New Requirements for Disclosure of Price Sensitive Information: A Guide for Hong Kong Listed Companies

New legislation in Hong Kong introduces a statutory regime for the disclosure of price sensitive information by SEHK listed companies. The regime substantially expands the existing framework. It imposes personal liability on officers of such companies, with directors and chief executive officers potentially facing fines of up to HK$8 million. Repeat offenders may be subject to imprisonment. In this guide, we provide an overview of the new legislation and offer suggestions on compliance.

The Securities and Futures (Amendment) Ordinance 2012 ("**Amending Ordinance**") introduces a statutory regime mandating that companies ("**listed companies**") listed on the Stock Exchange of Hong Kong ("**SEHK**") disclose price sensitive information. This legislation, which is expected to be accompanied by guidelines ("**Guidelines on Disclosure of Inside Information**") to be issued by the Securities and Futures Commission ("**SFC**"), is expected to take effect on January 1, 2013.

Background

The new disclosure regime will supplement existing disclosure requirements under the SEHK Listing Rules. The latter have sometimes been regarded as inadequate because sanctions for breach have historically been limited. However, given a more aggressive approach recently by the SFC and the courts in interpreting the Securities and Futures Ordinance ("**SFO**"), it is clear now that the existing disclosure regime is not as inadequate as some once thought. As a result, the new disclosure regime will, in fact, only provide another tool (albeit an important tool) for ensuring market transparency.

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[T]he [new disclosure] regime provides that, unless exempted, a listed company must, as soon as reasonably practicable after any inside information has come to its knowledge, disclose the information to the public.

Taken together, officers of listed companies now face an array of possible sanctions, both civil and criminal, for failing to properly disclose price sensitive information. It is therefore incumbent upon listed companies and their officers to establish policies and procedures to ensure compliance.

New Disclosure Regime

The new disclosure regime establishes obligations for listed companies to make disclosure and for their officers personally to ensure that disclosure takes place properly.

At the heart of the new disclosure regime is the definition of "inside information". This term determines what constitutes price sensitive information and therefore what needs to be disclosed and when.

For companies, the regime provides that, unless exempted, a listed company must, as soon as reasonably practicable after any inside information has come to its knowledge, disclose that information to the public.

Inside Information

The new legislation broadly adopts the existing definition of inside information (previously known as "relevant information") from the market misconduct regime. As a result, "inside information" means, in relation to a listed company, specific information that meets all of the following 3 conditions:

- *Relevant* – The information must be about the company, a shareholder or officer of the company or the listed securities of the company or their derivatives.
- *Non-Public* - The information must not be generally known to persons who are accustomed or would be likely to deal in the listed securities of the company.
- *Price Sensitive* - If generally known to persons who are accustomed or would be likely to deal in the securities of the listed company, the information must be likely to materially affect the price of those securities.

Practical Difficulties

In practice, what constitutes inside information is often a difficult question of judgment. Information which may constitute inside information in one context may not constitute inside information in a different context. For example, a HK$50 million transaction may be significant for one listed company but may be insignificant for another substantially larger listed company.

Equally, information may be of an uncertain nature and its materiality therefore difficult to ascertain. Reasonable men may differ as to whether any specific piece of information may, by itself or in conjunction with other information, be likely to affect the price of a company's securities in a material way. For example, where a listed company is in discussions about a possible transaction, the extent to which those discussions have progressed will be critical in determining whether information about that possible transaction constitutes inside information. There is no bright line test as to when the discussions will have progressed far enough to constitute inside information.

SFC Guidance

Whilst the SFC is expected to issue guidance as to what constitutes inside information and such guidance is admissible in court, it will not bind a court. Thus, in the end, in the event of any doubt as to what constitutes inside information, it will almost always be beneficial to seek independent professional advice. This is particularly so given that, as discussed below, (i) the new disclosure regime is not triggered unless a

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reasonable person would consider that the information in question is inside information, and (ii) the failure to seek such advice may be regarded as negligent, thus exposing officers to potential personal liability.

Management Accounts

It is unclear to what extent a listed company's financial position may constitute inside information ahead of the release of its financial results. Take for example a listed company whose financial year ends on December 31. By mid-January, the company may have a fairly good idea of its financial results for the previous financial year but the financial results will not be finalized until an audit is completed. The audit itself may not be completed until March. Does information as to the financial results as set out in the management accounts constitute inside information? At least to the extent that the financial results may differ markedly from market expectations, it may be argued that such information may constitute inside information, otherwise a person would be permitted to trade on the basis of this information. If this is correct, then under the new disclosure regime, a listed company must disclose this information, possibly in the form of management guidance, even before the financial results have been audited.

