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

Consultation Conclusions

A. BACKGROUND

1. On 29 March 2010, the Financial Services and the Treasury Bureau ("FSTB") launched a public consultation on proposed statutory codification of certain requirements to disclose price sensitive information ("PSI") by listed corporations. The objective is to cultivate a continuous disclosure culture among listed corporations.

2. The consultation paper sets out the proposed legislative framework as well as regulatory structure and related enforcement matters for the statutory regime. Annex 1 of the consultation paper provides indicative draft legislative provisions on the disclosure obligations, safe harbours and what would constitute a breach of the disclosure obligations, which are intended to be included in the Securities and Futures Ordinance ("SFO") (Cap. 571). In parallel with our consultation exercise, the Securities and Futures Commission ("SFC") conducted a separate consultation on its Draft Guidelines on Disclosure of Inside Information ("Draft Guidelines"). The SFC's consultation paper was attached at Annex 2 of FSTB's consultation paper. The SFC would separately issue its consultation conclusions on its Draft Guidelines.

B. OUTCOME OF CONSULTATION

3. We received a total of 110 written submissions[1], about half of which were from listed corporations, while the others were mainly from trade bodies of the financial services, accounting and legal

[1] The consultation period was originally set to end on 28 June 2010. But we have been receiving written submissions until late August 2010. In compiling these consultation conclusions, we have taken into account all submissions received.

sectors as well as investor/consumer groups. A list of respondents is at **Appendix I**.

4. We also conducted 8 briefings for organized groups, mostly trade and professional bodies, to introduce to them the legislative proposal and to listen to their views. These briefings were attended by a total of around 460 members of these organizations. A list of these briefings is at **Appendix II**.

GENERAL COMMENTS

5. The respondents generally supported the objective of the legislative proposal of cultivating a continuous disclosure culture among listed corporations. Certain professional bodies in the legal, accounting and financial fields, as well as consumer groups indicated general support to our proposed statutory regime. Noting that the lack of regulatory "teeth" in the Listing Rules has been an issue of public concern, supporters commented that reliance on non-statutory regulation raised doubt about enforcement effectiveness. A statutory regime could encourage compliance, enhance market transparency and provide better protection to investors. However, around 20% of the written submissions (mostly listed corporations, with a few trade bodies) did not support establishing a statutory regime. They opined that a statutory regime would lead to indiscriminatory disclosure of "half-baked" information and increase compliance cost.

6. We believe that a statutory regime is necessary to enhance market transparency and quality, to bring our regulatory regime for listed corporations more in line with those of overseas jurisdictions, and to sustain Hong Kong's position as China's global financial centre and a premier capital formation centre in the region.

7. To enhance clarity of the statutory disclosure requirements, we would refine the legislative provisions. In addition, the SFC would improve their Guidelines on Disclosure of Inside

Information. Appropriate safe harbours would be made available to safeguard the legitimate interests of listed corporations in preserving certain information in confidence to facilitate its operation and business development. Our aim is to put in place a statutory regime to promote effective compliance with, and allow effective enforcement of, the disclosure obligations, to be underpinned by adequate measures to protect the investing public against a breach of these statutory obligations. At the same time, we would ensure that no undue burden would be imposed on the listed corporations.

8. The consultation paper specifically sought the public's views on 12 questions relating to the main features of the proposed statutory regime. Apart from offering views on these 12 questions, many respondents provided detailed comments on the indicative draft legislative provisions set out in Annex 1 of the consultation paper. The following paragraphs set out the respondents' comments on these 12 questions and the indicative draft legislative provisions as well as the Administration's response.

THE DISCLOSURE OBLIGATION

Question 1(a): Do you agree with the proposal to adopt the existing definition of "relevant information" from the insider dealing regime under the SFO to define PSI?

Respondents' views

9. The respondents generally agreed with the adoption of the existing definition of "relevant information" (to be known as "inside information") to define PSI. Noting that the SFC would issue Guidelines on Disclosure of Inside Information, which would, among other things, summarize the key aspects of what had been viewed by the tribunals in Hong Kong as constituting "inside information", some respondents asked whether the Market Misconduct Tribunal ("MMT")'s future interpretation of "inside

information" in insider dealing cases would have an impact on the PSI regime. Other respondents suggested that the SFC provide more detailed guidelines on the interpretation of various elements of "inside information" – e.g. the interpretation of "likely to materially affect the price" within the definition of "inside information". A few respondents sought clarification as to whether "inside information" should be assessed from an objective or subjective perspective.

Our response

10. As suggested in the consultation document, we will adopt the existing concept of "inside information" in defining PSI in the statutory regime. The SFC intends to update its guidelines and provide additional guidance materials (e.g. in the form of frequently asked questions ("FAQs")), from time to time, to address comments and issues arising from the application of the statutory PSI disclosure requirements. The SFC's separate consultation conclusions would address the respondents' detailed comments on its Draft Guidelines.

11. To address the question of the appropriate test for determining "inside information", **we will specify in the legislative provisions that an objective test is to be applied in determining whether any particular piece of information is "inside information".**

<u>SFC to promulgate guidelines</u>

12. The consultation proposal includes the promulgation of detailed guidelines by the SFC to provide guidance on what constitutes inside information and when safe harbours would be applicable. There was a general consensus among the respondents on such promulgation of guidelines by the SFC.

Question 1(b): Do you agree that a listed corporation should be obliged to disclose to the public as soon as practicable any "inside information" that has come to its knowledge, and that it should be regarded to have knowledge of the inside information if a director or an officer has come into possession of that information in the course of the performance of his duties?

Timing of disclosure

Respondents' views

13. Many respondents provided detailed comments on the various components of the disclosure obligation set out in this question. First, on the disclosure timing of "as soon as practicable", while many respondents asked for more elaborate interpretation of the term "as soon as practicable", a number of respondents proposed revising it as "as soon as reasonably practicable" to allow time for listed corporations to verify all the facts and seek necessary advice, before making a decision on disclosure. A couple of respondents suggested that the timing be revised as "immediate", following the practice in Australia. One respondent asked about the need to synchronize disclosure of information in Hong Kong and other markets.

Our response

14. Our intention is that the timing of disclosure should cater for listed corporations' need to take time to verify the facts and seek professional advice as appropriate and reasonable in the circumstances of a particular case, and that the listed corporation should act reasonably in this regard. To make such intention more explicit, **we will revise "as soon as practicable" to "as soon as reasonably practicable" in the legislative provisions**. In addition, the SFC would expand its guidelines to specify that a listed corporation is allowed to take appropriate steps such as ascertaining details, conducting internal assessment and due diligence verification before making an announcement. It should

also be noted that PSI disclosure should be made as fast and as synchronized as possible between all markets on which the corporation is listed. In the event that timely disclosure in another market cannot be made due to its closure or any other reasons, the corporation should disclose the PSI in Hong Kong without delay and disclose the same in that other market as soon as the corporation is able to do so.

Scope of "officer"

Respondents' views

15. Most of the respondents providing comments on the disclosure obligation submitted that the definition of "officer" was too broad. They were concerned that the term would catch middle management or low ranking staff of the listed corporation. They proposed that the term should be replaced by "directors", "directors and chief executive officer ("CEO") ", "directors and senior management", "persons discharging managerial responsibilities", "persons in possession of key information of a corporation and participating in making major decisions". Some respondents proposed that a listed corporation should only be regarded as having knowledge of a piece of information when all or a majority of its executive directors have apprised of the information, or that the full board has been briefed about the information.

Our response

16. The term "officer" is already defined in Part 1 of Schedule 1 to the SFO – an "officer", in relation to a corporation, means "a director, manager or secretary of, or any other person involved in the management of, the corporation". Our intention is to catch directors and high-level individuals responsible for managing the listed corporation, not middle management or low-ranked staff. The SFC would explain in its guidelines that as a general principle, one must look to the object of the legislation and the context to determine the meaning of the term "manager". In the context of

the PSI regime, in considering whether a person is a "manager", the person's actual responsibilities are more important than the person's formal title. A "manager" normally refers to a person below the board level who is charged with management responsibility affecting the whole of the corporation or a substantial part of the corporation.

