

Process Review Panel
for the
Securities and Futures Commission

Annual Report
to the Financial Secretary

For 2006

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Chapter 1 General Information

Background and purpose of the Process Review Panel

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

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

1.3 In the course of reforming the regulatory regime for the securities and futures markets in 1999, the regulatees pointed out to the Administration that the checks and balances set out in paragraph 1.2 above could only apply in specific cases. The Administration, in consultation with the SFC, concluded that it would be preferable to improve the transparency of the SFC’s internal processes across the board, so that the public would be better able to see for itself that the SFC did act fairly and consistently in exercising its powers.

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

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

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

Terms of reference

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

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

1.9 The PRP is required to submit its reports to the Financial Secretary annually or otherwise on a need basis. The Financial Secretary may cause these reports to be published as far as permitted under the law.

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

Constitution of the PRP and Working Groups

1.11 As at 31 December 2006, the PRP comprises ten members, including eight members from the financial sector, academia and the legal and accountancy professions, and two ex-officio members including the Chairman of the SFC and the representative of the Secretary for Justice.

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

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

Chapter 2 Work of the PRP in 2006

Highlights of work

2.1 This report covers the work of the PRP from 1 January 2006 to 31 December 2006.

2.2 In 2006, the PRP reviewed 40 completed cases to examine if the action taken and decisions made are consistent with the relevant internal procedures and operational guidelines. The case reviews covered the following areas –

- (a) licensing of intermediaries;
- (b) inspection of intermediaries;
- (c) authorisation of collective investment schemes;
- (d) handling of complaints;
- (e) investigation and disciplinary action; and
- (f) processing of listing applications under the Dual Filing regime.

2.3 The PRP also examined the SFC's procedures in respect of cases which did not result in investigation or disciplinary action.

Selection of cases for review

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

adequacy of the manuals from the perspective of fairness and reasonableness.

2.5 The SFC also provided the PRP with monthly reports on on-going investigation and inquiry cases that had been outstanding for more than one year. The PRP may also select these cases for review upon completion of these cases.

Meetings of the PRP and Working Groups

2.6 The PRP conducted two meetings to discuss specific issues relating to the SFC's internal procedures and considered reports submitted by the two Working Groups which set out observations and recommendations arising from the review of cases.

2.7 The Working Group on Licensing, Intermediaries Supervision and Investment Products met twice and the Working Group on Corporate Finance and Enforcement met three times in 2006. The two Working Groups reviewed a total of 40 cases, which encompassed various areas of the SFC's work.

Table 1 – Breakdown of cases reviewed by the PRP

	No. of Cases
Licensing	7
Intermediaries supervision (<i>inspections</i>)	5
Investment products	7
Complaints (<i>6 against intermediaries and 1 against a listed company</i>)	7
Enforcement and surveillance	13
Corporate finance (<i>processing of listing applications under the Dual Filing regime</i>)	1
Total	40

Engagement with the industry

2.8 The PRP attaches great importance to the views from all users of the market on issues within its terms of reference. The PRP received comments from the relevant industry associations and trade bodies on the internal operational procedures of the SFC and followed up on issues raised by market players.

2.9 The PRP welcomes public views on the SFC's operational procedures which fall within the PRP's terms of reference¹. Suggestions and comments can be referred to the PRP Secretariat by post (Address: Secretariat of the Process Review Panel for the Securities and Futures Commission, Room 1801, 18th Floor, Tower 1, Admiralty Centre, 18 Harcourt Road, Admiralty, Hong Kong) or by email (email address: prp@fstb.gov.hk).

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

By post to : 8th Floor, Chater House, 8 Connaught Road, Central, Hong Kong
By telephone to : (852) 2840 9222
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 3 Observations and recommendations arising from the review of completed cases

3.1 On the basis of the cases reviewed in the period covered by this report, the PRP concluded that the SFC had generally followed its internal procedures in handling those cases. There were certain areas where the PRP had made recommendations to the SFC for improvement. Where the SFC had difficulties in adopting a recommendation, detailed explanations were given. The observations and recommendations are summarised below. Details of the SFC's responses to the recommendations accepted are at **Annex C**. Their response to the recommendation that has not been accepted in full is at **Annex D**.

