

INSIDER DEALING IN HONG KONG

OVERVIEW
AND UPDATE

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INTRODUCTION

Securities and Futures Ordinance (SFO) contains:

- civil market misconduct offences (Part XIII)
- criminal market misconduct offences (Part XIV)

6 types of market misconduct:

- insider dealing
- false trading
- price rigging
- disclosure of information about prohibited transactions
- disclosure of false and misleading information inducing transactions
- stock market manipulation

Civil market misconduct cases dealt with by the Market Misconduct Tribunal (MMT)

Criminal market misconduct cases dealt with by the courts



WHAT IS INSIDER DEALING?



Broadly, **insider dealing occurs:**

When a person connected with an HKEX-listed company (“Listco”) has privileged information, which could impact the company’s share price when it becomes publicly known, **deals or procures someone else to deal** in Listco’s securities or their derivatives to **make a profit or avoid a loss** before the information is made public

OR

A person obtains information from another person they know to be connected with a Listco + **deals or procures another person to deal** in Listco’s securities or their derivatives to **make a profit or avoid a loss** before the information is made public

7 CIRCUMSTANCES OF INSIDER DEALING UNDER THE SFO (ss 270 + 291)

1. Person with inside information deals in shares of a corporation with which he is connected – ss 270(1)(a) + 291(1)(a)

A person connected with a Listco has information they know is inside information +

- deals in Listco's listed securities or their derivatives OR in those of a related corporation OR
- counsels or procures another person to deal in Listco's listed securities or derivatives, knowing or having reasonable cause to believe that the other person will deal in them

2. Take-over offer - bidder deals in target's shares ss 270(1)(b) + 291(2)

A person who is contemplating or has contemplated making a take-over offer for a Listco + knows the information that the offer is contemplated, or is no longer contemplated, is inside information:

- deals in the Listco's listed securities or their derivatives or those of a related corporation otherwise than for the purpose of the take-over
- counsels or procures another person to deal in Listco's listed securities or derivatives otherwise than for the purpose of the takeover

Does not stop the bidder's directors buying the target's shares (or counselling or procuring others to do so) in a "dawn raid" where the sole purpose is to facilitate the takeover



3. Person connected with a Listco leaks inside information about it – ss. 270(1)(c) + 291(3)

When a person connected with a Listco:

- has information they know is inside information +
- discloses the information, directly or indirectly, to another person, knowing or having reasonable cause to believe that the other person will use the information to deal, or counsel or procure another person to deal, in Listco's listed securities or their derivatives or those of a related corporation

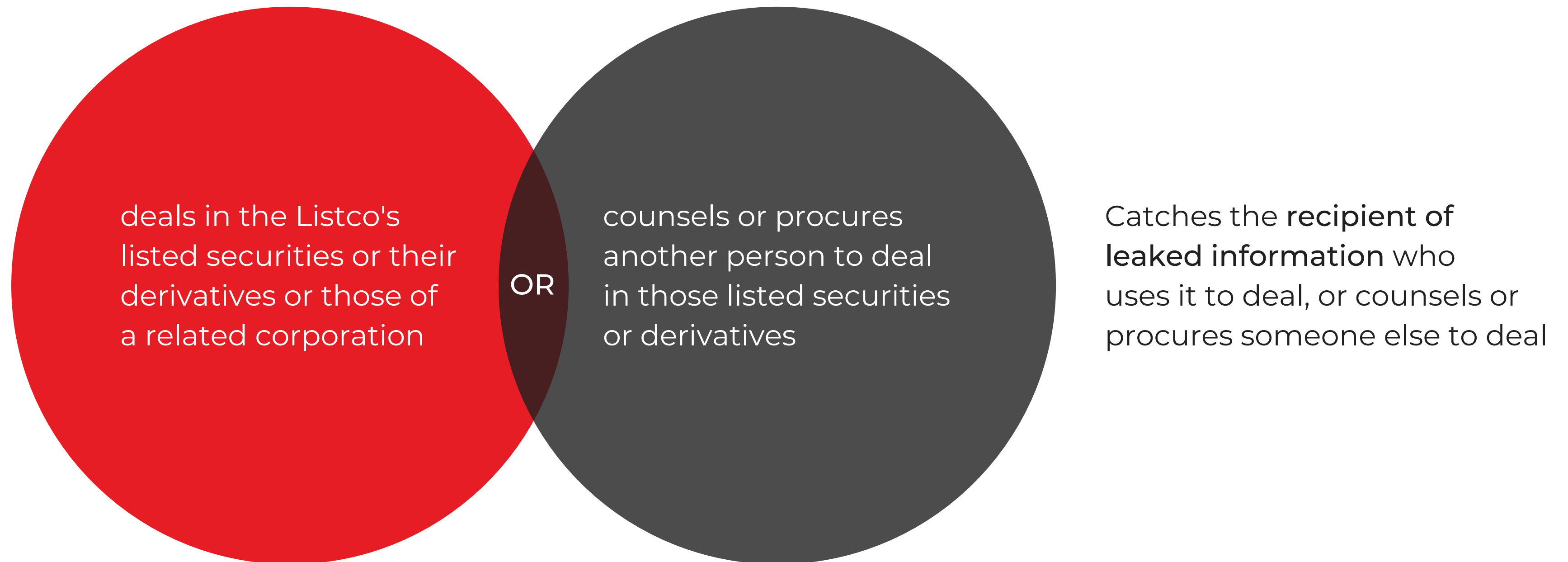
Offence catches those who **deliberately leak confidential information** with a view to someone using that information to make a favourable deal trading the securities



4. Bidder leaks take-over information – ss. 270(1)(d) + 291(4)

A person who is contemplating or has contemplated making a take-over offer for a Listco + knows that the information that the offer is contemplated or no longer contemplated is inside information, discloses the information, directly or indirectly, to another person, knowing or having reasonable cause to believe that the other person will use the information to deal or to counsel or procure another person to deal in the Listco's listed securities or their derivatives or those of a related corporation

5. Recipient of inside information from person connected with a Listco deals in Listco's listed securities or their derivatives – ss. 271(1)(e) + 291(5)



6. Recipient of inside information about a takeover deals in the target's shares – ss. 270(1)(f) + 291(6)

When a person has received, directly or indirectly, from a person they know or have reasonable cause to believe is contemplating or no longer contemplating making a take-over offer for a Listco, information to that effect which they know is inside information in relation to the Listco +

- deals in Listco's listed securities or their derivatives or those of a related corporation
- OR
- counsels or procures another person to deal in Listco's listed securities or their derivatives

Catches the recipient of the leaked information who uses it by dealing themselves or by counselling or procuring someone else to deal



1. Person with inside information seeks to facilitate dealing on overseas market – ss. 270(2) + 291(7)

When a person who knowingly has inside information in relation to a Listco in any of the previous circumstances +

counsels or procures another person to deal in Listco's listed securities or their derivatives or those of a related corporation, knowing or having reasonable cause to believe that the other person will deal in those listed securities or derivatives **outside Hong Kong on an overseas stock market**

OR

discloses the inside information to another person knowing or having reasonable cause to believe that they or **some other person** will use the inside information to deal, or counsel or procure another person to deal, in the Listco's listed securities or their derivatives or in those of a related corporation **outside Hong Kong on an overseas stock market**

Covers insider dealing in securities **dually-listed** in Hong Kong and overseas Note **extended mens rea** element