17. We do not propose limiting the obligation in the PSI regime to directors only. Such a limitation may create a potential loophole in the statutory regime whereby listed corporations may evade disclosure obligation by deliberately keeping PSI away from directors. It should be noted that section 279 of the SFO has already imposed an obligation for every "officer" of a corporation 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 phrase "ought reasonably to have"

Respondents' views

18. Most respondents providing comments on the disclosure obligation suggested deleting the phrase "ought reasonably to have". They expressed that it would be impossible to require a listed corporation to disclose information that was not actually known by the corporation's "officers". They considered it too onerous to require the disclosure of "constructive knowledge".

Our response

19. The purpose of including the concept of "constructive knowledge" or the phrase "ought reasonably to have" is to cater for situations where PSI has been channelled to an "officer" of a listed corporation who failed to open or read the document containing the PSI, or where employees of a listed corporation deliberately keep PSI away from being accessed by the "officers" of the listed

corporation. The concept of "ought reasonably to have" or "constructive knowledge" of the PSI 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. The law will not require a corporation to do the impossible – i.e. to disclose what the "officers", having acted reasonably and complied with their duties under clause 101G(1) (i.e. to take all reasonable measures from time to time to ensure that proper safeguards exist to prevent the breach of a disclosure requirement in relation to the corporation), did not know.

20. For the sake of clarity, **we intend to replace "come into possession of the information" with a phrase along the line of "come to the knowledge of the information" in clause 101B(2)**. This will also make the circumstances giving rise to a disclosure obligation more confined as "come into possession" is broader than "come to knowledge". And as mentioned in paragraph 11 above, to clarify and emphasize that listed corporation should act reasonably (which is an objective test) in assessing whether a piece of information is PSI and should be disclosed, we will specify in the legislative provisions that an objective test is to be applied in determining whether any particular piece of information is "inside information".

<u>The phrase "in the course of performing functions as an officer of the corporation"</u>

Respondents' views

21. Some respondents raised questions on the interpretation of "in the course of performing functions as an officer of the corporation". Where a director of the listed corporation is also an "officer" of the holding company of the listed corporation, they asked whether his knowledge of certain confidential information obtained in the latter capacity would be regarded as knowledge obtained in the course of performing functions in the former capacity, thus triggering the disclosure obligation of the listed corporation. One respondent

suggested broadening the circumstances giving rise to a disclosure obligation by covering inside information whether or not it was known in the course of the performance of the functions of an "officer".

Our response

22. Our intention is that information known in circumstances outside the course of performing functions as an "officer" of the listed corporation should not be caught. This is already reflected in clause 101B(2). As to the suggestion of broadening the scope to cover circumstances outside the course of performing functions as an "officer" of the listed corporation, it should be noted that we would retain the phrase "ought reasonably to have" in clause 101B(2) (please refer to paragraphs 19 – 20 above). As such, we consider that the removal of the phrase "in the course of performing functions as an 'officer' of the corporation" would render the obligation too wide.

<u>"A listed corporation fails to disclose the inside information required … if the information disclosed is false or misleading …" in clause 101B(3)</u>

Respondents' views

23. Some respondents suggested that clause 101B(3) be removed as it was a duplicate of section 384 of the SFO (provision of false or misleading information). A few other respondents proposed that the "negligence" element in clause 101B(3)(b) should be removed. Some of them commented that clauses 101B(3) and (4) appeared to reserve to the SFC and MMT a power to enforce the statutory obligations retrospectively. One respondent suggested that "full and non-selective disclosure" should be made a statutory requirement.

Our response

24. Clause 101B(3) is not intended to be a duplication of section 384 of the SFO[2]. Clauses 101B(3) and (4) are not intended to impose additional requirements on top of clause 101B(1), nor to give reserve power to the SFC or MMT. The intention is to put it beyond doubt that the disclosure of information which an "officer" knows or ought reasonably to have known to be false or misleading, or the "officer" is reckless or negligent as to whether the information is false or misleading, would not be regarded as complying with the disclosure requirement under clause 101B(1). In addition to the circumstances set out in Clause 101B(3), circumstances like delayed disclosure[3] or disclosure to a small group of people only[4] would not be regarded as complying with the disclosure requirements under clause 101B(1) either. Clause 101B(4) aims to avoid any misunderstanding that the circumstances in which a corporation fails to comply with the disclosure requirement of clause 101B(1) are confined to those set out in clause 101B(3). To enhance clarity, **we will improve clauses 101B(3) and (4) and set out our intention in a more direct manner.**

Question 1(c): Do you agree with the proposal that the disclosure must be made in a manner that can provide for equal, timely and effective access by the public to the information disclosed?

Respondents' views

25. The respondents generally agreed with the proposal. There were a few enquiries about our proposal of regarding disclosure via the electronic publication system operated by a recognized exchange company (i.e. currently the Hong Kong Exchanges and Clearing

[2] Provision of false or misleading information under section 384 of SFO is a criminal offence, while the statutory PSI disclosure regime is civil.
[3] That is – not disclosing the PSI "as soon as reasonably practicable" in clause 101B(1).
[4] That is – not complying with the manner of disclosure in clause 101C.

Limited's Electronic Publication System ("HKEx-EPS")) – as compliant with the required disclosure manner. One respondent wondered whether this would deprive people who were computer illiterate of access to PSI. Another respondent suggested that in addition to using HKEx-EPS, listed corporations should also be obliged to disseminate PSI on its website. Some respondents proposed that as an alternative to HKEx-EPS, other means like making announcement in the corporation's website, issuing press release through news or wire services should also be accepted as complying with the required disclosure manner.

26. Some respondents suggested that it should be made clear what actions listed corporations should take in case disclosure through HKEx-EPS was not possible, or if the PSI event took place outside the operating hours of HKEx-EPS. With reference to the practice of the Stock Exchange of Hong Kong Limited ("SEHK"), one respondent sought detailed requirements on languages and whether suspension of trading would be required before the announcement of PSI. Another respondent commented that dually listed corporations should disclose PSI to the investing public in Hong Kong at the same time as it made disclosure in other markets; and that in case of a delay in disclosing PSI, the listed corporation should give full explanation of the delay and set out whether any of its directors/officers had engaged in dealing during the delay.

Our response

27. HKEx-EPS is not intended to be the exclusive means of disclosure. A listed corporation may implement additional means such as using a press release disseminated through news or wire services, holding a press conference in Hong Kong and/ or posting an announcement on its own website. However, these additional means may not of themselves be sufficient to satisfy the obligation of providing equal, timely and effective access by the public. Indeed, HKEx-EPS is already being used by all listed corporations and they are encouraged to continue using it for announcing PSI. Normally, HKEx-EPS's operating hours for dissemination of announcements

are – Monday to Friday: 6am – 9am, 12:30pm – 2pm, 4:15pm – 11pm; and 6pm – 8pm of the previous non-business day. If HKEx-EPS is not operating due to system failure, HKEx has contingency measures in place to provide alternative dissemination venues. In the unlikely event that there is a complete failure of these systems/venues, the corporation should take appropriate steps in the circumstances to disclose inside information, in the required manner set out in clause 101C(1). The SFC would also provide in FAQs more information about the operating arrangements of HKEx-EPS and what alternative measures[5] a corporation may take in case of a breakdown of HKEx-EPS.

28. For dually listed corporations, the Listing Rules have already required that a disclosure of information in an overseas market should be made simultaneously in Hong Kong. As for the case of delay in disclosure (i.e. non-compliance with the statutory disclosure requirements), the SFC will conduct investigation as appropriate.

SAFE HARBOURS

Question 2(a): Do you agree with the provision of the four proposed safe harbours?

Safe Harbour 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

Respondents' views

29. The respondents generally agreed that Safe Harbour A was necessary. A few respondents suggested that Safe Harbour A

[5] If the electronic submission system is out of order, The Hong Kong Exchanges and Clearing Limited ("HKEx") could use alternate channels such as emails. If the HKEx website is out of order, there will be an alternate site with a bulletin board listing headlines of all recent announcements and documents. Users must then redirect themselves to the listed issuers' websites for the full announcement.

should not be lost in case of leakage by a third party, since the legal prohibition from disclosure by other legislation / the court would still be applicable even in the case of a leakage. Some respondents proposed extending Safe Harbour A to courts and law/rules/regulations in jurisdictions outside Hong Kong, where the relevant listed corporation conducts business or has presence or has substantial assets.