(A) Licensing of intermediaries

3.2 The PRP reviewed seven cases on licensing of intermediaries. The PRP noted that the SFC had generally followed the standard procedures in processing those cases. The longer processing time in certain cases was mainly attributable to the time taken by the applicants in providing information and documents to the SFC, or in fulfilling the licensing requirements.

(B) Inspection of intermediaries

3.3 The PRP reviewed five cases on inspection of intermediaries. The PRP noted that the SFC had generally followed the standard procedures in processing those cases. The longer processing time in certain cases was attributable to the time taken on the part of the intermediaries concerned to provide information and documents requested by SFC staff for reviewing issues identified during the inspections.

Selection of target for inspection

3.4 The PRP noted that the SFC selected intermediaries for inspection or prudential visit² on the basis of the risk profile of these firms. Under this approach, firms which were inactive and hence were not assessed to be high risk would not be selected for inspection. Since the risk profile of such firms might change over time, the PRP invited the SFC to advise on the tools adopted to detect changes in a firm's risk profile.

3.5 The SFC explained that it could detect changes in a firm's risk profile by conducting analysis and review of the firm's monthly financial returns, which provided information on the financial position and business operation of the company. If a firm which had been inactive for some time started to conduct a new line of business, its financial returns would reflect the change. For example, if a broker firm started to provide margin financing to its clients, the firm would be required by law to notify the SFC of a change in its nature of business. The broker firm was also required under the Securities and Futures (Financial Resources) Rules ("FRR") to report on the size of the outstanding margin loan in its returns. In addition, the SFC could review the annual audit report, which provided an independent assessment of the ability of the company in complying with the FRR and client assets rules. Other sources of information that could help the SFC detect changes in a firm's risk profile included market news, complaints lodged with the SFC, enforcement action, changes in the licensing database and sharing of information with Hong Kong Exchanges and Clearing Limited and overseas regulators. The PRP noted the SFC's clarification.

Letter of deficiencies

3.6 According to the procedural manual, in case the issues arising from an inspection are not resolved within four months, the SFC will issue an interim letter of deficiencies to the intermediary. The interim letter

² Generally speaking, prudential visits are more appropriate for firms which are considered to have lower risks. Prudential visits allow the SFC to gain an overall understanding of the business outlook and future viability of the companies through meetings with the senior management of the companies. Inspection involves on-site examination of the books and records of the firms and allows the SFC to examine the firm's compliance with legislation and rules, and evaluate the firm's financial position and internal control procedures. Inspection also acts as a deterrent against intermediaries undertaking dubious or illegal practices.

summarises the areas of concern, deficiencies and breaches identified and agreed. A final letter will be issued to the intermediary upon completion of review of all information received, including information relating to issues outstanding at the time of issue of the interim letter. The PRP noted in an inspection case that the SFC had not issued an interim letter of deficiencies within four months.

3.7 In response to the PRP's comment that the SFC should follow the procedures set out in the procedural manual and issue an interim letter of deficiencies in a timely manner, the SFC explained that the case was an isolated incident having regard to the particular circumstances surrounding the case. For the case in question, the subject officer who conducted the inspection had resigned but other officers of the team managed to follow up the case, in particular to take control of the situation after the identification of the problem with the overseas parent company of the firm inspected. The final letter of deficiencies was issued to the firm five months after completion of fieldwork. The SFC agreed to follow the established procedures as far as possible in future.

(C) Authorisation of collective investment schemes

3.8 The PRP reviewed seven cases on authorisation of collective investment schemes and noted that the SFC had generally followed the standard procedures in processing these cases. The longer processing time in certain cases was attributable to the time taken on the part of the applicants to respond to the SFC's enquiries and requests for information.

Time limit for putting an application on hold

3.9 The PRP noted that in one case, the processing work of an application for authorisation of a unit trust was put on hold for 13 months on the request of the applicant. While the procedural manual requires proper documentation of an applicant's request for withholding an application, the manual does not specify the time allowed for putting an application on hold. The PRP suggested introducing a time limit on putting an application on hold to avoid undue delay in the processing work. In response, the SFC agreed that in normal cases, the SFC would only accept a holding request of up to three months, and request for putting an application on hold for more

than three months would be accepted only in exceptional circumstances. The SFC would update the procedural manual accordingly.

