

SECURITIES AND FUTURES COMMISSION

Report on Errors in Newspaper Announcements of Allotment Results of the Initial Public Offering of Shares in China Life Insurance Company Limited

1. Purpose

- 1.1 This report is about errors in the 17 December 2003 newspaper announcements of the allotment results of the Initial Public Offering (“IPO”) of shares in China Life Insurance Company Limited (“China Life”). It describes the events leading up to the discovery of the errors and how the incident was resolved. It examines the nature and scope of the errors and how they occurred, identifies issues and explores the way forward, including making certain recommendations to improve the IPO process.
- 1.2 The report is based on chronologies and replies submitted in response to the Securities and Futures Commission (“SFC”) requests by Computershare Hong Kong Investor Services Limited (“Computershare”), Hong Kong Exchanges and Clearing Limited (“HKEx”), holding company of The Stock Exchange of Hong Kong Limited and Hong Kong Securities Clearing Company Limited (“HKSCC”), and Baker & McKenzie on behalf of the four Sponsors.
- 1.3 A list of the principal participants in the China Life IPO and their abbreviations is in Appendix 1.

2. Background

- 2.1 The China Life IPO application period opened on 8 December 2003 and closed on 11 December 2003. It was the largest IPO in terms of funds raised for 2003, raising over HK\$26 billion. A total of more than 364,000 applications were received and the IPO was about 172 times over-subscribed. This IPO marked the end of a spell of approximately 16 months (with the last large IPO being that of BOC HK Holdings in July 2002) where there were only smaller IPOs, with modest levels of subscription.
- 2.2 The China Life IPO utilized electronic submissions of IPO applications through the HKEx CCASS EIPO¹ system as well as printed application forms.
- 2.3 On 14 December 2003, the Sponsors and China Life approved at about 19:00 the basis of allotting shares in China Life to the IPO applicants. On 15 December 2003, by about 17:00, Computershare had completed the actual allotment process and produced data files containing the allotment results detailing all successful applicants. These data files were then passed to the printer, Equity Financial Press (“Equity”), for formatting into the allotment results announcement to be published in the newspapers. Final proofs of the

¹ The Central Clearing and Settlement System Electronic IPO (“CCASS EIPO”) is offered by HKSCC for subscribing for new shares in IPOs that allow CCASS EIPO as one of the subscription channels – see footnote 3 for a further explanation.

announcements were sent by Equity to two newspapers at about 00:30 on 17 December 2003.

3. Discovery of errors

- 3.1 On 17 December 2003, the allotment results for over 364,000 successful applications (other than non-IP Yellow Form applications²), printed on a total of 37 pages, were published in two major newspapers (the South China Morning Post and the Hong Kong Economic Times) and on HKEx's website. The allotment results for applications made by CCASS EIPO³ applicants with CCASS IP accounts were also available from the CCASS Interactive Voice Recording System ("IVRS") and Internet systems.
- 3.2 At about 09:10 on 17 December 2003, Computershare and HKSCC each received telephone inquiries which exposed discrepancies between the allotment results published in the newspapers and those on the HKEx website and CCASS. Investors called both parties to inquire as to their share allocations because it appeared in the newspapers that they had been allotted 3,000 shares, whereas they had actually been allotted 2,000 shares according to Computershare data. The allotment results produced by Computershare, on CCASS and on HKEx's website, were later confirmed to be correct.
- 3.3 Upon receiving the above referenced telephone inquiries from its Investor Participants, HKSCC sought clarification from Computershare. In the late morning of 17 December 2003, Computershare performed a quick check of the allotment results to confirm the accuracy of the results it had provided to HKSCC. At the time of confirming to HKSCC that the allotment results it had provided to HKSCC were correct, Computershare identified one additional error – the newspaper announcements for the CCASS EIPO applications showed an applicant with an identification reference number of "12000" who was allotted 12,000 shares, but there was no such applicant or allotment.

4. Extent of errors

- 4.1 HKEx, upon becoming aware of the discrepancies in the morning of 17 December 2003, made immediate enquiry of the Sponsors through their legal advisers Baker & McKenzie and requested that they determine the precise nature and scope of the errors and suggest remedial action as soon as possible.

