Part I

PRELIMINARY

Introduction

Overview of the Securities and Futures Ordinance

The Securities and Futures Ordinance came into effect on 1 April 2003.

The Securities and Future Bill was published on 7 April 2000 and consolidated 10 ordinances relating to the securities and futures industry at the time, which included:

(1) Securities and Futures Commission Ordinance (Cap.24) (enacted 1989)
(2) Commodities Trading Ordinance (Cap.250) (enacted 1976)
(3) Securities Ordinance (Cap.333) (enacted 1974)
(4) Protection of Investors Ordinance (Cap.335) (enacted 1974)
(5) Stock Exchanges Unification Ordinance (Cap.361) (enacted 1980)
(6) Securities (Insider Dealing) Ordinance (Cap.395) (enacted 1990)
(7) Securities (Disclosure of Interests) Ordinance (Cap.396) (enacted 1988)
(8) Securities and Futures (Clearing Houses) Ordinance (Cap.420) (enacted 1992)
(9) Leveraged Foreign Exchange Trading Ordinance (Cap.451) (enacted 1994)
(10) Exchanges and Clearing Houses (Merger) Ordinance (Cap.555) (enacted 2000)

The above repealed ordinances were considered complex and cumbersome by the government, and its regulatory approaches inadequate for investor protection. The Bill aimed to enshrine a user-friendly regulatory regime for the development of a fair, orderly and transparent market that would be competitive internationally as well as attractive to investors, issuers and intermediaries. Specifically it sought to create a modern legal framework that:

(1) promoted market confidence;
(2) secured appropriate investor protection;
(3) reduced market malpractice and financial crimes; and
(4) facilitated innovation and competition.

The reader of this Ordinance must be careful about the definitions of various terms. Schedule 1 to this Securities and Futures Ordinance (Cap.571) sets out all definitions which have general application across this Ordinance. The opening Division of a Part within the main body of the Ordinance sets out definitions of terms that are specific to that particular Part. Definitions of terms that are solely used in a single provision are found in the last subsection of each section. For example, "financial product" is defined in Schedule 1 for the purpose of this Ordinance generally. But this term is again separately defined in Schedule 9 to the Ordinance to have a different meaning in the context of insider dealing.

Long Title

An Ordinance to consolidate and amend the law relating to financial products, the securities and futures market and the securities and futures industry, the regulation of activities and other matters connected with financial products, the securities and futures market and the securities and futures industry, the protection of investors, and other matters incidental thereto or connected therewith, and for connected purposes.

[1 April 2003] *L.N. 12 of 2003*

(Enacting provision omitted—E.R. 2 of 2012)

(Originally 5 of 2002)

(*Format changes—E.R. 2 of 2012)

1. Short title

(1) This Ordinance may be cited as the Securities and Futures Ordinance.

(2) (Omitted as spent—ER 2 of 2012)

COMMENTARY

Enactment History

[1.01] The White Bill for consultation was gazetted on 7 April 2000 (Special Supplement No. 5 to Government Gazette of the same date). The Blue Bill was gazetted on 24 November 2000 and its first reading in the Legislative Council was on 29 November 2000. A Bills Committee was formed in December 2000 to study the Securities and Futures Bill and the Banking (Amendment) Bill 2000. The Securities and Futures Ordinance was passed by the Legislative Council on 13 March 2002.

2. Interpretation

(1) Schedule 1 contains interpretation provisions which apply to this Ordinance in accordance with their terms.

(2) Individual Parts and provisions of this Ordinance contain interpretation provisions which have application in accordance with their terms.

(3) The Commission may, by notice published in the Gazette, amend Parts 2, 3, 4 and 5 of Schedule 1.

COMMENTARY

Overview

[2.01] The Securities and Futures Ordinance (SFO) is based upon a number of important definitions.

Given the volume and importance of the definitions, the interpretation provisions are primarily set out in Part 1 to Schedule 1 of the SFO. While the definitions of general application are located in Part 1 to Schedule 1 of this Ordinance, specific definitions applying to the particular Parts of the SFO are set out in the opening provision of that relevant Part. Furthermore, definitions of terms that are relevant to a single section or the sections within a Part of this Ordinance are often set out at the end of a particular section of the relevant Part of that Ordinance.

Part II

SECURITIES AND FUTURES COMMISSION

Division 1 – The Commission

Division 2 – Accounting and financial arrangements

Introduction to Part II

Part II provides for the proceedings and the operation of the Securities and Futures Commission (SFC) and its constitutional framework.

Part II governs the SFC, its creation, regulatory functions, objectives, powers, and duties. It also describes the constitution and procedures of the SFC including some important accountability measures, such as: (i) restrictions on the delegation of various functions; (ii) the power of the Chief Executive to issue directions to the SFC; (iii) the obligation of the SFC to give certain information to the Financial Secretary on request; and (iv) budgetary, financial reporting, audit and investment requirements. These provisions are supplemented by more detailed procedures relating to the SFC's corporate governance in Part 1 of Schedule 2 of the Securities and Futures Ordinance

(SFO) and a list of SFC functions that the SFC board of directors may not delegate as prescribed in Part 1 of the Schedule 2 of the SFO. This Part II of the SFO changed little from the previous arrangements in the repealed Securities and Futures Commission Ordinance (Cap.24).

Division 1 – The Commission

3. Securities and Futures Commission

(1) Notwithstanding the repeal of the Securities and Futures Commission Ordinance (Cap.24) under section 406, the body established by section 3 of that Ordinance as the Securities and Futures Commission shall continue in existence in its original name as a body corporate with power to sue and be sued in that name.

(2) Subject to the provisions of this Ordinance, the corporate identity of the Commission, and the rights, privileges, powers, obligations and liabilities of the Commission and those of others in relation to the Commission, are not affected by the repeal of the Securities and Futures Commission Ordinance (Cap.24) under section 406, and any reference to the Commission (whether by reference to that Ordinance or otherwise) in any Ordinance or any instrument, record or document, or in or for the purposes of any proceedings, agreement or arrangement (whether in writing or not) shall be construed accordingly.

(3) The receipts of the Commission are not subject to taxation under the Inland Revenue Ordinance (Cap.112).

(4) Part 1 of Schedule 2 contains provisions relating to the constitution and proceedings of and other matters relating to the Commission.

COMMENTARY

Enactment History

[3.01] This section has no predecessor provision and came into effect on 1 April 2003.

Background

[3.02] The Securities and Futures Commission (SFC) was established in 1989 in the wake of the stock market crash in October 1987. It was established according to the recommendations of a report by the Securities Review

Committee (*The Operation and Regulation of the Hong Kong Securities Industry*, popularly known as the *Hay Davison Report*) in 1988.

The closure of the stock exchange in the aftermath of Black Monday led to the appointment of the Securities Review Committee on 16 November 1987 by Hong Kong's ex-Governor, Sir David Wilson. The Committee, chaired by Ian Hay Davison, was asked to review the constitution, powers, management and operation of the Stock and Futures Exchanges and their regulatory bodies.

The above report was presented to the Government on 27 May 1988, recommending major reforms, including a fundamental revision to the internal constitution of both the Stock and Futures Exchanges and the establishment of a single independent statutory body outside the Civil Service, the SFC, to regulate and supervise the securities and futures industry.

The SFC was originally established under s.3 of the repealed Securities and Futures Commission Ordinance (Cap.24). The provisions relating to the constitution and proceedings of the Commission are now set out in Part 1 of Schedule 2 of this current Securities and Futures Ordinance (Cap.571) (SFO) (previously contained in s.5 of the repealed Securities and Futures Commission Ordinance (Cap.24)).

Constitutional framework of the SFC

[3.03] Part II of the SFO and Schedule 2 to the SFO provide for the operations of the SFC and its constitutional framework. The previous constitutional framework of the SFC (i.e., before the current SFO came into effect) remains basically unchanged, but a few notable changes have been made to provide clarity and, where necessary, an appropriate degree of flexibility. All these reflect the need to clarify the objectives and functions of a modern securities regulator. Three changes are worth noting, as briefly discussed below:

(a) the introduction of a new Clause 4 setting out the regulatory objectives which the SFC is to pursue. This has no counterpart in the repealed SFC Ordinance (Cap.24);
(b) a new provision, Clause 6, which sets out the general duties of the SFC under this SFO; and
(c) the terminology used to delineate the ambit of the SFC's jurisdiction has been revised to better reflect the exact parameters and nature of its role.

Schedule 2 to the SFO

[3.04] Part 1 of Schedule 2 to the SFO sets out the constitution and proceedings of the Commission. It stipulates the number of chairman, chief executive officer and other members of Commission and it also stipulates the

appointment of the deputy chairman and vacancies in office of chairman or deputy chairman, etc. It also sets out the functions and office of members, and stipulates the conduct of meeting and passing of written resolution, etc. This part of the schedule also stipulates the setting up and composition of the advisory committee.

Part 2 of this same Schedule 2 to the SFO sets out its non-delegable functions. This list of non-delegable functions has been greatly expanded so as to encompass matters of broad market impact and any functions which involve consultation with the Financial Secretary.

The Split Model

[3.05] The split model proposes that the SFC be led by a chairman whose role be separated from the executive arm, while the executive arm be headed by a Chief Executive Officer (CEO).

The split model was introduced by the Securities and Futures (Amendment) Ordinance 2006. Since both the international and the local best governance practices tend to see the roles and responsibilities of chairman and chief executive of a public body to be separated, the government considered that SFC as the market regulator should implement such practice and set exemplary standard for others to follow. That would also be in line with the corporate governance practice of other public corporations in Hong Kong, e.g.: (i) the Hong Kong Exchange and Clearing Limited; (ii) the Airport Authority; (iii) the Canton Kowloon Railway Corporation; and (iv) the Mandatory Provident Fund Schemes Authority.

The government therefore proposed that the role of the Chairman of SFC should be separated from that of the CEO. The Chairman would focus on the: (i) establishment and development of an effective governing body; (ii) setting agenda and priorities; (iii) facilitating effective contribution of non-executive directors; (iv) representing SFC publicly and liaising with local and international financial institutions and organizations; and as well as (v) other stakeholders.

