

**立法會**  
**Legislative Council**

LC Paper No. CB(1)230/02-03  
(These minutes have been seen  
by the Administration, the  
SFC and the HKEx)

Ref : CB1/PL/FA/1

**Legislative Council**  
**Panel on Financial Affairs**

**Minutes of special meeting held on**  
**Wednesday, 31 July 2002 at 2:30 pm**  
**in the Chamber of the Legislative Council Building**

- Members present** : Hon Ambrose LAU Hon-chuen, GBS, JP (Chairman)  
Hon Henry WU King-cheong, BBS, JP (Deputy Chairman)  
Hon James TIEN Pei-chun, GBS, JP  
Hon LEE Cheuk-yan  
Hon Eric LI Ka-cheung, JP  
Hon NG Leung-sing, JP  
Hon Bernard CHAN, JP  
Hon CHAN Kam-lam, JP  
Hon SIN Chung-kai  
Dr Hon Philip WONG Yu-hong  
Hon Jasper TSANG Yok-sing, GBS, JP  
Hon Emily LAU Wai-hing, JP  
Hon MA Fung-kwok, JP
- Non-Panel member attending** : Hon Cyd HO Sau-lan  
Ir Dr Hon Raymond HO Chung-tai, JP  
Hon Martin LEE Chu-ming, SC, JP  
Hon Fred LI Wah-ming, JP  
Dr Hon LUI Ming-wah, JP  
Hon Margaret NG  
Hon Mrs Selina CHOW LIANG Shuk-ye, GBS, JP  
Hon CHAN Yuen-han, JP  
Hon Abraham SHEK Lai-him, JP  
Hon Albert CHAN Wai-yip  
Hon WONG Sing-chi  
Hon LAU Ping-cheung

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- Members absent** : Hon Albert HO Chun-yan  
Dr Hon David LI Kwok-po, GBS, JP  
Hon James TO Kun-sun
- Public officers attending** : Mr Frederick MA  
Secretary for Financial Services and the Treasury
- Miss AU King-chi  
Deputy Secretary for Financial Services and  
the Treasury (Financial Services)
- Mr Andrew SHENG  
Chairman  
The Securities and Futures Commission
- Mr Charles LEE  
Chairman  
The Hong Kong Exchanges and Clearing Limited
- Mr K C KWONG  
Chief Executive  
The Hong Kong Exchanges and Clearing Limited
- Ms Karen LEE  
Executive Vice President  
Listing, Regulation and Risk Management  
The Hong Kong Exchanges and Clearing Limited
- Attendance by invitation** : Mr David WONG Kwok-on  
Chairman  
Hong Kong Securities & Futures Industry Staff Union
- Mr Stephen CHEN Lai-hung  
Deputy Chairman  
Hong Kong Securities & Futures Industry Staff Union
- Mr Trini TSANG Chi-suen  
Chairman  
Hong Kong Securities Professionals Association
- Mr Wilfred WONG Wai-sum  
Chairman  
Hong Kong Stockbrokers Association Ltd

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Ms CHEN Po-sum  
Chairman  
The Institute of Securities Dealers Limited

Mr Kenneth LAM  
Director  
The Institute of Securities Dealers Limited

**Clerk in attendance** : Ms Anita SIT  
Chief Assistant Secretary (1)6

**Staff in attendance** : Ms Pauline NG  
Assistant Secretary General 1

Mr WONG Tin-yau, Anthony  
Senior Assistant Secretary (1)8

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**I      Proposals relating to the delisting mechanism announced by Hong Kong Exchanges and Clearing Limited**

Meeting with the Administration and relevant organizations

LC Paper No. CB(1)2373/01-02(01) - Press release issued by the Administration on 28 July 2002

LC Paper No. CB(1)2373/01-02(02) - Press release issued by the Hong Kong Exchanges and Clearing Limited (HKEx) on 25, 26, 27 and 28 July 2002

LC Paper No. CB(1)2373/01-02(03) - Executive summary of "Consultation paper on proposed amendments to the listing rules relating to initial listing and continuing listing eligibility and cancellation of listing procedures" issued by HKEx on 25 July 2002

LC Paper No. CB(1)2373/01-02(04) - Press release issued by the Securities and Futures Commission (SFC) on 26 July 2002

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LC Paper No. CB(1)2373/01-02(05) - Extract of article on "Quality of Market and the Case for More Effective Delisting Mechanism" issued by SFC on 25 July 2002

LC Paper No. CB(1)2374/01-02(01) - Letter addressed to the Secretary for Financial Services and the Treasury from Hon Emily LAU dated 29 July 2002

LC Paper No. CB(1)2374/01-02(02) - A joint statement in the press made by 72 listed companies and addressed to the Chief Executive, Hong Kong Exchanges and Clearing Limited, dated 29 July 2002

The Chairman welcomed to the meeting the representatives of the Administration, the Securities and Futures Commission (SFC), the Hong Kong Exchanges and Clearing Limited (HKEx) and the four industry bodies in attendance. The Chairman said that the purpose of the meeting was to discuss issues arising from the proposed amendments to the listing rules relating to the delisting mechanism announced by HKEx on 25 July 2002 and the unusual market movement of penny stocks on 26 July 2002.

