

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

**Annual Report**  
**for 2016-17**

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## Message from the Chairman

This is the fifth message I wrote as Chairman for the Annual Report of the Process Review Panel for the Securities and Futures Commission ("PRP"). PRP is tasked to ensure fairness and consistency in the operation of the Securities and Futures Commission ("SFC"). In so doing it seeks to enhance public confidence in the SFC's regulatory work. As its Chairman, I am pleased to report that PRP has been performing effectively.

Over the past five years, PRP has made a number of recommendations to the SFC for consideration. Timeliness, consistency, transparency and market expectations have all along been in our mind when we review the procedures taken by the SFC in its completed cases. We are pleased to report that our recommendations have received a positive response of the senior executives in the SFC and are deemed to be supportive to the SFC's goal to change for the better. For this year, PRP acknowledges the efforts made by the SFC in revamping its strategic priorities in the Enforcement Division. We appreciate the fruitful results in implementing the fund revamp process of the Investment Products Division. We welcome the big step taken by the SFC to promote cross-divisional cooperation and improve its responsiveness to market participants. All these measures improve upon the healthy development of the market.

In this annual report, I have continued the practice to set out some noteworthy observations on the case reviews conducted in the year. They are shown in Chapter 4 of the report. We have tried to include as much information as possible for readers to better appreciate the process of the work of the SFC.

**Message from the Chairman (*continued*)**

In undertaking this year's work, I must thank all fellow Members in selflessly devoting their precious time to study the cases, read the SFC's operational manuals and hold discussion with officers of the SFC despite their own hectic schedules. I would like to bid a warm welcome to Mr. Chester Kwok and Mr. Frederick Tsang as they are joining PRP as our new Members. Taking this opportunity, I would like to thank the Secretary for the Financial Services and the Treasury and his staff for the tremendous support given to PRP.

Together with all fellow Members and the secretariat, I shall continue to perform PRP's functions earnestly, independently and impartially. In close collaboration with the SFC, we shall forge towards the common goal of an ever improving and effective regulatory regime for the financial market of Hong Kong.

May I take this opportunity to wish everyone a good and successful year ahead!

Moses Cheng Mo-chi, GBM, GBS, JP  
Chairman

## Executive Summary

In 2016-17, PRP reviewed 62 cases selected from monthly closed case lists submitted by the SFC.

2. PRP conducted in-depth deliberation on each case. PRP aimed to suggest practical recommendations for the SFC to consider in enhancing its procedures. The recommendations include -

### **Reviewing Enforcement Process**

- ✧ The SFC to streamline its process and procedure in the disciplinary and enforcement cases

### **Streamlining Process in Disciplinary and Enforcement Cases**

3. Over the years, PRP has reviewed enforcement cases that took a relatively long time to process. In reviewing these cases, PRP noticed that different teams seem to have undergone an unduly long process in examining, preparing and reviewing the evidence collected.

4. PRP recommended the SFC to streamline its process and procedure in the disciplinary and enforcement cases so as to expedite the investigation and improve the overall efficiency.

5. The SFC responded that it had conducted a “Strategic Review” in the Enforcement Division. The SFC would move from a “try-to-do-everything” approach to a “focused” approach, targeting at the key risk areas. The SFC would adopt an approach of “frontloading its work” by giving the market clear messages that could help market participants change their market behaviour and hence avoid market misconduct from the outset. The SFC would also adopt a “One SFC” approach, through which the SFC would seek to use its full regulatory toolbox to tackle identified risks in a more coordinated manner.

## Work Prioritisation

6. The Enforcement Division formulated a new case intake process. Under the new process, a new case intake team would provide a score that indicated the importance of each new case based on a set of agreed criteria. The Enforcement Steering Committee would decide on the importance and priority of the case, and allocate resources accordingly.

7. The Enforcement Division set up permanent and temporary specialised teams to focus on the key risk areas and to deal with the situation whereby cases were increasingly complex and a higher caseload.

8. PRP looked forward to the SFC's further report on the efficiency of the new strategy and the effectiveness of the new measures.

### Enhancing Communication

- ✧ The SFC had room for improvement in both its internal communication among different divisions and departments and external communication with counsel, advisors, financial regulators and enforcement agencies

## Internal Communication among Divisions within the SFC

9. PRP reviewed quite a number of cases handled by the Enforcement Division on the conduct of intermediaries. PRP commented that the SFC could have processed the disciplinary cases quicker if there were more effective communication among different divisions within the SFC.

10. The SFC explained that one of the conclusions of the Enforcement Division's Strategic Review was to strengthen its collaboration with other divisions within the SFC. Under the "One SFC" approach, the setting up of cross-divisional working groups would enhance the working efficiency of the SFC as a whole.

## **Internal Communication among Departments within the Same Division**

11. When studying the Enforcement Division's investigation of intermediaries' conduct as referred by the Intermediaries Division or pursuant to complaints, PRP questioned on the need of reviewing the evidence of a case separately by the Investigation Department and the Discipline Department. PRP recommended that the SFC should review the current working relationship between the two departments in the Enforcement Division. The SFC advised that following the Strategic Review, the Enforcement Division would adopt a specialised team structure that aligned with the SFC's key enforcement priorities. The new team structure should enhance the efficiency of the enforcement process as a whole.

12. PRP reviewed a composite application comprising an application for an individual to be a responsible officer of a corporate applicant and another application of the corporate applicant seeking to become an approved introducing agent. PRP commented that it was important to have a close working relationship between the Licensing Department and the Intermediaries Supervision Department in the Intermediaries Division for effective processing of an application.

## **External Communication with the Mainland Regulators**

13. PRP noted the importance of cross boundary regulatory and enforcement cooperation. PRP recommended that the SFC should continue to maintain effective communication and collaboration with the Mainland authority.

14. The SFC advised that it had maintained a close and effective working relationship with the China Securities Regulatory Commission in managing the cross-boundary risks. The SFC noted that the relationship had become all the more important since the launch of the Stock Connect.

## External Communication with Local Regulators and Enforcement Agencies

15. PRP noted that the SFC and the Department of Justice signed the Memorandum of Understanding on 4 March 2016. Since then, the turnaround time for advice from the Department of Justice to the SFC on prosecution cases had reduced.

16. PRP reminded the SFC that it should ensure that it maintained close working relationships with other financial regulators and enforcement agencies.

## External Communication with Outside Advisors and Counsel

17. In reviewing different enforcement cases, PRP observed that external counsel or advisers spent much time to provide legal opinions or expert views. PRP reminded the SFC that it should monitor the work of the relevant external parties providing assistance to it very closely.

18. The SFC advised that the delays caused by the external advisers were often due to factors beyond the SFC's control. Case officers had been reminded to monitor progress closely based on the agreed timetable with the external advisers, and promptly escalate any delay to a more senior officer for advice and follow-up.

### **Leveraging Technology**

- ✧ The SFC should better leverage the technology across its market surveillance system and upgrade its case management system to enhance work efficiency



## Market Surveillance System

19. PRP recommended that the SFC should enhance its market surveillance system so that the SFC could detect any irregularities in the trades with a view to starting its investigation towards the suspects earlier.

20. The SFC responded that it had upgraded its market surveillance system in the past years. The SFC would take into account PRP's comments, constantly develop and enhance trade alerts and deploy new technologies in order to better detect any irregular trading activities.

## Case Monitoring System

21. As a part of the Strategic Review of the Enforcement Division, the Enforcement Division advised that it was developing an electronic "Case Management Dashboard" to facilitate senior management's monitoring of the case progress.

22. As regards the Corporate Finance Division, PRP felt that there should be room for improvement in the case monitoring system in the division for its seniors to monitor the progress of takeover and listing applications. In response, the Corporate Finance Division advised that it had worked with the IT Department to develop a new function in the system for generating team-wide inactivity reports to facilitate case monitoring. The new function was rolled out in May 2017.

## Staff Training on FinTech

23. PRP reviewed two different cases, and arrived at the same conclusion that the SFC should provide adequate training to its case officers on the development of innovative products and financial technology in the market in both cases.

24. The SFC responded that as part of the SFC's commitment to their staff, the SFC always encouraged staff to receive relevant training throughout their career with the SFC. There would be more training sessions on Fintech for the SFC staff.

**Reviewing Guidelines and Putting in place Pledges**

- ✧ The SFC to put in place performance pledges in the Corporate Finance Division and update its guidelines in various divisions to enhance efficiency and transparency

**Performance Pledges and Guidelines in Corporate Finance Division**

25. In response to PRP's earlier recommendation, the Corporate Finance Division drew up a set of performance pledges on the Takeovers Team's work related to the "applications and related documents under the Takeovers Code and Share Buy-backs Code" in December 2016.

**Application Lapse Period Policy**

26. In response to PRP's recommendation, the Corporate Finance Division was contemplating an application lapse period policy for exemption applications under Part XV of the Securities and Futures Ordinance (Disclosure of Interests).

**Guidelines and Monitoring System in Licensing Department**

27. PRP recommended the Licensing Department to stipulate and enforce the rule that applications without the requisite information would be returned to the applicant.

28. The SFC reviewed its guidelines regarding the return of sub-standard applications. The revised guidelines were stipulated in the Licensing Handbook, which was published on 21 April 2017.

29. The Licensing Department was developing a risk assessment approach with a view to identifying the potential risk areas of an application at the early stage. The new mechanism would help the department focus its resources on complex cases.

### **Enhancing Transparency in Complaints Handling**

- ✧ The SFC to maintain an effective communication with the complainants and ensure that its resources were allocated to handle genuine complaints

#### **Effective Communication**

30. PRP pointed out that the SFC should provide as much information as possible in its replies. The SFC should consider stating whether the SFC had handled the complaint in accordance with the complaint procedures against the SFC or those against its staff for complainants' information.

31. The SFC responded that although the SFC did not think it would be meaningful to inform the complainant which set of the complaint handling procedures it had applied at the early stage of investigation (which could change as new information emerged), it was more important to set out the rationale for the SFC's decision in the final reply to the complainant, which would normally indicate whether the complaint had been treated as one against the SFC or its employees.

#### **Reply to the Complainant**

32. In one case review, PRP noted that the complainant was not satisfied that the SFC had not told him the outcome of the SFC's investigation on an intermediary on which he complained.

33. The SFC undertook to continue to strike a good balance between the secrecy provision and the complainants' expectation to be kept informed. PRP looked forward to the result of the SFC's review to enhance its communication with the complainants.

## **Coordination of Complaint Handling**

34. PRP noted there were delays in completing the complaints handling procedures by the operational divisions, and invited the SFC to enhance the co-ordination and the monitoring role of complaint case handling.

35. The SFC responded that a new system, the “Complaints Control System”, was launched in March 2016. The system would enhance the transparency of the complaint handling procedures within different divisions in the SFC. It should help minimise the risk of delay in completing complaints handling procedures by the operational divisions.

36. The Commission Secretariat was also leading a process of reviewing divisional complaint handling procedures with a view to clarifying the division of labour and strengthening management oversight.

## **Handling Repeated and Anonymous Complaints**

37. PRP raised its concern on the resources spent by the SFC to handle the repeated and anonymous complaints.

38. The SFC responded that it had reminded complainants to provide full details of their complaints and relevant documents that would help the SFC assess their complaints.

