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# A Framework for the Delisting of Penny Stocks in Hong Kong

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# A Framework for the Delisting of Penny Stocks in Hong Kong

## **Cover Page Footnote**

International Law; Commercial Law; Law

# A Framework for the Delisting of Penny Stocks in Hong Kong

*Chee Keong Low* \*

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On July 25, 2002, the Hong Kong Exchanges and Clearing Limited published a consultation paper entitled "Proposed Amendments to the Listing Rules Relating to Initial Listing and Continuing Listing Eligibility and Cancellation of Listing Procedures" (Consultation Paper), which set out proposals for the delisting of shares in Part C, entitled "Continuing Listing Eligibility Criteria."<sup>1</sup> Although this section set out eleven broad quantitative and qualitative criteria for the delisting of shares, the focus was centered on the minimum share price criterion.<sup>2</sup> This criterion deemed the issuer in default when its share price traded below Hong Kong Dollar (HKD\$) 0.50, approximately United States Dollar (USD\$) 0.065, for more than thirty consecutive trading days.<sup>3</sup>

The following day, some HKD\$10 billion (approximately USD\$1.3 billion) was wiped off the market capitalization as investors sold off their holdings of penny stocks.<sup>4</sup> This prompted the unprecedented action of the removal of Part C of the Consultation Paper on July 28, 2002.<sup>5</sup>

This article examines the proposal to delist penny stocks. While agreeing with the general principles and objectives of the proposal, the author nonetheless finds fault with the proposed mode of implementation. This paper concludes with a proposal for an alternative framework that is more consistent with the government's aspirations to make Hong Kong the paragon of corporate governance.

## I. Introduction

The Asian financial crisis of 1997-1998 instilled an enhanced appreciation of the lagging standards of corporate governance in

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<sup>1</sup> See HONG KONG EXCHANGES & CLEARING LTD., CONSULTATION PAPER ON PROPOSED AMENDMENTS TO THE LISTING RULES RELATING TO INITIAL LISTING & CONTINUING LISTING ELIGIBILITY & CANCELLATION OF LISTING PROCEDURES (2002), available at <http://www.hkex.com.hk/consul/paper/HKEX%20Cover%20Jul.pdf>.

<sup>2</sup> *Id.* at 9-15.

<sup>3</sup> *Id.* at 9.

<sup>4</sup> ROBERT G. KOTEWALL & GORDON C.K. KWONG, GOV'T OF THE HONG KONG SPECIAL ADMIN. REGION, REPORT OF THE PANEL OF INQUIRY ON THE PENNY STOCKS INCIDENT, 109-21 (Sept. 2002), available at <http://www.info.gov.hk/info/pennystock-e.htm>.

<sup>5</sup> *Id.*

Asia.<sup>6</sup> In particular, it brought to the foreground the common occurrence of practices that allowed companies to engage in excessive over-leveraging, a number of which were aided implicitly by state guarantees.<sup>7</sup> The concepts of transparency, disclosure, and accountability were largely ignored in the lead-up to the crisis, as investors assumed a short-term outlook to derive increasing profits from the steadily rising regional financial markets.<sup>8</sup> The absence of governance was evident from the incidence of capricious decision-making, the shifting of assets within corporate groups, the undertaking of transactions without proper disclosure, and poor financial management by directors of these companies.<sup>9</sup>

The volatility of the financial markets prompted the government of the Hong Kong Special Administrative Region (HKSAR) to canvass a number of significant proposals<sup>10</sup> that were based on two fundamental principles: the maintenance of the reputation of the territory as an open and external-oriented international financial center and the preservation of the linked exchange rate system.<sup>11</sup> This subsequently led to a proposal to

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<sup>6</sup> See generally Marra Faccio et al., *Dividends and Expropriation*, 91 AM. ECON. REV. 54 (2001); Simon Johnson, et al., *Corporate Governance in the Asian Financial Crisis*, 58 J. FIN. ECON. 141 (2000).

<sup>7</sup> See generally Faccio et al., *supra* note 6; Johnson et al., *supra* note 6.

<sup>8</sup> See generally Faccio et al., *supra* note 6; Johnson et al., *supra* note 6.

<sup>9</sup> See generally Faccio et al., *supra* note 6; Johnson et al., *supra* note 6.

<sup>10</sup> See GOV'T OF THE HONG KONG SPECIAL ADMIN. REGION, REPORT ON FIN. MARKETS (1998), available at <http://www.info.gov.hk/eindex.htm>.

<sup>11</sup> *Id.* As with its American counterpart, the Hong Kong Dollar (HKD\$) is divisible into 100 cents. The linked exchange rate was introduced in October 1983 following a period of uncertainty surrounding the issue of the handover of Hong Kong by the United Kingdom to the People's Republic of China. GOV'T OF THE HONG KONG SPECIAL ADMIN. REGION, HONG KONG YEARBOOK, at <http://www.info.gov.hk/yearbook/2002/ehhtml/e04-11.htm> (last updated Aug. 21, 2004). The linked exchange rate provides for the issue and the redemption of bank notes at the fixed exchange rate of HKD\$7.80 to USD\$1, hence the use of the term "dollar peg" or "linked exchange rate." See generally Rajanet al., *Choice of Exchange Rate Regime: Currency Board (Hong Kong) or Monitoring Band (Singapore)?*, 41 AUST. ECON. PAPERS 538-56 (2002) (considering and contrasting the economies of Hong Kong and Singapore), at <http://www.ips.org.sg/pub/wp12.pdf>. This system is entirely market-driven with any expansion or contraction in the monetary base of the domestic currency, namely the Hong Kong Dollar, resulting in an automatic decrease or increase in the interest rate respectively. *Id.*

consolidate the structure of the capital markets in the HKSAR, which at that time was comprised of two member-owned, or mutualized, exchanges and three clearing houses.<sup>12</sup>

The members of both the Stock Exchange of Hong Kong Limited and the Hong Kong Futures Exchange Limited facilitated this move by voting overwhelmingly in favor of demutualizing and merging their exchanges and clearing houses in September 1999.<sup>13</sup> A new entity, the Hong Kong Exchanges and Clearing Limited (HKEx), was incorporated to allow the members of the stock and futures exchanges to either swap their existing shares for those of the HKEx or, alternatively, to receive a cash payment as consideration.<sup>14</sup> The latter thus became a holding company whose subsidiaries included the stock and futures exchanges as well as their clearing houses.<sup>15</sup> With the demutualization, trading rights were separated from ownership so that the holding of shares in the HKEx was no longer a prerequisite for trading on either the stock or futures exchange.<sup>16</sup> The HKEx subsequently became only the third exchange in the world to be publicly listed when its shares commenced trading on the Stock Exchange of Hong Kong in June 2000.<sup>17</sup>

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<sup>12</sup> FIN. SERVICES BUREAU, HONG KONG EXCHANGES & CLEARING LTD.: REINFORCING HONG KONG'S POSITION AS A GLOBAL FIN. CENTRE (1999) (policy paper written by the Financial Services Bureau of the Government of the Hong Kong Special Administrative Region), at <http://www.info.gov.hk/fstb/fsb/topical/doc/report-e.doc>.

<sup>13</sup> See CHEE KEONG LOW, FIN. MARKETS IN HONG KONG 46-51 (2000) for an overview of the Stock Exchange of Hong Kong Limited and the Hong Kong Futures Exchange Limited.

<sup>14</sup> *Id.*

<sup>15</sup> *Id.*

<sup>16</sup> *Id.*

<sup>17</sup> See *id.* at 51-67 (commentary on the Hong Kong Exchanges and Clearing Limited). See generally HONG KONG EXCHANGES & CLEARING LTD., at <http://www.hkex.com.hk> (last visited Sept. 24, 2004) (providing general information about the Hong Kong Exchanges and Clearing Limited). The Stockholm Exchange in Sweden was demutualized in 1992 and subsequently acquired by the OMX Group, a publicly listed company, in 1997, while the Australian Stock Exchange, the Singapore Exchanges, and the London Stock Exchange were listed on their own exchanges in 1998, 2000, and 2001 respectively. For a historical overview of these exchanges, see OMX, at [www.omxgroup.com](http://www.omxgroup.com) (last visited Oct. 10, 2004) (owns and operates the largest integrated securities market in Northern Europe and is a provider of marketplace services and solutions for the financial and energy markets); Australian Stock Exchange, at [www.asx.com.au/shareholder/13/asxoverview\\_as3.shtm](http://www.asx.com.au/shareholder/13/asxoverview_as3.shtm) (last visited Oct. 10, 2004);

The foregoing arrangement was deemed necessary to ensure that the HKEx would have no controlling shareholder when it became a public listed company, though it was still significantly controlled by the government of the HKSAR.<sup>18</sup> Although the government does not hold any shares in the HKEx, it nonetheless retains effective control of the fifteen-member board of directors through the appointment of no more than eight “Public Interest Directors” by the Financial Secretary.<sup>19</sup>

## II. The Regulatory Framework in the HKSAR

The HKSAR adopted a three-tiered system of regulation of financial markets in which functions are defined as “macro policy,” “watchdog,” and “operational.”<sup>20</sup> Under the new ministerial system of government, adopted on July 1, 2002, responsibility for the regulation of the banking and securities industries and oversight of the governance of companies, provident funds as well as the insurance sector, falls within the purview of the Secretary for Financial Services and the Treasury.<sup>21</sup>

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[http://info.sgx/SGXWeb\\_CORPCOM.nsf/newDOCNAME/Background\\_On\\_SGX](http://info.sgx/SGXWeb_CORPCOM.nsf/newDOCNAME/Background_On_SGX;);  
London Stock Exchange: Our History, at <http://www.londonstockexchange.com/en-gb/about/cooverview/history.htm> (last visited Sept. 24, 2004).

<sup>18</sup> See GOV'T OF THE HONG KONG SPECIAL ADMIN. REGION, SECURITIES & FUTURES ORDINANCE § 77 (Mar. 13, 2002), available at [http://www.justice.gov.hk/blis\\_ind.nsf/CurAllEngDoc?OpenView&Start=568&Count=30&Expand=568#568](http://www.justice.gov.hk/blis_ind.nsf/CurAllEngDoc?OpenView&Start=568&Count=30&Expand=568#568) [hereinafter SECURITIES & FUTURES ORDINANCE]. HONG KONG EXCHANGES & CLEARING LTD., Articles of Association of the HKEx, Art. 90, available at <http://www.hkex.com.hk>. (last visited Sept. 24, 2004).

<sup>19</sup> See SECURITIES & FUTURES ORDINANCE, *supra* note 18. A high degree of government control was deemed necessary to both protect the integrity as well as to facilitate the further development of its financial markets, the latter of which is enshrined in Article 109 of the Basic Law of the HKSAR. See GOV'T OF THE HONG KONG SPECIAL ADMIN. REGION, HONG KONG: THE FACTS - THE BASIC LAW, available at <http://www.info.gov.hk/hkfacts/baslaw.pdf> (last visited Sept. 24, 2004).

<sup>20</sup> See KOTEWALL & KWONG, *supra* note 4, at 13-33.

<sup>21</sup> See CHIEF EXECUTIVE CHEE WAH TUNG, GOV'T OF THE HONG KONG SPECIAL ADMIN. REGION, RESPONSIBILITIES OF THE FIN. SECRETARY & THE SECRETARY FOR THE FIN. SERVICES & THE TREASURY (H.K.) (2003), at [http://www.info.gov.hk/fso/pdf/fs-sfst\\_e.pdf](http://www.info.gov.hk/fso/pdf/fs-sfst_e.pdf). In response to the uncertainties that arose during the penny stock debacle of July 2002 and to minimize the degree of overlap, the responsibilities of the Financial Secretary and the Secretary for Financial Services and the Treasury have been delineated since June 2003. See *id.* The Honorable Tung Chee Wah, Chief Executive (CE) of the HKSAR, sought to establish a scheme of governance whereby three principal senior officials, namely the Chief Secretary, the Financial Secretary, and the Secretary for

Sitting at the apex of the regulatory regime, the Secretary is entrusted with the responsibility of formulating and implementing such policies as are necessary to enhance the standing of the HKSAR as an international financial center.<sup>22</sup>

The Securities and Futures Commission (SFC) occupies the next highest tier.<sup>23</sup> Pursuant to section three of the Securities and Futures Ordinance, the SFC is an independent statutory body responsible not only for administering the laws governing the securities and futures markets in the HKSAR, but also for facilitating and encouraging the development of these markets.<sup>24</sup> The policy-making body of the SFC is comprised of a Chairman and seven other directors, all of whom are appointed for fixed terms by the Chief Executive of the HKSAR.<sup>25</sup> The composition

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Justice, and eleven ministers with policy portfolios are appointed to sit on the Executive Council. The quasi-cabinet of the HKSAR, together with five other members without portfolios, collectively advises the CE on policy regarding the spectrum of public administration. See generally AUSTRALIAN GOV'T DEPT., HONG KONG COUNTRY – BRIEF OF FOREIGN AFFAIRS & TRADE (2004), at [http://www.dfat.gov.au/geo/hong\\_kong/hong\\_kong\\_brief.html](http://www.dfat.gov.au/geo/hong_kong/hong_kong_brief.html). This scheme is designed to enhance accountability, albeit singularly to the CE rather than to serve the public. *Id.* Nevertheless, public pressure over the perceived performance of some senior officials has led to the resignation of three ministers, namely the Financial Secretary and the Secretary for Security in July 2003 and the Secretary for Health, Welfare and Food a year later. See Press Release, HKSAR Government Information Center, Chief Executive Accepts Resignations of Two Principal Officials, HKSAR Government Information Center (July 16, 2003), at <http://www.info.gov.hk/gia/general/brandhk/0716253.htm>; Press Release, HKSAR Government Information Center, Statement by Permanent Secretary for Health, Welfare and Food (July 7, 2004), at <http://www.info.gov.hk/gia/general/200407/0707356.htm>.