Use of checklist for processing application for authorisation of unit trusts and mutual funds

3.10 The PRP noted that in the case of Investment-Linked Assurance Schemes, an applicant was required to fill in a standard compliance checklist. However, there was no such requirement for application for unit trusts and mutual funds. The PRP considered it a good practice to use a standard compliance checklist so that the relevant considerations could be captured in a standard template. The SFC explained that under the Code on Unit Trusts and Mutual Funds (“the Code”), all documents submitted with the application had to be annotated against the corresponding requirements stipulated in the Code. Moreover, the compliance officers of the company or of the fund would be required to confirm in writing that the documents had been checked against the relevant compliance requirements. The SFC considered that the current practice of requiring annotations on the application documents worked effectively as a compliance checklist and the existing arrangement had been working smoothly. The use of an additional checklist might not be desirable as it would impose additional cost and burden onto the applicants.

Implication of the five-day week arrangement on performance pledges

3.11 The SFC introduced five-day week in July 2006. The PRP has invited the SFC to consider possible impact on the performance pledges given in the procedural manual. The SFC advised that the total number of working hours in a week remained the same and hence there should not be any changes in the processing time of application for authorisation of investment products. Noting that some parts of the procedural manual used “week”³ to indicate the processing timeframe, the PRP invited the SFC to consider reviewing the procedural manual and, where appropriate, setting out the processing milestones in terms of business days. The SFC explained that the performance pledges given on its website and in SFC’s

³ For the processing of application for authorisation of Investment-Linked Assurance Schemes, the SFC’s procedural manual requires that a requisition letter be issued to an applicant within one week from the issue of a take-up letter.

internal guidelines used either business days or working days. Notwithstanding, the SFC agreed to review and, where appropriate, revise the procedural manual in the next revision exercise.

(D) Handling of complaints against intermediaries

3.12 The PRP reviewed six cases of complaints against intermediaries and concluded that the SFC had generally followed the standard procedures in handling these cases.

3.13 In one case, the SFC received a complaint against a securities company for refusing to execute trading instructions made by the representative of the account holder; and for taking an unduly long time to process an authorisation for the representative to trade in the account. The PRP noted that the SFC had generally followed the established procedures in handling the complaint but its reply to the complainant did not address the issue about the long time taken by the securities company to process the authorisation. The SFC explained that the time taken to process the authorisation was a quality of service issue. Therefore, the SFC in its reply to the complainant explained that it would only look into possible breaches of the rules and regulations administered by the SFC and would not be able to resolve commercial dispute which was outside the SFC's jurisdiction. The PRP suggested that, where appropriate, the SFC consider providing additional information on the proper channels for the complainant to lodge a complaint about the quality of service of securities companies, which was outside the SFC's jurisdiction. In response, the SFC agreed that where possible, it would explain to the complainant the proper channels to file his complaint on issues outside its jurisdiction.

3.14 The SFC informed the PRP that the SFC had introduced in March 2005 a new requirement to issue an interim reply to a complainant at quarterly intervals so as to keep the complainant informed that the case was receiving attention. The procedural manual would be updated to reflect this arrangement. The PRP considered that the new practice an improvement in the handling of complaints, and was pleased to note that the relevant requirement had been incorporated in the procedural manual in November 2006.

(E) Investigation and disciplinary action

3.15 In 2006, the PRP reviewed 13 enforcement and surveillance cases. For enforcement cases, it consisted of six cases involving settlement of disciplinary action, four cases relating to issue of warning letters and two cases on suspension of licence.

Settlement of disciplinary action (including fining)

Initiating settlement negotiation

3.16 In one case, a securities company reported to the SFC that it failed to maintain the level of liquid capital required by the FRR for several days due to the financing need of its clients in an initial public offering subscription. After reviewing the penalties in several cases of FRR breaches in the past, the SFC considered it appropriate to impose public reprimand and a fine on the company. The SFC invited the company to a without prejudice meeting for the purpose of resolving the matter by settlement. Taking into consideration the mitigating factors, including the company's agreement to appoint an auditor to conduct a review in relation to internal control failings, the SFC agreed to reduce the amount of the fine.

3.17 The PRP noted the SFC's earlier advice as reported in the PRP Annual Report for 2004 that it was the SFC's standing policy that it was not appropriate for the regulator to actively solicit settlement⁴. The SFC considered it a cardinal principle of settlement that settlement negotiations should be initiated by the person proposed to be disciplined unless the circumstances were exceptional. It was not appropriate for a regulator to actively solicit settlement as it would call into question the credibility of the regulator and any payment it sought. As it appeared from the case described in paragraph 3.16 that the settlement negotiation was not initiated by the company to be disciplined, the PRP invited the SFC to clarify any change in their policy regarding settlement.