### **Supervising Intermediaries**

- ✧ The SFC would continue its risk-based approach in selecting intermediaries for routine inspections, and would arrange more thematic reviews to address the emerging risks in the market

### **Measures to Ensure Effectiveness of Inspections**

39. The Intermediaries Supervision Department explained that it had adopted various measures to ensure the effectiveness of the inspections. Measures included the development of inspection checklists, the provision of training and sharing sessions, and the establishment of the case management system of the Intermediaries Supervision Department to monitor the process of inspections. The effectiveness of these measures would be subject to periodic review.

### **Risk-based Inspection Targeting Process**

40. The Intermediaries Supervision Department also explained that its risk-based inspection targeting process was handled by a centralised team. The team was tasked to identify inspection priorities. The identification of the overall inspection priorities would take into consideration the trends and the emerging risks in the market.

### **Front-loaded Regulatory Approach**

41. The SFC would arrange more thematic reviews to address specific and more complex risks in the market. The SFC also placed emphasis on changing behaviour through signalling to the industry the focuses of the SFC's inspections and the proper standards of behaviour.

## Chapter 1      General Information

### Background

1.1            PRP for the SFC is an independent panel established by the Chief Executive 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            PRP reviews completed or discontinued cases handled by the SFC and advises 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 authorisation of investment products, licensing of intermediaries, inspection of intermediaries, enforcement, corporate finance including processing of listing applications, and complaints handling.

1.3            PRP does not judge the merits of the SFC's decisions and actions. It focuses on the process.

1.4            The Terms of Reference of 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 Codes on Takeovers and Mergers and Shares Buy-back (formerly known as the 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.

1.5 PRP submits its annual reports to the Financial Secretary who may cause them to be published as far as permitted under the law.

1.6 The establishment of PRP demonstrates the Government's resolve to enhance the transparency of the SFC's operations, and the SFC's determination to boost public confidence and trust. PRP's work contributes to ensuring that the SFC exercises its regulatory powers in a fair and consistent manner.

### **Modus Operandi**

1.7 The SFC provides PRP with monthly lists of completed and discontinued cases. Members of PRP select cases from these lists for review. Members pay due regard to factors including processing time of completed cases, procedural steps taken by the SFC in arriving at its decisions and relevant checks and balances.

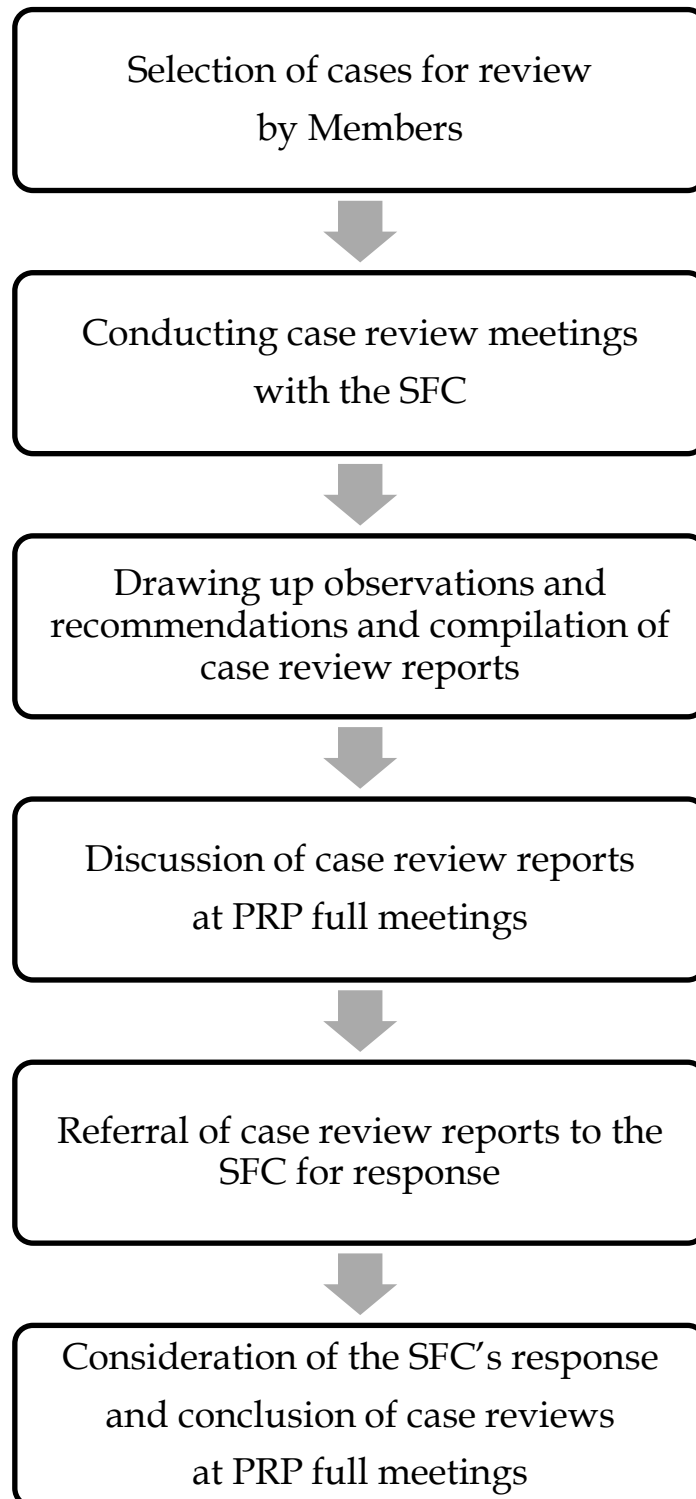
1.8 The SFC also provides PRP with monthly lists of on-going investigation and inquiry cases that have lasted for more than one year for PRP to take note and consider for review upon completion or closure of the case.

1.9 PRP members are obliged to keep confidential the information furnished to them in the course of PRP's work. To maintain independence and impartiality of PRP, all PRP members are required to make declaration of interest upon commencement of their terms of appointment and declare their interest in the relevant matters before conducting/discussing each case review, as appropriate.



## Case Review Workflow

1.10 The workflow of a PRP case review is set out below -



## Membership

1.11 Dr. Cheng Mo-chi, Moses is the Chairman of PRP.

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

1.13 The membership of PRP in 2016-17 is as follows -

### Chairman:

Dr. CHENG Mo-chi, Moses, GBM, GBS, JP since 1 November 2012

### Members:

Mr. CHAN Kam-wing, Clement since 1 November 2012

Ms. Lena CHAN since 1 June 2016

Ms. DING Chen since 1 November 2014

Dr. HU Zhanghong since 1 November 2012

Mr. KWOK Tun-ho, Chester since 1 November 2016

Ms. LEE Pui-shan, Rosita since 1 November 2012

Mr. LEE Wai-wang, Robert since 1 November 2012

Dr. MAK Sui-choi, Billy since 1 June 2016

Mr. TSANG Sui-cheong, Frederick since 1 November 2016

Ms. YUEN Shuk-kam, Nicole since 1 November 2014

### Ex officio Members:

Chairman, the Securities and Futures Commission Mr. Carlson TONG, SBS, JP since 20 October 2012