The CEO now has the executive responsibility for the day-to-day running of SFC. His key responsibilities include: (i) reporting to the governing body of SFC regularly with appropriate, timely and quality information; (ii) informing and consulting the Chairman on all matters of significance to the SFC; (iii) developing and delivering the strategic objectives agreed with the governing body; (iv) overseeing the day-to-day operation and regulatory work of the SFC; and (v) ensuring that the SFC is equipped with the necessary staffing, financial and risk management systems for its mission.

The Amendment Ordinance 2006 amended Part 1 of Schedule 2 of the Ordinance to the effect that:

(a) replace s.1(b) so that the number of SFC NEDs shall exceed the number of SFC EDs;
(b) repeal s.2 so that the Chairman of the SFC shall no longer be regarded as an ED of the Commission;
(c) amended ss.4, 6 and 7 so that an SFC NED may also be appointed as the deputy chairman of the Commission (DC/SFC) or be designated to act as C/SFC;
(d) the Chief Executive may appoint an SFC ED to be the CEO of the Commission; and
(e) add a new s.9A so that the Chairman of the SFC, the deputy chairman of the SFC and the CEO shall have such functions as are assigned to them by the Commission.

Chairman of the SFC

[3.06] The role of the Chairman of the SFC (C/SFC) is pivotal in leading the SFC governing body in setting the overall direction, policies and strategies of SFC and monitoring the performance of the executive arm in implementing the objectives set by the governing body. Given the importance of the role and in line with the trend of good governance practice, the role of the chairman were separated from that of the executive arm to further enhance the internal checks and balances of the SFC. This creates the conditions for enhancing the independence of the governing body and hence its ability to discharge its supervisory functions over senior management.

The idea is that the role of the chairman should be clearly separated from that of the CEO and should focus on the following responsibilities:

(a) establishing and developing an effective governing body;
(b) setting agenda and establishing priorities;
(c) facilitating effective contribution of non-executive directors (NEDs); and
(d) representing the SFC publicly, in liaison with local and international financial institutions and other stakeholders.

The chairman will not be involved in the day-to-day regulatory work (e.g., reviewing individual listing applications and investigating possible breaches of the Securities and Futures Ordinance, etc.).

CEO of the SFC

[3.07] The CEO carries the executive responsibility for the day-to-day running of the SFC. He should implement the objectives, policies and strategies agreed

by the SFC governing body, and facilitate the effective functioning of the governing body. The key responsibilities include:

(a) reporting to the governing body regularly with appropriate, timely and quality information;
(b) informing and consulting the chairman on all matters of significance to the SFC;
(c) developing and delivering the strategic objectives agreed with the governing body; and
(d) overseeing the day-to-day operation and regulatory work of the Commission and ensuring that the Commission is equipped with the necessary staffing and financial and risk management systems for its mission.

Independence of Chairman of SFC

[3.08] The government has stated clearly even in the consultation stage, that it was a fundamental policy objective of the government to preserve the independence of the SFC. In selecting the chairman of the SFC, the government would be keenly aware that he/she should be, and be perceived as, independent from external influence so as to preserve the integrity, reputation and image of the independent regulator under the three-tier regulatory system.

The government considered that the above can be achieved through:

(a) application of the current provisions in the SFO concerning avoidance of conflict of interests; and
(b) application of the SFC's internal Code of Conduct which requires the highest standards of integrity and conduct from its directors (C/SFC and NEDs included) and staff in carrying out their work properly, impartially and free from any suggestion of improper influence.

In addition, given public expectation on the independence of the post of C/SFC, it is the government's policy intention that during the tenure of the office of C/SFC, he should not:

(a) be a director of any listed company in Hong Kong; or
(b) have any material interest in any principal business activity of or is involved in any material business dealing with a listed company, or any person or institution engaged in activities regulated by the SFC.

The potential Chairman of SFC will be required to agree to comply with the above requirements before his/her appointment takes effect.

While it was the government's policy intention that the chairman should be non-executive, the government did not recommend stipulating this rigidly in

the legislation since it might be problematic to delineate in law the distinction between executive and non-executive duties and might impose unnecessary inflexibility on the future set up of the SFC. The government made reference to the UK Financial Services and Markets Act and pointed out that it also did not make such stipulation.

According to the papers submitted to the LegCo, the remuneration package for the CEO would be similar to that of the then executive Chairman while remuneration for the non-executive Chairman would be lower than that of the CEO since the Chairman's appointment was regarded as a service to the community, not an employment with the SFC. The government did not expect the financial implications to be significant relative to the overall budget of the SFC. In deciding the appropriate level of remuneration for Chairman of SFC, the government also draws reference from the remuneration for non-executive Chairmen of other public bodies in Hong Kong and relevant regulatory bodies overseas, as well as the remuneration for SFC's existing NEDs.

Safeguards against conflict of interests

[3.09] Concerns were expressed by the lawmakers as to whether adequate safeguards were in place to avoid any real or perceived conflict of interests between the roles of the future SFC Chairman and his/her past or current employment/connections with listed or private companies. The government has assured lawmakers that it attached great importance to the independence of the Chairman from any perceived or real conflict of interests.

On statutory safeguards, sections 378 and 379 of the SFO govern the preservation of secrecy and avoidance of conflict of interests respectively. The relevant provisions in the Prevention of Bribery Ordinance (Cap.201) are also applicable to all members (including Chairman, EDs and NEDs) and staff of the SFC. Moreover, the SFC's internal code of conduct which sets out the requirements on confidentiality, conflict of interests, personal investments and prevention of bribery, will continue to apply to the Chairman, EDs and NEDs and staff of the SFC under the split model.

There have also been additional requirements on the SFC Chairman that he should not be a director in any listed company in Hong Kong; and should not have any material interest in any principal business activity or be involved in any material business dealing with any persons or institution regulated by SFC.

According to the government, an example of "having a material interest" would be shareholder status or directorship of the SFC Chairman in a listed company/licensed intermediary. For a listed company, the holding of about 5% shares may be regarded as material. As regards being "involved in any

material business dealing with a listed company/licensed intermediary", an example is where the SFC Chairman or a company in which he holds shares or is a director has business dealings with the listed company or licensed intermediary.

Where the proposed SFC Chairman is a partner of a law firm whose clients are listed companies regulated by SFC, the government takes the view that there is a risk that a potential or real conflict of interest may arise if the proposed candidate is appointed as Chairman of SFC. Hence, as a condition for appointment, the candidate will be required to resign from the law firm. During the term of appointment, he should not have any direct or indirect interest in the law firm.

Concern has been raised about the efficacy or otherwise of the additional safeguards as they are only administrative, not statutory, requirements and carry no sanction against non-compliance. The government's intention was to include them in the terms of appointment of the prospective Chairman. In accepting the appointment, the candidate will be required to agree to comply with these requirements. The government did not consider it necessary to include the additional safeguards in the law as sections 378 and 379 of the SFO already provide criminal sanctions against any person who breaches the secrecy and avoidance of conflicts requirements under these two sections.

SFC's participation in the International Organization for Securities Commissions (IOSCO)

[3.10] During the legislative stage, it was noted that a former Chairman of the SFC had chaired the Technical Committee of IOSCO. Lawmakers were concerned as to whether the appointment of a non-executive Chairman might have adverse implications on SFC's future international status and affect its participation in IOSCO. They also noted from the SFC's written submission that the securities regulators, which were members of the Technical Committee, were all headed by executive chairmen and that Hong Kong might be denied the opportunity in the future to take up important chairmanship positions in the international community because the executive chairmen might not consider a non-executive chairman as an equal. In this regard, the government has provided for the LegCo Bills Committee's reference the written advice by the Secretary General of the IOSCO that the appointment of the Chairman of the IOSCO Technical Committee would be a personal appointment based on the recognized experience and authority of the appointee, rather than on the executive nature or otherwise of the post held by the person.

To assess further the impact of the splitting proposal on Hong Kong's standing in the IOSCO Technical Committee, the Bills Committee has

consulted the Chairman of the Executive Committee of IOSCO and the Deputy Chairman of the Technical Committee of IOSCO on their views. In the opinion of the former, the IOSCO principles are sufficiently broad to be adapted to domestic contexts and to provide some flexibility with respect to the governance structures of securities regulators. As such, there will be no bar to participation in IOSCO by a non-executive chairman. Nevertheless, in the selection of the Chairman of the Technical Committee, other executive chairmen may well not be confident in appointing a person who is not having detailed technical knowledge and experience normally gained from the day to day work as a securities regulator. The Deputy Chairman of the Technical Committee has advised that each regulatory body is responsible for appointing its representative to IOSCO. Active participation in discussions and chairmanship of various committees may hinge on the level of authority the representative can command. However, to the best of his knowledge, every member of the Executive Committee of IOSCO or of the Technical Committee is an executive chairman.

Notwithstanding that there has not been any explicit comment on the desirability of a non-executive chairman of a securities regulator to chair committees of IOSCO, lawmakers noted that relevant professional knowledge and experience possessed by the person in question are key factors for consideration. The government has also advised that in actual practice, participation and chairmanship at the committees of IOSCO are not restricted to executive chairmen of securities regulators.

The SFC's power to ratify its action

In the matter of *Securities and Futures Commission v A* [2008] 1 HKC 89, the [3.11] board of directors of the SFC authorised application for an injunction in respect of the amount of any profit gained from the sale of the defendant's shares in other companies. Subsequently, the board of the SFC passed a fresh board resolution stating, among other things, that for avoidance of doubt it ratified the injunction application made earlier.

Counsel for the defendant submitted that the Court had no jurisdiction to entertain the application for an interim injunction as it was made *ultra vires*, in that the board of directors of the SFC had failed to authorise the institution of the application.

