Process Review Panel

for the

Securities and Futures Commission

Annual Report

for 2012-13

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Chapter 1 General Information

Background

1.1 The Process Review Panel ("PRP") for the Securities and Futures Commission ("SFC") is an independent panel established by the Chief Executive ("CE") in November 2000. It is tasked to conduct reviews of operational procedures of the SFC and to determine whether the SFC has followed its internal procedures and operational guidelines to ensure consistency and fairness.

Functions

1.2 The PRP will review completed or discontinued cases handled by the SFC and advise the SFC on the adequacy of the SFC's internal procedures and operational guidelines governing the actions taken and operational decisions made by the SFC in the performance of its regulatory functions. These areas include licensing of intermediaries, inspection of intermediaries, authorization of investment products, receipt and handling of complaints, investigation and disciplinary action and processing of listing applications. The PRP does not judge the merits of the SFC's decisions and actions. It focuses on the process.

1.3 The terms of reference of the PRP are -

(a) To review and advise the Commission upon the adequacy of the Commission's internal procedures and operational guidelines governing the actions 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 -

(i) receipt and handling of complaints;

(ii) licensing of intermediaries and associated matters;

(iii) inspection of licensed intermediaries;

(iv) taking of disciplinary action;

(v) authorisation of unit trusts and mutual funds and advertisements relating to investment arrangements and agreements;

(vi) exercise of statutory powers of investigation, inquiry and prosecution;

(vii) suspension of dealings in listed securities;

(viii) administration of the Hong Kong Codes on Takeovers and Mergers and Share Repurchases;

(ix) administration of non-statutory listing rules;

(x) authorisation of prospectuses for registration and associated matters; and

(xi) granting of exemption from statutory disclosure requirements in respect of interests in listed securities.

(b) 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.

(c) 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.

(d) To call for and review the Commission's files relating to any case or complaint referred to in the periodic reports mentioned in paragraphs (b) and (c) above for the purpose of verifying that the actions 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.

(e) To receive and consider periodic reports from the Commission on all investigations and inquiries lasting more than one year.

(f) 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.

(g) 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.

(h) 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.

1.4 The PRP will submit its annual reports to the Financial Secretary who may cause them to be published as far as permitted under the law.

1.5 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 boost public confidence and trust. The PRP's work contributes to ensuring that the SFC exercises its regulatory powers in a fair and consistent manner.

Membership

1.6 Mr Anthony Chow Wing-kin chaired the PRP from 1 November 2006 to 31 October 2012. Since 1 November 2012, Dr Moses Cheng Mo-chi has taken up the chairmanship.

1.7 The PRP comprises nine members from the financial sector, academia, the legal and accountancy professions and the Legislative Council. In addition, there are two ex-officio members, including the Chairman of the SFC and the representative of the Secretary for Justice.

1.8 The membership of the PRP during 2012-13 was as follows:

Chairman:	
Mr CHOW Wing-kin, Anthony, SBS, JP	till 31 October 2012
Dr CHENG Mo-chi, Moses, GBS, JP	since 1 November 2012
Members:	
Mr CHAN Kam-wing, Clement	since 1 November 2012
Ms CHOW Yuen-yee	since 1 November 2010
Prof HO Yan-ki, Richard	since 1 November 2010
Dr HU Zhanghong	since 1 November 2012
Dr LAM Kit-lan, Cynthia	since 1 November 2010
Ms LEE Pui-shan, Rosita	since 1 November 2012
Mr LEE Wai-wang, Robert	since 1 November 2012
Dr the Honourable LEUNG Mei-fun, Priscilla, JP	since 1 February 2009
Mr MAK Chi-ming, Alfred	since 1 November 2012

Mr CHIU Chi-cheong, Clifton	till 31 October 2012
Mr FUNG Hau-chung, Andrew, JP	till 31 October 2012
Mr LEE Jor-hung, Dannis, BBS	till 31 October 2012
Mr LIU Che-ning	till 31 October 2012
Mr SUN Tak-kei, David, BBS, JP	till 30 June 2012
Ex officio Members:	
Chairman, the Securities and Futures Commission	
Dr FONG Ching, Eddy, GBS, JP	till 19 October 2012
Mr TONG Ka-shing, Carlson, JP	since 20 October 2012
Representative of the Secretary for Justice Mr LAI Ying-sie, Benedict, SBS, JP	since 4 May 2006
Secretariat:	
Financial Services Branch of Financial Services and The Treasury Bureau	

Chapter 2 Work of the PRP in 2012-13

Modus operandi

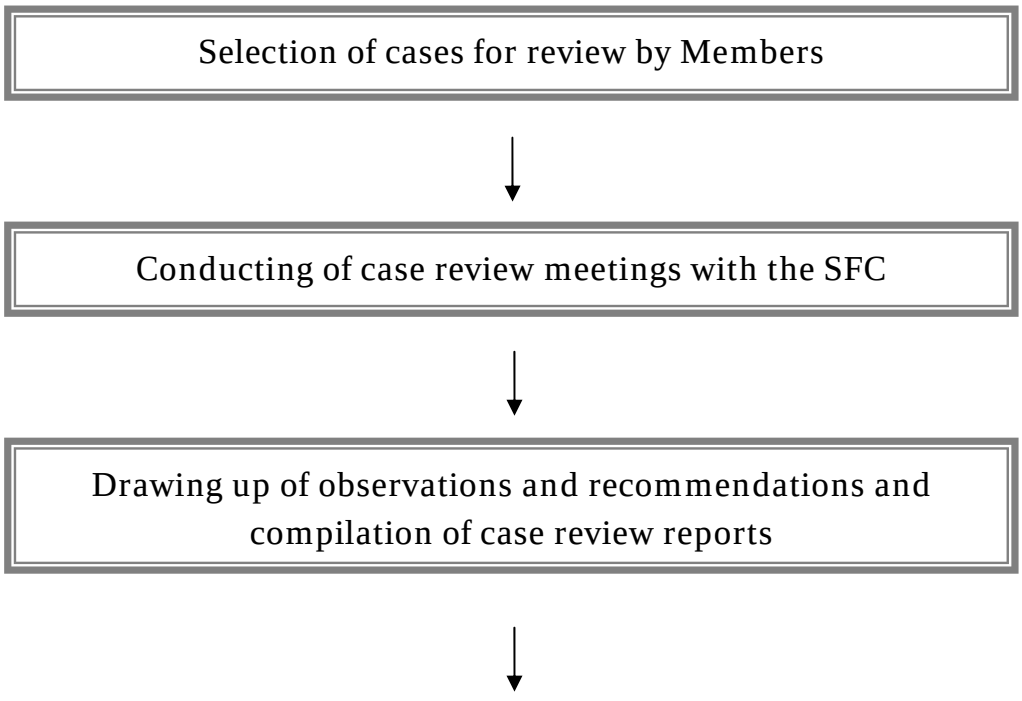
2.1 The SFC provides the PRP with monthly lists of completed and discontinued cases. Members of the PRP select individual cases from these lists for review with a view to examining cases encompassing different areas of the SFC's work. Members pay due regard to factors including processing time of the completed cases.

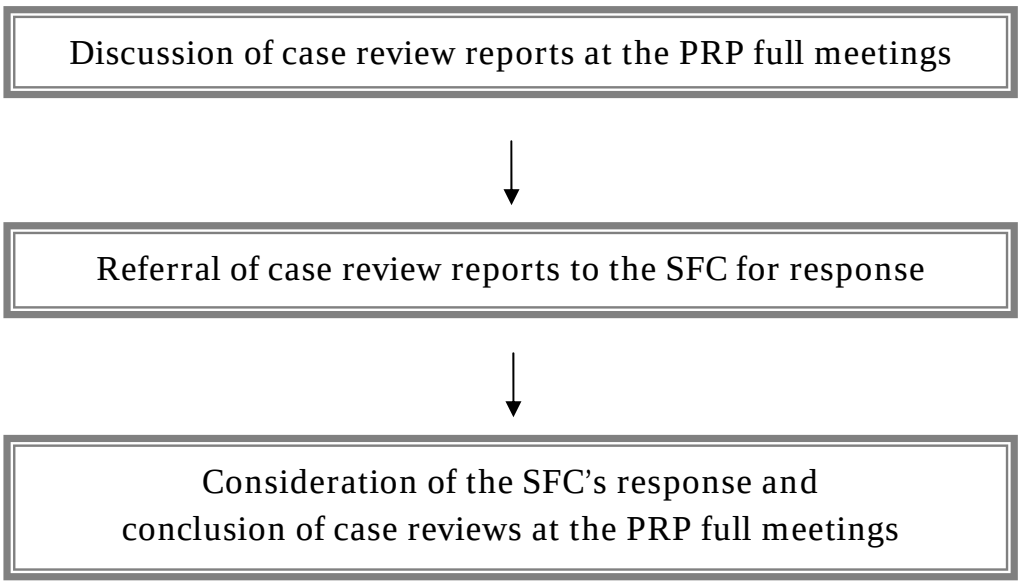
2.2 The SFC also provides the PRP with monthly lists of on-going investigation and inquiry cases that have lasted for more than one year for the PRP to note and consider for review upon the case completion or closure.

