Hong Kong Institute of
Certified Public Accountants
香港會計師公會

By email < psi_consultation@fstb.gov.hk > and by post

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Division 2, Financial Services Branch
Financial Services and the Treasury Bureau
18/F Tower 1 Admiralty Centres
18 Harcourt Road
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Dear Sirs,

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

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Please find attached in the Appendix the views of the Hong Kong Institute of Certified Public Accountants ("the Institute") on the proposals contained in the above-referenced consultation paper.

We support, in principle, measures to encourage more timely disclosure of price sensitive information ("PSI"). We consider that the ready availability of information about very significant transactions and developments affecting specific listed companies, promulgated in an expeditious and even-handed way, is essential to maintaining the integrity and transparency of the Hong Kong market.

Since proposals for statutory codification or backing of certain elements of the listing rules were first put forward several years ago, difficulties have primarily revolved around the detailed implementation of the proposals. In the case of price sensitive information disclosures, there is a concern that decisions as to whether certain information would be likely to be seen by investors as price sensitive, in any given circumstances, may be quite subjective and judgmental in nature. While the current proposals have clearly sought to address some of the reservations expressed about previous proposals for statutory codification of the PSI framework, the Institute has a number of remaining concerns, which are explained in the attached responses to the questions raised in the consultation paper.

We note that very serious breaches of the requirement relating to information disclosure can already be dealt with under section 384 of the Securities and Future Ordinance ("SFO") (in relation to the provision of false or misleading information) and, in a recent case, section 214 of the SFO (in relation to, inter alia, non disclosure of information that members might reasonably expect). The penalties under these provisions may be severe.

Under the circumstances, we believe that a fairly cautious approach should be adopted in implementing a statutory PSI disclosure regime for the first time in Hong Kong. Once the market has become accustomed to the way in which the framework operates and the expectations of all interested parties, if considered desirable, further changes can be considered in future.

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Given that decisions regarding PSI can be quite subjective and potentially contentious, we would emphasise the need for more specific guidance to be issued and for the existence of effective ongoing channels of communication between listed companies and regulators.

Any remedial action taken by the regulators and the market misconduct tribunal ("MMT"), where breaches are alleged, should adopt the principle of proportionality. The aim should be to help companies and directors to understand their disclosure obligations and encourage them to comply, rather than seek to impose the most stringent penalties, which could ultimately act as a disincentive to suitable candidates to take up directorships. In this regard, we also suggest that there is scope for removing some of the harsher proposed penalties or reducing their severity.

The safe harbour provisions, which set out circumstances in which disclosure may be delayed or withheld, are a key part of the PSI framework and, in our view, they need to be extended. The proposed legislation should not target companies or directors who have considered a particular situation and have, in good faith, come to the conclusion that certain information is not price sensitive, even though subsequently, with the benefit of hindsight (which will be available to the MMT) that judgment may turn out to be incorrect. In this regard, we suggest that there should be a safe harbour, akin to the "business judgment rule", to accommodate such situations.

If you have any questions on our submission or wish to discuss it further, please contact me at the Institute on 2287 7084 or by email at < peter@hkicpa.org.hk >.

Yours faithfully,

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PMT/ML/ay
Encl.

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Appendix

Comments from Hong Kong Institute of CPAs in response to the Consultation Paper on the Proposed Statutory Codification of Certain Requirements to Disclose Price Sensitive Information by Listed Corporations

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?

Given that the market already has some familiarity with the concept of "relevant information" under the insider dealing regime in the Securities and Futures Ordinance ("SFO"), adopting the definition of "relevant information" from the insider dealing regime to define price sensitive information ("PSI") under the PSI disclosure regime should, in principle, facilitate understanding of the scope of the latter.

However, we have some reservations about how this will work in practice. It is proposed to use the new term "inside information" for the PSI and the insider dealing regimes. The draft "Guidelines on the Disclosure of Inside Information" ("draft Guidelines") (Annex 2 of the Consultation Paper on the Proposed Statutory Codification of Certain Requirements to Disclose Price Sensitive Information by Listed Corporations ('the Paper")) quote past decisions of insider dealing tribunals in Hong Kong with regard to "relevant information". This would seem to suggest that future interpretations of "inside information" by insider dealing tribunals and, potentially, the court, in the context of insider dealing cases could have an immediate impact on the disclosure requirements under the PSI regime. This could create uncertainty.

