

**Process Review Panel  
for the  
Securities and Futures Commission**

**Annual Report  
to the Financial Secretary**

**For 2003**

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## **Chapter 1. General Information**

### Background and purpose of the Process Review Panel

1.1 The Process Review Panel (“PRP”) is an independent, non-statutory panel established by the Chief Executive in November 2000 to review the internal operational procedures of the Securities and Futures Commission (“SFC”) and to determine whether the SFC has followed its internal procedures, including procedures for ensuring consistency and fairness.

1.2 Since its inception, the SFC has been subject to various checks and balances designed to ensure fairness and observance of due process. These include statutory rights of appeal, judicial review and scrutiny by the Ombudsman and the Independent Commission Against Corruption.

1.3 In the course of reforming the regulatory regime for the securities and futures market, the regulatees pointed out to the Administration that these checks and balances could only apply in specific cases. The Administration, in consultation with the SFC, concluded that it would be preferable to improve the transparency of the SFC’s internal processes across the board, so that the public would be better able to see for itself that the SFC did indeed act fairly and consistently in the exercise of its powers.

1.4 The SFC’s ability to demonstrate that it already operates in this fashion is however constrained by statutory secrecy obligations which limit the extent to which the SFC can divulge information to the public regarding what it has or has not done when performing its regulatory functions.

1.5 In order to enhance the transparency and public accountability of the SFC, without compromising its confidentiality, the Administration saw merit in establishing an independent body to review the fairness and reasonableness of the SFC’s operational procedures on an on-going basis and monitor whether its procedures are consistently followed and to make recommendations to the SFC in relation to these objectives.

1.6 The establishment of the PRP demonstrates the Administration's resolve to enhance the transparency of the SFC's operations, and the SFC's determination to strengthen public confidence and trust. The PRP supports the objective to ensure that the SFC exercises its regulatory powers in a fair and consistent manner.

#### Terms of reference

1.7 The PRP is tasked to review and advise the SFC upon the adequacy of the SFC's internal procedures and operational guidelines governing the action taken and operational decisions made by the SFC and its staff in the performance of its regulatory functions, including, for instance, the receipt and handling of complaints, licensing and inspection of intermediaries, and disciplinary action.

1.8 To carry out its work, the PRP receives and considers periodic reports from the SFC in respect of the manner in which complaints against the SFC or its staff have been considered and dealt with. In addition, the PRP may call for, and review, the SFC's files to verify that the action taken and decisions made in relation to any specific case or complaint are consistent with the relevant internal procedures and operational guidelines.

1.9 The PRP is required to submit its reports to the Financial Secretary annually or otherwise on a need basis. The Financial Secretary may cause these reports to be published as far as permitted under the law. The PRP's first and second Annual Reports were published in May 2002 and May 2003 respectively.

1.10 The terms of reference of the PRP, as approved by the Chief Executive, are at **Annex A**.

#### Constitution of the PRP and Working Groups

1.11 As at 31 December 2003, the PRP comprises eleven members, including eight members from the financial sector, academia and the legal and accountancy professions, and three ex-officio members including the Chairman of the SFC, a Non-Executive Director of the SFC and the Secretary for Justice (or her representative).

1.12 For better execution, the PRP has set up two working groups. The Working Group on Licensing, Intermediaries Supervision and Investment Products focuses on cases involving application for registration, approval of investment products and inspection of intermediaries. The Working Group on Corporate Finance and Enforcement focuses on cases concerning investigation and disciplinary actions, takeovers and mergers transactions and prospectus-related matters.

1.13 The membership of the PRP and the two Working Groups is at **Annex B**.

## **Chapter 2. Work of the PRP in 2003**

### Highlights of work

2.1 This report covers the work of the PRP from 1 January 2003 to 31 December 2003.

2.2 In 2003, the PRP reviewed completed cases to verify that the action taken and decisions made are consistent with the relevant internal procedures and operational guidelines. The case review included the following areas –

- (a) registration of intermediaries
- (b) registration of Registered Institutions (“RIs”)
- (c) inspection of intermediaries;
- (d) prudential visits to intermediaries;
- (e) authorisation of collective investment schemes;
- (f) handling of complaints against intermediaries;
- (g) investigation and disciplinary action;
- (h) processing of listing applications under the Dual Filing regime;
- (i) approval of Approved Lending Agents (“ALAs”); and
- (j) handling of takeovers and mergers transactions.

2.3 The PRP also examined the SFC’s procedures in respect of the following areas to see if there was any room for streamlining and improvement –

- (a) performance pledges for processing applications for licence under the new licensing regime;
- (b) rationalisation of registration procedures of the SFC and the Stock Exchange of Hong Kong (“SEHK”);



- (c) registration and supervision of RIs;
- (d) appointment of auditors under Section 160 of the Securities and Futures Ordinance (“SFO”);
- (e) standardised procedures on issue of interim replies to complainants and target date for completion of investigation of complaints;
- (f) disclosure of information on investigation of complaints;
- (g) processing of listing applications under the Dual Filing regime;
- (h) mechanism for internal communication among the SFC’s divisions and departments; and
- (i) revised internal procedures on public consultations.

#### Selection of cases for review

2.4 In accordance with the terms of reference, the PRP may select any completed SFC cases for review. The SFC provided the PRP with monthly reports on all cases completed within that month. The Working Groups then selected individual cases from these monthly reports for review with a view to covering cases of different nature and length of processing time. Apart from checking the file records against the standard procedures laid down in the operation manuals, the Working Groups also assessed the adequacy of the manuals from the perspectives of fairness and reasonableness.

2.5 The SFC also provided the PRP with monthly reports on on-going investigation and inquiry cases that had been outstanding for more than one year so that the PRP could monitor the progress of these cases.

#### Meetings of the PRP and Working Groups

2.6 The PRP met on four occasions in 2003. At the meetings, the PRP discussed specific topics of the SFC’s internal procedures and commented on, and endorsed, reports submitted by the two Working Groups which contained observations and recommendations from the review of cases.

2.7 The two Working Groups met on six occasions during the period covered by this report and reviewed a total of 51 cases, which encompassed various areas of the SFC's work.

Table 1 – Breakdown of cases reviewed by the PRP

	No. of Cases
Licensing	10
Intermediaries supervision	15
Investment products	6
Corporate Finance	15
Enforcement	5
<b>Total</b>	<b>51</b>

2.8 After the review of each case, the Secretariat prepared a case report which summarised the findings and observations together with, where applicable, the recommendations for improvements. These reports were discussed at the meetings of the Working Groups where members might give additional comments. The consolidated views of the Working Groups were put to the PRP for comment and endorsement. The observations and recommendations were then conveyed to the SFC for consideration and necessary action. The SFC has been positive in adopting suggestions from the PRP. In cases where the suggestions could not be adopted, the SFC gave detailed reasons.

#### Engagement with the industry

2.9 The PRP attaches great importance to views from all users of the

market on issues within its terms of reference. The PRP maintains a dialogue with industry associations and representatives.

2.10 The PRP met the securities industry associations, namely, the Hong Kong Stockbrokers Association, the Institute of Securities Dealers, the Hong Kong Association of Online Brokers and the Hong Kong Securities Professionals Association to listen to their comments on the relevant procedures and processes of the SFC and suggestions for improvement. The PRP exchanged views with these associations on the internal operational procedures of the SFC, in particular the procedures on licensing, investigation and disciplinary action. The PRP also invited major firms which have dealings in the securities and futures industry to offer comments on SFC's operational procedures.

2.11 The PRP welcomes public views on the SFC's operational procedures which fall within the PRP's terms of reference<sup>1</sup>. Suggestions and comments can be referred to the PRP Secretariat by post (Address: Process Review Panel Secretariat, 18 Floor, Tower I, Admiralty Centre, 18 Harcourt Road, Admiralty, Hong Kong) or by email (Email address: prp@fstb.gov.hk).

#### Presentation by the SFC

2.12 With the implementation of the SFO on 1 April 2003, there were changes in the internal procedures of the SFC. The SFC has revised its operation manuals to incorporate the changes in internal procedures. To give the PRP members a better understanding of the changes in SFC internal procedures, the SFC conducted a presentation to the PRP on the major changes in its internal procedures on 24 November 2003.

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<sup>1</sup> The PRP reviews completed or discontinued cases of the SFC in order to assess whether the SFC has followed its internal procedures in handling the cases. Enquiries or complaints relating to non-procedural matters should be made to the SFC.

## **Chapter 3. Observations and recommendations arising from the review of completed cases**

3.1 From the 51 cases reviewed in the period covered by this report and the review of the SFC's operational procedures, the PRP concluded that the SFC had generally followed its internal procedures in handling cases and there was no serious deficiency in the SFC's operational processes. Yet there were certain areas where the PRP had made recommendations to the SFC for improvement. The SFC has been positive in adopting the recommendations of the PRP. Where the SFC could not adopt a recommendation, detailed explanations were given. The observations and recommendations are summarised below while the SFC's response to the recommendations is detailed in **Annexes C and D**.

### **(A) Registration of intermediaries**

3.2 The PRP reviewed four cases on registration of intermediaries<sup>2</sup>. The PRP noted that in one case which involved the processing of an application for registration in respect of corporations, the SFC spent almost three months examining the application before asking the applicant company to submit additional information to facilitate further processing<sup>3</sup>. The PRP recommended that the SFC expedite the processing of future applications as far as possible. The SFC explained that the delay was due to the exceptionally heavy workload of the Licensing Department when the case was conducted. The SFC agreed to the PRP's recommendation and would endeavour to expedite the processing of licence applications as far as practicable.

### **(B) Registration of Registered Institutions ("RIs")**

3.3 The PRP reviewed four cases on registration of RIs. The PRP noted that according to the SFC's performance pledge, the SFC would acknowledge receipt of an application for registration as a RI within two business days after

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<sup>2</sup> The processing time of these four cases were longer than that specified in the SFC's performance pledges.

<sup>3</sup> At the time when this case was processed (i.e. in 2002), the SFC's performance pledge for processing an application for registration in respect of corporations was fifteen weeks (about three and a half months). The overall processing time of this case was ten months.

receiving the application. However, in one of the cases, there was slippage in acknowledging receipt of an application. The acknowledgement was issued 21 calendar days after the application was received by the SFC. The PRP recommended that the SFC endeavour to observe its performance pledge in acknowledging receipt of an application for registration as a RI. The SFC agreed to the recommendation and reminded the case officers to observe the time frame of acknowledging receipt of an application within two business days.

3.4 The PRP also noted that according to the SFC's internal procedures and a Memorandum of Understanding ("MoU") signed between the SFC and the Hong Kong Monetary Authority ("HKMA"), upon receiving an application for registration as a RI, the SFC would, within two business days, pass a copy of it to the HKMA or request the applicant to provide any missing items or, if the application is substantially incomplete, return it to the applicant. In two of the four cases, the SFC passed a copy of the application concerned to the HKMA about two weeks after receiving the application, far beyond the time frame of two business days. The PRP recommended that the SFC observe the time frame as far as possible and review the reasonableness of the time frame taking into account the time taken in completed cases. The SFC explained that during the period when the two cases concerned were processed, the Licensing Department was under tremendous workload. Nevertheless, the SFC agreed to the PRP's recommendations. The SFC subsequently revised the time frame to seven business days on 1 March 2004 in consultation with the HKMA.

3.5 In one of the cases, after receiving an application, the SFC verbally requested the applicant to provide additional information. However, there was no record in the case file showing details of the request including when and by whom the request was made. The PRP recommended that the SFC keep a record in the case file on details of any verbal request made to the applicant for provision of information. The SFC agreed to the recommendation.

### **(C) Prudential visits to intermediaries**

3.6 The PRP noted that the SFC had introduced prudential visits to intermediaries in 2001/02 to improve communication with them and therefore selected six prudential visit cases for review. As a mean to promote communication between the SFC and the intermediaries, and to enhance the

effectiveness of the prudential visits, the PRP recommended that the SFC consider the feasibility of following up the result of the visit with the intermediary with a letter setting out the SFC's recommendations, if any. The SFC agreed to continue its existing practice of issuing a letter to an intermediary if any significant matters were noted during a prudential visit that required attention or improvement by the intermediary. In response to the PRP's recommendation, the SFC had also started, as from 1 August 2003, to send a "thank you" letter to an intermediary after the completion of a prudential visit to it to express appreciation for its cooperation where no significant matter requiring attention or improvement was noted.

3.7 The PRP noted from one of the six cases that subsequent to an inspection of an intermediary conducted in November 2000, the SFC conducted a prudential visit to the intermediary concerned two and a half years later in May 2003. After completion of the prudential visit, the inspection team recommended that the next inspection of the intermediary be conducted three years later (i.e. in mid-2006). It was specified in the SFC's internal procedures that a prudential visit was not a substitute for an inspection. However, according to the SFC, whether the SFC would conduct another inspection to the intermediary concerned three years after the prudential visit (i.e. by mid-2006) as recommended by the inspection team, or to replace the inspection with another prudential visit, would depend on the risk level of the intermediary and the availability of inspection resources by that time. In order to prevent the undesirable situation that an intermediary was only visited but not inspected for a prolonged period of time, the PRP recommended that the SFC consider whether there was any need to set a time-limit within which at least one routine inspection of an intermediary must be conducted.

3.8 The SFC replied that whilst the length of time elapsing since the last inspection was an important factor taken into account in its inspection targets selection process, which was primarily risk-based, it did not see fit to set a hard and fast time-limit for inspecting an intermediary because this might impede the deployment of resources to deal with more risky targets at any particular point in time. Moreover such time-limit might be mistaken to be the benchmark for a normal inspection cycle, and might set wrong expectations in some intermediaries that they were subject to inspection only at such fixed time intervals. Nevertheless, the SFC had provided sufficient procedural safeguards to ensure that an intermediary who was not inspected for a prolonged period of

time was not so treated due to oversight. Inspection history of each and every intermediary was logged in a computerised database and retrieved for review every quarter by the monitoring teams when they prepared their respective inspection schedule. Firms not having been inspected for a certain specified period were flagged for review by all team leaders to assess whether they should be accorded priority over other possible targets. Other inspection targets were nominated by all members of monitoring teams based on risk factors, these nominations would be subject to the endorsement of the respective team leaders; a designated Associate Director would perform a second review and a Senior Director would give final approval.