⁴ In 2004, the PRP reviewed a case and noted that the SFC decided to suspend the licences of two persons. The SFC subsequently entered into settlement agreement with only one of these two persons. The SFC explained that it was because only one of the persons had approached the SFC for settlement. The SFC's explanation was reported in the paragraph 4.18(c) of the PRP Annual Report for 2004.

3.18 The SFC advised that since 2005, they started on an experimental basis to approach persons proposed to be disciplined in certain circumstances to see if they were receptive to early settlement before starting formal disciplinary proceedings. The SFC pointed out that the relevant policy had been disclosed in the SFC Annual Report for 2005-06. Under the new policy, the SFC would “*actively make settlement approaches in suitable cases before starting formal action*”, and “*chose to settle only those cases where defendants had co-operated in investigations, the facts were relatively clear and the likely penalty was relatively predictable because there were enough similar cases.*”

3.19 The PRP considered that the criteria for the SFC to initiate settlement negotiation under the new policy should be set out properly in the procedural manual in order to ensure consistency in application. The SFC agreed and would include the relevant criteria in the procedural manual subject to the ongoing review of the settlement practices. The SFC explained that settlement could be initiated by a person at any stage. The SFC would initiate settlement negotiation only when the factual basis of the case was clear, the person proposed to be disciplined had co-operated with the SFC throughout the process and there was a body of precedent supporting an appropriate penalty range. The same policy applied whether or not the process was initiated by the SFC or by the affected party. The SFC further explained that the procedural manual already required the subject officer to provide a brief statement of facts which summarised the allegations before commencement of formal disciplinary proceedings and such statement provided the factual basis of the case.

Factors for determining the level of fines

3.20 In another case, the SFC entered into settlement agreement with a securities company and its two responsible officers for breaching the FRR and failed to report to the SFC within the required time limit. Under the terms of settlement, the company and its two responsible officers were given a public reprimand and one of the responsible officers was fined. The PRP noted that it was difficult to see a consistent pattern on the amount of fines in this case and the two cases reviewed in 2005, notwithstanding the nature of the misconduct in all the three cases were the same, i.e. breaching the FRR. Noting that there could be inherent difficulty in specifying the

amount of fines for each type of misconduct having regard to the difference in circumstances in each case, the PRP considered it imperative for the SFC to make reference to a database of precedent cases in considering the penalty and to maintain proper audit trails of such comparison and deliberation. The database could be refined in the light of experience with a view to developing a benchmark to determine the level of fines for different types of misconduct. In case the proposed penalty would deviate from the benchmark of precedent cases, the reasons for such deviation should also be properly documented.

3.21 The SFC agreed with the tenor of the PRP's recommendation. In fact, the SFC has all along kept a database of precedent cases. The SFC has also been requiring its staff to make reference to similar precedent cases before making any penalty proposal and to document the process on file. However, the SFC considered that it would not be helpful to require earlier decisions to become benchmarks in the sense of binding precedents. Every case would be different and each case has to be decided on its own merits. That was not to say earlier cases could not act as guides. Instead the SFC aimed to achieve greater consistency in penalties by adopting the same approach and a consistent set of criteria for their decisions, including comparison with previous similar cases.

Disciplinary action in addition to criminal prosecution

3.22 In the case described in paragraph 3.20 above, the SFC had also prosecuted the company and one of the responsible officers for failure to maintain the required level of liquid capital and for breaching the FRR. Following conviction of the persons concerned, the SFC considered disciplinary action and initiated settlement negotiation with the persons. The PRP noted that in two cases reviewed in 2005 concerning breaches of FRR, the SFC did not initiate prosecution. The PRP invited the SFC to consider putting in place a due process and introducing working tools such as a checklist of considerations to ensure consistency in the decision as to whether disciplinary action should be initiated in addition to prosecution or vice versa. The SFC agreed to develop a policy that would guide its staff in deciding when to take or recommend criminal proceedings in lieu of or in addition to disciplinary proceedings.