It is important that listed corporations should have a clear understanding of their obligations under the law and, therefore, that reasonably detailed guidelines on what constitutes PSI under the statutory disclosure requirements should be developed. While the draft Guidelines are helpful so far as they go, they are also quite generic. We would suggest that the Securities and Futures Commission ("SFC") discuss them with listed company representatives and other market participants, and seek to address any concerns by the inclusion of more specific examples in the final version of the guidelines.

For example, paragraph 26 of the draft Guidelines makes the point that it is necessary to distinguish between information about the "day-to-day activities" of a corporation, on the one hand, and "significant events and matters which are likely to change a corporation's course or indicate that there has been a change in its course", on the other hand. However, this begs the question of what is regarded as "day-to-day". There are many transactions that may fall well short of changing a corporation's course, but it is not entirely clear whether they would be regarded as day-to-day activities. For example, a company may engage in hedging on a very regular basis and, due to market volatility, which is widely reported in the media, the value of the relevant hedges may vary significantly and potentially affect the profit or loss of the company. Should disclosures be made with each significant fluctuation? In another case, a company may anticipate mark-to-market losses but, because its general business picks up, the overall losses will not be great. Do circumstances such as these give rise to a disclosure obligation and, if so, at what point in time. The issue of timing is also covered in our response to question 1(b).

(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?

We suggest that a listed corporation should be obliged to disclose to the public as soon as reasonably practicable any "inside information" that has come to its knowledge. However, from the perspective of listed corporations, there may be practical difficulties in determining at what point of time inside information should be disclosed, so as to comply with the disclosure requirements, without pre-empting events or prejudicing the outcome of negotiations/proposals. There are other uncertainties about the appropriate timing, such as when to disclose (aside from the question of whether to disclose) significant changes arising from fair value accounting. We would emphasise again, therefore, the importance of having clear guidelines on the timing of disclosure, in addition to adequate and effective "safe harbour" provisions to cater for legitimate circumstances where disclosure of inside information may be delayed or withheld. In this regard, the existing draft Guidelines do not seem to go far enough in dealing with the concerns about timing.

Under the existing listing rules, it is the responsibility of directors to ensure timely disclosure of price sensitive information, and to take all reasonable measures to ensure that proper safeguards exist to prevent a corporation from breaching the listing rules. We have reservations about going beyond the existing listing rule standard and consider that defining the trigger point (i.e., inside information coming to the knowledge of a company) as a director or officer coming into possession of that information in the course of the performance of his duties, may exceed the current requirement. In particular, there is no precise definition of the term "officer". If it is the intention to use the existing definition of "officer" specified in Part 1 of Schedule 1 to the Securities and Futures Ordinance ("SFO") (as footnote 6 on page 8 of the Paper indicates) in our view, the scope would be too wide in the context of PSI disclosure. This would be wider, for example, than the equivalent provisions under the UK regime.

It is likely that an officer will have to report possible inside information to the directors, who would then decide whether or not to disclose such information. Officers other than directors would not generally be delegated the responsibility of determining whether or not information is disclosable and deciding on the issuing of press releases relating to PSI.

In view of the above, we suggest that the trigger for the PSI disclosure obligation to arise in a particular case be defined with reference to knowledge in the hands of a director, and that this should not be extended to officers.

Furthermore, we note that the indicative legislative provisions at Annex 1 of the Paper extend the definition of when inside information has come to the knowledge of a company to include the situation in which an officer "…ought reasonably to have, come into possession of the information..." This is, in part, an objective test and there is nothing in the draft Guidelines to indicate how it will be applied. The concept of "coming into possession of certain information" is not entirely self-explanatory and the proposed objective element will make it even less clear. While the aim of this provision may be, not unreasonably, to deal with the situation in which a director deliberately turns a blind eye to certain information, in practice the implications may be much wider. For example, is information received in an email, which a director may have overlooked, information that "has come into his possession" or information that "ought reasonably to have come into his possession"? The phrase "ought reasonably to have"

is so wide that it would include a situation where a director does not in fact know the relevant information. It seems inappropriate to require a corporation or director to disclose possible inside information in circumstances where that corporation or director is in practice not aware of that information. Dropping the objective test, would also be in line with the offence of insider dealing, which requires actual knowledge that information is inside information.

