Securities and Futures (Amendment) Bill 2011 –

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

Frequently Asked Questions

Q1: Why should we codify the requirements to disclose price sensitive information into statute?

A1: The Administration supports the cultivation of a continuous disclosure culture among listed corporations. A way to achieve this is to oblige timely disclosure of price sensitive information ("PSI") under our statute, instead of relying on the existing Listing Rules of the Stock Exchange of Hong Kong ("SEHK") – a contractual relationship between the SEHK and each listed corporation. This will oblige listed corporations to make available necessary information for investors in making informed investment decisions.

Through continuous improvement of the regulatory regime in respect of listing, we are enhancing our market transparency and quality. This will also help sustain Hong Kong as a leading international financial centre and the premier capital formation centre in the region.

Q2: How is PSI defined under the Securities and Futures (Amendment) Bill 2011?

A2: The Bill proposes using the concept of "relevant information" currently used in the insider dealing regime to define PSI (to be referred to as "inside information" in the Bill). This concept is currently used in the Securities and Futures Ordinance ("SFO") in describing "insider dealing".

"Inside information", in relation to a listed corporation, means specific information that –

(a) is about—

(i) the corporation;

(ii) a shareholder or officer of the corporation; or

(iii) the listed securities of the corporation or their derivatives; and

(b) is not generally known to the persons who are accustomed or would be likely to deal in the listed securities of the corporation but would if generally known to them be likely to materially affect the price of the listed securities.

Put it simply, PSI will be the same set of information currently prohibited from being used for dealing in the securities of the listed corporation concerned. In other words, in addition to the existing prohibition from making use of PSI for insider dealing, listed corporations will be required to disclose PSI to the public in a timely manner.

Our approach of using the concept of "inside information" to define PSI is the same as the approach adopted by the United Kingdom ("UK") and other member states of the European Union ("EU").

Q3: Under the Bill, what are the statutory obligations of listed corporations, and their "officers"[1] involved in the management of the listed corporations?

A3: A listed corporation will be obliged to disclose to the public as soon as reasonably practicable any "inside information" that has come to the knowledge of the listed corporation. A listed corporation will be regarded to have knowledge of the inside information if information has, or ought reasonably to have, come to the knowledge of an "officer" involved in the management of the corporation in the course of performing his functions.

Every "officer" involved in the management of the corporation of a listed corporation would be obliged to take all reasonable measures from time to time to ensure that proper safeguards exist to prevent the corporation from breaching the statutory disclosure requirements.

Q4: When would an "officer" of a listed corporation be considered to be breaching the statutory disclosure requirements?

A4: Should a listed corporation be found not complying with the statutory disclosure requirements, and that such a breach is a result of any intentional, reckless or negligent act on the part of a particular "officer", or that a particular "officer" has not taken all reasonable measures from time to time to ensure that proper safeguards exist to prevent the breach, the particular "officer" would be liable to the breach.

Q5: Would the proposals under the Bill have exemptions?

A5: We need to ensure market transparency and fairness, and at the same

[1] Part 1 of Schedule 1 to the Securities and Futures Ordinance has already defined an "officer", in relation to a corporation, to mean "a director, manager or secretary of, or any other person involved in the management of, the corporation".

time to safeguard the legitimate interests of listed corporations in preserving certain information in confidence to facilitate its operation and business development. The Bill therefore proposes the following four safe harbours to allow listed corporations not disclosing or to delay disclosing certain PSI -

(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;

(B) when the information concerns an incomplete proposal or negotiation;

(C) when the information is a trade secret; and

(D) when the Government's Exchange Fund or a central bank provides liquidity support to the listed corporation. This safe harbour will allow the listed banking institution to recover from its liquidity difficulties to the benefit of its depositors, other creditors and shareholders and the overall stability of Hong Kong's financial markets.

The Bill proposes that the SFC be empowered to grant a waiver to listed corporations if they face disclosure prohibition arising from court orders or legislation of a place outside Hong Kong, or 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.

To allow for flexibility and to cater for unforeseen circumstances as a result of rapid market development in the financial services industry, the Bill also proposes to empower the SFC to, after consulting the Financial Secretary, make rules to prescribe further safe harbours if it considers that it is in the public interest to do so. Such rules are subsidiary legislation under the SFO, and will be subject to the Legislative Council's ("LegCo") negative vetting.

Except for Safe Harbour (A) above, all other safe harbours will be applicable only if the concerned listed corporation has taken reasonable precautions for preserving the confidentiality of the inside information and that there is no leakage of the inside information.