2.3 The PRP members are obliged to preserve secrecy in relation to information furnished to them in the course of the PRP's work, and to refrain from disclosing such information to other persons. To maintain the independence and impartiality of the PRP, all the PRP members are required to declare their interests upon commencement of their terms of appointment and before conducting each case review as appropriate.

Case review workflow

2.4 The workflow of the PRP case reviews is set out below –





Highlights of work

2.5 During the year, the PRP conducted a total of 12 meetings with the SFC's case officers on 58 selected cases that were completed or discontinued by the SFC. The PRP met four times in the year to discuss its modus operandi and the observations and recommendations of cases reviewed. The distribution of the 58 cases reviewed in 2012-13 is summarised below –

	No. of Cases
Authorisation of investment products	9
Licensing of intermediaries	7
Inspection of intermediaries	9
Investigation and disciplinary action	18
Handling of complaints	12
Corporate Finance including processing of listing applications	3
Total	**58**

2.6 Highlights of the PRP's observations and recommendations on selected cases and the SFC's response are set out in the following chapter.

Chapter 3 Observations and Recommendations

Authorisation of investment products

3.1 The PRP studied the processing time required to authorise investment products. The PRP noted that for completed cases under review, the application time ranged from 1 year & 2 months to 2 years & 3 months. The PRP made suggestions to streamline workflow and to review the application lapse policy as an ongoing initiative to improve the performance pledges.

(a) § Workflow and Performance Pledges

3.2 For four cases under review, the PRP had recommended measures to enhance the product authorization process.

The PRP's review (case one)

3.3 The PRP reviewed an application for authorisation of a fund that was related to Qualified Foreign Institutional Investor ("QFII"). The PRP noted there were multiple rounds of comments and responses between the SFC and the applicant during the application period, and queried the workflow process. The case took more than two years to be authorised after its submission.

3.4 The PRP recommended the SFC to arrange meetings and to engage active dialogue with applicants. This would help to resolve any outstanding issues and address applicants' concerns.

The PRP's review (case two)

3.5 In another application involving authorization of a Renminbi Qualified Foreign Institutional Investor ("RQFII") fund, the PRP noted that the SFC had again provided several rounds of comments to the applicant within a short period. The PRP considered the practice should be reviewed.

3.6 The PRP recommended the SFC to consolidate comments for applicants to respond. The SFC could arrange briefing sessions to all market participants when there was a new policy or a new type of investment product (like RQFII) to be launched to the market. The briefing should be held prior to receiving any application so that applicants knew what the SFC would require them to provide. This would expedite the application process.

3.7 Noting that the present performance pledges[1] included only time frames for acknowledging an application and issuing preliminary response, the PRP further recommended the SFC to formulate :

- a performance pledge for completing the authorization of an investment product; or

- internal guidelines on target timeframe for staff's compliance if the SFC considered it not feasible to announce to the market a pledged completion time.

The PRP's review (case three)

3.8 When reviewing another application involving authorization of a RQFII fund, PRP noted that the SFC had generally followed its operational guidelines. The long processing time (15 months) was due to the policy uncertainty in the Mainland, which was beyond the control of the SFC. The PRP again recommended the SFC to promulgate a performance pledge for an overall processing time in authorization of investment products under normal circumstance. This would enhance transparency of the SFC's operation.

The PRP's review (case four)

3.9 In accordance with prevailing guidelines, any application for an investment product authorization which was not completed within 12 months from the date of receipt, would lapse. The SFC had the discretion to grant time extension. As a reminder and notification to applicants, the SFC would issue a letter of mindedness nine months after the taking-up of the application.

3.10 In the case under review, the PRP noted that an applicant provided prompt response only after the SFC had issued the letter of mindedness. The case took 1 year and 2 months to complete.

3.11 The PRP recommended the SFC to review the 12-month application lapse policy. The SFC should consider approving time extension only under exceptional circumstance. Any change in the processing time policy should be clearly publicized to market participants.

The SFC's response

3.12 The SFC explained its overall process to the PRP. In brief, the SFC advised that its processing time on average constituted about one-third of the

[1] At present, the SFC' performance pledges for authorization of investment products are (a) taking-up of applications within 2 business days and (b) a preliminary response to applications after the take-up within 7/14 business days.

total processing time of applications for product authorization. The processing time attributable to applicants represented a significant portion of the total processing time.

3.13 Generally, authorization of QFII funds could only be granted after the relevant QFII quota was obtained from the State Administration of Foreign Exchange ("SAFE") of the Mainland. In the one case under review, the applicant took two years[2] to obtain the QFII quota from the SAFE. There were new disclosure requirements including the requirement to produce a product key facts statement that came into force in June 2010. In addition, the applicant made changes to the investment policy and dealing arrangements almost two years after the application date and repeatedly failed to properly address comments raised by the SFC. The above had resulted in multiple rounds of discussions and correspondence.

3.14 The SFC agreed with the PRP's recommendation to arrange meetings and engage in active dialogue with applicants to resolve any outstanding issues. The SFC had in practice been applying this approach to all cases, where appropriate. The SFC would continue to follow its existing practice using a combination of meetings, briefings, telephone discussions, and written communications to encourage applicants to resolve all outstanding issues.

Reviewing the application lapse policy & providing a pledge on approval timing

3.15 The SFC remarked that the authorization process was a dynamic one. The time that was required from application to authorization depended on a number of variables, many of which were not in the control of the SFC. Examples included the application's compliance with the SFC's requirements in the Code on Unit Trusts and Mutual Funds, the quality of the submission and the time taken by applicants to respond to requisitions. The promulgation of a performance pledge to cover the total processing time might negatively impact the SFC's core statutory duty of investor protection if this were interpreted as a hard deadline to be met by the SFC on all occasions for granting authorization.

3.16 Former PRP members had made similar observations, including that some applicants might have taken advantage of the application system by submitting premature applications. There were also concerns about the resource implications for the SFC in dealing with inactive applications. Responding to these comments, the SFC implemented the current 12-month application lapse policy. This was a definite time-frame within which applicants must complete their applications. It aimed to weed out applications where there was no serious intention to proceed. However, since the implementation of this policy in June 2010, the SFC had still seen a significant number of applicants who had not responded to requisitions

[2] Counting from the date the SFC took up the application.

promptly until the SFC had issued a letter of mindedness, which was done 3 months before the end of 12-month period. Out of 111 funds authorized from January to July 2013, 28% of the total processing time was attributable to the SFC and 72% was attributable to the applicants (i.e. the time spent by the SFC and applicants dealing with the other's requisitions or responses).

3.17 In light of the PRP's comments, the SFC has examined how the 12-month application lapse policy could be improved. The SFC had reviewed the approach adopted in other major overseas fund jurisdictions such as the United Kingdom, Luxembourg and Ireland, which generally had a 6-month application processing policy. The SFC planned to examine how a similar policy could be adopted in Hong Kong. This would mean that an application would lapse if, for any reason, 6 months had elapsed from the date of take-up of an application, subject to the SFC's right to grant an extension in exceptional circumstances. The SFC would consider issuing a letter of mindedness to notify applicants of the imminent expiry date 4 months after the taking-up of the application.

