

Annual Report

Process Review Panel for the Securities and Futures Commission

2018-19

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Abbreviations used in this Report

CFD	Corporate Finance Division
DoJ	Department of Justice
ENF	Enforcement Division
ESC	Enforcement Steering Committee
HKP	Hong Kong Police
IMMD	Immigration Department
IMT	Intermediaries Misconduct Team
ISD	Intermediaries Supervision Department
LIC	Licensing Department
Listing Rules	Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited
LOM	Letter of Mindedness
LSD	Legal Services Division
MOU	Memorandum of Understanding
NED	Non-executive Director
NFA	No Further Action
PRP	Process Review Panel for the Securities and Futures Commission
RO	Responsible Officer
SFC	Securities and Futures Commission
SFO	Securities and Futures Ordinance

Message from the Chairman

This is my first message for the Annual Report since I took up PRP's chairmanship in November 2018. I am delighted to have had the opportunity to serve the public in leading PRP to support the Government's resolve to enhance the transparency of the SFC's operations and ensure that the SFC exercises its regulatory powers in a fair and consistent manner by reviewing the internal operational procedures of the SFC. I am infused with a sense of mission in taking up this job.

This year, PRP continued to hold fruitful case review meetings with the SFC through which, and the subsequent PRP's full meetings, recommendations on areas for the SFC's improvement in terms of its process and procedures were drawn up. I am indebted to my predecessor, Dr Moses Cheng, for the solid foundation he has laid down for me to carry on the work of PRP. Dr Cheng had established and maintained an effective communication channel and adopted a collaborative approach with the SFC, which facilitated PRP's recommendations and comments to be deliberated within the SFC smoothly.

In recent years, the SFC had made various initiatives to revamp its process and procedures in areas such as enforcement, licensing and investment products with a view to enhancing operational efficiency and transparency as well as making better use of resources. I am pleased to note that PRP's recommendations to the SFC had played a part in this regard. Indeed, in a number of enforcement cases reviewed this year, PRP noted how the investigation process of these cases handled before the ENF's Strategic Review could have been expedited and refined by the new measures taken pursuant to the Strategic Review. We look forward to seeing improvements made in the various revamped processes in future case reviews.

Message from the Chairman (continued)

In acknowledging the revamping efforts made by the SFC, PRP has been mindful of market expectations and the ultimate objective of the SFC to safeguard the interests of investors. So in this year's case review, much of PRP's attention was drawn to the front-loaded regulatory approach introduced by the SFC in 2017, which is characterized by a more proactive approach for the SFC to take early intervention in market irregularities. We were cautious about the industry and other stakeholders' response to this new regulatory approach and how this might bring about possible negative impact on normal market operation. On this front, we have conveyed our concerns to the SFC and would be happy to see the success of the front-loaded regulation in deterring and minimising fraud and market misconduct while minimizing any of its possible side impact.

In balancing between the interests of market practitioners who are subject to the SFC's investigation to know the result of its investigation as soon as practicable and the SFC's tendency, we have also conveyed our concern over the SFC's fairness and transparency in making such notifications of investigation results for cases bundled for investigation where multiple parties are being investigated. We hope in conveying these concerns and making relevant recommendations to the SFC, we would help the SFC to further promote fair processes and accountability in the way they carry out their work.

PRP fully appreciates the caseload and the resources issues faced by the SFC. We hope that our recommendations could continue help streamlining the workflow of the SFC and enable the SFC to perform in an ever-improving manner.

Message from Chairman (continued)

On smooth completion of this year's work, I wish to thank all fellow Members for their devotion of time and efforts, in particular, in studying the case summaries provided by the SFC in conjunction with the operational manuals of respective divisions of the SFC for making fruitful case discussions and recommendations on areas for the SFC's improvement under PRP's terms of reference. I would also like to thank the Secretary for the Financial Services and the Treasury and his staff for their support to PRP.

While over half of the Members are new to PRP's work upon taking up their role in late-2018, I am pleased to witness a smooth beginning of the new term of PRP. In the years ahead, we will continue to bring issues and concerns to the SFC's attention in working towards our ultimate and common objectives of maintaining the fairness and competitiveness of Hong Kong's financial markets.

Lee Kam Hung Lawrence, BBS, JP

Chairman

Executive Summary

In 2018-19, PRP reviewed 60 cases selected from the monthly closed case lists submitted by the SFC.

2. PRP conducted comprehensive deliberation and discussion on each case being reviewed. PRP made practical recommendations to the SFC for enhancement of its processes and procedures. PRP's recommendations (as highlighted inside box frame) and the SFC's response are summarized below -

Front-loaded Regulatory Approach

- ✧ PRP reminded the SFC that in its attempt to address issues as early as possible under the front-loaded regulatory approach, there were possibilities that actions taken by the SFC might interfere with normal market operation.
- ✧ The SFC should stay alert to any possible unintended effects of the front-loaded approach and consider ways to minimize any such effects.

3. PRP welcomed the front-loaded regulatory approach adopted by the SFC since 2017, which enables it to act proactively in response to market irregularities by taking more targeted intervention and focusing on the more serious breach of the rules and regulations. In reviewing the cases relating to corporate finance during the year, PRP had given particular regard to the effect of this new regulatory approach. It was observed that whilst the SFC's early intervention helped to deter and tackle market misconduct, its direct intervention in normal market operation might possibly lead to unintended effects preventing reasonable and fair transactions and market activities from taking place.

4. Section 179 of the SFO empowers the SFC to compel the production of records and documents from persons related to a listed

company in relation to fraud or other misconduct. While PRP noted from the cases reviewed that there was no restriction on the number of requisitions issued by the CFD, PRP drew the SFC's attention to how such requisitions might possibly negatively affect a normal market activity. For example, a potential takeover based upon an agreement between the relevant parties to materialize the transaction as early as possible might take longer time than expected or even fail to be completed within the agreed timeframe as a result of the lapse of time in responding to the SFC's requisitions.

5. In anticipation of an uptrend of the SFC's early intervention in market irregularities, PRP recommended the SFC to closely monitor any possible unintended effects of such actions on normal market operation and consider ways to minimize these.

Cooperation between the SFC and the IMMD

- ✧ The SFC should consider signing an MOU with the IMMD given the close collaboration between various divisions of the SFC with the IMMD.

6. PRP considered it a fundamental issue to the SFC to maintain close collaboration with the IMMD with respect to its investigations involving expatriates and cross-border misconduct as well as processing of licensing applications involving working visas. In view that there had been noticeable improvement in the working process of provision of legal advice upon the SFC's signing of an MOU with the DoJ in 2016, PRP recommended the SFC to sign an MOU with the IMMD to formalize and enhance their cooperation.

7. The SFC advised that cooperation between the ENF and the IMMD relates to movement records to a large extent. For this, the SFC had had established practice to streamline the process. For enforcement cases as a whole, there are also clear and established communication channels between the ENF and the IMMD. In the case of licensing applications, the SFC considered that it is the applicants' responsibilities to ensure that they can legitimately work in Hong Kong with a working visa.

So instead of signing an MOU with the IMMD, the LIC has revised its Licensing Handbook which provided more guidance in the area concerning working visa.

8. Overall, the SFC found its cooperation with the IMMD effective and smooth and did not find an MOU necessary at this stage.

9. PRP was delighted to note that the SFC had taken a step forward to strengthen the mutual communication by establishing central contact points with the IMMD. While it is accepted that the signing of an MOU with the IMMD is a matter for the SFC, PRP asked the SFC to keep an open mind on this recommendation.

Overview of the Investigation Process

✧ Over the year, PPR noted long time spent in the process of investigation in various enforcement and complaint cases reviewed and concluded some common attributing factors in the following areas -

- *Handover of work upon staff change;*
- *Expansion of market expert / senior counsel pool;*
- *Application of IT;*
- *Repeated extensions of deadlines;*
- *Seeking legal advice; and*
- *Seeking information from external parties.*

Handover of Work upon Staff Change

10. PRP noted in several cases reviewed that due to staff change, the new case officers had to make tremendous efforts to review all materials and evidences afresh in taking over the cases, which inevitably resulted in longer investigation process. PRP recommended the SFC to put in place a mechanism to ensure that proper handover procedures are

followed by case officers and case progress is effectively monitored.

11. The SFC advised its established practices in handover of cases and case monitoring, which were set out in its internal manual.

12. The SFC did not set hard and fast targets for the completion of investigations but maintained internal key performance indicators, which served primarily as a management tool to monitor the progress of cases on top of other administrative measures, such as submission of progress reports by investigators at regular intervals.