#### **(D) Authorisation of collective investment schemes**

3.9 The PRP reviewed three cases on authorisation of collective investment schemes. In the operation manuals of the Investment Products Department (“IPD”) of the SFC, it was stipulated that all product authorisations were to be given by a Director of the IPD and there was a note in the manuals stating that “all reference to Director throughout the manuals should be construed as Senior Director”. Hence, authorisations of such products should be given by a Senior Director. However, in one of the cases, the authorisation of product was granted by a Director. According to the SFC, the note stating that the reference to Director should be construed as Senior Director was added after the only Director responsible for authorising investment schemes was promoted to Senior Director. When the Senior Director left the SFC, his duties were taken up by a Director but the relevant approving authority in the manuals had not been updated. The PRP recommended that the SFC amend the operation manuals of the IPD so as to properly reflect the approving authority for new products. The SFC agreed to the recommendation.

3.10 The PRP also noted that in an investigation case concerning a suspected breach of the Protection of Investors Ordinance<sup>4</sup>, the Enforcement Division of the SFC consulted the IPD of the SFC on whether a piece of promotional material had been authorised by the SFC. The IPD initially advised verbally that the piece of promotional material had not been authorised but subsequently confirmed in writing that it had in fact been authorised. To help

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<sup>4</sup> The Protection of Investors Ordinance was repealed on 1 April 2003 upon commencement of the SFO.

further improve the efficiency and accuracy in the search/checking of authorised promotional materials by the SFC, the PRP recommended that the SFC consider the feasibility of requiring the issuers to quote a reference number given by the SFC on each piece of authorised promotional material. The SFC replied that the misidentification of an authorised advertisement as unauthorised in this case was an isolated incident, which was highly unlikely to happen again. The SFC believed that the imposition of the requirement that a reference number be given by the SFC and quoted by the issuer on each piece of authorised promotional material might confuse the public and would be unduly burdensome for the industry.

### **(E) Handling of complaints against intermediaries**

3.11 The PRP reviewed seven complaint cases against intermediaries. In one of the cases, the complainant alleged, among other things, that his personal information had been disclosed by the subject company to a third party without his authorisation. However, the SFC had neither investigated this allegation nor addressed it in its reply to the complainant. The PRP considered that the SFC should have informed the complainant of the reason for not taking any action on the allegation. The PRP recommended that in handling complaints, the SFC should endeavour to address all the allegations made by a complainant, properly document the reason for not taking action on any allegation and inform the complainant accordingly. The SFC agreed that its decision should have been better documented.

3.12 In another case, the SFC received a copy of a complaint letter addressed to a foreign consulate in Hong Kong alleging that a company was selling an unauthorised investment plan, which was claimed to be supervised by an overseas securities regulator. The SFC, by way of a letter addressed to the complainant and copied to the foreign consulate, asked the complainant to provide further information on the allegation but the complainant did not respond. The SFC then closed the case without taking further action on the subject company or seeking information from the overseas securities regulator, the foreign consulate or the subject company against which the complaint was made. It appeared that the SFC had relied on the complainant for gathering evidence. The PRP invited the SFC to consider the feasibility of taking a more proactive approach in protecting the interests of investors.



3.13 The SFC replied that as a regulatory organisation, the SFC needed sufficient “information”, although not necessarily “evidence”, from the complainant to ascertain whether the subject matter of the complaint falls within the jurisdiction of the SFC and to make the necessary judgement as to whether more resources should be committed to a case. In the case where the complainant did not respond or was unwilling to co-operate, it was often very difficult, if not impossible, to proceed. The SFC had taken the initiative to revisit the case and had subsequently received confirmation from the overseas securities regulator that the investment company, which the subject company in Hong Kong had claimed was its overseas principal, was an entity duly licensed by them. The SFC had written to the investment company asking it to respond to the complaint that its agent was selling unauthorised products in Hong Kong.

#### **(F) Investigation and disciplinary action**

3.14 The PRP selected five cases on investigation and disciplinary action for review. In one of the cases, the subject company/persons had been publicly reprimanded pursuant to the terms of a negotiated settlement. One year later, they were found committing a similar offence again. Despite that it was a repeated offence, the SFC had not proceeded with prosecution nor imposed more severe sanctions due to insufficient evidence. The SFC came up with another settlement with the subject company/persons who were, pursuant to the terms of settlement, publicly reprimanded again.

3.15 The PRP invited the SFC to consider the feasibility of putting more effort and taking extra steps in the investigation of serious or repeated offences with a view to obtaining sufficient evidence to facilitate prosecution or imposition of more severe sanctions to achieve a deterrent effect. The PRP also invited the SFC to consider the need of the Enforcement Division of the SFC to consult the Legal Services Division (“LSD”) of the SFC before deciding whether to prosecute in cases involving serious or repeated offences.

3.16 The SFC replied that, in the particular case reviewed by the PRP, the SFC considered the repeated offences serious and had put an enormous amount of time and resources into this investigation. The SFC had considered the feasibility of putting more effort and resources into the investigation given the circumstances of the case. However, as the trades took place outside Hong Kong

and all records were maintained there, it was difficult if not impossible to obtain the required evidence even if extra staff were assigned to pursue the case. In this case, the SFC was satisfied that there was no further evidence that could usefully be gathered which would materially enhance the prospects of securing a conviction. On the other hand, when considering whether it would prosecute, the Enforcement Division considered in each potential prosecution case whether it should seek advice from the LSD. The Enforcement Division considered that there was insufficient evidence in this particular case to justify consulting the LSD.

3.17 The PRP noted from one of the cases that, upon completion of the investigation, the SFC issued a letter to those persons under investigation who would not be prosecuted by the SFC to inform them that the investigation had been concluded and no further action would be taken against them. The PRP expressed appreciation of this good practice.

3.18 In an investigation case concerning short selling activities, the Intermediaries Supervision Department (“ISD”) of the SFC conducted a routine inspection of a company in late 2001 and noted that some suspected short selling activities had been conducted in September 2001. However, the ISD reported the suspected short selling activities to the Complaints Control Committee (“CCC”) of the SFC nine months later. The CCC then referred the case to the Enforcement Division for further investigation. As the prosecution of short selling activities was subject to a time-limit of twelve months under the Securities Ordinance<sup>5</sup>, the Enforcement Division had to work expeditiously. The PRP recommended that the ISD should endeavour to refer suspected short selling activities to other relevant SFC departments for follow-up action within a reasonable period of time so as to allow sufficient time for processing by other departments even though under the SFO which took effect on 1 April 2003, the time-limit (relating to an offence under the SFO other than an indictable offence) had been set as “3 years after the commission of the offence”. The SFC replied that the case concerned was an exception with extenuating circumstances. The SFC would ensure that future referrals to the Enforcement Division would be made within a reasonable period of time that would not put the chance of prosecution at any risk.

3.19 In another investigation case, one of the SFC’s considerations when

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<sup>5</sup> The Securities Ordinance was repealed on 1 April 2003 upon commencement of the SFO.

deciding not to further investigate the issuing of unauthorised advertisements of authorised funds was the Magistrates' decisions on similar cases pursued by the SFC in the past. The PRP invited the SFC to consider whether more objective guidelines on the making of decisions on investigation and disciplinary action in connection with unauthorised advertisements should be made available under the SFO. The SFC replied, in brief, that in this particular case, the SFC had decided that it could not afford to spend its limited resources on such a case where prosecution was unlikely to achieve much in the way of the SFC's regulatory aims. When making the decision, the SFC had taken into account the Court's likely sentence in such cases, the fact that the matter was unlikely to pose any significant risk to investors and the evidential difficulties involved in pursuing this particular case. The SFC considered that the facts of each case are always unique and require separate analysis and did not consider it necessary to articulate more objective guidelines on the making of decisions on investigations in connection with unauthorised advertisements.

3.20 In one of the investigations concerning a suspected breach of the Securities (Disclosure of Interests) Ordinance<sup>6</sup>, there was a long lapse of time between an act of non-disclosure which took place in September 2000 and the receipt of a complaint by the SFC in May 2002 that uncovered such act. It appeared that the SFC had treated the non-disclosure as a single act and carried out investigation only on transactions made in a particular period at and around the act was made. The PRP considered that it would have been advisable for the SFC to extend the period covered by the inquiry to see if the subject person had committed similar breach in the subsequent period. The information so obtained might have a bearing on the appropriate disciplinary action. The PRP recommended that the SFC consider, for cases with a long lapse of time between the act of wrongdoing and the uncovering of such act, the feasibility of setting a longer inquiry period. The SFC replied that in the particular case, it had examined all transactions throughout the year 2000, but given that the amounts of the transactions involved did not meet the minimum threshold in accordance with the general criteria for taking action in such matters, and as there were no other unique or special features in respect of this case (e.g. a previous warning for failure to disclose), the SFC had decided not to pursue the matter any further, other than the issue of a warning. The SFC had carefully considered the Panel's recommendation of setting a longer inquiry period for cases with a long lapse of

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<sup>6</sup> The Securities (Disclosure of Interests) Ordinance was repealed on 1 April 2003 upon commencement of the SFO.

time between the act of wrongdoing and the uncovering of such act. The SFC considered that the implementation of the suggestion was not feasible given the resource constraints.

### **(G) Processing of listing applications under the Dual Filing regime**

3.21 Before commencement of the SFO on 1 April 2003, the enforcement regime for corporate information disclosure in Hong Kong has been mostly based on the non-statutory Listing Rules of the SEHK and on the contractual obligations of a listed company as set out in the Listing Agreement with the SEHK. The Securities and Futures (Stock Market Listing) Rules (“the Rules”) made under the SFO, which took effect on 1 April 2003, provide the SFC with statutory tools for more effective enforcement against false or misleading information disclosure.

3.22 The Rules require a corporation applying for listing of its shares to file copies of its listing application to the SFC after the same is submitted to a recognised exchange company (Dual Filing). To facilitate compliance and minimise any additional cost to a listing applicant, the Rules enable the applicant to fulfil this obligation by authorising the exchange company to file the material with the SFC on its behalf.

3.23 The PRP reviewed a total of eight cases on processing of listing application under the Dual Filing regime. In three of the eight cases reviewed by the PRP, there was delay in the SFC receiving the documents relating to listing applications. In one of the cases, the SFC received a document almost one month after it was submitted by the applicant. In the other two cases, the SFC received the relevant documents 15 days and 11 days later respectively after they were submitted by the applicants.

3.24 Section 6 of the Rules stipulates that the SFC may, within ten business days of an applicant filing an application for listing or supplying further information, require the applicant to supply further information or object to the listing in certain circumstances. The PRP considered that any delay in the receipt of the relevant documents by the SFC might jeopardise the SFC’s ability to follow the ten-day time frame as set out in the Rules. The PRP recommended that the SFC liaise with the Hong Kong Exchanges and Clearing Limited

("HKEx") to ensure that the SFC would receive listing applications and related documents promptly. The SFC replied that the delay happened at the earlier stage of the Dual Filing regime. The SFC had already brought up the issue with the HKEx after the occurrence. Following the PRP's recommendation, the SFC had further liaised with the HKEx and reached agreement with the HKEx that listing applications and related documents should be passed to the SFC within the ten-day time frame.

3.25 According to the internal procedures of the SFC, a decision to object to a listing application required the endorsement of the Executive Director ("ED") of the CFD. In two cases, after consulting the Dual Filing Advisory Group, the SFC informed the HKEx of its intention to object to a listing application. However, the SFC case files did not contain records on the ED's endorsement to object to the applications. The PRP recommended that the SFC consider documentation of the ED's endorsement on the intention to object to a listing application in the case file. The SFC agreed to the recommendation.

3.26 In two cases, the SFC issued a letter to the HKEx indicating its intention to object to the listing application. However, the SFC did not specify in the letter the reasons for its intention to object to the application. The PRP recommended that, to be fair to all parties concerned (i.e. the applicant, the HKEx and the SFC) and as a good practice in record keeping, the SFC should consider setting out the reasons for its intention to object to a listing application in its letter to the HKEx. The SFC agreed to the recommendation.

3.27 The PRP has also reviewed the SFC's internal operational procedures of processing listing applications under the Dual Filing regime as detailed in paragraphs 4.34 – 4.41.

#### **(H) Approval of Approved Lending Agents ("ALAs")**

3.28 Part XV of the SFO requires the disclosure by substantial shareholders of their interests in the securities of listed companies. The Securities and Futures (Disclosure of Interests – Securities Borrowing and Lending) Rules establish a simplified disclosure regime that will limit the disclosure obligation of certain classes of participants in the securities borrowing and lending industry provided that they are approved by the SFC as an ALA.

way of changes being made to documents after clearance by the Executive. There was also no current requirement in the Takeovers Code for the final printer's version of a document to be submitted for final clearance by the Executive. Moreover, such a change would encourage the market to rely more on the SFC in the drafting of documents. The SFC was also mindful of the likely impact of any such change on the already relatively tight offer timetable. According to the SFC, it is part of the broader policy objective of both the SFC and the HKEx to move gradually from a pre-vetting system towards a system which places more responsibility on companies and their advisers and more emphasis on enforcement. Ultimately it is the responsibility of the parties and their professional advisers to ensure that all information in a document is accurate and in full compliance with the Code.

3.29 The PRP reviewed four cases on application for approval as ALAs. The PRP noted that the SFC had not yet received any application for approval as an ALA by mid-March 2003. In light of the implications to the securities lending and borrowing market that would be caused by the lack of ALAs in the market when the SFO commenced in April 2003, the SFC urged, in mid-March 2003, the securities lending and borrowing industry participants to submit applications, and adopted an interim measure of granting temporary approval to applications lodged before April 2003. In all the four cases reviewed, the applicants were granted temporary approval which was valid up to 30 April 2003. The temporary approval was then replaced by a formal approval when the applicants provided all the essential information required by the SFC.

3.30 The PRP found that the SFC had followed the standard procedures in processing the four cases. The interim arrangement was considered reasonable as it aimed at preventing a possible disruption to the securities borrowing and lending market, which might be caused by a sudden large-scale withdrawal of securities from the market triggered off by the absence of ALAs in the market.

### **(I) Handling of takeovers and mergers transactions**

3.31 The PRP reviewed three cases on handling of takeovers and mergers transactions by the Corporate Finance Division (“CFD”) of the SFC. In the three cases, the PRP found that the SFC was heavily involved in the pre-vetting of draft documents submitted by the issuers. Normally, the case officers of the SFC would mark their comments on the draft and return a marked up copy to the issuer for making necessary amendments. With the exchange of plenty of such correspondence with the issuers, it might have been advisable for the SFC to ask for a final copy of the document for checking whether all the comments have been properly incorporated before it was issued. However, it was not a practice of the SFC to do so. The PRP sought the SFC’s view on the suggestion of requiring an issuer to submit a final version of the document for checking before it was issued.

