Timely Reminder to Hong Kong Listcos to Disclose Inside Information Promptly

30 March 2020

Introduction

On 25 March 2020, the Market Misconduct Tribunal ("**MMT**") found Magic Holdings International Limited ("**Magic**") and certain of its directors culpable of late disclosure of inside information. In recent weeks, the spread of Coronavirus has created great uncertainty about many listed companies' future performance and viability (resulting in extreme share price volatility) and the MMT's decision is a timely reminder to companies listed on the Hong Kong Stock Exchange to ensure that inside information is disclosed promptly.

Debevoise & Plimpton's Hong Kong contentious regulatory team has extensive experience advising listed companies and directors with complex situations requiring the disclosure of inside information as well as defending listed companies and directors in regulatory enquiries and proceedings. In this bulletin, we look at the MMT's findings and consider some practical steps that can be taken to avoid late disclosure of inside information.

The MMT's Decision

In March 2013, Magic entered into discussions with L'Oréal S.A. (the French cosmetics group) in relation to a proposed acquisition of Magic by L'Oréal.

The proposed acquisition (which constituted inside information) was leaked. However, Magic did not disclose the information relating to L'Oréal's acquisition proposal to the public until August 2013.

The MMT found that:

- Magic did not take reasonable precautions for preserving the confidentiality of the information arising from the negotiations.

- Magic did not take reasonable measures to monitor the confidentiality of the inside information.

- In circumstances where (i) confidentiality had not been preserved; and (ii) Magic had not taken reasonable precautions for preserving the confidentiality of the information, Magic was not entitled to rely on the "*incomplete proposal or negotiation*" safe-harbour under section 307D of the SFO.

- Accordingly, contrary to section 307B (1) of the SFO, Magic did not disclose to the public the inside information as soon as reasonably practicable after the inside information had come to its knowledge. This breach of the disclosure requirements was due to the fact that its directors were not informed in a timely manner of all information relevant to the determination of whether it was necessary to make disclosure about the potential acquisition by L'Oréal to the public.

- The Chairman and Company Secretary (both of whom were directors) failed to exercise the requisite skill and diligence, having regard to their respective knowledge, skill and experience. The MMT further found that five of the directors had failed to take all reasonable measures to ensure that proper safeguards existed within Magic to prevent it from breaching its disclosure obligation.

- Two of the directors (whose functions focused on business operations rather than regulatory matters) were not culpable of negligent conduct in relation to Magic's breach of the disclosure requirement. That notwithstanding, the MMT indicated that their conduct was far from competent and noted that they had failed to engage properly with the proposed acquisition, including failing to ask the right questions about the proposed transactions and not opening and reading relevant emails.

- Certain of the non-executive directors, who had taken a proactive approach in seeking to inform themselves of the operations of Magic (including suggesting an internal controls review), had taken all reasonable measures to ensure that proper safeguards existed to prevent the breach of Magic's disclosure requirement.

The Inside Information Disclosure Regime

In essence, "inside information"[1] is non-public information about a listed corporation that is likely to materially affect the share price. There are many events and circumstances which may affect the price of the listed securities of a corporation. In its 2012 guidance, the SFC set out some examples of events or circumstances where a corporation should consider whether a disclosure obligation arises. The examples that are particularly relevant to the current market conditions are "*changes in performance, or the expectation of the performance, of the business*" and "*changes in financial condition, e.g. cashflow crisis*".

The core obligations in relation to dealing with inside information are found in Part XIVA of the SFO. In particular:

- *A listed corporation must, as soon as reasonably practicable after any inside information has come into its knowledge, disclose the information to the public* (section 307B).
- *Disclosure must be made in a manner that can provide for equal, timely and effective access by the public* (section 307C).
- *Compliance is achieved through an electronic publication system operated by a recognised exchange company.*
- *Officers must ensure that proper safeguards exist* (section 307G).

The SFO contains various "safe harbour" exceptions which, if applicable, disclosure of inside information is not required. These safe harbours include, among other things, information that relate to trade secrets and incomplete proposals or negotiations (e.g. contract negotiations, corporate divestment, share placing and so on)[2].