<sup>22</sup> See TUNG, *supra* note 21; KOTEWALL & KWONG, *supra* note 4, at 24 (describing the responsibilities of the Secretary for Financial Services).

<sup>23</sup> Introducing the Securities and Futures Commission, at [http://www.hksfc.org.hk/eng/press\\_releases/html/publications/intro\\_sfc.pdf](http://www.hksfc.org.hk/eng/press_releases/html/publications/intro_sfc.pdf) (last visited Sept. 15, 2004). See also KOTEWALL & KWONG, *supra* note 4, at 19-21 (describing the functions of the Hong Kong Securities and Futures Commission).

<sup>24</sup> KOTEWALL & KWONG, *supra* note 4, at 19-21 (describing the functions of the Hong Kong Securities and Futures Commission). See also Introducing the Securities and Futures Commission, *supra* note 23 (explaining the organization of the Securities and Futures Commission).

<sup>25</sup> See SECURITIES & FUTURES ORDINANCE (SFO), *supra* note 18. The number of directors must not be less than eight with the majority being non-executive directors. *Id.* The Legislative Council of Hong Kong passed the SFO on March 13, 2002 to consolidate eleven securities and futures related ordinances to provide for a more streamlined system of regulation with appropriate levels of sanctions. *Id.* The ordinance



of the board is divided equally between executive and non-executive directors, with the Chairman being amongst the former.<sup>26</sup> The principal functions of the SFC include the maintenance of market integrity, the enforcement of the relevant ordinances and subsidiary legislation, the protection of investors, and the enhancement of the reputation of the financial markets of the HKSAR.<sup>27</sup> The SFC is bound by a set of statutory regulatory objectives which are as follows:<sup>28</sup>

- to maintain and promote the fairness, efficiency, competitiveness, transparency, and orderliness of the securities and futures industry;
- to promote understanding by the public of the operation and functioning of the securities and futures industry;
- to provide protection for members of the public investing in or holding financial products;
- to minimize crime and misconduct in the securities and futures industry;
- to reduce systemic risks in the securities and futures industry; and
- to assist the Financial Secretary in maintaining the financial stability of Hong Kong by taking appropriate steps in relation to the securities and futures industry.<sup>29</sup>

At the front-line is the HKEx, whose responsibility encompasses the operational administration of the “Rules Governing the Listing of Securities on the Stock Exchange of

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was gazetted on March 28, 2002 and became fully operative as of April 1, 2003 following the enactment of the requisite subsidiary legislation. *Id.*

<sup>26</sup> See Introducing the Securities and Futures Commission, *supra* note 23 (explaining the organization of the Securities and Futures Commission); KOTEWALL & KWONG, *supra* note 4, at 25 (describing the composition of the Securities and Futures Commission statutory body).

<sup>27</sup> See Introducing the Securities and Futures Exchange, *supra* note 23 (listing the functions of the Securities and Futures Commission).

<sup>28</sup> SECURITIES & FUTURES ORDINANCE, *supra* note 18, § 4. The powers of the SFC are extensive if they are exercised in the carrying out of its functions as it is empowered to “perform any function conferred by or under any other Ordinance” with the rubric of securities regulation. *Id.* §§ 3 & 5.

<sup>29</sup> See HONG KONG EXCHANGES & CLEARING LTD., REGULATORY FRAMEWORK & RULES, at <http://www.hkex.com.hk> (last visited Sept. 15, 2004).

Hong Kong” (Listing Rules).<sup>30</sup> They set out the contractual obligations that are imposed upon the stock exchange, the issuers, and their advisers for the seeking and maintenance of listings on the Stock Exchange of Hong Kong (SEHK).<sup>31</sup> To enhance regulatory efficiency through the minimization of overlaps, the HKEx signed a number of memoranda of understanding with the SFC to define their respective roles and functions.<sup>32</sup> The SFC retains the responsibility for detecting market misconduct with statutory implications and for the prudential regulation of the members of the stock and futures exchanges.<sup>33</sup> The HKEx maintains surveillance over trading operations and risk

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<sup>30</sup> See HONG KONG EXCHANGES & CLEARING LTD., RULES GOVERNING THE LISTING OF SECURITIES ON THE GROWTH ENTERPRISE MARKET OF THE HONG KONG EXCHANGES & CLEARING LTD., at [http://www.hkgem.com/listingrules/e\\_default.htm](http://www.hkgem.com/listingrules/e_default.htm) (last visited Oct. 10, 2004) (for rules that apply to issues seeking a listing on the Growth Enterprise Market (GEM)) [hereinafter LISTING RULES]. The GEM is sometimes conveniently referred to as the “Second Board” by commentators from within the region. See e.g., Foster Wong, *More GEM Firms Likely to Jump*, THE ST&ARD (Apr. 12, 2004) (referring to the GEM as the “second board”) available at [http://www.thestandard.com.hk/news\\_detail\\_frame.cfm?articleid=46633&intcatid=1](http://www.thestandard.com.hk/news_detail_frame.cfm?articleid=46633&intcatid=1). This is because of its objective of providing an alternative listing mechanism for companies that do not meet the stricter quantitative and/or qualitative requirements for a listing on the Main Board. See generally Growth Enterprise Market (for further information the GEM), at <http://www.hkgem.com> (last visited Sept. 24, 2004). The scope of this article will focus exclusively on the Main Board and its Listing Rules.

<sup>31</sup> SECURITIES & FUTURES ORDINANCE, *supra* note 18, § 27. Section 27 of the SFO provides the SEHK with “the exclusive right to establish, operate and maintain a stock market in Hong Kong.” *Id.* This has since been incorporated into Part 1, Schedule 1 of the SFO. *Id.*

<sup>32</sup> HONG KONG EXCHANGES & CLEARING LTD., MEMORANDUM OF UNDERSTANDING GOVERNING LISTING MATTERS BETWEEN SECURITIES & FUTURE COMM’N & THE STOCK EXCHANGE OF HONG KONG LTD. (2003), available at <http://www.hkex.com.hk/regdoc/regdoc.htm> [hereinafter LISTING MATTERS] (providing full details and copies of memoranda signed between the parties relating to the governance of list matters, SFC oversight, supervision of exchange participants, and market surveillance).

<sup>33</sup> See *id.* Although demutualized, the members of the stock and futures exchanges as of the date of the establishment of the HKEx had their trading rights in the respective markets “grandfathered” to ensure continuity and to minimize disruptions that may have arisen as a consequence of the merger. The maintenance of these rights is subject to the continued meeting of the licensing requirements of the SFC as well as any further conditions that may be imposed by the SFC and/or HKEx. See HONG KONG EXCHANGES & CLEARING LTD., STOCK EXCHANGE TRADING RIGHTS, at [www.hkex.com.hk/rule/exrule/chap-3a\\_eng.doc](http://www.hkex.com.hk/rule/exrule/chap-3a_eng.doc) (last visited Oct. 10, 2004).

management areas where it has a comparative advantage as a business-oriented commercial organization.<sup>34</sup>

As a for-profit company, the HKEx is duty-bound to maximize profits for its shareholders.<sup>35</sup> Its revenue is principally derived from the initial and annual listing fees, the trading levy imposed on securities and futures transactions, as well as any interest income that may be derived.<sup>36</sup> To avoid any conflicts of interest, the SFC is responsible for all matters associated with the continued listing of the HKEx on the SEHK.<sup>37</sup> In short, the SFC assumes the supervision of issues that would normally have been dealt with by the relevant divisions of the exchange insofar as these pertain to the listing status of the HKEx.<sup>38</sup> This arrangement allows the SFC to assume a broader, more active role as the principal regulator, especially since it is perceived to be more impartial than the HKEx when it pertains to matters which conflict with the business interests of the latter.<sup>39</sup>

Although the system of regulating financial markets is ostensibly three-tiered, it is nonetheless evident that the government of the HKSAR retains a significant degree of control.<sup>40</sup> Apart from setting the macro policies through the Secretary for Financial Services and the Treasury, the Chief Executive of the HKSAR also appoints all the directors of the SFC.<sup>41</sup> Additionally, it approves of the “public interest” directors who, by their number, effectively control the board of the HKEx.<sup>42</sup>

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<sup>34</sup> See KOTEWALL & KWONG, *supra* note 4, at 15-28.

<sup>35</sup> See generally LISTING MATTERS, *supra* note 32 (describing respective roles and responsibilities of the SFC, SEHK, and the HKEx).

<sup>36</sup> See KOTEWALL & KWONG, *supra* note 4, at 15-28.

<sup>37</sup> *Id.*

<sup>38</sup> See HONG KONG EXCHANGES & CLEARING LTD., MEMOR&UM OF UNDERST&ING FOR THE LISTING OF HONG KONG EXCHANGES & CLEARING LTD. ON THE STOCK EXCHANGE OF HONG KONG (Aug. 22, 2001), available at [http://www.hkex.com/regdoc/regdoc/mou/MOU%20\(New\)%20final\\_21-8-01\\_conformed%20copy.doc](http://www.hkex.com/regdoc/regdoc/mou/MOU%20(New)%20final_21-8-01_conformed%20copy.doc) [hereinafter LISTING OF HONG KONG EXCHANGES].

<sup>39</sup> See generally *id.* (describing the roles and responsibilities of the SFC). See also KOTEWALL & KWONG, *supra* note 4, at 15-28 (describing the respective roles of the government and the SFC in regard to the Hong Kong Exchange).

<sup>40</sup> See KOTEWALL & KWONG, *supra* note 4, at 15-28.

<sup>41</sup> *Id.*

<sup>42</sup> *Id.*

While the government has professed to adopt a hands-off approach to market regulation, the existing arrangement has nonetheless been criticized for allowing for a departure from the stated norm.<sup>43</sup>

### III. The Penny Stock Debate: Issues and Chronology

On July 25, 2002, the SFC held a press conference to release the principal findings of its research paper titled "Quality of Markets and the Case for More Effective Delisting Mechanism."<sup>44</sup> The key findings are summarized as follows:

- Although the SEHK is the tenth largest in the world, as measured in terms of market capitalization at the end of 2001, it nonetheless does not enjoy the same status when assessed by valuation, weighing in world portfolio investments and liquidity.<sup>45</sup>
- At the end of 2001, the weighted average price/earning ratio for the thirty-three constituent companies on the Hang Seng Index was fifteen. This lags significantly behind its blue chip counterparts in London (thirty-four), New York (thirty) and Australia (twenty-four).<sup>46</sup>
- The SEHK has a high incidence of stocks with low nominal values.<sup>47</sup> Twelve percent of its companies on the Main

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<sup>43</sup> See Byron S. J. Weng, *Recovery Will Come, But Only Slowly*, HONG KONG UPDATE (Dec. 1998-Jan. 1999), available at [www.csis.org/asia/hkupdate/hk14weng.html](http://www.csis.org/asia/hkupdate/hk14weng.html). An example of this is the unprecedented intervention in the stock and futures markets over a two-week period starting August 14, 1998 and culminating with the government purchasing more than HKD\$118 billion or about USD\$15 billion worth of shares that were the constituents of the benchmark Hang Seng Index. *Id.* While this intervention brought about significant losses to speculators who attempted to capitalize on the uncertainties in the financial markets during the East Asian financial crisis, it was achieved at the cost of putting a dent on the reputation of the HKSAR as a free economy that promotes a policy of positive non-intervention. *Id.*

<sup>44</sup> See Press Release, Securities and Futures Commission, Research Paper on Quality of Market and the Case for More Effective Delisting Mechanism (July 25, 2002), available at [http://www.hksf.org.hk/eng/press\\_releases/html/press\\_release/02/02pr149.htm](http://www.hksf.org.hk/eng/press_releases/html/press_release/02/02pr149.htm). Although co-authored by staff of the Corporate Finance Division and the Research Department of the SFC, the research paper expressly states that the findings therein do "not necessarily represent the views of the Securities and Futures Commission." *Id.*

<sup>45</sup> CORPORATE FINANCE DIV. & RESEARCH DEPT., SECURITIES & FUTURE COMM'N, QUALITY OF MARKET & THE CASE FOR MORE EFFECTIVE DELISTING MECHANISM, SFC QUARTERLY BULLETIN, at 21-32 (2002), available at <http://www.hksf.org.hk>.

<sup>46</sup> *Id.* at 21.

