulatory interest lies only in the prevention of SFO insider dealing cases;

(e) the SFC has been robust in enforcing the relevant laws and regulations regarding insider trading, resulting in a number of convictions in recent years;

(f) the reason for the new Rule is to reduce the risk of insider dealing and to reduce the market perception that insider dealing takes place. The rationale runs against the principle of the rule of law in Hong Kong. The issue should be addressed by enforcement efforts;

(g) that directors in a company are particularly informed investors and could potentially abuse their position is a state of affairs that is inevitable under Hong Kong's laws and regulations;

(h) if the regulators intend to step up insider dealing regulations, changes to the SFO would be the more appropriate way to achieve this; and

(i) the kind of insider dealing likely to cause regulatory concerns in the Hong Kong market tends to take place on the back of information about specific transactions and exceptional corporate activities rather than on financial results.

Relevant Factors

91. We mentioned at the beginning of this statement that the Hong Kong regulators do not regard listed issuers as having a well developed practice of regularly updating the market on their financial performance, prospects and financial condition. (See paragraph 14 above.)

92. We also noted that many of the directors' dealings appear clustered around the sensitive periods when unpublished information concerning the financial performance of the listed issuer accrues. We therefore queried whether the old 30-day black out period has failed to adequately address the adverse perception held by investors that company insiders like directors and employees may take advantage of information in their possession in the period leading up to the publication of the listed issuer's results. (See paragraph 34 above.)

93. In relation to paragraphs (a) to (g) above, the following factors may be of relevance:

- the new Rule deals with perceived abuse during the periods leading up to the announcement of financial results or other significant announcements of price sensitive information. The intention is to promote investor confidence by removing, or at least mitigating, any suspicion or perception of abuse by company directors and employees;

- insider dealing is prohibited under the SFO and attracts both criminal and civil penalties. The new extended black out is intended to supplement but not replace or substitute for the statutory provisions in the SFO on insider trading;

- it may be considered preferable to create a culture of good corporate governance through preventative regulation than to rely on law enforcement; and

- director shareholders not only may have access to information that is unavailable to others, they may also have control over the process of dissemination of that information. Although having "access" to information does not mean "possession" of the information, there is potential for a conflict of interests between director shareholders and other investors. The Rule change seeks to address the perception of possible misconduct which may flow from this conflict.

94. As regards paragraph (h), the question of whether the insider dealing laws need to be revisited is arguably separate from whether there is a need to review the adequacy of the black out period under the Listing Rules.

95. As regards paragraph (i), a director who, in breach of the SFO, exploits and profits from information concerning specific transactions (rather than financial results) will be sanctioned accordingly. This may not, however, be a reason for diminishing the importance of other aspects of the Listing Rules.

(ix) It is more restrictive than other comparable overseas jurisdictions

Comments

96. A number of the Submissions state that, compared with overseas regulations, the extended black out period is more restrictive. They further contend that the regulators' position that Australia and Singapore markets are different is unconvincing.

Relevant Factors

97. It may be difficult to compare different jurisdictions fairly given the variations in corporate culture and practices. A comparison of the likely effect of the rules and regulations in different jurisdictions needs to take into account other factors which may influence policy decisions in those jurisdictions. These include:

(a) Shareholding structure

It is widely recognised that Hong Kong has a large proportion of listed companies which are family owned and managed. There may be a perception that, in a family controlled company, permission for a director to deal in shares of the company will be granted somewhat liberally by the chairman. This is to be contrasted with Singapore and Mainland China where a majority of sizeable companies are state-owned and professionally managed.

Australian, UK and US companies tend to be managed by professional management and a sizeable majority of companies have a wide shareholding structure.

(b) Financial Reporting time limits and market practice

The existing Rules on financial reporting in Hong Kong are arguably more lax than in the relevant jurisdictions (See paragraph 19 above and Annexure I). Furthermore, market practice in those jurisdictions can result in a substantial number of listed companies, in particular large listed companies, reporting significantly earlier than the mandated deadlines.

(c) Other provisions act as deterrents

The US, the UK and Mainland China adopt measures to restrict short-term dealings in listed company shares by insiders.

98. Looking at each of the jurisdictions in turn:

US

Short-term dealings

99. The US does not have a provision equivalent to the Hong Kong black out period. However, it has legislation effectively acting as a deterrent to directors and other insiders from conducting short-term dealings in their companies' shares.

