

**Report on the Securities and Futures Commission's  
2005 annual review of the Exchange's performance  
in its regulation of listing matters**

**13 July 2005**

# Executive summary

This report summarises the Securities and Futures Commission's 2005 annual review regarding the performance of The Stock Exchange of Hong Kong Limited (Exchange) in its regulation of listing-related matters.

This report is divided into three parts:

- Section 1 explains the purpose of our assessment and the process;
- Section 2 sets out our observations on and recommendations for the various departments; and
- The Appendices
  - Appendix I contains a table summarising our recommendations and the Exchange's responses to those recommendations; and
  - Appendix II contains a structural chart of the Listing Division with details of headcount as at 31 December 2004.

## **Purpose of our assessment**

The purpose of our assessment was to review whether the Exchange's procedures in key listing-related functional areas were adequate to enable it to fulfil its statutory obligation to ensure, as far as reasonably practicable, an orderly, informed and fair market under section 21 of the Securities and Futures Ordinance. This report is focused on procedures because it relates to the first of a series of annual reviews, and follows the Exchange's adoption of new structures and revised procedures. In our future annual reviews we intend to build on this foundation by focusing on other aspects of the Exchange's listing functions, including quality of execution.

## **What we reviewed and assessed**

We reviewed and assessed the Exchange's procedures in the following key functional areas related to listing:

- listing applications;
- transactions requiring shareholder approval;
- disclosure of price sensitive information;
- review of financial disclosure – including its financial statements review programme;
- disciplinary actions; and
- maintenance of the public database of listed company information.

Our assessment covered the Exchange's operations in 2004 and January 2005.

## **Key observations and recommendations**

In our view, the Exchange's procedures in the areas examined are adequate to enable it to discharge its statutory obligation to maintain an orderly, informed and fair market.

In Section 2 of this report, we set out observations from our review and assessment. We also include some recommendations. In our view these matters do not mean that the Exchange's

procedures are currently inadequate to enable it to comply with its statutory obligation to ensure an orderly, informed and fair market. Rather, they identify areas of potential improvement which we will continue to discuss with the Exchange.

Our key recommendations are that the Exchange should consider:

- ways to improve the transparency of its policies and practices;
- establishing an electronic database to capture its institutional knowledge;
- establishing a comprehensive risk based programme for reviewing listed companies' periodic reports, including annual reports;
- establishing a comprehensive case management system in the Compliance and Monitoring Department that covers all the work of the Department, so as to enable senior management to analyse the Department's work and assess its performance with a view to improving the Department's efficiency and effectiveness;
- reviewing the search functions of and presentation of information on the public database of listed company information.

## Section 1: Introduction

1. This is the report of the Securities and Futures Commission (SFC) on its 2005 annual review regarding the performance of the Exchange in its regulation of listing-related matters.

### **Purpose and focus of review**

2. Section 21 of the Securities and Futures Ordinance requires the Exchange to ensure, as far as reasonably practicable, an orderly, informed and fair market (“the Exchange’s statutory duty”).
3. Section 5(1)(b)(i) of the Securities and Futures Ordinance requires the SFC to supervise, monitor and regulate the activities carried on by the Exchange. As recorded in the Memorandum of Understanding between the Exchange and the SFC dated 28 January 2003 (“Listing Matters MoU”), the Exchange and the SFC have also agreed that the SFC shall periodically review the Exchange’s performance in its regulation of listing-related matters.
4. In March 2004, the Government published its Consultation Conclusions on Proposals to Enhance the Regulation of Listing. Amongst other matters, the Government recommended that the SFC prepare annual reports on its reviews regarding the Exchange’s performance of its listing functions and submit them to the Financial Secretary, who shall cause the report to be published. This is the first report of a series of annual reports under the Government’s recommendation.
5. In addressing the Exchange’s statutory duty, the Exchange must establish procedures that provide sufficient assurance that it is operationally organised to meet its obligation. Accordingly the focus of this annual review was whether the Exchange’s operational procedures in key listing-related functional areas were adequate to enable it to fulfil this statutory obligation. This focus also arose because:
  - as described later in this section, and more fully in section 2 of this report, the Listing Division reorganised its operations into new functional departments in 2004;
  - during 2004 these new departments reviewed and modified some of the Exchange’s procedures relating to their functions; and
  - some of the modified procedures were not fully implemented until the latter part of the period covered in our review, rendering a review of the quality of their execution impracticable.

Hence this review, being the first after these changes were made, has basically been a review of process.

6. Our understanding and assessment of the Exchange’s procedures in these key functional areas related to listing will provide the basis for future annual reviews. Our future annual reviews will focus on other aspects of the Exchange’s listing functions, such as the Exchange’s:
  - monitoring of the Listing Division’s performance;
  - handling of complaints against the Listing Committee or the Listing Division;
  - handling of complaints against listing applicants and listed companies;

- suspension of trading in securities;
- handling of pre-IPO enquiries;
- handling of requests for clarification of Listing Rules;
- handling of review cases;
- handling of long suspended companies;
- identification and handling of novel matters; and
- implementation of the ICAC's recommendations on conflicts of interests.

### **What we reviewed and assessed**

7. In determining the scope of this annual review, we considered the Exchange's responsibilities as the frontline regulator of all listing-related matters as set out in the Listing Matters MoU. We reviewed and assessed the Exchange's operational procedures in the following key functional areas relating to listing:

- listing applications;
- transactions requiring shareholder approval;
- disclosure of price sensitive information;
- review of financial disclosure – including the financial statements review programme;
- disciplinary actions; and
- maintenance of the public database of listed company information.

The Exchange's Listing Division handles these areas except for the maintenance of the public database which is handled by the Information Services Department and the Information Technology Division.

8. As set out in the Listing Matters MoU, the Exchange is obliged to maintain an adequate strength of staff in the Listing Division with an adequate level of professionalism and experience to discharge the responsibilities of the Listing Division. During this annual review, we did not seek to assess the staff's professionalism and experience directly but by reference to the procedures in the areas covered by the review. Nothing came to our attention that suggests the staff do not have an adequate level of professionalism or experience. The Exchange advised us that further to a request by the Head of Listing, the HKEx Board approved a phased increase in the Listing Division's headcount over the course of the calendar year 2005 from 122 to 144 staff. As at 31 May 2005 the Listing Division had 136 staff in post or scheduled to join the Exchange compared to a budgeted headcount of 140.

9. Our assessment covered the Exchange's operations in 2004 and January 2005 which was the period since the Listing Division was restructured at the start of 2004. To increase effectiveness and efficiency, the Listing Division reorganised its operations into three functional teams:

- the Initial Public Offering Department (IPO Department);
- the Compliance and Monitoring Department (C&M Department); and
- the Listing Enforcement Department (Enforcement Department).

10. The IPO Department and the C&M Department were formed from the Corporate Finance Department, which dealt with all listing related matters. The Enforcement

Department is the successor to the Listed Company Compliance Unit, which investigated suspected breaches of the Listing Rules and pursued disciplinary actions.