Expansion of Market Expert / Senior Counsel Pool

13. PRP noted the SFC encountered difficulties in seeking opinion from market experts and senior counsel timely in some enforcement cases. There were occasions where extra time had been taken to engage a completely new market expert as the expert statements provided by the original one were not admissible to courts. This was partly attributed to the limitations facing the SFC in maintaining a pool of experts who were familiar with relevant legal requirements and who could be readily called upon to assist in enforcement cases.

14. The SFC advised that the ENF has been attempting to expand the pool of experts and senior counsel. For market experts, the current panel covered various fields, including accounting, securities trading and corporate finance. If the ENF considers that the quality of an expert does not meet its standards or expectations, the ENF may remove him or her from the panel.

Application of IT

15. PRP noted that the SFC's investigations, in particular, in enforcement cases always involved a great deal of manual work. It was not uncommon to find case officers spending a few months if not longer to review case documents and information in each case. While some of these documents, for example, announcements, circulars and financial statements were available in electronic format, PRP recommended the SFC to make suitable application of IT to reduce manual work with a view to enhancing the efficiency of investigations.

16. The SFC advised that the nature of work relating to reviewing and vetting announcements and circulars, etc. involves a substantial amount of human judgement and cannot be replaced by technology. Where appropriate, case officers will use the existing in-house IT tools in the administration of cases. The SFC will keep on exploring ways to improve its investigation efficiency through the use of new technology.

17. With respect to the CFD, recent technology-focused initiatives included –

- (a) introduction of a stock event dashboard summarising the trading data of a listed company;
- (b) mapping the corresponding event such as a profit warning onto a timeline; and
- (c) automated extraction of documents published by listed issuers.

Possible Abuse of Extension of Deadlines

18. PRP was aware of the SFC's liability, in exercising its investigative powers, to act reasonably having regard to natural justice and to provide an investigation subject with adequate time and opportunity to address the concerns raised by the SFC. However, in some cases where repeated extensions of deadlines in response to the SFC's requisitions were granted, PRP noted apparent avoidable delay in the investigation progress as a result of these extensions. PRP raised concerns about, apart from such implication on the timeliness of investigations, other possible detrimental impact such as the loss of evidences during the lengthy process of requisitions.

19. In view of the above, PRP recommended the SFC to –
- (a) draw up guidelines or set out principles to guide case officers in granting extension of deadline in response to the SFC’s requisition; and
 - (b) make reference to the practices of government departments and other relevant working parties.
20. The SFC advised that given the diverse nature of enquiries and investigations, it may not be feasible to draw up detailed guidelines in this aspect, which may hinder a proper judgement that should be made by the case officers having considered all facts and circumstances of a case. It would be more appropriate for the senior manager in charge to set the response deadline with considerations given to key factors such as natural justice requirements, the nature and seriousness of the allegations and the complexity of the matter, etc.
21. PRP considered that in spite of the SFC’s obligation to grant extension due to natural justice, case officers should be cautious about whether the extension would make the subsequent investigation more difficult. The SFC should stay alert to possible abuse of the mechanism resulting in, for example, the loss of key evidence.

Seeking Legal Advice

22. The ENF used to submit an evidence matrix to the LSD after finishing its investigation for the latter’s review and provision of legal advice. After the ENF’s Strategic Review, each specialized team of the ENF was designated with a counsel of the LSD who could readily provide legal advice during the course of the ENF’s investigation. This helped to expedite the investigation process by rectifying the previous situation where the LSD might suggest the ENF to collect additional evidence for further investigation only at a late stage after receiving the evidence matrix. In a case reviewed, PRP noted that this could result in the ENF’s taking of a year to seek legal advice from the LSD.

23. PRP welcomed the closer collaboration between the ENF and the LSD after the former's Strategic Review and recommended the ENF to continue to make improvements to shorten the time in taking legal advice from the LSD and also external counsel.

24. The SFC advised that the ENF would continue to explore measures to expedite the process of seeking legal advice internally and externally with a view to enhancing its efficiency in investigation.

Seeking Information from External Parties

25. In one of the cases reviewed, PRP noted that altogether it had taken the ENF eight months to collect information from brokers, banks and telephone companies. Since it was common for the SFC to seek information from external parties such as telephone companies in conducting investigations, PRP commented that the SFC should seek to ensure getting timely responses from these parties to avoid delay in the investigation process.

26. The SFC advised that in the case mentioned above, it carried on with other important investigative steps whilst waiting for the returns. These included issuing a number of investigation notices to various parties, conducting fund tracing and reviewing the collected evidence. Hence, the time spent on seeking information from external parties had no effect on the overall progress of the case. PRP commented that while it might be the case that there was no impact on the case itself, the SFC should nevertheless consider ways to shorten the time in obtaining information from outside parties for future cases. PRP reminded the SFC to be mindful that the subject of an investigation might take action which could prejudice the investigation during an unduly long period of time taken by the SFC to obtain information from external parties.

Timeliness in Making Notification of Investigation Result

- ✧ Without prejudicing the SFC's duty to enforce the law against wrongdoers, the SFC should avoid putting the subject of an investigation under pressure for an unnecessarily long period of time.

27. PRP noted in a case reviewed that the SFC had held up notifying the subjects of an investigation its NFA decision upon conclusion of the investigation because there was on-going investigation on the part of one of these subject persons. PRP found it undesirable that as a result, all the subject persons were only informed of the investigation result over one year subsequent to the SFC's NFA decision. The SFC was reminded of the expectation of the market that any investigation of the SFC should be completed and the investigation result should be made known to parties as soon as possible.

28. The SFC explained that in the above case, the ESC decided not to announce the investigation result until the SFC had finished investigating its related cases as new evidence might arise as a result of those investigations, which might prompt the SFC to re-consider the merits of this case. Noting the SFC's concern, PRP asked the SFC to keep a good balance between the interests of the investors and that of the subjects under investigation.

29. Without compromising its statutory secrecy obligations, the SFC undertook to, going forward, consider on a case-by-case basis for cases bundled for investigation where multiple parties are being investigated, notifying the persons under investigation for whom the SFC had made a NFA decision of this decision before the conclusion of the related investigations, taking into account relevant factors such as the possibility of new evidence being revealed and any potential prejudice to the SFC's on-going investigation.

Communication within the SFC

- ✧ The SFC should facilitate and reinforce intelligence and knowledge sharing across divisions and teams.

30. PRP noted that sometimes there might be issues uncovered in the licence application process that gave rise to query about an applicant's fitness and propriety to be licensed despite that he or she fulfilled all the licensing requirements. PRP observed a situation where a potential risk area remained unknown to the LIC until it was notified by the ENF in the latter's reply on an issue concerning an on-going disciplinary case. All these gave rise to PRP's concern about the effectiveness of communication between divisions within the SFC with respect to divisions' notification of each other of, for example, any indicator of high-risk licensee, potential breach of ordinances, rules and regulations, and the development of cases for investigations associated with one another, etc.

31. PRP recommended the SFC to facilitate and reinforce intelligence and knowledge sharing across divisions and teams and ensure that staff members are kept abreast of the latest development of Hong Kong's securities and futures markets through regular training, seminar or workshop, etc. In particular, the LIC should share its intelligence with the ISD for ongoing monitoring of licensees on whom the LIC casted doubt.

32. The SFC advised that under the LIC's current procedures, contentious cases are escalated to the senior management for further guidance and direction. As a prevailing practice, Commission Connection Series are regularly organized by the Learning and Development Team of the Human Resources Department of the SFC to facilitate sharing of knowledge and new policies across divisions.

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 in carrying out its work.

Functions

1.2 PRP reviews completed or discontinued cases handled by the SFC and advises the SFC on the adequacy of its internal procedures and operational guidelines governing the actions taken and operational decisions made by the SFC in performing its regulatory functions. The broad areas of the SFC's work cover authorisation of investment products, licensing of intermediaries, inspection of intermediaries, enforcement, corporate finance including processing of listing applications, and complaint 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 SFC upon the adequacy of the SFC's internal procedures and operational guidelines governing the actions taken and operational decisions made by the SFC and its staff in the performance of the SFC'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 SFC on all completed or discontinued cases in the above-mentioned areas, including reports on the results of prosecutions of offences within the SFC's jurisdiction and of any subsequent appeals.
- (c) To receive and consider periodic reports from the SFC in respect of the manner in which complaints against the SFC or its staff have been considered and dealt with.
- (d) To call for and review the SFC'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 SFC accordingly.
- (e) To receive and consider periodic reports from the SFC on all investigations and inquiries lasting more than one year.
- (f) To advise the SFC on such other matters as the SFC 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 SFC the majority of which members are independent of the SFC.

