CORPORATE REGULATION NEWSLETTER

ISSUE NO. 4
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An SFC newsletter to inform market participants about matters concerning disclosures by listing applicants and listed companies

Feedback and comments: CRnews@sfc.hk

Welcome to the fourth edition of the SFC's *Corporate Regulation Newsletter*. This series of newsletters highlights specific issues related to disclosures by listing applicants and listed companies.

In this edition, we remind listed companies to disclose inside information to the public as soon as reasonably practicable and to use clear and concise language when doing so. We advise companies of the importance, prior to making an announcement, of maintaining confidentiality and avoiding trading suspensions or keeping them as short as possible. We also discuss disclosure requirements for listed debt issuers and trends in inside information disclosure. Lastly, we highlight a recent Market Misconduct Tribunal (MMT) ruling on breaches of disclosure obligations and the impact of three new accounting standards.

We hope that these newsletters are of use to companies, sponsors, market practitioners and others interested in listed company disclosures. We would be grateful for your comments and feedback, including suggestions for topics you would like us to address in the future.

Please send your comments to CRnews@sfc.hk.

We look forward to hearing from you.

Highlights

- Periodic financial information
- Maintaining confidentiality and minimising suspensions
- Better quality in disclosure – use of percentages
- Disclosure requirements for Chapter 37 listed debt issuers
- Trends in inside information disclosure
- MMT ruling and enforcement efforts
- New accounting standards

Periodic financial information

We monitor company announcements on a daily basis to identify corporate misconduct and disclosure irregularities, including non-disclosure of inside information in a timely manner and disclosure of false or misleading information. Section 307B(1) of the Securities and Futures Ordinance (SFO) states that "a listed corporation must, as soon as reasonably practicable after any inside information has come to its knowledge, disclose the information to the public."

In the ordinary course of running a corporation, directors and officers are likely to possess information not generally known to the market. Monthly management accounts are one example. When considering such information, it is important to distinguish between non-public information relating to ordinary day-to-day activities, and occasions when those activities generate information of greater significance which could constitute inside information, such as matters which could change a corporation's course or indicate that there has been a change in its course. For example, when there is a material difference between the results which the market might predict based on the company's previous disclosures and the results the directors or officers expect based on information known to them, then that difference in expectation may constitute inside information which is required to be disclosed.

In this regard, we wish to remind directors and officers of listed companies that, under section 307G of the SFO, they must take all reasonable measures from time to time to ensure that proper safeguards exist to prevent a breach of a disclosure requirement. Almost all companies produce monthly management accounts and use them as part of their corporate reporting systems designed to meet their obligations to keep investors properly informed. The SFC would therefore expect monthly management accounts to be made available to the board of directors of listed companies with very few exceptions.

Maintaining confidentiality and minimising suspensions

As set out in the SFC's "Guidelines on Disclosure of Inside Information", a corporation must disclose any inside information to the public as soon as reasonably practicable unless the information falls within any of the safe harbours as provided in the SFO. It is important that a listed company ensures that inside information is kept strictly confidential and there is no leakage of information prior to making an announcement. Where confidentiality cannot be maintained, the listed corporation should immediately disclose the information to the public.

As an example, where talks are taking place in respect of a takeover, it is imperative that confidentiality is maintained. Where an obligation to make an announcement under Rule 3.7 of the Takeovers Code arises, we would normally expect the announcement to be relatively short and to disclose no more than the fact that talks are taking place. It is not acceptable for the indicative offer price or the form of consideration to be disclosed in a Rule 3.7 announcement[1] .

Where confidentiality has not been maintained and the listed corporation is not able to make an announcement, it should consider applying for a suspension of trading in its securities until disclosure can be made. In these circumstances, we wish to remind listed corporations that a suspension of trading should be avoided or kept as short as possible.

