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**Background Brief for Panel on Constitutional Affairs**

**Responsibilities of Principal Officials  
under the Accountability System**

**Purpose**

This paper details the referral from the Panel on Financial Affairs regarding the assessment of responsibilities of principal officials under the accountability system.

**Referral from the Panel on Financial Affairs**

2. In the course of discussing the issues arising from the Report of Panel on Inquiry on Penny Stocks Incident (the Report) by the Panel on Financial Affairs, one of the major concerns of Members is whether and how far the concerned parties and individuals should be held responsible for the mishaps of the Incident.
3. Members note that the inquiry panel had in its Report, devoted a complete chapter to discuss the accountability system and its implications. A copy of Chapter 6 of the Report is in **Appendix I**.
4. The inquiry panel discussed the roles and responsibilities of the individuals concerned in the incident in Chapter 12 of the Report. These individuals include the Financial Secretary, the Secretary for Financial Services and the Treasury, the Chairman of the Securities and Futures Commission, the Chief Executive of the Hong Kong Exchanges and Clearing Limited and other concerned officials in the Financial Services and the Treasury Bureau. A copy of Chapter 12 of the Report is in **Appendix II**.
5. To facilitate its discourse, the inquiry panel adopted four broad categories of responsibilities for assessment of the responsibilities of these individuals. These categories are policy responsibility, executive responsibility, systemic responsibility and personnel responsibility (paragraph 12.16 of the Report refers).

6. Members have expressed serious concern about the propriety of the four categories of responsibilities for assessment of responsibilities of principal officials and senior personnel of statutory agencies. As far as they can recall, the Administration has never made reference to such categorisation of responsibilities during the deliberations of Members on the accountability system for principal officials.

7. At its meeting on 8 October 2002, the Panel decided that the matter should be referred to the Panel on Constitutional Affairs for further discussion.

### **Deliberations of Members on the accountability system for principal officials and related issues**

8. The Administration has never advised Members that the responsibilities of principal officials under the accountability system would be assessed on the basis of the four broad categories of responsibilities referred to in paragraph 5 above (i.e. policy responsibility, executive responsibility, systemic responsibility and personnel responsibility).

9. The Administration had only, in paragraphs 12 and 13 of the "LegCo Paper on Accountability System for Principal Officials" presented to the Council on 17 April 2002, outlined the specific role and responsibility of principal officials under the accountability system and the possible consequences they had to face for serious policy failures and grave personal misconduct. Paragraphs 12 and 13 are reproduced below -

"12. Principal officials under the accountability system are the most important officials within the Government. They will be accountable to the Chief Executive for the success or failure of matters falling within their respective portfolios. They will accept total responsibility and in an extreme case, they may have to step down for serious failures relating to their respective portfolios. These include serious failures in policy outcome and serious mishaps in the implementation of the relevant policies. They may also have to step down for grave personal misconduct or if they cease to be eligible under the Basic Law.

13. They will be appointed to the Executive Council and will be responsible for all aspects of their portfolios: from determining policy objectives and goals, to policy initiation, policy formulation, policy implementation and policy outcome. The Secretaries of Department and Directors of Bureau will be directly responsible to the Chief Executive and they will have direct access to the Chief Executive. They will take part directly in the decision making process relating to the allocation of resources of the Government as a whole. They will have a strong say in the assignment of personnel working directly under

them and the share of financial resources allocated to them. More specifically, their role and responsibility will be as follows :

- (a) to gauge public opinion and take societal interests into account in serving the community;
- (b) to set policy objectives and goals, and develop, formulate and shape policies;
- (c) to take part as a member of the Executive Council in all of the deliberations and decision making at the Executive Council and assume collective responsibility for the decisions made;
- (d) to secure the support of the community and LegCo for their policy and legislative initiatives as well as proposals relating to fees and charges and public expenditure;
- (e) to attend full sessions of LegCo to initiate bills or motions, respond to motions and answer questions from LegCo members;
- (f) to attend LegCo committee, subcommittee and panel meetings where major policy issues are involved;
- (g) to exercise the statutory functions vested in them by law;
- (h) to oversee the delivery of services by the executive departments under their purview and ensure the effective implementation and successful outcome of policies; and
- (i) to accept total responsibility for policy outcome and the delivery of services by the relevant executive departments."

10. In response to Members' questions put to him at the Council meeting on 17 April 2002, the Chief Executive had also said that the appointment and removal of principal officials must be dealt with in accordance with the Basic Law. In the event that a motion of no-confidence had been passed by LegCo against an individual principal official, he would consider, among other things, the circumstances leading to such a motion.

