THE LAW SOCIETY OF HONG KONG 香港律師會

Consultation Papers

1. Financial Services and Treasury Bureau (FSTB)

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

2. Securities and Futures Commission (SFC)

"Draft Guidelines on Disclosure of Inside Information"

General Comments

The Law Society's Company and Financial Law Committee and Securities Law Committee have considered the proposals in the Consultation Papers. Our members have divergent views on giving statutory backing to the disclosure requirements for price-sensitive information (PSI), as outlined in the Consultation Paper published by FSTB *"Proposed Statutory Codification of Certain Requirements to Disclose Price Sensitive Information by Listed Corporations"* (Consultation Paper).

.

As Hong Kong builds its status as a key financial and business centre of the world, we understand the Government's intention to enhance investors' protection and corporate governance by stepping up regulation of disclosure failures and some of our members are sympathetic to the codification proposals.

However, a majority is very concerned about the prospect of giving statutory backing to the disclosure of PSI. Their reasons are summarised below:

- Whether something should be considered PSI can be an extremely complex and nuanced question. It is also a continuously evolving concept, which is evident in statistical trends.[1] The difficulty in defining inside information makes it inherently unsuitable for forming the subject of a positive statutory obligation (even on a civil basis). Imposing such an obligation is almost certain to result in over-disclosure which has the undesirable effects of disruption to businesses, mishandling of confidential information, and unnecessary and confusing surplus information in the market. If companies opt to over-disclose to avoid liability, the very purpose of encouraging the early disclosure of information that is <u>useful</u> to the market will be lost. In some members' view, the issues outlined in paragraphs 2.27 and 2.28 of the Consultation Paper give rise to serious concerns not just with respect to any future criminalisation, but also with respect to the proposals which are being put forward in the Consultation Paper.

[1] For example, in 2006, among the 204 companies listed on the Hong Kong Stock Exchange that recorded a decrease of 50% or more of their net interim profits for the first six months of 2006, only a very limited number of those companies issued profits warning announcements under Listing Rule 13.09. While the practice of issuing profit warning announcements is more prevalent subsequent to 2006, it has not become an inflexible requirement. In March 2009 a leading financial institution listed on the Hong Kong Stock Exchange announced a 62% decrease in pre-tax profit without issuing a profit warning in advance. In 2010, not all listed companies that reported an increase in profits opted for the issue of positive profit alert announcements. Codification of Rule 13.09 will not only impose a heavy burden on directors, it would create great confusion and uncertainty while what constitutes PSI remains unclear or changes over time.

- The need for the Government's main policy objective, namely to give the existing Listing Rule requirement more "*teeth*", has not been sufficiently demonstrated. No evidence has been put forward to show that companies are failing systematically to comply with Listing Rule 13.09. Whilst one could point to laws covering a similar concept overseas many of our members consider that this in itself is not a good reason for introducing burdensome legislation in Hong Kong without ample evidence of need. One of Hong Kong's traditional strengths has been that it has not been overburdened with legislation.

- With recent evidence of a real statutory remedy for substantial abuses of Listing Rule 13.09[2], the various successful insider dealing prosecutions by the SFC and the existing s.384 SFO penalty for any false or misleading information published in response to a Rule 13.09 enquiry, it is doubtful that Hong Kong needs another piece of legislation covering such a broad ambit.

- Many directors of small and medium-sized listed companies in Hong Kong are not professionally trained in securities laws. To guard against over-regulation which deters honest and able persons from taking up directorships (especially non-executive roles), attempts to expand the regulatory burden must be counter-balanced by appropriate protection for a director who makes an honest and reasonable mistake.

- In some cases, the directors' duty to keep information confidential where this is in the company's best interest may conflict with the statutory duty to disclose. If directors feel (in order to protect themselves from personal liability) safer to over-disclose, this may actually be detrimental to the company and shareholders.

There is a fundamental problem with imposing a vaguely drafted and potentially wide-ranging penalty regime where the regulators may impose a fine of up to HK$8 million (which might be construed as being aimed at deterrence)[3] and other very substantial sanctions.

We wish to emphasise that while we respond on the particular detailed questions below, some of our members are fundamentally against the idea of statutory backing of PSI. There is also considerable consensus that there are serious flaws in the "indicative" draft legislation which has been put forward.

