

Directors' blackout period in Hong Kong – a test of Corporate Governance in Hong Kong

Date: January 22, 2009

The asymmetry of information and blackout periods is a sub-issue of quarterly reporting in Hong Kong, another controversial and so far inconclusive debate, although we have not addressed it in any detail in this article.

Background information on reporting timelines in Hong Kong

Hong Kong requires publicly listed companies to report financial results only twice per year compared to quarterly in other major markets such as the United States, the United Kingdom, Singapore, even China.

In Hong Kong, financial results must be published no later than three months after the end of the interim financial period, and four months for the full year results. This time delay contrasts with other developed markets; for example, in the United States, results are published within forty days for quarterly periods and sixty days for full financial years. For Hong Kong securities, this time lag creates significant information asymmetries between insiders (directors or otherwise) and the trading public (often minority shareholders).

The existing blackout period in Hong Kong is one month prior to the publication of results, which again is considerably shorter than say, sixty days in the UK and hence offers a longer period during which directors may trade. It has been argued that directors almost certainly have knowledge of a company's performance during the prior period any time from the beginning of that period, with increasing knowledge as the period progresses, and especially during the two months after the period end towards the blackout. Outside investors however, are trading on financial information that can be up to ten months' old if we consider the last published interim results (say June) to the following April which is when a company whose year end is December would be required to publish. Another question that must be asked is: Do companies that delay results publication do so in order to allow director transactions to fall outside the blackout period?

Research suggests that insider trading does occur, and blackout periods do curb trading

Research indicates that blackout periods curb insider trading. One study^a by academics from Arizona and Utah Universities found that "blackout periods successfully suppress trading by insiders..."

Three Hong Kong-based professors examined the issue surrounding the Hong Kong market. In their 2005 study^b, they examined well over 3000 events from the 1993 – 1999 period and found that "the presence of insider trading.... [is] related to the signals of these simultaneous earnings and dividends announcements." In other words, that insider trading is rife around the time of publication of financial results (earnings or dividend announcements).

In a 2008 paper^c, again concerning Hong Kong specifically, local academics found that "there are significant net-insider-buying activities before the announcements of good newsand significant net-insider-selling activities before bad news"

The proposed extension to the blackout period and the resulting controversy

The Hong Kong Stock Exchange (HKSE) began a consultation on 11th January 2008 and received over 100 responses^d; it published its conclusions^e on 28th November 2008. Page 55, point 281, discusses the findings to the proposal that "the current 'black out' periods should be extended to commence from the listed issuer's financial period end date to the date on which the listed issuer published the relevant results

announcement.” resulting in HKSE adopting the relevant rule amendments. The new amendments were due to take effect from 1st January 2009.

In the days leading up to the New Year, directors of 238 listed companies collectively published an open letter to the exchange opposing the extension of the blackout period. The letter put sufficient pressure on the HKSE that it agreed to defer the effective date of the new blackout period until 1st April 2009. The Listing Committee of the HKSE has met several times to discuss the issue, however it has not yet come to an agreeable solution on how to move forward with the original extension approval, given the opposition from directors.

The Asia Sentinel^f highlights a number of high profile cases concerning insider trading in Hong Kong, all of which further points towards the existence of such activities and could be considered as a prime reason for why so many directors oppose the blackout extension.

Issues surrounding the blackout period and beyond

Actual prosecution of insider dealing cases in Hong Kong may be limited because of the reluctance of market enforcers, the Securities and Futures Commission (SFC) which incidentally, only stepped into the debate in mid-January. Also, the insiders involved may also be connected to Government institutions or many more large corporations in the territory.

The number of signatories to the open letter to the exchange was quite unnatural for directors of Hong Kong companies, not least because they acted collectively. It may be however, that the same directors signed on behalf of different entities which, in our view, ought only to be counted as one signatory. Also, there could be governance issues to deal with in cases where directors might have spent shareholders’ money to secure the signatories – in our view in direct contradiction to the rights of minority shareholders.