3.32 The SFC replied it would not be merited to require an issuer to submit a final version of the document for checking before it was issued. The current vetting procedure by the CFD (the Executive) was well recognised and accepted by the market. There was little evidence of abuse of the clearance process by

## **Chapter 4. Observations and recommendations arising from the review of specific subjects**

4.1 The PRP examined specific areas of the SFC's procedures as detailed in this chapter. The aim was to identify areas for improvement that could reduce the compliance burden of the industry without compromising the quality and integrity of regulation.

4.2 The PRP attaches great importance to views from the industry on possible areas for improvement on the SFC's procedures and where appropriate, referred the industry's proposals to the SFC for consideration and response. The PRP was pleased to note that the SFC had been positive in considering such proposals. The proposals discussed are summarised below while the SFC's responses to the proposals are detailed in **Annexes C and D**.

### **(A) Registration of intermediaries**

4.3 The industry associations commented that on some occasions, applications for a licence were not processed within the time frame specified in the performance pledges of the SFC<sup>7</sup>. The industry associations suggested that the SFC speed up the processing of an application for a licence. The PRP invited the SFC to comment on the suggestion. The SFC replied that it had always strived to speed up the processing of licence applications and had an established mechanism to prevent undue delay in processing such applications. The SFC would continue to comply with the performance pledges as far as possible.

4.4 The industry associations noted that market practitioners did not fully understand the licensing requirements under the new licensing regime. For instance, when some licensees changed jobs, their prospective employers might require them to apply for the addition of other regulated activities onto their licences, although such addition might not be absolutely necessary for their new

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<sup>7</sup> According to the performance pledges of the SFC, the time frame for processing applications for a licence is seven business days for a provisional licence for representatives, eight weeks for a normal licence for representatives, ten weeks for responsible officers and 15 weeks for corporations.



employment. As the applicants might not possess the relevant qualification and experience in relation to the additional regulated activities, the SFC might not approve their applications. This had put the licensed person in a difficult position. The industry associations suggested that the SFC further improve the knowledge of market practitioners on the licensing requirements under the new licensing regime. The PRP invited the SFC to comment on the suggestion. The SFC replied that it was sympathetic to the comment and would issue a circular to licensed corporations, reminding them that their representatives are only required to be licensed for those regulated activities that they carry on. The circular was issued on 27 January 2004.

4.5 Under the old licensing regime, a dealing director of non-Exchange participants needed to place a deposit with the SFC for his performance of dealing activities. When a dealing director of a non-Exchange participant ceased to be a dealing director, the deposit would be refunded by the SFC. The industry associations commented that the refund of such deposits should be made as early as possible. The PRP invited the SFC to respond to the suggestion. The SFC replied that refund of deposit cases had normally been dealt with reasonably promptly, after having satisfied all statutory requirements for obtaining a refund. The SFC would ensure that future refunding cases would also be processed expeditiously.

4.6 The industry associations noted that if a licensed person, who had left the industry for six months or more, wanted to carry on regulated activities before his application for a new licence was approved by the SFC, he had to apply for a provisional licence from the SFC and pay a fee for the provisional licence on top of the fee for the normal licence. The industry associations considered that the procedure was a bit cumbersome and added extra financial burden to the applicant. The industry associations suggested that the SFC examine whether the relevant licensing procedures could be simplified. The PRP invited the SFC to address the concern of the industry associations.

4.7 The SFC advised that the SFO provided that a representative's licence remains valid if he applied for change of accreditation within 180 days after he ceased to be accredited to his former employer. Following the approval of such application, he could carry on regulated activities without the necessity of applying for a provisional licence. It was only when a representative has left the

industry for half a year or more that he needs to re-apply for a licence. In that case, if he wishes to carry on regulated activities prior to the issuance of a normal licence, he must apply for a provisional licence subject to payment of an additional fee in light of the extra administrative cost and in line with the user-pay principle. A provisional licence would be granted when the SFC had no reason to doubt that the applicant is fit and proper, based on its own information, while awaiting confirmation from other parties (such as the Hong Kong Police and the Customs and Excise Department). The vetting of a re-entrant's application was considered necessary as the applicant had left the industry for a considerable period of time.

### **(B) Performance pledges for processing applications for licence under the new licensing regime**

4.8 In response to an earlier suggestion made by the industry associations that the SFC should set out clearly the time required for processing different types of application for licence, the SFC replied that the revised performance pledges on processing applications for licence would be published upon implementation of the new licensing regime under the SFO which took effect on 1 April 2003.

4.9 The SFC presented the revised performance pledges on processing applications for licences under the new licensing regime to the PRP in 2003. The revised performance pledges are as follows –

- ✧ Responding to license application – 2 business days (unchanged)
- ✧ Processing of application for new licence:
  - Representative (provisional licence) – 7 business days (new licence category)
  - Representative (normal licence) – 6 weeks (reduced from 10 weeks)
  - Representative (responsible officers) – 8 weeks (reduced from 15 weeks)
  - Corporation (normal licence) – 15 weeks (unchanged)

- ✧ Processing change of accreditation – 7 business days (no pledge under the old regime)

4.10 The SFC advised that the pledges were devised for a broad time frame and would apply under normal circumstances. In the two-year transitional period after implementation of the SFO, i.e., from April 2003 to March 2005, the pledges may not be met due to overwhelming workload associated with migrating about 27,000 existing licensees to the new regime and proposals to further finetune the SFO utilising existing resources. During the transitional period, the pledges in respect of “representative (normal licence)” and “representative (responsible officers)” are eight weeks and ten weeks respectively.

4.11 The PRP considered that there was improvement in the revised performance pledges as the processing time for various categories of licence had been shortened.

### **(C) Rationalisation of registration procedures of the SFC and the Stock Exchange of Hong Kong (“SEHK”)**

4.12 In late 2001, the PRP invited the SFC to consider a recommendation made by the industry associations that the SFC and the SEHK should rationalise their registration procedures so as to minimise duplication. The SFC agreed to the recommendation but indicated that implementation of the recommendation would require synchronisation of the work processes as well as the system designs of the SFC and the SEHK.

4.13 The SFC advised that the rationalisation of registration procedures with the SEHK has been completed in the first quarter of 2003. The SEHK has abolished the registration system for the “sale representatives” of its Exchange Participants. As a result, the “sales representatives” of Exchange Participants are only required to be licensed by the SFC as “representatives” to perform regulated activities under the new licensing regime implemented under the SFO. As regards the registration of the Exchange Participants’ “dealing directors” with the SEHK, a simplified arrangement has been put in place. The SEHK no longer requires an applicant to submit information which duplicates that submitted to the SFC. After submitting an application to the SFC for a licence as a

“responsible officer” under the new licensing regime, an applicant is only required to submit a simple SEHK form (Form 2) to the SEHK for registration as a “dealing director”, together with a certified true copy of the SFC’s Form 3 previously submitted to the SFC. The new arrangements took effect on 1 April 2003, coinciding with the implementation of the SFO.

4.14 The PRP considered the new arrangement an improvement in the registration procedures of the SFC and the SEHK which served to reduce the compliance burden of market practitioners.

#### **(D) Registration and supervision of Registered Institutions (“RIs”)**

4.15 Under the SFO, authorised financial institutions carrying on regulated activities in Hong Kong must be registered by the SFC as RIs and are then, together with their relevant individuals<sup>8</sup>, supervised by the HKMA and otherwise regulated jointly by the SFC and the HKMA. The PRP reviewed the SFC’s internal procedures on registration and supervision of RIs.

4.16 The PRP noted that, as specified in the MoU signed between the SFC and the HKMA, the HKMA would notify the SFC, as soon as reasonably practicable, of any “designated serious matter” about a RI that the HKMA is aware of. The PRP recommended that the SFC should consider discussing with the HKMA the need to set out a reasonable time frame for the referral of “designated serious matters”. The SFC replied that there should be a prompt exchange of information on matters designated as “serious matters” between the HKMA and the SFC if and when any of them arose. The degree of promptness had not been expressed in terms of hours or days because the speed at which it was reasonably practicable for these ad hoc matters (i.e. not regular occurrences) to be notified by a party to the other might be different, depending on the nature of the matter in question and the circumstances in which it arose. In urgent cases, initial notification would be made orally. As the communication and cooperation arrangements had been working well so far, it seemed unnecessary at present to specify any absolute time frame in addition to as soon as reasonably practicable.

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<sup>8</sup> Examples of relevant individuals are the executive officer of a RI who supervises its regulated activities and its staff who carries out regulated activities.

4.17 The PRP noted that, as specified in the MoU, upon receiving a complaint against a RI, the SFC would refer it to the HKMA in writing as soon as practicable. When a complaint was considered by the HKMA to be relevant to a matter that the SFC could investigate or conduct an inspection under the SFO, the HKMA would refer such complaint to the SFC. The PRP recommended that the SFC should consider discussing with the HKMA the need to set out a reasonable time frame for referral of complaints between the two parties. The SFC advised that although the MoU did not set out a specific time frame for referral of complaints between the parties, the parties had a basic obligation to refer a complaint to the other party as soon as possible. The promptness of the referral depended on the circumstances of individual cases. As the SFC and the HKMA had been working closely to fulfill their respective obligations under the MoU, the SFC considered that a rigid time frame for referral might not be necessary at this stage.

4.18 The SFC would continue to work closely with the HKMA and would review the cooperation arrangements between the parties from time to time to ensure that, for the purposes of regulation of RIs, there was timely exchange of information between the two regulators.

#### **(E) Inspection of intermediaries**

4.19 The industry associations noted that in some inspection cases, the SFC took a long time to issue a letter of deficiencies, which summarised the result of the inspection, to the inspected intermediary after completion of the inspection fieldwork. The industry associations considered that the SFC should speed up the issue of the letter of deficiencies and consider giving a performance pledge on the time frame for issuing of letter of deficiencies. The PRP invited the SFC to respond to the suggestions.

4.20 The SFC replied that it was a common practice for the SFC inspection team to discuss the preliminary findings with the inspected intermediary at the conclusion of the inspection fieldwork, which on average took only about two weeks, such that the firm was alerted of the possible deficiencies in its operations and may institute immediate remedial measures for matters that warrant quick action.

4.21 Notwithstanding the above, the SFC had taken various steps that aim to shorten the time for completing an inspection and issuing the letter of deficiencies. It implemented in October 2002 a procedure to issue an interim letter of deficiencies, summarising the areas of concern noted from the inspection fieldwork and highlighting that a final letter would follow after the review of all information received or to be received. The interim letter of deficiencies would be issued when the letter of deficiencies was not issued after four months from the inspection fieldwork. This arrangement would enable the intermediaries to be informed of the initial findings earlier. Besides, the ISD of the SFC had reorganised its structure and designated a larger pool of staff to conduct inspections. The new structure, effective from 1 April 2004, was expected to further increase the efficiency and effectiveness of inspections.

4.22 The SFC further advised that it was not practicable for it to pledge any rigid time frame for the issuing of a letter of deficiencies because the cooperation from the intermediaries, which was an uncontrollable factor, affected the inspection process and the number and complexity of issues arising from an inspection varied among different intermediaries, and so did the time needed to review them thoroughly.

#### **(F) Appointment of auditor under Section 160 of the Securities and Futures Ordinance (“SFO”)**

4.23 Under Section 160 of the SFO, the SFC can, upon application by a client of a licensed corporation, appoint an auditor to examine and audit the accounts and records of the licensed corporation and any of its associated entities and to report to the SFC on such matters as the SFC may direct.

4.24 The PRP reviewed the SFC’s internal procedures on appointment of auditors under Section 160 of the SFO and noted that, under the SFO, the SFC might order the person making the application for an audit to bear, wholly or partly, the cost of the audit. The PRP commented that an applicant who applied for an audit would consider it unreasonable for him to bear the cost if the audit was successful in identifying deficiencies in the operation of the company. Moreover, an individual applicant might have difficulties in paying the cost of an audit.

4.25 The PRP recommended that, to be fair to the applicant, the SFC consider whether it was feasible to inform the applicant before an auditor is appointed that there is a possibility that he would be required to bear the cost of an audit. However, in informing the applicant of the possibility of requiring him to pay for the cost, the SFC should exercise great care as the applicant might take it negatively as a threat against his making an application.

4.26 The SFC advised that in considering whether it was appropriate to direct the person applying for the appointment of auditor to bear wholly or partly the cost of the audit, the SFC would have regard to, among other things, whether true information relevant to the complaint was provided by the person, his share of responsibility for the intermediary's failure to account to him under the circumstances, etc. Before a direction for payment was made to the person, a letter would be sent to notify him of the SFC's intention to make a direction for payment and the reasons. The person would have at least 14 days to make a submission if he considered the direction unreasonable. The decision for a direction for payment was appealable to the Securities and Futures Appeals Tribunal ("SFAT") under Section 217 of the SFO.

4.27 The SFC shared the concern of the PRP that an applicant, when being informed of the possibility of having to bear the cost before appointing an auditor, might take it negatively as a threat against his making of an application. As such, the SFC considered that it might be of assistance, for the purpose of ensuring the applicant's awareness of the SFC's power in that regard, to include a copy of the provisions of section 160 of the SFO (which covers, among other things, the SFC's power of apportionment of cost) in the acknowledgment letter that the SFC sent to the applicant upon receiving his application.

**(G) Standardised procedures on issue of interim replies to complainants and target date for completion of investigation of complaints**

4.28 In late 2002, the PRP reviewed the complaint handling procedures of the SFC and noted that not all the operation divisions/departments of the SFC would periodically update the complainants on the progress of the complaints. The PRP made a recommendation to the SFC that the SFC should issue interim replies to complainants if the complaints could not be concluded within a reasonable period of time, and set a target date for issue of substantive replies to

complainants as a measure to guard against prolonged investigation of complaints.

4.29 The SFC agreed to the recommendations and adopted a standardised procedure on issue of interim replies to complainants since August 2003 and set a target date for completion of investigation of complaints. Salient points of the revised procedures are –

- (a) A letter will be issued to the complainant within two weeks after receiving the complaint.
- (b) When a case is transferred from an operation division to another one, the transferring division will write to notify the complainant that his/her complaint is being transferred to another division for further action.
- (c) If the operation division has not completed the investigation of the complaint within four months, an interim letter will be sent by the Investor Education and Communications Department of the SFC to the complainant after review of progress by the CCC.
- (d) If the operation division has not completed the investigation of the complaint within twelve months, it will send a second interim letter to the complainant.
- (e) If the complainant contacts the SFC to inquire about the status of the complaint, the operation division concerned will reply to the complainant within seven days.