INSIDER DEALING – DEFINITIONS

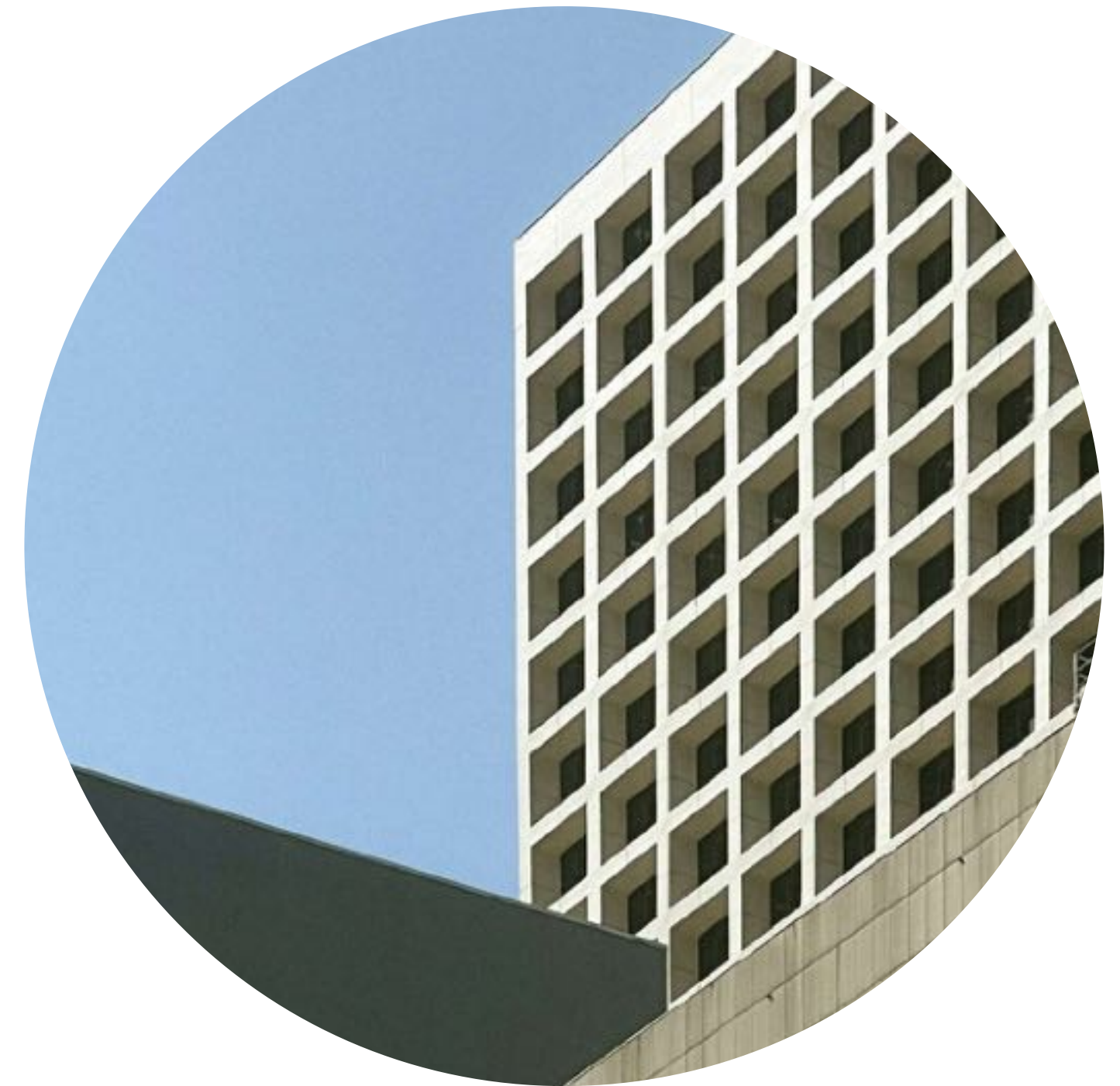
“SECURITIES”

- a) shares, stocks, debentures, loan stocks, funds, bonds or notes of, or issued by, or which it is reasonably foreseeable will be issued by, a body (incorporated or unincorporated), or a government or municipal government authority
- b) rights, options or interests (whether described as units or otherwise) in, or in respect of, any of the foregoing
- c) certificates of interest or participation in, temporary or interim certificates for, receipts for, or warrants to subscribe for or purchase, any of the foregoing



DEFINITION OF “SECURITIES” (CONT’D)

- d) interests in a collective investment scheme
- e) any interests, rights or property commonly known as securities (whether in the form of an instrument or not) and
- f) structured products not falling within paragraphs (a) to (e) where a structured product is defined as:
 - i) an instrument under which some or all of the return or amount due (or both the return and the amount due) or the method of settlement is determined by reference to one or more of:
 - o changes in the price, value or level (or a range within the price, value or level) of any type or combination of types of securities, commodity, index, property, interest rate, currency exchange rate or futures contract;



DEFINITION OF “SECURITIES” (CONT’D)

changes in the price, value or level (or a range within the price, value or level) of any basket of more than one type, or any combination of types, of securities, commodity, index, property, interest rate, currency exchange rate or futures contract

OR

the occurrence or non-occurrence of any specified event or events (excluding an event or events relating only to the issuer or guarantor of the instrument or both the issuer + the guarantor)

DEFINITION OF “SECURITIES” (CONT’D)

Definition of “structured product” (Cont’d)

- ii) a regulated investment agreement +
- iii) any interests, rights or property the SFC prescribes as structured products

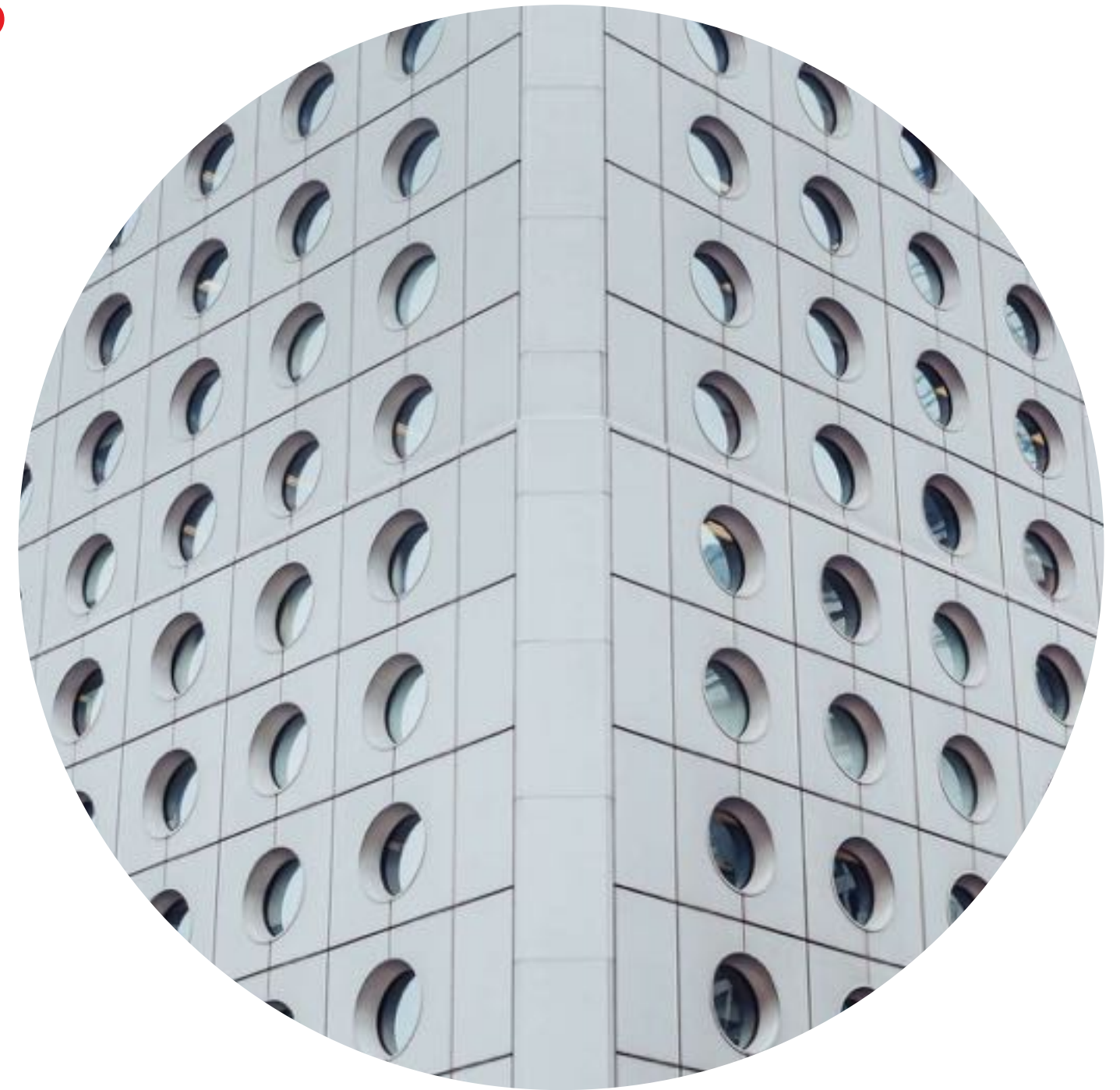


INSIDER DEALING IN FOREIGN-LISTED SECURITIES

SFO definition of “listed” securities:

- only covers HKEX-listed securities
- but catches “grey market” dealings before secondary market issues covering:
 - issued unlisted securities +
 - unissued securities, if reasonably foreseeable at time of insider dealing that they will be listed +/- issued + they are in fact listed +/- issued
- suspended shares treated as “listed”

Insider dealing in overseas-listed securities dealt with under s.300 SFO: Using Fraudulent or Deceptive Devices in Transactions in Securities, Futures Contracts or Leveraged Foreign Exchange Trading



LANDMARK CASE: SFC V. YOUNG BIK FUNG & OTHERS: FACTS

Betty was a lawyer seconded to a HK bank working on its takeover by tender offer of Taiwan-listed Hsinchu Bank

She knew of proposed takeover + tender offer price before the public announcement

Sister of one of solicitors opened a securities account in HK + purchased >1.5 mln Hsinchu shares before announcement

