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LEGEND OF ABBREVIATIONS

ASX	Australian Stock Exchange Limited
ASXSR	Australian Stock Exchange Supervisory Review Pty Limited
CCB	Commercial Crime Bureau of the Police
CSRC	China Securities Regulatory Commission
FS	Financial Secretary
FSA	Financial Services Authority (United Kingdom)
FSTB	Financial Services and the Treasury Bureau
GEM	Growth Enterprise Market
HKEx	Hong Kong Exchanges and Clearing Limited
HKLA	Hong Kong Listing Authority
HKMA	Hong Kong Monetary Authority
ICAC	Independent Commission Against Corruption
IOSCO	International Organisation of Securities Commissions
IPO	Initial Public Offering
LSE	London Stock Exchange
MAS	Monetary Authority of Singapore
NYSE	New York Stock Exchange
PIPSI	Panel of Inquiry on the Penny Stocks Incident
RS	Market Regulation Services Incorporated (Canada)
SEC	United States Securities and Exchange Commission
SEHK	Stock Exchange of Hong Kong Limited
SFAP	Securities and Futures Appeals Panel
SFAT	Securities and Futures Appeals Tribunal
SFC	Securities and Futures Commission
SFCO	Securities and Futures Commission Ordinance
SFO	Securities and Futures Ordinance
SFST	Secretary for Financial Services and the Treasury
SGX	Singapore Exchange Limited

EXECUTIVE SUMMARY

INTRODUCTION

1. The Report of the Panel of Inquiry on the Penny Stocks Incident (PIPSI Report) included as one of its recommendations to the Government that a study should be undertaken to review the three-tier regulatory structure relating to listing matters with a view to increasing its effectiveness, efficiency, clarity, fairness and credibility. As a result of this, the Financial Secretary (FS) announced on 26 September 2002 the appointment of a three-member Expert Group to review the roles and functions of the Government, Securities and Futures Commission (SFC) and Hong Kong Exchanges and Clearing Limited (HKEx)[1] over matters relating to the listing of securities and issuers with listed securities, the operation of the regulatory structure as regards listing matters and the lines of communication among the three tiers. The Expert Group was tasked to submit a report with findings and recommendations for improvements before the end of March 2003.

2. During the course of our work we received 28 written submissions, met with 33 interested groups and individuals, and conducted 65 personal interviews. Our respondents included the three tiers themselves, industry associations, Legislative Councillors, institutional investors both local and international, retail investor representatives, overseas regulators, small broker associations, investment banks, commercial banks, enforcement agencies, members of the legal and accounting professions, academics, listed companies both large and small, members of various regulatory committees and bodies, and others. We are satisfied that our discussions have been sufficiently wide-ranging to give us a comprehensive understanding of the issues involved and the range of opinions held. We have looked at the relevant laws, in particular the Securities and Futures Ordinance (SFO) (Cap. 571) which is a

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[1] We shall refer generally to Hong Kong Exchanges and Clearing Limited, its subsidiary Stock Exchange of Hong Kong Limited (SEHK), and other members of the group, as HKEx, for convenience, distinguishing between them only when strictly necessary.

consolidation of the ten existing ordinances governing the operation of the securities and futures markets and will come into effect on 1 April 2003. We have also studied the regulatory structures of the major international markets and global trends regarding market regulation.

3. We would like to sincerely thank these respondents, many of whom gave considerable time and thought to their submissions and comments. Many clearly hold strong views on the subjects under review and wish to contribute for the long-term good of Hong Kong and its financial markets. We would also like to thank the authors of the PIPSI Report which provided us with considerable background material as we embarked on our work.

4. Our observations and conclusions represent a distillation of the views expressed and we have not attributed specific opinions or proposals except in cases where the respondent has approved our doing so. Our recommendations are unanimous.

5. We have arrived at our conclusions and recommendations with due regard to the Government's stated objective of developing the Hong Kong market into "the premier capital formation centre of China"[2], "the Asian-time-zone pillar of the global futures and derivative markets and one of the top five equities markets in the world"[3]. If there were a different objective, it is quite possible that our conclusions would be different.

6. Our work has confirmed that Hong Kong's legal, business and technological infrastructure is widely respected by market participants both in Hong Kong and in the international community. The HKEx, during the past decade, has established itself as the venue of choice for leading Mainland enterprises wishing to tap the international capital markets. Hong Kong's pool of professional talent in the financial services sector is unrivalled in Asia. The SFC is held in high regard by its peers and among

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[2] Paragraph 17 of the Address by the Chief Executive the Honourable Tung Chee Hwa at the Legislative Council meeting on 8 January 2003.

[3] Paragraph 2.3 of the paper entitled "Hong Kong Exchanges and Clearing Limited: Reinforcing Hong Kong's Position as a Global Financial Centre" issued by the then Financial Services Bureau of the Hong Kong Special Administrative Region Government in July 1999.

other things, is a prominent and active member of the International Organisation of Securities Commissions (IOSCO) and of its Technical Committee, the group of regulators from markets recognised as well established and highly developed.

7. However, our work has also revealed a number of disturbing trends which, if unchecked, will undermine the stature that Hong Kong has established and will curtail its development potential.

8. We are well aware of the economic difficulties Hong Kong is facing and the prevailing mood of uncertainty. We also recognise that some of the sentiment expressed to us may appear to be critical of the current listing regime. But we believe that most respondents genuinely want to see reform and a strengthening of Hong Kong's position as an international financial centre. We are confident that the changes which we propose will enhance investors' confidence in and increase the competitiveness of the Hong Kong market. We see this as an opportunity for the Government to implement change which will ensure the healthy development of Hong Kong's financial markets and contribute significantly to Hong Kong's economic future.

ISSUES IDENTIFIED

9. Although many issues have been brought to our attention and will be discussed in detail later in the report, we have attempted to classify them into five major areas. As will be seen, all of them are inter-related and have important implications for investor protection and corporate governance. Our recommendations attempt to address all of these issues to the greatest degree possible.

(A) Quality of Market

10. There has been rising concern both in Hong Kong and overseas about the quality of the listings coming to the HKEx in recent years. Indeed, the origins of the Penny Stocks Incident itself reflected an effort by all parties concerned to address this issue.

11. Our study has revealed that there is a widespread belief that in the effort to achieve critical mass and maximise the quantity of new listings, the quality of the new listings on the HKEx has been seriously compromised. During 2002, for example, there were 117 new listings on the HKEx – an increase of 33% over 2001. This was achieved despite an 18% decline in the Hang Seng Index and a 17% decline in secondary market turnover. It was also in the context of a 36% decline in initial public offering (IPO) issuance globally and a net reduction in listed companies both in New York and London. To the extent that the increase in Hong Kong might be thought to be attributable to continuing economic growth in the Mainland, it is interesting to note that in 2002 there was also a 12% decline in new listings in Shanghai. As at the end of February 2003, 60% of the 117 new listings were trading below their IPO price, some of them by more than 90%. Half were trading below HK$0.50 (US$0.06)[4].

12. We have been told that only a handful of these new listings in Hong Kong were of any interest to professional investors or international sponsors. Indeed, some major international investment institutions told us that they only bought one or two of these offerings. Of the 60 Main Board listings, only five were sponsored by global investment banks. Only two

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[4] We have adopted the exchange rates of HK$7.8 to US$1.0 and HK$0.95 to RMB1.0 throughout the report.

of the 57 Growth Enterprise Market (GEM) listings were sponsored by global investment banks. Many respondents observed that Hong Kong has become a two-tier market with a small number of relatively high quality companies which are of interest to professional and international investors and a much larger number of companies which are not. The five Main Board issues referred to above sponsored by global investment banks accounted for 86% of the total funds raised on the Main Board.

13. It is notable that a large number of the remaining issues in both markets were very small in terms of total funds raised. Excluding the five issues referred to above, the average funds raised on the Main Board were about HK$114.2 million (US$14.6 million). A significant number raised the exact minimum amount allowable of HK$50 million (US$6.4 million). As a point of reference, the average funds raised in Shanghai last year was HK$701.2 million (US$90 million). Excluding the five issues referred to above, the average IPO price in Hong Kong in 2002 was HK$0.79 (US$0.10). The average IPO price in Shanghai was RMB7.17 (US$0.87). There is a danger that such new listings might cause international investors to come to view Hong Kong as a "penny stock market" whatever definition is applied. This is not to say that smaller companies are necessarily of poor quality. However, many of the new listings in Hong Kong did not attract meaningful levels of either institutional or retail investor interest and had negligible secondary market turnover. Many of them seem to have questionable initial spreads of shareholdings among the minimum number of unassociated holders, and have had poor post-listing performance.

14. Indeed, in many cases, it is difficult to establish just what the motivation for listing was; all that is clear, is that it was not the traditional purpose of raising funds from public investors to invest in an expanding business and create economic value and employment. We do not suggest, of course, that all public issues of shares are or need to be made for that purpose. Other reasons include creating liquidity, such as providing an opportunity for a wider range of investors to invest in an established and successful business, without an associated capital raising, but that is happening very rarely. Some issues appear to be contrived transactions to achieve listed status for some unclear or at least undisclosed objectives.

15. Furthermore, in recent years, many companies newly listed in Hong Kong have required regulatory attention because of false or misleading information being provided to investors and there has been an

increasing number of high profile corporate scandals. There is concern in the marketplace that there may be more to come.

16. The GEM market is not viewed as a success. Genuine investor interest is negligible. The performance of many issues has been poor with the GEM index falling by some 90% since its peak in March 2000, and by 45% in 2002 alone. Secondary market turnover is minimal and declining. Average daily volume fell from HK$253 million (US$32.4 million) in the first quarter of 2002 to HK$94 million (US$12.1 million) in the fourth quarter. About 80% of the stocks listed on the GEM market are trading at or below their IPO price. On most days during the period of our work, about half of the stocks listed did not trade at all and a number were suspended for a variety of regulatory reasons.

17. While there are a number of mitigating circumstances such as the deflation of the technology bubble, and while similar markets around the world have also fared badly, the fact remains that there have been few success stories. The GEM secondary market might be described as moribund and yet there were 57 new listings in 2002 and there appears to be a continuing high level of applications as we enter 2003. Such circumstances inevitably raise questions about the motivations of controlling shareholders and sponsors, the true placement of initial offerings and indeed the very existence of a genuine public float.

18. The SFC and HKEx have publicly expressed concern about this continued deterioration of new listings on both the Main Board and GEM. The failure of the current listing regime to arrest this trend indicates some degree of dysfunctionality.

19. In a disclosure based listing regime where *caveat emptor* (or buyer beware) is the guiding principle, there are obvious risks if the quality and veracity of information disclosed fall short of acceptable standards. In an attempt to build critical mass for competitive purposes the trade-off between quality and quantity is an important one. If too many poor quality companies are allowed to list then a market's reputation can be tarnished and it can have negative critical mass. Such an approach, where quantity is emphasised and quality addressed by relying on others to police wrongdoing, would be, in our opinion, fundamentally flawed and would operate to the long-term detriment of Hong Kong as an international financial centre.

20. It is inherent in a capitalist system, and in a stock market, that there will be both "good" and "bad" companies, and that some companies will succeed and some will fail. No system can entirely prevent poor quality companies from listing. In Hong Kong however the pendulum has swung too far. If too many companies engage in market misconduct, fail to trade after listing, or appear not genuinely to meet minimum requirements for spread of holdings, then damage is done to the credibility of all companies on that market, and those companies and their investors can suffer loss of value as a result. A number of Hong Kong's largest and highest quality companies have expressed concern to us that they are already being penalised in terms of valuation by this deterioration.

21. There are already signs that the high standing of the market as a whole is being tainted by the performance of many of the poor quality stocks. In the long term, this could lead to lower valuations, reduced liquidity and a higher cost of capital. If Hong Kong is to retain its perceived advantage of being a high quality, developed market capable of attracting the Mainland's best companies and investors who want to invest in the world's fastest growing major economy, it is essential that this problem is addressed as soon as possible.

(B) Conflict of Interests

22. No issue has been subject to such heated debate as the one concerning the appropriateness of the HKEx as a listed company retaining its role as the primary regulator of companies seeking entry to the stock market and of their conduct after listing.

23. In fact, the issue is considerably more complex than sometimes perceived. Firstly, the HKEx is listed on its own market. Secondly, it might have business relationships with other listed companies subject to its regulation. These conflicts have proven manageable by special arrangements whereby the SFC effectively takes over the regulatory role in such cases.

24. However, as a listed company motivated by profitability, the HKEx has a clear interest in listing as many companies as possible since listing fees represent a significant portion of revenues (12% in 2000; 14% in 2001; and 18% in 2002), and there is a disincentive to allocate resources to enforcement which is costly and produces no revenue. This is considerably more problematic in that while the HKEx has built an internal

"Chinese wall" intended to separate its business and regulatory activities, the Board of the HKEx still decides the allocation of resources to the regulatory function and as will be seen, the separation is more one of form than substance.

25. Furthermore, we note that a significant number of the Listing Division staff of the HKEx are holders of pre-listing share options and that all full-time staff in the Division are eligible for consideration for a discretionary performance-linked bonus. Bearing in mind that the Listing Committee has sub-delegated much of its work to the Listing Division, this is inconsistent with the notion that the business and regulatory activities of the HKEx are effectively separated.

26. These matters are discussed in detail in paragraphs 2.12 to 2.31 of Chapter 2 – Listing Committee, but in summary, our conclusion is that despite the undoubted quality and integrity of so many of the people involved, the present structure is fundamentally flawed. There is little accountability for the listing function; the listing function is unable to benefit from the wisdom and experience of the HKEx Board; and the system is not even making best use of the Listing Committee members. The outcome has been a rigid and mechanistic approach to the listing process as opposed to the flexible, non-bureaucratic and market sensitive model which was envisaged.

27. We have considered in detail the responses from the HKEx concerning the separation of functions and the delegation of its listing powers and functions to the Listing Committee. While that delegation is formally in place, the Listing Committee itself has not in practice felt either empowered or accountable.

28. We do not suggest that there is or was an intentional strategy on the part of the HKEx Board to maximise revenue by listing companies regardless of merit or their short to medium term prospects. Rather that the current structure has produced a "system" where large numbers of listings of doubtful merit appear to have become the norm; where listing itself becomes the objective, not merely the first step in a process of wider investor participation in companies with reasonable prospects of growth and development.

29. We have considered carefully the HKEx proposal to create a separate subsidiary to fulfil its regulatory function. It is clear that the

HKEx has given a great deal of thought and attention to the preparation of this suggested solution to the perceived problems, and it has been influential in the shaping of our proposed solution, but in the end, we do not consider their proposal goes far enough to achieve the desired result. This is discussed in detail in paragraphs 2.32 to 2.38 of Chapter 2.

30. Our firm conviction is that the listing function must be removed from the HKEx. The HKEx should then be allowed to concentrate its energies on its commercial activities, unrestrained by the burden of regulation and perceptions of conflict. Regardless of how well the conflict can be managed, the existence of such a conflict is, in itself, not conducive to the development of Hong Kong as an international financial centre.

31. Our response to the arguments against doing so is discussed extensively in Chapter 3, but we note here that the HKEx will in our model, still be able to exercise control on admission to trading on its exchange and assert its "brand image" through its own entry and exit criteria and conduct codes or rules. It will also be able to market its trading platforms, products and other services in close cooperation with those responsible for admission to listing in Hong Kong.

(C) Regulation of Listed Companies

32. There has also been frequent reference to the perceived lack of a lead corporate regulator in Hong Kong. At present there is a multiplicity of corporate regulators including the HKEx, the SFC, the Companies Registry and the Official Receiver's Office. Additionally, the Commercial Crime Bureau of the Police (CCB) and the Independent Commission Against Corruption (ICAC) deal respectively with commercial crime and corruption cases involving listed companies.

33. Most respondents feel that this has led to some enforcement deficiencies in Hong Kong and an imbalance between the risks and rewards of corporate wrongdoing. In particular, since the HKEx has only a contractual relationship with the companies listed on its exchange, has no investigative powers and limited enforcement ability or sanctions, it is viewed as an ineffective regulator. Similarly, the SFC has limited power given that about 80% of the companies listed in Hong Kong are incorporated overseas and are governed primarily by laws in those jurisdictions. This is aggravated in many cases by the fact that the business

operations, assets and directors of the companies are not located in Hong Kong.

34. It has also been pointed out to us that with very few exceptions, Hong Kong listed companies are still controlled by either one, or a small number of related shareholders. In many cases it is families, in others founding shareholders, and in the case of many Mainland listings, various arms of the government. Unlike major markets, such as New York and London, where most listed companies have evolved into entities with broad share ownership structures, this has led in Hong Kong to particular complexity as regards the protection of minority shareholders and corporate governance in general.

35. These are distinguishing features of the Hong Kong market, the former a unique feature so far as we are aware, and have led to an inherent difficulty in regulating these companies. Any solution to these issues must address that added degree of difficulty.

36. We believe that enforcement effectiveness is hampered by the current regulatory structure and would be significantly enhanced if the listing function were to be taken up by the SFC. The experience of the Financial Services Authority in the United Kingdom (UK) was that there were multiple synergies when the UK Listing Authority was transferred from the London Stock Exchange, not just in the area of enforcement but also in corporate governance, market development, intermediary supervision and others. We note that the SFC has recently increased its enforcement efforts in the listed company sector and that among its priorities for 2003, there is an emphasis on listed company crime. According to the SFC, there will likely be more listed company investigations and enforcement action arising from dual-filing, and there will be a tougher regime for the disclosure of insiders' interests in listed companies under the SFO.

37. Furthermore, as more Mainland companies list in Hong Kong, the relationship between the SFC and the China Securities Regulatory Commission (CSRC) will become increasingly important. It is not possible for the HKEx, as a commercial entity, to establish the same kind of close working relationship and information sharing with the CSRC as it is for the SFC as a statutory regulator.

(D) Regulation of Intermediaries

38. This subject attained significant media prominence during the period of our work. In the wake of several high-profile corporate scandals featuring questionable practices and standards on the part of intermediaries, there has developed an active debate among Government officials, regulators and the intermediaries themselves about the way forward. We note that the HKEx has proposed to consult the market on amendments to the Listing Rules to tighten regulation of IPO intermediaries, in particular sponsors and financial advisers.

39. The regulation of auditors, accountants, lawyers, financial advisers and valuers is beyond the scope of our report but certainly the oversight of sponsors (investment banks, corporate finance specialists and brokers) is a relevant component of any listing regime discussion.

40. Clearly, no matter how effective a regulatory regime is, it cannot be the first line of defence against corporate misconduct. In the first instance, the directors of companies, including the independent non-executive directors, should ensure proper corporate conduct.

41. There is nevertheless a broad consensus that in the case of sponsors, there needs to be more effective regulation. The threat of sanctions for misconduct must be real, and they must have sufficient "teeth" to act as a meaningful deterrent. In recent cases it seems that there have been considerable shortfalls in standards of due diligence and we believe that the burden of responsibility must be shifted back to sponsors among others. We are aware that the Mainland has introduced a "penalty" system whereby sponsors who fail to honour their professional obligations in a consistent fashion are restricted in their business activities by the central regulator. With the SFC as the primary regulator of intermediaries in Hong Kong, it is natural that oversight of the listing function would be a significant advantage in monitoring intermediary performance whether a quantitative system is adopted or not. For this reason, the consultation exercise referred to in paragraph 38 above should perhaps be carried out by the SFC.

(E) Roles and Responsibilities of the Three Tiers

42. Despite the apparent widespread acceptance of the concept of the so-called three-tier regulatory structure, there is much less shared understanding among market participants about what it really means. There might not even be a clear consensus among the three tiers regarding the proper division of roles and responsibilities.

43. In particular, many feel that the Government is at present too involved in the detail of regulation, and should only be a facilitator and overall policy setter. The Government, to which the SFC is accountable, of course needs to be able to perform its monitoring role, but otherwise it should remain to some extent, aloof and allow both the SFC and HKEx to supervise, administer and operate the market as appropriate.

44. The Government's involvement in the activities of the HKEx, a listed company, was noted by many respondents. The Government has historically appointed a majority of the HKEx Board and the Chairman has to have the approval of the Chief Executive of the Hong Kong Special Administrative Region. Both the Chairman of the SFC and the Chief Executive of the Hong Kong Monetary Authority sit on the HKEx Risk Management Committee. Such arrangements are adopted despite the fact that the Government holds no shares in the HKEx. Many respondents feel that the Government should continue to reduce its role in the operations of the HKEx and the removal of the listing function would give it an opportunity to accelerate the process.

45. The SFC in turn is viewed by some as lacking true enforcement powers yet by others as too preoccupied with pursuing minor infringements rather than serious corporate wrongdoing. It is also seen by some as excessively involved in the operations of the HKEx, perhaps as a result of the current regulatory overlap.

46. The SFC is wrongly perceived by some as the main **corporate** regulator with the role of ensuring both the quality of the market and the supervision of listed companies. That would require a regulator with wider powers and more resources than the SFC currently possesses. But in any event, quality assurance should begin at the gate and not be left until after listing.

47. The confusion as to the HKEx's regulatory role relates more to its internal arrangements. At least until recently, the theoretical separation of the Board of the HKEx from the listing function was not generally appreciated. In addition, as will be seen in Chapter 2, the Listing Committee, to which the function is delegated, does not have sufficient resources to do the job effectively, nor as a body of part-time volunteers could it be expected to.

48. The new dual-filing system that will begin operation on 1 April 2003 may in fact worsen the present situation. Under the system, the SFC will have a veto power to object to listing applications. We interpret the introduction of this system as an attempt to address, in an ad hoc fashion, some of the same concerns which have led to our process and our report. While it provides a mechanism for greater involvement by the SFC and more "quality control" in the process, this system cannot be the long-term solution. It is inherently inefficient and costly. The SFC will be duplicating the work of the Listing Division to some extent, but even more that of the Listing Committee. Friction between the SFC and HKEx could be exacerbated. We conclude that a longer term solution, as we shall suggest, is still essential.

49. With the exception of those who have an obvious and understandable interest in the continuation of the status quo, there is an overwhelming consensus that the HKEx should be relieved of its listing responsibilities and freed up to concentrate on its commercial activities.

50. Our terms of reference require us to address the issue of communication. As pointed out in the PIPSI Report, there is an abundance of liaison channels between the Government, SFC and HKEx (the PIPSI Report identified six regular high level fora). Despite the elaborate liaison network however, communication among the three parties does not seem to work satisfactorily. In fact, there is a strong feeling among market participants that the three bodies often send conflicting messages to the market. Since there is obviously no lack of channels, we conclude that the problem lies with the quality of communication, not the quantity of communication. This is discussed in detail in paragraphs 2.69 to 2.77 of Chapter 2.

RECOMMENDATIONS

51. There is overwhelming support in the written submissions received and in the meetings and personal interviews conducted by the Expert Group for making significant changes to the listing regime.

52. A number of major issues have been identified, all of them inter-related, which lead us to the clear conclusion that if Hong Kong is to maintain its credibility as a leading international financial centre in the Asia-Pacific region then significant reform is required urgently.

53. All of the considerations listed above logically converge into the following set of propositions –

(a) The listing function must be removed from the HKEx and should be performed by a new division of the SFC, to be known as the Hong Kong Listing Authority (HKLA), which should process listing applications, and make and administer rules on listing matters. This can be achieved within the SFO legal framework. The HKLA should be responsible and accountable for both regulation and market development. It should also be prepared to represent Hong Kong internationally, both to issuers and investors, and to support the HKEx in its continued efforts to expand its flow of quality listings, particularly from the Mainland.

(b) The HKLA should be led by an Executive Director of the Commission who should have a clear vision of the roles and functions of the HKLA in the listing regime. The HKLA should be staffed by highly skilled and experienced market professionals, capable of establishing the suitability of companies for listing and exercising discretion on whether exemptions from compliance with the Listing Rules are justified.

(c) Decisions of the HKLA should be subject to appeal to a Listing Panel to be set up under section 8 of the SFO, which should also function as an advisory body providing guidance, in particular practitioner and investor input, on listing policies in the overall context of market development and changes to

the Listing Rules to achieve the desired results. The Panel should comprise 18 to 20 members appointed by the SFC from various stakeholder groups, including the HKEx. The quorum for each Panel meeting should be one third of the total number of members. The Panel should be responsible for both the Main Board and GEM markets.

(d) To allow sufficient time for the HKLA executives to establish professional credibility, the Panel should during the first 18 months of its inception, as a transitional arrangement, remain involved in specific cases to approve or reject listing applications, as the existing HKEx Listing Committees are doing presently.

(e) The Listing Rules should have statutory backing to ensure their effectiveness but should remain non-statutory and not subject to legislative vetting, so that they can be changed by the HKLA whenever necessary to cope with the rapidly changing market environment.

(f) The HKEx should be allowed to set its own entry and exit criteria and conduct codes or rules for listed stocks to trade on the stock exchange, but these criteria, codes and rules cannot override the rules made by the HKLA. The HKEx, relieved of its regulatory burden, should be allowed to operate as a commercial entity with minimal Government influence (for example, with a continuing reduction in the number of Government appointed directors) and less SFC involvement in its day-to-day operations.

(g) In turn, the SFC should focus its attention on the synergies that integration of the listing function will bring and on ensuring that the HKEx is operating fair and orderly securities and futures markets with prudent risk management.

(h) The HKLA should levy listing fees, both for IPOs and maintaining listing status, on a cost-recovery basis. The HKEx can charge fees for admission to trading on the stock exchange, as a commercial service, at levels that should render the transfer of the listing function bottom line neutral to the company. The aim is to preserve Hong Kong's competitive

position relative to other markets and therefore the changes should be as close to being cost neutral to the issuers as possible.

(i) The SFC should be the statutory regulator of listed companies, exercising the powers and sanctions provided in the SFO in dealing with violations and misconduct by listed companies. Sufficient resources should be provided to enable the SFC to perform its tasks properly. Cases involving criminal elements such as fraud and corruption, should continue to be dealt with by the CCB and ICAC.

(j) As a matter of urgency, consideration should be given to raising entry levels for new listings, especially in the area of minimum number of shareholders and minimum public float, and the SFC should have full investigative power to establish the validity of initial placements. As an example, raising the minimum number of unassociated holders of shares in a new listing to 300 from the present 100, would bring Hong Kong more in line with its international counterparts.

(k) Regulation of intermediaries by the SFC should be strengthened and sanctions on wrongdoers should be toughened to deter violations.

(l) There should be more rigorous enforcement efforts generally by the SFC and other enforcement bodies, which will probably require additional resources. The SFC should be empowered to impose meaningful fines on major shareholders and directors of, and advisers to, listed companies wherever incorporated, with appropriate judicial appeal mechanisms, and continue to refer appropriate cases for prosecution.

(m) Given the increasing number of Mainland companies being listed in Hong Kong, there should be closer and more effective regulatory cooperation between the SFC and the Mainland regulator, i.e. the CSRC.

These recommendations and comments on their details and implementation are discussed in Chapters 3 and 4.

54. We are strongly of the view that the interests of Hong Kong will be better served by the Government taking an early decision to implement our proposal and commence that process. We have consulted widely in the course of preparing this report, and canvassed many of the same people whom the PIPSI had consulted just a few months before. We are confident that we have identified the views of all of the people who wish to express a view, and that our recommendations will receive broad support.

55. The implementation of our recommendations will be facilitated by the appointment of a high level working party involving the three tiers.

OTHER REMARKS

56. In the course of our review, the following issues have been brought to our attention, which are outside our ambit but, we believe, warrant the attention of the relevant authorities –

(a) To address the issues of confusion and inefficiency brought about by the existing multiplicity of regulators and inadequate enforcement of the Companies Ordinance (Cap. 32), the Government should consider subsuming the Companies Registry under the SFC to turn the latter into the sole statutory regulator of all companies.

(b) Given that high legal costs might have prevented minority shareholders from bringing civil actions against persons responsible for alleged market misconduct, the Government may wish to explore the feasibility of introducing a class action system to provide investors with an affordable means to seek redress.

(c) Some respondents have complained that listing prospectuses and some company announcements are difficult to understand. An effort should be made to simplify format with emphasis on clarity and plain language.

(d) Valuers are currently not subject to any formal regulation. Given the importance of their work, the Government may wish to consider ways to tighten the regulation of their conduct.

(e) There should be a more coordinated initiative to encourage secondments from the industry to the SFC. The value of having market experienced professionals transfer some of their skills to a market regulator has been demonstrated elsewhere and the SFC should be able to benefit from such an arrangement. On the other hand, the experience of working for the regulator could prove valuable for industry professionals when they return to their private sector jobs after the secondment.

These issues will be discussed in detail in Chapter 5.

CHAPTER 1
BACKGROUND

PENNY STOCKS INCIDENT

1.1 On 25 July 2002, the Hong Kong Exchanges and Clearing Company Limited (HKEx) released a "Consultation Paper on Amendments to the Listing Rules Relating to Initial Listing and Continuing Listing Criteria and Cancellation of Listing Procedures". The HKEx proposed, among other things, that shares of listed companies should be consolidated if their trading prices fell below HK$0.50 (penny stocks). Delisting would follow, after certain procedures and with recourse to appeal, if the companies concerned failed to consolidate their shares. The consultation was to finish by the end of August 2002.

1.2 On 26 July 2002, 577 (76%) of the 761 stocks on the Main Board suffered a loss. The total market capitalisation of the stocks with a quoted closing price of HK$0.50 or lower fell by HK$10.9 billion (US$1.4 billion), roughly equivalent to 10% of the market capitalisation of these stocks and about 0.3% of the total market capitalisation of the Main Board. Strong market reaction led the Financial Secretary (FS) to appoint a Panel of Inquiry on the Penny Stocks Incident (PIPSI) comprising Mr. Robert G. Kotewall and Mr. Gordon C. K. Kwong to look into the circumstances surrounding the incident and submit a report with conclusions and recommendations by 10 September 2002.

