

For information
on 16 September 2002

**The Legislative Council
Panel on Financial Affairs**

**Taking forward Recommendations
in the Report of the Panel of Inquiry on the Penny Stock Incident**

Introduction

This paper outlines the recommendations in the Report of the Panel of Inquiry on the Penny Stock Incident (“the Report”), and the way forward.

Background

2. On 31 July 2002, the Financial Secretary (FS) appointed a Panel of Inquiry to look into the circumstances relating to the preparation and release of the “Consultation Paper on Proposed Amendments to the Listing Rules Relating to Initial Listing and Continuing Listing Criteria and Cancellation of Listing Procedures”, which was released by the Hong Kong Exchanges and Clearing Limited (HKEx) on 25 July 2002 for public consultation.

3. The Panel of Inquiry submitted the Report to the FS on 9 September 2002. The Report was released to the public the following day.

4. A summary of the recommendations in the Report is at **Annex** for Members’ easy reference.

Way forward

5. The Government reaffirms its commitment to maintain and strengthen Hong Kong’s position as an international financial centre. The financial services sector is a major driver of our economy. To enhance the quality of our financial markets and reinforce our position as the premier capital formation centre for the Mainland, we shall keep on moving forward with our reform measures together with the market.

6. We shall, together with the Securities and Futures Commission (SFC) and HKEx, continue to develop initiatives to improve our securities market along the direction of enhancing corporate governance, improving regulatory environment and enforcement, streamlining procedures for listing, and providing an effective mechanism for delisting of companies of unacceptable quality. Successful implementation of market reforms along these directions requires consensus building among the investors, intermediaries and issuers, and joint efforts of the Government, SFC, HKEx and relevant professional bodies.

7. We accept the Panel's criticisms and welcome its recommendations. We have already started a dialogue with SFC and HKEx to study carefully the findings and recommendations of the Panel's Report in detail, with a view to mapping out the implementation plan in a co-ordinated manner. In the process, we would take into consideration market views as to the priorities and ways of implementing the Panel's recommendations.

8. Given Government's overall responsibility for financial and monetary policies, we will continue to co-ordinate and facilitate market reforms pursued by SFC and HKEx. We will ensure that all parties concerned, including market participants, would work closely with each other to take forward the recommendations in the Report. The Government is committed to performing its role as a facilitator and coordinator effectively under the three-tier regulatory regime.

Financial Services Branch
Financial Services and the Treasury Bureau
16 September 2002

**Summary of Recommendations in the Report of the Panel
of Inquiry on the Penny Stock Incident**

Key tasks		Action party
General		
1.1	Press ahead with the reform measures to enhance corporate governance, transparency and general quality of financial markets. [Para. 14.4]	Government SFC HKEx
1.2	Continue to conduct wide consultations on issues of concern to the public. [Para. 14.4]	Government SFC HKEx
Engaging the market and public		
2.1	Make the most constructive and efficient use of the existing consultation network. [Para. 14.7]	Government SFC HKEx
2.2	Expand the network where possible to increase its efficacy. [Para. 14.7]	Government SFC HKEx
2.3	Ensure that the network is broadly representative. [Para. 14.7]	Government SFC HKEx
2.4	Engage the consultation network at an early stage in discussing concept and framework and in formulating proposals. [Para. 14.7]	Government SFC HKEx
2.5	Tap knowledge of individuals in its boards and panels as practicable, even if informally and on an individual basis. [Para. 14.8]	HKEx SFC
2.6	The SFC should feel able to consult its Shareholders Group and its Advisory Committee, on draft consultation papers sent to it for comment by the HKEx. [Para. 14.8]	SFC

	Key tasks	Action party
2.7	Tap the market expertise of individual members of the HKEx Board and its Consultative Panels either in their individual capacity or through a new formalized framework on listing matters to supplement the role of the Listing Committee. [Para. 14.8]	HKEx
2.8	Engage the Listing Committee at a much earlier stage in discussing the concept and framework of proposals and keep the Listing Committee apprised of its work plans relating to amendments to the Listing Rules and the release of consultation papers. [Para. 14.8]	HKEx
2.9	Consider setting up working parties involving those with the necessary expertise as well as executives of the HKEx. [Para. 14.8]	HKEx
2.10	Consider increasing and improving liaison with brokers and the brokers' associations. [Para. 14.9]	HKEx
2.11	Consider setting up its own consumer panel or shareholders group. [Para. 14.11]	HKEx
2.12	Consider appropriate channels for the views of small-and-medium size financial intermediaries and companies to be heard. [Para. 14.12]	HKEx
2.13	Consider a two-stage process for outside consultation, the conceptual philosophical stage and the detailed proposal stage, which best fits its structure and needs. [Para. 14.13]	HKEx
2.14	Continue discussion on proposals to improve the process for sounding out the market in the preparation of consultation papers on proposed changes to its Listing Rules and bring this to its Board of Directors as soon as possible. [Para. 14.14]	HKEx