Our response

30. We agree that Safe Harbour A should still be applicable in case of leakage of the PSI, as the listed corporation would still be bound by the legal prohibition against disclosure. **We would therefore revise the drafting of Safe Harbour A to make it applicable irrespective of whether there is a leakage**. We however have concerns on extending Safe Harbour A to the court judgment and law/rules/regulations outside Hong Kong. In the light of the vast number of jurisdictions at which our listed corporations have business, the SFC would have practical difficulties in enforcing the statutory disclosure regime if Safe Harbour A is so extended. The SFC would however consider waiver applications in such circumstances. (Please refer to paragraphs 46-50 below on the waiver arrangements.)

<u>Safe Harbour 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</u>

Respondents' views

31. The respondents generally agreed that Safe Harbour B was necessary. A few respondents raised questions on the meaning of the term "impending negotiation" used in the main text of our consultation document as opposed to "incomplete negotiation" used in clause 101D(1)(c)(ii) in Annex 1 to the consultation document. A few other respondents suggested that Safe Harbour B should be extended to cover negotiations in relation to litigation,

hedging activities and fair value accounting issues under review.

32. Some respondents asked that the phrase "outcome of which may be prejudiced if the information is disclosed prematurely" be removed as it would be uncertain whether a disclosure might prejudice the outcome. A few suggested replacing this phrase with "outcome or normal patterns of these negotiations or developments may be prejudiced/affected", or not to require a disclosure until a decision on the matter under negotiation was made. A respondent suggested making Safe Harbour B applicable if the information disclosed might be misleading to the persons who were accustomed or would be likely to deal in the listed securities of the corporation, even if the outcome of the negotiations might not be prejudiced if the information were disclosed prematurely.

Our response

33. To avoid confusion, we would consistently use the term "incomplete negotiation" in the statutory provisions and in SFC's guidelines regarding Safe Harbour B. As for the scope of this safe harbour, incomplete negotiation in relation to litigation is already covered. If the corporation faces massive loss arising from hedging activities or fair valuations and if such information is price sensitive, disclosure will be required. The SFC will clarify these matters by issuing FAQs.

34. To cater for the possible circumstances under which a piece of PSI was related to an incomplete proposal or negotiation but its outcome might not be affected if the information were disclosed prematurely, **we would remove the phrase "the outcome of which may be prejudiced if the information is disclosed prematurely" from Safe Harbour B.** This would make Safe Harbour B consistent with the existing arrangement under the Listing Rules[6], and more in line with the takeovers regime.[7] The

[6] Under the Listing Rules, subject to preservation of confidentiality, there is currently an exemption to PSI disclosure in cases of incomplete negotiations short of a decision. Note 2 to Listing Rule 13.09(1) provides that, "When developments are on hand which are likely to have a significant effect

SFC will also clarify in its FAQs that a proposal or negotiation cannot be regarded as incomplete once a legally binding agreement is signed. Regarding the concern about misleading information, the listed corporation ought to disclose details to the extent that they are known. Where pertinent information is not known, that fact should be stated. It is the corporation's responsibility to ensure that the details disclosed are appropriate and not misleading.

Safe Harbour C – When the information is a trade secret

Respondents' views

35. The respondents generally agreed that Safe Harbour C was necessary. A number of respondents asked for more detailed elaboration on the interpretation of "trade secret". One respondent suggested that Safe Harbour C should cover commercially sensitive information contained in agreements or terms of business. Another respondent commented that trade secrets should not be disclosed even if there were leakage since a disclosure would aggravate the damage already made to the listed corporation.

Our response

36. The SFC will provide more detailed elaboration on "trade secret" in its guidelines. In general, a "trade secret" refers to proprietary information owned by a corporation (a) used in a trade or business

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on market activity in or the price of any listed securities, it is the direct responsibility of the directors to ensure that such information is kept strictly confidential until a formal announcement is made. To this end the directors must ensure that the strictest security is observed within the issuer and its advisers and if at any time it is felt that the necessary degree of security cannot be maintained or that security may have been breach, an announcement should be made…". Note 4 to Listing Rule 13.09(1) states that "The question of timing of the release of an announcement to the market is crucial, having regard to its possible effect on the market price of the issuer's listed securities. The overriding principle is that information which is expected to be price-sensitive should be announced immediately it is the subject of a decision...".

[7] Under the Codes on Takeovers and Mergers and Share Repurchases, subject to the preservation of confidentiality, the corporation as a target is not required to make disclosure when it receives an approach to an offer except under certain specified situations. The corporation is not required to justify the reason for not making disclosure.

of the corporation; (b) which is confidential (i.e. not in the public domain); (c) which, if disclosed to a competitor, would be liable to cause real or significant harm to the corporation; and (d) which the corporation must limit its dissemination. Trade secrets may concern inventions, manufacturing processes or customer lists. However a trade secret does not cover the commercial terms and conditions of a contractual agreement or the financial information of a corporation, which cannot be regarded as proprietary information or rights owned by the corporation. We do not propose introducing a statutory definition for "trade secret" because it might not be able to cater for changing circumstances of the market. It should also be noted that overseas jurisdictions having the same safe harbour (e.g. Australia and Singapore) have not defined "trade secret".

37. If the subject information is trade secret, a leakage of, say, part of the trade secret should not oblige the listed corporation to make a full disclosure. Disclosure is necessary only to the extent that the information is leaked.

Safe Harbour D – When the Government's Exchange Fund or a central bank provides liquidity support to the listed corporation

Respondents' views

38. The provision of Safe Harbour D was generally agreed among the respondents. A small number of respondents commented on the scope of this safe harbour. Their suggestions included expanding its scope to cover all kinds of liquidity support; confining the applicability of it to financial institutions; making it a waiver for the SFC to consider instead of a blanket safe harbour; and removing this safe harbour entirely to enhance transparency. One respondent sought clarification on the duration of the operation of this safe harbour.

Our response

39. As explained in paragraphs 2.18 and 2.19 of the consultation document, the circumstances in which this safe harbour would be used will be rare. The purpose is to maintain and safeguard financial stability, by enabling liquidity assistance to be provided in a manner which avoids potential panic or contagion and thereby avoids contributing to the build-up of systemic risk. It was proposed with reference to a similar safe harbour adopted in the United Kingdom ("UK"). Like the UK, the focus of this safe harbour is on the source of liquidity support (i.e. that it emanates from an entity charged with responsibility for financial stability), and not on the nature of the recipient corporation. Hence, we consider that the existing scope of this safe harbour is appropriate.

40. Under clause 101D(1)(c)(iv), the withholding of information under Safe Harbour D is permanent. The Hong Kong Monetary Authority ("HKMA") has concerns with regard to the inclusion of any requirement that the provision of liquidity support be disclosed at a later stage. From a financial stability viewpoint, it may be difficult to be certain that at a given point in time, it is safe to reveal past liquidity assistance. Indeed, disclosure of actual use of the Lender of Last Resort facility might be likely to increase moral hazard.

41. For clarity and as a drafting improvement, **we will expand the reference to "central bank" in Safe Harbour D to include other monetary authorities which perform the functions of a central bank**. The intention is to cover authorities which perform the functions of a central bank but do not bear the name of "central bank".

Conditions on confidentiality

Respondents' views

42. According to the consultation proposal, each of the safe harbours may be triggered only if the confidentiality conditions are met – i.e. (a) the corporation takes reasonable precautions for preserving the confidentiality of the information; and (b) the confidentiality of the information is preserved. At the same time, the proposal does not intend to oblige corporations to respond to mere rumours. A number of respondents sought clarification on when such confidentiality would be regarded as lost and the interpretation of "mere rumour". They were concerned that third parties might "fish" for deals under negotiation and such "fishing" could ruin a deal. There was also a request for elaboration of "reasonable precautions" for preserving confidentiality.

43. Some respondents were of the view that incomplete negotiation should not be disclosed irrespective of whether confidentiality was preserved. Indeed, a negotiation might not lead to any deal at the end. They also raised that the confidentiality conditions set out in the indicative draft legislative provisions in Annex 1 to the consultation document was inconsistent with the SFC's Draft Guidelines which stated that the safe harbours would be lost if the corporation became *aware* of a leakage. They commented that a listed corporation might not know that a third party has leaked a piece of inside information.