The Court disagreed and held that (para. 15):

> "The SFC is a body corporate by virtue of s.3 of Cap.571, and can ratify its actions as in the case of any other body corporate. The board of a corporation, whether statutory or otherwise, can ratify its acts by subsequent resolutions and the ratification would have retrospective effect (*Pennington's Company Law*, 8th Ed, pp.153-4; *Poon Yee Kan*

COMMENTARY

Predecessor provisions

[142.01] This section was newly introduced in the SFO and came into effect on 1 April 2003. It has no predecessor provision.

Overview

[142.02] This provision is basically self-explanatory.

143. Amendment of Schedule 6

The Commission may, by notice published in the Gazette, amend Sch.6.

COMMENTARY

Predecessor provisions

[143.01] This section was newly introduced in the SFO and came into effect on 1 April 2003. It has no predecessor provision.

Overview

[143.02] This provision is basically self-explanatory.

Part VI

CAPITAL REQUIREMENTS, CLIENT ASSETS, RECORDS AND AUDIT RELATING TO INTERMEDIARIES

Division 1 – Interpretation

144. Interpretation of Part VI

In this Part, unless the context otherwise requires–

"specified amount requirements" (指明數額規定) means the requirements specified in the financial resources rules pursuant to section 145(2)(a)(i).

COMMENTARY

Predecessor provisions

[144.01] Section 144 came into effect on 1 April 2003. It has no predecessor provision.

Explanatory note

This section simply provides the definition for "specified amount requirements" as it is applied throughout this Part VI of the Securities and Futures Ordinance (SFO). [144.02]

Division 2 – Capital Requirements

145. Financial resources of licensed corporations

(1) The Commission may, after consultation with the Financial Secretary, make rules requiring licensed corporations to maintain such financial resources as are specified in the rules.

(2) Without limiting the generality of subsection (1) and without prejudice to section 398(7) and (8), the Commission may in the rules referred to in subsection (1) –

(a) require licensed corporations to maintain financial resources in accordance with –
  (i) specified requirements as to the amount in which they are to be maintained; and
  (ii) any other specified requirements;
(b) specify the assets, liabilities and other matters to be taken into account under the rules to determine the amount of the financial resources of licensed corporations for the purposes of the rules and the extent to which, and the manner in which, they are to be taken into account for that purpose;
(c) provide for the different treatment of the assets, liabilities and other matters for the purposes of the rules according to whether or not they are approved by the Commission for that purpose;
(d) provide that the rules, or any of the provisions of the rules, do not apply to licensed corporations which maintain financial resources, in Hong Kong or elsewhere, in accordance with an authorization of an authority, in Hong Kong or elsewhere, which in the opinion of the Commission performs a function which involves the imposition of requirements relating to financial resources of persons carrying on activities similar to any regulated activity for which a licensed person may be licensed, or apply to such licensed corporations with specified modifications or only in specified circumstances;
(e) provide for the grant of approvals for specified purposes and for the amendment or revocation of such approvals, and for

the publication of such approvals and of any amendment or revocation of such approvals in the specified manner;

(f) require licensed corporations to submit to the Commission –
  (i) at specified intervals, returns relating to their financial resources and trading activities; and
  (ii) notice in writing of specified circumstances relating to their financial resources and trading activities;

(g) require licensed corporations to submit returns to the Commission in response to a request by the Commission for information relating to their financial resources and trading activities;

(h) provide for any other matter relating to financial resources of licensed corporations.

COMMENTARY

Predecessor provisions

[145.01] This section is based on section 28 of the repealed Securities and Futures Commission Ordinance (Cap.24); and sections 17 and 18 of the repealed Leveraged Foreign Exchange Trading Ordinance (Cap.451).

Explanatory note

[145.02] This section allows the Commission to make rules requiring licensed corporations to maintain such financial resources as specified in the rules. This section also enables the Commission to make rules requiring the specified licensed corporation to provide and specify certain information in relation to the financial resources of the licensed corporation.

The Securities and Futures (Financial Resources) Rules (Cap.571N) (FRRs) came into force on 1 April 2003 and is particularly relevant to this section. The FRRs are designed to ensure that licensed corporations have sufficient funds to operate their business and meet liabilities.

Depending on the type(s) of regulated activity that a licensed corporation is applying for, the FRRs require a licensed corporation to maintain at all times a specified amount of paid-up share capital and liquid capital. Licensed corporations are required to submit regular financial resources returns to the Securities and Futures Commission (SFC).

Part 3 and Part 4 of the FRRs details the financial resources requirements and liquid capital of licensed corporations. Schedule 1 of the FRRs sets

out the minimum paid-up share capital and liquid capital requirements for licensed corporations. The table below summarizes the minimum paid-up capital and liquid capital that a licensed corporation is required to maintain for each type of regulated activity.

Regulated activity	Minimum paid-up share capital	Minimum liquid capital
Type 1 – Dealing in securities		
(a) in the case where the corporation is an approved introducing agent or a trader	Not applicable	$500,000
(b) in the case where the corporation provides securities margin financing	$10,000,000	$3,000,000
(c) in any other case	$5,000,000	$3,000,000
Type 2 – Dealing in futures contracts		
(a) in the case where the corporation is an approved introducing agent, futures non-clearing dealer or trader	Not applicable	$500,000
(b) in any other case	$5,000,000	$3,000,000
Type 3 – Leveraged foreign exchange trading		
(a) in the case where the corporation is an approved introducing agent	$5,000,000	$3,000,000
(b) in any other case	$30,000,000	$15,000,000
Type 4 – Advising on securities		
(a) in the case where the corporation is subject to the specified licensing condition	Not applicable	$100,000
(b) in any other case	$5,000,000	$3,000,000
Type 5 – Advising on futures contracts		
(a) in the case where the corporation is subject to the specified licensing condition	Not applicable	$100,000
(b) in any other case	$5,000,000	$3,000,000
Type 6 – Advising on corporate finance		
(a) in the case where the corporation is subject to the specified licensing condition	Not applicable	$100,000
(b) in the case where the corporation is not subject to the no sponsor work licensing condition	$10,000,000	$3,000,000
(c) in any other case	$5,000,000	$3,000,000

Type 7 – Providing automated trading services	$5,000,000	$3,000,000
Type 8 – Securities margin financing	$10,000,000	$3,000,000
Type 9 – Asset management		
(a) in the case where the corporation is subject to the specified licensing condition	Not applicable	$100,000
(b) in any other case	$5,000,000	$3,000,000
Type 10 – Providing credit rating services		
(a) in the case where the corporation is subject to the specified licensing condition	Not applicable	$100,000
(b) in any other case	$5,000,000	$3,000,000

The minimum paid up share capital requirement and liquid capital requirement for a licensed corporation licensed for more than one type of regulated activity will have to satisfy the highest minimum requirements applicable to the respective regulated activities for which is it licensed. For instance, where a licensed corporation is licensed for a Type 1 and Type 3 regulated activity, and the minimum paid up share capital requirement for is $5 million and $30 million respectively, the licensed corporation will have to maintain a minimum paid up share capital of $30 million.

Required Liquid Capital, Liquid Assets, Ranking Liabilities

[145.03] The FRRs have detailed provisions as to how financial resources are calculated and maintained.

Liquid Capital

Liquid capital is one kind of financial resource that a licensed corporation is required to maintain under the FRRs. Liquid capital is the amount by which the liquid assets of a licensed corporation exceeds it ranking liabilities. Part 4 of the FRRs deal with the calculation of liquid capital and required liquid capital.

Liquid Assets

Liquid assets refer to the amount of assets that the licensed corporation is required to include in the calculation of its liquid capital. The value of such assets are subject to adjustments and includes and caters to factors such as illiquidity and credit risks. Only prescribed assets (that is, assets specified in Part 4 of the FRRs) should be included in liquid assets.

Section 20 of the FRRs states that liquid assets include cash in hand which the licensed corporation owns and money that the licensed corporations

beneficially owns and holds in its name with an authorized financial institution or an approved bank incorporated outside Hong Kong in the form of a demand deposit or time deposit with time of maturity of 6 months or less.

Subject to the exceptions in s.19(2) of the FRRs, a licensed corporation is deemed not to own any assets which it beneficially owns and has provided to another person as security for any liabilities or obligations.

Ranking Liabilities

Ranking Liabilities are the sum of the liabilities on a licensed corporation's balance-sheet with certain adjustments for factors such as market risk and contingency. The various liabilities that should be included are specified in Part 4 of the FRRs. For example, the FRRs have provisions covering payments due to clients, dealings in securities/futures/leveraged foreign exchange and the provision of securities margin financing.

Monitoring of FRRs and reporting to SFC

[145.04] Sections 146(1) and 146(3) of the SFO and section 54 of FRRs require a licensed corporation to notify the Securities and Futures Commission (SFC) in writing as soon as practicable and immediately cease carrying on any regulated activity for which the corporation is licensed, upon failure to meet the FRRs. However, the SFC may permit such licensed corporation to carry on business subject to any conditions it may impose. The licensed corporation will be subject to a fine or imprisonment for failure to comply. See s.146 of SFO.

Licensed corporations are obliged to notify the SFC in writing within one business day of becoming aware of certain matters, such as drop of liquid capital below 120% of the required liquid capital, a drop of liquid capital below 50% of the liquid capital stated in the last return submitted to the SFC. See s.55 of the FRRs.

The FRRs also require that a financial resources return be signed in the prescribed manner by a responsible officer or another officer of the licensed corporation approved by the SFC. Failure to verify the accuracy of financial resources returns can lead to disciplinary action. See s.56 of the FRRs.

Regulatory Enforcement

[145.05] There have been a number of cases where the SFC has taken disciplinary action for breaches of the FRRs. See s.146 of the SFO. These cases involve the falling of liquid capital below the required level, failure to monitor compliance with the FRRs or failure to verify the accuracy of financial resources returns.

Consultation on proposed changes to the FRRs

[145.06] Please note the SFC had released a consultation paper on17 July 2015 on proposed changes to FRRs relating to capital and other prudential requirements for licensed corporations engaged in over-the-counter derivatives activity. The consultation paper also include proposed changes to non-over-the-counter derivatives-related FRRs requirements.