As set out in the Hong Kong Exchanges and Clearing Limited's guidance letter for trading halts (GL83-15) issued in December 2015, "under the Listing Rules, issuer announcements containing inside information can only be published outside trading hours". When preparing to sign an agreement, listed companies should prepare an announcement ahead of time so that it can be released either immediately after the signing of an agreement outside of trading hours or as soon as the shares are suspended for the rest of the trading session.

[1] Please refer to the June 2016 edition of the *Takeovers Bulletin* (No.37) for further details.

Better quality in disclosure – use of percentages

We note that listed companies frequently use percentage figures to compare performance metrics in announcements such as profit warnings and alerts, business or operational updates and periodic financial disclosures. We encourage companies to use clear and concise language to avoid misunderstanding. Two examples of unclear and potentially misleading disclosure are:

Example 1:

> "ESTIMATED ***DECREASE IN PROFIT*** FOR THE INTERIM RESULTS FOR THE YEAR 2016
>
> The Company expects to record a negative amount in net profit attributable to the equity holders of the Company, representing ***a decrease of approximately 150%*** as compared to the corresponding period of the previous year."

A reduction in net profit by more than 100% is actually a net loss. In these circumstances, to state that there is a "decrease in profit" does not help investors understand the situation, and in extreme circumstances it could potentially be misleading. It would be clearer and more accurate to say, for example, that "the company is expected to record a loss of approximately $2,000,000" and amend the heading to: "estimated loss for the interim results for the year 2016".

Example 2:

> "Gross profits of the Group ***increased by*** approximately ***250%*** from $100 million for the year ended 30 June 2015 to $250 million for the year ended 30 June 2016."

In this context, an "increase by" a certain amount indicates the difference between the later value and the earlier one. The increase in gross profits described in this example is actually $150 million ($250 million minus $100 million), or 150% of the original $100 million. Thus, a better description might be:

> "Gross profit of the Group ***increased*** from $100 million for the year ended 30 June 2015 to $250 million for the year ended 30 June 2016 (an increase of 150%)."

Disclosure requirements for Chapter 37 listed debt issuers

According to Part XIVA of the Securities and Futures Ordinance (Disclosure of Inside Information), the definition of a listed corporation includes one whose securities are listed on The Stock Exchange of Hong Kong Limited. Chapter 37 debt issuers are therefore considered to be listed corporations for the purposes of Part XIVA of the SFO. Issuers whose debt securities are only issued to professional investors in compliance with Chapter 37 of the Listing Rules are reminded that they should, nevertheless, comply with the inside information disclosure regime and issue any inside information announcements in a timely manner in accordance with the SFO.

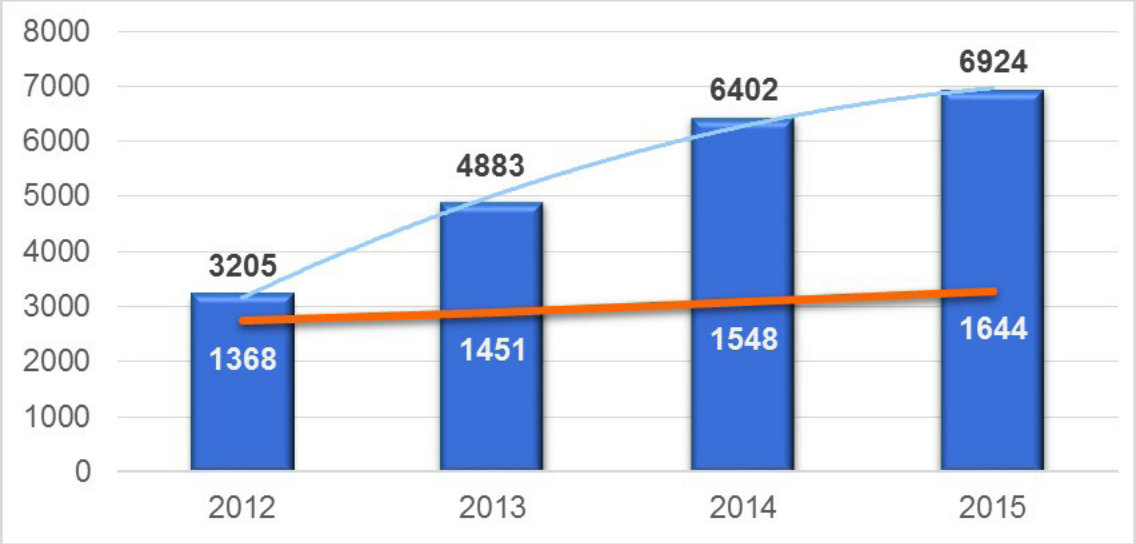
For Chapter 37 listed debt issuers, section 307A(1) of the SFO is interpreted as defining inside information to be "specific information in relation to a listed corporation that (a) is about (i) the corporation; (ii) its shareholders or officers; or (iii) the listed debt securities; and (b) is not generally known to professional investors but would, if generally known, be likely to materially affect the price of the listed debt securities"[2] .