Our response

44. A "mere rumour" means a rumour with no substance. "Leakage of inside information" occurs where there is widespread circulation of details which are significant and reasonably specific. The SFC will provide further elaboration in its guidelines in relation to the reasonable precautions expected to be undertaken by listed corporations.

45. If there were leakage of a piece of inside information, it should be the obligation of the listed corporation to make a disclosure so as to clarify matters and ensure market transparency. Hence, our intention is to require listed corporations to disclose incomplete negotiations (if it were inside information) when there is leakage. To address the concern that the listed corporation might not be aware of a leakage, **we would provide a defence for the relevant listed corporation if it can prove that it has taken reasonable measures to monitor the confidentiality and it has made disclosure as soon as reasonably practicable when it became aware of the leakage.** The effect is that under such circumstances, the listed corporation would not be regarded as breaching the PSI disclosure requirement before it becomes aware of the leakage[8].

[8] As mentioned in paragraph 30, we would revise the drafting of Safe Harbour A to make it applicable irrespective of whether there is a leakage. Hence, both the confidentiality conditions and defence would be irrelevant to Safe Harbour A.

Question 2(b): Do you agree that the SFC should be empowered to grant waivers, and to attach conditions thereto?

Respondents' views

46. There was a general consensus among the respondents that it would be useful to empower the SFC to grant waivers. Regarding the circumstances under which a waiver might be granted, some respondents suggested that it should be widened to cover all circumstances so long as the applicant could provide relevant justifications. A few respondents suggested that in addition to the circumstances where the listed corporations faced disclosure prohibition arising from court orders or legislation of a jurisdiction outside Hong Kong, the allowable scope of the waiver should also cover rules made by administrative agencies or other entities, to cater for the possible need of enterprises whose major operations were outside Hong Kong. A few other respondents proposed enabling the SFC to grant blanket waivers for certain circumstances.

47. On the operational aspect of the waiver, a few respondents suggested that waivers granted should be publicized to enhance transparency of the waiver arrangements. One respondent expressed concern on whether a listed corporation waiting for the result of a waiver application would be regarded as breaching the disclosure obligation. Another respondent sought clarification on whether the listed corporation seeking a waiver would need to approach SEHK on the matter.

Our response

48. The SFC will assess each waiver application on a case-by-case basis. We appreciate the practical concerns faced by enterprises which might be subject to administrative orders in places outside Hong Kong. However, having regard to the need to ensure market transparency and to avoid abuse of the waiver arrangements, we consider that such administrative orders must have certain legal

basis. **We would therefore extend the scope of the waiver to include situations concerning prohibition made by a law enforcement authority of a place outside Hong Kong or a government authority of a place outside Hong Kong exercising a power conferred by the legislation of that place.** We consider that a further extension of the scope of "any circumstances" would make the arrangement susceptible to abuse, and it would become impracticable for the SFC to consider under what circumstances a waiver should be granted. If market development warrants non-disclosure in specified circumstances which fall outside the allowable scope of the waiver arrangement, the more appropriate way to deal with this is to invoke the power under clause 101F to prescribe new safe harbours.

49. The waiver applicant should submit all relevant information including the source of the prohibition for the SFC to consider the matter. While the extent of the required details would depend on the specific case, such information is nevertheless confidential. The SFC therefore considers it inappropriate to publish details of the waivers granted.

50. Should a corporation apply for a waiver and withhold disclosure, the SFC would adopt a reasonable approach, taking into account all relevant circumstances, when considering whether enforcement action is warranted. The SFC will explain this in its FAQs. Listed corporations should however note that during an application for a waiver, confidentiality must be kept. If there is leakage of information or part of it, the corporation would be required to suspend trading before a disclosure is made. The SFC and HKEx would continue to maintain close liaison on matters concerning PSI disclosure, including whether a listed corporation has been granted a waiver.

<u>Fees for waiver application</u>

51. According to the consultation proposal, in line with the "user pays" principle, listed corporation should be charged with a fee for the

SFC to process waiver application. We received no substantive comments on this suggestion. The SFC now suggests a waiver application fee of $24,000, which is equivalent to that for a ruling under the Codes on Takeovers and Mergers and Share Repurchases ("Takeover Codes") or a waiver under Part XV of the SFO. It suggests a review application fee of $50,000, which is same as that of a review under the Takeovers Codes. **Such fees would be stipulated in the Securities and Futures (Fees) Rule (Cap. 571AF).**

Question 2(c): Do you think that the legislation should provide for additional safe harbours? If so, what are these additional safe harbours?

Respondents' views

52. Quite a number of respondents proposed various additional safe harbours. A small number of them proposed following the UK arrangement to allow a listed corporation to withhold or delay disclosure so as not to prejudice its legitimate interests provided that such omission would not be likely to mislead the public and provided that the issuer was able to ensure the confidentiality of that information. A number of them proposed adopting the following safe harbours as in Australia and Singapore – on information that comprises matters of supposition or was insufficiently definite to warrant disclosure; and on information generated for internal management purposes of the corporation. A small number of the respondents proposed offering a safe harbour if a reasonable person would not expect the information to be disclosed, following the practice in Australia.

53. One respondent proposed offering safe harbour to the provision of information to the parent company where it was necessary for the proper conduct of the group's business operations. A few respondents suggested that defamatory information should not be disclosed. Another respondent's proposed safe harbour was for

information which, if disclosed, might prejudice the listed corporation in arbitration or litigation proceedings.

54. Some respondents suggested that disclosure should not be required when trading of the listed securities was suspended. A few others proposed a safe harbour in the case that a listed corporation had responded to SEHK's enquiries regarding unusual price movement and that SEHK did not request a trading suspension.

Our response

55. The phrase "not to prejudice its legitimate interests" adopted in the UK is a rather vague concept. Indeed, the UK Disclosure Rules and Transparency Rules have spelt out some specific circumstances that might be related to legitimate interests as safe harbours. As mentioned in our consultation document, we are also mindful of the need to strike a reasonable balance between ensuring market transparency and safeguarding the legitimate interests of listed corporations in preserving certain information in confidence to facilitate its operation and business development. We have therefore set out certain specific safe harbours under our consultation proposal. There would also be a reserved power for the SFC to, after consulting the Financial Secretary, make rules under the SFO to prescribe further specific safe harbours if it considers that it is in the public interest to do so.

56. We consider it unnecessary to provide safe harbours for "matters of supposition" or "information which is insufficiently definite", because the definition of "inside information" (which refers to "specific information") already excludes such information. In Australia and Singapore, their definitions of PSI would cover such information because they do not contain such element of "specific information". The SFC's Draft Guidelines have already clarified that matters of supposition would generally fall outside the scope of "inside information", until such time when these matters become definite and/or generate specific outcomes that affect the corporation.

57. We consider it inappropriate to provide safe harbours for "information generated for internal management" or for information being passed to parent company, since PSI should not be distinguished by the purpose for which it is generated. On the other hand, information generated for internal management which concerns an incomplete proposal or negotiation would have already been covered under Safe Harbour B.

58. The proposed safe harbour regarding a "reasonable person" is similar to the test "persons who are accustomed or would be likely to deal…if generally known to them be likely to materially affect the price…", which is already incorporated in the definition of "inside information". In addition, as set out in paragraph 11 above, we will specify in the legislative provision that an objective test is to be applied in determining whether any particular piece of information is "inside information".

59. The legislative disclosure regime will only require listed corporations to disclose information which is true. The disclosure requirement would therefore not subject a listed corporation to defamation claims. For market transparency, we do not consider it appropriate to create a safe harbour for listed corporations to conceal PSI on the ground that a disclosure would prejudice their position in legal proceedings.

60. A trading suspension is for listed corporations to buy time to verify information. It should not be used for delaying a disclosure. The SFC would explain in its guidelines the purpose and effect of trading suspension in the context of the PSI regime. Since SEHK will not be responsible for enforcing the statutory PSI disclosure regime, it would not be appropriate for listed corporations to rely on the actions or non-actions taken by SEHK to justify whether a disclosure is required under the law.

Question 2(d): Do you agree that the SFC should be empowered to prescribe further safe harbours in the form of rules under the SFO?

Respondents' views

61. There was a general consensus among the respondents that this power to prescribe further safe harbours would be useful. Two respondents commented that additional safe harbours should be able to be introduced efficiently without lengthy legislative process. A number of respondents commented that market participants should have the opportunity to recommend further safe harbours.