3.18 Having regard to the balance of processing time experienced in recent years (with requisitions sitting with applicants for considerable periods), the SFC believed that a shorter 6-month application lapse policy would:

- instill greater discipline amongst applicants to only proceed with serious applications and to accelerate turn-around time;

- streamline the workload of the SFC so that it could spend more time on serious applications (i.e. ensuring that the system was not "clogged up" with tentative or delayed fund proposals); and

- signal to the market that a quality application complying with all relevant requirements, and where responses to requisitions were dealt with in a timely fashion, should be approved by the SFC within 6 months at the latest.

The above would mean that, in effect, the lapse policy also functioned as the SFC's own pledge on approval timing, provided that there was a quality application and a responsive applicant.

Approving time extension for application

3.19 The SFC's Answers to Frequently-asked Questions ("FAQs") set out exceptional circumstances in which the SFC might approve a time extension[3].

[3] As set out in the FAQs, in general, the SFC will only consider granting a time extension under exceptional circumstances upon the submission of satisfactory grounds by the applicant. Any extension of the application period may be granted by the SFC where there is no substantive outstanding issue at the time of the extension, except for the receipt of the following documents by the SFC:
(a) in the case of a fund primarily regulated by an overseas regulator, the formal written approval from the home regulator of the fund;

This had been notified to market participants and publicized online. The SFC agreed that it would continue to publicize any changes in the processing time policy.

Arranging briefing sessions to market upon launching of a new policy

3.20 The SFC advised that in general, it sought to review each single round of submission by applicants and communicate its comments as much as practicable in each single round of requisition instead of in batches. The vetting of fund applications, however, was a dynamic process. For example, where new issues arose from the applicant's responses to the SFC's enquiries or where regulatory developments (including those not initiated by the SFC) were emerging or evolving within a short period of time, very often the SFC was duty bound to raise further enquiries.

3.21 The two cases involving the RQFII pilot scheme were novel and evolved during the processing of the application. Close cooperation between the SFC and the Mainland authorities was required to enable the SFC to determine how the China Securities Regulatory Commission ("CSRC") and the SAFE would implement the RQFII rules. Shortly after the RQFII rules and regulations were promulgated by the Mainland authorities, and once the SFC obtained essential clarifications from the CSRC and the SAFE, the SFC called a "town hall meeting" with all RQFII fund applicants and their advisers to explain how the requirements of the CSRC and the SAFE would be implemented and how application documents should address these requirements.

3.22 The SFC agreed with the PRP that there should be sessions for all market participants when a new policy or a new type of investment product (like RQFII) was to be introduced to the market. The SFC has conducted some 150 meetings on product development and proposals during the 12-month period from 1 June 2012 to 31 May 2013; and over 13 industry wide briefings since 2010.

(b) in the case where overseas regulatory check has to be conducted on the management company or its delegate, the response from the relevant regulator; and/or

(c) the final signed version of the confirmation on compliance and/or Chinese translation confirmation(s).

(b) § Structured fund product

The PRP's review

3.23 The PRP noted that when the SFC reviewed an application involving an unprecedented structured fund product, the SFC had upon receipt of the application[4], assigned the case to its unit trust team for handling. The SFC engaged its structured products team to handle the application seven months after the receipt of the application. That might have lengthened the processing time.

3.24 The PRP recommended the SFC to:

- establish a mechanism to screen investment product applications upon receipt. Different experts/teams should be engaged in the early stage of the authorization process to speed up the process;

- review whether their subject officers had sufficient knowledge to understand the nature of new investment products which changed rapidly according to development of financial markets;

- consider if the SFC's Products Advisory Committee ("PAC") could provide guidance and assistance to the SFC's working level officers on new, hybrid and complex products; and

- take more proactive action, such as arranging meetings with applicants instead of having multiple rounds of comments and responses between the SFC and an applicant, to resolve issues identified by the SFC.

The SFC's response

3.25 The proposed product was "one of a kind" and, upon enquiry, it appeared that there was no precedent in any other major markets. The SFC believed that it was appropriate (not least from an investor protection perspective) to properly study and research the proposed product and, importantly, obtained essential clarifications from the applicant concerning the product.

3.26 The SFC agreed with the PRP's recommendation on the early engagement of different teams with the necessary expertise in processing applications, where appropriate. All structured fund applications were jointly reviewed by the funds and structured products teams from the

[4] Subject officers explained that the applicant marked on its application that it was "unit trust fund" and hence the application was assigned to the unit trust team.

take-up/beginning of an application.

3.27 The SFC had targeted its recruitment effort to employ market experts with the necessary range and diversity of skills and experience to complement its existing product authorization teams for the handling of a wide range of product applications. In order to keep up with market and technical changes in investment products, the SFC maintained regular dialogues with overseas regulators and the industry regarding market, regulatory and product trends.

3.28 The PAC had continued to be an advisory body that the SFC consulted in the wider context of market trends and policy development and implementation. The SFC had sought the views of the PAC on new product trends focusing on risk related issues. The SFC would continue to solicit the views of the PAC on more difficult product issues.

3.29 The SFC agreed with the PRP's recommendation that it would be useful to pursue a combination of engagement actions including meetings and written/oral communications to encourage applicants to resolve all outstanding issues. In the case under review, the SFC held a series of conference calls and meetings with the applicant to assist it to resolve outstanding issues.

Licensing of intermediaries

3.30 The PRP reviewed the licensing applications for different types of regulated activities and enquired how the SFC had monitored the case progress. The PRP recommended the SFC to review the performance pledge on licensing applications and made suggestion on how the SFC could deal with licensing agents to expedite the applications.

(a) § Performance pledge

The PRP's review

3.31 When reviewing a case involving an application to carry out Types 1 and 4 regulated activities and an application of Responsible Officers ("ROs"), the PRP noted that the case took 21 months' processing time which exceeded the pledged time. The SFC's subject officers had explained that the applicant was not keen in completing the application. The delaying factors[5] were beyond the control of the SFC.

3.32 The PRP also noted that the SFC had classified the case as "non-standard" type of application in which delays were occurred beyond the SFC's control. For all "non-standard" type of applications, the SFC would not include the result of the application in its performance pledge report.

3.33 When reviewing another application for an RO to carry out Type 6 regulated activity, the PRP considered the current performance pledge (10 weeks) could not keep pace with the speedy changes in the Hong Kong financial markets.

3.34 The PRP had recommended the SFC to:

- review the 10-week performance pledge for processing licensing application of RO;
- explain how the SFC had counted the 10-week pledged time for the application. Did it start upon the receipt of the application or the SFC counted it only after it had received all required information?

[5] One RO applicant had an accident that held up the application for 3 months. Another RO applicant resigned in the process that held up the application for 4 months.

- explain how the SFC defined "standard" and "non-standard" type of licensing application. The PRP noted that the SFC only include 'standard" type of licensing application in the performance pledge report to the public; and

- explain and review how the SFC had monitored the performance for those "non-standard" type of applications.

The SFC's response

Review of 10-week performance pledge

3.35 The SFC replied that the performance pledges were determined by reference to the relative complexity of the different types of applications to which they applied. The SFC did not regard its performance pledges as being fixed and incapable of change and reviews these from time to time. Currently, the SFC considered its performance pledges relating to licensing matters as being appropriate, bearing in mind the complexity of the different types of applications in question and the staffing resources within the Licensing Department ("LIC"). Accordingly, the SFC considers that there was an appropriate balance between serving the needs of the market, on the one hand, and the overall cost, in terms of the SFC resources, of achieving this, on the other hand.

3.36 With reference to its performance pledges generally, and the 10-week performance pledge for the processing of RO applications in particular, the SFC considered the integrity of the gatekeeping function that was performed by the LIC to be of paramount importance and something that should not be compromised. ROs played an important role in licensed corporations and it would be unwise, in the SFC's view, to relax the careful and detailed approach that the LIC took to the processing of the applications. Accordingly, any reduction in the 10-week performance pledge for the processing of RO applications could not be expected to result in any reduction in the time that was taken by the LIC to process them. It would more likely result in fewer RO applications being completed within the reduced performance pledge period, thereby giving RO applicants unrealistic expectations.

Counting 10-week pledged time

3.37 As regards the counting of 10-week processing time, the SFC explained that upon receiving any application, the LIC conducted a preliminary screening of it to ascertain whether it met the basic criteria, namely, of the applicant having answered all of the relevant questions in the application form, signed and dated the application, submitted all required supporting documents and paid the applicable application fee. If these basic criteria had not been met, the application was returned to the applicant as provided for in paragraph 7.8 of the SFC's Licensing Information Booklet.