Knowledge of Inside Information

As set out above, the new disclosure regime is triggered only when inside information has come to the knowledge of a listed company. In this regard, inside information has come to the knowledge of a listed company if 2 conditions are satisfied, namely:

- *Officer Knowledge* - The information has, or ought reasonably to have, come to the knowledge of an officer of the company in the course of performing functions as an officer of the company. Significantly, liability may follow if an officer "ought reasonably" to have known about the information and thus, it is no defence to deny actual knowledge.
- *Objective Test* - A reasonable person, acting as an officer of the company, would consider that the information is inside information in relation to the company. As a result of this condition, it seems that a good faith determination that information is not inside information does not discharge liability for breach of the new disclosure regime if it is subsequently held that such information was inside information.

It is not clear under the SFO who might qualify as an "officer" for the purpose of the new disclosure regime. The SFO does provide that an officer will include a director, manager or secretary or any other person involved in the management of a listed company but does not go on to define a "manager" or a "person involved in the management of a listed company". In an attempt to clarify, the SFC has suggested in its draft Guidelines on Disclosure of Inside Information that a "manager" will normally refer to a person under the immediate authority of the board who is charged with management responsibility affecting the whole of the corporation or a substantial part of the corporation.

Exemptions

Broadly, at present, there are 3 categories of exemption from the disclosure requirement. All these exemptions will apply on a case by case basis:

- *Disclosure Prohibited by Hong Kong Law* – A listed company is not required to disclose inside information if and so long as the disclosure is prohibited under or would contravene a restriction imposed by Hong Kong legislation or an order of a Hong Kong

A listed company is not required to disclose inside information if the information concerns an incomplete proposal or negotiation or the information is a trade secret. However, to qualify for exemption, the company must take reasonable precautions to keep the information confidential and confidentiality must in fact be kept.

court. In this regard, a mere contractual restriction on disclosure would seem insufficient to invoke exemption as such a restriction would not originate from Hong Kong legislation; however, to the extent that such a restriction were enforced by a Hong Kong court through an injunction, it would seem sufficient to invoke exemption.

- *Disclosure Prohibited by Foreign Law* – The SFC may, on an application by a listed company, waive a disclosure requirement if disclosure is prohibited under or would contravene any restriction imposed by legislation outside of Hong Kong or any order of a court outside Hong Kong or would contravene any restriction imposed by any law enforcement agency or other government authority outside of Hong Kong.
- *Information Confidential* – A listed company is not required to disclose inside information if the information concerns an incomplete proposal or negotiation or the information is a trade secret. However, to qualify for exemption, the company must take reasonable precautions to keep the information confidential and confidentiality must in fact be kept. If confidentiality is breached, a listed company must as soon as reasonably practicable after it becomes aware of the breach disclose the information. In this case, it will not be liable if, despite the breach, it had taken reasonable measures to maintain confidentiality. A listed company may, without breaching confidentiality, disclose the inside information to a person who requires the information to perform his functions and who is under a duty to keep the information confidential (*e.g.* a legal adviser).

Whilst the SFC has the power to create further exemptions in consultation with the Financial Secretary, at present, it may be that the regime is overly rigid given the absence of an *ad hoc* power for the SFC to waive or defer disclosure subject to conditions. As the SFO will use the same definition of inside information for the purpose of both the new disclosure regime and the market misconduct regime, it effectively assumes that policy considerations dictating a prohibition of trading whilst in possession of price sensitive information necessarily dictate disclosure of that same information. It leaves no room for competing public policy considerations (*e.g.* safety or public order) which may be applicable to relax a disclosure decision but which may be inapplicable to relax a trading prohibition. The absence of discretionary exemptive relief means that disclosure decisions will be based solely on a judgment as to whether information does or does not constitute inside information rather than on a judgment as to whether information should or should not be disclosed. This may pervert the meaning of inside information so that there may be cases where a person can trade on inside information in circumstances where, from a policy perspective, he should be prohibited from so doing and conversely, there may be cases where a listed company must disclose inside information where from a policy perspective such disclosure may be premature.

Disclosure

Where a listed company is obliged to disclose inside information, it may do so in any manner that can provide for equal, timely and effective access by the public to that inside information.