145A. Commission may vary financial resources rules for particular licensed corporations

(1) The Commission may, by a written notice served on a licensed corporation that engages in acts involving OTC derivative transactions, vary any financial resources rule applicable to the corporation, if satisfied, on reasonable grounds, that it is prudent to make the variation, taking into account risks associated with the corporation.

(2) If the Commission proposes to serve a notice under subsection (1) on a licensed corporation, it must serve a draft of the notice (***draft notice***) on the corporation.

(3) A draft notice must –

(a) specify –

(i) the financial resources rule proposed to be varied;

(ii) the manner in which that rule is proposed to be varied; and

(iii) the grounds for the proposed variation; and

(b) include a statement that the corporation may, within 14 days, or a longer period the Commission allows in a particular case, from the date of service of the draft notice, make written representations to the Commission on any or all of the matters specified in the draft notice.

(4) If representations are made in accordance with subsection (3)(b) on a draft notice served on a licensed corporation, the Commission may, after considering the representations –

(a) serve a notice on the corporation under subsection (1) in substantially the same terms as the draft notice;

(b) serve a notice on the corporation under subsection (1) in terms modified to take account of any one or more of those representations that satisfy the Commission that the modification ought to be made; or

(c) elect not to serve a notice on the corporation under subsection (1) because one or more of those representations satisfy the Commission that it should neither take the action mentioned in paragraph (a) nor take the action mentioned in paragraph (b).

(5) If no representations are made in accordance with subsection (3)(b) on a draft notice served on a licensed corporation, the Commission may serve a notice on the corporation under subsection (1) in substantially the same terms as the draft notice.

(6) If a financial resources rule applicable to a licensed corporation that engages in OTC derivative transactions is varied under this section, this Part (including rules made under section 145) applies, in relation to that corporation, with all necessary modifications to take account of the financial resources rule so varied.

(7) To avoid doubt –

(a) the Commission may serve a draft notice on a licensed corporation in substitution for an earlier draft notice served on the corporation; and

(b) the reference to substantially the same terms as the draft notice in subsections (4)(a) and (5) is not to be construed to include the statement required to be included in a draft notice under subsection (3)(b).

(8) The variation of a financial resources rule under subsection (1) takes effect at the time of the service of the written notice of the variation on the licensed corporation under that subsection or at the time specified in the notice, whichever is the later.

(Added 6 of 2014 s.14)

COMMENTARY

Explanatory note

[145A.01] Section 145A came into effect on 10 July 2015 by virtue of the Securities and Futures Amendment Ordinance 2014 which relates to the general framework of the OTC derivatives regulatory regime with regards to the mandatory reporting and related record keeping obligations under this regime.

Section 145A allows the Securities and Futures Commission (SFC) to vary the financial resources rules for licensed corporations that engage in acts involving OTC derivation transactions.

Varying financial resources rule

[145A.02] Section 145A(1) herein allows the SFC to vary any financial resources rule applicable to a licensed corporation that engages in OTC derivative transactions by serving a written notice. The SFC may do so if they are satisfied on reasonable grounds that it is prudent to make such variation, taking into account risks associated with the corporation.

Draft notice

[145A.03] If the SFC proposes to serve a notice under section 145A(1) herein, it must first serve a draft notice on the corporation. The content of the draft notice is set out in subsequent section 145A(3) herein and must include a statement that the corporation may make written representations to the SFC.

Serving notice

[145A.04] If written representations are made, the SFC may, after considering the representations, serve a notice in substantially the same terms as the draft notice, or a modified notice, or it may elect not to serve a notice.

If no representations are made, the SFC may serve a notice in substantially the same terms as the draft notice.

When the variation takes effect

[145A.05] The variation of the financial resources rule takes effect at the time of service of the written notice or at the time specified in the notice, whichever is the later. If a financial resources rule is varied under this s.145A, then Part VI of this SFO applies to that corporation with all necessary modifications accordingly.

146. Failure to comply with financial resources rule

(1) If a licensed corporation becomes aware of its inability to maintain or to ascertain whether it maintains, financial resources in accordance with the specified amount requirements that apply to it, it shall –

(a) as soon as reasonably practicable notify the Commission by notice in writing of that fact; and

(b) subject to subsection (2), immediately cease carrying on any regulated activity for which it is licensed, otherwise than for the purpose of completing such transactions as the Commission may permit.

(2) Where the Commission considers appropriate, the Commission may permit a licensed corporation which gives notice to the Commission under subsection (1)(a) to carry on any regulated activity for which it is licensed, subject to such conditions as may be imposed by the Commission by notice given to it, whether orally or in writing.

(3) If a licensed corporation becomes aware of its inability to comply with, or to ascertain whether it complies with, all or any of the requirements of the financial resources rules that apply to it, other than the specified amount requirements, it shall within one business day thereafter notify the Commission by notice in writing of that fact.

(4) Without limiting the generality of the financial resources rules and the rules that may be made under section 151, a licensed

corporation to which any of the requirements of the financial resources rules apply shall –

(a) keep its records in sufficient detail to establish readily whether all of such requirements are being complied with; and

(b) where the Commission by notice in writing served on it requires it to do so, make its records available to the Commission within 5 business days after the service of the notice.

(5) Without prejudice to sections 194 and 195, where the Commission reasonably believes that a licensed corporation is unable to maintain, or to ascertain whether it maintains, financial resources in accordance with the specified amount requirements that apply to it, the Commission may, whether or not notice has been given under subsection (1)(a) –

(a) by notice in writing served on the licensed corporation suspend the licensed corporation's licence, whether in relation to all or any, or any part of all or any, of the regulated activities for which it is licensed for such period or until the occurrence of such event as the Commission may specify; or

(b) permit the licensed corporation to carry on any regulated activity for which it is licensed, subject to such conditions as may be imposed by the Commission by notice given to it, whether orally or in writing.

(6) Where any conditions are imposed pursuant to subsection (2) or (5)(b) by notice given to a licensed corporation in writing, the Commission may amend any of the conditions in such manner as may be specified by the Commission, by notice given to the licensed corporation, whether orally or in writing, and where any of the conditions are so amended –

(a) such conditions shall have effect subject to the amendment accordingly; and

(b) where the conditions are amended by notice in writing, this subsection shall apply, with necessary modifications, to the conditions as so amended as if they had been imposed pursuant to subsection (2) or (5)(b) (as the case may be).

(7) Where any conditions are imposed pursuant to subsection (2) or (5)(b), or amended under subsection (6), by notice given to a licensed corporation otherwise than in writing, the Commission shall as soon as reasonably practicable give the licensed corporation a further notice in writing to confirm the conditions imposed or the conditions as amended (as the case may be), subject to such amendment (if any) in respect of the conditions as it may specify in the notice, and where any conditions are so confirmed subject to any amendment –

(a) the conditions shall have effect subject to the amendment accordingly; and

(b) subsection (6) shall apply, with necessary modifications, to the conditions as so amended as if they had been imposed pursuant to subsection (2) or (5)(b) (as the case may be).

(8) Notwithstanding anything in this section, the Commission shall not impose any conditions pursuant to subsection (2) or (5)(b), or amend any conditions under subsection (6), by notice given to a licensed corporation otherwise than in writing if the licensed corporation has on the occasion of being heard pursuant to subsection (12) in respect of the imposition or amendment (as the case may be) made a request to the Commission that the conditions shall only be so imposed, or amended, by notice given to it in writing.

(9) The suspension of a licence under subsection (5)(a) takes effect at the time when notice is served in respect of it pursuant to that subsection or at the time specified in the notice, whichever is the later.

(10) The imposition of any conditions pursuant to subsection (2) or (5)(b), or the amendment of any conditions under or pursuant to subsection (6) or (7), takes effect at the time when notice is given in respect of it pursuant to such subsection or at the time specified in the notice, whichever is the later.

(11) Where a licence of a licensed corporation is suspended under subsection (5)(a), sections 200(1), 201(2) and (5), 202 and 203 shall apply, with necessary modifications, in relation to the suspension as if it were a suspension under section 194 or 195.

(12) Notwithstanding anything in this section, the Commission shall not exercise any power under subsection (1)(b), (2), (4)(b), (5), (6), (7), (9) or (10) in respect of a licensed corporation unless the Commission has given the licensed corporation a reasonable opportunity of being heard.

(13) A licensed corporation which contravenes subsection (1)(a) or (b) commits an offence and is liable –

(a) on conviction on indictment to a fine of $1000000 and to imprisonment for 2 years and, in the case of a continuing offence, to a further fine of $100000 for every day during which the offence continues; or

(b) on summary conviction to a fine at level 6 and to imprisonment for 6 months and, in the case of a continuing offence, to a further fine of $10000 for every day during which the offence continues.

(14) A licensed corporation which contravenes a condition imposed pursuant to subsection (2) or (5)(b), or as amended under or pursuant to subsection (6) or (7), commits an offence and is liable –

(a) on conviction on indictment to a fine of $1000000 and to imprisonment for 2 years and, in the case of a continuing offence, to a further fine of $100000 for every day during which the offence continues; or

(b) on summary conviction to a fine at level 6 and to imprisonment for 6 months and, in the case of a continuing offence, to a further fine of $10000 for every day during which the offence continues.

(15) A licensed corporation which, without reasonable excuse, contravenes subsection (3) commits an offence and is liable –

(a) on conviction on indictment to a fine of $200000 and to imprisonment for 1 year; or

(b) on summary conviction to a fine at level 5 and to imprisonment for 6 months.

(16) A licensed corporation which contravenes subsection (4) commits an offence and is liable –

(a) on conviction on indictment to a fine of $1000000 and to imprisonment for 2 years; or

(b) on summary conviction to a fine at level 6 and to imprisonment for 6 months.