Delaying tactics used by defendants in disciplinary proceedings

3.23 In another case where the SFC found that a securities company had several internal control deficiencies, the SFC took disciplinary action against the company and several persons concerned. The PRP noted that the disciplinary process took 18 months to complete. In response to enquiries from the PRP, the SFC pointed out that one of the reasons for the delay was that the solicitors of the persons proposed to be disciplined had made repeated requests for documents of all kinds and sought extension for submission of representations. The PRP invited the SFC to consider introducing suitable steps in the procedures to guard against delaying tactics used by defendants causing inordinate delay in the disciplinary procedures. The SFC agreed.

Warning letters

3.24 The PRP reviewed four cases in relation to issue of warning letters. It was noted that in all the four cases, warning letters were issued following disciplinary action or as one of the terms of settlement agreements. In these cases, the companies or the persons concerned should have the opportunities to submit representations.

3.25 Since 2004, the PRP had been discussing with the SFC how the existing process could be improved to ensure the affected party was given an opportunity to be heard before a warning letter is issued. The SFC had difficulties to accept the PRP's recommendations in full. The SFC maintained its stance that their procedures reflected an appropriate balance of fairness and resources implication with due regard to the informal nature of a warning letter. The views of the PRP and the SFC were published in the PRP Annual Reports for 2004 and 2005.

3.26 Following the publication of the PRP Annual Report for 2005, the PRP received a comment from a group of market practitioners in October 2006 reiterating the concern about the lack of hearing and appellate process prior to the issue of warning letters. The market practitioners pointed out that although warning letter was not a formal or statutory sanction, it could be taken as a stigma and could have an unintended adverse consequence to the career or even the livelihood of the subject of the

warning. According to the practitioners, a job applicant would usually be required to disclose his/her previous involvement in investigation and disciplinary action in the application form, including investigation that resulted in the issue of a warning letter. Most employers would prefer not to employ persons with a record of warning to protect itself from future SFC actions should the persons commit another breach of the rules in future. In view of the adverse consequence on the recipient of a warning letter, it would be necessary to ensure that the persons would be given a chance to make representation prior to the issue of a warning letter, despite the SFC's intention that such warning was only informal.

3.27 The PRP noted the comments from the market practitioners and considered that there might be a perception gap between the market practitioners and the SFC on the use of warning letter. In order to better understand the issue, the PRP had invited the SFC to provide further information on the circumstance leading to the issue of a warning letter and would continue to discuss with the SFC on how the existing process could be improved in the coming year.

Suspension of licence

3.28 The PRP reviewed two disciplinary cases which resulted in suspension of licence. The PRP noted that the SFC had followed its established procedures in processing the two cases. In one case, an account executive of a securities company was found to have used clients' accounts to place personal orders and discretionary orders without authorisation from the clients. The SFC's investigation revealed that a responsible officer of the company was aware of the misconduct but did not report to the SFC until nearly a year later. The responsible officer was subsequently given a public reprimand. The PRP considered that the penalty should be proportionate to the gravity of the misconduct which, in the case in question, could possibly amount to harbouring of misconduct. The PRP invited the SFC to clarify whether the process in determining the penalty included comparison with precedent cases. If the penalty in the case in question was more lenient compared to similar cases in the past, the reasons for such deviation should be documented properly.

3.29 In response, the SFC explained that in the absence of conclusive evidence, the SFC did not consider the responsible officer had been harbouring the misconduct. In considering the penalty, the SFC had made a comparison with another case involving diligence failings. The SFC explained that in principle, penalty decisions would be made in the light of precedent cases. However, it was not always possible to find precedent cases so alike that a comparison of outcome or penalty would be helpful or meaningful. The SFC considered that each case should be determined on its own merits and in the light of prevailing circumstances. Accordingly, the SFC believed earlier cases could offer guidance but could not fetter the discretion that would be applied in each case.

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

3.30 The Securities and Futures (Stock Market Listing) Rules (“the Rules”) require a corporation applying for listing of its securities to file copies of its listing application with the SFC after the same is submitted to a recognised exchange company. To facilitate compliance and minimise any additional cost to a listing applicant, the Rules enable the applicant to fulfil this obligation by authorising the exchange company to file the material with the SFC on its behalf. This arrangement is known as “Dual Filing”.

3.31 Section 6 of the Rules stipulates that the SFC may, within ten business days of an applicant filing an application for listing or supplying further information, require the applicant to supply further information, or object to the listing application in certain circumstances as stipulated in the Rules. In order to ensure that the SFC’s ability to follow the ten-day framework set out in the Rules would not be jeopardised, the SFC sought and received a reaffirmation from The Stock Exchange of Hong Kong Limited (“SEHK”) in early 2004 of its commitment to forwarding listing applications and related documents to the SFC as soon as practicable.

