Bills Committee on Securities and Futures (Amendment) Bill 2011

Proposed scope of persons covered and liability of "officers" under the PSI regulatory regime

Purpose

This paper provides information in response to the following issues raised by Members and deputations at previous meetings of the Bills Committee –

(a) the proposed scope of persons covered under the price sensitive information ("PSI") regulatory regime and the rationale behind;

(b) liability of an "officer", and whether defence would be available to the "officer" if he/she actually does not have knowledge of the information; and

(c) comparison of the proposals in the Bill and the relevant legislation in comparable jurisdictions in respect of (a) and (b) above.

Scope of "Officers"

2. According to Part 1, Schedule 1 to the Securities and Futures Ordinance ("SFO"), the term "officer" in relation to a corporation, means "a director, manager or secretary of, or any other person involved in the management of, the corporation". Paragraph 52 of the draft guidelines of the SFC also supplements that a 'manager' 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.".

3. Under the present Market Misconduct regime, section 279 of the SFO has already imposed an obligation on "officers" to take all reasonable measures from time to time to ensure that 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 notion of "officers" is therefore familiar to the market. Insofar as disclosure of PSI is concerned, "officers", being persons charged with management responsibility affecting the whole of the corporation or a substantial part of the corporation, play a key role in handling PSI.

4. Some deputations suggested replacing the concept of "officer" by phrases such as "a director, or a senior manager directly responsible for supervision of the management of, the corporation"; or "(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". We are of the view that in practice, these alternative formulations cover similar group of persons as that under the existing definition of "officer".

5. One deputation suggested to include only executive directors. We do not agree with this suggestion. If only directors are covered in the statutory PSI disclosure regime (i.e. to replace all reference to "officer" by "director"), what might happen is that even if the directors have taken all reasonable measures from time to time to ensure that proper safeguards exist to prevent a breach of the disclosure requirement (e.g. by creating an internal control and reporting system to promptly identify and channel PSI upwards to the directors), the directors might still not know the PSI if senior personnel charged with management responsibility affecting the whole of the corporation or a substantial part of the corporation do not inform the directors of the PSI.

6. In such circumstances, it is unlikely that the disclosure requirement could be triggered and such other persons charged with management responsibility affecting the whole of the corporation or a substantial part of the corporation would not be subject to any liability as

they are not covered under the proposed regulatory regime. This would not be beneficial to the investors and pose a challenge to the effective implementation of the PSI disclosure requirements. It should also be noted that under Hong Kong law, there is no distinction between the duties and responsibilities of executive and non-executive directors.

7. As shown in Annex, our approach is similar to that of Australia.

Duty of "Officers" and related issues

8. Under section 307G(1) of the proposed PSI regulatory regime, "officers" have the responsibility of taking all reasonable measures from time to time to ensure that proper safeguards exist to prevent a breach of the disclosure requirement. As mentioned in paragraph 3 above, the persons who are now subject to section 279 of the SFO would also be subject to the duties under the new section 307G(1). This provision aims at fostering a continuous disclosure culture in corporations through the establishment of appropriate procedures and systems to identify and disclose PSI (see also paragraph 15 below).

9. The concept "ought reasonably to have come to knowledge" under section 307B(2) is an element that trigger the disclosure obligation for a listed corporation. It does not by itself result in a liability on "officers". It should be considered in the light of an "officer"'s duty under common law to exercise reasonable care in the discharge of his duties owed to a company.

10. Some deputations suggested adding a safe harbour to cover situation where a corporation has set up internal control procedures and concluded that certain information is not PSI out of good faith. It should be noted that, under section 307B(2)(b), there is an objective test of "reasonable person, acting as an 'officer' of the corporation" in determining whether a particular piece of information is PSI hence needs to be disclosed. Setting a safe habour of "good faith" would induce subjectivity that does not sit comfortably with the objective test.

11. We understand that no other comparable major markets adopt the standard of "good faith".

Practices in comparable jurisdictions

12. The table at Annex sets out the relevant provisions relating to the triggering of PSI disclosure requirement, and the circumstances under which a person would be liable.