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

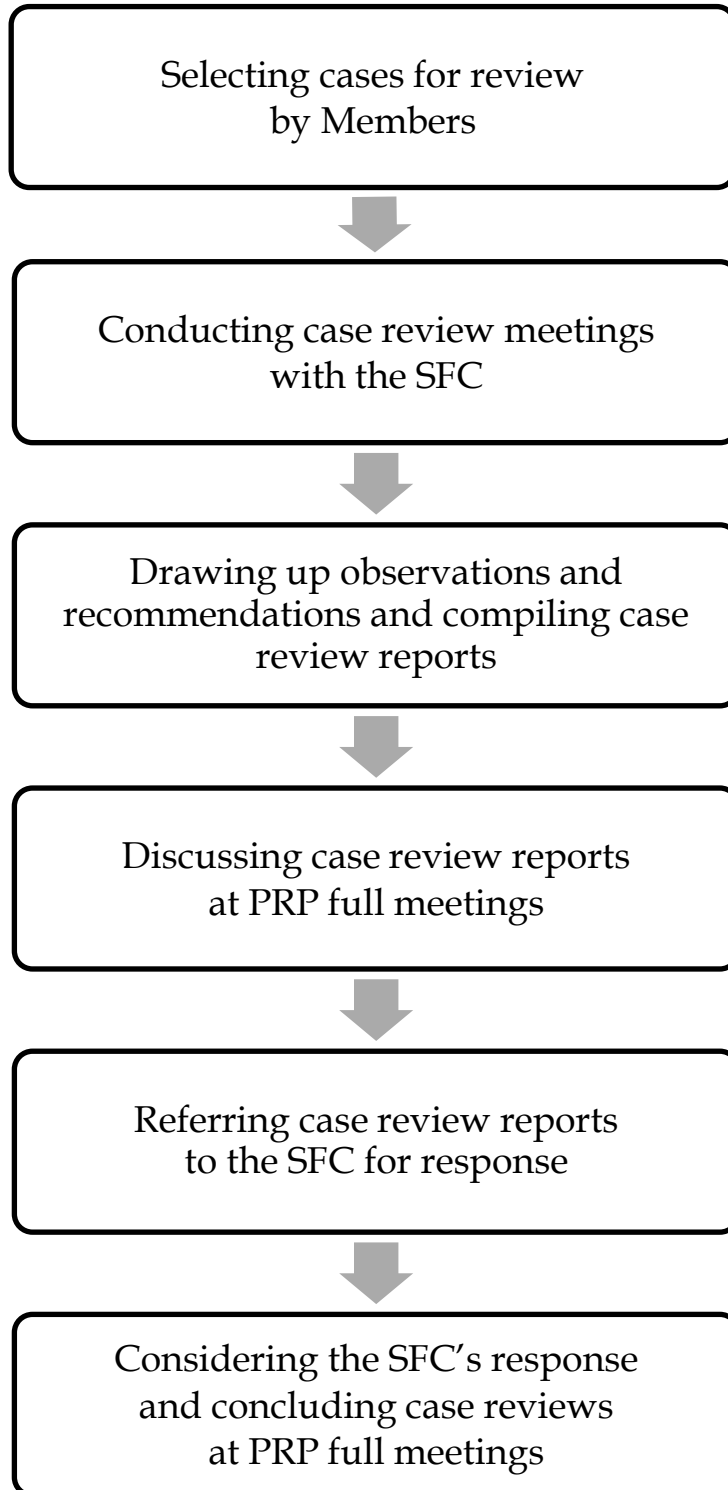
1.7 The SFC provides PRP with monthly lists of completed and discontinued cases from which members of PRP select cases for review. Members pay due regard to areas such as processing time of completed cases, procedural steps taken by the SFC in arriving at its decisions and relevant checks and balances.

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

1.9 PRP members are obliged to keep confidential the information provided to them in the course of PRP's work. To maintain the 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 they engage in each case review and relevant discussions, as appropriate.

Case Review Workflow

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



Membership

1.11 Mr. LEE Kam-hung, Lawrence 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, namely the Chairman of the SFC and the representative of the Secretary for Justice.

1.13 The membership of PRP in 2018-19 is as follows -

Chairman:

Mr. LEE Kam-hung, Lawrence, BBS, JP since 1 November 2018

Members:

Mr. CHAN Lap-tak, Jeffrey since 1 November 2018

Ms. Lena CHAN since 1 June 2016

Ms. CHAU Suet-fung, Dilys since 1 November 2018

Ms. CHUA Suk-lin, Ivy since 1 November 2018

Mr. CHUI Yik-chiu, Vincent since 1 November 2018

Ms. DING Chen since 1 November 2014

Ms. KWAN Wing-han, Margaret since 1 November 2018

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

Mr. LAI Hin-wing, Henry since 1 November 2018

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 since 20 October 2018

Mr. Tim LUI, SBS, JP

Secretary for Justice's Representative since 26 February 2015

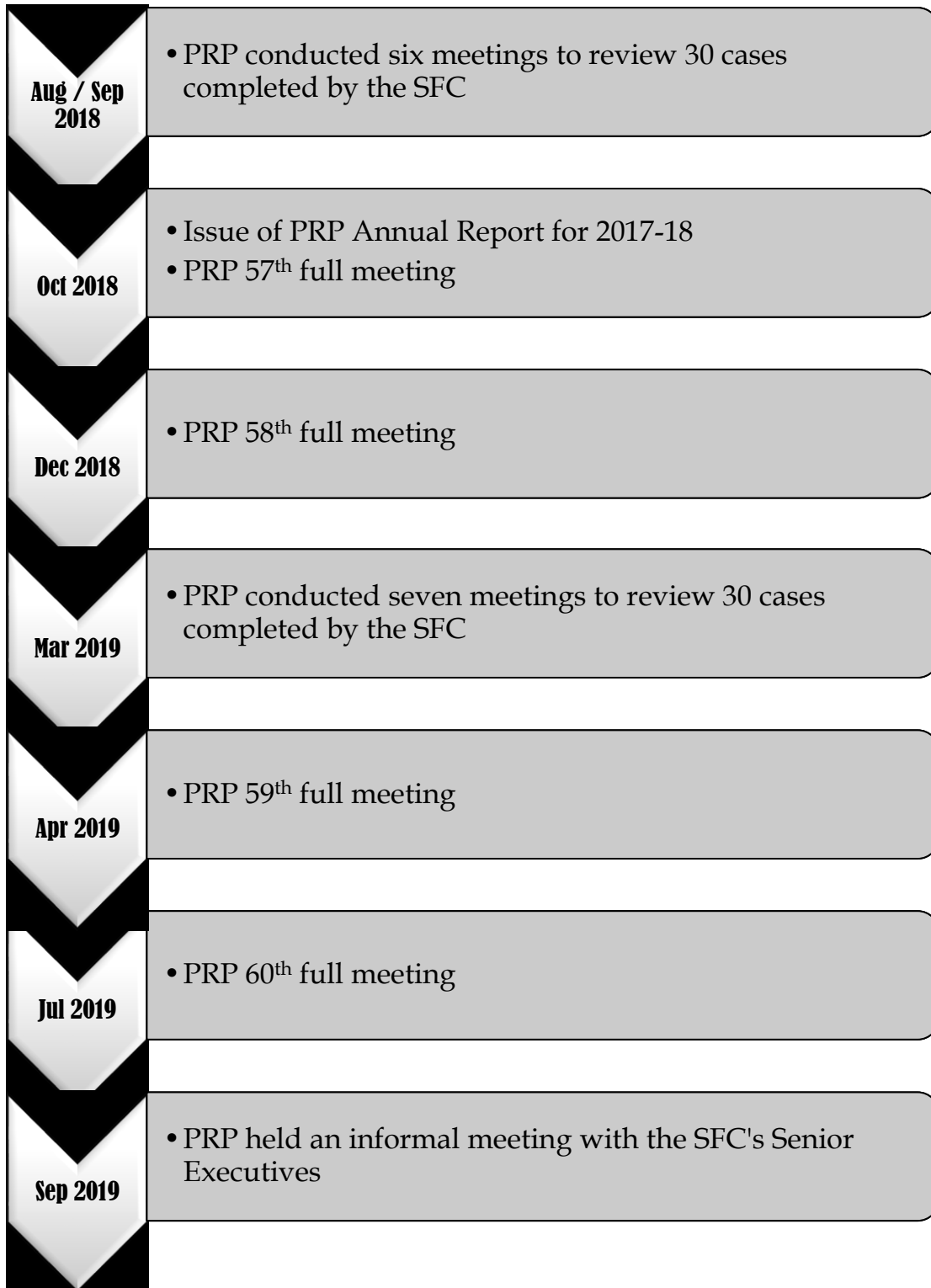
Ms. CHEUNG Kam-wai, Christina, JP

Secretariat:

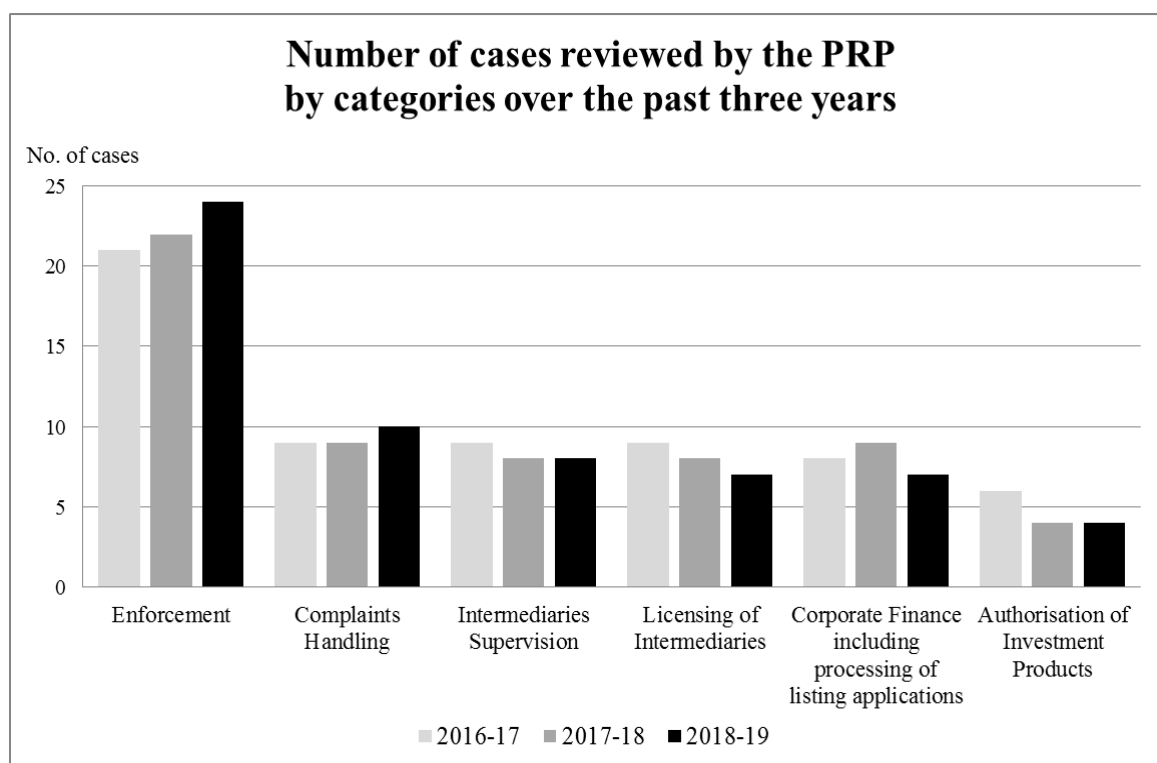
The Financial Services Branch of the Financial Services and the Treasury Bureau

Chapter 2 Highlight of the Work of PRP

2.1 Major events in 2018-19 are set out below –



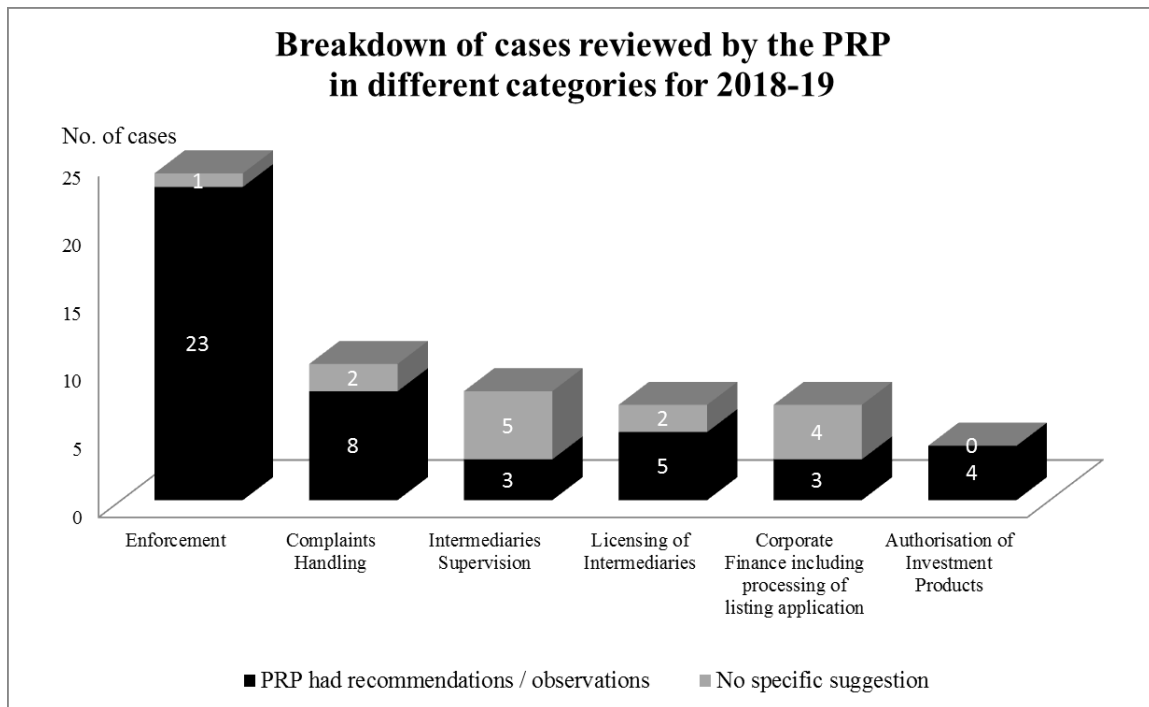
2.2 Distribution of the cases reviewed by PRP in the past three years is as follows -



2.3 Distribution of the 60 cases reviewed by PRP in 2018-19 is as follows -

	No. of Cases
Enforcement	24
Complaint Handling	10
Intermediaries Supervision	8
Licensing of Intermediaries	7
Corporate Finance including processing of listing applications	7
Authorisation of Investment Products	4
Total	60

2.4 Among these 60 cases, PRP made recommendations or observations on 46 cases, representing 77% of the reviewed cases.



2.5 Highlight of PRP's observations and recommendations is set out in Chapter 4. Follow-up actions taken by the SFC in response to PRP's recommendations in the last Annual Report (i.e. for 2017-18) are set out in Chapter 3.

Chapter 3 Follow-up Actions taken by the SFC on PRP's Recommendations in 2017-18

3.1 In response to the Annual Report of PRP for 2017-18, the SFC had reported progress in the following areas –

- (a) Strategic Review of the ENF; and
- (b) Revamp of Licensing Process.



A. Strategic Review of the ENF

3.2 The ENF launched a Strategic Review in late-2016, upon which a new case intake process was adopted, specialised teams were established, the electronic case management system was upgraded and the case management framework was reviewed. The SFC reported the effectiveness of these measures to PRP in mid-2018. In gist, there had been substantial reduction in the average time taken to complete an investigation. As a result, a vast majority of the investigations completed after the Strategic Review met the ENF's Key Performance Indicator. Besides, different specialised teams were also found to have been functioning well.

3.3 Following the Strategic Review, each specialised team of the ENF was designated with a counsel of the LSD to assist with individual investigations. In 2018-19, the SFC further reported how this arrangement had enhanced the efficiency of enforcement action.

3.4 As compared with the past practice where evidences were reviewed by the investigation team and then the discipline team, the discipline lawyer now worked together with the investigators in a specialised team. According to the SFC, the streamlined procedure had enabled the ENF to seek legal advice from the LSD timely. It rectified some

past situations where the investigation team was, upon the conclusion of investigation and forwarding the case to the discipline team for review, required by the latter to seek further evidences. It also enabled the investigators to take action earlier in situations where the discipline lawyer found it necessary to seek advice from the CFD and/or external experts. Overall, the arrangement for an assigned lawyer of the LSD to work with the investigators in each specialised team had expedited case progress.



B. Revamp of Licensing Process

3.5 In 2017-18, PRP suggested the LIC to revamp its process with a view to improving its efficiency in processing licensing applications, which involved lengthy processing time as revealed in PRP's case reviews. The PRP also suggested streamlining its workflow in order to cope with the anticipated increase in caseload given the growth in the number of licensees and a wider range of regulated activities carried out by the licensees.

3.6 The SFC responded that the LIC was conducting a holistic review to revamp its licensing process. The SFC then reported on how the new flattened hierarchy of the processing team requiring both Assistant Managers and Managers to report directly to Senior Managers; and having Assistant Managers to handle routine cases and Managers to handle complex cases had facilitated and enhanced the communication between the senior management and the case officers.