11. The purpose of this assessment was to review the Exchange's existing practices and procedures. We reviewed operational case files for the period after the relevant teams completed the change associated with their reorganisation. For example, the IPO Department reviewed and modified the Listing Division's practices relating to initial public offerings following its establishment on 15 January 2004. Certain procedures and practices were only implemented in the second half of 2004. Accordingly we reviewed operational case files for new listing applications submitted after June 2004. Similarly we did not seek to review the Listing Division's procedures and processes relating to compliance and monitoring prior to the establishment of the C&M Department in January 2004.
12. We reviewed and assessed the adequacy of the Exchange's operational procedures based on five criteria:
  - timeliness of decisions made;
  - consistency of decisions;
  - transparency of the Exchange's policies and practices;
  - completeness; and
  - management oversight.
13. In respect of the adequacy of the Exchange's operational procedures in maintaining the public database of listed companies, we reviewed and assessed the Exchange's performance as regards:
  - the security of its computer systems; and
  - completeness and presentation of information.

#### **How we conducted the assessment**

14. In conducting the assessment, we:
  - interviewed the Chairman of the Listing Committee;
  - sought market participants' views on an informal basis;
  - interviewed key personnel of the Listing Division, the Information Services Department and the Information Technology Division;
  - reviewed written policies and procedures of these divisions;
  - reviewed the IPO, C&M and Enforcement Departments' internal reports and operational case files;
  - reviewed the 2004 annual report of The Hong Kong Exchanges and Clearing Limited (HKEx), Exchange Newsletters, and the 2004 Listing Committee Report;
  - reviewed the Exchange's published disciplinary procedures, listing decisions and rejection letters; and
  - reviewed other related documents on the HKEx website.
15. We conducted our on-site review principally from 21 February to 12 March 2005; and the off-site review at HKEx data centre from 8 March to 11 April 2005. In April 2005, we held "exit" interviews with the heads of the IPO Department, C&M Department, Enforcement Department, Information Services Department and Information

Technology Division which the Head of the Listing Division also attended. We discussed our preliminary findings with them at the “exit” interviews.

16. We also discussed the final results of our assessment with the Head of the Listing Division, and sought the Exchange’s comments on both the factual matters set out in this report and our conclusions. The Exchange’s responses to our recommendations are set out in the Appendix.

## Section 2: Observations and recommendations

### Part A: Initial Public Offering Department

#### **Role of Department**

17. The Listing Division established the IPO Department in January 2004. The IPO Department's primary responsibility is to process new listing applications. It:
- assesses prospective new listings and vets draft prospectuses;
  - checks to ensure that listing applicants comply with the Listing Rules;
  - checks to ensure that listing applicants comply with the prospectus requirements in the Companies Ordinance;
  - reports to the Listing Committee and recommends the Listing Committee to:
    - o approve listing applications; and
    - o grant listing applicants waivers from the requirements of the Listing Rules; and
  - rejects listing applications.

#### **Assessment process**

##### *Documents reviewed*

18. We reviewed the following documents during our assessment:
- the IPO Department's written policies and procedures;
  - internal guidelines and reports, including case management reports;
  - reports, guidelines and other documents published on the HKEx website; and
  - 23 new listing application case files comprising 19 applications to list on the Main Board and 4 applications to list on the Growth Enterprise Market (GEM).

##### *On-site visit and interviews*

19. We conducted on-site visits and interviews with the Head of the IPO Department and other senior staff.

#### **Background to the establishment of the IPO and C&M Departments**

20. In January 2004, the Corporate Finance Department of the Listing Division was split into the IPO and C&M Departments. Prior to its reorganisation, the Corporate Finance Department dealt with all aspects of the Exchange's regulation of listing-related matters including:
- processing new listing applications;
  - monitoring listed companies' activities and compliance with the Listing Rules;
  - vetting of announcements and circulars;
  - dealing with complaints;
  - monitoring untoward price or volume movements; and
  - processing sponsor related applications.

21. The breadth of work put much time pressure on the staff which meant that much of the staff's working day was dictated by time critical work such as:
  - monitoring press reports for any price-sensitive but unannounced transaction or corporate activity in the morning before the market opens; and
  - vetting announcements in the evening for publication in newspapers the following day.The balance of the working day was devoted to other less time critical but important work.
22. The restructuring of the Corporate Finance Department was intended to enable staff dealing with initial public offerings to give undivided attention to listing applications.

### **Observations**

23. The IPO Department has put much emphasis on streamlining its internal procedures and its approach to vetting new listing applications. It has successfully implemented new procedures, which are now possible in light of the new Listing Division structure and have raised the standards of its work for the reasons set out below.
24. There were 37 professional staff in the IPO Department as at the end of 2004. The Department was divided into six teams. Each team had four to five members led by a team leader.
25. Since its establishment, the IPO Department has put in place structured procedures for processing listing applications and vetting prospectuses. Its written procedures set out step-by-step what each team must do in the course of processing a listing application, e.g. criteria to determine whether to accept a listing application, procedures for dual filing of prospectuses, and procedures for prospectus authorisation.
26. Within three weeks of accepting a listing application, the IPO Department will ordinarily compile and send listing applicants and their advisers its substantive comments (commonly known as the "first comment letter"). The practice of sending the first comment letter (as opposed to the previous practice of marking up comments directly onto a draft prospectus) has focussed the IPO Department's attention on substantive issues regarding the listing applicant's suitability for listing rather than drafting issues. The first comment letters are divided into three sections:
  - disclosure issues;
  - Listing Rules issues; and
  - accounting issues.
27. The Listing Committee plays an important role in giving the IPO Department direction on the approach to vetting listing applications. It sets the tone for the focus of the IPO Department's work. The main focus of the Listing Committee's comments at the hearings to consider a listing application is the listing applicant's suitability for listing. The strong steer from the Listing Committee has concentrated IPO Department staff's attention on whether an applicant is suitable for listing in addition to its technical compliance with regulations.

## **Timeliness**

28. The revised procedures in the IPO Department have generally improved the efficiency and efficacy of the Department's performance. A review of the IPO Department's case management database indicates that the Department has reduced the variance in the length of time taken to complete the listing application process.

## **Consistency**

29. The IPO Department takes the following steps to ensure consistency in its approach and interpretation of the Listing Rules:
- involving senior management of the Department at the early and final stages of the vetting process. This is also designed to ensure material issues are captured at the start of the vetting process;
  - having group discussions to consider the substantive issues to ensure that senior staff of the Department are aware of the approach taken in the listing applications. The group discussions are attended by senior staff and management, and the teams handling the respective applications;
  - supervision of each team by a senior staff member so that each team is aware of the latest approach taken;
  - rotating senior staff responsible for supervising teams to minimise inconsistency in individual senior staff member personal approaches;
  - issuing internal administrative guidelines to staff on particular matters which are likely to have common application;
  - establishing standardised written practices or checklists for certain routine tasks; and
  - creating written records of comment letters and reports to the Listing Committee.
30. However, the IPO Department does not have an electronic database that captures all of its precedent knowhow materials. The Department should consider establishing such a database to capture and share knowledge of its staff. The entire Listing Division should also share this database.
31. Where a listing applicant has sought a continuing transaction waiver, the IPO Department will meet with the C&M Department to discuss the application and agree on a common approach. The purpose of these meetings is to ensure consistency in approaches between the two departments. The meetings also serve to inform the C&M Department of the waiver so that they can follow up on the matter after the applicant is listed.

