Re: Bills Committee on Securities and Futures (Amendment) Bill 2011

Submission of the Hong Kong Bar Association

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1. Summary

1.1 The Hong Kong Bar Association (the "**HKBA**") welcomes the present legislative proposals to:

(1) Codify into statutory provisions in the Securities and Futures Ordinance (Cap. 571) the requirement on listed companies to disclose to the public any price sensitive information in a timely, equal, and effective manner;

(2) Entrust the Securities and Futures Commission with the responsibility of administering the new statutory provisions (including to give waivers) and investigating and prosecuting cases of non-disclosure or false or misleading disclosure; and

(3) Empower the Market Misconduct Tribunal to hear and decide such cases.

1.2 The present legislative proposals broadly follow the policy proposals and draft statutory language that the Government published for public consultation in 2010. The HKBA has made a response in the previous exercise and continues to support the proposals. A copy of the HKBA's earlier response is enclosed at Annex A.

2. Officer's Duty to Take Reasonable Measures

2.1 The HKBA has noted in its earlier response (at ¶¶3.3 to 3.6) a linguistic issue with the draft statutory language on officers' duty to take measures to prevent the listed corporation from breaching the disclosure requirement.

2.2 The HKBA notes that the present proposal, in s307G, has clarified the issue, and added that the duty is to take measures "to ensure that proper safeguards exist to prevent a breach of a disclosure requirement" rather than directly to prevent a breach of the requirement.

2.3 With the addition of the concept of "proper safeguards", it might be more natural or logically easier to express the duty in the positive (as a duty to have procedures and safeguards to ensure compliance) rather than in the double negative (as a duty to have safeguards to prevent a breach).

2.4 It is also important to consider how the expression of the duty might affect what kind of procedures and safeguards must be in place. Arguable, a "positive" duty (to ensure compliance) might require overall procedures, while a "negative" duty (to prevent breach) presupposes identification of potential problems and putting in place specific safeguards only in those areas.

2.5 The HKBA suggests that the Bills Committee and the Government considers this matter and also clarify the policy / legislative intent.

3. Safe Harbours and the Prohibition against Insider Dealing

3.1 The present legislative proposals, following the earlier policy proposals, contain several safe harbours from the disclosure requirement. For example, s307D(2)(c)(i) would allow a listed corporation not to disclose price-sensitive information about impending business negotiations or incomplete proposals.

3.2 The HKBA reads the draft legislative language as providing safe harbours only from the disclosure requirement, not from the prohibition against insider dealing. This must be logically correct. Indeed, as the Market Misconduct Tribunal and its predecessor Insider Dealing Tribunal has time and again ruled, information about ongoing matters can be just as price-sensitive as completed matters.

3.3 The HKBA suggests that the Bills Committee and the Government make some mention of this when explaining the safe harbours.

4. Concluding Views

4.1 The present proposal to codify in statute the requirement on listed corporations to disclose price-sensitive information is a significant step in continually improving Hong Kong's regulatory regime. The HKBA welcomes it.

The Hong Kong Bar Association
21st October 2011

Re: Consultation Paper on the Proposed Statutory Codification of Certain Requirements to Disclose Price Sensitive Information by Listed Corporations

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Response of the Hong Kong Bar Association

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1. Summary

1.1 The Hong Kong Bar Association ("**HKBA**") welcomes the Government's policy proposals to:

(1) Codify into statutory provisions in the Securities and Futures Ordinance (Cap. 571) (the "**SFO**") the requirement on listed companies to disclose to the public any price sensitive information ("**PSI**") in a timely, equal, and effective manner;

(2) Entrust the Securities and Futures Commission ("**SFC**") with the responsibility of administering the new statutory provisions (including to give waivers) and investigating and prosecuting cases of non-disclosure or false or misleading disclosure; and

(3) Empower the Market Misconduct Tribunal ("**MMT**") to hear and decide such cases.

1.2 In making the comments below, the HKBA has considered the available proposal details, the existing statutory as well as non-statutory rules applicable to the matter, certain relevant judicial decisions, and the types of non-disclosure or false or misleading disclosure that have led to public disciplinary actions in recent years. The overarching consideration is how the new proposals would fit within and impact the overall regulatory regime.

1.3 Details of the HKBA's response are as follows.

2. Codification of the Requirement

2.1 The requirement on listed companies to disclose PSI is presently in Rule 13.09 of the Listing Rules of the Stock Exchange of Hong Kong Ltd ("**Listing Rules**" and "**SEHK**").

2.2 As the Government pointed out in its Consultation Paper, the lack of "teeth" for the Listing Rules has been an issue of public concern. Reliance on non-statutory regulation raises doubt about enforcement ability and effectiveness. It also puts Hong Kong "out of sync" with other financial markets.

2.3 The HKBA agrees with the Government that the present proposal is appropriate for addressing these issues.

2.4 As the Government also noted in its Consultation Paper, some market participants have queried whether statutory regulation would become inflexible. There is also concern that a legal requirement might not adapt to the ever-changing commercial world. The HKBA, however, believes that such concerns should be alleviated for a number of reasons.