2. At the Chairman's invitation to speak, SFST thanked the Panel for giving the Administration, SFC and HKEx an opportunity to clarify various issues relating to the proposals on the delisting mechanism contained in the consultation paper on "Proposed amendments to the Listing Rules relating to Initial Listing and Continuing Listing Eligibility and Cancellation of Listing Procedures" (the Consultation Paper) released by HKEx. He said that as a principal government official responsible for financial affairs, he should bear a certain degree of responsibility for the problems arising from the proposals. He then spoke on the following -

- (a) the Administration's position on the need to establish a sound delisting mechanism after thorough consultation with market practitioners and the securities industry;
- (b) the background and rationale for the three-tier regulatory framework for the securities and futures industry in Hong Kong;
- (c) the role and responsibility of the Financial Services and the Treasury Bureau (FSTB) in the preparation and release of the Consultation Paper; and

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- (d) the extent of his knowledge about the Consultation Paper before and after the penny stocks incident on 26 July 2002, and the remedial actions he had taken on and after 26 July 2002.

In conclusion, SFST said that the direction of the proposed delisting mechanism was correct. The Administration respected the independent operation of SFC and HKEx, and believed that SFC and HKEx together would work out a better set of proposals, having regard to this incident, for consultation with the market in October 2002.

*(Post-meeting note: The speaking note of SFST and the Administration's paper entitled "A tiered regulatory framework for the securities and futures industry in Hong Kong" were tabled at the meeting and issued to members vide LC Paper No. CB(1)2387/01-02(03) dated 1 August 2002.)*

3. At the Chairman's invitation to speak, Mr Andrew SHENG, Chairman of SFC, gave a speech covering two major aspects, namely, the background and rationale for the proposals on the delisting mechanism and the procedures for making changes to the listing rules of HKEx. As a concluding remark, Mr SHENG said that SFC understood that the proposals in the consultation paper of HKEx had caused a lot of market confusion and certain key issues had not been communicated fully to the public. As the statutory regulator of HKEx, SFC felt deeply and regretful about the incident and its effects on the public. Henceforth, SFC would work more closely with HKEx to ensure better and wider discussions with market practitioners and the securities industry to collect their views. SFC hoped that such incident would not be repeated in future.

4. At the Chairman's invitation to speak, Mr Charles LEE, Chairman of the board of directors of HKEx, outlined HKEx's operation and reporting structure in terms of the regulation of listed companies. In gist, in accordance with the Memorandum of Understanding (MOU) Governing Listing Matters signed between SFC and HKEx on 6 March 2000, the HKEx board had delegated all of its functions and powers in relation to listing matters to the Listing Committee of HKEx and the HKEx board would not exercise concurrent jurisdiction. Under this framework, HKEx executives of the Listing Division were directly accountable to the Chief Executive of HKEx and the Listing Committee on issues relating to the regulation of listed companies, and HKEx reported to SFC and sought SFC approval on these matters. The Consultation Paper in question was drafted by the Listing Division of HKEx. It had been discussed by the Listing Committee and approved by SFC before it was released. He then handed over to Mr K C KWONG, the Chief Executive of HKEx.

5. As an opening remark, Mr K C KWONG said that he felt deeply regretful about the losses sustained by some shareholders as a result of the market reaction to certain proposals contained in the Consultation Paper. He then spoke on the rationale of the proposed \$0.5 minimum share price criterion

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for continuing listing (hereafter referred to as "the proposed \$0.5 criterion"), and the chronology of events leading to the release of this proposal, together with other proposals, for consultation on 25 July 2002. He also made brief comments on certain issues in retrospection of the events. In his concluding remarks, he said that in the light of the experience in this incident, HKEx would further improve its consultation work, including the impending consultation on the proposed amendments to the listing rules on continuing listing eligibility. He stressed that it was necessary to improve the delisting mechanism to raise the overall quality of the local stock market and to reinforce Hong Kong's status as an international financial centre.

*(Post-meeting note: The speaking notes of Mr K C KWONG were tabled at the meeting. His speaking notes and those of Mr Andrew SHENG and Mr Charles LEE were issued to members vide LC Paper No. CB(1)2402/01-02 dated 5 August 2002.)*

6. At the Chairman's invitation to speak, Mr Wilfred WONG of the Hong Kong Stockbrokers Association Ltd. (HKSA) presented the views of HKSA on the incident. The salient points of his speech were as follows:

- (a) HKSA considered that in putting together the consultation paper, a working group comprising representatives from the securities industry should have been formed, such that the industry's views and concerns could be taken into account in drawing up the proposals.
- (b) In the past, proposals in consultation papers and the final decisions of HKEx were very similar, creating the perception that consultation papers were virtually notifications of policy changes that would be forthcoming. Such a perception had caused the strong market reaction and the prices of some penny stocks to plunge in response to the Consultation Paper in question.
- (c) The proposal in Part C of the Consultation Paper to introduce a minimum share price of \$0.50 as a continuing listing eligibility criterion had significant impact on more than 300 listed companies. On the other hand, there was inadequate explanation for the rationale of the proposal.
- (d) Hong Kong had many small to medium size listed companies trading at a share price around or below \$0.5. These companies would definitely be affected by the proposed \$0.5 criterion. HKEx should have critically assessed the impact of this proposal before releasing the consultation paper.
- (e) HKSA agreed that penny stocks could be easily manipulated and there was a need to strengthen the corporate governance of listed

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companies. However, HKEx's proposal to set a minimum share price as a continuing listing eligibility criterion was controversial and had caused panic selling of penny stocks.

- (f) HKEx should be sensitive to market sentiment and as such it was inappropriate to conduct such a consultation when investors' confidence was already weak amidst recent happenings such as the Enron and similar cases in the United States.