We would also suggest that there be a defence from liability for other directors, where a director who has come into possession of inside information has willfully failed to disclose the information to the board.

(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?

We agree.

Question 2

(a) Do you agree to the provision of the four proposed safe harbours?

We agree, in principle, with the provision of the four proposed safe harbours, except that Safe Harbour B may not be sufficiently clear. We note that the wording at paragraph 2.10 of the Paper differs from the indicative legislation at Annex 1 (section 101D(c)(ii)) and, in referring to an “incomplete negotiation”, the indicative legislation is clearer than paragraph 2.10 of the Paper, which refers to “impending negotiations”. However, the term “incomplete proposal”, which is in both places, is not a clear term in this context.

In addition, while there may be circumstances in which disclosing the information could prejudice the outcome of negotiations, a belief that the outcome could be prejudiced by disclosure should not, in our view, be a necessary condition for invoking this particular safe harbour. It is noted that under the existing Listing Rules (note 4 of the main board rule 13.09(1)), "the overriding principle is that information which is expected to be price-sensitive should be announced immediately if it is a subject of a decision". Under the UK Disclosure and Transparency Rules ("DTR") 2.5, a listed issuer may delay the public disclosure of inside information so as not to prejudice its legitimate interests and “legitimate interests”, under DTR 2.5.3, may include "negotiations in course, or related elements, where the outcome or normal pattern of those negotiations would be likely to be affected by public disclosure". In similar situations under the statutory framework in Canada, we understand that no disclosure needs to be made unless a "decision" has been taken.

Given the above, we consider that there should not be a need to establish that disclosure may be prejudicial to an "incomplete proposal" or negotiation. Provided that confidentiality has been maintained and there has been no leak of information, in order to justify delaying or withholding disclosure, it should be enough to be able to say that, as a negotiation or proposal is at an incomplete stage only, it would be premature to disclose information, because the negotiation or proposal may come to nothing, or may be "affected" by public disclosure.

We also consider that the four safe harbours are not sufficient by themselves. We suggest some additional safe harbours in our response to question 2 (c) below.

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

We agree.

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

Yes. We believe that the primary target of the legislation should be those companies/directors who have (a) considered a situation and decided not to disclose information, and that decision is totally unreasonable, or (b) shown reckless indifference as to whether a particular set of circumstances could be regarded as price sensitive. On the other hand, the legislation should not target companies/ directors who have considered the situation and, in good faith, come to the conclusion that certain information is not price sensitive, even though subsequently, with the benefit of hindsight, that judgment may turn out to be incorrect. As the decision on whether a piece of information should be regarded as price sensitive at any given time often requires the exercise of judgment, and may involve a significant element of subjectivity, it would put directors in an invidious position if a judgment made honestly, reasonably and in good faith could render them liable under the proposed statutory disclosure regime.

Therefore, we would suggest that an additional safe harbour be provided, along the lines of the “business judgment rule”. This would apply in circumstances where a company has proper PSI procedures in place and, having taken reasonable steps to ensure that the issue is properly considered, the directors have exercised their judgment, with reasonable prudence and in good faith, and have concluded that a disclosure is not required at a particular time.

Further, we understand that, under the Australian Securities Exchange Listing Rules (Rule 3.1A.3), safe harbours are provided for "information that comprises matters of supposition or is insufficiently definite to warrant disclosure" and "information generated for the internal management purposes of the company". We suggest that consideration also be given to including similar provisions as additional safe harbours under the Hong Kong PSI disclosure regime.

We note from paragraph 2.30 of the Paper and section 101G of the indicative draft legislative provisions that, where a listed company is found to be in breach of the PSI requirements, and that breach is a result of any intentional, reckless or negligent act or omission on the part of any individual director or officer, or that director or officer has not taken all reasonable measures to prevent the company from breaching the requirements, that director or officer would also be regarded as having breached the PSI requirements. Further clarification and guidance is needed in relation to what would satisfy the test of “all reasonable measures” since, in terms of an individual's responsibility and liability, a good deal may hang on this.

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

We agree.