29 Sept. - tender offer announced. Sister accepted the offer for all the shares + distributed profits of approx. HK\$2.69 million among defendants

YOUNG BIK FUNG (CONT'D)



Due to case's extra-territorial feature,
Court relied on s. 300 SFO

S. 300 applied because offer to buy the shares
was made in HK

Sister's acceptance of the tender offer in HK
would also have brought case within s. 300

Betty's misuse of material price sensitive
information + breach of dealing restrictions
amounted to a scheme or act of deception under
s. 300

- Court of Final Appeal – s.300 applied in respect of securities listed outside HK, provided “substantial activities constituting the crime” occurred in HK
- SFO amendments will extend insider dealing to cover insider dealing conducted in HK involving securities listed on overseas stock markets or their derivatives

YOUNG BIK FUNG (CONT'D)

PERSONS CONNECTED WITH A CORPORATION

ss. 247 + 287

- they are a director or employee of the co. or a related co.
- they are a substantial shareholder (interested in >5% of the issued voting share capital) in the co. or a related co.
- their position may reasonably be expected to give them access to inside information due to:
 - a professional or business relationship between:
 - i) the person (or their employer, a co. of which they are a director, or a firm of which they are a partner) +
 - ii) that co., a related co., or an officer or substantial shareholder of either co. OR
 - the person being a director, employee or partner of a substantial shareholder of the corporation or a related corporation

PERSONS CONNECTED WITH A CORPORATION (CONT'D)



- the person has access to inside information by virtue of being connected (within the meaning above) with another corporation where the information relates to a transaction (actual or contemplated) involving both corporations or one of them + the listed securities of the other or their derivatives, or to the fact that such transaction is no longer contemplated or
- the person was connected with the corporation (within the meaning above) at any time in the 6 months before any relevant dealing
- a corporation is connected with another corporation if any of its directors or employees are connected
- ss. 248 + 288 — any public officer, member or employee of certain bodies who in such capacity obtains inside information about a corporation is deemed to be connected with that corporation



CORPORATION

The definition of “corporation” includes the large number of companies which are listed in Hong Kong but incorporated abroad

“RELATED CORPORATIONS”

Two or more corporations are “related corporations” of each other if one of them is:

- the holding company or subsidiary of the other
- a subsidiary of the holding company of the other

Corporations are also related if the same individual:

- controls composition of the board of directors of 2 or more corporations
- controls >50% of the voting power at general meetings of one or more corporations
- holds >50% of the issued share capital (excluding any part with no right to participate beyond a specified amount on a profit or capital distribution) of 2 or more corporations



INSIDE INFORMATION DEFINED

s. 245(1) SFO defines “inside information” in relation to a corporation as specific information about:

- the corporation
- a shareholder or officer of the corporation OR
- the corporation’s listed securities or their derivatives which is not generally known to the persons who are accustomed, or would be likely, to deal in the corporation’s listed securities, but would, if it were generally known to them, be likely to materially affect the price of the listed securities





INSIDE INFORMATION DEFINED

INSIDE INFORMATION
MUST BE “SPECIFIC”

Information will be **specific** if it is capable of being identified, defined and unequivocally expressed

FIRSTONE INTERNATIONAL HOLDINGS LTD

Information will be sufficiently specific:

“if it carries with it such particulars as to a transaction, event or matter, or proposed transaction, event or matter, so as to allow that transaction, event or matter, to be identified and its nature to be coherently described + understood”

INSIDE INFORMATION MUST BE “SPECIFIC” (CONT’D)



Information does not need to be precise to be specific

It is not necessary that all particulars or details of the transaction, event or matter are precisely known

Information can still be specific even if it has a vague quality

Contrast with mere rumours, vague hopes and worries, and unsubstantiated conjecture

INSIDE INFORMATION IS “NOT GENERALLY KNOWN”

SFC GUIDELINES ON DISCLOSURE OF INSIDE INFORMATION

- Inside information is information that is **not generally known** to the market
- Rumours or media speculation relating to a company **does not** mean information is “generally known”
- Information in the media, analyst research reports or electronic subscription databases **cannot be assumed** to be **generally known** to the market
- In determining whether information is generally known, need to consider:
 - how widely the information is disseminated
 - whether information is accurate + complete
 - whether the information is reliable

INFORMATION IN THE MEDIA, ANALYST RESEARCH REPORTS OR ELECTRONIC SUBSCRIPTION DATABASES

- whether the sources contain all the information that would need to be disclosed as inside information under s. 307B(3) SFO, so that there are no material omissions which could make the disclosure false or misleading
- whether the market will realise that the information in these sources reflects information known to the corporation and
- whether the information will be regarded as speculation or opinion of persons outside the corporation

If the information known to the market is incomplete or has material omissions, or doubts exist as to its bona fides, it cannot be considered to be “generally known”



- The information must be price sensitive
- The effect must be material



**INFORMATION THAT
IS LIKELY TO HAVE
A MATERIAL EFFECT
ON THE LISTED
SECURITIES' PRICE**

INFORMATION THAT IS LIKELY TO HAVE A MATERIAL EFFECT ON THE PRICE OF THE LISTED SECURITIES

Materiality standard — whether the information on the particular share would influence persons who would be likely to deal in the share, in deciding whether or not to buy or sell it

- test is hypothetical
- no fixed thresholds of price movements or quantitative criteria
- Magnitude of share price movement after information becomes publicly known is not conclusive - may be due to mixed impact of information released and other factors



DEALING IN SECURITIES – DEFINITION

● s. 249 SFO – a person deals, whether they act as principal or agent

● Agreeing to deal + buying or selling the right to deal are also “dealing”

WHAT IS NOT INSIDER DEALING?

THE DEFENCES ss. 271 + 292

DEFENCES

The dealing, counselling or procuring was made:

- for the sole purpose of acquiring qualifying shares as a director or intending director of a corporation;
- in good faith in performance of an underwriting agreement for the listed securities or derivatives in question; or
- in good faith as a liquidator, receiver or trustee in bankruptcy



CHINESE WALL DEFENCE

A corporation (eg an investment bank or sponsor firm) has a defence if:

- there were **effective arrangements in place** (a “Chinese wall”) to ring-fence inside information in the possession of any director or employees +
- each person who took the decision for the corporation to deal, or counsel or procure a dealing, in the listed securities or derivatives:
- **did not have the inside information** at that time +
- had not received advice from those in possession of that information



INNOCENT PURPOSE DEFENCE

It is a defence if:

- the purpose for which the person dealt in, or counselled or procured another to deal in, the listed securities or their derivatives, or disclosed information, DID NOT include the purpose of securing or increasing a profit or avoiding or reducing a loss, whether for themselves or another, by using the inside information
- the person dealt, or counselled or procured another to deal, in a corporation's listed securities or their derivatives as agent, IF:
 - he did not select or advise on the selection of the listed securities or derivatives; +
 - he did not know that the person for whom he acted was connected with that corporation or had the inside information



OFF-MARKET DEALINGS

It is a defence if the dealing occurred off-market in Hong Kong and:

- the person dealing in listed securities or their derivatives + the other party:
 - entered into the dealing directly with each other +
 - at the time of the dealing, the other party knew, or ought reasonably to have known, of the inside information **OR**
- where a person counselled or procured another person to deal in listed securities or their derivatives, he counselled or procured the other party to enter into the dealing **directly with him** + at that time the other party knew, or ought reasonably to have known, of the inside information.



OFF-MARKET DEALINGS (CONT'D)

It is a defence where a person dealt in listed securities or their derivatives, but did not counsel or procure the other party to deal,

IF

at the time of the dealing the other party knew, or ought reasonably to have known, that the person was a person connected with the corporation

OFF-MARKET DEALINGS (CONT'D)

A person has a defence if they counselled or procured another to deal in listed securities or their derivatives + :

- the other person did not counsel or procure the other party to the dealing to deal in the listed securities or derivatives +
- at the time he counselled or procured the other person to deal, the other party to the dealing knew, or ought reasonably to have known, that the other person was a person connected with the corporation



OFF-MARKET DEALINGS (CONT'D)

A defence is available to a person who deals or counsels or procures another to deal in a corporation's listed securities or their derivatives where:

- the person acted in connection with any dealing under consideration or the subject of negotiation, or in the course of a series of such dealings, **with a view to facilitating the accomplishment of the dealing or series of dealings +**
- the inside information was **market information** arising directly out of their involvement in the dealing or series of dealings



MARKET INFORMATION – DEFINITION

Market information includes information containing one or more of the following facts:

- that there has or is to be, or has not been or will not be, a dealing in listed securities or their derivatives, or that such dealing is under consideration or negotiation
- the quantity and price or price range of the listed securities or their derivatives involved +
- the identity of the persons involved

This gives a defence to a person who trades with knowledge of their own trading intentions or activities



Dealing subject to the rules of a recognised clearing house has a defence where the deal is entered into by the clearing house with a clearing participant for the purposes of the clearing and settlement of a market transaction

