Legislative Council Panel on Financial Affairs

Proposed Statutory Codification of Certain Requirements to Disclose Price Sensitive Information by Listed Corporations

Purpose

The Administration commenced on 29 March 2010 a three-month consultation on the proposed statutory codification of certain requirements to disclose price sensitive information ("PSI") by listed corporations. The consultation paper was issued to Members through the Legislative Council Secretariat on the same day. This paper briefs Members on the salient features of the proposal.

Background

2. The Administration supports the cultivation of a continuous disclosure culture among listed corporations. A way to achieve this is to oblige timely disclosure of PSI under our statute, instead of relying on the existing non-statutory Listing Rules, which are contractual in nature.

Legislative Framework

Legislative Approach and Obligations

3. We propose codifying certain requirements for listed corporations to disclose PSI in the statute, by adopting the existing concept of "relevant information" as defined under the Securities and Futures Ordinance ("SFO") (Cap. 571) (to be referred to as "inside information" under our proposal) to define PSI. This concept has been used for two decades in the statutory "insider dealing" regime and the market is familiar with it. Under this approach, it will be the same set of information which is prohibited from being used for insider dealing and which is required to be disclosed to the public. The European Union ("EU") adopts the same approach.

4. We propose specifying in the law that a listed corporation be obliged to disclose to the public as soon as practicable any "inside information" that has come to the knowledge of the listed corporation. We also propose that directors and officers must take all reasonable measures from time to time to ensure that proper safeguards exist to prevent the corporation from breaching the statutory disclosure requirements. Should a listed corporation be found to have breached the statutory disclosure requirements, and that such a breach is a result of any intentional, reckless or negligent act or omission on the part of any individual director or officer, or that any individual director or officer has not taken all reasonable measures to prevent the breach, the director/officer would also be in breach of the statutory disclosure requirements.

Safe Harbours

5. We recognise the need to strike a reasonable balance between ensuring market transparency and fairness in the provision of information to investors, and safeguarding the legitimate interests of listed corporations in preserving certain information in confidence to facilitate their operation and business developments. To cater for legitimate circumstances where non-disclosure or delay in disclosure would be permitted, we propose to provide safe harbours for the following circumstances -

(a) when the disclosure would constitute a breach against an order made by a Hong Kong court or any provisions of other Hong Kong statutes;

(b) when the information is related to impending negotiations or incomplete proposals the outcome of which may be prejudiced if the information is disclosed prematurely;

(c) when the information is a trade secret; and

(d) when the Government's Exchange Fund or a central bank provides liquidity support to the listed corporation. This safe harbour will allow a listed banking institution to recover from its liquidity difficulties to the benefit of its

depositors, other creditors and shareholders and the overall stability of Hong Kong's financial markets.

These safe harbours emulated those provided for in the EU (including the United Kingdom).

6. To allow the statutory disclosure regime to evolve with future market development, we propose to empower the Securities and Futures Commission ("SFC") to create new safe harbours through subsidiary legislation to be made under the SFO. Such subsidiary legislation would be subject to negative vetting by the Legislative Council.

Facilitating Compliance

7. To facilitate compliance, we propose that the SFC should promulgate guidelines to provide guidance on what constitutes "inside information" and when the safe harbours would be applicable. We also propose that the SFC should provide an informal consultation service on the disclosure requirements.

8. To facilitate communication with the public and market participants, we have attached to our consultation paper indicative draft legislative provisions on the statutory disclosure requirements and safe harbours. The SFC has also prepared draft guidelines on disclosure of inside information and is in parallel consulting the public on its draft guidelines.

Enforcement and Sanctions

9. We propose that the SFC be the enforcement authority. It will, upon receipt of a referral from the Stock Exchange of Hong Kong ("SEHK") of possible breach or upon detection of a possible breach at its own initiative, carry out investigation and pursue follow-up proceedings of the case with its existing investigatory powers under the SFO.

10. In devising the proposed sanctions, we recognize that the purpose of the statutory codification is to encourage compliance and hence enhance the transparency and quality of our market. We have also

made reference to international market experience. In the United Kingdom, the Financial Services and Markets Act stipulates that civil fines may be imposed on breaches of disclosure obligations on PSI. This is in line with the EU practice. Under our proposal, one or more than one of the following civil sanctions may be imposed on those breaching the disclosure requirements-

(a) a regulatory fine up to $8 million on the listed corporation and/or the director;

(b) disqualification of the director or officer from being a director or otherwise involved in the management of a listed corporation for up to five years;

(c) a "cold shoulder" order on the director or officer (i.e. the person is deprived of access to market facilities) for up to five years;

(d) a "cease and desist" order on the listed corporation, director or officer (i.e. an order not to breach the statutory disclosure requirements again);

(e) an order that any body of which the director or officer is a member be recommended to take disciplinary action against him; and

(f) payment of costs of the civil inquiry and/or the SFC investigation by the listed corporation, director or officer.

11. Since the Market Misconduct Tribunal ("MMT") has experience in dealing with cases concerning "inside information" and in considering orders set out in paragraph 10(b) to (f) above, we propose extending the jurisdiction of MMT to breaches of the statutory disclosure requirements. We further propose to empower the SFC to institute proceedings on breaches of the disclosure requirements direct before the MMT, without having first to report to the Financial Secretary for his decision to do so. This will help streamline the process in implementing the civil regime.

12. The fines mentioned in paragraph 10(a) above are intended to be regulatory in nature, and the MMT will be required to comply with the

principle of proportionality when determining the amount of regulatory fines to be imposed by reference to the facts and circumstances in a particular case. We propose to require the MMT to only order the payment of a fine which is, in the circumstances of the case, proportionate and reasonable in relation to the conduct of the listed corporations and/or director breaching the disclosure requirements. The factors that MMT may take into consideration include-

(a) the seriousness of the conduct of the one breaching the disclosure requirements;

(b) whether the conduct was intentional, reckless or negligent;

(c) whether the conduct may have damaged the integrity of the securities and futures market;

(d) whether the conduct may have damaged the interest of the investing public;

(e) whether the conduct has resulted in a benefit to the person or any other person;

(f) the financial resources of the one breaching the disclosure requirements;

(g) whether the conduct has resulted in any gain or loss avoided to the person in breach; and

(h) any conduct by the one breaching the disclosure requirements which-

i. previously resulted in it/him being convicted of an offence in Hong Kong;
ii. previously resulted in it/him being identified by the MMT as having engaged in any market misconduct;
iii. previously resulted in it/him being identified as an insider dealer.

13. In addition, we propose that persons suffering pecuniary loss as a result of others breaching the disclosure requirements could rely on the MMT findings to take civil actions to seek compensation from those

having breached the disclosure requirements. The SFC may also, where appropriate, take action under existing provisions of the SFO to apply for injunctive and disqualification orders.

Way Forward

14. Compared with the existing regime under the non-statutory Listing Rules made by the SEHK, the proposed statutory regime would mark an important step forward by specifying the PSI disclosure requirements (with safe harbours) clearly in the law to facilitate compliance, as well as allowing the SFC to conduct more effective investigation into a suspected breach of these statutory requirements and the MMT to inquire and impose a range of civil sanctions. We look forward to receiving the public's feedback by 28 June 2010. Our aim is to formulate a proposal that would encourage compliance with, and facilitate enforcement of, the statutory disclosure obligations. Subject to public comments, our plan is to introduce a bill to the Legislative Council to codify the PSI disclosure requirements in the SFO in the 2010/11 legislative session.

Financial Services Branch
Financial Services and the Treasury Bureau
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