香港董事學會
The Hong Kong Institute of Directors

28 June 2010

Division 2, Financial Services Branch
Financial Services and the Treasury Bureau
18/F Tower I
Admiralty Centre
18 Harcourt Road
Hong Kong

Dear Sirs

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

The Hong Kong Institute of Directors ("HKIoD") is pleased to forward our response to the captioned consultation paper.

HKIoD is Hong Kong's premier body representing professional directors working together to promote good corporate governance. We are committed to contributing towards the formulation of public policies that are conducive to the advancement of Hong Kong's international status.

In developing the response, we have consulted our members and organised focused discussions.

Should you require further information regarding our response, please do not hesitate to contact me on tel no. 2889 9986.

With best regards

Yours sincerely
The Hong Kong Institute of Directors

Dr Carlye Tsui
Chief Executive Officer

Enc

cc: Dr Kelvin Wong, Chairman of Council, HKIoD
Mr Henry Lai, Council Member, HKIoD & Chairman, Corporate Governance Committee

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

In relation to the Consultation Paper, The Hong Kong Institute of Directors ("HKIoD") is pleased to present its views and comments.

Capitalized terms used herein but are not otherwise defined shall have the meanings ascribed to them in the Consultation Paper.

General comments

We recognize that the current proposal is one rational means to encourage "the cultivation of a continuous disclosure culture among listed corporations". The HKIoD supports efforts to improve and promote compliance among listed corporations so that we can maintain a capital market that prides itself on transparency and quality. We support the cultivation of a continuous disclosure regime that will enable all investors to make informed decisions.

The proposed rule requires a duty to disclose once the company has come to possession of "inside information", subject to the safe harbours (or waivers, if granted). Under the proposed rule, PSI that requires timely disclosure takes on the existing definition of "relevant information" from the insider dealing regime under the SFO and will be termed "inside information".

It has always not been an easy task to assess what is or is not material, price-sensitive information. Some of our members have concerns about the approach taken in the current proposal. They believe the current proposal would create a tough task on directors of listed companies, adding to their liability exposure but does not give them a clear understanding of how to satisfy that statutory duty. They are concerned that, if they have at one time come to the conclusion that a piece of information need not be disclosed, how would that judgment call be subsequently measured for purpose of whether they have discharged the statutory duty under the current proposal. They believe that to extend statutory punishment on company and its "officers" (which definition includes directors) for an honest, good faith, even reasonable assessment made in this regard which unfortunately turns out to be incorrect does not make good law.

The obligation to disclose material, price-sensitive information about a listed company is already in the Listing Rules (i.e., Listing Rule 13.09). Failure to comply can result in disciplinary actions and suspension, even cancellation, of listing. The Listing Rule 13.09 scheme has been in operation for some years now. It does not appear to us that there has been large-scale abuse of this general obligation of disclosure, or that the current sanctions have not been effective in fostering compliance. There may be an argument to leave the

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general obligation to disclose material, price-sensitive information under the realm of the Listing Rules.

Nonetheless, the HKIoD is confident that listed company directors who have been following good disclosure practices under the Listing Rule and the SEHK Guide on disclosure of price-sensitive information (January 2002) would be in a better position to prepare themselves for compliance under a statutory regime. The HKIoD does not have an objection in principle to legislate a PSI disclosure regime if the concerns raised in this submission are addressed.

The HKIoD will be glad to provide further comments and assistance towards the implementation of a PSI disclosure regime suitable to the Hong Kong market. We are also planning to produce guidelines, technical notes and practice tools and to organize training for listed companies and their directors and other officers to help them prepare for compliance with the PSI disclosure regime finally adopted. Through these efforts, the HKIoD hopes to contribute towards a healthy disclosure culture among Hong Kong listed companies.

Response to questions for consultation

Subject to our general comments above, we state our responses to specific questions as set out in the Consultation Paper as follows:-

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?

(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?

(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?

HKIoD response:

- As to 1(a), we think the proposal to adopt the existing definition of "relevant information" from the insider dealing regime under the SFO to define PSI is a reasonable choice.

  However, from the perspective of trying to understand the nature of information that a company ought to disclose so that the market has good information about the company to assess its listed shares, the formulation in Listing Rule 13.09(1) is perhaps more useful and on point. Directors and officers who have to make disclosure

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decisions are familiar with this definition, which has been in place for some years. For this reason, we ask the Administration to consider the possibility of adopting the Listing Rule 13.09(1) formulation as the definition of PSI.