² The non-Investor Participant ("IP") yellow form applications allow applicants to apply for an IPO in a nominee's name.

³ The CCASS EIPO service is offered by HKSCC to its participants for subscribing for new shares in IPOs that prescribe CCASS EIPO as one of the permissible subscription channels. In the case of Investor Participants, they place their EIPO subscription instructions through CCASS' IVRS or Internet website with the relevant subscription monies debited from the Investor Participants' designated accounts. Successfully allotted shares will be credited to the relevant Investor Participants' account in CCASS. For CCASS Participants who are brokers and custodians, they usually enter the EIPO instructions into the CCASS system on behalf of their clients. Subscription monies (on a per instruction basis) will be debited from the relevant CCASS Participants' accounts. Successfully allotted shares will be credited into the CCASS Participants' accounts in CCASS and the brokers/custodians will inform the clients about allotment results.

The request by HKEx was repeated several times to the Sponsors and Baker & McKenzie throughout the day. HKEx made it clear to those parties that if satisfactory rectification measures, including meaningful dissemination of the correct information to investors, were not implemented, trading in China Life shares might not be allowed to commence on 18 December 2003 as scheduled since the maintenance of a fair and orderly market could not be ensured. Late in the afternoon of 17 December, when HKEx began to suspect that the publication problems might be more extensive than at first indicated by the limited number of telephone inquiries it had received earlier in the day with possible market impact, HKEx advised the SFC.

4.2 Responding to requests of the SFC and HKEx, the Sponsors arranged for a comprehensive set of checks to be performed. Between 21:45 on 17 December 2003 and 01:00 on 18 December 2003, Equity performed a complete check of the reformatted data and identified the extent of the errors. Computershare also independently reconciled Equity's reformatted data (used in the newspapers) with its original allotment data (which Computershare had prepared and forwarded to Equity earlier) and confirmed the extent of the errors. These were –

- A number of successful applicants who had applied via the CCASS EIPO method and who were allotted 2,000 shares each were wrongly categorised as successful applicants allotted 3,000 shares each in the newspaper announcements. A total of 9,186 such applicants were finally identified.
- The newspaper announcements showed that a CCASS EIPO application with the identification reference number of 12000 was allotted 12,000 shares. There was, in fact, no such application or allotment.
- The newspaper announcements omitted a CCASS EIPO applicant with the identification reference number of “2000” who was allotted 1,000 shares.
- A number of joint applicants using “white form” applications⁴ who were allotted shares, were omitted from the newspaper announcements.⁵
- One applicant's identification reference number appeared twice in the newspaper announcements.

5. Rectification measures

5.1 After receiving confirmation of the precise extent of the errors from the Sponsors, HKEx informed the Sponsors and Baker & McKenzie that upon satisfying certain conditions HKEx was minded to permit shares of China Life to be traded on 18 December 2003 as scheduled. The conditions included (i) completion of an investigation into the full scope and nature of the errors by 8:30 a.m. on 18 December 2003; (ii) confirmation that the investigation had

⁴ Applicants using white forms to apply for an IPO do so in their own name.

⁵ About 13 such applications were involved.

not revealed any further significant errors (with any identified isolated errors to be explained); and (iii) the publication of a paid announcement in English and Chinese newspapers by 7 a.m. on 18 December 2003 containing details about the extent and the nature of the errors, and sources where investors could obtain reliable allotment information.