One final issue that has come to light is that the views of investors might have been under-represented in the ‘official count’. The notable example is that in an opinion poll conducted by Webb-site.com^g, an overwhelming 463 out of 475 (97.5%) respondents were in favour of prohibiting directors from dealing in shares from the end of the financial period until the publication of those financial results; these 463 respondents were likely counted as only “one vote” under the submission^h by Webb-site.com.

ASrIA supports the extension of the blackout period.

In ASrIA’s opinion, governance in the Hong Kong market would be strengthened, or at least brought more in-line with other major international markets, if the blackout period was extended as per the conclusions of the consultation. Directors would avoid giving the appearance of insider trading or a conflict of interest because no dealing after the period end would preclude issues concerning ‘insider information’. Directors wishing to trade the stock of their companies would be encouraged to publish financial results on a more timely basis, creating a more level playing field for investors. A more level playing field would make Hong Kong a more competitive market, attract more capital investment, and demonstrate its maturity amongst regional peers.

We encourage individuals to support the extension of the blackout period. If you support this view and wish to make your opinion count, **please download the following letter**, sign it and send it to the Hong Kong Stock Exchange.

<Download the letter: http://www.asria.org/publications/lib/Directors_Blackout_letter.doc>

By email: cvw@hkex.com.hk

By fax: (+852) 2524 0149

Or by mail: Corporate Communications Dept.
Hong Kong Exchanges and Clearing Ltd.
12th Floor, One International Finance Centre
1 Harbour View Street, Central
Hong Kong

Further resources

Consultation Conclusions: Proposals in the 2008 Combined Consultation Paper
<http://www.hkex.com.hk/consul/conclusion/cc200811.pdf>

More background information into certain issues

<http://webb-site.com/articles/blackout.htm>

<http://webb-site.com/articles/blackout2.htm>

News articles

The Financial Times (29 December 2008)

http://www.ft.com/cms/s/0/60a2d9ea-d5d3-11dd-a9cc-000077b07658.html?nclick_check=1

The Standard (30 December 2008)

http://www.thestandard.com.hk/news_detail.asp?we_cat=4&art_id=76386&sid=22065153&con_type=1&str=20081230&fc=2

The Asia Sentinel (6 January 2009)

http://www.asiasentinel.com/index.php?option=com_content&task=view&id=1649&Itemid=224

The Standard (8 January 2009)

http://www.finance.thestandard.com.hk/en/business_news_view.asp?aid=76772

The Standard (14 January 2009)

http://www.thestandard.com.hk/news_detail.asp?pp_cat=30&art_id=77031&sid=22236642&con_type=3

The Standard (16 January 2009)

http://finance.thestandard.com.hk/en/business_news_view.asp?aid=77145

Mingpao (15 January 2009, in Chinese)

http://www.mpfinance.com/htm/Finance/20090115/News/ec_ea1.htm

Endnotes

^a Bettis, J. Carr, Lemmon, Michael L. and Coles, Jeffrey L., Corporate Policies Restricting Trading By Insiders, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=76649

^b Cheng, Louis T. W., Szeto, Ricky W. F., Leung, T. Y., Insider Trading Activities Before the Simultaneous Announcements of Earnings and Dividends, <http://ideas.repec.org/a/wsi/rpbfmp/v08y2005i02p279-307.html>

^c Cheng, Louis T. W. and Leung, T. Y., Is There Information Content from Insider Trading Activities Preceding Earnings and Dividend Announcements in Hong Kong?, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1224072

^d List of responses to the Consultation Paper, http://www.hkex.com.hk/consul/response/combined_cp.htm

^e Consultation Conclusions: Proposals in the 2008 Combined Consultation Paper, <http://www.hkex.com.hk/consul/conclusion/cc200811.pdf>

^f Keeping the Trading at Home in Hong Kong, by Stephen Vines, http://www.asiasentinel.com/index.php?option=com_content&task=view&id=1649&Itemid=224

^g Opinion poll results can be found at <http://webb-site.com/vote/result.asp?p=25>

^h Response number 104 to the Consultation Paper, http://www.hkex.com.hk/consul/response/combined_cp.htm