A Quick Look at the New SFC Guidelines on Disclosure of Inside Information

Quick Read

Hong Kong’s new statutory price sensitive information/inside information disclosure regime (PSI Disclosure Regime) will take effect on 1 January 2013. As part of the new regime, the Securities and Futures Commission (SFC) has gazetted its “Guidelines on Disclosure of Inside Information” (PSI Disclosure Guidelines) to assist the market to understand and comply with the new requirements. It will also take effect on 1 January 2013.

Under the PSI Disclosure Regime, we believe that three questions will most concern corporations and their officers (including directors):

• Whether a given situation or a piece of information is “inside information”?
• What a corporation should do to invoke disclosure safe harbours?
• What else should a corporation or its officers do to prevent a breach?

This legal update highlights what the PSI Disclosure Guidelines say about these three basic questions.

You can download copies of the PSI Disclosure Guidelines via the link below:


Please also refer to our previous legal update “New Statutory Price Sensitive Information Disclosure Regime to Take Effect on 1 January 2013”. Please read this legal update in conjunction with our previous legal update.

The PSI Disclosure Guidelines

The PSI Disclosure Guidelines will not have the force of law. One month before the PSI Disclosure Regime takes effect on 1 January 2013, SFC will launch a consultation service to assist corporations to understand how to comply with the disclosure obligations. The consultation service will initially last for two years and may be extended subject to review. SFC expects that most queries will relate to the application of the safe harbours. Also, SFC has made it clear that it is not in a position to judge or give advice to a corporation about whether a particular piece of information is inside information.

Whether a given situation or a piece of information is “inside information”?

THE PSI DISCLOSURE GUIDELINES PROVIDE SOME EXAMPLES

The market is presumably familiar with the concept of inside information as it adopts the definition from the insider dealing regime under the Securities and Futures Ordinance that has been in place for many years. By way of illustration, the PSI Disclosure Guidelines set out a non-exhaustive list of possible inside information examples. These examples mainly include:

• changes in the businesses, performance, conditions, assets and liabilities, directors and management, auditors, policies, shareholding or corporate structures and share capital of the corporation; and
• other significant events such as winding up, insolvency and legal disputes.

The PSI Disclosure Guidelines also offer some guidance on how to handle specific situations. Please refer to the Appendix at the end of this legal update.

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1 For discussion about “inside information”, please see our previous legal update “New Statutory Price Sensitive Information Disclosure Regime to Take Effect on 1 January 2013”
OBJECTIVE TEST VS. SUBJECTIVE TEST

Under the PSI Disclosure Regime, a corporation needs to make disclosure when it knows (or should have known) about the “inside information”. A corporation does not act on its own and can only act on its officers “controlling mind”. However, it is not sufficient for the board of directors of a corporation to claim that it “thinks” a given situation or a piece of information is “inside information” or not.

“REASONABLE OFFICER” TEST

The PSI Disclosure Guidelines remind us that when deciding whether a situation or a piece of information is inside information, the “reasonable officer” test should apply. So, it is not the officers’ subjective (albeit honest) view about the situation or information that will count. Instead, an objective test applies. If a “reasonable officer” would consider the information is “inside information” based on the officer’s knowledge of all relevant facts and circumstances at the time, then the corporation should, subject to any available safe harbours, make a disclosure. This test should be applied based on the facts and circumstances at the time, not hindsight.

NO “GOOD FAITH” OR “BUSINESS JUDGEMENT” APPROACH

Market practitioners had lobbied that it should be for the officers to decide if the subject information is “inside information”, having carefully considered the circumstances (taking professional advice, where appropriate) and exercised judgement, with reasonable prudence and in good faith. However, the PSI Disclosure Regime does not adopt this “good faith” or “business judgement” approach.

What a corporation should do to invoke disclosure safe harbours?

As noted in our previous legal update “New Statutory Price Sensitive Information Disclosure Regime to Take Effect on 1 January 2013”:

- “reasonable precautions” to preserve confidentiality is a pre-requisite if corporations want to rely on disclosure safe harbours; and
- the concepts of “incomplete proposal or negotiation” and “trade secret” may need further explanation.

The PSI Disclosure Guidelines provide further guidance on these terms.