- 5.2 The SFC supported HKEx's position and was satisfied with the rectification measures to be put in place by the Sponsors: namely (i) the publication of a clarification announcement that would correct the allotment results on 18 December 2003 in the newspapers, on the HKEx website, the Computershare website and the China Life website and (ii) the manning of Computershare's hotlines to answer allocation inquiries during the first few days of trading after the IPO. Upon being satisfied that the clarification announcement published on 18 December 2003 was in order and that the correct allotment information had been disseminated widely through the media and the websites of the relevant parties, HKEx agreed to allow trading in the shares in China Life to commence on 18 December 2003 as originally scheduled.
- 5.3 The possible consequence of the errors was that if an investor sold 3,000 shares when only actually allocated 2,000, he or she could incur a loss when buying an extra 1,000 shares to meet the sell order (as well as inadvertent naked short selling). Throughout the initial period of trading, the SFC and HKEx closely monitored trading activities to ensure that any such activities did not detract from the maintenance of a fair and orderly market.
- 5.4 In addition to the published clarification announcement, HKSCC released broadcast messages to its Participants requesting them to check the correct number of China Life shares allotted to them and their clients before dealing in the shares. A similar message was also released to Investor Participants of HKSCC. Trading on 18 December 2003 commenced smoothly.
- 5.5 As the allotment results errors were identified and corrected in an announcement published in newspapers and on various websites and adequate remedial measures were put in place prior to the start of trading in China Life shares in Hong Kong, there was fair and orderly trading in the shares of China Life and no investors suffered losses because of the errors.

6. Cause of errors

- 6.1 According to information provided by Baker & McKenzie, Equity received from Computershare "processable" electronic files containing the identification document numbers or identification codes of successful applicants arranged by the numbers of allotted shares. Equity used software to electronically extract from Computershare's files the identification document numbers and identification codes and saved them onto its database.
- 6.2 Equity then proceeded with the typesetting, which involved the "grouping and formatting" of data in its database file into categories for publication in the

press. This process is semi-manual and semi-electronic and comprised the following procedures:

- Based on the source data appearing electronically in Computershare's files, Equity's staff manually sorted and grouped the data saved in its database file into categories by the number of allotted shares.
- By using desktop publishing software, Equity then formatted and typeset the "grouped" data for publication in the press.
- A printed proof of the announcement was then produced and circulated to all relevant parties. After incorporating comments from all parties concerned, Equity then "transformed" the proof (containing the undetected errors) into a "post-script" file and emailed this file to the newspapers for publication.

- 6.3 According to Equity, the errors relating to the 2,000 and 3,000 EIPO shares' categories were caused by a mistake made by their staff in the manual "grouping" process. A successful EIPO applicant known by the identification code "3000" was allotted 2,000 shares. When "grouping" the data, Equity's staff mistook the number "3000" to be the "3,000 share category", and, as a result, some 9,000 EIPO applicants allotted 2,000 shares each whose identification document numbers or identification codes followed that applicant were erroneously grouped under the "3,000 share category".
- 6.4 The identification reference number that is normally used for CCASS EIPO input is a "reference number" which is arbitrarily assigned to the application. In cases where a CCASS EIPO instruction has been input, those inputting the instruction can assign a random number or sometimes the client's account number to the application for easy identification when allotment results are obtained. The length and combination of these numbers may vary greatly. When an assigned number is the same as the number of allocated shares, there is an increased risk of error, especially when the printer's work involved both electronic and manual processes.
- 6.5 This type of error is less likely to appear in relation to the printed white form of application because, in most cases, an investor's Hong Kong Identity Card number will be used as the unique identification reference number.
- 6.6 According to Equity, the other errors mentioned in China Life's corrective announcement dated 17 December 2003 were caused by a technical problem with its software.
- 6.7 As the subscription allotment announcement errors appeared in the newspaper announcements only and not the allotment results which Computershare had provided to HKEx and which HKEx had published (which had not been

reformatted by Equity), it is clear that the error occurred in the process of reformatting the raw data by Equity. That said, the SFC believes that the printing problem and the ancillary errors may have been avoided if better software had been used by Equity and a more rigorous review and reconciliation process had been in place.

7. Conclusion

7.1 The allotment results announcement of the China Life IPO was inaccurate because of errors which occurred at the printer, Equity. In assessing the overall arrangement of the China Life IPO by the Sponsors, the SFC considers that it was reasonable for them to rely on Equity and the Sponsors' legal advisers to compile accurately the data content of the allotment announcement. It was not reasonably foreseeable, having regard to the reliance placed by the Sponsors on other professionals, that there might be a significant error by the Printer in compiling the allotment results announcement, particularly when no similar incidents had occurred in the past. The errors were corrected and adequate remedial measures were put in place by the Sponsors prior to the start of trading of China Life shares in Hong Kong. Overall, the SFC is of the view that no disciplinary action against the Sponsors is required.