Representative of the Secretary for Justice since 26 February 2015

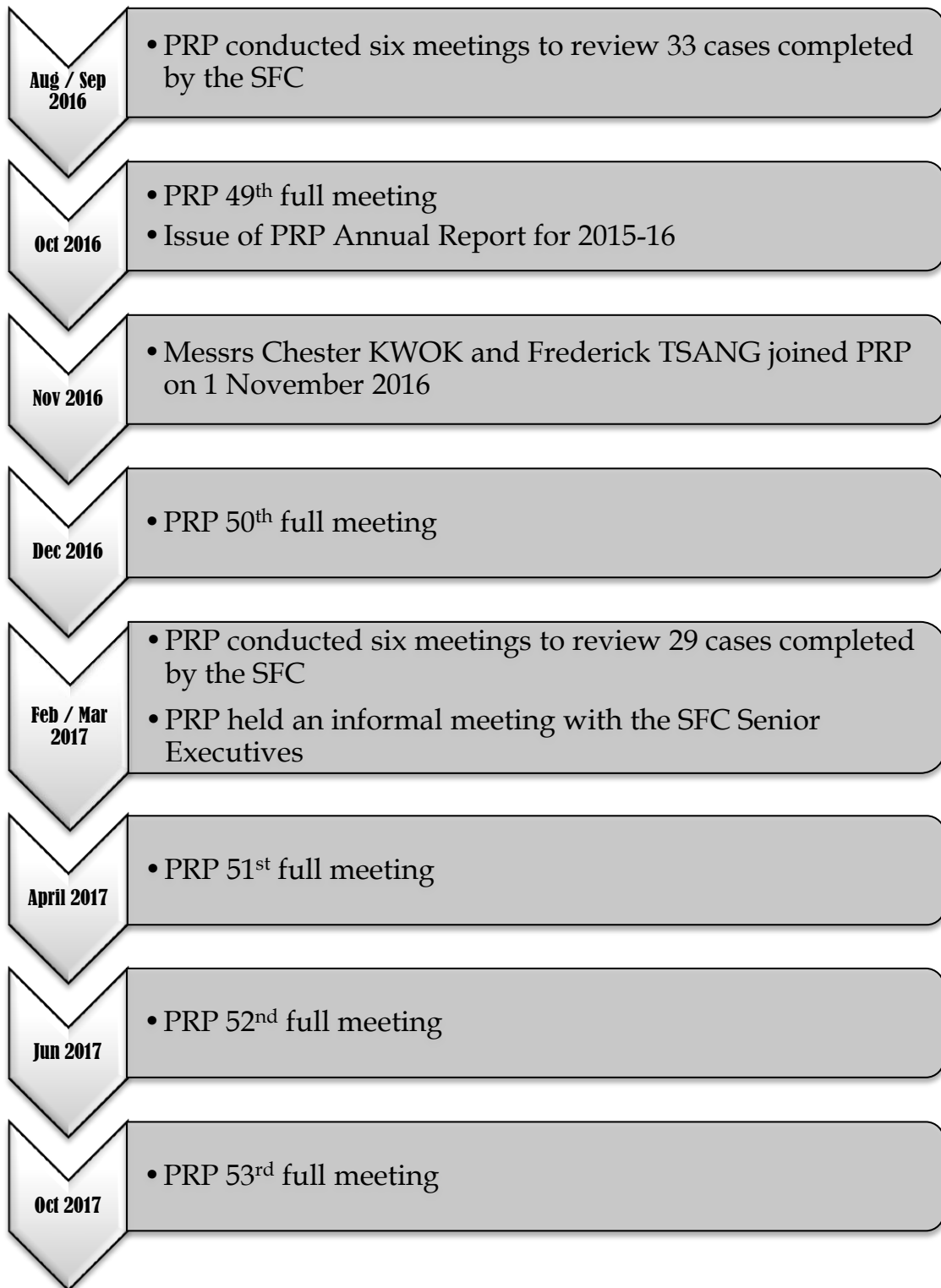
Ms. CHEUNG Kam-wai, Christina, JP

### Secretariat:

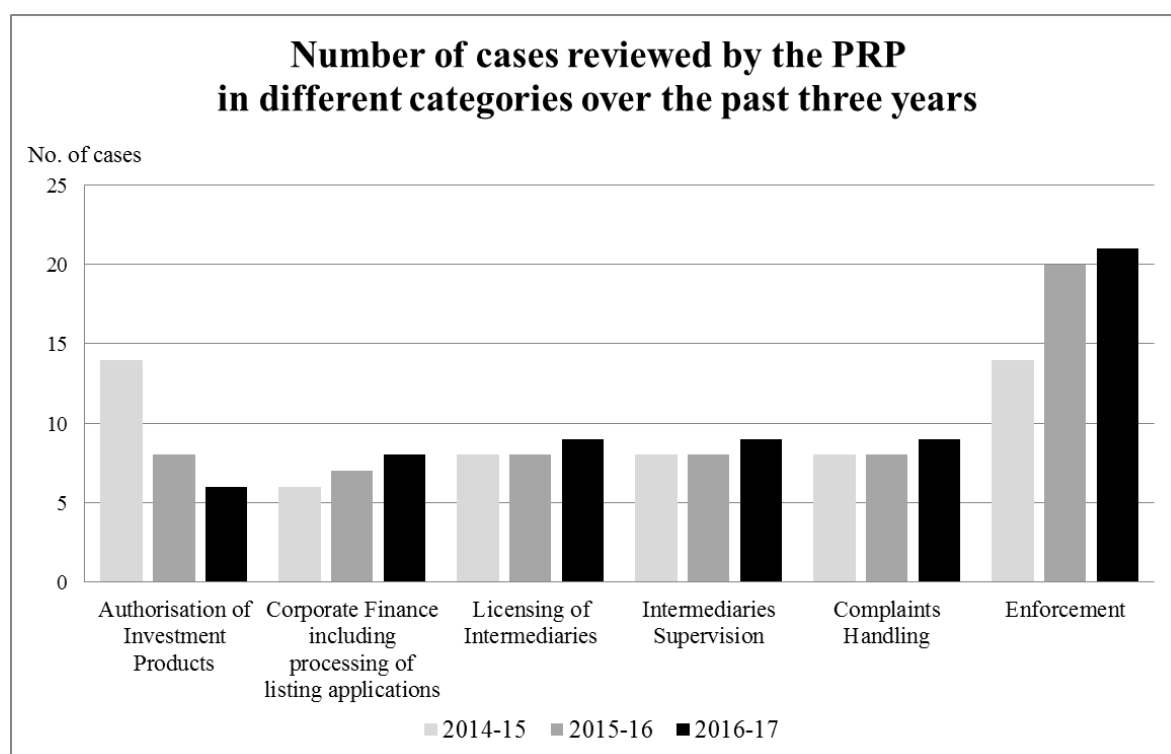
The Financial Services Branch of the Financial Services and the Treasury Bureau

## Chapter 2 Highlights of the Work of PRP

2.1 Major events in 2016-17 are set out below -



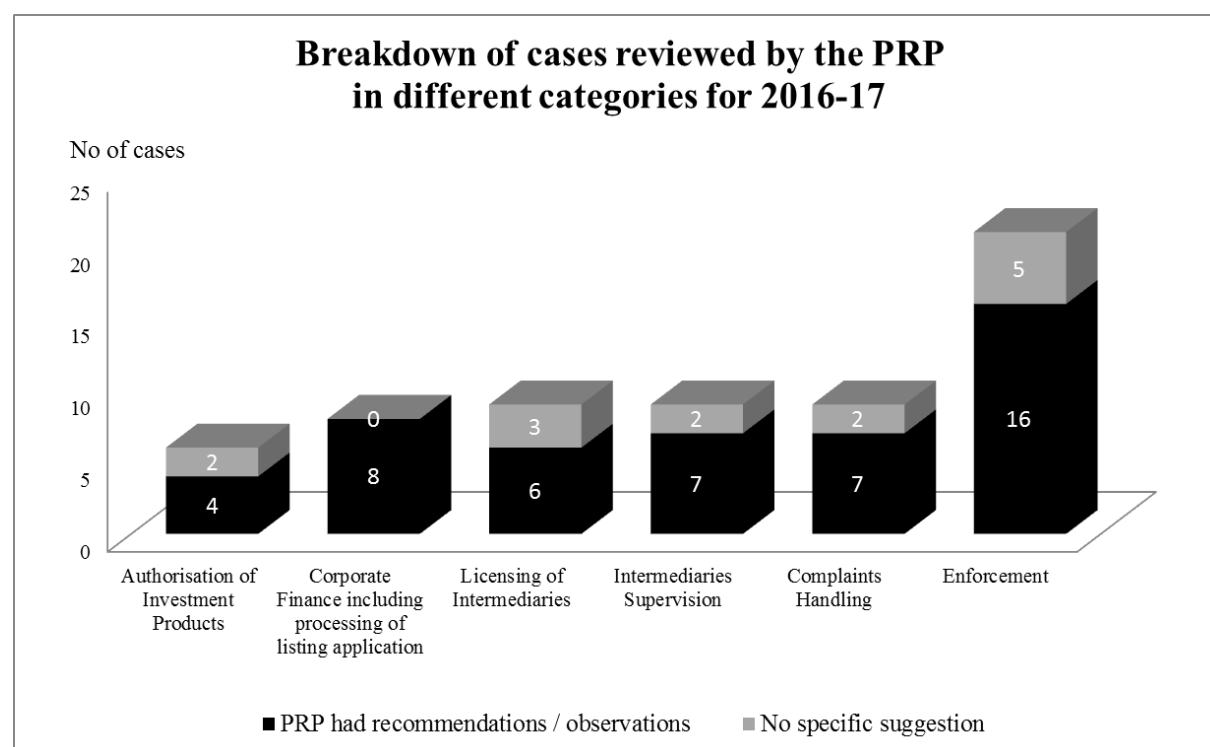
2.2 Distribution of the cases which PRP has reviewed in the past years –



2.3 Distribution of the 62 cases which PRP has reviewed in 2016-17 -

	No. of Cases
Authorisation of Investment Products	6
Corporate Finance including processing of listing applications	8
Licensing of Intermediaries	9
Intermediaries Supervision	9
Complaints Handling	9
Enforcement	21
<b>Total</b>	<b>62</b>

2.4 Among these 62 case reviews, PRP made recommendations or observations on 48 cases, representing 77% of the cases being reviewed.



2.5 Highlight of PRP's observations of and recommendations for the case reviews are set out in Chapter 4. Follow-up actions taken by the SFC in response to PRP's recommendations in the last Annual Report are set out in Chapter 3.

## Chapter 3 Follow-up Actions by the SFC on PRP's Recommendations in 2015-16

3.1 Responding to the Annual Report of PRP for 2015-16, the SFC was committed to reporting progress in the following areas –

- (a) Strategic Review of the Enforcement Division (“ENF”);
- (b) Checks and balances on the issue of statutory notices to brokers;
- (c) Monitoring the follow-up actions taken by Licensed Corporations (“LCs”) after the Intermediaries Supervision Department (“ISD”) had completed the inspection;
- (d) Monitoring the progress of the complaint investigation conducted by the SFC’s operational divisions; and
- (e) Effectiveness of the SFC’s Fund Process Revamp.



### A. Strategic Review of the ENF

3.2 The ENF undertook to re-assess its enforcement focus, organisation structure and enforcement tools in 2015-16 with a view to identifying the key areas of concern, maximising the effectiveness of process taken in the ENF and reviewing its surveillance capabilities.

3.3 The ENF reported that it had changed its approach from a “try-to-do-everything” to a “focused” one with resources deployed to the key risk areas.

3.4 In this context, the ENF set up permanent and temporary specialised teams to focus on the key risk areas and deal with specific topics of concern –

- (a) four permanent specialised teams on (i) Corporate Fraud, (ii) Corporate Mifecance, (iii) Insider Dealing and Market Manipulation, and (iv) Intermediary Misconduct; and
- (b) four temporary specialised teams on (i) Sponsor, (ii) Growth Enterprise Market, (iii) Anti-Money Laundering, and (iv) Specific Products.

3.5 More details on the new measures imposed after the Strategic Review are set out in Chapter 4.



## **B. Checks and Balances on Issue of Statutory Notices to Brokers**

3.6 PRP invited the ENF to review its monitoring mechanism on the issue of statutory notices to brokers. PRP pointed out that the ENF should impose effective measures to guard against seeking from brokers information more than absolutely necessary. The ENF should explore a “maker-checker” system whereby a statutory notice prepared by an officer should be reviewed by another officer of higher seniority before the notice was issued.

3.7 The ENF reported that it had implemented the “maker-checker” system on the issue of statutory notices to brokers on 3 January 2017. With the introduction of the system, the scope of investigation as stated in the statutory notices was more specific. The number of statutory notices issued to brokers asking for information was reduced.



### **C. Monitoring Follow-up Actions Taken by LCs after ISD’s Inspection**

3.8 In the case review of 2015-16, PRP invited the ISD to examine and review the inspection process with a view to improving the effectiveness of supervision of intermediaries. PRP pointed out that the ISD should have a set of standard procedures to monitor remedial actions proposed by or taken by the LC after the ISD completed the on-site inspection and issued the closure letters to the LC.

3.9 The ISD reported that after conducting inspections of the LC, the ISD would issue a letter of deficiencies to the LC inviting it to take remedial actions. The letter of deficiencies would be issued within four months after the inspection. The ISD would further issue a closure letter to the LC to mark the conclusion of the inspection. Whether the ISD would check the effectiveness of the remedial action(s) taken by the LC before it issued the closure letter would depend on the seriousness of the deficiencies identified. For deficiencies involving systemic risks and investors’ interests, the ISD would do so.

3.10 More details on the supervision of intermediaries are set out in Chapter 4.



### **D. Monitoring Progress of Complaint Investigation Conducted by the SFC’s Operational Divisions**

3.11 PRP recommended that the SFC should consider tasking the Complaints Control Committee (“CCC”) with a role to monitor the progress of complaint handling by the operational divisions.



3.12 The SFC advised that the CCC assigned the complaints to the operational divisions for further assessment based on their expertise. The SFC launched a new Complaints Control System in March 2016. The new system provided a platform for operational divisions to note the progress of the complaints and to close a case upon completion. The system would facilitate case monitoring by the operational divisions.



### **E. The SFC's Fund Process Revamp**

3.13 PRP invited the SFC to report on the effectiveness of the SFC's fund process revamp, which was formally implemented on 9 May 2016, in expediting the processing time.

3.14 The SFC advised that the overall processing time of the SFC-authorized funds had been reduced by 51% as of 30 March 2017. The average processing time for standard applications was around one month while that for non-standard applications was less than three months. The quality of the applications had improved.



## **Chapter 4      Observations and Recommendations of Case Reviews in 2016-17**

4.1            In 2016-17, PRP reviewed 62 cases which were concluded by the SFC during the period from December 2015 to October 2016. The processing time for the cases being reviewed ranged from one month to ten years, depending on the nature of the cases.

4.2            As per the established practice in the past years, PRP has selected cases that the SFC had taken a relatively longer time to complete. PRP appreciated the importance of the SFC's regulatory work to safeguard market integrity. The SFC had to carry out the vetting, the investigation and the inspection tasks vigilantly, which took time to complete. Some enforcement cases had taken several years to complete as the process involved legal proceedings.

