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SFC Commences Market Misconduct Proceedings for Alleged Breaches of Inside Information Disclosure Requirements

The SFC has commenced proceedings in the Market Misconduct Tribunal against two companies for alleged breaches of the inside information disclosure requirements under the Securities and Futures Ordinance (**SFO**). Senior executives of those companies were also charged with reckless or negligent conduct that caused the alleged breaches. The statutory regime for inside information disclosure under Part XIVA of the SFO came into effect two years ago on 1 January 2013.

Inside Information Disclosure Requirements under Part XIVA of the SFO

The SFO defines inside information as specific information about the corporation, its shareholder(s)/officer(s) or its listed securities/derivatives that is not generally known to people who are accustomed to dealing or would be likely to deal in that company's listed securities, but if the information were generally known to such people, it would be likely to affect the price of those listed securities materially.

Section 307B of the SFO requires listed corporations to disclose inside information to the public as soon as reasonably practicable after that information has come to its knowledge. Under section 307G of the SFO, officers of listed corporations who engage in intentional, reckless or negligent conduct that results in a listed corporation's breach of the disclosure requirement will themselves be in breach of the disclosure requirement.

Late Disclosure of Audit Issues

In its notice to the Market Misconduct Tribunal on 4 March 2016, the SFC alleged that Mayer Holdings Limited (**Mayer**) was in breach of section 307B of the SFO when it failed to disclose to the public in a timely manner the following:

- a large prepayment made by one of Mayer's subsidiaries to a supplier without security, which Mayers' auditors believed to be irrecoverable;
- other outstanding audit issues identified by the auditors that Mayer did not address and the auditors' notification that they would qualify their audit report if these issues were not resolved; and
- the auditors' subsequent resignation.

Mayer had been informed by the auditors of various outstanding audit issues since August 2012 at the latest. On 23 August 2012, the auditors informed Mayer that they would have to qualify their audit report if the outstanding audit issues were not resolved. The SFC alleges that the outstanding audit issues and the notification of the possible qualification of the audit report were known by the company on 23 August 2012.

The auditors resigned on 27 December 2012, citing Mayer's lack of cooperation in relation to resolving the audit issues it had identified and communicated. Mayer did not announce the auditors' resignation until 23 January 2013.

Ten current and former senior executives of Mayer (including the company secretary/financial controller, the chairman of the board and the chairman of the audit committee) were also alleged by the SFC to have breached section 307G of the SFO by failing to ensure that Mayer complied with its disclosure obligation under section 307B.

Failure to Disclose Significant Deterioration in Financial Performance

On 6 April 2016, the SFC commenced proceedings against Yorkey Optical International (Cayman) Limited (**Yorkey**) for failing to disclose information about the company's substantial losses and significant deterioration in its financial performance in the second half of 2012 (the **Deterioration**).

In its 2012 unaudited interim results, Yorkey had reported a decrease in revenue of 12.1% and a net profit decrease of 62% compared to the corresponding period in 2011. Nevertheless, it predicted "significant growth over that in the first half of the year, alongside with increasing profitability" for the second half of 2012.

Yorkey's 2012 audited annual results were announced on 25 March 2013. They recorded a 99% drop in net profit as compared to 2011, and net profit for the whole of 2012 was less than that for the first six months. The company's share price fell 21.25% in the three days following the results announcement.

Yorkey did not issue any profit warning announcement or otherwise inform the public of the Deterioration between the publication of its 2012 unaudited interim results on 16 August 2012 and the publication of its 2012 audited annual results on 25 March 2013. The SFC alleges that this lack of disclosure to the public constituted a breach of section 307B of the SFO.

In its notice to the Market Misconduct Tribunal, the SFC alleged that information about Yorkey's material losses and the significant deterioration in its financial performance in the second half of 2012 were already apparent from its monthly management accounts for the five months between July and November 2012. The SFC therefore alleges that the inside information came to the knowledge of the company either:

- from around mid-December 2012 when the consolidated monthly management accounts up to November 2012 had, or ought reasonably to have, come to the knowledge of Yorkey's Chief Executive Officer; or
- at the latest, from around mid-January 2013 when the internal management accounts for the whole of 2012 were made available to Yorkey's Chief Executive Officer.

The SFC further alleges that the chief executive officer and the financial controller/company secretary of Yorkey were aware of the Deterioration well before the publication of the 2012 financial results. The SFC considers that their failure to ensure timely disclosure of the Deterioration constitutes reckless or negligent conduct which resulted in Yorkey's breach of the disclosure requirement.

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