2.5 First, the proposed statutory provision states a principle: A listed company must, as soon as practicable, disclose inside information to the public. This principle is expressed clearly and also flexibly. It is well capable of application to different facts in different cases.

2.6 Second, the law is, by nature, concerned with the application of general principles to particular facts. Commercial and financial law routinely deals with the diverse business world. The codification of a non-statutory rule into a statutory provision should not cause any concern about its applicability to different facts.

2.7 Third, existing section 214(1)(c) of the SFO already empowers the SFC to apply to the High Court for remedies (usually the disqualification of directors but also potentially the compensation of investors) where shareholders of a listed company "have not been given all the information that they may reasonably expect". In *Re Warderly International Holdings Ltd*, HCMP No. 1742 of 2009, 9 April 2010, per Harris J, the Court accepted that non-disclosure in breach of the Listing Rules amounts to such a situation. The SFC already has wide powers to hold company management responsible for non-disclosure of PSI. The new statutory provisions only bring this matter squarely to the fore and, moreover, to provide for a specific adjudicatory process.

2.8 Fourth, the proposed statutory provision is narrower than the present Listing Rule 13.09. It covers only information about a listed company or the company's shareholders, officers, listed securities or their derivatives, and which "would be likely to materially affect the price of the listed securities". Rule 13.09, in comparison, covers "information on any major new developments in [the company's] sphere of activity" and any information that is "necessary to avoid the establishment of a false market in [the company's] securities". The more tightly worded statutory provision facilitates application.

2.9 Fifth, the proposed provision adopts the concept as well as definition of "inside information" (currently labeled "relevant information" and to be renamed), which has long existed in statutes in underpinning the prohibition against insider dealing. Experience has proven this to be a comprehensible, workable expression. Moreover, listed companies and directors should be already familiar with it.

2.10 Sixth, the concept and definition of "inside information" are very similar across most leading jurisdictions. Market participants, their advisers, the SFC, and (if necessary) the MMT can draw on a wealth of decided cases to aid in dealing with any particular set of facts.

2.11 Seventh, under the new regime the SFC would issue (and is currently consulting upon) a set of Guidelines on Disclosure of Insider Information. It may also issue further guidance from time to time. This follows the regulatory practice in other jurisdictions.

2.12 Eighth, there would be (as proposed) a mechanism for informal consultation with the SFC regarding disclosure requirements. To any extent market participants and their advisers might still have doubts in a particular situation even after careful consideration of the statutory provision, case law, regulatory guidance, and the particular facts, they could "play safe" and disclose more rather than less.

2.13 For the above reasons, the HKBA supports the codification of the requirement on listed companies to disclose PSI into statutory provisions with the force of law.

3. Liabilities of Directors and Officers

3.1 A company makes decision and acts (or fails to decide or act) through its officers. For the new statutory requirement to achieve its proper effect, it should place the burden of compliance not only on listed companies, but also on their officers. This is also the approach in other areas of corporate or securities regulation, e.g., making directors liable for false or misleading statements in prospectuses, subject to the defence of having taken all reasonable steps to ensure accuracy.

3.2 The HKBA supports the Government's proposals expressly to require officers of listed companies to take all reasonable measures from time to time to ensure that proper safeguards exist for the proper disclosure of PSI.

3.3 The HKBA notes that the proposed draft statutory provision (section 101G(2) of the SFO) would make an officer (a) whose intentional, reckless or negligent act or omission has resulted in a breach by the company of the disclosure requirement, or (b) who has not taken all reasonable measure to prevent the breach, to be also personally in breach of the requirement.

3.4 Situation (a) appears sensible. Alternative (b) may be problematic. As currently drafted, it might require officers to take all reasonable measures to prevent each and every conceivable breach. This raises a conceptual issue.

3.5 How are the sufficiency and reasonableness of measures (i.e., whether an officer has take all reasonable measures) judged? Surely the standard of care should not be determined with the benefit of hindsight. The sensible answer probably turns both on the general (e.g., the internal management system that the company has in place) and the specific (e.g., any particular situation the company is in). In some situations, e.g., surprise discovery of financial troubles, a company and its officers may need to put in place additional measures above the usual safeguards.

3.6 It may be that the proposed draft section 101G(2)(b), in speaking of "the breach", is aimed to include both the general and the specific. Provided it does so without meaning to invoke hindsight, the HKBA would support such a requirement.

4. The SFC to Administer the New Statutory Provisions

4.1 The SFC is the statutory regulator of the securities market in Hong Kong. It vets, in parallel with the SEHK, disclosure by listing applicants. It investigates market

misconduct, insider dealing, false or misleading disclosure by listed companies (pursuant to the Securities and Futures (Stock Market Listing) Rules (Cap. 571V)), and management misconduct (under section 214 of the SFO).

4.2 The HKBA agrees with the Government that the SFC is the natural public agency to be tasked with the administration of the new statutory provisions. As part of this, it must be reasonable for the SFC to have the power to grant waivers, including conditional waivers. This would follow the usual practice; the SFC is given such powers in its other regulatory responsibilities, e.g., prospectuses and other disclosure vetting, licensing, takeovers and mergers.