11. In the course of discussing the accountability system, some members of the Subcommittee to Study the Proposed Accountability System for Principal Officials and Related Issues were of the view that constitutional conventions should be established to enhance the accountability of principal officials, e.g. in

the event that a no-confidence motion had been passed by LegCo against a principal official, he should resign and the Chief Executive should accept his resignation. The response given by the Administration to the Subcommittee was the same one given by the Chief Executive at the Council meeting on 17 April 2002.

### **Consideration by Panel on Constitutional Affairs**

12. With the agreement of Hon Andrew WONG, the Panel Chairman, the issue referred by the Panel on Financial Affairs has been scheduled for discussion at the Panel meeting to be held on 21 October 2002. Members may wish to consider, inter alia, whether the four broad categories of responsibilities referred to in paragraph 5 above should be adopted for assessing the responsibilities of principal officials under the accountability system.

Council Business Division 2  
Legislative Council Secretariat  
18 October 2002

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## **CHAPTER 6**

# **THE ACCOUNTABILITY SYSTEM AND ITS IMPLICATIONS**

### **INTRODUCTION**

6.1 This chapter describes, as best we can, the new accountability system introduced on 1 July 2002. We also try to discuss its implications on the three-tiered regulatory framework. We have, however, to admit that it has not been possible to conduct very meaningful or full research. Such an exercise will most likely fall completely outside our Terms of Reference however benevolently construed. We also acknowledge that neither of us claim to be political scientists or theorists on constitutional structures.

### **ACCOUNTABILITY SYSTEM**

6.2 A new accountability system was introduced with effect from 1 July 2002, to tie in with the Chief Executive's second term of office. As the Administration explained, the objectives of the system are to: strengthen the accountability of principal officials; ensure that the Government can better respond to the needs of the community; enhance co-ordination in policy formulation; strengthen the cooperation between the Executive and the Legislature; ensure effective implementation of policies and provide quality services to the public<sup>45</sup>. Under the accountability system, there are three Secretaries of Departments and 11 Directors of Bureau.

### **ROLE OF THE FINANCIAL SECRETARY**

6.3 The Financial Secretary (FS) is one of the three Secretaries of Department. He assists the Chief Executive (CE) in supervising relevant policy bureaux and in ensuring harmonization in policy formulation and implementation in the financial, economic and employment areas. He also covers specific priority areas of the CE's policy agenda. The FS exercises

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<sup>45</sup> See Legislative Council Paper "Accountability System for Principal Officials" presented by the Constitutional Affairs Bureau on 17 April 2002 and re-iterated in Items for Establishment Subcommittee of the Finance Committee EC(2002-03)2 also issued by the Constitutional Affairs Bureau for discussion on 6 June 2002.

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statutory functions, for example, in respect of public finance and monetary affairs. He is responsible for the Government budget in accordance with the CE's policy area. Included in his job description are the duties to "explain Government policies to and answer questions from the Legislative Council, members of the public and the media".

6.4 In relation to the financial services sector, the FS has a wide range of statutory powers to appoint members to key boards, appoint inspectors, make rules, and approve budgets and business plans of regulators. At the same time, the FS has the duty to consult specified committees before exercising certain powers. Some of his statutory powers and duties are set out at **Annex 6.1**.

## **ROLE OF THE SECRETARY FOR FINANCIAL SERVICES AND THE TREASURY**

6.5 The Secretary for Financial Services and the Treasury (the Secretary) is one of the eleven Directors of Bureau. Like the FS, the Secretary is not a civil servant. He is the head of the Financial Services and the Treasury Bureau (the Bureau), and is responsible for determining policy objectives and goals, how they are initiated, formulated and implemented and how effective they are in practice. His list of duties is wide. They include:-

- (a) gauging public opinion and responding to the needs of the community;
- (b) setting policy objectives and goals, and developing, formulating and shaping policies;
- (c) exercising the statutory functions vested in him by law; and
- (d) overseeing the delivery of services by the executive departments under his purview and ensuring the effective implementation and successful outcome of policies.

6.6 The Secretary has inherited some of the statutory powers previously vested in the Secretary for Financial Services. Such powers include permitting the disclosure of classified information by the SFC,

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varying the amount of the special levy payable to the Futures and Unified Exchanges and appointment of members of the Securities and Futures Appeals Tribunal. In addition to his own statutory powers, the Secretary provides support and advice to the FS in exercising a range of statutory powers vested in the latter.

## **IMPLICATIONS OF THE ACCOUNTABILITY SYSTEM ON THE THREE-TIERED REGULATORY FRAMEWORK**

6.7 There is nothing that we have been able to consult which indicates that the Administration intends to change the principles and practices of the existing regulatory regime as a result of the newly introduced accountability system. That notwithstanding, the emphasis on the accountability of principal officials may have heightened the public expectation about the role and responsibilities of the Government. Two points are noteworthy.