4.3            Notwithstanding the above, PRP reminded the SFC of the market participants' expectation. As a financial regulator responsible for granting licences and authorising investment products, the SFC has been expected to conclude the processing of applications and the authorisations within a reasonable timeframe. As an enforcement agency upholding market integrity, the SFC would be expected to complete investigations the soonest possible in order to protect the investors, to alleviate the pressure on the persons being investigated, as well as to send a timely message to the market to deter similar market misconducts, if any.

4.4            PRP has studied the steps taken by the SFC in each case review and provided observations and recommendations for the SFC's consideration to enhance the effectiveness and efficiency of the regulator's work.

4.5            For the case reviews conducted this year, PRP focused on the workflow of the cases to look for areas for streamlining; the internal guidelines to ensure consistency in handling similar cases by different teams; the mechanism to ensure timely guidance being given by supervisors; resource allocation and the use of technology system to

enhance work efficiency; and the cooperation and communication among different teams.

4.6 PRP noted common observations among different divisions in the above areas and has drawn up recommendations under the following categories –

- (a) Reviewing Enforcement Process;
- (b) Enhancing Communication;
- (c) Leveraging Technology;
- (d) Reviewing Guidelines and Putting in place Pledges;
- (e) Enhancing Transparency in Complaint Handling; and
- (f) Supervising Intermediaries.





## A. *Reviewing Enforcement Process*

4.7 Over the years, PRP has reviewed enforcement cases that took a relatively longer processing time. In reviewing these cases, PRP noticed that different teams seemed to have undergone an unduly long process in examining, preparing and reviewing the evidence collected. For example, in one case being reviewed, the SFC investigators took one year to collect and examine the evidence, another year to review and prepare an evidence matrix for referral to the SFC disciplinary officers; and in turn the SFC disciplinary officers took another year to review the evidence matrix and prepare a Notice of Proposed Disciplinary Action (“NPDA”) to the intermediary under investigation. The disciplinary case took a total of three and a half years to complete. PRP also noticed that in some cases being reviewed, the disciplinary officers (who were involved in reviewing the evidence at the later stage of the case processing) had to send the cases back to the investigators and asked the investigators to collect further evidence from experts. As such, the evidence collection process had to be repeated. PRP asked if such procedures could be streamlined so that relevant evidence could be identified and collected simultaneously to avoid duplication of such efforts which would in turn lengthen the processing time.

4.8 PRP was told that the processing of some cases had been held up because case officers had to handle a number of investigation and disciplinary cases concurrently. There were delays in the processing in view of competing priorities. PRP understood there were resource issues in every public organisation and asked the SFC if case officers had been trained on how to prioritise their work and if their supervisors were aware of their caseload and the case progress handled by the respective teams.

4.9 PRP also noted that the SFC took up investigations on alleged misconducts based on the information in open blogs. Bearing in mind the resource issues in the SFC, PRP asked if the SFC would conduct investigation on all allegations based on information in open blogs and of the media; and if not, how the SFC would select prima facie cases for follow-up actions.

### § PRP's recommendations

4.10 PRP recommended the SFC to streamline its process and procedure in the disciplinary and enforcement cases so as to expedite the investigation and improve the overall efficiency. In this connection, the SFC undertook to re-assess its enforcement focus, organisation structure and enforcement tools with a view to identifying key areas of concern, enhancing the effectiveness of enforcement process and upgrading its surveillance capabilities.

### § SFC's responses

4.11 The SFC conducted a "Strategic Review" in the ENF. The SFC would move from a "try-to-do-everything" approach to a "focused" approach, targeting at the key risk areas. The SFC would also adopt an approach of "frontloading its work" by giving the market clear messages that could help market participants change their market behaviour and hence avoid market misconduct from the outset. The SFC would also adopt a "One SFC" approach, through which the SFC would seek to use its full regulatory toolbox to tackle identified risks in a more coordinated manner. As part of the "One SFC" approach, the SFC established a cross-divisional working group "ICE" that involved the INT, the CFD and the ENF in July 2016. The SFC anticipated that there would be closer collaboration and better efficiency at the operating level under the "One SFC" approach.

### *Work Prioritisation*

4.12 The ENF formulated a new case intake process. Under the new process, a new case intake team would provide a score that indicated the importance of the new case based on a set of agreed criteria that aligned with the priorities of the SFC and its divisions, and the investigatory and enforcement practicalities. The case intake team would recommend to the Enforcement Steering Committee (“ESC”) whether to investigate a case based on the score. The ESC would then exercise its executive judgement to decide whether to start an investigation, and if so, its priority based on its collective experience and discussion with the division referring the case to the ENF.

4.13 With the implementation of the new case intake process, the SFC would allocate more resources to cases of higher priority.

### *Specialised Teams*

4.14 The ENF set up permanent and temporary specialised teams to focus on the key risk areas and deal with cases of growing complexity and a higher caseload.

4.15 The four permanent specialised teams, with examples of their focused areas, were as follows-

- (i) Corporate Fraud
  - IPO fraud;
- (ii) Corporate Misfeasance
  - corporate governance and false or misleading financial statements;

- (iii) Insider Dealing and Market Manipulation
  - insider dealing before announcements and high concentration of new IPO shares; and
- (iv) Intermediary Misconduct
  - misappropriation of client assets and systemic internal control failures.

4.16 The four temporary specialised teams, with examples of their focused areas, were as follows -

- (i) Sponsor
  - listing of fraudulent or seriously problematic companies, systemic issues and failures in sponsor firms;
- (ii) Growth Enterprise Market
  - untoward volatilities and shell manufacturing;
- (iii) Anti-Money Laundering
  - deficient Anti-Money Laundering / Know-your-client internal controls; and
- (iv) Specific Products
  - mis-selling of financial products.

4.17 The adoption of a specialised team structure aligned with the SFC's key enforcement priorities should enhance the efficiency of the enforcement process as a whole.

### *Enforcement Efficiency Indicator*

4.18 Following the Strategic Review, the ENF also formulated a different Enforcement Efficiency Indicator (“EEI”) for each specialised team. In determining the EEL, the ENF took into account the relevant statistics on previous cases.

#### **§ PRP’s Concluding Remarks**

4.19 PRP welcomed the steps taken by the SFC to improve its process in handling its enforcement work and the conduct of intermediaries cases. PRP looked forward to the SFC’s further report on the efficiency of the new strategy and the effectiveness of the new approaches in the next six months.







## ***B. Enhancing Communication***

4.20 Over the years, PRP has recommended that the SFC should improve upon its communication with stakeholders. PRP observed that the SFC had room for improvement in the communication, both –

- (a) internally within different divisions of the SFC, and between different departments of the same division in the SFC; and
- (b) externally between the SFC and overseas regulators, local regulators, enforcement agencies or advisors and counsel engaged by it.

### ***Internal Communication***

#### ***➤ Different Divisions within the SFC***

4.21 PRP reviewed quite a number of cases handled by the ENF on the conduct of intermediaries. These cases were relatively straight forward, as compared with market misconduct cases handled by the ENF, as the cases did not involve legal proceedings. Most of the cases were referred by the Intermediaries Division (“INT”) to the ENF for investigation. The processing times taken in handling these cases ranged from around one year to three and a half years.

4.22 While the SFC had generally followed its procedures in handling these cases, PRP commented that the SFC could have processed the cases quicker if the communication among the different divisions within the SFC could be more effective.

## § *PRP's recommendations*

4.23 PRP reviewed a case regarding the ENF's investigation into the allocation of placement shares by intermediaries. The intermediaries explained that their allocation approach was fair, and they had not received any clients' complaint. In the process of the ENF's investigation, which took one year and two months to complete, the ENF sought advice from outside market participants on the allocation approach as adopted by the intermediaries. PRP questioned why the ENF had not sought that advice from the Corporate Finance Division ("CFD"), which should be more readily-available to assist the ENF to complete the investigation efficiently.

4.24 PRP also reviewed another case regarding the ENF's investigation into an intermediary's misappropriation of clients' assets. The investigation revealed significant internal control issue of the intermediary; and after the ENF had completed its investigation, the ENF returned the case to the INT for follow-up. Since then, the ENF has not received any feedback on the action taken by the INT.

4.25 PRP recommended that for effective discharge of responsibilities by the different divisions, the SFC should strengthen the communication among the divisions. Each division of the SFC should understand that its division was working on the case for the SFC as a whole. Different divisions should share their intelligence and experience, and leverage on each other's expertise in the discharge of their duties. This would make the ENF's investigation more efficient and the INT's monitoring of the intermediaries conduct more effective.

## § *SFC's responses*

4.26 The SFC explained that one of the conclusions of the ENF's Strategic Review was to strengthen its collaboration with other divisions within the SFC. The IMT would be working closely with the INT.

4.27 The SFC also tasked the relationship managers of the ENF to foster closer communication between the ENF and other operating divisions. This would ensure the alignment of the objectives and operating processes among the different divisions. Through close collaboration and ongoing information sharing, the divisions could minimise any inefficiencies resulting from duplication of work. Under the "One SFC" approach, the setting up of cross-divisional working groups would enhance the efficiency of the SFC as a whole.

4.28 There should also be a better cooperation between the ENF and the Legal Services Division ("LSD"). Designated lawyers from the LSD would be assigned for each team of the ENF. The LSD would also recruit additional lawyers with a view to providing timely advice to the ENF.

### ➤ *Different Departments within the Same Division*

#### ✧ **Within the ENF**

4.29 In the investigation of intermediaries' conduct referred by the INT or pursuant to complaints, the ENF took the following steps -

- (a) the Investigation Department ("INV") issued statutory notices seeking information and documents from intermediaries;
- (b) the INV reviewed the information and documents collected, interviewed the suspects and prepared an evidence matrix for onpass to the Discipline Department ("DIS") for further review; and

- (c) the DIS reviewed the evidence matrix and, where breaches of conducts were found, issued a NPDA to the investigated party .

4.30 PRP observed that the above internal procedures followed by the ENF could take three years to complete. PRP noted that the DIS might at the juncture of (c) call for the original copy of the documents, a copy of which would have been submitted by the intermediaries to the INV before, for further review. The DIS might also at the juncture of (c) seek new evidence or advice from outside counsel. The overall processing time for cases under review could last nearly four years.

### **§ *PRP's recommendations***

4.31 PRP questioned the need of reviewing the evidence of a case by the INV and the DIS separately. Specifically, PRP invited the SFC to review if there was an absolute need for both departments to review the evidence, and how this procedure could be streamlined to expedite the overall processing time. PRP also pointed out that the communication between the departments should be enhanced. During the case review meeting, PRP observed that the subject officers from the two departments were not fully conversant with the actions taken by the other department on the same case. PRP commented that there should be more discussion between the two departments on the documents required to be submitted by the intermediaries for the investigation so that the ENF, as a whole, could issue fewer rounds of statutory notices to the intermediaries requesting for documents.

4.32 All in all, PRP recommended that the SFC should review the current working relationship and communication between the different departments in the ENF.

## § SFC's responses

4.33 The SFC reiterated that following the Strategic Review, the ENF would form specialised team which would enable better communication and coordination during the investigation. Details can be found in paragraph 4.17 of this Chapter.

