

Welcome to the third 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 suggest points to think about when listed companies make announcements and disclose information. We highlight some specific issues that relate to the various platforms for making announcements and publishing information.

We make it clear that listed companies should strive for accuracy, clarity and balance when making announcements. There is some related analysis of market movements and volatility. We also make some comments about when trading may be resumed in Hong Kong whilst trading suspensions remain in place elsewhere.

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

- Disclosure using websites and social media
- Avoidance of incomplete or misleading statements
- Objective is accuracy, clarity and balance
- Trading suspensions and resumptions for companies listed in multiple jurisdictions

How inside information should be disclosed

Section 307C of the Securities and Futures Ordinance (SFO) provides that inside information must be disclosed in a manner that can provide for equal, timely and effective access by the public.

Whilst the legislation does not set out a particular system that must be used to ensure such disclosure, a company will be considered as complying with the statutory requirement if it has disseminated the inside information through the electronic publication system operated by the Hong Kong Exchanges and Clearing Limited (HKEX), ie, the HKExnews website. In addition, under the Listing Rules, a listed company is required to publish announcements of inside information through HKEX's platform.

A company using other means to communicate inside information to the public may run the risk of uneven disclosure. There is less certainty that alternative methods allow every investor to have equal and effective access to the same information at the same time. A company may thereby create unfair advantages for some market participants and potentially prejudice the interests of other investors. The following sections set out how disclosure made solely on a company's website or through social media may create problems.

Posting on corporate website – equal?

A company's website may be a useful platform for more sophisticated investors or analysts to find detailed information about a company, including its goals, aspirations and financial performance. However, not all members of the investing public may closely follow the information published periodically on a company's website. This may give those investors who keep a close eye on the corporate website an advantage over those who do not.

There have been instances when the market reacted to information which was posted exclusively on a company's website but may not have been generally known to the public. For example, one listed exploration company posted a general press release on its website about a major breakthrough at one of its sites. The share price surged by over 50% on the next trading day despite the fact that the breakthrough was not reported in the media. In the absence of other news or announcements, it is reasonable to conclude that the significant price movement was related to the press release. Those investors who spotted the press release and bought the company's stock were likely to be better off than investors who were not aware of the breakthrough despite following the company on HKExnews.

Posting on corporate website – effective?

Listed companies need to ensure that they handle press releases with care. Press releases that relate to developments at the company but do not amount to inside information and are not required to be announced under other regulatory provisions, such as the Listing Rules, should not be released through the HKExnews system. In such cases it may be entirely appropriate for such a press release to be issued exclusively through the company's own website. However, it is still important to make clear the significance of the announcement and provide sufficient context for readers to understand its impact on the company's affairs.

One company concluded that the signing of a particular contract did not amount to inside information. Nevertheless, it made an announcement through its website that referred to the new contract and suggested that it was a major step forward for the company. In fact, the impact of the contract on the financial performance of the company was very limited and as a consequence the subsequent rise in the company's share price was disproportionate. Investors who read the press release would have made decisions about whether to trade after receiving a potentially misleading impression of the contract's significance.

Posting on corporate website – timely?

Listed companies should ensure that they have a clear understanding of how inside information is disclosed using their own website, even when the information is intended to be published simultaneously through the HKExnews system.

This point made headlines in April last year when Twitter's own financial results were released nearly two hours ahead of schedule by a data mining company using software that is relatively easily obtained.

Twitter at that time used a standard formulation for its URLs (or web addresses) and so it was possible to predict what URL would be used to post its upcoming results announcement on its website. The data mining company used a "web-scraping" to search for the predicted URL on a continuous cycle. Within seconds of Twitter uploading the pdf file in preparation for its formal release, the web-scraping had downloaded it. Seconds later, various algorithms automatically processed the document and extracted its key features. The results were then published, via Twitter, and Twitter's share price moved less than ten seconds afterwards as trading volume spiked. Of course, rather than publishing the results via Twitter, it would have been equally possible for the automated system to pass the information privately to a single trading desk.

Clearly this event raises a number of issues that should be considered by listed companies. The responsibility for preventing such a breach of confidentiality lies with the listed company and, under section 307G of the SFO, with the officers of the listed company.

Use of social media

Key executives occasionally use social media, such as Weibo, Facebook or Twitter, to update the market about their company's operating performance and latest developments. Registered users who subscribe to the executives' news feed may receive an instant message when a new post appears, whereas other stakeholders may not be alerted and only pick up the news at a later time. Such messages may also have inbuilt limitations, such as restrictions on the number of characters that can be used to compose a message. Many embarrassed individuals have had to explain what they *really* meant after posting a brief message without any preamble or context which may have made the meaning clearer.