(17) The financial resources rules may provide that a licensed corporation which, without reasonable excuse, contravenes any specified provision of the financial resources rules that applies to it, other than that imposing any of the specified amount requirements, commits an offence and is liable to a specified penalty not exceeding –

(a) on conviction on indictment a fine of $200000 and a term of imprisonment of 1 year;

(b) on summary conviction a fine at level 5 and a term of imprisonment of 6 months.

(18) A licensed corporation is not excused from complying with subsection (3) only on the ground that to do so might tend to incriminate it.

COMMENTARY

Predecessor provisions [146.01]

This section is based on sections 65C, 121AC(3), and 121AC(6) of the repealed Securities Ordinance (Cap.333) and section 19 of the Leveraged Foreign Exchange Trading Ordinance (Cap.451).

Part XIVA

DISCLOSURE OF INSIDE INFORMATION

Background

On 1 January 2013, the amendments to the Securities and Futures Ordinance (Cap.571) (SFO) came into effect to provide for a new Part XIVA under the SFO giving statutory backing those principles in the Rules Governing the Listing of Securities (Listing Rules) on the Stock Exchange of Hong Kong Limited (Stock Exchange). The provisions under Part XIVA impose a general obligation of disclosure of price sensitive, or "inside" information by those listed corporations. In regards to listed corporations, note that where depositary receipts are issued, the corporation whose shares in respect of which the depositary receipts are issued is considered the listed corporation for the purposes of this new Part XIVA of the SFO.

This Part XIVA of the SFO was created due to concerns that the framework governing listed companies' disclosure of inside information (or price sensitive information as it was then referred to) previously set out in the Listing Rules lacked "statutory teeth". As a non-statutory body, the Stock Exchange had no power to impose fines for breach of the disclosure requirements and the available remedies were restricted to issuing criticisms or, in the most severe cases, delisting. Under this new SFO regime, civil proceedings can be brought in the Market Misconduct Tribunal (MMT) against a listed company, its directors and other senior officers and the MMT is empowered to fine the company and its directors up to HK$8 million.

This new statutory regime for the disclosure of price sensitive information, also referred to and regarded as "inside information" under this new Part XIVA, has been in effect since 1 January 2013. Disclosure of inside information has long been governed by the non-statutory Listing Rules (under Chapter 13 of the Main Board Rules and Chapter 17 of the GEM Rules). However, since the start of January 2013, the obligation to disclose such price sensitive information became a statutory obligation under this new Part XIVA of the SFO. Any breach of this obligation is considered a civil offence for which the listed companies and their directors may be liable on conviction to a fine of up to HK$8 million under section 307N(d) of this Part XIVA of the SFO.

This new statutory backing for the listed companies' obligation to disclose price sensitive information has been a long time in the making from the Legislative Council (LegCo) and the Securities and Futures Commission (SFC). A listed company's obligations under the Listing Rules used to be contractual obligations that they undertook to the Stock Exchange to fulfill. They did not have the force of statute and did not give the Exchange statutory regulatory powers. Accordingly, the Stock Exchange's disciplinary powers were limited as it had no power to impose fines, but might publicly or privately censure firms in breach, and in extreme cases might suspend or cancel the listing of an issuer's securities.

A number of major jurisdictions which previously followed the non-statutory approach moved to a statutory approach in recent years and empowered their statutory agencies and courts to take statutory action against those breaching the rules. The UK transferred its listing regulatory role from the London Stock Exchange to the Financial Services Authority (FSA) which recast the listing requirements as statutory rules with statutory enforcement. Likewise Australia and Singapore have given their listing rules "statutory backing".

In Hong Kong, concerns were expressed about the lack of "regulatory teeth" in the Listing Rules. Both LegCo and the SFC have already taken a number of initiatives aimed at strengthening regulation of listed companies. In 2003, the "dual filing" regime was established under the Securities and Futures (Stock Market Listing) Rules (Cap.571V) (SMLR). This subsidiary legislation imposes criminal liability on listing applicants and listed issuers who intentionally or recklessly disclose materially false or misleading information to the public.

In 2004, proposals were put forward to build on the dual filing regime and codify the most important Listing Rule obligations into subsidiary legislation. The SFC would then be responsible for enforcing those provisions while the Exchange would continue to receive listing applications and administer the listing process as the frontline regulator of listed companies.

To that end, the SFC published a consultation paper in January 2005 (*the Consultation Paper on Proposed Amendments to the Securities and Futures (Stock Market Listing) Rules*) proposing the statutory codification of the following three (3) areas of issuers' obligations under the Listing Rules:

i. Disclosure of price-sensitive information;
ii. Publication of annual and interim financial reports; and
iii. Disclosure and shareholders' approval requirements for Notifiable and Connected Transactions

Respondents to the consultation had concerns that importing the detailed requirements of the Listing Rules into this Ordinance could reduce flexibility making it difficult for the rules to be amended expeditiously in response to market needs. There were also concerns that an unintentional breach of the detailed requirements could be subject to severe statutory sanctions.

As a result, the Consultation Conclusions published in February 2007 put forward an alternative approach: the statutory listing requirements would comprise a set of general principles representing issuers' fundamental obligations. These would be supplemented by ancillary provisions set out in a schedule to the SFC facilitating easier amendment of the requirements if and when necessary. Non-compliance with the new general principles was proposed to constitute "market misconduct' under Parts XIII and XIV SFO and subject to one of three types of sanction in serious cases: (i) SFC disciplinary action; (ii) civil proceedings before the Market Misconduct Tribunal; or (iii) criminal prosecution.

Nevertheless, the amendments to the SFO were passed by LegCo and came into full effect on 1 January 2013. Note that these obligations to disclose inside information under Part XIVA of the SFO are separate and distinct from the disclosure requirements under the Listing Rules and those under the Codes on Takeovers and Mergers and Share Repurchases.

Under section 307A of this Part XIVA of the SFO, the definition of "inside information" is *the same as* the definition of "relevant information", which forms the basis of the offence of insider dealing under both Parts XIII and XIV of the SFO. Hence, the information which listed companies are required to announce under the new statutory disclosure obligation is the same information which, if possessed by a listed company's directors and other insiders, prohibits them from dealing in the company's securities under the insider dealing offences in Parts XIII and XIV of the SFO.

The greatest challenge facing listed companies, their directors and advisers under this new Part XIVA of the SFO was the difficulty of determining with certainty whether any given information falls within this definition of 'inside information'. This is a matter of judgment. However, any error of judgment used to attract, at worst, disciplinary actions from the Stock Exchange. But under this new Part XIVA of the SFO, it could cost a listed company up to HK$8 million under s.307N(d) of the SFO.

Company's obligations under this new disclosure requirement

This new Part XIVA created a statutory obligation on corporations to disclose price sensitive information (also regarded as 'inside information') to the public, *as soon as reasonably practicable after* such inside information has come to its knowledge. Breaches of this price sensitive information or

inside information disclosure requirement will be dealt with by the Market Misconduct Tribunal (MMT) which is able to impose a number of civil sanctions, including a maximum fine of HK$8 million on the corporation and on its directors and chief executive in certain circumstances. This new statutory framework seeks to counter allegations that the existing Listing Rules' framework lacks "regulatory teeth" and reflects developments in other international markets.

Under this Part XIVA, the Securities and Futures Commission (SFC) will be able to directly institute proceedings before the MMT to enforce this price sensitive information or inside information disclosure requirement and to deal with the six types of market misconduct under Part XIII SFO with effect from 4 May 2012 under s.252A of the SFO as previously only the Financial Secretary could institute proceedings before the MMT.

As previously touched upon, the six types of market misconduct include: (i) insider dealing; (ii) false trading; (iii) price rigging; (iv) disclosure of information about prohibited transactions; (v) disclosure of false or misleading information inducing transactions; and (vi) stock market manipulation.

Also note that this Part XIVA made certain consequential amendments to the SFO. These include amending the definition of "business day" to exclude Saturdays ("Business day" is defined in Part 1 of Schedule 1 to the SFO). This in turn affects (among other applications) the timing of giving notices of interests under the disclosure of interests regime in Part XV of the SFO.

Summary of key points of Part XIVA

The main aspects of this new disclosure requirement under Part XIVA of the SFO includes:

i. adoption of the concept of "relevant information" used under the insider dealing regime to define price sensitive information (PSI) (called "inside information" under Parts XIII and XIV of the SFO);
ii. application of an objective test in determining whether information is indeed "inside information" - whether a reasonable person, acting as an officer of the corporation, would consider that the information is inside information in relation to the corporation;
iii. obligation on a corporation to disclose "inside information" as soon as reasonably practicable after it comes to the knowledge of the corporation (i.e. after the information has, or ought reasonably to have, come to the knowledge of an officer of the corporation in the course of performing functions as an officer of the corporation);

iv. obligation on the directors and officers of a corporation to take all reasonable measures to ensure that proper safeguards exist to prevent the corporation breaching the statutory disclosure requirement;

v. for the directors and officers of a corporation to be individually liable for the corporation's breach of the statutory disclosure obligation, if they are in breach of the obligation referred to above or if the corporation's breach is a result of any intentional, reckless or negligent conduct on their part;

vi. advent of provisions regarding safe harbours for legitimate circumstances where non-disclosure or late disclosure is permitted;

vii. Securities and Futures Commission is able to rely on its powers under the SFO to investigate suspected breaches and to institute proceedings directly before the Market Misconduct Tribunal (MMT);

viii. MMT is able to impose a range of civil sanctions, including a fine of up to HK$8 million on the corporation, a director or chief executive of the corporation and disqualification of a director or officer for up to 5 years; and

ix. A corporation or officer found to have breached the statutory disclosure requirement may be liable to pay compensation to any person who has suffered financial loss as a result of the breach (provided it is fair, just and reasonable that it/he should do so).