DEFENCE FOR TRUSTEES + PERSONAL REPRESENTATIVES

ss.272 + 293 defence for a trustee or personal representative who deals in, or counsels or procures a dealing, in listed securities or their derivatives:

- acting on advice obtained in good faith from a person appearing to be an appropriate person to provide that advice +
- where that person does not appear to be someone who would be insider dealing if they dealt in the listed securities or their derivatives

DEFENCE FOR PERSONS EXERCISING SUBSCRIPTION RIGHTS

ss.273 + 294 defence for a person who dealt in listed securities or their derivatives:

- in exercising a right to subscribe for, or otherwise acquire, those securities or their derivatives where
- that right was granted or derived from securities held before the person became aware of the inside information

INNOCENT PURPOSE DEFENCE

SFC V. YIU HOI YING CHARLES & OTHERS

- the respondents, Mr. Yiu and Ms. Wong held 6 mln shares + 10 mln shares in Asia Telemedia Limited (**Asia Telemedia**), respectively
- Asia Telemedia owed HK\$58.08 million to Goodpine Limited
- Goodpine Limited served a statutory demand + said it **would issue a winding-up petition against Asia Telemedia** if the debt was not repaid within 21 days
- Mr. Yiu + Ms. Wong sold their shares making profits of HK\$5.3m + HK\$5.1 m, respectively, when the ATML share price surged

SFC alleged:

- respondents' knowledge of Goodpine Limited's statutory demand was **inside information** +
- they engaged in insider dealing when they **relied on that information to dispose of their shares at a profit**



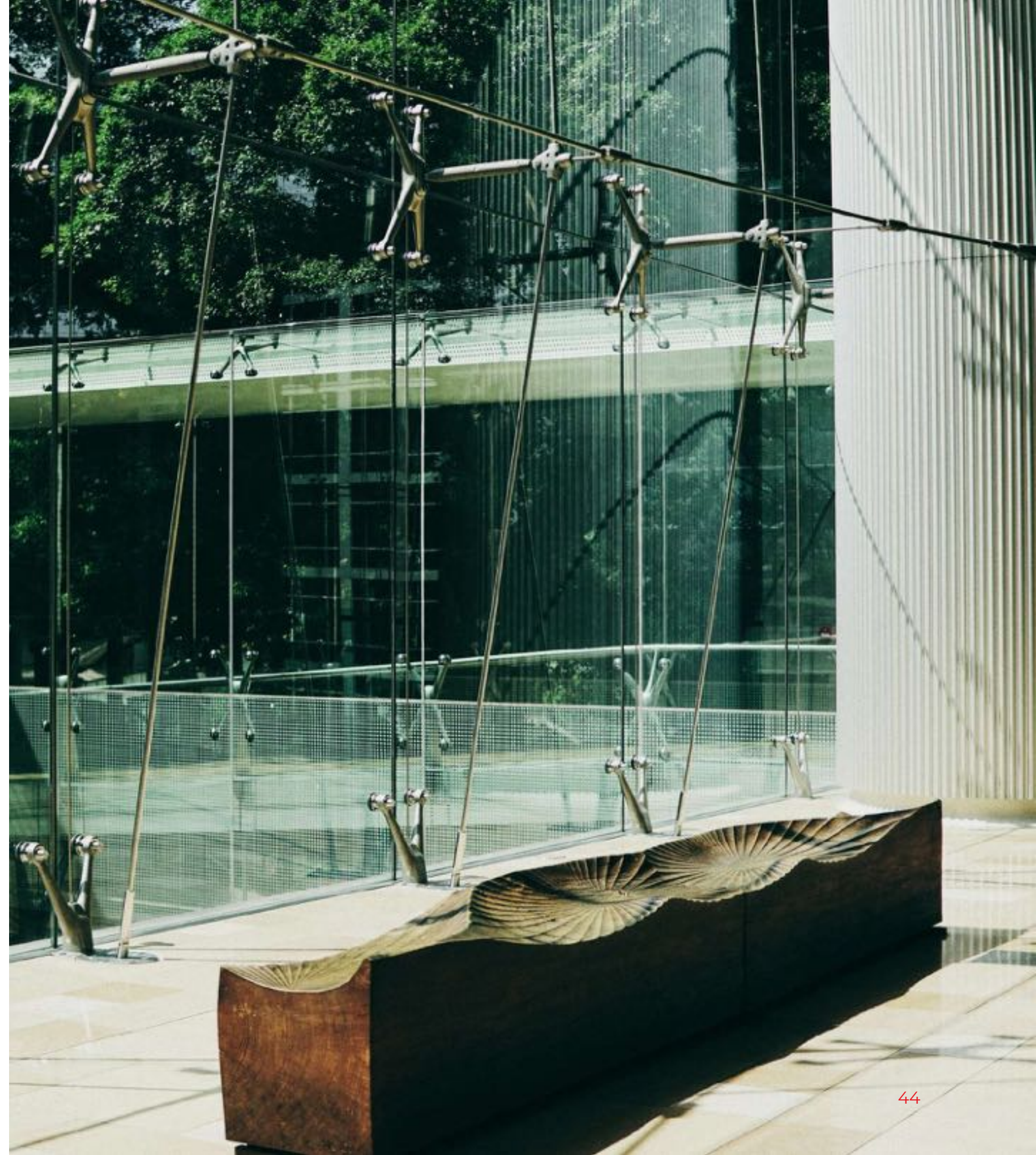
INNOCENT PURPOSE DEFENCE (CONT'D)

- Mr. Yiu + Ms. Wong relied on the innocent purpose defence – they sold because of share price rise – not the inside information
- MMT (+ later the Court of Appeal) accepted that defence
- CFA's 4-to-1 decision for the SFC rejected it
- CFA said using inside information means **turning the possession of inside information into action**
- Mere withholding or non-disclosure of inside information is **insufficient** to show **use** of the inside information - the inside information must be **exploited for financial advantage**
- Respondents knew ATML share price was artificially high because of the inside information they possessed + sold the shares to profit from that knowledge



INNOCENT PURPOSE DEFENCE (CONT'D)

- MMT orders against Mr. Yiu and Ms. Wong:
 - 3-year disqualification order against Mr. Yiu
 - HKICS disciplinary referral order against Ms. Wong
 - 3-year cold shoulder orders, cease and desist orders, disgorgement orders, and Government + SFC cost orders



MMT PROCEEDINGS

SFC can institute proceedings before MMT under s. 252 to determine:

- whether any market misconduct has taken place
- the identity of the persons engaged in market misconduct +
- the amount of any profit gained or loss avoided as a result of the market misconduct



MMT PROCEEDINGS (CONT'D)

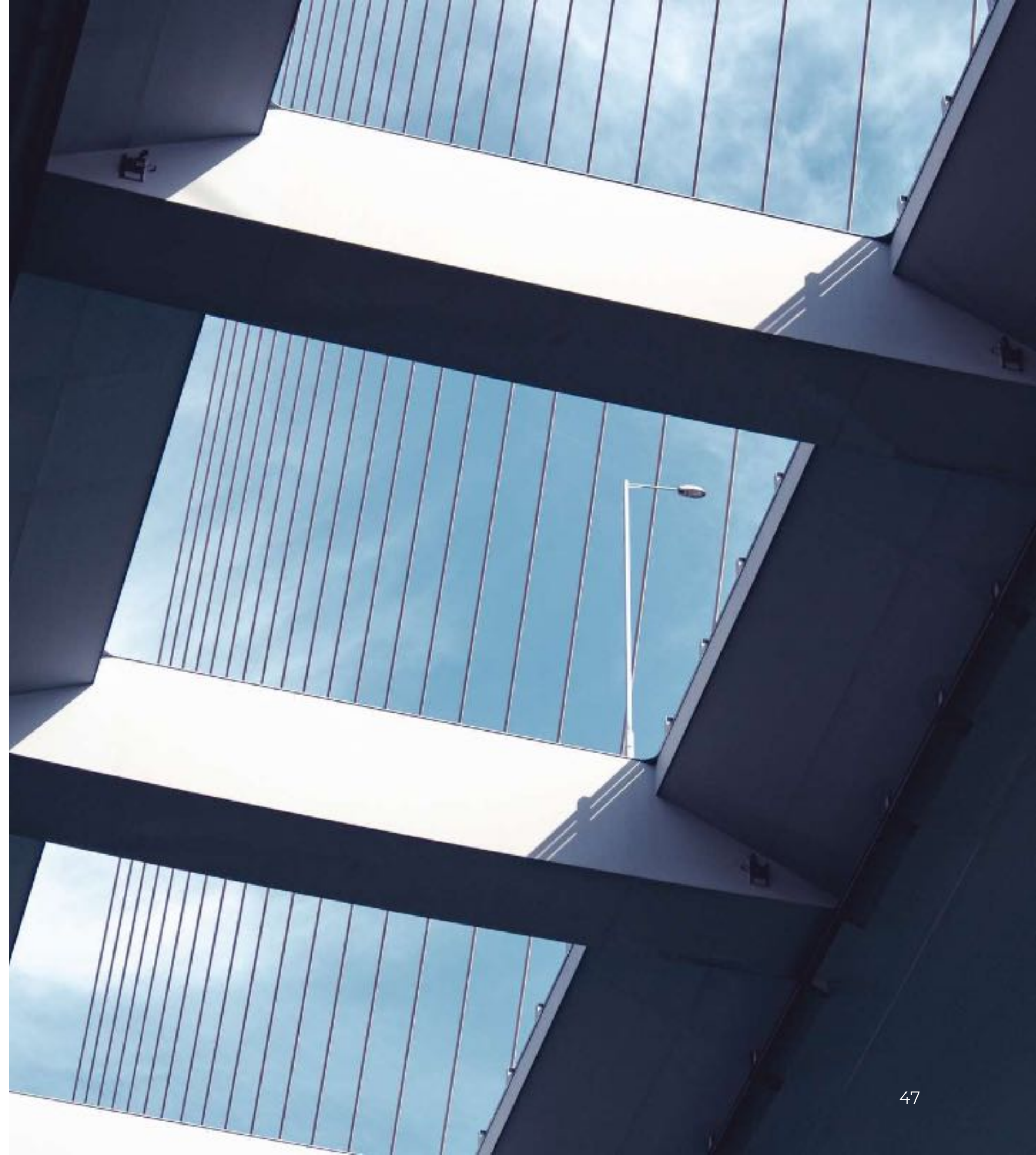
MMT can identify a person as having engaged in insider dealing if:

- they committed insider dealing
- the insider dealing was committed by a corporation of which the person is an officer with their consent or connivance OR
- another person committed insider dealing + they assisted or connived with that person in the perpetration of the insider dealing, knowing that the conduct constituted or might constitute insider dealing



MMT PROCEEDINGS (CONT'D)

- Civil standard of proof applies
- Must be satisfied that a person has engaged in insider dealing on the balance of probabilities
- MMT has powers to receive evidence, compel the giving of evidence, + prevent publication of evidence received
- s. 253(4) – permits the MMT to consider self-incriminatory evidence



SFC V. CHENG CHAK NGOK: FACTS

- Mr. Cheng was the executive director, CFO + company secretary of ENN Energy Holdings Limited
- he obtained information re:
 - the consortium formed to finance the acquisition
 - the timing of the announcement of the general offer (the **Announcement**) +
 - the offer price
- Mr. Cheng used 3rd party's securities account to buy China Gas shares before the Announcement, making HK\$3 mln profit when he then sold the shares
- but MMT not satisfied on the balance of probabilities that Mr. Cheng dealt in the shares at material times
- insider dealing could not be proved



PRINCIPLES SET BY THE COURT OF APPEAL IN SFC V. CHENG CHAK NGOK

Nature of MMT Inquiry

- the nature of the MMT's inquiry on market misconduct is civil and inquisitorial

Standard of Proof

- on a balance of probabilities
- case law - the standard of proof will be proportional to the seriousness of the allegations

Burden of Proof

- Only relevant in adversarial proceedings
- In inquisitorial proceedings, no party has the burden of proof



SFC'S GROUNDS FOR APPEAL

SFC specified 4 grounds of appeal:

1. MMT had erred in law in:
 - misdirecting itself that the inquiry was adversarial in nature
 - misdirecting itself that burden of proof applied and rested with the SFC +
 - failing to exercise its investigative powers under the SFO
2. MMT had applied criminal standard of proof
3. MMT erred in concluding that it could not be satisfied that Mr. Cheng had engaged in insider dealing on a balance of probabilities
4. MMT failed to exercise its investigative powers under the SFO before concluding the inquiry



DECISION OF THE COURT OF APPEAL

Standard of proof

- MMT had not properly evaluated the available evidence + was **wrong** in applying the criminal standard
- MMT erred in requiring the SFC to prove the case on basis of the criminal standard of proof

Burden of proof

- MMT incorrectly imposed the burden of proof on the SFC - no burden of proof in an inquisitional inquiry
- The SFC is only required to present evidence + information to the MMT, which should investigate the facts to reach a decision on the **balance of probabilities**

Remittal

- CA allowed the appeal + remitted the matter to a different tribunal to determine whether Mr. Cheng had dealt in the shares



MMT RETRIAL

- MMT concluded that it was more probable than not that Mr. Cheng dealt in the shares from the following evidence:
 - Mr. Cheng received all correspondence + statements re. the securities accounts
 - Clear correlation between the share trading + the acquisition of inside information
 - Correlation between Mr. Cheng's whereabouts + the IP address from which orders were placed
 - No 3rd party nominee or other individual would have been in a position to place the orders
- Following orders were made:
 - 54-month disqualification order
 - 52-month cold shoulder order
 - cease and desist order
 - disgorgement order (almost HK\$ 3 mln)
 - Government + SFC costs orders
 - HKICPA disciplinary referral order



MMT ORDERS

s. 257(1) SFO



1 a disqualification order

2 cold-shoulder order

3 cease and desist order

4 disgorgement order

5 cost orders

6 a disciplinary referral

- SFO s.257(2) – MMT can take into account previous convictions in Hong Kong

- SFO ss. 253(2) + 254(6) – maximum fine of HK\$ 1 mln + maximum 2 years' imprisonment for failure to comply

APPEALS



May appeal to the Court of Appeal on a **point of law**

Need to **obtain leave** of the Court of Appeal for an appeal based on a question of fact (s. 266)

In the case of SFC disciplinary actions, can appeal to the SFAT

SFC + SFAT proceedings are **civil in nature** + use the **civil standard of proof**

MMT CASE – RE. CHINA HUIYUAN JUICE GROUP LTD

- Ms. Sun Min was prosecuted for buying around 8.6 mln shares of China Huiyuan Juice Group Ltd.
- Ms. Sun made a profit of HK\$55.1 mln + when she sold her shares in the company within 48 hours after the public announcement of the Coca-Cola takeover
- Ms. Sun had close connections with the management of the company, but no direct evidence that she received insider information
- Ms. Sun had close connections with the management of the company, but no direct evidence that she received insider information
- She denied having any inside information or knowledge of the takeover
- SFC's case centred on the circumstantial evidence + inferences from handwritten notes on the takeover in Ms. Sun's secretary's diary



MMT CASE – CHINA HUIYUAN JUICE GROUP LTD (CONT'D)

- MMT held - if the identity of the connected person who passed on the inside information could not be ascertained, the MMT would decide, based on all available evidence, whether a compelling inference could be drawn
- MMT inferred that the information came from an insider even though the insider's identity could not be ascertained
- The inside information in the diary must have come from Ms. Sun or she must have known of the information



MMT CASE – WARDERLY INTERNATIONAL HOLDINGS LIMITED

- Former company secretary (Lo) + lender and potential investor (Luu) held Warderly shares
- Mid-2006 - Warderly had cash flow problems
- Lo + Luu sold their shares in March + April 2007
- SFC alleged Lo + Luu engaged in insider dealing as, when they sold their shares, they had price sensitive information concerning Warderly's poor financials, which was not publicly known + avoided losses by selling their shares



MMT CASE – WARDERLY INTERNATIONAL HOLDINGS LIMITED (CONT'D)

SFC alleged the following events were “inside information”:

- tightening of banking facilities from July 2006, overdue loans, rescheduled payments, demand letters + writs issued by banks + lenders
- a HK\$2 mln loan from Luu in Nov. 2006 at a 5% monthly interest rate
- further loans from Luu totalling HK\$7.2 mln at a 5% interest rate in Dec. 2006
- Warderly’s failure to repay the loans + interest due to Luu when they became due in Jan. 2007 +/-or
- a HK\$10 mln loan from Mr. Luu in Feb. 2007 at a 3% monthly interest rate which was secured by 50 mln Warderly shares



MMT CASE – WARDERLY INTERNATIONAL HOLDINGS LIMITED (CONT'D)

MMT decision - the information regarding Warderly's poor financials was already known to the public + there was no adverse impact on the stock price

The information was therefore not relevant information + Lo + Luu were held not to have engaged in insider dealing

Whether insider dealing has taken place or not is fact specific

CRIMINAL LIABILITY



All forms of market misconduct are liable to prosecution as a criminal offence under Part XIV SFO – maximum penalty is 10 years' imprisonment + a fine up to HK\$10 mln

The court can also make disqualification, cold shoulder + disciplinary referral orders

Non-compliance is an offence liable to a maximum fine of HK\$1 mln + up to 2 years' imprisonment

