Guidance Note
A practical guide to good governance

The Hong Kong Institute of Chartered Secretaries
Chartered Secretaries. More than meets the eye.

Insider Dealing
Part II

June 2008 • Reference number: 7
The Hong Kong Institute of Chartered Secretaries

Hong Kong Office
3F Hong Kong Diamond Exchange Building, 8 Duddell Street, Central, Hong Kong
Tel: (852) 2881 6177  Fax: (852) 2881 5050
E-mail: ask@hkics.org.hk  Website: www.hkics.org.hk

Beijing Representative Office
Rms 1014-1015, 10F Jinyu Mansion,
No 129 Xuanwumen Xidajie Xicheng District, Beijing, China PC 100031
Tel: (8610) 6641 9368  Fax: (8610) 6641 9078
E-mail: bro@hkics.org.hk  Website: www.hkics.org.hk
Insider Dealing

Part II

Introduction

Part I of the guidance note on insider dealing ("Part I") published by the Institute in March 2008 has addressed the legal elements of insider dealing. This guidance note is a continuation of Part I and aims at explaining why and how listed companies should avoid insider dealing.

Terms which have been defined in Part I will be used herein. Further, some important concepts related to insider dealing which have been explained in Part I will not be elaborated herein again. Readers are therefore advised to make reference to Part I in reading this guidance note.

Why should companies bother?

As noted in Part I, insider dealing is a serious offence which carries harsh criminal penalties including fines of up to HK$10 million and imprisonment of up to ten years. However, it is more than a breach of the law. Insider dealing is generally considered in all jurisdictions as an act which is unacceptable and unethical. The prevention of insider dealing is therefore an integral part of good business ethics and corporate governance.

The company secretary of a listed company, being an officer of the company who is primarily responsible for promoting good corporate governance, should take the lead in putting in place the necessary policies and procedures within the company for the avoidance of insider dealing.

Though the legal liability for insider dealing is personal to the people who committed the offence, it is always in the interest of the listed company to put in place necessary procedures to prevent any insider dealing in its shares. The reputation of a listed company will inevitably be tarnished if its shares are the subjects of insider dealing. Not only does it imply its failure to handle price-sensitive information carefully and properly, it further indicates that it has not put in place effective internal controls and code of ethics to prevent the leakage of important information about the company. The blow to its goodwill will even be more severe if its officers are involved with the insider dealing as it shows that its management and/or staff may not have the requisite integrity which its shareholders and the investing public invariably consider essential for making the company a great success.

Even though the listed company in question and its directors will not be liable for insider dealing simply for the reason that price-sensitive information of the company has been leaked, they may
however find themselves in breach of the Listing Rules thereby rendering them subject to reprimand, criticism, censure or other kinds of sanctions which the Listing Committee has the power to impose.

Pursuant to Rule 13.09 of the Listing Rules\(^1\), a listed company is under an obligation to provide to its shareholders and the general investing public price-sensitive information relating to the company as soon as reasonably practicable. In particular, they provide that "information should not be divulged outside the issuer and its advisers in such a way as to place in a privileged dealing position any person or class or category of persons. Information should not be released in such a way that Exchange transactions may be entered into at prices which do not reflect the latest available information".

The board of directors of a listed company is under a continuing obligation to consider whether changes in its financial condition, in the performance of its business or in its expectation as to its performance may be price-sensitive and require disclosure under the Listing Rules\(^2\).

Consequentially, in the case where its shares have become the subjects of insider dealing, it is possible that the listed company in question and its directors who have undertaken to procure the listed company to comply with the Listing Rules, will be held responsible for failure to put in place appropriate controls to prevent leakage of price-sensitive information\(^3\).

**Are there ways to avoid insider dealing?**

As with other kinds of malpractices, the risk of insider dealing can be reduced if effective policies and systems are put in place within the company. The followings are some recommended practices for the listed companies to adopt with the assistance of their company secretaries.

1. **Induction programme**

Under the SFO, all directors, employees and substantial shareholders of a listed company are deemed to be connected persons and hence insiders. While it may seem unreasonable to expect the company to provide training to its shareholders (unless they are also directors and/or employees of

---

\(^1\) For companies listed on the GEM board, please refer to GEM Listing Rule 17.10.