SFC's *Draft Guidelines on Disclosure of Inside Information* (draft Guidelines)
With regard to the draft Guidelines, in the view of some members the fact that these are thought necessary (i.e. that the legislation itself is not sufficiently clear) is a worrying comment on the wisdom of introducing the legislation at all.

Some members are also uncomfortable with the draft Guidelines because in some paragraphs (for example paragraphs 63, 64, 70, 71) these may actually represent the SFC's desired position rather than the law. It is made clear in paragraph 2 that the draft Guidelines cannot be relied upon as an authoritative legal opinion, but it is a relevant concern that the SFC's view has not always held up with the tribunals. Just to take one detailed example, reference to the "possibility for a substantial price cut in [a listed company's] products" in paragraph 63. Once such matter becomes "specific or definite .... the corporation should make an announcement as soon as practicable". This does not sit at all easily with the IDT's decision in the *Tingyi* tribunal

[2] The application of s.214 SFO in SFC v. Yeung Kui Wong and others, HCMP 1742/2009.
[3] See the Court of Final Appeal case of Koon Wing Yee v Insider Dealing Tribunal and another, [2008] 3 HKLRD 372; (2008) 11 HKCFAR 170 where the Court held that punitive deterrent penalties render an offence criminal under the Hong Kong Bill of Rights, irrespective of whether it was classified as civil, and hence proof beyond reasonable doubt was required.

hearing, which looked at possession of five or six different pieces of information obtained by analysts (including information on profit margins) and came to the view these would not be relevant information unless in the context of what was known by investors (which itself required exhaustive analysis) it meant that expectations for bottom line results would be meaningfully affected.

In paragraph 2, it should perhaps suggest that the listed company should seek independent legal "and other professional" advice instead of just legal advice; it may need to seek advice from its accountants as to whether the specific information is material, and from its financial advisers as to whether such specific information is price sensitive.

Paragraph 5 and 14: in general the summary of the tribunals' decisions is fair, but some members were concerned that without reference to *Tingyi*, all key aspects of tribunals' views on relevant information have not been set out as fulsomely as they should be.

In paragraph 9, there are comments that the reference to "which might unduly prejudice a corporation's legitimate interests" does not actually accord with the drafting of the safe harbour.

With respect to paragraph 29, there are comments that the list should not include 'pledge of the corporation's shares by controlling shareholders' as one of the possible events or circumstances where a listed company should consider whether a disclosure obligation arises, given that (a) such event is governed by the SDI regime under the SFC under which no disclosure is required if such pledge of shares is to a bank or other qualified lenders and (b) such event does not constitute a price sensitive information under paragraph 6 of the *Guide on Disclosure of Price Sensitive Information* issued by the Hong Kong Stock Exchange in January, 2002 - noting that the list therein is also for illustrative purpose and is not a definitive list (vide paragraph 7 thereof); the market is aware of the SDI regime under SFO in relation to the pledge of shares by controlling shareholders and hence if this is incorporated, the market may have a different interpretation as to whether the regulators intend to regulate such disclosure by back-door means; if the regulators do intend to regulate such pledge of shares by way of disclosure, this should be the subject of a separate consultation and should not be grouped under the PSI regime.

Some members are concerned as to whether the fact that the draft Guidelines highlight specific information that there is a "difference between the results which the market might predict and the results the directors or officers know" (paragraph 27 of the draft Guidelines) and the comments in relation to "material changes in the corporation's ... performance of its business [etc.]" (paragraph 45 of the draft Guidelines) will exacerbate issues regarding reporting of profits / losses, and possibly reopen by the back door the issue of frequency of reports.

With regard to paragraph 55, a query has been raised on the meaning of "impending" negotiations and a view has been expressed that there should be more guidance (ideally in the legislation itself) as to what "incomplete" means. Query whether there are issues which might not be described as "proposals" or "negotiations" to which the same concept should apply.

Some members consider that it is unsatisfactory that an attempt to describe "trade secrets" is made in paragraph 57 rather than in the legislation itself.

In Appendix A, the SFC has omitted some cases – it should include all cases.

Law Society's Response to Questions in FSTB's Consultation Paper

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?

Law Society:
There were divergent views on this:

Opposing view
It is one thing to prohibit a person from dealing in securities whilst in possession of unpublished "relevant information" even though the definition "relevant information" lacks precision or may be incomplete. If a statutory disclosure obligation is to be imposed on a person in possession of "relevant information", consideration should be given to refining the definition such that the disclosure obligation can be properly discharged, noting that criminal liability is already attached to making any incomplete or misleading announcement.

