
CHAPTER 9

THE SIX EVENTFUL DAYS – 26TH TO 31ST JULY

MARKET RESPONSE

9.1 The Consultation Paper did not have any major impact on the market on the afternoon of the 25 July. When trading commenced at 10:00 a.m. on the 26 July (Friday), all was relatively normal until around 10:45a.m. Thereafter, for about an hour, there was a large sell-off of stocks, leading to prices tumbling. Out of the 761 stocks listed on the Main Board, 577 (or 76%) recorded a loss, 151 (or 20%) were unchanged and 33 (or 4%) made gains. Of the 370 penny stocks (i.e. stocks with closing prices at or below \$0.5 on 25 July), 283 (or 76%) recorded a loss, 75 (or 20%) had no change and 12 (or 3%) increased in price. The aggregate market capitalization for penny stocks declined by \$10.91 billion, representing about 10% of the market capitalization of that sector and 0.3% of the total market capitalization of the Main Board. Sixty-six stocks (62 of which were penny stocks) suffered a decline of 20% or more. The top loser saw a price plunge of 88%.

9.2 Chapter 10 describes in detail what happened on the 26 July and why.

THE AFTERMATH

Overview

9.3 The six days after the release of the Consultation Paper were eventful. The chronology of events is summarized below:-

Time	Event
26.7.2002	Friday
a.m.	The HKEx dispatched hard copies of the Consultation Paper; The HKEx' s reach-out programmes commenced.
a.m.	Unusual movement of stocks started at about 10:45 a.m.
p.m.	The Secretary met with the media, stressing that it was only a paper for

Time	Event
	consultation.
p.m.	The HKEx issued press statement to clarify proposals on penny stocks.
p.m.	The SFC issued a press statement.
Evening	The Secretary, after consulting the HKEx Chairman, gave a media stand-up, saying that the price threshold of \$0.5 was subject to further discussion.
27.7.2002	Saturday
Whole day	The FS discussed with the Secretary the market reaction and the need for prompt action during the CE's Retreat in a hotel in the New Territories.
a.m. and p.m.	The HKEx announced extension of the consultation period by two months to 31.10.2002 and its plan to publish a supplementary paper on the delisting proposal, first through radio programmes in the morning, then by press release in the afternoon.
p.m.	The FS asked his Administrative Assistant to arrange a meeting with the Secretary, the SFC and the HKEx to discuss the way ahead.
Late afternoon	Administrative Assistant (AA) to the Secretary requested the Principal Assistant Secretary (Securities) of the Bureau (Yan) to prepare a chronology of events for the Secretary's reference by 29.7.2002 (Mon).
28.7.2002	Sunday
lunch	The Secretary and the HKEx Chairman gave luncheon to brokers.
4:00 p.m.	Meeting among the FS, the Secretary, the SFC Chairman, Chairman and Chief Executive of the HKEx.
6:00 p.m.	Press conference by the Secretary, the SFC Chairman, the HKEx Chairman and Chief Executive, announcing the withdrawal of Part C of the Consultation Paper (delisting proposals).
29.7.2002	Monday
a.m.	In response to media enquiries, the FS mentioned that the HKEx:- <ul style="list-style-type: none"> • might not have given sufficient thought to the details of the proposal; • might have under-estimated the market reaction; and • had not notified the Bureau of the Consultation Paper prior to its

Time	Event
	release.
p.m.	The Bureau (Yan), after completing the chronology and consulting the Permanent Secretary (Miller) and the Deputy Secretary, (Au), passed the chronology to AA to the Secretary.
30.7.2002	Tuesday
	The Secretary, the Chairman and Chief Executive of the HKEx and the Chairman of the SFC met to prepare for the special meeting of the LegCo Panel on Financial Affairs.
31.7.2002	Wednesday
a.m.	Further meeting of the Secretary, the SFC Chairman, Chairman and Chief Executive of the HKEx to prepare for the special meeting of the LegCo Panel on Financial Affairs.
p.m.	The FS announced the appointment of a Panel of Inquiry on the Penny Stocks Incident.
p.m.	Special meeting of the LegCo Panel on Financial Affairs.