[2] Please refer to the "Guidelines on Disclosure of Inside Information" issued by the SFC in June 2012 for further information.

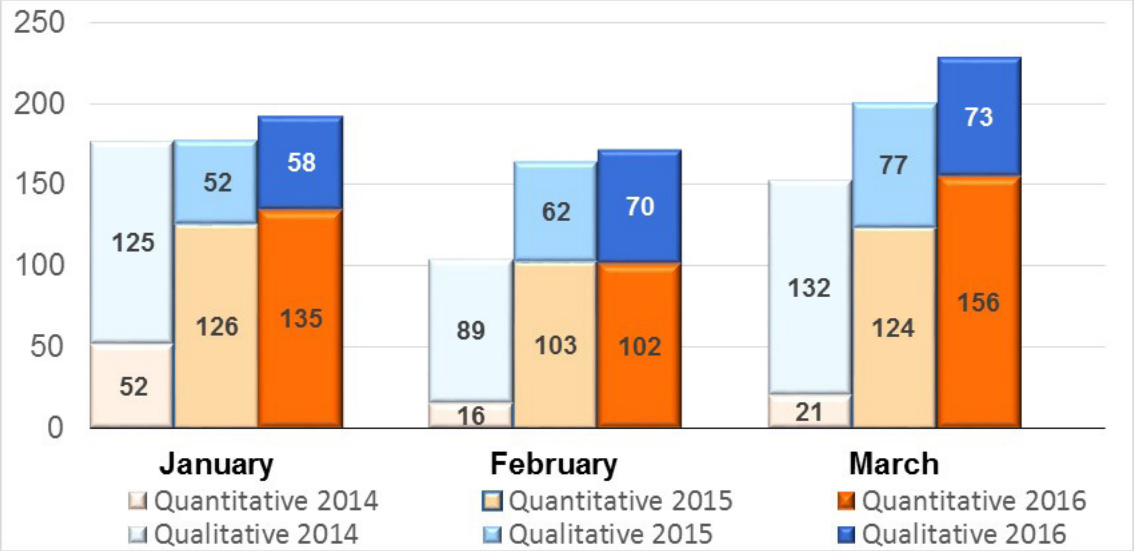
Trends in inside information disclosure

Since the implementation of the inside information regime in January 2013, the number of inside information announcements published by listed companies has increased. There was a 52.4% year-on-year increase in the number of inside information announcements published in 2013, followed by a 31.1% increase in 2014. However, the number increased by only 8.2% in 2015, suggesting that listed companies have become more familiar with how Part XIVA applies to their businesses, and many companies have systems in place to identify inside information as it arises.

Number of inside information announcements



First-quarter profit alerts and warnings in 2014-16



The total number of announcements is not a relevant metric for determining the quality of announcements made by listed companies or the level of compliance with Part XIVA. Companies should bear in mind that announcements should aim to help investors understand the company's situation. A clear and concise announcement is more informative than a sequence of poorly-expressed and vague statements about possible initiatives or transactions.