3.32 The PRP reviewed one case relating to the processing of a listing application under the Dual Filing regime. The PRP noted that in that case, the SFC received the listing application and relevant documents from the SEHK within ten days and provided its observations to the SEHK promptly. The PRP noted that the SFC had followed the established procedure in processing the case.

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

4.1 The PRP attaches great importance to views from the industry on possible areas for improvement to the SFC's procedures. In 2006, the PRP received and referred to the SFC for consideration several comments and suggestions from market practitioners and members of the public. In April 2006, the PRP received a request asking the Panel to review two cases relating to suspected disclosure of false or misleading price sensitive information. The PRP has reviewed these cases and provided the SFC with its observations and comments. The PRP's discussion and views on these issues are summarised below. Details of the SFC's response to the PRP observations and recommendations are at **Annex C**.

(A) Audit trail of decision to take no further action

4.2 In one case, a listed company announced that arising from an incorrect application of a new accounting standard, the unaudited profits given in its earlier announcement had been overstated. There were comments made to the PRP that profit was an indicator of performance and could materially affect the share price of a listed company. Disclosure of incorrect information in this respect could potentially mislead investors.

4.3 To proceed with the review of the case, the PRP invited the SFC to provide the relevant case files. The SFC advised that the matters were discussed and assessed amongst senior members of the Surveillance Department who decided that the matters did not warrant a formal inquiry or investigation. Since no follow up action was required, no case file had been opened. Nonetheless, for the purpose of PRP review, the SFC provided a chronology of events of the case. On the basis of information provided and having regard to its terms of reference, which is confined to the adequacy of the SFC's internal procedures and the adherence of such procedures by the SFC but not the merit of the case, the PRP considered that the SFC had followed the existing procedures in ascertaining whether there was a prima facie case of misconduct and taking appropriate follow-up action.

4.4 The PRP however considered that in this case, the SFC had actually taken a decision that no further action was required. The PRP recommended that, as far as the decision making process was concerned, a proper audit trail on the considerations leading to the SFC's decisions should be maintained.

4.5 In response, the SFC advised that it was of paramount interest and concern to the SFC to ensure that decisions to open and close investigation cases were well-made and reasoned. For this reason, it was an area that the SFC was keen to refresh and improve and would add this process to the procedural manual in due course.

(B) Handling of complaint on alleged improper disclosure of price sensitive information

4.6 In another case, the SFC received several complaints about the remarks made by a person who was the chairman of a listed company regarding his plan to inject assets to that company. The company concerned subsequently issued an announcement denying such plan. The complainants alleged that the person might have improperly disclosed price sensitive information. The PRP had reviewed the files on the complaints and noted that the SFC had issued written replies to the complainants promptly. The PRP considered that the SFC had followed the established procedures in handling the complaints. In reaching this finding, the PRP has made due regard to the fact that merits of the SFC's decision was outside the PRP's jurisdiction.

4.7 The PRP however noted that the SFC's consideration of the complaint was primarily based on a paper review of media reports about the person's remarks and the company announcements. The PRP commented that it would be useful if the SFC could also conduct interview with the subject of the complaint to obtain clarifications. The SFC took note of the PRP's suggestion.

Chapter 5 Way forward

5.1 In 2006, the PRP performed its functions through the review of completed cases and selected topics of the SFC's operational procedures and made relevant recommendations to the SFC. The PRP also maintained a dialogue with the industry with a view to gauging the industry's views on procedural matters.

5.2 For 2007, the PRP will follow up on a number of the recommendations made in 2006. These include the SFC's internal procedures on the issue of warning letters to intermediaries, the development of a policy on initiating criminal proceedings in lieu of or in addition to disciplinary proceedings, and prescribing in the procedural manual the circumstances in which the SFC may initiate settlement negotiation.

5.3 The PRP will continue its work on the review of completed cases to ensure that the SFC adheres to its internal procedures consistently. It will also continue its dialogue with market players affected by the SFC regulatory processes and procedures to listen to their concerns about the exercise of powers by the SFC.