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Morning and Early Afternoon

9.4 After the unusual stocks movement in the morning, the HKEx and the SFC alerted the Bureau to the market reaction, and continued to monitor the movements in the market. The Secretary received a call from one of his contacts informing him of the plunge. He then got in touch with the Chief Executive of the HKEx. Afterwards, he clarified publicly that the proposals were merely proposals, that the consultation period would be until the end of August, that the proposals, even if endorsed, would only be implemented in late 2002 or early 2003, and that companies would be given a 12-month period to comply. He also reiterated that the authorities would seek the views of the market before implementing the proposals and that the measures would enhance transparency and the quality of the market. In the early afternoon, the FS was informed by his Administrative Assistant that the market had reacted strongly to the HKEx's proposals and that the Secretary had already made a clarification in the public. Later in the afternoon, the Secretary phoned the FS, updating him on the market situation.

The HKEx' s Press Statement

9.5 The HKEx issued a press statement in response to media enquiries. The statement clarified that:-

- (a) The proposals were only part of a market consultation relating to the Main Board Listing Rules.
- (b) The HKEx expected a variety of responses from market participants.
- (c) It would take a few months to formulate the rules for the implementation of any changes after the consultation.
- (d) If any rules on delisting of existing penny stocks were adopted, there would be a 12-month transitional period before implementation.

The SFC' s Press Statement

9.6 The SFC also issued a press statement to echo the HKEx' s statement:-

- (a) An effective delisting mechanism was good for the market as a whole and for the reputation of Hong Kong as an international financial centre.
- (b) The proposals were for public consultation. No decision would be made until after the consultation had been completed. There would also be a long transitional period for stocks to meet the listing requirements or for their orderly exit if necessary.
- (c) The trading volume had not been heavy. Turnover for the top 30 losers was \$84.3 million, about 1% of market turnover. One of them (Terabit Access Technology International Ltd), accounted for \$51 million. Of the 30 stocks, 22 were below 10 cents at the closing prices on 25 July 2002, and none above

25 cents. The loss of market capitalization attributable to those 30 stocks amounted to about 0.06% of the total market capitalization.

The Secretary's Media Stand-up

9.7 In a media stand-up that evening, the Secretary made another appeal to the public not to panic. Reiterating that the proposals were under consultation, he stressed that the suggested threshold of 50 cents was only a proposal subject to further discussion.

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The HKEx's Clarification and Extension of Consultation Period

9.8 The HKEx decided to extend the consultation period by two months to the 31 October 2002 to "give individuals and organizations more time to consider the proposals and submit their response and comments." The HKEx also undertook to publish a supplementary paper relating to the proposal to delist stocks priced below 50 cents. The HKEx emphasized that it was "genuinely consulting the market on the package of proposals set out in the Consultation Paper". The HKEx then provided details on how interested parties could contact them to express their views. The decision was announced first through radio programmes in the morning, then through press statements in the afternoon.

Discussion between the FS and the Secretary

9.9 During pauses in the CE's Retreat, the FS and the Secretary discussed the market reaction to the HKEx's Consultation Paper and the need for prompt action to address the anxiety in the market. In view of the public concern, the FS requested his Administrative Assistant to arrange a meeting in the afternoon of Sunday, the 28 July 2002 with the Secretary, the SFC and the HKEx to discuss the way forward.

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Luncheon with Brokers

9.10 The Secretary and the HKEx Chairman had a luncheon meeting with brokers. During the luncheon, brokers expressed concerns about not being consulted on the delisting proposals and the problems of having 50 cents as a delisting criterion for delisting. There were also worries about potential brokers' default. After the luncheon the HKEx Chairman suggested withdrawing the delisting proposals from the Consultation Paper.

Meeting at the FS' Residence

9.11 At the meeting, the HKEx Chairman said that in view of the market concern about the delisting proposals, the HKEx planned to withdraw those proposals from the Consultation Paper for the time being. It was agreed that the Secretary, the SFC Chairman, and the Chairman and Chief Executive of the HKEx would hold a press conference at 6:00 p.m. to announce the withdrawal and further explain the rationale behind the proposal to alleviate public anxiety.

Press Conference at 6:00 p.m.

9.12 The Secretary, the SFC Chairman, and the Chairman and the Chief Executive of the HKEx attended the press conference. Statements were made. Salient points of the statements made are set out below:-

- (a) **The HKEx.** The HKEx Chairman said that the market mistakenly believed that shares with a market price below 50 cents were to be delisted. They clarified that the HKEx was proposing that companies' stocks falling below 50 cents should and could address the deficiency by consolidating their shares, or by other means. To meet the concerns and clear up misconceptions, the HKEx had decided to take out the whole of Part C of the Consultation Paper (on continuing listing and delisting) for separate discussion with the market in order to strengthen the proposals. The HKEx would publish a supplementary consultation paper at the end of October and the market would be given three months to express its views.