## **Transparency**

32. To improve transparency of its work the IPO Department publishes on the HKEx website monthly progress reports of new listing applications, new listing announcements, details of new listings, and reasons for rejecting a listing applicant.

33. However, there is room to improve the transparency of the IPO Department's work:
- During the course of vetting a listing application, the IPO Department may face many new complex issues which may be unique to a particular listing applicant. It then develops its policies and practices in response to these issues while processing the listing application concerned. Where a policy or approach so developed is likely to have common application, the Department will issue internal administrative guidelines to staff on the particular matter. However, these guidelines are not made public. To improve transparency of its latest approach and practices, the IPO Department should consider how they can publish these guidelines on the HKEx website so that the market can benefit from them.
  - The IPO Department should consider giving advance public notice, absent exceptional circumstances, before it seeks to change an established practice or approach in a way that would be expected to have a significant market impact but which does not involve a rule change or modification that requires the SFC's prior consent. Changing the Exchange's established practice or approach without warning may disrupt listing applicants' timetables and confuse the market. For instance, when the Exchange recently decided to change its practice to require stub period comparatives in the accountants' report as specified by the Listing Rules, it did not advise the market generally in advance. Instead the Department advised individual applicants during the vetting process of its view that comparatives are necessary. There was significant adverse reaction from the market as a number of listing applications were in an advanced stage of preparation and a number of listing applicants believed they would have had difficulty producing the required comparatives within a short period of time. In light of the market reaction, the change to require stub period comparatives was introduced more gradually than originally envisaged.
  - The IPO Department should also consider posting its checklists on the HKEx website. Currently these checklists are only available on the HKEx e-submission system and upon request.
34. Market practitioners have advised us that they would like the IPO Department to consider how:
- it can give advance notice of the Listing Committee's expected hearing dates; and
  - it can build into the listing application process a way for listing applicants to seek early guidance from the Listing Committee on complex or novel issues.

### **Completeness and management oversight**

35. To enable management to monitor the IPO Department's performance and the progress of initial listing applications, the Department has a detailed case management database which records the details of all listing applications and the progress of each application.
36. The case management database has enabled the IPO Department to analyse the length of time taken to process a listing application from submission of the application to the Listing Committee hearing stage in 2004. Initial analysis by the Department shows that small listing applicants generally take more time to respond to the Department's comments than for the Department to review the application. In 2004, on average the Department also spent about 50% more time reviewing medium and small applicants'

listing applications (applicants with estimated market capitalisation less than \$1 billion) than those of large applicants.

37. Initial analysis of the average life of listing applications indicates that:
- time taken for the IPO Department to issue its first comment letters is not affected by the size of the listing applicant's market capitalisation;
  - processing times are more likely to be correlated to market capitalisation than to whether the listing is to be on the GEM or the Main Board; and
  - processing times for applicants with smaller market capitalisation are generally longer. This is explained in part by the fact that small issuers generally take twice as long as large issuers to respond to the IPO Department's comments.

### **Record keeping**

38. The IPO Department does not have a formal protocol on how documents and correspondence should be filed. Each team maintains a file for each listing applicant. However, we noted that the teams generally file all outgoing and incoming correspondence separately. All draft prospectuses and checklists are also filed separately from the correspondence.

### **Recommendations**

39. We note that the IPO Department has sought to improve transparency in its work during the course of 2004, although there is still room for improvement. The IPO Department should consider how it could communicate its practices and policies to the market generally. The Department should review its internal guidance for staff to see which of these should be communicated to the market.
40. Where the IPO Department changes an established practice or approach in a way that would be expected to have a significant impact on the initial public offering process but which does not involve a rule change or modification that requires the SFC's prior consent, the IPO Department should consider providing prior notice to the market before implementing the changes.
41. To capture staff knowledge, the IPO Department should consider establishing an electronic database comprising all its precedent and knowhow materials. This will facilitate information sharing and distribution within the IPO Department and the Listing Division.

## Part B: Compliance and Monitoring Department

### Role of Department

42. The C&M Department has primary responsibility for monitoring compliance with the Listing Rules by listed companies. The work of the C&M Department can be divided into the following activities:-
- monitoring media reports to ensure they comply with the Listing Rules governing the disclosure of price sensitive information. Essentially the Department reviews newspaper articles to check if they contain price sensitive information that has not been previously announced by the listed company;
  - monitoring untoward or unusual price and trading volume movement of shares listed on the Exchange, as these unusual movements may indicate uneven dissemination of price sensitive information;
  - vetting announcements and circulars to ensure compliance with the Listing Rules;
  - considering applications for waivers of the Listing Rules' requirements;
  - handling complaints, including initial enquiries into whether there is any breach of the Listing Rules. It will refer the matter to the Enforcement Department for investigation when it suspects the company concerned and/or its directors have breached the Listing Rules;
  - annual report review to ensure compliance with the Listing Rules;
  - processing sponsor related applications;
  - considering applications for listing of further securities; and
  - handling including liaising with other departments on, trading arrangements, suspension and resumption of trading, and dissemination of announcements.

### Assessment process

#### *Documents reviewed*

43. During our assessment, we reviewed the following documents:
- C&M Department's written policies and procedures;
  - management reports and internal guidelines;
  - documents published on the HKEx website;
  - 51 company files; and
  - 20 transaction files in respect of transactions that required shareholder approval.