7. Mr Trini TSANG, Chairman of the Hong Kong Securities Professionals Association said that its views on the proposals relating to the HKEx' proposed listing amendments were as contained in its letter dated 30 July 2002 to the Panel Chairman. The letter was tabled at the meeting.

8. Mr David WONG, Chairman of the Hong Kong Securities & Futures Industry Staff Union said that the staff union had not been consulted on HKEx' proposals on the delisting mechanism. It would in due course present a paper setting out its views and recommendations to HKEx. It hoped that in future HKEx would improve communication with industry bodies in the course of developing policies or proposed changes to the listing rules.

9. Ms CHEN Po-sum, Chairman of the Institute of Securities Dealers Limited presented the institute's views as contained in its letter dated 30 July 2002 to the Panel Chairman. The letter was tabled for members' reference.

Discussion

10. The Chairman informed members that he had received a letter dated 31 July 2002 from the Financial Secretary (FS). In his letter, FS advised that he had decided to appoint an independent panel of inquiry to look into the circumstances leading to the penny stocks incident, including the arrangements for preparation and release of the aforesaid consultation paper, and to recommend measures for improvement. The Chairman further said that in response to his subsequent enquiry, the Financial Secretary had confirmed that he would be using his administrative powers to appoint the panel of inquiry. (A copy of the letter was tabled at the meeting.)

11. Ms Margaret NG recalled that the relationship between the Administration and HKEx, and the composition of the board of directors of HKEx were discussed at length at LegCo when it was proposed that HKEx should become a listed company. One of the concerns raised was that the HKEx board would comprise a number of representatives appointed by FS. The justification given by the then Secretary for Financial Services was that such a composition would facilitate the implementation of Government policies. Based on this understanding, the Administration was expected to be actively involved in and responsible for HKEx' decisions and actions. It was therefore difficult to believe, as SFST had claimed, that the Administration was not aware

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of HKEx's proposals on the delisting mechanism. Ms NG considered that SFST could not justifiably distance himself from the whole incident.

12. In response, SFST reiterated that as a principal government official, he was prepared to take a certain degree of responsibility for the whole incident. He acknowledged that he was aware of HKEx's plan to introduce proposals on the delisting mechanism, but he had not been involved in the formulation of the proposals and did not know the details of the proposals. He considered that under the current three-tier regulatory framework, it was not appropriate nor within his scope of responsibilities to interfere with the formulation and consultation processes in respect of the delisting proposals, as these were the responsibilities of HKEx and SFC.

13. Ms Margaret NG said that SFST coming on board as a new principal official since 1 July 2002, did not appear to have done enough to obtain a good grasp of the important issues under his purview which should include HKEx's proposals on the delisting mechanism. She opined that this might be a case of under-performing one's official duties.

14. SFST said that whilst he should be familiar with the policy issues under his purview, the implementation matters in relation to listing rules were the responsibilities of HKEx and SFC under the three-tier regulatory framework. He therefore could not accept the accusation that he had not duly performed his duties in this case.

15. Mr SIN Chung-kai said that SFST's claim that he had not received a copy of HKEx's consultation paper until 28 July 2002 could not serve as a good defense for SFST's lack of knowledge of the proposed "\$0.5" criterion that triggered the plunge of the prices of penny stocks on 26 July 2002. He pointed out that the proposal had been widely reported in various local newspapers on the 18, 19, 22 and 23 July 2002.

16. SFST said that he had read about the proposed "\$0.5" criterion in the newspapers. However, he had not been involved in the discussions on the details of the proposal with SFC or HKEX, nor had his contacts from the industry alerted him that there were problems with the proposal. SFST recapitulated the events surrounding the incident as follows -

- (a) he received a call on the night of 25 July 2002 alerting him that there were indications that the consultation paper released on the same day might cause adverse impact on the market;
- (b) At 11:00am on 26 July 2002, the same party called cautioning him that penny stocks displayed unusual market movements;
- (c) After a meeting in the morning of 26 July 2002, he immediately called Mr K C KWONG at about noon to enquire about the matter;



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- (d) At 12:30 pm, he clarified with the media that the proposed "\$0.5" criterion was not a confirmed policy but only a proposal for consultation with the market;
- (e) On the evening of 26 July 2002 and thereafter, he continued to clarify the matter at all public and official occasions available to him.

17. SFST further said that had he been able to predict the market reaction, he would have conveyed his concern to SFC and HKEx and urged them to consider stopping issuance of the consultation paper. He concurred that communication with the industry prior to the release of the consultation paper had not been adequate, and there could be improvement in this regard.

18. Mr SIN Chung-kai referred to Mr Andrew SHENG's speech which stated that SFC would keep the Administration informed of matters relating to board regulatory principles and policies. He then asked whether SFC had in any way informed SFST of the proposed "\$0.5" criterion, which Mr SIN considered had high relevance to broad regulatory principles. SFST said that prior to the release of the consultation paper on 25 July 2002, SFC and HKEx had not discussed the said proposal with him nor had he been given a copy of the consultation paper. SFST further said that it was after the event that he discovered from his staff that HKEx had sent a summary of the proposals contained in the Consultation Paper to his office prior to the release of the Consultation Paper. However, somehow due to the enormous amount of papers that came across his desk, he had not read the summary.