- As to 1(b):-

  - we support the cultivation of a continuous disclosure regime that will enable all investors to make informed decisions. The proposed rule requires a duty to disclose "as soon as practicable" once the company has come to possession of "inside information", subject to the safe harbours (or waivers, if granted). The difficulty when putting the proposal into practice lies in determining the proper timing of the disclosure (e.g., how soon is "as soon as practicable" in a particular situation), whether any one or more of the safe harbours should apply, and whether a waiver from disclosure should properly have been granted. If there is no clear and consistent guidance on these matters, directors (and officers) of listed companies will indeed be faced with a difficult task.

  - we are concerned that to deem a corporation to have knowledge of inside information if "an officer" has come into possession of that information in the course of the performance of his duties can amount to an extraordinary amount of pressure on many company employees in determining whether information that they come to know could amount to "inside information" requiring disclosure. According to the SFC's draft Guidelines on Disclosure of Inside Information, an "officer" is defined to include "a director, manager or secretary of, or any other person involved in the management of, the corporation". That definition seems too broad for purpose of imputing knowledge of "inside information" to the company.

- As to 1(c):-

  - we agree with the principle that the disclosure of "inside information" must be made in a manner that can provide for equal, timely and effective access by the public. We also agree that the "Electronic Publication System" or the HKEx-EPS is a good medium for purpose of satisfying the "equal, timely and effective access" requirement.

Question 2

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

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

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

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

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HKIoD response:

- As to 2(a):-

  - For Safe Harbour A, we think it is necessary to extend the exception to include court orders or law provisions of all relevant jurisdictions in which the issuer group conducts business or has presence, subject (as currently proposed) to the requirement that the information has been kept confidential.

  - For Safe Harbour B, as a minimum, the latitude and leeway now contemplated by Rule 13.09 (e.g., under Note 1, Note 2 and Note 7) and the SEHK Guide on disclosure of price-sensitive information (January 2002) to be replicated in full here.

  - For Safe Harbour C, it is not exactly clear what would constitute "trade secret" and what would not. There is no uniform definition on what is "trade secret", although the general perception is such relates to some technical know-how or secret formulae or recipes to certain manufacturing or production processes. Many businesses, however, rely on other forms of proprietary information to maintain their competitive advantage. In addition to customer lists (which the SFC draft guidelines mentioned), companies may well be establishing new distribution mechanisms or channels, or entering into new business collaborations or alliances in ways previously unknown to or thought impossible by competitors of the field. The fact of these new business arrangements arguably have to be disclosed, but what about the price and other terms underlying these arrangements? Such information can reasonably be said to be proprietary information important to the competitive strengths of the business. Does it fall under "trade secrets"? More consultation and guidance may be necessary.

  - For Safe Harbour D, we agree in principle.

- As to 2(b), the SFC power to grant waivers and to attach conditions where appropriate should not be limited only to the situations as currently stated in the Consultation Paper. The SFC should have sufficient flexibility and freedom to grant waivers to deal with situations that may arise. Market participants will be eager to know the factors and parameters that would determine whether a waiver is to be granted. In our view, such factors and parameters ought to reflect and respond to commercial and practical needs of listed companies. See also our response to 2(d).

- As to 2(c), if the SFC has broad power to grant waivers and impose conditions as appropriate, as we advocate in our response to 2(b), we do not think there is a need for additional safe harbours in the legislation at this time. When the PSI disclosure regime has come into operation for some time, we may be in a better position to re-visit this issue.

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- As to 2(d), we think it is appropriate for the SFC to have power to, after consulting the Financial Secretary (or another Principal Official such as the Secretary for Financial Affairs & the Treasury), prescribe further safe harbours in the form of rules under the SFO. Experience gained in granting or rejecting waivers and in prescribing conditions can be useful background when introducing new safe harbours that suit market needs.

Question 3

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

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

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

HKIoD response:

- As to 3(a), we agree. The MMT deals with insider dealing cases and the familiarity with the concept of "relevant information" for insider trading purposes should make it a suitable forum to adjudicate cases involving disclosure of "inside information" which, under the current proposal, is conceptually same and similar to "relevant information".

