Consolidated Comments from the Securities and Futures Commission ("SFC") and The Stock Exchange of Hong Kong ("Exchange") in response to the list of follow up questions dated 28 November 2006 following the Special Meeting on 23 November 2006

1. *Members express grave concern about the discrepancies in the information on the developments of the PCCW deal as provided in Mr Richard LI's letter dated 15 November 2006 and in Mr Francis LEUNG's Statement dated 21 November 2006. In particular, they consider that there is considerable confusion over whether Mr Richard LI had knowledge of Mr LI Ka-shing's involvement in the deal. Noting from the paper provided by the Securities and Futures Commission (SFC) and The Hong Kong Exchanges and Clearing Limited (HKEx) (Last paragraph of LC Paper No. CB(1)308/06-07(01)) that "listed issuers are subject to a general requirement to ensure announcements are accurate and complete in all material respects and not misleading or deceptive", members have requested SFC/HKEx to advise the Panel of the following, where practicable:*

   (a) Whether investigation has been carried out on the compliance or otherwise with the above-mentioned general requirement by parties concerned in making public announcements relating to the proposed sale of shares of PCCW;

   On 3 October 2006, the SFC commenced an investigation under section 182(1) of the Securities and Futures Ordinance ("**SFO**") into whether PCCW or persons connected with it may have provided any false or misleading information to the market contrary to section 384 of the SFO.

   The SFC was not prepared to disclose or confirm the fact of this investigation at the Special Meeting on 23 November 2006. This was in line with the SFC's statutory obligations. The SFC was particularly conscious of the need to preserve confidentiality and the reputation and good will of relevant parties pending a decision on the share sale by the independent shareholders of Pacific Century Regional Developments Ltd ("**PCRD**").

   This concern has disappeared now the independent shareholders of PCRD have met and made their decision.

   In this context, the SFC believes that it is now appropriate to disclose the fact of the investigation. This is in line with section 378(1) of SFO which provides that SFC's obligations to preserve secrecy applies except in the performance of a function under the SFO, and section 5(1)(g) which provides that it is SFC's function to maintain and promote confidence in the securities and futures industry in such manner as it considers appropriate, including by the exercise of its discretion to disclose to the public any matter relating or incidental to the performance of any of its functions.

   The Exchange has closely monitored the company's regulatory disclosures and media coverage as it has developed since June 2006 when PCCW had made its initial announcement with respect to a possible sale of its telecommunications and media assets. Throughout this period the Exchange has been particularly mindful of the issue of compliance with the applicable Listing Rules by PCCW. In accordance with its usual practice, the Exchange sought clarifications when appropriate. Based on information available, it is the Exchange's current view that no further action should be taken in relation to concerns about compliance with the Listing Rules in relation to this matter.

(b) *If the answer to (a) above is in the affirmative, to provide the Panel with the findings of the investigation and to address members' concern about whether the interests of minority shareholders of PCCW have been adequately safeguarded.*

The SFC has now completed its fact finding and is in the process of reviewing the material. Based on the information gathered the investigation is not likely to result in any further action. The SFC will not disclose further details of the investigation due to the secrecy provisions in section 378 of the SFO.

When the case is complete it will be available for review by the Process Review Panel (PRP) established by the Chief Executive in November 2000 to review the SFC's internal operational procedures. The 2005 Annual Report of the work of the PRP includes the following explanation of the rationale for the establishment of the PRP, which is highly relevant here:

> "The Administration, in consultation with the SFC, concluded that it would be preferable to improve the transparency of the SFC's internal processes across the board, so that the public would be better able to see for itself that the SFC did indeed act fairly and consistently in the exercise of its powers.
>
> The SFC's ability to demonstrate that it already operates in this fashion is however constrained by statutory secrecy obligations which limit the extent to which the SFC can divulge information to the public regarding what it has or has not done when performing its regulatory functions.
>
> In order to enhance the transparency and public accountability of the SFC, without compromising its confidentiality, the Administration saw merit in establishing an independent body to review the fairness and reasonableness of the SFC's operational procedures on an on-going basis and to monitor whether its procedures are consistently followed and to make recommendations to the SFC in relation to these objectives."

Members may wish to note the PRP is also subject to the secrecy provisions in section 378 of the SFO.

The primary responsibility for safeguarding minority shareholders interests lies with a company itself and its board of directors who are under a fiduciary duty to act in the best interests of a company. The question of whether or not a director of a listed company has acted in the best interests of the company and whether he has breached his fiduciary duties is ultimately a matter for a court of law to decide.

(c) *If SFC/HKEx decide against disclosing the information requested in (a) and (b), the statutory basis or policy consideration for such a decision.*

See the responses to questions 1(b) above and 2(a) below.

