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By post & By Email: yhcheung@legco.gov.hk

Mr. Noel Sung
Clerk to Bills Committee on Securities and Futures (Amendment) Bill 2011
Legislative Council
Legislative Council Complex
1 Legislative Council Road
Central
Hong Kong

Dear Mr. Sung

Bills Committee on Securities and Futures (Amendment) Bill 2011

Thank you for your letter of 25 July 2011.

Please find enclosed our comments on the captioned Bill. Should you require any further information, please feel free to contact our Manager, Ms. Heidi Hung at 2521-1169.

Regards

Eva Wong
Secretary

Enc.

Chairman Bank of China (Hong Kong) Ltd
Vice Chairmen The Hongkong and Shanghai Banking Corporation Ltd
Standard Chartered Bank (Hong Kong) Ltd
Secretary Eva Wong Mei Seong

主席 中國銀行（香港）有限公司
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渣打銀行（香港）有限公司
秘書 黃美嫦

Bills Committee

Securities and Futures (Amendment) Bill

Submission of Hong Kong Association of Banks

6 October 2011

Introduction

This paper sets out the views of The Hong Kong Association of Banks (“**HKAB**”) in relation to the proposed amendments to the Securities and Futures Ordinance (Cap. 571 of the Laws of Hong Kong) (“**SFO**”), in relation to the regulation of listed corporations to disclose inside information to the public.

We have examined the changes proposed in the Securities and Futures (Amendment) Bill 2011 (“**Bill**”) with the assistance of Mallesons Stephen Jaques, and we have identified the areas of concern that we wish to raise with the Bills Committee. These are set out in the “**HKAB’s response**” section of this written submission.

We would be pleased to engage in further discussions with the Bills Committee in relation to the proposed changes and to provide further industry input where necessary.

Executive summary

HKAB and its members fully understand the policy rationale behind the introduction of the Bill and the regulatory objective of codifying certain requirements to disclose price sensitive (“**inside**”) information.

In summary, HKAB:

- 1 supports the objective test set out in the Bill for determining “**inside information**” and the requirement to make a disclosure “*as soon as reasonably practicable*” (not immediately);
- 2 is concerned that the term “**officer**” has been used in Part XIVA of the Bill, without any reference to seniority;
- 3 asks that the Bill specifically empower the SFC to specify additional means of disclosure, to provide flexibility when publication of inside information “**through an electronic publication system operated by a recognized exchange company for disseminating information to the public**” is not possible;
- 4 suggests that the Bill empower the Securities and Futures Commission (“**SFC**”) to grant expedient one-off waivers from the disclosure requirements where the public interest requires and the other circumstances set out in section 307F cannot be relied upon;
- 5 welcomes clarifications from the SFC and the Financial Services and the Treasury Bureau (“**FSTB**”) that the standard of care for determining liability should not be determined with the benefit of hindsight, but suggests that this should be confirmed in non-statutory guidelines;
- 6 supports the inclusion of sections 307N(h) and (i) of the Bill, to assist listed corporations and their officers prevent a breach of their statutory disclosure requirements. However, we

suggest that the Hong Kong Monetary Authority (“**HKMA**”) be consulted in relation to any action proposed to be taken in relation to “authorized financial institutions”;¹

- 7 believes that the proposal (in section 307I of the Bill) for the SFC to have direct access to the Market Misconduct Tribunal to institute proceedings for breaches of the statutory disclosure requirements is unnecessary and inappropriate in the context of the SFO as a whole; and
- 8 takes this opportunity to make an ancillary suggestion that is particularly relevant to HKAB’s members. We suggest that the Administration consider explicitly subordinating the claims of aggrieved shareholders of an insolvent listed corporation (for example, arising from a failure to disclose inside information, or from the provision of false or misleading information) to the claims of other creditors, to clarify the Hong Kong legal position on this issue.

Structure of our response

Our comments are grouped into the following thematic categories:

- Part A** - The disclosure obligation
- Part B** - Safe harbours
- Part C** - Duties and liabilities
- Part D** - Ancillary suggestion

HKAB would be pleased to elaborate on any of these matters to the Bills Committee if required.

¹ As defined in Part 1 of Schedule 1, SFO.

HKAB's response

HKAB understands the policy rationale behind the introduction of the Bill and the regulatory objective of codifying certain requirements to disclose price sensitive information in order to cultivate a continuous disclosure culture among listed corporations.

In connection with these legislative proposals, we have identified the following areas of concern that we wish to raise with the Bills Committee.