1.3 The Panel of Inquiry submitted its report (PIPSI Report) to the FS on 9 September 2002. One of the recommendations made was that the Government should review the three-tier (Government, Securities and Futures Commission (SFC) and HKEx) regulatory structure of the securities and futures markets over listing matters, in particular the existing structure, roles and operation of the Listing Committee.

EXPERT GROUP AND ITS TERMS OF REFERENCE

1.4 The FS accepted the Panel's recommendation and announced on 26 September 2002 the appointment of a three-member Expert Group to review the roles and functions of the Government, SFC and HKEx over matters relating to the listing of securities and issuers with listed securities, the operation of the regulatory structure as regards listing matters, and the lines of communication among the three tiers of the regulatory structure, and make recommendations for improvements.

1.5 The Expert Group is chaired by Mr Alan Cameron and has Dr Raymond Ch'ien and Mr Peter Clarke as members.

1.6 The detailed terms of reference of the Expert Group are as follows –

(a) With a view to increasing the effectiveness, efficiency, clarity, fairness and credibility of the regulatory system for the securities and futures markets of Hong Kong, and ensuring the integrity of the markets and the proper protection of the investing public, to –

(i) review the roles and functions of the Government, SFC and HKEx and its subsidiaries over matters relating to listing of securities and issuers with listed securities;

(ii) review the operation of the regulatory structure as regards listing matters;

(iii) review the lines of communication among the Government, SFC and HKEx; and

(iv) recommend changes and improvements relating to issues in (i) to (iii) above where appropriate.

(b) In conducting the review, the Expert Group shall have regard to –

(i) the need to maintain the status of Hong Kong as an international financial centre;

(ii) developments in the local and international securities and futures markets;

(iii) the competitiveness of Hong Kong as a centre for listing companies from the Mainland, Asian-time-zone and global capital markets;

(iv) the diversity of issuer and investor bases of the Hong Kong securities and futures markets;

(v) the outcome of the deliberations in the Legislative Council in respect of the Securities and Futures Ordinance (SFO) (Cap. 571); and

(vi) the findings and recommendations of the PIPSI.

(c) The Expert Group should also –

(i) invite submissions from interested parties and the public, including but not limited to representatives of issuers, stockbrokers and investing public, Legislative Councillors and the Standing Committee on Company Law Reform;

(ii) consider the regulatory structures and systems in other major markets; and

(iii) use its best endeavours to submit its report before the end of March 2003.

DETERMINATION OF AMBIT AND MODUS OPERANDI

1.7 There was considerable concern in the market, following our press conference on 9 October 2002, that the review might be focused on listing matters in such a way as to neglect other important issues. There were even more critical comments that the review would be no more than a "whitewash" exercise, just to show that the Government had heeded the Panel's recommendation. We always considered that our terms of reference were wide enough for us to study all matters relevant to the regulatory role of the various parties involved and to recommend changes as necessary. And we were assured by the FS at the outset that we were at liberty to look at any issues that are important to the regulation of the securities and futures markets. We have conducted the review on this basis and have not hesitated to identify and bring to the Government's attention issues that are important but may technically be outside our terms of reference.

1.8 We should note that despite the specific reference to "futures" in our title and terms of reference, no issue with respect to the futures market in Hong Kong was raised with us. We will not again refer to the futures market for that reason.

1.9 Though the Chairman is based in Australia, and the two members both have busy schedules, the Expert Group arranged to hold working meetings in Hong Kong at least once every month from October 2002 to March 2003. Between the meetings, we communicated extensively through e-mail and telephone conferencing. In total we had six rounds of working meetings in Hong Kong each lasting between two to six days.

1.10 We divided our work into three stages. The first stage was to solicit views and gather information, during which we received comments and submissions from interested parties, collected and studied information on the current regulatory regime in Hong Kong and the regulatory structures of major markets as well as global trends of market regulation. At the second stage, we evaluated the views and information obtained, and identified key issues of concern. At the final stage, we formulated our conclusions and recommendations, and wrote this report.

1.11 In the course of our review, a full-time secretariat staffed by civil servants has provided us with effective and efficient support in arranging visits and meetings, conducting researches into relevant reference materials, and preparing this report. The members of the Expert Group particularly extend their thanks and appreciation for their hard work, to the dedicated staff of the secretariat.

SOLICITATION OF VIEWS AND SUBMISSIONS RECEIVED

1.12 In accordance with our terms of reference, we have consulted widely with all stakeholder groups. We held a press conference on 9 October 2002 to formally announce the commencement of the review and its remit, and the invitation of submissions. Advertisements were placed in local and regional major financial papers on the same day to invite views and submissions by 20 November 2002. Notwithstanding the deadline, we have considered all late submissions presented to us. Altogether, 28 formal submissions were received from across the industry and the community at large, including the Government, SFC, HKEx, Consumer Council, directors of listed companies, stockbrokers, investment banks, Legislative Councillors, investors and chambers of commerce. A list of the groups and individuals that have sent in written submissions is at Annex 1. We are most grateful to all respondents, many of whom gave considerable time and thought to putting together their submissions.

MEETINGS WITH PARTIES CONCERNED

1.13 From November 2002 to March 2003, we had meetings with 33 interested groups and individuals, and a further 65 individual interviews to gather information and views. We would like to thank them for taking time out of their busy schedules to meet with us and for the frank views expressed during these meetings.

1.14 We also made use of our own networks, and through our own private visits, to talk to industry participants in the United States (US), United Kingdom (UK) and Australia to learn about the latest developments in these major markets and their perception about the Hong Kong market.

STUDY OF REGULATORY STRUCTURES OF MAJOR MARKETS

1.15 In pursuance of our terms of reference, we have researched into the regulatory regimes of the securities markets in the US, UK, Australia, Canada, Japan, Singapore and the Mainland. Most of the information has been obtained from the relevant official websites. A list of these websites is at Annex 2. Where necessary, we have sought further information and clarification from the regulators and exchanges concerned. We have also through our own personal contacts in overseas markets and regulatory bodies obtained updates on the latest developments in the major markets and the global trend of market regulation. Our findings are at Annex 3. We have included in the same Annex a description of Hong Kong's existing regulatory structure, to facilitate comparison with the regulatory structures in other markets. We have not undertaken any special overseas visits as the information obtained by the above means has provided sufficient materials for our study.

1.16 The New York Stock Exchange (NYSE) in the US and the London Stock Exchange (LSE) in the UK are the world's leading exchanges. The LSE is the most international of all stock exchanges with about 470 companies from over 60 countries admitted to trading on its various trading boards. They account for about 21% of both domestic and international stocks listed on the LSE. The experience of the UK regulatory authorities provides us with valuable reference given that about 80% of the listed companies in Hong Kong are incorporated outside the territory. The fact that the LSE has also recently listed on its own exchange has provided a useful comparison with the HKEx. The Australian Stock Exchange (ASX) and the Singapore Exchange Limited (SGX) are also demutualised and listed on their own exchanges. The Toronto Stock Exchange demutualised in 2000 and has become a publicly listed company during the course of our inquiry. We have also looked at the Mainland model having regard to, above all, Hong Kong's goal to serve as the premier capital formation centre of China.

1.17 The findings of our research show that there is a trend towards stock exchange demutualisation, i.e. conversion of a not-for-profit member-owned exchange to a shareholder-owned for-profit organisation. This has been largely driven by the increase in international competition among exchanges, which requires them to operate more efficiently and to have broader access to capital to finance investment in new technology. The key regulatory issue arising from the demutualisation of exchanges is the real and perceived conflicts of interests arising from the arrangement whereby a for-profit commercial entity is also responsible for market regulation, i.e. the listing of companies. The common concern is that a for-profit commercial exchange may be less inclined to refuse listing applications, which are a direct source of income in the forms of listing fees and transaction levies, and less willing to commit the resources that rigorous self-enforcement would require.

1.18 The Technical Committee of the International Organisation of Securities Commissions (IOSCO) has published an Issues Paper on the subject[5]. The Paper contains many useful observations on the nature of conflicts of interests, including that conflicts had been a feature of the traditional member-based model as well. It observes that there is no single "right" regulatory path to follow when exchanges demutualise and self-list, and does not prescribe any solution which should be adopted, as that will depend on the circumstances. We agree, and have not regarded the adoption of a solution in any other place as a sufficient reason to adopt that solution in Hong Kong (nor of course should our report be seen as implying that any other place should necessarily follow our suggested model). But the experiences of other places should be studied, if only to seek to avoid adopting a solution which experience elsewhere has shown may not work as well in practice as theory had suggested.

1.19 We have studied how the exchanges that have been demutualised and listed are responding to this challenge –

(a) In Australia, the ASX addressed the issue by establishing a subsidiary company, ASX Supervisory Review (ASXSR).

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[5] June 2001, available at www.iosco.org.

The ASXSR is an internal review mechanism (with external participation) to provide a level of assurance that the ASX is directing appropriate resources to supervisory functions, but is not independent of the ASX in terms of structure and funding. We understand that notwithstanding the above arrangement, the market is still concerned that conflicts of interests, be they real or perceived, will compromise the ASX's supervisory activities. Despite those continuing concerns, reflected in press coverage, a parliamentary committee reported in February 2002 that no major change to the supervisory framework should be contemplated at that time, but the committee would review the matter if there was a significant material change in ASX operations or should the ASX merge with another exchange or enter into a new alliance with another exchange[6].

(b) In Canada, the TSX Group has established a separate subsidiary, Market Regulation Services Incorporated (RS), to oversee exchange member regulation upon demutualisation. The RS is independent of and structurally separated from the for-profit operations of the Group.

(c) In Singapore, the SGX responded to the concern about conflicts of interests by entering into a Deed of Undertaking with the Monetary Authority of Singapore (MAS). The Deed sets out the arrangements and procedures for handling conflict of interests cases. The SGX's compliance with the listing rules established by its own exchange is supervised by the MAS. The Board of SGX has to appoint a "Conflicts Committee" to consider possible conflicts of interests that may arise from the listing or quotation of SGX shares on its exchange.

(d) In the case of the UK, the LSE transferred the role of UK Listing Authority to the statutory regulator, the Financial

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[6] Senate Economics References Committee, Inquiry into the Framework for the Market Supervision of Australia's Stock Exchanges, February 2002, available at www.aph.gov.au.

Services Authority (FSA), thereby removing altogether any perceived or real conflicts of interests.

1.20 Not all major exchanges are faced with the same conflict of interests issue, although many would argue that there has always been a conflict issue in the way broker-controlled exchanges operated, even if profits could not be distributed to the broker members directly. In the US, the NYSE has been operating on a not-for-profit basis and the issue of perceived or real conflict of interests based on the profit motive has not arisen. Though the listing function in the US is vested in the exchanges, securities must be registered with the regulator, i.e. the Securities and Exchange Commission (SEC), before they are admitted to trading. In the case of the Mainland, both the Shanghai and Shenzhen Stock Exchanges are non-profit institutions, and the listing regime is controlled by the China Securities Regulatory Commission (CSRC) which is the statutory regulator of the securities and futures markets.

1.21 We are persuaded, despite some views to the contrary, that the conflicts of interests arising from an exchange's dual role as a market regulator and a commercial entity are real, and cause concern to both the market and the regulator, and that is why efforts have been made in so many places to tackle the issue. Measures taken usually involve the setting up of a regulatory subsidiary under the exchange, or the signing of an agreement between the exchange and the regulator to set out the procedure for handling conflicts. These measures are aimed at resolving, instead of eliminating, conflicts. The only jurisdiction whereby all possible conflicts of interests have been removed is the UK where the listing function has been transferred from the LSE to the FSA.

1.22 Our research has also provided us with useful reference as to the role played by the regulator. In the US, though the listing function is performed by the exchanges, all securities must be registered with the SEC before trading. In the Mainland, stock issuance is subject to the CSRC's approval. Even in these two cases where the exchanges operate on a not-for-profit basis, and there is accordingly less concern about possible conflicts of interests, the regulators still play an active role in the listing regime.

1.23 We must emphasise that while we have had regard to the regulatory models in other financial markets and the models of best

practice discussed at various international fora, we have not overlooked the unique circumstances of the Hong Kong market, which include the monopoly held by the HKEx, the fact that the majority of the companies listed in Hong Kong are not incorporated here, and the extent to which the market operates as an entry point, with first world infrastructure, to a major but nevertheless emerging market. We have not recommended a wholesale application of a regulatory model which works perfectly well in another jurisdiction, because what works elsewhere may not be in the best interest of Hong Kong. Consistent with our terms of reference, our aim has been to develop a model that can meet the present need of the Hong Kong market and is flexible enough to cater for future developments.

SECURITIES AND FUTURES ORDINANCE

1.24 We commend the Government on the improvements that will be brought about by the implementation of the SFO, which consolidates and modernises the existing ten ordinances regulating the securities and futures markets and will come into effect on 1 April 2003. The regulatory objectives of the SFC spelt out in the SFO are in line with the core objectives of securities regulation promulgated by the IOSCO, namely –

(a) protection of investors;

(b) ensuring that markets are fair, efficient and transparent; and

(c) reduction of systemic risk.

In formulating our recommendations, we have worked within the SFO framework and put forward suggestions that would further improve the regulatory regime.

CHAPTER 2
DISCUSSION OF SPECIFIC ISSUES

2.1 In this chapter, we discuss in greater detail some of the issues raised in the Executive Summary.

QUALITY OF MARKET

2.2 We have discussed at some length in the Executive Summary the quality of the Hong Kong market, concluding that there is a worrying deterioration in the quality of the new companies listed on both the Main Board and Growth Enterprise Market (GEM) in recent years, in particular the preponderance of small issues which have poor post-initial public offering (IPO) performance, little investor interest and negligible secondary market turnover. We do not intend to repeat the same discussions here but shall provide some more data to substantiate our observations.

2.3 Of the 117 new listings in 2002 (60 on the Main Board and 57 on the GEM), 90% (105 issues) had initial market capitalisation of less than HK$1 billion (US$128 million)[7]. Excluding the nine investment companies[8], 65% (33 issues) of the **Main Board** listings had market capitalisation below HK$390 million (US$50 million) which is the minimum required by the Nasdaq **Small Cap** Market.

2.4 Many of the new listings on the Main Board could barely fulfil the minimum IPO requirements. Excluding investment companies, eight listings raised exactly HK$50 million (US$6.4 million) – the minimum public float required. Twenty-four of the 57 GEM listings raised less than HK$50 million (US$6.4 million). The actual amounts of funds the new listings raised were even lower after deducting listing costs. After allowing for all expenses and any offers for sale, 30 raised less than HK$30 million (US$3.8 million) for the issuers.

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[7] All data referred to in paragraphs 2.3 to 2.7 are provided by the SFC.

[8] We have excluded the nine investment companies that are not subject to any market capitalisation or public float requirement but in fact raised an average amount of HK$84 million (US$10.8 million).

2.5 Pre-IPO dividends paid out by some of the 60 Main Board new listings were high compared to the funds raised by listing and the profits earned during the track record period as stated in the prospectus. Twenty-one (excluding investment companies and Mainland State-owned enterprises[9]) paid dividends of over 100% of the company's profit in the year just before the IPO. In three cases the dividend exceeded the aggregate profits of the entire track record period. Eighteen paid out pre-IPO dividends that exceeded the net amounts of listing proceeds they ultimately received.

2.6 Most of the 117 new listings in 2002 generated little public investor interest. Excluding investment companies and listings by introduction, 53 listings had subscription rates of less than five times and 31 had subscription rates of less than two times. In fact, 19 of the offerings were barely covered at less than 1.2 times.

2.7 As at the end of February 2003, 23% of the 117 new listings have seen their share prices drop by over 50%. In three cases, the prices fell more than 90% within a couple of months of initial listing. Eight companies have seen their market capitalisations dropping to values less than the funds they received from listing within just a few months of listing (after discounting the proceeds from any offer for sale).

2.8 All of these facts raise questions about the commercial logic of many of the new listings. Some respondents have suggested that certain listings are carried out to provide a vehicle for manipulation. Others believe that listings are done to create a "shell" that can later be sold – which one reporter has dubbed "real listing, fake fund-raising". Still others observe that listings may be done for reasons of status, not merely personal status for the controlling shareholders, but also status of the kind which will enhance business prospects, add credibility to the company's reputation and facilitate additional financing opportunities, e.g. in the banking sector. It has also been suggested that in some cases, part of the funds "raised" in the listing actually originated from the controlling shareholders or their associates.

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[9] Mainland State-owned enterprises often undergo substantial re-organisations, with significant dividend distributions, before listing. Being part of the transition from state ownership and administration to corporate form and management, this is very different from the cases discussed here.

2.9 None of these suggestions enhances Hong Kong's reputation as an international financial centre.

2.10 The HKEx has also expressed concern about poor market quality. In the seventh issue of the "Exchange" published in January 2003[10], the HKEx pointed out that "the existence of a significant number of poorly-performing companies is still a genuine problem, even if it were only a matter of perception ……". It suggested that "the starting point in preventing the accumulation of problematic companies is obviously the admission criteria in the Listing Rules." But it also pointed out that "the listing criteria of the Main Board are in fact set at rather high levels by comparison with most developed international markets." A comparison of the quantitative IPO requirements of the Main Boards of major financial markets is at Annex 4. The table is compiled based on the information published by the exchanges themselves. While it can be seen that the quantitative entry criteria set by the Stock Exchange of Hong Kong (SEHK) are in most respects comparable to those of the major exchanges, it is noted that the minimum requirement for a spread of shareholders is low in Hong Kong and as mentioned in our Executive Summary, we believe that this should be increased as a matter of urgency. The SEHK, like the major exchanges, such as the LSE in London, the NYSE in New York and the Tokyo Stock Exchange in Tokyo, has broad discretion and can apply qualitative criteria when considering listing applications. However, we are given to understand that such discretion has been rarely exercised in recent years.

2.11 If Hong Kong is to achieve its stated goal to be the premier capital formation centre of China and one of the top five equities markets in the world, these market quality issues must be addressed and improvements must be made urgently.

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[10] The journal is available at the HKEx's website at www.hkex.com.hk.

LISTING COMMITTEE

2.12 The PIPSI Report raised some important questions about the role, responsibilities and effectiveness of the Listing Committee (paragraphs 11.51 to 11.55). Many of the written submissions, meetings and individual interviews also commented on these matters.

2.13 In summary, these issues may be categorised as follows –

(a) delegation of functions and powers from the HKEx Board to the Listing Committee and the Listing Committee in practice;

(b) composition of the Listing Committee; and

(c) part-time volunteers versus full-time professionals.

(a) Delegation of functions and powers from the HKEx Board to the Listing Committee and the Listing Committee in practice

2.14 As the PIPSI Report noted, the terms of reference of the Listing Committee clearly state that it shall exercise all the functions and powers of the Board in relation to all listing matters. The relevant extracts from the HKEx's Listing Rules concerning the Listing Committees of the Main Board and the GEM are at Annex 5. The necessary implication is that the Board has abdicated all responsibilities in this important area, and the Board is not even informed regarding either strategic or operational aspects of listing policy, in an endeavour to demonstrate a clear separation of business and regulatory responsibilities. This was clearly illustrated in the PIPSI Report (paragraph 11.47) where it was found that the Board had not been consulted on the contents of the Consultation Paper on Amendments to the Listing Rules Relating to Initial Listing and Continuing Listing Criteria and Cancellation of Listing Procedures.

2.15 We note however that the Listing Committee has in turn sub-delegated back to the Listing Division and the Chief Executive of the SEHK most of these powers and functions subject to review procedures (Rule 2A.02 of the Listing Rules). This inevitably raises questions as to the true substance of the separation of powers. We also note that the Chairman of the GEM Listing Committee, since its inception, has in fact been a member of the HKEx Board, raising further questions as to how real the separation can be.

2.16 Our inquiries have found a lack of clarity as to the real authority and accountability of the Listing Committee.

2.17 Firstly, with the exception of the Chief Executive of the HKEx, the Listing Committee consists of highly experienced but part-time volunteers. These volunteers are unpaid and in many cases view their involvement as public service in much the same way as many of them are involved in charitable or other public spirited activities. They are all busy professionals in their own right and cannot be expected to dedicate a high proportion of their time to Listing Committee matters. We will comment further on this in paragraphs 2.27 to 2.31 below.

2.18 Secondly, the Committee operates without its own support. So far as we can establish, all that has been delegated to it is the right and duty to make decisions, based on material it has not requested, and over which it has no control. It does not control or set its agenda. The detailed work is done by the Listing Division, but the Committee does not consider or approve the Division's budget, nor is it involved in discussions of organisational structure or recruiting or assessing the performance of staff. There is little evidence of a reporting relationship between the Listing Division and the Committee and in practice the former reports to HKEx executives. Some have told us that the Division views the Committee as a step in an internal process. In turn, the Committee may view itself as primarily a consultative body, to provide a check and balance function. It does not seem to consider itself fully responsible for the listing function, or accountable. It does not appear to be asked by the HKEx Board to account for its stewardship of its delegated responsibilities. Some members say that in practice it is not a committee at all but a panel from which a relatively small number of members are drawn for particular cases. Not surprisingly, this set of circumstances seems to have led to considerable frustration for many of those concerned.

2.19 Our findings also suggest that the Listing Committee is handicapped in a number of other ways –

(a) Since only five of its 25 members are required for a quorum and the members have different skill sets and perspectives, decisions depend too much on the luck of the draw – who is available on the day. Such inconsistent decision-making is not best practice regulation. It has been suggested that the minimum number for a quorum be increased to perhaps eight to ten to provide better balance particularly on policy issues.

It has also been mentioned however that a low quorum may be the only practical solution because in contentious cases many members may not be able or indeed want to attend.

(b) Decisions made by one group of members are not always circulated to absent members promptly – in some cases not until months later. Since decisions on cases that are appealed are not always circulated to other members promptly, this can lead to inconsistency and a lack of an accurate understanding of precedents.

(c) Committee members work under considerable time constraints with voluminous papers being made available relatively shortly before meetings. The usual practice is that papers are delivered on Tuesday afternoon for meetings on Thursday, but of course, members all have jobs to do as well. We did hear examples of papers being delivered after the relevant meeting was held.

(d) The Committee works to an agenda set by the Listing Division and in most cases enters the discussion quite late in the process – when lengthy discussions have already been held by staff with applicants and their representatives, and no doubt understandings reached. Hence, their effectiveness is limited. They have little ability to set their own agenda.

2.20 In summary, the separation of duties necessitated by the current listing regime has led to a flawed structure where accountability is not at all clear, where the valuable time of those willing to serve on the Listing Committee is not well used, and where the wealth of experience available on the HKEx Board and its other committees and panels is not utilised at all (other than through the Chief Executive of the HKEx, and on the GEM Listing Committee, one other director).

(b) Composition of the Listing Committee

2.21 There is criticism of the current structure of the Listing Committee. According to the Listing Rules (Rule 2A.17), the Listing Committee shall consist of 25 members made up in the following manner: the Chief Executive of the HKEx as an ex-officio member or in his absence, the Chief Executive of the SEHK, six exchange participants or directors of

exchange participants, six directors of listed issuers who are neither exchange participants nor officers or employees of exchange participants, and 12 individuals from the following five categories who are neither exchange participants nor officers or employees of exchange participants –

(a) a director or partner of a fund management firm;

(b) an officer or senior employee of a merchant bank;

(c) a barrister or partner of a firm of solicitors;

(d) a partner of an accounting firm; and

(e) a person who is otherwise involved or experienced in the securities market and corporate finance matters or securities regulation.

A maximum of four members may come from any of the five categories.

2.22 Many have observed that the heavy weighting of brokers, listed companies, investment banks, lawyers and accountants make the Committee excessively issuer biased. In fact there is currently only one representative from the fund management industry on the Committee even though up to four are permitted. Many respondents suggested that the structure of the Committee needed substantial overhaul with much more investor representation. Some very senior practitioners have even suggested that half of the Committee should be investor based.

2.23 While we certainly sympathise with the thrust of these comments both in terms of cosmetics and in seeking broader perspectives, one practical constraint became apparent during our work. Hong Kong's community of financial intermediaries including brokers, investment bankers, financial advisers, accountants and lawyers is both well developed and deep. The pool of available experienced volunteers is quite large. Similarly there is a well-qualified pool of listed company directors who have many years of experience in Hong Kong.

2.24 In contrast, it is more difficult to find such a deep pool of very experienced international fund managers who are willing and able to dedicate significant time to regulatory oversight. Most fund managers are interested in only a tiny proportion of the new listings in Hong Kong which

in turn represents only a small part of their regional portfolios. A number told us that of last year's 117 issues they had interest in barely a handful. Additionally, some may feel a potential conflict of interests in sitting on the Listing Committee in that they are potential buyers of new listings and could become privy to inside information if involved in discussions of specific cases. There is no such conflict on policy or strategy issues however.

2.25 While there is broad support for more involvement by investors, it will not be easy to implement. Nor should such involvement, by the way, be restricted to the Listing Committee. A number of respondents suggested that the directors of the HKEx and SFC should include investor representatives – at present there are no investor representatives on either the HKEx Board or the Commission. We note that the SFC has included investor representation on its Advisory Committee and established its Shareholders Group which does include a number of institutional investors as well as prominent academics, commentators and professional advisers.

2.26 As to Hong Kong's retail investors, there is limited organised representation and that which does exist is focused quite understandably on investor education and protection, and the number of potential volunteers who can provide representative investor input may be limited. Nevertheless, for Hong Kong's financial markets to develop in a balanced manner, continuing efforts must be made to identify experienced people willing to provide investor representation.

(c) Part-time volunteers versus full-time professionals

2.27 We received considerable comments on this issue. To some, the days of the part-time volunteer are over and the listing decision-making function should be led by highly skilled, independent and experienced professionals. These regulators should be capable of setting strategy, establishing the suitability of companies for listing and deciding whether exemptions from rules are justified. They should also be capable of making decisions recognising commercial reality and balancing their dual roles of investor protection and market development. In this scenario, any part-time Listing Committee would become more of an advisory and appeal panel.

2.28 At the other extreme there are those who believe that the involvement and advice of experienced market practitioners is an essential complement to the rule-based operational style of the current Listing Division. Most commentary regarding the Listing Division begins with a recognition that the staff are hard-working, diligent and thorough but continues to say that turnover is high, experience levels are low, decision-making abilities are limited and the staff tend to operate in a bureaucratic "box-ticking" mode rather than exercising commercial judgement. Some have observed that even very minor issues are brought to the Listing Committee by the Division as an alternative to taking responsibility for their own decisions (a form of upward delegation).

2.29 While attracting and retaining skilled and experienced staff is an issue for most regulators around the world, in the current environment there should be opportunities to strengthen the senior levels of staff with market-experienced professionals. This in turn would help in the training and development of the younger staff and help streamline the listing function by focusing resources on issues of substance as well as detail.

2.30 We note that the HKEx in its submission has proposed a more active role for the Listing Committee as part of its efforts to improve the quality of new listings. This proposal suggests that the Committee should probe the substance of an applicant's business, the rationale for its application and the relationship between the proposed listing vehicle and any private companies of the controlling shareholders. If the Committee finds any aspect of the application unconvincing, or does not receive satisfactory answers to its questions, it can refer the matter back to the applicant until it is satisfied.

2.31 While we welcome the recognition that these steps should be implemented, we feel that it is both impractical and unfair to expect a part-time body to fulfil this function. Rather, full-time professionals should be responsible and accountable for this work but be able to seek guidance from the Committee when required.

HKEX'S SEPARATE SUBSIDIARY PROPOSAL

2.32 The HKEx, in its various submissions, has recognised the perception problems which exist relating to its listing and enforcement responsibilities. In an attempt to address these concerns, the HKEx has proposed the formation of a subsidiary company to be known as the Hong Kong Listing Limited (HKL), to which the Board would formally delegate the HKEx's listing-related responsibilities both for listing approvals and on-going administration of the Listing Rules. The HKL's constitution would clearly specify its duties and make it clear that the quality and efficiency of listing regulation is the HKL's priority. The HKL's budget would be approved by the HKEx Board.

2.33 The Board of HKL would be known as the Exchange Listing Board (ELB) and would be appointed by the HKEx, using a nomination procedure similar to that of the present Listing Committee. The ELB would consist of non-executive, senior and experienced individuals from the market and may include several of the public interest directors of the HKEx Board. It would include investor representation and would be the decision-making body on all listing policy matters.

2.34 Underneath the ELB would be a new Listing Committee which would deal with individual listing applications and delisting proposals. Members would continue to be volunteers and would include more investors than currently. Panels of five to six members would be drawn, either by lot or rotation, to handle individual cases preserving practitioner input to the decision-making process. To maintain consistency and continuity, the Chairman or Deputy Chairman of the Committee would participate in all panels. Whether the panels would be advisory or decision-making is open to discussion. Either there would be a Listing Appeals Committee, as at present, or the ELB would act in this capacity.

2.35 The ELB would appoint an Advisory Committee, which would include members of the Listing Committee as well as others, to advise it on significant policy initiatives.

2.36 The HKEx considers that the above structure would fully address the lack of clarity regarding the powers and responsibilities of the current Listing Committee, would add weight to the listing function and

preserve market input to the decision-making process. It would also help in recruitment, strengthen the internal "Chinese Wall" between the listing function and the revenue-generating units, and should enable the SFC to feel comfortable in standing back to a greater extent and allowing the ELB to perform its functions. The HKEx also considers that it would clarify accountability which would rest clearly with the ELB except in relation to statutory enforcement which would continue to rest with the SFC.

2.37 We have considered this proposal in detail and have the following responses –

(a) The proposal demonstrates the HKEx's recognition of the existing problem and is to be welcomed.

(b) Using a separate subsidiary leads to a clearer definition of regulatory responsibilities than the existing structure.

(c) The proposed inclusion of more investor representation in the HKL's Board and Committees is a positive initiative.

(d) The proposal to have the Chairman or Deputy Chairman of the Listing Committee participate in all panels would help ensure consistency in decision-making.

(e) The delegation of listing powers to several layers of part-time professionals would be extremely difficult in practice just as it has been with the existing Listing Committee.

(f) The fact that the HKEx Board would approve the budget defines where ultimate control would reside.