100. In general, each of the directors, officers and beneficial owners of more than 10% of any class of equity securities (collectively, "insiders") of a US reporting company are subject to the reporting requirements under Section 16(a) and the "short-swing profit recovery rules" under Section 16(b) of the US Securities Exchange Act of 1934 (the "Exchange Act"). Section 16(b) makes these insiders liable to the company for any short-swing profits from any purchase and sale, or any sale and purchase, within any period of less than six months of any equity security of the company (other than an exempted security and certain exempted

transactions) or a security-based swap agreement involving any equity security of this kind, unless this security or security-based swap agreement was acquired in good faith in connection with a debt previously contracted.

101. Where the company fails to bring a suit against a Section 16 insider for recovery of the profit from a short-swing violation within 60 days after demand by a stockholder to do so (or fails to prosecute the suit diligently), a suit may be brought on behalf of the company by the stockholder. No suit may be brought more than two years after the date this profit was realised.

102. Short-swing violations are identifiable by the public upon a review of the filings made by Section 16 insiders under the beneficial ownership reporting requirements under Section 16(a).

103. Section 16(b) of the Exchange Act is applied strictly, and liability is not dependent on a proven or actual use of material, non-public information and may be imposed regardless of good faith. Thus, the insider's actual intentions and actual awareness or possession of inside information at the time of the trade are irrelevant. These provisions are therefore, as with the lengthened black out under the amended Model Code, prophylactic in nature. They apply to the people most likely to be in possession of insider information irrespective of whether or not trading has taken place on the basis of insider information.

Illegal insider trading

104. Any person (i.e., not only executive officers or directors of the company) may be subject to criminal and civil fines and penalties, as well as imprisonment, for engaging in transactions in the company's securities when this person was aware of material, non-public information about the security or the company as well as for disclosing the information to others who then trade on this information.

105. To protect the company and its insiders from liability under insider trading laws, many companies lay down a regular quarterly trading black out period that begins two to four weeks before the end of their fiscal quarters and ends one or two trading days after the public announcement of financial results for the quarter. Many companies also have mandatory pre-clearance procedures which apply irrespective of whether a trading black out period is in force.

UK

106. The dealing restrictions are set out in the Model Code in the Listing Rules.

107. A restricted person (i.e. a person discharging managerial responsibilities or employee insider) must not deal in any securities of the company without obtaining clearance to deal in advance. A restricted person must not be given clearance to deal in any securities of the company during a "prohibited period" or on considerations of a short-term nature.

108. A "prohibited period" means any "close period" or any period when there exists any matter which constitutes inside information in relation to the company.

109. In the case of annual results, the close period is the 60 days immediately before either the preliminary announcement of annual results or the publication of the annual financial report or, if shorter, the period from the end of the relevant financial year up to and including the time of the announcement or of the publication (as the case may be). A company must publish its annual financial report at the latest 4 months after the end of each financial year.

110. For the half-year report, the close period runs from the end of the relevant financial period up to and including the time of the publication. The half-yearly financial report must be made public as soon as possible, but no later than 2 months, after the end of the period to which the report relates.

111. For an issuer reporting quarterly financial information, the close period immediately before the announcement of the results for the first quarter, second quarter and third quarter is 30 days or, if shorter, the period from the end of the relevant financial period up to and including the time of the announcement.

112. Accordingly, a company reporting on a half-yearly basis will have total close periods of up to approximately 120 days while a company reporting quarterly will have total close periods of up to 150 days.

113. The UK requirement of a fixed close period may appear to be less restrictive than the new extended black out period in Hong Kong. In the UK, the maximum single prohibition is only 60 days (in the case of the annual results) or 2 months (in the case of the half-year results of an issuer reporting half-yearly) compared to a maximum of 4 months and 3 months respectively for a Hong Kong Main Board issuer under the current Listing Rules which, upon implementation of the new extended black out period, might create black out period of up to 7 months in total. However, this is the theoretical, maximum time. Where companies report earlier, their black out period is correspondingly shortened. According to our analysis in Table A, the new extended black out period averages at approximately 4.5 months for Hang Seng Index constituent companies.

114. The impact of the new extended black out period is exaggerated by the fact that Hong Kong listed issuers tend to report later than other developed markets where a substantial number of listed companies report significantly earlier than the mandated deadlines and/or the mandated deadlines are much shorter than the current requirements in Hong Kong.