We looked into the quality of announcements relating to profit alerts or profit warnings in each of the first quarters of 2014, 2015 and 2016. We classified these announcements as either "quantitative", where a number is cited, or "qualitative", where the announcement does not contain any numbers, and found that the number of announcements which include a number increased in the past three years. This is more informative for investors and we encourage listed companies to publish informative announcements which help investors better understand the listed company's actual situation.

MMT ruling on AcrossAsia and enforcement efforts

On 7 November 2016, the MMT found that AcrossAsia Limited, its former chairman and former chief executive officer failed to disclose inside information as soon as reasonably practicable. The MMT made an order for AcrossAsia to pay a fine of $600,000, its former chairman to pay $800,000 and its former chief executive officer to pay $600,000. All three parties were ordered to pay costs and both individuals were ordered to undergo a training programme [3].

This is the first time the MMT made a finding of breaches of the disclosure obligations imposed on listed companies since they became effective on 1 January 2013.

AcrossAsia, its former chairman and former chief executive officer admitted that they had been late in disclosing inside information about a petition filed by AcrossAsia's subsidiary and major creditor against AcrossAsia and a related summons. They also admitted that their negligence resulted in AcrossAsia's breach of the disclosure requirement.

Listed corporations should disclose inside information which has come to their knowledge as soon as reasonably practicable. Timely and non-misleading disclosure of inside information is central to the orderly operation of the market and underpins the maintenance of a fair and informed market.

As our Executive Director of Enforcement, Mr Thomas Atkinson, has pointed out, the SFC's enforcement actions will focus on holding individual wrongdoers accountable for their misconduct. The SFC has broad powers under the SFO to hold directors and individuals involved in the management of companies responsible for the misconduct committed by the companies they manage. Over the past three years, we initiated proceedings against over 50 directors and senior executives of listed companies for misconduct, breach of directors' duties and reckless or negligent conduct that contributed to their company's failings.

As part of this initiative, the Corporate Finance Division has referred over 50 cases to the Enforcement Division each year. Going forward, we will continue to focus our efforts to combat corporate fraud and misfeasance.

[3] The MMT's report, published on 29 November 2016, is available on the MMT website (www.mmt.gov.hk).

New accounting standards

Three new International Financial Reporting Standards (IFRS) - IFRS 9 (Financial Instruments), IFRS 15 (Revenue from Contracts with Customers) and IFRS 16 (Leases) have been issued by the International Accounting Standards Board[4].

The new revenue standard (IFRS 15) provides a single, principles-based, five-step model for revenue recognition that is designed to improve comparability over a range of industries, companies and geographical boundaries. In some instances, it may change the timing of a listed company's recognition of revenue and the impact may be significant.

The new financial instrument standard (IFRS 9) introduces changes to the accounting for credit losses and how financial assets are measured on an ongoing basis. This new standard may result in more timely recognition of expected credit losses for loans and other financial instruments.

The new leases standard (IFRS 16) changes the previous lease accounting model such that a lessee will now reflect more assets and liabilities arising from its leases on its balance sheet. This may significantly affect a listed company's key financial ratios.

Implementation of the new standards may require significant changes and necessitate a listed company's review of its existing contracts with customers as well as its financial instruments and lease arrangements. Companies should conduct appropriate assessments of the expected effects of the new standards on their financial reporting as soon as possible.

4 IFRS 9 and IFRS 15 are effective for annual periods beginning on or after 1 January 2018. IFRS 16 is effective for annual periods beginning on or after 1 January 2019. Equivalent Hong Kong Financial Reporting Standards will be adopted in Hong Kong with the same effective dates.

All issues of the *Corporate Regulation Newsletter* are available under 'Published resources – Industry-related publications – *Corporate Regulation Newsletter*' on the SFC website at www.sfc.hk.

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