Our response

62. Under our consultation proposal, further safe harbours prescribed by the SFC would be subject to the Legislative Council's negative vetting. We consider the proposed arrangement appropriate. The SFC would work closely with HKEx to collect feedback from listed corporations from time to time and to keep in view changing market circumstances, to see if new safe harbours would be required.

DUTIES AND LIABILITIES

Clause 101G(1): "Every officer must take all reasonable measures from time to time to ensure that proper safeguards exist to prevent the breach of a disclosure requirement"

Respondents' views

63. As mentioned in paragraph 15 above, most of the respondents providing comments on the disclosure obligation submitted that the definition of "officer" was too broad. A few respondents commented that in practice, listed corporations might delegate to certain individuals / committee the task of establishing and maintaining an effective compliance system and/or the authority to

discharge its statutory disclosure obligation. They suggested that the duty to implement the safeguards should be placed on the corporation, not the "officers", or that the people with delegated authority need not escalate information to the Board to facilitate timely compliance. A few respondents expressed concerns that with clause 101G(1), two potential infringements were created – the SFC might investigate whether a corporation had appropriate safeguards, in addition to the power to investigate whether a breach of the disclosure requirement had occurred. A major professional body in the legal sector expressed support to imposing the burden of compliance on "officers" and noted that this was the same approach adopted in other areas of corporate or securities regulation, e.g. directors would be liable for false or misleading statements in prospectuses.

64. A few respondents sought elaboration on how to satisfy the test of "all reasonable measures". Another respondent commented that the need to take *all* reasonable measures *from time to time* was too onerous.

Our response

65. On the scope of "officers", please refer to paragraphs 16 – 17 above. Directors and senior management (i.e. "officers") of a listed corporation have the responsibility to ensure that the corporation takes all reasonable measures to ensure compliance. We do not intend to prescribe that a decision of whether to make a disclosure must only be made by the Board of Directors. Even the Board of Directors choose to, e.g. appoint a committee to handle all PSI disclosure, the "officers" would remain liable under clause 101G(2). For instance, if the director has been reckless in the choice and/or supervision of the committee, and such recklessness resulted in a non-disclosure by the listed corporation, the director would still be liable. (Please refer to paragraphs 71 - 76 below on the liabilities of listed corporations and "officers".) We would also like to clarify that the mere failure for an "officer" to take all reasonable measures from time to time to ensure that proper

safeguards exist does not by itself amount to a contravention of the statutory obligations on the part of that "officer". The SFC will not be empowered to conduct investigation in such a failure. Such a failure would amount to a contravention of the law only if the listed corporation is in the first place in breach of a disclosure requirement (see clause 101G(2)(b) of the indicative draft legislative provisions). The SFC would then have the power to conduct investigation where it has reasonable cause to believe that a breach of the disclosure requirement may have taken place.

66. In relation to what reasonable measures "officers" should take from time to time, we would like to stress that the aim of establishing a statutory PSI disclosure regime is to cultivate a continuous disclosure culture among listed corporations. The key to ensuring compliance is the establishment of a proper internal system within the listed corporation to ensure that PSI will be promptly identified and properly channelled to the senior management for the corporation to make a disclosure as soon as reasonably practicable. It is therefore important for every "officer" to bear the responsibility of ensuring that such a system is in place. For the sake of clarity and to ensure that the duties imposed under clause 101G(1) will be carried out (which is what we would like to encourage), the standard used in clauses 101G(1) and 101G(2)(b) should align. **Hence, we would amend clause 101G(2)(b) to "who has not taken all reasonable measures from time to time to ensure that proper safeguards exist to prevent the breach".** The effect is that clause 101G(2)(b) will be tightened up. In addition, the SFC would issue further guidance on "reasonable measures" referred to in clause 101G(1) by way of FAQs.

Clauses 101A(2) and 101G(2): Liabilities of listed corporations and "officers"

Respondents' views

67. A major professional body in the legal sector expressed that it would support our proposal of making individual "officers" liable in the case that the listed corporation was in breach and that the individual "officer" had not taken all reasonable measures to prevent the breach, provided that the standard of care should not be determined with the benefit of hindsight. A considerable number of listed corporations and a few trade bodies and law firms provided various detailed proposals to narrow down circumstances where liabilities would arise. Many of them suggested that a contravention should not be based on strict liability They considered that to establish a contravention, both the elements of *mens reas* (the "guilty mind") and *actus reus* (the "guilty act") must be present. They opined that a corporation and its "officers" should not be held liable if they could show that they had duly and carefully considered a piece of information and made a non-disclosure decision based on the prevailing circumstances. Some of them suggested that for individuals, only directors knowingly concerned about the breach should be liable, or that negligence should not be caught.

68. Many of these respondents requested that the "business judgment rule" should be made applicable – i.e. when the directors had duly and carefully considered a piece of information, with advice from professionals, and come to a conclusion in good faith and/or on reasonable grounds that the information should not be subject to the statutory disclosure requirement and hence decided that it need not be disclosed, such directors should not be held liable if they could show that there were clear and proper records of the Board's deliberation of the matter concerned. By making reference to the administrative law principle of "Wednesbury" unreasonableness, a few of these respondents suggested that there should be no liability if a reasonable Board of Directors, after taking into account the

facts and circumstances existed at the relevant time, concluded that the information in question was not inside information, even if another reasonable Board of Directors might have come to a different conclusion.

69. Many of these respondents also commented that if proper safeguards were put in place, then the corporation and "officers" should not be held liable if the breach was due to non-submission of information or wrongdoing of an individual "officer".

70. A few of these respondents suggested adding a defence for directors in circumstances where the corporation could demonstrate that it had set out reasonable safeguards and measures to ensure that the directors receive the PSI and that (a) there had been no intentional, reckless or negligent act or omission on the part of any individual "officer", or that (b) a certain director had deliberately withheld the information from the Board.

Our response

71. We would like to confirm that we have no intention to determine the standard of care with the benefit of hindsight.

72. Further, as mentioned in paragraphs 11 and 19 above, the disclosure obligation will arise when a listed corporation, having considered objectively and reasonably all relevant matters, is of a view that a piece of information which comes to its knowledge (or ought reasonably to have come to its knowledge) is price sensitive. This is required to encourage compliance and cultivate a continuous disclosure culture. If a reasonable man will not regard such information as price sensitive, the disclosure obligation will not be triggered.

73. A negligent contravention causes the same damage to the market as an intentional one. We would therefore retain "negligence" in the clause 101G(2)(a), which will only catch the particular "officer(s)" whose intentional, reckless or negligent act or omission has

resulted in a breach by the listed corporation. We would also like to clarify that if an individual "officer" has carried out his duties to ensure proper safeguards according to clause 101G(1), and that the breach by the listed corporation is not caused by his intentional, reckless or negligent act or omission, he will not become liable. As a drafting improvement, **we will replace the phrase "act or omission" with "conduct"**, as the latter is already defined in Part 1 of Schedule 1 to the SFO to include any act or omission, and any series of acts or omissions.

74. We consider the proposed threshold of "in good faith" too low. As mentioned in paragraph 11 above, in considering whether a piece of information is "inside information", an objective test should be adopted. From the investor protection perspective and taking into account the need to ensure market transparency, we consider that it would prejudice the interests of the investing public if PSI could be withheld on grounds that the directors believe in good faith (which is a subjective test) that the information is not subject to the statutory disclosure requirement. Indeed, we understand that the "business judgment rule" used in other jurisdictions provides a defence for business judgment, not for carrying out statutory duties[9]. We do not think it is appropriate to introduce such concept into the PSI regime.

75. The principle of "Wednesbury" unreasonableness is an administrative law concept. It refers to decisions of a public authority which are so absurd that no sensible person could ever dream that it lays within the powers of the authority or which is so outrageous in its defiance of logic or accepted moral standards that no sensible person who has applied his mind to the question to be decided could have arrived at it. This concept is not relevant to

[9] In the US, "business judgment rule" is a case law derived jurisprudential expression of "the presumption that in making business decisions not involving direct self-interest or self-dealing, corporate directors act on an informed basis, in good faith, and in the honest belief that their actions are in the corporation's best interest." (Black's Law Dictionary, ninth edition, p.226). In Australia, "The rule that the business judgment of the directors of a company, as long as it is exercised in good faith and not for improper purposes, is not open to review by the courts…" (Butterworths Concise Australian Legal Dictionary 1997, p. 57). In the UK, the Companies Act 2006 does not have a statutory business judgment rule as a defence to directors' duty of care.

the PSI context because we are not concerned with the exercise of administrative powers by a public authority.