5.4 The PRP welcomes views from the general public, especially the users of the securities and futures markets, on the performance of functions by the SFC with a view to identifying any areas of improvement to the procedures and processes.

Chapter 6 Acknowledgement

6.1 The PRP would like to express its gratitude to the SFC for their assistance in facilitating the review work, and their co-operation in responding to the PRP's enquiries and recommendations in the past year. The PRP is also grateful to members of the industry who have offered valuable comments on the possible areas of improvement to the SFC's internal procedures and processes.

6.2 The PRP has also passed a vote of thanks to the outgoing Chairman, Mr Vincent Cheng and members, Mr Henry Cheong, Hon Audrey Eu, Mr Fong Hup, Mr Edward Kwan, Dr York Liao, Mr Joseph Pang and Mr Martin Wheatley, for their dedicated service and valuable contribution to the work of the PRP.

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

Terms of reference

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

2. To receive and consider periodic reports from the Commission on all completed or discontinued cases in the above-mentioned areas, including reports on the results of prosecutions of offences within the Commission's jurisdiction and of any subsequent appeals.

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

**Membership
of the Process Review Panel
for the Securities and Futures Commission**
(up to 31 October 2006)

- Chairman: Mr. CHENG Hoi Chuen, Vincent, GBS, JP
- Members: Professor CHAN Yuk Shee, BBS, JP
- Mr. CHEONG Ying Chew, Henry
- Mr. CHOW Wing Kin, Anthony, SBS, JP
- The Honourable EU Yuet Mee, Audrey, SC, JP
- Mr. FONG Hup, MH
- Mr. KAM Pok Man
- Mr. KWAN Pak Chung, Edward
- Mr. PANG Yuk Wing, Joseph, JP
- Ex-officio members: Chairman, Securities and Futures Commission
(Mr. Martin WHEATLEY)
(up to 22 June 2006)
- Non-Executive Director, Securities and Futures
Commission (Dr. York LIAO, SBS, JP)
- Representative of Secretary for Justice
(Mr. Ian G M WINGFIELD, GBS, JP)
(up to 3 May 2006)
(Mr. LAI Ying Sie, Benedict, JP)
(with effect from 4 May 2006)

**Membership
of the Process Review Panel
for the Securities and Futures Commission**
(with effect from 1 November 2006)

Chairman: Mr. CHOW Wing Kin, Anthony, SBS, JP

Members: Professor CHAN Yuk Shee, BBS, JP

Mr. CHIU Chi Cheong, Clifton

Mr. FUNG Hau Chung, Andrew

Mr. KAM Pok Man

Mr. LEE Jor Hung, Dannis, BBS

Mr. LIU Che Ning

Mr. SUN Tak Kei, David, BBS

Ex-officio members: Chairman, Securities and Futures Commission
(Mr. FONG Ching, Eddy, SBS, JP)

Representative of Secretary for Justice
(Mr. LAI Ying Sie, Benedict, JP)

Membership of Working Groups
(as at 31 December 2006)

Working Group on Corporate Finance and Enforcement

Chairman: Professor CHAN Yuk Shee, BBS, JP

Members: Mr. CHOW Wing Kin, Anthony, SBS, JP

Mr. FONG Ching, Eddy, SBS, JP

Mr. LEE Jor Hung, Dannis, BBS

Mr. LIU Che Ning

Working Group on Licensing, Intermediaries Supervision and Investment Products

Chairman: Mr. KAM Pok Man

Members: Mr. CHIU Chi Cheong, Clifton

Mr. FUNG Hau Chung, Andrew

Mr. LAI Ying Sie, Benedict, JP

Mr. SUN Tak Kei, David, BBS

Securities and Futures Commission's responses⁵ to the observations and recommendations that are accepted