### **Statutory Powers and Functions of the FS and the Secretary**

6.8 As a result of a recent amendment to the Interpretation and General Clauses Ordinance (Cap. 1) which took effect on 1 July 2002, the definition of “Financial Secretary” includes “Secretary for Financial Services and the Treasury” unless otherwise specified in the relevant legislation or unless there is contrary intention in law. Hitherto, the definition of the FS included “the Secretary for the Treasury”. The recent amendment to include the Secretary appears to have been a consequential amendment to the nomenclature under the new accountability system. Statutory powers and duties currently vested in the FS can, thus, unless a contrary intention has been expressed, or unless otherwise specified in the relevant legislation, be exercised by the Secretary.

6.9 We have sought clarification from the Secretary for Constitutional Affairs, who advised that:-

- (a) As a matter of general policy, it is intended that only those statutory powers and functions relating to public finance, for example, those powers and functions under the Public Finance Ordinance (Cap. 2) which were previously exercised by the Secretary for the Treasury should now be exercised by the Secretary for the Financial Services and Treasury. In taking

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over the responsibility of the former Secretary for Financial Services, the Secretary has not been invited to exercise any of the statutory powers and functions of the FS in respect of the financial services policy area. In exercising the statutory powers and functions relating to public finance, the standing arrangement is that the Secretary is not required to report to or inform the FS unless the Secretary considers it appropriate to do so. That said, the Secretary is accountable to the FS in exercising such statutory powers and functions in the sense that the FS assists the CE in supervising the Bureau and the Secretary.

- (b) The Bureau is conducting a review of the relevant legislative provisions and expects to complete the review before the end of the year. The intention is to formalize the pre-existing arrangements for the exercise of these powers and functions between the FS and the Secretary under the new accountability system.

### **Responsibility over Executive Departments**

6.10 As one of the Secretary's duty is to oversee the delivery of services by the executive departments under his purview and to ensure the effective implementation and successful outcome of policies, a question has been raised as to whether the SFC or the HKEx are executive departments under his purview, and whether the Secretary should be accountable for the effective implementation and successful outcome of their policies.

6.11 On this point, the Secretary for Constitutional Affairs advised that:-

- (a) Generally when the Government refers to "executive department" as it does in the context of the accountability system, it means Government departments for which a Director of Bureau has responsibility. It does not include statutory agencies within the purview of the Director of Bureau.
- (b) Specifically in the context of the Secretary, the term "executive department" is not intended to include the SFC and the HKEx.

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- (c) Directors of Bureau are accountable for matters falling within their policy portfolios and in extreme cases, they may have to step down for serious policy failures. They are responsible for all aspects of their portfolios. They are responsible for overseeing the work of the executive departments falling within the purview of their respective portfolios and the delivery of services by such executive departments. They are thus accountable for such executive departments. In the case of statutory agencies within the purview of the relevant Directors of Bureau, due regard would have to be given to the relevant statutory provisions. Such statutory agencies may be required under the statute under which they are established to act independently in certain aspects. In general, subject to the relevant legislative provision, statutory agencies enjoy a high degree of autonomy in their day-to-day operations, while the Government's policy objectives are determined by the relevant Directors of Bureau.

## **OBSERVATION**

6.12 We agree that under the three-tiered structure, neither the SFC nor the HKEx can in any wise be considered executive departments under the purview of the Secretary. The departments contemplated are clearly those within the Government and not institutions outside the civil service, especially in the case of the SFC the rationale of which is to be independent of the Government. The HKEx is, of course, a publicly listed company governed by its own board of directors and other executives. This point will be discussed in greater detail in the context of the role of the FS and the Secretary in Chapter 12.

## **CHAPTER 12**

### **ROLES OF INDIVIDUALS**

#### **INTRODUCTION**

12.1 We have dealt in passing with the roles, functions and participation of the Bureau, the SFC and the HKEx. In this chapter, we draw together some strands relating to the involvement of some of the individuals, namely, the FS, the Secretary, the SFC Chairman, the Chief Executive of the HKEx and officers in the Bureau.

#### **FINANCIAL SECRETARY**

##### **His Involvement**

12.2 The FS was informed of the HKEx's plan to review its listing rules to streamline and strengthen their enforcement. He was aware of the HKEx's plan to introduce a Consultation Paper on listing criteria and delisting procedures in late July or early August 2002. He was not involved in the formulation of the proposals, and he did not receive a copy of the Consultation Paper or any Executive Summary before its release. He read the Executive Summary of the Consultation Paper for the first time on the Sunday, the 28 July when his Administrative Assistant downloaded a copy from the Internet. More details are at paragraphs 7.65 to 7.67.