115. The maximum period of restriction would only occur if companies report at the last possible moment allowed under the Rules. As mentioned above, experience in Hong Kong is that 35% of all listed companies report their final results in the last fortnight and a further 25% report within one month of the deadline in the Listing Rules. For those companies concerned with the extension of the black out period they may see this as an incentive to report earlier. Ultimately, the length of the black out period is, to a certain extent, within their own control. Even though their close periods are shorter than the new extended black out periods in Hong Kong, many UK companies still report earlier than required under the set deadlines which, as will be the case under Hong Kong's new extended black out periods, effectively shortens the close periods.

Australia

116. There is no prohibition under Australian law against directors' dealings during a "black out period". Australian companies generally set their "black out periods" before the release of annual or half-yearly results.

117. While there is no requirement for black out periods, under Recommendation 3.2 of the Australian Securities Exchange ("ASX") Corporate Governance Principles and Recommendations, every company is expected to establish a policy on trading in company securities by directors, senior executives and employees and disclose that policy or a summary of that policy. For instance, ASX as a listed company sets a policy for its directors, employees, contractors and secondees. They are only allowed to trade in ASX securities across any year in three periods of 5 weeks starting the day after the announcement of the half-year results, the full-year results and the AGM.

118. ASX conducted 2 reviews of trading by directors in 2008. These looked at trading during what the report referred to as the black out period. This being the period between the close of books and the release of the relevant listed company's half-year or full-year results.

119. Following these reviews, there has been much public debate in Australia about trading during black out periods. This culminated, in December 2008, in the Australian Government calling for a review in this area. The Australian Minister for Superannuation and Corporate Law, Nick Sherry, voiced his concern that "active trading between the close of books and the release of results has the potential to affect confidence in the integrity of Australia's markets. From a policy perspective, this confidence is central to maintaining Australia's attractiveness as an investment destination."

120. Thus, in looking to Australia for precedence we need to note that reliance on companies setting their own code appears not to have struck the right balance between self-regulation and imposed requirements that the Australian market is looking for. It is too early to judge whether, and if so how long, a specific black out period will be introduced in Australia. However, it is clear that one of the options being looked at is a black out period starting at the end of the financial reporting period.

Singapore

121. The provisions regulating dealings in securities are set out in Rule 1207(18) of the Singapore Listing Rules. It requires the listed issuer to include a statement in its annual report on whether and how it has complied with the following best practices on dealings in securities:-

    (a) a listed issuer should devise and adopt its own internal compliance code to provide guidance to its officers with regard to dealing by the listed issuer and its officer in its securities;

    (b) an officer should not deal in his company's securities on short-term considerations; and

(c) a listed issuer and its officers should not deal in the listed issuer's securities during the period starting two weeks before the announcement of the company's financial statements for each of the first three quarters of its financial year, or one month before half year or financial year, as the case may be, and ending on the date of announcement of the relevant results.

122. While the above provisions may suggest a less restrictive black out regime, it has to be borne in mind that the vast majority of sizable companies are state owned and the adoption of formal black out rules are not seen as needed to protect the market from insider trading.

123. In addition, most Singapore companies report as early as six weeks after the half year or financial year end.

PRC

124. Effective from 1 January 2006, the PRC Securities Law put in place several measures to regulate short-term transactions by directors, supervisors, members of the senior management and shareholders holding 5% or more of the company's shares of a listed issuer from trading in the company's shares.

125. Article 47 of the PRC Securities Law provides that if a director, supervisor, a member of the senior management or a shareholder holding 5% or more of the listed company's shares trades in the company's shares, the company is entitled to the profits made from: (i) the sale of the company's shares within six months of the purchase; and (ii) the purchase of the company's shares within six months of the sale of these shares. In addition, the measures include:

(a) introducing an avenue for judicial redress for shareholders if the board fails to respond to the request for collection of profits;

(b) requiring the board of directors to assume joint and several liability if the board fails to respond to the request for collection of profits; and

(c) imposing administrative liability including a warning and/or a fine between RMB30,000 and RMB100,000 on the director, the supervisor, members of senior management and the shareholders holding 5% or more of the company's shares who conduct securities trading in the six-month lockup period.

