

Client Update

Inside Information Disclosure Regime: No Exception for NEDs and INEDs

HONG KONG

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INTRODUCTION

On 11 March 2016, the Securities and Futures Commission (SFC) commenced proceedings in the Market Misconduct Tribunal (MMT) against Mayer Holdings Limited (Mayer), and ten of its current and former senior executives (Senior Executives), in connection with Mayer's failure to disclose inside information¹ under Part XIVA of the Securities and Futures Ordinance (SFO). This is the second set of MMT proceedings brought by the SFC under Part XIVA of the SFO since it became effective on 1 January 2013.

OVERVIEW OF THE INSIDE INFORMATION DISCLOSURE REGIME

Subject to limited exceptions,² section 307B of the SFO requires a listed company to disclose inside information as soon as reasonably practicable. Section 307G of the SFO further imposes personal obligations on officers of a listed company to take all reasonable measures to ensure that proper safeguards exist to ensure the company's compliance.

¹ Pursuant to section 307A of the SFO, inside information is information that is specific, not generally known to the segment of the market which deals or would likely deal in the listed company's securities, and if so known, would be likely to have a material effect on the price of the listed securities.

² Pursuant to section 307D of the SFO, no statutory disclosure is required if (i) the disclosure would breach an order by a Hong Kong court or any provisions of a Hong Kong statute; (ii) the information relates to an incomplete proposal or negotiation; or (iii) the information concerns a trade secret. For the categories (ii) and (iii), the confidentiality of the information must have been preserved.

BACKGROUND

Mayer is a company incorporated in the Cayman Islands listed on the Main Board of The Stock Exchange of Hong Kong Limited, principally engaging in the business of processing and manufacturing steel sheets and steel pipes.

It is alleged by the SFC that between April and August 2012, the then auditors of Mayer had repeated communications with Mayer's management regarding issues identified in the course of auditing Mayer's financial statements for the year ended 31st December 2011 (Outstanding Audit Issues), including that:

- the nature of the disposal of a wholly-owned subsidiary for a consideration of HK\$15,500,000 was questionable;
- Mayer's projects in Vietnam were not under its control, and the prospects of those projects were far less promising than initially valued and contemplated; and
- two subsidiaries of Mayer's jointly controlled entity entered into two supply agreements, whereby substantial prepayments in the sum of US\$10,000,000 and US\$4,000,000 were respectively made to the suppliers without security (Prepayments), which caused the auditors to raise concerns as to their recoverability.

Mayer failed to give satisfactory answers to any of the Outstanding Audit Issues.

On 23 August 2012, Mayer's then auditors sent a list of "potential qualifications to the audit report" to Mayer indicating that they would have to qualify their audit opinion 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 (Auditors' Resignation) which was addressed to "The Audit Committee and the Board of Directors" of Mayer.

On 23 January 2013, Mayer disclosed the Auditors' Resignation and the Outstanding Audit Issues in an announcement.

SFC'S ALLEGATION

The SFC alleges that each of the Outstanding Audit Issues, the Potential Qualified Audit Report, the Prepayments and the Auditors' Resignation contained specific price sensitive information generally not known to the public,

and thus constituted “inside information” within the meaning of Part XIVA of the SFO (see footnote 1).

The SFC alleges that the Outstanding Audit Issues and the Potential Qualified Audit Report came to the knowledge of Mayer on 23 August 2013, and the Auditors’ Resignation (which was addressed to the board and audit committee of Mayer) came to the knowledge of Mayer on 27 December 2012. Specifically, the SFC considers that each of the above issues did, or alternatively, ought to reasonably have, come to the knowledge of the Senior Executives in the course of performing their functions as officers of Mayer.

For the above reasons, the SFC commenced MMT proceedings against Mayer for its purported failure to disclose inside information under section 307B of the SFO, and against the Senior Executives of Mayer for their reckless or negligent conduct (which allegedly led to Mayer’s failure to disclose inside information), under section 307G of the SFO.

OBSERVATION

These MMT proceedings not only highlight the SFC’s determination to enforce the statutory disclosure regime in connection with inside information, but also exemplify the SFC’s effort to hold senior management personally liable for serious violation of the SFO.

It shall be noted that unlike the MMT proceedings concerning AcrossAsia,³ where the SFC’s allegations were only directed at the chairman and chief executive officer, the Senior Executives of Mayer who are subject to the MMT proceedings include Mayer’s chairman and executive director; company secretary and financial controller; executive directors; independent non-executive directors (INED) and non-executive director (NED) in office at the material time.

It is not uncommon for INEDs and NEDs to sit on a listed company’s audit committee. The commencement of these MMT proceedings sends a clear message to listed companies and their senior officers that even NEDs and INEDs, who presumably have no day-to-day control over the management of a listed company’s affairs, can still be held personally accountable for a listed company’s failure to disclose inside information in accordance with Part XIVA.

³ On 27 July 2015, the SFC commenced proceedings in the MMT against AcrossAsia Limited, its Chairman and Chief Executive Officer for failing to disclose inside information as soon as reasonably practicable pursuant to sections 307B and 307G of Part XIVA of the SFO. This is the first set of MMT proceedings brought by the SFC under Part XIVA of the SFO.

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Please do not hesitate to contact us with any questions.