Client Alert.

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Statutory Obligation to Disclose Price-Sensitive Information Effective on January 1, 2013

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Effective on January 1, 2013, HK-listed companies will have a statutory obligation under new Part XIVA of the Securities and Futures Ordinance[1] (SFO) to disclose price-sensitive information (defined as "**inside information**") to the public, as soon as reasonably practicable after the inside information has come to their **knowledge**.

Breaches of the statutory disclosure requirement will be subject to civil sanctions, including a regulatory fine up to HK$8 million on the listed company and/or each of the directors, and potential civil liability to those who suffer pecuniary loss as a result. By the end of 2012, listed companies will wish to ensure they have protocols in place to manage price sensitive information and that they understand the statutory safe harbors and how to deal with speculation and rumors.

In conjunction with the new disclosure regime, the Securities and Futures Commission (SFC) has also published draft Guidelines on Disclosure of Inside Information (Guidelines). The final Guidelines are expected to be published in June 2012. The Guidelines help to illustrate how the statutory disclosure requirements will operate in practice and the relevant compliance issues, though the Guidelines will not have the force of law. A flowchart illustrating the new regime is set out in the Appendix to this article.

CONCEPT OF "INSIDE INFORMATION"

The key elements comprising the concept of inside information are:

(a) specific information about a particular listed corporation, a shareholder/officer or its listed shares/their derivatives;

(b) the information is not generally known to those who are accustomed or would be likely to deal in the corporation's securities; and

(c) if known, the information would be likely to have a material effect on the price of the listed securities.

For details of how these elements are applied, see the flowchart and related notes in the Appendix.

WHAT CONSTITUTES "KNOWLEDGE"?

A listed corporation will be regarded as having knowledge of inside information if:

(a) information has, or ought reasonably to have, come to the knowledge of an officer of the corporation in the course of performing functions as its officer; and

[1] See the Securities and Futures (Amendment) Ordinance 2012, which was gazetted on May 4, 2012.

(b) a reasonable person, acting as an officer of the corporation, would consider that the information is inside information in relation to the corporation.

"officer"

An "officer" is "a director, manager or secretary of, or any other person involved in the management of, the corporation." The intention of the proposed legislation is to include directors and high-level individuals responsible for managing listed companies.

"ought reasonably to have come to the knowledge"

The concept of "ought reasonably to have come to the knowledge" is an element that triggers the disclosure obligation for a listed company and does not by itself result in liability on "officers." The intention is to prevent listed companies evading the disclosure obligation by arguing that inside information has been channeled to its officers but has not been read, or deliberately keeping inside information from being accessed by the officers.

Based on proposed section 307G, an "officer" would be held liable only if the breach of a disclosure requirement is the result of the officer's intentional, reckless or negligent conduct, or his failure to take all reasonable measures from time to time to ensure that proper safeguards existed to prevent a breach of a disclosure requirement.

The SFC will set out clearly in the final Guidelines that assuming a listed corporation has implemented reasonable measures to prevent a breach, an officer (including a non-executive director (NED)) who acts in good faith and in accordance with all his fiduciary duties without actual knowledge of the information or involvement in the corporation's breach is unlikely to be personally liable on grounds of intentional, reckless or negligent conduct.

For a list of examples of such reasonable measures, please refer to Appendix V of the Guidelines. Additional guidance on officers' liability and obligations of NEDs is set out in Appendix VI of the Guidelines.

"reasonable person" test

If an "officer" acted reasonably in deciding that information is not inside information, and therefore did not disclose the information, it will not cause the officer or the company to be treated as having knowledge of inside information.

TIMING OF DISCLOSURE

A listed corporation should disclose inside information as soon as reasonably practicable, unless the information falls within any of the safe harbors provided in the SFO. The Guidelines clarify that "as soon as reasonably practicable" means that the corporation should immediately take all steps that are necessary in the circumstances to disclose the information to the public, such as ascertaining sufficient details, internally assessing the matter and its likely impact, seeking professional advice and verifying the facts.

CONFIDENTIALITY PRIOR TO DISCLOSURE

A listed corporation must ensure that inside information is kept strictly confidential before the information is fully disclosed to the public. If confidentiality cannot be maintained or may have been breached, the corporation should immediately disclose the information to the public.

The Guidelines state that a listed corporation could consider issuing a "holding announcement" if it needs time to clarify the details of, and the impact arising from, an event or a set of circumstances. However, a listed corporation should consider applying for a suspension of trading where confidentiality has not been maintained and it is not able to make a full or holding announcement.

SAFE HARBORS

There are five safe harbors within which listed companies can withhold or delay disclosure of inside information. Please refer to the flowchart in the Appendix for further details.