Manner of Disclosure

Under the new disclosure regime, a listed company will be deemed to have disclosed information in a manner that provides for equal, timely and effective access if it disseminates the information through the SEHK.

If a listed company breaches disclosure requirements, an officer may be personally liable if (i) his intentional, reckless or negligent conduct resulted in the breach, or (ii) he failed to take all reasonable measures from time to time to ensure that proper safeguards existed to prevent breaches.

Whilst on a reading of the new legislation disclosure is not limited to dissemination through the SEHK, the SFC has indicated in its draft Guidelines on Disclosure of Inside Information that it does not consider that the issuance of a press release or the dissemination of information through a press conference would satisfy the requirement for equal, timely and effective access.

Ultimately, it seems that any manner of disclosure ought to satisfy the requirement provided that it results in the information becoming available at the same time to persons who are accustomed to or would be likely to deal in the relevant securities.

False or Misleading Disclosure

A listed company is taken not to have complied with its disclosure obligation if both the following conditions are met:

- the company discloses information that is false or misleading as to a material fact, or is false or misleading through the omission of a material fact, and
- an officer of the company knows or ought reasonably to have known that, or is reckless or negligent as to whether, the information disclosed is false or misleading as to a material fact, or is false or misleading through the omission of a material fact.

Holding Announcements and Suspensions

Where a listed company needs more time to clarify its position before disclosing information, the SFC has suggested in its draft Guidelines on Disclosure of Inside Information that the company should consider issuing a holding announcement which details as much of the subject matter as possible and sets out reasons why a fuller announcement cannot be made.

The requirement for equal, timely and effective access may, in practice, require that listed companies seek a suspension of trading in their securities pending the disclosure of inside information. Failure to do so may result in unequal disclosure.

Obligations on Officers

Officers of listed companies who fail to comply with disclosure obligations may bear personal liability. Under the new legislation, every officer of a listed company must take all reasonable measures from time to time to ensure that proper safeguards exist to prevent a breach of disclosure requirements. If a listed company breaches disclosure requirements, an officer may be personally liable if (i) his intentional, reckless or negligent conduct resulted in the breach, or (ii) he failed to take all reasonable measures from time to time to ensure that proper safeguards existed to prevent breaches.

It is significant to note that an officer may bear personal liability even if he has no intention to mislead the investing public. Negligence itself will suffice if it resulted in a breach, as will a failure to take all reasonable measures to ensure that proper safeguards are in place.

The negligence standard implies that listed companies should seek professional advice when there is any issue as to the appropriateness of the compliance program or as to whether information constitutes inside information. Failure to seek such professional advice may be regarded as a basis for a claim of negligence.

Enforcement

It is contemplated that the new disclosure regime will be enforced by the SFC through the Market Misconduct

Of particular concern for directors and chief executives of listed companies (but not other officers), the MMT may disqualify the person from being a director or from otherwise being concerned or taking part in the management of the listed company for up to 5 years… or impose a regulatory fine of up to HK$8 million.

Tribunal ("**MMT**"). Thus, the SFC will investigate and if thought fit, refer the matter to the MMT for adjudication or further investigation. Should the MMT find a breach of disclosure requirements, it may make a number of civil orders.

In the first instance, the MMT has no jurisdiction to impose criminal penalties such as imprisonment. However, where a person has been found by the MMT to have breached disclosure requirements and as a result, the MMT has ordered that the person must not again breach the disclosure requirements, if the person does breach disclosure requirements again, that person will commit a criminal offence punishable on indictment by imprisonment for up to 2 years.

Directors and Officers Liability

Of particular concern for directors and chief executives of listed companies (but not other officers), the MMT may (i) disqualify the person from being a director or from otherwise being concerned or taking part in the management of a listed company or any other specified company for up to 5 years, (ii) prohibit the person from dealing in securities, futures or leveraged foreign exchange contract or any interest in them or a collective investment scheme for up to 5 years, or (iii) impose a regulatory fine of up to HK$8 million.

Constitutionality of Fines

It is unclear whether the power to impose a fine of up to HK$8 million is or is not constitutional. In *Koon Wing Yee v. Insider Dealing Tribunal* [20008] HKCFA 21, [2008] 3 HKLRD 372, (2008) 11 HKCFAR 170, the Court of Final Appeal struck down as unconstitutional the power of the Insider Dealing Tribunal under predecessor legislation to fine a person found to have engaged in insider dealing. That legislation, like the present legislation, classified the offence as a civil one but the court found that the offence was in substance criminal rather than civil in nature.