2. *Members note that under section 378(3)(a) of the Securities and Futures Ordinance (SFO) (Cap. 571), SFC may disclose information in the form of a summary compiled from any information in its possession. In this connection, SFC/HKEx are requested to provide a more detailed analysis of the aforesaid section, including the following:*

Section 378(3)(a) of the SFO provides that "Notwithstanding subsection (1), the Commission may disclose information…in the form of a summary compiled from any information in the possession of the Commission, including information provided by persons under any of the

relevant provisions, **if the summary is so compiled as to prevent particulars relating to the business or identity, or the trading particulars, of any person from being ascertained from it**;" (emphasis added).

Any summary that the SFC could provide of its activities in relation to the PCCW matter would inevitably fail to comply with the highlighted part of section 378(3)(a) set out above. Therefore, this is not an available gateway to enable the SFC to disclose information about this matter.

(a) The policy intent and interpretation of section 378 of SFO, including the application of the said section on cases where public interests are at stake.

In the SFC's view, the secrecy obligation in section 378 exists to safeguard –

- the public interest that the SFC should not be compromised in its operations and the pursuit of its regulatory objectives by the leakage of information;
- the right of all persons, whether individuals or corporations, to be presumed innocent until proven guilty;
- the reputation of individuals and the good will of firms investigated by the SFC or undergoing disciplinary proceedings;
- commercially sensitive information that intermediaries, and others co-operating with the SFC, would be unwilling to disclose to the SFC if there were a danger that the information would be revealed to other intermediaries;
- the integrity of the market, for example by keeping price-sensitive information secret pending its release (perhaps in the form of an announcement by a listed corporation) to the market; and
- the status of Hong Kong as an international financial centre, by ensuring that the SFC complies with international standards of confidentiality comparable to those observed by its counterpart regulators in all major markets.

Section 378 is a complex provision but it comprises three main elements:

- Section 378(1) contains the obligation to preserve secrecy. It provides that a specified person[1] "shall preserve and aid in preserving secrecy with regard to any matter coming to his knowledge by virtue of his appointment under any of the relevant provisions,[2] or in the performance of any function under or in carrying into effect any of the relevant provisions, or in the course of assisting any other person in the performance of any function under or carrying into effect any of the relevant provisions". However, the *chapeau* to section 378(1) provides that the secrecy obligation applies "[e]xcept in the performance of a function under, or for the purpose of carrying into effect or doing anything required or authorized under, any of the relevant provisions". (See further below).

[1] A "specified person" is defined in section 378(15) as including the SFC, persons working for the SFC and anyone assisting such persons in the performance of any function under or carrying into effect any of the relevant provisions.

[2] The term "relevant provisions" is defined in Schedule 1 to the SFO as meaning the SFO, subsidiary legislation made under the SFO and certain provisions in Parts II and XI
I of the Companies Ordinance.

- Section 378(2) provides that certain matters are not covered by the secrecy obligation at all. These include the disclosure of information in accordance with a court order.
- Section 378(3) lists a number of persons to whom the SFC may disclose information despite the secrecy obligation. Such persons include a liquidator appointed under the Companies Ordinance and the Securities and Futures Appeals Tribunal.

The exception in section 378(1), mentioned above, is the crucial provision in this context. The SFC's key functions are specified in section 5 of the SFO. Section 5(1)(g) provides that it is one of the SFC's functions "to maintain and promote confidence in the securities and futures industry in such manner as it considers appropriate, including by the exercise of its discretion to disclose to the public any matter relating or incidental to the performance of any of its functions". Section 6(2)(d) of the SFO provides that in performing its functions the SFC "shall have regard to…the importance of acting in a transparent manner, having regard to its obligations of preserving secrecy and confidentiality…".

The SFC does not normally disclose the fact that it is conducting an inquiry or investigation into any matter. This is similar to the practice of other major regulators.[3] The UK Financial Services Authority ("**FSA**") will make a public announcement that it is or is not investigating a matter where there has been public concern, speculation or rumour and it is necessary to make an announcement in order to maintain public confidence in the financial system, protect consumers, prevent widespread malpractice or help the investigation itself e.g. by bringing forward witnesses. The Australian Securities and Investments Commission ("**ASIC**") will make such an announcement when it is in the public interest to do so e.g. where there has been a major corporate collapse. Both the FSA and ASIC are subject to confidentiality requirements under their respective laws that are similar to those applicable to the SFC under section 378 of the SFO.[4]

In common with the FSA and ASIC, the SFC has on a number of occasions decided that the circumstances warranted the disclosure of the fact that it was conducting an inquiry into a company[5] under section 179 of the SFO or an investigation under section 182 of the SFO. Before doing so, the SFC will take into account its obligations to those who may have provided confidential information to the SFC, the risk of reputational damage to third parties and the risk of prejudice to the SFC's functions. The SFC is also conscious of its obligation to exercise its duties and perform its functions fairly.

