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

By email (yhcheung@legco.gov.hk) and by post

10 October 2011

Our Ref.: C/CFC, M79601

The Hon Chan Kam-lam, SBS, JP
Chairman
Bills Committee on Securities and Futures (Amendment) Bill 2011
Legislative Council Building
8 Jackson Road
Hong Kong

Dear Mr. Chan,

Bills Committee on Securities and Futures (Amendment) Bill 2011

Thank you for your letter dated 25 July 2011 inviting comments from the Hong Kong Institute of CPAs ("Institute") on the Securities and Futures (Amendment) Bill 2011 ("the Bill").

In principle, the Institute is supportive of a statutory price sensitive information ("PSI") disclosure regime within a framework of non-criminal sanctions. It is generally agreed that listed corporations and their directors and senior management should disclose PSI on a timely basis, where practical, to maintain a fair, orderly and efficient securities market in Hong Kong.

However, the Institute has a number of concerns over the interpretation and detailed implementation of the law, which are further explained in this submission.

Definition of PSI

Decisions as to whether investors would be likely to see certain information as price sensitive, in any given circumstances, may be quite subjective and judgmental in nature. We note that the legislation sets out general principles and that, in order to assist listed corporations and their directors and senior management to comply with their obligations under the law, the Securities and Futures Commission ("SFC") is developing associated guidance. In view of the importance of the SFC's proposed "Guidelines on Disclosure of Inside Information" ("draft guidelines") and frequently asked questions ("FAQs") to the understanding of the legislation, in particular, the interpretation and implementation aspects, we strongly recommend that the initial set of SFC guidelines and FAQs be considered together with the Bill as a single package of proposals.

Given that decisions regarding PSI can be subjective and potentially contentious, we would emphasise the need for additional, reasonably detailed, guidance and specific illustrations of what constitutes PSI under the statutory disclosure requirements, including on the difference between day-to-day activities that do not need to be disclosed and significant events, which are disclosable. Paragraph 30 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.

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However, this begs the question of what is regarded as "day-to-day" in this context. 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 could be 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? A company may anticipate other mark-to-market losses but, because its general business picks up, there may be no major loss overall. Do circumstances such as these give rise to a disclosure obligation and, if so, at what point in time? More detailed guidance is needed on how and when significant mark-to-market changes should be disclosed, particularly during ongoing market volatility.

It is noted, in the conclusions of the public consultation on the proposed statutory codification of requirements to disclose PSI by listed corporations ("consultation conclusions"), released in February 2011, that the SFC intends to update its guidelines and provide additional guidance materials (e.g., in the form of FAQs), from time to time. The aim is to address issues arising from the application of the statutory PSI disclosure requirements and provide detailed guidance on what constitutes PSI (paragraphs 10 and 12 of the consultation conclusions).

It is also noted that the SFC will issue FAQs to clarify a number of specific issues raised by respondents to the public consultation. These include (i) how to define "significant" changes in fair valuations and "massive" loss arising from hedging activities, and at what point in time disclosure obligations arise (paragraph 33 of the consultation conclusions); (ii) what would constitute an "incomplete proposal" under safe harbour B, and that a proposal/ negotiation cannot be regarded as incomplete once a legally binding agreement has been signed (paragraph 34); (iii) what would satisfy the test of having taken "all reasonable measures", under the provision whereby a director or officer potentially faces a liability because he or she "has not taken all reasonable measures from time to time to ensure that proper safeguards exist to prevent the breach" (paragraph 66). However, the relevant FAQs are not yet available.

In view of the importance of the SFC guidelines and FAQs to the understanding of the statutory PSI disclosure requirements, and the commitment that specific issues raised by the respondents to the consultation would be addressed by the SFC in the form of further guidance or FAQs, we would suggest that the full set of SFC guidance and FAQs to address the issues identified at the consultation stage should be made available for consideration together with the Bill, because this provides a proper context for the Bill.

In relation to the draft guidelines, paragraph 33 states that "… it is not unusual that profit forecasts made on a corporation by different analysts vary considerably and media reports contain inconsistencies. As such, analysts' reports, financial journals and media reports often fall short of providing information which is accurate, complete and not misleading or deceptive. Accordingly, a corporation should not normally treat these as information that is generally known and disclosure of any inside information [i.e., PSI] would be necessary." As investment houses and fund managers produce reports on listed corporations from time-to-time for their clients' information, and the publication of such reports does not require the consent of the companies involved, it could be difficult for a listed corporation to keep track of all the reports about itself.

In addition, it is not entirely clear what aspects of analysts' and media reports would need to be clarified and how far reports must fall short of accuracy and completeness before listed corporations would be required to make a disclosure. There is also a possibility that triggering events of this kind could be abused, imposing an undue burden on listed corporations to make frequent disclosures.