### ✧ Within the INT

4.34 PRP reviewed an application for an individual to be a Responsible Officer ("RO") of a new corporate applicant handled by the LIC. The corporate applicant also planned to refer clients to its parent company for carrying out certain regulated activities and therefore had applied to the INT seeking the SFC's approval to act as an approved introducing agent<sup>1</sup>. It took one year and three months to complete processing the applications, which was six times of the SFC's performance pledge for an individual RO application<sup>2</sup>. PRP noted that the INT had taken the following steps in handling the application –

- (a) the INT received a composite application, including a licence application of a new LC, two RO applications and an application of the corporate applicant seeking to become an approved introducing agent;
- (b) the ISD of the INT, which was responsible for handling the introducing agent application, returned the application to the applicant and explained that the approval for an introducing agent could only be granted to a LC (i.e. when a company was licensed);
- (c) Licensing Department ("LIC") of the INT handled the

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<sup>1</sup> For the purposes of the Securities and Futures (Financial Resources) Rules, the SFC may approve a licensed corporation as an approved introducing agent where the licensed corporation satisfies the Commission that it meets with certain criteria.

<sup>2</sup> The SFC has pledged to complete an application for the Responsible Officer of a licensed entity within 10 weeks. (Source: <http://www.sfc.hk/web/EN/about-the-sfc/corporate-governance/performance-pledges.html>)

application of the corporate applicant seeking to be the LC for Type 3 regulated activity and the related RO applications;

- (d) the ISD confirmed with the applicant its intention to continue the introducing agent application upon receiving the LIC's confirmation that it was prepared to grant approval-in-principle for the corporate licence application;
- (e) the ISD then handled the application for the introducing agent; and
- (f) the LIC approved the LC application together with the related RO applications when the ISD advised that it was prepared to grant approval for the corporate applicant to become the introducing agent.

4.35 PRP studied the work flow of both the LIC and the ISD of the INT. PRP understood that the INT had to discharge its duties according to the stipulated rules, namely, (a) an introducing agent status could only be granted to a LC (hence the LIC had to handle the corporate licence application first) and (b) an individual would only be granted a RO licence when his accredited company had been licensed and had obtained the SFC's approval as an introducing agent (hence the ISD had to handle the introducing agent application first). Under these circumstances, the RO application would take a longer time to complete.

### **§ PRP's recommendations**

4.36 PRP commented that it was important to have a close working relationship between the two departments in the INT for effective processing of an application. PRP also commented that as a licensed entity could only start its business when the INT had granted

approval for the RO<sup>3</sup>, the SFC should pay more attention to the timeliness in completing the processing of the applications.

### § *SFC's responses*

4.37 The SFC advised that when the LIC handled the licence application and the ISD handled the introducing agent application, the case managers of the two departments had maintained close dialogue to keep each other updated on the progress in their respective applications.

### *External Communication*

#### ➤ *With Mainland Regulators*

4.38 PRP reviewed a number of enforcement cases in relation to corporate misconduct in which the misconduct, or the evidence thereof, took place or was located in the Mainland. PRP noted the importance of cross-boundary regulatory and enforcement cooperation.

### § *PRP's recommendations*

4.39 PRP recommended that the SFC should continue to maintain effective communication and collaboration with the Mainland authorities.

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<sup>3</sup> According to Licensing Handbook of the SFC, a licensed entity must have at least two ROs to directly supervise the conduct of each regulated activity. (Source: <http://www.sfc.hk/web/EN/assets/components/codes/files-current/web/licensing-handbook/licensing-handbook.pdf>)

## § SFC's responses

4.40 The SFC advised that it had maintained a close and effective working relationship with the China Securities Regulatory Commission in managing the cross-boundary risks. The SFC noted that this relationship had become all the more important since the launch of the Stock Connect.

### *With Local Regulators and Enforcement Agencies*

4.41 The SFC is one of the financial regulators in Hong Kong. It has frequent cooperation with other financial regulators and enforcement agencies to approve applications for licences or funds, and to carry out investigation of potential market misconduct. PRP reminded the SFC of the importance to maintain close communication with other local regulators and enforcement agencies.

#### ✧ **Communication with Department of Justice**

4.42 Department of Justice (“DoJ”) is one of the close working partners of the SFC especially when it comes to the investigation of market misconduct cases involving criminal prosecution. PRP noted that after the SFC and the DoJ signed the Memorandum of Understanding (“MOU”) on 4 March 2016, the turnaround time for advice from the DoJ to the SFC on prosecution cases had significantly reduced.

4.43 The SFC supplemented that its cooperation with the DoJ had been smooth since the signing of the MOU. The time for advice from DoJ was within the time limit as set out in the MOU.



✧ **Communication with Mandatory Provident Fund Schemes Authority and Hong Kong Monetary Authority**

4.44 PRP reviewed two applications cases which required co-vetting by the SFC and another financial regulator to study the working relationship between the SFC and the other regulators.

4.45 PRP reviewed an application for approval to withdraw an authorisation of a Mandatory Provident Fund as the fund had been merged with another fund and would no longer be available for subscription in the market. This was a straight forward case. The total processing time taken was 3.5 months and the Investment Products Division (“IPD”) advised that most of the time was spent by the Mandatory Provident Fund Schemes Authority (“MPFA”) to follow up with the applicant in fulfilling the relevant legislative requirements for cancelling the approval status of the Mandatory Provident Fund Scheme under the Mandatory Provident Schemes Ordinance. At the case review meeting conducted with the SFC officers, PRP was told that the SFC case officers did chase the MPFA for its review progress although such action had not been documented. PRP was satisfied with the action taken by the IPD and made a gentle reminder that the SFC should record its follow-up action with the MPFA as the best practice for audit trail.

4.46 PRP also reviewed an application for a bank seeking to become a registered institution (“RI”) to carry on regulated activities. This was also a straight forward application. The total processing time taken was one year and nine months. The LIC of the INT advised that most of the time was spent by the Hong Kong Monetary Authority (“HKMA”) to vet the proposed application. The vetting by the HKMA was part and parcel of the application procedures for a RI to carry on the regulated activities. Throughout the process, the HKMA kept the LIC informed of the assessment progress via the HKMA’s monthly reports. The LIC advised that the applicant was aware of the roles played by the SFC and the HKMA in processing the RI application, and would not expect the SFC to expedite the processing work handled by the HKMA. In the circumstances, the LIC considered that it was not

practicable for the SFC to have full control over the handling of such kind of application.

### **§ PRP's recommendations**

4.47 PRP noted different actions taken by the subject teams when they worked on the cases that involved advice and input from other financial regulators. PRP reminded the SFC that it should ensure that it had maintained close working relationships with other financial regulators which provided input to the SFC's applications, and worked for the interests of the market participants.

### **§ SFC's responses**

4.48 The IPD advised that it had documented its communication with the MPFA at the early stage, which included the information that the MPFA would keep the IPD updated of its review process. That said, the IPD concurred with PRP's comments and would continue with its efforts to follow up with the MPFA on reviewing case progress on a monthly basis.

4.49 The LIC elaborated on the different statutory roles played by HKMA and the SFC in vetting a RI application to carry on regulated activities, and considered that the SFC would not have full control over the handling of licensing applications related to the RI. Senior staff of the LIC should continue meeting with its HKMA counterparts periodically to discuss matters of mutual interest, including the progress of a particular licensing application related to the RIs. In view of PRP's recommendations, the LIC issued internal reminder to its staff in August 2017, advising its staff to follow up with the HKMA case officers more closely on the progress of those applications which specific issues were noted in the HKMA's monthly reports or had been outstanding for a substantial period of time. The case officers should contact the HKMA case officers direct to understand more about the progress of the applications.

➤ *With Outside Advisors and Counsel*

4.50 In reviewing different enforcement cases, PRP observed that external counsel or advisers spent much time to provide legal opinions or expert views. In a case being reviewed, the ENF sought expert advice only at a mature stage of case investigation and the overall case processing time was further extended as the ENF had to wait for the expert advice. In another case being reviewed, the ENF had to wait for the report of the advisers engaged for the case on the internal control measures taken by the intermediary in order to assess whether the intermediary should be subject to disciplinary action. The overall processing time to complete these cases was lengthened as the SFC had to wait for these expert reports.

§ *PRP's recommendations*

4.51 PRP reminded the SFC to monitor the work of the relevant external parties providing assistance to it very closely. PRP advised that a waiting time of three to six weeks for a counsel or an expert to provide advice, though did not sound unreasonably long, might have detrimental effect on an investigation on financial market misconduct. A suspect could have siphoned off all of his assets within a very short period, and the financial market might have undergone drastic development within a week. The SFC should bear the above in mind and take active steps to follow up with the counsel and experts for their advice.

§ *SFC's responses*

4.52 The SFC advised that the delays caused by the external advisers were often due to factors beyond the SFC's control. These factors might include the discovery of unexpected issues, the unavailability of records required for the report, or a high number of control deficiencies identified by the external advisers, etc. Case officers had been reminded to monitor progress closely based on the

agreed timetable with the external advisors, and promptly escalate any delay to a more senior officer for advice and follow-up. The ENF case officers would also maintain frank and open dialogue with external advisers to ensure any issues causing delay could be resolved as early as possible.

4.53 In addition, the SFC expected that with the formation of the specialised team, the decisions on whether or not to appoint an external adviser would be made earlier in the future, and hence minimising the chances of late appointment as a cause of the delay.

4.54 To ensure the efficient use of the service of external counsel, the LSD would also regularly review the progress of all the cases that had been referred to the external counsel. The LSD set deadlines for external counsel to provide written advice and proactively follow up with external counsel to ensure that advice was provided within the expected time-frame. The LSD would continue to be proactive in managing external legal counsel.

### **§ *PRP's Concluding Remarks***

4.55 PRP noted the SFC's commitment to enhance its communication with various stakeholders and looked forward to the overall enhancement in the SFC's regulatory work as a result.





### C. *Leveraging Technology*

4.56 PRP commented that the SFC should better leverage the technology across its market surveillance system and its case management system so as to strengthen the effectiveness in detecting market misconduct activities and to improve the effectiveness in case monitoring.

#### *Enhancement of Market Surveillance System and Case Monitoring System in the ENF*

4.57 PRP recommended that the SFC should enhance its market surveillance system. An effective surveillance system would allow an early investigation towards the suspects, without the need to wait for the Stock Exchange of Hong Kong's ("SEHK") referral or to receive the complaints from members of the public. In the cases being reviewed, PRP asked if the SFC could have detected the irregularities through its surveillance system in the ENF.

#### *§ PRP's recommendations*

4.58 PRP studied a case about manipulation of the futures market. The SFC formally started its case when it received the SEHK's referral on the possible manipulation, which was some time after the suspicious trading had been done. Upon discussion with the SFC officers, PRP learnt that the SFC's surveillance system had not been able to detect such suspicious trading at the material time and hence it was not possible to start its formal investigation earlier.