<sup>47</sup> *Id.* The ratio of the turnover velocity to the market capitalization is the lowest of

Board were capitalized at less than HKD\$100 million, or USD\$13 million,<sup>48</sup> which would not have qualified them for an initial listing.<sup>49</sup> In addition, approximately eight of every ten of such companies incurred losses.<sup>50</sup>

- There were 107 penny stocks as of May 31, 2002, defined in the research paper as shares which trade at or below HKD10 cents or about USD1.3 cents.<sup>51</sup>

The prevalence of penny stocks was viewed as being inconsistent with international standards and gave rise to three main policy implications.<sup>52</sup> First, the pricing mechanism of the trading system works less efficiently for penny stocks compared to those with higher prices.<sup>53</sup> This provides opportunities for market manipulation as a few transactions would usually suffice to cause substantial fluctuations in the price of these securities.<sup>54</sup> Second, the absence of an effective delisting mechanism deprives stockholders of an orderly exit option with which to cash in their investments.<sup>55</sup> Third, an accumulation of a large number of underperforming penny stocks is perceived to reflect poorly upon the standing and reputation of an exchange.<sup>56</sup> This may, in turn, lead to an avoidance of the exchange by otherwise suitable listing

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all major markets studied. *Id.* In fact, the “relatively low turnover velocity and the low weighting in the MSCI index correlate to the low free float of Hong Kong stocks.” *Id.*

<sup>48</sup> *Id.* at 22. While this requirement is relatively low compared with the requirement for applicants seeking a listing on the New York Stock Exchange (USD\$60 million) or on the Nasdaq SmallCap (USD\$50 million), it is nonetheless significantly higher than the minimum required by the Australian Stock Exchange (A\$10 million or about USD\$7.3 million) and the London Stock Exchange (GBP700,000 or about USD\$1.2 million). See New York Stock Exchange, at <http://www.nyse.com> (last visited Oct. 10, 2004); Australian Stock Exchange, at [http://www.asx.com.au/shareholder/13/asxoverview\\_as3.shtm](http://www.asx.com.au/shareholder/13/asxoverview_as3.shtm) (last visited Oct. 10, 2004), [http://info.sgx/SGXWeb\\_CORP.COM.nsf/newDOCNAME/Background\\_On\\_SGX](http://info.sgx/SGXWeb_CORP.COM.nsf/newDOCNAME/Background_On_SGX); London Stock Exchange: Our History, at <http://www.londonstockexchange.com/en-gb/about/cooverview/history.htm> (last visited Sept. 24, 2004).

<sup>49</sup> CORPORATE FINANCE DIV. & RESEARCH DEPT., *supra* note 45, at 22.

<sup>50</sup> *Id.*

<sup>51</sup> *Id.*

<sup>52</sup> *Id.*

<sup>53</sup> *Id.* at 24.

<sup>54</sup> *Id.*

<sup>55</sup> *Id.* at 27.

<sup>56</sup> *Id.*

candidates and, in the long term, affect the liquidity of the market.

Later that day, the HKEx published the Consultation Paper,<sup>57</sup> and the media focused immediately and almost exclusively on Part C, which sought to cancel the listing of securities that were traded on the Main Board of the SEHK if they failed to meet specified criteria.<sup>58</sup> Although eleven broad quantitative and qualitative criteria were specified, the minimum share price criterion was highlighted.<sup>59</sup> This provision deemed the issuer in default when its share price trades below HKD\$0.50, or about USD\$0.065, for more than thirty trading days.<sup>60</sup> Such a determination could lead to the delisting of the shares unless specified remedial actions, including the consolidation of shares or reverse stock-splits, are taken.<sup>61</sup>

The proximity of the release of the two documents gave rise to the presumption of an agenda to remove penny stocks from the Hong Kong markets.<sup>62</sup> It is reasonably safe to assume that the reasons differ between the SFC and the HKEx. The SFC has always professed its aspiration to make the regulation of capital markets in the HKSAR on par with international standards.<sup>63</sup> Nevertheless, with the introduction of the more politically inclined ministerial system of governance, it is not unreasonable to infer that the release of the research report by the SFC may have been expedited at the express or implied instigation of the Financial Secretary and/or the Secretary for Financial Services and the

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<sup>57</sup> HONG KONG EXCHANGES & CLEARING LTD., *supra* note 1.

<sup>58</sup> *Id.* at 73-100.

<sup>59</sup> *Id.*

<sup>60</sup> *Id.* at 83-84.

<sup>61</sup> *Id.* See *infra* Part IV.

<sup>62</sup> See Chairman Charles Lee, Remarks at the Government Press Conference on Market Consultation Relating to Listing Eligibility (July 28, 2002), *available at* <http://www.hkex.com.hk/news/hkexnews/020728news.htm>; HONG KONG EXCHANGES & CLEARING LTD., REPORT ON MODIFIED STRUCTURES FOR LISTING MATTERS (July 24, 2002), *available at* <http://www.hkex.com.hk/news/hkexnews/020724news.htm> [hereinafter Modified Structures for Listing Matters].

<sup>63</sup> See, e.g., Press Release, Hong Kong Economic and Trade Office, Hong Kong to Implement Securities and Futures Ordinance On April 1, (Mar. 31, 2003), *available at* [http://www.hongkong.org/press/ny\\_033103.htm](http://www.hongkong.org/press/ny_033103.htm) (statement by Secretary for Financial Services and Treasury, Frederick Ma, that the SFO will strengthen and enhance Hong Kong's status as an international financial center).

Treasury.<sup>64</sup>

The interest of the HKEx is likely to have been consistent with its objectives as a for-profit company. Its role as a front-line market regulator is, at least in the short-term, a cost center with minimal, if any, immediate financial returns.<sup>65</sup> This is especially true with the regulation of penny stocks since the corporate transactions that they undertake are usually large relative to their size, which necessitates various levels of approvals to ensure that the interests of shareholders are protected.<sup>66</sup> It is also not uncommon for these companies to run into financial difficulty that requires the undertaking of corporate restructuring.<sup>67</sup> This increases the cost of regulation because corporate restructuring involves voluminous documentation from proposal through implementation.<sup>68</sup> In this context, it is more cost effective for the HKEx to delist penny stocks given the direct implications for its profitability as a listed entity.<sup>69</sup>

It is often said that a week is a long time in politics.<sup>70</sup> The

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<sup>64</sup> *Id.* See Lee, *supra* note 62. At a press conference on July 24, 2002, the Secretary for Financial Services and the Treasury announced that he had jointly reviewed the new listing regime with the SFC and the HKEx. REPORT ON MODIFIED STRUCTURES FOR LISTING MATTERS, *supra* note 62. He also informed the media that the “HKEx will shortly conduct a public consultation on a proposed framework for continued listing and delisting arrangements.” *Id.* This appeared to conflict with the subsequent assertion by the Financial Secretary, on July 28, 2002, that the HKEx had not consulted the government on the issue although, at that time, government appointees comprised the majority of the board of directors of the HKEx. Lee, *supra* note 62. To deny any knowledge, whether actual or implied, under the circumstances would suggest the total absence of oversight and would, in turn, run against the fundamental concept of accountability.

<sup>65</sup> See David Webb, *The Delisting Fiasco*, WEBB-SITE.COM (2002) at <http://www.webb-site.com/articles/delisting.htm> (last visited Oct. 10, 2004); David Webb, *PIPSI Submission*, WEBB-SITE.COM (2002) at <http://www.webb-site.com/articles/pipsi.htm> (last visited Oct. 10, 2004).

<sup>66</sup> See Webb, *The Delisting Fiasco*, *supra* note 65; Webb, *PIPSI Submission*, *supra* note 65.

<sup>67</sup> See Webb, *The Delisting Fiasco*, *supra* note 65; Webb, *PIPSI Submission*, *supra* note 65.

<sup>68</sup> See Webb, *The Delisting Fiasco*, *supra* note 65; Webb, *PIPSI Submission*, *supra* note 65.

<sup>69</sup> See Webb, *The Delisting Fiasco*, *supra* note 65; Webb, *PIPSI Submission*, *supra* note 65.

<sup>70</sup> This quote is credited to Sir Harold Wilson, the former Prime Minister of the

adage may also hold true for financial markets in the HKSAR as is made evident from the following chronology of events sparked by the release of the Consultation Paper by the HKEx:<sup>71</sup>

- July 26 The share prices of the penny stocks collapse with an estimated HKD\$10 billion, or approximately USD\$1.3 billion, wiped off the market capitalization of the SEHK. The prices of individual shares dropped by as much as 88% from their previous close as investors rushed to dump their penny stock holdings.<sup>72</sup>
- July 27 Following a clarification a day earlier, the HKEx announces an extension of the proposed consultation period from August 31, 2002 to October 31, 2002.<sup>73</sup>
- July 28 The Chairman of the HKEx announces the withdrawal of the delisting proposals following a series of meetings with the Secretary for Financial Services and the Treasury, the Chairman of the SFC, and market participants.<sup>74</sup> A new set of proposals is planned to be published in its place at the end of October 2002.<sup>75</sup>
- July 29 In the wake of persistent public outcry, the aforementioned individuals are summoned by the Financial Affairs Panel of the Legislative Council of the HKSAR<sup>76</sup> to a meeting on July 31 to explain their

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United Kingdom. *See, e.g.*, Arik Hesseldahl, Best Politics Blogs, Forbes.com, Feb. 12, 2004, at [http://www.forbes.com/business/2004/02/12/cx\\_ah\\_0212politicsblogs.html](http://www.forbes.com/business/2004/02/12/cx_ah_0212politicsblogs.html)

<sup>71</sup> KOTEWALL & KWONG, *supra* note 4, at 100-22.

<sup>72</sup> *Id.* at 102. The prices of more than 220 stocks, representing almost a third of all companies listed on the Main Board of the SEHK, fell by a minimum of 5% on the day in question. *Id.*

<sup>73</sup> *Id.* at 104.

<sup>74</sup> *Id.* at 105. The announcement is unprecedented because it was made on a Sunday. Allegedly, the haste was necessitated by the potential for a run on a number of brokerages that had engaged in margin lending. KOTEWALL & KWONG, *supra* note 4, at 121. The collapse of the prices of the penny stocks exposed these brokerages to potentially significant financial difficulties especially if the securities continued on their downward trend. *Id.* This could have the effect of disrupting the orderly settlement of trades and consequently affect the confidence of investors. *Id.*

<sup>75</sup> *See* Lee, *supra* note 62.

<sup>76</sup> *See* HONG KONG SPECIAL ADMIN. REGION OF THE PEOPLE'S REPUBLIC OF CHINA, LEGISLATIVE COUNCIL TODAY (2004), available at <http://www.legco.gov/hk/english/index.htm>. The Legislative Council of the HKSAR, or LegCo, has



- respective roles in the “penny stocks crash.”<sup>77</sup> The prices of penny stocks improve but generally fail to fully recover to their levels prior to the release of the Consultation Paper by the HKEx as uncertainty persists.<sup>78</sup>
- July 30 The SFC launches an investigation into the penny stock crash to determine whether market manipulation was the cause.<sup>79</sup> Particular emphasis is directed at allegations that some brokers had colluded to engineer the plunge in the prices of penny stocks to exploit the uncertainties surrounding the issue and create panic selling amongst investors.<sup>80</sup>
- July 31 Preempting the call for the establishment of an official Commission of Inquiry, the Financial Secretary exercises his administrative prerogative to establish a two-man Panel of Inquiry into the Penny Stock Incident.<sup>81</sup> Although definitive answers proved elusive

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responsibility for enacting legislation, controlling public expenditure, and monitoring of government by putting forward questions of public interest. *Id.* It holds two major debates in each legislative session focused on the government policies as announced in the annual Policy Address by the Chief Executive of the HKSAR as well as on the annual Appropriation Bill that is tabled by the Financial Secretary in his Budget Speech. *Id.* The LegCo is currently comprised of sixty members, thirty of whom are directly elected from geographical constituencies under a proportional system of representation which covers the whole territory of the HKSAR. *Id.* The remaining thirty are elected by the functional constituencies that have much narrower voter bases, some of which number less than 100 electors. *Id.* See, for example, [http://www.civic-exchange.org/n\\_pub\\_cont\\_04.htm](http://www.civic-exchange.org/n_pub_cont_04.htm) for some discussion on various aspects of the electoral system in Hong Kong and <http://www.info.gov.hk/cab/cab-review/eng/index.html> for updates on the progress of constitutional development in Hong Kong.

<sup>77</sup> KOTEWALL & KWONG, *supra* note 4, at 106-07.

<sup>78</sup> *Id.* at 106-07.

<sup>79</sup> *Id.* at 107.

