香港特別行政區政府
財經事務及庫務局
財經事務科
香港金鐘添美道二號
政府總部二十四樓

電　　話 TEL.: 2810 2056
圖文傳真 FAX.: 2529 2075
本函檔號 OUR REF.: SUB/12/2/2/5
來函檔號 YOUR REF.:

FINANCIAL SERVICES BRANCH
FINANCIAL SERVICES AND
THE TREASURY BUREAU
GOVERNMENT OF THE HONG KONG
SPECIAL ADMINISTRATIVE REGION
24TH FLOOR
CENTRAL GOVERNMENT OFFICES
2 TIM MEI AVENUE
ADMIRALTY
HONG KONG

18 January 2012

CB(1)900/11-12(02)

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

Dear Ms Sit,

Bills Committee on Securities and Futures (Amendment) Bill 2011
Follow-up to meeting on 3 January 2012

Thank you for your email of 3 January 2012.

In response to item (a) in the list of follow-up action attached to your email, the Securities and Futures Commission (SFC) has prepared the paper at **Annex**. We share the views therein.

On the suggestion of providing some quantitative thresholds in the SFC's Guidelines with regard to price sensitive information, we note that the Insider Dealing Tribunal (IDT) and now the Market Misconduct Tribunal (MMT) have given on occasions views on the concept of material change. To facilitate compliance, the SFC would set out in its Guidelines relevant precedent cases in the IDT and the MMT in Hong Kong for listed corporations' reference in deciding whether a particular piece of information is price sensitive.

Reponses to the other items will follow.

Yours sincerely,

(Mr Anthony LI)
for Secretary for Financial Services
and the Treasury

Annex

Bills Committee on Securities and Futures (Amendment) Bill 2011

Response to The Hong Kong Institute of Certified Public Accountants' Submission dated 21 December 2011

Purpose

1. This paper provides information in response to the comments raised by The Hong Kong Institute of Certified Public Accountants ("HKICPA") in its submission dated 21 December 2011.

Comments raised and our response

Safe harbour for "reasonable procedures", "good faith" etc

HKICPA's comments

2. HKICPA suggested adding a safe harbour to cover the situation where a corporation has appropriate internal control procedures in place, has taken reasonable steps to ensure a specific issue has been properly considered and the directors, having carefully considered the circumstances (taking professional advice, where appropriate), have exercised judgment, with reasonable prudence and in good faith, concluding that certain information is not price sensitive information ("PSI") and does not warrant a disclosure at that time.

Our response

3. During the consultation, we have considered public comments requesting additional safe harbours akin to or incorporating a "good faith defense" or "business judgment safe harbour". We have now specified in the new section 307B(2)(b) of the Bill that a "reasonable officer" test (which is an objective test) be applied in determining whether a piece of information is "inside information". The test is whether a reasonable officer would determine that a piece of information is inside information based on the facts and circumstances at the time.

4. A corporation and its officers cannot be expected to do more than is reasonable at the time in assessing whether a piece of information is inside information. On the other hand, from an investor protection perspective, it would be unacceptable to allow non-disclosure of inside information if a listed corporation decided in "good faith" that a piece of information was not inside information but it had not acted reasonably in reaching such a decision. There is a clear need for an objective standard, and we note that no other major jurisdictions adopt a "acting in good faith" test.

Safe harbour for not holding corporations liable if reasonable steps are taken

HKICPA's comments

5. HKICPA suggested adding a safe harbour similar to that in Singapore where some form of negligence, recklessness or intention must be established on the part of the company before it can be held liable. HKICPA believed that prima

facie, the proposed Hong Kong regime is stricter than in Singapore in this respect.

Our response

6. Under section 307G(2) of the Bill, an officer would be held liable if he is negligently, intentionally or recklessly concerned in the breach or if he fails to take all reasonable measures to prevent the breach. This approach is generally in line with that of the other comparable jurisdictions.

7. In line with the policy intention to enhance corporate disclosure in Hong Kong, we consider that it is appropriate in the circumstances to apply civil sanctions on corporations breaching the obligations without the need to establish a mental element. This proposal is closely similar to the position in the UK and Australia.

8. We note that in Singapore, a breach of the disclosure requirement by a corporation can lead to both criminal and civil sanctions. In this important respect, the proposed regime in Hong Kong only imposes civil sanctions in case of breaches. This should be taken into account in the comparison.