4.59 In another case being reviewed, the SFC received a public complaint and commenced its investigation. It was revealed that a person had been conducting voluminous matched trades to create an

active trading environment with a view to inducing more trading from market participants. The person traded through two to three securities firms only and the trading volume of the stock was inflated more than 400% within a month. PRP commented that the extreme change in trading volume should have been an obvious signal of possible market manipulation. Upon discussion with the SFC officers, PRP learnt that the SFC's surveillance system had not been able to detect these matched trades at the material time. PRP suggested that the SFC should look into how it could enhance its surveillance system.

### § *SFC's responses*

#### ✧ *Market Surveillance System in the ENF*

4.60 The SFC had upgraded its market surveillance system in the past years. Currently, it had a real-time automated market surveillance system to generate real-time alerts in both the cash and futures markets separately or cross-market. Other than the ordinary price and/or volume alerts, the SFC had also designed pattern-specific alerts to detect different kinds of market malpractices, including matched trades carried out by a number of brokers. The SFC would take into account PRP's comments and constantly develop and enhance trade alerts and deploy new technologies in order to better detect any irregular trading activities.

#### ✧ *Case Monitoring System in the ENF*

4.61 In addition to the enhancements to the market surveillance system, as a part of the Strategic Review of the ENF, the ENF advised that it was developing an electronic "Case Management Dashboard". Some important case information had been extracted from its existing case management system to the "Case Management Dashboard" for the senior management to review and monitor case progress more effectively.

### *Case Monitoring System in the CFD*

4.62 PRP reviewed a takeover application that had taken a long time to complete. PRP noted that the case had remained dormant for seven months, when the CFD case officers should have checked the case progress for follow-up. The CFD case officers explained that there had been a human oversight in processing the case at the material time because the case officers were extremely busy and did not take timely follow-up action. The case team had subsequently made various attempts to contact the legal advisers to clarify the latest position of the application, and closed the case as the legal advisors of the applicant did not respond. The CFD case officers reported that certain measures had been put in place to prevent similar incidents from recurring in the future, including the generation of a weekly 30-day inactivity report in addition to the display of the case name on the computer dashboards of the case members.

4.63 In reviewing another case involving dual filing, PRP observed that the SFC had discovered that the SEHK had forgotten to send a document to the SFC. The SFC had, however, not taken the required follow-up. Upon discussion with the case officers, PRP was told that there was no formal case monitoring system in the CFD to bring up a case to check actions taken/required to be taken at major milestone dates. There was only an electronic case filing system in the CFD.

### **§** *PRP's recommendations*

4.64 PRP was told that apart from the reminder shown on the computer dashboard for cases which had been dormant for 30 days, the follow-up on cases being processed would rely on the case officers' own arrangement. PRP felt that there should be room for improvement in case monitoring. PRP commented that it was crucial to have an effective case monitoring system for the senior management to monitor progress. PRP further suggested that the CFD could consider setting

up an “escalating reminder system”. Under such a system, an alert would be sent to the case officers if an application case had remained inactive for five days. Further alerts would be sent to case officers and the case directors if the case had remained inactive for 15 days. Such a systematic reminder arrangement would help senior management monitor the progress of case handling and avoid oversight by case officers particularly during the latter’s peak working season.

4.65 In respect of the dual filing for listing applications, PRP was informed that the SFC had an electronic filing system which provided alerts to the CFD case officers only when the six-month application time was over. In this connection, PRP reiterated that there should be a proper case monitoring system that provided alerts on important dates, such as bringing up the case to keep in view the result of the SEHK’s hearing on an application, for necessary follow-up.

### § *SFC’s responses*

4.66 The CFD reported that since the launch of CF-CMS in November 2014, the name of a case that had been dormant for 30 days would appear on the team members’ dashboard (including that of the case director). In addition, the CFD had worked with the IT Department to develop a new function in the system for generating team-wide inactivity reports. Through this new function, a team-wide inactivity report which contained a full list of all takeovers matters that had been inactive for a specified number of days would be created. The new function was rolled out in May 2017. The CFD also continued circulating on a weekly basis the 30-day inactivity report.

4.67 Regarding an escalating reminder system, the CFD advised that its case officers already set up reminders on a case-by-case basis to ensure that a case would be dealt with promptly. Together with the IT Department, the CFD introduced a new function in its CF-CMS in May 2017, which prompted a case officer to consider setting up a reminder deadline whenever a document was electronically filed. The case officer would exercise his/her judgement as to when a reminder



was needed, and if so, the duration, based on the nature and circumstances of the cases.

4.68 The electronic filing system could also generate a real time report setting out the latest status of the outstanding cases and highlighting those dual filing cases which the CFD had not issued a response before the deadlines.

### *Staff Training on Fintech*

4.69 PRP reviewed two different cases, and arrived at the same conclusion for both. The conclusion was that the SFC should provide adequate training to its case officers on the development of innovative products and financial technology in the market.

4.70 One of the cases reviewed related to the investigation conducted by the ENF on an intermediary's compliance of rules in running its dark pool business in the past two years. The investigation started in 2012 and took four years and five months to complete. The long processing time was attributed not only to the complexity of the case, but also to the need for the SFC's staff to understand the operation of the dark pool business so as to carry out the investigation and decide on the disciplinary action.

4.71 The other case review related to a complaint against the ISD's handling of a compliance issue of certain options under the Financial Resources Rules ("FRR"). The complainant alleged that the case officers of the ISD fell short of the professional standard to understand the concept of the options and how the FRR should be applied to this kind of products. The complainant further alleged that the ISD had not studied the options documents that the licensed corporation had prepared, and simply asked the company to engage an independent advisor (at the cost of the licensed corporation) to provide independent views on the compliance issue. The licensed corporation subsequently ceased its business on the options.

### § *PRP's recommendations*

4.72 PRP commented that the SFC case officers should be provided with training on the latest financial technology and new products in the market. The training was important for the SFC to set an appropriate market standard for such products and to process any application in relation thereto, as well as to carry out investigation in an effective manner.

### § *SFC's responses*

4.73 As part of the SFC's commitment to their staff, and to assist them to stay relevant to their jobs, the SFC always encouraged staff to participate in relevant training throughout their career with the SFC.

4.74 For the two-year period from April 2015 to April 2017, the SFC had arranged 14 local and overseas training sessions on Fintech for its staff. Examples included "*Algorithmic Trading Systems and Cybersecurity*", "*Information Security Trend on FinTech*" and "*Global FinTech Innovation*". There would be more training sessions on Fintech for the SFC staff in 2017.

### § *PRP's Concluding Remarks*

4.75 PRP noted the SFC's responses. PRP reiterated that leveraging the technology was important to uphold market integrity, manage the SFC's caseload and facilitate market development.





#### ***D. Reviewing Guidelines and Putting in place Pledges***

4.76 The SFC had drawn up performance pledges, guidelines and procedures to assist its staff to process different cases, and its applicants to prepare for the submission of various applications. PRP reviewed the procedures taken by the SFC in handling different applications. Based on its findings and observations, PRP invited the SFC to update their guidelines and procedures, as well as to put in place new performance pledges to enhance efficiency and transparency.

#### ***Performance Pledges and Guidelines in the CFD***

4.77 As stated in its previous Annual Report <sup>4</sup>, PRP recommended the CFD to formulate performance pledges for different types of application. This would enhance the timeliness of the processing of the cases and the transparency of the work of the division.

4.78 PRP learnt from the case officers of the CFD that there were only internal guidelines requiring the staff to respond to the applicants within five business days for each round of enquiry. Staff generally followed this rule well. The CFD responded that the processing time of an application depended much on the time taken by the applicant to provide all the necessary information for the application, instead of the time taken by the CFD officers for processing the application.

#### ***§ PRP recommendations***

4.79 PRP reviewed a case on a takeover and mergers transaction. The processing time of the case was reported to be one and a half year.

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<sup>4</sup> Source : PRP Annual Report for 2015-16 (Para 4.4.6 – 4.4.13)

The unexpectedly long processing time was caused by a human oversight as the case had been left unattended for over half a year. PRP suggested that the CFD should review the control measures in implementing the five-business-day rule and the adequacy of the guidelines on case monitoring. PRP also reiterated its proposal that the CFD should draw up performance pledges for the handling of various types of applications.

### § *SFC's responses*

4.80 The CFD reported on the following new measures –

- (a) With effect from July 2015, the CFD had been circulating a reminder on monthly basis reminding all team members to close cases. Since September 2016, senior management and all members of the Takeovers Team of the CFD had been receiving a weekly case list of all inactive cases to help them keep track of the situation;
- (b) In December 2016, the CFD drew up a set of performance pledges on the Takeovers Team's work relating to the applications and related documents under the Takeovers Code and Share Buy-backs Code<sup>5</sup>; and
- (c) In May 2017, the CFD introduced a new function to prompt case officers to consider setting a reminder in the CF-CMS.

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<sup>5</sup> The pledges were available on the Takeovers section of the SFC's website (<http://www.sfc.hk/web/EN/about-the-sfc/corporate-governance/performance-pledges.html>)

### *Application Lapse Period Policy in the CFD*

4.81 PRP reviewed an application seeking exemption of disclosure of interests in the securities of a listed company under section 309(2) of the Securities and Futures Ordinance (Chapter 571) (“SFO”). The overall processing time took nearly one year, including an 11-month waiting period for the applicant to confirm the date of listing and submit the required information. While it was inevitable that the CFD had to wait for the applicant to submit outstanding information, PRP considered that it would be better if the CFD would take a proactive step by introducing an application lapse period policy to applications handled by the CFD. This had proven to be a very effective policy in the IPD to expedite the submission of the information by applicants requesting for fund authorisation.

### *§ SFC’s responses*

4.82 The CFD was contemplating an application lapse period policy for exemption applications under Part XV of the SFO (Disclosure of Interests).

### *Guidelines on Quality required in Licensing Applications*

4.83 PRP reviewed a corporate licensing application. PRP was told that the case being reviewed was a second application from the firm, the first one of which was submitted six months ago but was returned to the applicant by the LIC in view of the poor quality of the application. Notwithstanding the LIC had listed out all outstanding information when it returned the first application, the firm made the second application in sub-standard quality again without providing the essential information. The LIC accepted the application this time but had to spend a lot of time and resources to process the case, including making multiple rounds of requisition to the applicant asking for supporting documents. In this connection, PRP asked the SFC to elaborate on its criteria when an application should be returned to the

applicant.

4.84 PRP also reviewed an application in which the applicant was found to have provided the required information in a piecemeal fashion, resulting in difficulties by the LIC in processing the application.

### § *PRP recommendations*

4.85 PRP recommended the LIC to -

- (a) provide a comprehensive checklist of the required documents for each type of application. An applicant should be asked to countercheck its application against the checklist and should confirm the availability of all the required documents before submitting the application to the SFC; and
- (b) stipulate and enforce the rule that applications without the requisite information would be returned to the applicant.

### § *SFC's responses*

4.86 The SFC reviewed its guidelines on the “Return of Applications”. The revised guidelines were stipulated in the Licensing Handbook, the latest version of which was published on 21 April 2017. It was stated in the handbook that the SFC might return a licensing application if it was incomplete or had unresolved fundamental issues. There were examples illustrating the situations whereby the applications would be returned.