<sup>80</sup> *Id.*

<sup>81</sup> See *How Events Unfold*, S. CHINA MORNING POST (Hong Kong), Sept. 11, 2002, at N4; see also *At the Crossroads*, S. CHINA MORNING POST (Hong Kong), Nov. 8, 2002, at S1 (discussing the two-man inquiry created to investigate the penny stock crash). The terms of reference for the Panel of Inquiry included a review of the arrangements for the preparation and release of the Consultation Paper. See KOTEWALL & KWONG, *supra* note 4. The Panel of Inquiry had no real power at law to call for evidence or to protect those who provide evidence, and its establishment raised conflicts of interest, given that the actions and/or omissions of the Financial Secretary may itself be a subject of the inquiry. Webb, *The Delisting Fiasco*, *supra* note 65; Webb, *PIPSI Submission*, *supra* note 65.

at times, the Financial Services Panel<sup>82</sup> of the Legislative Council subjects the Secretary for Financial Services and the Treasury,<sup>83</sup> the Chairman of the SFC, and the Chairman and Chief Executive of the HKEx to intense questioning.<sup>84</sup> The various officials extend their apologies for “underestimating” the market reaction to the delisting proposals.<sup>85</sup>

August 1 As the Chief Executive expresses his support for the Panel of Inquiry,<sup>86</sup> public pressure grows for the Chairman of the SFC and the Chief Executive of the HKEx to resign from their respective roles in the handling of the penny stock issue.<sup>87</sup> Victims of the penny stock crash announce their intention to initiate legal action against regulatory bodies for compensation

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Despite these reservations, it is to the credit of its authors, Robert Kotewall and Gordon Kwong, that the report was reasonably well received.

<sup>82</sup> See Enoch Yiu, *Legislators Inviting Comments on Penny Stocks*, S. CHINA MORNING POST (Hong Kong), Oct. 17, 2002, at B2. The Financial Affairs Panel is one of the eighteen committees established by the LegCo to monitor and examine government policies and issues of public interest. *Id.* The panel may invite any person to provide information on the matters being examined and may summarize its findings as well as make recommendations to the House Committee which may, if necessary, table it at a council sitting. *Id.*

<sup>83</sup> At the meeting, the Secretary for Financial Services and the Treasury insisted that he did not know of the details of the delisting proposals nor did he need to know the nitty-gritty details of the same. See Ambrose Leung, *Ministerial System Has Been Beset by Scandals of All Scales*, S. CHINA MORNING POST (Hong Kong), June 30, 2003, at N4. Nonetheless, he agreed that he bore a certain degree of responsibility, although no one had complained about the delisting proposals being too harsh before their release. See Jimmy Cheung, *Minister Bows To the Pressure; Financial Services Chief Apologizes for Penny Stocks Controversy But Critics Are Far from Happy*, S. CHINA MORNING POST (Hong Kong), Sept. 12, 2002, at N6.

<sup>84</sup> See *At the Crossroads*, *supra* note 81.

<sup>85</sup> See *How Events Unfolded*, *supra* note 81.

<sup>86</sup> See Enoch Yiu, *Stock Exchange Chief Says He Will Stand Down Next April; Kwong Ki-chi's Move Ends Speculation which Followed the Penny Stocks Fiasco*, S. CHINA MORNING POST (Hong Kong), Nov. 14, 2002, at N1. The Chief Executive declined to initiate a statutory investigation under the “Commissions of Inquiry Ordinance” which would have given him more extensive powers despite a vote by the Legislative Council requesting that he do the same. *Id.* He instead stated that the establishment of the Panel of Inquiry by the Financial Secretary was “very appropriate” and pledged that there would be no cover-up in the course of the inquiry. *Id.*

<sup>87</sup> *Id.*

for their losses.<sup>88</sup>

It is obvious that cross-sectional support is assured for any proposal that seeks to enhance the standards of corporate governance of listed companies in the HKSAR.<sup>89</sup> Unfortunately, the above chronology of events illustrates how a good idea can be turned into a public relations debacle as a result of poor communication or poor implementation.<sup>90</sup> The entire process could have been viewed as a comedy of errors on the part of the regulators if not for the fact that many investors lost money and the reputation of the capital markets of the HKSAR suffered as a result.

The prompt withdrawal of the delisting proposals, seemingly under threat of a populist revolt by certain vested interests, merits criticism. This action contradicts the widely held view that there is a need to improve the regulation of penny stocks, and highlights the insensitivity of the regulators to the marketplace. The circumstances surrounding the release of the Consultation Paper created the impression that the objectives had been determined and all that remained to be resolved was the manner in which the delisting proposals were to be implemented. The inept handling came at the expense of public interest. At the very least, the contradictory assertions by various officials caused investors to lose confidence in the public administration of the HKSAR, ensuring that the new ministerial system of governance that was introduced by the Chief Executive just weeks before on July 1, 2002, would fail.

#### **IV. A Critique of Part C**

In attempting to cover its bases, the HKEx may have done itself an injustice by complicating what could have been an otherwise more streamlined and comprehensible proposal to delist shares. The Consultation Paper specified eleven quantitative and

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<sup>88</sup> See Jimmy Cheung, *Finance Chief's Role under Scrutiny*, S. CHINA MORNING POST (Hong Kong), Sept. 16, 2002, at N2.

<sup>89</sup> See generally KOTEWALL & KWONG, *supra* note 4, at 24-33 (describing the interaction of the three-tiered structure of the securities industry).

<sup>90</sup> See *id.* at 99 (acknowledging in hindsight that better communication and explanation should have been given at time of the proposal).

qualitative criteria, any of which would have been sufficient to commence the procedure leading to the delisting of the securities.<sup>91</sup> In a nutshell, an issuer would be considered as failing to meet the requirements for continued listing if it fell within any one of the following categories:

- incurring losses for three consecutive years with negative equity, or incurring losses for three consecutive years with an average market capitalization of less than HKD\$50 million, or about USD\$6.5 million, for thirty consecutive trading days;<sup>92</sup>
- shareholder equity less than HKD\$50 million and average market capitalization of less than HKD\$50 million for thirty consecutive trading days;<sup>93</sup>
- average market capitalization of less than HKD\$30 million for thirty consecutive trading days regardless of its shareholders' equity;<sup>94</sup>
- insolvency due to issuer or its principal subsidiary being served with a winding-up order or going into receivership or provisional liquidation;<sup>95</sup>
- adverse or total disclaimer opinion by auditors;<sup>96</sup>
- a moving average of the daily volume weighted share price less than HKD\$0.50, or about USD\$0.065, for thirty consecutive trading days;<sup>97</sup>
- the issuer takes a corporate action leading to a decrease in total assets or operations or after-tax profits by at least seventy-five percent over those of the immediate preceding financial year, and remaining business is unable to meet the initial listing eligibility criteria of the SEHK;<sup>98</sup>
- designation as a cash company, defined as one with ninety percent of its net assets in cash, short-dated securities,

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<sup>91</sup> HONG KONG EXCHANGES & CLEARING LTD., *supra* note 1.

<sup>92</sup> *Id.* at 77.

<sup>93</sup> *Id.* at 78.

<sup>94</sup> *Id.* at 79.

<sup>95</sup> *Id.* at 81.

<sup>96</sup> *Id.* at 82.

<sup>97</sup> *Id.* at 85.

<sup>98</sup> *Id.* at 90.

- portfolio shares investment, or other marketable securities;<sup>99</sup>
- suspension of shares from trading for a continuous period of more than twelve months;<sup>100</sup>
  - breaching the Listing Rules;<sup>101</sup> or
  - undertaking operations that are either illegal or contrary to the general principles of the SEHK.<sup>102</sup>

With two exceptions, the foregoing proposals were to take effect immediately upon the passing of the requisite amendments to the Listing Rules.<sup>103</sup> The HKEx proposed a twelve month transition period for compliance with the rules where issuers had breached either the financial standards or minimum share price criteria.<sup>104</sup> The transition period was premised on the need to protect the issuers and their minority shareholders against the potentially harsh effects of the these proposals.<sup>105</sup>

There are at least three critiques of the proposed delisting of penny stocks: the arbitrary nature of the proposed minimum price, the inconsistencies between various parts of the proposals, and the failure to establish a ready market for delisted stocks. Each of these is addressed in the following paragraphs.

#### *A. Arbitrary Nature of Proposed Minimum Price*

Despite its importance, the HKEx did not provide any rationale as to why the figure of HKD\$0.50 was selected as the proposed minimum share price.<sup>106</sup> Nevertheless, it did disclose the following detailed chronology of its discussions with the SFC

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<sup>99</sup> *Id.* at 93. This definition does not extend to investment companies, banks, insurance, or other similar financial services companies which are “qualified lenders.” See SECURITIES & FUTURES ORDINANCE, *supra* note 18, § 308(1).

<sup>100</sup> HONG KONG EXCHANGES & CLEARING LTD., *supra* note 1, at 95.

<sup>101</sup> *Id.*

<sup>102</sup> *Id.* at 98.

<sup>103</sup> *Id.* at 99-100.

<sup>104</sup> *Id.* at 99. The procedure for the delisting of securities is set out in Part E of the Consultation Paper, entitled “Cancellation of Listing Procedures.” *Id.* These are relatively non-contentious, with a primary emphasis on the need for fairness and transparency within an effective mechanism. *Id.*

<sup>105</sup> *Id.* at 99.

<sup>106</sup> *Id.* at 85.

regarding the matter.<sup>107</sup>

- July 30, 2001            The HKEx submits a preliminary draft proposal to the SFC seeking to require the consolidation of stocks that trade at HKD\$0.01, or USD\$0.0013, for more than twenty trading days within a three month period.<sup>108</sup> It further proposes that the minimum consolidated price be no less than HKD\$0.10, or USD\$0.013, and that issuers be barred from undertaking any corporate transaction that would result in their theoretical value falling below this threshold.<sup>109</sup>
- August 8, 2001        The SFC responds by stating that the criterion should either be HKD\$1 or HKD\$5, USD\$0.13 or USD\$0.65, respectively.<sup>110</sup>
- December 12, 2001    The HKEx revises its proposals to mandate that issuers seek consolidation of stocks when their shares trade at below HKD\$0.20, or USD\$0.026, for the period in question.<sup>111</sup>
- December 24, 2001    The SFC insists that the threshold be set at no less than HKD\$1.<sup>112</sup>
- April 30, 2002        The HKEx further revises its proposal by increasing the threshold to HKD\$0.30, or USD\$0.039, and for a minimum initial public offering (IPO) price of HKD\$1 for all new issues that follow the amendment of

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<sup>107</sup> Press Release, Hong Kong Exchanges and Clearing Limited, Transcript of Remarks by Kwong Ki-chi, Chief Executive of Hong Kong Exchanges and Clearing Limited at the Financial Affairs Panel of the Legislative Council (Aug. 31, 2002), available at <http://www.hkex.com.hk/news/hkexnews/0207313news.htm>.

<sup>108</sup> *Id.*

<sup>109</sup> *Id.*

<sup>110</sup> *Id.*

<sup>111</sup> *Id.*

<sup>112</sup> *Id.*

- the Listing Rules.<sup>113</sup>
- May 5, 2002 The SFC reiterates its position that the minimum price threshold should be set at HKD\$1, while the minimum IPO price should be HKD\$5.<sup>114</sup>
- May 15, 2002 The HKEx responds by stating that the proposed HKD\$1 minimum price threshold is “too hasty” and agrees to discuss a range between HKD\$0.30 and HKD\$0.50 as an interim measure.<sup>115</sup>
- June 8, 2002 The HKEx submits its second draft proposal, which includes revised thresholds set at HKD\$0.50 as the minimum share price at which consolidation would be required and HKD\$2 as the minimum price of IPOs.<sup>116</sup>
- June 17, 2002 The SFC replies that it has “no definite views” on the proposed revised thresholds.<sup>117</sup>
- July 10, 2002 The HKEx sends the fifth draft of its Consultation Paper to the Listing Committee of the SEHK<sup>118</sup> for comments and approval after the SFC replies that it has no strong opinion on the same.<sup>119</sup>

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<sup>113</sup> *Id.*

<sup>114</sup> *Id.*

<sup>115</sup> *Id.*

<sup>116</sup> *Id.*

<sup>117</sup> *Id.*

<sup>118</sup> See LISTING RULES, *supra* note 30, at ch. 2. While the Listing Division of the SEHK, a wholly owned subsidiary of the HKEx, processes applications for listing on both the Main Board and the Growth Enterprise Market, the listings are subject to the approval of the relevant Listing Committee of the board to which the applicant seeks the listing. See *id.* All of the powers and functions regarding all listing matters are discharged by the Listing Committee and/or its delegates under the authority of the board of the SEHK. *Id.* The composition of the Listing Committee of the Main Board is specified under Rule 2A.17 of the Listing Rules, which states that a maximum of four of its twenty-five members can be engaged in fund management. *Id.*

<sup>119</sup> Press Release, HONG KONG EXCHANGES & CLEARING LTD., *supra* note 107.