Additional safe harbours like those in the UK and Australia

HKICPA's comments

9. HKICPA suggested introducing additional safe harbours – for example, in the UK, an issuer may delay public disclosure of inside information, such as not to prejudice its legitimate interests provided that, inter alia, "such omission would not be likely to mislead the public". In Australia and Singapore, no disclosure is required where, for example, a reasonable person would not expect the information to be disclosed, the information is confidential and "the information comprises matters of supposition or is insufficiently definite to warrant disclosure" or "the information is generated for the internal management purposes of the entity".

Our response

10. We have carefully considered these safe harbor provisions.

11. Our proposed definition of inside information only covers information that is specific, hence would not include information that comprises matters of supposition or is insufficiently definite, and the question of providing a safe harbor for such circumstances does not arise. Paragraph 76 of the Draft Guidelines also clarifies that a matter of supposition does not amount to inside information. In Australia and Singapore, their definitions of price sensitive information are not confined to "specific" information. As for the UK, in our view, if it is the case that the omission of information would not mislead the public (the UK safe harbor), that information should not amount to inside information under our proposals and therefore no safe harbour is necessary.

Scope of the term "officer"

HKICPA's comments

12. HKICPA believes that (i) the term should, preferably, be clarified in the Bill itself, not just in guidelines and (ii) it should embrace the concept adopted in the UK, that is, a director or senior executive who (a) has regular access to inside information relating to the issuer; and (b) has the power to make managerial decisions affecting the future development and business prospects of the issuer.

Our response

13. Under the present market misconduct regime, section 279 of the Securities and Futures Ordinance ("SFO") imposes an obligation on "officers" to take all reasonable measures from time to time to ensure proper safeguards exist to prevent the corporation from acting in a way which would result in the corporation perpetrating any conduct which constitutes market misconduct. The concept of "officers" is therefore already entrenched in the SFO regime.

14. Paragraph 52 of the Draft Guidelines clarifies that a "manager" (within the definition of "officer") normally refers to "a person under the immediate authority of the board who is charged with management responsibility affecting the whole of the corporation or a substantial part of the corporation". There is no major difference between this formulation in the Draft Guidelines and the UK definition.

15. The clarification concerning "officers" will be made in the Guidelines which will be issued under section 399 of the SFO. According to section 399(6), the Guidelines made thereunder shall be admissible in evidence and may be taken into account as a relevant matter in deciding any question arising in the proceedings under the SFO, although a failure to comply shall not by itself render a person liable to any judicial or other proceedings. In discharging its functions under the proposed disclosure regime, the Securities and Futures Commission ("SFC") will of course have regard to the Guidelines when assessing whether a breach of the PSI provisions under the SFO has taken place. The Guidelines will be made with the SFC's Board approval. It is the SFC's stated policy to conduct a public consultation on any codes or guidelines it proposes to make under section 399 of the SFO. We do not consider that any change needs to be made to the Bill.

SFC Draft Guidelines and Frequently Asked Questions ("FAQs")

HKICPA's comments

16. To address the key issues in relation to the operation of the disclosure requirements, HKICPA suggested that the Bill, the Draft Guidelines and the FAQs be reviewed at the same time as a package.

Our response

17. We have consulted the public on the Draft Guidelines and submitted these to members of the Bills Committee.

18. After the implementation of the PSI regime, we intend to issue FAQs from time to time to address questions arising from the application of the requirements in "live" situations. The FAQs are likely to reflect actual (unnamed) cases which the SFC has handled through the consultation service and waiver application process. It follows that no FAQs can be available at this stage.

SFC's consultation service

HKICPA's comments

19. HKICPA was concerned that the SFC will not offer advice to a corporation on whether a particular piece of information is inside information. It believed that the SFC should not decline giving advice on whether certain information is in the nature of PSI without which the system may become deficient. HKICPA further highlighted the current regime under the Listing Rules where the Exchange encourages issuers to consult the Exchange when in doubt as to whether disclosure should be made (see note 11 of Listing Rule 13.09).

Our response

20. SFC will provide a consultation service to assist corporations understand the application of the disclosure provisions initially for a period of two years. During consultations, the SFC would explain the key elements of the test in determining when a piece of information constitutes inside information and the availability of safe harbours under certain circumstances. Nonetheless, it is the responsibility of the listed corporation (with, as appropriate, its advisers) to exercise its own judgement in deciding whether a piece of information is inside information in the context of its own affairs and based upon its own first-hand knowledge of all relevant facts and circumstances. The PSI regime would be undermined if a listed corporation were effectively to transfer to the regulators the responsibility to decide on whether disclosure is required in a particular case and we do not believe regulators in other comparable jurisdictions would accept this outcome.