The SFC has disclosed the fact that it was conducting an inquiry or investigation on four occasions so far this year. It did so in general terms in relation to each of the three

[3] The US Securities and Exchange Commission is even stricter and does not disclose such information at all.
[4] Section 349(1) of the Financial Services and Markets Act 2000 provides that the confidentiality requirement in section 348 does not prevent the disclosure by the FSA "of confidential information which is (a) made for the purpose of facilitating the carrying out of a public function; and (b) permitted by regulations made by the Treasury under this section". Section 127(3) of the Australian Securities and Investments Commission Act 2001 provides that "the disclosure of information by a person for the purposes of…performing the person's functions as…a member, staff member or ASIC delegate…is taken to be authorized use and disclosure of the information".
[5] The SFC would not disclose the fact that it was conducting an inquiry or investigation in relation to an individual.

broker failures (Whole Win Securities, Tiffit Securities and Wing Yip Company) and regarding the listed Ocean Grand Holdings Limited and Ocean Grand Chemicals Holdings Limited. In each of these cases, which involved corporate or broker collapse, this was to reassure investors and the general public that appropriate action was being taken without revealing any of the details of the inquiry or investigation.

Such disclosure is decided on a case-by-case basis in the light of the following functions and objectives of the SFC:

- to maintain and promote confidence in the securities and futures industry (section 5(1)(g) SFO);
- to provide protection for members of the public investing in or holding financial products (section 4(c) SFO);
- to minimize crime and misconduct in the securities and futures industry (section 4(d) SFO); and
- to reduce systemic risks in the securities and futures industry (section 4(e) SFO).

Members may wish to note that the secrecy provisions had been thoroughly debated back in 2001 before the Securities and Futures Bill was passed. Members noted that to protect the privacy and proper business interests of those regulated, the regulator had to operate to a certain extent in confidence, thereby restricting public scrutiny. The current section 378 has also addressed the concerns of Members of the Bills Committee on Securities and Futures Bill and Banking (Amendments) Bill 2000, including the view that the SFC's obligation to preserve secrecy should not be too relaxed.

(b) Whether HKEx is bound by the secrecy requirements under section 378 of SFO and if so, the relevant provisions in the section applicable to HKEx. The legal adviser to the Panel has also been invited to provide input, if necessary, on (a) and (b). Members have also urged SFC/HKEx to seriously consider disclosing information on the proposed sale of PCCW's shares to allay public concerns about irregularities, if any.

The Exchange performs a function under provisions of the Securities and Futures Ordinance ('the Ordinance'), and accordingly the obligations of secrecy found in section 378 of the Ordinance attach to its regulatory work. The basis for this conclusion is set out below.

Section 378 of the Ordinance applies to a "specified person" in the performance of a function under, or for the purpose of carrying into effect or doing anything required or authorised under, any of the "relevant provisions". The term "specified person" is defined in section 378(15) to include any person appointed under any of the relevant provisions, or performing any function under or carrying into effect any of the relevant provisions. The term "relevant provisions" is defined in Schedule 1 to the Ordinance to include the provisions of the Ordinance.

The Exchange has a statutory duty under section 21 of the Ordinance to maintain an orderly, informed and fair market for the trading of securities, and to act in the interest of the public in the discharge of such duty. In furtherance of this, the Exchange is empowered by section 23 of the Ordinance to make rules for, inter alia, the proper regulation and efficient operation of the market. The functions performed by the Exchange with a view to maintaining an orderly, informed and fair market are therefore functions for the purpose of carrying into effect provisions of the Ordinance. The

Exchange is therefore a "specified person" for the purposes of section 378 and accordingly in performing its regulatory role the Exchange is required to observe and is bound by the requirements of secrecy imposed under section 378 of the Ordinance.

On Members' request for disclosure of information on the proposed scale of PCCW's shares, please see the response to question 1.

3. *Noting from Mr Francis LEUNG's press release issued on 12 November 2006 that the Takeovers Executive (the Executive) of SFC has ruled that there is not sufficient evidence to conclude that Mr Francis LEUNG, Mr LI Ka-shing, LI Ka Shing Foundation Limited and LI Ka Shing (Canada) Foundation are acting in concert in respect of PCCW within the meaning of the Code, members are concerned about the factors/circumstances which have been considered by the Executive in arriving at the ruling, in particular whether any exemption has been granted. In this connection, members have urged SFC to consider publishing its ruling and the underlying reasons pursuant to paragraph 16.3 of the Introduction of The Codes on Takeovers and Mergers and Share Repurchases.*

The Executive intends to publish a statement in due course, subject to confidentiality considerations as provided under section 16.3 of Introduction to the Takeovers Code, setting out the details of its ruling and the reasons for it so that its activities may be understood by the public.