#### *Interviews*

44. We conducted on-site interviews with the Head of the C&M Department and other senior staff.

## Observations

45. Of the three departments in the Listing Division, the C&M Department has the most varied and wide responsibilities. There were 38 professional staff in the C&M Department as at the end of 2004. The Department is divided into 4 teams and a number of sub-teams. Each team is responsible for monitoring compliance by a number of listed companies. The companies are divided among the various teams according to alphabetical order and groups of listed companies. Each sub-team consists of a case manager supported by one or two executives. Each sub-team reports to a team leader. There are 4 team leaders, who supervise four to six sub-teams each.
46. The functions and responsibilities of the C&M Department are discharged through the teams. Team leaders supervise the work of the teams and report to the Head of Department. Senior management relies on team leaders to identify issues that require their attention. In addition, senior management look into matters raised by third parties, for instance concerns raised by issuers or their advisers, complaints from the public and media reporting.
47. The C&M Department has dedicated staff and long established operating practices. The Department's management approach places significant reliance on the experience, knowledge and competence of team leaders and case managers:
  - Team leaders are responsible for managing, supervising and monitoring their teams' work. The relevant team leaders may exercise their discretion in deciding how to manage, supervise and monitor his or her teams' work. Team leaders are expected to work directly on the more important and complex transactions and supervise the case managers' work on more routine matters.
  - Case managers are expected to deal with the more straightforward and routine matters. Where difficult or complex issues are embedded in apparently routine matters, case managers are expected to identify these issues and raise them with their team leaders at an early stage.
  - Assistant managers and executives who assist the case managers deal with the more administrative work.
48. The knowledge, experience and competence of individual staff members are significant elements in the supervision of listed companies. Given the heavy reliance on staff, staff turnover could significantly reduce the Department's efficiency and effectiveness. We note with some concern that the C&M Department had the highest turnover in the Listing Division at 38% in 2004 although many of those who resigned were assistant managers and executives.
49. Much of the C&M Department's work is urgent matters, such as monitoring media reports, price and trading volume alerts, and vetting announcements that must be cleared for publication in the newspapers the following day and so are completed within the day. Given this urgency, there is a tendency for staff to prioritise their work to deal with the more urgent matters first and leave aside those matters with longer deadlines to be dealt with later or when they become urgent.
50. The C&M Department does not have a comprehensive and detailed case management system that allows the Head of the Department to monitor the various teams' performance, and the timeliness and completeness of their work. The various teams' interaction with listed companies and their advisers helps ensure that matters relating to

vetting of announcements and circulars, and applications for waivers and further listing applications, are completed within the deadline for a particular transaction. The Department also prepares a number of spreadsheets recording certain activities such as daily announcements, stocks of which trading has been suspended and resumed, and the deadlines for listed companies to publish their annual and interim reports including financial statements. For complaints, the Department prepares a progress report of all complaints received for inclusion in the monthly report sent to the SFC. These diverse records allow senior management to monitor the level of the recorded and reported activities and the listed companies' level of compliance with the relevant Listing Rules requirements.

51. Whilst we did not observe anything calling into question the professionalism and experience of the C&M Department, the lack of a comprehensive case management system to monitor the Department's performance should be addressed as a priority, especially in light of the breadth and nature of the Department's work.

### **Timeliness**

52. Some of the C&M Department's work has a very short life, such as untoward price and volume movement alerts which are generally dealt with by the end of the same day. Matters such as clearing announcements and circulars, and processing waiver and further listing applications, are completed when the announcement or circular is issued, or the application granted. Accordingly there is an externally imposed time pressure for announcements and circulars that are pre-vetted to be completed in a timely manner.
53. In respect of other less pressing work, it is up to the individual teams to prioritise their work and the team leaders to monitor its progress. We are unable to make observations or conclusions as to the timeliness of the Department's work owing to the lack of a comprehensive case management system to monitor the progress of the various tasks performed by the C&M Department. Each team operates its own informal control process for monitoring the progress of matters at hand.

### **Consistency**

54. The C&M Department has an informal structure for achieving consistency in its decisions. It generally relies on staff to ensure they know the Department's established practice and interpretation of the Listing Rules. Team leaders will give directions to any team member who is unsure of the Department's approach or interpretation. Where any staff member is unsure of the Department's approach in previous cases, he or she is encouraged to discuss with other officers or seek advice from team leaders or from two senior staff members specially assigned for this purpose. Staff members are also encouraged to raise complex or novel issues with the Head of the Department and, if necessary, with the Head of the Listing Division for directions.
55. When staff members are faced with complex or novel questions or interpretation of the Listing Rules, they are expected to raise these matters at the C&M Department's daily morning meetings. All case managers, team leaders and other senior staff of the Department attend these meetings. The relevant case manager is required to prepare a management note documenting a summary of the issue, the team's analysis and the decision made. These management notes are stored with all other internal documents in the Department's computer system. Anyone interested in a particular topic must

conduct a search of all documents in the relevant part of the system. This is time consuming and highly inefficient.

56. The C&M Department has a large number of staff and four team leaders dealing with a wide variety of issues. Hence, ensuring consistency of approach and decisions represents a significant challenge for the Department. The Department should consider how to bring together all the experience and knowledge held within the Department in a way that is readily accessible to all staff. One key element needed to improve efficiency and provide consistency would be to establish an electronic database to capture and share knowledge of the Department's staff. At present the Department relies on the knowledge of a few senior staff members who have been with the Listing Division for some years. The Department should consider establishing such a database to facilitate information sharing within the Department and the Listing Division.

### **Transparency**

57. To improve transparency of its work and to provide useful information to investors, the C&M Department publishes on the HKEx website various information on listed companies. The Department has also publicised its policy and practices on various compliance issues such as suspension policy in the Exchange magazine (a quarterly publication which is available on the HKEx website). The C&M Department has also conducted and participated in seminars and training courses to explain the Exchange's consultation conclusion and rule changes. Supplementary materials on the March 2004 Listing Rule changes such as the FAQs on the corporate governance rule changes have also been published on the HKEx website.
58. The C&M Department should consider ways in which it can improve the transparency of its work and practices, particularly when it is implementing new practices. The Department recently launched a pilot project to reduce the extent of its pre-vetting activities. This may, in due course, result in a reduction of the types of announcements that it must approve. Although the Listing Rules only require listed companies to obtain the Exchange's prior approval for certain announcements such as notifiable transaction announcements, it had become common practice for listed companies to seek the Exchange's approval for most if not all announcements. The C&M Department sought to change this practice by allowing announcements that do not require prior approval under the Listing Rules to be issued without approval. Instead the Department would post-vet these announcements the following day.
59. The Exchange has not announced the pilot project despite the fact that the project has been implemented for half a year. The C&M Department has established some criteria for announcements that do not require pre-vetting. Its approach has been to look at a draft announcement submitted by a listed company or its professional advisers and advise whether or not the Department would comment on the draft. The Department expected that over time listed companies and professional advisers would come to understand its practice.
60. Although the C&M Department has expressed confidence that the market understands its new post-vetting policy, we have received feedback from market practitioners that they do not understand which announcements require the Department's prior approval and which do not. Some market practitioners advised us that they have received

contradictory advice from different members of the Department. The Department should consider how it can communicate its new policies and practices to the market.