(g) The presence of HKEx Board representatives on the ELB, while adding their experience to the decision-making process, re-opens the debate about the true separation of roles.

(h) There is no discussion of the executive management structure of the subsidiary and the role of the Chief Executive of the HKEx.

(i) The proposal contains three layers of part-time volunteers: the ELB itself, the new Listing Committee and the Advisory Committee. The evidence received by us suggests that what is required is more full-time professional expertise to handle the listing function, not more part-time volunteers.

(j) It is questionable whether such a structure would make it easier to recruit experienced professionals, who would prefer clear reporting lines and strong full-time leadership.

2.38 In summary, while the HKEx proposal contains many useful ideas, we are not convinced that the separate subsidiary proposal goes far enough to address existing concerns. The delegation of powers to part-time volunteers has proven difficult in the past and would continue to be problematic in the proposed structure. The perceived conflict of interests issue would not go away and the endeavour to upgrade the level of professionalism of the process would not necessarily be assisted. We cannot support the proposal.

REGULATION OF LISTED COMPANIES

2.39 The spate of corporate scandals involving Enron, World Com, Global Crossing, Tyco and others has highlighted some major problems of corporate disclosure and of corporate misgovernance in the US, and there have been many similar cases in other major markets. In Hong Kong, investors have not been immune to similar corporate misadventures, though on a lesser scale.

2.40 In October 2002, Euro-Asia Agricultural (Holdings) Company Limited announced that it had serious cash flow problems. This was followed by the resignation of its top management, financial advisers and auditors and the suspension of trading of its shares, and reports that its controlling shareholder was being held for investigation on the Mainland. It was reported that Euro-Asia's claim to have had turnover worth HK$2 billion (RMB2.1 billion) in a three-year period prior to listing did not reconcile with the Mainland taxation authorities' record which showed a turnover figure of less than HK$95 million (RMB100 million)[11].

2.41 In December 2002, some executive directors and executive staff of three companies listed on the Main Board (Yue Fung International Group Holding Limited, Gold Wo International Holdings Limited and Fu Cheong International Holdings Limited), together with a number of other people including an accountant, a financial consultant, a senior manager of an accounting firm, and a director and an owner of other companies, were arrested by the Independent Commission Against Corruption (ICAC) for alleged false accounting and bribery in relation to the listing of the three companies.

2.42 These incidents and others more recently have seriously shaken investors' confidence. The Euro-Asia case in particular has prompted market concern about the regulators' failure to detect false disclosure and the failure of intermediaries to exercise the necessary due diligence in the listing process. Market sentiment is that a critical review of the listing regime and the regulation of financial intermediaries is urgently needed.

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[11] Caijing Magazine, 20 October 2002 issue.

2.43 Many market participants have told us that the existing listing regime and regulatory framework cannot prevent effectively the kind of corporate misconduct mentioned above from happening repeatedly. Some have pointed to the absence of a lead corporate regulator in Hong Kong while more have lamented the inadequacy of legal deterrence and enforcement against corporate malfeasance, particularly vis-à-vis Mainland based listed companies.

2.44 The principal regulatory roles regarding listed companies are presently split between the HKEx and SFC. There are also other government departments and enforcement agencies that are involved in regulating company activities. The Companies Registry is responsible for the incorporation and registration of companies and the enforcement of various ordinances such as the Companies Ordinance (Cap. 32), Limited Partnerships Ordinance (Cap. 37), Trustee Ordinance (Cap. 29), Registered Trustees Incorporation Ordinance (Cap. 306) and other miscellaneous incorporation ordinances. The Official Receiver's Office administers court insolvencies for both bankruptcies and the compulsory liquidation of companies under the Bankruptcy Ordinance (Cap. 6) and the Companies Ordinance respectively. The Commercial Crime Bureau of the Police (CCB) and ICAC deal with commercial crime and corruption cases involving listed companies respectively. In addition, the FS can launch investigations under section 142 or 143 of the Companies Ordinance.

2.45 In the current three-tier regulatory structure, the HKEx is the "front line" regulator and is solely responsible for the day-to-day administration of all listing-related matters and the supervision and regulation of listed companies through the making and enforcement of the Listing Rules. The Listing Rules are non-statutory and commitment to compliance is effected by means of the HKEx entering into listing agreements, which are commercial contracts, with the issuers. Non-compliance with the Listing Rules may attract sanctions such as private reprimand, public criticism, public censure, suspension of trading or cancellation of listing. These sanctions are however not considered effective by many who argue that reprimands and censures may not serve as sufficient deterrents if the financial gain from the wrongdoing outweighs the loss of reputation. Suspension of trading and delisting will mainly disadvantage the minority shareholders.

2.46 Some respondents felt that the HKEx lacked "teeth" to enforce the Listing Rules rigorously. The HKEx, being a commercial entity and not a statutory regulator, does not have statutory powers of investigation and compelling companies' cooperation with its investigations. Nor could it impose statutory sanctions. Some said that it did not appear to have sufficient resources to monitor compliance with the Listing Rules at a level that was satisfactory to the market.

2.47 Under the Securities and Futures Commission Ordinance (SFCO) (Cap. 24), and under the new SFO, the SFC has some statutory investigative powers over listed companies and the abilities to bring summary prosecutions and launch unfair prejudice actions. The SFC also administers the Code on Takeovers and Mergers and the Code on Share Repurchases, and has a statutory function of supervising, monitoring and regulating the SEHK's performance of the listing function. The SFC however devotes the majority of its resources to focus on intermediary licensing and supervision, investment product authorisation, market infrastructure and the enforcement of securities laws and regulations governing, for example, insider dealing, disclosure of interest in securities, etc., but not so much as a corporate regulator of listed companies.

2.48 At present, the SFC relies on sections 29A and 37A of the SFCO (preserved respectively in sections 179 and 214 of the SFO) to deal with misconduct of listed companies. Section 29A authorises the SFC to direct a company under inquiry to produce records and documents if there is suspected fraud, misfeasance, oppressive behaviour or other misconduct towards members of the company, e.g. not providing those members with all the information about the company's affairs that they might reasonably expect. If, after investigation, the SFC establishes that the affairs of the company have been conducted in a manner unfairly prejudicial to the interests of members of the company, it may, after consultation with the FS, petition the Court under section 37A for an order to –

(a) restrain the commission of the misconduct;

(b) commence a derivative action in the name of the company;

(c) appoint a receiver or manager of the company;

(d) regulate the conduct of the company's affairs in the future; or

(e) compel the company or any of its shareholders to purchase the shares of the other shareholders.

The SFC may also petition the Court under section 45 of the SFCO for an order to wind up a company if the SFC establishes that it is expedient in the public interest to do so.

2.49 The above measures are in practice so extreme as to be of little practical value, and do not usually lead to action against the individual perpetrators. They entail direct intervention by the SFC in the operation of the companies concerned and, in the worst cases, the winding up of the companies. However, in such cases, the companies will have failed substantially. The measures are therefore not effective in the day-to-day regulation of listed companies.

2.50 Other than the Listing Rules administered by the HKEx and the powers conferred on the SFC under the SFCO (and the SFO), listed companies that are incorporated locally are also bound by the Companies Ordinance the greater part of which is administered and enforced by the Companies Registry. However, the Companies Registry has primarily confined its enforcement actions to filing and non-filing cases which are pursued as summary offences at magistrate courts, because of limitations on investigative capabilities and resource constraints. A real problem that is hampering the Companies Registry's work, which is so far as we know unique to Hong Kong, is that about 80% of the listed companies are incorporated elsewhere and are therefore not subject to the provisions of the Companies Ordinance. A significant proportion of these companies have their major business activities elsewhere, which means that their management and the bulk of their assets are located outside Hong Kong. This also affects the regulatory work of the HKEx and SFC as normally a market regulator can assume that the company whose stock is listed on its market is subject to its enforcement activity when necessary – that the company and its officers can normally be found within the legal jurisdiction where the regulator has authority to act. This is not the case for Hong Kong.

2.51 If the current trend continues, which it probably will given Hong Kong's stated objective to be the premier capital formation centre of China, there will be more and more Mainland companies listed in Hong Kong. The growing number of companies from the Mainland, where the legal and commercial infrastructures are still developing, has created new challenges for the regulators.

2.52 The Securities and Futures (Stock Market Listing) Rules made by the SFC under section 36(1) of the SFO, which will come into effect on 1 April 2003, represents a first step towards giving more "teeth" to the Listing Rules. Rule 3 of the said Rules requires, among other things, an application for the listing of any securities issued or to be issued to contain such particulars and information which is necessary to enable an investor to make an informed assessment of the activities, assets and liabilities and financial position of the applicant at the time of the application and its profits and losses and of the rights attaching to the securities. Rule 5 stipulates that an applicant shall file a copy of its application with the SFC after it has submitted its application to the HKEx. Rule 6 empowers the SFC to request further information from an applicant and to object to a listing of any securities. Rule 7 further stipulates that an issuer shall file with the SFC a copy of any announcement, statement, circular or other document made or issued. Together with section 384 of the SFO which makes it an offence for anybody to provide the SFC or HKEx with false or misleading information, the new dual-filing system will enable the SFC to take enforcement action against directors and others who file false or misleading corporate information.

2.53 However, even with the dual-filing requirement, the SFO still stops short of specifying the information that needs to be disclosed by listing applicants and listed issuers, nor does it deal with non-disclosure – failure to file a document in breach of a listing rule requirement, or omissions from a filed document, might not give rise to liability. There is also the worry that the new arrangement may further complicate the delineation of responsibility and accountability between the HKEx and SFC.

2.54 We shall set out our recommendations on how to improve the present situation in Chapter 3. We have taken into account the Corporate Governance Action Plan for 2003 (a copy is at Annex 6), formulated by the Government and other relevant parties to upgrade the quality of the equities market through efforts to bring the corporate governance of companies, in particular listed companies, in line with international standards, when drawing up our recommendations.

2.55 In passing, we should point out that concern has been expressed about the level of communication and cooperation among the three principal enforcement agencies – the SFC, CCB and ICAC. Our inquiries indicate that considerable progress has been made and that the working relationships among the three parties continue to improve. We have been told that the SFC and CCB have regular liaison meetings and joint training sessions, and arrangements have been made for the CCB's inspectors to be seconded to the SFC.

LISTING RULES

2.56 The existing Listing Rules contain detailed requirements relating to, among other things, the following matters –

(a) criteria for initial and continuing listing;

(b) disclosure in listing documents;

(c) disclosure in periodic reports by listed issuers;

(d) disclosure of price sensitive or material events and information;

(e) duties of directors and advisers of listed issuers;

(f) trading by directors of a listed issuer in its securities;

(g) certain categories of transactions of listed issuers, including, as defined in the Listing Rules, "notifiable transactions", which, in turn, include connected transactions, discloseable transactions, major transactions, etc.; and

(h) certain corporate activities of listed issuers, including secondary issues and placements, rights issues, and granting of share options.

2.57 We have heard strong arguments for providing statutory backing to the Listing Rules. But what does providing statutory backing mean? We interpret it to mean that with statutory backing, suspected breaches of the Listing Rules will be dealt with by a statutory regulator that has effective powers to investigate, including the power to compel compliance, and to impose meaningful sanctions. As a statutory regulator would have a wider range of sanctions than the HKEx on the listed companies and company directors as well as the intermediaries for proven breaches, the enforcement of the Listing Rules under such an arrangement will have more "teeth" than the existing arrangement where the HKEx makes and administers the Listing Rules the compliance with which by issuers are based on contractual listing agreements between the HKEx and the issuers.

2.58 Many of our respondents strongly support statutory backing on this basis. However, some are concerned that this could produce the consequence that the Listing Rules will be subject to vetting by the legislature and can be overturned. Application and administration of the Listing Rules will also become a legalistic process requiring strict rules of legal interpretation. On the other hand, Listing Rules that are not statutory or based on legal provisions are not subject to the same requirements and can therefore be made or amended more quickly and flexibly, but they have been widely regarded as less than effective because of the limited sanctions that can be imposed.

2.59 There is a need to strike a right balance between the desire to ensure effectiveness on the one hand and the desire to satisfy the market's need for speed and flexibility on the other. The same concern arises in other jurisdictions, and is addressed in different ways. But in no major market of which we are aware is it addressed by having the whole set of stock exchange listing rules replicated in the statute subject to legislative process. We do not support this approach.

2.60 The Securities and Futures (Stock Market Listing) Rules which provide for a dual-filing system are in fact a measure to provide some statutory backing for the Listing Rules. It is because the SFC will be able to impose sanctions provided in the SFO on listed companies and their controlling shareholders and directors in proven cases of providing false or misleading information. The issue to consider is whether the Listing Rules need more statutory backing than is provided for by the dual-filing system, and how this should be achieved.

2.61 We shall discuss how this issue could be addressed in Chapter 3.

REGULATION OF INTERMEDIARIES

2.62 The Euro-Asia case and others have prompted extensive discussion throughout the market and strong calls for tighter regulation of intermediaries especially in relation to sponsors of IPOs.

2.63 The SFC is responsible for regulating sponsors and other registered intermediaries. According to the Securities Ordinance (Cap. 333), a non-registered individual cannot deal in securities or act as an investment adviser, which includes handling IPO applications, and will be punished by the SFC if found to do so. The SFC has the power to reprimand, suspend or revoke the licences of those who fail in their duty. The GEM Listing Rules stipulate that sponsors have to register with the SFC as an investment adviser or a securities dealer, or must have been declared by the SFC to be an exempt dealer (Rule 6.13), and observe the Code of Conduct for Corporate Finance Advisers. However, unlike the GEM Listing Rules, the Main Board Listing Rules do not specify that a sponsor must be registered with the SFC.

2.64 Currently, the HKEx requires companies listed on the GEM to have a sponsor for its first two years of operation after being listed. Rule 6.03 of the GEM Listing Rules specifies the role of a sponsor as follows –

> "The sponsor's role is of particular importance to the successful operation of GEM, since it is the expectation of the Exchange that each issuer should, with the guidance and assistance of the sponsor, comply with and discharge its responsibilities under the GEM Listing Rules without having to rely unduly on the advice of the Exchange. In this regard, the sponsor is expected to advise the issuer on those responsibilities in a competent, professional and impartial manner, so providing reassurance to investors."

2.65 The GEM Listing Rules also lay down the eligibility criteria for sponsors, including previous IPO experience and the engagement of a specified number of employees with sufficient relevant experience. The HKEx can refuse to deal with a sponsor who repeatedly attempts to bring

poor quality companies to the market. For Main Board listings, the Main Board Listing Rules only mention that "the sponsor has a particular responsibility to satisfy himself, on all available information, that the issuer is suitable to be listed" (Rule 3.04). While sponsors are to observe the guidelines set out in the model code for sponsors issued by the HKEx, there are no specific eligibility criteria for sponsors nor is there any prescribed punishment for non-performing sponsors. This difference in eligibility criteria between the two trading boards means that a sponsor who is not qualified to handle GEM listing applications can do IPO listings on the Main Board. In our view, the Main Board, with higher entry requirements on capitalisation, track record, etc., should require greater due diligence on the part of IPO sponsors whose role is crucial to ensuring that issuers fully comply with the listing requirements. We therefore see no valid reasons why the eligibility criteria for sponsors for the Main Board should be less stringent than those of the GEM, which is supposed to have higher risks and is designed for professional and informed investors.

2.66 We have been told that it was often difficult to prove whether the sponsor or the management of the company should be held responsible for the provision of false information in a listing document. This situation has not been helped by the fact that even though the SFC is responsible for the registration and regulation of sponsors, it is the HKEx, instead of the SFC, that has more direct working contacts with the individual sponsors as the front line regulator. This appears to be a fundamentally unsatisfactory arrangement.

2.67 The SFO will tighten the regulation of intermediaries, including sponsors, by requiring each intermediary to nominate at least two responsible officers who participate in or are responsible for directly supervising the business of the regulated activity for which the intermediary is licensed. In addition to existing sanctions, the SFC will be empowered to impose civil fines, the maximum of which will be the higher of $10 million or three times the amount of the profit gained or loss avoided, for proven misconduct.

2.68 Strengthening the regulation of intermediaries dealing with IPOs will help to ensure that listing applicants comply with the listing requirements, and hopefully help to improve the quality of the securities market. The Government, SFC, HKEx and the intermediaries themselves have over the past few months put forward various proposals

in this area. The HKEx has proposed to consult the market on amendments to the Listing Rules to tighten the regulation of IPO intermediaries, in particular sponsors and financial advisers. The SFC has made proposals to the Standing Committee on Company Law Reform on amendments to the Companies Ordinance to extend the prospectus-related liability to IPO sponsors and possibly other IPO intermediaries, for ensuring quality disclosure to investors. These initiatives are parts of the Corporate Governance Action Plan for 2003 mentioned in paragraph 2.54. Separately, the Hong Kong Society of Accountants has undertaken to strengthen the regulation of their profession, by reforming the process of investigating complaints concerning accountants. We welcome and support these initiatives.

COMMUNICATION AMONG THE THREE TIERS OF THE REGULATORY STRUCTURE

2.69 Our terms of reference require us to look at the lines of communication among the Government, SFC and HKEx. The PIPSI Report (paragraph 4.15) identified four major fora for the Government to communicate and discuss matters of common concern with the SFC and HKEx –

(a) Regular meetings between FS, Chairman of SFC and Secretary for Financial Services and the Treasury (SFST)

These meetings take place about nine times a year, to discuss major developments in the financial markets and to keep the FS posted on the general direction of major market reform initiatives.

(b) Securities and Futures Liaison Meeting

This is a monthly liaison meeting between the Financial Services and the Treasury Bureau (FSTB) and SFC dealing with the latter's housekeeping matters.

(c) Tripartite Meeting

This is a bi-monthly liaison meeting between the FSTB, SFC and HKEx to facilitate general monitoring of issues affecting the development of the securities and futures markets, and communication between the SFC and HKEx.

(d) Coordination Committee

This is another tripartite forum involving the FSTB, SFC and HKEx, that is convened either bi-monthly or quarterly, to identify, discuss and resolve regulatory and policy issues to facilitate the HKEx's implementation of its strategic plan, also referred to as "the McKinsey Report".

2.70 The PIPSI Report also mentioned the **Financial Market Development Task Force** and the **Financial Stability Committee** (paragraph 4.16). The Financial Market Development Task Force is chaired by the SFST and comprises the Chief Executive of the Hong Kong Monetary Authority (HKMA), the Chairman of the SFC, the Commissioner of Insurance, the Director-General of Investment Promotion and the Managing Director of the Mandatory Provident Fund Schemes Authority. It meets once every three months to identify and coordinate, where necessary, new initiatives in promoting the development of the financial markets, with a view to maintaining the status of Hong Kong as an international financial centre. **Five working groups** have been set up under the Task Force to work on the following five specific areas: banking (chaired by the HKMA), debt market (chaired by the FSTB), securities and futures markets (chaired by the SFC), insurance (chaired by the Commissioner of Insurance) and fund management (chaired by the HKMA). These working groups meet as needed. The Financial Stability Committee is chaired by the SFST with the Chairman of the SFC, the Chief Executive of the HKMA and the Permanent Secretary for Financial Services and the Treasury (Financial Services) as members. It meets about once a month and monitors on a regular basis the functioning of the financial markets (including the money, foreign exchange and securities markets) and deliberates on events, issues and developments with possible cross-market and systemic implications, and where appropriate, formulates and coordinates responses.

2.71 In addition to the above fora that were mentioned in the PIPSI Report, we note that there is also a **Risk Management Committee** set up by the HKEx under section 9 of the Exchanges and Clearing Houses (Merger) Ordinance (Cap. 555) to formulate policies on risk management matters relating to the HKEx's activities for the HKEx Board's consideration. The Committee is chaired by the Chairman of the HKEx and consists of seven other members of whom five are appointed by the FS (including two non-executive Public Interest Directors, the Chairman of the SFC, the Chief Executive of the HKMA and an outside professional) and two by the HKEx (of whom at least one is a member of the HKEx Board and not the Chief Executive of the HKEx).

2.72 We mention in passing that the presence of the Chairman of the SFC and the Chief Executive of the HKMA on the Risk Management Committee of a listed company seems inappropriate. To the extent that issues relating to financial stability or systemic risk may arise which

require the participation of the HKEx, such issues ought to be discussed by the Financial Stability Committee, co-opting the HKEx. The Risk Management Committee of the HKEx should then be left to perform the conventional functions of a risk management committee of a listed company.

2.73 At the operational level, the Corporate Finance Division of the SFC and the Listing Division of the SEHK meet every month at what is known as the **SEHK-SFC (Listing) Liaison Committee Meetings**, to discuss –

(a) any matters arising out of the monthly report on the activities of the SEHK in relation to its listing responsibilities;

(b) matters relating to the regulation of listed companies, and oversight of the SEHK by the SFC in relation to listing-related matters; and

(c) any policy or other matters, including proposed rule changes, relating to any of the listing functions and responsibilities of the SEHK or the SFC.

Apart from these regular meetings, the staff of the Corporate Finance Division and the Listing Division are in frequent contact over the telephone and through exchanges of letters and e-mails.

2.74 Most recently a **High Level Group** has been set up to discuss the regulation of listed companies. Its membership includes the Chairman of the SFC, the Chairman of the HKEx, the Chief Executive of the HKEx, the Chairman of the Main Board Listing Committee, the Chairman of the GEM Listing Committee, the Chairman of the Panel on Takeovers and Mergers, the Executive Vice President of the HKEx's Listing, Regulation and Risk Management Unit, and the Executive Director of the SFC's Corporate Finance Division. The High Level Group held its first meeting on 9 December 2002.

2.75 The preceding paragraphs demonstrate an abundance of communication channels among the three tiers of the regulatory structure. However, from what we have gathered, despite the elaborate liaison network that has been put in place, actual communication does not seem to work satisfactorily, as pointed out by the PIPSI Report. There is a strong feeling among market participants that the three parties often send confusing, if not conflicting, messages to the market.

2.76 We learnt in addition from some that the atmosphere at the Listing Liaison Committee Meetings has not always been cordial and tension could be high when the Corporate Finance Division commented unfavourably on the Listing Division's work. We realise that some tension is inherent in a regulatory relationship and thus inevitable. So long as the HKEx is performing a regulatory function, i.e. as the front line regulator of all listing-related matters and issuers listed on its markets, it would have to be subject to the SFC's oversight. And as a for-profit listed public company, the HKEx might feel the SFC's regulatory supervision excessive and intrusive at times. The implementation of the dual-filing system which will give rise to some degree of overlap of duties between the SFC and HKEx in respect of listing matters may further complicate the situation.

2.77 We believe that a clear translation of the Government's policy objectives into unambiguous missions of the SFC and HKEx, especially the role of the listing authority regarding the promotion of market quality, and a re-ordering of responsibilities for listing as we recommend, should help to change things for the better. When each party is aware of and accepts its role and responsibilities in the regulatory regime, there should be less need for clarification and negotiation, and still lesser need for intervention and possible friction. Frank discussion and close cooperation would then follow. In due course, the communication channels should be streamlined when mutual understanding and cooperation are at such a level to require less fora and lower frequency for meetings. A greater reliance on ad hoc meetings and setting sunset dates for all new groups (and perhaps some of the existing ones) will impose greater discipline on all concerned, by establishing a requirement to review the usefulness of the continued existence of such fora.

CHAPTER 3
RECOMMENDATIONS

3.1 In this chapter we set out our proposal in more detail and explain the reasoning behind the concepts. We also discuss the various arguments which have been raised against a significant reform of the listing regime and our response to them. In the next chapter, we discuss some implementation issues, including transitional arrangements, etc.

PROPOSED NEW LISTING AUTHORITY AND LISTING PANEL WITHIN THE SFC

Listing Authority

3.2 We recommend that the listing function should be taken out of the HKEx. The listing function, including the processing of listing applications and the making and administering of rules on listing-related matters, should be performed by a new Hong Kong Listing Authority (HKLA) to be established within the SFC.

3.3 The HKLA should be staffed by highly skilled, full-time professionals who are market experienced and able to exercise proper discretion to process listing applications in pursuance with Hong Kong's objective to be the premier capital formation centre of China and one of the top five equities markets in the world. They should be capable of setting strategies, establishing the suitability of companies for listing in accordance with the Listing Rules, and exercising discretion on whether exemptions from the Rules are justified. The HKLA should look in the first instance to recruit from the staff of the HKEx's Listing Division, many of whom should possess the qualifications and abilities expected of the new HKLA executives. The HKLA should also recruit from outside, both locally and overseas, professionals who can help raise the level of expertise and bring greater credibility. In order to do this, the compensation packages offered will have to be sufficiently attractive. We recognise the importance and the sensitivity of the staff issue, and shall discuss the matter further in Chapter 4.

3.4 The HKLA should be headed by a strong leader who is familiar with the operation of the financial markets and widely respected by people in the industry. He or she should have a clear vision of the roles and functions of the HKLA in the listing regime.

3.5 We further recommend that the HKLA head should be an Executive Director of the Commission to provide a vital link between this important operational unit and the highest decision-making body of the SFC, to report to the Commission on the work of the HKLA, to seek policy guidance and to secure the necessary resources from the Commission for the HKLA to perform its listing function effectively and efficiently.

3.6 The HKLA should be a separate functional unit within the SFC with its own cost-recovery based budget, but should work closely with the other units of the SFC to share information and cooperate in enforcement actions.

3.7 The SFC may make rules under the SFO to provide for the establishment of the HKLA and prescribe its composition, terms of reference and modus operandi. It is however clear that the SFO was formulated on the basis that the status quo with respect to the listing regime, i.e. the HKEx being the front line regulator of listing matters and listed companies, and responsible for making and administering the Listing Rules, was to continue.

3.8 Although the SFO provides sufficient leeway for our recommendations on the transfer of the listing function to be implemented without its amendment, the Government may wish to consider amending the SFO in due course, so that the legislative framework will match the new administrative reality.

Listing Panel

3.9 Decisions of the HKLA should be subject to appeal to a Listing Panel to be set up under section 8 of the SFO, whose status should be similar to that of the Takeovers and Mergers Panel. The Panel should comprise 18 to 20 members appointed by the SFC from the following groups: the HKEx, exchange participants, issuers, investors, brokers, investment fund firms, banks and other market intermediaries such as lawyers and accountants. The quorum for each Panel meeting should be one third of the total number of members, as a larger quorum may be

difficult to achieve given that the Panel members would all have busy schedules and various demands on their time, and that some may not be able to attend meetings to discuss contentious cases in which they may have an interest.

3.10 We have considered suggesting a specific number of representatives from each stakeholder group but have decided against it, having regard to the difficulty in identifying the right personalities in certain sectors who are both qualified and willing to render their service. This is particularly relevant for investor representation. Consideration should thus be given to inviting members of the SFC's Shareholders Group to serve on the Panel. We would stress that the different stakeholder groups should be as evenly represented as possible to ensure that no one group can dominate. We believe a total of 18 to 20 members should allow reasonable representation of each stakeholder group. Each Panel member should normally be appointed on a two-year term and should not serve more than four years to prevent any one member from having direct influence on the listing process for too long a period, except when considered necessary to maintain continuity or when no appropriate replacement can be found. Panel members should be replaced in phases to provide for continuity. We are of the view that terms shorter than two years do not allow members to familiarise themselves with the operation of the Panel and function effectively before their tenure is over.

3.11 The Chairman of the Panel should be a respected member of the industry with unquestionable integrity, and should be prepared to make major contributions in terms of personal expertise and time to lead the Panel to face the many challenges ahead. He or she should not be a Director of the Commission to avoid any perception that the Commission has too much direct influence or control over the Panel. The Chairman and members of the Panel are to be appointed by the SFC in their personal capacity. They should perform their functions independently of the Commission and should tender their advice without fear or favour and in the overall interest of the Hong Kong market.

3.12 Apart from adjudicating on appeals against decisions of the HKLA, the Panel should function as an advisory body providing guidance on listing strategies in the overall context of market development and changes to the Listing Rules to achieve the desired effects. It should be responsible for oversight of both the Main Board and GEM markets. It should also be a proactive group in terms of consultation on new proposals and be included by the HKLA in such discussions as early as possible.

3.13 The HKLA should provide sufficient support to the Panel, which should include general secretariat support for Panel meetings such as preparation of agendas, papers and minutes, as well as research and analysis work. We are aware that this will require considerable resource allocation. But if we want the listing function discharged effectively, this is in our opinion necessary to enable the Panel to successfully perform the role it is given.

3.14 We are mindful of the possible conflict that may arise if the same pool of executives who are responsible for making decisions on listing applications, also provide secretariat support to the Panel which reviews the decisions made by the executives themselves. But we believe that this possible conflict should not be too serious as the Panel's decisions are made by Panel members who are all coming from non-SFC stakeholder groups, **not** the SFC executives. We also think that the Panel, being an advisory and appeal body, may not need to meet frequently and the entailed workload would probably not justify the setting up of a full-time dedicated team to provide support. However, the Government may wish to consider this issue more thoroughly.

3.15 To allow sufficient time for the HKLA executives to build up credibility and hence the market's confidence in their ability to do the job professionally, we recommend that, as a transitional arrangement, during the first 18 months of its inception, the present Listing Committee members supplemented by several investor representatives, should constitute the Panel, and the Panel should be the ultimate authority to approve or reject listing applications, in addition to performing the functions mentioned in paragraph 3.12. A transitional period of 18 months should be sufficient to allow the HKLA to demonstrate its ability to balance regulation and market development in its work. A longer transitional period would not be acceptable as we believe that the market is in urgent need of the changes recommended.

3.16 During the transitional period, the Panel will therefore operate rather like the existing Listing Committees, convening meetings once every week, and the secretariat should provide members with papers for discussion before a prescribed deadline – we suggest, two clear days. Papers that fail to reach members before the deadline should not be considered except in special circumstances and with the Chairman's agreement. The secretariat should assist members to obtain additional information and if necessary research into specific issues to facilitate members' consideration of each case.

3.17 At the end of the transitional period, the Panel should become an advisory and appeal body as suggested in paragraph 3.12. It should then meet less frequently and members can focus more on providing guidance on listing policy and strategies, and adjudicating on appeal cases.