3.38 Upon the submission of an application that met the basic criteria, it was formally accepted by the LIC and the performance pledge clock started running. It did not stop running until the application had been finally completed, irrespective of whether this occurred within the performance pledge period or outside it, and irrespective of whether any delays that had occurred during the processing of the application were outside the control of the LIC. The LIC did not turn the performance pledge clock off when delays occurred that were beyond its control because this would create an unacceptable administrative burden. Instead, the LIC conducted a retrospective monthly review of the relatively few cases in which the applicable performance pledges had not been met. This approach reduced the overall administrative burden, encouraged greater consistency and simplifies, and made more effective, the monitoring of this process. Because this procedure occurred after the event, it had no effect on the manner in which applications were processed.

3.39 The SFC reported that since the beginning of 2013, approximately 86% of new licence applications dealt with by the LIC met the relevant performance pledges and approximately 14% did not. It was this latter group of applications that the SFC reviewed monthly, after the event, in order to ascertain whether or not the failure to observe a relevant performance pledge resulted from matters beyond the control of the LIC or factors which require the SFC to subject an application to greater scrutiny than was normally the case. In almost all of the cases, such failure was the result of one or more factors that were beyond the control of the LIC. Those factors included applicants having requested a delay in the granting of their licences, the failure of applicants to provide information in a timely manner, delays by other regulators in responding to the SFC vetting requests, licence applications by individuals being delayed until the corporations to which these individual applicants were to be accredited have been licensed, concerns as to the fitness and properness of applicants and unpaid fees.

Monitoring "exceptional" cases

3.40 The SFC reiterated that a large majority of applications dealt with by LIC complied with the SFC's performance pledges. Of the relatively small number of other cases that were not completed within the applicable performance pledge period, most were "exceptional" cases, in which the processing of the applications was delayed by circumstances beyond the control of the LIC or factors which required the SFC to subject an application to greater scrutiny than was normally the case.

3.41 In the interest of clarity, the SFC preferred not to label licensing applications as "standard" and "non-standard". To enhance transparency, the LIC proposed that, in future, it would report the number of applications that were not completed within the applicable performance pledge period and that it would identify, within this group of cases, whether they were exceptional (meaning that factors beyond the control of the LIC or those

requiring greater scrutiny prevented the completion of the processing of the applications within the applicable performance pledge periods) or whether they were not exceptional (meaning that factors beyond the control of the LIC did not prevent it from complying with the applicable performance pledges).

3.42 The LIC staff were expected to deal with licensing applications, of a similar type, in a similar manner. No distinction was drawn between an application which remained uncompleted within the applicable performance pledge period and one in respect of which this period had already been exceeded.

3.43 Computer generated reports which listed the aging of all outstanding applications were issued to the LIC staff twice every month. Through these reports, each processing team was able to monitor the progress of the outstanding applications for which it was responsible. It was the obligation of the Senior Manager or Associate Director heading each LIC team to monitor the statistics and to intervene when any particular case appeared to be making slow progress.

(b) § Registered institutions

The PRP's review

3.44 In accordance with the Securities and Futures Ordinance (Cap. 571) ("SFO"), for a corporation to become a Registered Institution ("RI"), it should first be registered as an authorized financial institution ("AI") with banking licence approved by the Hong Kong Monetary Authority ("HKMA").

3.45 The PRP had reviewed one application for an RI to carry out Types 1, 4 and 9 regulated activities. The case took 17 months to complete. The SFC had no performance pledge for RI applications as it opined that the processing time for RI applications depended heavily on the HKMA's processing time. The SFC noted case progress of the HKMA by referring to a monthly list of outstanding cases submitted by the HKMA.

3.46 The PRP was concerned how the SFC had monitored the progress for RI applications and requested the SFC to provide the latest list of outstanding cases with relevant action party, i.e. the HKMA or the SFC. The PRP had recommended the SFC to:

- set up a pledge time to complete an RI application once the applicant had become an authorized financial institution;
- keep the applicant informed of the progress of application so that the applicant could make direct enquiry with the processing party.

This would avoid giving a false impression to the applicant that the SFC was holding up the application unduly; and

- enhance communication and coordination with the HKMA to monitor RI application progress. Apart from noting the progress from the HKMA's monthly list of outstanding cases, the SFC could make phone enquiry with the HKMA and chased up the HKMA to expedite the application.

The SFC's response

Setting up performance pledge

3.47 The SFC played a generally limited role in respect of RI applications. It received them and then referred them to the HKMA for assessment under section 119 of the SFO. By agreement with the HKMA, the SFC made these referrals within 7 days. After the HKMA had assessed an application and reported to the SFC concerning the merits of the application, the SFC must make a final decision as to whether the application for registration should be granted. Normally, this was a relatively routine matter because it was the role of the HKMA to carry out the detailed assessment of the application. Since the SFC's role in dealing with RI applications tended to be more procedural than substantive, and because the HKMA's role involved a detailed assessment of the merits of such applications, the SFC did not feel that publishing performance pledges concerning its role would be particularly helpful. The reason for this was that the SFC's performance pledges were intended to provide applicants with an indication of the length of time that their applications could be expected to take when the SFC played the substantive assessment role, and to serve as a constant reminder of this to the LIC staff.

3.48 In the case of RI applications, it was the HKMA's assessment that was time consuming. As this was a role that was imposed on the HKMA by statute and one which must be performed by the HKMA, the SFC was not in a position to publish a performance pledge with which, in effect, the HKMA would be expected to comply.

Enhancing communication with the HKMA to monitor case progress

3.49 The SFC remarked that it was important to recognize that the respective roles of the SFC and the HKMA were stipulated in section 119 of the SFO. Accordingly, it was not appropriate for one regulator to interfere in the performance by the other of the statutory functions that had been conferred on it. The monthly reports provided by the HKMA constituted a formal communication with the SFC concerning the status of RI applications that the SFC had previously referred to the HKMA. Telephone inquiries would likely be viewed as unwarranted interference on the SFC's part in the performance

by the HKMA of its statutory function and would probably not elicit any more information than was already contained in the monthly reports.

3.50 Senior staff of the SFC met periodically with their HKMA counterparts to discuss matters of mutual interest. At these meetings, the SFC had, on occasions, tactfully raised with the HKMA RI applications that appeared to be making unusually slow progress.

Informing applicants of progress

3.51 As explained in the above, applicants under section 119 of the SFO were well aware of the respective roles played by the SFC and the HKMA in relation to their applications. They also dealt directly with the HKMA during the course of its processing of such applications and were aware that this was the responsibility of the HKMA. Accordingly, applicants were aware that if there were delays or matters giving rise to concern during the processing period, their inquiries must be directed to the HKMA.

3.52 Since these applications were typically with the SFC for such short periods, and since applicants were aware of this, the SFC considered that little benefit would be gained from the SFC providing applicants with progress updates during these short periods. The approach that the HKMA adopted to updating RI applicants was entirely a matter for the HKMA and one in relation to which it would not be appropriate for the SFC to interfere. However, it would be reasonable to assume that the HKMA's approach was not unlike that of the SFC, which was generally not to provide regular updates. The reason why the SFC did not provide regular updates in all cases was that this would be time consuming and was normally unnecessary because the SFC constantly communicated with applicants during the processing of their applications. Accordingly, they were usually aware of the progress that the SFC was making. On this basis, it was reasonable to assume that RI applicants should have a good idea, at any given time, of the progress that was being made by the HKMA with their applications.

Outstanding RI application

3.53 The SFC supplemented that as of end May 2013, there were 3 outstanding RI applications, 4 applications for the addition of regulated activities, and 1 application for the removal of a registration condition that were under consideration by the HKMA. Accordingly, the RI matters constituted a small part of the work of licensing section in the SFC. RI applications had represented less than 5% of all the SFC's new corporate applications received each year since 2008. Since the beginning of 2013, the SFC had received no RI application.

3.54 The issues of the SFC taking a proactive role in chasing up the HKMA in order to expedite the processing of RI applications and coordinating with the HKMA to keep applicants informed, had been addressed in the SFC's

responses to the matters raised above. Briefly, and by way of summary, the SFC and the HKMA performed different statutory functions under section 119 of the SFO. Because of this, the SFC did not consider it appropriate for the SFC to interfere with the performance by the HKMA of its processing function or to be involved in informing applicants concerning the progress that was being made by the HKMA in the performance of this statutory function.