21. While the Exchange also encourages issuers to consult, its long standing practice has been that it does not advise or decide on whether specific information is inside information during consultations. Note 11 of the Listing Rule states that –

"It is the responsibility of the directors of the issuer to determine what information is material in the context of the issuer's business, operations and financial performance. The materiality of information varies from one issuer to another according to the size of its financial performance, assets and capitalisation, the nature of its operation and other factors. An event that is "significant" or "major" in the context of a smaller issuer's business and affairs is often not material to a large issuer. The directors of the issuer are in the best position to determine materiality. "

Linkage between "relevant information" under insider dealing and "inside information" under PSI

HKICPA's comments

22. HKICPA raises concerns that aspects of the fundamental definition of "inside information" remain unclear. While the definition is the same as that of "relevant information" under the insider dealing regime (paragraph 14 of the Draft Guidelines), the draft guidelines qualify the relevance of this connection by stating (paragraph 15 of the Draft Guidelines),"... *the circumstances in which insider dealings are regarded to have taken place would be different from the context in which the obligation to disclose may arise and thus the interpretative guidance available from these decisions may not apply.*"

Our response

23. Whilst the definition of "inside information" is the same under the proposed Part XIVA (PSI disclosure) and the existing Part XIV (insider dealing), it is obvious that the circumstances in which a disclosure obligation is triggered and those in which insider dealing is regarded to have taken place would be different. However the question of whether information is "inside information" is identical and therefore interpretative guidance from Insider Dealing Tribunal ("IDT") and Market Misconduct Tribunal ("MMT") decisions on this aspect is relevant.

Information in media reports, rumours, analysts report and whether they are generally known etc

HKICPA's comments

24. HKICPA referred to a number of paragraphs set out in the Guidelines, raising concerns about whether a company would be forced to make disclosure in light of incomplete reports in the media. It also queried why the Guidelines did not distinguish information which is not generally known but not price sensitive, from information which is not generally known but price sensitive. It also sought clarification as to whether a company is required to keep track of reports made by other third parties.

Our response

25. We would like to clarify the following key points:

    (a) If a corporation has inside information but relies on a safe harbour which requires preservation of confidentiality and the inside information is leaked, then disclosure is required. Media reports or market rumours report may well evidence leakage. Given that the confidentiality has not been preserved, the safe harbour falls away and therefore disclosure is required. (Paragraphs 61 and 74 of the Guidelines.)

    (b) If a corporation does not have inside information but media reports and market rumours report false or untrue information, the corporation is not obliged to clarify under the SFO. (Paragraph 74 of the Guidelines.)

    (c) If a corporation has inside information but relies on a safe harbour which requires preservation of confidentiality and the inside information is reported by an analyst, it is likely that confidentiality has not been preserved and again the safe harbour falls away and disclosure is required. (Paragraph 61 of the Guidelines.)

    (d) If a corporation does not have inside information but an analyst report contains errors or misinterpretations by drawing on out-of date historical data of a corporation, the corporation has no obligation to clarify. (Paragraph 81 of the Guidelines.)

    (e) There is no independent legal obligation to track third party reports.

26. We propose to redraft these paragraphs so that they are grouped in one section of the Guidelines for easy reference.

Changes in macro-economic / market conditions

HKICPA's comments

27. Clarification was sought as to whether, for example, a fall in real property values due to a change in macro-economic conditions which would be likely to adversely affect the expected earnings of the corporation would be regarded as generally known information and, if not, whether disclosure is required.

Our response

28. Paragraph 84 of the Draft Guidelines makes clear that listed corporations are not expected to disclose general external developments, such as foreign currency rates, the market price of commodities or changes in a taxation regime. However, if the information has a particular impact on the corporation this may be inside information that should be disclosed.

29. Accordingly, if a fall in real property values is likely to have an adverse and material impact on a property investment company then it should disclose that information with an assessment of the magnitude of the impact.

External factors affecting the share price

HKICPA's comments

30. As stated in the Draft Guidelines (paragraphs 27 and 29), the test of whether the information is likely to materially affect the price of securities is a hypothetical one. HKICPA felt that the guidance was implying that future extraneous factors or considerations should be considered when assessing PSI disclosure.