12.3 In analyzing the FS' role in the Incident, we have considered, more particularly, the following matters:-

- (a) the division of responsibility between the FS and the Secretary for Financial Services and the Treasury (the Secretary);
- (b) the responsibility of the FS and the Government for this Incident under the current regulatory framework and the new accountability system; and
- (c) his remarks on the 29 July. (See summary at paragraphs 9.15 and entry in the chronology.)

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## **Division of Responsibility between the FS and the Secretary under the New Accountability System**

12.4 As mentioned in Chapter 6, the reference to “Financial Secretary” in any Ordinance is to be interpreted to include both the FS and the Secretary. This is the effect of section 3 of the Interpretation and General Clauses Ordinance (Cap. 1). Both the FS and the Secretary are directly accountable to the CE and, unlike the position pre-July 2002, the Secretary no longer reports to the FS in the sense that he is accountable to him. The division of responsibility between them is therefore not entirely clear.

12.5 We know that, in practice, the Secretary assists the FS in carrying out many of his statutory functions, and an organization chart prepared for the LegCo debate on the question of accountability shows the Secretary to be in a grouping under the FS. The theory, and practice, appears to be that while the Secretary is accountable only to the CE, the CE has delegated certain duties and functions relating to Hong Kong’s economy and finances to the FS who, at the CE’s behest, has the role also of supervising the groupings under him, including the Bureau and the Secretary as its director. The Secretary therefore, in practice, reports in the first instance to the FS. He and his bureau also assist the FS in managing Hong Kong’s finances. The set-up is consistent with this understanding since the FS has only a smallish office with an administrative assistant, a press secretary and no doubt clerical and other staff. He has to rely on the Bureau for support and to screen any matters which may arise in, for instance, the securities market, insurance, the mandatory provident fund scheme and, to a lesser extent, the banking sector.

12.6 Under the current framework, the FS is the most senior official looking after the economic, financial, fiscal and employment arenas in Hong Kong, over which he has to consider broad policy. Housed under the Bureau are all these matters relating to the detailed formulation of policy, the sponsoring of legislation through the Legislative Council and the monitoring of other executive bodies.

12.7 In other words, in the actual running of the Government, the FS looks after the biggest possible financial picture. The Secretary carries out his statutory duties and functions as well as assisting the FS when called

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upon to do so. There are, of course, practices already in place to ensure the smooth running of the system.

12.8 We are told that the Administration is in the process of working out a clearer division, but that the study has yet to be completed. In the light of the concerns raised over this lack of clarity, even though we are assured that the system works in practice, and that the Secretary has a fairly clear job description (See **Annex 12.1**), we believe that a clearer demarcation of roles would be welcomed by all and sundry.

12.9 At this juncture, we ought to re-iterate the caveat that our terms of reference (and the time constraints) would not allow us to venture too deeply into these and related areas. Our remaining observations have to be considered in the light of the caveat.

### **Political Responsibility under the Accountability Systems**

12.10 We attempt hereunder to set out our understanding of political responsibility under the accountability system. This is also subject to the same caveat about our terms of reference, the exigencies of time, plus our relative lack of expertise which we have tried to remedy, without notable success, over the past six weeks.

12.11 We start with the relatively simple proposition that there is no universal meaning that we know of which has been used to describe or define the term “political responsibility”.

12.12 Second, different political structures and systems attribute different consequences and effect to the term.

12.13 Third, what political responsibility means or entails depends in large measure on a territory’s history, politics, constitution, constitutional conventions, political sophistication and the system of government. So that in the United States, members of the Cabinet, not being in Congress, are only accountable to the President. In the United Kingdom, where the term originated, one of its consequences, after years of development and refinement, is for the Government to resign if it suffers a major setback in the Parliament. Similarly, cabinet ministers are sometimes expected to resign over major errors or gaffes, including those by underlings, if the delinquency or consequence is sufficiently serious.

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12.14 Fourth, as a matter of language, accountability means, or is at least the cognate of, the requirement or necessity to give an account of something, usually of what happened – the obligation to give an explanation, perhaps even to justify what happened or did not happen. It does not usually imply or stipulate what happens after an account has been given. Any further repercussion would depend on what happened, the severity of the consequences and the considerations adverted to in the third point made earlier. The contrast is with a dictator who does not have to explain, justify or to give an account of himself or herself.

12.15 With these preliminary observations, which we recognize lack depth and sophistication, we venture to offer a view as to what ultimately can legitimately be expected of someone in the position of the FS and the Secretary.

