CB(1)18/11-12(12)

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THE CHAMBER OF HONG KONG LISTED COMPANIES

By Fax and by Post

October 6, 2010

Legislative Council
Hong Kong Special Administrative Region of the People's Republic of China
Legislative Council Building
8 Jackson Road
Central
Hong Kong

Attention: Clerk to Bills Committee

Dear Sir/Madam,

Submission to the Bills Committee
On the Securities and Futures (Amendment) Bill 2011

The Chamber of Hong Kong Listed Companies is pleased to submit its views to the Bills Committee on the Securities and Futures (Amendment) Bill 2011 of the Legislative Council for its consideration.

The Chamber supports the principles behind the Bill, namely to oblige listed issuers to disclose "inside information" as soon as reasonably practicable, and to encourage them to put themselves in a position to discharge this duty. We believe it is vital that the Bill strikes the right balance between the public interest in disclosure, and the company's right to protect commercially sensitive information. Disclosure requirements which lead to premature or over-disclosure may have the counter-productive effect of misleading investors. We put forward our views below on how the Bill can be improved in a way which better strikes this balance. Also attached for convenience is a mark-up of the relevant provisions of the Bill which would give effect to our recommendations (some minor consequential amendments to other provisions may be required if our recommendations are accepted).

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1. The Bill provides that the issuer's obligation to disclose information arises whenever an "officer" has, or "ought reasonably to have", knowledge of inside information, and would consider such information as inside information in relation to the corporation (Section 307B(2)(a) and (b)). This sets a standard that is more stringent than is commercially realistic. Many officers are not in a position to know whether a given piece of information is "inside" information, and in particular whether it is price-sensitive. It is an established and accepted reality and fact that only the board of directors of a listed issuer, which has the necessary overview of such issuer's overall affairs, is able to make an informed assessment of these matters. The obligation to disclose as soon as reasonably practicable should therefore be triggered once the information comes, or "ought reasonably to have come", to the knowledge (the latter type of knowledge being referred to here as "constructive knowledge") of a director, and not any officer of that corporation. The concept of "constructive knowledge" requires elaboration. Our proposal is to amend Section 307B(2) to provide that if knowledge would have existed, had all reasonable measures been taken by the listed issuer to ensure proper safeguards were in place to prevent breach of the disclosure obligation, then knowledge will be deemed to exist. The threat of individual liability for directors if the non-disclosure is due to their fault or delay in the information filtering through to those charged with the relevant responsibility will provide a further impetus to ensure that proper systems are in place to bring any information which might be inside information to their attention. Section 307B(2) should therefore be amended such that the actual or constructive knowledge of any "director" (not "officer") is made the central pillar for triggering this new statutory obligation. This formulation gives due recognition to commercial reality, and the well accepted practice.

2. While the Government has (correctly) recognised that the decision whether to disclose involves difficult questions of assessment, the drafting of the Bill does not currently accommodate this factor. Under Section 307B(2)(b), the disclosure obligation would be triggered if "a reasonable person acting as an officer of the corporation would consider that the information is inside information". There are two problems with this formulation. The first is that, as noted above, the current drafting of the Bill does not reflect the commercial reality that it is only the board of directors which takes, and is best placed to take, disclosure decisions, not individual officers. The second is that different individuals or boards of directors might, acting reasonably, reach different views as to whether a given piece of information is "inside information", such is the difficult, and to a large extent subjective, nature of the assessment. This Section should therefore be amended such that a corporation will not be treated as having knowledge of any piece of information (and will consequently be under no obligation to disclose) if the board of directors of the listed corporation had (or would have had, if

the information had come to its knowledge) reasonable grounds to determine, having regard to all relevant and prevailing facts and circumstances, that the information is not inside information. This strikes the right balance between the obligation to disclose, and the fact that issuers should be left with a degree of discretion exercised in a reasoned and considered manner in assessing whether a given piece of information constitutes "inside information".

3. Section 307G(1) seeks to impose a separate obligation on "every officer" of each listed issuer to take all reasonable measures to ensure that proper safeguards exist to prevent breach of such issuer's disclosure obligation. There is no need, or reasonable justification, for the creation of such a highly unusual separate obligation. This would enable the SFC to open an investigation to establish whether a listed corporation had adequate compliance safeguards in place, even if there was no suggestion or evidence that it had failed to comply with its disclosure obligation. This is a particular concern, given the low threshold for opening an investigation: all the SFC would need to have is a reasonable suspicion that a breach of Section 307(G)(1) may have occurred. To give an enforcement authority independent legislative power to check whether a company was implementing adequate safeguards to complying with a separate statutory duty, when there is no reasonable cause to suspect a breach of that duty, is excessive, overly intrusive and disproportionate. This sub-section should therefore be deleted. The disclosure obligation itself, together with the potentially severe sanctions for failure to disclose, the constructive knowledge attributed to the listed corporation if adequate safeguards are not put in place (as suggested in (1) above), and the individual liability of directors (and others) where they are at fault (see (4) below), will provide sufficient impetus for listed issuers to ensure proper compliance safeguards are in place. Moreover, even if all these factors were not sufficient to ensure the listed corporation has in place adequate compliance safeguards (which is highly unlikely) and a breach of the disclosure obligation results, the Government is proposing that the Tribunal can impose orders requiring companies to submit to independent reviews of their compliance systems, and directors and others to undergo compliance training (Section 307N(1)(h) and (i)). This is further evidence that the separate statutory obligation in Section 307G(1) is entirely unnecessary.