126. The underlying rationale behind the provision is that the law recognises that directors, supervisors, members of the senior management and shareholders holding more than 5% of the company's shares (who are majority shareholders under the PRC law) are in a better position than the public to acquire information on the listed company. Therefore, the law restricts their trading in the company's securities so as to maintain market fairness.

(x) The Rule change is detrimental to Hong Kong's competitiveness

Comments

127. Some of the Submissions say that the extended black out is detrimental to Hong Kong's competitiveness as a listed venue and significantly damages Hong Kong's position as an international finance and capital formation centre.

128. It has also been said that the new Rule may act as a deterrent to companies considering listing in Hong Kong.

Relevant Factors

129. The Model Code establishes rules on best practice and is, in particular, concerned with perceived abuse during the periods leading up to the announcement of financial results or other significant announcements of price sensitive information. The Model Code is considered to have a preventative function in encouraging directors and key employees not to engage in improper conduct, thus raising corporate governance standards for Hong Kong listed companies. It thereby increases investor confidence in the market which is fundamental to Hong Kong's position as an international finance and capital formation centre.

130. For individual listed companies, failure to adhere to appropriate standards of corporate governance can undermine investor confidence and increase the risk that shareholders perceive an "uneven playing field" where a privileged few are able to profit unduly from trading on inside information. The absence of investor confidence can have financially damaging effects. Investors may be discouraged from taking a long-term interest in the company which may, in turn, erode investor support for fund raising in the primary market and may lead to a higher cost of capital for the listed company. Liquidity and valuations may be adversely affected if investors cannot be confident that they will be treated equitably and decide to avoid the securities of certain listed companies.

131. Overseas investors may be discouraged from investing in the Hong Kong market by a perception of an uneven playing field. Overseas investors are a vital ingredient in maintaining and developing Hong Kong's position and aspirations as an international financial centre.

132. The choice of a company listing venue may ultimately not be affected by the tightening of the securities trading restrictions on directors. Rather, market integrity and investor confidence are crucial factors to be considered as they will directly impact on the capability to raise funding.

(xi) It will have a negative impact on the flow of information

Comments

133. A question has been raised on the implications of the extended black out period on the flow of information, namely, whether directors are prevented from discussing corporate performance with analysts and fund managers during the extended black out period.

Relevant Factors

134. We are aware that listed companies sometimes adopt so called "dark periods" when directors and senior management will not engage in meetings with analysts and the media. One of the reasons for this is to avoid concerns and regulatory enquiries about whether selective disclosure of potentially price-sensitive information has taken place given that the meetings take place in a sensitive period in the financial reporting cycle.

135. The Listing Rules in Hong Kong do not prohibit these meetings. To address these concerns listed companies must firstly ensure that they continue to meet their obligations of continuous disclosure. To avoid regulatory concerns about selective disclosure to analysts and fund managers listed companies may consider adopting a practice of issuing a pre-dark period or pre-closing period trading statement. This approach cures potential concerns about the flow of information.

136. The *Guide on disclosure of price-sensitive information* published by us ("Guide") provides specific guidance on handling meetings with analysts. Paragraph 24 of the Guide states that issuers should decline to answer analysts' questions where individually or cumulatively the answers would provide unpublished price-sensitive information. Further, directors should resist pressure from analysts to provide or comment on data that may involve the dissemination of unpublished price-sensitive information.

137. The above paragraph is guided by the principles and criteria set out in Paragraph 4 of the Guide which include:

- Until an announcement in relation to this information is made, directors of issuers must ensure that this information is kept strictly confidential.

- Information should be disclosed to the market as a whole and all users of the market have simultaneous access to the same information. It is important that price-sensitive information should not be divulged selectively outside the issuer and its advisers so as to place in a privileged dealing position any person or class or category of persons.

138. Whether a director is prevented from discussing corporate performance with analysts depends on whether the particular circumstances in question contravene the guidance, guiding principles and criteria as stated above. The obligations to disclose unpublished price sensitive information and not to engage in selective

disclosure are applicable any time, irrespective of whether this discussion takes place within the extended black out period.

(xii) The consultation process was flawed

Comments

139. Some of the Submissions say that the consultation process was flawed. The reasons given include:

    (a) the number of opposition is not insignificant and the consultation results are inconclusive;
    (b) a significant part of the market has deep reservations;
    (c) the CCP contained too many issues and deterred issuers from expressing views on all issues;
    (d) the consultation was conducted in haste and it adopted a broad brush approach;
    (e) the extension of the black out period is an issue of grave impact and directors of listed companies have not been consulted specifically;
    (f) there was not enough communication to listed companies and the public to ensure that they were properly informed of the proposal so as to respond or raise objection if they so wished; and
    (g) there was no interim disclosure of responses and detailed analysis of the extent and size of the market represented by dissenting views.