12.16 In the context of what we are now discussing, we believe that there are the following four broad categories of responsibilities. The first is policy responsibility. The second is executive responsibility. The third may be described as systemic responsibility, something relating to the design of the system. The fourth one is personnel responsibility, meaning whether those responsible and in a position to do so have appointed the right person(s) to do the job in question.

12.17 We use this incident as an illustration. First, policy responsibility. If a delisting mechanism for under-performing companies is the wrong policy, then allowing the policy would mean that a mistake has been made. If the idea to revise the delisting mechanism is a bad one, then the Secretary and even the FS would have to take at least some of the policy responsibility because they endorsed the principle or concept. In this case, however, there was and is overwhelming support for the policy, though there are different views on how the policy should be implemented, which is precisely why a public consultation was and is necessary.

12.18 Executive responsibility here would be in the crafting, design and drafting of the documentation as well as the rollout and publicity arrangements. Here, this would not be part of the responsibility of the FS or the Secretary.

12.19 Systemic responsibility would involve considering whether the three-tiered system is the right one and within the three-tiered system,

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whether each constituent was performing its function. The HKEx to formulate and draft, the SFC to offer suggestions and comment and the Secretary and the Bureau to give the necessary encouragement, support and co-ordination but not interfering. If something went wrong with the actual documentation or the consultation process by the HKEx and with the SFC, then it would not be the Government's systemic responsibility. If, however, the problem had lain with the three-tiered structure, that would be the Government's responsibility because the Government designed the system. In this case, the general view seems to be and our view is that the three-tiered system is sound in principle, though in the light of what happened, some refinements would not be out of place if they can lead to a clearer delineation of responsibilities, especially between the SFC and the HKEx and to better co-ordination within those two tiers.

12.20 Personnel responsibility here relates to whether the right people are in place and who appointed them.

12.21 Also, the FS as the most senior "financial" official would have at least a political duty to find out what happened, and, if necessary, to consider questions of blame and responsibility. Insofar as he is able to, the FS must also ensure that if something has gone wrong, that the problem is corrected as quickly as possible and to take steps to minimize the effect any such mistake may have on the economy. Thirdly, we believe that the FS also has the responsibility to make sure that measures are taken so that similar mistakes or mishaps do not happen again.

### **Remarks on the 29 July 2002**

12.22 The first point about the FS' remarks on the 29 July is that the Stock Exchange had not notified the Bureau of the Consultation Paper. This remark spawned comments that he was finger-pointing before all the facts were known. Also, the allegations were made that the FS was shirking his responsibilities and, worse, that he was misrepresenting the facts when he said that the Government had not been notified of the HKEx's Consultation Paper. It was, however, only on the subsequent Wednesday (31 July), that the Secretary informed him, contrary to what he had previously told the FS, that his staff had received the Executive Summary of the Paper from the HKEx. We have already covered this topic at paragraphs 9.16 and 9.17. The FS was clearly misinformed and no blame

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can be laid on him in respect of these remarks. He must be entitled to trust what the Secretary told him.

12.23 Regarding his remarks that the Stock Exchange might not have given sufficient thought to the details and might have under-estimated the market reaction, the reason the FS made them was that the 50 cents threshold did not appear to have been spelt out in the paper as essentially one for consolidation and it was somehow communicated to, or understood by, the public as a delisting criteria and trigger. Also, one of the obvious concerns would have been what shareholders could do if companies in which they hold shares were delisted. The FS took the view that some discussion of the desirability or otherwise of an alternative platform after delisting would have been, at the least, desirable, and may have avoided any panic. And since this was the Consultation Paper of the HKEx, it was reasonable and logical for him to have assumed that these were errors of judgment on the part of the HKEx. We agree. (See paragraph 7.87.)

### **Observations**

12.24 We have already described our views of the four-pronged responsibility of the FS. We are quite unable to say that he has failed to discharge any of those responsibilities. While the Incident may have disclosed some cracks in the actual operation of the three-tiered structure in terms of the delineation of responsibilities, especially between the HKEx and the SFC and what happens within the HKEx and its communication with the outside world, these are more wrinkles for the HKEx to address in the first instance. It is also our view that the FS, in conjunction with the Secretary, should supply the necessary authoritative encouragement to enable these difficulties to be resolved.

## **SECRETARY FOR FINANCIAL SERVICES AND THE TREASURY**

### **His Involvement**

12.25 The Secretary assumed office on the 1 July 2002. He was aware of the delisting proposal, but was not informed of, or consulted on, the details. In the context of preparing for the joint press conference on the 24 July, he was aware that the HKEx would announce the Consultation Paper on the 25 July. On the 17 July, his Administrative Assistant placed in his in-tray a copy of the SFC Summary Table setting out the gist of the

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proposal, but he did not see it. He had a dinner engagement that evening after which he flew to London and did not return to his office until Monday the 22 July. Also, he only became aware on the morning of the 31 July that the Bureau had obtained the HKEx Executive Summary which was not passed on to him. He then informed the FS accordingly.