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- (b) **The SFC.** The SFC Chairman stressed that what was proposed about delisting was for consultation only. No decision had been made. The SFC would continue to work with the HKEx on this matter. The SFC would also watch the market very closely to see if any manipulation of the market had taken place.
- (c) **The Secretary.** The Secretary re-affirmed that the Government supported the establishment of a mechanism for listing and delisting that commanded consensus. A comprehensive and sound delisting mechanism would help enhance corporate governance and improve the quality of the market. This would in turn protect investors' interests effectively. He added that the Government, the SFC and the HKEx appreciated that some people in the market had misunderstandings about the delisting mechanism proposed by the HKEx.

9.13 At the conference, the SFC Chairman was asked whether the SFC was involved in the HKEx's proposal for a 50 cents minimum share price threshold. The SFC Chairman's answer in Cantonese was that the SFC "did not discuss with the Exchange any one price". Another question brought forth a not dissimilar answer. It was only when asked for the third time that the SFC Chairman, who had been groping for his words with apparent difficulty, managed to say that "of course, a range of prices were discussed; a dollar, several tens of cents, and other prices were all discussed. But the SFC did not specify one price."

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Preparing a Chronology of Events for the Secretary

9.14 In the late afternoon of 27 July 2002 (Saturday), the Administrative Assistant to the Secretary (Miss Clara Tang) asked the Principal Assistant Secretary (Securities) (Miss Salina Yan) to prepare a chronology of what happened for the Secretary's reference by 29 July 2002 (Monday). Miss Yan went back to her office on the 28 July 2002 (Sunday) to do this task. Not knowing the purpose of the chronology, she was under the impression that it should show the broad developments since the penny

stocks issue came to the knowledge of the Bureau. Since the relevant files were not available, she was only able to put together a brief chronology of the relevant events. On the 29 July 2002 (Monday), after completing her draft, she passed it to the Deputy Secretary and Permanent Secretary for quick comments. She then sent the chronology to the AA to the Secretary. The chronology did not mention the HKEx Executive Summary which she had received on the 17 July since it was, in her view, similar to the SFC Summary Table which she had passed to the AA to the Secretary on the 17 July. This understandable omission in the chronology led to some unfortunate consequences. The Secretary thought that his Bureau never received anything from the HKEx and this was what he told the FS who repeated it before the press on the same day. This led to criticism of both the Secretary and the FS and certain extravagant and intemperate allegations of lying and bad faith.

The FS' Remarks

9.15 In responding to media enquiries on his way back to the office on 29 July 2002, the FS said that:-

- (a) the HKEx had not consulted the Bureau on the Consultation Paper before its release. He hoped that the parties concerned would improve the situation in the future.
- (b) the HKEx might not have given sufficient thought to the details of the proposal, or it might have under-estimated the market reaction. He expressed the hope that the HKEx could improve on this aspect in the future.

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Discussion between the Bureau and the Secretary

9.16 On the morning of the 30 July 2002, realizing that the HKEx's Executive Summary might be regarded as a material document in the overall shape of things and noting that the document could be confused with the SFC's Summary Table, (as it appeared to have been during the special session before the LegCo Panel on Financial Affairs on the 31 July) Miss Yan drew this to the attention of the Deputy Secretary, Miss K C Au,

and confirmed that she had received the HKEx Executive Summary (on the 17 July) at a tele-conference with the Secretary and the Deputy Secretary. It is worth a quick reminder that the Permanent Secretary, the Deputy Secretary and the Miss Yan all had their offices in Admiralty Centre, while the Secretary and his AA had offices in the Central Government Offices. The Secretary does not recall this message. He thought that he was informed the next morning. We do not think anything turns on this difference.

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Clarification

9.17 On the morning of the 31 July 2002, the Secretary convened a meeting with the SFC Chairman, the Chairman and Chief Executive of the HKEx and the Bureau to prepare for the special meeting of the LegCo Panel on Financial Services that afternoon. Before the meeting, the Deputy Secretary, Miss Au, said that there were rumours that the Bureau had obtained a copy of the Consultation Paper before its release. To clarify exactly who knew what, Miss Yan confirmed at the meeting that she had received the SFC's Summary Table on 10 July 2002 and had passed it to the Secretary's Administrative Assistant on the 17 July 2002. She had also received the HKEx's Executive Summary from the HKEx's Listing Division on the 17 July 2002 but she did not pass this on to the Secretary. It was then that the Secretary became aware that the Bureau had received a copy of the HKEx's Executive Summary and he then mentioned this to the FS afterwards.