(c) § Agent for handling application

The PRP's review

3.55 The PRP noted that the SFC took nine months to process an application lodged by a firm for its RO to carry on Types 2 and 5 regulated activities. The applicant had appointed a legal advisor to handle the application.

3.56 The SFC explained that the application was delayed because of substandard work quality prepared by the legal advisor. As a result, the SFC had to make several rounds of requisition.

3.57 The SFC further explained that the applicant was involved in a bankruptcy petition during the application period. The SFC had to launch additional vetting from an overseas regulator to confirm the applicant's licensing criteria. In this aspect, the PRP appreciated the SFC's initiative to enquire the applicant about the bankruptcy petition without waiting for its disclosure.

3.58 The PRP recommended the SFC to:

- alert the applicant of the slow responses or substandard work quality submitted by its handling agent (say, legal/professional advisors) so that the applicant understood the delay was not due to the SFC and could take necessary remedial action;

- explain why the SFC had not communicated with the corporation directly on licensing application as stipulated in the SFC's Licensing Information Booklet;

- elaborate on the present rules and guidelines requiring an applicant to disclose any material changes and major events to the SFC during the application period; and

- advise how the SFC had enforced the rules for the above.

The SFC's response

3.59 The SFC advised that it was essential that there be one line of communication between the SFC staff and the applicant or, where the applicant chose to instruct a legal or compliance adviser, between the SFC staff and that adviser. The reason for this was that if communications were made variably between the SFC and the legal or compliance adviser on some occasions and between the SFC and the applicant on other occasions, confusion tended to occur as a result of the left hand sometimes not knowing what the right hand was doing. If an applicant chose to instruct a legal or compliance adviser, this was a matter for the applicant. It was not for the SFC to question this decision. It was not appropriate for the SFC to actively criticize the performance of an applicant's legal or compliance adviser. In those cases in which the SFC considered an adviser's conduct of the application to be deficient, the policy adopted by the SFC was to communicate its concerns to the adviser and to copy the correspondence to the applicant. It was then a matter for the applicant to decide whether it wished to continue availing itself of the services of the legal or compliance adviser. On some occasions, such as when the SFC was not satisfied with the adviser's responses, the SFC had no alternative but to communicate directly with the applicant and to request a direct response from the applicant.

Dealing with handling agents

3.60 The SFC explained that for the case under review, the SFC had voiced its concerns regarding the delay in the processing of the application in an e-mail, which was sent to the legal adviser and copied to the applicant. Following this, the applicant took a more active role in connection with the application by communicating directly with the SFC to address the outstanding concerns.

3.61 The SFC supplemented that dealing with incompetent legal and compliance advisers could be difficult. The SFC recognized that they were not doing the best by their clients, but at the same time it was not for the SFC to dictate to applicants who should and who should not advise them. When difficulties were experienced, as in the subject case, it usually did not take an applicant long to realize the difficulties being created by an incompetent adviser when the SFC copied correspondence to the applicant. Invariably, in the circumstances, the applicant made a decision to terminate the adviser's involvement or to restrict the adviser's role.

Direct communication with licensed corporation

3.62 Although not relevant to the case under review, in a case to which paragraph 7.5 of the Licensing Information Booklet applied, the licensed corporation might well wish to instruct a legal or compliance adviser to act for it in connection with the joint application. If this occurred, the SFC's communications would be conducted with the licensed corporation through

its legal or compliance adviser. This would not in any manner be inconsistent with paragraph 7.5, which required that for standalone applications made by individuals, the SFC's communications were to be with the licensed corporation, as distinct from being with the individual seeking to be licensed or approved as an RO.

3.63 In the case under review, paragraph 7.5 of the Licensing Information Booklet was of no relevance because the application was a corporate application in which the applicant corporation sought to be licensed. Notwithstanding this, during the course of processing the application, the SFC's communications were in fact with the applicant corporation through its legal adviser.

Rules requiring an applicant to disclose material changes and the SFC's enforcement to the rules

3.64 Section 4 of the Securities and Futures (Licensing and Registration) (Information) Rules required applicants to disclose any changes to the information provided in their applications within 7 business days after the changes took place. The SFC's application forms specifically reminded applicants of their obligation to notify the SFC of such changes.

3.65 Failure to comply with this obligation was a criminal offence under section 135 of the SFO. A conviction arising out of a failure of this type would be viewed seriously by the SFC and would call into question a licensee's fitness and properness to be, or to remain, licensed. A breach of section 4 might come to light during the licensing process, in which event the SFC might well refuse to grant the licence being sought. Alternatively, in the event of such a breach subsequently being revealed (e.g. during the course of the processing of a subsequent licence application or during an inspection or investigation), it would likely result in disciplinary action being taken, including the possibility of the licence in question being revoked.

3.66 It was a criminal offence, contrary to section 383 of the SFO, for an applicant to knowingly or recklessly make a representation in support of a licence application that was false or misleading in a material particular. The SFC's licence application forms also drew this to the attention of applicants. A conviction under section 383 was viewed seriously by the SFC and would also call into question the offender's fitness and properness to be, or to remain, licensed.

3.67 The processing of licence applications by the SFC was not a mechanical or box-ticking procedure. It involved the staff of the LIC thinking laterally, being familiar with market or other issues that might be relevant to, or influence, the outcome of the applications that they were processing, and raising issues of concern with applicants. The subject case was an example of this, but was by no means an isolated case.

Inspection of intermediaries

3.68 The PRP had reviewed a number of inspection cases involving "high-risk" firms and enquired how the SFC had planned its inspection on this kind of licensed corporation. The PRP also observed that the SFC had a practice issuing letter of deficiencies exactly four months after the SFC had inspected the intermediaries and enquired the rationale behind.

(a) § Inspection frequency – poor compliance history

The PRP's review

3.69 The PRP reviewed an inspection case on a firm's compliance with anti-money laundering ("AML") regulatory requirements. The SFC concluded "there were poor compliance culture and lack of awareness of AML controls". The SFC issued a letter of deficiencies to the firm eight months after the inspection. The case took nine months to complete.

3.70 The PRP noted that for this case, the SFC had issued a letter of exit without any follow up inspection. The PRP enquired why the SFC had not revisited the firm to confirm that all deficiencies had been duly rectified before it issued the letter of exit and closed the case involving inspection results of poor compliance.

3.71 Upon further enquiry, the SFC supplemented that it had not conducted or planned to conduct another inspection to the firm since it issued the letter of exit. The PRP noted that one year had lapsed since the SFC's last inspection. The SFC had not planned any further follow up inspection. The PRP recommended that the SFC should strengthen the monitoring and increase inspection frequency for firms with a history of poor compliance culture.

The SFC's response

3.72 The SFC pointed out that the SFC's inspection process included procedures for the inspection team to discuss any preliminary concerns with management of the firm shortly following the completion of fieldwork and set out the identified breaches of regulatory requirements and areas for improvement in a letter of deficiencies upon completion of the review. The firm was required to provide a written response stating the corrective actions which had been or would be taken.

3.73 In assessing the extent and nature of the corrective actions taken, the

inspection team might also require the firm to provide additional information and supporting documents to substantiate the actions taken. Whether this warranted a revisit to the firm would be determined on a case by case basis.

3.74 The SFC explained that on-site inspection (including routine, special and thematic inspections) was a key tool that complemented off-site monitoring in the SFC's risk-based supervision of licensed corporations. A balanced top-down (industry-wide and linked to the SFC's overall priorities) and bottom-up approach (firm-specific and linked to a risk and impact assessment framework for all licensed corporations) was adopted in the SFC's risk-based on-site inspection framework to identify overall inspection priorities, determine whether routine, special or thematic inspections should be conducted, and the targets of inspections.

3.75 The SFC confirmed that the risk and impact assessment of a licensed corporation took into account, among other inputs, inspection findings and history of compliance culture on the firm as important assessment factors. It would be updated on an ongoing basis by the off-site monitoring case officer. Relevant information was maintained in computer systems developed to automate some risk analyses. Licensed corporations assessed as requiring close monitoring would generally be inspected more frequently.

3.76 The PRP's emphasis on compliance culture as a key assessment factor was well noted. The SFC constantly re-assessed the use of various factors, compliance culture included, in order to obtain the best possible holistic risk assessment for a licensed corporation.