- As to 3(b), we agree, provided that the principle of "proportionality and reasonableness in relation to the breaching conduct" is adhered to when determining the amount of fines.

- As to 3(c), we agree to grant the SFC direct access to the MMT to institute proceedings on breaches of the statutory disclosure requirements. Although we agree there may not be a need for the Financial Secretary to actually institute such proceedings (as in current practice), we think there is merit to retain a requirement for the SFC to consult the Financial Secretary (or another Principal Official such as the Secretary of Justice or the Secretary for Financial Affairs & the Treasury) before instituting proceedings.

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?

HKIoD response:

- Yes, we agree that the SFC should provide informal consultation. We think the initial period of 12 months is appropriate, but we ask the Administration and the SFC to re-visit the issue in due course and consider whether to extend the informal

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consultation for a longer time or even to make it permanent. Given that the current proposal would have the effect of requiring "officers" to determine what is "inside information", which can itself be a difficult judgment, there is conceivably a real and significant demand for consultation in this regard. We ask the Administration and the SFC to anticipate, in light of the approach taken by the current proposal, the scope and nature of the consultation inquiries and plan accordingly.

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?

HKIoD response:

- The arrangements involve noticeable overlap between the two regulators. Issuer companies have good reasons to worry how the actual enforcement efforts will be divided or coordinated between the two. For instance, would the decision to investigate or not investigate, or the enforcement actions taken or not taken, by one regulator affect or preclude the decisions or actions of the other? Further elaboration on these aspects would help the market understand the regulatory environment they are faced with. Subject to the above, we think the arrangements proposed in paragraphs 3.8 - 3.9 are generally appropriate.

Other comments

Scope of "officers"under the current proposal

In our response to Question 1(b), we note that the definition of "officers" seems too broad for purpose of imputing knowledge of "inside information" to the company.

We also note that in s.101G(1) of the indicative draft legislation, "[e]very officer of a listed corporation must take all reasonable measures from time to time to ensure that proper safeguards exist to prevent the breach of a disclosure requirement in relation to the corporation". Again, "officer" here includes managers. Although some "managers" may be senior in ranks so as to having responsible charge for devising internal control safeguards and ensuring they are followed, we surmise the broad definition will catch many "managers" who do not have that authority. At most they can only be expected to follow internal procedures that have been properly put in place by the company.

Other disclosure matters that deserve more regulatory "teeth"?

As we consider the merits of the PSI disclosure regime as currently proposed, we invite the Administration and other stakeholders to also consider other areas of concern that may affect our market integrity.

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The current proposal is not very detailed on what to do once "inside information" has been selectively disclosed, and what is the consequence if an issuer company or its "officers" selectively disclosed "inside information".

If we were to have rules that will have the effect of promoting full and fair disclosure of information to the market, another obvious object of such rules would be to timely redress information asymmetry and to deter the practice of selective disclosure in the first place.

Information asymmetry results from selective disclosure of non-public information to some recipients but not the whole market, and this is clearly detrimental to market integrity. Sometimes, the disclosure is "unintentional". Other times, there may be a deliberate attempt by some corporate insiders to benefit their friends and families. Worse, the controlling minds of the company collectively might be tempted to use corporate inside information as commodity to gain favour from select market participants or investors. In the end, the adverse results are the same: a privileged few gain an informational edge and wield the ability to use that edge to profit. This runs against the principle of a level playing field and seriously erodes investors' confidence in the integrity of the market.

Selective disclosure of material, price-sensitive information can be seen as a form of "tipping" in the context of insider trading. Those who trade on the tip from selective disclosure and benefit therefrom can be dealt with under the insider trading regime. Those who provide that tip through selective disclosure, unless they themselves are engaging in insider trading, are not covered directly by current laws for those acts of selective disclosure that cause much harm and wrong on the market.

The regulatory area that also deserves more "teeth" might be on statutory provisions to deter instances of selective disclosure and if such has happened, to require timely efforts to redress the information asymmetry that results. Selective disclosure, once it happened, is an objective fact that can be more readily ascertained. Punishment on the issuer company and its personnel (appropriately defined in scope) for acts of selective disclosure and for failure to timely redress the information asymmetry that results is reasonable, in that there is a clear connection between the wrongful act and the punishment.

In giving statutory backing to disclosure matters, we ask the Administration to also consider legislation on selective disclosure.

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