#### **(H) Investigation and disciplinary action**

4.30 The industry associations noted that some licensed persons who had received warning letters from the SFC had encountered difficulties in changing employment because their prospective employers treated the warning letter as formal disciplinary action and declined their application for employment. The industry associations suggested that the SFC improve the knowledge of the market practitioners on the nature and classification of formal disciplinary action and its distinction from a warning letter. The PRP invited the SFC to respond to the suggestion.



4.31 The SFC replied that a warning letter was not formal disciplinary action and should not bar a person from working in the industry. An explanation to this effect was published in the SFC Alert (Sept/Oct 2003 issue, page 3, "Application for re-entry into the industry by persons with disciplinary records"). It was entirely a matter for employers to decide what, if any, weight to attach to the fact that a prospective employee has previously received a warning letter from the SFC, having regard to the nature of the matter to which the warning related. There was nothing in the secrecy provisions under the SFO to prevent a potential employer from asking an applicant for employment whether they have ever received a warning letter from the SFC and nothing to inhibit the applicant from revealing that fact and providing the potential employer with a copy of the letter. The SFC would consider the need for further guidance for market practitioners on these matters. The SFC subsequently posted two "Frequently Asked Questions" to clarify this matter onto its website on 4 February 2004. In view of the concern of the industry associations, the PRP will, in 2004, examine further the issue of warning letters to intermediaries by the SFC.

4.32 The industry associations noted that individual market practitioners and small brokerage firms had difficulties in engaging legal representatives when they were involved in SFC investigations. In order to allow individual market practitioners and small brokerage firms to have better understanding of their rights and obligations in connection with SFC investigations, the industry associations suggested that the SFC consider whether a special unit could be set up within the SFC to answer enquiries, in particular the legal aspects of the rights and obligations of market practitioners, relating to SFC investigations. The PRP invited the SFC to comment on the suggestion. The SFC advised that persons who are interviewed by the SFC receive formal advice on their statutory rights and obligations at the outset of all interviews. It was considered not appropriate for an enforcement agency like the SFC to provide legal advice to those whose conduct was under the SFC's investigation. The SFC considered that this was the sort of service which could be arranged by an industry association for the benefit of its members, possibly by the association retaining the services of a firm of solicitors to give advice on a general or case by case basis.

#### **(I) Disclosure of information on investigation of complaints**

4.33 In 2002, the PRP received a suggestion from the industry associations

that the SFC should inform the management of a company of complaints made against the company and the identity of any of their staff being investigated by the SFC so that the management could take immediate remedial action if necessary. The PRP invited the SFC to consider the suggestion. The SFC replied that there might be some benefit, in a limited number of cases, in informing an employer of suspected misconduct by an employee. The SFC recognised that there were considerable potential dangers in adopting this in all cases. Some employers might, for example, be tempted to destroy or tamper with evidence, thereby prejudicing an investigation; others might resort to the summary dismissal of the employee concerned, before a conclusive finding has been made. Nevertheless, the SFC agreed to revise its internal procedures to allow, in exceptional circumstances, disclosure to be made. It should however be noted that disclosure may only be made if it is in the performance of the SFC's functions or falls within one of the exemptions permitted under the statutory secrecy provision. Moreover, even if disclosure can be made under the SFO, it is necessary for the SFC to carry out a balancing exercise between the need for confidentiality and the need for disclosure.

#### **(J) Processing of listing applications under the Dual Filing regime**

4.34 The PRP conducted a preliminary review of the SFC's internal procedures in processing new listing applications under the Dual Filing regime and noted that the Dual Filing Team of the SFC might "select" a particular listing application for review for a number of reasons including referrals from other divisions of the SFC, complaints received, press reports, intelligence, market trends, known risk areas or random selection. The PRP recommended that the SFC should consider whether more specific criteria should be set out for selection of listing applications for review and whether such selection criteria should be published for better transparency. The SFC replied that since the market trend and types of listing applicants were constantly changing and the disclosure issues in different listing applications varied greatly, it was not possible to set out an exhaustive list of issues.

4.35 Regarding the publishing of selection criteria, the SFC replied that the SFC strove to maximize transparency. The SFC would continue to achieve transparency in the work of the Dual Filing regime by issuing periodic updates on the regime, holding press briefings, and participating in industry sharing

sessions.

4.36 The PRP considered that a preliminary review on all listing applications might be essential before the SFC decided which applications should be selected for detailed study. The PRP invited the SFC to consider the need of conducting a preliminary review of all listing applications. The SFC agreed to the recommendation and advised that since the launching of the Dual Filing regime, the SFC had undertaken a preliminary review of all listing applications before deciding whether to pass any comments to the applicants through the SEHK. The SFC's Shareholders' Group and Dual Filing Advisory Group also agreed with the PRP's view concerning the need of conducting a preliminary review of all listing applications but have raised concerns regarding the resource issue. The SFC would keep this issue under review.

4.37 The PRP noted from the SFC's internal procedures that the Dual Filing Team might object to a new listing application that has a "material deficiency". The PRP recommended that the SFC consider whether a database of "material deficiencies" of listing applications that the SFC has objected to should be published for better transparency. In light of the secrecy provision, the PRP considered that the SFC should be careful in considering whether and how the database was to be published. The SFC might consider describing the "material deficiencies" only in general terms. The SFC agreed to the recommendation. The SFC had been describing and explaining the deficiencies in its periodic update and press briefings and would continue to do so.

4.38 The PRP noted that as the Dual Filing regime had been implemented since April 2003, the market should be able to provide comment on the operation of the Dual Filing process. The PRP recommended that the SFC establish a regular dialogue with the industry on the operation of the Dual Filing regime. The SFC agreed to the recommendation and commented that since the Dual Filing regime came into force, the SFC had made various efforts to reach out to market participants, both to ensure that they were aware of the operation of the Dual Filing arrangements and to solicit their input regarding the listing application process. The SFC had made reports to the SFC Advisory Committee, the Shareholders' Group, and the Dual Filing Advisory Group. The SFC had also provided periodic updates to the market and the public and participated in sharing sessions with industry practitioners. The SFC would continue to look for

opportunity for communication with the market.

4.39 The SFC advised the PRP that it would, in practice, consult the Dual Filing Advisory Group on every case of listing application to which it intended to object. However, the practice of consulting the Dual Filing Advisory Group on every listing application to which the SFC intends to object was not stated in the SFC's internal procedures. The PRP considered that at the initial stage of the Dual Filing regime, in order to get an overall direction on how listing applications should be handled, it might be essential for the SFC to follow that practice. The PRP recommended that the SFC consider setting out the practice in its internal procedures. The SFC agreed to the recommendation.

4.40 The PRP noted that a Director of the Corporate Finance Division ("CFD") was responsible for monitoring the giving of comments on or raising no objection to a listing application. However, the role of the Director was not clearly stated in the SFC's internal procedures. The PRP recommended that the SFC consider setting out clearly the role of the Director in the internal procedures on processing listing applications under the Dual Filing regime. The SFC agreed to the recommendation.

4.41 Dual Filing is an important subject under the SFO regime. The PRP has only been able to conduct a preliminary review of the SFC's internal procedures on this important subject in late 2003 because it was only by that time that sufficient completed listing application cases under the Dual Filing regime were available for review. The PRP would therefore continue to review the SFC's internal procedures in processing listing applications under the Dual Filing regime in 2004.

#### **(K) Communication with the industry**

4.42 In engaging the industry associations, the PRP learned that there was room for improvement in the communications between the SFC and small brokerage firms. The industry associations suggested that the SFC explore more channels for communication with small brokerage firms. The PRP invited the SFC to respond to the suggestion.

4.43 The SFC advised that a number of channels for communication between the SFC and small brokerage firms have already been established. Examples of these communication channels are –

- (a) consultation with industry practitioners, including small brokerage firms, on new policy initiatives prior to issuing public consultations;
- (b) invitation of market representatives to join working groups;
- (c) operation of an intermediaries relationship system by the Intermediaries and Investment Products Division of the SFC that facilitates two-way communication between the SFC and the industry;
- (d) regular meetings with the stockbroking industry associations; and
- (e) regular posting of Frequently Asked Questions on SFC web-site, issuing of advisory circulars through FinNet, and publication of periodicals like SFC Alert, Quarterly Bulletin, etc.

4.44 The SFC advised that although many channels of communication with small brokerage firms already exist, the SFC welcomes any further specific comments from the industry as to what improvements could be made and what additional channels of communication could be explored.

**(L) Mechanism for internal communication among the SFC's divisions and departments**

4.45 The PRP noted that the various operation divisions of the SFC, although responsible for distinct functions, work in interaction with each other and hence communication among them on operational matters is crucial to the effective operation of the SFC as a whole. The PRP therefore invited the SFC to provide information on its mechanism for internal communication among divisions and departments on operational matters.

4.46 The PRP noted from the information provided by the SFC that the internal communication of the SFC had been improved. Most of the SFC's work could be handled and recorded in the "e-workflow system" and information in

the system could be shared amongst staff. There were various regular and ad hoc meetings among different divisions and among different layers of staff in the same division for discussion, and information and experience sharing on operational matters. Multi-disciplinary workgroups would be formed to take care of matters with common interest amongst divisions. Moreover, the Chief Operating Officer of the SFC, whose appointment started on 26 May 2003, had been assigned to co-ordinate cross-divisional functions and communications.

#### **(M) Revised internal procedures on public consultations**

4.47 In December 2002, the PRP reviewed the SFC's internal procedures on public consultations. The PRP noted that it was the responsibility of the operation divisions of the SFC to initiate public consultation exercises on certain proposals while the full Commission had the authority to decide whether and how such public consultation exercises was to be conducted. However, this division of responsibilities was not clearly specified in the internal procedures on public consultations for SFC staff. The PRP recommended that the SFC should set out the division of responsibilities clearly in its internal procedures. The SFC agreed to the recommendation.

4.48 In 2003, the SFC presented its revised internal procedures on public consultations to the PRP. The PRP noted that the revised procedures set out more clearly the division of responsibility between the operation divisions of the SFC and the full Commission.

## **Chapter 5. Way forward**

5.1 In 2003, the PRP performed its functions through the review of completed cases and selected topics of the SFC's operational procedures and made relevant recommendations to the SFC. The PRP also maintained a dialogue with the industry with a view to gauging the industry's views on procedural matters.

5.2 For 2004, the PRP will examine, among other things, the SFC's internal procedures for the execution of subjects covered by the MoU governing listing matters between the SFC and the HKEx, including the SFC's regulatory oversight of the HKEx's performance of listing functions and the SFC's performance in administering the Dual Filing regime. The PRP will also review the SFC's internal procedures on issue of warning letters to intermediaries.

5.3 The PRP will also follow up a number of the recommendations made in 2003. These include the provision of further guidance to market practitioners on the nature and classification of formal disciplinary action, and the conduct of preliminary reviews on all listing applications under the Dual Filing regime.

5.4 The PRP will continue its work on review of completed cases to ensure that the SFC follows its internal procedures consistently and will further cultivate its dialogue with market participants affected by the SFC regulatory processes and procedures.

5.5 The PRP will continue to engage the industry to listen to their concerns about the exercise of powers by the SFC, and welcome views from the general public, especially the users of the securities and futures markets, on the performance of functions by the SFC with a view to identify any areas of improvement in the relevant procedures and processes.

## **Chapter 6. Acknowledgement**

6.1 The PRP would like to express its gratitude to the Chairman of the SFC and his staff for their assistance in facilitating the review work and cooperation in responding to the PRP's enquiries and recommendations in the past year. The PRP is also grateful to members of the industry who have rendered their views to the PRP for improvements to the SFC's internal procedures and processes.



**Process Review Panel for the  
Securities and Futures Commission**

**Terms of reference**

1. To review and advise the Commission upon the adequacy of the Commission's internal procedures and operational guidelines governing the action taken and operational decisions made by the Commission and its staff in the performance of the Commission's regulatory functions in relation to the following areas-
  - (a) receipt and handling of complaints;
  - (b) licensing of intermediaries and associated matters;
  - (c) inspection of licensed intermediaries;
  - (d) taking of disciplinary action;
  - (e) authorisation of unit trusts and mutual funds and advertisements relating to investment arrangements and agreements;
  - (f) exercise of statutory powers of investigation, inquiry and prosecution;
  - (g) suspension of dealings in listed securities;
  - (h) administration of the Hong Kong Codes on Takeovers and Mergers and Share Repurchases;
  - (i) administration of non-statutory listing rules;
  - (j) authorisation of prospectuses for registration and associated matters; and
  - (k) granting of exemption from statutory disclosure requirements in respect of interests in listed securities.

2. To receive and consider periodic reports from the Commission on all completed or discontinued cases in the above-mentioned areas, including reports on the results of prosecutions of offences within the Commission's jurisdiction and of any subsequent appeals.
3. To receive and consider periodic reports from the Commission in respect of the manner in which complaints against the Commission or its staff have been considered and dealt with.
4. To call for and review the Commission's files relating to any case or complaint referred to in the periodic reports mentioned in paragraphs 2 and 3 above for the purpose of verifying that the action taken and decisions made in relation to that case or complaint adhered to and are consistent with the relevant internal procedures and operational guidelines and to advise the Commission accordingly.
5. To receive and consider periodic reports from the Commission on all investigations and inquiries lasting more than one year.
6. To advise the Commission on such other matters as the Commission may refer to the Panel or on which the Panel may wish to advise.
7. To submit annual reports and, if appropriate, special reports (including reports on problems encountered by the Panel) to the Financial Secretary which, subject to applicable statutory secrecy provisions and other confidentiality requirements, should be published.
8. The above terms of reference do not apply to committees, panels or other bodies set up under the Commission the majority of which members are independent of the Commission.

