Disclosure obligations for listed companies and officers

11 December 2012
Tim Mak, Partner, Financial Services Regulatory Group, Hong Kong
Outline

• Background to the new statutory disclosure regime

• The key disclosure obligation, and consequences of non-compliance

• Exemptions

• Officers’ liability

• SFC Guidance

• Recent examples of Stock Exchange disciplinary action for disclosure failure
Background

- Current position (pre-1 January 2013): continuing disclosure obligations and disciplinary penalties in Listing Rules – perceived lack of "regulatory teeth"

- Importance of accurate, timely information flow from listed issuers

- Government's consultation conclusions on statutory codification of requirements to disclose price sensitive information by listed corporations: February 2011

- Securities and Futures (Amendment) Ordinance 2012 ("Amendment Ordinance") gazetted: 4 May 2012

- SFC Guidelines on Disclosure of Inside Information gazetted: 8 June 2012 (effective 1 January 2013)

- Statutory disclosure regime takes effect: 1 January 2013 (provisions relating to SFC directly instituting proceedings before Market Misconduct Tribunal for the 6 existing types of market misconduct plus disclosure failure in force since 4 May 2012)
Key disclosure obligation

- Obligation contained in new Part XIVA of the SFO – to be read in conjunction with the SFC Guidelines

- General rule: a listed corporation must disclose any “inside information” to the public “as soon as reasonably practicable” once the information has “come to its knowledge”, unless one of the prescribed safe harbours applies

- A listed corporation will not comply with that if any information it discloses is false/misleading as to a material fact or through the omission of a material fact, and that an officer knows (or ought reasonably to have known) that, or is reckless/negligent as to whether the information disclosed is false/misleading

- Breach might lead to civil sanctions for the listed corporation and/or its officer(s), as well as potential liability to compensate those who have suffered pecuniary losses because of the breach
Enforcement and penalties

- SFC to investigate any suspected breach, and to institute proceedings before MMT directly
- Civil sanctions similar to those currently available to MMT for market misconduct:
  - regulatory fine: up to HK$8m for the listed corporation, its director(s) or chief executive
  - disqualification order: up to 5 years
  - cold-shoulder order: up to 5 years
  - “cease-and-desist” order
  - disciplinary referral
  - costs order
  - any order that the MMT considers necessary to ensure that a breach of the disclosure requirement does not occur again eg, independent adviser to review internal compliance procedures, officer to undergo training
- MMT's decisions may be appealed to Court of Appeal
Claims for compensation

• In addition to the MMT’s available civil penalties, anyone who has suffered pecuniary loss because of a breach of the disclosure obligation may commence civil proceedings to seek compensation from anyone found to be in breach of the obligation – whether or not the loss was incurred from entering into a transaction at a price affected by the breach

  – “Fair, just and reasonable”
What is “inside information”? 

- Same definition as “relevant information” under SFO’s insider dealing regime. It is “specific information” (note: does not have to be “precise”) –

  - about a listed corporation, the corporation’s shareholder or officer, or the corporation’s listed securities or their derivatives

  - that is not generally known to those who are accustomed or would be likely to deal in the corporation’s listed securities but would, if generally known to them, be likely to materially affect the price of the listed securities

- SFC Guidelines provide colour on the meaning of “specific”, “not generally known”, and “material effect on the price”, closely following past Insider Dealing Tribunal and MMT decisions
What is “inside information”? SFC Guidelines

“Specific”

- Information that can be clearly defined and articulated. Be careful with distinction between non-precise (but specific)/preliminary information vs mere rumours, vague hopes and worries, and unsubstantiated conjecture

“Not generally known”

- Care should be taken to identify those who are “accustomed or would be likely to deal” – may well comprise a wider group of people than just professional dealers and investors

- Information covered by the media, analysts’ reports or news service providers: consider not only how widely the information has been disseminated, but also the accuracy and completeness of the information and the reliance that the market can place on it

“Material effect on the price”

- In assessing “materiality”, should take into account various factors including anticipated magnitude of the event in the context of the totality of the corporation’s activities, relevance of the information for price-determination, reliability of the source, and market variables (eg, prices, returns, volatility, liquidity, price relationships among securities, volume, supply, demand etc)
When to disclose?