NO DOUBLE JEOPARDY

- A person who has been subject to criminal proceedings under Part XIV may not be subject to MMT proceedings if:
 - those proceedings are still pending or
 - no further criminal prosecution could be brought against that person again under Part XIV in respect of the same conduct + vice versa (ss. 283 + 307)
- Decision as to whether to take civil or criminal proceedings is made by the Secretary for Justice
- SFC can institute summary criminal proceedings before a magistrate for less serious market misconduct offences



CIVIL LIABILITY: PRIVATE RIGHT OF ACTION

- SFO creates a private right of civil action against the perpetrator in favour of anyone who has suffered a pecuniary loss as a result
- unless it is fair, just + reasonable that the perpetrator should not be liable (ss. 281 + 305)
- A person is taken to have committed market misconduct if:
 - he has perpetrated any market misconduct
 - a corporation of which he is an officer perpetrated the market misconduct with his consent or connivance
 - any other person committed market misconduct + he assisted or connived with that person in perpetrating the market misconduct, knowing that such conduct constitutes or might constitute market misconduct
- Not necessary to have a finding of market misconduct before civil proceedings, but findings are admissible as prima facie evidence



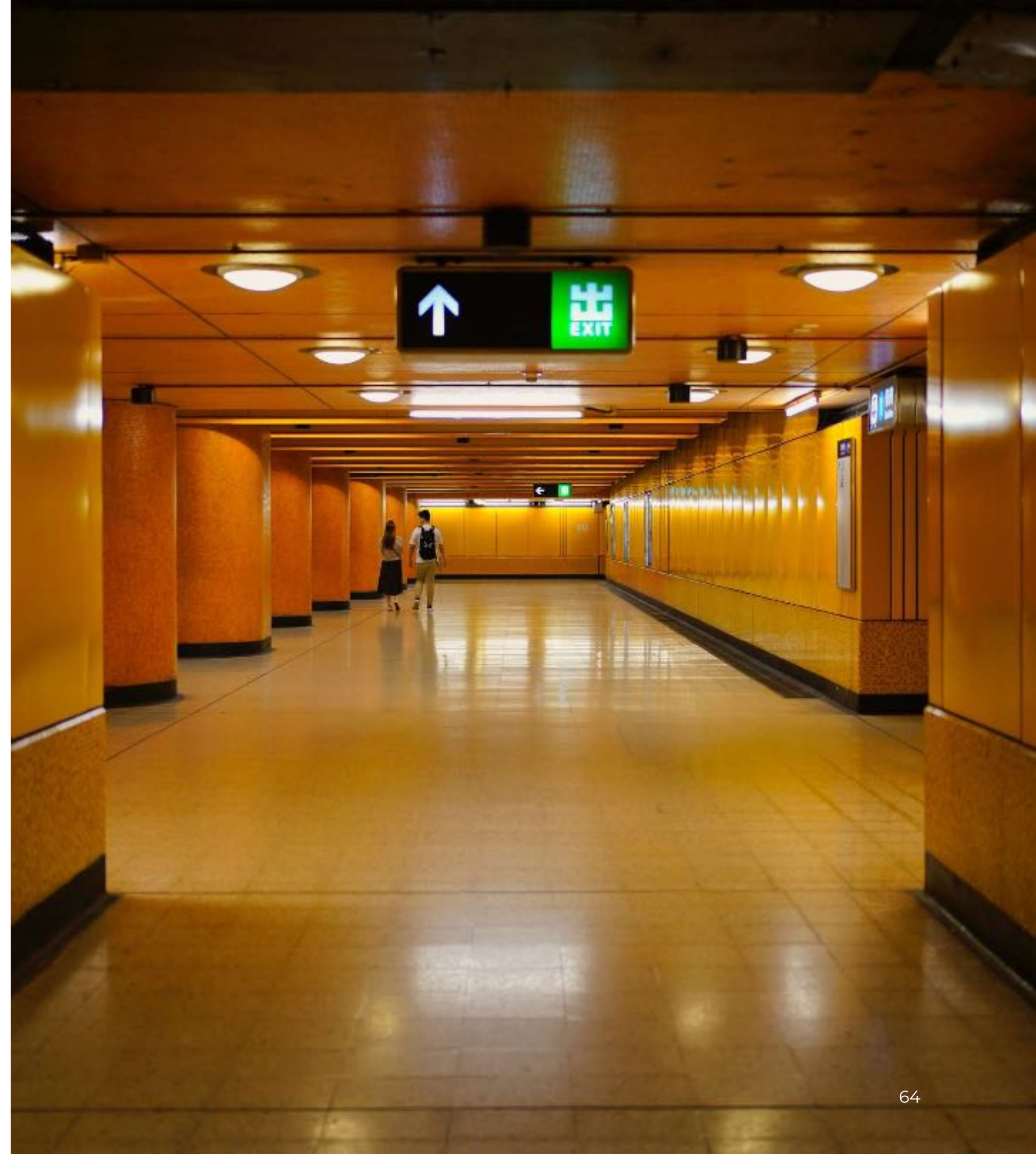
TRANSACTIONS NOT VOID OR VOIDABLE

ss. 280 + 304 SFO - a transaction is not void or voidable by reason only that it constitutes market misconduct

OFFICERS' LIABILITY

Officers' Duty

- s. 279 SFO – duty on all Listco officers to take reasonable measures to ensure that **proper safeguards exist** to prevent it from perpetrating any market misconduct
 - “**officer of a corporation**” includes a director, manager or secretary of, or any other person involved in the management of, the Listco
- s. 258 SFO – where a corporation has been identified as having been engaged in market misconduct + the market misconduct is **directly or indirectly attributable to a breach by any person as an officer of the corporation of the duty imposed on him under s.279**, the MMT can make one or more orders even if that person has not been identified as having engaged in market misconduct themselves



CIVIL LIABILITY

- Anyone who suffers pecuniary loss as a result of market misconduct has a right of civil action to seek compensation



CRIMINAL LIABILITY

- s. 390 SFO – where it is proved that an offence committed under Part XIV was aided, abetted, counselled, procured or induced by, or committed with the consent or connivance of, or attributable to the recklessness of, any officer of the corporation, or any person purporting to act in any such capacity, that person, as well as the corporation, is guilty of the offence + liable to be punished accordingly

DISCIPLINARY PROCEEDINGS

- Under Part IX SFO – any regulated person who is guilty of misconduct or who, in the opinion of the SFC, is not a fit and proper person to be or to remain the same type of regulated person, is subject to a range of disciplinary procedures
- “Misconduct” = any contravention of the SFO or of the terms of any licence issued or registration
- Examples of disciplinary orders:
 - revocation or suspension of a person's licence in respect of all or any regulated activities
 - a fine not exceeding the greater of HK\$10 mln or 3 x the profit gained or loss avoided
 - prohibition orders
 - suspension or revocation of approval as a responsible officer



DISCIPLINARY PROCEEDINGS (CONT'D)

- Persons covered by the disciplinary proceedings provisions:
 - Corporations licensed under the SFO
 - Their Responsible Officers + persons involved in their management
 - Authorised financial institutions + their executive officers, persons involved in the management of their regulated business + individuals named in their register as carrying on a regulated activity