**Membership  
of the Process Review Panel  
(as at 31 December 2003)**

**Chairman**

Mr. CHENG Hoi Chuen, Vincent, JP

**Members**

Mr. CHEONG Ying Chew, Henry

Mr. FONG Hup

Mr. KOTEWALL, Robert George, SBS, SC

Mr. KWAN Pak Chung, Edward

Professor LIU Pak Wai, SBS

Mr. PANG Yuk Wing, Joseph, JP

Mr. Alan Howard SMITH, JP

**Ex-officio members**

Chairman, Securities and Futures Commission  
(Mr. Andrew L T SHENG, SBS, JP)

Non-Executive Director, Securities and Futures Commission  
(Dr. York LIAO, JP)

Representative of Secretary for Justice  
(Mr. Ian G M WINGFIELD, GBS, JP)

**Membership of the  
Working Group on Corporate Finance and Enforcement  
*(as at 31 December 2003)***

**Chairman**

Mr. KWAN Pak Chung, Edward

**Members**

Mr. CHENG Hoi Chuen, Vincent, JP

Mr. KOTEWALL, Robert George, SBS, SC

Mr. Alan Howard SMITH, JP

Mr. Ian G M WINGFIELD, GBS, JP

**Membership of the  
Working Group on Licensing, Intermediaries Supervision  
and Investment Products  
(as at 31 December 2003)**

**Chairman**

Mr. FONG Hup

**Members**

Mr. CHEONG Ying Chew, Henry

Dr. York LIAO, JP

Professor LIU Pak Wai, SBS

Mr. PANG Yuk Wing, Joseph, JP

Mr. Andrew L T SHENG, SBS, JP

**Observations and recommendations that  
have been accepted by the SFC**

(A) Registration of intermediaries

Item 1	Case findings/ market views	In one of the cases on registration of intermediaries, the SFC spent almost three months examining an application for registration in respect of corporations before asking the applicant company to submit additional information to facilitate further processing. (At the time when the case was processed, the SFC had a performance pledge of completing the processing of an application for registration in respect of corporations within fifteen weeks, i.e. about three and a half months.)
	PRP recommendations /observations	The PRP recommended that the SFC expedite the processing of future applications as far as possible.
	Response from SFC	The SFC would endeavour to expedite the processing of licence applications as far as practicable. In the particular case concerned, the delay was mainly due to the significant increase in workload in preparation for the implementation of the new SFO and partly due to several statutory holidays (Christmas, New Year & Chinese New Year) between December 2001 and February 2002, the period during which the case was processed by the SFC.
Item 2	Case findings/ market views	The industry associations commented that on some occasions, applications for a licence were not processed within the time frame specified in the performance pledges of the SFC. The industry associations suggested that the SFC speed up the processing of an application for a licence. (According to the performance pledges of the SFC, the time frame for processing applications for a licence is seven business days for a provisional licence for representatives, eight weeks for a normal licence for representatives, ten weeks for responsible officers and 15 weeks for corporations.)
	PRP recommendations /observations	The PRP invited the SFC to comment on the suggestion.
	Response from SFC	<p>The SFC had always strived to speed up the processing of licence applications and will continue to do so. In year 2003, despite the heavy workload associated with the transitional arrangements under the SFO, the SFC managed to process 88% and 74% of the provisional licence applications and normal licence applications for representatives respectively within the pledged time frames, whereas for the responsible officer applications and corporate applications the respective figures were 84% and 88%.</p> <p>However, in certain cases where there were complications, such as those where incomplete documentation was received, there appeared to be fitness and propriety concerns, or a licensing condition had to be imposed, the processing time might exceed the performance pledges.</p>

		<p>The SFC had always been willing to look into individual cases where there are extenuating circumstances requiring the processing to be expedited. The SFC had an established mechanism to prevent undue delay in processing licensing application. The SFC would continue to comply with the performance pledges as far as possible.</p>
Item 3	Case findings/ market views	<p>Under the old licensing regime, a dealing director of non-Exchange participants needed to place deposit with the SFC for his performance of dealing activities. When a dealing director of a non-Exchange participant ceased to be a dealing director, the deposit would be refunded by the SFC. The industry associations commented that the refund of such deposits should be made as early as possible.</p>
	PRP recommendations /observations	<p>The PRP considered that the SFC should be invited to respond to the suggestion.</p>
	Response from SFC	<p>Refund of deposit cases had normally been dealt with reasonably promptly, after having satisfied all statutory requirements for obtaining a refund. The SFC would ensure that future refunding cases would also be processed expeditiously.</p>
Item 4	Case findings/ market views	<p>The industry associations noted that market practitioners did not fully understand the licensing requirements under the new licensing regime. For instance, when some licensees changed jobs, their prospective employers might require them to apply for the addition of other regulated activities onto their licences, although such addition might not be absolutely necessary for their new employment. As the applicants might not possess the relevant qualification and experience in relation to the additional regulated activities, the SFC might not approve their applications. This had put the licensed person in a difficult position.</p> <p>The industry associations suggested that the SFC further improve the knowledge of market practitioners on the licensing requirements under the new licensing regime.</p>
	PRP recommendations /observations	<p>The PRP invited the SFC to comment on the suggestion.</p>
	Response from SFC	<p>The SFC was sympathetic to the comment, but it seemed that the issue concerns the arrangement between the employers and the representatives concerned. It is possible that a corporation is licensed for certain regulated activities other than those for which an individual representative is licensed if that representative does not conduct such regulated activities.</p> <p>Nevertheless, the SFC issued a circular to licensed corporations on 27 January 2004 reminding them that their representatives are only required to be licensed for those regulated activities that they carry on.</p>

(B) Performance pledges for processing applications for licence under the new licensing regime

Item 5	Case findings/ market views	<p>The PRP noted the SFC's revised performance pledges on processing applications for licences under the new licensing regime as follows –</p> <ul style="list-style-type: none"> <li>✧ Responding to license application – 2 business days (unchanged)</li> <li>✧ Processing of application for new licence: <ul style="list-style-type: none"> <li>• Representative (provisional licence) – 7 business days (new licence category)</li> <li>• Representative (normal licence) – 6 weeks (reduced from 10 weeks)</li> <li>• Representative (responsible officers) – 8 weeks (reduced from 15 weeks)</li> <li>• Corporation (normal licence) – 15 weeks (unchanged)</li> </ul> </li> <li>✧ Processing change of accreditation – 7 business days (no pledge under the old regime)</li> </ul> <p>The pledges were devised for a broad time frame and would apply under normal circumstances. In the two-year transitional period after implementation of the SFO, i.e., from April 2003 to March 2005, the pledges may not be met due to overwhelming workload associated with migrating about 27,000 existing licensees to the new regime and proposals to further finetune the SFO utilising existing resources. During the transitional period, the pledges in respect of “representative (normal licence)” and “representative (responsible officers)” are eight weeks and ten weeks respectively.</p>
	PRP recommendations /observations	The PRP considered that there was improvement in the revised performance pledges as the processing time for various categories of licence had been shortened.
	Response from SFC	N.A.



(C) Rationalisation of registration procedures of the SFC and the Stock Exchange of Hong Kong (“SEHK”)

Item 6	Case findings/ market views	<p>In late 2001, the PRP invited the SFC to consider a recommendation made by the industry associations that the SFC and the SEHK should rationalise their registration procedures so as to minimise duplication. The SFC agreed to the recommendation but indicated that implementation of the recommendation would require synchronisation of the work processes as well as the system designs of the SFC and the SEHK.</p> <p>The PRP noted that the SFC had completed the rationalisation of registration procedures with the SEHK in the first quarter of 2003. The SEHK has abolished the registration system for the “sale representatives” of its Exchange Participants. As a result, the “sales representatives” of Exchange Participants are only required to be licensed by the SFC as “representatives” to perform regulated activities under the new licensing regime implemented under the SFO.</p> <p>As regards the registration of the Exchange Participants’ “dealing directors” with the SEHK, a simplified arrangement has been put in place. The SEHK no longer requires an applicant to submit information which duplicates that submitted to the SFC. After submitting an application to the SFC for a licence as a “responsible officer” under the new licensing regime, an applicant is only required to submit a simple SEHK form (Form 2) to the SEHK for registration as a “dealing director”, together with a certified true copy of the SFC’s Form 3 previously submitted to the SFC. The new arrangements took effect on 1 April 2003, coinciding with the implementation of the SFO.</p>
	PRP recommendations /observations	The PRP considered the new arrangement an improvement in the registration procedures of the SFC and the SEHK.
	Response from SFC	N.A.

(D) Registration of Registered Institutions (“RIs”)

Item 7	Case findings/ market views	<p>According to the SFC’s performance pledge, the SFC would acknowledge receipt of an application for registration as a RI within two business days after receiving the application. In one of the four cases on registration of RIs reviewed by the PRP, there was slippage in acknowledging receipt of an application. The acknowledgement was issued 21 calendar days after the application was received by the SFC.</p>
	PRP recommendations /observations	The PRP recommended that the SFC endeavour to observe its performance pledge in acknowledging receipt of an application for registration as a RI.

	Response from SFC	The SFC agreed to the recommendation and reminded the case officers to observe the time frame of acknowledging receipt of an application within two business days.
Item 8	Case findings/ market views	According to the SFC's internal procedures and a MoU signed between the SFC and the HKMA, upon receiving an application for registration as a RI, the SFC will, within two business days, pass a copy of it to the HKMA or request the applicant to provide any missing items or return it to the applicant if it is substantially incomplete. The PRP noted that in two of the four cases on registration of RIs, the SFC passed a copy of the application concerned to the HKMA about two weeks after receiving it, far beyond the time frame of two business days.
	PRP recommendations /observations	The PRP recommended that the SFC observe, as far as possible, the time frame set out in its internal procedures and the MoU in passing a copy of the application to the HKMA. The PRP also recommended that the SFC review the reasonableness of the time frame taking into account the time taken in completed cases.
	Response from SFC	<p>During the period when the two cases concerned were processed, the Licensing Department of the SFC was under tremendous workload having to deal with normal licence/registration applications, licensees migrating to the new regime as well as teething issues arising from the implementation of the new SFO, etc.</p> <p>The SFC agreed to the recommendations and reminded the case officers to observe the time frame set out in its internal procedures in passing a copy of the application to the HKMA. In addition, the SFC would work with the HKMA to review the reasonableness of the current time frame of passing a copy of a registration application to the HKMA within two business days having regard to the current circumstances. The SFC subsequently revised the time frame to seven business days on 1 March 2004 in consultation with the HKMA.</p>
Item 9	Case findings/ market views	In one of the cases on registration of RIs, after receiving an application, the SFC verbally requested the applicant to provide additional information. However, there was no record in the case file showing details of the request including when and by whom the request was made.
	PRP recommendations /observations	The PRP recommended that the SFC keep a record in the case file on details of any verbal request made to the applicant for provision of information.
	Response from SFC	The SFC agreed to the recommendation and reminded the case officers to keep proper file notes on verbal requests made to the applicant for provision of information.

## (E) Inspection of intermediaries

Item 10	Case findings/ market views	<p>The industry associations noted that in some inspections cases, the SFC took a long time to issue a letter of deficiencies, which summarised the result of the inspection, to the inspected intermediary after completion of the inspection fieldwork. The industry associations considered that the SFC should speed up the issue of the letter of deficiencies.</p>
	PRP recommendations /observations	<p>The PRP invited the SFC to respond to the comment of the industry.</p>
	Response from SFC	<p>The SFC had taken steps to shorten the time for completing an inspection and issuing the letter of deficiencies. If complex compliance matters were uncovered during an inspection, more resources would be allocated to work on the inspection. The computer system for inspection work, i.e. the Inspection Activities Management System had also been enhanced to generate exception reports and statistical summaries on outstanding inspection cases.</p> <p>Furthermore, it was a common practice for the SFC inspection team to discuss the preliminary findings with the inspected intermediary at the conclusion of the inspection fieldwork, which on average took around two weeks, such that the firm was alerted of the possible deficiencies in its operations and may institute immediate remedial measures for matters that warrant quick action.</p> <p>In addition, the SFC implemented since October 2002 a procedure to issue an interim letter of deficiencies summarising the areas of concern noted from the inspection fieldwork and highlighting that a final letter would follow after the review of all information received or to be received. The interim letter of deficiencies would be issued when the letter of deficiencies was not issued after four months from the inspection fieldwork.</p> <p>According to the SFC's record, the average time taken to issue the letter of deficiencies was 3.4 months for the year 2003 on the whole – which was less than the four-month time frame expiry of which triggers the issue of an interim letter of deficiencies as described above. Besides the above measures, the ISD of the SFC had also re-organised its structure and designated a larger pool of staff to conduct inspections. The new structure, effective from 1 April 2004, was expected to increase the efficiency and effectiveness of inspections.</p>

(F) Prudential visits to intermediaries

Item 11	Case findings/ market views	The PRP noted that the SFC had introduced prudential visit to intermediaries in 2001/02 to improve communication with them.
	PRP recommendations /observations	In order to promote communication between the SFC and the intermediaries, and to enhance the effectiveness of the prudential visits, the PRP recommended that the SFC consider the feasibility of following up the result of the visit with the intermediary with a letter setting out the SFC's recommendations, if any.
	Response from SFC	Whilst prudential visits were not aimed at checking the compliance with regulatory requirements, the SFC always upheld the best practice of issuing a letter to an intermediary if any significant matters were noted during the course of the prudential visit that require attention or improvement by the intermediary. The SFC started, as from 1 August 2003, to send a "thank you" letter to an intermediary after the completion of a prudential visit to it to express appreciation for its cooperation where no significant matter requiring attention or improvement was noted.

(G) Appointment of auditors under Section 160 of the Securities and Futures Ordinance ("SFO")

Item 12	Case findings/ market views	<p>The PRP reviewed the SFC's internal procedures on appointment of auditors under Section 160 of the SFO and noted that the SFC might order the person making the application for an audit to bear, wholly or partly, the cost of the audit.</p> <p>The PRP commented that an applicant who applied for an audit would consider it unreasonable for him to bear the cost if the audit was successful in identifying deficiencies in the operation of the company. Moreover, an individual applicant might have difficulties in paying the cost of an audit.</p> <p>The PRP noted, however, that the power to apportion cost of an audit was given to the SFC under the SFO. An applicant might appeal to the SFAT against the decision of the SFC in apportioning cost of an audit.</p>
	PRP recommendations /observations	The PRP recommended that, to be fair to the applicant, the SFC consider whether it was feasible to inform the applicant before an auditor is appointed that there is a possibility that he would be required to bear the cost of an audit. However, in informing the applicant of the possibility of requiring him to pay for the cost, the SFC should exercise great care as the applicant might take it negatively as a threat against his making an application.