3.18 Parties who are not satisfied with the decisions of the Panel can seek judicial review. During the transitional period, as discussed in paragraphs 3.15 and 3.16, the Panel should adjudicate on appeals in the same manner as that adopted by the existing Listing Committees. However, we recommend that when reviewing a decision, members of the Appeal Panel should be provided with the reasons for the decision and relevant precedents to facilitate their consideration of the case.

ARGUMENTS AGAINST MOVING THE LISTING FUNCTION TO THE SFC

3.19 Within the few submissions and respondents in favour of leaving the listing function with the HKEx there have been some consistent reasons and concerns expressed. These could be categorised as follows –

(a) The SFC as a regulator would be risk-averse to the extent of inhibiting market development.

(b) The SFC would be bureaucratic and distant from the market.

(c) The inability of the HKEx to offer "one-stop shopping", particularly in the Mainland, would leave it at a commercial disadvantage to other exchanges in an increasingly competitive operating environment.

(d) The SFC would not be effective as a marketing organisation.

(e) The concentration of responsibilities at the SFC would create an unduly powerful entity with unprecedented powers.

(f) Moving the listing function to the SFC would entail the Listing Rules becoming subsidiary legislation subject to legalistic administration.

(g) Transferring the listing function to the SFC represents a significant departure from the HKEx's listing document.

3.20 We discuss each of these in turn.

(a) The SFC as a regulator would be risk-averse

3.21 The proponents of this argument would say that any listing authority run by full-time regulators would be unduly risk-averse, legalistic and more intent upon preventing potential problems than market development.

3.22 Our response to this is several fold. Firstly, while this is a logical and fair concern, we believe it is one which can be managed by setting clear goals. It must be clearly articulated that the objective of the HKLA includes achieving Hong Kong's strategic goal for its financial markets, and that the leadership of the HKLA is fully accountable for **both** investor protection and market development and that they will be evaluated and rewarded accordingly. The new SFO largely achieves this already. It includes a specific provision which states that the SFC has the regulatory objective to, inter alia, maintain and promote the efficiency and competitiveness of the securities and futures industry.

3.23 Secondly, it is our view that it is people, and in particular leadership, that define the culture of an entity such as the HKLA. As such, we feel that it is important that the HKLA should be led by a very experienced, independently minded and widely respected individual with many years of experience as a market practitioner. In addition to the leader, there must be sufficient senior staff with the necessary experience to plan strategy and implement the process without undue dependence on the Listing Panel.

3.24 Finally, we would point to international comparisons such as New York, London and indeed the Mainland where a central regulator has not inhibited market development.

(b) The SFC would be bureaucratic and distant from the market

3.25 We received a variety of views on this subject. Some practitioners found the HKEx itself to be excessively bureaucratic and not sufficiently market sensitive. There were certainly those who felt that the SFC was not necessarily more distant from the market and (perhaps because of their intermediary supervision role) the SFC could appear in some respects to be closer to the market than the HKEx. Still others noted a higher degree of responsiveness and professionalism in their dealings with the SFC.

3.26 This is not to say that all input about the SFC was positive, but we are not persuaded that the SFC is noticeably more bureaucratic and distant from the market than the HKEx.

3.27 In any event we are satisfied that with the right system of accountability and leadership structure, concerns about bureaucracy and market awareness can be alleviated.

(c) The inability of the HKEx to offer "one-stop shopping", particularly in the Mainland, would leave it at a commercial disadvantage to other exchanges in an increasingly competitive operating environment

3.28 There is no doubt that the Mainland has become the focus of attention for exchanges around the world. Not only global leading markets such as the NYSE, Nasdaq and LSE are increasing their marketing efforts but exchanges from Singapore, Australia, Tokyo, Frankfurt and others are also promoting their services.

3.29 Hong Kong has maintained its strong competitive position to date due to its early efforts in developing the H share market and has become the natural home for the bulk of Mainland companies seeking international listings.

3.30 The HKEx considers that its control of the listing function gives it a significant competitive advantage by allowing it to offer "one-stop shopping" for Mainland enterprises. While we can understand the commercial attraction of such an arrangement, it does demonstrate all too clearly the potential conflict of interests issue discussed elsewhere in this report - the temptation to offer regulatory concessions to attract listings. Furthermore, we note that the leading exchanges from both New York and London compete quite effectively without such total control of their "product", and leading Mainland companies should not and do not appear to have difficulty in coping with a statutory regulator.

3.31 Finally, our judgement is that many of the smaller Mainland companies which have listed in Hong Kong would have been of limited interest to leading global exchanges. Their interest, and that of international sponsors, is in the larger issuers such that many of the recent Hong Kong listings would not have been prime targets for listing elsewhere.

(d) The SFC would not be effective as a marketing organisation

3.32 This concern is, in our opinion, misplaced. It is not the role of any regulator to market actively to potential issuers. If the listing function moves to the SFC, it would still be the role and responsibility of the HKEx to promote its services and its trading platforms. In the same context, as far as we are aware, neither the SEC nor the FSA is involved in direct marketing in the Mainland. Rather it is the market operators such as the

NYSE, Nasdaq and LSE that are responsible for market promotion, not to mention the efforts of the investment banking community and other intermediaries. There is no reason however why the SFC should not visit the Mainland and other places from time to time to add credibility to the HKEx's marketing efforts. Demonstrating that Hong Kong has a world-class regulatory structure and listing regime should be one of the objectives of the SFC and delivering this message to potential listing candidates as well as investors should be one of its responsibilities.

(e) The concentration of responsibilities at the SFC would create an unduly powerful entity with unprecedented powers

3.33 This is an understandable concern, expressed mostly by the small broker community and some smaller listed companies. We note that there is in the current system an effective set of external checks and balances on the SFC's use of its powers. The Non-executive Directors of the SFC oversee its work on a regular basis and act as the first line of independent supervision. Then there is the Securities and Futures Appeals Panel (SFAP) which hears appeals against decisions made by the SFC relating to the registration, regulation and discipline of intermediaries. The SFAP will be replaced by the Securities and Futures Appeals Tribunal (SFAT) which will commence operation upon the coming into effect of the SFO on 1 April 2003. The SFAT will be independent of the SFC and headed by a judge assisted by two lay members with relevant experience. It will have the jurisdiction to review the SFC's decision on the full merits of the case, and the power to affirm, vary or substitute the decision. Parties affected by an SFC decision can also seek judicial review and those dissatisfied with the way the SFC has handled any particular matter can complain to the Ombudsman. There is also the Process Review Panel, set up in November 2000, to review the internal operational procedures of the SFC and to determine whether it has followed its internal procedures, including procedures for ensuring consistency and fairness. The SFC is also subject to the scrutiny of the ICAC.

3.34 We have not seen any evidence to indicate that such checks and balances are inadequate, and feel that the benefits gained by the transfer of the listing function more than outweigh any risk associated with the SFC having more powers as a statutory regulator. If the listing function is transferred to the SFC as we recommend, parties aggrieved by the HKLA's decisions on listing matters can appeal to the Listing Panel, and have further recourse by means of judicial review.

(f) Moving the listing function to the SFC would entail the Listing Rules becoming subsidiary legislation subject to legalistic administration

3.35 Concern was expressed by several parties that making the Listing Rules statutory would render it more difficult to amend the Rules to take account of new investor protection requirements and new financial products. The operation and interpretation of statutory rules were also suggested to be legalistic and likely to generate recourse to the courts, which in turn would reduce the efficiency of Hong Kong's capital formation system. This issue is discussed in detail elsewhere in this report but we emphasise several points here.

3.36 While the SFC is indeed a statutory regulator, it does not follow that the Listing Rules once administered directly by the SFC will necessarily become subsidiary legislation. The SFC already administers non-statutory codes. Some of these codes, such as the Code of Conduct for Persons Registered with the SFC, are detailed guidelines on how the SFC would interpret and apply the statutory requirements as set out in the SFO. Others such as the Codes on Takeovers and Mergers and Share Repurchases represent a consensus of opinion of market participants and the SFC. These non-statutory Codes are administered by the SFC which has the statutory powers to conduct investigations and gather evidence in cases of suspected violations.

3.37 While we agree that non-statutory rules could provide the flexibility for future amendments to align with market development, we strongly believe that the Listing Rules should have statutory backing in order to be an effective regulatory tool. We shall discuss this further in paragraphs 3.44 to 3.48 below.

(g) Transferring the listing function to the SFC represents a significant departure from the HKEx's listing document

3.38 This issue was raised in the context that the comparatively recent listing of the HKEx was on the stated basis of the present regulatory arrangements, and that any change could expose those responsible for the floatation to some legal liability to investors. We are satisfied this is not a real concern, for the following reasons.

3.39 The HKEx was listed on the Main Board by way of introduction, **not** a public offering. The listing document that was distributed to the public was not registered as a listing prospectus with the Companies Registry and would therefore not attract prospectus liability. We recognise that that does not exclude, in theory, common law liability, but as will be seen, that does not arise either.

3.40 Even if the document were argued to be a listing prospectus subject to the provisions of the Companies Ordinance, references to the HKEx's performing the listing function were true and not misleading at the time. No liability should arise from a change of that position now. Any reference made to the existing provision could not have been a representation that there would never be a change of circumstances. This is certainly the view of the institutional investors we have spoken to.

3.41 But there was no such representation on the subject at all. Therefore no investor is likely to be able to argue successfully that they invested on the basis of a representation which has been abandoned, since that representation was never made.

3.42 We are proposing that the HKEx retains the surplus from its listing fees, and that the new HKLA be funded on a cost-recovery basis. We shall discuss this further later in this chapter and in Chapter 4. Arguably (although we do not give investment advice or valuations) the HKEx may be better off, since their management will no longer be distracted by regulatory work and will be free to concentrate on their commercial activities.

3.43 On a related matter, there may also be a concern that the Government may have some responsibility arising from historical statements concerning the administration of the listing regime. We have taken legal advice and are advised that it is improbable that the statements give rise to a substantive legitimate expectation that the Government would not change its policy. The advice notes that the courts have recognised that the Government must remain free to change its policy in the public interest.

LISTING RULES

3.44 We strongly recommend that the Listing Rules should have statutory backing in the sense described in paragraph 2.57 of Chapter 2 and should continue not to be subject to legislative vetting. We also recommend that the HKLA, if our proposal is adopted, should be responsible for making and administering the Listing Rules.

3.45 How the Listing Rules can be given the necessary statutory backing requires careful legal analysis by the Government and other relevant parties. We shall nonetheless discuss some possibilities below.

3.46 One option is to have the SFC make subsidiary legislation under the SFO, linking the Listing Rules to certain general requirements which are sufficiently important for investor protection to be set out in the law, but without turning the Rules themselves into subsidiary legislation. For example, the new subsidiary legislation could require full, accurate and timely disclosure of information **to the satisfaction of the HKLA**, and what would satisfy the HKLA would be set out in the Listing Rules. Specifically, to address one limitation of the dual-filing system as discussed in paragraph 2.53, non-disclosure could become an offence carrying statutory sanctions. The Listing Rules will become a kind of code of practice enforced by the HKLA of the SFC, a statutory regulator. The code itself would be non-statutory, but represent detailed guidance on how the relevant statutory requirements are to be interpreted and complied with. Since the Listing Rules are linked to some statutory requirements and administered by a statutory regulator, there can be a wide range of sanctions on the listed companies and company directors as well as the intermediaries of proven breaches. This arrangement would preserve the non-legislative status, and hence the flexibility, of the Listing Rules.

3.47 Another alternative is to give the Listing Rules the same status as that of the codes and guidelines that the SFC may publish under section 399 of the SFO, upon the transfer of the listing function from the HKEx to the HKLA. This will allow the Listing Rules to remain non-statutory so that they can be changed promptly by the HKLA to respond quickly to market requirements. The HKLA as a statutory regulator will have statutory powers of investigation and obtaining evidence under the SFO in dealing with suspected breaches of the Listing

Rules, and will have access to the array of sanctions in the SFO to punish offenders, which will greatly improve the regulatory regime's effectiveness and credibility. The range of sanctions available for breaches under this option may be more restricted than would be desirable and the limitation of the dual-filing system referred to earlier will remain unaddressed, but it has the advantage of being available immediately.

3.48 The above possibilities will provide statutory backing to the Listing Rules to be made and administered by the HKLA without amending the primary legislation. A further option is to set out the general requirements described in paragraph 3.46 in the primary legislation, i.e. the SFO. It will be a more elaborate legislative exercise that would achieve the same effect as the option described in paragraph 3.46. It may however be desirable in the long term to place the listing requirements in question in the primary legislation to reflect their importance.

3.49 Regardless of which approach the Government adopts to give the Listing Rules the kind of statutory backing that we support, we recommend that the HKLA should in future seek market views and consult the Listing Panel before making changes to the Listing Rules, so that market inputs are properly considered in the process. We understand that the HKEx has adopted different approaches in consulting the market publicly on proposals to make or amend the Listing Rules, depending on the importance of the proposals. For significant changes, the HKEx would issue consultation papers to solicit views on its proposals. For less important amendments, it would publish a paid advertisement in the press to invite comments. For insignificant changes, such as drafting changes, clarifications or administrative matters, it would simply inform the market of the changes to be made by placing paid advertisements in the press. The HKLA should consider adopting similar arrangements. In cases where a decision is made not to consult the market, the HKLA should explain in its announcement the reasons for not doing so. The Listing Panel should nonetheless be consulted in all cases to draw on its expertise.

3.50 We further recommend that while the HKLA should be responsible for the making and administration of the Listing Rules, the HKEx should be allowed to set its own entry and exit criteria and conduct codes or rules with regard to the trading of securities that have been approved for listing by the HKLA on the stock exchange. This will enable the HKEx to define its "brand image".

LISTING FEES

3.51 We recommend that the HKLA should levy fees for processing initial listing applications and for granting continuing listing status, as the HKEx presently does. The fees levied should be set at levels that can cover all the costs of the HKLA performing the listing function, i.e. on a cost-recovery basis, and having regard to the levels of fees imposed by exchanges outside Hong Kong. The rates of fees should be set out in the Listing Rules and the basis for the calculations should be explained to the market as clearly as possible.

3.52 The HKEx should continue to be allowed to impose fees for listed securities to trade on the stock exchange, i.e. for access to its trading platform as a commercial service. The HKEx should propose an appropriate rate for the SFC's consideration and approval. While the fees to be charged by the HKEx should in due course be determined principally by commercial considerations such as competitive forces, in the short term, the HKEx should be expected to pass on to issuers the benefit it will receive from the significant reduction in its cost base as a result of the transfer of the bulk of the Listing Division to the HKLA.

3.53 To minimise impact on the market, the total of the listing fees levied by the HKLA and the fees charged by the HKEx should as far as possible not exceed the listing fees currently charged by the HKEx. We are mindful however that if the SFC is to improve on the regulation of listed companies, it may need to expend more on its new regulatory function. The setting of the fee levels would therefore require careful consideration.

3.54 We believe that the above arrangement is a fair one and would have the least adverse impact on the HKEx as a for-profit commercial entity and to its shareholders, and would at the same time allow the SFC to ensure that the fees charged by the HKEx, which has been given the right to operate the only stock market in Hong Kong, are reasonable and conducive to maintaining the competitive edge of the Hong Kong market.

REGULATION OF INTERMEDIARIES

3.55 We recommend further strengthening the regulation of intermediaries, especially sponsors given the importance of their role in ensuring the quality of listings. Enforcement should be strengthened to ensure that those who are not discharging their responsibilities properly are adequately and swiftly sanctioned. The SFC's new power under the SFO to impose fines on intermediaries guilty of misconduct should provide the Commission with added "teeth" in its enforcement efforts. As mentioned in Chapter 2, the Government, SFC, HKEx and some intermediaries have recently put forward proposals in this area. We support these initiatives and would urge relevant parties to carefully study these proposals so that improvement measures can be implemented at an early date.

3.56 Our proposal to move the listing function to the HKLA within the SFC, if adopted, will enable the SFC, which is responsible for the regulation of intermediaries, to have closer contact with sponsors and thus better monitoring of their performance. It will also clarify accountability as there will be no split regulation and the SFC will be the sole regulator of intermediaries. Enforcement efforts will be swifter and more effective as the SFC will not have to rely on the HKEx for information or wait for referrals or reports from the latter. There will also be synergies within the SFC as its various regulatory functions can complement and support one another.

3.57 We have mentioned in Chapter 2 that currently the Main Board Listing Rules contain less stringent requirements for sponsors than the GEM Listing Rules. We recommend that the SFC should consider providing in the Main Board Listing Rules specific eligibility criteria for sponsors and their role in handling IPOs which should be equivalent to, if not more stringent than, those in the GEM Listing Rules. We believe that this will help the effort to improve the quality of Main Board listings.

CHAPTER 4
IMPLEMENTATION

WORKING PARTY AND TRANSITION PERIOD

4.1 The outline of our proposed solution appears in the Executive Summary, at paragraph 53, and we shall not repeat it here. We concentrate in this section on some of the issues which will arise in the implementation of our proposal. These issues will require negotiation between the HKEx and SFC in particular, in order to ensure a smooth transition, and no doubt the Government will encourage that process as needed, including appointing a top level **working party** involving the three tiers to resolve the details as soon as possible. The comments made here are intended to assist that process.

4.2 We have consulted widely in the course of preparing this report, and canvassed many of the same people whom the PIPSI had consulted just a few months before on related issues. We are confident that we have identified the views of all of the people who wish to express a view, and that our recommendations will receive broad support. We believe that there would be widespread approval if the Government were to take the view that further formal consultation on the concept we propose was unnecessary, and we doubt that any further consultation would elicit different opinions. We are strongly of the view that the interests of Hong Kong will be better served by the Government taking an early decision to implement our proposal and commence that process. Views expressed after publication on details, as opposed to the concept, can of course be taken into account in the implementation process.

4.3 We consider that **a transition period of 18 months** would be necessary and desirable to send the right messages, that Hong Kong is re-organising but there is no crisis, and it will be business as usual during the transition. Dual-filing will be in operation as from 1 April 2003 in any event, and as noted elsewhere, that will give the SFC an immediate role in assisting the HKEx to lift the quality of listings.

STAFFING

4.4 As recommended in paragraph 3.3 of Chapter 3, we propose that as far as possible staff of the Listing Division should be offered employment in the new HKLA. They should in fairness be given that assurance at the earliest opportunity.

4.5 We expect that some will decline that offer, for a variety of reasons, including in some cases that they wish to remain with the HKEx, which will in our proposal have a continuing role of deciding their own entry and exit criteria and conduct codes or rules for listed stocks to trade on the stock market. But we hope that, with the encouragement of the HKEx, in whose interest it will be, enough senior and experienced people will accept the offers that there can be no doubt that the HKLA staff administering the Listing Rules are familiar with them.

4.6 Of course, this is not to say that all the transferred staff are guaranteed employment **indefinitely** at the HKLA, any more than they are now at the HKEx. There is a need to refresh and upgrade the skill levels of the staff working on the listing process, as more elements based on judgement and direct experience of markets are brought into the system.

4.7 The offer of employment should as far as possible be on **terms that are no less favourable** in overall effect, than the present employment with the HKEx. It will not be possible to replicate the terms exactly, since the HKEx as a listed company has been able to offer inducements such as options, which are not possible for the SFC. But these inducements can be valued under the supervision of the working party mentioned in paragraph 4.1 if necessary.

4.8 The SFC is in the process of recruiting some 15 staff as part of the dual-filing regime, and they together with the transferred staff of the Listing Division, should form the nucleus of the staff of the HKLA. But the process of attracting, training and retaining well-qualified staff within the HKLA should be ongoing.

FINANCE

4.9 If the Listing Division is viewed as an accounting entity, there is a surplus of revenue over expenditure. In forming our recommendations, our guiding assumptions have been that, as far as possible –

(a) the HKEx should not be materially worse off, and if possible not worse off at all, as a result of the proposed changes, which means that the listing fees need to be shared in some fashion between the HKEx and the HKLA;

(b) total listing fees paid by listing applicants and issuers should not rise in the short term as a result of this change, and should only rise at all if the amount spent on the activities related to listing needs to rise in response to market needs;

(c) the costs of the HKLA should be fully recovered from listing fees, that is, they should not be a drain on the resources available to the SFC for its other work; and

(d) the HKEx should have a significant reduction in its cost base following the transfer of the listing function to the HKLA.

4.10 There will be setup costs, as the SFC cannot absorb up to 100 extra staff without leasing and fitting out premises. These may need to be amortised over several years, and to be factored into the setting of the listing fees.

4.11 We have recommended that the HKLA and HKEx collect fees for listing and trading on the stock exchange separately. Some may say that separate payment is undesirable as it introduces duplication and is inefficient, but it is a minor inefficiency in the scheme of things. New York and London have gone for the separate payment arrangement. Of course, the HKLA and HKEx may well agree on a basis for a single payment shared between them.

CHAPTER 5
OTHER REMARKS

5.1 In the course of our review, we have come across some issues which are considered to be of importance to the financial markets but are clearly outside our immediate terms of reference. In this chapter we respond to the invitation by the FS to flag these issues for the Government's consideration.

CASE FOR A SINGLE CORPORATE REGULATOR

5.2 Quite a few submissions and comments we received pointed out the absence of a single corporate regulator in Hong Kong, and that the shared regulation of companies by multiple agencies had led to confusion and inefficient regulation. There was a suggestion that the SFC should take on the role of the statutory regulator of **all** companies, with the Companies Registry subsumed under it, to achieve synergies and economies of scale as well as consistency in regulatory actions. This is very similar to the arrangements in Australia, for example.

5.3 Under the present regulatory regime, the HKEx is the front line regulator of companies listed on its stock exchange and the Companies Registry deals with the incorporation and registration of companies. Oversight of company conduct involves the HKEx which administers the Listing Rules, the SFC which administers the Codes on Takeovers and Mergers and Share Repurchases, the ICAC which deals with corruption cases and the CCB on fraud and theft. In addition, the FS can appoint inspectors under section 142 or 143 of the Companies Ordinance to investigate company activities.

5.4 It has been put to us that the need to coordinate the regulatory efforts of the various regulators has led to delays in regulatory response, because no one regulator has the total picture of what the perpetrator is up to. There is a widely held view that enforcement of the Companies Ordinance has not been adequate, probably due to the lack of investigative capabilities and resources on the part of the Companies Registry.

5.5 As far as we are aware, only Australia and Pakistan have adopted the "single corporate regulator" approach to regulate the operations of companies. Most other jurisdictions have, like Hong Kong, gone for the shared regulation model. We are confident that the regulation of listed companies will be enhanced with the listing function transferred from the HKEx to the SFC, which would among other things reduce regulatory arbitrage by companies. On the other hand, it is clear to us that the Companies Registry has been hampered by resource constraints on its investigative and prosecution work in enforcing the provisions of the Companies Ordinance and the fact that about 80% of listed companies are incorporated outside Hong Kong. We therefore consider that the Government should seriously look into the viability of subsuming the Companies Registry under the SFC and turn the latter into a dedicated statutory regulator of all companies.

CLASS ACTIONS BY INVESTORS TO SEEK REDRESS

5.6 Some submissions we received commented on the inadequacy of current shareholder remedies. One suggestion is to introduce the private class action system practised in the US whereby a securities class action may be brought pursuant to the Federal Rules of Civil Procedure on behalf of a group of persons who purchased the securities of a particular company during a specified period of time, if it is alleged that the company and/or certain of its officers and directors violated one or more of the federal or state securities laws. Together with the contingent legal fees ("no-win-no-fee") mechanism, this system appears to have provided investors with an affordable way to seek redress. It should be noted however the system has been accused of encouraging frivolous private securities litigation in the US, and these rights of action were to some extent curbed in the mid 1990s. Nevertheless private rights of action are widely regarded as one of the main reasons why the US market is seen to be effectively regulated.

5.7 Presently under the common law, a person in Hong Kong who has suffered loss as a result of market misconduct may seek redress through a civil action against the person responsible for that misconduct. The soon to be effective SFO will provide investors with the rights of civil action to institute civil proceedings to claim compensation from persons for any pecuniary loss that the former has sustained as a result of the reliance on the fraudulent, reckless or negligent misrepresentation by the latter. It has however been pointed out that minority shareholders in Hong Kong are rarely able to justify the costs involved in taking private legal action against alleged market misconduct by directors and/or controlling shareholders, which can be prohibitive when compared to the amount of compensation claimed.

5.8 The Standing Committee on Company Law Reform has proposed in the Consultation Paper on Proposals Made in Phase I of the Corporate Governance Review other possible remedies, including giving shareholders and the SFC a statutory right of derivative action on behalf of the company, in cases of fraud, negligence or breach of duty. In this connection, the Government will introduce into the Legislative Council a Companies (Amendment) Bill in 2003 to create, among others, a provision to provide shareholders a statutory right of derivative action. The

Government also plans to release jointly with the SFC in 2003 a consultation paper on the concept of empowering the SFC to take derivative actions for minority shareholders.

5.9 While any initiative to give investors more legal rights to seek remedies is to be welcome, we are not entirely convinced that statutory derivative actions will be of much practical help to small investors as these actions will need to be paid for by the plaintiff until the case is won and damages are awarded. Even if a case is won, the damages will go to the company which is still controlled by the people who caused losses in the first place and it is doubtful whether the plaintiff will receive his or her rightful share of compensation. The same consideration applies also to derivative actions taken by the SFC, about which there could be debates on whether public funds should be expended to seek compensation, without certainty of success, for private investors. Although this issue is definitely outside our remit, we would suggest that the Government should also look into the feasibility of introducing either contingency fees based class actions, or the Australian system of pre-trial hearing in which a judge decides whether the claimant has any reasonable prospect of success, and if he or she does, may order **the company** to fund the claim. The court's discretion to award costs should deter frivolous suits in either a class action system or a preliminary funding case.

PROSPECTUSES AND COMPANY ANNOUNCEMENTS

5.10 There were criticisms about prospectuses and company announcements being too complex, legalistic and difficult to understand. It was suggested that they should contain only essential information and should be written in a way that can be understood by the average investors. We agree that efforts should be made to simplify the format of prospectuses and company announcements with emphasis on clarity, conciseness and plain language. Various other jurisdictions, including the UK and Australia, have done a great deal of work on this, as has the IOSCO. If our proposal is adopted, we suggest this should be a priority for the SFC and its HKLA.

REGULATION OF VALUERS

5.11 Although the work of valuers has significant impact on IPOs and connected transactions of listed companies through the valuation of the issuers' assets and brand names of companies, valuers are, unlike accountants and lawyers who are regulated and bound by the standards and rules of their respective self-regulatory organisations, not subject to any formal regulation. In light of recent corporate scandals involving grossly overstated assets, there are voices in the market that call for proper regulation of valuers. Some valuers have in fact expressed support for regulation on grounds that they would then be able to better resist pressure from their clients to make valuations which are in favour of the companies but not in the best interests of investors.

5.12 We note that the HKEx has proposed to consult the market on amendments to the Listing Rules to tighten regulation of IPO intermediaries, including valuers. Separately, the SFC has put forward proposals to the Standing Committee on Company Law Reform on amendments to the Companies Ordinance to extend prospectus-related liability to IPO sponsors, and possibly other IPO intermediaries, for ensuring quality disclosure to investors. We welcome and support such moves which could only be good for the healthy development of the Hong Kong market.

STAFF SECONDMENTS

5.13 We have received a suggestion that secondments of executives from the industry to the SFC should be encouraged in order to improve the SFC staff's understanding of the industry which they regulate. The secondees themselves would benefit by gaining first-hand experience of the operation of the regulator, which should help their companies' compliance work when they return to their own jobs at the end of the secondment. We note that some overseas regulators, such as the FSA in the UK, have a policy of encouraging secondments from the relevant industry sectors and believe that the SFC and the Hong Kong market should be able to benefit from such an arrangement.

5.14 We understand that the SFC has in fact been hiring directly from the market professionals with considerable experience in recent years. So perhaps the need for a large number of secondees is not as great as it might have been in the past. Nevertheless, it is also our understanding that the SFC recognises the potential benefit of such an initiative particularly where the secondee has specialist knowledge. We do realise that there are certain conflict of interests issues which must be managed effectively in any discussion of this subject.

Annex 1

LIST OF WRITTEN SUBMISSIONS RECEIVED

Groups

1. Asian Capital (Corporate Finance) Limited
2. CLP Holdings Limited
3. Consumer Council
4. Democratic Party
5. Financial Services and the Treasury Bureau
6. Goldman Sachs (Asia) L.L.C.
7. Hong Kong Exchanges and Clearing Limited
8. Hong Kong Society of Accountants
9. Hong Kong Stockbrokers Association Limited
10. Morgan Stanley Dean Witter Asia Limited
11. Professional Insurance Brokers Association Limited
12. Securities and Futures Commission
13. Tai Fook Capital Limited
14. The British Chamber of Commerce in Hong Kong
15. The Chamber of Hong Kong Listed Companies Limited
16. The Chinese General Chamber of Commerce
17. The Hong Kong Association of Banks
18. The Hong Kong Association of Online Brokers
19. UBS Warburg Asia Limited

Individuals

1. Dr Edgar W K Cheng, GBS, JP
2. Mr R T Gallie
3. Dr Hon David Li Kwok-po, GBS, JP
4. Dr K S Lo
5. Mr Mark Mobius
6. Mr Vernon Moore
7. Mr Alex Pang Cheung Hing
8. Mr David M Webb
9. 鍾 賢 先 生

Annex 2

OFFICIAL WEBSITES OF THE REGULATORY BODIES OF MAJOR FINANCIAL MARKETS AND RELATED SITES

Organisation	Website
Australia	
Australian Stock Exchange Limited	www.asx.com.au
Australian Securities and Investments Commission	www.asic.gov.au
Parliament of Australia	www.aph.gov.au
Canada	
Department of Finance	www.fin.gc.ca
Market Regulation Services Incorporated	www.regulationservices.com
Ontario Securities Commission	www.osc.gov.on.ca
TSX Group	www.tse.com
Hong Kong	
Bilingual Laws Information System	www.justice.gov.hk/Home.htm
Financial Services and the Treasury Bureau	www.info.gov.hk/fstb
Hong Kong Exchanges and Clearing Limited	www.hkex.com.hk
Securities and Futures Commission	www.hksfc.org.hk

Japan

Financial Services Agency	www.fsa.go.jp
Ministry of Finance	www.mof.go.jp
Tokyo Stock Exchange	www.tse.or.jp

Mainland China

China Securities Regulatory Commission	www.csrc.gov.cn
Shanghai Stock Exchange	www.sse.com.cn
Shenzhen Stock Exchange	www.sse.org.cn

Singapore

Monetary Authority of Singapore	www.mas.gov.sg
Singapore Exchange Limited	www.ses.com.sg

UK

Financial Services Authority	www.fsa.gov.uk
London Stock Exchange	www.londonstockexchange.com

US

National Association of Securities Dealers, Incorporated	www.nasd.com
New York Stock Exchange	www.nyse.com
Securities and Exchange Commission	www.sec.gov

REGULATION OF THE SECURITIES MARKET IN THE UNITED STATES

The United States (US) Congress makes laws on the regulation of the financial services industry. The securities market is regulated by the Securities and Exchange Commission (SEC), which is the primary overseer and regulator of the US securities market. The SEC's mission is to protect investors and maintain the integrity of the securities market.