*(Post-meeting note made by the Administration: SFST clarified at the Financial Affairs Panel meeting on 16 September 2002 that while a summary table of the proposals prepared by SFC had been passed to his Private Office on 17 July 2002, he only became aware of the summary table on 26 July 2002. He had not read the summary table before the event. Another document, the Executive Summary of the consultation paper prepared by HKEx had been obtained by the Bureau on 17 July 2002. However, the document had not been passed to his Private Office and he was only aware of it on 31 July 2002. SFST further advised that he had not clarified earlier in order not to prejudice the independent inquiry of the Panel of Inquiry on the Penny Stocks Incident.)*

19. Dr Philip WONG said that while he supported the objective of establishing an effective delisting mechanism, he empathized with the reactions of the market to the proposed "\$0.5" criterion. It was understandable that the proposal had propelled them into panic selling as they feared that they would have little chance to recoup any return from the shares they were holding when the proposal became a policy in the future. Dr WONG said that he was

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surprised that the relevant authority/authorities had failed to anticipate the market's reaction, given the fact that over 300 listed companies were trading at \$0.5 or below at the time of the release of the consultation paper. Dr WONG asked if the relevant authority/authorities had considered including in the proposed delisting package a buying-back mechanism whereby the issuer or majority shareholder be required/encouraged to buy back shares from minority shareholders at a fair price when the delisting procedure was invoked. He considered that inclusion of such a mechanism might have prevented the panic selling of penny stocks.

20. Mr K C KWONG said that consideration had been given to safeguard the interest of minority shareholders in drawing up the proposed continuing listing eligibility criteria. For example, if as a result of a corporate action the share price of a listed company should fall near or below \$0.50 and put the company at risk of being delisted, the issuer would be required to obtain independent shareholders' approval prior to making such a move.

21. Mr CHAN Kam-lam said that he appreciated the apology given by Mr K C KWONG for the penny stocks crash triggered by the Consultation Paper. He noted that according to Mr KWONG's speech, SFC had been intimately involved in setting the "\$0.50" minimum share price criterion. He asked if SFC and the Listing Committee of HKEx had underestimated the reaction of the market to the proposal.

22. Mr Andrew SHENG said that when SFC reviewed the minimum share price criterion for continuing listing, the objective was to identify a threshold at which shares should be consolidated. Consolidation of shares was a measure to prevent manipulation of the prices of penny stocks. Mr SHENG said that pending SFC's investigation into the unusual market movement of penny stocks on 26 July 2002, it was difficult to say whether the market reaction on that day had been under-estimated. He however acknowledged that the incident took him by surprise.

23. Mr K C KWONG said that the Listing Committee was supportive of all the proposals contained in the Consultation Paper, and approved the paper as the basis for consultation. Members of the Listing Committee did not voice any opinion that the release of the Consultation Paper at that time would lead to any irregular price volatility for penny stocks.

24. Mr CHAN Kam-lam further asked if SFC suspected any parties had taken advantage of the release of the Consultation Paper to manipulate the market. Mr Andrew SHENG replied that SFC was undertaking an investigation into the unusual market movement of penny stocks on 26 July 2002. The investigation report would be presented to FS as soon as possible.

25. Referring to paragraphs 13 and 14 of Mr KC KWONG's speaking note, Ms CHAN Yuen-han said that it appeared that in determining the appropriate

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timing for the release of the consultation paper, SFC and HKEx had sensed that the consultation paper contained some sensitive proposals. She asked if HKEx and SFC had made contingency plans before releasing the consultation paper.

26. Mr K C KWONG clarified that in view of the increasing media coverage of some of the proposals on the delisting mechanism before the release of the Consultation Paper, HKEx considered it appropriate to release the details of the proposals as soon as possible to facilitate feedback and comments from the market. In regard to contingency measures, Mr KWONG said that a system for monitoring the market for contingencies was in place. However, the market situation over the period from 17 July to 25 July 2002 did not suggest the possibility of a strong market reaction to the proposals on the delisting mechanism. He however acknowledged that with hindsight, the market reaction to the delisting proposals had been under-estimated.

27. Ms CHAN Yuen-han questioned the propriety of releasing the consultation paper in the early afternoon of 25 July 2002, which was a Thursday, rather than after the close of the market on Friday 26 July 2002. She considered that the latter option would have allowed more time for the market to digest and establish a better understanding of the proposals. Mr K C KWONG said that in retrospect, he would certainly have chosen a Friday afternoon when the market had closed, but the scenarios running up to the release of the Consultation Paper did not suggest that there was a need to so arrange. He would definitely draw reference from the experience in this incident in deciding the timing for the release of HKEx's consultation papers in future.

28. Mr Henry WU declared that he represented the financial services sector, was a non-executive director of a listed company and a member of the Disciplinary Appeal Committee of HKEx. He said that details relating to the proposed "\$0.5" criterion had not been made available to the public until 25 July 2002, and the strong reaction of the market to the proposal was understandable. He commented that there had been inadequate communication with the industry, as pointed out by the deputations in attendance, and that the one-month consultation period initially planned was too short for such voluminous proposals with far-reaching implications on the market. Additionally, he noted that members of the Listing Committee had been given only eight days from 10 July to 18 July 2002 to read the consultation documents before the meeting at which they were asked to approve the documents. He asked if SFC and HKEx had been acting under immense pressure to rush through the implementation of the proposals.

29. Mr K C KWONG said that the consultation document was not as lengthy as they appeared, since part of the document was a questionnaire. The timing and other arrangements for presenting the documents to the Listing Committee in this case were similar to past practices. As to whether HKEx was under any pressure to implement the proposals by a certain deadline, Mr KWONG said that HKEx had discussed the various proposals in the

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consultation paper with SFC for about a year, which indicated that there was no particular target date to meet for implementation.