76. Regarding the proposed defence for "officers" who might be liable under clause 101G(2)(b), we would point out that the SFC has the burden to prove before the MMT that an "officer" has not carried out his duty under clause 101G(1). The proposed defence is therefore not necessary.

SANCTIONS

Question 3(a): Do you agree to extend the jurisdiction of the MMT to handle breaches of the statutory disclosure requirements?

Respondents' views

77. There was a general consensus among the respondents for the MMT to handle breaches of the statutory PSI disclosure requirements. A small number of respondents commented that the composition of MMT should ensure there would be members with the required expertise and professional knowledge.

Our response

78. Under the existing arrangement, the Chairman of the MMT sits with two members from the business and professional community. This arrangement works well and will continue.

Question 3(b): Do you agree with the proposed range of civil remedies as set out in paragraphs 2.31, 2.35 and 2.36 of the consultation document?

Civil regime

Respondents' views

79. As mentioned in the consultation document, we would focus on civil sanctions against non-disclosure of PSI by listed corporations. The respondents generally support a civil regime. Many listed corporations commented that the proposed civil sanctions were already strong measures and would be highly deterrent. There were a few respondents proposing a criminal regime, to enhance the deterrence effect. A respondent was of the view that it would be easier to sanction persons breaching the disclosure requirement under civil proceedings than in criminal proceedings.

Our response

80. As mentioned in the consultation document, we would keep under review the effectiveness of the statutory regime, and consider the need for creating additional sanctions, including criminal sanctions, in the light of local and international market experience.

Regulatory fine of up to $8 million

Respondents' views

81. At our briefing sessions with organized groups, a number of participants asked whether the maximum $8 million fine was an aggregate amount for listed corporations and all directors. Regarding the applicable scope of the fine and the maximum level, respondents had diverse views. Some respondents commented that a regulatory fine would be a strong measure for individuals / independent non-executive directors / medium and small-sized listed corporations, or that it was excessive for civil liability.

Some other respondents suggested that the fine to be imposed on directors should be for intentional and reckless breaches only. A few respondents proposed other level of the fine ceilings, ranging from $3 million to unlimited amount. A few other respondents commented that imposing a fine on the listed corporation would mean penalizing the shareholders as well. One respondent suggested that financial resource should not be a factor for considering the actual amount of fine to be imposed, since it had no correlation with the offender's conduct.

Our response

82. We would like to clarify that under our proposal, the listed corporation and each of its directors could be fined up to $8 million separately. The ceiling is not an aggregate amount.

83. We consider that our proposed maximum level of $8 million is appropriate and such a ceiling would allow sufficient scope for the MMT to determine the exact amount. As mentioned in our consultation document, the fine is 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. The relevant factors to be considered include, among others, whether the conduct was intentional, reckless or negligent, and the financial resources of the one breaching the disclosure requirements. There are already precedent cases showing that financial wealth of an insider dealer would not increase the financial penalty to be imposed. The insider dealer's financial resources and ability to pay within a reasonable time were, however, relevant mitigating factors. We expect the MMT to consider financial resources as a mitigating factor in the context of the PSI regime. In Hong Kong, executive directors and non-executive directors are subject to the same duties imposed on a director by the Companies Ordinance, the SFO and the common law. Hence, we do not intend to specify a different level of fine for these directors.

Disqualification order, "cold shoulder" order, "cease and desist" order, recommendation to take disciplinary action and payment of costs

Respondents' views

84. There were no major objections to enabling the MMT to impose these orders in cases of breaches of the PSI disclosure requirements. A number of respondents however commented that disqualification order and "cold shoulder" order were strong measures and would be too harsh to impose on an error of judgment. They were also concerned about the "cease and desist" order since a breach of it would be criminal. One respondent proposing criminal sanction was of the view that the maximum duration of the disqualification and "cold shoulder" orders should be extended from 5 years to 10 years.

Our response

85. We consider that these orders are an appropriate range of possible sanctions for the MMT to consider. We expect that the MMT will consider the seriousness of the case and whether it is an intentional breach on the part of an "officer" in determining whether a specific order should be imposed. We would keep under review the effectiveness of the regime, and consider the need for creating additional sanctions in the light of local and international market experience.

Reliance on MMT findings to seek compensation for pecuniary loss

Respondents' views

86. A number of respondents were concerned that such provision might lead to numerous litigation and possibly heavy monetary implications. A couple of respondents were concerned that small investors still lack the means to recover loss arising from non-disclosure of PSI on the part of the listed corporations.

Our response

87. Similar provision is already available in section 281 of the SFO. Even without the proposed provision, people suffering pecuniary loss as a result of a breach could also take civil actions to seek compensation from those who have breached the disclosure requirements. The proposed provision facilitates such civil actions by allowing the plaintiffs to rely on the MMT findings to help establish their case. (Please also refer to paragraph 89 below.)

Actions under the existing sections 213 and 214 of SFO

Respondents' views

88. A few respondents questioned whether the sanctions under sections 213 and 214 of the SFO would duplicate those available to the MMT. A few other respondents raised concerns about the SFC invoking section 214 of the SFO, even if the MMT had found no breach or the MMT had not imposed a disqualification order (which is also available under section 214).

Our response

89. The sanctions under sections 213 and 214 will be complementary to the MMT remedies. For example, section 213 may be used to obtain an order directing a corporation to issue an announcement where there has been a breach of a PSI disclosure obligation. Further, it might be possible for the SFC to obtain an order from the court ordering a director to compensate those persons who have suffered damage as a result of the director's misconduct. The SFC has confirmed that it will not commence a proceeding under section 214 for a suspected breach of the PSI disclosure obligation where the MMT has already concluded that no such breach has occurred.

Other remedies

Respondents' views

90. Some respondents proposed enabling the MMT or SFC or SEHK to issue private reprimand to deal with less serious breaches.

Our response

91. We consider that in the case of private reprimand where the public may not be aware that a breach has occurred, it would not be effective in encouraging compliance and cultivating a continuous disclosure culture.

92. We have however reviewed that under the existing arrangements, one of the remedial measures that the Listing Committee may invoke is that under Listing Rule 2A.09 – to "require a breach to be rectified or other remedial action to be taken within a stipulated period…". Based on this, the Listing Committee frequently makes directions on "Training of Directors"[10], "Internal Control Review"[11] and "Retention of Compliance Adviser"[12]. We consider that these are useful measures for improving corporate governance practice of listed corporations and hence are worthwhile to be introduced into the statutory PSI disclosure regime. **We would therefore empower the MMT to make such order as is necessary to ensure that the corporation takes appropriate action to prevent a similar breach of the disclosure requirement.** Such power includes ordering an "officer" to undergo training, ordering a corporation to appoint an independent

[10] Requires a director to undergo training on compliance of Listing Rules, director's duties and corporate governance matters for a certain number of hours to be provided by a recognized professional organization satisfactory to the Listing Division.

[11] Requires the listed corporation to retain an independent professional adviser satisfactory to the Listing Committee and/or the Listing Division to conduct a thorough review of and make recommendations to improve the corporation's internal controls including its procedures and compliance systems to ensure compliance with the Listing Rules.

[12] Requires the listed corporation to appoint an independent professional adviser satisfactory to the Listing Division on an ongoing basis for consultation on Listing Rules compliance for a certain period of time.

professional adviser to review its compliance procedure, and ordering a corporation to appoint an independent professional adviser to advise on compliance matters.

Question 3(c): Do you agree to grant the SFC direct access to the MMT to institute proceedings on breaches of the statutory disclosure requirements?

Respondents' views

93. The majority of the respondents who did not agree with the proposal were from listed corporations, believing that this would lead to a loss of checks and balances. Some were concerned that the SFC should not be both the investigator and prosecutor. Two respondents from the legal and banking sectors sought further elaboration on the reasons for granting the SFC direct access. A few respondents raised concerns about the resource implications to the MMT as a result of direct access. At the same time, a major professional body in the legal sector agreed with the proposal. It pointed out that the SFC has direct and expert knowledge of the securities market and law, and it would suffice to rely on the SFC's judgment as to whether a case should be referred to the MMT. Involving the Financial Secretary or the Department of Justice ("DoJ") to institute proceedings before the MMT would amount to duplication of efforts with the SFC. The professional body also pointed out that the MMT itself provides the best checks and balances in the enforcement regime.

