

## Speech

### Speech by SFST at Hong Kong Institute of Directors speaker luncheon (English only)

Friday, June 4, 2010

Following is the speech by the Secretary for Financial Services and the Treasury, Professor K C Chan, at the Hong Kong Institute of Directors speaker luncheon meeting today (June 4):

#### Disclosure of Price Sensitive Information and Corporate Governance

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Kelvin, ladies and gentlemen,

I am very glad to have this opportunity to join this luncheon organised by the Hong Kong Institute of Directors. The Institute has been our active partner in promoting good corporate governance and director professionalism in Hong Kong. Since 2001, it has been organising the Directors of the Year Awards; and for the past many years, it has been providing a wide range of training programmes for both newly appointed directors and long-serving directors. I am thankful to the Institute's continuous efforts in improving the corporate governance culture in Hong Kong. And thanks to the Institute's invitation, I am having this opportunity today to introduce to you one of our latest efforts in promoting good corporate governance.

In late March, we launched a public consultation on the proposal to statutorily oblige listed corporations to disclose price sensitive information (PSI).

#### Background

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Many of you may be aware that this is not a new proposal. We have been considering providing statutory backing to our Listing Rules since as early as 1999. Since the idea was first floated, as well as so far for the current

consultation exercise, we have been receiving general support from market participants as well as the public to put the PSI disclosure requirements into statute. The market and the general public appreciate the benefits of having a statutory regime on PSI disclosure. Such a regime would enable effective investigation and imposition of meaningful sanctions. In addition, spelling out when a listed corporation would be permitted to delay or withhold disclosure of PSI, that is, setting out the safe harbours in the statute, would also facilitate compliance. The ultimate objective is to promote a continuous disclosure culture among listed corporations, which would enhance market transparency, improve market quality, promote corporate governance and in turn attract investors to come to our market.

#### Previous approaches

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This exercise has, however, taken longer than we expected. This is not because of a lack of market support; rather, we have to acknowledge that it is not an easy task to codify the Listing Rules into law. Since the Listing Rules are not written in legal language, it would not be straightforward to turn them into law, which requires precision in interpretation. Another downside is that, if listing rules are written into statute, it might be done at the expense of the flexibility that is required to respond to changing market circumstances. There is a need to balance enforceability and flexibility.

In the past few years, we have considered different ways to provide statutory backing to the key requirements of our Listing Rules. Our first attempt was to consider whether to amend the Securities and Futures Ordinance (SFO) to empower the Securities and Futures Commission (SFC) to make statutory listing rules. In addition to making such statutory listing rules, the SFC could issue codes and guidelines in relation to the operation of these listing rules to assist compliance. There was however major concern that the statutory listing rules were unduly detailed, and a minor breach of the rules might attract severe statutory sanctions.

Another option was to prescribe a set of general principles in the SFO. These principles would represent the fundamental obligations of listed corporations. They would be supported by a list of factors for the adjudicator to consider when determining whether there was a breach of the general

principles. The SFC would also promulgate a code to provide guidance on how to interpret and comply with the statutory obligations. But what should these fundamental obligations be? And what should be the relevant factors? Such factors may vary depending on the market capitalisation of the listed corporation and the prevailing market condition. It would be impracticable to devise an exhaustive list of such factors.

#### Current approach

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After much effort, and working closely with the SFC and the Stock Exchange of Hong Kong (SEHK), we have come up with a new legislative approach. We have gone back to the basic principle and asked what objectives we wanted to accomplish. Our objective is to encourage a disclosure culture and we want to facilitate market compliance. So, why don't we start with a concept which the market would find familiar?

The insider dealing regime has been in place for many years. And 20 years ago, we started using the concept of "relevant information" in the then Securities (Insider Dealing) Ordinance. Very briefly, under the law, we have all been prohibited from making use of such "relevant information" to deal in listed securities. This concept of "relevant information" is inherited by the insider dealing regime under the SFO. Let's call this type of information "inside information".

Our current proposal is to make use of this same concept of "inside information", and request a listed corporation to, as soon as practicable, disclose such "inside information" that has come to its knowledge. In essence, the set of information required to be disclosed would be the same as that currently prohibited from being used for insider dealing.

At the same time, listed corporations would have legitimate reasons to preserve certain PSI in confidence to facilitate their operation and business development. Hence, we also propose introducing certain safe harbours in the legislation.

The approach of obliging disclosure of "inside information" is actually the same as the one adopted by the European Union (EU). In 2003, the EU

promulgated a directive on insider dealing and market manipulation. This directive requires all EU member states to prohibit insider dealing, and at the same time, requires all EU member states to ensure that issuers of financial instruments, for example, a listed corporation, inform the public as soon as possible of the "inside information". Thereafter, the EU promulgated a further directive on the definition and public disclosure of "inside information". EU countries like the United Kingdom, Germany, France and Belgium have all implemented these requirements. In other words, in the EU, you are not only prohibited from trading on inside information, you are also required to disclose it as soon as possible. This is the approach we are taking now in our own proposal.

Some of you may ask why we do not follow the United States approach? We note that the US has a disclosure regime vastly different from ours. They do not have a concept of "PSI" as such. Rather, in the US, public companies are required to announce major events that shareholders should know about within four business days upon the occurrence of such event. In addition, when a listed corporation discloses material non-public information to certain persons, it must disclose that information to the public immediately. I want to note that this is very different from the continuous disclosure practice currently adopted in the Listing Rules in Hong Kong.

In taking our current approach, our objective really is to encourage compliance and to raise the continuous disclosure culture to a higher level. We believe most of the listed corporations are complying with the Listing Rules already. We do not intend to burden these corporations and their directors with undue requirements or impose unnecessary compliance costs on them.