30. Ms Emily LAU said that she fully supported the policy objective of strengthening Hong Kong's corporate governance regime through appropriate measures, including the establishment of an effective delisting mechanism. She got the impression from SFST's opening speech and other remarks made so far that he should not be expected to be involved in developing the delisting proposals for market consultation and in the release of the Consultation Paper. On the other hand, he said that he would have taken action to avert the penny stocks crash should any of his personal contacts or the industry had alerted him of the possible impact of the delisting proposals. She asked SFST to clarify his remark that he would "bear a certain degree of responsibility" in the incident.

31. Ms Emily LAU further said that for emergencies such as the penny stocks crash on 26 July 2002, the Administration and other relevant parties should take prompt remedial actions to rectify the situation and pacify public sentiment. It was however unveiled from the events from 26 July to 28 July 2002 that the Administration nor other relevant parties had not been able to act decisively in addressing the concerns of the market. She was concerned that the reputation of Hong Kong as an international financial centre had been jeopardized in the incident.

32. SFST clarified that under the three-tier regulatory framework, it was not his responsibility but the role of HKEx to assess market reaction to the proposals contained in the Consultation Paper before the release of the Consultation Paper. The SFC should alert the Bureau to any systemic impact of the proposals on the market. As a policy secretary, his role was to ensure that the proposals were in the right direction from a policy point of view. With regard to the his clarification made to the media on 26 July 2002 that the proposed delisting package was promulgated for consultation only, SFST said that he had the responsibility to take appropriate and prompt action to pacify market sentiment in view of the unusual market movement of penny stocks in the morning of 26 July 2002. The situation might have become worse if he had not taken any action.

33. Mr Andrew SHENG said that the drop in the share prices of some penny stocks on 26 July 2002 did not have a significant impact on the overall stock market. The remark that the scenario on 26 July 2002 had jeopardized Hong Kong's status as an international financial centre could not be conclusive.

34. Ms Emily LAU noted from paragraph 10 of Mr K C KWONG's speaking note that normally, during the drafting process of consultation papers, HKEx would not consult individual organizations of the industry so as to avoid giving "unnecessary pressure" to SFC or the Listing Committee. She questioned whether such an approach was appropriate. Mr K C KWONG said that in retrospect, some "sounding out" with the industry on the proposals would have benefited HKEx in making the appropriate consultation

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arrangements.

35. Mr Bernard CHAN expressed concern that the decision to withdraw Part C from the Consultation Paper in response to the strong market reaction would be seen by the international community as the Government backing down its own policies. He asked if any adverse comments had been received from overseas investors in this regard. Mr Andrew SHENG replied that he was not aware of any such comments.

36. Mr Fred LI said that according to the chronology of events as described in Mr KC KWONG's speaking note, back-and-forth discussions on the minimum share price criterion for continuing listing between HKEx and SFC had taken place over almost a year. He sought clarification as to whether during this time the Administration had been made aware of these discussions and the proposed "\$0.5" criterion.

37. Mr Andrew SHENG said that for proposals relating to the listing rules for consultation with the market, the Administration would be involved only when such proposed changes would affect policy objectives. As the minimum share price criterion for continuing listing did not constitute a change of policy, SFC did not see the need to discuss the matter with the Administration in the process of drawing up the proposal.

38. Mr CHAN Wai-yip said that he was totally disappointed at the way the Administration had handled the matter. Investors had sustained substantial losses but the authorities concerned were trying to shirk responsibilities. He considered that the whole incident had reflected poorly on the credibility of the Accountability System of Principal Officials. He could not accept SFST's defensive remark that he was not and should not be expected to be aware of the details of the proposals in the Consultation Paper. He also considered it not plausible that SFST had not been informed of the details of the major proposals in the Consultation Paper, including the proposed "0.5" criterion, before the release of the consultation paper.

39. Mr CHAN Wai-yip said that many members of the public who suffered financial losses from the penny stock crash were aggrieved, and asked the Administration if there was any mechanism for providing recompense to them. He further said that FS should not put himself in a position above investigation by appointing a panel of inquiry to investigate into the incident. It was hardly convincing that such an investigation would be fair and independent.

40. SFST said that he would not wish to reiterate the principles underlying the three-tier regulatory framework but only wished to mention that the framework was endorsed by LegCo in March 2002 and that the Administration would intervene in the work of SFC/HKEx only when it was absolutely required in the public interest, to assume the role of the "watchdog of the watchdog". This also explained that before the release of the Consultation Paper, he had no

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role to play but since 26 July 2002, he had been and had to be actively involved in taking necessary remedial actions, including the hosting of the press meeting on 28 July 2002 together with SFC and HKEx. Notwithstanding this, he agreed that there was room for improvement in the inter-tier communication among the Administration, SFC and HKEx.

41. In regard to compensation for investors who had suffered financial losses in the penny stock crash, Mr Andrew SHENG said that pending further investigation into the incident, it would be difficult and premature to determine whether there was a case for investors to seek recompense for the financial losses. Mr K C KWONG said that such claims would be considered by HKEx as and when they were received.

42. Mr Martin LEE cited a historical episode to highlight the message that for principal government officials, "ignorance was just as inexcusable as negligence" and both should not be allowed to go unchecked in the public interest. He said that given his job responsibilities, SFST ought to have known or deemed to have known the content of the Consultation Paper. He considered that the Administration, SFC and HKEx were equally responsible for the misfortune as the three parties had key roles to play in launching the proposals. Under the Accountability System of Principal Officials, SFST as a team leader should have the courage to bear responsibility for the consequences arising from the proposals, and should act responsibly to have the spirit of the accountability system rightfully realized.