12.26 Between the 25 July and 31 July, he was in constant touch with the FS, the SFC Chairman, the Chairman and Chief Executive of the HKEx as well as his contacts in the business and securities world trying to understand the situation and formulate strategies on how best to handle the incident.

### **His Responsibilities**

12.27 While appearing before the LegCo Financial Affairs Panel, he admitted that he should accept “a certain degree of responsibility”. We have already stated our view that both the Secretary and the FS have the responsibilities described in paragraphs 12.10 to 12.21. Leaving aside the Secretary's sub-par performance before the LegCo Panel meeting (as to which see our views at paragraphs 9.20 and 9.21), we do not think he has failed in the discharge of his responsibilities. We also note that the Secretary joined the Government on the 1 July 2002 and that, thereafter, he had a great deal of catching up to do. The change in job responsibility and culture would have taken some acclimatizing. We have seen his engagement diary. The Secretary clearly had a very full plate. On top of all that, he did not have a close geographical connection with his Bureau staff and communications somehow broke down, leading to confusion and misunderstanding over what actually happened. A very steep learning curve plus things going wrong when the Secretary was still inexperienced in his post contributed to the distressing encounter with the LegCo Panel on Financial Affairs. Moving forward, it is now necessary for the Secretary to take the lead in reviewing such systemic and other issues which may have contributed to what happened on the 26 July.

## **THE SFC CHAIRMAN**

### **His Involvement**

12.28 The SFC Chairman was aware of the delisting initiative, but was not involved in the details, including discussions about the price

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threshold, although he was kept generally in the picture. As this was a consultation document of the HKEx, only staff of the Corporate Finance Division were involved in the day-to-day communications with the HKEx. Unless matters of controversy or of important policy were involved, consultation papers of the HKEx would not be submitted to the SFC Chairman for approval or comment. He would be involved after the consultation and rule changes have been made by the HKEx and submitted to the full Commission for approval.

12.29 He was first informed of the idea of mandatory share consolidation in late 2000. There have been general discussions at internal staff meetings and he was briefed on the HKEx's proposals in broad terms in one of these meetings on 30 May 2002. He began to be involved from the 9 July onwards when he participated in a meeting to do with the PR roll-out plan for the 24 July and the SFC issued a press statement on the 25 July. Mr Sheng made certain comments at a press briefing on the 28 July and he first read the Consultation Paper after that briefing. He appeared before the LegCo Panel on Financial Affairs on the 31 July. He did not attend the SFC's media briefing on the quality of the Hong Kong market on the 25 July. We have already seen his earlier correspondence on the quality of the Hong Kong stock market with the SFS, Mr Stephen Ip, Mr Charles Lee, the Chairman of the HKEx and Mr Ma, the then newly installed Secretary.

### **Remarks on the 28 July**

12.1 An important event involving the SFC Chairman was the press briefing on the 28 July during which he made certain remarks in Cantonese, in response to a reporter's question, that the SFC did not "discuss with the HKEx any one price." In a subsequent follow-up question, he said, again in Cantonese, that "of course, a range of prices was discussed; a dollar, several tens of cents, and other prices were all discussed. But we did not specify (指定) one price.". The earlier remark, taken on its own, was considered inconsistent with the events inserted into the chronology presented by the Chief Executive of the HKEx at the special meeting of the Legislative Council Panel on Financial Affairs on the 31 July 2002. There were questions as to whether he was telling the truth.

12.31 We note that:-

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- (a) Mr Andrew Sheng's Cantonese, on matters technical, is less than articulate. He had read his statement in English at the press conference on the 28 July. The others, the Secretary, the Chairman and the Chief Executive of the HKEx, all used Cantonese in the briefing. Mr Sheng's normal practice was to answer media questions in the same language in which the questions were asked - a practice he adhered to, unwisely, on the 28 July.
- (b) After the press conference, Mr Sheng asked his staff whether his remarks may have caused confusion or misunderstanding about the SFC's role. Having checked the relevant record, SFC staff were satisfied that there should be no risk of confusion when the remarks were read in conjunction with the subsequent clarification. The SFC staff also monitored newspaper articles on the Monday and Tuesday. They reported that Mr Sheng had said that the SFC had discussed a range of prices. In view of this, the SFC staff did not see the need for clarification, which might have caused further debate. To assist journalists in understanding the full picture, staff from the Corporate Communications Division of the SFC sent to the media the relevant section of the transcript of the 28 July press conference.