HISTORICAL BACKGROUND

2. Before the Great Crash of 1929, there was little support for federal regulation of the securities market. Tempted by the promises of "rags to riches" transformations and easy credit, most investors gave little thought to the danger inherent in uncontrolled market operation. It is estimated that of the US$50 billion (HK$390 billion) in new securities offered during the 1920s, half became worthless.

3. Following the Great Crash, public confidence in the market plummeted. There was a consensus that for the economy to recover, the public's faith in the capital market needed to be restored. The Congress held hearings to identify the problems and search for solutions. Based on the findings in these hearings, the Congress passed the Securities Act 1933 and the Securities Exchange Act of 1934. As stated in section 2 of the Securities Exchange Act, transactions in securities "are affected with a national interest which makes it necessary to provide for regulation and control of such transactions and of practices and matters relating thereto". The laws were designed to restore investor confidence in the capital market by providing more structure and government oversight. The Congress also established the SEC in 1934 to enforce the securities laws, to promote stability in the market and to protect investors. The two Acts continue to provide the basis for the regulation of the securities market to this day.

SECURITIES ACT OF 1933

4. The 1933 Act has two basic objectives –

(a) ensuring that investors receive financial and other significant information concerning securities being offered for public sale; and

(b) prohibiting deceit, misrepresentations and other frauds in the sale of securities.

5. A primary means of achieving these goals is the disclosure of important financial information through the registration of securities. In general, the Act prohibits any public distribution of securities that has not been registered with the SEC. Registration with the SEC requires –

(a) a description of the company's properties and business;

(b) a description of the security to be offered for sale;

(c) information about the management of the company; and

(d) financial statements certified by independent accountants.

SECURITIES EXCHANGE ACT 1934

6. This Act provides for, inter alia, the creation of the SEC. It gives the SEC broad authority over all aspects of the securities industry, including the power to register, regulate and oversee brokerage firms, transfer agents and clearing agencies, as well as the self-regulatory organisations (SROs) which include the stock exchanges and the National Association of Securities Dealers, Incorporated (NASD), Municipal Securities Rulemaking Board (MSRB), and clearing agencies (SROs that help facilitate trade settlement).

MAIN PARTIES INVOLVED IN THE REGULATION OF THE SECURITIES MARKET

A. The SEC – market regulator and overseer of SROs

7. The SEC is comprised of five presidentially-appointed Commissioners, four Divisions and 18 Offices. It is based in Washington, DC and has 11 regional and district offices throughout the country.

8. The five Commissioners are appointed by the President with the advice and consent of the Senate. Their terms last five years and are staggered with one Commissioner's term ending on 5 June each year. To ensure that the Commission remains non-partisan, no more than three Commissioners may belong to the same political party. The President designates one of the Commissioners as Chairman, who is the Commission's top executive.

9. The Commissioners meet to discuss and resolve a variety of issues brought to their attention by staff of the Commission. At these meetings the Commissioners –

(a) interpret federal securities laws;

(b) amend existing rules;

(c) propose new rules to address changing market conditions; and

(d) enforce rules and laws. (There is a statutory framework, including the Securities Act of 1933, that provides for the SEC's oversight of the securities market. As the statutory regulator, the SEC engages in rule-making to maintain fair and orderly market and to protect investors by altering regulations or creating new ones.)

The meetings are open to the public and the media unless the discussion pertains to confidential subjects, such as whether to begin an enforcement investigation.

10. The Division of Corporation Finance oversees corporate disclosure of important information to the investing public. It reviews documents that publicly-held companies are required to file with the Commission, including registration statements of newly-offered securities, annual, quarterly or interim filings, proxy materials sent to shareholders before an annual meeting, annual reports to shareholders, documents relating to tender offers and filings relating to mergers and acquisitions. Connected transactions, mergers and acquisitions, and corporate actions in general are matters for the law of the state in which the issuer is incorporated. The relevant proxy solicitations (i.e. circulars setting out matters on which shareholders are requested to vote) are however subject to SEC regulation.

11. The Division of Market Regulation establishes and maintains standards for a fair, orderly and efficient market by regulating the major securities market participants: broker-dealer firms, SROs, transfer agents (parties that maintain records of stock and bond owners) and securities information processors. Its major activities include –

(a) carrying out the Commission's financial integrity programme for stockbrokers;

(b) reviewing and approving proposed new rules and proposed changes to existing rules filed by SROs;

(c) establishing rules and issuing interpretations on matters affecting the operation of the securities market; and

(d) monitoring market activities.

12. The Division of Investment Management oversees and regulates the US$15 trillion (HK$117 trillion) investment management industry and administers the securities laws affecting investment companies and investment advisers. It also exercises oversight of registered or exempt utility holding companies under the Public Utilities Holding Company Act of 1935.

13. The Division of Enforcement investigates possible violations of securities laws, and recommends Commission action where appropriate. Under the securities laws, the Commission can bring enforcement actions either in the federal courts or internally before an

administrative law judge. It also negotiates settlements on behalf of the Commission. While the SEC has civil enforcement authority only, the Division works closely with various criminal law enforcement agencies to develop and bring criminal charges when the misconduct warrants more severe action.

B. SROs – Self-regulators overseen by SEC

14. An SRO is a member organisation that creates and enforces rules for its members based on the federal securities laws. SROs are registered and overseen by the SEC and are the front line regulator of broker-dealers. The exchanges and the NASD are SROs. SROs must create rules that allow for disciplining members for improper conduct and for establishing measures to ensure market integrity and investor protection. SROs' proposed rules or changes to existing rules are published for public comment before final SEC review and approval. The SEC may also amend the rules of SROs as it deems necessary or appropriate. A rule so adopted should include a statement of the reason for or purpose in so amending the rule.

New York Stock Exchange

15. The New York Stock Exchange (NYSE) is the largest exchange, and is responsible for the supervision of member firms to enforce compliance with financial and operation requirements, periodic checks on broker's sales practices and continuous monitoring of specialist operations. Every transaction made at the NYSE is under continuous surveillance during the trading day.

16. The NYSE has its origin in a founding agreement in 1792. It registered as a national securities exchange with the SEC in 1934. In 1971, it was incorporated as a not-for-profit corporation. In 1972, its board members voted to replace the Board of Governors with a 25 member Board of Directors, comprising a Chairman and CEO, 12 representatives of the public and 12 representatives from the securities industry. Its mission is to add value to the capital-raising and asset-management processes by providing the highest-quality and most cost-effective self-regulated marketplace for the trading of financial instruments, promote confidence and understanding in the processes, and serve as a forum for discussion of relevant national and international policy issues.

National Association of Securities Dealers, Incorporated

17. The National Association of Securities Dealers, Incorporated (NASD) is a non-profit organisation of which virtually all securities firms doing business with the public are members. Its membership includes 5 300 brokerage firms, with over 92 000 branch offices and more than 664 000 registered securities representatives. It provides education to industry professionals and investors. It operates the largest securities dispute resolution forum with arbitration and mediation programmes in the world, and also monitors all tradings on the Nasdaq Stock Market and other selected markets worldwide. Until recently, NASD was known as the owner of Nasdaq. In 2000, it decided to sell Nasdaq in order to concentrate solely on its core mission – ensuring market integrity and investor confidence.

C. The Executive Branch and the Legislature

18. The executive branch is not involved in the day-to-day regulation of the securities market, nor the establishment of rules governing the operation of the securities market and SROs (including the exchanges). The regulatory function is performed by the SEC which is an independent statutory body set up by statute.

19. Neither the executive branch nor the legislature has any power of direction over the SEC. The checks and balances under constitutional and administrative law doctrines are ensured through the power to appoint the Commissioners and to require the SEC to make reports and give evidence to the legislature. The SEC will consult the Secretary of the Treasury if the proposed changes to rules filed with the SEC by registered securities associations primarily concern conduct relating to transactions in government securities. There is no statutory requirement for the SEC to consult the Secretary of the Treasury on other changes to the rules proposed by the SROs.

LISTING AND DELISTING

20. Before securities may be admitted to trading on an exchange, they must be authorised for listing by the exchange and, in addition, must be registered under the Securities Exchange Act of 1934. An issuer is

required to file an application with the exchange and file with the SEC a duplicate original of a registration statement conforming to the rules of the SEC. Having received the application and sufficient supporting documents, the exchange will authorise the company's securities for listing and certify such authorisation to the SEC. Registration becomes effective automatically 30 days after receipt by the SEC of the exchange's certification, but may become effective within a shorter period, by order of the SEC, upon request made by the company to the SEC. Once the registration process is completed, the company's securities can be traded. The original listing date can be set for a day any time after the effectiveness of registration.

21. The exchanges set their own standards for listing and continuing to trade, such as rules governing corporate governance standards, board meetings, audit and other committees, concentration of voting power, voting rights, etc. The SEC does not set listing standards. The initial listing requirements mandate that a company meets specified minimum thresholds for the number of publicly traded shares, total market value, stock price and the number of shareholders. Some exchanges such as the NYSE have broad discretion regarding the listing of a company. An exchange may deny listing or apply additional listing criteria even if the company meets all the stipulated listing standards. After a company starts trading, it must continue to meet the various standards set by the exchanges. These continuing standards are usually less stringent than the initial listing requirements.

22. When a company fails to meet any of the continued listing criteria, the exchange may suspend its securities from dealings or remove the securities from the list at any time. In the case of delisting, the exchange will suspend trading in the security and submit an application to the SEC to strike the security from listing and registration.

23. Although the SEC does not set listing standards, it is involved in the process of changing the rules, including listing rules, set by the exchanges in the following ways –

(a) all proposed new rules or changes to existing rules of the registered exchanges have to be reviewed and approved by the SEC;

(b) the SEC may amend the rules of registered exchanges as it

deems necessary or appropriate; and

(c) the SEC may ask the registered exchanges to review their rules, including those relating to listing standards. For instance, in the aftermath of the "meltdown" of significant companies due to failures of diligence, ethics and controls, the former SEC Chairman, Mr. Harvey Pitt, asked the NYSE on 13 February 2002 to review its corporate governance listing standards. Pursuant to that request, the NYSE appointed a Corporate Accountability and Listing Standards Committee to review the NYSE's listing standards, along with recent proposals for reform, with the goal of enhancing the accountability, integrity and transparency of the companies listed on the exchange. Following the review, the NYSE has filed the Corporate Governance Proposals for new corporate governance listing standards with the SEC for review and approval.

24. Listing, or delisting, is an arrangement between the exchanges and the applicants/listed companies. The setting and enforcement of listing rules are primarily the responsibilities of exchanges which also serve as "self-regulators" in operating the market and administering the listing regime. As stated above, the SEC does have some control over the setting of listing rules as the rules proposed by the exchanges are subject to its review, amendment and approval. Backed by statutory enforcement powers, the SEC can investigate any potential securities violation "as it deems necessary" and can impose a wide range of sanctions. The law also provides that wilful and knowing violations of securities law are criminal offences subject to prosecution, and that investors who have suffered losses in the purchase or sale of securities in reliance on false or misleading statements and reports may initiate class action suits to seek damages.

REGULATION OF INVESTMENT MARKETS IN THE UNITED KINGDOM

In the United Kingdom (UK), the HM Treasury is responsible for the overall institutional structure of regulation in the field of financial stability, and the legislation which governs it.

2. The Financial Services and Markets Act (FSMA), which came into force on 1 December 2001, sets out the statutory framework for the regulation of the financial markets, and provides for the establishment of the Financial Services Authority (FSA) as the single statutory regulator directly responsible for the regulation of deposit-taking, insurance and investment businesses. It is an independent non-governmental body (a company limited by guarantee and financed by levies on the industry) accountable to the Treasury and, through it, to the Parliament. Although the members of its board are all appointed by the Chancellor of the Exchequer, the FSA is not subject to the executive authority of the Treasury. There are however a variety of circumstances where the FSA will need to alert the Treasury about possible problems, such as serious problems which could cause wider economic disruption, diplomatic or foreign relations problems, or a problem that might suggest the need for a change in law, etc. The government's power of oversight lies in the requirement for the FSA to produce an annual report on its work to the Treasury, which has to be laid before the Parliament, and the Treasury's power to commission investigations into activities that may give rise to public concern, and independent reviews of the FSA's resource management.

BACKGROUND FOR SETTING UP THE FSA

3. Prior to the coming into effect of the FSMA, the responsibility for the regulation of the financial matters was shared by several organisations, namely the Bank of England, the Securities and Investments Board (which became the FSA), Self-Regulating Organisations (SROs)[1], the Department of Trade and Industry Insurance

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[1] Self-regulatory organisations include the Investment Management Regulatory Organisation, Personal Investment Authority, and Securities and Futures Authority.

Directorate, the Building Societies Commission, the Friendly Societies Commission and the Registry of Friendly Societies. Their powers had derived from different pieces of legislation, and each had approached its regulatory tasks in its own distinctive way.

4. The FSA is in corporate and legal terms the Securities and Investments Board renamed. The purpose of creating a single regulator was to produce a more coherent and cost-effective approach to regulation, and to remove the scope for duplication, gaps and inconsistency that had affected the old system. The FSA acquired its responsibility for supervising banks, listed money market institutions and related clearing houses from the Bank of England, and the regulatory and registration functions from the SROs (including the listing function of the London Stock Exchange (LSE)). The FSA's assuming all of the listing regulatory functions formerly performed by the LSE has removed the potential for conflict of roles on the part of LSE, particularly in light of pressures to relax listing standards, and has recognised that statutory regulators can better weigh public interest arguments than a profit-seeking exchange.

FSA'S STATUTORY OBJECTIVES

5. The FSMA requires the FSA to pursue four objectives –

(a) to maintain confidence in the UK financial system;

(b) to promote public understanding of the financial system;

(c) to secure an appropriate degree of protection for consumers while recognising their own responsibilities; and

(d) to reduce the scope for financial crime.

Regulatory Approach

6. To achieve the goal of maintaining efficient, orderly and clean financial markets, and help retail consumers achieve a fair deal, the FSA has embarked on a risk based approach to regulation, which recognises both the proper responsibilities of consumers and of a firm's

own management, and the impossibility and undesirability of removing all risks and failure from the financial system. It switches resources from reactive post-event actions towards front-end intervention, and creates incentives for firms to manage their own risks better thereby reducing the burden of regulation.

Responsibilities of the FSA

7. A summary of the responsibilities of the FSA is at Appendix.

8. As far as the investment markets are concerned, the FSA is responsible for –

(a) supervising exchanges, clearing and settlement houses and other market users and practitioners –

The FSA recognises and supervises eight Recognised Investment Exchanges (RIEs). These are organised markets on which member firms can trade investments such as equities and derivatives. Examples are the LSE and the London Metal Exchange. The FSA is also responsible for recognising and supervising Recognised Clearing Houses which organise the settlement of transactions on RIEs. It also has the responsibility for applications from, and supervision of, recognised overseas investment exchanges (such as the Sydney Futures Exchange and Nasdaq) and recognised overseas clearing houses regarding cross-border trading.

(b) conducting market surveillance and transaction monitoring –

The FSA analyses transactions collected from authorised firms, RIEs and settlement systems to look for unusual trading activities. It has issued the Code of Market Conduct which sets out the standards required of all market participants and monitors compliance with powers to impose financial penalties.

LISTING OF SECURITIES

9. Unlike the United States where the stock exchange is responsible for assessing the eligibility of an issuer to be listed whilst the regulator is responsible for information disclosed to the market by the issuer, all responsibilities for primary market regulation in the UK lie with the UK Listing Authority (UKLA), a division of the FSA which is the competent authority responsible for admission of securities to the official list. There is a distinction between "admission to listing" and "admission to trading". The former process is to ensure that minimum standards for the protection of investors are met and to provide for mutual recognition of the listing status across the European Union. The latter process is for a stock exchange to decide whether trading of a security should be permitted on its trading board.

10. The UKLA establishes and updates listing rules which govern the listing of securities with the regulatory objectives to –

(a) provide an appropriate level of protection for investors in securities;

(b) facilitate access to capital markets for a broad range of enterprises; and

(c) seek to maintain the integrity and competitiveness of UK markets for listed securities.

Under the FSMA, the FSA has a duty to publicly consult on any proposed changes to the rules or the issuing of guidance, and to conduct and publish cost benefit analysis.

11. More specifically regarding the listing and delisting of securities, the UKLA's responsibilities include –

(a) Admitting securities to the official list for listing. The UKLA considers applications for listing by examining and approving prospectuses, listing particulars and equivalent offering documents to ensure that the issuer has met all the relevant conditions as set out in the listing rules before it is admitted to the official list. The power to make non-disciplinary decisions (e.g. listing approval) rests with the

relevant FSA executives, with appeal to the Listing Authority Review Committee (LARC). The UKLA seeks to ensure that listed companies comply with their on-going obligations under the listing rules (including the provision of a regular flow of relevant information into the market), and has the power to impose a financial penalty on a listed company or its directors for breaches of the listing rules. The FSMA requires the FSA to publish a policy statement setting out the factors to be taken into account in its decisions to impose financial penalties.

(b) Regulation of sponsors and advisers. Sponsors and advisers cannot provide services to issuers unless they are approved by the FSA, as "fit and proper".

(c) Imposing and enforcing ongoing obligations on issuers to promote full, accurate and timely disclosure to the market of all relevant information through the continuing obligations set out in the listing rules. As with the vetting of prospectuses for listing, the UKLA does not investigate or verify the accuracy or completeness of the information given, but it reserves the right to require additional information.

(d) Suspending and cancelling listing to protect investors from trading without access to full and complete information. The UKLA will suspend securities from the official list if there is not enough information available to ensure an orderly market. It will cancel a company's securities if there are special circumstances which prevent normal dealings in them. The power to make disciplinary decisions rests with a Regulatory Decisions Committee (RDC).

Firms which are aggrieved by the regulatory decisions of the LARC or RDC may appeal to the Financial Services and Markets Tribunal. Review is on the full merits of the case. Parties may introduce new evidence and the Tribunal can affirm, reverse, or otherwise alter any determinations of the LARC or RDC.

12. Officially listed securities are traded on the RIEs including the LSE's main market, virt-x and CoredealMTS. These exchanges choose whether or not they wish to admit an officially listed security to trading on their market, but have no role in the admission of securities to the official list.

LONDON STOCK EXCHANGE

13. The LSE is one of the world's leading equity exchanges and the most international of all stock exchanges, with about 470 companies from over 60 countries admitted to trading on its various trading boards. It is a publicly listed company and, in the context of the FSMA, one of the RIEs recognised and supervised by the FSA.

Historical Background

14. Prior to the setting up of the FSA, the LSE was a private limited company, and was the Competent Authority for Listing in the UK. In July 1999, the LSE announced its intention to move from its mutual ownership to a new basis of transferable share ownership, ending the traditional link between usage and ownership of the Exchange. The purpose was to move the Exchange towards a more commercial basis of operation that would allow greater speed and flexibility in its decision-making process, which had become essential because of the increasing competition and demand for more efficient delivery of services and more innovative products. After announcing its intention to demutualise, the Exchange had discussed with the Treasury about its statutory role as the Competent Authority for Listing. In the light of the new ownership structure that the Exchange intended to create, and its intended move to a more commercial basis of operation, the Treasury agreed with the LSE to transfer the role of Listing Authority to the FSA. In 2000, the LSE transferred its role as the UK Listing Authority to the FSA and became a public limited company. It was listed in July 2001. Notwithstanding the transfer of the listing functions, the Exchange has continued to set its own requirements for companies quoted on its trading boards, including the right to decide whether or not to admit a listed security to trading and to make and enforce its own rules.

RELATIONSHIP BETWEEN THE FSA AND LSE IN THE REGULATION OF LISTING/TRADING

15. The FSMA provides the framework for the regulation of the securities market. It is a criminal offence to carry on a regulated activity without authorisation or exemption. Most of the statutory powers are held by the FSA, to which the LSE is answerable as an RIE. To become and remain an RIE, an exchange must satisfy the FSA that it meets the various prerequisites set out in the FSMA, including effective arrangements for monitoring and enforcing compliance with its rules.

(a) Admission to trading

Admission to trading on the main market is a two-stage process. A company which wants to have its securities admitted to trading on the LSE has to apply to the FSA for the admission of its securities to the Official List by the UKLA of the FSA. Having obtained admission to the Official List, the company would need to seek admission to trading on the Exchange.

(b) Continuing Obligations

After admission to trading, the companies must comply with continuing obligations which include timely publication of price sensitive information in accordance with the UKLA's listing rules, and disclosure of information as set out in the Admission and Disclosure Standards (Standards) devised and enforced by the Exchange which are applicable to companies admitted to trading on the main market. The purpose of requiring companies to comply with continuing obligations is to give their investors proper information for determining the current value of the securities.

(c) Enforcement

The Exchange monitors compliance with the Standards. It can censure a company for breaching the Standards by suspending trading in the company's securities and, in extreme cases, cancel the right of a company's securities to be traded.

16. The FSA has issued in July 2002 a discussion paper entitled "Review of the Listing Regime" for public comments. It was noted in the paper that "there remains a degree of uncertainty in the corporate sector about the role of the competent authority". It appears that many market participants were unclear, following the transfer of the UK Listing Authority from the LSE to the FSA, about the boundaries between those functions carried out by the LSE and those performed by the FSA as the competent authority for listing. The FSA has expressed its intention to explain clearly the role and responsibility of the competent authority in the context of the changing UK and European Union regulatory environment.

Appendix

A SUMMARY OF THE RESPONSIBILITIES OF UK'S FINANCIAL SERVICES AUTHORITY

(a) Authorisation

The FSA authorises or approves all firms or individuals before they can carry on a regulated activity unless the firm is exempt from regulation under the FSMA. It aims to allow only those firms and individuals satisfying the "threshold conditions" (which include honesty, competence and financial soundness) to engage in regulated activities.

(b) Supervision

It supervises deposit-takers and insurance firms, major financial groups, pension review, investment markets and exchanges, listing matters, and regulates investment firms.

(c) Enforcement

The FSMA provides the FSA with statutory investigation and enforcement powers. The FSA investigates and where appropriate, disciplines and/or prosecutes firms/individuals for breaches of the FSA's rules and FSMA requirements. Enforcement actions may take the form of withdrawal of a firm's authorisation, financial penalties, seeking injunctions, prosecution actions and requiring the firms to compensate consumers, etc.

(d) Reducing Financial Crime

The FSA focuses on money laundering, fraud and dishonesty, and criminal market misconduct such as insider dealing. Under the FSMA, the FSA can make rules on firms' systems and controls relating to money laundering; supervise firms' compliance with those requirements; and prosecute firms for systems and controls failures in this area.

(e) International Activity

The FSA maintains bilateral contacts with other regulators in Europe and around the globe, as well as supporting groups where regulators can share information with one another.

(f) Service to Consumers

It promotes public understanding of the financial system and secures an appropriate degree of protection for consumers by providing information and generic advice to consumers, operating a consumer help line and providing schools with resources on personal finance education.

REGULATION OF THE SECURITIES AND INVESTMENTS MARKETS IN AUSTRALIA

The supervision of securities exchanges in Australia is the responsibility of the following three parties –

(a) the Minister for Financial Services and Regulation who has functions and powers to maintain market integrity and investor protection in a general sense;

(b) the Australian Securities and Investments Commission (ASIC) as the statutory regulator which broadly oversees market supervision; and

(c) the exchanges which are the front line regulators of the markets.

This is generally known as a co-regulatory model, a combination of statutory and self-regulation, aimed at contributing to investor confidence and market integrity.

2. Chapter 7 of the Corporations Act provides the legal foundation for securities industry regulation, dealing with markets, exchanges and associations, clearing houses, industry participants and their conduct, investor protection funds and misconduct.

FINANCIAL SERVICES REFORM ACT 2001

3. The Financial Services Reform Act 2001 (FSR Act) was passed by the Parliament in August 2001. It maintains the above basic framework for regulatory oversight of the securities exchanges, but has made significant changes to licensing requirements and ongoing obligations of markets. It has created a single licensing regime for financial sale, advice and dealings in relation to financial products and more uniform regulation. More specifically, it has ended the former distinction between securities and futures exchanges by introducing a single licensing regime for "financial markets" and harmonises the legislation relating to securities and futures contracts, thereby achieving a more flexible regulatory regime.

MINISTER FOR FINANCIAL SERVICES AND REGULATION

4. Under the Corporations Act, the Minister for Financial Services and Regulation is vested with powers relevant to market approval and supervision. The Act sets out a number of criteria that must be satisfied before the Minister can approve a body as a securities exchange. These criteria are aimed at maintaining standards of market integrity and consumer protection. Specifically, it requires the body to have listing rules which set out the conditions under which securities may be traded, and for the protection of the interests of the public. The Minister has specific powers to require a securities exchange to provide the ASIC with a report on its compliance with ongoing obligations, to direct an exchange to take action to meet those obligations, to exercise a disallowance function with respect to operating rule amendments and revoke the approval of a securities exchange.

AUSTRALIAN SECURITIES AND INVESTMENTS COMMISSION

5. The ASIC received its current name in July 1998. It is an independent Commonwealth government body established by the Australian Securities and Investments Commission Act 1989. It began on 1 January 1991 as the Australian Securities Commission to administer the then Corporations Law, replacing the National Companies and Securities Commission and the Corporate Affairs Offices of the States and Territories.

6. The ASIC operates under the direction of three full-time Commissioners appointed by the Governor-General on the nomination of the Treasurer. It reports to the Commonwealth Parliament and to the Treasurer and the Parliamentary Secretary to the Treasurer. Its role is to enforce company and financial services laws to protect consumers, investors and creditors. It regulates and informs the public about Australian companies, financial markets, financial services organisations and professionals who deal in and advise on investments, superannuation, insurance, deposit taking and credit. The Corporations Act confers a range of specific functions and powers on the ASIC in respect of its oversight role of market supervision. These include powers to review compliance reports by exchanges, suspend trading of securities, consider changes to market operators' rules, apply to Court to order compliance

with the business or listing rules of an exchange or to require an exchange to pursue an enforcement action under its listing rules, and supervisory and enforcement functions and powers including the powers of investigation, inspection of books and information gathering. The ASIC is also responsible for the licensing of brokers. Consideration is being given to the ASIC having a power to impose fines.

AUSTRALIAN STOCK EXCHANGE LIMITED

7. Australia currently has three operational stock exchanges, namely the Australian Stock Exchange Limited (ASX), the Stock Exchange of Newcastle Limited and the Bendigo Stock Exchange Limited, and a specialist futures exchange, the Sydney Futures Exchange Limited. For all intents and purposes, the ASX is Australia's only significant stock exchange. It operates Australia's primary national stock exchange for equities, derivatives and fixed interest securities.

8. Prior to 1998, the ASX was a mutual enterprise. A company limited by guarantee, it was owned collectively or mutually by its members and run on behalf of its members under its own constitution and operating rules. Its members were the brokers who used the facilities of the exchange to deal with securities.

9. The initiative to demutualise the ASX came from within the exchange itself. The major considerations that drove demutualisation were the prospect of competition for ASX business and services, divergence of members' interests from one another and the exchange itself, and a proposition that in the longer term, it is undesirable for control of an entity to reside with one group of its customers. In return for ceding mutual membership and any control of the ASX that mutual membership may bestow, each relevant member would be allocated shares in the ASX.

10. ASX members endorsed the demutualisation proposal in October 1996. The legislation authorising and facilitating demutualisation came into force in December 1997. The exchange subsequently demutualised and listed its shares on the exchange in October 1998.

11. The ASIC supervises the ASX's listing and undertakes the day-to-day supervision of its compliance with the listing rules to ensure that the ASX is subject to the same independent scrutiny as all other listed entities.

12. The ASX supervises the market of the exchange on a day-to-day basis with the objective of ensuring the market is fair and orderly. It does this through a series of contractual arrangements with market participants whereby they agree to comply with rules for admission to and continued participation in trading activity. It monitors the compliance of listed entities with the ASX Listing Rules and the compliance of participating organisations and affiliates with the ASX Business Rules. It works closely with the ASIC to ensure that the highest levels of market integrity are maintained.

13. The ASX's supervisory activities include –

(a) Markets

It conducts surveillance of market activities and preliminary investigation of unusual trading. Where necessary, it will refer cases to the ASIC for follow-up actions.

(b) Listed Entities

It sets standards for listed entities through the ASX Listing Rules and supervises compliance.

(c) Market Participants

It sets standards for market participants through the ASX Business Rules and supervises compliance. It also investigates breaches and instigates cases for disciplinary action if foul play is proven.

(d) Systems

It establishes standards for testing and authorisation of designated trading, and gauges compliance with trading rules and procedures.