And under our proposal, every director and officer involved in the management of a listed corporation must take all reasonable measures to prevent the corporation from breaching the PSI disclosure requirements. This is consistent with the spirit and requirements under the existing Listing Rules. While most of the obligations under the Listing Rules apply to listed issuers, not directly on individual directors, responsibility for the issuer's compliance rests with the "controlling mind" of the corporation - this includes its directors. Directors are therefore already required to use their best endeavours to procure the issuer's compliance with the Listing Rules.

I have talked about the deliberations behind the current PSI proposal because I believe we should have an open dialogue with our stakeholders on how we have come to the current approach, what are the factors we have considered, and how we strike a balance between practicality and general policy objectives.

I would make a few observations about the principles that guided us in coming to this proposal. These same principles, in my view, are also relevant to discussions about other proposals in the area of financial regulation.

First, our regulation must be consistent and predictable. Our current approach is consistent with the well-understood "insider dealing" legislation and the principle-based approach in regulation.

Second, we need to strike a balance between compliance cost and enforceability. If compliance cost is too high, it ultimately hurts the investing public.

Third, we have to listen and explain. We need to understand the concerns of stakeholders and market participants, and we need to explain why we make a particular decision. This will help in getting the proposal accepted and ultimately improve the chance of success in facilitating compliance.

Fourth, we need to build common ground. We have considered whether to include criminal sanctions in our PSI disclosure regime. But we have decided that there is little added benefit of criminal sanctions at this stage, but the controversy around the idea of putting criminal sanctions into the statutory regime will detract from deliberations on the more fundamental policy objectives.

Win-win situation

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We are trying to create a win-win situation both for investors as well as for listed corporations and their directors. Investors would benefit from a more transparent market. Listed corporations and directors should find the disclosure requirements clearer. By using the familiar concept of "inside information", specifying safe harbours in the law and having the SFC to

promulgate detailed guidelines, we would like to facilitate compliance. In addition, the SFC would provide a consultation service for listed corporations in the initial period of implementing the statutory regime. I would also encourage the Institute to provide training courses to company directors and other market participants, to enhance their understanding of the statutory requirements. And the Government and the SFC stand ready to support it.

I would like to emphasise that indeed, we are not creating unnecessary burdens for you. But our new approach is devised to address the market's previous concerns on the lack of flexibility of statutory listing rules and, at the same time, making it clear to the market what needs to be disclosed.

And do we have to make a change? Many overseas jurisdictions have already given statutory status to their listing rules. They include other major international financial centres like the UK. We need to continuously improve our listing regime to sustain investor confidence in our market. This is particularly important given that most of the listed corporations in Hong Kong are incorporated offshore, and we have so far been relying on the Listing Rules, instead of our local legislation, as the principal tool for regulating them. We now have a proposal which could facilitate market compliance, encourage disclosure and provide quality information to investors. We are now ready to put in place the legislative regime.

Our consultation will close on June 28. We welcome your comments. I sincerely hope that we will have your support.

Similarly, we need your support for another important issue. The Legislative Council (LegCo) will soon decide whether to approve the Government's package of proposals on the methods for selecting the Chief Executive and for forming the Legislative Council in 2012.

Why should I bring up this subject in a luncheon with the Institute of Directors?

First and foremost, this package of proposals deals with the important subject of constitutional development in Hong Kong, which is related to you and me, and our future generations. With the common aspirations of our community for democratic development, this has been the most important

subject with far-reaching impact for public discussion since the establishment of the Hong Kong Special Administrative Region (HKSAR).

And yet we have failed in the past to make progress on this subject. The failure of the 2005 proposal to get passed by LegCo has been a great setback and disappointment.

Making progress on our electoral arrangements towards universal suffrage is not only important in its own right, but it also reflects on how well our political system can deliver results for the good of Hong Kong.

That is why I bring up this issue today even if constitutional development is not a usual subject for a talk with a financial and corporate audience. When I previously explained our approach in implementing financial regulatory reforms, I emphasised the need for balancing various interests, seeking common ground, and striking a balance between practicality and ideals. I believe these principles are also valid for our current discussion on the constitutional development of Hong Kong.

The HKSAR is less than 13 years old. Our political system is still in its infancy. The challenges faced by our young political system are however many, and are related to the economic and social development of the HKSAR. Meeting these challenges also requires hard work, careful balancing between various objectives, and a commitment to working towards the common good. The same political hard work and compromises are required to make progress on any controversial issues in an open, democratic society. If our political system cannot make progress on the single most important issue to our community, such as our constitutional development, how can it earn confidence in its ability to tackle other controversial issues? The endless arguments on constitutional development will detract from the important work of bringing about an improvement of economic and social well-being of our community.

Compared with the existing electoral arrangements, this package opens new doors for political participation, enhances the democratic elements of our system, and creates favourable conditions to achieve universal suffrage.

The road ahead is clear. The Central Government has made it clear that

Hong Kong may implement universal suffrage for the Chief Executive in 2017 and for the Legislative Council in 2020, and all that Hong Kong needs to do is to decide on the methods for doing so. That is why it is so important and we are so keen to make progress in 2012. If we can come together and agree on the arrangement for 2012, we can take off from there to sail towards universal suffrage.

Whether the package can be passed is entirely our own choice. Do we want to see progress, and not another stalemate? Do we want to focus on common ground, rather than cling to our own views? Should we work together for the best interests of Hong Kong, rather than pursue our own narrow interests?

Since the start of our campaign "Act Now", we have taken our proposal to the public to appeal for their support. It is my belief that the public wants to see progress. The public recognises the need for balancing various interests. The public also expects our political system to work out the common ground. The public wants us to get up and get going, rather than be stuck in the mud.

I hope I have your support. Tell your LegCo representatives: "Act Now". Thank you.