13. On the circumstances that would trigger the PSI disclosure requirement, the proposed regime in the Bill is similar to the arrangement in Australia, wherein a listed corporation would become aware of the PSI if a director or executive officer (a person taking part in the management of the company) has, or ought reasonably to have come into possession of the information in the course of the performance of their duties as a director or executive officer of that corporation. The regime in the United Kingdom provides that an issuer must disclose any inside information which directly concerns the issuer as soon as possible, and the regime in Singapore requires an issuer to disclose any inside information it knows. In both regimes, when a piece of inside information would be regarded as known to the listed corporation would depend on the actual circumstances of each case. We consider that the proposed regime in the Bill, with express provision, provides more clarity and certainty, hence facilitate compliance.

14. Both the United Kingdom and Australia also adopt an objective test in determining what information should be disclosed. The United Kingdom uses the concept of a "reasonable investor", while Australia uses a "reasonable person". As regards liability of "officers", the proposed regime under the Bill is similar to the regimes in Australia and Singapore. As for the United Kingdom, if a corporation is in breach, a person who was at the material time a director of the corporation and knowingly concerned in the contravention will also be held liable. In this regard, we note that the Financial Services Authority of the United Kingdom may impose unlimited fine on a corporation or the director(s) knowingly concerned in the contravention of such amount as it considers appropriate.

Practical steps

15. The Bill aims at fostering a culture of continuous disclosure in listed corporations and enhancing investor protection. The following are some practical steps that officers of a listed corporation could take to ensure proper safeguards exist to prevent the corporation from breaching the disclosure obligations –

(a) Establish systems for monitoring business and corporate developments and events so that any potential inside information is promptly identified and escalated.

(b) Establish periodic financial reporting procedures so that key financial and operating data is identified and escalated in a structured and timely manner.

(c) Maintain and regularly review a sensitivity list identifying factors or developments which are likely to give rise to the emergence of inside information.

(d) Appoint a committee comprising officers and other executives to assess and decide whether the information concerned constitutes inside information.

(e) Maintain an audit trail of meetings and discussions concerning the assessment of inside information.

(f) Provide regular training to employees to help them understand the corporation's policies and procedures as well as their relevant disclosure duties and obligations.

(g) Document the disclosure policies and procedures of the corporation in writing and keep the documentation up to date.

Financial Services and the Treasury Bureau
Securities and Futures Commission

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Annex

Regulation of Disclosure of Price Sensitive Information
Comparison of the proposals in the Bill and relevant legislation in comparable jurisdictions

Hong Kong (Proposed)	United Kingdom	Australia	Singapore
(a) When would an obligation be triggered			
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 of the corporation; and b) a reasonable person, acting as an officer of the corporation, would consider that the information is inside information in relation the corporation.	An issuer must disclose any inside information which directly concerns the issuer as soon as possible.	An entity becomes aware of information if a director or executive officer has, or ought reasonably to have, come into possession of the information in the course of the performance of their duties as a director or executive officer of that entity. An executive officer is a person concerned in, or taking part in, the management of the entity.	Issuers are required to announce any information known to the issuer concerning it or any of its subsidiaries or associated companies which is either necessary to avoid the establishment of a false market or would be likely to materially affect the price or value of its securities.
(b) Who would be liable and under what circumstances would they be liable			
A corporation will be held liable for a breach. If a corporation is in breach of a disclosure requirement, an officer of the corporation – a) whose intentional, reckless or negligent conduct 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. An officer is a director, manager or secretary of, or any other person involved in the	A corporation will be held liable for a breach. If a corporation is in breach, a person who was at the material time a director of the corporation and knowingly concerned in the contravention will be held liable.	A corporation will be held liable for a breach. A person who is involved in a listing disclosing entity's contravention of the disclosure obligation contravenes the obligation. However, a person will not contravene the obligation if the person proves that it: a) took all steps (if any) that were reasonable in the circumstances to ensure that the listed disclosing entity complied with its obligations; and b) after doing so, believed on reasonable grounds that the listed	A corporation who intentionally, recklessly or negligently fails to disclose the information contravenes the provision. If the contravention is committed with the consent or connivance of, or attributable to any neglect on the part of, an officer of the corporation, the officer will be guilty of the contravention as well. An officer includes any director, secretary or a person employed in an executive capacity by the corporation.