Listing and Delisting

14. The ASX Listing Rules govern the admission of entities to the official list, quotation of securities, suspension of securities from quotation and removal of entities from the official list. They also govern disclosure and some aspects of a listed entity's conduct. They specify certain listing standards such as the minimum standards of an entity's quality, size, operation and disclosure, sufficiency of investor interest, and integrity, accountability and responsibility of the entities and their officers, etc.

15. The Listing Rules are not just binding contractually. They are enforceable against listed entities and their associates under the Corporations Act. The Listing Rules create obligations that are additional, and complementary, to common law obligations and statutory obligations. Under the Corporations Act, Listing Rule amendments must be lodged with the ASIC. They are subject to disallowance by the Minister for Financial Services and Regulation. Companies that are in dispute with the ASX may appeal to the ASX Listing Appeal Committee which is made up of external industry practitioners.

16. The ASX has an absolute discretion concerning the admission of an entity to the official list (and its removal) and quotation of its securities (and their suspension). The ASX also has discretion whether to require compliance with the Listing Rules in a particular case. In exercising its discretion, the ASX takes into account the principles on which the Listing Rules are based.

17. The ASX may suspend an entity's securities from quotation if –

(a) the entity does not comply with the Listing Rules;

(b) it is necessary to do so to prevent a disorderly or uninformed market;

(c) the ASX's rules, including the Listing Rules, Business Rules and articles of association, require the suspension; and

(d) it is appropriate to do so for some other reason.

The ASX may also remove an entity from the official list if the entity does not comply with the Listing Rules, has no quoted securities or it is appropriate to do so for some other reason.

VIEWS ON THE EXISTING REGULATORY FRAMEWORK

18. In February 2002, the Senate Economics References Committee released a report entitled "Inquiry into the Framework for the Market Supervision of Australia's Stock Exchanges". The remainder of this note is a paraphrase of the Executive Summary of that report. The Committee found that the market was well served by having as its front line supervisor an operator that is familiar with the day-to-day operations of the market and is able to respond quickly to developments in the market itself. The existing framework is considered to have the following advantages –

(a) familiarity with and proximity to the market – being both the operator and front line supervisor places the ASX in a strong position to recognise any irregularities in trading and respond to them quickly and flexibly;

(b) the ASX has the ability to adapt elements of its supervisory arrangements to meet the needs of the market and its users and cater for developments in business practices, through changes to its operating rules; and

(c) the framework bestows a commercial incentive on the ASX to ensure that it discharges supervisory responsibilities effectively – it has a vested interest in maintaining reputation and attracting investments.

The Committee also noted some significant disadvantages arising from the ASX's demutualisation and listing. They include –

(a) conflicts between commercial and supervisory responsibilities – there are questions about whether a "for profit" exchange will devote sufficient resources to ensuring effective supervision, whether it will be tempted to commercialise services such as the provision of information that might otherwise have been considered a public good, or

to reduce listing standards to attract listing;

(b) an inherent conflict of interests resulting from self-listing; and

(c) conflicts of interests resulting from the ASX's expansion of its commercial activities, which result in it being required to supervise the activities of direct competitors.

ASX SUPERVISORY REVIEW PTY LIMITED

19. To address such concerns, the ASX had already established a subsidiary company called ASX Supervisory Review Pty Limited (ASXSR) which reports to the ASIC and the government, to provide a further level of assurance that it is directing appropriate resources to supervisory functions and maintaining standards. The ASXSR, set up to develop policies and practices for the ASX's regulatory function, is not, in terms of its structure and funding, independent of the ASX but is more like the ASX's internal review mechanism with an external reporting role. It is not a market regulator.

20. The ASXSR Board is comprised of a majority of independent directors who has not had any material connection with the ASX for the last two years and chosen from a panel nominated by the ASX, although the ASIC retains a power to veto any proposed members and also to veto their removal prior to the expiry of their terms.

21. The ASXSR's role and functions are as follows –

(a) review the policies and procedures of areas in the ASX Group which have supervisory functions, including the level of funding and resources for supervisory functions;

(b) provide reports and express opinions to the ASX Board on whether appropriate standards are being met and whether the level of funding for supervisory activities is adequate;

(c) provide assurance that the ASX Group adequately complies with its ongoing responsibilities as a market and clearing house operator, and is conducting its supervisory activities

ethically and responsibly; and

(d) oversee supervision of listed entities with special identified conflicts that select ASXSR supervision (listed entities that have opted to seek the extra level of protection offered by ASXSR scrutiny is known as the Review Group).

22. The ASX has maintained that there is a commercial disincentive associated with failing to maintain the highest standards of integrity, which offsets any temptation that might have existed to take commercial advantage of its position. It has been pointed out that the ASXSR, the Trade Practices Law, the monitoring activities of the Australian Competition and Consumer Commission, and the ASIC can all provide safeguards against problems associated with real or perceived conflicts of interests.

23. The Committee concluded that, despite the above, there is still concern that demutualisation and listing of the ASX would give rise to conflicts of interests that might compromise its supervisory activities. There is a consensus that, in view of the globalisation of the financial markets, imposition of too many layers of regulation with a view to removing all possible conflicts of interests will make the conditions of trading unnecessarily costly, thereby making the market unattractive for both local and international investors. Parties involved in the regulation of the Australian financial markets are well aware of the need to strike a delicate balance between concern over the possible conflicts of interests of the ASX which has both commercial and supervisory responsibilities, and the need to maintain flexibility and professionalism of the regulatory regime. Notwithstanding the above observations, the Committee is of the view no major change to the existing market supervision framework should be contemplated in the near future.

REGULATION OF THE SECURITIES MARKET IN CANADA

The regulation of the Canadian securities industry is carried out by the provinces and territories, each of which has its own securities regulator. The 13 provincial and territorial regulators collaborate through the Canadian Securities Administrators (CSA), which is an informal body with no powers of enforcement. The goal of the CSA is to harmonise and streamline securities regulation in Canada through enhanced inter-provincial cooperation. By collaborating on rules, regulations and other programmes, the CSA helps avoid duplication of work and streamlines the regulatory process for companies seeking to raise investment capital and others working in the investment industry.

2. The provincial securities regulators delegate some authority to self-regulatory organisations (SROs) such as the exchanges, which have a long history of regulating and supervising market intermediation in Canada. The well-recognised SROs are the Toronto Stock Exchange (TSX), the Montreal Exchange (in Quebec), Market Regulation Services Incorporated (RS), which is jointly owned by TSX and the Investment Dealers Association of Canada (IDA), and the IDA itself outside Quebec. The IDA membership includes investment dealers that are actively engaged in securities trading in Canada. The IDA monitors the activities of investment dealers across the country in terms of their capital adequacy and business conduct.

3. We have chosen to look at the regulatory regime in Ontario in view of the fact that the majority of Canada's equity trading is done at the TSX in Toronto.

ONTARIO SECURITIES COMMISSION

4. The Ontario Securities Commission (OSC) administers the Ontario Securities Act and Commodity Futures Act. Its mandate is to protect investors from unfair, improper and fraudulent practices, foster fair and efficient capital markets and maintain public and investor confidence in the integrity of these markets. It has the statutory authority to make rules with binding legislative effect, subject to a

process involving both public comment and review of the proposed rule by the Minister of Finance. This power enables OSC to respond flexibly and quickly to market developments.

Oversight of SROs

5. The Securities Act permits the OSC to recognise market participants including SROs, exchanges, clearing agencies and quotation and trading reporting systems. An SRO as defined in the Act is a "person or company that represents registrants and is organised for the purpose of regulating the operation and the standards of practice and business conduct of its members and their representatives with a view to promoting the protection of investors and the public interest." Currently, only stock exchanges must be recognised in order to carry on business in Ontario. The Draft Report issued by the Five Year Review Committee in May 2002 recommended that the Act be amended to require that all SROs must be recognised to carry on the functions as defined in the Act.

6. Recognised SROs have the ability to establish codes of behaviour and practice, and impose sanctions for breaches of these rules, both through contractual agreements with their members and through their by-laws. Unlike the SROs in the US, SROs in Ontario are not required to enforce Ontario securities law.

7. When an organisation is recognised by the OSC, it continues to regulate the operations and standards of practice and business conduct of its members, but is subject to the OSC's oversight. The OSC has the authority to review any of the organisation's directions, decisions, orders or rulings.

8. The Securities Act also confers on the OSC powers to review and approve by-laws, hear appeal against decisions of an SRO, and ask an SRO to retain an auditor to conduct compliance reviews, etc.

TSX GROUP

9. In 1999 Canada's established exchanges underwent a major realignment in order to operate along lines of market specialisation and to better compete with exchanges abroad and new electronic entrants

penetrating the Canadian market. The Toronto Stock Exchange became the sole senior equity exchange (similar to Hong Kong's Main Board); the Montreal Exchange assumed responsibility for all derivatives such as stock index options, bond futures and stock options; and the Canadian Venture Exchange (CDNX), created through merger of the Vancouver and Alberta (and later Winnipeg) exchanges, took over sole responsibility for junior equity (for emerging companies). In May 2001, the Toronto Stock Exchange signed an agreement to acquire full ownership of the CDNX, thus bringing all of Canada's equity trading under one organisation for the first time. In April 2002, the CDNX was renamed TSX Venture Exchange, and is now part of the TSX Group, which also includes the Toronto Stock Exchange and TSX Markets.

10. Apart from realignment, the exchanges in Canada have also demutualised from member-owned cooperative institutions into leaner for-profit firms in response to intensifying international competition brought about by consolidation of exchanges. The TSX was demutualised in 2000, and became a listed public company in mid-November 2002. It is believed that with the change of ownership from "a cozy club of brokerage firms" to a wide circle of institutionalised and individual shareholders, the Group would be completely free to focus on the sole objective to build a stronger Canadian capital market.

11. A pressing issue surrounding the self-regulatory regime in Ontario is the potential conflict of interests between the regulatory/public interest role of an SRO and its commercial objective. The TSX is subject to possible conflicts because it is owned by member shareholders and is also the market regulator. Against this background, when the TSX demutualised in 2000, it established a separate subsidiary, RS, which is specifically mandated to oversee member regulation. Under its terms of recognition, the RS must be operated on a cost-recovery basis and shall be independent and structurally separated from the for-profit operations of the TSX. The RS is organised in this way so as to ensure that member regulation is not a for-profit activity and that trading operations do not subsidise regulation. In addition, the RS has a separate committee which reports to the TSX board and over half of its directors cannot be associated with any participating organisation. The RS has a segregated budget which is subject to the approval of the TSX board. In granting the TSX recognition on these terms, the OSC was of the view that this organisational structure addressed the potential for conflict between member advocacy and market regulation at the TSX.

Listing on TSX

12. The TSX Listings Committee considers and approves all applications for listing on the TSX. The Listings Committee is comprised of members of the Exchange's Issuer Services. In addition, the Listings Committee may consult the TSX's Listings Advisory Committee, which is comprised of representative figures of the securities industry. Listing requirements such as public distribution, management, sponsorship and financial conditions, etc. are laid down by the TSX. The TSX may at any time temporarily halt trading in any listed securities or suspend trading or delist a company's securities if it is satisfied that the company has failed to comply with the provisions of the Listing Agreement, or such action is necessary in the public interest.

RECENT DEVELOPMENTS

13. The Draft Report released in May 2002 by the Five Year Review Committee appointed by the Ontario Minister of Finance called for the creation of a single securities regulator with responsibilities for the capital markets across Canada. Because securities regulation in Canada is a matter of provincial jurisdiction – there are 13 different sets of securities laws administered by 13 provincial and territorial regulatory authorities, there is believed to be opposition to this proposal in other provinces, with no likelihood of its early adoption.

REGULATION OF THE SECURITIES MARKET IN JAPAN

The securities market in Japan is governed by the Securities and Exchange Law which was first enforced in 1947. The Financial System Reform, dubbed the "Japanese Big Bang", that began in November 1996, brought about a number of changes to the regulation of the financial markets. The aim of the Reform was to rebuild the Japanese financial markets into a free, fair and global market comparable to the New York and London markets. In December 1998, the Financial System Reform Law came into force. It is a package of revisions to a number of laws including the Securities and Exchange Law. These revisions included switching from a licensing system to a registration system for securities companies to promote entry of banks, securities companies and insurance companies into one another's business, liberalising cross-border capital transactions and foreign exchange business, fully liberalising brokerage commissions, improving disclosure system, setting up fair trading rules and protecting customers in times of failure of financial institutions.

FINANCIAL SERVICES AGENCY

2. The Financial Services Agency (FSA) is responsible for ensuring the stability of the financial system in Japan, protection of depositors, planning and policy making concerning the financial system, inspection and supervision of the private sector financial institutions and surveillance of securities transactions. It was first set up in 1998 as an administrative organ of the Prime Minister's Office responsible for the inspection and supervision of private sector financial institutions and surveillance of securities transactions. In conjunction with the reorganisation of central government ministries, the FSA was established as an external organ of the Cabinet Office in January 2001, and took over the responsibility of disposition of failed financial institutions from the former Financial Reconstruction Commission.

3. The FSA's duties in respect of the securities sector include –

(a) planning and policy making – establishing rules for financial institutions through legislation, amendment and abolition of financial-related statutes and regulations such as the Securities and Exchange Law;

(b) inspection of private sector financial institutions' compliance and risk management – conducting on-site inspections in accordance with inspection manuals which summarise the fundamental principles of inspection and specific points of focus in inspection;

(c) supervision of financial institutions – ensuring sound and proper business operations of financial institutions by conducting on-site inspection and off-site monitoring, obtaining reports on risk-related data from financial institutions, and requesting institutions to take remedial measures should their capital adequacy ratio fall below the threshold;

(d) establishment of rules for trading in securities market and financial futures exchanges; and

(e) surveillance of compliance of rules governing the securities market.

SECURITIES AND EXCHANGE SURVEILLANCE COMMISSION

4. The Securities and Exchange Surveillance Commission (SESC) was set up under the Ministry of Finance in 1992, following a series of financial scandals involving major securities houses, to monitor compliance in the securities and financial futures markets. The Commission was detached from the Ministry and put under the FSA in 1998. It consists of a Chairperson and two Commissioners appointed by the Prime Minister with the consent of the Diet.

5. The SESC conducts inspections of securities companies for compliance with transaction rules, daily market surveillance, and investigation of criminal offences including insider trading, market manipulation and falsified financial statements. It also conducts joint on-site inspections with the Inspection Bureau of the FSA. It may recommend to the FSA to take disciplinary administrative actions against non-compliant securities brokers, or refer cases involving securities crimes to the prosecutors. On the policy side, the SESC may make proposals to the Prime Minister, the Minister of Finance and the FSA to ensure fairness of securities transactions.

6. The SESC is also authorised to review the activities of self-regulatory organisations (SROs), including the Japan Securities Dealers Association (JSDA) and stock exchanges. The role of the SROs is stipulated in the Securities and Exchange Law. The SROs establish standards of acceptable conduct for members' compliance, inspect securities companies and monitor securities trading on a daily basis. In effect, the SESC and SROs share the responsibilities of monitoring compliance by securities firms and conducting market surveillance.

DEMUTUALISATION

7. The Securities and Exchange Law and the Financial Futures Trading Law were amended in December 2000 to allow the stock exchanges to be organised in the form of joint-stock companies or continue to operate in the form of membership organisations. The disciplinary measures and the authorising system of self-established rules that apply to membership stock exchanges, will also apply to exchanges operating in the form of a joint-stock company. The purpose of allowing exchanges to develop into joint-stock companies was to speed up the exchanges' decision-making process to better respond to the changing needs of market users, allow exchanges to raise funds for systems investment, and improve international standing of the Japanese securities markets.

8. To safeguard public interests, the exchanges have to meet the following requirements –

(a) capital must not be less than an amount specified in the relevant law;

(b) no entity might hold more than 5% of a stock exchange's outstanding shares;

(c) the scope of business is limited to opening of markets and business incidental to it;

(d) the articles of association must stipulate that members have to comply with the laws and rules set by the exchanges, and that sanctions will be imposed on members for breaches of the laws and rules; and

(e) the authority may order amendments of the self-established rules such as the articles of association and measures necessary for supervisory reasons in respect of business management and conditions of assets.

(a) and (b) are only applicable to exchanges that are joint-stock companies.

TOKYO STOCK EXCHANGE

9. The Tokyo Stock Exchange (TSE) is Japan's leading stock exchange. It is a stock corporation that provides a market for the trading of securities under the authorisation of the Prime Minister. The TSE had operated as a not-for-profit membership organisation, and was demutualised in November 2001 to become a joint-stock company, i.e. Tokyo Stock Exchange, Incorporated.

10. The TSE is responsible for the listing of securities, monitoring listed companies, monitoring trading and supervising trading participants. The Securities and Exchange Law stipulates that the stock exchanges themselves shall establish rules for the listing of securities. Accordingly, the TSE has established, among others, "Listing Regulations", "Criteria for Stock Listing" and "Regulations for Notice or the Like by Issuer of Listed Security".

Listing

11. A company applying for initial listing has to meet quantitative criteria such as number of shareholders, market capitalisation, net profit before tax and financial statements and audit reports, etc. If these criteria are met, the TSE would conduct a rigorous check against certain non-quantitative criteria such as business continuity and profitability, soundness of corporate management, adequacy of corporate disclosure, public interest and the protection of investors, etc. Listing will be approved if the TSE determines that the stock is appropriate for listing, and the applicant will enter into a "Listing Agreement" with the Exchange. Stocks are traded on either the first or the second sections of the Exchange. Newly listed domestic stocks are generally assigned to the second section (which has lower thresholds in terms of the number of shares and shareholders, trading volume, market capitalisation and net profit, etc.) except under special circumstances. The TSE examines stocks at the end of each business year to determine whether they should be transferred to the other section.

Listing of Foreign Companies

12. A foreign corporation has to file a Securities Registration Statement with the Prime Minister when it makes a public offer or sale of securities at the time of listing or after listing on the Exchange, and will have to continue to disclose specified information in their Annual Securities Reports and other reports. These statements and reports are prepared in accordance with the "Ministerial Ordinance" with respect to the disclosure of corporate information. Foreign corporations must also engage the services of the following institutions –

(a) Securities firm

It must be selected from the trading participants authorised by the TSE.

(b) Attorney-in-fact in Japan

The attorney-in-fact of a company is an officer of a foreign applicant residing in the Tokyo area who is responsible for liaising with the TSE before and after listing.

(c) Shareholder Services Agent

It is usually a Japanese trust bank for handling matters regarding shareholders in Japan.

(d) Dividend Payment Services Bank

It is usually a trust bank or major bank with branch offices nationwide to serve as a Dividend Payment Services Bank.

(e) Custodian in Home Country

A Central Securities Depository in the home country usually provides custodian service for share certificates. However, when there is no such depository, a competent commercial bank may provide the service.

13. An applicant company can adopt the accounting standard of its home country only if the FSA does not object to it on public interest and investor protection grounds.

REGULATION OF THE SECURITIES MARKET IN SINGAPORE

Pursuant to the Monetary Authority of Singapore Act of 1970 (MASA), the Monetary Authority of Singapore (MAS) was established on 1 January 1971 and is empowered to approve financial institutions and control their operations if their business would affect monetary stability and credit and exchange conditions in Singapore, the development of Singapore as a financial centre or the financial situation of Singapore. The Securities and Futures Supervision Department of the MAS has supervisory responsibility for the capital market and administers the Securities and Futures Act (SFA) of 2001. It regulates the origination and trading of securities and their derivatives products, supervises capital market intermediaries, regulates prospectuses and collective investment schemes, and oversees takeover issues. It has regulatory oversight of securities and futures exchanges and clearing houses. It also enforces the civil penalty regime for market misconduct.

2. The Singapore Exchange Limited (SGX) is a publicly listed company that operates the securities and futures markets. It was formed by the demutualisation and merger of the Stock Exchange of Singapore and the Singapore International Monetary Exchange Limited under the Exchanges (Demutualisation and Merger) Act of 1999, in December 1999, and was listed in November 2000. The demutualisation and merger were based on the recommendation of the Committee on Governance of the Exchanges made in 1999, to improve ownership and governance structure of the exchanges to cope with increasing competition and globalised investment environment.

3. The SFA consolidates legislation relating to the capital market and provides the legislative framework for a disclosure-based regulatory regime.

4. As the statutory regulator of the securities and futures markets, the MAS has the following powers –

(a) approving and making regulations relating to the establishment and operation of the securities market or futures market;

(b) endorsing, amending or supplementing the listing rules and business rules of the securities exchange and futures exchange;

(c) giving directions to the securities exchange or the futures exchange if it is considered necessary or expedient for ensuring a fair and orderly securities market or futures market, the integrity of and proper management of systemic risks in the securities market or futures market, or in the public interest or for the protection of investors; and

(d) removing officers of the securities exchange or the futures exchange.

5. A general provision in the SFA authorises the MAS to apply to the High Court for an order to require a person to comply with the listing rules. The MAS may apply to the court for a restraining order on any person who appears to have committed an offence. The MAS may, with the consent of the Public Prosecutor, begin civil proceedings in court for imposition of civil penalties. Criminal prosecutions require the consent of the Attorney-General.

6. The SFA also provides for the establishment of the Securities Industry Council which is an advisory body that advises the Minister for Finance on all matters relating to the securities industry. The Securities Industry Council consists of representatives of business, the Government and the MAS appointed by the Minister. The MAS may consult the Council on the proper and effective implementation of the SFA.

7. The SGX carries on, inter alia, the business of providing, regulating and maintaining facilities for conducting the business of a stock exchange in Singapore pursuant to the Securities Industry Act. The Singapore Exchange Securities Trading Limited (SGX-ST) is a wholly-owned subsidiary of the SGX. It is a stock exchange which has been approved as provided in section 16(2) of the Securities Industry Act and is the front line regulator for corporations listed on it. It is not vested with any statutory powers but is responsible for front line regulatory functions such as listing approval and market surveillance. It regulates listing matters by issuing the Listing Manual which sets out the requirements that apply to issuers, the manner in which securities are to

be offered, and the continuing obligations of issuers. It has also published a Best Practice Guide to provide guidance on the principles and best practices in corporate governance and dealings by listed issuers and their directors and employees in the securities of the listed issuers, and has adopted the Code of Corporate Governance issued by the Corporate Governance Committee. The underlying principles of the listing rules which are subject to MAS approval are to ensure that issuers shall have minimum standards of quality, operation, management experience and expertise. Issuers are required to disclose all the information necessary for investors to make assessment and shall act in the interests of shareholders as a whole.

THE LISTING PROCESS

8. The SGX-ST is directly responsible for approving listing applications in accordance with the rules sets out in the Listing Manual. The SGX-ST considers an issuer's application and may issue approval in-principle for listing with or without conditions. The issuer can then lodge and register the final copy of the prospectus or offering memorandum with the MAS and the SGX-ST, and launches offer. On satisfaction of the conditions expressed in the in-principle approval, the issuer is admitted to the Official List at the discretion of the SGX-ST. Trading of the listed securities commences on a date determined by the SGX-ST. The MAS has the power to issue "stop orders" to halt an offering and require the return of moneys if there are problems.

9. The SGX-ST may at any time suspend trading of the listed securities of an issuer and may remove an issuer from the Official List.

CONFLICT OF INTERESTS

10. The Exchanges (Demutualisation and Merger) Act of 1999 confers on the MAS the authority to require the SGX to enter into arrangements for dealing with possible conflicts of interests that may arise from the listing and quotation of the SGX on a stock exchange, and for the purpose of ensuring the integrity of trading of the securities of the transferee holding company. In this regard, the SGX, SGX-ST and MAS signed a Deed of Undertaking which sets out listing arrangements

and procedures for handling conflicts of interests. The MAS is authorised to make all decisions and take action in relation to the SGX that would be taken by the SGX-ST in the case of other corporations listed on the SGX-ST. SGX and SGX-ST have to abide by and comply with the decisions taken by the MAS. The SGX's compliance with the listing rules of the SGX-ST as a corporation listed on the SGX-ST is supervised by the MAS. The MAS has all the powers and functions that the SGX-ST has in relation to a corporation listed on the SGX-ST, including the power to remove the SGX from the stock exchange Official List and the power to suspend or stop the quotation of securities of the SGX on the stock exchange, in order for the MAS to discharge its supervisory role in relation to the listing of the SGX on the SGX-ST. The procedures to deal with conflicts of interests are set out in the Appendix to the Deed of Undertaking, which requires the Board of the SGX to appoint a committee (the "Conflicts Committee") to consider possible conflicts of interests or conflicts of interests that may arise from the listing or quotation of SGX shares on the SGX-ST. The Conflicts Committee shall notify the MAS of any proposals for resolving a conflict of interests in a manner which assures the proper performance of the SGX's regulatory functions. The following matters shall be referred directly to the MAS instead of the Conflicts Committee –

(a) complaints received concerning insider trading in SGX shares; or

(b) market surveillance reports indicating that insider trading in SGX shares could have taken place or investigations into possible insider trading in SGX shares; or

(c) the receipt by the SGX-ST of a listing application from an applicant that the SGX regards as a competitor of the SGX.

REGULATION OF THE SECURITIES MARKET IN THE MAINLAND

CHINA SECURITIES REGULATORY COMMISSION

The China Securities Regulatory Commission (CSRC) is the central statutory regulatory body of the securities and futures markets on the Mainland. In April 1998, the CSRC became a ministry rank unit under the State Council and the authorised department governing the securities and futures markets of Mainland China. It directly supervises the two exchanges in Shanghai and Shenzhen, organisations engaged in securities trading formerly supervised by the People's Bank of China, and all local securities regulatory departments.

2. The main functions of the CSRC are –

(a) to establish a centralised supervisory system for securities and futures markets and assume direct leadership over securities and futures market supervisory bodies;

(b) to strengthen the supervision over securities and futures business, stock and futures exchange markets, listed companies, fund management companies investing in securities, securities and futures investment consulting firms, and other intermediaries involved in the securities and futures business; raise the standard of information disclosure;

(c) to increase the abilities to prevent and handle financial crisis;

(d) to organise the drafting of laws and regulations; study and formulate principles, policies and rules; formulate development plans and annual plans for the securities market;

(e) to direct, coordinate, supervise and examine matters related to securities in various regions and relevant departments; direct, plan and coordinate test operations of the futures market; and

(f) to exercise centralised supervision of the securities industry.

3. Specifically, the CSRC is responsible for –

(a) studying and formulating policies and development plans regarding securities and futures markets; drafting relevant laws and regulations on securities and futures markets; and working out relevant rules on securities and futures markets;

(b) supervising securities and futures markets and exercising vertical power of authority over regional and provincial supervisory institutions of the securities market;

(c) overseeing the issuance, trading, custody and settlement of equity shares, convertible bonds and securities investment funds; approving the listing of corporate bonds; supervising the trading activities of listed government and corporate bonds;

(d) supervising the listing, trading and settlement of domestic futures contracts; monitoring domestic institutions engaged in overseas futures businesses in accordance with relevant regulations;

(e) supervising the behaviour of listed companies and their shareholders who are liable for relevant information disclosure in securities market;

(f) supervising securities and futures exchanges and their senior management in accordance with relevant regulations, and securities associations in the capacity of the competent authorities;

(g) supervising securities and futures companies, securities investment fund managers, securities registration and settlement companies, futures settlement institutions, and securities and futures investment consulting institutions; approving in conjunction with the People's Bank of China, the qualification of fund custody institutions and supervising their fund custody business; formulating and implementing

rules on the qualification of senior management for the above-mentioned institutions; and granting qualification of the people engaged in securities and futures-related business;

(h) supervising direct or indirect issuance and listing of shares overseas by domestic enterprises; supervising the establishment of securities institutions overseas by domestic institutions; and supervising the establishment of domestic securities institutions by overseas organisations;

(i) supervising information disclosure (the PRC Securities Law and State Council regulations contain continuous disclosure requirements) and proliferation related to securities and futures; being responsible for the statistics and information resources management for securities and futures markets;

(j) granting, in conjunction with relevant authorities, the qualification of law firms, accounting firms, asset appraisal firms, and professionals in these firms, engaged in securities and futures intermediary business, and supervising their relevant business activities;

(k) investigating and penalising activities violating securities and futures laws and regulations (the CSRC has express powers to impose administrative penalties/fines, "responsibility and correction orders", and warnings); and

(l) managing the foreign relationships and international cooperation affairs in the capacity of the competent authorities.

SHANGHAI AND SHENZHEN STOCK EXCHANGES

4. The Shanghai Stock Exchange and Shenzhen Stock Exchange were set up in December 1990, each being a non-profit institution and legal person. They are to provide a fair, transparent and efficient trading environment for market participants and ensure normal operation of the securities market under the supervision of the CSRC.

5. The Shanghai Stock Exchange has a wholly-owned subsidiary, i.e. Shanghai Securities Central Registration and Settlement Company, which is responsible for central registration, custody, management and settlement. Similarly, the Shenzhen Stock Exchange has a wholly-owned subsidiary, i.e. Shenzhen Securities Settlement Company, which is responsible for the registration, custody and settlement of shares listed on the exchange.

STOCK ISSUANCE

6. Stock issuance is subject to approval by the CSRC. Article 11 of the PRC Securities Law stipulates that "public offer of shares shall, in compliance with the conditions provided for in the Company Law, be reported to the securities regulatory authority under the State Council for verification".

7. The examination and approval of stock issuance applications are the responsibilities of the Public Offering and Listing Review Committee, set up by the CSRC in 1993 pursuant to Article 14 of the PRC Securities Law which states that "in the securities regulatory authority under the State Council an issuance examination commission shall be established to examine according to law applications for issuance of shares. The issuance examination commission shall be composed of professionals from the security regulatory authority under the State Council and other relevant specialists engaged from outside the said authority, who shall vote on applications for issuance of shares and state their opinions after examination." Prospectuses, listing applications, periodic reports and public announcements are filed with the CSRC. Their contents are governed by the Securities Law, the Company Law, applicable State Council regulations, and various CSRC rules and forms.

8. The listing regime is therefore controlled directly by the CSRC, while the stock exchanges provide a trading environment and ensure smooth operation of the market.