The court's reasoning was based on the fact that insider dealing is misconduct of a very serious and dishonest nature and the fact that the fine was punitive. Arguably, the failure to properly disclose inside information is as serious and as dishonest as dealing whilst in possession of inside information. Indeed, such a failure constitutes a criminal offence in some jurisdictions.

It is difficult to see how the fine can be viewed as being other than punitive in nature. However, the court in *Koon Wing Yee* acknowledged that the regulatory character of legislation tends to support a conclusion that proceedings are civil rather than criminal. Here, the power to fine is limited to directors and chief executive officers, presumably on the basis that only such persons have voluntarily subjected themselves to the regulatory regime of the SEHK Listing Rules and the SFO. Furthermore, the power to fine is specifically termed a "regulatory" fine. Finally, certain other jurisdictions vest regulatory bodies with the power to impose fines on a civil basis for breach of their respective disclosure requirements. It is not clear to what extent the courts in the future will accept that a fine for failing to disclose inside information is regulatory in nature.

Statutory right of action

Independent of regulatory enforcement through the MMT, a person who breaches a disclosure requirement may be liable to pay compensation by way of damages to any other person who sustains any pecuniary loss as a result of the breach. Thus, for example, it seems that if a person relies upon publicly available information to make an investment and the information turns out to be wrong and as a result, the person suffers a loss on his investment, he may sue for that loss. However,

Where a listed company… fails to give to its shareholders (or any part of them) all information with respect to its business or affairs that they might reasonably expect or has engaged in misconduct, on a petition by the SFC, a court may… order that the listed company shall sue certain persons.

liability for compensation will only arise where it is fair, just and reasonable.

The significance of this right of action is that it is a subsidized lawsuit. Under the new disclosure regime, a finding of a breach by the MMT is not only admissible as evidence to prove a breach but, unless the contrary is proved, is conclusive evidence of the breach for the purposes of the right of action. As a result, a private litigant need not undertake what would normally be expected to be a complex process of establishing liability.

Existing Regime

It is important to note that the new disclosure regime is not an exhaustive regime to ensure the proper and timely disclosure of price sensitive information. In particular, the SEHK Listing Rules (together with the Guide on Disclosure of Price-Sensitive Information issued by the SEHK) remain relevant and the SFC may seek to enforce them through the SFO.

SEHK Listing Rules

Under the SEHK Listing Rules, a listed issuer should keep the SEHK and its shareholders informed as soon as reasonably practicable of any information relating to the company which (i) is necessary to enable them and the public to appraise the company's position, (ii) is necessary to avoid the establishment of a false market in its securities, or (iii) might be reasonably expected materially to affect market activity in and the price of its securities. Such information will include information on any major new developments in the company's sphere of activity which is not public knowledge and which meets the foregoing criteria.

Differences Between Listing Rules and SFO

It is significant to note that the threshold test as to what information needs to be disclosed under the SEHK Listing Rules will be different from that under the SFO. Whereas the SFO's focus on inside information will mean, in practice, emphasis on head (iii) above in the SEHK Listing Rules test, under the SEHK Listing Rules, information to be disclosed may include information under heads (i) and (ii) above (*i.e.* information necessary to enable investors to appraise a company's position and information necessary to avoid the establishment of a false market).

The extent to which the tests under the SFO and the SEHK Listing Rules differ is unclear. It may be, for example, that the SEHK Listing Rules would require a listed company to issue a statement to dispel a false rumour and thus, to avoid the establishment of a false market but that the SFO would not.

It is unclear whether, in the future, the SEHK will harmonize the disclosure thresholds by adopting the inside information test under the SFO.

Breaches of SEHK Listing Rule Disclosure Requirements

Where a listed company fails to comply with disclosure requirements under the SEHK Listing Rules or otherwise fails to give to its shareholders (or any part of them) all information with respect to its business or affairs that they might reasonably expect or has engaged in misconduct, on a petition by the SFC, a court may make certain orders including:

- an order that the listed company shall sue certain persons (*e.g.* directors who were responsible for disclosure failures); or

[I]t is both an offence and a civil wrong for a person to disclose, circulate or disseminate (or authorize or be concerned in the disclosure, circulation or dissemination of) information that is likely to induce a person to deal in securities or to maintain, increase, or reduce the price of securities if the information is false or misleading.