Hong Kong (Proposed)	United Kingdom	Australia	Singapore
management of, the corporation. A manager refers to a person who, under the immediate authority of the board, is charged with management responsibility affecting the whole of the corporation or a substantial part of the corporation.		disclosing entity was complying with its obligations.	
(c) Sanctions			
The MMT may impose the following orders: a) disqualification orders; b) cold shoulder orders; c) cease and desist orders, d) regulatory fine of up to $8 million on the corporation, its chief executive or directors; e) recommended orders for discipline; f) payment of costs; g) appointment of professional advisers to review internal controls or advise on compliance matters; h) training orders.	The FSA may impose a penalty on a corporation or any person who was the director and knowingly concerned in the contravention a penalty of such amount as it considers appropriate. The FSA may publish a statement censuring the corporation or the director concerned instead of imposing a penalty on them.	Criminal orders a) A maximum penalty of 200 penalty units for an individual or 1,000 penalty units for a corporation (each penalty unit means $110) and/or b) An imprisonment for 5 years. Civil penalty orders a) $200,000 for an individual; or b) $1 million for a corporation. Infringement notice a) $100,000 if the disclosing entity is a Tier 1 entity; or b) $66,000 if the disclosing entity is a Tier 2 entity; or c) $33,000 if the disclosing entity is a Tier 3 entity. Note: The tier of a disclosing entity is determined by reference to that entity's market capitalisation on the relevant day.	Criminal orders a) A fine not exceeding $250,000 for an individual or $500,000 for a corporation and/or b) An imprisonment for a term not exceeding 7 years. Civil penalty orders a) a civil penalty of a sum not less than $50,000 and not more than $2 million.

Hong Kong (Proposed)	United Kingdom	Australia	Singapore
(d) What are the safe harbours			
No disclosure is required on information which is prohibited by law in Hong Kong. Subject to the preservation of confidentiality, no disclosure is required on the following: a) the information concerns an incomplete proposal or negotiation; b) the information is a trade secret; c) the information concerns the provision of liquidity support from the Exchange Fund; or d) the disclosure is waived by the Commission.	An issuer may, under its own responsibility, delay the public disclosure of inside information, such as not to prejudice its legitimate interests provided that: a) such omission would not be likely to mislead the public; b) any person receiving the information owes the issuer a duty of confidentiality, regardless of whether such duty is based on law, regulations, articles of association or contract; and c) the issuer is able to ensure the confidentiality of that information. An issuer may have a legitimate interest to delay disclosing inside information concerning the provision of liquidity support by the Bank of England or by another central bank to it or to a member of the same group as the issuer.	No disclosure is required while all of the following are satisfied. a) A reasonable person would not expect the information to be disclosed. b) The information is confidential and ASX has not formed the view that the information has ceased to be confidential. c) One or more of the following applies. i. It would be a breach of law to disclose the information. ii. The information concerns an incomplete proposal or negotiation. iii. The information comprises matters of supposition or is insufficiently definite to warrant disclosure. iv. The information is generated for the internal management purposes of the entity. v. The information is a trade secret.	No disclosure is required on information which it would be a breach of law to disclose. No disclosure is required while each of the following conditions applies. a) A reasonable person would not expect the information to be disclosed; b) The information is confidential; and c) One or more of the following applies: i. the information concerns an incomplete proposal or negotiation; ii. the information comprises matters of supposition or is insufficiently definite to warrant disclosure; iii. the information is generated for the internal management purposes of the entity; iv. the information is a trade secret.