Division 1 – Interpretation

307A. Interpretation of Part XIVA

(1) In this Part –

breach of a disclosure requirement (違反披露規定) – see subsection (2) and section 307G(2);

derivatives (衍生工具), in relation to listed securities, means any of the following (whether or not they are listed and regardless of who issued or made them) –

(a) rights, options or interests (whether described as units or otherwise) in, or in respect of, the listed securities;

(b) contracts, the purpose or pretended purpose of which is to secure or increase a profit or avoid or reduce a loss, wholly or partly by reference to the price or value, or a change in the price or value, of –

(i) the listed securities; or

(ii) any rights, options or interests referred to in paragraph (a);

(c) rights, options or interests (whether described as units or otherwise) in, or in respect of –

(i) any rights, options or interests referred to in paragraph (a); or

(ii) any contracts referred to in paragraph (b);

(d) instruments or other documents creating, acknowledging or evidencing any rights, options or interests or any contracts referred to in paragraph (a), (b) or (c), including certificates of interest or participation in, temporary or interim certificates for, receipts (including depositary receipts) in respect of, or warrants to subscribe for or purchase –

(i) the listed securities; or

(ii) the rights, options or interests or the contracts;

inside information (內幕消息), in relation to a listed corporation, means specific information that –

(a) is about –

(i) the corporation;

(ii) a shareholder or officer of the corporation; or

(iii) the listed securities of the corporation or their derivatives; and

(b) is not generally known to the persons who are accustomed or would be likely to deal in the listed securities of the corporation but would if generally known to them be likely to materially affect the price of the listed securities;

listed (上市) means listed on a recognized stock market – see also subsection (3);

listed corporation (上市法團) means a corporation which has issued securities that are, at the time of the breach of a disclosure requirement in relation to the corporation, listed;

listed securities (上市證券) means –

(a) securities which, at the time of a breach of a disclosure requirement in relation to a corporation, have been issued by the corporation and are listed;

(b) securities which, at the time of a breach of a disclosure requirement in relation to a corporation, have been issued by the corporation and are not listed, but which, at that time, it is reasonably foreseeable will be and which, in fact, are subsequently listed; or

(c) securities which, at the time of a breach of a disclosure requirement in relation to a corporation, have not been issued by the corporation and are not listed, but which, at that time, it is reasonably foreseeable will be and which, in fact, are subsequently so issued and listed;

securities (證券) means –

(a) shares, stocks, debentures, loan stocks, funds, bonds or notes of, or issued by, or which it is reasonably foreseeable will be issued by, a body, whether incorporated or unincorporated, or a government or municipal government authority;

(b) rights, options or interests (whether described as units or otherwise) in, or in respect of, such shares, stocks, debentures, loan stocks, funds, bonds or notes;

(c) certificates of interest or participation in, temporary or interim certificates for, receipts for, or warrants to subscribe for or purchase, such shares, stocks, debentures, loan stocks, funds, bonds or notes;

(d) interests, rights or property, whether in the form of an instrument or otherwise, commonly known as securities; or

(e) interests, rights or property, whether in the form of an instrument or otherwise, prescribed by notice under section 392 as being regarded as securities in accordance with the terms of the notice;

Tribunal (審裁處) means the Market Misconduct Tribunal established by section 251.

(2) For the purposes of this Part –

(a) a breach of a disclosure requirement takes place if any of the requirements in section 307B or 307C is contravened in relation to a listed corporation; and

(b) in those circumstances, the listed corporation is in breach of the disclosure requirement.

Note:

Section 307G(2) provides that, in certain circumstances, an officer of a listed corporation may also be in breach of a disclosure requirement.

(3) For the purposes of this Part, securities listed on a recognized stock market are to continue to be regarded as listed during any period of suspension of dealings in those securities on that market.

COMMENTARY

Predecessor provisions

[307A.01] This section came into effect on 1 January 2013 which was implemented under Part 2 of the Securities and Futures (Amendment) Ordinance 2012 which was gazetted on 4 May 2012.

Overview

Section 307A of this Part XIVA provides and defines all the relevant terms referred to under this new price sensitive information or inside information disclosure regime. [307A.02]

Defining 'inside information' under this new part

This new Part XIVA applies the term "inside information" to refer to the price sensitive information (PSI) which a corporation must disclose. [307A.03]

Note that the definition of this new term "inside information" as applied in this Part XIVA of the SFO is the same as that of "relevant information" used in previous section 245 in Part XIII of the SFO in connection with insider dealing. The decisions of the Market Misconduct Tribunal in relation to insider dealing, and "relevant information" are relevant for the purposes of determining what constitutes "inside information" assists in determining when an obligation to disclose information arises under the Ordinance.

"Inside information" as defined in this section 307A of SFO is:

"specific information" that:

(a) is about:

i. the corporation;

ii. a shareholder or officer of the corporation; or

iii. the listed securities of the corporation or their derivatives; *and*

(b) is not generally known to the persons who are accustomed or would be likely to deal in the listed securities of the corporation but would if generally known to them be likely to materially affect the price of the listed securities.

Key elements of this definition

The three (3) key elements to emphasize in regards to the wording of this definition what is considered "inside information" includes the facts that the: [307A.04]

i. information must be *specific*;

ii. information *must not be generally* known to that segment of the market which deals or which would likely deal in the corporation's securities; and

iii. information would, if generally known be *likely to have a material effect on the price of the corporation's securities.*

Specificity of the information to be disclosed

The information that a listed corporation is duty bound to be disclosed must be capable of being identified, defined and unequivocally expressed. As such, the information regarding a corporation's affairs will be sufficiently specific [307A.05]

if: "it carries with it such particulars as to a transaction, event or matter, or proposed transaction, event or matter, so as to allow that transaction, event or matter to be identified and its nature to be coherently understood".

In addition, the information required to be disclosed may meet this 'specific' requirement even though the particulars or details are not precisely known. For example, information that a corporation is in financial difficulty or proposes to conduct a share placing would be regarded as specific even if the details are not known.

Furthermore, information on a transaction that is only contemplated or under negotiation (and not yet subject to a final agreement (formal or informal)) can be regard as 'specific information' and therefore required to be disclosed. To constitute specific information, a proposal should be beyond the stage of a vague exchange of ideas or a "fishing expedition".

As stated in the Insider Dealing Tribunal (IDT) matter of *Chevalier (OA) International Limited*:

> "… what percentage is deemed to be "material" or "significant" or "substantial" in an insider dealing case may vary and it would be dangerous to lay down any hard and fast or arithmetic test …"

If negotiations or contracts have occurred, there should be a substantial commercial reality to the negotiations which should be at the stage where the parties intend to negotiate with a realistic view to achieving an identifiable goal.

Information not specific enough to be disclosed

[307A.06] Note that mere rumours, vague hopes or worries, wishful thinking and unsubstantiated conjecture are not considered 'specific' information.

The SFC has issued Guidelines on the disclosure of inside information on or about June 2012. See *Guidelines on Disclosure of Inside Information* (June 2012). These Guidelines note that rumours, media speculation and market expectation about an event or circumstances of a corporation *cannot* be equated with information which is generally known to the market. There is a clear distinction between the market having actual knowledge of a hard fact which has been properly disclosed by the corporation and speculation or expectation as to an event or circumstances which will require proof. In determining whether information the subject of media comments or analysts' reports or carried by news service providers is generally known, the corporation should consider the accuracy, completeness and reliability of the information disseminated and not only how widely the information

has been disseminated. Where the information disseminated is incomplete or there are material omissions or there are doubts as to its bona fides, the information cannot be regarded as generally known and the corporation is required to make full disclosure.

Defining that information 'likely to have a material effect on the price of the listed securities'

[307A.07] Whether inside information is 'likely to materially affect the price' of a corporation's securities is based upon whether the inside information *would influence* persons who are accustomed to or would be likely to deal in the corporation's shares, in deciding whether or not to buy or sell such shares. The test is necessarily a hypothetical one since it must be applied at the time the information becomes available.

SFC Guidelines' examples of what can be considered 'inside information'

[307A.08] The *SFC Guidelines* provide samples of what can be considered 'inside information' which must be disclosed under this Part XIVA. These types of information considered to be 'inside information' that should be disclosed includes but is not limited to:

i. Changes in performance, or the expectation of the performance, of the business or its financial condition;
ii. Changes in financial condition, e.g. cashflow crisis, credit crunch;
iii. Changes in directors and (if applicable) supervisors and their service contracts;
iv. Changes in auditors or any other information related to the auditors' activity;
v. Changes in the share capital, e.g. new share placing, bonus issue, right issue, share split, share consolidation and capital reduction;
vi. Takeovers and mergers (corporations will also need to comply with the Takeovers Codes that include specific disclosure obligations);
vii. Purchase or disposal of equity interests or other major assets or business operations;
viii. Filing of winding up petitions, the issuing of winding up orders or the appointment of provisional receivers or liquidators';
ix. Legal disputes and proceedings;
x. Revocation or cancellation of credit lines by one or more banks;
xi. Changes in value of assets (including advances, loans, debts or other forms of financial assistance);
xii. Insolvency of relevant debtors;
xiii. Reduction of real properties' values; etc.

Division 2 – Disclosure of Inside Information

307B. Requirement for listed corporations to disclose inside information

(1) A listed corporation must, as soon as reasonably practicable after any inside information has come to its knowledge, disclose the information to the public.

(2) For the purposes of subsection (1), inside information has come to the knowledge of a listed corporation 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 an officer of the corporation; and

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

(3) Without limiting subsection (1), a listed corporation fails to disclose the inside information required under that subsection if –

(a) the information disclosed is false or misleading as to a material fact, or is false or misleading through the omission of a material fact; and

(b) an officer of the corporation knows or ought reasonably to have known that, or is reckless or negligent as to whether, the information disclosed is false or misleading as to a material fact, or is false or misleading through the omission of a material fact.

(4) This section is subject to sections 307C, 307D, 307E and 307F.

COMMENTARY

Predecessor provisions

[307B.01] This section came into effect on 1 January 2013 which was implemented under Part 2 of the Securities and Futures (Amendment) Ordinance 2012 which was gazetted on 4 May 2012.