4.87 The SFC also updated the information on its website to provide more guidance on how to apply for a licence.

### *Monitoring the Progress of Licensing Applications*

4.88 PRP reviewed nine licensing applications for different types of regulated activities in the year. The processing time of the cases ranged from seven months to seven years and one month. For all these cases being reviewed, PRP raised concerns about how the case officers, their supervisors and the senior management had monitored the case progress. Noting that a number of cases being reviewed had taken longer than the SFC's performance pledge to complete, PRP asked how these outstanding cases had been monitored by the senior management.

#### *§ PRP's recommendation*

4.89 PRP recommended that the LIC should enhance its monitoring of the processing of licensing applications. Specifically, the senior management should be informed of the status of the outstanding applications so that they could provide timely guidance to the case officers if necessary, and ensure that appropriate resources were allocated for effective processing of the applications.

#### *§ SFC's responses*

4.90 The LIC had a system that generated reports for the monitoring by its management on a bi-weekly basis. In addition, the LIC prepared a report summarising all long outstanding cases which would be presented at the LIC's management meeting for discussion on a monthly basis. The report was also circulated to the INT Divisional Head for review.

4.91 In addition to the above, the LIC advised that it was reviewing and working on a risk assessment approach with a view to identifying the potential risk areas of an application at an early stage. After the assessment, the application would be assigned to staff with appropriate knowledge and experience for handling. Applications that were more complex in nature would be brought to the attention of

Licensing Directors for closer monitoring and guidance. The LIC considered that the new mechanism would help ensure more resources would be allocated to the complex cases.

**§ PRP's Concluding Remarks**

4.92 PRP was pleased to note that the CFD had promulgated performance pledges on the turnaround time to respond to the applicants and encouraged the division to formulate pledges on the time for completion of an application. PRP also looked forward to more efficient processing of licensing applications upon the implementation of the new strategy adopted by the senior management.







### *E. Enhancing Transparency in Complaint Handling*

4.93 During the year, PRP spent much time reviewing completed complaint cases handled by the various divisions of the SFC. Same as other regulatory organisations, the SFC has been receiving complaints from various sources, including its licensees, professional commentators, Legislative Council Members and the public. Some complainants had provided details of the allegations and their contacts so that the SFC could get more information for investigation while some were anonymous. For cases being reviewed in the year, PRP found that upon receiving one complaint referral, different divisions within the SFC had been involved in handling the case covering the respective ambit of the division at different stages. For example, a complaint against a licensee would first be handled by the External Relations Department (“ER”), and then by other operational divisions and potentially the ENF for a decision on the disciplinary action. The overall processing time of one complaint case could take several years. In another case being reviewed in the year, the handling of the complaint was also complicated by civil litigation commenced during the investigation period, and the processing of the complaint case had lasted seven years. Furthermore, PRP found that it was not uncommon that the same complainant would submit repeated complaints to the SFC on similar issues. In one case being reviewed, PRP noted that a complainant had sent 11 complaint letters to the SFC within an 11-month period on the suspension of trading of a listed company. Both the ER and the CFD were involved in providing the replies to each of the complaint letters.

4.94 PRP understood that the SFC had published two sets of procedures, one focused on handling complaints against intermediaries and market activities and the other against the SFC or its employees.

Both procedures had been revamped and put in force since 2014<sup>6</sup>. When reviewing the complaint cases, PRP considered how the procedures could have enhanced the complaint handling in the above circumstances.

### *Effective Communication*

4.95 PRP reviewed a handful of complaint cases in the year. PRP noted a common problem in these cases was a lack of effective communication between the SFC and complainants during the process. As a result, the complainants felt being ignored, unfairly treated, and very aggrieved by the SFC's response. They would often escalate the complaints to the Chairman of the SFC or sought assistance from Legislative Council Members. In one case being reviewed, the principal of a licence applicant commenced legal proceedings against the SFC during the process of his/her application and the complaint investigation. The SFC had to hold up the application until the legal action was concluded. The SFC had taken over seven years to conclude this licensing application and the complaint investigation.

### *§ PRP's recommendations*

4.96 PRP pointed out some current practices in the SFC, which if changed, would help improve the communication and facilitate the work. Examples included setting out written internal guidelines on the timeframe for the SFC to respond to a licensing applicant, and providing more information in the replies so that a complainant could better understand the follow-up action taken by the SFC in dealing with his/her complaint. PRP also pointed out that the SFC's standard reply to complainants in relation to complaints against the SFC or its employees, which was stated in the SFC complaint handling procedures,

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<sup>6</sup> The two sets of procedures in handling complaints against intermediaries and market activities and against the SFC or its employees were revamped from three sets of complaints procedures previously used by the SFC. (Source : PRP Annual Report for 2014-15)

lacked the essential information including whether the SFC had handled the complaint as one against the SFC or against its staff<sup>7</sup>. The two types of complaints involved different handling procedures and decision-making level. The SFC should review its reply and consider explaining in a reply the set of complaint handling procedures which the SFC had applied in the investigation. This would enhance the transparency of how a complaint was being handled.

### § *SFC's responses*

4.97 The LIC had developed internal guidelines on how to handle applications which were put on hold due to legal proceedings. The guidelines covered timely escalation of the matters to senior management, as well as seeking legal advice on the appropriate way forward and the necessary communication with the applicants regarding the application status.

4.98 The CEO of the SFC would normally be consulted on the proposed classification of a complaint against the SFC or its employees. Although the SFC did not think it would be meaningful to inform the complainant which set of the complaint handling procedures it had applied at the early stage of investigation (which could change as new information emerged), the SFC considered that it was more important to set out the rationale of the SFC's decision in the final reply to the complainant, which would normally indicate whether the complaint had been treated as one against the SFC or its employees.

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<sup>7</sup> The relevant procedures are set out on the SFC's website (<http://www.sfc.hk/web/EN/lodge-a-complaint/against-the-sfc/>).

### *Reply to the Complainant*

4.99 In one case review, PRP noted that the complainant was not satisfied with the SFC's reply. The complainant said that he had made a complaint to the SFC against an intermediary in January 2012 and received a reply from the SFC in June 2012, stating that "...we have taken appropriate action on the matter. We are restrained by secrecy provision... accordingly we are not in a position to disclose further information". The complainant was not satisfied that the SFC had not told him the outcome of the SFC's investigation on the intermediary, and escalated the matter to the Chairman of the SFC as well as sought assistance from Legislative Council Members.

### **§** *PRP's recommendations*

4.100 PRP held several case review meetings to study the complaint case when the SFC closed the case in 2016. PRP noted that the SFC had generally followed its operational guidelines and procedures in processing the case. PRP enquired how the case, which took place in 2012, had been handled by the ER and different operational divisions, as well as how the case had been monitored by the CCC at the material time. While PRP noted that the SFC had enhanced its complaint handling procedures in 2014 and that all operational divisions were now requested to provide a brief explanation of their assessments to the complainant in the reply, PRP made further comment that the SFC should provide as much information to the complainant as possible.

4.101 PRP suggested that as the first contact point with the complainant, the ER might help the complainant provide more detailed information on his allegation. PRP was also of the view that the operational division responsible for complaint investigation should take more initiative to contact the complainant directly if the division considered that further evidence from the complainant would be helpful. The operational division might also invite the complainant to confirm if he had any more information to supplement before the

division concluded its investigation. This might save resources to reactivate the investigation when the complainant provided new information shortly after the SFC had completed its investigation.

### **§ SFC's responses**

4.102 The SFC undertook to continue to strike a good balance between the secrecy provision and the complainants' expectation to be kept informed.

4.103 The SFC also advised that its operational divisions would not refrain from contacting the complainants. Whether an operational division would contact a complainant for information, or rely solely on the ER to collect the information, would be subject to the judgement of the case officers of the operational division. For the case being reviewed, the SFC had considered the documents and information gathered from the complainant and the target through various channels including physical meeting, telephone conversations and written correspondences before concluding its review. In the course of following up with the complaint, the complainant had also been reminded to write to the SFC again if he had any additional information regarding the complaint. It was not until more than one year after the SFC had concluded the case did the complainant provide new information to the SFC to review the complaint again.

4.104 The SFC took note of PRP's comments on its complaint handling and would continue to look for room for improvement in its complaint handling procedures.

### ***Coordination of Complaint Handling***

4.105 PRP noted that the ER of the SFC would co-ordinate all complaint cases (except complaints against SFC and its staff) received by the SFC for the review by the CCC. After the CCC had reviewed the complaint and decided that the case warranted the SFC's further

assessment, the CCC would pass the case to the relevant operational division for handling and replying the complainant. The CCC would not ask the operational divisions to report their investigation progress. In this connection, PRP invited the SFC to put in places measures to monitor the progress of complaint handling by the operational divisions, for example by assigning the CCC to do so.

4.106 PRP appreciated the CCC's coordinating role in complaint handling. The CCC took the initial step to assess whether a complaint warranted further investigation and thereby ensured an effective use of the SFC staff resources for the subsequent investigation. PRP commented that with the introduction of the "One-SFC" approach, whereby operating divisions responsible for intermediaries, enforcement and listing matters had pooled their expertise to form cross-divisional working groups, the SFC might consider involving the ER in the "One-SFC" approach in coordinating the complaint investigation by different divisions to ensure an effective handling of the cases.

4.107 PRP noted that for several cases being reviewed, the operational divisions had overlooked the procedures to close the complaint cases. In one case handled by the Corporate Regulation Team of the CFD, the case was closed in the SFC complaint system after the investigation had been completed for one and a half years. The SFC explained that this was due to a human oversight in the communication between the ER and the CFD. In another complaint case investigated by the LIC, the case was closed after the investigation had been completed for six years. The SFC again explained that the belated case closing was due to an oversight.

### **§ PRP's recommendations**

4.108 PRP enquired the measures taken by the SFC in monitoring the investigation on complaint cases. PRP commented that the SFC should review its internal communication procedures and take effective measures to avoid a recurrence of the above incidents. PRP also learnt

that the SFC had developed a new complaint case management system that provided access for the staff members of the operational divisions to close their cases in the system. PRP recommended that the SFC should provide sufficient training to its staff on the operation of the new system and how the system could help the case officers to manage the case progress.

### § *SFC's responses*

4.109 The SFC reiterated that the CCC was an internal committee to facilitate the allocation of complaints to the operational divisions for further assessment based on their expertise. The SFC believed that it was more efficient for the operational divisions to which the cases were allocated to be tasked to keep track of the progress of the investigation. This would avoid unnecessary reporting procedures by the operational divisions to the CCC. Notwithstanding the above, the Commission Secretariat was leading a process of reviewing the divisional complaint handling procedures with a view to clarifying the division of labour and strengthening management oversight of case progress so that the cases being allocated to and handled by the operational divisions could be processed effectively.

4.110 The revised divisional complaint handling procedures would better delineate the responsibilities for complaint handling and provide clarity about the expectations on the operational divisions. As an additional management oversight, the revised procedures aimed to provide for a "bring-up" report that would be sent to the Executive Director of the relevant Division for complaints that had been outstanding for more than six months upon case allocation by the CCC. The "bring-up" report for all Divisions would also be reported to the SFC's Executive Committee on a quarterly basis.

4.111 The SFC also supplemented that a new system, "Complaints Control System" ("CCS"), was launched in March 2016. Under the CCS, the operational divisions could view the progress of the complaint cases and were responsible to close the cases in the system

upon completion. The enhanced transparency of the CCS should prevent belated case closing in future.