8. Way Forward

8.1 Although no investors suffered losses and the SFC has concluded that no disciplinary action against the Sponsors is merited, the errors in the China Life IPO allotment results announcement were unfortunate and gave rise to some public concern. In order to reduce the risk of similar mistakes occurring in future, the following recommendations are made:

- Share registrars should produce data formats that allow for the checking of data at every stage (e.g. the use of macros, hash/control totals). This will enable reconciliation of data to be efficiently carried out.
- In cases where allotment results are to be presented in a manner similar to that in China Life's case, the source data from the share registrar should be sorted in the order of number of allotted shares. The share registrar should also provide a file containing appropriate control totals such as the total number of records, total number of shares and the start and end ID numbers for each level of allotted shares for checking. Primary information on the allotment results should also be provided to the printer with control totals, in soft and paper form, to facilitate checking and reconciliation by the printer. The SFC will write to the Federation of Share Registrars requesting them to ensure that in all subsequent IPOs, the share registrars will provide data formats which allow for checking and reconciliation.

- There was no lead or coordinating sponsor among the four joint sponsors of the China Life IPO. It has been proposed in the Joint SFC/HKEx Consultation Paper on the regulation of Sponsors and Independent Financial Advisors in May 2003 that a single coordinating sponsor be required to be identified in the case of multiple sponsorships. Pending implementation of this requirement in the Listing Rules, sponsors should in any event provide clear contact information of clearly specified responsible senior staff who are in a position to act quickly and decisively if problems arise in the IPO process. The SFC proposes to reflect this recommendation in amendments to the Corporate Finance Adviser Code of Conduct.
- Sponsors are reminded to put in place sufficient arrangements and adequate resources to ensure that their public offers and all matters ancillary thereto are conducted in a fair, timely and orderly manner. In particular, where the responsibility of preparing and finalising documents or announcements with a large amount of numeric data content is delegated to other parties, the sponsors should be satisfied that (i) the other parties fully agree on and understand the roles each of them is to perform; (ii) checking methods employed by each of the other parties are appropriate; (iii) the checking processes have been completed, and any errors rectified, prior to publication. These measures are particularly important for allotment results announcements which can contain a significant amount of numeric data, but which are prepared within a very short timeframe.
- Sponsors should consider arranging the manning of a hotline to answer queries throughout the IPO process.
- The option of expanding eIPO services (including CCASS EIPO) in future IPOs should be explored to make the IPO process more efficient and less manually intensive for larger IPOs. The SFC will work with HKEx and will consult the market in order to find the appropriate solution.
- Sponsors should be encouraged to explore possible solutions for more channels to disseminate IPO results including through telephone hotlines and the Internet (e.g. websites of the issuer, the sponsor or other parties). In addition, an appropriate safety mechanism would ensure consistency of all information disseminated through the different channels.
- The SFC will increase its efforts to enhance investor awareness and education on various aspects and logistics throughout an IPO process.

8.2 The SFC will continue to discuss with market experts on ways to improve the IPO process.

Securities and Futures Commission
April 2004

Encl.

The Principal Participants in the China Life IPO

Issuer: China Life Insurance Company Limited (“China Life”)

Sponsors: China International Capital Corporation (Hong Kong) Limited (“CICC”)
Citigroup Global Markets Asia Limited (“Citigroup”)
Credit Suisse First Boston (Hong Kong) Limited (“CSFB”)
Deutsche Bank AG, Hong Kong Branch (“Deutsche Bank”)

Legal Advisers to Sponsors: Baker & McKenzie

Legal Advisers to Issuer: Allen & Overy

Accountants: PricewaterhouseCoopers

Registrar: Computershare Hong Kong Investor Services Limited
 (“Computershare”)

Printer: Equity Financial Press (“Equity”)

Exchange: The Stock Exchange of Hong Kong Limited (“SEHK”)

Clearing House: Hong Kong Securities Clearing Company Limited (“HKSCC”)