“REASONABLE PRECAUTIONS” TO PRESERVE CONFIDENTIALITY

The PSI Disclosure Guidelines reiterate the importance of preserving confidentiality and give some leak-prevention suggestions. Corporations should consider:

- implementing measures to
  - sign confidentiality agreements before significant negotiations;
  - restrict employee access to inside information on a need-to-know basis and those who need to know understand the confidentiality obligation; and
  - disseminate information via the electronic publication system operated by The Stock Exchange of Hong Kong Limited (SEHK) before any other channel.
- putting in place procedures to
  - deal with analysts and media (e.g. pre-vet external presentations, recording briefings and discussions and subsequent checking for inadvertent disclosures). The PSI Disclosure Guidelines remind that comments (in particular significant, specific and credible ones) about the corporation in the media or analysts’ reports might indicate that confidentiality has been lost; and
  - respond to market rumours and deal with external enquiries (e.g. designating a spokesperson(s) with appropriate skills and training).

The PSI Disclosure Guidelines acknowledge that a corporation’s advisers, lenders, major shareholders, negotiation counterparties and regulators may receive inside information from the corporation provided that they understand their duty to preserve confidentiality and do so.

“INCOMPLETE PROPOSAL OR NEGOTIATION”

The PSI Disclosure Guidelines set out a few examples of incomplete proposal or negotiation which include the following situations:

- when a contract is being negotiated but has not been finalised;
- when a corporation decides to sell a major holding in another corporation;
- when a corporation is negotiating a share placing with a financial institution; and
• when a corporation is negotiating the provision of financing with a creditor.

If a corporation is in financial difficulty and is in negotiations with third parties for funding, then the safe harbour could relieve its disclosure obligation regarding the negotiations and the status of those negotiations. However, it would not permit the corporation to withhold disclosure of any material change in its financial position or performance which led to the funding negotiations. If it falls within the ambit of inside information, then it should be the subject of an announcement.

“TRADE SECRET”
The PSI Disclosure Guidelines explain that a trade secret generally refers to proprietary information owned by a corporation:

• used in a trade or business of the corporation;
• which is confidential (i.e. not already in the public domain);
• which, if disclosed to a competitor, would be liable to cause real or significant harm to the corporation’s business interests; and
• the circulation of which is confined to a limited number of persons on a need-to-know basis.

Trade secrets may concern inventions, manufacturing processes or customer lists.

What else should a corporation or its officers do to prevent a breach?
An officer of a corporation will be personally liable for the corporation’s breach of disclosure obligation if:

• the officer intends for the non-disclosure (intentional);
• the officer couldn’t care less (reckless); or
• the officer simply fails to take reasonable action to cause the corporation to comply with a disclosure requirement (negligence).

These officers are required under the PSI Disclosure Regime to take all reasonable measures to ensure that proper safeguards exist to prevent a breach of the disclosure requirement.

SUGGESTED “REASONABLE MEASURES”
The PSI Disclosure Guidelines clarify that reasonable measures include putting in place appropriate and effective systems and procedures to enable the corporation to comply with the disclosure requirements. Alongside the leak-prevention suggestions mentioned above, the PSI Disclosure Guidelines also give suggestions on systems and procedures to promote and facilitate upward reporting of sensitive matters and internal awareness of company policies:

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<th>UPWARD REPORTING OF SENSITIVE MATTERS</th>
<th>INTERNAL AWARENESS OF COMPANY POLICIES</th>
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<td>• establish periodic financial reporting procedures</td>
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<td>• establish controls for monitoring business and corporate developments and events</td>
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<td>• maintain and regularly review a sensitivity list</td>
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<td>• maintain an audit trail of meetings and discussions</td>
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<td>• authorize designated officer(s) or an internal committee to handle inside information reporting of a matter</td>
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<td>• provide regular training to relevant employees</td>
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<td>• document the disclosure policies and procedures and keep the documentation up to date</td>
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<td>• publish the disclosure policies and procedures so that the media and other stakeholders understand the corporation’s statutory disclosure obligations</td>
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These suggestions are not conclusive nor exhaustive.
EXECUTIVE DIRECTORS VS. NON-EXECUTIVE DIRECTORS

The PSI Disclosure Guidelines recognise that although all directors should exercise due care, skill and diligence to fulfil their obligations under the PSI Disclosure Regime, the fact that non-executive directors are not involved in the daily operations of the corporation may result in different expectations as to what they need to do.