Our response

94. Indeed, the MMT proceedings have already provided for appropriate checks and balances. The MMT is an independent tribunal. All MMT cases are heard by a high court judge assisted

by two members appointed by the Chief Executive[13]. The MMT is able to inquire into the matter and issue orders to obtain further evidence during the proceedings pursuant to the SFO. Legal representatives are entitled to appear at the MMT on behalf of persons suspected of having engaged in market misconduct; and any person who is dissatisfied with the MMT's findings may appeal to the Court of Appeal[14]. It is the MMT, not the SFC, which will determine whether there has been market misconduct or whether there has been a breach of the PSI disclosure requirement.

95. At present, under the SFO, a decision to refer a case to the Financial Secretary for considering institution of proceedings before the MMT is exercised by the SFC[15], and such function of the SFC cannot be delegated to any of its director or employee. With direct access, it is still the SFC (not certain director or employee) which will decide whether a case should be referred to the MMT.

96. In addition, most major financial services regulators including those in the UK, United States and Australia are empowered to institute and manage its own civil enforcement work for serious market misconduct where civil remedies exist. Streamlining the referral procedure is consistent with international practice.

97. The MMT is already handling the existing six types of market misconduct cases. The addition of PSI cases may have implications on the workload of the MMT, and we would keep in view the need for additional resources.

98. In the light of the above, we are of the view that the SFC should be granted direct access to the MMT to institute proceedings on the existing six types of market misconduct and the breaches of the statutory PSI disclosure requirement.

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[13] Or appointed by the Financial Secretary under delegated authority.
[14] The appeal can be made on a point of law or on a question of fact.
[15] As a matter of statutory requirement, non-executive directors of the SFC outnumber executive directors.

99. While breaches of the PSI disclosure obligation will only be subject to civil sanctions, the existing six types of market misconduct may be subject to criminal proceedings[16]. Since DoJ has been given the exclusive responsibility for the control of criminal prosecutions in Hong Kong under the Basic Law, the SFC has been referring cases of suspected market misconduct to DoJ for advice in the first instance.[17] This arrangement in respect of the six types of market misconduct will remain consequent upon granting the SFC direct access to the MMT.

ROLES OF SFC AND SEHK

SFC to enforce the statutory regime and conduct investigation

Respondents' views

100. There was a consensus among the respondents for the SFC to enforce the statutory regime and investigate alleged breaches. While one respondent commented that the threshold for the SFC to invoke investigation (i.e. "has reasonable cause to believe that a breach of the disclosure requirement may have taken place") was too high, many listed corporations commented that the threshold was too low. Some respondents sought clarification on what relevant considerations SEHK would take in determining whether a case should be referred to the SFC. One respondent raised concern that the SFC might not be able to require a non-Hong Kong-resident director to attend an interview. Another respondent commented that an SFC investigation should be confidential and should not be regarded as PSI.

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[16] Under Part XIV of the SFO, the SFC may report its investigation findings to DoJ to consider criminal prosecution. Under Part XIII of the SFO, the FS may institute proceedings before the MMT whether or not following any report by the SFC or any notification by DoJ.

[17] The SFC's policy is to examine all options and bring criminal prosecution as a matter of priority if there is sufficient evidence and where criminal prosecution is in the public interest. It is only after DoJ has ruled out a market misconduct case for criminal prosecution that the SFC will consider other enforcement options, including the MMT proceedings.

Our response

101. The MMT proceedings and our proposed threshold of invoking investigation with respect to breaches of the PSI disclosure requirement are the same as those applicable to market misconduct cases. We consider them appropriate for the PSI disclosure regime as well. Since the SFC, not SEHK, will be the enforcement agency, SEHK's intention is to refer all possible breaches of the statutory PSI disclosure requirements to the SFC.

102. As for the confidentiality of the SFC's investigation, the SFC is of the view that the mere fact that it is conducting a statutory enquiry or investigation is unlikely to be inside information and so a disclosure obligation will seldom arise. However, there may be rare cases where the fact of an enquiry or investigation is inside information and so will need to be disclosed. An example is where the SFC is conducting an investigation into misconduct in office by the corporation's CEO and the CEO resigns or ceases to discharge his duties, pending the conclusion of the investigation. In such rare circumstances, the SFC expects any corporation who decides to make a disclosure about an SFC investigation will inform the SFC before making such disclosure.

Question 4: Do you agree that the SFC should provide informal consultation for the listed corporations with regard to the statutory disclosure requirements, initially for a 12-month period?

Respondents' views

103. There was a general consensus that an informal consultation service would be useful. Many respondents suggested that it should be made longer or a continuous service. A number of them suggested that the SFC should publish their response to common questions to facilitate compliance. A few of them suggested that the SFC should set a response time to enquiries.

Some others were of the view that the SFC should give advice on whether a piece of information is PSI and whether disclosure is needed. There were some other respondents suggesting SEHK to provide such service instead because it has already had years of experience in this aspect.

Our response

104. In the light of respondents' comments, the SFC would extend the consultation service to 24 months initially. It would also update its guidelines and publish FAQs from time to time. The response time will depend on the nature of the matter involved and the quality and adequacy of the justifications provided by the listed corporation. The SFC would strive to reply the listed corporations expeditiously.

105. Listed corporation itself should be the one who knows its business well and be in the best position to determine whether a piece of information is PSI. The SFC, as the regulator, will not be in a position to do so for the listed corporation. And since SEHK will not be responsible for enforcing the statutory regime, neither will it be in a position to give advice on it.

Question 5: Do you think the administration and enforcement arrangements proposed by the SFC and SEHK in paragraph 3.8 – 3.9 of the consultation document are appropriate? Do you have any comments on the respective roles of the SFC and SEHK to further enhance clarity?

<u>Modifying Listing Rules to dovetail them with statutory provisions</u>

Respondents' views

106. The respondents generally agreed with the proposal of aligning the requirements in the Listing Rules with the statutory PSI disclosure requirements. One respondent queried whether Listing Rule

13.09 should be removed. Some respondents suggested that the legislative exercise and amendments to the Listing Rules should be done simultaneously.

Our response

107. On review, SEHK intends to delete Listing Rules 13.09(1)(a) and (c) which closely mirror the proposed statutory PSI disclosure obligation. SEHK and the Listing Committee should not be put into the position of interpreting / administering the statutory obligation of disclosing PSI. The residual part of Listing Rule 13.09 and its notes (e.g. sub-rule (1)(b) which is applicable in circumstances where there is an obligation to clarify inaccurate and/or misleading information already in the market, which SEHK would still need to address whether or not issues of price-sensitivity have arisen; and sub-rule (2) which requires listed corporations dually listed on Hong Kong and overseas markets to make a disclosure to SEHK at the same time as the information is released to the other markets) will be retained elsewhere in Chapter 13 of the Listing Rules. All existing SEHK's guidelines on PSI will be superseded and replaced by the SFC's guidelines. Amendments to the Listing Rules would have to take into account the final form of the statutory PSI disclosure regime and hence may only be done after the enactment of the statutory regime. In addition, following established procedure, Listing Rules would only be amended after public consultation and with the SFC's approval. We however intend to align the commencement date of the statutory regime and the amended Listing Rules to facilitate compliance.

<u>Avoidance of overlap of SFC and SEHK's duties and investigation</u>

Respondents' views

108. A number of respondents commented that there should be no dual regulation or duplicated investigation. Clear delineation of the duties between the SFC and SEHK would therefore be needed. A

few respondents commented that SEHK should not take disciplinary action if MMT had found no breaches to the statutory disclosure obligation.