Thus, the proposals on the appropriate definition of a penny stock, as measured in terms of its value, ranged from a low of HKD\$0.10, as suggested by the HKEx, to a high of HKD\$5, as suggested by the SFC.<sup>120</sup> In the absence of any stated reason, and in view of the series of exchanges between the HKEx and the SFC, it is not unreasonable to assume that the proposed minimum share price threshold was made rather arbitrarily. Under the circumstances, it is perhaps somewhat of an anomaly that no specific reference was made to the par value of the shares.<sup>121</sup> This is significant because, as illustrated by Table 1 below, there are thirty-eight different par values ranging from a low of HKD\$0.001 to a high of HKD\$5. In fact, so lax is the extent of the monitoring that seven companies<sup>122</sup> have par values of less than HKD\$0.01 which, as of June 30, 2002, is the lowest market price for which trades may be executed.<sup>123</sup>

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<sup>120</sup> *Id.*

<sup>121</sup> The par value is otherwise known as the nominal value of the shares. See COMPANIES ORDINANCE, ch. 32, § 5(4)(a) (1997), at <http://www.justice.gov.hk/home.htm> (last visited Sept. 12, 2004) (requires companies to state the amount of share capital that they propose to be registered and their division into shares of a fixed amount).

<sup>122</sup> The seven companies: are Gold Wo International Holdings Limited (SEHK Stock Code 0090), Cheuk Nang (Holdings) Limited (0131), Star East Holdings Limited (0198), Asia Orient Holdings Limited (0214), New City (Beijing) Development Limited (0456), The Sun's Group Limited (0988), and Fulbond Holdings Limited (1041). [The author acknowledges with gratitude the kind assistance of the respective companies in providing the information.]

<sup>123</sup> See LISTING AGREEMENT, at para. 30 (providing that "where the market price of the securities of the Issuer approaches the extremities of HKD\$0.01 or HKD\$9,995.00, the Exchange reserves the right to require the Issuer . . . to proceed with a consolidation or splitting of its securities"). *Id.* Trades are conducted electronically with varying ask/bid spreads depending on the price at which the shares are traded. See LOW, *supra* note 13, at 69-89. All clearing and settlement is effected through the Central Clearing and Settlement System (CCASS) and the CCASS Depository, a computerized book-entry system that is based on the immobilization of shares in a central depository operated by Hongkong Clearing, a subsidiary of the HKEx. *Id.* Hongkong Clearing performs securities clearing and settlement, electronic money settlement, depository, common nominee and share registration services for eligible securities that are listed on the SEHK. *Id.*



**Table 1: Par Values of Shares Listed on the Stock Exchange of Hong Kong<sup>124</sup>**

Par Value	HKD	USD	RMB	AUD
0.001	4	1	0	0
0.005	2	1	0	0
0.01	111	9	0	0
0.0125	1	0	0	0
0.02	19	2	0	0
0.025	9	1	0	0
0.05	22	2	0	0
0.08	2	0	0	0
0.1	372	6	2	0
0.12	1	0	0	0
0.125	1	0	0	0
0.18	1	0	0	0
0.2	28	0	0	1
0.25	20	1	0	0
0.3	1	0	0	0
0.4	5	0	0	0
0.5	36	2	0	0
0.6	1	0	0	0
0.65	1	0	0	0
0.7	1	0	0	0
0.75	1	0	0	0
1.00	57	0	50	0
2.00	4	0	0	0

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<sup>124</sup> Data compiled from publicly available information obtained from the websites of the HKEx as of June 30, 2002, the end of the month immediately preceding the release of the Consultation Paper, HONG KONG EXCHANGES & SECURITIES LTD., at <http://www.hkex.com.hk/invest/isc.htm> (last visited Sept. 12, 2004), or hand collected directly from the companies concerned. In the opinion of the author, the HKEx should have considered the relevance of par value in the context of company law in Hong Kong and taken note of the same in determining an appropriate value for the definition of penny stock. This would have minimized the arbitrariness which appeared to have been involved during the lengthy discussions between the HKEx and the SFC on the subject of classifying penny stocks.

2.50	2	0	0	0
4.00	1	0	0	0
5.00	7	0	0	0

The Companies Ordinance does not require that the capital of companies be denominated in Hong Kong Dollars<sup>125</sup> nor does it dictate how that capital should be divided.<sup>126</sup> Companies are accorded some degree of flexibility because shares may be issued for cash or for non-cash consideration.<sup>127</sup> But, as a general principle, the courts have sought to ensure that a company has received the capital that is reflected as paid in its books and that it is not improperly returned to its shareholders.<sup>128</sup>

As evident from Table 1 above, there were four different currencies used to specify the par values of shares that were listed on the Main Board as of June 30, 2002. They are the Hong Kong Dollar (710 companies), the Chinese Renminbi (52 companies), the U.S. Dollar (25 companies), and the Australian Dollar (one company).<sup>129</sup> Almost one-half of all companies listed on the Main Board had a par value of, or equivalent to, HK\$0.10. A mere 170 companies, or less than 22% of the total number of listed companies at the material time, had par values at or above the proposed delisting threshold of HK\$0.50.

The reference to par value is significant because, at common law, companies may not validly issue their shares at a discount even if it is in their interest to do so.<sup>130</sup> Furthermore, a company could not give itself the capacity to issue shares at a discount by

<sup>125</sup> See *Re Scandinavian Bank Group plc* [1988] Ch 87, [1987] 2 W.L.R 752 (Eng.).

<sup>126</sup> See COMPANIES ORDINANCE, *supra* note 121.

<sup>127</sup> *Id.*

<sup>128</sup> *Id.*

<sup>129</sup> HONG KONG EXCHANGES & CLEARING LTD., RULES GOVERNING THE LISTING OF SECURITIES ON THE STOCK EXCHANGE OF HONG KONG LTD., CH. 19 (2004), at [http://www.hkex.com.hk/rule/listrules/Chapter%2019%20\(0331\).doc](http://www.hkex.com.hk/rule/listrules/Chapter%2019%20(0331).doc) (stating that dual listings are permitted and companies incorporated in jurisdictions other than those specified above may apply for a secondary listing on the SEHK on a case-by-case basis); HONG KONG EXCHANGES & CLEARING LTD., BASIC LISTING REQUIREMENTS FOR EQUITIES, at <http://www.hkex.com.hk/issuer/listhk/equities.htm> (last visited Sept. 15, 2004) (the SEHK allows companies that are incorporated in the HKSAR, Bermuda, the Cayman Islands, and the People's Republic of China to seek a primary listing on the exchange).

<sup>130</sup> See *Ooregum Gold Mining Co. of India Ltd. v. Roper*, [1892] A.C. 125. (Eng.).

including such a provision in its objects clause.<sup>131</sup> Nevertheless, the common law has been statutorily amended in two ways. First, if it fulfills certain stringent conditions, a company may issue shares at a discount, but this is restricted to those of a class that it has already issued.<sup>132</sup> Second, a company is permitted to pay a commission, not exceeding ten percent, in consideration of a person subscribing for shares.<sup>133</sup>

When the HKEx reviewed the options for the delisting of penny stocks it should have taken into consideration the emphasis the law places upon the importance of par values, as evidenced by its imposition of strict guidelines to prevent the issuance of shares at a discount.<sup>134</sup> Taking into consideration these guidelines and the need to provide for an equitable solution to the delisting of penny stocks, a correlation should have been drawn between the par value of the shares of a company and the proposed minimum price. In short, shares should only be considered as potential delisting candidates when they trade at prices below their par values over a specified period of time. At the very least, this will avoid the arbitrary nature through which the HKEx appears to have arrived at its proposed threshold. It also provides an objective benchmark against which share price performance can be evaluated and, perhaps most importantly, its adoption will

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<sup>131</sup> Per judgment of Lord Halsbury LC; wherein his Lordship referred to precedent from *Ashbury Co. v. Riche* [1875] L.R. 7 (Eng.). See COMPANIES ORDINANCE, *supra* note 121, § 5A-C (stating that companies that are incorporated in the HKSAR are no longer required to state their objects in their memorandum of association); *Pearl Island Hotel Ltd. v. Li Ka-yu* [1988] 2 HKLR 87 (P.R.C.); *European Asian Bank v. Reicar Inv. Ltd.* [1988] 1 HKLR 45 (P.R.C.); *Stable Inv. Ltd. (in liquidation) v. Chang Shin-cheun* [1982] HKLR 79 (P.R.C.); *So Kwan Nane v. Kowloon Stock Exch. Ltd.* [1973-76] 1 HKC 315 (P.R.C.) (stating that the provision has no retrospective effect and companies that retain their objects clauses remain subject to the application of the doctrine of *ultra vires* in the HKSAR).

<sup>132</sup> COMPANIES ORDINANCE, *supra* note 121, § 50. The conditions include an authorization by the members at general meeting which is sanctioned by the court. *Id.* The shares must thereafter be issued within a month of the sanction by the court or within such period as specified by order of the court. *Id.*

<sup>133</sup> *Id.* § 46. This requires authorization in the articles of association and disclosure of the details to the members. *Id.* If the maximum ten percent commission is granted, the subscriber would only need to pay HKD\$0.90 as full consideration for the issue of a share with a par value of HKD\$1. See PAUL L. DAVIES, *GOWER'S PRINCIPLES OF MODERN COMPANY LAW* 306 (6th ed. 1997) (describing application of this section).

<sup>134</sup> See COMPANIES ORDINANCE, *supra* note 121, at § 50.

allow for enhanced transparency in the market place.

To balance the dual objectives of minimizing potential disruption to the market on the one hand and the need to enhance the regulation of penny stocks on the other, the HKEx should have initially compelled all companies listed on the SEHK to have a par value of no less than HKD\$0.10 or its equivalent. This would have affected 181 companies or about 23% of all those listed on the Main Board when the Consultation Paper was released on July 25, 2002. In addition, the HKEx should have made clear that these companies would neither be delisted automatically nor immediately because all that was required at that time was a promise to undertake the necessary capital restructuring to consolidate their shares, otherwise known as a reverse stock-split.

Yet, this threshold must be viewed as merely a means to an end if the objective is to enhance corporate governance in the HKSAR. Given the prominence that the law presently places on the par value of shares and companies, unequivocal benchmarks and time frames should be established for the implementation of a system that would minimize the incidence of different par values. For example, the HKEx could set HKD\$1.00 or its equivalent as its ultimate target for the minimum par value of shares that are listed on the SEHK by December 31, 2006. By doing so, the HKEx would avoid the uncertainties and confusion that beset the market when it released its Consultation Paper on July 25, 2002. Such a move would be viewed as a positive contribution by the HKEx towards realizing the stated objective of establishing Hong Kong as a paragon of corporate governance within the region.<sup>135</sup>

### *B. Inconsistency of Proposals*

The collapse in the prices of penny stocks on July 26, 2002, may be based, at least in part, on the apparent ambiguities and inconsistencies of the Consultation Paper.<sup>136</sup> Although much of the focus was directed at the proposed delisting of penny stocks, the Consultation Paper had a wider reference in seeking to address issues that arose from the following areas:

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<sup>135</sup> See Donald Tsang, The 2001-2002 Budget Speech, at <http://www.info.gov.hk/fstb/tb/budget/budget01-02/english/efile.htm> (last visited Oct. 10, 2004).

<sup>136</sup> See generally HONG KONG EXCHANGES & CLEARING LTD., *supra* note 1.

- initial listing eligibility criteria;<sup>137</sup>
- continuing obligations of listed companies,<sup>138</sup> and,
- disclosure requirements at the time of initial listing.<sup>139</sup>

Collectively, the different sections of the Consultation Paper were designed to enhance the perceived “quality” of the listed companies by assessing their financial performance as well as investor acceptance and by benchmarking these against those of their counterparts within particular industries.<sup>140</sup> Unfortunately, whether by design or accident, various parts of the Consultation Paper appear to conflict with each other,<sup>141</sup> further compounding the uncertainties financial markets loathe. This section of the article highlights two principal anomalies that must be rectified to avoid the possibility of a repeat of the penny stock debacle.

### *1. Conflict of Interests*

The proposed Initial Listing Eligibility Criteria set out in Part B<sup>142</sup> conflicts with the proposed delisting criteria of the Consultation Paper.<sup>143</sup> The former proposes amending the “Listing Rules” to specify a minimum issue price of HKD\$2, or about USD\$0.26, with a minimum market capitalization of HKD\$200 million, or approximately USD\$26 million.<sup>144</sup> The existing rules do not specify any minimum initial offering price, which is left entirely to the discretion of the company and its advisers and underwriters.<sup>145</sup> However, the rules as they applied did specify that the minimum market capitalization at the time of listing should be HKD\$100 million, or half of what is proposed in the

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<sup>137</sup> *Id.* at 33-72.

<sup>138</sup> *Id.* at 101-13.

<sup>139</sup> *Id.* at 123-30 .

<sup>140</sup> *Id.* at 1-25.

<sup>141</sup> See *infra* p.104. The section titled “Adoption of Contradictory Ratios” is a further elaboration of the inconsistencies in the Consultation Paper.

<sup>142</sup> See Hong Kong Exchanges and Clearing Limited, *supra* note 1, at 33-72.

<sup>143</sup> *Id.* at 73-100.

<sup>144</sup> Compare HONG KONG EXCHANGES & CLEARING LTD., *supra* note 1, ¶¶59 & 92 with ¶144. The rationale provided for these proposals is founded on the need to minimize the market manipulation which is deemed more prevalent with companies with lower market capitalization and shares that trade at relatively lower price levels.