### **Completeness**

61. Reviewing periodic reports including financial statements would bring to the regulator's attention any undisclosed significant transactions during the financial year. Despite the importance of having a sound periodic report review programme to monitor listed companies' compliance with the Listing Rules, the C&M Department does not have a formal protocol for reviewing periodic reports. The Department advised us that its policy is to review all results announcements to identify which company's annual reports should be reviewed. The Department's policy is to review a company's annual report if the auditors' report on the financial statements is qualified, if it was a company's first annual report after listing or if reported results are significantly different from those of the previous year.
62. The C&M Department advised us that it has assigned a senior staff member to review and design an annual report review programme but that currently review of annual reports has been given a low priority in light of the few regulatory issues identified historically. There is no systematic mechanism to ensure that (a) all results announcements are reviewed, and (b) the Department reviews those annual reports that fall within the criteria described in the above paragraph. The current system depends on individual teams to manage their own work.
63. In other areas such as post vetting of announcements there is no single system to ensure that all matters that the C&M Department should look at have been dealt with. Each individual team has its own procedures for ensuring that it has dealt with all necessary matters. The absence of a standard system makes it difficult for the Department to monitor completeness of its work.
64. For announcements and circulars that are pre-vetted, applications for waivers and further listing applications, there is a natural external check and balance that ensures these matters are dealt with. These draft documents require the team leaders' approval. However, where there is no such external interaction, the completion of the task depends on the relevant case manager and the relevant team leader. In order to prepare for the Exchange's planned reduction in pre-vetting, it is crucial that the C&M Department enhances the system by which senior management monitor whether the Department's procedures have been completed.

### **Management oversight**

65. The C&M Department does not have a comprehensive and detailed case management database or management tool which enables management to monitor the efficiency and effectiveness of the Department's procedures, or assess its performance in monitoring and ensuring listed companies' compliance with the Listing Rules. Of the three departments in the Listing Division, management oversight is the most crucial for the C&M Department in view of the breadth and nature of the Department's work. Senior management relies on team leaders to bring their attention to issues they need to look into. A more comprehensive and detailed case management system would enable senior management to analyse the Department's work and assess its performance with a view to improving the Department's efficiency and effectiveness.

66. Senior management relies heavily on team leaders to deal with the more complex and significant transactions and to supervise the case managers responsible for monitoring listed companies' compliance with the Listing Rules. All announcements, circulars, untoward price or volume alerts etc require team leader clearance or approval before the matter can be completed. The team leader in turn relies on the case managers to deal with the 'routine matters' and identify significant, complex or novel issues that may arise in these matters. This puts much pressure on case managers to be able to identify and raise such issues with team leaders. Where the case managers do not identify an issue it may only be addressed late in the process. The non-involvement of team leaders in such matters until the final stage exacerbates the problem because of the lack of time to deal properly with an issue. Although nothing came to our attention indicating that it is a widespread problem, the Department should consider how it can address this issue.

### **Record keeping**

67. The C&M Department has no written filing protocol. However we noted that staff file correspondence relating to transactions in transaction files and other correspondence in the correspondence files. We have noted a few instances where documentation relating to the review of annual reports including financial statements was not filed in the correspondence files but filed together with documents relating to a transaction. There is no file note or record in the correspondence file to note that the relevant team had reviewed the company's financial results. The C&M Department advised that in those instances the review of financial statements was conducted in relation to the transaction in question and therefore the relevant documentation was filed in the transaction files. Accordingly reviewing only a correspondence file might not provide a full understanding of the supervisory history of a listed company. Instead, one has to rely on the relevant team leader and case manager's experience and knowledge of a company's recent transaction and compliance history.

### **Recommendations**

68. The C&M Department should institute a comprehensive risk based programme for reviewing listed companies' periodic reports, including annual reports.
69. The C&M Department does not have a comprehensive or detailed case management system that allows the Head of the Department to monitor the various teams' performance, and the timeliness and completeness of their work. Instead the Head of the Department relies on team leaders to manage, supervise and monitor the various teams' work. The Department also relies on team leaders to raise issues that require their attention. The Department should consider establishing a comprehensive and detailed case management system that covers all the work of the Department, so as to enable senior management to analyse the Department's work and assess its performance with a view to improving the Department's efficiency and effectiveness
70. The C&M Department should consider ways in which it can improve the transparency of its work and practices, particularly when it is implementing new practices.
71. To capture its staff's knowledge, the C&M Department should consider establishing an electronic database capturing all its precedent and knowhow materials. This will facilitate information sharing and distribution within the C&M Department and the Listing Division.

## Part C: Enforcement Department

### **Role of Department**

72. The Enforcement Department investigates suspected breaches of the Listing Rules, and institutes disciplinary action before the Listing Committee for such breaches by companies and their directors.
73. The Enforcement Department does not play an active role in identifying breaches of the Listing Rules. It primarily acts on referrals from the C&M Department, the SFC and complaints received from the public. It does not normally receive referrals from the IPO Department as listing applicants are not subject to the Listing Rules, and newly listed companies are transferred to the C&M Department immediately upon listing.

### **Assessment process**

#### *Documents reviewed*

74. We reviewed the following documents during our assessment:
  - the Enforcement Department's written policies and procedures;
  - internal guidelines and reports, including case management report;
  - documents published on the HKEx website;
  - 12 on-going investigation and enforcement operational files; and
  - 7 completed disciplinary cases and 2 no further action cases.

#### *On-site visit*

75. We conducted on-site visits and interviewed the Head of the Enforcement Department about the general operations of the department, and two members of the Department.

### **Observations**

76. The Enforcement Department is the smallest department in the Listing Division with only 8 professional staff as at the end of 2004. In view of its size, each investigation and disciplinary case is handled by a case officer and supervised by the Head of the Enforcement Department.
77. The Enforcement Department has streamlined its procedures to focus more resources on the more urgent and important cases. It has adopted a risk-based approach in its investigation and enforcement work. It prioritises cases according to the severity of the breaches. This allows the Department to focus and place more resources on cases with strong public interest and which pose significant regulatory concern. Minor breaches are dealt with by way of warning letters.
78. In 2004, the Enforcement Department reduced the number of unresolved cases and increased the number of disciplinary cases relating to substantive breaches. As at March 2004, 60% of the disciplinary cases that had been tabled before the Listing Committee were simple cases of late filing of annual and interim reports including

financial statements<sup>1</sup>, while only 30% and 10% of cases related to breaches of disclosure and connected transaction requirements respectively (see **Table 1**). A year later, in February 2005, the portion of disciplinary cases relating to breaches of disclosure and connected transactions requirements increased to 58% (see **Table 2**). The number of disciplinary cases also increased by two and a half times.

79. **Table 1** below shows a snapshot of the number of cases the Enforcement Department was handling as at March 2004 and February 2005. Although the number of investigation cases decreased from 174 in March 2004 to 132 in February 2005, the number of disciplinary cases increased from 10 as at March 2004 to 26 as at February 2005.

**Table 1: Number of investigation and disciplinary cases<sup>2</sup>**

As at	Investigation cases	Disciplinary cases <sup>3</sup>	Total
March 2004	174	10	184
February 2005	132	26	158

80. Table 2 below breaks down the disciplinary cases pending before the Listing Committee as at March 2004 and February 2005. The table shows that the number of substantive cases has increased, and the number of cases involving late filing of annual and interim reports including financial statements has decreased.