Part A - The disclosure obligation

1 Definition of inside information and timing of disclosure

1.1 HKAB welcomes and supports the revision and clarification in the Bill of:

- (a) an objective test of "*a reasonable person*" as the appropriate test for determining "inside information" (in section 307B(2)); and
- (b) the requirement to disclose "as soon as *reasonably* practicable" (in section 307B(1)).

1.2 These revisions give listed corporations greater certainty and discretion to make well-considered disclosures, after conducting sufficient verification of, and clarifying, relevant facts.

2 Scope of "officer"

2.1 HKAB is concerned that the term "officer" has been used in Part XIVA of the Bill, without any reference to seniority.

2.2 The term "officer" is defined in Part 1 of Schedule 1 to the SFO as:

"in relation to a corporation... a director, manager or secretary of, or any other person involved in the management of, the corporation..."

This means that a range of management staff, irrespective of their level or rank, will be caught by the Bill. We suggest that this is inappropriate.

2.3 HKAB notes that the FSTB² and the SFC³ both clarified in their respective consultation conclusion papers that the statutory disclosure provisions are intended only to catch directors and high-ranking individuals, and not middle management or junior ranked staff. Both the FSTB and the SFC indicated that the SFC guidelines would be updated to reflect this.

² FSTB, Consultation Conclusions on the Proposed Statutory Codification of Certain Requirements to Disclose Price Sensitive Information by Listed Corporations dated 11 February 2011.

³ SFC, Consultation Conclusions on the Draft Guidelines on Disclosure of Inside Information dated February 2011.

- 2.4 HKAB expressed its significant concern in the FSTB consultation,⁴ and now reiterates its concern to the Bills Committee, that the Bill is drafted too broadly. In particular, we believe it should not apply to a middle or junior ranked manager because these members of staff may not have the skills or knowledge to assess whether an event is discloseable, nor the power to make the decision to disclose.
- 2.5 We also suggest that it will not be possible simply to interpret the term “officer” more narrowly in non-statutory guidelines issued by the SFC. This is because that term is used throughout the SFO and does not lend itself well to interpretation for the purposes of Part XIVA alone.
- 2.6 Accordingly, we ask that the term “officer” be defined specifically for the purposes of Part XIVA of the Bill (in section 307A), precisely stating the persons caught. Similar to the approach taken in the United Kingdom,⁵ we suggest a definition to the following effect:

““officer” (高級人員), in relation to a listed corporation, means (a) a director of the corporation; or (b) a senior manager of the corporation who (i) has regular access to inside information relating, directly or indirectly, to the corporation; and (ii) has the power to make managerial decisions affecting the future development and business prospects of that corporation.”

- 2.7 HKAB suggests that this approach would fairly attribute liability to those who have access to relevant information and should take responsibility for disclosure.

3 Dissemination of information

- 3.1 HKAB is concerned that section 307C of the Bill does not give listed corporations sufficient guidance as how inside information should be disclosed.
- 3.2 For example, HKAB expressed its concern, in response to the FSTB’s consultation,⁶ that the Bill does not specify what action should be taken where disclosure “through an electronic publication system operated by a recognized exchange company for disseminating information to the public” is not possible.
- 3.3 While we appreciate that section 307C is non-exhaustive (that is, subsection (2) makes clear that the manner of disclosure is not limited), it sets the benchmark for appropriate disclosure.
- 3.4 It is possible that publication of inside information through a recognized exchange company is impossible in certain circumstances. This could arise as a result of system / internet delays or disruptions.
- 3.5 By way of example, disruptions occurred to the website of Hong Kong Exchanges and Clearing Limited (“HKEx”), as a result of the ‘hacking’ of that website, on 10 August 2011. We understand that this resulted in the HKEx website becoming unstable and unavailable between the hours of 11:00am and 8:00pm and certain securities and related structured products (including seven equity securities of listed issuers) being suspended.

⁴ Question 1(b), Submission of the Hong Kong Association of Banks to the FSTB Consultation Paper for the Proposed Statutory Codification of Certain Requirements to Disclose Price Sensitive Information by Listed Corporations, 9 July 2010 (“HKAB FTSB Submission”).

⁵ Section 96A and 96B, *Financial Services and Markets Act 2000* (United Kingdom).

⁶ Question 1 (c), HKAB FSTB Submission.