(a) Delaying Structure

3.7 In 2018-19, the SFC reported further on the effectiveness of the delaying structure, which had –

- (a) made available more officers to handle licensing cases with experienced Assistant Managers designated as case officers; and
- (b) facilitated team heads to give direct supervision and guidance to case officers so that critical issues could be escalated to the senior management more efficiently.

3.8 In general, the delaying structure had expedited case progress and saved resources to cope with the anticipated increase in caseload.



3.9 The SFC also reported the other changes effected from the licensing revamp, including refinement of its assessment approach to be more risk-based and outcome-oriented, and revision of its publications and licensing forms.

(b) Initial Vetting of Application

3.10 As part of the SFC's front-loaded approach to address issues as early as possible, the LIC had redesigned the licensing forms which became effective in early April 2019 to capture more relevant and specific information upfront instead of relying on rounds of requisitions subsequently made between the LIC and applicant. For areas to do with business profile and internal controls, the LIC had introduced a set of self-assessment questionnaires for the applicant to affirm whether appropriate policies or procedures are in place. These new forms emphasized the disclosure of more recent and significant investigations, disciplinary actions and civil litigations. The SFC reported that these new forms had expedited the processing of applications in the following ways –

- (a) the LIC could identify potential regulatory issues at an early stage; and
- (b) team heads could give more guidance to subordinates at an earlier stage and deploy resources in higher-risk areas.



(c) Streamlined Vetting Procedures

3.11 Having performed an in-depth empirical study and back tested cases processed in the past few years, the SFC had implemented a new approach for vetting with overseas regulators in processing licensing applications since early August 2019. Under the new approach, the LIC performs external vetting on persons licensed overseas who have a close link to the corporate applicant or licensed corporation. The LIC takes into account factors such as the role, position, control and impact of the person on the corporate licence applicant or licensed corporation.

3.12 Besides, the LIC checks against the online database of overseas regulators for the licensing and disciplinary records of vetting targets, supplemented by other intelligence to conduct background checking. If relevant checking reveals adverse information which relates to matters falling within the jurisdiction of the overseas regulators, the case officer would seek guidance from team heads as to whether such adverse information provides sufficient details for the assessment of the fitness and properness of the vetting target. If not, direct confirmation from the relevant overseas regulator on specific matters causing concern would be sought, with endorsement from team heads or above.

3.13 Applications with concerns or outstanding for a prolonged period of time are tabled for discussion in a weekly management meeting during which team heads, Directors and Senior Director will agree on how to proceed with those applications. If it is decided that an application should be refused on grounds of unresolved fitness and properness

concerns, and after consulting senior management, a LOM would be prepared for the applicant to make representations within a given period of time.

3.14 Since the adoption of the new approach, the internal vetting procedures had been streamlined. Externally, the SFC had organised five industry workshops in February and March 2019 with an attendance of over 1,300 industry participants to help them better understand the enhanced licensing process.

3.15 In gist, the streamlined vetting procedures would –

- (a) facilitate the SFC’s assessment of the fitness and properness of the applicants more effectively;
- (b) make the SFC’s licensing functions more transparent and efficient;
- (c) enable the SFC to better utilize its resources and concentrate on key risks; and
- (d) strengthen the SFC’s interaction with the industry.



§ PRP’s comments

3.16 PRP welcomed the revamped licensing process and looked forward to seeing further enhancement in the efficiency of the vetting procedures. Notwithstanding this, PRP had raised concern to the SFC about the potential risk involved in the LIC’s reliance on the information available from the online database of overseas regulators in conducting background check such that vetting request would only be sent to the relevant overseas regulators if the online check pointed to such a need. PRP was mindful that the revised arrangement would only work on condition that the relevant online databases are exhaustive.

§ SFC's response

3.17 The SFC advised that the LIC had conducted a detailed study and back testing of previous cases when developing the new vetting arrangement. For example, the LIC had compared the external vetting replies received from overseas regulators in the past year against the information revealed from external intelligence database and the regulators' online registers. It showed that a vast majority of the adverse comments provided by overseas regulators are found either on their online registers or external intelligence databases. The fact that case officers may seek endorsement from the senior management and initiate vetting requests to the relevant regulators if it is found critical to the assessment after considering the online information ensures the completeness and reliability of the revised vetting arrangement.

§ PRP's remarks

3.18 PRP reminded the SFC to continue to conduct reasonable due diligence to ensure the reliability of the online databases.



Chapter 4 Observations and Recommendations of Cases Reviewed in 2018-19



4.1 In 2018-19, PRP reviewed 60 cases which were concluded by the SFC during the period from November 2017 to November 2018. The processing time of these cases, which were of different nature and complexity, ranged from two months to several years.

4.2 As a financial regulator striving to strengthen and protect the integrity and soundness of Hong Kong's securities and futures markets, the SFC performs a broad spectrum of work such as vetting of listing applications, supervision of intermediaries, granting of licences, authorisation of investment products, complaints handling and taking of enforcement actions upon investigations and disciplinary and legal proceedings. Given the authorities vested with the SFC, PRP is well aware that the SFC has stayed alert to upholding the legitimacy and completeness of its work, in particular, in combating market misconduct through enforcement actions. However, this could have compromised the timeliness of sending deterrent messages to the market and protecting the interest of the investing public as a result of lengthy processing time in enforcement cases. Besides, it gave rise to concerns about putting the subjects of investigations under pressure for an unduly long period of time.

4.3 Given the above and the significant impact of the SFC's work on the market as a whole, the SFC is expected to process enforcement cases and perform its other regulatory functions effectively and systematically with a view to safeguarding market integrity and enhancing industry-wide operational efficiency. Over the year, PRP kept drawing the SFC's attention to the market participants' expectations and gave due regard to these expectations in conducting case review.

4.4 For the case reviews conducted this year, PRP continued to focus on the workflow of cases having regard to the peculiarities of the areas of work of individual divisions of the SFC. For cases processed by the ENF, for example, PRP looked for areas for improvement in terms of timeliness, supervision and resource allocation, etc. while giving due regard to relevant matters in the ENF's investigation process. The workflow of cases handled by other divisions of the SFC was examined along the same line.

4.5 During the year, PRP made observations on common factors leading to long processing time by various divisions of the SFC. In enforcement and complaint cases, which accounted for over half of the cases reviewed, PRP found common factors such as staff change, long time taken to seek expert opinion, legal advice and information from external parties, heavy manual work and repeated extensions of deadlines in response to requisitions, which had resulted in lengthened investigation processes. PRP also studied the new regulatory approach in its course of review. Accordingly, PRP made comments and recommendations to the SFC on the following areas –

- (a) Possible impact of Front-loaded Regulatory Approach on market operation;
- (b) Enhanced cooperation between the SFC and the IMMD;
- (c) Overview of the investigation process;
- (d) Timeliness in making notification of investigation result to subjects being investigated; and
- (e) Communication within the SFC.



A. Front-loaded Regulatory Approach

4.6 The SFC has adopted a front-loaded regulatory approach since 2017. The front-loaded regulation of listing applicants and listed companies emphasized earlier and more targeted intervention to tackle market irregularities by focusing on the more serious breach of the rules and regulations. To protect the investing public, the SFC directly intervened in the listing market, where necessary, and cooperated with the SEHK in joint policy actions. In line with the “One-SFC” approach, the SFC ensured that regulatory actions so taken are coordinated and targeted.

4.7 PRP welcomed this proactive approach, which has complemented the SFC’s traditional enforcement actions and allowed it to get ahead of possible serious irregularities and address persistent problems. Over the year, PRP reviewed seven cases relating to corporate finance with special attention given to the implementation of this new regulatory approach.

4.8 In one of the cases reviewed, the SFC had issued two rounds of requisitions under Section 179 of the SFO, which gave the SFC the power to compel the production of records and documents from persons related to a listed company in relation to potential fraud or other misconduct. PRP noted that there was no restriction on the number of requisitions issued by the CFD. While the CFD would usually give a week to the company for response, it was common that the company would request for extension of deadline, which would be granted under normal circumstances.

4.9 According to the SFC, the prevailing practice of making requisitions under Section 179 of the SFO allowed flexibility for merger and takeover activities which were subject to tight deadline to complete the deals; such that if the company strived for completion of a transaction as soon as possible, it would have the incentive to respond to the SFC more swiftly.