Relevant Factors

140. The consultation period ended on 7 April 2008. We received a total of 105 submissions from a wide spectrum of respondents including listed issuers, market practitioners and professional and industry associations. Except for one respondent who requested us not to publish its submission, all the submissions were posted on our website in April and May 2008 for public reference.

141. The consultation process spanned a period of approximately 3 months from the publication of the CCP on 11 January 2008. We notified the authorised representatives of all listed issuers by way of a letter informing them of the publication of the CCP and invited their views. The letter was also published on our website. Over one thousand hard copies of the CCP were distributed or collected from our offices by listed issuers, industry and professional representative bodies and market practitioners.

142. During the consultation period, issues in the CCP (including the black out issue) were also the subject of a number of seminars run by various organisations at which our staff spoke.

143. The Rule change has been made after due process, in accordance with normal procedures adopted for previous Rule changes.

144. Addressing the specific arguments raised:

(a) Number of opponents not insignificant and consultation results inconclusive

145. The main purpose of consultation (whether on an open or closed basis) is to improve decision-making, by ensuring that decisions are soundly based, that they take account of the views and experience of those affected by them, that alternative options are considered and that the new arrangements are workable. The consultation process is an exercise to assess the merits of the arguments on either side. Relying on numbers could also lead to a distorted result. By way of example, while one individual or company making a submission is counted as one respondent, a group of companies or a professional or industry body making a submission is also counted as one respondent.

(b) Significant part of market has deep reservations

146. As discussed above, the Rule change is a result of careful consideration of the arguments put forward by both sides.

(c) Combined Consultation Paper contained too many issues and deterred issuers from expressing views on all issues

147. The CCP contained more than 40 proposals which were grouped together as 18 substantive policy issues and some minor Rule changes.

148. The issues included in the CCP originated from several sources and they arose over time. In order to maximise the efficiency of our consultation, the different policy issues on which we sought market input were combined into a single paper.

149. The issues were arranged in the order of the relevant Listing Rules. The Model Code which contains the "black out" provision is in Appendix 10 of the Main Board Listing Rules, and it therefore formed Issue 18 of the paper.

150. It is uncertain whether issuers are more likely to respond to policy issues if they are published separately in several different consultation papers.

(d) Hasty and broad brush approach with consultation and implementation of rule change;

151. The consultation process lasted approximately 3 months and followed due and established process.

(e) Extension of black out period is an issue of grave impact and directors of listed companies have not been consulted specifically

152. The consultation was aimed at soliciting views from all sectors of the market. Directors were not singled out for specific consultation. Notwithstanding this, in addition to the publications and seminars that have been run by various trade and professional bodies following the publication of the CCP, we also notified individual authorised representatives of all the listed issuers of the publication of the CCP. Authorised representatives of listed issuers are typically either directors or company secretaries.

(f) Not enough communication and (g) absence of interim disclosure and detailed analysis of extent and size of market represented by dissenting views

153. In addition to the publication of the CCP and all the responses (except one) on our website, we notified each listed issuer by letter and invited their views. The content of the consultation paper including the black out issue was also widely publicised by local media and was the subject of seminars run by industry and professional groups. The extent and size of the market represented by dissenting views were taken into consideration in our analysis.

(xiii) The arguments put forward to support extending the black out period are flawed

Comments

154. The argument that extending the black out period will encourage companies to report earlier is flawed:

(a) the argument that extending the black out period will serve as an incentive for listed issuers to report earlier is to do injustice to the integrity of listed issuers' directors, i.e. directors would rush and race to announce results so that they could deal in their issuers' securities;

(b) the argument that the black out period is long because listed companies leave reporting deadlines to the last minute is irresponsible. Time is needed to finalise correct management accounts and to wait for auditors to start work, usually after they finalise audit projects for more important clients; and

(c) the object of encouraging listed issuers to report earlier on their financial results should be done by amending the time limits for publication of financial results instead. The black out period need not be extended as the reporting deadline will be shortened.

Relevant Factors

155. As regards (a) above, our position remains that this reason in itself is not enough to support the change, but is a possible beneficial side effect of the Rule change.