Timing of disclosure of inside information

[307B.02] A corporation must disclose the price sensitive or inside information to the public *as soon as reasonably practicable* after any inside information has come to its knowledge under this s.307B(1) herein.

Inside information has come to the corporation's knowledge if:

i. the inside information has, or ought reasonably to have, come to the knowledge of an officer of the corporation in the course of performing functions as an officer of the corporation; *and*

ii. a reasonable person, acting as an officer of the corporation, would consider that the information is inside information in relation to the corporation (s.307B(2) of the SFO).

Corporations must now have in place and employ effective systems and procedures to ensure that any material information which comes to the knowledge of any of their officers is promptly identified and escalated to the board to determine whether it needs to be disclosed.

Defining "as soon as reasonably practicable"

[307B.03] The *SFC Guidelines* to this Part XIVA of the SFO defines "as soon as reasonably practicable" to mean that the corporation should immediately take all steps that are necessary in the circumstances to disclose the information to the public. The necessary steps that the corporation should immediately take before the publication of an announcement may include: (i) ascertaining sufficient details; (ii) internal assessment of the matter and its likely impact; (iii) seeking professional advice where required; and (iv) verification of the facts. See para. 40 of the *SFC Guidelines*.

The corporation must ensure that the information is kept strictly confidential until it is publicly disclosed. If the corporation believes that the required degree of confidentiality cannot be maintained or that there may have been a breach of confidentiality, it should immediately disclose the information to the public. See para. 41of the *SFC Guidelines*. The *SFC Guidelines* also give the corporation the option of issuing a "holding announcement" to give the corporation time to clarify the details and likely impact of an event before issuing a full announcement.

Defining who is considered an "officer" under this Part XIVA

[307B.04] Part 1 of Schedule 1 of the SFO defines the term "officer" to include a director, manager or secretary of a corporation or any other person involved in its management.

In the context of this price sensitive or inside information disclosure regime, a 'manager' generally connotes a person who, under the immediate authority of the board, is charged with management responsibility affecting the whole or a substantial part of the corporation. A secretary herewith refers to a company secretary.

Also, it is clarified that the formulation that 'in the course of performing functions as an officer of the corporation' confines the required discloseable inside information to that information which becomes known in situations where the officer *is acting in capacity* as an officer. In other words, information known in circumstances *outside the course* of performing functions as an officer of the corporation will not be caught under the new regime.

Proceedings before the enactment of this Part XIVA

[307B.05] Prior to the enactment of this Part XIVA, regulatory actions against listed companies for non-disclosure of inside information were commenced in connection to breach of the pre-2013 Listing Rule 13.09 which required listed companies to disclose price sensitive information. Sanctions imposed by the Listing Committee generally involved censures, criticisms, and requirements to undertake Listing Rule compliance training and/or appoint a compliance adviser. The SFC has however also used its powers under s.214 of the SFO against companies breaching their disclosure obligations. This was justified as that s.214 of the SFO entitled the SFC to seek a range of orders from the court, including orders for the disqualification of directors or to restore parties to their original financial position, where, among others, a listed company's business has been conducted in a manner resulting in some or all of its shareholders not being given information in respect of the company that they might expect to receive, or involving misconduct towards the company's shareholders.

First action brought by the SFC for the breach of the disclosure obligation under this Part XIVA

[307B.06] But on 22 July 2015, the Securities and Futures Commission (SFC) commenced proceedings for the first time for breach of listed companies' obligation to announce inside information as soon as reasonably practicable under this Part XIVA of the SFO. The SFC started proceedings in the Market Misconduct Tribunal (MMT) against *AcrossAsia Ltd* (AAL) for failing to disclose highly sensitive inside information as soon as reasonably practicable in breach of this s.307B herein.

The SFC's allegations relate to AAL's 13-day delay in announcing the commencement of insolvency-related proceedings in Indonesia against AAL related to enforcement proceedings brought by AAL's subsidiary for repayment of its loan to AAL. The SFC also commenced proceedings under later section 307G of the SFO against AAL's Chairman and CEO for reckless or negligent conduct resulting in the company's breach of the disclosure obligation. See the SFC press release at: http://www.sfc.hk/edistributionWeb/gateway/EN/news-andannouncements/news/doc?refNo=15PR78.

Notice to the MMT in regards to the commencement of this matter of the listed securities of *Across Asia Limited* pursuant to section 3071(2) and Schedule 9 of the SFO was properly sent to the MMT as well as to all concerned parties. The copy of the notice can be found at http://www.mmt.gov.hk/eng/rulings/AcrossAsia_Ltd%20_22072015_e.pdf.

Provisions violated

Section 307B(1) herein requires a listed corporation to disclose inside information to the public as soon as reasonably practicable after such information has come to its knowledge. Inside information is defined as specific information about a listed corporation, a shareholder or officer of the corporation, or the listed securities of the corporation or their derivatives, which is not generally known to the persons who are accustomed or would be likely to deal in the listed securities of the corporation, but would if generally known to them be likely to materially affect the price of the listed securities. A listed corporation is taken to have knowledge of inside information when the information is known, or ought reasonably to be known, by an officer of the corporation provided that a reasonable person acting as an officer of the corporation would consider the information to constitute inside information.

AcrossAsia Ltd (AAL) was further charged with violating later section 307G(1) of the SFO which requires the officers of listed corporations to take *all reasonable measures* to ensure that proper safeguards exist to ensure the corporation's compliance with its disclosure obligations. While breach of this provision is not punishable in itself, where a listed corporation breaches the inside information disclosure obligation, an officer will also be regarded as in breach of the disclosure requirement if: (i) his intentional, reckless or negligent conduct resulted in the breach; or (ii) he failed to take reasonable measures to ensure the existence of proper safeguards to ensure the corporation's compliance with the disclosure obligation.

Basis for the SFC's allegations

The SFC alleges that AAL's Insolvency Petition and Summons B together with the information they contained constituted inside information within the definition set out in previous s.307A(1) of the SFO, in that it was specific information about AAL *which was not generally known* to those accustomed or likely to deal in its listed securities, but would, if generally known, be likely to materially affect the price of those securities.

The SFC's Notice to the MMT states that the inside information came to the knowledge of Messer. Cheok and Ang, officers of AAL, on or about 4 January 2013 in the course of performing their duties. Since a reasonable person, acting as an officer of AAL, would have considered the information

to be inside information in relation to AAL, AAL therefore had knowledge of the information on or about 4 January 2013. It was therefore obliged to announce that information as soon as reasonably practicable under this s.307B(1) of the SFO. In fact, the information was not announced until 17 January 2013, *a delay of 13 days*.

As such, the SFC notice alleges that AAL's failure to disclose the Insolvency Petition and Summons B as inside information *as soon as reasonably practicable* after it came to its knowledge on or about 4 January 2013 breached this s.307B(1) of the SFO.

Furthermore, the SFC alleges that Messr. Cheok and Ang, as AAL officers, were or may be guilty of reckless or negligent conduct in failing to ensure that AAL complied with its disclosure obligation, and that conduct resulted in AAL's breach of the disclosure requirement. Messr. Cheok and Ang are therefore alleged to be in breach of the disclosure requirement by virtue of later s.307G(2)(a) of the SFO.

This proceeding is still pending before the MMT. See http://www.hkex.com.hk/eng/csm/ShowNews.asp?mkt=hk&FileName=http://www.hkexnews.hk/listedco/listconews/gem/2015/0727/ GLN20150727031.pdf.

SFC commences the second set of proceedings for the breach of the disclosure obligation under this Part XIVA

[307B.07] It now seems that this Part XIVA is the main source for the commencement of proceedings against companies for the failure to disclose highly sensitive inside information as soon as reasonably practicable.

A few months after the SFC commenced proceedings against *AirAsia Ltd* (AAL) for failing to disclose highly sensitive inside information as soon as reasonably practicable, the SFC on or about 11 March 2016 commenced proceedings in the Market Misconduct Tribunal (MMT) against *Mayer Holdings Limited (Mayer)* for failing to disclose price sensitive information as soon as reasonably practicable under this s. 307B herein.

The SFC has also commenced proceedings in the MMT against the company's 10 current and former senior executives for their reckless or negligent conduct causing the alleged breach by Mayer of the provisions of the statutory corporate disclosure regime in accordance with later s.307G(2)(a) of the SFO.

Mayer's suspect activities

The SFC found that between April and August 2012, while auditing Mayer's financial statements for the year ended 31 December 2011, the then auditors

of Mayer repeatedly communicated with Mayer's management about issues they identified including:

- the suspicious nature of the disposal of a wholly-owned subsidiary of Mayer, for HK$15.5 million;
- Mayer did not control projects in Vietnam, which it bought for HK$620 million, and their valuations appeared to have been inflated; and
- two subsidiaries of Mayer's jointly controlled entity had made substantial prepayments of US$10 million and US$4 million respectively without security to suppliers which appeared to be irrecoverable (collectively, outstanding audit issues).

On 23 August 2012, Mayer's then auditors indicated that they would qualify their audit opinion for the financial statements for the year ended 31 December 2011 if the outstanding audit issues were not resolved (potential qualified audit report).

On 27 December 2012, Mayer received a resignation letter from its then auditors. But, Mayer only disclosed the auditors' resignation together with brief details of the outstanding audit issues on 23 January 2013.

Basis for the SFC's allegations

The SFC identified the following three categories of "inside information":

- the auditors' resignation;
- the outstanding audit issues together with the potential qualified audit report; and
- the US$10 million prepayment to the supplier.

The SFC alleges that the: (i) auditors' resignation; (ii) the outstanding audit issues together with the potential qualified audit report; and (iii) the US$10 million prepayment to the supplier, were specific information regarding Mayer, price sensitive and not generally known to the public at the material time. This information would also have been viewed negatively by the investors and were of sufficient gravity and severity to *affect the share price* of Mayer.