Key tasks		Action party
Assessing market reaction		
3.1	The HKEx relies heavily on the media as the channel to gauge market views and disseminate information to the market. Other channel ought to have been engaged. [Para. 11.43]	HKEx
3.2	Securities and Futures Ordinance stipulates that the rules submitted by the HKEx to the SFC for approval must contain explanations of their purpose and likely effect, including their effect on the investing public, in sufficient detail to enable the SFC to decide whether or not to approve them. The HKEx should consider similar arrangements for consultation papers, and not merely those sent to the SFC for comment. [Para. 14.15]	HKEx
3.3	In seeking the approval of the Listing Committee for the issue of consultation papers, the HKEx should provide its analysis of the likely effect of the proposals, particularly the effect on the investing public, in sufficient detail to enable the Committee to decide whether the Consultation Papers should be published and, if so, on what terms. [Para. 14.15]	HKEx
3.4	In releasing consultation papers, the HKEx should explain fully to the different stakeholders the likely effect of the proposals on the investing public. [Para. 14.15]	HKEx
3.5	The assessment of the likely market reaction should be brought to the attention of both the SFC and the Bureau at the earliest opportunity. [Para. 14.16]	HKEx
Improving the consultation process		
4.1	It would have been better had the HKEx announced the package after the close of market on Friday. [Para. 11.66]	HKEx

Key tasks		Action party
4.2	Duration of the periods for consultation should be commensurate with the sensitivity, technicality and complexity of the subjects under consideration. [Para. 14.17]	Government SFC HKEx
4.3	Consultation papers should contain general discussions of the concepts, and designed to encourage and allow the public to express their views on general directions and possible options. [Para. 14.17]	Government SFC HKEx
4.4	Issue conclusion reports on consultation papers, summarizing views expressed in representations made, its observations on and responses to those views and its conclusions. [Para. 14.17]	HKEx
4.5	Continue and expand reach-out programmes. For topics affecting the investing public, the HKEx has to consider organizing special sessions and seminars for them. [Para. 14.17]	HKEx
Reviewing the three-tiered regulatory structure		
5.1	The HKEx and the SFC should critically review how best to ensure effective coordination between them. [Para. 14.19]	SFC HKEx
5.2	Further clarify roles of the SFC and the HKEx in the Memoranda of Understanding, setting out clear provisions on their functions and responsibilities and the procedures for processing consultation papers and amendments to the Listing Rules. [Para. 14.19]	SFC HKEx
5.3	Strengthen the current liaison mechanism, if necessary by introducing a new high-level body. Both organizations should feel at liberty to propose topics for discussion. This should allow periodic review of systemic and policy issues. This body would be in addition to the working level meetings on operational issues. [Para. 14.19]	SFC HKEx

Key tasks		Action party
5.4	Clearly identify the areas for joint consultations by the SFC and the HKEx (See paragraphs 5.23 and 5.24). [Para. 14.19]	SFC HKEx
5.5	Review how best to redefine the roles and functions over listing matters with a view to increasing effectiveness, efficiency, clarity, fairness and credibility of the regulatory system. [Para. 14.21]	Government SFC HKEx
5.6	Reposition itself as a facilitator and a co-ordinator and not as a regulator, leaving market forces to work within the broad policy framework and without political interference. The Government must communicate its role clearly to the industry and investing public to avoid false and unrealistic expectation. [Para. 14.22]	Government
5.7	Keep free from the day-to-day regulatory functions. Focus on keeping regulatory framework under review, ensure sufficient checks and balances, act as coordinator, keep reserve power for exercise in emergencies, and provide sound environment for the development of the financial market. [Para. 3.14]	Government
Strengthening investor education and protection		
6	Further and continuously consider how minority shareholders' rights can be better protected. [Para. 14.23]	Government SFC HKEx
Other recommendations		
7.1	As soon as practicable complete the review on the exercise of statutory powers and functions currently vested with the FS by the SFST. [Para. 14.24]	Government
7.2	As soon as practicable clarify the division of responsibilities and lines of commands between the FS and the SFST. [Para. 14.24]	Government

Key tasks		Action party
7.3	Supply the necessary authoritative encouragement to enable the wrinkles in the actual operation of the three-tiered structure (especially between the HKEx and the SFC) be resolved. [Para. 12.24]	FS SFST
7.4	The incident has highlighted occasional difference and unhappiness between the SFC and the HKEx over their respective roles. These wrinkles must now be ironed out. [Para. 12.33]	Chairman, SFC CE/HKEx
7.5	The HKEx should be primarily responsible for deciding whether to set up an alternative trading board. [Para. 11.38]	HKEx

Source : Reproduced from the Report of the Panel of Inquiry on the Penny Stocks Incidents, 9 September 2002. The number in square brackets denotes the paragraph number in the Report where the recommendation is made.