(b) § Hire of external consultant to conduct inspection

The PRP's review

3.77 The SFC engaged an external consultant to perform inspection on AML compliance. The external consultant had access to sensitive information of the inspected firms. Noting that external consultants were not the SFC staff and were not subject to the SFC's Code of Conduct, the PRP invited the SFC to elaborate on measures it had taken to avoid the leakage of sensitive information by external consultants.

3.78 The PRP further recommended the SFC to add a clause regarding "conflict of interests" in its appointment contract with external consultants. This would debar the external consultants from using the information gained during the inspection for their own purposes, which might be contrary to the interests of the SFC.

The SFC's response

3.79 The SFC confirmed that the external consultants engaged by the SFC to assist in performing inspection on licensed corporations, like the SFC's staff, were subject to the preservation of secrecy and avoidance of conflict of interests provisions of the SFO (ss 378 & 379), contravention of which was an offence punishable by imprisonment and fine. The statutory provisions were specifically drawn to the attention of the external consultant firm and were acknowledged in writing. Engagement letters with external consultants normally contained further provisions restricting the use of information.

(c) § Letter of deficiencies

The PRP's review

3.80 The PRP reviewed several intermediaries inspection cases and noted the SFC issued letter of deficiencies exactly four months after its inspections. Questions were raised as to whether the issue of letter of deficiencies was unnecessarily held up until four months after its inspections, which was exactly the SFC's internal pledged time. It should be noted that any undue delay in issuing the letter of deficiencies could cause relevant licensed persons unnecessary worries.

3.81 The PRP requested the SFC to:

- provide past 12-month statistics showing the duration required to issue letter of deficiencies after inspection; and
- explain the rationale why letter of deficiencies could not be issued earlier.

The SFC's response

3.82 In 2012-2013, there were a total of 242 completed inspection cases with the following breakdown on duration to issue the letter of deficiencies:

- between 0 to 3 months: 25 cases;
- between 3 to 4 months: 216 cases;
- more than 4 months: 1 case (An interim letter of deficiencies was issued within 4 months in this case).

3.83 The SFC explained that the total amount of time generally needed for the completion of a normal inspection counting from the start of the inspection work was between 3 and 4 months. However, this was not a performance pledge and it was not practicable for the SFC to set any rigid time frame for issuing a letter of deficiencies because the degree of cooperation from the firm under inspection and the number and complexity of issues arising from an inspection varies from case to case.

3.84 The SFC issued an interim letter of deficiencies to ensure that the firm was informed of interim findings if the inspection was expected to take longer to complete. A final letter of deficiencies was always sent to the firm upon the completion of the inspection. The issue of an interim letter within 4 months was an internal procedure adopted in light of the experience of inspections over many years; it recognized that even in difficult or protracted cases it should be possible to formally notify a firm of interim findings within 4 months, and this often followed early verbal notification.

(d) § Inspection frequency–high-risk company

The PRP's review

3.85 The PRP reviewed two cases involving the same company: (a) the Enforcement team conducted investigation and concluded that there were improper trading activities by staff in the company while (b) the Inspection team conducted special inspection on the firm's compliance on selling practices requirements. For both cases, the PRP noted respective teams of the SFC had generally followed their operational guidelines and procedures.

3.86 The PRP was concerned that for securities company which the SFC had concluded "there were improper trading", the SFC should classify the company as "high-risk" licensed corporation and step up its inspection.

The SFC's response

3.87 The SFC adopted a risk-based approach in the regulation of licensed firms. The SFC took into account the identified breaches and deficiencies in the inspection and the compliance history among other risk factors to evaluate and track the risk profile of individual licensed firms. Higher risk firms would generally be covered for inspection in a shorter timeframe under the risk-based approach.

Investigation and disciplinary action

3.88 The PRP studied cases with relatively long investigation time and made recommendations on the closure of case.

(a) § Investigation process – legal advice

The PRP Review

3.89 The PRP reviewed a suspected market manipulation case. The SFC took more than two years to complete the investigation, which included nine months[6] "waiting time" for legal advice from the SFC in-house and an external counsel. The case was subsequently closed with no action taken.

3.90 The PRP noted that Enforcement team had classified the case as "high priority" and had reported investigation progress to the Enforcement Steering Committee ("ESC") on a monthly basis. Notwithstanding that, the PRP was of the view that the ESC had not taken proactive action chasing up legal advice to expedite the investigation.

3.91 The PRP recommended the SFC to review management's supervision for "high priority" case and to consider:

- setting up internal guidelines on time required to offer in-house legal advice; and
- establishing a mechanism to monitor service of external counsel, namely, its response time and quality of advice. The PRP considered that four-month waiting time from a hired external counsel was totally unreasonable.

3.92 The PRP added that prolonged investigation time, let alone nine months spent for seeking legal advice, would hinder effective enforcement / prosecution action.

The SFC's response

3.93 There had been severe resourcing issues in the Legal Service Department ("LSD") that had created a backlog. These resourcing issues were addressed through increases in budgeted headcount and recruitment of

[6] Five months for SFC's in house legal advisor and four months for SFC's hired external counsel.

additional litigators.

3.94 External counsel were instructed to advise on factually or legally complex cases and on some other cases where it was considered necessary in order to improve turnaround time for legal advice. When external counsel were instructed, the LSD Counsel would agree a date for the provision of legal advice and would chase external counsel for their advice. However, specialist counsel tended to be in high demand and it was not always possible to secure a quick turnaround for their advice despite the SFC's efforts.

3.95 The SFC was unable to impose any performance pledge on external barristers/senior counsel. Despite this, the LSD did obtain estimated dates to monitor progress.

(b) § Referral of cases to other regulators

The PRP's review

3.96 The PRP had reviewed one case involving a licensed corporation's facilitation of unlicensed activities by employees of an unlicensed corporation. The unlicensed corporation was a member of the Hong Kong Confederation of Insurance Brokers ("HKCIB").

3.97 The SFC fined the licensed corporation and suspended the licence of its Responsible Officer. As for the unlicensed corporation, the SFC issued a compliance advice letter.

3.98 The PRP noted that the SFC had generally followed its internal procedures in handling the case. However, the PRP would like to know if the SFC had considered referring the unlicensed corporation, which was an insurance broker, to the Office of the Commissioner of Insurance ("OCI") for necessary follow-up.

The SFC's response

3.99 The SFC replied that it had not referred the case to the OCI. In future, if investigations revealed potentially problematic conduct on the part of the HKCIB's members, the SFC would seriously consider referring the matter to the OCI for appropriate follow-up action.

3.100 On the PRP's further comments that there should be a standard mechanism of referring cases to other regulators to avoid any regulatory loopholes for cases related to misconduct of persons/companies which were not under the SFC's regulatory ambit, the SFC reiterated that there was a

mechanism for referral. In the case under review, disciplinary action was not taken against the unlicensed corporation and therefore the case did not fall within the ambit of the referral mechanism.

(c) § Closing of completed case

The PRP's review

3.101 The PRP noted that the SFC Enforcement Team had held up one case for three years before closing. No further action was taken during the three-year period. The case involved a complainant and the SFC's referral to an overseas regulator.

3.102 The PRP recommended the SFC should:

- establish proper procedures to monitor cases involving referral to overseas regulators; and

- arrange proper and timely closure of cases.

3.103 The PRP invited the SFC to clarify if it had complied with its internal procedures.

The SFC's response

3.104 The SFC advised that this case was left open due to an administrative oversight. It did not involve any investigation. The file was opened to handle an administrative liaison issue with the overseas regulator. In the normal case, all cases had a closing protocol and checklist to ensure they were closed properly. This was not a factor in this file because it was not an investigation file.

Timely closing and proper authority to close a case

3.105 There was a protocol and process governing the management of investigation cases that followed a project management methodology of assessment, planning, reporting and closure. The Enforcement Steering Committee approved the closure of investigation cases.