Q6: Does the Bill require listed corporations to respond to rumours?

A6: The Bill will not oblige listed corporations to respond to mere rumours. Otherwise, they may be under an undue burden of responding to

rumours from time to time. However, where rumours indicate that the inside information intended to be kept confidential has been leaked, the listed corporation would need to disclose the inside information.

Q7: What assistance would be given to listed corporations to facilitate their compliance?

A7: The SFC will promulgate guidelines on what constitutes "inside information" and when the safe harbours would be applicable. This should facilitate the listed corporations in complying with the statutory disclosure requirements.

The SFC would also provide an informal consultation service to assist listed corporations in understanding how to apply the new statutory disclosure requirements. The service would initially last for 24 months.

Q8: What are the sanctions against offending corporations/persons under the Bill's proposal?

A8: We aim to formulate a proposal that would promote compliance by listed corporations and facilitate enforcement of the disclosure obligations. The Bill proposes that one or more than one of the following civil sanctions be imposed in case of a breach of the disclosure requirements-

(a) a regulatory fine up to $8 million on the listed corporation, each of its directors and/or its chief executive[2];

(b) disqualification of the "officer" from being a director or otherwise involved in the management of a listed corporation for up to five years;

(c) a "cold shoulder" order on the "officer" (i.e. the person is deprived of access to market facilities) for up to five years;

(d) a "cease and desist" order on the listed corporation or "officer" (i.e. an order not to breach the statutory disclosure requirements again);

(e) a recommendation order that the "officer" be disciplined by any body of which that person is a member;

[2] Chief executive is defined under s.308(1)) of SFO as "the person employed or otherwise engaged by a corporation who, either alone or together with one or more persons, is or will be responsible under the immediate authority of the board of directors for the conduct of the business of the corporation".

(f) payment of costs of the civil inquiry and/or the SFC investigation by the listed corporation or "officer"; and

(g) such order as is necessary to ensure that the corporation takes appropriate action to prevent a similar breach of the disclosure requirement. This 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.

Q9: Which entity would decide on the sanctions to be imposed?

A9: In view of the Market Misconduct Tribunal ("MMT")'s experience in handling cases concerning "inside information" and in considering orders (b) to (f) in A8 above, the Bill proposes extending the jurisdiction of MMT to deal with breaches of the PSI disclosure requirements.

Q10: Who may institute MMT proceedings for PSI cases?

A10: To streamline the proposed civil regime, the Bill proposes to empower the SFC to institute proceedings on breaches of the disclosure requirements direct before the MMT.

Q11: Who may institute MMT proceedings for the existing six types of market misconduct?

A11: Under the current Securities and Futures Ordinance ("SFO"), market misconduct is regulated by two alternative and mutually exclusive means: criminal prosecution under Part XIV of the SFO and civil proceedings before the MMT under Part XIII of the SFO. The SFO empowers Financial Secretary ("FS") to institute proceedings before the MMT and FS will as a routine practice consult the Secretary for Justice ("SJ") before exercising this power.

To streamline the process, the Bill replaces FS with the SFC in instituting these proceedings for market misconduct. However, to ensure the primacy of criminal prosecution, the Bill will provide that the SFC must not institute any such MMT proceedings for market misconduct unless it has obtained consent from SJ. SJ may withhold the giving of consent to MMT proceedings in respect of any conduct

only if and so long as proceedings for an offence under Part XIV of SFO are contemplated; or proceedings for an indictable offence (other than an offence under Part XIV of SFO) are contemplated, or have been instituted, and institution of MMT proceedings would be likely to cause serious prejudice to the investigation or prosecution of that offence.

SJ's consent to institute MMT proceedings is not applicable to cases of breaches of PSI disclosure requirement which will not give rise to any criminal liability.

Q12: What remedies are available under the Bill?

A12: Based on section 281 of the SFO, the Bill proposes that persons suffering pecuniary loss as a result of others breaching the disclosure requirements could rely on the findings of the MMT to take civil actions to seek compensation from those having breached the disclosure requirements.

The SFC may also, where appropriate, take action under existing provisions of the SFO to apply for injunctive and disqualification orders.

Q13: Which entity will be responsible for enforcement and investigation?

A13: The SFC will be the enforcement authority. It will, upon receipt of a referral from the SEHK of possible breach, or upon detection of a possible breach at its own initiative, carry out investigation and pursue follow-up proceedings of the case.

Q14: What are the changes made to the legislative proposal after the consultation in 2010?