### **His Responsibilities**

12.32 The confusion about Mr Sheng's remark on the 28 July is unfortunate. It should not have led to the serious recriminations subsequently, but it did and, with hindsight, it would have been better to have clarified the matter at the earliest possible moment. We do not, for a moment, consider that Mr Sheng meant to mislead and we also believe that, taking everything he said in context, there should not have been confusion.

12.33 Mr Sheng mentioned at the meeting of the LegCo Panel on Financial Affairs on the 31 July 2002 that he would accept full responsibility if there had been any errors in regulating the HKEx or if he or any of his staff had done anything wrong. We are not convinced that the SFC could have done much more, either in terms of its input into the Consultation Paper (see paragraph 7.45) or to have prevented what happened on the 26 July.

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We note the occasional difference and unhappiness between the SFC and the HKEx over their respective roles, philosophies and responsibilities over the regulation of listed companies as well as the communication channels within and between them. This incident has highlighted many of these differences and some of these wrinkles must now be ironed out.

## **CHIEF EXECUTIVE OF THE HKEX**

### **His Involvement**

12.34 The Chief Executive of the HKEx was involved in setting the direction and parameters of the Consultation Paper. The groundwork was done by his Listing Division staff. He did not participate in the day-to-day discussion between the Listing Division and the Corporate Finance Division of the SFC, but he was consulted on all key issues including the negotiation on the price threshold, and the presentation and timing for the release of the Consultation Paper. He discussed so-called “milestone” events with the Listing Division at regular and at ad hoc meetings. He also commented on a late draft of the Consultation Paper. He was a member of the Listing Committee although he did not attend the meeting on the 18 July. He presided at the press conference announcing the release of the Consultation Paper on the 25 July 2002.

### **His Responsibilities**

12.35 As the Consultation Paper was issued by the HKEx, the Chief Executive of the HKEx would have these responsibilities:-

- (a) **Executive responsibility.** He was and is the Chief Executive. This is the HKEx’s Consultation Paper. The Chief Executive need not condescend to all the details, but he has broad policy direction as well as the responsibility to ensure that the crafting, drafting and presentation of the Consultation Paper was all up to standard. As the most senior executive officer in the HKEx, he would have to bear responsibility on behalf of the HKEx for any major policy shortcomings in the preparation and release of the Consultation Paper, for instance the lack of sufficient emphasis that the 50 cents threshold was for consolidation and not for delisting, the lack of adequate discussion about

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alternative trading platforms, and the lack of adequate communication with the trade during the formulation process.

- (b) **Systemic responsibility.** The Chief Executive must ensure that proper systems and framework are in place within the HKEx, and between it and the SFC. In this connection, the Chief Executive adhered strictly to the standard practice not to sound out other parties before the actual consultation. He also observed the strict separation of the Board and Listing function with the result that the HKEx was not able to tap into the rich reservoir of expertise in the Board and in the Consultative Panels, to the extent that even the Chairman of the Board had no input into the Consultation Paper. The Chief Executive was following well-established practices. He should not be criticized for having done so. Having said that, we believe that these are practices well worth re-visiting. We have made (paragraphs 5.20, 7.70, 11.49, 11.50, 13.13 and 14.6 to 14.14) some suggestions and we note that the HKEx has produced suggestions of their own which we hope can be considered soon by its Board and by the SFC.

We have also made certain remarks about the role and function of the Listing Committee (See paragraphs 4.10, 4.11, 5.20, 5.21, 7.39 to 7.43 and 7.45(d)). We refer to them here not as a criticism of the Chief Executive of the HKEx for allowing that state of affairs to occur, but to underline the importance of making full use of the experience and expertise within the extended HKEx family (see also paragraphs 4.5 and 4.22)

- (c) **Personnel responsibility.** He was responsible for making sure that sufficient resources in terms of numbers and quality were devoted to the preparation of the proposals. In this case, it is not entirely clear whether, given the inherent complexity of the matter, sufficient resources had been allocated to this important exercise. On balance, we are not convinced that the Chief Executive should be faulted for this.

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## FINANCIAL SERVICES AND THE TREASURY BUREAU

### Involvement

12.36 Within the Bureau, there were three officers directly involved in this case:-

- (a) Mr Tony Miller – Permanent Secretary for Financial Services and the Treasury (Financial Services) (PSFS), who assumed duty on 1 July 2002
- (b) Miss Au King-chi – Deputy Secretary for Financial Services (1), (DS(1)) who oversaw the securities team and the special services team on the Securities and Futures Ordinance
- (c) Miss Salina Yan – Principal Assistant Secretary for Financial Services (Securities) (PAS(S)), who was the officer in de facto charge of securities matters.