4. Individual liability for breach of a corporation's disclosure requirement under Section 307G(2) should not be attributed to any "officer" (which according to Part 1 Schedule 1 of the SFO means a director, manager or secretary of, or any other person involved in the management of, the corporation) but be restricted to directors and chief executives, and to persons "who, under the immediate authority of the board, are charged with management responsibility affecting the whole of the corporation or a substantial part

of the corporation". This proposed concept is consistent with the principle accepted by SFC in its latest draft guidelines[1], namely that in considering whether a person is a "manager" the person's actual responsibilities are more important than the person's formal title. Where, as in this case, personal liability (with potentially severe sanctions) is sought to be fastened to persons whose intentional, reckless or negligent conduct (which can specifically be clarified to include the failure to implement all reasonable measures to ensure that proper safeguards exist to prevent the breach) has resulted in the corporation's breach of the disclosure requirement, a clearer delineation (in this case by reference to the person's level of work and reporting responsibility) will offer a reasonable and balanced alternative to the potentially opened ended (and therefore administratively and practically ill-defined) class of "managers" or "officers" to whom this current Bill provision may extend.

Further Suggestions and Comments

The decision of whether or not to disclose information often involves difficult questions of judgment. It would therefore be useful if the SFC would in its guidelines give more specific guidance on issues such as when the price change would be considered material, the degree of change in profit/loss from the previous accounting period which would require disclosure, and the amount of litigation claim which would be considered material enough to require disclosure.

The use of threshold would be particularly helpful. For example, we understand that in Shanghai, the change in profit of 50% of more from the previous accounting period would require disclosure, and litigation claim would be considered material if the amount in dispute was 10 million RMB or more. Similar thresholds in the SFC guidelines would be helpful to the market.

In addition, we would like to point out a potential danger that under the new PSI regime, any breach of any disclosure requirement under the Listing Rules may be subject to both the Listing Rules regime and also the statutory PSI regime. Practically, any breach of any disclosure requirement under the Listing Rules, for example, a failure to disclose a material connected transaction under chapter 14A, will likely be price sensitive and hence subject to the PSI regime. If so, the PSI codification has far wider coverage that Chapter 13.09 (1) (a) and (c) of the Listing Rules than it was intended. Therefore, it is suggested that other disclosure requirement other than Chapter 13.09 (1) (a) and (c) of the Listing Rules be carved out from the definition of inside information such that inside information should exclude all information that is required to be disclosed under the Listing Rules.

[1] Para 52.

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Above are the views of the Chamber on the Securities and Futures (Amendment) Bill 2011. We hope the Bills Committee would give our views and suggested changes to the relevant Bill provisions its due consideration.

Yours sincerely
For and on behalf of
The Chamber of Hong Kong Listed Companies

Mike Wong
Chief Executive Officer

Suggested Changes to the Relevant Provisions of the Securities and Futures (Amendment) Bill 2011

Division 2

Disclosure of Inside Information

307B. Requirement for listed corporations to disclose inside information

(1) A listed corporation must, as soon as reasonably practicable after any inside information has come to its knowledge, disclose the information to the public.

(2) For the purposes of subsection (1), inside information has come to the knowledge of a listed corporation if—

(a) information has~~, or ought reasonably to have,~~ come to the knowledge of ~~an officer of the corporation in the course of performing functions as an officer~~a director; or

(b) information ought reasonably to have come to the knowledge of a director if all reasonable measures had been taken to ensure that proper safeguards exist to prevent breach of a disclosure requirement in relation to the corporation

unless the board of directors of the corporation~~; and~~

~~(b) a reasonable person, acting as an officer of the corporation,~~ had, or would ~~consider~~have had (if the information had come to its knowledge), reasonable grounds to determine, having regard to all relevant and prevailing facts and circumstances, that the information is not inside information in relation to the corporation.

(3) Without limiting subsection (1), a listed corporation fails to disclose the inside information required under that subsection if—

(a) the information disclosed is false or misleading as to a material fact, or is false or misleading through the omission of a material fact; and

(b) an officer of the corporation knows or ought reasonably to have known that, or is reckless or negligent as to whether, the information disclosed is false or misleading as to a material fact, or is false or misleading through the omission of a material fact.

(4) This section is subject to sections 307C, 307D, 307E and 307F.

307G. Duty of ~~officers~~directors of listed corporations

~~(1) Every officer of a listed corporation must take all reasonable measures from time to time to ensure that proper safeguards exist to prevent a breach of a disclosure requirement in relation to the corporation.~~

~~(2)~~

If a listed corporation is in breach of a disclosure requirement, ~~an officer~~a director or chief executive of the corporation, or a person who, under the immediate authority of the board, is charged with management responsibility affecting the whole or a substantial part of the corporation—

~~(a)~~, whose intentional, reckless or negligent conduct (including, where applicable, failure to implement all reasonable measures from time to time to ensure that proper safeguards exist to prevent the breach) has resulted in the breach; ~~or~~

~~(b) who has not taken all reasonable measures from time to time to ensure that proper safeguards exist to prevent the breach.~~

———, is also in breach of the disclosure requirement.