§ PRP's recommendations

4.10 PRP reminded the SFC that in its proactive intervention to address issues as early as possible under the front-loaded approach, there were possibilities that actions taken by the SFC might have impact on the normal market operation. For example, in the SFC's initiating inquiry under Section 179 of the SFO in a takeover case where there was an agreement between the relevant parties that the transaction must be completed within a short period of time, there might be chance that the exchange of correspondence between the SFC and the companies involved had taken longer than expected (especially when the companies involved did not respond swiftly) or even rendering the transactions failed to be completed within the agreed timeframe. PRP was mindful that in such a case, an otherwise fair and reasonable deal might be withheld. In quoting this example, PRP recommended the SFC to take into account the possible negative implication of the front-loaded regulatory approach and consider ways to minimize any such impact.

§ SFC's response

4.11 The SFC noted and would consider the above recommendation.

§ PRP's remarks

4.12 PRP fully appreciated the objective of the front-loaded approach adopted by the SFC to ensure that markets are fair and orderly. In anticipation of an uptrend of the SFC's early intervention in market irregularities, PRP looked forward to receiving further report from the SFC addressing the PRP's concern.



B. Enhanced Cooperation between the SFC and the IMMD

4.13 In reviewing the cases handled by the ENF and the LIC, PRP noted that the SFC has had close working relationship with the IMMD with respect to cross-border misconduct and working visas, etc. In two cases handled by the LIC, PRP noted that the LIC's approval of the licensing applications hinged on the IMMD's granting of working visas to the proposed representative or the RO of the licensed corporations. In both cases, the LIC granted approval-in-principle subject to the IMMD's granting of working visa to the proposed representative or the RO, apart from other conditions.

4.14 In one of the above cases involving a working visa application made by the licensing applicant, PRP noted that the case took longer time to process as issues relating to the working visa application processed by the IMMD emerged.

4.15 In some cases handled by the ENF, PRP noted that the ENF also cooperated with the IMMD.

§ *PRP's recommendations*

4.16 Given the close link between the SFC and the IMMD with respect to the former's performance of enforcement and licensing functions, in particular, the tackling of cross-border misconduct, PRP recommended the SFC to sign an MOU with the IMMD to formalise the working process and enhance mutual cooperation. With clear terms of cooperation defined, the MOU would facilitate the SFC to streamline its process related to the IMMD's work.

§ SFC's response

4.17 In general, the SFC found its cooperation with the IMMD effective and smooth and did not find an MOU necessary at this stage, given the nature of its cooperation with the IMMD. Notwithstanding that, in response to PRP's recommendations, the SFC had initiated establishing central contact points with the IMMD with a view to strengthening communication in future.

4.18 Specifically, the SFC explained that in the case of licensing applications, it was the applicants' responsibilities to ensure that they could legitimately work in Hong Kong. In the case reviewed by PRP where the IMMD was involved in a working visa application, the IMMD had in fact approached the LIC to seek clarifications of the latter's approval criteria. Instead of signing an MOU with the IMMD, the LIC has revised its Licensing Handbook which provided more guidance in the area concerning working visa.

4.19 For enforcement cases, the SFC viewed that there were clear and established communication channels between the ENF and the IMMD. The cooperation between the SFC and the IMMD, to a large extent, related to movement records which the SFC had had established practice to streamline the process.

§ PRP's remarks

4.20 PRP noted encouraging feedback after the SFC had entered into MOUs with different working parties in the recent years. Example included the noticeable improvement in the timeliness in the provision of legal advice after formalising the working process between the DoJ and the SFC in an MOU in 2016. The MOU signed between the SFC and the HKP in 2017 also allowed the SFC to combat crimes relating to the securities and futures industry more efficiently and effectively through strengthened collaboration between the two parties. Against this background, PRP considered that establishing an MOU with the IMMD

would help enhancing the efficiency of the SFC's work.

4.21 While PRP was delighted to note the progress in the SFC's attempt to establish central contact points to enhance its cooperation with the IMMD, PRP opined that the SFC should keep an open mind on establishing an MOU with the IMMD as well given the positive results of the precedent arrangements.



C. Overview of the Investigation Process

4.22 PRP reviewed 24 enforcement cases and 10 complaints during the year. The investigation processes, among other areas, of these cases were examined. With respect to cases involving lengthy processing time, particular regard was given to relevant attributable factors. PRP observed that handover of work upon staff change, difficulties in seeking expert opinion, prolonged period of time required for seeking legal advice internally / externally and repeated extensions of deadlines in response to the SFC's requisitions had caused interruptions, which seemed to be avoidable in some investigation processes.

4.23 PRP also commented on the overall planning of investigation in enforcement and complaint cases noting that interviews for collecting evidence were scheduled nearly a year after the commencement of investigation in some of these cases. This might increase difficulties in locating interviewees and make it more difficult for the interviewees to recollect relevant matters. PRP recommended the SFC to plan ahead timeframes for investigation, in particular, to arrange interviews at the early stage of an investigation. For complaint cases, PRP recommended the SFC to kick off all preliminary steps, such as seeking consent from the complainant for disclosure of information provided in the complaint to relevant parties and obtaining background information from other agencies, simultaneously instead of sequentially.

4.24 PRP noted in some cases that the investigators reviewed and analysed a tremendous volume of documents and emails, which involved prolonged processing time. In this context, PRP recommended the SFC to apply technology as appropriate to reduce manual work with a view to enhancing the overall efficiency in investigation.

4.25 The ensuing paragraphs highlight the common factors causing unnecessary long investigation time as identified by PRP in the case reviews and its recommendations for the SFC's improvement.



(a) Handover of Work upon Staff Change

4.26 PRP noted in a few cases that due to staff change, the investigation process was lengthened as the new case officers made tremendous efforts to review all materials and evidences afresh in taking over the cases. In one of the cases, PRP noted that the new officer who was handling a large number of cases concurrently had taken over a year to review the evidences again before referring the case to the DIS. While the ENF explained that the ESC was aware of the progress of cases as the cases were required to be reported to the ESC quarterly, PRP found it undesirable, notwithstanding the regular monitoring, that the investigation in this case had been held up for long simply due to staff change.

4.27 PRP raised concerns about prolonged investigation as a hindrance to the SFC's taking of timely enforcement action such that the longer the period cases were dragged on, the less effective the deterrent effect of enforcement action could yield. Notwithstanding the implications of resource constraint and heavy caseload on the SFC's case officers, PRP pointed out that the SFC should set a clear timeframe for investigation and exercise proper control over it in the event of change of case officers. The SFC should also review its handover arrangement to ensure that cases were assigned to case officers who had the capacity to handle the investigation.

§ PRP's recommendations

4.28 PRP recommended the SFC to put in place a mechanism to ensure that proper handover procedures were followed. More importantly, the effectiveness of case monitoring should be regularly reviewed to ensure that cases were completed without avoidable delay. PRP asked the SFC to elaborate on its established practices in these aspects.

§ SFC's response

4.29 The SFC explained that all its investigations were managed with a strong sense of urgency. While many of its investigations were complex, wide-ranging and subject to the secrecy provisions in the SFO, they often involved numerous individuals and entities located in Hong Kong and overseas as well as evidence located in multiple jurisdictions. Procedural fairness had to be afforded to persons under investigation who, for example, might wish to assert legal privilege claims.

4.30 Given the above, the ENF maintained internal key performance indicators, which served primarily as a management tool to monitor the progress of cases instead of setting hard and fast targets for the completion of investigations. The importance of a proper handover in anticipation of a change of staff was regularly reinforced in the management meetings of the ENF. With respect to case monitoring, if during the course of an investigation, the case became more complex or appeared to be more serious than it seemed to be on initial assessment, the Mini-ESC might decide to escalate it to be put under the ESC's monitoring.

4.31 Furthermore, during the course of an investigation, the investigator submitted progress reports at regular intervals to the Director and/or Senior Director to monitor the progress of investigation and discuss the merits of the case. This progress report summarised all the evidence gathered in the investigation to date. When an

investigation needed to be transferred to another investigator, the new investigator might review the progress reports and discuss the scope, direction and status of the investigation with the original case officer.

4.32 The SFC has included written guidance on proper handover procedures in its internal manual.



(b) Expansion of Market Expert / Senior Counsel Pool

4.33 PRP noted in three enforcement cases that the ENF had taken seven months to fifteen months to seek opinion from market experts. In one of these cases, the ENF had taken extra time to guide the external expert to beef up his original expert report, which was revised for several times in order to meet the standard of the LSD and the external counsel. In the other case, the ENF had taken extra time to engage a completely new market expert as the expert statements provided by the original one were not admissible to courts. According to the ENF, both market experts were new to the role and were hence, not familiar with relevant legal requirements.

4.34 In some cases reviewed in previous years, PRP made similar observations that the SFC faced problems about engaging market experts as well as senior counsel. PRP noted that the SFC had taken measures to identify more experts and engage senior counsel to assist them in enforcement cases. However, the situation was yet to be found noticeably improved.