Preparation

9.18 During the preparatory meeting, the Secretary, the SFC Chairman and the HKEx Chairman read out drafts of the statements they were to read out in the afternoon. The Chief Executive of the HKEx had a draft available, which he said was about 60% complete. The draft did not contain the detailed chronology that was in the statement he read out in the afternoon.

Special Meeting of LegCo Panel on Financial Affairs on 31 July 2002

9.19 At the Special meeting of LegCo Panel on Financial Affairs, representatives of the Government, the SFC and the HKEx attended. There were other interested parties who were invited to make representations. The Secretary, the SFC Chairman, the Chairman and the Chief Executive of the HKEx each read out their statement. During the meeting, the parties commented on their respective roles and action. Brief capsules are set out in the following paragraphs.

The Secretary

9.20 In his answers to questions from Legislative Councillors, the Secretary mentioned that:-

- (a) He “accepted a certain degree of responsibility”.
- (b) Neither the SFC Chairman nor the Chief Executive of the HKEx had called him to inform him of the details of the Consultation Papers.
- (c) If he was asked whether he would have stopped the proposals had he realized that there would be such a strong market reaction, he would definitely have said yes. We note that there was an unclear passage when the Secretary, seemingly flustered and probably somewhat frustrated, appeared to have said that had he been aware of the proposals, he would definitely have stopped them. In context, it is clear to us that he was saying that if he had been able to foresee what happened on the 26 July, he would have done something to prevent it. It is plain that the Secretary did not deny that he was aware of the Consultation Paper (though not the details) or that it was to have been published on 25 July 2002.
- (d) It only came to his attention on the 31 July 2002 that a colleague had obtained a summary table from the SFC which was passed to his office. However, he had not read the document, "since the papers and files in my office were piling up like a mountain and that I could not possibly have read every

document" (our rough translation). He was not aware that the SFC Summary Table arrived in his in-tray on the 17 July when he was about to rush out to dinner and thereafter to the airport for his trip to England. (For details, see items 115 and 174 in the chronology at [Annex 7.1](#)).

- (e) In connection with the three-tiered regulatory structure, the Secretary said repeatedly, and here we are paraphrasing, that the division of responsibility ordained by the structure meant that he did not have to know the details of any consultation proposals from the HKEx. Nor ought he to have known or found out.

9.21 Most of these assertions, although in some ways reasonable and even justifiable, if put across somewhat differently, did not go down well. The Secretary was bombarded with a series of hostile and severe criticisms to which he was unable to acquit himself with either clarity or distinction. It would have required the skills and experience of a much more seasoned bureaucrat to have come out of that barrage relatively unscathed.

The SFC Chairman

9.22 The SFC Chairman stated that “The SFC is the statutory regulator of the HKEx. If there are any errors in regulation of the HKEx, I think the Commission must be responsible, too. I personally bear responsibility. The Consultation Paper was issued by the Stock Exchange, the SFC discussed with them. So therefore, we cannot escape part responsibility in this and I said if we have done anything wrong, if any of my staff have done anything wrong, I bear full responsibility.”

Chief Executive of the HKEx

9.23 In his statement, the Chief Executive of the HKEx included a chronology on how the HKEx arrived at the 50 cents price threshold after a series of discussion with the SFC. It was pointed out that the SFC had, in the first instance, proposed \$5 and \$1 as the threshold for initial listing and consolidation. The implications and inferences drawn in the media from the Chief Executive’s statement the next few days were favourable. He was the only one to have apologized. And had it not been for the HKEx’s

insistence, the price threshold for delisting seemingly proposed by the SFC would have been \$1 which would have caused even more havoc on the 26 July. There were also later suggestions that the sequence of events referred to by the Chief Executive showed that the SFC's involvement was much more than previously understood, that its efforts to distance itself from the debate was unbecoming and that the SFC Chairman's remarks on 28 July 2002 about not having discussed any (one) price with the HKEx was shown to have been a lie.

9.24 As we have made clear in passing, we do not share these criticisms of the SFC: see paragraph 7.10. All in all, the HKEx and its Chief Executive were the only parties who had a relatively good press the next few days.