4.112 Upon the launch of CCS, the SFC had provided training to all divisions about the features of CCS. A user manual had also been prepared for all staff.

### *Handling Repeated and Anonymous Complaints*

4.113 PRP appreciated that different divisions within the SFC had spent a vast amount of resources in handling complaints. Some complaints revealed areas of improvement in the brokerage industry and as a result, the SFC took proper disciplinary measures to uphold the market integrity. However, PRP noted that out of the nine complaint cases being reviewed in the year, five cases involved repeated complaints, anonymous complaints or complaints lacking in substance. The SFC had taken cautious steps in investigating all these cases and spent much effort gathering the facts during the investigation. In this connection, PRP raised its concern on the –

- (a) resources spent by the SFC in handling the complaints, in particular complaints that lacked substance or were anonymous such that the SFC had to devote extra resources in the investigation owing to the limited information available; and
- (b) measures taken by the SFC to avoid its complaint channel from being abused by persons in lodging vexatious complaints.

4.114 PRP enquired how the SFC would decide whether the complaints warranted further investigation. In case where the complainant provided only limited information, how would the SFC decide whether the case should be pursued or not. In case of the complainant lodging repeated complaints, how would the SFC decide whether investigation of the same issue should be undertaken.



## § *PRP's recommendations*

- 4.115 PRP recommended that the SFC should consider –
- (a) educating the public on the importance of providing sufficient information and contact details when making enquiries or complaints. Request without the details might not be processed;
  - (b) imposing measures to avoid the abuse of the complaint mechanism of the SFC. For example, the SFC might consider assigning a repeated complaint to a different team for investigation. This would serve as checks and balances to ensure that all the issues raised in the complaint had been thoroughly considered and fully addressed. When a repeated complaint had been investigated by different teams in the division, subject to the evaluation by an officer at an appropriate level, the SFC should take no further action to investigate the repeated complaint in the future; and
  - (c) how the current complaint procedures on the definition and handling of “persistent complainant” could be enhanced to ensure that the SFC could deploy its resources in investigating genuine complaints.

## § *SFC's responses*

4.116 The SFC always encouraged complainants to provide more information to the SFC to facilitate its investigation on the allegations.

4.117 The SFC had reminded complainants to provide full details of their complaints and relevant documents that would help the SFC assess their complaints. The message was clearly promulgated on the SFC's website. If the complainants could not provide the information or evidence required for the SFC to follow up, the SFC might not be able

to proceed with the case and would reallocate its resources to cases which could be substantiated by more information.

4.118 The SFC also advised that for repeated complaints with no new substantial information, the division responsible for investigation could submit an Evaluation Sheet which stated its decision that no further action was deemed necessary to the CCC for consideration.

4.119 According to the Procedures for Complaint Handling, the SFC had an established procedure for dealing with “persistent complainant” i.e. complainants who were unwilling to accept the SFC’s decision on his/her complaint, and continued to approach the SFC without making any new allegation or providing substantial new information. The SFC would seek its Executive Committee’s endorsement to classify a complainant as a “persistent complainant”, upon which the SFC would issue a standardised final reply. It would not take further action on his/her complaints afterwards.

4.120 The SFC took a prudent approach in classifying someone as a “persistent complainant”, and would not do so simply because someone approached the SFC a few times urging for a review of his/her previous complaint. The SFC had been trying its best to explain its decision to the complainants; and in most cases, the complainants were satisfied with the SFC’s further explanation.

4.121 The SFC considered that the current practice in classifying a “persistent complaint” had generally worked well.

### **§ PRP’s Concluding Remarks**

4.122 PRP noted the SFC’s responses and looked forward to the result of the SFC’s review on the divisional complaint handling procedures.





## *F. Supervising Intermediaries*

### *Measures to Ensure Effectiveness of Inspections*

4.123 PRP reviewed nine cases related to inspections or visits to LCs conducted by the SFC. Same as the recommendations made in 2015-16 (*as set out in Chapter 3*), PRP pointed out that the ISD should review its measures in its inspections with a view to ensuring the effectiveness of the inspection in identifying irregularities. The measures should include, but not limited to, the follow-up action taken by the ISD before it issued closure letters. The ISD was also advised to expedite the inspection process with a view to improving the overall efficiency of supervision of intermediaries.

#### *§ PRP's recommendations*

4.124 PRP learnt that it was the practice to leave it to the inspection team to decide when the ISD should issue closure letter after the inspection. PRP asked the ISD to establish a formal checking system to ensure that all remedial actions were completed to an acceptable standard before the inspection team issued the closure letters.

#### *§ SFC's responses*

4.125 The ISD explained that it had adopted various measures to ensure the effectiveness of the inspections. They included –

- (a) development of inspection checklists to provide internal guidance for the different teams;
- (b) provision of training and sharing sessions;

- (c) review of inspection files and draft letters by senior management; and
- (d) establishment of the Inspection Activities Management System (“IAMS”) which was a case management system of the ISD to monitor the process of inspections.

The effectiveness of these measures would be subject to periodic review.

4.126 The ISD also reported that it had clearly stated in its letter of deficiencies to an inspected firm that the firm had to confirm in writing to the SFC its proposed remedial actions and the estimated time to complete such actions.

4.127 The ISD would issue a closure letter to the inspected firm to conclude the inspection only when the rectification steps were sufficient to properly rectify the major breaches and address significant systemic risks identified in the inspection. If not, the ISD would advise the firm to take further action and the issue of closure letter to it would be held up.

4.128 In going through the above procedures, the ISD advised that there was a two-tiered control –

- (a) Inspection Managers or Assistant Managers were responsible for following up and evaluating the sufficiency of the remedial actions; and
- (b) Case Senior Managers or Associate Directors were responsible for checking the evaluation and deciding whether a closure letter could be issued.

4.129 Even though no deadline was stipulated for the issue of closure letters, the SFC would complete the follow-up work as soon as reasonably practicable. For effective monitoring of inspection cases for which the issue of closure letters had remained outstanding for more than six months after the letter of deficiencies had been issued, the IAMS would generate alert reports for management on a bi-weekly basis. In addition, the Senior Managers or Associate Directors working on the case would

provide update on the current status of the follow-up work for those cases and discuss ways to expedite the completion of the cases at the ISD monthly internal meeting.

### *Risk-based Inspection Targeting Process*

#### *§ PRP's enquiries*

4.130 PRP enquired how the ISD had prioritised the cases under its risk-based approach for inspection and subsequent monitoring. PRP also asked how the ISD had -

- (a) prepared its inspection schedule for the inspection teams; and
- (b) updated the prepared inspection schedule. Specifically, PRP would like to know how frequent the centralised team responsible for preparing the inspection schedule would consult other divisions for updating the inspection schedule.

#### *§ SFC's responses*

4.131 In assessing the risk level of an intermediary, the ISD took into account various factors and information, including self-reported breach or misconduct of the intermediary or its licensed person. When the ENF considered that the intermediary or the licensed person was possibly guilty of misconduct, or not fit and proper, the INT also took the information into account in assessing the risk level of the intermediary. In general, an intermediary with higher risk and significant presence and impact in the market would be given a higher priority for on-site inspections. Similarly, more intense off-site monitoring might be performed on an intermediary with higher risk, e.g. obtaining regular update of the intermediary's implementation of enhanced control procedures, requesting for client complaint records and making follow-up enquiries.

4.132 The ISD's risk-based inspection targeting process was handled by a centralised team. The team was tasked to identify the inspection priorities, determine whether routine, thematic or special inspections should be conducted, and prepare a list of inspection targets. Currently, inspection priorities setting was carried out annually, and inspection targets were selected at semi-annual intervals.

4.133 The identification of the overall inspection priorities would take into consideration the trends and the emerging risks in the market. Other SFC divisions and departments were also invited to provide inputs on possible inspection priorities for consideration. For example, when identifying the inspection priorities for 2016/2017, the CFD suggested looking into the placing of Growth Enterprise Market Initial Public Offerings ("GEM IPO") in light of the volatility of many of the GEM IPOs listed by placing only. As a result, the ISD conducted a thematic inspection of placing agents that were involved in a particular GEM IPO placing as identified by the CFD. The ISD also conducted inspections on placing agents of unlisted corporate warrants based on the CFD's inputs.

4.134 In deciding the level of supervision required for a LC, the ISD would make reference to the risk and impact assessment of the LC, or its relevance to a thematic area that had been identified as an inspection priority, having regard to different sources of information about the LC either maintained within the ISD (e.g. financial data provided by the LC and compliance history) or provided by other divisions / departments (e.g. disciplinary actions taken by the ENF, complaints lodged by clients).

### *Front-loaded Regulatory Approach*

#### *§ PRP's enquiries*

4.135 PRP was informed that the SFC had reviewed its work priorities and strategies in supervising the intermediaries. PRP invited the SFC to elaborate on its latest regulatory approach, especially on the new policy on inspection of intermediaries.

## § *SFC's responses*

4.136 The SFC explained that the emphasis of its regulatory approach was on front-loaded regulation, thematic reviews and transparency etc. The SFC would arrange more thematic reviews to address specific and more complex risks in the market. For example, thematic inspections on issues ranging from selling practices of Chapter 37 bonds to alternative liquidity pools, best execution and client facilitation, anti-money laundering, placing of GEM IPO stocks and cybersecurity were carried out in the past year.

4.137 The SFC also placed emphasis on changing behaviour through signalling to the industry the focuses of its inspections and the proper standards of behaviour. For example, the SFC notified the industry in October 2016 that it would conduct a cybersecurity thematic review on the brokers' internet or mobile trading systems, and set out the common deficiencies and vulnerabilities that the SFC would focus.

4.138 Lastly, the SFC pointed out that supervision of intermediaries also called for transparency by providing the industry with the necessary guidance and clarification, as well as increasing the industry awareness and supporting their efforts to comply with the regulatory requirements. In the past year, the SFC issued circulars and hosted or participated in workshops on different regulatory topics with an aim to achieving the above goals.

## § *PRP's Concluding Remarks*

4.139 Over the years, PRP has raised much concern on the SFC's effectiveness in supervising the intermediaries. PRP was pleased to note the ISD's review in this year, including its new strategy and control measures. PRP looked forward to the effective implementation of the new strategy.

## Chapter 5 Way Forward

5.1 In the year ahead, PRP would continue its work with a view to ensuring that the SFC adheres to its internal procedures for consistency and fairness.

5.2 PRP welcomes and attaches great importance to the views from market practitioners. Comments on the work under PRP's terms of reference can be referred to PRP through the following channels<sup>8</sup>-

By post to: The 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](mailto:prp@fstb.gov.hk)

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<sup>8</sup> 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](mailto:enquiry@sfc.hk) (for general enquiries, comments and suggestions,  
etc.)  
: [complaint@sfc.hk](mailto:complaint@sfc.hk) (for public complaints)



## **Chapter 6      Acknowledgement**

6.1            PRP would like to express its gratitude to the support and corporation of the SFC in the review work. Special thanks must go to the Senior Director, Commission Secretary Mr Paul YEUNG and his team, for their assistance in facilitating the review work and in coordinating the responses from different divisions within the SFC.

**Process Review Panel  
for the Securities and Futures Commission  
October 2017**