REGULATION OF THE SECURITIES MARKET IN HONG KONG

The Securities and Futures Commission (SFC) is the statutory regulator of the securities and futures markets in Hong Kong. It was set up in 1989 under the Securities and Futures Commission Ordinance (Cap. 24), after the October market crash in 1987 and on the recommendation of the Securities Review Committee chaired by Mr. Ian Hay Davison. The SFC has the following regulatory objectives –

(a) maintain and promote the fairness, efficiency, competitiveness, transparency and orderliness of the securities and futures industry;

(b) promote understanding by the public of the operation and the functioning of the securities and futures industry;

(c) provide protection for members of the public investing in or holding financial products;

(d) minimise crime and misconduct in the securities and futures industry;

(e) reduce systemic risks in the securities and futures industry; and

(f) assist the Financial Secretary in maintaining the financial stability of Hong Kong by taking appropriate steps in relation to the securities and futures industry.

2. The SFC supervises and monitors the activities of the Hong Kong Exchanges and Clearing Limited (HKEx) and its subsidiaries in the operation of the securities market and futures market. The regulatory objectives, functions, responsibilities and powers of the SFC are enshrined in the Securities and Futures Ordinance (SFO) (Cap. 571) passed by the Legislative Council on 16 March 2002 to come into effect on 1 April 2003. The Ordinance consolidates and modernises ten pieces of securities and futures legislation enacted over the last quarter of a century and aims to maintain fair, transparent and orderly markets,

promote public confidence in the securities and futures markets, provide an appropriate level of investor protection, minimise market misconduct and facilitate market innovation and competition. Its main features include a streamlined licensing system under which one single licence covers all regulated activities that a licensee can conduct; additional disciplinary sanctions on licensees; parallel civil and criminal regimes to combat market misconduct and the establishment of a Market Misconduct Tribunal; private civil action for individuals who have suffered pecuniary loss caused by market misconduct or false or misleading information; a strengthened disclosure of interest regime; a new investor compensation scheme covering a broader range of market intermediaries; a flexible licensing regime to cater for companies providing automatic trading services; extended supervisory, investigation and intervention powers along with enhanced checks and balances on the SFC, including the establishment of an independent Securities and Futures Appeals Tribunal.

3. The SFC has four operational divisions. The Corporate Finance Division oversees the stock exchange listing-related functions and responsibilities, administers securities legislation relating to listed companies, the Takeovers and Mergers Code and the Share Repurchases Code. The Intermediaries and Investment Products Division devises and administers licensing requirements for securities and futures, and leveraged foreign exchange trading intermediaries, supervises and monitors intermediaries' conduct and financial resources, and regulates the public marketing of investment products. The Enforcement Division conducts market surveillance to identify market misconduct for further investigation, undertakes inquiry into alleged breaches of relevant laws and codes, and institutes disciplinary procedures for misconduct by licensed intermediaries. The Supervision of Markets Division supervises and monitors activities of the exchanges and clearing houses, encourages development of the securities and futures markets, promotes and develops self-regulation by market bodies, and oversees and manages the investor compensation funds.

4. The securities and futures markets are operated by the Stock Exchange of Hong Kong Limited (SEHK) and the Hong Kong Futures Exchange Limited (HKFE), both wholly owned subsidiary of the HKEx which became the holding company of the SEHK, HKFE, the Hong Kong Securities Clearing Company Limited (HKSCC), the SEHK Options Clearing House Limited (SEOCH) and the HKFE Clearing Corporation Limited (HKCC) on 6 March 2000 following demutualisation and merger.

The HKEx was listed on the SEHK on 27 June 2000 by way of introduction.

5. The HKEx is a recognised exchange controller under the Exchanges and Clearing Houses (Merger) Ordinance (Cap. 555). It owns and operates the only stock exchange (SEHK) and futures exchange (HKFE) in Hong Kong and their related clearing houses. The SEHK has the right under the Stock Exchanges Unification Ordinance (Cap. 361) to establish, operate and maintain a stock exchange in Hong Kong and the HKFE is licensed under the Commodities Trading Ordinance (Cap. 250) to establish and operate a commodity exchange. The HKSCC, SEOCH and HKCC are the recognised clearing houses for the purposes of the Securities and Futures (Clearing Houses) Ordinance (Cap. 420).

6. Although the SFC has been entrusted with the statutory responsibility to oversee the securities and futures markets, the government is ultimately responsible for stability of the financial markets. According to Articles 109 and 110 of the Basic Law, the Government of the Hong Kong Special Administrative Region (HKSAR) shall provide an appropriate economic and legal environment to maintain Hong Kong's status as an international financial centre, and safeguard the free operation of financial business and financial markets, and regulate and supervise them in accordance with law. Section 11 of the SFO empowers the Chief Executive of the HKSAR to give written instructions to the SFC in extraordinary emergencies to safeguard public interest. The directions must be related to the functions of the SFC and in the public interest, and only issued after the Chief Executive has consulted the Chairman of the SFC.

7. The securities and futures markets are therefore regulated under a three-tier regulatory structure, namely, self-regulation by front line market operators, market regulation by the SFC and government supervision at the third level to ensure effective regulation by the SFC and sufficient coordination with other regulatory organisations.

THE LISTING REGIME

8. Under the Amended and Restated Memorandum of Understanding (MOU) Governing Listing Matters signed between the SFC and the SEHK on 6 March 2000, the date on which the SEHK

became a wholly-own subsidiary of the HKEx following the demutualisation and merger of the two exchanges and three clearing houses, the SFC has agreed to the SEHK continuing to be solely responsible for the day-to-day administration of all listing-related matters (except for the functions performed by the SFC), acting as the primary front line regulator responsible for the supervision and regulation of listed companies, including their directors and controlling shareholders, and market users. Within the regulatory framework, the SFC has the following functions –

(a) administering relevant ordinances and the rules and regulations made thereunder;

(b) supervising and monitoring the activities of the SEHK to ensure that it discharges its regulatory responsibilities in a professional and impartial manner;

(c) taking measures to safeguard the interests of persons dealing in securities;

(d) providing policy advice on the regulatory regime for listed and other public companies;

(e) proposing reforms of securities laws;

(f) promoting and developing self-regulation by market participants in the securities industry;

(g) administering the Takeovers and Mergers Code and the Share Repurchases Code;

(h) administering the Code on Unit Trusts and Mutual Funds which establishes guidelines for the authorisation of collective investment schemes;

(i) investigating alleged breaches of relevant laws and the Codes mentioned in (g) and (h); and

(j) encouraging the development of the securities market and the use of the market by local and overseas investors.

9. According to the MOU, the SEHK is responsible for –

(a) establishing and operating a fair, orderly and efficient stock exchange for the trading of securities, protecting the interests of the investing public;

(b) making and promulgating rules prescribing listing requirements for the quotation of securities on and for the proper and efficient operation and management of the stock market;

(c) establishing a Listing Committee (for the Main Board) and a Growth Enterprise Market (GEM) Listing Committee (with respect to the GEM) whose membership is broadly representative of the various securities industry groups with interests in the proper regulation of the securities market, to discharge the listing functions and powers impartially, independently and professionally; and

(d) establishing fair and clear procedural rules for discharging listing functions.

10. The Board of the SEHK has arranged for all of its powers and functions in respect of all listing matters to be discharged by the Listing Committee, subject to certain review procedures. Accordingly, the Listing Committee and, in relation to certain powers of review, the Listing Review Committee have sole power and authority to act on all listing matters to the exclusion of the Board, unless and until the Board revokes these arrangements. In addition to the powers to suspend or cancel a listing, the Listing Committee can impose the following sanctions for non-compliance with the Listing Rules –

(a) private reprimand;

(b) public criticism;

(c) public censure;

(d) reporting the offender's conduct to the SFC or another regulatory authority;

(e) banning a professional adviser or an individual employed by a professional adviser from representing a specific party;

(f) requiring a breach to be rectified or other remedial action to be taken within a specified period;

(g) in the case of wilful or persistent failure by a director of a listed issuer to discharge his/her responsibilities under the Listing Rules, stating publicly the retention of the office by the director is prejudicial to the interests of investors; and

(h) in the case of wilful or persistent failure by a listed issuer to discharge its responsibilities under the Listing Rules, disallowing that issuer access to the facilities of the market and prohibiting dealers and financial advisers from acting or continuing to act for that issuer.

11. The Listing Committee has delegated most of these powers and functions to the Listing Division and the Chief Executive of the SEHK, subject to certain reservations and review procedures. The Listing Division therefore deals with all matters concerning listing in the first instance; and interprets, administers and enforces the Listing Rules. It can propose new rules and amendments to the existing rules for the Listing Committee's consideration. Changes to the Listing Rules have to be approved by the SFC before they can come into effect.

12. To provide for the listing of the HKEx on the SEHK and to ensure that the primary regulatory listing functions are not compromised by the HKEx's becoming a publicly listed for-profit company, the SFC has signed with the HKEx and the SEHK on 19 June 2000 a Memorandum of Understanding for the Listing of Hong Kong Exchanges and Clearing Limited on the Stock Exchange of Hong Kong Limited. The MOU sets out the way the parties involved will relate to one another regarding: (i) the HKEx's and other applicants' and issuers' compliance with the Listing Rules, (ii) the SEHK's enforcement of the Rules of the Exchange in relation to the securities of the HKEx and other applicants and issuers, (iii) the SFC's supervision and regulation of the HKEx as a listed issuer, (iv) conflicts of interests that may arise between the interests of the HKEx as a listed company and companies of which it is a controller, and the interests of such companies in the proper performance of the regulatory functions, and (v) market integrity.

13. The MOU also stipulates the arrangements and relationship between the parties acting in different capacities, including: (i) the SFC acting as the statutory regulator of Hong Kong's securities and futures markets and, where a conflict of interests may arise between the HKEx as a listed company and other companies or persons, as the front line regulator of those companies or persons, (ii) the SEHK acting as the front line regulator of listed issuers and exchange participants (except with respect to the HKEx and other companies or persons where a conflict of interests may arise) and as a securities exchange, (iii) the HKEx acting as an applicant for listing, a listed issuer and the holding company of the SEHK and other companies of which the HKEx is the controller, and (iv) the subsidiaries of the HKEx performing regulatory functions and exercising regulatory powers.

14. The SFC signed a further MOU with the HKEx and the SEHK on 22 August 2001 to replace the earlier one, mainly to extend the scope to cover the GEM as well and bring up-to-date the provisions therein. The text of the MOU can be found at the HKEx and SFC websites at *www.hkex.com.hk* and *www.hksfc.org.hk* respectively.

15. As measures to ensure that the regulatory functions are properly carried out and the public interest is duly protected, the majority of the HKEx Board are non-executive directors appointed by the Financial Secretary and the election of the Chairman is subject to the approval of the Chief Executive of the HKSAR. The Board has undertaken not to revoke or vary the delegation of the functions and powers in respect of all listing matters to the Listing Committee, unless in exceptional circumstances and only after having given written notice to the SFC and the Listing Committee. The Listing Committee and the Listing Division operate apart from the for-profit business units of the HKEx.

NEW DEVELOPMENT

16. The Secretary for Financial Services and the Treasury announced at a press conference on 24 July 2002 the introduction of a package of measures to improve the present listing structure and procedures, with the aim to create a market environment that is conducive to the listing of high quality companies and strengthen Hong Kong's position as an international financial centre.

17. The main features of the new listing package include –

(a) Establishment of an integrated Listing Committee with remit to decide on Main Board and GEM listings and delistings. The Committee would have broadly based participation of market users.

(b) Streamlined listing process administered by high calibre experts with overseas experience. Senior executives would vet all applications to identify key issues. This would shorten approval time and help reduce the overall listing costs.

(c) Strengthened back-end enforcement of disclosure requirements to ensure quality of information under the streamlined regime.

18. In relation to back-end enforcement, the new SFO, together with the Securities and Futures (Stock Market Listing) Rules made under the Ordinance, provides for a new dual-filing requirement on listing applicants and listed issuers whereby the same information in relation to initial public offerings and ongoing corporate disclosure will have to be filed with both the HKEx and the SFC. This will enable the SFC to exercise statutory enforcement powers where it has reasons to believe that disclosure documents as filed contain false or misleading information. The SFC may ask a listing applicant to provide more information and may object to listing if the applicant fails to comply with such a requirement or if it appears to the SFC that the applicant has supplied false or misleading information in its application, or if listing of the security is not in the public interest or the interest of the investing public. Similar requirement will apply to public statements and other ongoing disclosure of information by listed companies to the public. The SFC may direct the SEHK to suspend dealings in the securities of a listed company, if the company is found to have supplied or disclosed false or misleading information in its listing documents or other public announcements or publications. To facilitate compliance, the applicant can fulfil the disclosure obligation by authorising the SEHK to file the materials with the SFC on its behalf. Detailed arrangements between the SFC and the HKEx in respect of the dual-filing requirement are set out in the new Memorandum of Understanding Governing Listing

Matters signed on 28 January 2003 between the SFC and the SEHK (the full text is available at *www.hkex.com.hk* or *www.hksfc.org.hk*). By allowing the SFC to ask for more information, to object to listing and to impose sanctions against non-compliance and where appropriate bring offenders to court, there would be a more effective deterrent against disclosure of false or misleading information, and the quality of corporate information disclosure could hopefully be improved.

COMPARISON OF THE QUANTITATIVE IPO REQUIREMENTS OF THE MAIN BOARDS OF MAJOR FINANCIAL MARKETS

	Australia	**Hong Kong**	**Japan**	**Mainland**	**Singapore**	**United Kingdom**	**United States**
Exchange	Australian Stock Exchange	Stock Exchange of Hong Kong	Tokyo Stock Exchange	Shenzhen and Shanghai Stock Exchanges	Singapore Exchange Securities Trading Limited	London Stock Exchange	New York Stock Exchange
Net asset/capital requirement	**Domestic listing** *Assets test (Alternative 1):* A$2 million net tangible assets (or A$10 million market capitalisation) *Profit test (Alternative 2):* N/A **Foreign exempt listing** *Assets test (Alternative 1):* A$2 billion net tangible assets *Profit test (Alternative 2):* N/A	N/A	¥1 billion (shareholders' equity)	RMB50 million (shareholders' equity)	N/A	N/A	**Domestic standards** US$60 million (equity or market value of public shares) **Alternate listing standards for non-US companies** US$100 million worldwide (equity or market value of public shares)

	Australia	Hong Kong	Japan	Mainland	Singapore	United Kingdom	United States
Minimum market capitalisation	**Domestic listing** *Alternative 1:* A$10 million (or A$2 million net tangible assets) *Alternative 2:* N/A **Foreign exempt listing** N/A	HK$100 million	¥2 billion At least 4 000 units of shares to be traded (1 unit is the minimum amount of shares with 1 voting right)	N/A	*Alternative 1:* N/A *Alternative 2:* N/A *Alternative 3:* S$80 million	£700,000	N/A
Profit	**Domestic listing** *Alternative 1:* N/A *Alternative 2:* A$1 million after tax profit over last 3 years and A$400,000 over last 12 months; still profitable **Foreign exempt listing** *Alternative 1:* N/A *Alternative 2:* A$200 million in each of the	After tax profits of HK$50 million in the last 3 years (HK$20 million in the most recent year and an aggregate of HK$30 million for 2 preceding years)	*Alternative 1:* Pre-tax profits Most recent year: ¥400 million Second most recent year: ¥100 million *Alternative 2:* Pre-tax profits Most recent year: ¥400 million Third most recent year: ¥100 million Total past 3	Profitable for 3 consecutive years	*Alternative 1:* S$7.5 million before tax profit over the last 3 years, with at least S$1 million in each year *Alternative 2:* S$10 million for the latest 1 or 2 years *Alternative 3:* N/A	N/A	**Domestic standards** *Alternative 1:* US$6.5 million pre-tax earnings over last 3 years with US$2.5 million in most recent year and US$2 million in each of the 2 preceding years *Alternative 2:* US$6.5 million pre-tax earnings over last 3 years with US$4.5

	Australia	Hong Kong	Japan	Mainland	Singapore	United Kingdom	United States
	previous 3 years		years: ¥600 million *Alternative 3:* ¥100 billion total market capitalisation if previous year's sales is more than ¥10 billion				million in most recent year *Alternative 3:* US$25 million aggregate operating cash flow for last 3 years for companies over US$500 million in market capitalisation and US$100 million in revenue in last 12 months *Alternative 4:* US$100 million in revenue for last year and US$1 billion average global market capitalisation **Alternate listing standards** *Alternative 1:* Aggregate US$100 million pre-tax earnings

	Australia	Hong Kong	Japan	Mainland	Singapore	United Kingdom	United States
							over last 3 years with US$25 million in each of last 2 years *Alternative 2:* US$100 million aggregate operating cash flow for last 3 years with US$25 million for each of last 2 years for companies over US$500 million in market capitalisation and US$100 million in revenue in last 12 months *Alternative 3:* US$100 million revenue for last year and US$1 billion average global market capitalisation

	Australia	Hong Kong	Japan	Mainland	Singapore	United Kingdom	United States
Operating History	**Domestic listing** 3 years **Foreign exempt listing** *Alternative 1:* N/A *Alternative 2:* 3 years	3 years	3 years	3 years	*Alternative 1:* 3 years *Alternative 2:* N/A *Alternative 3:* N/A	3 years	N/A
Minimum public float	N/A	HK$50 million or 25% of the issued share capital, whichever is higher (for companies with over HK$4 billion market value, 10-25%)	20% (the number of shares held by the 10 largest shareholders, directors and related parties must not exceed 80%; 75% by the end of the first year after listing)	25% (for companies with over RMB400 million market value, 15%)	25% issued shares held by 1 000 holders. If market capitalisation over S$300 million, shareholder spread varies between 12-20%	25%	**Domestic standards** 1.1 million shares **Alternate listing standards** 2.5 million shares worldwide
Shareholder spread	**Domestic listing** 500 shareholders each with shares worth at least A$2,000 or 400 shareholders	Minimum 100, with not less than 3 holders per HK$1 million worth of shares	800 – 2 200 (depending on the number of shares listed)	At least 1 000 each holding shares worth at least RMB1,000 (par value at RMB 1)	2 000 shareholders worldwide for secondary listings	N/A	**Domestic standards** 2 000 round lot holders or 2 200 total shareholders with average

	Australia	Hong Kong	Japan	Mainland	Singapore	United Kingdom	United States
	each with shares worth at least A$2,000 plus 25% held by unrelated parties **Foreign exempt listing** 1 000 shareholders each with shares worth at least A$500						trading volume of 100 000 shares for last 6 months or 500 total shareholders with average trading volume of 1 million shares for last 12 months **Alternate listing standards** 5 000 shareholders worldwide each holding 100 shares or more
Delisting criteria	N/A	Rule 6.01 of the Listing Rules states that delisting may occur under the following circumstances: (1) failure to comply with the Listing Rules or Listing	Less than 4 000 units of shares listed; Insufficient public float or shareholder spread; Average monthly trading volume less than 10 units for the most recent	3 consecutive years of loss and no hope of recovery	Public shares of less than 10% for 3 months	Public shares below 25%	Market capitalisation and shareholders' equity of less than US$50 million or average global market capitalisation less than US$15 million for 30 consecutive days; Public shares of

	Australia	Hong Kong	Japan	Mainland	Singapore	United Kingdom	United States
		Agreement (2) insufficient public float (3) insufficient level of operations or assets (4) issuer or its business no longer suitable for listing	year or no trades for last 3 months; Market capitalisation less than ¥1 billion; Excess liabilities for last 2 years				less than 600 000; Closing price of less than US$1 for 30 consecutive days; Total shareholders of less than 400; Total shareholders of less than 1 200 and average monthly trading volume of less than 100 000 shares in last 12 months; For companies listed under the global market capitalisation standard: (a) average global market capitalisation less than US$500 million for 30 consecutive days and revenue less than US$20

	Australia	Hong Kong	Japan	Mainland	Singapore	United Kingdom	United States
							million over the last 12 months; or (b) average global market capitalisation less than US$100 million over 30 consecutive days
Requirement for non-executive directors	Top 500 listed entities should have an audit committee which should include some non-executive directors	At least 2 independent non-executive directors	Recommended but not mandatory	At least one-third of the board members	2 independent non-executive directors; Every listed company must have an audit committee with a majority of members being independent of management or related parties	Yes	Each listed issuer must have an audit committee comprising at least 3 independent non-executive directors

Notes:

1. In Australia and Singapore, companies may list by means of one of the alternatives but must satisfy all requirements under the chosen alternative.
2. In US, non-US companies may choose to qualify for listing either under the Alternate Listing Standards for non-US companies or the Domestic Listing Criteria. An applicant must meet all the criteria of the standards under which it seeks to qualify for listing.

EXTRACTS FROM RULES GOVERNING THE LISTING OF SECURITIES ON THE STOCK EXCHANGE OF HONG KONG LIMITED (MAIN BOARD)

Chapter 2A

GENERAL

COMPOSITION, POWERS, FUNCTIONS AND PROCEDURES OF THE LISTING COMMITTEE, THE LISTING APPEALS COMMITTEE AND THE LISTING DIVISION

General

2A.01 The Board has arranged for all of its powers and functions in respect of all listing matters to be discharged by the Listing Committee and/or its delegates, subject to the review procedures set out in this Chapter. Any function which under the Exchange Listing Rules may be performed by the Exchange or any power which under the Exchange Listing Rules may be exercised by the Exchange may, therefore, be performed or exercised by the Listing Committee and/or its delegates. Accordingly, the Listing Committee and, in relation to certain powers of review, the Listing Appeals Committee have sole power and authority to act in relation to all listing matters to the exclusion of the Board, unless and until the Board revokes these arrangements.

2A.02 The Listing Committee has arranged for most of these powers and functions to be discharged by the Listing Division and the Chief Executive of the Exchange, subject to the reservations and review procedures set out in this Chapter. In the first instance, therefore, all matters concerning the Exchange Listing Rules will be dealt with by the Listing Division. The Listing Division will also interpret, administer and enforce the Exchange Listing Rules subject to the review procedures set out in this Chapter.

2A.03 In discharging their respective functions and powers the Listing Appeals Committee, the Listing Committee, the Listing Division and the Chief Executive of the Exchange are required to administer the Exchange Listing Rules, and otherwise to act, in the best interest of the market as a whole and in the public interest.

2A.04 All references in Chapters 2A and 2B to decisions and rulings of the "Listing Division" include decisions and rulings made by the Chief Executive of the Exchange.

Application Procedures

New Applicants

2A.05 Subject to rule 2A.05A, every application for listing by a new applicant should be submitted to the Listing Division which may reject it or recommend it. However, the Listing Committee has reserved to itself the power to approve all applications for listing from a new applicant and this means that even if such an application is recommended by the Executive Director – Listing or the Chief Executive of the Exchange it must still be approved by the Listing Committee. The Listing Committee may at the request of the Listing Division give an "in principle" approval, that a particular issuer or its business, or a particular type of security is suitable for listing, at an early stage in the application process (but will again consider the full application after the Listing Division has processed it). Otherwise the Listing Committee will not consider an application from a new applicant until the Listing Division has processed the application. If the Listing Committee approves a listing the Listing Division will issue a formal approval letter, in due course.

2A.05A The Listing Committee has delegated to the Executive Director – Listing the power to approve an application for listing of debt securities issued or guaranteed (in the case of guaranteed issues) by the following issuers or (in the case of guaranteed issues) guarantors:—

i) States;

ii) Supranationals;

iii) State corporations;

iv) banks and corporations having an investment grade credit rating (and the term "investment grade" shall have the same meaning as in note (2) to rule 15.13); and

v) issuers whose equity securities are listed on the Exchange and which have a market capitalization, at the time of the application, of not less than HK$5,000,000,000.

Listed Issuers

2A.06 Applications for listing by a listed issuer will be dealt with by the Listing Division and it is the Executive Director – Listing who will normally approve the listing and issue the formal approval letter, in due course. However, the Listing Committee may determine the matter in the first instance at the request of the Listing Division where it considers it appropriate to do so.

Guidance

2A.07 Prospective issuers, and in particular new applicants, are encouraged to contact the Listing Division to seek informal and confidential guidance as to the eligibility of a proposed application for listing at the earliest possible opportunity.

Cancellation Procedures

2A.08 The Listing Committee has reserved to itself the power to cancel the listing of a listed issuer. This means that a listed issuer will not have its listing cancelled unless the Listing Committee has considered the matter.

Disciplinary Procedures

2A.09 In addition to its powers to suspend or cancel a listing, if the Listing Committee finds there has been a breach by any of the parties named in rule 2A.10 of the Exchange Listing Rules it may:—

(1) issue a private reprimand;

(2) issue a public statement which involves criticism;

(3) issue a public censure;

(4) report the offender's conduct to the Commission or another regulatory authority (for example the Financial Secretary, the Commissioner of Banking or any professional body) or to an overseas regulatory authority;

(5) ban a professional adviser or a named individual employed by a professional adviser from representing a specified party in relation to a stipulated matter or matters coming before the Listing Division or the Listing Committee for a stated period;

(6) require a breach to be rectified or other remedial action to be taken within a stipulated period including, if appropriate, the appointment of an independent adviser to minority shareholders;

(7) in the case of wilful or persistent failure by a director of a listed issuer to discharge his responsibilities under the Exchange Listing Rules, state publicly that in the Exchange's opinion the retention of office by the director is prejudicial to the interests of investors;

(8) in the event a director remains in office following a public statement pursuant to (7) above, suspend or cancel the listing of the issuer's securities or any class of its securities;

(9) in the case of wilful or persistent failure by a listed issuer to discharge its responsibilities under the Exchange Listing Rules, order that the facilities of the market be denied for a specified period to that issuer and prohibit dealers and financial advisers from acting or continuing to act for that issuer;

(10) take, or refrain from taking, such other action as it thinks fit, including making public any action taken pursuant to paragraphs (4), (5),(6),(8) or (9) above.

2A.10 The sanctions in rule 2A.09 may be imposed or issued against any of the following:

(a) a listed issuer or any of its subsidiaries;

(b) any director of a listed issuer or any of its subsidiaries or any alternate of such director;

(c) any member of the senior management of a listed issuer or any of its subsidiaries;

(d) any substantial shareholder of a listed issuer;

(e) any professional adviser of a listed issuer or any of its subsidiaries;

(f) any sponsor of a listed issuer or a new applicant;

(g) any authorised representative of a listed issuer;

(h) any supervisor of a PRC issuer.

For the purposes of this rule "professional adviser" includes any financial adviser, lawyer, accountant, property valuer or any other person retained by an issuer to provide professional advice in relation to a matter governed by the Exchange Listing Rules.

Notes: (1) The scope of any disciplinary action taken, in particular any ban imposed on a professional adviser pursuant to rule 2A.09(5), shall be limited to matters governed by or arising out of the Exchange Listing Rules.

(2) In exercising its powers of sanction the Exchange will recognise the differing roles and levels of responsibility of the persons against whom sanctions may lie in pursuance of rule 2A.10. In particular, professional advisers' obligations to use all reasonable efforts to ensure that their clients understand and are advised as to the scope of the Exchange Listing Rules are subject to any relevant requirements of professional conduct, as policed and enforced by any professional body of which that adviser is a member.

2A.11 The Listing Committee will, if requested by any party to be reprimanded, criticised, censured or otherwise sanctioned in pursuance of the powers contained in rules 2A.09 and 2A.10 (an "appellant") give its reasons in writing for the decision made against that appellant pursuant to rules 2A.09 and 2A.10 and that appellant shall have the right to have the decision against him referred to the Listing Committee again for review. If the Listing Committee modifies or varies the ruling of the earlier meeting, it will, if requested by the appellant, give its reasons in writing for the modification or variation and, in respect of decisions pursuant to rule 2A.09(2), (3), (5), (7), (8) or (9) only, the appellant shall have a right to a further and final review of the decision against the appellant by the Listing Appeals Committee. The decision of the Listing Appeals Committee on review shall be conclusive and binding on the appellant. If requested by the appellant, the Listing Appeals Committee will give reasons in writing for its decision on review.

2A.12 A request for a review of any decision of the Listing Division or the Listing Committee made pursuant to rule 2A.11 must be notified to the Exchange within seven days of the Listing Division's or the Listing Committee's decision unless written reasons for a decision are requested, in which case a request for a review of that decision must be notified within seven days of the receipt of the written reasons.

2A.13 Any request for the Listing Division, the Listing Committee or the Listing Appeals Committee to give its reasons in writing for its decision shall be made within three business days of its decision. Where requested, written reasons for a decision will be provided by the Listing Division, the Listing Committee or the Listing Appeals Committee (as the case may be) as soon as possible and, in any event, within fourteen days of the request.

2A.14 Any person, other than an issuer, its sponsor and authorised representatives, who is aggrieved by a decision of the Listing Division or the Listing Committee may express his views, in writing, to the Chairman of the Listing Committee. The Listing Committee may, in its sole discretion, decide to fully review the matter, having regard to the rights of any third party which may have been created in reliance upon the earlier decision.

2A.15 The Listing Committee may from time to time prescribe such procedures and regulations for any review meetings or hearings as it may think fit.

Rights of Parties to be Heard

2A.16 In any disciplinary proceedings of the Listing Committee and on any further review of the decision resulting from those proceedings by the Listing Committee or the Listing Appeals Committee, the party the subject of such proceedings shall have the right to attend the meeting, to make submissions and to be accompanied by its professional advisers. In all disciplinary proceedings the Listing Division will provide the parties with copies of any papers to be presented by it at the meeting, in advance of the meeting.

