

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

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

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

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.