**Table 2: Disciplinary cases before the Listing Committee<sup>3</sup>**

Listing Rules breach concerning	February 2005	March 2004
Late filing of annual and interim reports including financial results	2	6
Connected party transaction and disclosure requirements	1	0
Disclosure	5	3
Connected transactions	9	1
Directors' dealings	1	0
Sponsor review – suspension of sponsor status	2	0
Others	<u>6</u>	<u>0</u>
<b>Total</b>	<b><u>26</u></b>	<b><u>10</u></b>

## Timeliness

81. To ensure that straightforward cases with significant regulatory concern are dealt with in a timely manner, the Enforcement Department seeks to settle late filing of annual and interim reports including financial statements cases such that the parties agree to a public sanction against the company. This ensures both timeliness and effectiveness in such disciplinary actions. The Enforcement Department completed 8 cases of late filing of annual and interim reports including financial statements during the period

<sup>1</sup> i.e. breaches of rules 13.46, 13.48 or 13.49 of the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Ltd or rules 18.03, 18.48A, 18.49, 18.53, 18.66, 18.78 or 18.79 of the Rules Governing the Listing of Securities on the Growth Enterprise Market

<sup>2</sup> Source: the Enforcement Department

<sup>3</sup> Disciplinary cases are where the Enforcement Department concludes that there may have been a breach of the Listing Rules and there should be a disciplinary hearing before the Listing Committee.

between 1 July 2004 and 31 January 2005. The average time taken by the Enforcement Department to initiate these disciplinary proceedings (from the date of the case's referral to the Department) was 16 months. However, if three 2001 cases are excluded, the average time taken decreases to 4 months. The average completion time for these disciplinary cases (from the date the case commences to the hearing date) was 18 months. If the three 2001 cases are excluded the average time decreases to 6 months.

### **Consistency of decisions**

82. The Enforcement Department has also streamlined its internal procedures, and documented them; this helps to ensure both clarity of and consistency in its regulatory decision-making. Senior management take an active role in the investigation and disciplinary process. This is designed to ensure that the Enforcement Department takes a consistent approach in its disciplinary actions. To assist the Listing Committee in determining the appropriate sanction where a company breaches the Listing Rules, the Enforcement Department includes in its report to the Committee previous sanctions that have been imposed in similar cases.

### **Transparency**

83. Although the Enforcement Department has taken steps to improve transparency of its enforcement strategy and disciplinary actions taken, we are of the view that there is room for improvement. The Department informs the public of its enforcement strategy in seminars given to various organisations and publishes the outcome of disciplinary cases by way of press releases. However, unlike information on new listings, which is archived under "Listing Matters and Listed Companies" on the HKEx website, information relating to the Department is not made available on the HKEx website under a discrete section containing all enforcement and disciplinary related matters. For instance, investors who wish to find out about past disciplinary actions must search every press release issued each year.
84. The Enforcement Department has recently adopted a policy of only recommending public sanctions. However, we note that the Exchange issued 3 private reprimands in 2004<sup>4</sup>. We commend the Department's policy because the practice of issuing private reprimands detracts from the transparency of the Exchange's procedures and outcomes. Private reprimands should be avoided wherever possible so that the market can be confident that the Exchange is acting consistently. Further, private sanction against listed companies and their directors is not an effective disciplinary tool. The effectiveness of the Exchange's disciplinary powers relies on the sanctions imposed being made public. Private sanctions are not publicised and there is no repercussion from private sanctions. The effect of such sanctions is similar to warning letters. We note that the Exchange has consulted on amendments to the Listing Rules which will remove private reprimands as a disciplinary sanction.

### **Completeness and management oversight**

85. To enable management to monitor the Enforcement Department's performance and the progress of all investigation and disciplinary cases, the Department has a detailed case

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<sup>4</sup> HKEx Annual Report 2004

management database which records every case being investigated and every disciplinary case.

86. The Enforcement Department also maintains a compliance record of all companies showing the records of sanctions imposed and warning letters issued against the companies since 1994. This allows the Department to review and assess a company's compliance record.

### **Recommendations**

87. To improve transparency, the Enforcement Department should archive information regarding its enforcement philosophy and policy, and disciplinary actions, in one dedicated section on the HKEx website to promote ease of search and access to the information. In particular, it is important that there should be a search facility to enable investors to find out whether a particular company or individual has been censured.

## Part D: Maintenance of the Public Database of Listed Company Information

88. In reviewing the Exchange's maintenance of the public database of listed company information, we reviewed the procedures and processes of two departments, namely:
- the Information Services Department (IS Department). The IS Department is responsible for uploading announcements, circulars and all other corporate information submitted by listed companies for publication on the HKEx website; and
  - the Information Technology Division (IT Division). The IT Division is responsible for supporting and maintaining HKEx's computer systems.
89. HKEx maintains two websites:
- a general website at [www.hkex.com.hk](http://www.hkex.com.hk) containing its corporate information as a listed entity and all other information relating to its regulatory functions (HKEx website); and
  - a special website at [www.hkgem.com](http://www.hkgem.com) containing information relating to the Growth Enterprise Market (GEM website).
90. The HKEx website contains information relating to Main Board and GEM listed companies, whereas the GEM website only contains information relating to GEM listed companies.

### Assessment process

91. We did not seek to review the overall integrity and security of HKEx's computer systems but only reviewed those systems that have a bearing on the integrity of listed company information posted on the HKEx and GEM websites. We reviewed the two systems that support the Listed Company Information Public Database, namely the Electronic Publication System ("EPS") and e-Submission System ("ESS").
92. The IS Department uploads announcements, circulars and other documents lodged in the following manner on the HKEx and GEM websites via EPS:
- fax;
  - Internet (through ESS); and
  - Diskettes.
- Servers for the two systems are installed in the HKEx's data centre.
93. We reviewed the following general IT controls during our assessment:
- change management;
  - physical and environmental control;
  - system and network access control;
  - backup and restore procedure;
  - capacity planning;
  - logging and monitoring control; and
  - patch management.

94. We also reviewed the following business application specific controls of the ESS and EPS:
- user account management;
  - password policy;
  - privilege management;
  - data access control;
  - incident handling; and
  - business continuity.

*Documents reviewed*

95. We reviewed:
- the IS Department's written policies and procedures for uploading documents on the HKEx website;
  - the IS Department's internal reports and documents;
  - the IT Division's written policies and procedures applicable to ESS and EPS; and
  - the IT Division's production control records and server configurations/settings (where applicable) to assess the effectiveness of the identified controls.

*Interviews conducted*

96. We interviewed several key personnel from the IS Department and the IT Division.

**Observations**

*Search function of the public database of listed company information*

97. The HKEx website provides access to Main Board and GEM Board company information, whilst the GEM website only provides access to GEM Board company information. The HKEx and GEM websites do not share the same search functions. One can search for information regarding a company on:
- the HKEx website by stock code, stock name, document type or content search, and date; and
  - the GEM website by stock code or stock name.
98. When a company changes its name, a search for the company's information on the HKEx website using the new name only shows records of the company under its new name. A similar search using the company's old name will show the company's records under its old name only. We noted one case where a company changed its names twice – the second time back to its original name. A search using this name did not show announcements issued during the period when the company was operating under the other name.
99. A search on the GEM website using the company's new name will show the company's records under its old and new names. However, a similar search on the GEM website using the company's old name will not yield any result. Thus, the search function on the GEM website only allows a search by a company's stock code or its current name.