Our response

109. The SFC and SEHK consider that the delineation of duties is likely to be set out by amending the Memorandum of Understanding Governing Listing Matters between the SFC and SEHK, signed on 28 January 2003. They would finalize the details when the content of the statutory PSI regime is enacted. With the taking effect of the statutory regime, SEHK will no longer be in a position to handle cases involving non-disclosure of PSI. However, if certain information (whether PSI or not) should have been, but has not been disclosed, there may also be a breach of specific Listing Rules on, e.g. financial reporting and notifiable or connected transactions. SEHK would reserve its right of action under the Listing Rules in such cases. However, possible breaches of the statutory PSI disclosure requirements will take precedence for investigation and enforcement by the SFC. The SFC and SEHK will continue to liaise closely in this regard to avoid duplication as far as possible.

C. CONCLUSIONS

110. In summary, compared with our consultation proposal and the indicative legislative draft provisions, we plan to implement the statutory PSI disclosure regime with the following major improvements to be set out in the SFO -

(a) making it explicit that the timing of disclosure is "as soon as reasonably practicable";
(b) specifying that an objective test should apply in considering whether a piece of information is price sensitive;
(c) replacing "come into possession of the information" with a phrase along the line of "come to the knowledge of information" in

clause 101B(2);

(d) improving the drafting of clause 101B(3) and (4) to enhance clarity;

(e) revising Safe Harbour A so that it would be applicable irrespective of whether there is leakage;

(f) removing "the outcome of which may be prejudiced if the information is disclosed prematurely" from Safe Harbour B;

(g) in Safe Harbour D, expanding the reference to "central bank" to include "an authority that exercises functions that correspond with the functions of a central bank";

(h) adding a new provision to the effect that where a piece of information has been leaked and hence a safe harbour falls away, it would be a defence for the corporation to prove that it has taken reasonable measures to monitor the confidentiality and it has made disclosure as soon as reasonably practicable when it became aware of the leakage;

(i) extending the grounds for granting a waiver to restrictions imposed by a law enforcement authority of a place outside Hong Kong or a government authority of a place outside Hong Kong exercising a power conferred by the legislation of that place;

(j) replacing "act or omission" with "conduct" in clause 101G(2)(a);

(k) aligning the liability provision for "officers" with the duty provision by using "who has not taken all reasonable measures from time to time to ensure that proper safeguards exist to prevent the breach" in clause 101G(2)(b); and

(l) empowering the MMT to make such order as is necessary to ensure that the corporation takes appropriate action to prevent a similar breach of the disclosure requirement. Such power includes-

i. ordering an "officer" to undergo training;

ii. ordering a corporation to appoint an independent professional adviser to review its compliance procedure; and

iii. ordering a corporation to appoint an independent professional adviser to advise on compliance matters.

111. In addition, we will stipulate in the Securities and Futures (Fees) Rule that the fee for a waiver application would be $24,000, and

that for a review would be $50,000. The SFC's informal consultation service will be extended to 24 months initially. Subject to public consultation and approval by the SFC, SEHK intends to delete the existing Listing Rule 13.09(1)(a) and (c) but to retain the residual part of Listing Rule 13.09 and its notes elsewhere in a revised Chapter 13 of the Listing Rules.

D. WAY FORWARD

112. Our plan is to introduce a bill to the Legislative Council to codify the disclosure requirements in the SFO in the 2010/11 legislative session.

Financial Services Branch
Financial Services and the Treasury Bureau
11 February 2011

Appendix I

Respondents

Organisations

1 Allen & Overy

2 Ascent Partners Group Limited

3 Association of Chartered Certified Accountants Hong Kong

4 Australasian Compliance Institute

5 Baker & McKenzie

6 Baker Tilly Hong Kong Limited

7 British Chamber of Commerce in Hong Kong, The

8 Cathay Pacific Airways Limited

9 Celestrial Asia Securities Holdings Limited and CASH Financial Services Group Limited

10 Century Legend (Holdings) Limited

11 Chamber of Hong Kong Listed Companies, The

12 Charltons – representing Access Capital Limited; Anglo Chinese Corporate Finance Limited; CIMB Securities (HK) Ltd.; Quam Limited; Somerley Limited; and Taifook Capital Limited

13 Cheung Kong (Holdings) Limited

14 Chinese General Chamber of Commerce, The

15 Chinese Manufacturers' Association of Hong Kong, The

16 Chinese Securities Association of Hong Kong

17 Clifford Chance and Linklaters

18 Climax International Company Limited

19 CLP Holdings Limited

20 CompliancePlus Consulting Limited

21 Consumer Council

22 COSCO Pacific Limited

23 Cross-Harbour (Holdings) Limited, The

24 Deacons

25 Democratic Party

26 Emperor Capital Group Limited

27 Emperor Entertainment Hotel Limited

28 Emperor International Holdings Limited

29 Emperor Watch & Jewellery Limited

30 Esprit Holdings Limited

31 Far East Holdings International Limited

32 Forefront Group Limited

33 Fountain Set (Holdings) Limited

34 Golden Resorts Group Limited

35 Great Eagle Holdings Limited

36 Guoco Group Limited

37 Hai Tong (HK) Financial Holdings Ltd.

38 Henderson Investment Limited

39 Henderson Land Development Company Limited

40 Heritage International Holdings Limited

41 Hermes Equity Ownership Services Limited

42 Hong Kong Aircraft Engineering Company Limited

43 Hong Kong Association of Banks, The

44 Hong Kong Association of Restricted Licence Banks and Deposit-taking Companies, The

45 Hong Kong Bar Association

46 Hong Kong Federation of Women Lawyers

47 Hong Kong General Chamber of Commerce

48 Hong Kong Institute of Certified Public Accountants

49 Hong Kong Institute of Chartered Secretaries, The

50 Hong Kong Institute of Directors, The

51 Hong Kong Investor Relations Association

52 Hong Kong Securities Association Ltd.

53 Hong Kong Securities Professionals Association

54 Hong Kong Society of Financial Analysts, The

55 Hongkong Electric Holdings Ltd.

56 Hopewell Holdings Limited

57 Hua Yi Cooper Holdings Ltd.

58 Hutchison Harbour Ring Limited

59 Hutchison Telecom Hong Kong Holdings

60 Hutchison Whampoa Limited

61 Hysan Development Company Limited

62 Institute of Accountants in Management, The

63 K. Wah International Holdings Limited

64 Kong Sun Holdings Limited

65 KPMG

66 Law Society of Hong Kong, The - Company and Financial Law Committee and Securities Law Committee

67 Mallesons Stephen Jaques

68 Mandatory Provident Fund Schemes Authority

69 Mascotte Holdings Limited

70 Melco International Development Limited

71 Miramar Hotel and Investment Company Limited

72 MTR Corporation Limited

73 New Media Group Holdings Limited

74 Prosperity Investment Holdings Limited

75 PYI Corporation Limited

76 Real Estate Developers Association of Hong Kong, The

77 Rosedale Hotel Holdings Limited

78 Ruyan Group (Holdings) Limited

79 SBI E2-Capital (HK) Limited

80 Starlight International Holdings Ltd.

81 Stephenson Harwood

82 Sun Hung Kai & Co. Limited

83 Sun Hung Kai Properties Ltd.

84 Swire Pacific Limited

85 Techtronic Industries Company Limited

86 Unity Investments Holdings Limited

87 Willie International Holdings Limited

88 Y.T. Realty Group Limited

89 Yugang International Limited

90 中信泰富小股東關注組

91 中國光大集團有限公司

92 Respondent requested that its name not to be disclosed

93 Respondent requested that its name not to be disclosed

94 Respondent requested that its name not to be disclosed

95 Respondent requested that its name not to be disclosed

96 Respondent requested that its name not to be disclosed

97 Respondent requested that its name not to be disclosed

98 Respondent requested that its name not to be disclosed

99 Respondent requested that its name not to be disclosed

Individuals

1 Chan Kwok Chuen, Augustine

2 Ricky Chan

3 Chiu Ka Wah

4 Eva Lam

5 Patrick Meaney

6 Clement Shum

7 Suen Chi Wai

8 Tang Chi Ming

9 Benny Wong

10 Allan Yap

11 Angus Young and Tina Chu

Appendix II

Groups Briefed

1 Chamber of Hong Kong Listed Companies, The

2 Hong Kong Institute of Certified Public Accountants - Corporate Finance Interest Group

3 Hong Kong Investment Funds Association

4 Hong Kong Investor Relations Association

5 Hong Kong Securities Institute

6 Professional Validation Council of Hong Kong Industries

7 SFC's Public Shareholders Group

8 Standing Committee on Company Law Reform