The board as a whole, including the non-executive directors, will be expected to be directly involved in establishing and monitoring these internal controls and reporting procedures. However, officers with an executive role may be expected to be more involved given that they are:

- to monitor the proper implementation and functioning of the systems and procedures; and
- ensure that any material deficiencies are detected and resolved promptly.

Future Developments

We will closely monitor the latest developments of the PSI Disclosure Regime from time to time and will issue updates as and when appropriate. In the meantime, please do not hesitate to contact us if you require any advice or further information.

Contact Us

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## Appendix

### GUIDANCE ON SPECIFIC SITUATIONS

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<th>SPECIFIC SITUATIONS</th>
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| **Dealing with Media Speculation, Market Rumours and Analysts’ Reports** | • There is no general obligation under the PSI Disclosure Regime to:  
  » make a response to media speculation or rumours  
  » track third parties’ or analysts’ reports  
  • Be careful to ensure that no inside information is leaked when answering questions from analysts or reviewing analysts’ reports  
  • Disclosure may be required if:  
    » the speculation, rumours and reports suggest leakage and safe harbours cease to apply  
    » SEHK or the Rules Governing the Listing of Securities on SEHK require clarification announcement  
    » inside information helps to correct factual errors or fundamental market misconception  
  • If a response is to be made:  
    » there should be no selective release of information  
    » it should be made by way of formal announcement |
| **Internal Matters and Internal Management Reports** | • **No need to disclose non-specific information**: Day-to-day issues, matters of supposition, internal consideration and/or planning for scenarios (e.g. new product development, competitor’s new product, redundancy planning, potential price-cut) are generally not specific information. Therefore, no disclosure is required. Premature disclosure of non-specific information may be more misleading than informative  
  • **Specific information may become inside information**: But if the matter shows a change in trading performance (e.g. significant reduced sales) or otherwise becomes specific, then it may become inside information |
| **Management Accounts, Draft Accounts and Preparation of Periodic/Structured Disclosures** | • **No hard-and-fast rule**: Whether disclosure is required will have to be decided on a case-by-case basis  
  • **Draft accounts**: Draft annual/interim accounts, management accounts, or information during preparation of periodic/structured disclosure (e.g. circulars and other periodic financial reports) are generally not specific enough to be inside information  
  • **Previously unknown information**: Previously unknown inside information may transpire in the course of preparation of accounts, periodic/structured disclosure or financial trends may have crystallised. If so, immediate disclosure may be necessary |
### Specific Situations

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<td><strong>Unexpected losses or profits</strong>: Knowledge of substantial losses or profits (even without precise magnitude) may be inside information if it deviates significantly from market prediction.</td>
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<td><strong>Market prediction</strong>: When assessing what results the market predicts, past results or forecasts issued by the corporation, analysts’ projection and other publications which allow for a logical deduction of the corporation’s results should be considered. But analysts’ projection and other publications may contain inaccurate information. Please see “Dealing with Media Speculation, Market Rumours and Analysts’ Reports” above.</td>
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### External Developments and Publications by Third Parties

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<td><strong>No general obligation to disclose external, third-party information</strong>: There is no obligation to disclose general external developments (e.g., foreign currency rates, market price of commodities or changes in a taxation regime) or publications by third parties (e.g., industry regulators, government departments, rating agencies or other bodies).</td>
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<td><strong>May need to disclose likely impact</strong>: If the information has a particular impact on the corporation, then it may amount to inside information which would require disclosure by the corporation with an assessment of the likely impact of those events.</td>
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### Corporation Listed on more than One Exchange

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<td><strong>General principle</strong>: Release of inside information in Hong Kong and the overseas markets should be simultaneous.</td>
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<td><strong>Suspension if simultaneous disclosure not feasible</strong>: If simultaneous disclosure is not feasible, then the corporation should consider requesting a suspension of trading in its securities pending the issue of an announcement in Hong Kong.</td>
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