Composition of the Listing Committee

2A.17 The Listing Committee shall consist of 25 members, comprising the following number of persons from the following categories:—

(1) Exchange Participants

Six individuals who are Exchange Participants or directors of Exchange Participants which are companies;

(2) Listed company representatives

Six individuals who are directors of listed issuers of varying sizes and business activities and who are neither Exchange Participants nor officers or employees of Exchange Participants;

(3) Market practitioners and users

Twelve individuals who are neither Exchange Participants nor officers or employees of Exchange Participants and who are:—

(i) a director or a partner of a company or firm principally engaged in the business of fund management;

(ii) an officer or senior employee of a merchant bank;

(iii) a barrister or a partner of a firm of solicitors in private practice in Hong Kong;

(iv) a partner of an accounting firm; or

(v) a person who is otherwise involved in or experienced in the securities market and corporate finance matters or securities regulation;

A maximum of four members may come from any of the foregoing categories in this paragraph (3);

(4) The Chief Executive of HKEC acting as ex officio member and, in his absence or if he so directs in any particular case, the Chief Executive of the Exchange to act as his alternate;

2A.18 Each individual to be appointed a member of the Listing Committee must meet the following criteria:—

(1) the individual must have relevant experience;

(2) the individual must be a highly regarded member of his profession/occupation; and

(3) the individual must be available to assume the duties and responsibilities of a member of the Listing Committee, as the case may be, for the duration of his term of office.

Appointment and Removal of Members of the Listing Committee

2A.19 All members of the Listing Committee shall remain in office until any change or changes are made to their appointment or their offices are vacated pursuant to rule 2A.23 or 2A.26. Subject to rule 2A.25, all members of the Listing Committee are eligible for re-appointment.

2A.20 Members of the Listing Committee shall be appointed by the Board. The Board may appoint only persons nominated in accordance with rule 2A.21.

2A.21 The persons eligible for appointment or re-appointment in each year as members of the Listing Committee under any of the categories set out in rule 2A.17 shall be nominated by a Listing Nominating Committee comprising the Chief Executive of the Exchange and two members of the board of HKEC and the Chairman and two Executive Directors of the Commission. In their deliberations the Listing Nominating Committee shall seek the views of the current Chairman and Deputy Chairman of the Listing Committee.

2A.22 The Chairman and Deputy Chairman of the Listing Committee shall be nominated by the Listing Nominating Committee and appointed by the Board. The Chief Executive of HKEC or the Chief Executive of the Exchange (acting as his alternate) may not be elected as either Chairman or Deputy Chairman of the Listing Committee.

2A.23 All members of the Listing Committee shall vacate office annually at the earlier of:–

(a) the conclusion of the meeting of the Board appointing a new Listing Committee, which is held after an annual general meeting of the Exchange; and

(b) thirty days after the date of the first meeting of the Board held after the annual general meeting of the Exchange next following the date of their appointment;

unless they are re-appointed by the Board for a further full term or such shorter period as the Board may stipulate at the time of re-appointment.

2A.24 The Board may fill any casual vacancies that may occur in the Listing Committee by reason of resignation, retirement or otherwise. A person eligible for appointment to fill any such casual vacancy shall be nominated by the Listing Nominating Committee and shall be a person who is eligible within the same category of rule 2A.17 as the member who has vacated office.

2A.25 Members of the Listing Committee may only remain in office for a maximum of three consecutive years. Any person who serves as the Chairman or the Deputy Chairman of the Listing Committee may remain in office for a total of four years. A member (including the Chairman and Deputy Chairman) who has served for the maximum period permitted by this rule may be eligible for re-appointment after the lapse of two years from the date on which he last vacates office. Notwithstanding the foregoing, in exceptional circumstances, the Listing Nominating Committee shall have the discretion to nominate a person for re-appointment at any time before the lapse of two years from the date such person vacates office and the Board shall have the power to appoint such person.

2A.26 The office of a member of the Listing Committee shall be vacated if any one of the following events occurs:—

(1) in respect of a member appointed under the category referred to in rule 2A.17(1), if he ceases to be an Exchange Participant or a director of an Exchange Participant which is a company;

(2) if a receiving order is made against him or he makes any arrangement or composition with his creditors;

(3) if he becomes insane or is found to be of unsound mind within the meaning of the Mental Health Ordinance (Cap. 136);

(4) if by notice in writing to the Board and the Listing Committee, he resigns from his office; or

(5) if by reason of serious misconduct he is removed by the Board and a written statement setting out the reasons for his removal has been delivered to the Commission.

Provided that the acts of such member shall nevertheless be treated as valid and effectual in all respects up to and until an entry of the vacation of office shall be entered in the minutes of the Listing Committee.

Functions and Powers of the Listing Committee

2A.27 The Listing Committee shall exercise all the powers and functions of the Board in relation to all listing matters. The Listing Committee's exercise of such powers and functions is only subject to the powers of review in the Listing Appeals Committee.

Conduct of Meetings of the Listing Committee

2A.28 The Listing Committee shall meet for the despatch of business, adjourn and otherwise regulate its meetings in accordance with the provisions of the rules made by the Board for this purpose, including rules governing members' conflicts of interest, subject to the provisions of this rule 2A.28. The quorum necessary for the transaction of any business by the Listing Committee shall be five members present in person. The Chief Executive of HKEC or the Chief Executive of the Exchange (acting as his alternate) may be counted in the quorum for a meeting of the Listing Committee (including a meeting at which the Listing Committee is determining a matter in the first instance) except that he shall not be counted in the quorum for any meeting at which a decision of the Listing Division or the Listing Committee is under review pursuant to any disciplinary proceedings. The Chief Executive of HKEC or the Chief Executive of the Exchange (acting as his alternate) may attend meetings of the Listing Committee convened for such purpose and put forward his views (if any) on the matter under review pursuant to any disciplinary proceedings but he shall not thereafter be entitled to participate in the deliberations of the Listing Committee or to vote on such matters. At any meeting held to review an earlier decision of the Listing Committee pursuant to any disciplinary proceedings, all of the members present at the second meeting must be persons who were not present at the first meeting.

Composition of the Listing Appeals Committee

2A.29 The Listing Appeals Committee shall consist of the chairman and two other members of the board of HKEC.

2A.30 The Chairman of the Listing Appeals Committee shall be the chairman of the board of HKEC.

2A.31 The Chairman of the Listing Appeals Committee shall appoint a Deputy Chairman from amongst the members of the board of HKEC, except the Chief Executive of HKEC. The Chairman of the Listing Appeals Committee shall vacate office upon a new chairman of the board of HKEC being appointed by the members of the board of HKEC and approved in writing by the Chief Executive of Hong Kong or upon his earlier removal from the chairmanship of the board of HKEC. The Deputy Chairman of the Listing Appeals Committee shall vacate office upon (i) the expiry of his term as a director of HKEC unless he is re-appointed or re-elected as a director of HKEC (as the case may be) and re-appointed by the Chairman of the Listing Appeals Committee as Deputy Chairman; or (ii) his earlier removal as director of HKEC.

2A.32 The third member shall be chosen and invited to sit on the Listing Appeals Committee by the Chairman of the Listing Appeals Committee as and when the Listing Appeals Committee is required to review a decision of the Listing Committee and shall cease to be a member once the Listing Appeals Committee has given its decision upon the matter or upon resignation, whichever is the sooner. The third member shall be a member of the board of HKEC, except the Chief Executive of HKEC.

2A.33 In the event that either the Chairman or the Deputy Chairman of the Listing Appeals Committee is materially interested in the outcome of a review (otherwise than as a member of the board of HKEC and, where applicable, of the Board) or is otherwise unavailable to hear a review then the one who is available shall appoint a replacement member for the purposes of hearing that review and such person shall cease to be a member once the Listing Appeals Committee has given its decision upon the matter or upon resignation, whichever is the sooner. The replacement member appointed must be a member of the board of HKEC, except the Chief Executive of HKEC.

2A.34 In the event that both the Chairman and the Deputy Chairman of the Listing Appeals Committee are materially interested in the outcome of a review (otherwise than as a member of the board of HKEC and, where applicable, of the Board) or are otherwise unavailable to hear a particular review the board of HKEC shall appoint a temporary Chairman of the Listing Appeals Committee from the members of the board of HKEC. The temporary Chairman shall appoint a temporary Deputy Chairman and a third member of the Listing Appeals Committee from the members of the board of HKEC to hear that review. The temporary Chairman, the temporary Deputy Chairman and the third member appointed by the temporary Chairman shall all cease to be members of the Listing Appeals Committee once the Listing Appeals Committee has given its decision upon the matter or upon resignation whichever is the sooner. The provisions of rule 2A.33 and this rule shall apply mutatis mutandis to the temporary Chairman and temporary Deputy Chairman as if all references to the Chairman and Deputy Chairman were references to the temporary Chairman and temporary Deputy Chairman respectively.

2A.35 The Chairman of the Listing Appeals Committee may not invite a person to sit on the Listing Appeals Committee if that person was present at any meeting of the Listing Committee at which the decision under review was made or considered or is otherwise materially interested in the outcome of the review (otherwise than as an Exchange Participant or a member of the board of HKEC and, where applicable, of the Board).

Functions and Powers of the Listing Appeals Committee

2A.36 The Listing Appeals Committee shall be the review body in respect of any decision of the Listing Committee on any of the following matters:—

(1) that a sponsor is not acceptable under rule 3.01;

(2) that the role of an authorised representative appointed under rule 3.05 must be terminated;

(3) that an application for listing by a new applicant has been rejected solely on the grounds that the issuer or its business is unsuitable for listing;

(4) that an application for the lifting of a suspension of dealings in the securities of an issuer has been rejected where the suspension has been in place for more than 30 consecutive days;

(5) that the listing of a listed issuer be cancelled;

(6) any decision pursuant to rule 2A.09(2), (3), (5), (7), (8) or (9);or

(7) that trading in the shares of an issuer be restored pursuant to Rule 6.07 of the Listing Rules.

Conduct of Meetings of the Listing Appeals Committee

2A.37 The Listing Appeals Committee shall meet for the despatch of business, adjourn and otherwise regulate its meetings in accordance with the provisions of the rules made by the Board for this purpose, including rules governing members' conflicts of interest, subject to the provisions of this rule 2A.37. The quorum necessary for the transaction of any business by the Listing Appeals Committee shall be three members present in person.

Bona Fide Acts of Committee Members

2A.38 All bona fide acts of a member of the Listing Committee or any member of the Listing Appeals Committee pursuant to the resolutions passed at any meeting of those Committees shall, as regards all persons dealing in good faith with the Exchange, notwithstanding that it be subsequently discovered that there was some defect in the appointment of any such member or that such member was for some reason ineligible for appointment, be deemed to be valid as if every member had been duly appointed and was qualified to be a member of the relevant Committee.

EXTRACTS FROM RULES GOVERNING THE LISTING OF SECURITIES ON THE GROWTH ENTERPRISE MARKET OF THE STOCK EXCHANGE OF HONG KONG LIMITED

Chapter 3

GENERAL

COMPOSITION, POWERS, FUNCTIONS AND PROCEDURES OF THE GEM LISTING COMMITTEE, THE LISTING APPEALS COMMITTEE AND THE GEM LISTING DIVISION

General

3.01 The Board has arranged for all of its powers and functions in respect of all listing matters in relation to GEM to be discharged by the GEM Listing Committee and/or its delegates, subject to the review procedures set out in this Chapter and Chapter 4. Any function which under the GEM Listing Rules may be performed by the Exchange or any power which under the GEM Listing Rules may be exercised by the Exchange may, therefore, be performed or exercised by the GEM Listing Committee and/or its delegates. Accordingly, the GEM Listing Committee and, in relation to certain powers of review, the Listing Appeals Committee have sole power and authority to act in relation to all listing matters to the exclusion of the Board unless and until the Board revokes these arrangements.

3.02 The GEM Listing Committee has arranged for most of these powers and functions to be discharged by the GEM Listing Division and the Chief Executive of the Exchange (the "Chief Executive"), subject to the reservations and review procedures set out in this Chapter and Chapter 4. In the first instance, therefore, all matters concerning the GEM Listing Rules will be dealt with by the GEM Listing Division. The GEM Listing Division will also interpret, administer and enforce the GEM Listing Rules subject to the review procedures set out in this Chapter and Chapter 4.

3.03 In discharging their respective functions and powers the Listing Appeals Committee, the GEM Listing Committee, the GEM Listing Division and the Chief Executive are required to administer the GEM Listing Rules, and otherwise to act, in the best interest of the market as a whole and in the public interest.

3.04 All references in Chapters 3 and 4 to decisions and rulings of the GEM Listing Division include decisions and rulings made by the Chief Executive.

Application procedures

New applicants

3.05 Every application for listing by a new applicant (whether in relation to equity securities or debt securities) should be submitted to the GEM Listing Division which may reject it or recommend it. However, the GEM Listing Committee has reserved to itself the power to approve all applications for listing from a new applicant and this means that even if such an application is recommended by the Executive Director - GEM Listing Division or the Chief Executive, it must still be approved by the GEM Listing Committee. The GEM Listing Committee may at the request of the GEM Listing Division give an "in principle" approval, that a particular issuer or its business, or a particular type of security is suitable for listing, at an early stage in the application process (but will again consider the full application after the GEM Listing Division has processed it). Otherwise the GEM Listing Committee will not consider an application from a new applicant until the GEM Listing Division has processed the application. If the GEM Listing Committee approves a listing the GEM Listing Division will issue a formal approval letter, in due course.

Listed issuers

3.06 Applications for the listing of equity securities by a listed issuer will be dealt with by the GEM Listing Division and it is the Executive Director - GEM Listing Division who will normally approve the listing and issue the formal approval letter, in due course. However, the GEM Listing Committee may determine the matter in the first instance at the request of the GEM Listing Division where it considers it appropriate to do so. Applications for the listing of debt securities by a listed issuer shall be dealt with in the same manner as applications by new applicants as set out in rule 3.05.

Sponsors

3.07 The GEM Listing Committee has reserved to itself the power to approve or reject the application of any prospective Sponsor for admission to the Exchange's list of Sponsors, to remove any Sponsor from such list and to decide that any Sponsor admitted to such list should be regarded as ineligible to act in any particular case. This means that a prospective Sponsor will not have its application for admission to the list of Sponsors accepted or rejected, nor will a Sponsor be removed from such list nor will a Sponsor be ruled ineligible to act in any particular case unless the GEM Listing Committee has decided on the matter.

Guidance

3.08 Prospective issuers, and in particular new applicants, are encouraged (through their Sponsors, where applicable) to contact the GEM Listing Division to seek informal and confidential guidance as to the eligibility of a proposed application for listing at the earliest possible opportunity.

Cancellation procedures

3.09 The GEM Listing Committee has reserved to itself the power to cancel the listing of a listed issuer. This means that a listed issuer will not have its listing cancelled unless the GEM Listing Committee has considered the matter.

Disciplinary procedures

3.10 In addition to its powers to suspend, resume or cancel a listing, if the GEM Listing Committee finds that there has been a breach by any of the parties named in rule 3.11 of the GEM Listing Rules it may:—

(1) issue a private reprimand;

(2) issue a public statement which involves criticism;

(3) issue a public censure;

(4) report the offender's conduct to the Commission or another regulatory authority (for example the Financial Secretary, the Commissioner of Banking or any professional body) or to an overseas regulatory authority;

(5) ban a professional adviser or a named individual employed by a professional adviser from representing a specified party in relation to a stipulated matter or matters coming before the GEM Listing Division or the GEM Listing Committee for a stated period;

(6) require a breach to be rectified or other remedial action to be taken within a stipulated period including, if appropriate, the appointment of an independent adviser to minority shareholders;

(7) in the case of wilful or persistent failure by a director of a listed issuer to discharge his responsibilities under the GEM Listing Rules, state publicly that in the Exchange's opinion the retention of office by the director is prejudicial to the interests of investors;

(8) in the event a director remains in office following a public statement pursuant to (7) above, suspend or cancel the listing of the issuer's securities or any class of its securities;

(9) in the case of wilful or persistent failure by a listed issuer to discharge its responsibilities under the GEM Listing Rules, order that the facilities of the market be denied for a specified period to that issuer and prohibit dealers and financial advisers from acting or continuing to act for that issuer;

(10) take, or refrain from taking, such other action as it thinks fit, including making public any action taken pursuant to paragraphs (4), (5), (6), (8) or (9) above.

3.11 The sanctions in rule 3.10 may be imposed or issued against any of the following:—

(a) a listed issuer or any of its subsidiaries;

(b) any director of a listed issuer or any of its subsidiaries or any alternate of such director;

(c) any member of the senior management of a listed issuer or any of its subsidiaries;

(d) any substantial shareholder of a listed issuer;

(e) any management shareholder or significant shareholder;

(f) any professional adviser of a listed issuer or any of its subsidiaries;

(g) the person fulfilling the role of the listed issuer's qualified accountant (as such role is prescribed in rule 5.10);

(h) any authorised representative of a listed issuer;

(i) any supervisor of a PRC issuer; and

(j) the guarantor of an issuer in the case of a guaranteed issue of debt securities.

For the purposes of this rule "professional adviser" includes any financial adviser, lawyer, accountant, property valuer or any other person retained by an issuer to provide professional advice in relation to a matter governed by the GEM Listing Rules.

Notes: 1 *The scope of any disciplinary action taken, in particular any ban imposed on a professional adviser pursuant to rule 3.10(5), shall be limited to matters governed by or arising out of the GEM Listing Rules.*

2 *In exercising its powers of sanction the Exchange will recognise the differing roles and levels of responsibility of the persons against whom sanctions may lie in pursuance of rule 3.11. In particular, professional advisers' obligations to use all reasonable efforts to ensure that their clients understand and are advised as to the scope of the GEM Listing Rules are subject to any relevant requirements of professional conduct, as policed and enforced by any professional body of which that adviser is a member.*

3 *The Exchange's powers of sanction against any Sponsor (and/or any director or employee of any Sponsor) are set out in rules 6.67 and 6.68.*

3.12 The GEM Listing Committee will, if requested by any party to be reprimanded, criticised, censured or otherwise sanctioned in pursuance of the powers contained in rules 3.10 and 3.11 or rules 6.67 and 6.68 (an "appellant") give its reasons in writing for the decision made against that appellant pursuant thereto and that appellant shall have the right to have the decision against him referred to the GEM Listing Committee again for review. If the GEM Listing Committee modifies or varies the ruling of the earlier meeting, it will, if requested by the appellant, give its reasons in writing for the modification or variation and, in respect of decisions pursuant to rule 3.10(2), (3), (5), (7), (8) or (9) or rule 6.69 only, the appellant shall have a right to a further and final review of the decision against the appellant by the Listing Appeals Committee. The decision of the Listing Appeals Committee on review shall be conclusive and binding on the appellant. If requested by the appellant, the Listing Appeals Committee will give reasons in writing for its decision on review.

3.13 A request for a review of any decision of the GEM Listing Division or the GEM Listing Committee made pursuant to rule 3.12 must be notified to the Exchange within 7 days of the GEM Listing Division's or the GEM Listing Committee's decision unless written reasons for a decision are requested, in which case a request for a review of that decision must be notified within 7 days of the receipt of the written reasons.

3.14 Any request for the GEM Listing Division, the GEM Listing Committee or the Listing Appeals Committee to give its reasons in writing for its decision shall be made within 3 business days of its decision. Where requested, written reasons for a decision will be provided by the GEM Listing Division, the GEM Listing Committee or the Listing Appeals Committee (as the case may be) as soon as possible and, in any event, within 14 days of the request.

3.15 Any person, other than an issuer, its Sponsor and authorised representatives, who is aggrieved by a decision of the GEM Listing Division or the GEM Listing Committee may express his views, in writing, to the Chairman of the GEM Listing Committee. The GEM Listing Committee may, in its sole discretion, decide to fully review the matter, having regard to the rights of any third party which may have been created in reliance upon the earlier decision.

3.16 The GEM Listing Committee may from time to time prescribe such procedures and regulations for any review meetings or hearings as it may think fit.

Rights of parties to be heard

3.17 In any disciplinary proceedings of the GEM Listing Committee and on any further review of the decision resulting from those proceedings by the GEM Listing Committee or the Listing Appeals Committee, the party the subject of such proceedings shall have the right to attend the meeting, to make submissions and to be accompanied by its professional advisers. In all disciplinary proceedings the GEM Listing Division will provide the parties with copies of any papers to be presented by it at the meeting, in advance of the meeting.

Composition of the GEM Listing Committee

3.18 The GEM Listing Committee shall consist of 21 members, comprising the following number of persons from the following categories:—

(1) Exchange Participants

4 individuals who are Exchange Participants or directors of Exchange Participants which are companies;

(2) Listed company representatives

4 individuals who are directors of listed issuers on GEM or the Main Board of varying sizes and business activities and who are neither Exchange Participants nor officers or employees of Exchange Participants;

(3) Market practitioners and users

12 individuals who are neither Exchange Participants nor officers or employees of Exchange Participants and who are:—

(a) a director or a partner of a company or firm principally engaged in the business of fund management;

(b) an officer or senior employee of a merchant bank;

(c) a barrister or a partner of a firm of solicitors in private practice in Hong Kong;

(d) a partner of an accounting firm;

(e) a senior member of an industrial body with an interest in furthering the development of technology or scientific-based research; or

(f) a person who is otherwise involved in or experienced in the securities market and corporate finance matters or securities regulation;

A minimum of 1 member and a maximum of 4 members may come from any of the foregoing categories in this paragraph (3);

(4) The Chief Executive of HKEC acting as ex officio member and, in his absence or if he so directs in any particular case, the Chief Executive to act as his alternate.

3.19 Each individual to be appointed a member of the GEM Listing Committee must meet the following criteria:—

(1) the individual must have relevant experience;

(2) the individual must be a highly regarded member of his profession/occupation; and

(3) the individual must be available to assume the duties and responsibilities of a member of the GEM Listing Committee for the duration of his term of office.

Appointment and removal of members of the GEM Listing Committee

3.20 All members of the GEM Listing Committee shall remain in office until any change or changes are made to their appointment or their offices are vacated pursuant to rule 3.24 or 3.27. Subject to rule 3.26, all members of the GEM Listing Committee are eligible for re-appointment.

3.21 Members of the GEM Listing Committee shall be appointed by the Board. The Board may appoint only persons nominated in accordance with rule 3.22.

3.22 The persons eligible for appointment or re-appointment in each year as members of the GEM Listing Committee under any of the categories set out in rule 3.18 shall be nominated by a Listing Nominating Committee comprising the Chief Executive and 2 members of the board of HKEC and the Chairman and 2 Executive Directors of the Commission. In their deliberations the Listing Nominating Committee shall seek the views of the current Chairman and Deputy Chairman of the GEM Listing Committee.

3.23 The Chairman and Deputy Chairman of the GEM Listing Committee shall be nominated by the Listing Nominating Committee and appointed by the Board. The Chief Executive of HKEC or the Chief Executive (act as his alternate) may not be elected as either Chairman or Deputy Chairman of the GEM Listing Committee.

3.24 All members of the GEM Listing Committee shall vacate office annually at the earlier of:—

(1) the conclusion of the meeting of the Board appointing a new GEM Listing Committee which is held after an annual general meeting of the Exchange; and

(2) 30 days after the date of the first meeting of the Board held after the annual general meeting of the Exchange next following the date of their appointment;

unless they are re-appointed by the Board for a further full term or such shorter period as the Board may stipulate at the time of re-appointment.

3.25 The Board may fill any casual vacancies that may occur in the GEM Listing Committee by reason of resignation, retirement or otherwise. A person eligible for appointment to fill any such casual vacancy shall be nominated by the Listing Nominating Committee and shall be a person who is eligible within the same category of rule 3.18 as the member who has vacated office.

3.26 Members of the GEM Listing Committee may only remain in office for a maximum of 3 consecutive years. Any person who serves as the Chairman or the Deputy Chairman of the GEM Listing Committee may remain in office for a total of 4 years. A member (including the Chairman and Deputy Chairman) who has served for the maximum period permitted by this rule may be eligible for re-appointment after the lapse of 2 years from the date on which he last vacates office. Notwithstanding the foregoing, in exceptional circumstances, the Listing Nominating Committee shall have the discretion to nominate a person for re-appointment at any time before the lapse of 2 years from the date such person vacates office and the Board shall have the power to appoint such person.

3.27 The office of a member of the GEM Listing Committee shall be vacated if any one of the following events occurs:—

(1) in respect of a member appointed under the category referred to in rule 3.18(1), if he ceases to be an Exchange Participant or a director of an Exchange Participant which is a company;

(2) if a receiving order is made against him or he makes any arrangement or composition with his creditors;

(3) if he becomes insane or is found to be of unsound mind within the meaning of the Mental Health Ordinance (Cap. 136);

(4) if by notice in writing to the Board and the GEM Listing Committee, he resigns from his office; or

(5) if by reason of serious misconduct he is removed by the Board and a written statement setting out the reasons for his removal has been delivered to the Commission.

Provided that the acts of such member shall nevertheless be treated as valid and effectual in all respects up to and until an entry of the vacation of office shall be entered in the minutes of the GEM Listing Committee.

Functions and powers of the GEM Listing Committee

3.28 The GEM Listing Committee shall exercise all the powers and functions of the Board in relation to all listing matters in relation to GEM. The GEM Listing Committee's exercise of such powers and functions is only subject to the powers of review in the Listing Appeals Committee.

Conduct of meetings of the GEM Listing Committee

3.29 The GEM Listing Committee shall meet for the despatch of business, adjourn and otherwise regulate its meetings in accordance with the provisions of the rules made by the Board for this purpose, including rules governing members' conflicts of interest, subject to the provisions of this rule. The quorum necessary for the transaction of any business by the GEM Listing Committee shall be 5 members present in person. The Chief Executive of HKEC or the Chief Executive (act as his alternate) may be counted in the quorum for a meeting of the GEM Listing Committee (including a meeting at which the GEM Listing Committee is determining a matter in the first instance) except that he shall not be counted in the quorum for any meeting at which a decision of the GEM Listing Division or the GEM Listing Committee is under review pursuant to any disciplinary proceedings. The Chief Executive of HKEC or the Chief Executive (act as his alternate) may attend meetings of the GEM Listing Committee convened for such purpose and put forward his views (if any) on the matter under review pursuant to any disciplinary proceedings but he shall not thereafter be entitled to participate in the deliberations of the GEM Listing Committee or to vote on such matters. At any meeting held to review an earlier decision of the GEM Listing Committee pursuant to any disciplinary proceedings, all of the members present at the second meeting must be persons who were not present at the first meeting.

Annex 6

Enhancing Corporate Governance

The Mission

Maintaining and enhancing our competitiveness as a leading international financial centre and the premier capital formation centre for our country.

Objective

To upgrade the quality of our market by bringing our corporate governance standards in line with international standards, and to be the preferred support base for Hong Kong and Mainland companies by providing quality international financial and other professional services.

The Corporate Governance Action Plan for 2003

The Administration has, together with the Securities and Futures Commission (SFC) and the Hong Kong Exchanges and Clearing Limited (HKEx), reviewed the measures proposed by concerned parties to improve corporate governance; and taken the lead in drawing up an Action Plan for 2003 to identify priority areas, assign ownership and devise a timeframe for implementation.

The Administration, SFC and HKEx are fully committed to this Action Plan. Together we shall review progress regularly; and coordinate efforts to close any gaps and remove inconsistencies in implementation.

The Action Plan in no way pre-empts the findings of the Expert Group, and will be amended and adapted as necessary to meet any structural or procedural changes flowing from those recommendations.

Five Priority Areas

Priority I: Upgrading the Listing Rules and Listing Functions

- By Q2 2003: HKEx to introduce amendments to the Listing Rules and

promulgate a revised Code on Best Practice to implement various corporate governance measures consulted since Jan 2002.

- By Q1 2003: HKEx to complete streamlining of the listing process in order to improve quality control at the point of entry by focussing on critical matters.

- By phases, starting from Q2 to Q4 2003: HKEx to amend the Listing Rules to improve the initial and continuing listing requirements and delisting procedures, following consultation started in July and November 2002.

- By Q4 2003: The Administration to follow up recommendations of the FS-appointed Expert Group scheduled for publication in March 2003 with a view to improving Listing Functions; and delineating roles of FSTB, SFC and HKEx under the tiered regulatory structure.

Priority II: Tightening the regulation of IPO intermediaries

- By Q1 2003: HKEx to consult the market on amendments to the Listing Rules to tighten regulation of IPO intermediaries, in particular sponsors and financial advisors. Target is implementation in H2, 2003.

- By Q1 2003: SFC to put forward proposals to the Standing Committee on Company Law Reform (SCCLR) on amendments to the Companies Ordinance to extend the prospectus-related liability to IPO sponsors, and possibly, other IPO intermediaries, for ensuring quality disclosure to investors.

- By Q3 2003: FSTB, in consultation with the Hong Kong Society of Accountants, to finalise legislative proposals to enhance the regulation of the accountancy profession.

Priority III: Effective Roll Out of the Securities and Futures Ordinance

- By 1 April 2003: SFC to formulate an effective strategy in enforcing the Securities and Futures Ordinance (SFO), in particular with regard

to execution of "dual filing", inquiries into corporate misconduct, regulation of licensed IPO sponsors, cooperation with HKEx in combating pre-IPO market manipulation, etc. SFC to adopt a case specific approach as a corporate regulator under SFO and 'dual filing'.

Priority IV: Successful completion of SCCLR Phase II Corporate Governance Review

- By Q1 2003: The Administration, SFC and HKEx to render full support to the SCCLR for completion of its Phase II Review, with SFC and HKEx putting forward further proposals to SCCLR, including amendments to the Companies Ordinance on related party transactions, shareholders' rights, disclosure requirements, liability of professional advisers relating to misstatements in listing documents etc.

Priority V: Early implementation of SCCLR Recommendations from its Phase I Corporate Governance Review

- By Q1 2003: FSTB and SFC to release a joint consultation paper on the concept to empower SFC to conduct derivative actions for minority shareholders of a listed company, including legal issues, scope and effectiveness of remedies, and possible implementation arrangements.

- By Q2 2003: FSTB to introduce to LegCo a Companies (Amendment) Bill to enhance corporate governance by implementing SCCLR Phase I recommendations relating to shareholders' remedies.

- By Q4 2003: FSTB, in consultation with the listed sector and the accountancy profession, to finalise and take forward a proposal to establish a Financial Reporting Review Panel to investigate financial statements of companies and enforce changes thereto.

Financial Services and the Treasury Bureau
13 January 2003