Further, a listed corporation is not deemed to have failed to preserve the confidentiality of any inside information if disclosure is required for the purposes of allowing a person

---

1 Section 307A(1) of the SFO states that "inside information", 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."

2 Section 307D(2).

(e.g. lawyers, accountants and financial advisers) to perform functions in relation to the corporation or if disclosure is required by law[3].

There are various penalties for companies and directors that fail to disclose inside information promptly.

Recent Market Volatility and Heightened Need to Monitor Inside Information

As the Coronavirus has spread to become a global pandemic, many listed companies have experienced extreme share price volatility. As the severity and impact of the pandemic develops and government responses evolve on an almost daily basis, the future performance and financial position of many listed companies remain highly uncertain. This period of stress will be a new experience for more recently listed companies and the economic effects of the Coronavirus will no doubt present different challenges to listed companies that survived previous crises, such as the Global Financial Crisis.

In these circumstances, the need to monitor inside information closely and take steps to promptly disclose that information is more important than ever. Indeed, the SFC and Exchange are keeping a close eye on this issue and, on 16 March 2020, issued an updated joint statement[4] specifically noting in the FAQs that "*if the issuer's business operations, reporting controls, systems, processes or procedures are materially disrupted by the SRD outbreak and/or the related travel restrictions, management should assess whether any inside information has arisen* [under the SFO]… *and, if so, make a separate announcement as soon as reasonably practicable*".

We note that other financial regulators are also taking a close interest in the management of price-sensitive information. In particular, on 23 March 2020, the U.S. Securities and Exchange Commission issued a reminder to publicly traded companies of their regulatory obligations to guard against improper dissemination and use of material non-public information (see our update here).

---

[3] Section 307D(3).

[4] FAQs to Joint Statement in relation to Results Announcements in light of Travel Restrictions related to the Severe Respiratory Disease associated with a Novel Infectious Agent.

Handling Inside Information in Times of Crisis

Debevoise & Plimpton has significant experience advising Hong Kong listed companies in relation to sensitive and contentious matters relating to inside information. Set out below is a selection of practical steps that can be taken to ensure that inside information is handled correctly and, where necessary, disclosed:

- Directors should be reminded of their duties in relation to the need to monitor and disclose inside information. Training refreshers should be provided if necessary.

- The current market conditions could be a timely juncture to review the company's policy for determining what information is sufficiently significant for it to be price-sensitive and its procedures for disclosure. Many companies operate a "sensitivity list" for categories of price-sensitive information. Responsibility for disseminating price sensitive information should be clearly delegated.

- Depending on the nature of the operations of the company, the board will likely need to pay close attention to changes in the current and future financial position of the company. This could include frequent (i.e. daily) calls among the board. The fact that directors may be unable to hold physical board meetings (due to social distancing protocols) will not be an acceptable reason for failing to disclose inside information. Alternative arrangements for effective communication between board members will need to be established.

- If monitoring of Coronavirus is delegated to a board sub-committee, an effective system of communication will be required to keep other board members informed of the situation.

- To ensure that the financial position of the company can be properly assessed, the company will need access to management and financial information that is accurate and up to date. In some cases, the directors will need to assess whether the company is facing insolvency (which could occur very quickly). Additional personnel could be required to ensure the accurate and timely production of such information.

- The discussions between board members and any decisions in relation to disclosure or non-disclosure of inside information should be properly documented, especially the reasons for any non-disclosure or delay in disclosure.

- The board should involve its compliance and legal advisers in discussions about potential inside information and whether it should be disclosed.

- Insider Lists should be kept under review and Insiders should keep up to date as to what information is public and what is inside information.

- Use and distribution of inside information should be restricted to relevant personnel (e.g. ensure that distribution lists are accurate and kept under review).

- Avoid communications and announcements that blur price sensitive information with public information. Announcements should include all the relevant information that shareholders and potential investors need to know, including what steps the company intends to take to address current financial or operational difficulties.

* * *

If you would like to discuss any of the matters raised in this bulletin, please do not hesitate to contact us.

HONG KONG

Gareth Hughes
Partner
ghughes@debevoise.com

Mark Johnson
Partner
mdjohnson@debevoise.com

Edwin Northover
Partner
enorthover@debevoise.com

Emily Lam
International Counsel
elam@debevoise.com

Allison Lau
Associate
asylau@debevoise.com

Ralph Sellar
Associate
rsellar@debevoise.com