There could be a conceptual problem between using the same definitions for the insider dealing and the PSI regime: there may well be sufficiently specific information for the relevant people to be restricted from dealing, but which is not of a type, or is not yet, suitable for publication. The proposed legislation, and in particular both the scope and clarity of the proposed safe harbours, does not address this.

Some of those who objected supported retaining the definition of PSI under Listing Rule 13.09 with which the market is familiar.

Favourable view
"Relevant information" is a concept familiar to the market and there are case law / tribunal decisions on the application of this concept, therefore, it is practical and reasonable to define PSI in similar terms.

As pointed out in the Consultation Paper, what constitutes "relevant information" involves the making of an assessment on the part of the directors taking into consideration a number of broadly crafted principles and so express provisions could be included in the legislation (either in the "relevant information" provisions, or as a safe harbour) to the effect that:

- the corporation should not be held liable if a reasonable board of directors, taking into account the guidelines issued by the SFC (Guidelines), could have come to the conclusion that the specific information does not amount to "inside information", even if another reasonable board of directors could have come to a contrary conclusion; and

- directors will not be liable provided they act honestly and reasonably in making their decision.

Question 1(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?

Law Society:
There are many potential problems with this proposal.

As mentioned above, a majority of our members are very concerned about giving statutory backing to the disclosure of PSI disclosure requirement. Their view is that the existing obligation under Listing Rule 13.09 does not require codification.

There is some support the proposals could be acceptable subject to the following qualifications:

- The term "as soon as practicable" should be more clearly defined. The draft Guidelines states that this means "immediately take all steps that are reasonable in the circumstances". While there can be black and white cases of inside information, in many cases compliance with such vague legislation is likely to be problematic. Every individual officer in possession of information which is not public (and officers will continually be in possession of confidential information relating to the relevant business) will have to make frequent judgement calls as to whether the information is potentially serious enough to require escalation for decision making (including judgement calls of a type that in some cases have required hundreds of pages of analysis in tribunal decisions).

- A director or an officer who has come into possession of inside information should be obliged to notify the listed corporation according to procedures it has established for the purpose, but the listed corporation should not be regarded as having knowledge of the information if the relevant director or officer failed to notify the listed corporation according to such procedure. The listed corporation should however be held liable if it has failed to establish such relevant procedure.

- There should not be a broad requirement to release <u>any</u> inside information that has come to the company's possession. For example, a listed company may receive PSI in the course of negotiating a transaction with a third party (e.g. another listed company) and it may be under a contractual obligation to keep the PSI confidential. In such a case, it does not make sense for the first listed company to be under an obligation to release such information to the public. The general principle should be the <u>timely</u> release of PSI but not in cases where such information is still premature.

- In relation to the presumption of knowledge, the current definition of "officer" under the SFO is too wide, as it includes not only directors, managers and secretaries, but also "any other involved in the management of the corporation". It is inappropriate for individual liability to be imposed on persons who are not directors, as proposed in s.101G(2) of the draft provisions. In comparison, in the UK, only directors are subject to individual liability in respect of non-disclosure, and only if they have acted "knowingly" (not recklessly or negligently, as the Government has proposed). We suggest that only directors and persons occupying equivalent senior management positions and having power to make managerial decisions affecting the future development and business prospects of the company (such as a chief executive) should be capable of having their knowledge imputed to the company.

- The requirement that directors and officers be required to take "<u>all</u> reasonable measures <u>from time to time</u>" [emphasis added] to ensure that proper safeguards exist to prevent the company from breaching the statutory disclosure requirements is problematic. This wording emanates from the existing compliance duty in s.279 SFO, but the scope of that duty, which relates to the prevention of obviously egregious activities, is in reality narrower than a duty which involves a positive obligation to do something (the scope of which is intrinsically unclear in many circumstances). Even if an officer has not been negligent, he will still be held to the "all reasonable" standard. Without knowing how this standard will

be administered in practice (e.g. whether it is sufficient to ensure that general protocols have been circulated, or whether some objective measure of "effective" circulation will be applied after the event; and whether all directors and officers need to supervise information dissemination, etc) severe difficulties will exist for directors and officers in their everyday compliance duties.

- Another problem with s.101B(1) is that it imposes absolute liability on the company for non-compliance, whereas individuals are to be liable only if they are at fault. Absolute liability is not appropriate where decisions involve in many cases difficult, subjective and marginal assessments, as is acknowledged to be the case with PSI. The SFC acknowledges in the draft Guidelines that it cannot advise companies on whether something constitutes inside information, and that this is for the company to assess.