\(^2\) See “Announcement regarding Clarification of Formal Reporting Requirements for Profit Forecasts by Main Board Issuers and Obligations of Main Board and GEM Issuers on the Release of Price Sensitive Information” made by the Stock Exchange of Hong Kong Limited on 11 September 2006.

\(^3\) In May 2002, the Listing Division of the Stock Exchange of Hong Kong Limited wrote to the board of directors of New World Development Company Limited expressing its views that New World had breached certain obligations under paragraph 2 of the Listing Agreement since its employee had in the course of his employment, before the publication of the interim results, disclosed to a few analysts including Ms Ting Chuk Kwan, the interim profit figures of the company which was price-sensitive information, leading to the publication of their revised profit forecasts. In June 2003, Ms Ting was publicly reprimanded by the SFC for selective disclosure of price-sensitive information in the internal broadcast of her then employer. The disciplinary proceedings commenced by the Listing Division against New World and its directors also led to an application by New World for judicial review of the disciplinary procedures of the Stock Exchange. For details, please refer to the judgment of the Court of Final Appeal (Final Appeal No.22 of 2005 (Civil)).
the company), it is advisable for the company to put together an induction programme for all staff including the directors, whether executive or non-executive, the senior management and the employees, regardless of their level or seniority for the purpose of giving them a better understanding of insider dealing. Knowledge of an offence including the relevant legal consequences is the first step towards its prevention.

As part of the induction programme, legal practitioners having profound knowledge of the SFO, particularly market misconducts, should be invited to give a briefing to all staff on issues such as the essential elements of insider dealing, the penalties and exemptions etc. Such induction should be provided as soon as the directors and employees join the company and subsequently on a regular basis. Updates should also be provided whenever there is any material or important change in the relevant law.

2. Code of ethics

Insider dealing is not only a legal issue. It is also an ethics issue. For companies which have already put together a code of ethics, they should make sure that avoidance of insider dealing is fully addressed in the code. For instance, prevention of leakage of confidential or sensitive information which is highly pertinent to insider dealing should be covered by the code. And for those companies which have yet to compile a code of ethics, there are many good reasons for them to publish one as soon as practicable.

A code of ethics, in order to be successfully implemented, should be fully communicated to all staff (by way of ethics trainings or otherwise) as well as people with whom the company maintains professional or business relationships. As a lot of the malpractices which the code seeks to prevent involve outside parties such as suppliers, contractors and business partners, the circulation of the code of ethics to them has become all the more important as it helps ensure that they are well aware of the good business ethics which the company is determined to uphold.

In so far as insider dealing is concerned, it should also be borne in mind that all the aforesaid outside parties, including their directors, employees and substantial shareholders may also be considered as insiders under the SFO for the purpose of insider dealing. It is therefore of great importance that they are warned of the legal liability resulting from any possible misuse of the sensitive information of the company such as insider dealing.

3. Policy for handling price-sensitive information

Preventing price-sensitive information from leaking is the key to the avoidance of insider dealing. Every listed company should put in place a clear policy detailing proper ways and procedures for the handling of price-sensitive information such as the information related to any take-over offer,

---

4 See "Business Ethics - A Path to Success" jointly published by The Hong Kong Institute of Chartered Secretaries and Hong Kong Shue Yan University in September 2007 http://www.hkics.org.hk/Publications/2073_Business%20Ethics.pdf

mergers and acquisitions and fund raising exercise of the company (regardless of whether the aforesaid transactions also constitute notifiable or connected transactions under the Listing Rules). In order to prevent leakage of price-sensitive information, the policy is recommended to contain, inter alia, the following requirements:

- Identification by a code - a project should be identified by a code without stating the full names of the concerned parties during the initial stage of the project and before public announcement.
- “Need to know” basis - dissemination of the information related to a project should be limited to the core members within the company who are responsible for or involved with the project and the professional advisers such as lawyers and accountants who advise on the project.
- Audit trail - a clear record documenting the audit trail of the distribution of the information including the identities of the recipients and the time of receipt etc should be kept by the company.
- Meetings with securities analysts - when having regular meetings with interested fund managers and securities analysts with a view to briefing them on the business and prospect of the company, the directors and those who attend such meetings on behalf of the company should be wary of any possible disclosure of price-sensitive information about the company to such outside parties.
- Disclosure to business partners - in the normal course of business, it may be necessary for the company to provide certain price-sensitive information to outside parties before entering into any business relationship with them. Before or upon the giving of such information, the company should enter into a confidentiality agreement with the recipient party requiring the latter to keep the information strictly confidential and use it for the sole purpose of the furtherance and completion of the transaction in question.
- Share dealing approval - directors and other members of the senior management who are likely to have access to price-sensitive information about the company should be required to get approval from the chairman or the CEO before they deal in the securities of the company, whether by exercise of their share options or otherwise.
- Reminder by company secretary - the company secretary of a listed company is always the officer tasked with the duty to prepare the public announcement in connection with any important transactions entered into by the company or any important changes affecting the company. Such transactions or changes are under most circumstances also price-sensitive information which can be used for insider dealing. It is a good practice that the company secretary should send a reminder to the directors and other persons who have access to the price-sensitive information or be privy to any negotiations or agreements related to the important transactions that they are under a duty to keep the relevant information confidential and to refrain from share dealing either in its own

---

6 See Enforcement News of the SFC dated 17 June 2003 for more details about the case of Ting Chuk Kwan.
name or through any third parties as well as procuring or counseling others to deal until proper disclosure is made in accordance with the Listing Rules.

The company secretary, given his important role in the information disclosure and the promotion of good corporate governance of the company, should actively participate in the implementation of the above recommended practices which are crucial for the avoidance of insider dealing as well as the promotion of good corporate governance.

What are the additional duties of directors regarding share dealing?

While insider dealing applies to all people who are considered as connected with a listed company including without limitation to its directors, there are certain additional duties regarding share dealings which are imposed on directors. As it is not unusual that people confuse insider dealing with such duties, it is worthwhile to study briefly such additional duties in this guidance note though they are separate from insider dealing and not governed by the SFO.

Apart from insider dealing, directors of main board listed companies should also have regard to the Model Code for Securities Transactions by Directors of Listed Issuers (Appendix 10) ("Model Code") of the Main Board Listing Rules which sets out the required standard and principles applicable to directors' share dealing.

The most important thrust of the Model Code is that directors who are aware of or privy to any notifiable transactions under Chapter 14 of the Listing Rules or connected transactions under Chapter 14A of the Listing Rules or any price-sensitive information must refrain from dealing in the securities of the company as soon as they become aware of them or privy to them until proper disclosure of the information in accordance with the Listing Rules. Directors who are privy to relevant negotiations or agreements or any price-sensitive information do have a duty to caution those directors who are not so privy that there may be unpublished price-sensitive information and that they must not deal in the securities of the company for a similar period.

Under the Model Code, apart from the absolute prohibition that a director must not deal in the securities of the company at any time when he is in possession of unpublished price-sensitive information, a director is also prohibited from dealing in the securities for a period of one month immediately preceding the earlier of: (i) the date of the board meeting for the approval of the issuer's annual, half-yearly or quarterly results; and (ii) the deadline for the issuer to publish its annual, half-yearly or quarterly results, and ending on the date of the results announcements. Such period when dealing is prohibited is referred to as the "black out" periods.

For companies listed on the GEM board, please refer to GEM Listing Rules 5.46 - 5.68
Several proposals relating to the Model Code have been made in the Combined Consultation Paper released by the Hong Kong Exchanges and Clearing Limited (“HKEx”) in January 2008. Such proposals include expanding the list of exceptions to the definition of "dealing", clarifying the meaning of "price-sensitive information" in the context of the Model Code, extending the current "black out" periods and restricting the time for responding to the request for clearance to deal, and the time for dealing once clearance has been received.

Pending publication of the consultation conclusions by the HKEx, it is uncertain if any of the proposals will be implemented eventually. This guidance note will therefore not go into details of the rules and principles governing directors' share dealing.

To conclude, directors of listed companies should bear in mind the general principle that they are absolutely prohibited to deal in the securities of their companies when they are in possession of unpublished price-sensitive information. Further, when they are dealing in the securities of their companies, they must have regard to both the SFO and the Listing Rules, in particular, the Model Code. Great care should be taken to ensure that such dealing will not constitute insider dealing or any breach of the Model Code which may also amount to a breach of the Listing Rules.

June 2008

This guidance note is only intended to provide a general guide on the subject matter and should not be regarded as a substitute for detailed advice in individual cases. HKICS does not accept liability for loss or damage sustained by any person or organisation as a result of reliance on the information or views stated herein.