4.3 As mentioned above, existing section 214 of the SFO already empowers the SFC to bring cases of non-disclosure of PSI to court and the present proposals would serve to bring the SFC's role and responsibility to the fore. This is potentially a sea change. Although the proposals strike expressly only at disclosure of PSI and the Government has stated a deliberate policy decision not to cover other aspects of the Listing Rules (e.g., financial reporting, other periodic disclosures, notifiable transactions), problems in those other situations could also constitute or involve non-disclosure of PSI.

4.4 A review of the SEHK's disciplinary cases illustrates this point. For example, in mid and late 2009, the SEHK took actions against 2 companies and their directors for not disclosing in a timely manner certain transactions or changes to the terms of transactions and also for not seeking shareholders' approval or re-approval in breach of Listing Rules 14.34, 14A.47, 14A.45, and 14A.52. As another example, earlier in the same year, the SEHK took action against a company and its directors for failure to disclose a loan exceeding 8% of its assets in breach of Rule 13.13 and failure to disclose the same as a "discloseable transaction" in breach of Rules 14.34 and 14.38. Indeed, a substantial majority of recent cases involved one or more elements of non-disclosure of important information.

4.5 If and after the proposed statutory regulation comes into effect, such cases would raise an issue of which of the SFC and SEHK should lead in taking action. Since the SFC has more statutory "teeth" and the consequences of breach of statutory provisions would be more serious, it should be the first port of call. The HKBA agrees with the intended arrangement, stated in paragraph 3.9 of the Consultation Paper, that the SFC's investigation and enforcement should take precedence.

4.6 The Consultation Paper, however, did not highlight that the SFC, in investigating potential non-disclosure of PSI or false or misleading disclosure of information, will, to significant extent in practice, be investigating breaches of specific Listing Rules. The administrative implications should not be underestimated. The HKBA urges both the Government and the SFC to ensure that the regulator has proper resources, internal processes, and liaison with the SEHK to discharge the probable workload.

5. <u>The Market Misconduct Tribunal</u>

5.1 The Consultation Paper proposes for the MMT to decide cases of alleged breach of the new statutory requirement. Insofar as this follows from the policy decision not to criminalize the matter, the MMT would be a natural avenue. But it is not the only choice.

5.2 There are at present two key tribunals of securities regulation in Hong Kong. The MMT has general jurisdiction in that any member of the public might be alleged to have engaged in market misconduct or insider dealing and hence have to come before the tribunal. The Securities and Futures Appeals Tribunal ("**SFAT**") has a more specialized jurisdiction. The SFAT hears cases where the SFC has decided to discipline an intermediary or its staff and the person seeks a review.

5.3 Since listed companies and their officers belong to a regulated class, cases against them for non-disclosure of PSI could be disciplinary actions by the SFC with a right of appeal to the SFAT. The process might be more expedient. But it would also invite challenges about fairness and independence.

5.4 The MMT, unlike the SFAT, makes first-instance decisions. This may add to the length of hearings; indeed experience has been that MMT cases tend to take some time. But the process protects the SFC from accusations of being simultaneously "cop, prosecutor, judge, and jury".

5.5 Furthermore, the MMT is the tribunal with jurisdiction over insider dealing. The future statutory requirement on disclosure of PSI would be founded on the same concept of "inside information". It makes sense for the MMT to hear and decide both types of cases.

5.6 The HKBA supports the proposal to empower the MMT to hear and decide cases of alleged failure to disclose PSI in a timely, equal, and effective manner.

6. SFC's Direct Access to Institute Proceedings

6.1 At present, the SFC cannot institute MMT proceedings. It must refer the case to the Financial Secretary, who would consult the Department of Justice, after which step he/she shall decide whether to institute proceedings. The procedures require three arms of government (and countless staff) to review the same papers, viz., the SFC's investigatory report and underlying materials.

6.2 This appears rather unnecessary. The SFC is the agency with the most direct and expert knowledge of the securities market, securities law, and the particular case. Its judgment (reached internally at a sufficiently senior level) on whether to bring proceedings before the MMT ought to suffice.

6.3 To any extent there may be concern about the SFC's zealousness, the MMT itself provides the best check and balance.

6.4 The HKBA supports the Government's proposal that the SFC be empowered with direct access to institute proceedings before the MMT for suspected breach of the new statutory requirement. The HKBA further suggests the Government to review the existing arrangement and consider giving the SFC direct access in relation to all MMT cases.

7. Concluding Views

7.1 The Government's present proposals to codify in statute the requirement on listed companies to disclose PSI are a significant step towards addressing a long-known concern about the existing generally non-statutory regulatory regime.

7.2 Moreover, as explained earlier, the proposed statutory regulation of PSI would in effect strengthen the non-statutory requirements on other disclosures.

7.3 The proposals would also put the SFC at the fore as responsible for investigating and taking enforcement actions against disclosure failures. This greatly heightens accountability. It also correspondingly increases the regulator's workload.

7.4 The HKBA welcomes the proposals, but urges both the Government and the SFC to ensure that the regulator has proper resources, internal processes, and liaison with the SEHK to discharge its responsibilities.

The Hong Kong Bar Association
27th August 2010