There have been instances of the market reacting to information posted by a company's senior management on social media. On one occasion, a director of a retail company talked about the full-year sales target through his personal social media account. The expected sales growth figure he gave was a significant drop compared with the sales growth of the previous year. The share price of the company fell significantly shortly after the post. Shareholders who did not follow the director on social media were less likely to be aware of the company's negative outlook. They were denied the chance to take this information into account when considering their investment decisions.

Incomplete or misleading statements

Where a company makes a disclosure through the corporate website or social media, there is a greater risk that it pays less attention to the content of the information. Section 307B of the SFO provides that any inside information disclosed must not be false or misleading as to a material fact, or false or misleading through the omission of a material fact.

There have been instances where corporate communications contained piecemeal, unbalanced or inaccurate information which could make them sufficiently false or misleading to be regarded as a breach of the SFO. For example:

- A listed company announced that it had signed a major contract without disclosing any details of the terms. The company's share price rose significantly after the announcement. Subsequently, the financial statements revealed that the profit generated from this contract was minimal. The company's share price drifted downwards after the financial results became clearer. Investors who traded on the possible upside of the contract might not have bought the shares if they had been provided with more complete details of the terms of the contract and sums involved, which were known to the company at the time of the first announcement.
- A company posted its operating statistics on its corporate website and they showed a notable increase in sales volume for the year. A few days later, the company published a profit warning disclosing a significant drop in its net profit for the year despite the increased sales volume, due to a substantial fall in its selling price. The company's share price plunged after that announcement. Those investors who bought the shares based on the operating statistics may have suffered financial losses.
- A senior executive of a company mentioned the product sales target for the coming year in a call with analysts. The target indicated a substantial slowdown of business. Some analysts immediately downgraded the company and the share price fell sharply on the next trading day. The company subsequently issued an announcement clarifying that the sales target quoted by the executive was a personal view and the company had not prepared such a figure. Investors in such circumstances are left wondering who to believe.

Potentially questionable announcements

Sometimes companies make statements of seriously questionable validity, which could in the most extreme cases be regarded as false or misleading as to a material fact, or false or misleading through the omission of a material fact.

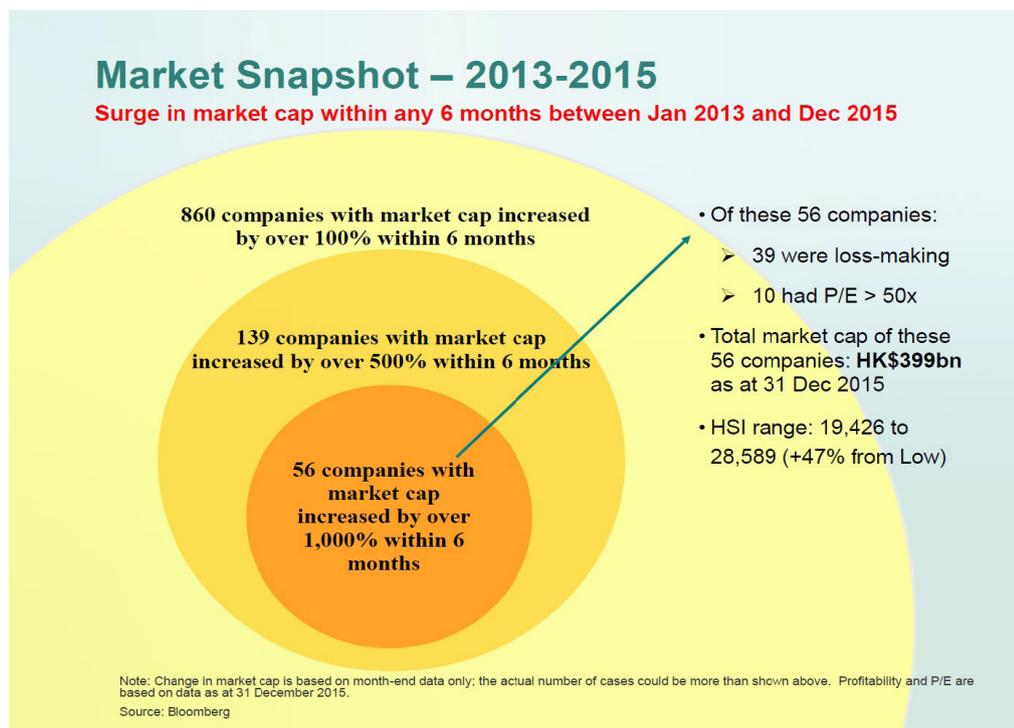
- When a company issues bonus shares to its shareholders, it could be construed as misleading if it is described as "a reward". As the shareholders already own 100% of the issued shares, issuing further shares on a pro rata basis simply spreads the value of the company over a larger number of shares and so can hardly be described as a reward, whether for long-term shareholding or any other reason.
- Similarly, the issuance of bonus shares does not have the effect of "widening the capital base of the company". Issuing bonus shares does not involve the raising of capital and it is hard to see how it could be accurately described as widening the capital base (other than spreading the share capital over a larger number of shares).