A14: Compared with our consultation proposal, the Bill has, in addition to drafting improvements, made the following major revisions to the proposal -

(a) making it explicit that the timing of disclosure is "as soon as reasonably practicable" (see the proposed section 307B(1));

(b) specifying that an objective test should apply in considering whether a piece of information is price sensitive. This objective test is now set out in the proposed section 307B(2)(b) – "…inside information has come to the knowledge of a listed corporation if …(b) **a reasonable person, acting as an officer of the**

corporation, would consider that the information is inside information in relation to the corporation";

(c) replacing "come into possession of the information" in the then section 101B(2) in the consultation proposal with "information has … come to the knowledge" in the proposed section 307B(2);

(d) revising Safe Harbour (A) in A5 above so that it would be applicable irrespective of whether there is leakage (see the proposed section 307D(1));

(e) removing "the outcome of which may be prejudiced if the information is disclosed prematurely" from Safe Harbour (B) (see the proposed section 307D(2)(c)(i));

(f) in Safe Harbour (D) in A5 above, expanding the reference to "central bank" to include "an institution which performs the functions of a central bank" (see the proposed section 307D(2)(c)(iii));

(g) adding a new section 307D(4) 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;

(h) 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 (see the proposed section 307E(1)(c) and (d));

(i) 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 the proposed section 307G(2)(b);

(j) extending the regulatory fine to cover chief executives as well (in addition to listed corporations and their directors under the consultation proposal). This is in light of the consideration that like the directors, the chief executive plays a much more prominent role than other "officers" who are not directors in a listed corporation, and that he is head of the staff of the corporation. Both directors and the chief executive have already been subject to specific statutory requirements under the SFO which do not apply

to other "officers" (see the proposed section 307N(1)(d));

(k) 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 (see the proposed section 307N(1)(h) and (i)); and

(l) providing that the SFC must not institute any MMT proceedings for market misconduct unless it has obtained consent from Secretary for Justice (see the proposed section 252A). This however is not applicable to cases of breaches of PSI disclosure requirement. (Please also refer to A11 above.)

Q15: What are the advantages of having a statutory regime?

A15: As compared with the existing continuous disclosure obligations under the SEHK Listing Rules, proposals under the Bill have the following advantages-

Proposals under the Bill	**Existing SEHK Listing Rules**
(a) Creating a formal statutory obligation for compliance with certain PSI disclosure requirements	The existing requirement is contractual in nature
(b) Providing a clearer set of PSI disclosure requirements with obligations and safe harbours explicitly set out in the law, to be supported by guidelines to be promulgated by the SFC to facilitate listed corporations in ensuring compliance	There are no explicit safe harbours in the Listing Rules
(c) Allowing the SFC to resort to its powers under the SFO to conduct more effective investigation into a suspected breach of these	The Listing Rules lack regulatory teeth and the SEHK which administers the Listing Rules does not have investigatory power

statutory requirements	
(d) Enabling all alleged breaches to be heard by an independent statutory body (the MMT)	Alleged breaches of the Listing Rules are considered by the SEHK
(e) Empowering the SFC to institute proceedings before the MMT without having to seek the Financial Secretary's prior approval, therefore enabling a streamlined civil regime for promoting PSI disclosure	
(f) Imposing a wide range of statutory civil sanctions in respect of any proven breach of these PSI disclosure requirements	At present, SEHK may only resort to certain disciplinary actions under the Listing Rules such as private reprimand, public censure or public statement of criticism
(g) Enabling persons suffering from pecuniary loss as a result of others breaching the statutory disclosure requirements to rely on the results of the MMT proceedings to take civil actions against those breaching the requirements for compensation	Those suffering pecuniary loss have nothing with legislative effect to rely on for seeking compensation
(h) Bringing our regime more in line with overseas jurisdictions (such as the UK and other EU countries) in the approach of defining PSI in the statute and giving a statutory status to the requirements to disclose PSI	We lag behind these major jurisdictions in giving a statutory status to the requirements to disclose PSI

The proposals under the Bill would help demonstrate to the market our commitment to enhancing market transparency and quality, and would

be an important step in enhancing Hong Kong's position as China's global financial centre and the premier capital formation centre in the region.

Q16: What is the legislative timetable?

A16: The Securities and Futures (Amendment) Bill 2011 will be gazetted on 24 June 2011 and introduced into the Legislative Council for First and Second Readings on 29 June 2011.

Financial Services Branch
Financial Services and the Treasury Bureau
22 June 2011