100. Information on the HKEx and GEM websites is retrieved differently. Unlike the HKEx website, it is not possible to access all records relating to a GEM company on the GEM website as the documents are filed by category. This is not user friendly.
101. A company's public documents on the GEM website can only be retrieved by the following categories:
- company profile;
  - announcements;
  - financial reports;
  - listing documents, circulars, proxy forms;
  - share repurchase reports;
  - disclosure of interest reports; and
  - prospectuses.
102. In addition to these categories, a Main Board company's documents can also be accessed by several other categories, including:
- all documents;
  - tender notices;
  - notices and results of general meetings; and
  - trading arrangements.

*Completeness and presentation of search results on the public database*

103. We have concerns about the completeness of the search results of the HKEx and GEM websites in certain circumstances. We searched the HKEx and GEM websites for announcements between January and April 2005 for three companies that changed their names during this period. On comparing the results of the searches we noted that for each company the list of announcements on either the HKEx or the GEM website did not contain all the announcements shown by the other website.
104. The Exchange should review the presentation of information and the search function on both the HKEx and the GEM websites.

*Microsoft patch management on the EPS and ESS*

105. Microsoft releases many security patches during a year. Microsoft ranks as "critical" those patches which it deems crucial to address system vulnerabilities and recommends should be applied in a timely manner. Timely implementation of critical patches is essential to minimise risk exposure of servers, particularly those servers that allow Internet browsing or are exposed to the Internet.
106. To mitigate any potential vulnerability exposure of the HKEx Microsoft Windows servers, the IT Division's policy is to:
- implement as soon as practicable after they are released by Microsoft security patches designated by Microsoft as "critical" and which the IT Division considers urgent and relevant;
  - review all security patches released by Microsoft on a semi-annual basis to determine whether these patches are relevant and necessary for implementation before the next annual update; and

- update the Windows servers with all relevant outstanding security patches annually.
107. We recommend the IT Division considers amending its implementation practice so as to install at six monthly intervals all outstanding security patches relevant to the HKEx's computer systems that Microsoft identifies as "critical" and which have not already been installed.

### **Recommendations**

108. The Exchange should review the presentation of information and completeness of the search function on both the HKEx and the GEM websites.
109. We recommend the IT Division considers amending its implementation policy so as to install at six monthly intervals all security patches relevant to the HKEx's computer systems that Microsoft identifies as "critical" and which have not already been installed.

Key Recommendations	Exchange's response
<b>IPO Department</b>	
<p>1. We note that the IPO Department has sought to improve transparency in its work during the course of 2004, although there is still room for improvement. The IPO Department should consider how it could communicate its practices and policies to the market generally. The Department should review its internal guidance for staff to see which of these should be communicated to the market.</p>	<p>Further to one of the SFC's observations, the Listing Division has arranged for the "Guidelines for New Listing Applications" to be available to the public on the Exchange's website as of 1<sup>st</sup> July 2005. The materials can be found at <a href="http://www.hkex.com.hk/issuerservice.htm">www.hkex.com.hk/issuerservice.htm</a>. The Division intends to continue to increase the amount of information regarding our practices and policies available to the public in the future.</p>
<p>2. Where the IPO Department changes an established practice or approach in a way that would be expected to have significant market impact on the initial public offering process but which does not involve a rule change or modification that requires the SFC's prior consent, the IPO Department should consider providing prior notice to the market before implementing the changes.</p>	<p>Following a decision to accept a listing application for vetting, if the application appears to afford materially inadequate disclosure, as for example through omission of material information, a failure to comply with accepted accounting principles or a failure to adhere to the requirements of the Listing Rules and the published interpretations of the Exchange, the usual practice of the Listing Division is to bring the deficiency to the attention of the applicant and the sponsor through the comment process and to afford a reasonable opportunity to discuss the matter and make the necessary corrections. This was the approach adopted in handling inconsistent compliance with the stub period comparative Listing Rules.</p> <p>The Listing Division's established practices and procedures also require senior staff members of the Listing Division to review and approve all matters expected to have a significant market impact prior to action being taken, and to reduce unnecessary disruptive effects to the extent possible. Accordingly, the Exchange regularly issues Listing Decisions and announcements to ensure applicants, sponsors and their advisors are aware of the Listing Division's positions, and will continue to do so.</p>

Key Recommendations	Exchange's response
IPO Department (cont'd)	<p>In the event that the Listing Division believes action is necessary to ensure compliance with the Listing Rules and the protection of investors in the future, we reserve the right to do so without prior notice to the market generally following appropriate authorisation by senior staff. In our view such day-to-day action to ensure investor protection is fully consistent with our designated role as the front line regulator of listed companies in Hong Kong. The Listing Division's actions also remain subject to review and reconsideration by the Listing Committee in all respects, as set out in the Listing Rules.</p>
<p>3. To capture staff knowledge the IPO Department should consider establishing an electronic database comprising all its precedent and knowhow materials. This will facilitate information sharing and distribution within the IPO Department and the Listing Division.</p>	<p>The IPO Team maintains a searchable electronic record of its precedent materials that is available to staff members. The Listing Division as a whole is currently undertaking a comprehensive review of information technology practices. We expect changes to be made to improve the functionality of our electronic records as a result of this larger project.</p>
<p><b>C&amp;M Department</b></p>	
<p>4. The C&amp;M Department should institute a comprehensive risk based programme for reviewing listed companies' periodic reports, including annual reports.</p>	<p>An Assistant Vice President, with an accounting background, was redeployed in January 2005 to be responsible for the C&amp;M Department's work in monitoring financial information compliance by listed issuers. A review programme incorporating risk-based selection criteria and a random element of selection is being prepared.</p>