43. SFST said that he had no intention to shirk responsibility and he had been doing his job conscientiously. Under the three-tier regulatory framework, he was not expected to learn the details of the proposals relating to the exchange rules for market consultation and should not interfere with the work of HKEx and SFC unless their work was not in concordance with Government's policies. He however welcome Members' views on how the regulatory framework could be improved if Members were of the opinion the framework was deficient in certain ways.

44. Mr NG Leung-sing said that the penny stocks crash was a misfortune for the community when the economy was already at a low. He suspected that the panic selling of penny stocks triggered by the "0.5" proposal was much attributed to the public's perception gathered from past cases that HKEx's consultations were no more than a formality to undergo before formal implementation of a policy. Mr NG also commented that the incident revealed a lack of market sensitivity on the part of relevant authorities, and the anomaly of the Administration not having been fully informed of market sensitive proposals. The role of the Listing Committee, seen as the gatekeeper for market sensitive proposals on the listing rules under the existing regulatory system, was problematic. Mr NG urged the Administration to critically review the current regulatory system in the light of the incident.

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45. SFST said that under the current regulatory framework, HKEx and SFC should be given a free hand to develop proposals on listing rules within approved policies, and to take care of the consultation process. The Administration remained confident that HKEx and SFC would duly perform their duties.

46. Mr K C KWONG said that there were many past cases where proposals were dropped or amended as a result of feedback from the market and the public. For example, in the recent consultation on the proposal to extend trading time of the exchange, HKEx had subsequently adjusted the proposal in the light of the feedback received. The allegation that HKEx had handled consultations simply as a matter of formality was groundless. He also clarified that while the Listing Committee had not specifically raised concern about the possibility that the market might over-react to the proposed delisting package, the Listing Committee had in fact provided a lot of views on the various proposals in the Consultation Paper.

47. Mr James TIEN supported in principle the proposed delisting mechanism to strengthen Hong Kong's corporate governance regime. He queried whether the unfortunate panic selling of penny stocks could have been avoided if HKEx had included in its proposed delisting package fair mechanisms for minority shareholders to trade/dispose of their shares when a company were delisted. He also noted that in meeting the press on 25 July 2002, HKEx had not explained in detail how and to what extent listed companies with low-priced shares would be affected under the proposed delisting mechanism. Mr TIEN also sought clarification on the working relationship between the HKEx and SFC, and the role of the HKEx's board in relation to the proposals on the delisting mechanism.

48. Mr Charles LEE reiterated that according to the MOU Governing Listing Matters signed between HKEx and SFC, the HKEx board had delegated all of its functions and powers in relation to listing matters to the Listing Committee, and the board would not exercise concurrent jurisdiction. The segregation arrangement was intended to avoid potential conflicts of interest between HKEx' business and regulatory functions. Mr LEE said that all along, the Listing Committee had enjoyed genuine independence in performing its functions and in his view, the present system had contributed to maintaining a high standard of corporate governance in Hong Kong. He therefore maintained that the HKEx should not interfere with the Listing Committee's work. However, he held an open mind as to whether sensitive proposals should be submitted to the HKEx Board for review in future before promulgation to the public.

49. Mr K C KWONG said that the concern of the media had focused mainly on whether a company would be automatically delisted if its share price fell below \$0.5 for 30 consecutive trading days. During the course of contact with the media on and after 25 July 2002, HKEx had consistently highlighted that the \$0.5 minimum share price criterion was not a mechanism for automatic

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delisting of a company, but a threshold below which share consolidation would be required for continuing listing. Mr KWONG said that HKEx appreciated that the public was very concerned about what arrangements were available for minority shareholders to trade/dispose of their shares after a company was delisted, and thus HKEx would take this into consideration and make recommendations to address this concern in the future consultation on the delisting mechanism.

50. Mr LEE Cheuk-yan expressed dissatisfaction with the way FS and SFST had reacted in the penny stocks incident. He said that SFST's claims that under the three-tier regulatory system he was not required to know the proposed delisting package, and that neither the industry nor his personal contacts had given him advance caution on the possible impact of the delisting package were unacceptable. Mr LEE considered that SFST should bear responsibility for the lack of sensitivity to market sentiments. With his commercial experience, he should not have passively depended on the industry or his contacts to alert him of the possible impact of the delisting proposals on the market. Mr LEE also expressed disappointment that FS was not present to give an explanation to the Panel, as he considered that FS was truly the ultimate "watchdog of the watchdog" under the regulatory framework for the securities industry.

51. SFST repeated that under the existing regulatory framework, he was not required to know about the details of the proposed delisting package for consultation. It would be counter-productive if he meddled with the work of SFC or that of HKEx in this respect.

52. The Chairman said that as FSTB was the bureau corresponding to the Financial Affairs Panel on financial and finance matters, the Panel did not make special arrangements to invite FS to this meeting.

53. Mr Andrew SHENG said that he had not reported to FS on the proposed delisting package and that he had not discussed with SFST the details of the delisting package. SFC was the statutory regulator of HKEx and that SFC had been involved in developing the proposals in the consultation paper issued by HKEx. As the Chairman of SFC, he would not escape responsibility if he or his staff had committed any errors in the incident.

54. Mr MA Fung-kwok asked whether HKEx had any plan to deal with the claims from investors and listed companies for financial losses or other damages they had sustained in the penny stock crash. Mr K C KWONG said that HKEx would have to review the claims as and when they were received, but he felt regretful for the losses sustained by investors and some listed companies in the incident. He maintained that the proposals on the delisting mechanism were genuinely meant for consultation and HKEx had not taken any firm decision on the proposals.



