THE LAW SOCIETY OF HONG KONG 香港律師會

CONSULTATION PAPER ON RULE CHANGES CONSEQUENTIAL ON THE ENACTMENT OF THE SECURITIES AND FUTURES (AMENDMENT) ORDINANCE 2012

Part B Consultation Questions

Chapter 2: Proposed Amendments

Main Features of Proposed New Rules

Questions 1
Do you agree with our proposed inclusion of express statements regarding the SFC's and the Exchange's role and responsibilities for enforcement of the obligation to disclose inside information under the SFO in MB Chapter 13 and GEM Chapter 17?

Law Society's response

Yes. We agree with the principle but also note the discussions in the paper that the Exchange will have to interpret and administer certain provision in the Listing Rules that will involve consideration of the meaning of inside information. Further, we note that the Exchange will remain the frontline regulator for monitoring the market, media, etc. and requiring announcement and trading halt or trading suspension on a day-to-day basis. We believe that this would also invariably involve interpretation of the meaning of inside information. Insofar as the latter is concerned, we assume the SFC will be involved by the Exchange, if necessary, to ensure that a consistent approach to interpretation is adopted.

We would like to see that a transparent mechanism is in place for such co-operation between the two regulatory bodies.

Question 2
Do you agree with our proposed deletion of MB Rules 13.09(1)(a) and 13.09(1)(c) (GLRs 17.10(1) and 17.10(3))?
Law Society's response

Yes. From the perspective of issuers and directors, the extent of their responsibilities will be clarified by the deletion.

Question 3
Do you agree to delete some of the notes to Rule 13.09(1) (GLR17.10) and elevate some of them to rules, as proposed?

Law Society's response

Yes.

Question 4
Do you agree with the proposed changes to Rule 13.10 (GLR17.11)?

Law Society's response

We have the following concerns:

1. Where an enquiry relates to a matter that has been adequately answered, for example, where a rumour or a press report is entirely false and a bare denial is published, the listed company should not always be required to make an announcement stating that its directors (having made due enquiry) are not aware of any inside information that should be announced under the Securities and Futures Ordinance ("**Ordinance**"), even though such information is unrelated to the subject matter or situation. This is particularly the case where an enquiry relates to "any other matters" (i.e. where there are no unusual price movements or trading volume and no false market).

2. It appears to us that the regulatory intention of the Rule is primarily to appraise members and the market about the matter or situation in question, rather than to necessarily oblige directors, whenever an enquiry is made, to:

(a) activate an internal check (i.e. the due enquiry requirement) with respect to whether the issuer has complied with the Ordinance, and

(b) then make a negative confirmation ("**negative confirmation**") by way of a public announcement where, having made due enquiry, they are not aware of any non-compliance with the Ordinance in respect of disclosure of any inside information required to be disclosed.

3. The above view is supported by the current wording of the Rule (proposed to be replaced), which basically restricts the negative confirmation to "any matter or

development that is or may be relevant to the unusual price movement or trading volume.

4. The standard announcement prescribed by the current Rules, to the extent that it requires a negative confirmation (i.e. that there is no (other) price sensitive information which is required to be disclosed), is applicable only in situations where there have been unusual price movements (but not in respect of an enquiry about "any other matters").

5. However, the current position is changed under the proposed Rules. The proposed form of standard announcement requires a negative confirmation about disclosure of (a) inside information in accordance with the Ordinance, and (b) information required to prevent and/or correct a false market, irrespective of whether the enquiry relates to or involves unusual price movements or trading volume.

6. Negative confirmations should not be triggered every time an enquiry is made, not least because in the context of inside information, non-compliance with the Ordinance attracts a civil fine, but an incorrect negative confirmation potentially attracts far more serious civil and criminal sanctions.

7. We are quite concerned about the negative confirmations regarding false market.

(a) First, regarding the negative confirmation about information required to prevent a false market from arising, some guidance and clarification is needed where the false market relates to non-disclosure of inside information exempt from disclosure on the basis of the various safe harbours under the Ordinance. It is noted that such safe harbours do not apply to the obligation to prevent or correct a false market. Such safe harbours may be lost if an information is leaked (in which case it should be appropriately disclosed), but certain safe harbours are not premised on confidentiality (such as where the disclosure will contravene Hong Kong laws or court orders, or where a waiver is granted by the SFC on account of prohibitions under overseas laws or court orders., or on account of rules made by the SFC).

(b) Second, it is unclear what information is required to be disclosed, and the extent thereof, in order to correct a false market, which is a new requirement. Some clarification or guidance will be required.

(c) Third, although the current form of Rule 13.09 requires issuers to disclose information which "is necessary to avoid the establishment of a false market", there is no requirement of "due enquiry" on the part of issuers and their Directors. The requirement of "due enquiry" may potentially be difficult and onerous to comply in the context of false market, which appears to be a somewhat nebulous concept in any event.

Please see our further comments on Question 5.

Question 5
Do you agree that the issuer should be required to confirm all the four negatives set out in the proposed new standard announcement under MB Rule 13.10 (GLR17.11), as proposed in paragraph 17?

Law Society's response

No. Please see our comments on Question 4.

Paragraph 17 of the Consultation Paper states that "an issuer is required to confirm *all the four matters* referred to in the standard announcement".

In our view, the first negative confirmation in the proposed form of announcement directly responding to the enquiries of the Exchange, i.e., that the issuer and its Directors, having made due enquiry, are not aware of the reasons for the price or volume movements or the subject matter of the Exchange's enquiry, is necessary for the protection of investors.