<sup>145</sup> See LISTING RULES, *supra* note 30.

Consultation Paper.<sup>146</sup>

While the HKEx professes not to subscribe to the view that there is any relationship between the market capitalization and the quality of the issuer, it nonetheless stated that an increase in the former will ensure “only companies of a reasonable size could be listed on the Exchange.”<sup>147</sup> Regarding the proposal for setting the minimum initial public offering price of HKD\$2, the HKEx expressed the opinion that “the predominance of low priced securities, so-called penny stocks, on the Exchange may have an adverse effect on the perception of the quality of the Hong Kong market” and is, therefore, “not compatible with the goodwill that Hong Kong has been building up as an international financial centre.”<sup>148</sup>

Noble as such reasons are, the author rejects the “bigger is better” principle upon which the HKEx appears to have premised the rationale for its proposals. The presumption that larger capitalized companies and/or those with a higher share price are less likely to suffer financial difficulties has been effectively disproved by recent corporate bankruptcies in the United States.<sup>149</sup>

The HKEx proposals have two principal problems. First, the proposals do not address possible remedies if the market capitalization falls below the required HKD\$200 million after the listing of the company because the emphasis is on raising the threshold rather than on the subsequent maintenance of the same. Second, although the minimum initial public offering price is set at HKD\$2, the selection of this number seems rather arbitrary because no rationale is provided.

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<sup>146</sup> See *id.* ¶¶8.08, 8.09(1), 8.09(2) (specifying the maintenance of the minimum public float and the mechanism for the same respectively). An amendment that took effect Mar. 31, 2004 revised this number to HKD\$200 million. *Id.* ¶8.05(2).

<sup>147</sup> HONG KONG EXCHANGES & CLEARING LTD., *supra* note 1, at 48.

<sup>148</sup> *Id.* at 62.

<sup>149</sup> See, e.g., Ethan G. Zelizer, *The Sarbanes-Oxley Act: Accounting for Corporate Corruption?*, 15 LOY. CONSUMER L. REV. 27 (2002) (discussing several recent corporate bankruptcies in the U.S.). At its peak in the year 2000, Enron was the seventh largest capitalized company in the United States, yet it collapsed spectacularly within a period of a few months. *Id.* Another recent example is WorldCom the shares of which traded in excess of USD\$60 during the height of the internet bubble, and yet within two years it attained the dubious distinction for being the largest corporate bankruptcy in the United States. *Id.*

As the imposition of a higher initial market capitalization and/or a higher initial public offering price would not, by itself, raise the level of protection accorded to investors, it is possible that the reason may have more to do with the financial performance of the HKEx than has been disclosed. The principal sources of income for the HKEx are the initial and annual listing fees as well as the trading levy of 0.01% that it receives on each transaction.<sup>150</sup> The proposals as described would enhance the profitability of the HKEx in two ways: by increasing its income through the trading fee based on the velocity of turnover of shares<sup>151</sup> and by reducing the cost of its regulatory functions as set out in the Listing Rules. The latter is not insignificant especially with respect to penny stocks which often cost disproportionately more to regulate than their larger capitalized counterparts.<sup>152</sup> The

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<sup>150</sup> The buyer and seller to the transaction share this levy equally, at a rate of 0.005% each. See SECURITIES & FUTURES ORDINANCE, *supra* note 18. The HKEx also receives a settlement fee of 0.002% subject to a minimum of HKD\$2 and a maximum of HKD\$100 for transactions through its subsidiary that operates the Central Clearing and Settlement System (CCASS). *Id.* As such, the HKEx derives an income of at least 0.014% for each transaction that is executed on the SEHK, the latter of which is a legal monopoly under § 19 of the Securities and Futures Ordinance. *Id.* § 19.

<sup>151</sup> The velocity of turnover is the percentage at which the stock of a company changes hands over any given period and may be computed by dividing the annual turnover of a particular stock with its market capitalization. See *Quality of Market and the Case for More Effective Delisting Mechanism*, CORPORATE FINANCE DIV. & RESEARCH DEPT. OF THE HONG KONG SECURITIES & FUTURES COMM'N, (July 2002) at [http://www.hksfc.org.hk/eng/press\\_releases/html/index/index2.html](http://www.hksfc.org.hk/eng/press_releases/html/index/index2.html). As of December 31, 2001, the HKEx had a velocity of turnover of 50%, which is dwarfed by those of NASDAQ (382%) and the stock markets of Korea (196%) and Taiwan (186%). *Id.* The dealing in shares of larger capitalized companies and/or higher prices generates more revenue for the HKEx than penny stocks, since the computation of the trading levy and the settlement fee is based on the price at which the trade was executed. *Id.* The direct financial interest of the HKEx is illustrated by the fact that it is not uncommon for the top 100 companies on the SEHK to account for about 90% of its total market capitalization on any given trading day. *Id.*

<sup>152</sup> This is due to two principal reasons. First, transactions undertaken by penny stock companies are generally large in relation to their size. See, e.g., Webb, *The Delisting Fiasco*, *supra* note 65; Webb, *PIPSI Submission*, *supra* note 65. Second, a number of these companies get into financial difficulty and need to restructure. See, e.g., Webb, *The Delisting Fiasco*, *supra* note 65; Webb, *PIPSI Submission*, *supra* note 65. Both of these require adherence to procedure and the preparation of voluminous documentation that are costly in terms of monitoring and regulating for the HKEx. See, e.g., Webb, *The Delisting Fiasco*, *supra* note 65; Webb, *PIPSI Submission*, *supra* note 65.

foregoing clearly exposes the conflict of interest faced by the HKEx in its dual role as a for-profit company and front-line regulator.

## 2. *Adoption of Contradictory Ratios*

While Part B of the Consultation Paper advocates setting the minimum initial public offering price at HKD\$2 and increasing the initial minimum market capitalization to HKD\$200 million, the ratios adopted for these contradict with those proposed for the delisting of shares as outlined in Part C.<sup>153</sup> If the foregoing ratio of 100,000,000 to 1 minimum market capitalization to minimum share price<sup>154</sup> was to be consistently applied for the purpose of delisting penny stocks, then the threshold ought to have been set at HKD\$0.30 or approximately USD\$0.039. This is because the HKEx proposed the delisting of shares which had an average market capitalization of less than HKD\$30 million for thirty consecutive trading days regardless of its shareholders equity.<sup>155</sup> Be that as it may, this threshold of HKD\$0.30 will still be subject to the same contention that it is arbitrarily derived because its computation is premised upon the proposed minimum initial public offering price of HKD\$2.<sup>156</sup>

A closer examination of the proposed ratios further exposes anomalies which could possibly lead to the delisting of relatively financially stronger companies, while relatively weaker entities remain.<sup>157</sup> For example, under the proposals it would be possible for a company with a market capitalization of more than HKD\$50 million to be delisted if its share price drops below the minimum price threshold of HKD\$0.50, while its counterpart with a market

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<sup>153</sup> Compare HONG KONG EXCHANGES & CLEARING LTD., *supra* note 1, ¶¶59 & 92 with *id.* ¶144.

<sup>154</sup> See HONG KONG EXCHANGES & CLEARING LTD., *supra* note 1, at 47-50, 61-62 (July 2002). The ratio of 100,000,000 to 1 is derived by dividing the specified minimum market capitalization (HKD\$200 million) by the minimum initial public offering price (HKD\$2).

<sup>155</sup> *Id.* at 79. If the minimum market capitalization is set as HKD\$30 million, then the applicable minimum share price ought to be HKD\$0.30, if the ratio of 100,000,000 to 1 is adopted and applied consistently.

<sup>156</sup> Compare HONG KONG EXCHANGES & CLEARING LTD., *supra* note 1, ¶131 with ¶144.

<sup>157</sup> *Id.*



capitalization of just HKD\$30 million would remain its price remained above the requisite level.<sup>158</sup> This appears somewhat illogical, but it is nonetheless a foreseeable consequence of the proposals set out in the Consultation Paper. Although the size of a company as measured by its market capitalization is easily quantifiable, its significance and importance may be less relevant than the performance of the company.<sup>159</sup> Companies may grow organically and/or by acquisitions, and it should be a function of the SEHK to facilitate rather than to impede this growth, the latter of which is a foreseeable consequence if seemingly arbitrary and contradictory thresholds are applied.

### *C. The Absence of a Ready Market for Delisted Penny Stocks*

The price of any security is a function of demand and supply. Investors determine the overall demand principally on their assessment of the relative risks and returns associated with the security and how these fit within their individual investment profile. Central to this price discovery mechanism is the availability of a market that facilitates the meeting of buyers and sellers. Stock markets fulfill this function, providing the requisite framework to instill confidence.

As the front-line regulator of the stock market and the activities of the listed companies, the HKEx has a duty to ensure its facilities provide for an orderly and fair market in securities trading. The interests of the investing public must be paramount given their position as a vital cog in the overall machinery of efficient financial markets. To achieve these objectives, the HKEx may establish and implement rules that pertain to transactions effected on or through its facilities. The SFC supervises the HKEx by requiring the latter to seek its approval before any new rule or regulation is issued.<sup>160</sup> In short, the HKEx not only provides the facilities investors need to trade securities, it also ensures a certain degree of protection for investors by imposing a set of continuing obligations on issuers.<sup>161</sup> Just as the admission to listing on the SEHK assures the issuers and their investors access to such

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<sup>158</sup> *Id.*

<sup>159</sup> *Id.*

<sup>160</sup> See SECURITIES & FUTURES ORDINANCE, *supra* note 18, at § 24.

<sup>161</sup> See LISTING RULES, *supra* note 30, chs. 13, 14, & 14A.

facilities, the proposed delisting of penny stocks will deprive them of the same.

In view of the gravity of the consequences, especially regarding the protection of minority shareholders, it would be convenient to mandate the continued listing of shares until such companies faced liquidation<sup>162</sup> or are privatized. In both instances, investors would have no further need for the market since their shares would either be worthless or acquired. Although it should not be a function of the HKEx to provide an absolute guarantee that its facilities will be open to all companies that are listed on the Main Board regardless of whether they are in breach of the applicable rules and/or fail to meet the continuing obligations imposed, the responsibility of the HKEx is such that it should not be involved in depriving investors of a market for the shares that are delisted. The duty to ensure the provision of facilities for an orderly and fair market in the trading of securities would require the HKEx to establish an alternative market for the trading of the delisted shares, at least on an "over-the-counter" or "OTC" basis. This market could be the "OTC Board" of the SEHK with the other two being the Main Board and the Growth Enterprise Market, or GEM.<sup>163</sup> Both the ask-bid spreads and the transactions costs are likely to be higher in the OTC Board compared with those on either the Main Board or on GEM, but such would be the natural consequence of a less efficient market. In any event, an inefficient market is still better than not having any ready market at all.

## V. An Alternative Framework

This author does not question the need for an effective delisting mechanism on the grounds that it leads to an enhancement of the standards of corporate governance and

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<sup>162</sup> This process is known as corporate bankruptcy in the United States. 11 U.S.C. §§ 101-1330 (1993).

<sup>163</sup> The HKEx is the ideal candidate under the existing regulatory regime to assume oversight of the proposed OTC Board because it would provide investors with the same degree of protection under the Listing Rules. See LISTING RULES, *supra* note 30. A different scale of charges for listing and transactions may need to be imposed given the higher risks and volatility of the market, but such mechanics would be relatively easy to resolve by establishing the OTC Board. This is an important condition precedent before the HKEx can implement the proposals for the delisting of shares.

unequivocally supports the rationale which has been advanced by the Chairman of the SFC.<sup>164</sup> That rationale can be summarized as follows:

- The threat of delisting provides incentive to management and controlling shareholders to improve corporate governance and company performance.<sup>165</sup>
- With no exit, some controlling shareholders have no incentive to turn companies around from making losses year after year.<sup>166</sup>
- Stocks tend to have higher volatility and are more easily manipulated when they have low unit prices and very thin trading.<sup>167</sup>
- The low unit prices could mislead investors into thinking that the stocks are cheap when in reality those unit prices do not reflect a company's fundamentals.<sup>168</sup>
- The continued listing of poorly performing companies affects the overall reputation of Hong Kong SAR as an international financial center.<sup>169</sup>

#### *A. Criteria for Delisting*

In order for any proposed delisting mechanism to work effectively, it must be simple, equitable, and clear. Its framework must provide sufficient safeguards to ensure the protection of minority shareholders' interests and eliminate penalties against shareholders for or by the actions of the company and/or its directors over whom they may not have any control. In addition, there should also be some benchmarking against the initial listing criteria imposed by the HKEx to ensure consistency. The following paragraphs take into consideration these requirements and propose an alternative framework for the delisting of penny stocks. In a nutshell, the author proposes that the Listing Rules be

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<sup>164</sup> See Press Release, Securities and Futures Commission, Chairman's Statement on HKEx's Delisting Consultation (July 2002), available at [http://www.hksfc.org.hk/eng/press\\_releases/html/press\\_release/02/02pr158.htm](http://www.hksfc.org.hk/eng/press_releases/html/press_release/02/02pr158.htm).