- 3.6 Under Rule 2.07C(6)(a) of the Rules Governing the Listing Securities of the Stock Exchange of Hong Kong Ltd (“**Listing Rules**”), a listed issuer is required to publish on its own website any announcement that it has submitted to the HKEx, which includes price sensitive information announcements pursuant to Chapter 13 of the Listing Rules. Publication must take place at the same time as submission to HKEx.
- 3.7 HKAB therefore suggests that publication on the listed corporation’s own website is an appropriate alternative means for making disclosure, where publication through the website of a relevant exchange company is not possible.⁷
- 3.8 To minimise drafting changes to the Bill, and allow appropriate standards to be applied to any such alternative means, we suggest this could be addressed by empowering the SFC to specify additional means of disclosure. For example, section 307C(2) could be amended as follows:

“Without limiting the manner of disclosure permitted under subsection (1), a listed corporation complies with that subsection if it has disseminated the inside information required to be disclosed under section 307B through an electronic publication system operated by a recognized exchange company for disseminating information to the public or in another manner approved by the Commission.”

Part B - Safe harbours

4 Waivers

- 4.1 HKAB is concerned that the circumstances (under section 307E) in which the SFC may grant a waiver are too narrow.
- 4.2 HKAB appreciates the FSTB’s concern in its consultation conclusions⁸ that an extension of the SFC’s power to grant waivers in “any circumstance” may make the waiver arrangements in section 307E of the Bill susceptible to abuse.
- 4.3 However, HKAB reiterates its own concern to the Bills Committee that in practice, situations might arise where the obligation to disclose inside information should be waived on a one-off basis, even where the circumstances set out in paragraphs (1)(a) to (d) of section 307E do not apply.
- 4.4 The reason that we ask is that section 307E is specifically attuned to preventing a contravention of foreign laws, regulations and court orders. For example, it allows the SFC to grant a waiver if it is satisfied that disclosure is prohibited under the legislation of a place outside Hong Kong.
- 4.5 We suggest that this is insufficient to respond to rapidly developing situations that pose difficult and novel challenges. Section 307F (which gives the SFC power to make rules containing exemptions from disclosure) do not address this problem because rule-making involves administratively cumbersome procedures.
- 4.6 The lessons learned from the 2008 global financial crisis suggest that regulators need sufficient flexibility to address those challenges quickly and appropriately. For example, if the SFC considers that a particular disclosure would be materially prejudicial to market stability and Hong Kong investors, it must be in a position to act swiftly.

⁷ We note however that not every listed issuer necessarily may have its own dedicated website.

⁸ Paragraph 48, FSTB consultation conclusions.

4.7 We therefore suggest that section 307E of the Bill include an additional paragraph that allows a waiver to be granted by the SFC from the requirements of section 307B:

- (a) on the application of a listed corporation and subject to such conditions as the Commission may choose to impose (as currently set out in section 307E of the Bill); and
- (b) subject to the public interest test (as currently imposed under section 307F).

We suggest this could be drafted as follows:

“In addition to the circumstances set out in subsection (1), the Commission may, on an application by a listed corporation, grant a waiver in relation to the disclosure of any inside information required to be disclosed under section 307B if the Commission considers it is in the public interest to do so.”

4.8 HKAB also reiterates the concern it expressed to the FSTB⁹ that section 307E of the Bill empowers the SFC to provide a permanent waiver from the requirements of section 307B, whereas sections 307D(1) and (2) provide only a temporary (albeit indefinite) exemption from those requirements. For the avoidance of doubt, HKAB asks that section 307E reflect the reasoning of the “if and so long” language of sections 307D(1) and (2) and we suggest a further additional paragraph, which could be drafted as follows:

“For the avoidance of doubt, the Commission may revoke a waiver granted under subsection (1) if any of the circumstances in subsections (a) to (d) cease to exist.”

4.9 We suggest that this could also apply to the circumstances set out in section 307E, and in relation to the further circumstances proposed in paragraph 4.7.

5 Additional safe harbours in the legislation

5.1 HKAB welcomes the clarification by the FSTB¹⁰ and SFC¹¹ in their respective consultation conclusion papers that information that comprises “matters of supposition” will fall outside of the scope of “inside information” until such time that these matters become definite and/or specific.

5.2 We suggest that this clarification be formalised in non-statutory guidance to ensure it is sufficiently understood by the industry.

Part C - Duties and liabilities

6 Liability of listed corporations and “officers”

6.1 HKAB welcomes the clarification by the FSTB in its consultation conclusion paper¹² that the standard for determining liability under section 307B should not be determined with the benefit of hindsight. We also appreciate that sections 307B(2)(a) and (b) refer to a standard of reasonableness.

⁹ Question 2(b), HKAB FSTB response.

¹⁰ Paragraph 56, FSTB consultation conclusions.

¹¹ Paragraph 63, SFC consultation conclusions.

¹² Paragraph 71, FSTB consultation conclusions.