The second and third negative confirmations in the proposed form of announcement, i.e., that the issuer and its Directors, having made due enquiry, are not aware of any information which must be announced to correct or to prevent a false market in the company's securities, appear vague and could unfairly expose issuers and their Directors to potential liability.

First, it is unclear what constitutes "due enquiry" for this purpose. We believe it is not proposed that an issuer should (save perhaps in very exceptional or isolated cases where the issuer or its Directors is/are in fact aware of specific aspects of the false market information necessitating such an enquiry) have to search through the market, press or web etc. for any rumours or information about itself, its shareholders, its securities and their trading situation etc., and assess whether such information may have a false market impact on its securities. This is not reasonable, and investors are already protected by the proposed Rule 13.09(1).

Second, the confirmation required will require an issuer and its Directors to enquire about the existence (or non-existence) of *any* information that might have a false market impact, although such information may or may not be relevant to the subject matter of the Exchange's enquiry.

In relation to the fourth negative confirmation in the proposed form of announcement, i.e. that the issuer and its Directors, having made due enquiry, are not aware of any inside information which must be disclosed under the Ordinance - although this is not out of line with the existing confirmation about compliance with the general obligation under Rule 13.09, bearing in mind that disclosure of inside information is now regulated by statute, issuers should not invariably be required to confirm that they have not breached a statutory requirement.

Investors are protected by the sanctions contained in the Ordinance for failure to disclose. Requiring a statement of compliance as a standard and invariable response to an enquiry of the Exchange potentially subjects an issuer unfairly to wider liability.

Question 6
Do you agree that the obligation under Rule 13.09(1)(b) (GLR17.10(2)) should remain in the Rules despite implementation of Part XIVA of the SFO?

Law Society's response

Yes given the statutory duties of the Exchange, but we would like our concerns regarding false market in Question 4 to be addressed.

Question 7
Do you agree with the drafting in the proposed new MB Rule 13.09(1)(GLR17.10(1))?

Law Society's response

No. See our comments on Question 7 above.

Question 8
Do you agree to clarify the obligation to apply for a trading halt? Do you agree with the proposed new MB Rule 13.10A (GLR17.11A)?

Law Society's response
We do not have any issue with the concept of a trading halt.

However, in order to be consistent with the SFO and proposed Rule 14.37(3), paragraph 13.10A(3) should be qualified by a reasonableness requirement to read "circumstances exist where it reasonably believes or it is reasonably likely that ....".

Question 9
Do you agree that a trading halt will be required if an issuer reasonably believes there is inside information which requires disclosure under the SFO but it cannot disclose the information promptly? Do you agree with the proposed new MB Rule 13.10A(2) (GLR17.11A(2))?

Law Society's response

Yes.

Question 10
Do you agree to include MB Rule 13.06A (GLR17.07A) which imposes an obligation to preserve confidentiality of inside information until disclosure?

Law Society's response

In order to be consistent with the SFO, Rule 13.06A should be qualified by a reasonableness requirement to read "An issuer and its directors must take all reasonable steps ..."

Other Changes

Part A: New Defined Terms and Revise Some Defined Terms

Question 11
Do you agree that we should define Part XIVA of the SFO as "Inside Information Provisions"?

Law Society's response

Yes.

Question 12
Do you agree with the proposed changes to the defined terms set out in paragraphs 26(b) and 26(c) of the Consultation Paper?

Law Society's response

We would prefer to see the Securities and Futures Ordinance defined using its full name, or as the "SFO". These terms are more familiar to readers and will avoid the need to turn to the definitions while reading. We suggest that the words "for the purposes of Part XIVA of the Ordinance" at the end of the definition of "inside information", are not required.

Question 13
Do you agree with the proposed definition of the term "trading halt" and its use in the proposed Rule changes?

Law Society's response

Yes.

Part B: Other Consequential Changes

Question 14
Do you agree with our proposal to replace the term "price sensitive information" in the Rules with the term "inside information"?

Law Society's response

Yes.

Question 15
Do you agree with our proposal to retain provisions such as MB Rules 10.06(2)(e) and 17.05 (GLR13.11(4) and 23.05) by replacing the term "price sensitive information" with the term "inside information", although their enforcement would require the Exchange's interpretation of whether certain information is inside information?

Law Society's response

Yes. Please see our comments on Question 1.

Question 16
Do you agree with our proposal to delete references to the obligation to disclose information under the current general disclosure obligation and in particular, MB Rules 13.09(1)(a) and (c) and GLR17.10(1) and (3)?

Law Society's response

Yes. Please see our comments on Question 2.

Question 17
Do you agree with our proposal to create specific rules in respect of those matters which are currently discloseable under the general disclosure obligation, i.e. the proposed new MB Rules 13.24A, 13.24B, and the revised Practice Notes 15 and 17?

Law Society's response

Yes, such Rules will be administered by the Exchange as the front line regulator.

Question 18
Do you agree with our proposed changes to the provisions and the Listing Agreements in respect of the issue of debt securities?

Law Society's response

Yes.

Question 19
Do you agree with our proposal to clarify the obligation on guarantors of debt securities to disclose information which may have a material effect on their ability to meet the obligations under the debt securities?

Law Society's response

Yes.

Part C: Plain Writing Amendments

Question 20
Do you have any comments on the plainer writing amendments? Do you consider any part(s) of these amendments will have unintended consequences? Please give reasons for your views.

Law Society's response

We have no particular views on the general style of the current drafting.

The Law Society of Hong Kong
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