	Response from SFC	<p>In considering whether it was appropriate to direct the person applying for the appointment of auditor to bear wholly or partly the cost of the audit, the SFC would have regard to, among other things, whether true information relevant to the complaint was provided by the person, his share of responsibility for the intermediary's failure to account to him under the circumstances, etc.</p> <p>The above criteria were set out in the SFC's written procedures. The relevant procedures also require the case manager's recommendation for apportionment of cost to be reviewed by the Senior Manager and approved by the Directorate Staff to ensure its reasonableness. Before a direction for payment is made to the person, a letter would be sent to notify him of the SFC's intention to make a direction for payment and the reasons. The person would have at least 14 days to make a submission if he considered the direction unreasonable. The decision for a direction for payment was appealable to the SFAT under Section 217 of the SFO.</p> <p>The SFC shared the concern of the PRP that an applicant, when being informed of the possibility of having to bear the cost before appointing an auditor, might take it negatively as a threat against his making an application. As such, the SFC considered that it might be of assistance, for the purpose of ensuring the applicant's awareness of the SFC's power in that regard, to include a copy of the provisions of Section 160 of the SFO (which covers, among other things, the SFC's power of apportionment of cost) in the acknowledgment letter that the SFC sent to the applicant upon receiving his application.</p>
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(H) Authorisation of collective investment schemes

Item 13	Case findings/ market views	<p>In one of the cases on authorisation of collective investment schemes, the authorisation of product was given by a Director of the IPD of the SFC. In the operation manuals of the IPD, it was stipulated that all product authorisations were to be given by a Director and there was a note in the manuals stating that "all reference to Director throughout the manuals should be construed as Senior Director". Hence, authorisations of such products should be given by a Senior Director. According to the SFC, the relevant note stating that reference to Director should be construed as Senior Director was added when the only Director responsible for authorising investment schemes was promoted to Senior Director. When the Senior Director left the SFC, his duties were taken up by a Director but the relevant approving authority in the manuals had not been updated.</p>
	PRP recommendations /observations	<p>The PRP recommended that the SFC amend the operation manuals of the IPD so as to properly reflect the approving authority for new products.</p>
	Response from SFC	<p>The operation manuals of the IPD had been amended to reflect the current situation where the Head of the Department, who, as usual, was delegated the power to authorise products, holds the rank of Director, instead of Senior Director as in the case of her predecessor.</p>

(I) Handling of complaints against intermediaries

Item 14	Case findings/ market views	In one of the complaint cases, the complainant alleged, among other things, that his personal information had been disclosed by the subject company to a third party without his authorisation. However, the SFC had neither investigated this allegation nor addressed it in its reply to the complainant.
	PRP recommendations /observations	The PRP considered that the SFC should have informed the complainant of the reason for not taking any action on the allegation. The PRP recommended that in handling complaints, the SFC should endeavour to address all the allegations made by a complainant, properly document the reason for not taking action on any allegation and inform the complainant accordingly.
	Response from SFC	The SFC agreed that its decision should have been better documented. The complainant in this case did not pursue the matter further after receiving the final reply.
Item 15	Case findings/ market views	<p>In another complaint case, the SFC received a copy of a complaint letter addressed to a foreign consulate in Hong Kong alleging that a company was selling an unauthorised investment plan, which was claimed to be supervised by an overseas securities regulator. The SFC, by way of a letter addressed to the complainant and copied to the foreign consulate, asked the complainant to provide further information of the allegation but the complainant did not respond. The SFC then closed the case without taking further action on the subject company or seeking information from the overseas securities regulator or the foreign consulate.</p> <p>It appeared that the SFC had relied on the complainant for gathering evidence. The PRP considered that had the SFC approached the overseas securities regulator or the foreign consulate for information, it might have received assistance from them for further investigation of the complaint.</p> <p>The SFC had not approached the subject company for an explanation on the allegation. According to the SFC, it was not desirable to approach the subject company for information before a case of breach was established as it might prejudice subsequent prosecution. While the SFC's concern was understandable, it merited consideration whether the SFC should contact the subject company at an early stage so as to prevent possible market malpractice from happening at the outset, or to wait and take action after a case of breach was established.</p>
	PRP recommendations /observations	The PRP invited the SFC to offer comment on the above observations and consider the feasibility of taking a more proactive approach in protecting the interests of investors.

	Response from SFC	<p>As a regulatory organisation, the SFC needed sufficient “information”, although not necessarily “evidence”, from the complainant to ascertain whether the subject matter of the complaint falls within the jurisdiction of the SFC and to make the necessary judgement as to whether more resources should be committed to a case. In the case where the complainant did not respond or was unwilling to co-operate, it was often very difficult, if not impossible, to proceed.</p> <p>Nevertheless, the SFC had taken the initiative to revisit the case and had subsequently received confirmation from the overseas regulator that the investment company, which the subject company in Hong Kong had claimed was its overseas principal, was an entity duly licensed by them. The SFC had written to the investment company asking it to respond to the complaint that its agent was selling unauthorised products in Hong Kong.</p>
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(J) Standardised procedures on issue of interim replies to complainants and target date for completion of investigation of complaint

Item 16	Case findings/ market views	<p>In late 2002, the PRP considered the complaint handling procedures of the SFC and noted that not all the operation divisions/departments of the SFC would periodically update the complainants on the progress of the complaints. The PRP made a recommendation that the SFC should issue interim replies to complainants if the complaints could not be concluded within a reasonable period of time, and set a target date for issue of substantive replies to complainants as a measure to guard against prolonged investigation of complaints.</p> <p>The SFC agreed to the recommendations and adopted a standardised procedure on issue of interim replies to complainants since August 2003 and set a target date for completion of investigation of complaints. Salient points of the revised procedures are –</p> <ul style="list-style-type: none"> <li>(a) A letter will be issued to the complainant within two weeks after receiving the complaint.</li> <li>(b) When a case is transferred from an operation division to another one, the transferring division will write to notify the complainant that his/her complaint is being transferred to another division for further action.</li> <li>(c) If the operation division has not completed the investigation of the complaint within four months, an interim letter will be sent by the Investor Education and Communications Department of the SFC to the complainant after review of progress by the CCC.</li> <li>(d) If the operation division has not completed the investigation of the complaint within twelve months, it will send a second interim letter to the complainant.</li> </ul>
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		<p>(e) If the complainant contacts the SFC to inquire about the status of the complaint, the operation division concerned will reply to the complainant within seven days.</p> <p>In relation to target completion date, the Investigation Team of the Enforcement Division aims to finish an investigation within twelve months from the date it is referred to them.</p>
	PRP recommendations / observations	The PRP noted the revised procedures.
	Response from SFC	N.A.

### (K) Investigation and disciplinary action

Item 17	Case findings/ market views	In an investigation case, the subject company/persons had been publicly reprimanded pursuant to the terms of a negotiated settlement. One year later, they were found committing a similar offence again. Despite that it was a repeated offence, the SFC had not proceeded with prosecution nor imposed more severe sanctions due to insufficient evidence. The SFC came up with another settlement with the subject company/persons who were, pursuant to the terms of settlement, publicly reprimanded again.
	PRP recommendations / observations	<p>The PRP considered that the SFC might have to put more effort and take extra steps in the investigation with a view to obtaining sufficient evidence to facilitate prosecution or imposition of more severe sanctions. Moreover, it might be a better approach if the Enforcement Division consulted the LSD before deciding whether to prosecute. The PRP invited the SFC to –</p> <ul style="list-style-type: none"> <li>(a) advise on its approach in handling repeated offences;</li> <li>(b) consider the feasibility of putting more effort and taking extra steps in the investigation of serious or repeated offences with a view to obtaining sufficient evidence to facilitate prosecution or imposition of more severe sanctions to achieve a deterrent effect; and</li> <li>(c) consider the need of the Enforcement Division to consult the LSD before deciding whether to prosecute in cases involving serious or repeated offences.</li> </ul>
	Response from SFC	In general, the SFC took a very serious view of repeated offences and where the evidence supported it, it would impose severe penalties. The SFC attracted considerable publicity in recent months because it had started meting out heavier penalties under its enhanced powers in the SFO. This trend would continue and the SFC intended to make full use of its new fining power to deter misconduct by intermediaries.



		<p>Any case should be investigated and dealt with according to its merits. Generally, the more serious an allegation or suspicion, irrespective of whether it was a repeated offence, the more time and resources would be allocated to it. Accordingly, there might be certain repeated offences which were relatively minor and not deserving of any significant allocation of resources.</p> <p>In the particular case reviewed by the PRP, the SFC considered the repeated offences serious and had put an enormous amount of time and resources into this investigation. The SFC had considered the feasibility of putting more effort and resources into the investigation given the circumstances of the case. However, as the trades took place outside Hong Kong and all of the records were maintained there, it was difficult if not impossible to obtain the required evidence even if extra staff were assigned to pursue the case. In this case, the SFC was satisfied that there was no further evidence that could usefully be gathered which would materially enhance the prospects of securing a conviction.</p> <p>When considering whether it would prosecute, the Enforcement Division considered in each potential prosecution case whether it should seek advice from the LSD. The Enforcement Division considered that there was insufficient evidence in this particular case to justify consulting the LSD.</p>
Item 18	Case findings/ market views	The PRP noted from an investigation case that, upon completion of the investigation, the SFC issued a letter to those persons under investigation who would not be prosecuted by the SFC to inform them that the investigation had been concluded and no further action would be taken against them.
	PRP recommendations /observations	The PRP expressed appreciation of this good practice.
	Response from SFC	N.A.
Item 19	Case findings/ market views	In an investigation case concerning short selling activities, the ISD conducted a routine inspection of a company in late 2001 and noted that some suspected short selling activities had been conducted in September 2001. However, the ISD reported the suspected short selling activities to the CCC of the SFC nine months later. The CCC then referred the case to the Enforcement Division for further investigation. As the prosecution of short selling activities was subject to a time limit of twelve months under the Securities Ordinance, the Enforcement Division had to work expeditiously. (The Securities Ordinance was repealed on 1 April 2003 upon commencement of the SFO.)
	PRP recommendations /observations	The PRP recommended that the ISD should endeavour to refer suspected short selling activities to other relevant SFC departments for follow-up action within a reasonable period of time so as to allow sufficient time for processing by other departments even though under the SFO, which took effect on 1 April 2003, the time limit (relating to an offence under the SFO other than an indictable offence) had been set as “3 years after the commission of the offence”.

	Response from SFC	<p>Before referring any case to Enforcement Division, the ISD was obliged to conduct certain amount of pre-vetting. To do otherwise might result in premature referrals causing the Enforcement Division to conduct time-consuming and possibly duplicate inquiries, and additional inconvenience to the intermediary and other persons concerned.</p> <p>The referral system had by and large worked very well. The case concerned was an exception with extenuating circumstances. Nevertheless, the SFC managed to get a successful prosecution. The ISD would ensure that future referrals to the Enforcement Division would be made within a reasonable period of time that would not put the chance of prosecution at any risk.</p>
Item 20	Case findings/ market views	<p>The industry associations noted that some licensed persons who had received warning letters from the SFC had encountered difficulties in changing employment because their prospective employers treated the warning letter as formal disciplinary action and declined their application for employment. The industry associations suggested that the SFC improve the knowledge of the market practitioners on the nature and classification of formal disciplinary action and its distinction from a warning letter.</p>
	PRP recommendations /observations	<p>The PRP invited the SFC to respond to the suggestion.</p>
	Response from SFC	<p>The SFC maintained a statutory register open for examination by the public, which included details of formal disciplinary sanctions imposed on licensed persons by the SFC.</p> <p>A warning letter was not formal disciplinary action and should not bar a person from working in the industry. An explanation to this effect was published in the SFC Alert (Sept/Oct 2003 issue, page 3, "Application for re-entry into the industry by persons with disciplinary records"). It was entirely a matter for employers to decide what, if any, weight to attach to the fact that a prospective employee has previously received a warning letter from the SFC, having regard to the nature of the matter to which the warning related.</p> <p>The SFC might impose all or any of the following formal disciplinary penalties:</p> <ul style="list-style-type: none"> <li>(a) a reprimand;</li> <li>(b) a suspension;</li> <li>(c) a revocation;</li> <li>(d) a fine;</li> <li>(e) a prohibition order.</li> </ul>

	<p>While a warning letter was not a formal disciplinary sanction, the SFC might consider it in future disciplinary proceedings against the same person and it might affect the severity of any sanction imposed in those subsequent proceedings. The SFC would consider, among other things, how long ago had a warning been issued when deciding how relevant it was to those subsequent proceedings. The subject of a warning might comment on the grounds for the warning and its relevance to subsequent proceedings. Any earlier response to a warning by its recipient would be kept on file and would also be considered in subsequent action.</p> <p>There was nothing in the secrecy provisions under the SFO to prevent a potential employer from asking an applicant for employment whether they have ever received a warning letter from the SFC and nothing to inhibit the applicant from revealing that fact and providing the potential employer with a copy of the letter.</p> <p>The SFC would consider the need for further guidance for market practitioners on these matters. The SFC subsequently posted two “Frequently Asked Questions” to clarify this matter onto its website on 4 February 2004.</p>
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(L) Disclosure of information on investigation of complaints

Item 21	Case findings/ market views	<p>In 2002, the PRP received a suggestion from the industry associations that the SFC should inform the management of a company of complaints made against the company and the identity of any of their staff being investigated by the SFC so that the management could take immediate remedial action if necessary. The PRP invited the SFC to consider the suggestion.</p> <p>The SFC replied that that there might be some benefit, in a limited number of cases, in informing an employer of suspected misconduct by an employee. However, there were considerable potential dangers in adopting this in all cases. Some employers might, for example, be tempted to destroy or tamper with evidence, thereby prejudicing an investigation; others might resort to the summary dismissal of the employee concerned, before a conclusive finding has been made. Nevertheless, the SFC agreed to revise its internal procedures to allow, in exceptional circumstances, disclosure to be made.</p>
	PRP recommendations /observations	The PRP invited the SFC to report on the progress of the revision of internal procedures.
	Response from SFC	The SFC presented the revised internal procedures of the Enforcement Division to the PRP in 2003. The revised procedures allowed disclosure to be made in exceptional circumstances. However, disclosure might only be made if it is in the performance of the SFC’s functions or falls within one of the exceptions permitted under the statutory secrecy provisions. Moreover, even if disclosure could be made under the SFO, it was necessary for the SFC to carry out a balancing exercise between the need for confidentiality and the need for disclosure.