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55. Mr Jasper TSANG declared that he was a non-executive director of SFC. He asked if HKEx or SFC had a code of practice governing the procedure and approach for the release of sensitive information to the public. Mr TSANG noted that both HKEx and SFC had admitted that they had not expected the strong market reaction to the Consultation Paper. He asked whether in retrospect, HKEx and SFC considered that the incident was something unpredictable within reasonable bounds or it was attributed to poor assessment of market reaction by relevant personnel of SFC and HKEx.

56. Mr K C KWONG replied that to his knowledge, such a code of practice was not in place. However, in line with HKEx's normal practice, HKEx had been monitoring the market trading condition since 17 July 2002 when HKEx had revealed some information on the proposals on the delisting mechanism to the market. HKEx had observed that the market trading conditions up to 25 July 2002 had been normal. Over this period, industry commentators had not raised concern that any of the proposals would trigger abnormal price fluctuations of penny stocks, though some had raised the issue that the minimum share price criterion for continuing listing should be lower than \$0.50.

57. Mr Andrew SHENG said that if SFC were to issue a consultation paper, SFC would normally undertake substantial informal consultation with the securities industry before the release of the relevant consultation document.

58. Mr Eric LI said that SFST as a principal official should step in whenever public interest was at stake. He had the duty to ensure that the issues arising from the incident would be thoroughly and satisfactorily addressed, and to see to it that investors who had suffered financial losses in the incident received a fair treatment. He therefore sought assurance from SFST that upon completion of the inquiry by the independent panel, he would promptly brief the Panel on the findings of the inquiry, explain to the Panel whether there had been any market manipulation leading to the plunge of penny stocks on 26 July 2002, to make a fair judgement as to who should legitimately be held responsible, and to cause the full report of the inquiry to be released to LegCo Members. Lastly, SFST should make concrete recommendations to reinstate Hong Kong's reputation as an international financial centre, and to decide on the way forward for the proposals on the delisting mechanism, which had been lifted from the Consultation paper.

59. SFST said that he concurred with Mr LI's views and suggestions generally and that he had responsibilities to bear in the incident but not without limits. He reiterated that from a policy perspective, the Administration considered that the work to establish an effective delisting mechanism should continue since this was important for strengthening the corporate governance regime in Hong Kong. The Administration would assist or advise as appropriate but would not step in on matters within the purview of SFC or HKEx.

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60. Mr Eric LI further asked whether SFST would be prepared to intervene in the public interest if eventually, the public and LegCo Members considered that the matter remained unresolved and justice had not been duly done. In response, SFST said that the Administration was primarily responsible for policy directions and advise on such matters. SFC and HKEx were each responsible for enforcement and implementation matters under their respective ambits. In response to Mr LI's further question, SFST said that he could not be held answerable to all mishaps. However, he would not seek to shirk responsibility.

61. Mrs Selina CHOW said that one would always hope that there had been more foresight than hindsight in regard to the penny stocks crash, and it was always easier to criticize than to develop fool-proof plans before launching the Consultation Paper. She considered that notwithstanding the three-tier regulatory framework, the Administration, HKEx and SFC were all responsible to a certain extent for the mishap in this case. It was evident that there had been inadequate "sounding out" with the financial industry and this was one of the main reasons for the strong and unexpected market reaction when the Consultation Paper was released. She supported FS's decision to set up an independent panel of inquiry to look into the incident so as to throw light on the events leading to the incident and to unveil the underlying gaps and problems. She also concurred with the temporary withdrawal of the proposals on the delisting mechanism for further consideration but considered it not advisable to shelve the proposals indefinitely because of this incident.

62. Mr K C KWONG said that he agreed with Mrs CHOW's comments and would discuss with SFC how in the process of preparing consultation documents, the views of the securities industry and market practitioners could be harnessed.

63. Mr Abraham SHEK said that while the three-tier regulatory framework was basically sound and effective, the real problem surfaced was ineffective communication and the lack of communication between the tiers. It appeared awkward that for such a sensitive proposal as the "\$0.5" criterion, the Administration had not been duly informed of the details. Moreover, when HKEx and SFC discussed which share price was the best option as the minimum share price criterion, they should have, but apparently had not, taken into account the possible impact on the market in assessing the merits of different options.

64. Mr Andrew SHENG said that SFC had conveyed to FSTB the broad principles of the proposed delisting package, but not the implementation or procedural details. In this regard he would welcome the independent panel of inquiry to investigate the procedural and implementation aspects under the three-tier regulatory framework. Mr K C KWONG also welcomed the inquiry panel to look into the respective responsibilities of SFC and HKEx in the process of preparation and release of consultation documents.

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65. Mr Abraham SHEK further queried why SFC had not drawn the attention of the Administration to the proposed delisting package, in particular the proposed “\$0.5” criterion. Mr Andrew SHENG replied that basically, consultation on listing rule changes were implementation matters. As the “\$0.5” proposal for consultation was meant to be a threshold for share consolidation rather than a criterion for automatic delisting, he did not expect that the release of the proposal would have a strong impact on the market.

66. Mr Henry WU said that a hefty price had been paid in exchange for the lessons from the incident. Apart from the financial losses sustained by investors, Hong Kong’s reputation as an international financial centre had been jeopardized. He opined that in view of the far reaching implications of the proposed delisting package, the HKEx board should have a say on the proposals before their release. The penny stocks incident revealed a need to review the powers and responsibilities of the HKEx board vis-à-vis those of the Listing Committee.