- an order that persons responsible for disclosure failures be disqualified from being a director or otherwise being concerned in, or taking part in, the management of a company for a period up to 15 years.

False or Misleading Disclosures

Quite apart from the new disclosure regime, listed companies and their officers may be held to account for failing to disclose or improperly disclosing inside information under current provisions of the SFO.

Market Misconduct

Broadly, it is both an offence and a civil wrong under the market misconduct regime for a person to disclose, circulate or disseminate (or to authorize or be concerned in the disclosure, circulation or dissemination of) information that is likely to induce a person to deal in securities or to maintain, increase, or reduce the price of securities if the information is false or misleading. In this regard, information will be false or misleading if it is false or misleading as to a material fact, or is false or misleading through the omission of a material fact. However, the person will only be liable on a criminal basis if he knows that, or is reckless as to whether, the information is false or misleading. He may be liable on a civil basis on any of the basis on which he may be criminally liable or on the basis that he is negligent as to whether the information is false or misleading.

Offence for False or Misleading Announcements

At the same time, a person commits an offence if (i) he provides to the SEHK any record or document which is false or misleading in a material particular, (ii) he knows that, or is reckless as to whether, the record or document is false or misleading in a material particular, and (iii) he has been warned by the SEHK that the provision of a false or misleading record would constitute an offence. In this context, as the SEHK Listing Rules require material price sensitive developments to be notified to the SEHK, to the extent that a press announcement by a listed company may be false or misleading in a material particular, the listed company may be criminally liable if the requisite warning has been given.

In this regard, where a listed company commits this offence, an officer of the company may bear personal criminal liability if (i) the offence is attributable to the recklessness of the officer, (ii) the offence was committed with the consent of the officer, or (iii) the offence was counselled or induced by the officer.

Protective measures

Whilst not immediately apparent, the remedies available under the new disclosure regime are not limited to those set out in the Amending Ordinance. Under the SFO, any breach of the SFO (which, by definition, will include the SFO provisions relating to the new disclosure regime), provides the basis for various protective and remedial orders by a court on the application of the SFC. Similarly, if it appears to the SFC that there may be such a breach, the SFC may seek such orders. These orders include orders to prohibit dealings in property, to take steps to remediate any breach or to do or refrain from doing any act.

Action required

With the introduction of the new disclosure regime, it is perhaps timely for listed companies to review their policies and procedures to ensure compliance. Appropriate policies and procedures will, amongst other things, enable a listed company to demonstrate that it has in place reasonable precautions to preserve

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confidentiality of inside information which is not yet ripe for disclosure and to enable officers of a listed company to demonstrate that they have put in place proper safeguards to ensure disclosure as required. A failure in either of these regards may mean that a listed company will be unable to withhold disclosure of confidential information relating to a proposal or negotiation that has not yet reached fruition or that an officer may be more likely to be personally liable for a breach of a disclosure requirement.

The new legislation does not spell out what policies and procedures are required. The references to "reasonable measures" and "proper safeguards" are vague. We suggest a formal written statement setting out the terms of a compliance program, staff training to ensure knowledge of the program and program content broadly as follows:

- *Governance Structure for Disclosure*. This may, for example, include establishing (i) a disclosure committee to determine whether information constitutes inside information and what information will be disclosed, (ii) procedures for monitoring and escalating information which may constitute inside information to the disclosure committee, and (iii) procedures for seeking advice from legal advisers and regulatory bodies as the case may be to determine whether information constitutes inside information.
- *Disclosure Methodology*. Policies and procedures may, for example, include (i) designating one or more spokespersons conversant with regulatory requirements to control the flow, quality and consistency of inside information being disclosed, whether written or verbal, and (ii) developing protocols for the release of information to vet the accuracy of information to be disclosed and to ensure timely and equal access by the investing public. These protocols should address how spokespersons should deal with rumors, analyst reports, conference calls and media requests for inside information.
- *Security and Confidentiality*. Policies and procedures (i) to ensure that inside information which is not disclosed is kept confidential, (ii) to review publicly available information and information disclosed to analysts, the media or in conference calls to determine whether confidentiality has been breached, and (iii) to disclose inside information where confidentiality has been breached.
- *Record Keeping*. Policies and procedures should be adopted to ensure that disclosure committee decisions are defensible and that there is no misunderstanding as to what has been disclosed and when.