- Finally, the words "or ought reasonably to have" in s.101B(2) should be deleted, otherwise a company would be obliged to do the impossible, i.e. to disclose information it does not have. Only actual knowledge should attract liability for breaches of the statutory disclosure requirements. Another serious problem with the concept is that it puts the company on notice and expects it to make enquiries, but there is potentially no limit on how far such enquiries should go, which could produce an impossible dilemma for the company.[4]

Question 1(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?

Law Society:
We agree with the proposal, subject to some concern with regard to the codification approach generally and the safe harbours we propose in this response.

Question 2(a)
Do you agree to the provision of the four proposed safe harbours?

Law Society:
Subject to the stated objections to codification generally, we agree in principle with the proposed safe harbours. However, there is a problem with s.101D(1)(b) in that the benefit of the safe harbours would be lost, and the disclosure obligation triggered, even if the company is unaware that information had leaked. This would be unfair, and does not seem to be the intention of the proposal - under the draft Guidelines the safe harbours would be lost only if the company is aware that information has leaked.

In addition, we have the following comments on the four proposed safe harbours:

Safe Harbour A
Although it is proposed that the SFC be empowered to grant a waiver to listed corporations if they face disclosure prohibitions arising from court orders or legislation of another jurisdiction, there may be a situation where a listed corporation or director or officer is prohibited from notifying the SFC of such inside information in the first place. The safe harbour should be extended to cover such situations. The delay inherent in the waiver application will likely have a

[4] For example: A major supplier is considering terminating supplies of a key product but has not yet made a decision. The fact is known to the company but it does not know that even if there is no termination, prices will be increased significantly. If the company then releases an announcement admitting that termination is possible, is the announcement complete?

material impact on the obligation to disclose price sensitive information "as soon as practicable". A listed corporation wishing to avail itself of the foreign statute and court order safe harbour will of course need to be able to prove that it falls within it, if challenged.

Safe Harbour B
We support the safe harbour for incomplete proposals or negotiations. In the draft Guidelines the SFC provided four examples to illustrate this safe harbour. All four focus on the premature disclosure of information which might "jeopardize" or "undermine" a transaction. This is similar to Note 7 to Listing Rule 13.09 which applies where "disclosure...might prejudice the issuer's business interests".

Circumstances may exist where premature disclosure would create an undesirable state of affairs which does not necessarily amount to "jeopardizing" or "undermining" a transaction. We urge the FSTB and SFC to consider adopting wording similar to that in the UK Disclosure and Transparency Rules (DTR 2.5.1), namely, "*the outcome or normal pattern of those negotiations [being] likely to be affected by the public disclosure*" as this is broader than the draft. The safe harbour should be available even if the "outcome" of the proposal or negotiation is not prejudiced, to avoid premature disclosure of negotiations or proposals which may cause unnecessary speculation and confusion.

Finally, the concept of "incompleteness" requires clarification in the statutory provision.

Safe Harbour C
We generally agree with this safe harbour. However, concern was expressed over the definition of "trade secret". "Trade secret" is not a term defined in any ordinance in Hong Kong. Nor is it a common term encountered in a securities law context, as it is usually linked to intellectual property laws and regulations. In practice, this may be counter-productive to efficient compliance.

The elaborations in the draft Guidelines are mainly focused on technology-intensive processes, e.g. inventions and manufacturing processes. Customer lists are cited as a further example. The draft Guidelines are silent about other types of potentially sensitive information of a more commercial nature, such as the terms and conditions of key business alliances, distribution agreements and pricing policies. We believe the market would benefit from more detailed guidance on the meaning of "trade secret".

Safe Harbour D
We agree with this safe harbour.

Question 2(b)
Do you agree that the SFC should be empowered to grant waivers, and to attach conditions thereto?

Law Society
We agree with this proposal. However, we think that the SFC's ability to grant waivers and to attach conditions should be far wider than under the proposed draft s.101E which only allows the SFC to grant a waiver if disclosure is prohibited by or contravenes a foreign court order or foreign laws or regulations. The SFC should have complete discretion to grant a waiver in any circumstances it deems appropriate.

Question 2(c)
Do you think that the legislation should provide for additional safe harbours? If so, what are these additional safe harbours?