Question 3

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

While we do not object to the principle of extending the jurisdiction of the MMT to handle breaches of the statutory disclosure regime, we would suggest that consideration also be given to introducing a settlement arrangement, where this may be more appropriate than referring a case to the MMT. Given that the Paper proposes that persons suffering pecuniary loss as a result of others breaching the PSI requirements will be able to rely on the MMT findings to seek compensation in civil actions, and bearing in mind also that persons appearing before the MMT do not have the right of silence, there would seem to be a case for introducing a settlement procedure for less severe or less clear cut cases. This procedure could include provision for remedying the alleged non-disclosure, where this is appropriate.

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

We understand that the relevant authorities in the UK and Australia cannot issue disqualification or cold shoulder orders for breaches of the equivalent requirements in those jurisdictions. We would suggest, therefore, that the need to include these possible remedies in the initial stages of the Hong Kong statutory PSI regime be reviewed. If they are retained, the proposed maximum durations that may be imposed in respect of these penalties should be reconsidered, with a view to reducing them.

We would also caution against any overuse of "cease and desist" orders, which are defined as orders not to breach the statutory disclosure requirement again. Given that difficult assessments are often involved in disclosure decisions, and that breach of a cease and desist order is a criminal offence, it would seem harsh for a company or a director to be issued with such an order upon a first infringement. We would suggest, therefore, that cease and desist orders be imposed only following a series of intentional or reckless breaches, which would merit potentially more serious consequences.

Where the remedies are applied to directors, the more severe remedies should be imposed only on directors who are directly involved in a particular breach or who knowingly failed to take action to prevent it (in this regard, see also our response to question 2(c) above). In addition, as stated at paragraph 2.33 of the Paper, the MMT should be required to comply with the principle of proportionality, and it should be made clear how this will be monitored and given effect. Our comments above in relation to, e.g., the timing of disclosure, safe harbours, and the need for additional guidance, should also be taken on board in the context of deciding on the appropriate range of remedies.

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

No, we have reservations about the proposals to grant the SFC direct access to MMT to institute proceedings on breaches of the statutory disclosure requirements, without having first to submit the case to the Financial Secretary for his decision to do so.

While we understand the aim of expediting the process of enforcing the statutory disclosure requirements, we consider that the existing safeguards and system of checks and balances should not be compromised in order to achieve this.

As noted in our response to question 3(a) above, persons alleged to have breached the PSI requirements will not have the right of silence before the MMT and, under the proposals in the Paper, the MMT's findings may also be relied upon in civil claims for compensation by persons who have suffered loss as a result of the breach. As such, the existing arrangements for persons accused of breaching the PSI requirements provide them with a reasonable additional safeguard, i.e., an independent assessment of the case/report from the SFC by the Department of Justice to assist the Financial Secretary to decide whether proceedings should be instituted before the MMT. If this process is currently resulting in delays, then other practical steps, which do not involve removing a layer of checks and balances, should be considered to help speed up the process.

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?

We agree, provided that informal consultation can be utilised by listed companies on a "no names" basis. However, we would suggest that no specific time limit be placed on this consultation channel, given that there will continue to be new listings and companies new to the market, whose knowledge and experience of the operation of the PSI regime is limited.

Question 5

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

We believe there may be some confusion and uncertainty with regard to the arrangements, depending upon how the interface between the SFC and SEHK actually works in practice. Where, for example, there are any technical issues with the Electronic Publication System, listed companies will presumably need to take these up with SEHK, whereas if there are any content issues, they will need to address these to the SFC.

The respective roles of the SFC and SEHK need to be made very clear to minimise the risk of confusion. As it may not be entirely clear cut at the outset how the division of responsibilities will operate, we would suggest that some allowance be given and a

degree of flexibility applied in the initial period after implementation of these arrangements.

The risk of confusion would be less if the SEHK, as the front line regulator, were to continue its monitoring role, and to refer possible breaches of the PSI disclosure obligation meriting further investigation to the SFC for follow-up action.

If, in future, there are any significant differences between the listing rules relating to disclosure of PSI and the statutory requirements, this will create two overlapping but different regimes, administered by two separate regulators, which would exacerbate any uncertainty. It is important, therefore, that the listing rule and statutory obligations relating to PSI disclosure will dovetail with one another.