Delay in Part XIVA disclosures will not be tolerated

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Introduction

The Securities and Futures Commission (**SFC**) has previously identified five areas to be its strategic enforcement priorities, namely: corporate fraud, insider dealing and market manipulation, intermediary misconduct, sponsor misconduct and money laundering. While disclosure breaches were not specified as a top enforcement priority, it remains clear that the SFC is vigilant in monitoring and curbing these breaches. Since the commencement of the disclosure regime under Part XIVA of the Securities and Futures Ordinance (**SFO**) on 1 January 2013, the SFC has successfully brought proceedings against listed companies and their management for disclosure breaches in the Market Misconduct Tribunal (**MMT**). This client briefing highlights some of the key points of the enforcement actions and discusses some of the key cases in respect of Part XIVA breaches over the past six years.

The Part XIVA disclosure regime

Under the regime, listed companies and their management are placed under statutory obligations to disclose inside information in a timely manner. In substance, inside information means specific information about a listed company, its shareholders or officers, or its listed securities or their derivatives, that is not generally known in the market but, if it were, would be likely to materially affect the price of the listed securities. Once an officer becomes aware of any inside information concerning the listed company, the listed company must make an announcement as soon as reasonably practicable, unless one of the exceptions applies. The most common exception is the safe harbour defence provided in section 307D of the SFO, which, for instance, excludes information about incomplete proposals or negotiations, provided that the listed company has taken reasonable precaution to preserve and has actually preserved the confidentiality of such information.

This disclosure obligation is imposed on every officer of the listed company, which means that every officer has the same duty to ensure that proper safeguards are in place to prevent a Part XIVA breach. Officers may also be liable if the breach results from their intentional, reckless or negligent conduct. Under the regime, listed companies and each of their directors or chief executives may be fined up to HK$8 million. Officers may also be disqualified from being involved in the management of listed companies for up to five years. In addition, if any person suffers a pecuniary loss as a result of a breach by an officer, that person may be able to claim compensation from the officer in question.

The first decision – AcrossAsia Limited (2016)

In November 2016, the MMT handed down its first decision in respect of Part XIVA breaches against AcrossAsia Limited (**AcrossAsia**) and its officers for their failure to make timely disclosure of certain legal proceedings against the company in Indonesia. In particular, the MMT considered whether it was unreasonable to expect the listed company to announce information which its management did not fully understand, given that the court documents were in Bahasa Indonesian. The MMT concluded that it was reasonable to allow time for AcrossAsia to obtain a translation of the court documents and to seek legal advice

before making an announcement. However, even taking into account such allowance, there was a 7-day delay in disclosure from the receipt of legal advice. The MMT commented that the level of seriousness of this case was "firmly towards the bottom of the scale" due to mitigation. A total fine of HK$2 million was imposed on AcrossAsia, its chairman and its CEO for the breach. It is interesting to note that the Chairman had not admitted to market misconduct until after the MMT hearing commenced and therefore did not receive any discount on the regulatory fine imposed.

The second decision – Mayer Holdings Limited (2017)

In this case, Mayer Holdings Limited (**Mayer**) was 23 days late in announcing the resignation of its auditors from the date on which the company had been notified of such resignation. The MMT found that nine of its current and former officers, including independent non-executive directors, of Mayer had failed to take reasonable measures to ensure that proper safeguards existed to prevent the disclosure breach. In this case, severe penalties amounting to a total of HK$10.2 million were imposed on Mayer and other specified persons, including the Financial Controller. The MMT concluded that the Financial Controller would be considered as a "chief executive", which is defined in the SFO to mean a person employed or engaged by a corporation who is responsible under the immediate authority of the board for the conduct of the business of the corporation.

The third decision – Yorkey Optical International (Cayman) Limited (2017)

Shortly after the decision in respect of Mayer, the MMT published its third decision. The MMT found that there had been a 13-week delay in the disclosure of the material deterioration in the financial performance of Yorkey Optical International (Cayman) Limited (**Yorkey**) since the receipt of its monthly management accounts. The delay was found to be a result of the reckless conduct of the CEO and Financial Controller. In this case, despite the fact that Yorkey's monthly management accounts had been sent directly to the CEO and not the Financial Controller, and hence the Financial Controller had not known about the deterioration until he had seen the draft final results, the MMT held the Financial Controller responsible for failing to put in place a system whereby the accounts would also be sent to him. The MMT disqualified the Financial Controller for 15 months and recommended the Hong Kong Institute for Certified Public Accountants (**HKICPA**) to take disciplinary action against him.

Ongoing investigations

Apart from the three concluded cases, the SFC has instituted disclosure proceedings in the MMT concerning Fujikon Industrial Holdings Limited, Magic Holdings International Limited (**Magic**), Health and Happiness (**H&H**) International holdings Limited and CMBC Capital Holdings Limited (**CMBC**). These cases are scheduled to be heard in 2019. These listed companies are alleged to have delayed in disclosing inside information by one to four months. The nature of the inside information concerned ranges diversely, including the discontinuance of business by a top customer, a potential acquisition and changes in the financial performance of the company. In the case of Magic and CMBC, not only the executive directors, but also the non-executive directors are named specified persons in the disclosure proceedings.

Conclusion

From the three decided cases and other disclosure proceedings which are still ongoing, it is clear that the SFC will not hesitate to take action when there are Part XIVA breaches. Listed companies and their officers should not expect the SFC or the MMT to take a lenient approach towards them, especially given that the Part XIVA regime has come into force for more than six years. All board members, including non-executive directors, as well as other persons who may be considered as "chief executives", are

likely to be caught under the SFO and may face severe penalties – significant fines, disqualification orders and disciplinary actions by professional bodies, which would adversely affect their livelihood. It is therefore worth bearing in mind the importance of discharging one's Part XIVA obligations as soon as reasonably practicable. Listed companies and officers should take reasonable measures to ensure that proper safeguards are in place to prevent any breach of such obligations. Also, in order to rely on the safe harbour defence, officers should ensure that the confidentiality of the inside information concerned is actually preserved. In case there is any sign of leakage, immediate disclosure should be made. Prompt legal advice should be sought if any potential issue arises. Finally, where there is unlikely to be any defence to the breach, it may be best for listed companies and their officers to attempt early settlement for discounts in penalties.

If you would like to discuss any of the contents of this Briefing, then please do not hesitate to contact:

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