3.106 Investigatory assistance under the Multilateral Memorandum of Understanding ("MMOU") or a bilateral Memorandum of Understanding ("MOU") with foreign regulators was a very limited exercise that usually might not require investigation. In most cases, the request was for a single piece of information. The foreign regulator not only identified what it wanted but also where the information could be located. Under MMOU and bilateral MOU arrangements, the SFC complied with these requests routinely. They

might not involve the investigation of any HK subject. The relevant investigation was one being conducted by the foreign regulator and not by the SFC. These files recorded the SFC's administration of the request for assistance. Given the routine nature of these cases, a Director was authorized to close cases involving requests for assistance. A Senior Director also reviewed a list of foreign assistance requests on a monthly basis to ensure that progress was satisfactory. Accordingly, there was already a responsible process for such cases.

Handling of complaints

3.107 The PRP reviewed completed cases involving complaints lodged against staff and listed companies. The PRP made recommendations to the procedures of handling complaints in the SFC.

(a) § Complaint involving listed companies

The PRP's Review

3.108 The PRP reviewed three closed complaint cases involving listed companies. For the first two cases, the complainants had directed their claims to the Hong Kong Exchanges and Clearing Ltd ("HKEx") or the Stock Exchange of Hong Kong ("SEHK"), with copies to the SFC. For the third case, the complainant sent two emails to the SFC on two consecutive days, which were Thursday and Friday.

3.109 Upon enquiry, the PRP learnt that the Complaints Control Committee of the SFC ("CCC") convened its meeting every Friday and issued its agenda every Wednesday. For cases which were received by the SFC on Thursday and Friday (including the third case), the case had to be discussed at the CCC and be referred to the SEHK on the following Friday as the agenda of the meeting had already been issued.

3.110 The PRP commented that all the cases were relatively straightforward. It was evident the HKEx / SEHK were action parties, but not the SFC. The PRP invited the SFC to review if such kind of cases needed to go through CCC vetting. Given the CCC met only once a week, its role to endorse the SFC's action, which was simply a referral back to the HKEx / SEHK for follow up, might give an impression that the SFC had held up the cases for days to go through the CCC without added values. The PRP recommended the SFC to:

- consider passing such cases to relevant regulators immediately upon receipt; and notify the CCC of the case background and action taken subsequently; and

- review the SFC's definition of a "complaint" that required routing via the CCC before taking action, for example, differentiating "complaints" from enquiries or other categories.

3.111 When reviewing one of the above-mentioned cases, the PRP was told that the SFC had followed up the case progress with the SEHK. The PRP would like to know how the SFC had followed up with the SEHK.

The SFC's response

3.112 The SFC agreed that for clear cut or urgent cases, immediate action could be taken by regulatory unit immediately with the CCC being advised. The SFC's existing complaints handling procedures also allowed such flexibility in handling complaints.

3.113 The SFC commented that for the case reviewed by the PRP, the case did not appear to be very straightforward. Accordingly, the SFC followed the established procedures for the CCC to conduct a preliminary assessment and decide on the next course of action.

Screening Mechanism before routing to the CCC

3.114 The SFC agreed that it was useful to have a mechanism to differentiate incoming correspondence by its nature. The SFC currently had an initial screening process in order to distinguish whether correspondence should be treated as a complaint, an enquiry or another category. CCC only reviewed complaints (versus enquiries) that fell within the SFC's jurisdiction. In general, when a complaint was determined to fall within the SFC's jurisdiction, the SFC would proceed to prepare reports for the CCC's consideration.

Follow up monitoring action

3.115 The SFC advised that under the SFC's complaints handling procedures a complaint would be closed once it was referred to an external body (e.g. the SEHK).

3.116 As part of the SFC's oversight of the SEHK, the SFC received a monthly report which included a "List of complaints referred by the SFC and received by the SEHK directly". This list contained a summary of the complaints received by the SEHK and its assessment and decision in respect of them. If the SFC had concerns or questions about the way a complaint was handled, the SFC would raise the matter with the SEHK.

(b) § Staff complaint

The PRP's review

3.117 The PRP reviewed a complaint case lodged against a SFC's staff regarding her attitude and manner when handling an enquiry.

3.118 In accordance with the "Procedures for Handling Complaints against SFC staff", the SFC had referred the case to an Executive Director ("ED") for investigation and decision-making. Six months after the receipt of the complaint, the ED informed the complainant that investigation had to be held up as the staff would proceed on maternity leave. The ED subsequently interviewed the staff five months afterwards when she resumed from her leave and concluded that "there was no basis for further action". The ED then informed the complainant of the decision. The whole process took 11 months.

3.119 The PRP invited the SFC to elaborate on:

- why the case investigation had to be held up; and
- how it had monitored the progress of complaint case investigation against staff.

3.120 The PRP understood that the long processing time taken in this case (11 months) was partly attributable to the three-month maternity leave of the staff. Nevertheless, the PRP considered that the complaint was relatively straightforward and could have been handled earlier. The PRP was concerned that the delay would pose undue pressure on the staff being complained.

The SFC's response

3.121 There was currently an established process adopted by the SFC for the Commission Secretary to monitor progress of complaint cases against staff and reported to the Audit Committee on a quarterly basis.

(c) § Case involving regulators in the Mainland

The PRP's review

3.122 The PRP reviewed one case involving a group of clients of a firm in the Mainland, alleging that their offices in the Mainland were sealed by the Security Bureau of the Mainland and that they could not locate the person-in-charge of the firm. Enforcement Division of the SFC considered that the information was insufficient for any investigation. Intermediaries Supervision Department of the SFC made enquiry with the firm regarding the operation of its offices in the Mainland and its dealing with clients in the Mainland. Finally, the case was closed with no further action.

3.123 The PRP asked the SFC if it had taken steps to confirm with the

Security Bureau or relevant regulators of the Mainland about the allegation of the closure of the offices in the Mainland. The allegation appeared serious. There were possible concerns that the clients' money were at risk.

3.124 The PRP recommended the SFC to consider taking more proactive action when it investigated similar cases in future, including:

- to liaise/seek clarification direct with the relevant Mainland counterparts; and

- to adopt a more interactive approach, e.g. meeting with the firm concerned, in order to minimize the turnaround time in written communication.

The SFC's response

3.125 The SFC elaborated that based on the SFC's enquiry with the complaint target, the complaint target's two representative offices in the Mainland solely engaged in advisory, liaison, market research and other non-business related activities and did not handle client assets. The firm denied the allegation about the close down of its two representative offices by the Mainland authority. The SFC also did not receive any referral from the CSRC in relation to the complaint.

3.126 Since there was no evidence to substantiate the complainants' allegations or for further investigation, it was not necessary to seek assistance from Mainland authorities in respect of an unsubstantiated complaint.

3.127 The SFC appreciated the PRP's recommendation. The SFC and the CSRC had cooperation arrangements in relation to various aspects, including securities enforcement cooperation. The SFC's Enforcement Division had frequent dialogue with the CSRC's Enforcement Bureau, and both parties may notify or seek investigatory assistance from each other if there was suspected misconduct on the part of the SFC licensees in the Mainland.

3.128 The SFC thanked the PRP for their recommendation. In the current case, the SFC met with the senior management of the complaint target shortly after the case was referred to it. In that meeting, the SFC made enquiry about the operation of the complaint target's two representative offices in the Mainland and the complaint target confirmed that the two Mainland representative offices had no client servicing function. The SFC's enquiry continued after the meeting by conducting further review on the complaint target's books and records and controls and procedures pertaining to safeguard of client assets in order to ascertain its compliance.

3.129 The SFC would continue to adopt appropriate strategy and approach with a view to handling complaints expeditiously.

(d) § *Reply to Complainant*

The PRP's review

3.130 In reviewing another complaint case against a listed company, the PRP noted that the SFC only replied to the complainant with a short response, like "*the case being evaluated and appropriate action to be taken as necessary*". The PRP raised concern if such simple and standard reply was adequate. The PRP noted that there had been accusations from industry members on the lack of transparency in the SFC's replies to complainants.

3.131 At the case review meeting, the subject officers of the SFC explained that a simple reply was appropriate as the SFC had to balance between the secrecy of any information involving potential disciplinary case and a reply to complainant on its allegations.

3.132 The PRP could not fully agree to the above. The PRP recommended the SFC to devise a better complaint handling mechanism to deal with complaints. The guiding principle was that complainants should be aware of progress and result of their complaints.

The SFC's response

3.133 The SFC noted the PRP's views on the complaint handling mechanism. Under the existing complaint handling procedures, the SFC would inform complainants the status of their cases periodically and the result after completion of the review to the extent permitted under the secrecy provision of SFO.