(M) Processing of listing applications under the Dual Filing regime

Item 22	Case findings/ market views	The PRP conducted a preliminary review of the SFC's internal procedures in processing listing applications under the Dual Filing regime and noted that the Dual Filing Team of the SFC might "select" a particular listing application for review for a number of reasons including referrals from other divisions of the SFC, complaints received, press reports, intelligence, market trends, known risk areas or random selection.
	PRP recommendations /observations	The PRP recommended that the SFC should consider whether such selection criteria should be published for better transparency.
	Response from SFC	<p>The SFC strove to maximize transparency. For Dual Filing in particular, having the market understand and agree with the SFC's review approach was key to improving the quality of disclosure and the efficiency of the listing process. Since Dual Filing regime came into effect, the SFC had given several periodic updates to the market and the public, discussing work progress, case statistics, and common issues. It had also held press briefings and participated in sharing sessions with market practitioners.</p> <p>The disclosure issues in different listing applications vary greatly. Moreover, as the market trend and types of listing applicant change, even the common issues change. The SFC should respond and communicate to the market as it detected evolving trends and common issues.</p> <p>The SFC would continue to do this through a variety of channels, e.g., issuing periodic updates, holding press briefings, and participating in industry sharing sessions. This would achieve the purpose of communicating the criteria and the common issues about which the SFC was concerned. It would also achieve transparency in providing the most meaningful information to the market and the public.</p>
Item 23	Case findings/ market views	The PRP considered that a preliminary review on all listing applications might be essential before the SFC decided which applications should be selected for detailed study.
	PRP recommendations /observations	The PRP invited the SFC to consider the need of conducting a preliminary review of all listing applications.
	Response from SFC	<p>The SFC agreed with the suggestion. This was especially important since the disclosure issues in each application could vary greatly. As a matter of practice since the introduction of Dual Filing regime, the SFC had undertaken a preliminary review of all listing applications before deciding whether to pass any comments to the applicants through the SEHK.</p> <p>The SFC's Shareholders' Group and Dual Filing Advisory Group also agreed with the PRP's view concerning the need of conducting a preliminary review of all listing applications but have raised concerns regarding the resource issue. The SFC would keep this issue under review.</p>

Item 24	Case findings/ market views	The PRP noted from the SFC's internal procedures that the Dual Filing Team might object to a new listing application that has a "material deficiency".
	PRP recommendations /observations	The PRP recommended that the SFC consider whether a database of "material deficiencies" of listing applications that the SFC has objected to should be published for better transparency. In light of the secrecy provision, the PRP considered that the SFC should be careful in considering whether and how the database was to be published. The SFC might consider describing the "material deficiencies" only in general terms.
	Response from SFC	The SFC agreed with the recommendation. As the PRP pointed out, considering the secrecy concerns, and indeed also as a matter of fairness to the applicants, the "material deficiencies" should only be described in general terms. The SFC had sought to achieve this by describing and explaining the deficiencies in its recent periodic update/press briefing (in October 2003). The SFC would continue with this practice.
Item 25	Case findings/ market views	The PRP noted that as the Dual Filing regime had already been implemented since April 2003, the market should be able to provide comment on the operation of the Dual Filing process.
	PRP recommendations /observations	The PRP recommended that the SFC establish a regular dialogue with the industry on the operation of the Dual Filing regime.
	Response from SFC	<p>The SFC agreed with the recommendation. Since the Dual Filing regime came into force, the SFC had made various efforts to reach out to market participants, both to ensure that they were aware of the operation of the Dual Filing arrangements and to solicit their input regarding the listing application process. The SFC had made reports to the SFC Advisory Committee, the Shareholders' Group, and the Dual Filing Advisory Group. The SFC had also provided periodic updates to the market and the public.</p> <p>The members of the Advisory Committee, the Shareholders' Group, and the Dual Filing Advisory Group gave especially helpful guidance since the SFC was able to share confidential information with them. (For the Dual Filing Advisory Group, the SFC provided copies of the comments it made on the applications.)</p> <p>The SFC had also participated in sharing sessions with industry practitioners. The SFC would continue to look for such opportunities, both in relation to occasions that the SFC organised and informal ongoing contact. Furthermore, the SFC had indicated to various professional associations that it would continue to be interested in joining sessions that they hosted.</p>

Item 26	Case findings/ market views	The PRP noted that a Director of the Corporate Finance Division (“CFD”) was responsible for monitoring the giving of comments on or raising no objection to a listing application. However, the role of the Director was not clearly stated in the SFC’s internal procedures.
	PRP recommendations /observations	The PRP recommended that the SFC consider setting out clearly the role of the Director in the internal procedures on processing Dual Filing cases.
	Response from SFC	The SFC agreed to the recommendation.
Item 27	Case findings/ market views	<p>In three of the eight new listing application cases reviewed by the PRP, there was delay in the SFC receiving documents relating to listing applications.</p> <p>In one case, the SFC received a document almost one month after it was submitted by the applicant. In the other two cases, the SFC received the relevant documents 15 days and 11 days later respectively after they were submitted by the applicants.</p> <p>Section 6 of the Securities and Futures (Stock Market Listing) Rules stipulates that the SFC may, within ten business days of an applicant filing an application for listing or supplying further information, require the applicant to supply further information or object to the listing in certain circumstances.</p> <p>The PRP considered that any delay in the receipt of relevant documents by the SFC might jeopardise the SFC’s ability to follow the ten-day time frame as set out in the Securities and Futures (Stock Market Listing) Rules.</p>
	PRP recommendations /observations	The PRP recommended that the SFC liaise with the HKEx to ensure that the SFC would receive listing applications and related documents promptly.
	Response from SFC	The delay happened at the earlier stage of the Dual Filing regime. The SFC had already brought up the issue with the HKEx after the occurrence. Following the PRP’s recommendation, the SFC had further liaised with the HKEx and reached agreement with the HKEx that listing applications and related documents should be passed to the SFC within the ten-day time frame.

Item 28	Case findings/ market views	According to the internal procedures of the SFC, a decision to object to a listing application required the endorsement of the Executive Director (“ED”) of the CFD. In two new listing application cases reviewed by the PRP, after consulting the Dual Filing Advisory Group, the SFC informed the HKEx of its intention to object to a listing application. However, the SFC case files did not contain records on the ED’s endorsement to object to the applications.
	PRP recommendations /observations	The PRP recommended that the SFC clarify in what context did the ED endorse the intention to object to the application in these two cases and consider documentation of the ED’s endorsement in the case file.
	Response from SFC	In both cases, a director of CFD obtained the ED’s verbal agreement on the intention to object to the listing application before informing the HKEx of such. Following the PRP’s recommendation, the SFC would record the ED’s endorsement in the case file.
Item 29	Case findings/ market views	In two listing application cases reviewed by the PRP, the SFC issued a letter to the HKEx indicating its intention to object to a listing application. However, the SFC did not specify in the letter the reasons for its intention to object to the application.
	PRP recommendations /observations	The PRP recommended that, to be fair to all parties concerned (i.e. the applicant, the HKEx and the SFC) and as a good practice in record keeping, the SFC should consider setting out the reasons for its intention to object to a listing application in its letter to the HKEx.
	Response from SFC	The SFC agreed to the PRP’s recommendation.
Item 30	Case findings/ market views	<p>The SFC advised the PRP that it would, in practice, consult the Dual Filing Advisory Group on every case of a listing application to which it intended to object. However, the practice of consulting the Dual Filing Advisory Group on every listing application to which the SFC intends to object was not stated in the SFC’s internal procedures.</p> <p>The PRP considered that at the initial stage of the Dual Filing regime, in order to get an overall direction on how listing applications should be handled, it might be essential for the SFC to follow the practice.</p>
	PRP recommendations /observations	The PRP recommended that the SFC consider setting out the practice in its internal procedures.
	Response from SFC	The SFC agreed to the recommendation.

(N) Approval of Approved Lending Agents (“ALAs”)

Item 31	Case findings/ market views	<p>The PRP reviewed four cases on application for approval as ALAs. The PRP noted that the SFC had not yet received any application for approval as an ALA by mid-March 2003. In light of the implications to the securities lending and borrowing market that would be caused by the lack of ALAs in the market when the SFO commenced in April 2003, the SFC urged, in mid-March 2003, the securities lending and borrowing industry participants to submit applications, and adopted an interim measure of granting temporary approval to applications lodged before April 2003.</p> <p>In all the four cases reviewed, the applicants were granted temporary approval which was valid up to 30 April 2003. The temporary approval was then replaced by a formal approval when the applicants provided all the essential information required by the SFC.</p>
	PRP recommendations /observations	<p>The PRP found that the SFC had followed the standard procedures in processing the four cases. The interim arrangement was considered reasonable as it aimed at preventing a possible disruption to the securities borrowing and lending market, which might be caused by a sudden large-scale withdrawal of securities from the market triggered off by the absence of ALAs in the market.</p>
	Response from SFC	N.A.

(O) Mechanism for internal communication among the SFC’s divisions and departments

Item 32	Case findings/ market views	<p>The various operation divisions of the SFC, although responsible for distinct functions, work in interaction with each other and hence communication among them on operational matters is crucial to the effective operation of the SFC as a whole. The PRP therefore invited the SFC to provide information on its mechanism for internal communication among divisions and departments on operational matters.</p>
	PRP recommendations /observations	<p>The PRP noted that the internal communication of the SFC had been improved. Most of the SFC’s work could be handled and recorded in the “e-workflow system” and information in the system could be shared amongst staff. There were various regular and ad hoc meetings among different divisions and among different layers of staff in the same division for discussion, and information and experience sharing on operational matters. Multi-disciplinary workgroups would be formed to take care of matters with common interest amongst divisions. Moreover, the Chief Operating Officer of the SFC, whose appointment started on 26 May 2003, had been assigned to co-ordinate cross-divisional functions and communications.</p>
	Response from SFC	N.A.



(P) Revised internal procedures on public consultations

Item 33	Case findings/ market views	In December 2002, the PRP reviewed the SFC's internal procedures on public consultations. The PRP noted that it was the responsibility of the operation divisions of the SFC to initiate public consultation exercises on a certain proposals while the full Commission had the authority to decide whether and how such public consultation exercises were to be conducted. However, this division of responsibilities was not clearly specified in the internal procedures on public consultations for SFC staff. The PRP recommended that the SFC should set out the division of responsibilities clearly in its internal procedures. The SFC agreed to the recommendation and presented, in 2003, its revised internal procedures on conducting public consultations to the PRP.
	PRP recommendations /observations	The PRP noted that the revised procedures set out more clearly the division of responsibilities between the operation divisions of the SFC and the full Commission.
	Response from SFC	N.A.

(Q) Communication with the industry

Item 34	Case findings/ market views	The industry associations noted that there was room for improvement in the communications between the SFC and small brokerage firms. The industry suggested that the SFC explore more channels for communication with small brokerage firms.
	PRP recommendations /observations	The PRP invited the SFC to respond to the suggestion.
	Response from SFC	The channels for communication between the SFC and small brokerage firms presently included the following: <ul style="list-style-type: none"> <li>(a) It was the SFC's practice during consultations to discuss new policy initiatives with industry practitioners, including small brokerage firms, prior to issuing public consultations.</li> <li>(b) Gathering views of small brokerage firms on specific topics by inviting several representatives from that sector to join the respective working groups; e.g. Working Group on Review of the Financial Regulatory Framework for Intermediaries, and Working Group on Brokers' Fidelity Insurance.</li> </ul>

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|  |  | <p>(c) The Intermediaries and Investment Products Division of the SFC operated an intermediaries relationship system that facilitates two-way communication between the SFC and the industry. Under this system, individual relationship officers from both the Licensing and Intermediaries Supervision Departments of the SFC were assigned to handle verbal or written enquiries from firms within their portfolios and to contact such firms on day-to-day compliance matters. Firms might also contact the SFC through a designated e-mail address for receiving enquiries related to the SFO or the SFC Complaint Hotline manned by dedicated staff resources.</p> <p>(d) The SFC frequently conducted training seminars for the industry or provided speakers or facilities to industry training seminars. For example, the SFC had organised a series of seminars on the SFO for the industry and some were held jointly with the industry at the request of the stockbroking industry associations. The SFC had also worked with other parties such as the Hong Kong Securities Institute and the SEHK in holding seminars and training for the industry.</p> <p>(e) Regular meetings with the stockbroking industry associations to discuss various market and compliance matters. Agenda was set by both the SFC and the industry associations for these meetings, which were attended by representatives from all relevant departments of the SFC.</p> <p>(f) The SFC regularly posted Frequently Asked Questions on its web-site and from time to time sent advisory circulars through FinNet to provide guidance to small brokerage firms and other licensed intermediaries on the SFO and other compliance matters.</p> <p>(g) The SFC published periodicals like SFC Alert, Quarterly Bulletin, etc to update intermediaries and other stakeholders about SFC's initiatives, market and regulatory developments that are of interest to them.</p> <p>Although many channels of communication with small brokerage firms already exist, the SFC welcomes any further specific comments from the industry as to what improvements could be made and what additional channels of communication could be explored.</p> |
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## Recommendations that have not been accepted by the SFC

### (A) Registration of intermediaries

Item 1	Case findings/ market views	<p>The industry associations noted that if a licensed person, who had left the industry for half a year or more, wanted to carry on regulated activities before his application for new licence was approved by the SFC, he has to apply for a provisional licence from the SFC and pay a fee for the provisional licence on top of the fee for the normal licence.</p> <p>The industry associations considered that the procedure was a bit cumbersome and added extra financial burden to the applicant. The industry suggested that the SFC examine whether the relevant licensing procedures could be simplified.</p>
	PRP recommendations /observations	<p>The PRP invited the SFC to address the concern of the industry.</p>
	Response from SFC	<p>The SFO provided that a representative's licence remains valid if he applied for change of accreditation within 180 days (60 days in the former regime) after he ceased to be accredited to his former employer. Following the approval of such application, he could carry on regulated activities without the necessity of applying for a provisional licence.</p> <p>It was only when a representative had left the industry for half a year or more that he needs to re-apply for a licence. In that case, if he wishes to carry on regulated activities prior to the issuance of a normal licence, he must apply for a provisional licence subject to payment of an additional fee in light of the extra administrative cost and in line with the user-pay principle.</p> <p>A provisional licence would be granted when the SFC had no reason to doubt that the applicant is fit and proper, based on its own information, while awaiting confirmation from third parties (such as the Hong Kong Police and the Customs and Excise Department). The vetting of a re-entrant's application was considered necessary as the applicant had left the industry for a considerable period of time.</p>

## (B) Inspection of intermediaries

Item 2	Case findings/ market views	The industry associations noted that in some inspection cases, the SFC took a long time to issue a letter of deficiencies, which summarised the result of the inspection, to the inspected intermediary after completion of the inspection fieldwork. The industry associations suggested that the SFC consider giving a performance pledge on the time frame for issuing of letter of deficiencies.
	PRP recommendations /observations	The PRP invited the SFC to respond to the suggestion.
	Response from SFC	<p>Although the SFC aimed at completing each inspection and finalising the letter of deficiencies as quickly as possible, it was not practicable for it to pledge any rigid time frame for the following reasons:</p> <ul style="list-style-type: none"> <li>(a) The cooperation from the intermediaries, which was an uncontrollable factor, affected the inspection process and the time needed to complete the inspection and finalise the letter of deficiencies.</li> <li>(b) The number and complexity of issues arising from an inspection varied among different intermediaries, and so did the time needed to review them thoroughly and conclude whether there are deficiencies requiring corrective action.</li> </ul>

## (C) Prudential visits to intermediaries

Item 3	Case findings/ market views	<p>The PRP noted from a prudential visit case that subsequent to an inspection of an intermediary conducted in November 2000, the SFC conducted a prudential visit to the intermediary concerned two and a half years later in May 2003. After completion of the prudential visit, the inspection team recommended that the next inspection of the intermediary be conducted three years later (i.e. in mid-2006).</p> <p>It was specified in the SFC's internal procedures that a prudential visit was not a substitute for an inspection. However, according to the SFC, whether the SFC would conduct another inspection of the intermediary concerned three years after the prudential visit (i.e. by mid-2006) as recommended by the inspection team, or to replace the inspection with another prudential visit, would depend on the risk level of the intermediary and the availability of inspection resources by that time.</p>
	PRP recommendations /observations	In order to prevent the undesirable situation that an intermediary was only visited but not inspected for a prolonged period of time, the PRP recommended that the SFC consider whether there was any need to set a time-limit within which at least one routine inspection of an intermediary must be conducted.