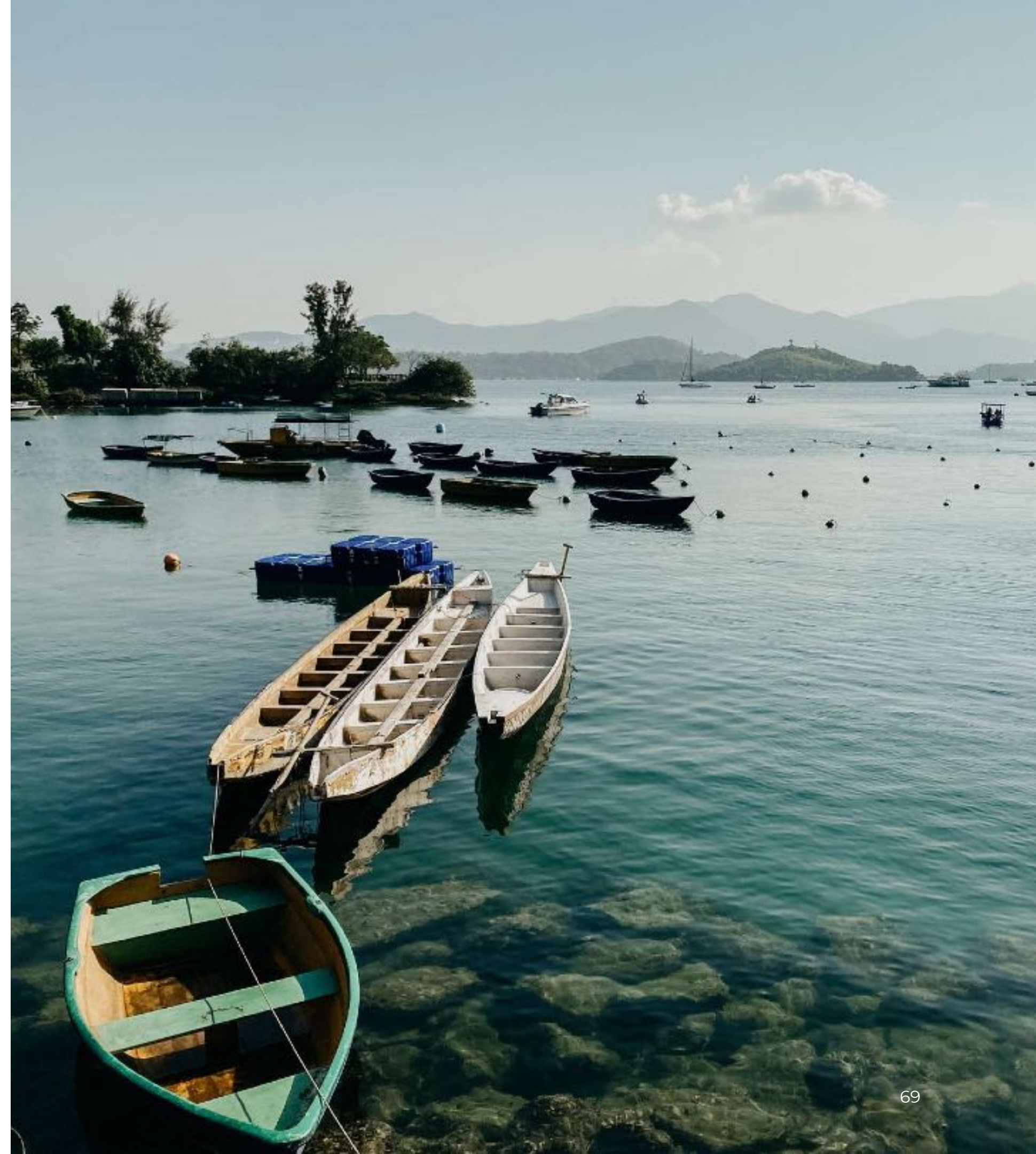
PROCEEDINGS UNDER S. 213 THE SFO

s. 213 – on the application of the SFC, CFI can grant orders to prevent or remedy breaches of the SFO + other relevant ordinances

PROCEEDINGS UNDER SECTION 213 OF THE SFO (CONT'D)

s. 213 of the SFO also covers:

- aiding, abetting or assisting, counselling or procuring another person to commit a breach of the SFO
- inducing, by threats, promises or otherwise, another person to commit a breach of the SFO
- directly or indirectly being knowingly involved in, or a party to, a breach of the SFO
- attempting or conspiring with others to commit a breach of the SFO



PROCEEDINGS UNDER S. 213 SFO – REMEDIES

Injunctions + orders

- requiring the person to take steps to restore the parties to a transaction to the position they were in before the transaction OR
- restraining or prohibiting a person from acquiring, disposing of or dealing in any property

CFI must satisfy itself that:

- it is **desirable** to make one or more of the order(s) +
- that the order(s) will **not unfairly prejudice** any person



SFC v. TIGER ASIA

- Tiger Asia received confidential + price sensitive information regarding placements of the shares of 2 banks
- It then took short positions in the banks' shares before the placings were announced to the public + made a substantial profit
- Tiger Asia also manipulated the CCB share price downwards during the closing auction session
- Court ordered Tiger Asia + the 2 senior officers to pay around HK\$45.3 million to investors affected by their insider dealing

Case confirmed CFI's ability to make orders sought by SFC under s. 213 without a prior finding of insider dealing (or other market misconduct by the MMT or a criminal court



HKSAR V. DU JUN

- Du Jun was convicted of insider dealing in the shares of China Resources Holdings and sentenced to 6 years' imprisonment + fined HK\$1.7m
- In civil s. 213 proceedings, court granted a restoration order against Du Jun, ordering him to pay HK\$23.9 mln to 237 affected investors

Case demonstrated that SFC can pursue criminal insider dealing proceedings + s. 213 civil proceedings for investor compensation



RE. TELEEYE HOLDINGS LIMITED (“TELEEYE”)

- 2016 - Ms. Yik acted as TeleEye’s controlling shareholder’s representative in negotiating proposed takeover of TeleEye
- She bought 22.7 mln TeleEye shares through accounts she controlled before the takeover was announced
- TeleEye’s share price rose 70% on announcement of the takeover
- She then sold 15 mln shares making a profit of almost HK\$13 mln
- SFC brought s. 213 proceedings
- 2017: COFI granted Mareva injunction over Ms. Yik’s assets + 2 other defendants agreed to pay HK\$ 13 mln into court



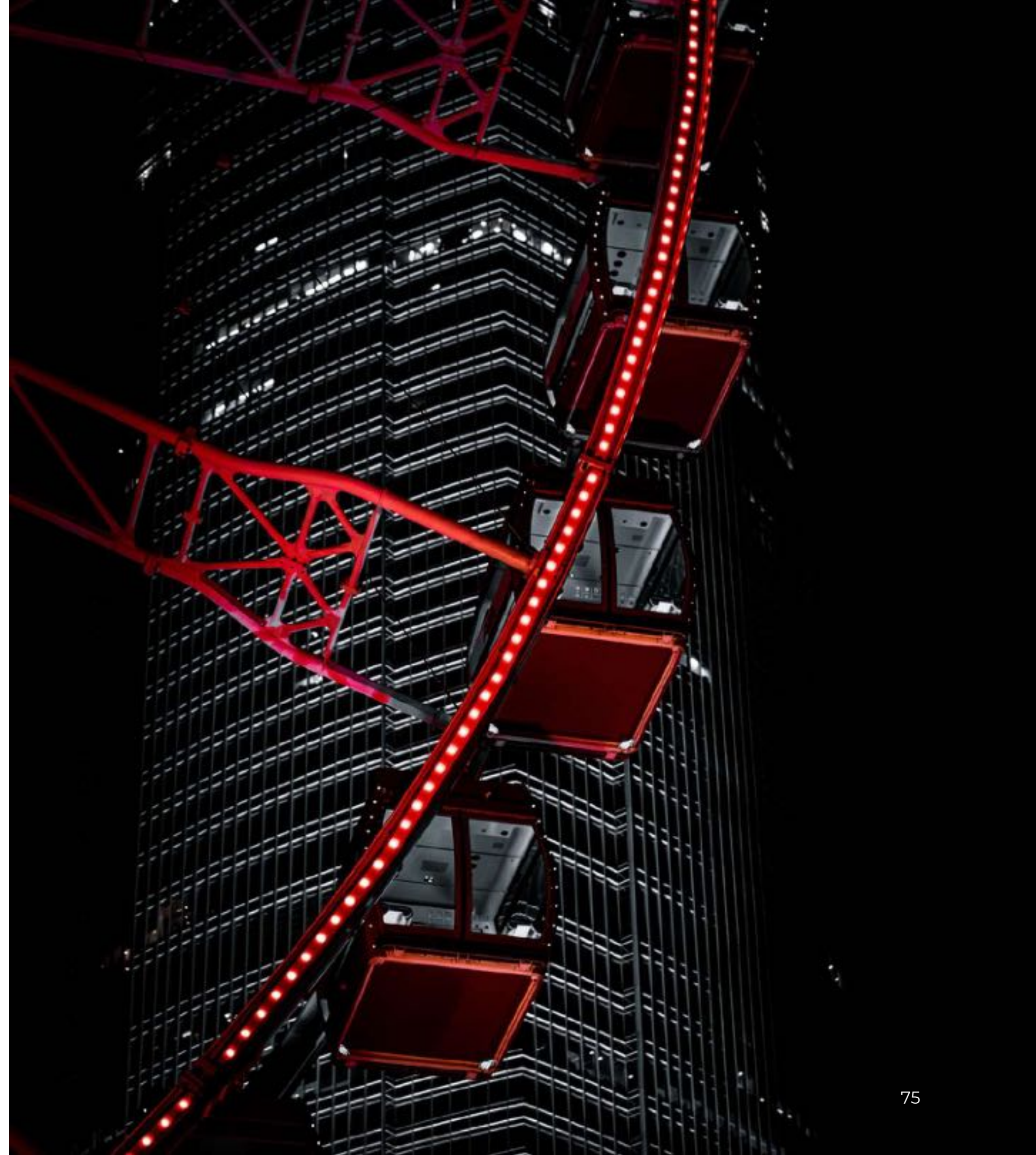
RE. TELEEYE HOLDINGS LIMITED CONT'D

- 2021 - Ms. Yik convicted of insider dealing
- She was a person connected with TeleEye – acted as selling shareholder’s representative in negotiations with buyer + involved in negotiating takeover
- That information was “specific information” + not generally known – not in dispute
- Material impact on share price was shown
- Was ample evidence that Ms. Yik knew the information was inside information
- 2 other defendants also convicted – they dealt in TeleEye shares having information they knew was inside information which they received from someone they knew to be connected with TeleEye
- In s. 213 proceedings, court ordered payment of HK\$13 mln to share sale counterparties