• Inside information generally regarded as having “come to a listed corporation’s knowledge” if:
  
  – the information has, or ought reasonably to have, come to the knowledge of an “officer” of the corporation in the course of performing his/her functions as an officer; and
  
  – a reasonable person, acting as an officer of the corporation, would consider that the information is inside information

• “Officer”: director, manager or secretary of, or any other person involved in the management of the corporation
  
  – government indicated its intention is to “catch directors and high-level individuals responsible for managing the listed corporation, not middle management or low-ranked staff”, and that “the person’s actual responsibilities are more important than the person’s formal title”
How to disclose?

- **Aim of disclosure:** to ensure equal, timely and effective access to information by the public

- **Method of disclosure:** the rules provide that a listed corporation will comply with its disclosure obligation if it disseminates inside information through SEHK’s electronic publication system (although not the only permissible method of disclosure)
When and how to disclose: SFC Guidelines

- “As soon as reasonably practicable” not defined in the Amendment Ordinance: SFC Guidelines provide that it means the corporation “should immediately take all steps that are necessary in the circumstances to disclose the information to the public”
  - Such steps may include ascertaining and verifying the facts, internally assessing the matter and its likely impact, and seeking professional advice
  - Consider the need for a “holding announcement”/trading suspension pending disclosure

- SFC “would expect a corporation to use [the electronic publication system operated by the Stock Exchange] for dissemination of inside information” – listed corporations should aim to satisfy that expectation
Exemptions from disclosure

Five prescribed “safe harbours”

(1) Disclosure is prohibited under, or would constitute a breach of a Hong Kong court order or a Hong Kong statutory provision
   • This might apply, for example, in the context of certain regulatory investigations

(2) Information concerns an incomplete proposal or negotiation
   • Information about the negotiation vs circumstances which led to the negotiation

(3) Information is a “trade secret”

(4) Information relates to the provision of liquidity support to the listed corporation/its group companies

(5) SFC has waived the disclosure requirement
   • SFC may grant specific waivers if, for example, disclosure would contravene foreign legislation or a foreign court order
Important points about exemptions

- Safe harbours (2) to (5) only available if the listed corporation has taken reasonable precautions to preserve the confidentiality of the inside information, and confidentiality is in fact preserved

  - Watch out for unexplained movements of the corporation’s share price or comments in the media or analysts’ reports – may indicate leaks

  - Keep under review whether confidentiality is still maintained – if not, must disclose promptly, otherwise risk of breaching the disclosure obligation
Permitted “confidential” disclosure

- Disclosure in certain circumstances will not generally be regarded as resulting in confidentiality being lost. For example, disclosure can be made to a person who requires the information to perform his/her functions and who owes the corporation a duty of confidentiality. SFC's Guidelines provide examples of such persons:

  - the corporation’s advisers and advisers of other persons involved in the matter in question

  - persons with whom the corporation is negotiating, or intends to negotiate, any commercial, financial or investment transaction

  - the corporation’s lenders

  - the corporation’s major shareholders

  - any government department, statutory or regulatory authority, for example, SFC and SEHK
Officers’ liability and management controls

- Every officer of a listed corporation has an obligation to take all reasonable measures from time to time to ensure that “proper safeguards” are in place to prevent the corporation from breaching a disclosure requirement.

- Each officer can be held personally responsible for the listed corporation’s breach, if his/her intentional, reckless or negligent conduct resulted in the breach, or if he/she failed to take “all reasonable measures” to prevent a breach.
Responsibility for compliance and management controls: SFC Guidelines

• Who are considered to be “in charge”?
  – SFC will look to a person’s actual responsibilities rather than just his/her formal title (substance versus form)
  – A “manager” normally refers to a person who, under the immediate authority of the board, is charged with management responsibility affecting the whole of the corporation or a substantial part of it
  – A person is regarded to be “involved in the management of the corporation” if the person discharges the role of a “manager”
  – A “secretary” means a company secretary under the Companies Ordinance