Response from SFC	<p>The SFC used a risk-based approach in selecting inspection targets. Firms identified to have greater risks would be accorded higher priority. While the length of time elapsing since the last inspection was an important factor the SFC would take into account, the SFC did not see fit to set a hard and fast time-limit for inspecting an intermediary due to the following concerns –</p> <ul style="list-style-type: none"> <li>• this might impede the deployment of resources to deal with more risky targets at any particular point in time; and</li> <li>• such time-limit might be mistaken to be the benchmark for a normal inspection cycle, and might set wrong expectations in some intermediaries that they were subject to inspection only at such fixed time intervals.</li> </ul> <p>On the other hand, there were sufficient procedural safeguards to ensure that an intermediary who was not inspected for a prolonged period of time was not so treated due to oversight –</p> <ul style="list-style-type: none"> <li>• Inspection history of each and every intermediary was logged in a computerised database and retrieved for review every quarter by the monitoring teams when they prepared their respective inspection schedule.</li> <li>• Firms not having been inspected for a certain specified period were flagged for review by all team leaders to assess whether they should be accorded priority over other possible targets.</li> <li>• Other inspection targets were nominated by all members of monitoring teams based on risk factors; these nominations would be subject to the endorsement of the respective team leaders; a designated Associate Director would perform a second review and the Senior Director of the ISD would give final approval.</li> </ul>
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(D) Supervision of Registered Institutions (“RIs”)

Item 4	Case findings/ market views	The PRP noted that, as specified in the MoU signed between the SFC and the HKMA, the HKMA would notify the SFC, as soon as reasonably practicable, of any “designated serious matter” about a RI that the HKMA is aware of.
	PRP recommendations /observations	The PRP recommended that the SFC should consider discussing with the HKMA the need to set out a reasonable time frame for the referral of “designated serious matters”.

	Response from SFC	<p>The description of the nature of matters designated as “serious matters” under the MoU indicated that there should be prompt exchange of information on such matters between the HKMA and the SFC if and when any of them arose. But the degree of promptness had not been expressed in terms of hours or days because the speed at which it was reasonably practicable for these ad hoc matters (i.e. not regular occurrences) to be notified by a party to the other might be different, depending on the nature of the matter in question and the circumstances in which it arose. Rather, the MoU highlighted in paragraph 12.3 that “in urgent cases, initial notification will be made orally” signifying the need for basically immediate notification where the urgent circumstances so require it.</p> <p>As the communication and cooperation arrangements had been working well so far, it seemed unnecessary at present to specify any absolute time frame in addition to as soon as reasonably practicable. Nevertheless, the SFC would re-consider it if future experience in such information exchange suggested that there might be a need for setting an absolute deadline with the HKMA.</p>
Item 5	Case findings/ market views	The PRP noted that, as specified in the MoU, upon receiving a complaint against a RI, the SFC would refer it to the HKMA in writing as soon as practicable. When a complaint was considered by the HKMA to be relevant to a matter that the SFC could investigate or conduct an inspection under the SFO, the HKMA would refer such complaint to the SFC.
	PRP recommendations /observations	The PRP recommended that the SFC should consider discussing with the HKMA the need to set out a reasonable time frame for referral of complaints between the two parties.
	Response from SFC	<p>Paragraphs 8.1 and 8.2 of the MoU required the parties to inform each other as soon as reasonably practicable of any complaints against RIs. Although the MoU did not set out a specific time frame for referral of complaints between the parties, the parties had a basic obligation to refer a complaint to the other party as soon as possible. The promptness of the referral depended on the circumstances of individual cases. As the SFC and the HKMA had been working closely to fulfill their respective obligations under the MoU, the SFC considered that a rigid time frame for referral might not be necessary at this stage.</p> <p>The SFC would continue to work closely with the HKMA and would review the cooperation arrangements between the parties from time to time to ensure that, for the purposes of regulation of RIs, there was timely exchange of information between the two regulators.</p>

(E) Authorisation of collective investment schemes

Item 6	Case findings/ market views	In an investigation case concerning a suspected breach of the Protection of Investors Ordinance (which was repealed on 1 April 2003 upon commencement of the SFO), the Enforcement Division of the SFC consulted the IPD of the SFC on whether a piece of promotional material had been authorised by the SFC. The IPD initially advised verbally that the piece of promotional material had not been authorised but subsequently confirmed in writing that it had in fact been authorised.
	PRP recommendations /observations	To help further improve the efficiency and accuracy in the search/checking of authorised promotional materials by the SFC, the PRP recommended the SFC consider the feasibility of requiring the issuers to quote a reference number given by the SFC on each piece of authorised promotional material.
	Response from SFC	<p>The misidentification of an authorised advertisement as unauthorised in this case was an isolated incident, which was highly unlikely to happen again given that IPD staff had since been instructed not to provide identification based on verbal descriptions of an advertisement. The investigation had not been affected by this incident as the error was rectified as soon as the hard copy was received by the IPD for identification, in accordance with normal practice.</p> <p>The IPD believed that the implementation of the recommendation might confuse the public and would be unduly burdensome for the industry for the following reasons –</p> <ul style="list-style-type: none"> <li>• Under Section 103 of the SFO, sponsors were required to submit advertisements for authorisation by the SFC only if the issue of these advertisements was not exempted from the general prohibition under the Section. There were more than 20 exemptions to this prohibition, each of which was considered by the legislature to be an acceptable alternative arrangement to SFC authorisation for investor protection purposes. All these “exempted” advertisements, while issued legally, would not carry a SFC authorisation number. This would create confusion to the public who might believe that all the advertisements which have no SFC authorisation numbers were illegal, which was not necessarily true.</li> <li>• If the issuer was obliged to reveal a reference number on the advertisement, this must be accompanied by an appropriate SFC disclaimer, which stated to the effect that the SFC had neither assessed the financial soundness or merits of the scheme nor verified the accuracy or truthfulness of statements made or opinions expressed in the advertisement, so as to ensure that the public was not misled by this “stamp of authorisation”. This would be considered unduly burdensome for the industry, particularly in cases where lengthy footnotes and other warning statements already exist in an advertisement for sophisticated products.</li> </ul>

(F) Investigation and disciplinary action

Item 7	Case findings/ market views	In an investigation case, one of the SFC's considerations when deciding not to further investigate the issuing of unauthorised advertisements of an authorised fund was the Magistrates' decisions on similar cases pursued by the SFC in the past.
	PRP recommendations /observations	The PRP invited the SFC to consider whether more objective guidelines on the making of decisions on investigation and disciplinary action in connection with unauthorised advertisements should be made available under the SFO.
	Response from SFC	<p>Given that the SFC only had limited resources, in deciding whether to pursue a case, the SFC would consider, amongst other things, the level of risk to investors and whether a regulatory message could be sent to potential offenders as a deterrent.</p> <p>Therefore, having regard to the Court's likely sentence and the considerable difficulties that would be encountered in collecting evidence in view of the domain location being overseas in addition to the matter being of low risk to investors, it was decided that the SFC could not afford to spend its limited resources on such a case, i.e. where prosecution was unlikely to achieve much in the way of the SFC's regulatory aims. These reasons were the objective reasons upon which the SFC's decision was based.</p> <p>The facts of each case are always unique and require separate analysis. For the reasons given, the SFC did not consider it necessary to articulate more objective guidelines on the making of decisions on investigations in connection with unauthorised advertisements.</p>
Item 8	Case findings/ market views	In an investigation concerning a suspected breach of the Securities (Disclosure of Interests) Ordinance (which was repealed on 1 April 2003 upon commencement of the SFO), there was a long lapse of time between an act of non-disclosure which took place in September 2000 and the receipt of a complaint by the SFC in May 2002 that uncovered such act. The SFC had treated the non-disclosure as a single act and carried out investigation only on transactions made in a particular period at and around the act was made. The PRP considered that it would have been advisable for the SFC to extend the period covered by the inquiry to see if the subject person had committed similar breach in the subsequent period. The information so obtained might have a bearing on the appropriate disciplinary action.
	PRP recommendations /observations	The PRP recommended that the SFC consider, for cases with a long lapse of time between the act of wrongdoing and the uncovering of such act, the feasibility of setting a longer inquiry period.



	Response from SFC	<p>The case concerned stemmed from a complaint which alleged that the director of a company had acquired shares in September 2000 and not disclose it. The Enforcement Division of the SFC looked at all transactions throughout the year 2000. On the basis that the amounts of the transactions involved did not meet the minimum thresholds in accordance with the general criteria for taking action in such matters, and as there were no other unique or special features in respect of this case (e.g. a previous warning for failure to disclose), the Enforcement Division decided not to pursue the matter any further, other than the issue of a warning.</p> <p>The SFC had carefully considered the Panel's recommendation of setting a longer inquiry period for cases with a long lapse of time between the act of wrongdoing and the uncovering of such act. Given the SFC's limited resources, it was not feasible for the SFC to adopt the recommendation.</p>
Item 9	Case findings/ market views	<p>The industry associations noted that individual market practitioners and small brokerage firms had difficulties in engaging legal representatives when they were involved in SFC investigations. In order to allow individual market practitioners and small brokerage firms to have better understanding of their rights and obligations in connection with SFC investigations, the industry suggested that the SFC consider whether a special unit could be set up within the SFC to answer matters, in particular the rights and obligations of market practitioners, relating to SFC investigations.</p>
	PRP recommendations /observations	<p>The PRP invited the SFC to comment on the suggestion.</p>
	Response from SFC	<p>Persons interviewed by the SFC were informed of the reasons for the interview and where such persons were themselves regarded as under investigation they were informed of the basis for that belief. Interviews were conducted in the interviewee's native language but translation was provided at the SFC's expense if required. Interviewees received formal advice on their statutory rights and obligations from investigators at the outset of all interviews. They were also asked to signify in writing that they understood those rights and obligations before the interview proceeded further. In the case of criminal matters, persons under investigation were reminded of their right to legal representation.</p> <p>It was considered not appropriate for an enforcement agency like the SFC to provide legal advice to those whose conduct was under the SFC's investigation. It appeared, however, that this was the sort of service which could be arranged by an industry association for the benefit of its members, possibly by the association retaining the services of a firm of solicitors to give advice on a general or case by case basis.</p>

(G) Handling of takeovers and mergers transactions

Item 10	Case findings/ market views	<p>The PRP reviewed three cases on handling of takeovers and mergers transactions by the CFD of the SFC. In the three cases, the SFC was heavily involved in the pre-vetting of draft documents submitted by the issuers. Normally, the case officers of the SFC would mark their comments on the draft and return a marked up copy to the issuer for making necessary amendments. With the exchange of plenty of such correspondence with the issuers, it might have been advisable for the SFC to ask for a final copy of the document for checking whether all the comments have been properly incorporated before it was issued. However, it was not a practice of the SFC to do so.</p>
	PRP recommendations /observations	<p>The PRP sought the SFC's view on the suggestion of requiring an issuer to submit a final version of the document for checking before it was issued.</p>
	Response from SFC	<p>The function of the CFD (the Executive) to comment on takeover documents was set out in Rule 12 of the Takeovers Code, which provided that "all documents must be filed with the Executive for comment prior to release or publication and must not be released or published until the Executive had confirmed that it had no further comments thereon".</p> <p>When the Executive was satisfied that the draft document was in acceptable form it issued written confirmation to the parties that it had no further comments. Thereafter ultimately it was the responsibility of the parties and their financial advisers to ensure that no material changes were made.</p> <p>Regarding the question of whether it would be merited to require an issuer to submit a final version of the document for checking before it was issued, the SFC did not believe that such change would be merited at this stage for the reasons set out below.</p> <ul style="list-style-type: none"> <li>• The Executive's current vetting procedure was well recognised and accepted by the market. There was little evidence of abuse of the clearance process by way of changes being made to documents after clearance by the Executive.</li> <li>• There was no current requirement in the Takeovers Code for the final printer's version of a document to be submitted for final clearance by the Executive.</li> <li>• Such a change would encourage the market to rely more on the SFC in the drafting of documents. The SFC would like to emphasis that the CFD's clearance procedure was not meant to be a "hand-holding" exercise. The SFC was also mindful of the likely impact of any such change on the already relatively tight offer timetable.</li> </ul>

		<p>According to the SFC, more generally, it is part of the broader policy objective of both the SFC and the HKEx to move gradually from a regulatory system focused on pre-vetting to one which placed more responsibility on companies and their advisers and more emphasis on “back end” enforcement of the rules in cases of bad disclosure. To increase detailed vetting work would run counter to this objective.</p> <p>The SFC was satisfied that current CFD procedures were adequate for the purpose of the Code. Financial advisers were well aware of the fact that they must not make material changes to documents after clearance and that to do so might result in disciplinary action being taken against them. Ultimately it was the responsibility of the parties and their professional advisers to ensure that all information in a document was accurate and in full compliance with the Code.</p>
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#### (H) Processing of listing applications under the Dual Filing regime

Item 11	Case findings/ market views	The PRP reviewed the SFC’s internal procedures in processing listing applications under the Dual Filing regime and noted that the Dual Filing Team of the SFC might “select” a particular listing application for review for a number of reasons including referrals from other divisions of the SFC, complaints received, press reports, intelligence, market trends, known risk areas or random selection.
	PRP recommendations /observations	The PRP recommended that the SFC should consider whether more specific criteria should be set out for selection of listing applications for review.
	Response from SFC	The market trend and types of listing applicants were constantly changing and the disclosure issues in different listing applications varied greatly. It was not possible to set out an exhaustive list of issues. The SFC therefore regularly updated the market on its review approach, including common issues or areas of concern. This was considered more beneficial to the market as compared to having an exhaustive list of items.