Our response

31. The relevant Guidelines (including the word "hypothetical") emphasises that there cannot be a judgment in hindsight taking account of factors which were not reasonably known at the time. Therefore the actual size of the share price movement once the information becomes public is by no means conclusive as this may be impacted by other independent factors unrelated to the information itself. This serves to emphasise that future extraneous factors or considerations are irrelevant when assessing whether there is an obligation to disclose.

Hedging transactions

HKICPA's comments

32. A company may engage in hedging on a very regular basis and, due to widely-reported market volatility, the value of the relevant hedges may vary significantly and, potentially, affect the profit or loss of the company. Should disclosures be made with each significant mark-to-market fluctuation or only at certain times and, if so, when?

Our response

33. If a company engages in effective hedging then the movement in the hedging instrument and the hedged asset or liability should closely balance out and,if so, changes in values would be unlikely to be inside information. If the positions are not effective hedges but are speculative positions then like any other significant

items, disclosure will be required when the overall impact on the company's financial position, if known, is likely to result in a material adjustment to the share price.

Knowledge of substantial losses or profits and what is regarded "substantial"

HKICPA's comments

34. As stated in paragraph 31 of the Draft Guidelines, knowledge of substantial losses or profits made by a corporation, even though the precise magnitude is not yet clear, may be inside information. HKICPA was of the view it could be dangerous if listed companies are required to make a vague statement on financial performance, based on preliminary information. In addition, there should be more guidance / benchmarks to explain what is regarded as "substantial". For example, in the Mainland, a difference of over 50% in profits / losses as compared to the previous corresponding period requires disclosure.

Our response

35. We believe that an assessment based on preliminary information does not equate to making a vague statement. A listed corporation with appropriate financial reporting systems would have available to it a structured flow of key financial and operational data necessary for management appraisal. This should not be "vague" information.

36. The example cited in relation to the Mainland is one circumstance that would trigger disclosure. A company also has a general obligation to disclose on a timely basis any information the Mainland exchange or the company considers that will have a relatively significant impact on the price of the securities. No quantitative benchmarks are offered to define what constitutes "relatively significant impact".

37. The general view of leading international regulators is that the materiality of information varies from one issuer to another according to its financial performance, assets, capitalization and size, the nature of its operations and other factors. An event that is significant in the context of a smaller issuer's business and affairs is often not material to a large issuer. It is wholly inappropriate to adopt a single bright line test or numerical figure for all listed corporations for determining materiality for disclosure purposes. No other major jurisdictions define or provide guidance on materiality in terms of quantitative criteria.

38. This approach is consistent with the HKICPA's own guidance for the accounting profession when it comes to determining materiality. The Conceptual Framework for Financial Reporting (QC11) states the "the Board cannot specify a uniform quantitative threshold for materiality or predetermine what could be material in a particular situation". Similarly HKSA 320 on Materiality in Planning and Performing an Audit shies away from setting any benchmarks.

Examples of possible inside information

HKICPA's comments

39. HKICPA felt that the examples of possible inside information listed in paragraph 34 of the Guidelines are so generic that they raise more questions than giving

answers. Specifically it sought clarification on certain listed examples, i.e. changes in auditors or any other information related to the auditors' activity, changes in accounting policy, and changes in investment policy.

Our response

40. The list of examples set out in paragraph 34 of the Draft Guidelines is stated as a non-exhaustive and purely indicative list. Inclusion of an event or a set of circumstances in the list does not mean that it is automatically inside information, nor does exclusion from the list indicate that it cannot be inside information. A corporation must exercise judgement to determine whether a piece of information amounts to inside information based on the particular facts and circumstances.

41. The examples listed have all been sourced from other jurisdictions or from facts that led to a decision by the IDT and MMT. The variety of topics and the fact that for most circumstances listed it is easy to envisage some cases where disclosure would be required and other cases where disclosure would not demonstrate the difficulty of relying on lists. Our view is that it would be better not to provide this further guidance by way of example as the list cannot be comprehensive and for almost every example some cases will and some will not involve inside information. We have nevertheless decided to provide an indicative list in response to market requests for additional guidance on specific circumstances that might give rise to a disclosure obligation, and we believe that this should be helpful.

42. Whether a change in auditors, accounting policy or investment policy is inside information depends on the particular facts and circumstances. For example, a minor change in accounting policy that has no impact on profits would not be inside information, whereas a significant change arising from a revaluation or from a new accounting standard that will significantly change profits would normally be inside information.

Securities and Futures Commission
January 2012