Key Recommendations	Exchange's response
<p>5. The C&amp;M Department does not have a comprehensive or detailed case management system that allows the Head of the Department to monitor the various teams' performance, and the timeliness and completeness of their work. Instead the Head of the Department relies on team leaders to manage, supervise and monitor the various teams' work. The Department also relies on team leaders to raise issues that require their attention. The Department should consider establishing a comprehensive and detailed case management systems that covers all the work of the Department, so as to enable senior management to analyse the Department's work and assess its performance with a view to improving the Department's efficiency and effectiveness.</p>	<p>In view of the nature of the C&amp;M Department's responsibilities a challenge exists in establishing an organisational structure which creates an appropriate balance between senior management control and extending discretion and responsibility to frontline staff in order to provide a flexible and efficient model of working. Various basic reporting mechanisms have been developed to enable an appropriate degree of monitoring at the team level or on a thematic basis.</p> <p>The Listing Division agrees that a more detailed and comprehensive case management system would enable senior management to analyse the Department's work and assess its performance in greater depth and using this information make refinements in working practice. Such a recommendation is consistent with the Division's plans. The Division has obtained budget approval for developing the management reporting capability of its case database. Further work will be carried out during 2005 to define the scope of this project.</p>
<p>6. The C&amp;M Department should consider ways in which it can improve the transparency of its work and practices, particularly when it is implementing new practices.</p>	<p>Further to the SFC's observations, the Listing Division will circulate a letter to all issuers in July 2005 describing the pilot-project to achieve an orderly reduction in its pre-vetting activities.</p>
<p>7. To capture its staff's knowledge, the C&amp;M Department should consider establishing an electronic database capturing all its precedent and knowhow materials. This will facilitate information sharing and distribution within the C&amp;M Department and the Listing Division.</p>	<p>The C&amp;M Department takes and has taken a number of steps to address the incidence and impact of material inconsistency in decision making and interpretation of the Listing Rules.</p> <p>The experience and knowledge of competent staff and the clarity of the Listing Rule obligations and associated guidance are key elements in ensuring consistency. The March 2004 amendments to the Listing Rules</p>

Key Recommendations	Exchange's response
C&M Department (cont'd)	<p>represented a comprehensive overhaul of many aspects of the continuing obligations regime which is administered by the C&amp;M Department. One of our secondary objectives in introducing the amendments was to improve the transparency of the Listing Rules and the Exchange's practices. Where possible, we tried to express the Listing Rules in simple terms and to codify much of the Exchange's existing practice in interpreting and applying the Listing Rules to provide greater certainty for issuers and their advisers. As a consequence the Listing Division's dependence on the knowledge of long servicing staff members has greatly diminished.</p> <p>Involving senior staff (team leaders) at the early and final stages of handling transactions also helps to manage the risk of inconsistency and to ensure that material issues identified by issuers and their advisers have the team leader's attention at the start of the vetting process. Team leaders screen incoming documents and concentrate their own direct efforts on important and complex issues. At the end of vetting process team leaders review and approve documentation and correspondence within their authority to ensure the substantive accuracy and completeness of such correspondence and documentation.</p> <p>From time to time, the Listing Division's interpretation of a listing rule or how it should be applied is not accepted or inconsistencies are highlighted. The majority of disputes between an issuer, its directors or an adviser are settled between the Listing Division staff member and the issuer, director or adviser. Where an issuer, director or adviser does not accept the view of the Listing Division, they can seek to have the initial view of the Listing Division reviewed.</p> <p>This review will usually take the form of either a meeting of senior staff within the</p>

Key Recommendations	Exchange's response
C&M Department (cont'd)	<p>Listing Division or a consultation with senior staff within the Listing Division. This process usually involves the Head of Listing. At such a meeting the request for guidance on the application of the listing rules in the particular circumstances involved will be discussed. The decision of this review meeting should be taken to be the Listing Division's considered view on the matter. The Listing Rules then provide a further opportunity for the decisions and interpretations of the Listing Division to be reviewed through the formal mechanisms established in the Listing Rules. These review mechanisms help to reinforce consistency and mitigate any adverse impact that might arise.</p> <p>Comprehensive and limited scope ad hoc reviews of the Listing Division's interpretation and practice in respect of specific Listing Rules are also undertaken in response to concerns about consistency. These reviews drill down into the practices adopted within individual teams in the C&amp;M Department and seek to redress, through modification or clarification of practice, any material element of inconsistent treatment. Such reviews may be initiated by the Listing Committee, the Head of Listing or C&amp;M Department or in response to either requests made by the SFC in its supervisory role or to complaints. The Listing Division will look to increase the scope and frequency of these reviews.</p> <p>Precedent decisions are often a source of help in ensuring consistency but are not always determinative in providing Listing Rule interpretations in the context of specific facts and circumstances. In addition to the arrangements described above, the C&amp;M Department maintains a searchable electronic record of its precedent materials that is available to staff members. Major decisions and decisions on novel issues are currently recorded in the management meeting</p>

Key Recommendations	Exchange's response
C&M Department (cont'd)	<p>notes and can be searched using ISYS (the Division's rule citation system). We do not regard the current precedent search process as highly inefficient and note a comment in a previous SFC report that the system was easy to use. However we recognise that with advances in technology there is scope to improve the current system.</p> <p>The Listing Division as a whole is currently undertaking a comprehensive review of information technology practices. We expect changes to be made to improve the functionality of our electronic records as a result of this larger project. As part of this review we will seek further input from the SFC to obtain a better understanding of the ideal standard that should apply in maintaining a precedent database covering the significant volume of decisions and interpretations routinely made by the Listing Division.</p> <p>In the interim, the C&amp;M Department has reviewed and is enhancing its file indexing protocols so that searches via ISYS can be conducted in a more efficient way.</p>

Key Recommendations	Exchange's response
<b>Enforcement Department</b>	
<p>8. To improve transparency, the Enforcement Department should archive information regarding its enforcement philosophy and policy, and disciplinary actions, in one dedicated section on the HKEx website to promote ease of search and access to the information. In particular, it is important that there should be a search facility to enable investors to find out whether a particular company or individual has been censured.</p>	<p>Further to the SFC's observations, the Listing Division has arranged for the creation of a new dedicated section on the Exchange's website with effect from 1<sup>st</sup> July 2005. The section includes a copy of the article carried in the October 2004 edition of the Exchange magazine describing the Listing Division's Enforcement strategy and also a searchable database of disciplinary decisions.</p>
<b>IS Department and IT Division</b>	
<p>9. The Exchange should review the presentation of information and completeness of the search function on both the HKEx and the GEM websites.</p>	<p>The Exchange will review and consider enhancing the search functions of the HKEx and GEM websites including the presentation of the search results highlighted in the SFC's observations.</p>
<p>10. We recommend the IT Division considers amending its implementation policy so as to install at six monthly intervals all security patches relevant to the HKEx's computer systems that Microsoft identifies as "critical" and which have not already been installed.</p>	<p>The Exchange will continue with its existing policy to implement as soon as practicable after thorough testing those security patches designated as "critical" by Microsoft and assessed as urgent and of direct relevance to the Exchange's systems. In addition, going forward the Exchange will install at six month intervals all the outstanding critical security patches relevant to the EPS and ESS computer systems.</p>

**Listing Division structure and headcount as at 31<sup>st</sup> December 2004**

	Professional staff	Secretarial / Administrative
<b>Head of Listing</b>	1	1
<b>IPO Transactions Department including the Debt and Derivative team</b>	42	7
<b>Compliance and Monitoring Department</b>	38	6
<b>Listing Enforcement Department</b>	8	2
<b>Committee Secretariat</b>	2	1
<b>Listing Policy</b>	6	0
<b>Management and Administrative Support</b>	3	5
	<b>100</b>	<b>22</b>