156. As regards (b) above, this is not a comment made by us. What we have said is that, as a factual matter when compared with the UK, there is a tendency for Hong Kong listed issuers to report closer to the deadlines imposed by the Rules (please see our analysis in paragraphs 20 to 24 above) and the black out period could be shortened if the financial reporting were made earlier than the set deadline. In this connection, we note comments that some smaller cap issuers may have experienced difficulty in securing the service of audit firms for earlier financial reporting notwithstanding their intention to do so.

157. As regards (c), we refer to our earlier discussion on our proposal to shorten reporting deadlines (see paragraphs 18 to 26 above).

(xiv) Directors do not necessarily possess unpublished price sensitive information just because a financial period has ended. There is no justification for the proposed length of the extension

Comments

158. One or two of the Submissions say that directors will not be in possession of unpublished price sensitive information relating to the company's accounts until around one month before the actual financial reporting. One Submission says that the new black out period suffers from artificiality. In reality, management will be aware of the financial results of the company for some time before the financial period end.

Relevant Factors

159. It is widely perceived that unpublished price sensitive information relating to the company's accounts could arise in a number of circumstances, including when a listed issuer is preparing certain disclosure in prescribed structured formats, for example, regular periodic financial reports, circulars and listing documents. While preparing these prescribed disclosure documents, investors would expect listed issuers to become aware of material information previously unknown to senior management and the directors, or information about a matter or financial trend in the course of development may crystallise into material information.

160. Listed issuers should be aware that material information which requires disclosure under Main Board Listing Rule 13.09(1) may emerge during the preparation of these disclosures, in particular during the preparation of periodic financial information, and that a listed issuer cannot defer releasing the potential price sensitive information until the prescribed disclosure document is issued. Separate immediate disclosure of the information is needed to bring it to the attention of the market.

(xv) The extension of the black out period should be reconsidered together with the proposals to shorten the reporting deadlines and mandatory quarterly reporting

Comments

161. Instead of introducing the new extended black out periods now, this change in the Rules should be reconsidered together with the closely related topics of whether quarterly reporting should be introduced in Hong Kong and the relationship between the black out and the timetable for introducing shorter reporting deadlines for annual and interim results announcements.

Relevant Factors

162. [If mandatory quarterly reporting is implemented, there may be a case for revising the length of the black out period. We invite the Listing Committee's comments on this issue.]

(xvi) The extension of the black out period will add to the administrative burden of issuers and deter listing in Hong Kong

Comments

163. The UK Model Code was amended in 2007 to remove application to "employee insiders" in order to reduce the administrative burden on issuers who had to maintain lists of employee insiders, often containing hundreds of names, and regulate dealings by those employee insiders. In direct opposition to this trend, the proposal to extend the black out periods would require Hong Kong listed issuers to monitor the dealings of its directors and the numerous other persons (directors' family members, trustees and investment managers) who are subject to the restrictions for up to seven months of the year. This increased administrative burden may be a significant deterrent to companies choosing Hong Kong as a listing venue or a place of incorporation.

Relevant Factors

164. The Rule change should not create a significant administrative burden for listed issuers and may even reduce it because the revised black out periods are entirely predicable and can be made widely known in the company.

(xvii) The extended black out may lead to a high concentration of transactions during certain periods, and may result in market instability

Comments

165. The black out periods affect not just the directors but also their immediate family members, trustees and investment managers. As a majority of the Hong Kong-listed issuers have a December year-end, several groups of people will only be entitled to sell their shares within certain shared open window periods. This may lead to a high concentration of transactions during these periods, and may result in market instability.

Relevant Factors

166. Our analysis shows that trading by directors and their associates represent only a small percentage of market liquidity. (See Tables F to H above). Please see also ability of listed companies to raise funds in paragraphs 72 to 75 above.