Disclosure obligation

It is noted that the statutory disclosure obligation rests with the corporation and its officers. The term "officer", in relation to a corporation, as defined in Part 1 of Schedule 1 to the Securities and Futures Ordinance ("SFO"), means "a director, manager or secretary of, or any other person involved in the management of the corporation".

The scope of "officer" and, in particular, the meaning of "manager" and "person involved in the management", are considered to be too wide for the purposes of this Bill. In our view, the range of persons who may be held to account should be narrowed down, otherwise, the legislation could catch middle management or relatively low-ranking staff of a listed corporation.

Instead of "officer", we suggest that reference be made to equivalent provisions under the UK regime. The Financial Services Authority Handbook refers to a "person discharging managerial responsibilities", which is defined as a director or a senior executive who has regular access to inside information relating, directly or indirectly, to the issuer; and (ii) has power to make managerial decisions affecting the future development and business prospects of the issuer.

It is noted that paragraph 52 of the draft guidelines provides an interpretation of "manager", which indicates that, as a general principle, one must look to the object of the legislation and the context to determine the meaning of "manager". It further explains that 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 the corporation. If this interpretation of "manager" is to be taken as indicating the legislative intent of the PSI disclosure regime (Part XIVA of the SFO), the scope of the term should be set out clearly in the Bill, e.g., under the proposed new section 307A (Interpretation of Part XIVA), rather than simply being included in SFC guidance.

Safe Harbours

The Institute believes that the objective of the legislation is to encourage and inculcate good and prudent behaviour. Given the need for listed corporations and their "officers" to exercise judgment, and given that whether specific information should be regarded as PSI at a certain time can be fairly subjective and debatable, we believe that the safe harbour provisions, which permit disclosure of PSI to be delayed or withheld, should be extended. We consider that there should be a safe harbour to cover the situation where a company has appropriate internal control procedures in place, has taken reasonable steps to ensure a specific issue has been properly considered and the directors, having carefully considered the circumstances (taking professional advice, where appropriate), have exercised judgement, with reasonable prudence and in good faith, concluding that certain information is not PSI and does not warrant a disclosure at that time. This should be so even if subsequently, with the benefit of hindsight (which will be available to the Market Misconduct Tribunal ("MMT")) that judgment may turn out to be challengeable.

Sanctions

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

We propose that consideration be given to introducing a settlement arrangement for less severe or less clear cut cases, where this may be more appropriate than referring a case to the MMT.

We understand that the relevant authorities in the United Kingdom and Australia cannot issue disqualification or cold shoulder orders for breaches of the equivalent requirements in those jurisdictions. We would suggest, therefore, that the inclusion of these possible remedies at this stage in the development of Hong Kong's statutory PSI regime be reviewed. 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. As difficult assessments are often involved in disclosure decisions, and as a breach of a cease and desist order is a criminal offence, it may be overly harsh for a company or a director to be issued with such an order in less serious cases. We would suggest that cease and desist orders be reserved for cases involving a series of intentional or reckless breaches, which would generally be regarded as meriting more severe consequences.

We believe that remedial action taken by the regulators and the MMT, where breaches are alleged, should adopt the principle of proportionality in relation to sanctions generally. 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. Although the proposed new section 307N(3) in the Bill refers to the principle of proportionality, this applies only in relation to the imposition of fines. More generally, paragraph 85 of the consultation conclusions indicates that the MMT would be expected to consider the seriousness of a particular case, and whether it is an intentional breach, when deciding on the appropriate sanctions. However, there seems to be nothing in the Bill that explicitly requires the MMT to consider the question of proportionality other than in relation to fines.

We have reservations about granting 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. While we understand the desire to expedite the process of enforcing the statutory disclosure requirements, the existing safeguards and system of checks and balances should not be compromised in order to achieve this. The current procedure for taking cases to the MMT would provide persons accused of breaching the PSI requirements with a reasonable additional safeguard, i.e., an independent assessment by the Department of Justice of cases initiated by the SFC, to assist the financial secretary to decide whether proceedings should be instituted before the MMT.

Communication

There can expected to be a regular stream of new listings in Hong Kong and companies fresh to the market, whose knowledge and experience of the operation of the statutory PSI disclosure regime will be limited. Therefore, there will be an ongoing need for effective channels of communication between listed companies and regulators. Listed corporations should be permitted to seek prior feedback from the SFC in relation to PSI disclosure matters on a continuous basis to ensure timely disclosure of meaningful information to the market.

Should you have any questions on this submission, or require further clarification, please do not hesitate to contact me at the Institute.

Yours sincerely,

Peter Tisman
Director, Specialist Practices

PMT/ML/ay

c.c. The Hon. Paul Chan Mo-po, MH, JP