§ PRP's recommendations

4.35 PRP recommended the SFC to continue with its efforts in expanding its market expert and senior counsel pool. In particular, further attempts should be made to identify market experts who had experience in writing expert statements for court cases.

§ *SFC's response*

4.36 The SFC responded that the ENF has been attempting to expand the pool of market experts whom it could call upon to assist in enforcement cases although this remained challenging. Currently, the ENF has a panel of experts covering various fields, including accounting, securities trading and corporate finance. The panel of potential experts was available to all case officers in the ENF. The ENF kept its panel of market experts current by adding names of individuals who were willing and qualified. If the ENF considered that the quality of an expert did not meet its standards or expectations, the ENF might remove him or her from the panel.



(c) Application of IT to Assist in Investigation Work that Required Manual Efforts

4.37 PRP noted that enforcement and complaint cases often involved review of a substantial amount of documents and information. In a case reviewed, the case officers had spent nine months to review the documents of the four listed companies concerned. In another case reviewed, two case officers had shouldered the responsibility of reviewing over 20 box files of due diligence records and nearly one terabyte of emails. In the former case, PRP noted that the relevant documents, including announcements, circulars, financial statements and disclosure of interest forms were available in electronic format and opined that suitable application of IT could have relieved the case officers' workload.

§ PRP's recommendations

4.38 PRP recommended the SFC to apply the latest technology to review documents and consolidate information. This will improve the efficiency of investigation by saving time and resources from heavy manual work. With lesser amount of manual checking, case officers could then focus on other aspects of an investigation.

§ SFC's response

4.39 The SFC responded that the nature of work relating to reviewing and vetting announcements and circulars and assessing a proposed transaction inevitably involved a substantial amount of human judgement. That could not be replaced by technology. Identifying anomalies and misconduct, applying the relevant rules and regulations, and assessing a case primarily relied on the experience and judgement of case officers. Where appropriate, case officers would use the existing in-house IT tools in the administration of cases.

4.40 In the case relating to information available in electronic format, the case officers generated a trading summary using the SFC's in-house reporting system to track how the interests of the parties concerned had changed over time which was based on public disclosure of interest filings. This was cross-checked manually against announcements issued by the relevant listed company and the actual filings. The checking of the trading summary facilitated the case officers in identifying red flags and focusing on questionable dealings.

4.41 Notwithstanding the above, the SFC has been exploring ways to improve its investigation efficiency through the use of new technology. For example, the SFC was planning to upgrade its IT equipment to improve the efficiency of its digital forensic computer labs which manage and process digital search seizures. In parallel, the ENF has assessed IT programmes which might assist in reviewing and analysing electronic documents such as emails. The ENF would

continue to explore other tools to further enhance investigation efficiency.

4.42 The CFD would also continue to seek new ways to improve efficiency and streamline workflow. Recent technology-focused initiatives include the introduction of a stock event dashboard summarising the trading data of a listed company and mapping the corresponding event such as a profit warning onto a timeline, and also automated extraction of documents published by listed issuers.



(d) Possible Abuse of Extension of Deadlines

4.43 PRP noted that it was not uncommon to find repeated extensions of deadlines by the SFC for relevant parties to furnish response to their requisitions in enforcement, corporate finance and complaint cases. In some cases reviewed, PRP found unavoidable delay in case processing due to repeated extensions of deadlines.

§ PRP's comments

4.44 PRP noted the obligations of case officers to maintain reasonableness and fairness in considering each extension request. That said, PRP was mindful that respondents could abuse the mechanism by making repeated requests for extension in order to delay or hinder the SFC's investigation or action. PRP questioned if case officers had been conscious about this possible abuse and its far-reaching impact on the overall progress of an investigation. In particular, PRP was concerned that evidence might be inadvertently lost or intentionally destroyed by the respondents in a lengthy investigation.

4.45 PRP noted that there had been no established guidelines nor policy for case officers to consider requests for extension of deadlines. Each case was considered by case officers on individual merits. In this

regard, PRP reminded the SFC to ensure consistency among different divisions and case officers in making relevant decisions, and the need to prevent abuse of the mechanism.

§ PRP's recommendations

4.46 PRP recommended the SFC to look into the situation by reviewing cases with long processing time, which involved multiple requests for extension of deadlines in response to the SFC's requisitions; and draw up guidelines or set out principles to guide case officers in forming their judgement about approving a request for extension or not. PRP made some suggestions on factors for consideration, which included seriousness of potential penalties, number of documents requested and whether third-party information was required.

4.47 In connection with the above, PRP also recommended the SFC to make reference to any guidelines or principles followed by government departments or other relevant working parties in granting extension of deadlines in response to requisitions.

§ SFC's response

4.48 The SFC responded that in exercising its investigative powers under sections 179 and 182 of the SFO, two overarching principles apply -

- (a) the SFC acted reasonably; and
- (b) an investigation subject was provided with adequate time and opportunity to address the concerns raised by the SFC.

The latter principle was particularly important in disciplinary cases which could result in penalties or attract serious consequences. This was in the interest of natural justice and fairness and helped to ensure

the sustainability of the decision in question, i.e. the disciplinary action taken.

4.49 Given the diverse nature of enquiries and investigations, it might not be feasible to draw up detailed guidelines for dealing with each extension application, which might hinder a proper judgement as to whether a requested extension was justifiable. Case officers would consider all facts and circumstances of the case when granting extensions. Besides, where new information was revealed in responses provided in each round of the requisitions, it was the responsibility of the case officers to issue requisitions to further clarify the new information.

4.50 Broadly speaking, considerations given to extension requests include natural justice requirements, the nature and seriousness of the allegations, the number of questions raised, the complexity of the matter, the number of parties involved, etc., and the weight of each factor varies from each application to application and case to case. It was considered more appropriate to leave it to the discretion of the senior manager in charge to set the response deadline having considered all relevant facts and circumstances of the case. For example, different requests for extensions of deadlines for the same period of time would not be treated in the same way where public holidays such as Christmas and New Year was involved in a request but not the others.

4.51 To sum up, the SFC was mindful of striking a balance between natural justice and unnecessary delay in case processing.

§ *PRP's remarks*

4.52 PRP considered that in spite of the SFC's obligation to grant extension due to natural justice, case officers should be cautious about whether the extension would make the subsequent investigation more difficult. The SFC should stay alert to the possible abuse of the mechanism resulting in, for example, the loss of key evidence.

(e) Seeking Legal Advice

4.53 Before the ENF's Strategic Review, the ENF submitted an evidence matrix to the LSD upon completion of investigation. The LSD then reviewed the case and provided legal advice to the ENF. During the process, the LSD might suggest the ENF to collect additional evidence for further investigation. In reviewing one of the cases handled before the Strategic Review, PRP noted that it had taken the ENF one year and two months to seek legal advice from the LSD and a further three months to seek legal advice from external counsel.

4.54 After the Strategic Review, each specialised team of the ENF was dedicated with an access to a counsel of the LSD to assist with individual investigations, which helped to shorten the process for the ENF to seek legal advice from and take forward action recommended by the LSD with closer collaboration between the two divisions.

§ PRP's comments

4.55 PRP reiterated the need for the ENF to seek timely legal advice from the LSD and where necessary, external counsel to avoid delay of the investigation process. PRP looked forward to further improvements in this regard in future case reviews.

§ SFC's response

4.56 The SFC responded that the ENF would continue to take appropriate measures to enhance its efficiency in investigation and when seeking legal advice.



(f) Seeking Information from External Parties

4.57 In one of the enforcement cases reviewed, PRP noted that it had taken the ENF eight months to collect information from brokers, banks and telephone companies. The telephone companies accused that given the numerous requests they received from other agencies and government departments, they could not accord a higher priority to the SFC's requests.

§ PRP's comments

4.58 PRP commented that the delay of investigation due to an unduly long period of time taken by external parties to respond to the SFC's requests for information was not justifiable, in particular, in cases involving possible market manipulation which called for prompt enforcement action. The SFC should make it clear to the external parties the importance of the information sought and the necessity for them to respond to the SFC before the deadline given.

§ SFC's response

4.59 The SFC responded that in the case referred to by PRP, whilst waiting for subscriber details from the telephone companies, the SFC carried on with other important investigative steps including issuing a number of investigation notices to various parties, conducting fund tracing, which took some time as there were many layers of fund transfers, and reviewing the collected evidence. Hence there was no effect on the overall progress of the case.

4.60 In general, when case officers follow up with telephone companies on any delay in the provision of information, the usual explanation was that the telephone companies also received other requests from various government bodies and would endeavour to deal with the SFC's requests as soon as possible.