Law Society
Yes, if the codification approach is adopted, we strongly recommend the following safe harbours be added:

Reasonableness test
We believe that, on the question of what constitute "inside information", a listed corporation should not be held liable for not treating certain information as "inside information" as long as the decision is not "*Wednesbury*" unreasonable. Thus, a listed corporation should not be held liable if a reasonable board of directors, taking into account the guidelines issued by the SFC, and by reference to the circumstances existing at the relevant time of making the disclosure, could have come to the conclusion that the specific information does not amount to "inside information", even if another reasonable board of directors could have come to a contrary conclusion. This can operate either as an additional safe harbour or as a separate provision.

Internal reporting procedures
There should be an additional safe harbour to the effect that a company will not need to disclose where it has followed proper internal processes to ensure that the matter is escalated to the Board as soon as reasonably practicable, and the Board has decided in good faith, on reasonable grounds, and as soon as reasonably practicable, that the information is not subject to the disclosure requirement. To this end, the SFC may provide general guidance as to what internal procedures a listed company should have in place.

Disclosure by listed subsidiary to parent
In a group company situation, the parent entity may be under a legal or regulatory obligation (e.g. where the parent is listed or is a regulated entity such as a bank) to collect financial or management information from its listed subsidiary for the purpose of constructing its own accounts which are to be released or reported at the same time as the listed subsidiary's financials or perhaps to prepare reports to its regulator on a more frequent basis. Such financials are likely to be price-sensitive in relation to the listed subsidiary and might present a practical problem which is not dealt with satisfactorily under the current or proposed regime.

Paragraphs 72 and 73 of the draft Guidelines relate to preparation of financials and other "structured disclosures". These paragraphs focus on the obtaining of PSI previously unknown to the directors and officers and stress the importance of "separate and immediate" disclosure of any PSI which has arisen from the preparation of periodic disclosures. There is no additional guidance on (1) how a listed subsidiary may be expected to assist its parent to comply with the parent's disclosure or reporting obligations; and (2) how the timing of the "separate and immediate" disclosure (as stated in paragraph 72) should be managed alongside the respective publications of the two companies' financial reports.

We suggest that an express safe harbour should be available for:

(a) generally providing information to the parent where (1) it is necessary for the proper conduct of the group's or substantial shareholders' business operations and (2) the directors of the company supplying the information are of the opinion that it is in the best interest of the company to provide such disclosure; and

(b) specifically, the provision of financial information by a listed company to another for the purposes of compliance with financial reporting or other legal or regulatory requirements of the other,

in each case subject to an undertaking by the recipient of the information to keep the information strictly confidential and not to use it for any other purpose.

M&A and due diligence / financing
Currently, Note 1 to Listing Rule 13.09 provides a de facto safe harbour for advance disclosure of information to "persons with whom negotiations are taking place with a view to the making of a contact or the raising of finance", subject to strict confidentiality and non-dealing requirements. We suggest that this express safe harbour be preserved and expanded in the new regime as described below:

In an M&A context, a listed issuer may be obliged to provide information about its business to the prospective buyer, for example where (1) the company is doing a share exchange offer or otherwise issuing its own shares as consideration for an acquisition; (2) where a substantial or controlling shareholder is disposing of its stake and the listed company is required to facilitate due diligence; or (3) where a new potential investor is considering a purchase of shares (whether primary or secondary) in the listed company. In principle, there should be no impediment to the provision of PSI by a listed company to facilitate a transaction or contract (to which the company may or may not be a party) with a third party, provided that the recipient is under a duty to keep it confidential, and to refrain from any dealing that would infringe the insider dealing laws. We would strongly recommend the FSTB and the SFC to consider reflecting this principle in the draft Guidelines.

Suspension of trading
We also believe that a safe harbour should be available for corporations which have applied for a suspension of trading of its shares pending the release of the PSI.

Question 2(d)
Do you agree that the SFC should be empowered to prescribe further safe harbours in the form of rules under the SFO?

Law Society:
We agree with this proposal.

Question 3(a)
Do you agree to extend the jurisdiction of the MMT to handle breaches of the statutory disclosure requirements?

Law Society:
Subject to the proviso that there are objections to the codification approach generally, this proposal is acceptable. The MMT already deals with civil cases under the insider dealing provisions. Putting this Tribunal in charge of PSI disclosure cases will be a natural extension of its function and would facilitate consistency and certainty in the approach concerning disclosure and use of PSI.