<sup>165</sup> *Id.*

<sup>166</sup> *Id.*

<sup>167</sup> *Id.*

<sup>168</sup> *Id.*

<sup>169</sup> *Id.*

amended so that stocks which fail to implement the necessary remedial action to the satisfaction of the HKEx are earmarked for possible delisting only if they meet any two of the following criteria:

- The shares trade at or below the minimum prescribed par value of HKD\$0.10 for ten or more trading days within a three-month period.<sup>170</sup>
- The market capitalization of the shares is less than HKD\$200 million for any period of ten trading days within a three month period.<sup>171</sup>
- The company is suspended from trading for a continuous period of more than six months.
- The company accounts are disclaimed or subject to adverse opinion by its auditors.<sup>172</sup>

Using the first three criteria listed above, only eighty-four stocks, or about 9.7% of the total number of companies listed on the Main Board, would have been identified as potential delisting candidates as of June 30, 2004.<sup>173</sup>

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<sup>170</sup> See *supra* text accompanying notes 106-135 for a discussion of the rationale. As almost half of the companies on the Main Board have a par value of HKD\$0.10, it is proposed that the HKEx set the minimum par value at this level to minimize disruptions to the market. Under the circumstances this will also be the *de facto* minimum price at which delisting will be considered. However, the HKEx should also set out a clear timetable within which it will seek to increase the par value to such level as it deems necessary for the effective governance of companies that are listed on the SEHK.

<sup>171</sup> The rationale for this threshold is to ensure consistency between the existing minimum requirement for applicants seeking a listing on the SEHK and the continuing requirements thereof. In short, it should be made an integral aspect of the Listing Rules for companies to always maintain the minimum market capitalization as the time of listing as a prerequisite for their continued listing on the SEHK.

<sup>172</sup> An "adverse audit opinion" would include any qualified opinion expressed by the auditors as well as when the company incurs three years of losses and/or has negative shareholder equity. Companies that are subject to the latter two circumstances may be on the verge of insolvency or may be in need of debt restructuring to improve their financial position. To better protect the interests of investors, auditors should be required to highlight these in their report. In addition, auditors should be required to express an opinion as to whether the company meets with the initial public offering requirements as set out in the Listing Rules. See *generally* LISTING RULES, *supra* note 30.

<sup>173</sup> A list of these companies, excluding those for which accounts have been qualified, is set out *infra* Appendix I. The data was compiled from (i) the websites of the HKEx and the individual companies, for the par value of the shares, and (ii) Datastream, for the prices and market capitalization of the companies. The companies would need to be in breach of any two of the three requirements; namely, trading below the prescribed

### B. Procedure for Delisting

Given the potential gravity of the consequences, the rules of natural justice must be applied to any proposed delisting procedure. Companies should have the right to respond to, and be provided with, adequate opportunity to rectify their alleged breach of the delisting criteria. To this end, a clear procedure and framework must be set out in the revised Listing Rules. Table 2 below provides a possible range of remedial actions to be undertaken depending on the nature of the breach by the companies.

**Table 2: Nature of Remedial Actions to be Undertaken by Company**

Nature of breach of delisting criteria	Remedial action(s) required
Trading at below minimum price for ten or more trading days within a three month period.	Maintain a market price above the minimum level for at least ten consecutive trading days. Demonstrate that steps (such as share consolidation or reverse stock splits and revenue generation initiatives) are being taken to enhance the value of the shares, in which case the HKEx may consider granting a grace period to facilitate compliance.
Market capitalization of less than HKD\$200 million for ten or more trading days within a three month period.	Maintain a market capitalization above the minimum level for at least ten consecutive trading days. Demonstrate that steps (such as asset and/or capital injection and revenue enhancement) are being taken to meet the target, in which case the HKEx may consider granting a grace period to facilitate compliance.

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minimum par value of HKD\$0.10, having a market capitalization of less than HKD\$200 million, and/or being suspended from trading on the SEHK for a period exceeding six months. But this list does not include eleven companies whose shares have been suspended from trading for more than six months including China Investment Holding (132), Datronix Holdings (889), Global Trend (691), Gold Face Holdings (396), New City (456), Shanghai Merchant Holdings (1104), Shanghai Land (67), Sun Man Tai (433), Surge Recreation (703), The Sun's Group (988), and Yue Fung International (965). These companies are presently facing a number of specific problems including liquidation, receivership, restructuring, and finalization of accounts. *Prolonged Suspension Status Report*, Main Board (Aug. 11, 2004), available at [www.hkex.com.hk/listing/psuspenrpt/psuspenrep\\_mb.doc](http://www.hkex.com.hk/listing/psuspenrpt/psuspenrep_mb.doc). The author acknowledges with gratitude the assistance provided by Mr. Lam Chun Kwong, Assistant Librarian of the Chinese University of Hong Kong Library Reference Department in compiling the data for Appendix I.

Suspension for a period exceeding six months.	Lift the suspension and ensure trading is not suspended again for any period of ten consecutive trading days within the next six months. Propose corporate restructuring be required to facilitate the early lifting of suspension, in which case the HKEx may consider the granting of a grace period to facilitate compliance.
Accounts disclaimed or subject to an Adverse Opinion.	Where possible, work with the relevant parties to rectify the problems identified. Consider the continued viability of the company and decide on any actions appropriate under the circumstances, including capital injection, corporate restructuring, scheme of arrangement, or liquidation.

As the complexity of the proposed remedial actions may differ between companies, the author proposes that the HKEx be granted the flexibility to extend the initial three month period on the application of companies that demonstrate progress in the implementation of their proposals. To enhance accountability and transparency, the HKEx should provide written reasons for any case in which it does not grant the extension sought by the companies. These companies should then be allowed to appeal to the SFC within a specified period of time, and the decision of the SFC will be conclusive.<sup>174</sup> Table 3 below sets out a proposed timeframe for the delisting of shares from the Main Board and their subsequent transfer and listing on the OTC Board operated by the HKEx.<sup>175</sup>

**Table 3: Proposed Time Table for the Delisting of Shares**

Timeframe	Action to be taken
Date of notification ("T")	Formal written notification with clear grounds specified by HKEx to company

<sup>174</sup> Since the decision of the SFC will be based upon the exercise of its powers under the Securities and Futures Ordinance, it may be subject to administrative review by the Ombudsman and/or judicial review by the courts where illegality, irrationality and/or procedural impropriety is alleged. As such, it is perhaps more accurate to say that the decision by the SFC is not strictly legally definitive. *See, e.g., Cheng Kai-man William v. Panel on Takeovers and Mergers & Anor* [994] 1 HKC 413 (P.R.C.); *Ainsely Fin. Corp. v. Ontario Sec. Comm'n* [1994] 21 OR (3d) 104 (Ont.); *Williams v. Keelty* [2001] 19 ACLC 1535 (Vict.). *See also* SUP. CT. R. Order 53.

<sup>175</sup> *See supra* note 163.

T + three months	Company to rectify or appeal against alleged breach of delisting criteria as stated by HKEx
Between T + four months and T + nine months	Extension of grace period for compliance by HKEx
T + ten months	Commence procedure for the transfer of the shares for listing on the OTC Board
T + twelve months	Trading of shares on the OTC Board to commence

To ensure adequate investor protection, the market must be fully informed about the identification of a company as a potential delisting candidate for its breach of the criteria. This may be reasonably easy to achieve by simply placing the prefix “X” before the stock code of the share involved, which should then be prominently displayed through the trading screen system of the HKEx. The “X” indicates the particular stock may be subject to increased volatility and risks because it is subject to possible delisting from the SEHK should it fail to undertake the necessary remedial action. A color-coded identification system may be required to enable investors to distinguish between those shares at various stages of the timeline leading towards their eventual delisting.<sup>176</sup>

### C. Privatization

It is reasonable to assume that rational shareholders will start to sell down their potential penny stock holdings if they fear that the shares may be delisted. The potential for the delisting of shares may be a self-fulfilling prophesy as rational investment decisions are likely to cause a collapse in the price of such securities when they approach the status of being classified as penny stocks. In view of the depressed price of the shares, a highly probable consequence is an opportunity for the undertaking of “privatization on the cheap” is minimized by controlling

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<sup>176</sup> Alternatively, a different set of alphabets could be adopted to indicate the degree of risk. For example, “X” could be the first level, followed by “Y” and “Z” as the next levels of risk, with “Z” being the most serious, indicating that delisting is imminent. Such a measure has already been adopted for companies that are listed on GEM, which uses stock codes beginning with the number eight to distinguish them from their Main Board counterparts. See Information on Listed Companies, GROWTH ENTERPRISE MARKET (giving a full listing of companies that are listed on GEM), at [http://www.hkgem.com/company/e\\_default.htm](http://www.hkgem.com/company/e_default.htm) (last visited Oct. 10, 2004).

shareholders of the company at the expense of the minority shareholders. This scenario is particularly relevant in the HKSAR given the strong dominance of families and the state in the ownership of companies, which collectively control some ninety-four percent of all the companies that are listed on the Main Board.<sup>177</sup>

To ensure that opportunities for "privatization on the cheap" three further proposals should be considered. First, the controlling shareholders should be compelled to make a general offer for all the shares at a price no less than the weighted average for the six months preceding the formal notification of delisting by the HKEx.<sup>178</sup> Although share prices are likely to fall in the period immediately preceding the threat of delisting, they may trade closer to their true values in the absence of the same. The imposition of such a rule would act as a deterrent to controlling shareholders who may otherwise exploit opportunities to force a delisting. Second, pecuniary penalties should be imposed on those who are found to have abused the system for personal financial gains.<sup>179</sup> Finally, the controlling shareholders and directors of

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<sup>177</sup> See Larry Lang et al., ECONOMIC ANALYSIS CO-RELATING THE PERFORMANCE OF PUBLIC LISTED COMPANIES WITH THEIR SHAREHOLDERS' PROFILE, available at [http://www.info.gov.hk/cr/download/scclr/economics\\_e.pdf](http://www.info.gov.hk/cr/download/scclr/economics_e.pdf). Although significant, the dominance of the family and the state is not limited to companies in the HKSAR. See also S. Classens et al., *Separation of Ownership from Control of East Asian Firms*, 58(1) J. OF FIN. ECO. 81 (2000) (examining the separation of ownership and control for 2,980 corporations in nine East Asian countries); R. La Porta et al., *Corporate Ownership Around the World*, 54(2) J. OF FIN. 471 (1999) (presenting data on ownership structures of large corporations in 27 wealthy economies, making an effort to identify ultimate controlling shareholders of these firms).

<sup>178</sup> This will apply only where the company is privatized and/or is privatized within a year of the transfer of its listing to the proposed OTC Board. Due care should be taken in the formulation of this proposal as an in-depth analysis would have to be directed at a number of important issues such as the possibility of parties acting in concert, the manner in which the time frame is computed as regards the privatization and the need to be fair to all parties to the transaction.

<sup>179</sup> To be an effective deterrent, the computation of this penalty could be based on that adopted for insider dealing which is up to three times the profits made. Provisions would have to be made for the SFC to take action against the relevant parties and to thereafter reimburse investors for any losses that arise directly from the privatization. To ensure an equitable outcome for all parties, it is further proposed that the quantum of compensation will be the net of proven losses less the share of the costs of the action by the SFC. All surpluses that arise out of such actions should be maintained in a separate account to fund further actions and must not be treated as extraordinary income for the



companies that are so privatized should be disqualified from accessing the facilities of the HKEx for a prescribed period.<sup>180</sup>

As the foregoing necessitates the pronouncement of a new set of rules as well as a change in the mindsets of regulators and the government, a detailed analysis remains outside of the scope of this article. Nonetheless, it raises a number of significant policy initiatives that warrant further detailed exploration as they bode well for the aspirations of the government of the HKSAR to establish the territory as a paragon of corporate governance.

## VI. Conclusion

Much has transpired since the penny stock debacle of July 2002. Following the publication of the report by the Panel of Inquiry on the Penny Stock Incident, the Financial Secretary established an expert group chaired by Mr. Alan Cameron, who served as the Chairman of the Australian Securities and Investments Commission between 1993 and 2000, to review the operation of the securities and futures market regulatory structure.<sup>181</sup> The expert group made a number of significant

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SFC. The Public Shareholders Group of the SFC could be entrusted with the formulation of detailed guidelines with respect to the application of this surplus.

<sup>180</sup> This proposal will be similar in its application to Part IV. A of the Companies Ordinance which deals with the disqualification of directors of insolvent companies. COMPANIES ORDINANCE, *supra* note 121. Part IV. A empowers the court to disqualify persons from assuming the position of director when they are convicted of an indictable offence for persistent default in relation to the provisions of the Companies Ordinance, fraud or general unfitness. The last of the four categories requires the court to consider the conduct of the person to determine whether he or she is unfit to be involved in the management of companies. *See e.g.*, COMPANIES ORDINANCE, *supra* note 121, § 168H; *Official Receiver v. Chung Kwan Yee et al.*, [1994] MP No 3605 of 1994 (unreported decision of Mar. 31, 1995), *available at* <http://www.htklii.org>; *Re Moorgate Metals Ltd* [1995] 1 BCLC 503. Just as directors of insolvent companies may be disqualified for their “unfitness to manage” under a prescribed set of circumstances, it is proposed that controlling shareholders and directors of companies that “privatize on the cheap” be similarly treated in view of their treatment of investors. The rationale is two-fold. First, it is founded on the fact that the shareholders who provide the capital lose out simply by placing their trust on others and not through any fault of their own. Second, the regulatory framework should provide some effective deterrent to minimize the potential abuse of corporate law.