§ *PRP's remarks*

4.61 The PRP opined that there was room for improvement in the SFC's process of getting information from external parties in that the latter had directed the schedule. While it might be the case that there was no impact arising from the waiting time on the case itself, the SFC should nevertheless consider ways to shorten the time in obtaining information from outside parties for future cases. The SFC should be mindful that the subject of an investigation might take action, which could prejudice the investigation during the time taken by the SFC to obtain information from external parties. The SFC should take a serious view on this and take appropriate measures for improvement.



D. Timeliness in Making Notification of Investigation Result

4.62 In reviewing an enforcement case which investigated whether the two sponsors in a listing application had failed to conduct reasonable due diligence inquiries, PRP noted that the SFC, after making a NFA decision with respect to the sponsors, had held up informing the sponsors of the investigation result for over a year, until the conclusion of the investigation of other non-compliance cases concerning one of the sponsors. The other sponsor and related party of the investigation who were entirely unrelated to the other cases had been implicated in a way.

§ PRP's comments

4.63 Without prejudicing the SFC's duty to enforce the law against wrongdoers, PRP reminded the SFC to be mindful of the expectation of the market that any investigation of the SFC should be completed and the investigation result should be announced as soon as possible in order to avoid putting the subject of an investigation under pressure for an unnecessarily long period of time. PRP also reminded the SFC of its responsibility to inform the subjects of investigations at the earliest practicable moment in accordance with the ENF's operational manual.

4.64 PRP made no comment on the SFC's decision to bundle the case reviewed with other cases relating to the sponsor concerned for investigation and to inform this sponsor of the investigation results upon conclusion of all the cases. However, PRP opined that the case officers should have followed the operational manual in notifying the other sponsor and related party of the investigation the result of the case once the NFA decision was endorsed. PRP found it undesirable for them to have waited for over a year unnecessarily for the investigation result.

§ PRP's recommendations

4.65 PRP asked the SFC to continue to keep a good balance between the interests of the investors and that of the subjects under investigation. For cases bundled for investigation which involved multiple subjects, the SFC should inform the relevant subject(s) of any NFA decision once endorsed.

§ SFC's response

4.66 The SFC responded that in accordance with the ENF's internal procedures and policies, the SFC would notify the persons under investigation of its NFA decision upon the conclusion of a case. For the case in question, the ESC decided not to conclude it until the SFC had finished investigating its related cases as new evidence might arise as a result of those investigations, which might prompt the SFC to re-consider the merits of the case. The progress of this case and its related cases were regularly reported to the ESC. The SFC considered that it had informed the subjects under investigation in this case of the investigation result as soon as practicable after endorsement by the ESC, which was in line with the prevailing procedures.

4.67 Going forward, without compromising its statutory secrecy obligations, for cases bundled for investigation where multiple parties are being investigated, the SFC would consider, on a case-by-case basis, notifying the persons under investigation for whom the SFC had made a NFA decision of this decision before the conclusion of the related investigations, taking into account, however, factors such as –

- (a) the possibility of new evidence being revealed in the related investigations which might prompt the SFC to re-consider the merits of the case and re-assess the liability of the subjects under investigation; and

- (b) whether the notification might prejudice the SFC's ongoing investigation into other subjects under investigation.

§ PRP's remarks

4.68 PRP appreciated the SFC's response, which showed its receptiveness to the PRP's recommendation by undertaking to consider its application in future on a case-by-case basis.



E. Communication within the SFC

4.69 When reviewing cases, PRP frequently noted areas where there could be more effective communication and knowledge sharing within different divisions and departments of the SFC. For the sake of enhancing the efficiency of regulatory work, the SFC should continue investing more efforts to enhance its internal communication.

4.70 In a licensing case reviewed, PRP noted that various issues uncovered in the vetting processing gave rise to suspicion on the applicant's fitness and properness to be licensed. While the applicant was eventually granted with the licence for having fulfilled all the licensing requirements, PRP considered that the issues uncovered were clear indicators of the licensee being high-risk in terms of non-compliance and prone to be involved in market misconduct, on whom close monitoring should be brought up to the ISD.

4.71 PRP also noted that a potential breach of Chapter 21 of the Listing Rules by an applicant, which is a key risk area remained unknown to the LIC until three months after its receipt of this licence application. It only came to the LIC's knowledge that the application was not permissible under the Listing Rules when the ENF replied on an issue concerning an on-going disciplinary case in respect of the two NEDs of the applicant. The LIC subsequently sought advice from the CFD and informed the applicant immediately. PRP observed that should there be no on-going enforcement case concerning the two NEDs, the potential breach might have been revealed even later.

4.72 In reviewing an enforcement case involving under-reporting of short positions, PPR noted that the SFC had already spent 19 months to investigate a similar incident in another enforcement case of the same company before it spent another 18 months for investigating the current case and coming to a conclusion that there were apparent deficiencies in the company's short positions reporting system and that independent reviewers should be engaged. PRP noted that the Director and Senior Director supervising the cases respectively were both in the IMT and questioned if there had been any effective discussion between them so that they were

aware of the development and serious implication of the two cases as well as the urgency for the company to take rectification action.

§ PRP's recommendations

4.73 In the licensing case reviewed, PRP recommended the LIC to share its intelligence with the ISD for on-going monitoring of licensees on whom the LIC casted doubt.

4.74 In the enforcement case reviewed, PRP recommended the SFC to enhance coordination and communication between the investigation teams and discipline teams so that prompt enforcement action could be taken with respect to the latest development of related cases.

4.75 In general, PRP suggested that the SFC should facilitate and reinforce intelligence and knowledge sharing across divisions and teams for better coordination in taking joint actions, and equipping staff members with wider knowledge of the SFC's work and relevant ordinances and rules. Staff members should also be kept abreast of the latest development of Hong Kong's securities and futures markets through regular training, seminar or workshop, etc.

§ SFC's response

4.76 The SFC responded that under the LIC's current procedures, contentious cases are escalated to the senior management for further guidance and direction. For the case reviewed by PRP, the case officer brought up the issue for discussion in the weekly management meeting. Subsequently, the case officer also shared the intelligence with the relevant team of the ISD.

4.77 As far as the potential breach of Chapter 21 of the Listing Rules was concerned, the case officers escalated the issue to its management as soon as it was revealed and upon which agreed on an approach to take forward the case. The requirement under the relevant Listing Rules and a

list of investment companies at the material time were shared within the department. The LIC then issued internal guidelines to explain the issue. In addition, the case officers had presented the case to the LIC staff in an internal training session.

4.78 For the enforcement case in question, the SFC responded that both the Director and Senior Director supervising the case and its related case were aware of the under-reporting of short positions and that this might have been caused by systemic issues, hence the decision to investigate these matters. As a related issue, it was noteworthy that the decision to deal with the short position under-reporting cases together with other regulatory failings of the company concerned on a consolidated basis had resulted in significant savings of time and resources, and led to a more effective and efficient enforcement outcome.

4.79 As a prevailing practice, the Learning and Development Team of the Human Resources Department of the SFC regularly organises training and sharing sessions to facilitate sharing of knowledge and new policies across divisions. For example, in one of these sessions held in February 2019, the LIC gave a presentation to all the SFC staff members on the LIC's strategic reform.

§ PRP's remarks

4.80 PRP would like to remind the SFC that it should continue making more efforts to enhance internal communication and to facilitate intelligence and knowledge sharing.



Chapter 5 Way Forward

5.1 When preparing the annual report of this year, PRP would like to record its appreciation on the SFC's commitment in its pursuit in protecting the investors' interest and upholding the integrity of financial market. PRP noted that the SFC spared no effort and taking one reviewed case as an example, the SFC undertook years of due diligence to protect the investing public from the consequences of wrongdoing and to restore the financial position of the investors. PRP is confident that the SFC will continue to reinforce its role as the market gatekeeper.

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

5.3 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 channels¹-

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

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

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

Chapter 6 Acknowledgement

6.1 PRP would like to express its special gratitude Dr Moses Cheng, its former Chairman. Under Dr Cheng's exemplary leadership in the past six years, there has been a closer collaboration between PRP and the SFC, which in turn facilitated a series of successful process revamp and procedural enhancements in the SFC.

6.2 PRP would also like to pay tribute to Mr Clement Chan, Dr Hu Zhanghong, Ms Rosita Lee and Mr Robert Lee who retired from PRP after having served as Members for six years. PRP is grateful to their efforts that have been generously given.

6.3 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.

6.4 As always, PRP Secretariat has continued providing its solid support to the work of PRP. In particular, the Chairman and Members wish to place on record their appreciation to Mr William Chow, an outgoing PRP Secretariat teammate, for his hard work and contribution to PRP in the past nine years.

**Process Review Panel
for the Securities and Futures Commission
November 2019**