DEALING WITH SPECULATION, MARKET RUMORS AND ANALYSTS' REPORTS

As clarified in the Guidelines, no analyst, investor or journalist should receive a selective release of inside information.

Generally, companies are not obliged to respond to press speculation or market rumors. However, where press speculation or market rumors are largely accurate and the information underlying the speculation or rumors constitutes inside information, the company should disclose the information as soon as reasonably practicable.

In relation to incorrect analysts' reports, the company is not obliged to make corrections or provide clarification under the SFO, unless it knows inside information which has not been disclosed but requires disclosure. The SFC has commented that, for good practice, it may be appropriate for a corporation to clarify historical information and correct any factual errors in analysts' assumptions which are significant to the extent that they may mislead the market, provided any clarification is confined to drawing the analyst's attention to information that has already been made available to the market. However, companies will wish to avoid routinely correcting errors published by others, as this would then be widely interpreted as tacit confirmation of any reports or data which they do not correct.

Note that the obligations to disclose inside information under Part XIVA of the SFO are distinct from the disclosure requirements under the Listing Rules[2] and the Takeovers Code. For general guidance on handling particular situations and issues pursuant to the Listing Rules, see the Exchange's letter "Recent economic developments and the disclosure obligations of listed issuers" dated October 31, 2008 here.

ENFORCEMENT AND SANCTIONS

Breaches of the statutory disclosure requirement will be dealt with by the Market Misconduct Tribunal (MMT), which will be able to impose a number of civil sanctions including a regulatory fine up to HK$8 million on the listed company and/or each of the directors. Those who suffer pecuniary loss as a result of others breaching the disclosure requirements will also be able to rely on the findings of the MMT to take civil actions seeking compensation. For a list of civil sanctions that may be imposed by the MMT, please refer to our earlier client alert here.

In addition, the SFC is now able to institute proceedings directly before the MMT (previously only instituted by the Financial Secretary) to enforce the statutory disclosure requirement, as well as to deal with various market misconduct under Part XIII SFO.

[2] In May 2012, the Exchange clarified that under the Listing Rules, although an issuer is not expected to respond to all market comments, if any comment has, or is likely to have, an effect on the issuer's share price such that there may be a potentially false market, it should make a clarification announcement or request a trading halt pending the clarification to address potential or actual market disorder.

For a copy of the Securities and Futures (Amendment) Ordinance 2012, please follow the link:
http://www.gld.gov.hk/egazette/pdf/20121618/es1201216189.pdf

For a copy of the SFC's draft Guidelines on Disclosure of Inside Information, please follow the link:
http://www.sfc.hk/sfc/doc/EN/speeches/public/consult/psi_guidelines_eng_c.pdf

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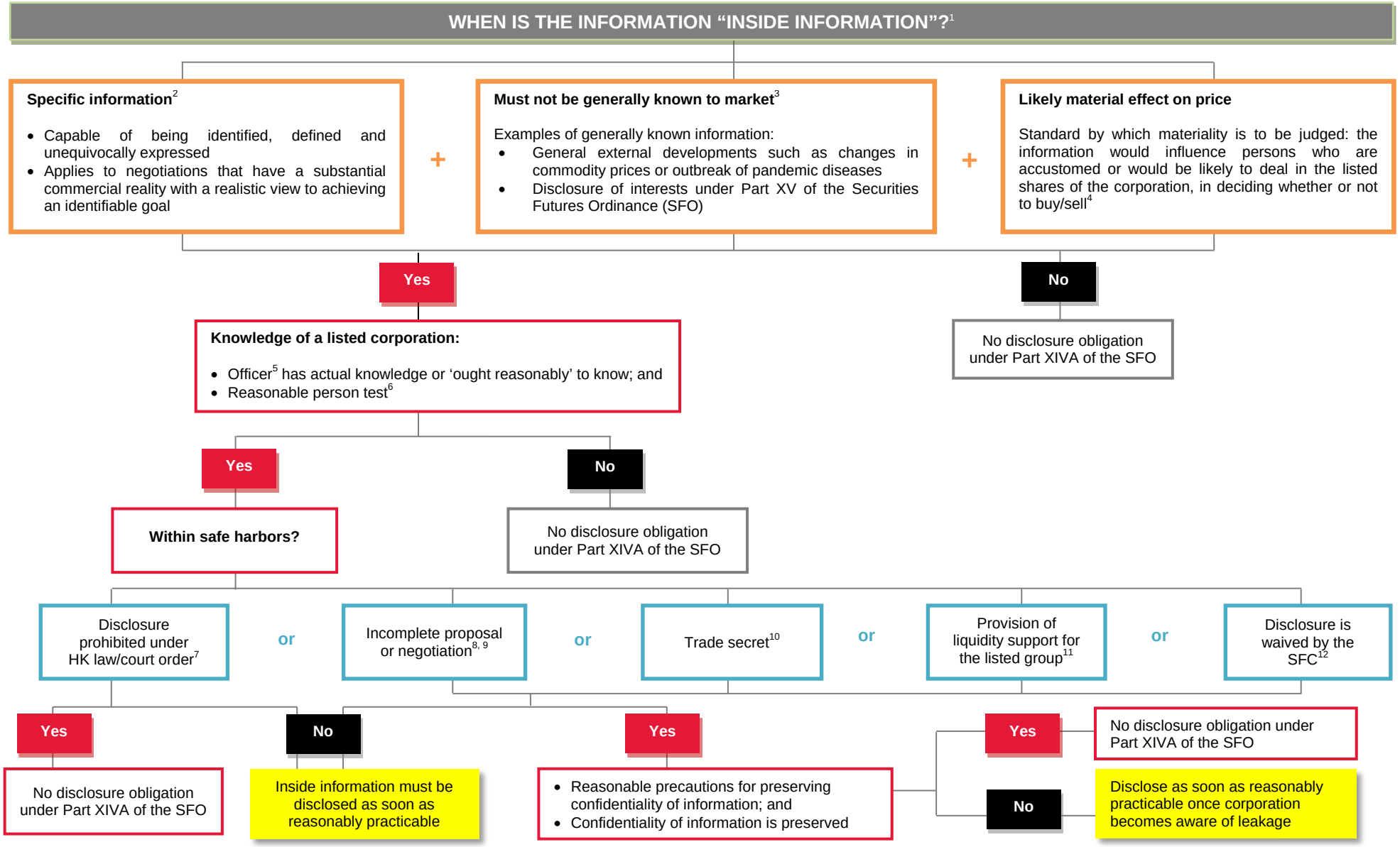
Appendix