12.37 Highlights of their involvement are in the table below. Unless otherwise stated, the principal participant in the events is Miss Salina Yan.

<b>Date</b>	<b>Event/Task</b>
October 2000 to November 2001	Miss Yan relayed concerns expressed by the Hong Kong Stockbrokers Association regarding penny stocks and dilution of shares to the SFC, and following up.
December 2001	Co-ordinated the setting up of the first tripartite meeting.
March – May 2002	Attended meetings of the Co-ordination Committee chaired by the Chief Executive of the HKEx, during which he mentioned the progress on the delisting proposals.
8 July 2002	Set up preparatory meetings to flesh out the key proposals and roll-out plan for the Secretary to announce the listing committee reform.
9 to 17 July 2002	Prepared materials for the Secretary regarding the press conference on 24 July 2002.
10 July 2002	Obtained the SFC Summary Table on the delisting proposals.
17 July 2002	Obtained the HKEx Executive Summary of the Consultation Paper.
17 July 2002	Passed copy of the SFC Summary Table to Administrative

Date	Event/Task
	Assistant to the Secretary.
18 July 2002	Prepared a brief analysis on the delisting proposal for the attention of DS(1) and PS(FS).
29 July 2002	Prepared chronology of events, which was subsequently passed to the Secretary and Financial Secretary, omitting the item about obtaining the HKEx Executive Summary. The chronology was cleared with DS(1) and PS(FS).
30 and 31 July 2002	Informed the Secretary about the omission.

12.38 The Bureau has policy responsibility for the development of the securities and futures market in Hong Kong. The PAS(S) is the main contact point at the working level on matters relating to the SFC and the HKEx. The Bureau did not and does not participate in deliberations by the regulator, the SFC or the market operator, the HKEx, on proposals for public consultation relating to changes to the rules of the HKEx. Where such proposals may support or further government policies, the Bureau keeps an eye on the general progress. The Bureau also reflects to the regulator and market operator any views conveyed to it by market users.

12.39 The Bureau first came across the subject of penny stocks in late 2000 during bi-monthly meetings between the Bureau and the Hong Kong Stockbrokers Association.

12.40 Three incidents are worth underlining. First, Miss Yan, sent a copy of the SFC Summary Table but not the HKEx Executive Summary to the Administrative Assistant to the Secretary. Second, she omitted the obtaining of the HKEx Executive Summary in her chronology for the Secretary, which was also sent to the FS. Third, she did not mention this omission until the morning of the 30 July 2002 and stressed the same to the Secretary on the 31 July 2002.

12.41 Miss Yan explained that she did not consider it necessary to send a copy of the HKEx Executive Summary because the SFC Summary Table was, in her view, “as helpful in the circumstances as the HKEx Executive Summary”. The SFC Summary Table, was in a format fit for submission to the Secretary for quick reference. We believed that her action was, in the circumstances, sensible and reasonable. It was not common for the HKEx to send advance copies of consultation papers or executive summaries to the Bureau. Had it not been for the need to co-

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ordinate the PR rollout plan for the Press Conference on 24 July, Miss Yan would not have asked for the HKEx Executive Summary.

12.42 On the second point, Miss Yan explained that she was under the impression that the chronology should show the overall development. Her chronology therefore only included salient events. In her view, the HKEx Executive Summary was similar in nature to the SFC Summary Table. Moreover, she was asked to prepare the document at short notice during the weekend when the office was closed. Since the relevant files were not available, she only managed to put together a rough draft based on what she had. The omission should not have been material, and Ms Yan should not be faulted for leaving out that item in the chronology.

12.43 Miss Yan's action was, in our view, reasonable and understandable given that both the SFC Summary Table and the HKEx Executive Summary were obtained as background material for the joint press conference on the 24 July 2002. They were not supplied to the Bureau as part of the SFC's and the HKEx's efforts to inform the Bureau on the details of the proposals included in the draft Consultation Paper. Both documents served a similar purpose. It was perhaps unfortunate that, not knowing of the omission, the FS had made some remarks on the basis and understanding that the HKEx had not told the Bureau about the Consultation Paper.

### **Responsibilities**

12.44 The Bureau's involvement from late 2000 has been dealt with. It drew to the attention of the SFC the problem, it encouraged the HKEx to engage stockbrokers and it set up and participated in different meetings to encourage better communication between, in particular, the SFC and the HKEx. In the process, we believe it managed to get the balance about right. What it did would not have been seen as interference, yet it provided a level of co-ordination previously lacking. We do not think that the Bureau should be faulted, the mix-up with the summaries and the chronology notwithstanding.