• In determining whether a certain piece of information is inside information, an officer is expected to base his/her decision on his/her knowledge of all the relevant facts and circumstances at the time – SFC has indicated that such information cannot be judged in hindsight with factors not known at the time
Responsibility for compliance and management controls: SFC Guidelines

- Managing internal information flow very important

- Identify, assess and escalate: establish and maintain effective systems and procedures to ensure that any material information which comes to any officer’s knowledge will be promptly identified, assessed and escalated for the Board’s attention so it can determine whether disclosure is necessary
  - Particularly important for NEDs who are not involved in the corporation’s daily operations
  - The Board should establish and maintain appropriate and effective reporting procedures to ensure a timely and structured flow of relevant financial and operational data
  - Systems and procedures should cater for the particular needs and circumstances of the corporation
Responsibility for compliance and management controls: SFC Guidelines

SFC suggests the following should be considered in designing systems and procedures:

• Establish **controls for monitoring** business and corporate developments and events

• Establish **periodic reporting procedures** so that key financial and operating data is identified and escalated in a structured and timely manner

• Maintain and regularly review a **sensitivity list** identifying factors or developments likely to give rise to inside information

• Authorise **designated officer(s) or an internal committee** to be notified of potential inside information and to escalate to the Board

• Maintain an **audit trail** of meetings and discussions concerning the assessment of inside information (evidence of practical operation of procedures and decisions)

• **Restrict access** to inside information to a limited number of employees on a need-to-know basis. Ensure they are fully conversant with their obligations to preserve confidentiality
Responsibility for compliance and management controls: SFC Guidelines

- Ensure appropriate confidentiality agreements are in place when the corporation enters into significant negotiations
- Disseminate inside information via SEHK’s electronic publication system before it is released via other channels
- Designate a small number of executives with the appropriate skills and training for public communication
- Develop procedures to review presentation materials before they are released in any analysts’ or media briefings
- Record and check briefings and discussions for inadvertent disclosure
- Develop procedures for responding to market rumours, leaks and inadvertent disclosures
- Have *written disclosure policies* and procedures, update and publish them
- Provide regular training for employees so they understand the disclosure policies and procedures
Responsibility for compliance and management controls: SFC Guidelines

• Officers with an executive role have a duty to:

  – oversee the proper implementation and functioning of internal control mechanisms

  – ensure that any material deficiencies are detected and resolved in a timely manner

• Ultimately it is the officers’ responsibility to ensure the corporation’s compliance

  – if a corporation has implemented reasonable measures to prevent a breach, an officer who acts in good faith and in accordance with his/her duties is “unlikely to be personally liable” for any breach
Guidance on particular situations and issues: SFC Guidelines

(1) Media speculation, market rumours and analysts’ reports

- Generally no obligation to respond

- However, possible indication of a leak, if the corporation is relying on a safe harbour to withhold disclosure

- Accurate and extensive rumours and speculation, or information contained in analysts’ reports, may not amount to information that is “generally known” – disclosure may be necessary (if the corporation has inside information)

- If the corporation does not have inside information, and reports or rumours carry false or untrue information, not obliged to make further disclosure – however may still be required to issue a negative, “refuting” announcement

- Consider correcting significant errors/misrepresentation in a factual way, by drawing attention to information that is already publicly available
Guidance on particular situations and issues: SFC Guidelines

(2) External publications

• Publications by industry regulators, government departments, rating agencies etc may affect the price of, or market activity in, the securities of the corporation – may amount to inside information that should be disclosed with an assessment of the likely impact of any such publication.