Appendix

Notes:

[1] Note the distinct disclosure requirements under the Listing Rules and Takeovers Code.

[2] Specific information that is about the corporation, a shareholder/officer or the listed shares or their derivatives. The information need not be precise – it may still be "specific" even though it has a vague quality, and may be broad, allowing room for further particulars. For example, information about a corporation's financial crisis or contemplation of share placing would be regarded as specific, even if details are unknown.

[3] The market is defined as those persons who are accustomed or likely to deal in the listed securities of the corporation. Where the information known to the market (i) is incomplete; (ii) contains material omissions; or (iii) is of doubtful bona fides, such information cannot be regarded as generally known, and full disclosure is necessary.

[4] The following factors should be taken into consideration in determining whether a material effect on price is likely to occur:

(a) the anticipated magnitude of the event or circumstances in the context of the corporation's overall activities;

(b) the relevance of the information as regards the main factors that determine the price;

(c) the reliability of the source; and

(d) market variables that affect the price (such as prices, returns, volatilities, liquidity, price relationships among securities, volume, supply, demand, etc.).

In relation to volatility, the Guidelines state that while a certain percentage movement for a small company's stock might be seen as immaterial, the same (or even a lower) percentage movement in a large company's stock might be considered material by virtue of the stock's nature and size.

[5] Defined as "a director, manager or secretary of, or any other person involved in the management of, the corporation."

[6] Whether a reasonable person, acting as an officer of the corporation, would consider that the information is inside information in relation to the corporation.

[7] This safe harbor does not apply to information the disclosure of which is prevented by a contractual duty.

[8] Examples include (i) when a contract is being negotiated but has not been finalized; (ii) when a corporation decides to sell a major holding in another corporation; (iii) when a corporation is negotiating a share placing with a financial institution; or (iv) when a corporation is negotiating the provision of financing with a creditor.

[9] This safe harbor does not allow withholding disclosure of any material change in financial position or performance to the extent that this is inside information.

[10] Commercial terms and conditions of a contract or financial information of a corporation cannot be regarded as trade secrets, as these are not proprietary information or rights owned by the corporation.

[11] Where the liquidity support is from the Exchange Fund of the Government of Hong Kong or from an institution which performs the functions of a central bank, including such an institution located outside Hong Kong.

[12] A listed corporation may apply for a waiver from the SFC if there are circumstances where disclosure of the information is prohibited under or would constitute a contravention of a restriction imposed by (a) the legislation; (b) an order of a court exercising jurisdiction under the law; (c) a law enforcement agency; or (d) a governmental authority in the exercise of a power conferred by the legislation of a place outside Hong Kong, especially where the corporation or certain of its subsidiaries are incorporated or operate outside Hong Kong.