Strive for accuracy, clarity and balance

Selective or uneven dissemination of inside information will undermine market integrity. Public disclosure made by a company or its officials should be accurate, complete and not misleading. The objective should be to present both good news and bad news equally, in a clear and balanced way without glossing over or omitting any material facts. The disclosure should contain sufficient details for investors to make a reasonable and realistic assessment of the company's affairs.

Where there is insufficient or delayed disclosure of corporate developments there is always a risk that rumour or ill-informed speculation fills the void and in such circumstances investors may be disadvantaged.

The importance of transparency and the need to provide appropriate information to investors was stressed in a presentation at the SFC Regulatory Forum 2016 held on 23 February. The full presentation is available on the SFC website, and two slides in particular are directly relevant to this issue.



There may be various reasons why a market valuation moves substantially away from one based on fundamental analysis. But when this happens, it is likely to be associated with problems linked to disclosure and as a consequence investors may lose out.

Volatility of Newly-listed GEM Companies

- Highly volatile post-IPO share price performance in 2015
- Average first-day increase from offer price: **7 times**

Most volatile newly-listed GEM companies in 2015*

Company	Business sector	First day price change from IPO price	Highest price vs IPO price	Peak market cap (HK\$'bn)	Decrease from peak (%)
Company A	Software development	+21 times	+21 times	8.8	-98%
Company B	Construction	+17 times	+17 times	5.0	-97%
Company C	Magazine publishing	+10 times	+17 times	4.7	-97%
Company D	Video conferencing/multimedia audio-visual solutions	+14 times	+15 times	5.9	-97%
Company E	Construction	+12 times	+17 times	4.6	-97%

*In terms of price change from offer price to peak closing price
Note: Data as of 31 Jan 2016
Source: Bloomberg

Companies listed in multiple jurisdictions

Some companies are listed in more than one jurisdiction. Whilst various regulatory regimes are motivated by similar objectives, the impact of different sets of rules for listed companies can lead to different regulatory outcomes.

Hong Kong operates under a strongly disclosure-based regime. When a listed company becomes aware of inside information, it is under a statutory obligation to disclose that information as soon as practicable, unless it is covered by one of the exceptions to disclosure set out in the legislation. One of the more commonly used exceptions is if the information relates to an incomplete proposal or negotiation (section 307D(2)(c)(i) of the SFO).

Where a company has requested suspension of trading of its securities because it has inside information to disclose, the suspension should be kept as short as possible. As HKEX made clear in its Guidance Letter issued in December 2015, "*The duration of any trading halt should be for the shortest possible period. Listed issuers are obliged to ensure that trading of their securities resume [sic] as soon as practicable following the publication of an announcement or when the reasons for the trading halt no longer apply*".

Some listed companies may also be subject to regulatory regimes that require suspension of trading of their securities whilst other processes continue. For market integrity reasons, it may be generally desirable for suspensions to be simultaneously imposed in different jurisdictions. However, as the Guidance Letter makes clear, if the reason for requesting a suspension of trading in Hong Kong is that the company has inside information to disclose, then that information should be disclosed as soon as practicable and trading resumed shortly afterwards.

Where a listed company requests a suspension on the grounds that it has inside information to disclose, the SFC may take action to determine what this information is and the reasons why it cannot be disclosed immediately. The SFC may choose to write formally requesting details of the information that cannot be announced immediately or use statutory powers to require a listed company to provide this information. Where on further consideration by the company there is no inside information to be disclosed or the inside information is announced, trading can be resumed. This may mean that trading of securities listed in Hong Kong resumes, whilst trading in other securities of the listed company in other jurisdictions remains suspended.

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