6.2 However, we ask that non-statutory guidelines formalise the FSTB's clarification and make clear that the standard takes into account relevant surrounding circumstances at the time when information came into existence or to the knowledge of a particular person.

7 Sanctions - prevention of breach

7.1 HKAB supports the insertion of the additional sanctions contained in sections 307N(h) and (i), which gives the Market Misconduct Tribunal power to make such order as is necessary to ensure that a listed corporation takes appropriate action to prevent itself, or its officers, committing a similar breach of the disclosure requirements.

7.2 We note that this power requires the approval of the SFC in relation to certain actions (such as appointing an advisor to the listed corporation).

7.3 However, we suggest that the Bills Committee also consider including a requirement that the Market Misconduct Tribunal consult the HKMA in relation to any action proposed to be taken in relation to a listed corporation that is an "authorized financial institution".¹³ The reason is that the HKMA is the primary regulator of such listed corporations and itself has expansive powers under section 52 of the Banking Ordinance (Cap. 155 of the Laws of Hong Kong).

8 SFC direct access to the Market Misconduct Tribunal to institute proceedings

8.1 HKAB suggests that section 307I is unnecessary and inappropriate.

8.2 In this respect, HKAB reiterates its comment in response to the FSTB consultation¹⁴ that it does not see a clear case for changing the current system to allow the SFC to have direct access to the Market Misconduct Tribunal to institute proceedings for breaches of the statutory disclosure requirements.

8.3 HKAB considers the current system, whereby the Financial Secretary acts as the 'filter' for instituting proceedings in the Market Misconduct Tribunal under section 252 of the SFO, is appropriate under the new regime.

8.4 We suggest this will enhance the perception of due process and fairness, given the SFC's role as investigator in such proceedings. We also believe that the SFC already has sufficiently wide powers under the SFO, and that further expansion is inappropriate.

Part D - Ancillary suggestion

9 Subordination of shareholder claims - statutory clarification

9.1 As an ancillary matter, HKAB takes this opportunity to suggest that the Administration consider making legislative changes that explicitly subordinate the claims of aggrieved shareholders of an insolvent listed corporation to the claims of other creditors.

9.2 This step has been taken in the United States and Australia, and has also been considered in a number of other jurisdictions.

9.3 Although it is not a novel issue, this is relevant to this consultation because the Bill specifies the type of information that a listed corporation must provide to the market to enable people to make informed decisions about buying and selling securities, thereby enhancing the current

¹³ Part 1 of Schedule 1, SFO.

¹⁴ Question 3(c), HKAB FSTB submission.

legislative standards for providing information about securities. A person could argue, for example, that they purchased listed shares on the faith of information that was provided (but was misleading or inaccurate), or without the benefit of inside information that should have been provided by the listed corporation pursuant to Part XIVA of the Bill.

- 9.4 This issue was recently brought into the spotlight in an Australian case,¹⁵ in which the High Court of Australia held that shareholders who had been misled into purchasing their shares would be treated equally with ordinary creditors upon the company's insolvency.
- 9.5 The practical consequences of this interpretation are that:
- (a) the insolvency process could be significantly more cumbersome, because of the need to adjudicate shareholder claims and the possibility of class actions; and
 - (b) the amount owing to creditors could be substantially diluted.
- 9.6 In light of these significant challenges, the Australian Government amended the *Corporations Act 2001* (Cth) to clarify that creditors' claims take priority over claims arising by virtue of a person's shareholding, or as a result of buying, holding, selling or otherwise dealing in the company's shares.¹⁶ This effectively reversed the decision of the High Court of Australia and provided a vital clarification for the market.
- 9.7 It is not clear whether a Hong Kong court would take the same approach. However, we suggest that certainty is important for the Hong Kong financial services industry and that it would be preferable not to wait until the matter is tested in the Hong Kong courts. From HKAB's perspective, the clarification is particularly relevant because:
- (a) its members frequently provide finance to listed corporations; and
 - (b) if a Hong Kong court were to adopt an approach similar to the one taken by the High Court of Australia, HKAB members would need to factor into their credit assessments (and arguably their ongoing capital assessments) the possibility of ranking equally with not only a borrower's creditors, but also to a potentially very large body of shareholders.
- 9.8 We therefore take this opportunity to ask the Administration to clarify the position in Hong Kong as soon as reasonably possible. HKAB would be pleased to discuss this matter further and render any assistance necessary.

¹⁵ *Sons of Gwalia Ltd v Margaretic; ING Investment Management v Margaretic* (2007) 232 ALR 232.

¹⁶ Pursuant to the *Corporations Amendment (Sons of Gwalia) Act 2010* (Cth), which applies to shareholder claims arising after 18 December 2010.