Listing Division of HKEx, February 2009

Annexure I

Table 3: Comparison of existing Rules with other international securities markets regarding deadlines for publication of periodic financial information as at 31 July 2007

Publication	Hong Kong Stock Exchange			Shanghai and Shenzhen Stock Exchanges (CSRC Notices)	New York Stock Exchange (SEC Rules)	London Stock Exchange (UKLA Rules)	Frankfurt Stock Exchange (Exchange Rules)	Toronto Stock Exchange (Listing Manual)	Tokyo Stock Exchange (Securities & Exchange Law)	Australian Securities Exchange (Listing Rules)	Singapore Stock Exchange (Listing Manual)
	Main Board (Listing Rules)		GEM (Listing Rules)								
	Proposal	Current	Current								
1. Annual results	90 days (3 months) (audited)	120 days (4 months) (audited) (Rule 13.46)	90 days (3 months) (audited) (Rule 18.49)	120 days (4 months) (audited) (Notice 2 Item 14)	Large Accelerated filers: 60 days Other Accelerated filers: 75 days Others: 90 days (audited) (Form 10-K) **(Note 1)**	120 days (audited) (DTR 4.1.3)	120 days (4 months) (audited) (Rule 62)	90 days (audited) (Sec. 437)	90 days (3 months) (audited) (Article 24)	60 days (audited or reviewed) (Rule 4.3.1) **(Note 4)**	45 days (unaudited) (Rule 705) **(Note 5)**
2. Interim results	60 days (2 months) (unaudited)	90 days (3 months) (unaudited) (Rule 13.48)	45 days (unaudited) (Rule 18.78)	60 days (2 months) (unaudited) (Notice 3 Item 11)	All Accelerated filers: 35 days Others: 45 days (unaudited) (Form 10-Q) **(Note1)**	60 days (unaudited) (DTR 4.2.2)	60 days (2 months) (unaudited) (Rule 63)	45 days (unaudited) (Sec. 443)	90 days (3 months) (reviewed by auditors) (Article 24.5)	60 days (audited or reviewed) (Rule 4.1.1) **(Note 4)**	45 days (unaudited) (Rule 705) **(Note 5)**
3.Quarterly results	45 days (unaudited)	N/A	45 days (unaudited) (Rule 18.79)	30 days (1 month) (unaudited) (Notice 13 Item 3)	All Accelerated filers: 35 days Others: 45 days (unaudited) (Form 10-Q) **(Note1)**	**(Note 2)** (DTR 4.3)	60 days (2 months) (unaudited) (Rule 63)	45 days (unaudited) (Sec. 443)	45 days (reviewed by auditors) **(Note 3)**	30 days (1 month) (Mining exploration entity only) (Rule 5.3)	45 days (unaudited) (issuer with market capitalisation exceeding S$75 million) (Rule 705)

Table 3 *(continued)*

Note 1	Large accelerated filer: defined in the US as an issuer with an aggregate worldwide market value of the voting and non-voting common equity held by its non-affiliates of US$700 million or more. Accelerated filer: defined as an issuer with an aggregate worldwide market value of the voting and non-voting common equity held by its non-affiliates of US$75 million or more, but less than US$700 million. Other issuers that do not meet the US Securities Exchange Act definition of an accelerated filer are permitted to continue filing annual reports under a 90 days deadline and quarterly reports under a 45 days deadline. An affiliate is defined as an "affiliate" of, or a person "affiliated" with, a specified person, is a person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, the person specified.
Note 2	Under the Disclosure and Transparency Rule 4.3, companies listed on the London Stock Exchange are required to produce two interim management statements during the six month period between the publication of its annual and interim results. Such statements must be made no earlier than 10 weeks after the beginning of the six month period and no later than six weeks before the end of the six month period. It shall contain information covering the period between the beginning of the relevant six month period and the date of publication of the statement. Such statements shall provide: - an explanation of material events and transactions that have taken place during the relevant period and their impact on the financial position of the issuer; and - a general description of the financial position and performance of the issuer during the relevant period. There is no requirement to present a balance sheet or an income statement. The Disclosure and Transparency Rules are effective for accounting years beginning on or after 20 January 2007. Listed issuers who do not produce quarterly financial reports should provide quarterly management statements.
Note 3	Based on information available from the Tokyo Stock Exchange's website, beginning with financial years starting on or after 1 April 2008, companies listed on the Tokyo Stock Exchange will need to publish quarterly financial reports, which should include a consolidated balance sheet and a consolidated income statement.
Note 4	A listed entity is required to send its annual report to the Australian Securities Exchange (Rule 4.7) as well as holders of its ordinary and preference shares (Rule 4.6) within four months of the end of its financial year.
Note 5	A listed issuer is required to send its annual report to its shareholders and to the Singapore Stock Exchange at least 14 days before the date of its AGM but in any event not later than three months after the financial year end (Rule 707).