<sup>181</sup> *See* Press Release, Hong Kong Government, FS Appoints Expert Group to Review Operation of the Securities and Futures Market Regulatory Structure (Sept. 26, 2003) (stating the terms of reference of the Expert Group and a brief vitae of its three members), *available at* <http://www.info.gov.hk/gia/general/200209/26/0926219.htm>.

recommendations in its report in March 2003, which were initially welcomed by the government.<sup>182</sup>

Enthusiasm waned, however, following rigorous objections from various sectors of the financial industry, resulting in a further round of consultation by the government.<sup>183</sup> On March 26, 2004, the Secretary for Financial Services and the Treasury released its "Consultation Conclusions on Proposals to Enhance the Regulation of Listing,"<sup>184</sup> which sought to strike a balance between the different interests. This has led to criticisms that the government is not prepared to undertake substantive steps in order to consolidate its standing as an international financial center.<sup>185</sup> While both interesting and important, these issues nonetheless remain outside the scope of this paper and are better left for a more detailed analysis in another forum.

The Main Board of the SEHK had a total market capitalization of approximately HKD\$5.5 trillion or some USD\$703 billion as of June 30, 2004.<sup>186</sup> On this date, the market capitalization of its three largest companies, HSBC Holdings plc, China Mobile (Hong Kong) Limited, and Hutchison Whampoa Limited, was approximately 35% of this number, while the aggregate for the top fifty companies accounted for almost eighty percent.<sup>187</sup> Yet, the market capitalization of its smallest company (Garron International Limited) was a mere HKD\$8.02 million or barely

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<sup>182</sup> See FIN. SECRETARY, REPORT BY THE EXPERT GROUP TO REVIEW THE OPERATION OF THE SECURITIES & FUTURES MARKET REGULATORY STRUCTURE (2003), available at [www.info.gov.hk/info/expert/expertreport-e.htm](http://www.info.gov.hk/info/expert/expertreport-e.htm).

<sup>183</sup> See GOV'T OF THE HONG KONG SPECIAL ADMIN. REGION, CONSULTATION CONCLUSIONS ON PROPOSALS TO ENHANCE THE REGULATION OF LISTING 10, available at <http://www.info.gov.hk/fstb/fsb/ppr/consult/doc/erlcon-e.pdf> (last visited Sept. 24, 2004).

<sup>184</sup> See *id.*

<sup>185</sup> See, e.g., D-graded PERL of the Orient (Mar. 28, 2004) (discussing of the issues that remain to be resolved on a satisfactory level), available at [www.webb-site.com/articles/PERLdecision.htm](http://www.webb-site.com/articles/PERLdecision.htm).

<sup>186</sup> See Stock Exchange Hong Kong Main Board (listing stock exchange data on June 30, 2004), available at <http://www.hkex.com.hk/deta/merketstat/TV2004.htm> (last visited Oct. 8, 2004).

<sup>187</sup> See generally HONG KONG EXCHANGES & CLEARING LTD., TRADING INFORMATION (2004), available at <http://www.hkex.com.hk/tradinfo.htm>; HONG KONG EXCHANGES & CLEARING LTD., DATA & STATISTICS (2004), available at <http://www.hkex.com.hk/datastatistics.htm>.

over USD\$1 million, a completely insignificant and miniscule amount by any measure.<sup>188</sup> No less than fifty-eight companies, or almost 6.7% of the 869 companies that were listed on the SEHK, had a market capitalization of less than HKD\$100 million, the minimum benchmark required at the point of their listing on the SEHK.<sup>189</sup> These statistics should focus the attention of the government and regulators to determine the type and quality of market that Hong Kong should work towards achieving.

Turning to the specific issues raised in the delisting debate, it is evident that the proposals as contained in Part C of the Consultation Paper require further study.<sup>190</sup> A number of its principal deficiencies have been identified in this paper and proposals for their rectification advanced. The government of the HKSAR has consistently professed its aspiration to be the paragon of corporate governance within the region,<sup>191</sup> but its actions suggest a lack of political will and/or technical know-how to attain this lofty objective. Ensuring that the proposals for the delisting of shares are implemented properly with adequate protection of minority shareholders is an essential requirement if the government seeks to provide a stronger signal to facilitate the further development of its financial markets.

By the same token, any mistakes, perceived or otherwise, will result in declining confidence by investors because mistakes will make the aspirations of the government appear unrealistic. With

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<sup>188</sup> TRADING INFORMATION, *supra* note 187 (providing trading information regarding the Hong Kong Exchanges and Clearing Limited); DATA & STATISTICS, *supra* note 187 (providing data and statistics regarding the Hong Kong Exchanges and Clearing Limited).

<sup>189</sup> This requirement was increased to HKD\$200 million, or approximately USD\$25.6 million, as of March 31, 2004. See LISTING RULES, *supra* note 30, at 8.05(2). Appendix I sets out the details of the eighty-four companies whose market capitalization were below this amount and would therefore not have qualified to list on the SEHK had their applications been submitted on or after March 31, 2004.

<sup>190</sup> Despite a statement by the HKEx that it would release a revised proposal for public consultation by October 2002, it has not materialized. HKEx placed the issue of the delisting of penny stocks on the back burner as the spectacular corporate collapses of Enron and WorldCom in the United States changed the present focus of the regulators to corporate governance. See Press Release, HKEx Today Released Its Revised Consultation Paper on Continuing Listing Criteria and Related Issues (Nov. 15, 2002), at <http://www.hkex.com.hk/news/hkexnews/2002.htm>.

<sup>191</sup> Tsang, *supra* note 135.

the driving principles based upon the wider collective interests of the various stakeholders within the financial markets rather than being merely limited to the select few, the time to act is now.<sup>192</sup>

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<sup>192</sup> See Chee Kong Low, *A Road Map for Corporate Governance in East Asia*, 25 NW. J. INT'L L. & BUS. (forthcoming 2004).

## APPENDIX I

### LIST OF POTENTIAL DELISTING CANDIDATES

**AS REPORTED ON JUNE 30, 2004**

Stock Code <sup>a</sup>	Name of Company	Stock Price <sup>b</sup>	Capitalization (HK\$m) <sup>c</sup>
1226	GARRON INTERNATIONAL	0.1	8.02
339	EARNEST INVS. HDG.	0.024	8.64
401	401 HOLDINGS (March 28, 2003)*	0.03	11.01
657	G-VISION INTL.(HDG.)	0.03	14.55
905	HAYWOOD INVESTMENTS	0.085	14.69
204	EVEREST INTL. INVS.	0.045	15.98
922	VISION TECH INTL.HDG. (February 6, 2003)*	0.049	17.87
620	UDL HOLDINGS	0.02	18.71
1190	BAKER GROUP INTL.HDG. (August 26, 2002)*	0.036	19.17
726	SOUTH EAST GROUP	0.067	22.15
397	STARBOW HOLDINGS	0.035	25.75
90	GOLD WO INTL. (December 16, 2002)*	0.08	25.92
371	SHANG HUA HOLDINGS	0.024	26.65
2336	SUNLINK INTL.HDG.	0.058	27.43

<sup>a</sup> This column states the four digit stock code as assigned by the SEHK. See HONG KONG EXCHANGES & CLEARING LTD., TRADING INFORMATION: SECURITIES MARKET-CLOSING PRICE CALCULATION, at [www.hkex.com.hk/tradinfo/closepricecal/closepricecal.htm](http://www.hkex.com.hk/tradinfo/closepricecal/closepricecal.htm) (last visited Sept. 14, 2004).

<sup>b</sup> This column states the closing prices of the shares as of June 30, 2004. All amounts are expressed in Hong Kong Dollars. Hence the number "0.01" means HKD\$0.01 or one Hong Kong cent. Under a normal operating environment, the closing price of a share is determined by the median of five nominal prices in the last minute of the trading hour for the day. See *id.*

<sup>c</sup> This column states the market capitalization of the companies as at June 30, 2004. All amounts are expressed in millions of Hong Kong Dollars. Hence, the number "8.02" means HKD\$8.02 million or about USD\$1.03 million.

\* This indicates that the trading of the share has been suspended. The date of suspension is located in parentheses. Only companies for which trading has been suspended on or before December 31, 2003 have been included as a requirement of the present proposal to be effective for a period of at least six months.

1139	VICTORY GROUP	0.027	29.03
993	SIMSEN INTERNATIONAL	0.078	32.18
313	DICKSON GROUP HDG.	0.046	35.51
327	SHANXI CENTRAL PHARM. (July 25, 2003)*	0.015	36.12
650	SHUN CHEONG HDG.	0.078	36.17
1095	SINOCAN HOLDINGS (June 24, 2002)*	0.044	37.38
254	ECYBERCHINA HOLDINGS (June 30, 2003)*	0.014	40.14
228	HON PO GP.(LOBSTER KING)	0.065	40.95
467	ORIENT RES. GP.	0.043	41.27
288	BERJAYA HOLDINGS (HK.)	0.071	41.96
1176	NAM FONG INTL.HDG.	0.031	42.16
901	RADFORD CAPITAL INV.	0.029	43.79
577	SKYNET (INTL.GP.) HDG. (October 16, 2003)*	0.01	45.07
916	FU CHEONG INTL.HDG. (December 16, 2002)*	0.038	45.6
501	RNA HOLDINGS (June 2, 2003)*	0.027	45.78
979	CHINA NAN FENG GP.	0.058	46.1
211	STYLAND HDG.	0.025	46.78
851	MAE HOLDINGS	0.014	47.64
1130	BENEFUN INTL.HDG.	0.045	50.94
385	CHINNEY ALLIANCE GP.	0.013	51.56
193	CAPITAL ESTATE	0.016	52.31
476	CHINA ELEGANCE (HDG.)	0.06	53
1013	PLUS HOLDINGS	0.04	55.65
305	MAGNUM INTL.HDG.	0.094	57.81
295	KONG SUN HOLDINGS	0.025	64.03
430	ORIENTAL EXPLORER HDG.	0.036	64.8
519	APPLIED INTL.HDG.	0.071	66.82
736	NORTHERN INTL. HDG.	0.014	67.65
720	WO KEE HONG HDG.	0.032	70.92
925	PEAKTOP INTL.HDG.	0.1	73.09
1003	CAPITAL PROSPER	0.06	76.71
729	GORIENT (HOLDINGS)	0.06	78.76
1141	XIN	0.072	79.4
689	GREAT WALL CYBERTECH (March 24, 2003)*	0.01	80.76
59	RENREN HOLDINGS	0.012	81.35
718	BESTWAY INTL. HDG.	0.029	82.68

412	HERITAGE INTL.HDG.	0.031	86.55
559	FT HOLDINGS INTL.	0.034	88.1
353	JACKLEY HOLDINGS	0.071	88.39
990	THEME INTERNATIONAL HDG.	0.036	90.3
547	SUN INNOVATION HDG.	0.019	92.74
516	PYXIS GROUP	0.04	96
1191	CHINA RICH HOLDINGS	0.043	97.04
1046	UNIVERSE INTL.HDG.	0.06	97.48
651	WONSON INTL.HDG.	0.015	102.56
439	CLIMAX INTL.	0.027	105.64
155	REXCAPITAL INTL.HDG.	0.066	112.82
530	FORTUNA INTL. HDG.	0.011	113.59
835	WANJI PHARM.HDG.	0.021	114.29
491	RUILI HOLDINGS	0.011	116.76
70	MASSIVE RES.INTL.	0.013	118.06
542	MORNING STAR RES.	0.052	125.56
1218	EASYKNIT INTL.HDG.	0.099	131.04
555	REXCAPITAL FINL.HDG.	0.044	132
875	FIRST DRAGONCOM AGRO-STRATEGY HDG.	0.065	138.62
240	I-CHINA HDG.	0.018	140.65
115	GRAND FIELD GP.	0.07	143.27
276	NEW WORLD CYBERBASE	0.025	145.62
164	PREMIUM LAND	0.032	145.65
399	FAR EAST PHARM. TECH.	0.068	147.95
79	CENTURY LEGEND (HDG.)	0.072	148.68
479	CIL HOLDINGS	0.025	154.37
2362	GOLDIGIT ATOM-TECH HDG.	0.092	156.39
663	SWANK INTL. MNFG.	0.051	159.37
285	CHINA SPECIALISED FIBRE (November 26, 2002)*	0.089	165.54
767	PACIFIC PLYWOOD HDG.	0.032	178.59
262	DESON DEV.INTL.HDG.	0.039	180.94
261	CCT TECH INTL.	0.013	183.8
419	UNIVERSAL HOLDINGS	0.057	186.63
603	CHINA CITY NATURAL GAS	0.02	190.44

