

For information

**Legislative Council
Panel on Financial Affairs**

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

Introduction

The Panel of Inquiry on the Penny Stock Incident (PIPSI) published its report on 9 September 2002 with a number of recommendations for the Hong Kong Exchanges and Clearing Limited (HKEx), the Securities and Futures Commission (SFC) and the Government. This paper summarises the progress of the implementation of the PIPSI recommendations for Members' information.

Implementation of PIPSI recommendations

2. The Government, SFC and HKEx are pressing ahead with reform measures to enhance the transparency and quality of the financial markets, and corporate governance in Hong Kong. Consultations will continue to be conducted on issues of concern to the public when taking forward the necessary reforms.

Engaging the market and the public

3. HKEx recognises the importance of engaging the market and the stakeholders early and effectively in the preparation of consultation documents. To this end, it has set up networks for sounding out various stakeholders groups, as appropriate, when formulating the concept and framework of consultation proposals. For proposals concerning listing matters, the HKEx Board and Listing Committees have agreed on a pre-sounding mechanism whereby the Listing Committees, SFC executives, non-executive directors of HKEx and, where appropriate, ad hoc working groups with relevant representation from the market, will be engaged in the early stage of the policy formulation process. In addition, HKEx has widened continuing communications with the market. For instance, HKEx executives hold regular meetings with financial intermediaries and market practitioners to discuss topical issues and receive views to facilitate the formulation of policies on listing.

4. In line with the PIPSI recommendations, HKEx will consider conducting a two-stage consultation for complicated proposals, i.e. a consultation on conceptual and regulatory philosophy issues, followed by a consultation on the detailed proposals.

5. HKEx has agreed with SFC for HKEx to consult SFC's Shareholders Group and Advisory Committee on relevant issues of interest either on a presounding basis or with draft consultation papers. SFC and HKEx will assess the extent of involvement desirable in relation to individual proposals. As a result of this arrangement and having regard to the presounding mechanism and measures of widening communication with the market discussed above, HKEx believes that there is no need to establish a separate and potentially duplicative shareholders group on its own.

Assessing market reactions

6. HKEx adopts the practice that when conducting consultations on regulatory proposals, the relevant consultation papers would contain explanations of the purpose and likely effect of the proposals, including their effect on the investing public, in sufficient detail. In seeking the approval of the Listing Committees for the issue of consultation papers, HKEx provides an analysis of the likely effect of the proposals including the effect on the investing public, for the Listing Committees' consideration.

7. Similarly, HKEx will bring to SFC's attention the likely market reaction to the consultation proposals, if any, as a matter of standard practice. SFC will bring any issues that are likely to have policy ramifications or cross-market impact to the attention of the Administration.

Improving the consultation process

8. HKEx has taken on board the PIPSI recommendations to improve the consultation process. HKEx agrees that consultation papers should contain general discussions of the concepts, and be designed to encourage and allow the public to express their views on general directions and possible options. HKEx will take into account the sensitivity, technicality and complexity of the subjects when deciding the length of the consultation period.

9. HKEx will also continue its reach-out programmes after the release of its consultation papers and where necessary organise special sessions and seminars to brief stakeholders. In line with existing practice, HKEx will issue

conclusion reports after completion of consultations, summarising the views and comments received, HKEx's observations and responses, and the conclusion.

Reviewing the three-tiered regulatory structure

10. In order to strengthen the current liaison mechanism, HKEx and SFC have jointly established in December 2002 a new high-level body known as the HKEx/SFC High Level Group on Listed Company Regulation. The membership of the High Level Group includes Chairmen of SFC and HKEx, Chief Executive of HKEx, Chairmen of the Main Board and Growth Enterprise Market Listing Committees, Chairman of the Takeovers and Mergers Panel of SFC and senior executives of SFC and HKEx. The High Level Group meets regularly to discuss topics of interest relating to listed company regulation.

11. SFC and HKEx have also revised their Memorandum of Understanding (MOU) relating to listing matters to clarify their respective roles and responsibilities in respect of the new "dual filing" regime under the Securities and Futures Ordinance and policy formulation. The revised MOU was signed on 28 January 2003.

12. The Financial Secretary (FS) appointed an Expert Group in September 2002 to review the roles and functions of the Government, SFC and HKEx over matters relating to listing of securities, and the lines of communication among the three parties. The Expert Group is expected to submit its report to FS by end of March 2003. We will consider carefully the Expert Group's recommendations on improvement of the listing functions and delineation of the roles of the Government, SFC and HKEx under the tiered regulatory structure, and take them forward as appropriate.

13. In line with the PIPSI recommendations, we have taken concrete measures to communicate the Government's role as a facilitator and co-ordinator clearly to the industry and the investing public, such as including this message in the website of the Financial Services and the Treasury Bureau and other widely circulated Government publications.

Relationship between FS and Secretary for Financial Services and the Treasury (SFST)

14. In light of the PIPSI recommendation, the Government is conducting a review on the division of responsibilities between FS and SFST, and the related issue of the definition of FS under the Interpretation and General Clauses Ordinance (Cap. 1). This subject will be dealt with in another information note to be issued to Members.

Strengthening investor education and protection

15. SFC and HKEx place great emphasis in the protection and education of investors and shareholders. SFC distributes publications through various channels, including Consumer Council's advice centres, and conducts media programmes, such as radio segments, regular newspaper columns, to explain the basics of investing and the rights and obligations of investors. SFC also maintains an electronic Investor Resources Centre, which serves as a centralised source of information on investing and allows investors to conduct research through the Internet. Besides, SFC produces video series for broadcast on public transportation and replicates the series on VCDs for free distribution. SFC will continue to organise seminars and workshops proactively to raise the general financial literacy of the population and promote proper attitudes towards investing. These will include education initiatives, such as teaching kits and market update workshops for secondary school teachers and general education courses for university students. HKEx, on the other hand, organises regular seminars to familiarise investors with the features and functions of new financial products.

16. The Government will continue to act as the co-ordinator and facilitator and work with the parties concerned to further promote investor education and enhance the rights of shareholders in Hong Kong.

Conclusion

17. The Government, SFC and HKEx have substantially implemented the PIPSI recommendations. The three parties will continue to follow up the initiatives on an on-going basis with a view to improving the consultation process and the regulatory regime for the securities and futures market as a whole.

Financial Services Branch
Financial Services and the Treasury Bureau
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