LEUNG PAK KEUNG – CASH FINANCIAL SERVICES GROUP (CFSG)

- April 2019 - SFC commenced proceedings v Mr. Leung (Leung), a practising solicitor, in relation to insider dealing in shares of CASH Financial
 - Leung was advising on a proposed acquisition of a 44% interest in CASH Financial
 - He allegedly bought > 2mln CASH Financial shares while in possession of inside information
 - He sold 1.2 mln shares after the proposed acquisition was announced resulting in profit of >HK\$ 45,000
- Eastern Magistrates' Court acquitted Leung in April 2021 because:
 - The witness provided conflicting evidence +
 - It was not demonstrated beyond reasonable doubt that Leung knew the information was inside information
- The SFC is reviewing the decision



CHOW CHIU CHI – CHINA AUTOMATION

- Dec. 2020 - Eastern Magistrates' Court convicted Mr. Chow (Chow), co. sec. of China Automation of insider dealing in its shares
- Chow sentenced to 45 days' imprisonment + fined HK\$45,000
- Chow purchased 534,000 shares through his wife's securities account on learning of a possible general offer + being instructed to arrange suspension of trading on 11 April 2016
- Trading was suspended on afternoon of 11 April + China Automation published an announcement on 12 April about the possible general offer
- On resumption of trading on 13 April, the share price rose 18.81% from the previous closing price
- Between 14 – 21 April 2016, Chow sold China Automation shares making HK\$7,417 profit
- Notional profit of the remaining unsold shares was HK\$36,865
- Chow, by virtue of his position, had access to inside information + used it to profit from trading shares gaining an unfair advantage in the market + abused the co's trust



SFC V. CHAN PAK HOE PABLO

- Chan was found guilty of insider dealing + initially sentenced to 240 hours of community service + ordered to pay SFC's investigation costs
- On review, Eastern Magistrates Court sentenced Chan to 4 months' imprisonment + fined HK\$120,000
- On appeal, the CFI restored the original sentence - the Magistrate lacked jurisdiction to grant the application for review of a sentence once notice of appeal had been lodged
- CFA reversed that decision – a pending appeal against one part of a Magistrate's decision **does not preclude** review of another part. The 4 months' imprisonment + fine were restored
- Hon. Justice Ribeiro clarified that **the appropriate sentencing** for insider dealing cases is a **custodial sentence** + a fine to disgorge all profits made from insider dealing



INSIDER DEALING IN LISTCO PRIVATISATIONS

BLOOMAGE BIOTECHNOLOGY CORPORATION LIMITED (“BLOOMAGE”) PRIVATISATION

- Former executive general manager of China CITIC Bank International Limited, Mr Wu, worked on a loan to finance the privatisation of Main Board-listed Bloomage
- Wu bought >1 mln Bloomage shares before the privatisation was made public + made HK\$3 million on share sale after the privatisation was announced

I.T LIMITED PRIVATISATION

- Suspected insider dealing in shares of I.T. Limited (“IT Ltd”)
- Ms Tsang was a manager at an investment bank + allegedly tipped off Mr. Kwok re. privatisation of IT Ltd
- They bought 2.8 mln IT Ltd shares before the planned privatisation was announced
- When share price rose 44.8% on announcement of the privatisation, they sold the shares making a profit of > HK\$4 mln
- May 2023: COFI granted freezing orders over assets of Ms Tsang + Mr. Kwok under s.213 SFO

BRIGHT SMART SECURITIES INTERNATIONAL (H.K.) LIMITED

- Aug. 2022 – SFC issued restriction notice to Bright Smart – an SFC-licensed broker – freezing assets held in a client account holding proceeds of suspected insider dealing
- Notice issued under ss. 204 + 205 SFO – allow SFC to issue a written notice prohibiting a licensed corporation from disposing of, or dealing in, any property it holds on behalf of its clients
- As Bright Smart was not suspected of insider dealing, the notice did not affect its operations or other clients
- SFC considered issued of restriction notice to be desirable + to serve the interests of the public as it prevented dissipation of proceeds of suspected insider dealing held in clients' accounts



UPCOMING CHANGES TO THE SFO INSIDER DEALING PROVISIONS

SFC Consultation Conclusions on Proposed Amendments to Enforcement-related Provisions of the SFO published 8 August 2023

- SFC will adopt proposed changes to widen the territorial scope of HK's insider dealing regime
- Current regime does not apply to:
 - securities that are only listed overseas (or their derivatives), even if relevant conduct is perpetrated in HK
 - insider dealing involving HK-listed securities (or their derivatives) where relevant conduct is perpetrated outside HK
- SFC will extend SFO insider dealing to include:
 - insider dealing perpetrated in HK involving securities listed on overseas stock markets or their derivatives +
 - insider dealing perpetrated outside HK, if it involves HK-listed securities or their derivatives



INSIDER DEALING IN HK INVOLVING OVERSEAS-LISTED SECURITIES OR THEIR DERIVATIVES

- Suspected insider dealing in HK of overseas-listed securities (or derivatives) – options 1) give intelligence to overseas securities regulators or 2) rely on SFO's fraud or deception market misconduct provisions
- Young Bik Fung case, SFO insider dealing provisions did not apply because the company was not listed in HK
- CFA determined that s. 300 SFO had been breached + granted orders under s. 213 SFO
- But difference in nature and amount of relief between s. 300 + insider dealing



INSIDER DEALING IN HONG KONG INVOLVING OVERSEAS-LISTED SECURITIES (OR THEIR DERIVATIVES) (CONT'D)

- In another case, an HK licensed intermediary dealt in overseas-listed securities before the announcement of a placing
 - Intermediary had inside information provided by another HK-based intermediary when it dealt
 - Apart from the mechanics of trading, the acts relating to the offence occurred in HK
 - Inadequate evidence to demonstrate suspect engaged in fraudulent or deceptive acts – precluded action under s. 300 SFO
- S. 300 is a criminal offence: criminal standard of proof applies
 - No civil equivalent provision under Part XIII



INSIDER DEALING IN HONG KONG-LISTED SECURITIES OR THEIR DERIVATIVES WHICH TAKES PLACE OUTSIDE HK

- SFO insider dealing provisions currently do not explicitly apply to insider dealing involving HK-listed securities or their derivatives where insider dealing occurs outside HK
 - To determine territorial jurisdiction, SFC applies common law test of whether a substantial measure of the crime's activities took place in HK
- > 60% of insider dealing cases handled by SFC 2017-2021 related to insider dealing perpetrated outside HK in HK-listed securities or their derivatives
- SFO insider dealing regime will be expanded to cover any act which takes place outside Hong Kong involving HK-listed securities or their derivatives
- Amended provisions will also apply to OTC transactions in overseas-listed debt securities



UPCOMING CHANGES TO SFO INSIDER DEALING PROVISIONS (CONT'D)

- Amend definition of “listed” in ss. 245(2) + 285(2) to include overseas-listed securities + their derivatives
 - Definition currently only covers securities listed on a “recognised stock market”, i.e. the stock market operated by HKEX, or their derivatives
- Add new section to Parts XIII + XIV SFO to expand territorial scope of insider dealing to cover acts of insider dealing involving:
 - HK-listed securities or their derivatives regardless of where they occur +
 - overseas-listed securities or their derivatives if any one or more of such acts occur in HK provided the conduct is also unlawful in the relevant jurisdiction
 - but acts in relation to overseas listed-securities only unlawful if the conduct is also unlawful in jurisdiction of the securities’ listing
- Repeal ss. 270(2) + 291(7)
 - presently extend scope of insider dealing to dealings in securities dually-listed in HK + overseas (or their derivatives), as will be redundant





UPCOMING CHANGES TO SFO INSIDER DEALING PROVISIONS (CONT'D)

- Amend section 271(5) of the SFO - Off-market dealings defence
 - to make the defence available to insider dealing involving overseas-listed securities or their derivatives
- Align the 2 mens rea formulations for insider dealing taking place through disclosure of inside information by adopting formulation in ss. 270(2)(b) + 291(7)(b)
 - Mens rea element for ss. 270(2)(b) + 291(7)(b) which apply to dually-listed securities or their derivatives is met if:
 - person disclosing inside information knows or has reasonable cause to believe that the **other person to whom the information is disclosed “or some other person”** will deal
 - Mens rea element of other ss 270 + 291 sub-sections which apply to securities listed **only** in HK or their derivatives is met if:
 - person disclosing inside information knows or has reasonable cause to believe that **only “the other person”** to whom the information is disclosed will deal in the listed securities or their derivatives
 - The formulation of mens rea that applies to HK-listed securities or their derivatives is currently narrower - does not cover “some other person” dealing