3.134 The SFC advised that it had established procedures to deal with complaints received from external sources, which included responding to complainants at different stages of the process. The SFC was mindful of the expectation of a deserving complainant (who might be the victim of the subject of the complaint) to be informed of the progress and outcome of the case. The SFC was however restrained by the overriding secrecy provisions set out in section 378[7] of the SFO which, together with overriding fairness consideration for all involved – including any person against whom a complaint was made – limited how much information the SFC could give to a complainant.

3.135 The SFC had plans to review its complaints handling procedure, with a

[7] Section 378 prohibits the Commission and its staff from divulging details of the progress of a complaint (in particular but not limited to the fact that an investigation is underway) unless the information is already in the public domain, or any other specific exemption in that section applies.

view to minimizing overlaps and gaps and enhancing transparency and consistency. The review was expected to include the classification of complaints, to whom they should be referred and under what circumstances, whether any exceptions were justifiable, and the extent to which the SFC could keep complainants informed of progress bearing in mind the secrecy obligations.

3.136 For the case under review, the SFC reiterated that an announcement was issued following the SFC's review of the matter. After that, the SFC noted that the complainant commented that the listed company had published an announcement as a result of the complaint. Given this, the SFC took the view that it was not necessary to write to the complainant to inform him/her of the outcome of the SFC's review.

Corporate Finance including processing of listing applications

3.137 The PRP had reviewed a number of completed cases on corporate finance and concluded that the SFC had generally followed its operational guideline in the process. In the course of reviews, the PRP had recommended the SFC to enhance publicity on disclosure obligations by the listed companies and invited the SFC to elaborate on the difference of cessation between "beneficiary interest" and "legal interest" in the declaration of interest.

(a) § Regular reminder on disclosure obligations

The PRP's review

3.138 The PRP reviewed a case relating to a firm's failure to make public disclosure of dealings as required by the Takeovers Code. The PRP recommended that the SFC should consider more measures reminding fund managers of the disclosure obligations. Examples included (a) annual reminder via the Takeovers Bulletin and (b) publishing message in the Hong Kong Investment Funds Association publication.

The SFC's response

3.139 The SFC thanked the PRP for the helpful suggestions. In going forward, the SFC would issue an annual reminder in the Takeovers Bulletin. The SFC would also liaise with the Hong Kong Investment Funds Association and other similar bodies with a view to publishing a similar reminder in their publications.

(b) § Publicity on disclosure of interest

The PRP's review

3.140 The PRP had reviewed one investigation case involving the late disclosure of interest by a non-executive director of a company listed on the SEHK.

3.141 While the PRP noted the SFC had generally followed its operational guideline in processing the investigation, the PRP recommended the SFC to enhance its publicity on directors' responsibility to disclose interests and to

liaise with the HKEx on how to promote education among listed corporations.

The SFC's response

3.142 The SFC responded that it had not issued media releases for these cases for some years.

3.143 The obligation on listed company directors to disclose changes of interests was one that was well-known. The SFC applied a policy to avoid prosecuting the most trivial kind of cases. The SFC would consider what means there were to educate listed company directors as to their responsibilities. However, the number of these cases was relatively low suggesting the vast majority of listed company directors were well aware of their obligations.

(c) § Declaration of Interest

The PRP's review

3.144 The PRP noted another investigation case involving the breaches of disclosure of interest. There were complicated situations in declaration of interest arising from time difference of cessation between "beneficiary interest" and "legal interest".

3.145 The PRP invited the SFC to elaborate, with inputs from the HKEx, the following –

- the requirements to report cessation of interest on:

  (a) entering into a contract of an intention to transfer/sell the shares to a third party at a future date, i.e. transfer of beneficiary interest; and

  (b) conducting the actual transaction of transfer/sale of the shares, i.e. transfer of actual interest; and

- the timing when the shares concerned were regarded to have been legally transferred/sold under (a) and (b) above, and hence the change in the shareholding position which would affect the shareholder's status, e.g. of being a substantial shareholder.

The SFC's response

3.146 The SFC elaborated that for requirements to report cessation of interest:

- Where a duty of disclosure arose under section 310(1)(b) of the SFO in the circumstances specified in section 313(1)(d) of the Ordinance (e.g. where there is a change in nature of an interest on a person entering into a contract for the sale of shares) then if the change in the nature of his interest was due to his entering into a contract for the sale of shares under which he was required to deliver the shares to the purchaser within 4 days from the date of the contract the vendor was not required to give a notification under section 324 of the SFO (see section 5 of the Securities and Futures (Disclosure of Interests – Exclusions) Regulation). If a person contracted to sell shares with a settlement date (the day when he delivers the shares to the purchaser) 5 or more trading days after the date of the contract, then he must file a notice within 3 business days after the date of the contract.

- In each case the purchaser must file a notice within 3 business days of the day that he first acquired an interest in the shares (i.e. within 3 business days of the date of the contract) (see section 310(1)(a) in the circumstances specified in section 313(1)(a) or (c) of the SFO).

- In each case the vendor must file a notice within 3 business days after the date that he ceased to be interested in the shares (the date on which he delivers/transfers the shares to the purchaser) (see section 310(1)(a) in the circumstances specified in section 313(1)(b) or (c) of the SFO).

3.147 The SFC elaborated that for timing when the shares concerned were regarded to have been legally transferred/sold:

- Under (a) above, when a person entered into a contract of an intention to transfer/sell shares to a third party at a future date, the shares had been legally "sold" but only the beneficial interest of the shares (not legal interest) passed to the purchaser. Both the purchaser and the vendor were interested in the shares during this period. The purchaser should file a notice within 3 business days after he acquired an interest in the shares (i.e. within 3 business days of the date of the contract).

- Under (b) above, on settlement date (when the shares are delivered/transferred to the purchaser) the legal interest of the shares would be transferred to the purchaser and hence there would be a change in the nature of the purchaser's interest. This change in the nature of the purchaser's interest need not be notified to the Exchange if his equitable interest in those shares had been notified to the Exchange and the listed corporation concerned (see section 310(1)(b) of the SFO in the circumstances specified in section 313(1)(d) of the Ordinance but see the exception in section 313(13)(i)

therein). However, the vendor must file a notice within 3 business days after the date that he ceased to be interested in the shares (the date on which he delivered/transferred the shares to the purchaser).

Chapter 4 Way forward

4.1 In the year ahead, the PRP would continue its work with a view to ensuring that the SFC adheres to its internal procedures consistently.

4.2 The PRP welcomes and attaches great importance to the views from market practitioners. Comments on the work under the PRP's terms of reference could be referred to the PRP through the following channels[8] –

By post to: Secretariat of the Process Review Panel
for the Securities and Futures Commission
24th Floor, Central Government Offices
2 Tim Mei Avenue
Tamar
Hong Kong

By email to: prp@fstb.gov.hk

[8] For enquiries or complaints relating to non-procedural matters, they could be directed to the SFC by the following channels –

By post to	: The Securities and Futures Commission, 35th Floor, Cheung Kong Center, 2 Queen's Road Central, Hong Kong
By telephone to	: (852) 2231 1222
By fax to	: (852) 2521 7836
By email to	: enquiry@sfc.hk (for general enquiries, comments and suggestions, etc.)
	: complaint@sfc.hk (for public complaints)

Chapter 5 Acknowledgement

5.1 The PRP would like to express its gratitude to the SFC and its staff, in particular the Commission Secretary Ms Christine KUNG and Mr Paul YEUNG, for their assistance in facilitating the review work, and their co-operation in responding to the PRP's enquiries and recommendations in the year.

5.2 The PRP would also like to express its gratitude to the outgoing Chairman and members for all the years of hard work with the PRP. They are Mr CHOW Wing-kin, Anthony, Mr CHIU Chi-cheong, Clifton, Dr FONG Ching, Eddy, Mr FUNG Hau-chung, Andrew, Mr LEE Jor-hung, Dannis, Mr LIU Che-ning and Mr SUN Tak-kei, David. With their expertise and efforts, the PRP has managed to recommend practical measures for the consideration by the SFC.

5.3 The PRP would also like to place on record its appreciation to the support rendered by the outgoing Secretary, Ms Sanny CHAN, to the PRP's operation in the past three years.

Process Review Panel
for the Securities and Futures Commission
October 2013