(3) External developments

• Corporations not expected to disclose general external developments eg, forex rates, market price of commodities, tax changes. However information may be discloseable if it has a particular impact on the corporation.
Guidance on particular situations and issues: SFC Guidelines

(4) Internal matters

• Matters of an indefinite nature being considered in a corporation’s day-to-day running will not be regarded as “specific” information
  
  – eg, development of a new technology, the planning of a major redundancy programme, potential price cut

• Information contained in internal management reports, even if negative, may not constitute inside information

(5) Multiple listings

• Synchronise disclosure in all markets in which the corporation’s securities are listed as closely as possible. If information cannot be released in Hong Kong at the same time due to market close, issue an announcement in Hong Kong before the Hong Kong market opens
(6) In the course of preparing periodic disclosures

- A corporation may come across inside information previously unknown when preparing prescribed disclosure documents eg, periodic financial reports, circulars and listing documents – cannot defer disclosure until the prescribed document is issued
Recent examples of SEHK enforcement

Companies (and directors) censured/criticised for failing to disclose “as soon as reasonably practicable”

- Provision of financial assistance by the issuer to a connected party through a loan agreement between the issuer and a third party, and legal action commenced against the issuer when the connected party failed to repay the loan (June 2012)
  - internal controls: issuer also found to have failed to maintain adequate and effective internal controls regarding the identification, reporting and approval of connected transactions and financial assistance transactions – no procedure and guidance in place for identifying discloseable information
  - in addition to the censure, HKEx expressed its opinion that the retention of office by the Chairman would be prejudicial to investors’ interests – if he remains in office, HKEx may consider suspending/cancelling the issuer’s listing
Recent examples of SEHK enforcement

Companies (and directors) censured/criticised for failing to disclose “as soon as reasonably practicable”

• A non-exclusive licence agreement, which, if disclosed, would have quashed positive market rumours that had caused a spike in the company’s share price (October 2011)

• Significant deterioration in the company’s business and financial performance. Directors were aware but decided the drop in profit was “temporary” and due to “exceptional events” (August 2011), or should have been aware as they were sent monthly management accounts and had held discussions with the company’s compliance team (June 2011)

• Cancellation of the company’s banking facilities, legal proceedings against the company, and contemplated restructuring (February 2011)
Recent examples of SEHK enforcement

Selective disclosure

- Company director told reporters during an interview that the company’s profit was expected to double that year, as well as estimates on the company’s earnings and dividend pay-out ratio

- Article containing the disclosed information appeared on the internet the next day – 3 months before the annual results were published

- Company censured. Director criticised (March 2007)

- “This case reinforces the need for issuers and those authorised to communicate with the media, analysts and investors to take all reasonable care to avoid selective disclosure… Company executives should exercise great caution and should decline to answer questions which could elicit information alone or cumulatively which may represent unpublished price-sensitive information.

  If a Company executive errs and there is a risk of a false market or there is otherwise a leak of price-sensitive information the Company is under an obligation to correct the position with a clear and unambiguous announcement to the market without delay.”
Recent examples of SEHK enforcement

Selective disclosure

• Company director divulged during a press conference, in response to reporters’ questions, information regarding a new product: (i) the selling price; (ii) the production cost; (iii) the sales amount so far; (iv) the estimated sales amount; and (v) the estimated profit margin. Information was not in the public domain

• Company and director censured (June 2009)

• “In this case, potentially price-sensitive information was selectively disseminated on a non-trading day. This is not acceptable because it places the recipients of the information in the privileged position of having more time to consider and analyse the information, and so undermines the integrity of the market.

In conducting press briefings, Company executives should ensure that answers to questions raised do not amount to unpublished price-sensitive information. If price-sensitive information leaks or there is a risk of a false market, the issuer must correct the position by publishing a clear announcement without delay.”
Prior to 1 January 2013

- SFC expects listed corporations to prepare for compliance with the new statutory regime and to establish the necessary internal control systems before 1 January 2013

- Listed corporations, and in particular their officers, should critically assess their existing systems and controls to ensure that, in practice, information which might amount to inside information will be escalated to the Board in a timely manner, so that the Board can consider whether a disclosure obligation is triggered
Notes

- These materials and the information contained in them are not, and should not be construed as, legal advice

- Specific advice should be obtained in respect of specific issues/questions/problems

- Principal contacts in Hong Kong:
  - Tim Mak – tim.mak@hsf.com / +852 2101-4141
  - Matt Emsley – matt.emsley@hsf.com / +852 2101-4101
  - Jason Sung – jason.sung@hsf.com / +852 2101-4607
  - Winnie Chung – winnie.chung@hsf.com / +852 2101-4604