Accordingly, the SFC alleges that Mayer failed to disclose such inside information to the public *as soon as reasonably practicable* after the information had come to its knowledge and therefore breached this s.307B(1) of the SFO. Also, that its 10 current and former senior executives (including a company secretary and financial controller and members of the board of directors), as officers of Mayer, failed to ensure Mayer complied with its disclosure obligations as they are required to do so under later s.307G(2)(a) of the

SFO. See: https://www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/doc?refNo=16PR25.

307C. Manner of disclosure

(1) A disclosure under section 307B must be made in a manner that can provide for equal, timely and effective access by the public to the inside information disclosed.

(2) Without limiting the manner of disclosure permitted under subsection (1), a listed corporation complies with that subsection if it has disseminated the inside information required to be disclosed under section 307B through an electronic publication system operated by a recognized exchange company for disseminating information to the public.

COMMENTARY

Predecessor provisions

[307C.01] This section came into effect on 1 January 2013 which was implemented under Part 2 of the Securities and Futures (Amendment) Ordinance 2012 which was gazetted on 4 May 2012.

Manner of disclosure

[307C.02] Subsection 307C(1) of this provision prescribes that the disclosure of inside information must be made in a manner that can provide for equal, timely and effective access by the public to the information disclosed. Subsequent subsection 307C(2) of this provision provides that the publication of inside information via the electronic publication system operated by the HKEx will meet the requirements for provision of equal, timely and effective access.

The *SFC Guidelines* also allow corporations to use additional means to disseminate the information such as: (i) press releases issued through news or wire services; (ii) press conferences in Hong Kong; and/or (iii) posting an announcement on their own websites. Such measures are however of themselves unlikely to satisfy the requirements of section 307C(1) herein and may require an additional step of also providing the information via the electronic publication system operated by the HKEx.

The *SFC Guidelines* further provide that where a corporation is listed on more than one stock exchange, it should ensure that inside information is disclosed

to the public in Hong Kong at the same time as it is released to the overseas markets. If inside information is released to an overseas market while the Hong Kong market is closed, the corporation should issue an announcement in Hong Kong before the Hong Kong market opens for trading.

The information contained in an announcement of inside information must be complete and accurate in all material respects and not be misleading or deceptive (whether by omission or otherwise).

307D. Exceptions to disclosure requirement

(1) A listed corporation is not required to disclose any inside information under section 307B if and so long as the disclosure is prohibited under, or would constitute a contravention of a restriction imposed by, an enactment or an order of a court.

(2) A listed corporation is not required to disclose any inside information under section 307B if and so long as –

(a) the corporation takes reasonable precautions for preserving the confidentiality of the information;

(b) the confidentiality of the information is preserved; and

(c) one or more of the following applies –

(i) the information concerns an incomplete proposal or negotiation;

(ii) the information is a trade secret;

(iii) the information concerns the provision of liquidity support from the Exchange Fund established by the Exchange Fund Ordinance (Cap.66) or from an institution which performs the functions of a central bank (including such an institution of a place outside Hong Kong) to the corporation or, if the corporation is a member of a group of companies, to any other member of the group;

(iv) the disclosure is waived by the Commission under section 307E(1), and any condition imposed under section 307E(2) in relation to the waiver is complied with.

(3) For the purposes of subsection (2) –

(a) a listed corporation has not failed to take reasonable precautions for preserving the confidentiality of any inside information only because the corporation has, in the ordinary course of business, disclosed the information to any person who –

(i) requires the information to perform the person's functions in relation to the corporation; and

(ii) by virtue of any enactment, rule of law, contract, or the articles of association of the corporation, is under a duty to the corporation not to disclose the information to any other person; and

(b) in those circumstances, the confidentiality of the information is to be regarded as having been preserved.

(4) Despite subsection (2)(b), a listed corporation is not in breach of a disclosure requirement in respect of inside information the confidentiality of which is not preserved if –

(a) the corporation has taken reasonable measures to monitor the confidentiality of the information; and

(b) the corporation discloses the information in accordance with section 307C as soon as reasonably practicable after the corporation becomes aware that the confidentiality of the information has not been preserved.

COMMENTARY

Predecessor provisions

[307D.01] This section came into effect on 1 January 2013 which was implemented under Part 2 of the Securities and Futures (Amendment) Ordinance 2012 which was gazetted on 4 May 2012.

Overview

[307D.02] Section 307D herein provides four exceptions or safe harbours (as they have come to be known) which permit the corporations to: (i) *not* disclose; or (ii) delay the disclosure inside information. Except for the safe harbor condition allowed in subsection 307D(1) of this provision, a corporations may *only rely* on the other three (3) safe harbor conditions if they have taken reasonable precautions to preserve the confidentiality of the inside information and the inside information has not been leaked.

Safe harbour of non-disclosure because such disclosure would breach a Court Order

[307D.03] Subsection 307D(1) of this provision provides that disclosure is not required when such disclosure would breach an order by a Hong Kong Court or any provisions of the other Hong Kong Ordinances or legal precedence. This exception grants a safe harbour to corporations if they are prohibited from disclosing inside information under a Hong Kong Court order or any other Hong Kong statute.

Safe harbour of non-disclosure when the information relates to an incomplete proposal or negotiation

[307D.04] Subsection 307D(2)(c)(i) of this provision provides that disclosure is not required where such information relates to an incomplete proposal or negotiation. Some examples of this instance are when:

i. a contract is in the process of being negotiated but not yet finalised by all aprties;
ii. a corporation decides to sell a major holding in another corporation;
iii. a corporation is negotiating a share placing with a financial institution; or
iv. a corporation is negotiating the provision of financing with a creditor.

It should be noted that where a corporation is in financial difficulty and is negotiating with third-parties for funding, reliance on this exception to disclosure will mean that it will not be necessary to disclose the negotiations. This safe harbor, however, does not allow the corporation to withhold disclosure of any material change in its financial position or performance which led to the funding negotiations and, to the extent that *this is inside information* that should be the subject of an announcement.

Safe harbour of non-disclosure when the information relates to or is a trade secret

[307D.05] Subsection 307D(2)(c)(ii) of this provision provides that *disclosure is not required* where such information is considered to be a 'trade secret'. The difficulty here lies in the fact that there is no true statutory definition of what constitutes a 'trade secret'. However, the *SFC Guidelines* provided such guidance to this exception in that a "trade secret" generally refers to proprietary information owned by a corporation:

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

Trade secrets may also concern inventions, manufacturing processes or customer lists. However a trade secret does not cover the commercial terms and conditions of a contractual agreement or the financial information of a corporation, which cannot be regarded as proprietary information or rights owned by the corporation.

Safe harbour of non-disclosure when the Government's Exchange Fund or a Central Bank provides liquidity support to the corporation

[307D.06] Under the safe harbor provided in subsection 307D(2)(c)(iii) of this provision, no disclosure is required for information concerning the provision of liquidity support from the Exchange Fund of the Government or from an institution which performs the functions of a central bank (including one located outside Hong Kong) to the corporation or any member of its group. The purpose of this safe harbour is to ward off financial contagion. This exception resembles a similar stability ensuring liquidity support mechanism employed in the UK regime.

Condition of confidentiality associated with these exceptions to disclosure

[307D.07] Except for safe harbour condition as allowed in that section 307D(1) herein, these exceptions to disclosure are only available *if and so long as*: (i) the corporation takes reasonable precautions for preserving the confidentiality of the information; and (ii) the confidentiality of the information is preserved.

If this confidentiality is lost or the information has somehow been leaked, these safe harbour principles will cease to be available and the corporation must then disclose the inside information as soon as practicable.

However, if the confidentiality is lost, the corporation will not be regarded as in breach of the disclosure requirement in respect of inside information if it can show that it: (i) took reasonable measures to monitor the confidentiality of the information in question; and (ii) made disclosure as soon as reasonably practicable, once it became aware that the confidentiality of the information had not been preserved and lost thereafter.

Regarding media speculation, market rumours, and analysts' reports

[307D.08] In all regards, corporations are not obliged to respond to media speculation, market rumours or analysts' reports. But if a corporation *truly does* possess the inside information which has been speculated and relies on a safe harbour provision to withhold such required disclosure and where such media speculation, market rumours or analysts' reports about the corporation are indeed largely *accurate* and *based* on the inside information, this confidentiality has most likely been lost. In such case, the safe harbour will no longer be available and the corporation must make the inside information publicly available.

But where a corporation truly *does not* have inside information, and all media reports or market rumours carry false or untrue information to this sextent, the corporation is *not required* to make any further disclosure under the SFO. The Stock Exchange may, however, require that corporation to

provide disclosure or clarification which is not required under the SFO. If a corporation wishes to respond to market rumours, it should do so by publication of an announcement rather than by a remark to a single publication or press release.

Moreover, corporations should be careful to ensure that no such inside information is accidentally provided when responding to analysts' questions or reviewing analysts' reports.

307E. Waiver

(1) The Commission may, on an application by a listed corporation, grant a waiver in relation to the disclosure of any inside information required to be disclosed under section 307B if the Commission is satisfied that the disclosure –

(a) is prohibited under, or would constitute a contravention of a restriction imposed by, the legislation of a place outside Hong Kong;

(b) is prohibited under, or would constitute a contravention of a restriction imposed by, an order of a court exercising jurisdiction under the law of a place outside Hong Kong;

(c) would constitute a contravention of a restriction imposed by a law enforcement agency of a place outside Hong Kong; or

(d) would constitute a contravention of a restriction imposed by a government authority of a place outside Hong Kong in the exercise of a power conferred by the legislation of that place.

(2) The Commission may grant a waiver under subsection (1) subject to any condition that it considers appropriate to impose.

COMMENTARY

Predecessor provisions

[307E.01] This section came into effect on 1 January 2013 which was implemented under Part 2 of the Securities and Futures (Amendment) Ordinance 2012 which was gazetted on 4 May 2012.

Securities and Futures Commission's power to grant waivers

[307E.02] The Securities and Futures Commission (SFC) under subsection 307E(1) of this provision is empowered to grant waivers where the disclosure of price sensitive or inside information in Hong Kong would be prohibited under a court order or legislation of another jurisdiction or would contravene a