Question 3(b)
Do you agree with the proposed range of civil remedies as set out in paragraphs 2.31, 2.35 and 2.36?

Law Society:
Subject to the proviso that there are objections to the codification approach generally, we believe the proposals regarding MMT's jurisdiction must be reconsidered taking into account the following:

- In respect of paragraph 2.35, liability should attach to the listed corporation only.

- Some of our members do not agree that civil remedies be extended to persons suffering pecuniary loss as a result of breaching the PSI obligation. These members believe it is too onerous an obligation to be imposed on directors of listed companies.

- Comments have been made it is essential that the ability to issue a private reprimand should be preserved to deal with less serious breaches of the disclosure obligations. Concern has been expressed that the proposed maximum fine of HK$8 million is excessive for a *civil* offence given the MMT has no power to impose a fine (other than to make an order for the payment of a profit made or loss avoided) for a *civil* market misconduct offence under s.257 SFO, and the maximum fine for a *criminal* market misconduct offence is set at HK$10 million. There is disagreement that disqualification orders should be a potential penalty for breach of the proposed disclosure obligation. This is a harsh penalty which should only be warranted in the more serious cases, namely where the non-disclosure constitutes a civil market offence under Part XIII SFO or amounts to misconduct towards the company's members under s.214 SFO. If harsher penalties are retained, then clearer guidelines should be laid down as to their imposition, for instance for repeat offenders.

- **We do not support the proposal to introduce a criminal regime for failure to disclose PSI to the public.**

Question 3(c)
Do you agree to grant the SFC direct access to the MMT to institute proceedings on breaches of the statutory disclosure requirements?

Law Society:
We generally agree with this proposal. However, by removing the Financial Secretary "filter" will there be a risk that the MMT may become overburdened, particularly since this would apply not just to PSI but to civil market abuse cases?

We disagree that the SFC, with the role of investigator, should be empowered to institute proceedings directly before the MMT (or any other tribunal or court established to handle PSI cases), without the approval of the Financial Secretary. We believe this filter is appropriate.

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 12-month period?

Law Society
We agree that the SFC should provide informal consultation with the following additional comments:

- There is likely to be an ongoing need for advice and there is no reason in principle why informal guidance should have a time limit. The guidance service should be made available generally.

- The guidance service should not be restricted to applicability of safe harbours as suggested in the Consultation Paper. At the moment, if directors are in any doubt as to whether what they possess amounts to "relevant information", they should not be subject to legal sanctions as long as they do not deal in the relevant securities. Under the proposed legislation, they must make an assessment on the basis of the broadly crafted principles set out in the SFC Guidelines and decide whether the information amounts to "inside information". We believe that this creates difficulties for directors and a consultation service provided by the SFC would be useful.

- Going forward, as the SFC consolidates the questions it receives it should consider issuing advice, for example in the form of FAQs, to help listed companies comply.

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?

Law Society:
As there are existing areas of market regulation where the two regulators already work closely together in referrals, we do not have a problem in principle with the co-operative enforcement arrangements outlined in paragraphs 3.8 and 3.9. However, we believe the proposed regime can be improved by taking into account the following:

1. The regime outlined in paragraph 3.9 involves significant overlap of the SFC and SEHK's functions in monitoring and enforcing the PSI rules. In particular, paragraph 3.5 states that the current Listing Rule 13.09 will continue to exist and to be administered by SEHK (after modifications to dovetail the rule with its statutory equivalent).

   It is not easy to tell from paragraph 3.9 what will happen where there is suspected breach e.g.:

   - what are the relevant considerations for SEHK to refer a case to the SFC?

   - what are the practical differences for the listed company if one regulator (rather than the other) initiates investigations or disciplinary action?

   - in a case initiated by the SFC, whether it is possible for the SFC to refer it back to the SEHK for handling under the Listing Rules rather than the statutory regime (which involves different disciplinary proceedings and carries a different range of sanctions)

   - whether one body taking action means the other will be precluded from doing so, and whether there is any chance of re-opening a case by another regulator, or any form of "double jeopardy"?

2. Consistently with the stated policy objective of retaining SEHK's role as a "frontline regulator", the role of monitoring unusual movements in share prices/ volumes should continue to be carried out by SEHK which may refer cases warranting further investigation to the SFC. This would be a way of resolving the potential for overlaps, duplication (and resulting confusion) identified above.

The Law Society of Hong Kong
Company and Financial Law Committee
Securities Law Committee
22 June 2010

135475v5