67. Mr Charles LEE said that under the MOU aforementioned, the Listing Committee had been delegated all the powers and functions to handle all listing matters without reference to the HKEx board. The proposed delisting package was launched for consultation only, and as such there was no need to inform the HKEx board of the proposals.

68. SFST said that the Administration took note of Mr Henry WU’s concern about the delineation of responsibilities between the board of directors and the Listing Committee of HKEx.

69. At the close of this discussion session, the Chairman thanked the representatives of the Administration, SFC, HKEx and industry associations for attending the meeting.

The way forward

70. Mr SIN Chung-kai referred to FS’s letter and expressed concern that the scope of the investigation to be undertaken by the panel of inquiry appeared to be too narrow. Mr Martin LEE concurred with Mr SIN and said that it was not mentioned in FS’s letter that the panel would address the issue of who should bear the responsibility for the mishap in the incident.

71. Ms Emily LAU said that in the United States, it was common that more than one inquiry panels conducted investigations into the same incident concurrently. Ms LAU was concerned that given the narrow scope of investigation of the inquiry panel to be appointed by FS, a number of issues would still be left unresolved, such as FS’ role and responsibility in the whole incident. She also noted that the time given to the inquiry panel to present its report by 10 September 2002 was tight, and might be inadequate for conducting a thorough investigation. If it was expected that FS’ independent panel of inquiry

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would leave key issues unresolved, it might be preferable for LegCo to set up its own select committee to inquiry into the incident.

72. Mr LEE Cheuk-yan expressed doubt on the credibility of the investigation to be conducted by the panel of inquiry appointed by FS, pointing out that FS himself should be a subject of investigation but the panel was to be answerable to FS.

73. Mr SIN Chung-kai opined that to ensure that the body to inquire into the incident was vested with necessary investigative powers and that a thorough and truly independent inquiry was conducted, the Chief Executive should appoint a commission of inquiry under the Commission of Inquiry Ordinance (Cap. 86) to investigate the incident.

74. Mr LEE Cheuk-yan and Ms Emily LAU supported Mr SIN's suggestion, Ms LAU further suggested that the commission of inquiry should examine FS' role and responsibility in the incident, and whether there was a case for investors to seek recompense for their financial losses sustained in the penny stocks crash.

75. Mr CHAN Kam-lam said that if members felt that the terms of reference of the independent panel of inquiry were unclear, FS should be asked to clarify them. He expressed reservation on the need to set up a commission of inquiry under the Commission of Inquiry Ordinance.

76. Mrs Selina CHOW considered it appropriate for FS to appoint an independent panel of inquiry to investigate the incident as FS was accountable to LegCo on financial affairs. She recalled that during the stock crisis in 1987, it was the then FS who had been answerable to LegCo for the incident. In this case, FS had undertaken to release the report of the inquiry to the public and to brief LegCo after the completion of the inquiry. She therefore considered that the panel of inquiry to be appointed by FS would already serve the purpose of an independent and thorough inquiry. Mrs CHOW however agreed that the scope of the investigation could be expanded and made clearer.

77. Mr SIN Chung-kai said that at the time of the stock crisis in 1987, the current three-tier regulatory framework had not come into being, and the Commission of Inquiry Ordinance was not in existence. He maintained that to ensure a thorough and credible inquiry on the incident, the best option was for CE to appoint a commission of inquiry under the Ordinance. He recalled that in the past, commissions of inquiry had been expeditiously set up within days.

78. Mr Eric LI said that he had no objection to the suggestion of setting up a commission of inquiry with statutory powers, but was concerned that the associated procedures might delay the investigation process.

79. Mr Martin LEE cautioned that the panel of inquiry to be appointed by FS would probably have the job half-done only. He supported the proposal that

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a commission of inquiry with statutory powers should be appointed by CE.

80. Mr James TIEN said that he was inclined to support FS's decision to set up an independent panel of inquiry, but he concurred that the scope of the inquiry should be clearly set out.

81. Ms Emily LAU reiterated her concern about the propriety of FS appointing the inquiry panel given FS's role and responsibility for overseeing the soundness of the financial sector, and his possible involvement in the events leading to the incident. Ms LAU further said that there was consensus among Members on the issues to be addressed in the inquiry and that FS should be held accountable for the incident. She then moved the motion that the Panel should request the Chief Executive to set up a commission of inquiry under the Commission of Inquiry Ordinance to investigate into the incident.

82. The Chairman said that since members had expressed different views on Ms LAU's motion, he put the motion to vote by members. Five members voted for and four voted against the motion. The Chairman declared that the motion was carried.

83. On the scope of the investigation, Ms Emily LAU said that apart from making recommendations on improvements, the inquiry should cover the roles and responsibilities of the relevant government officials, including FS, and the key personnel of SFC and HKEx, and address the issue of whether there was any failure to duly perform their duties on the part of the persons/parties concerned. The inquiry should also examine whether there was a case for investors to seek compensation for financial losses sustained in the penny stocks crash. Members agreed to Ms LAU's suggestions.

*(Post-meeting note: A draft version of the letter to CE was circulated to members on 1 August 2002 vide LC Paper No. CB(1)2390/01-02. The letter, signed by Mr Henry WU, Deputy Chairman of the Panel, was sent to CE on the same day and issued to members vide LC Paper No. CB(1)2396/01-02.)*

**II Any other business**

84. There being no other business, the meeting ended at 6:50 pm.