(A) Inspection of intermediaries

Item (1)
<p><u>Case findings/market views</u></p> <p>The PRP noted that the SFC selected intermediaries for inspection or prudential visit on the basis of the risk profile of these firms. Under this approach, firms which were inactive and hence were not assessed to be high risk would not be selected for inspection.</p>
<p><u>PRP recommendation/observation</u></p> <p>Since the risk profile of firms might change over time, the PRP invited the SFC to advise on the tools adopted to detect changes in a firm's risk profile. (Para. 3.4 of Chapter 3)</p>
<p><u>SFC's response</u></p> <p>On-site inspection is indeed just one of the many regulatory tools used in the supervision in licensed corporations. The SFC is also able to detect the change in the firm's risk profile by performing off-site review of the following sources of information:</p> <p>(a) <i>Monthly financial returns</i></p> <p>The SFC critically analyses information contained in the financial returns to understand financial position and business operation of a licensed corporation. If a previously inactive firm suddenly starts to conduct a new line of business, its financial returns will reflect the change. Take the example where a cash broker starts to provide margin financing to clients. Firstly, the broker is required by law to notify the SFC of this significant change in nature of business. Secondly, the outstanding margin loan will also be reflected in the Securities and Futures (Financial Resources) Rules ("FRR") return.</p> <p>(b) <i>Annual report submitted by the auditors of licensed corporations</i></p> <p>Annual audit report is also one of our major regulatory tools to understand the risk profile of the licensed firms, for example, how well they have been complying with the FRR, client assets rules etc.</p> <p>(c) <i>Other sources of intelligence</i></p> <p>This includes market news, complaints received by Complaints Control Committee, enforcement cases and actions, change in the licensing database, sharing of information with the Hong Kong Exchanges and Clearing Limited and overseas regulators.</p> <p>Responsible case officers will perform their risk assessment on the firms under their portfolio and make recommendations for inspection to be conducted where needed.</p>

⁵ Editorial changes are made mainly to remove case specific information.

Item (2)

Case findings/market views

According to the procedural manual, in case the issues arising from an inspection are not resolved four months after completion of the fieldwork, the SFC will issue an interim letter of deficiencies to the intermediary. The interim letter summarises the areas of concern, deficiencies and breaches identified and agreed. A final letter will be issued to the intermediary upon completion of review of all information received, including information relating to issues outstanding at the time of issue of the interim letter. The PRP noted in an inspection case that the SFC had not issued an interim letter of deficiencies four months after the fieldwork.

PRP recommendation/observation

The SFC should follow the procedures set out in the procedural manual and issue an interim letter of deficiencies in a timely manner. (Para. 3.7 of Chapter 3)

SFC's response

The SFC clarified that staff resignation was not the only reason for the delay in issuing the interim letter. In fact, the main reason was the break-out of the problem with the inspected firm's overseas parent company and the need to urgently take control of the situation in Hong Kong thereafter. The above notwithstanding, the SFC took note of the PRP member's comments and would endeavour to adhere to established procedures as far as possible in the future.

(B) Authorisation of collective investment schemes

Item (3)

Case findings/market views

The PRP noted that the processing work of an application for authorisation of a unit trust was put on hold for 13 months on the request of the applicant. While the procedural manual requires proper documentation of an applicant's request for withholding an application, the manual does not specify the time allowed for putting an application on hold.

PRP recommendation/observation

The PRP suggested introducing a time limit on putting an application on hold to avoid undue delay in the processing work. (Para. 3.9 of Chapter 3)

SFC's response

The request was accepted as the SFC's procedural manual did not specify any time limit for a request from an applicant to put an application on hold. The subject request was accepted in line with past practice. In light of the comments from the PRP, the SFC have since then tightened its consideration on any requests from an applicant to put a fund application on hold. In normal cases, the SFC will only accept a holding request of up to 3 months. Any request for a longer holding period will only be allowed in

exceptional circumstances. The SFC will update the relevant provisions in the procedural manual to reflect the above in due course.

Item (4)

Case findings/market views

The SFC introduced five-day week in July 2006. The PRP has invited the SFC to consider possible impact on the performance pledges given in the procedural manual. The SFC advised that the total number of working hours in a week remained the same and hence there should not be any changes in the processing time of application for authorisation of investment products.

PRP recommendation/observation

Noting that some parts of the procedural manual used “week” to indicate the processing timeframe, the PRP invited the SFC to consider reviewing the procedural manual and, where appropriate, setting out the processing milestones in terms of business days. (Para. 3.11 of Chapter 3)

SFC’s response

As regards the SFC’s performance pledges, there should be no confusion to external parties as the corresponding information is currently set out on the SFC website at <http://www.sfc.hk/sfc/html/EN/aboutsfc/performance/performance.html>. For ease of reference, it is stated on the website that the target for issuing a “[p]reliminary response to applications after take-up for ... investment-linked assurance schemes” is “7 business days.”

Internally, there should be no confusion from an operational perspective. It is worth noting that section 2.17 of the SFC’s internal procedural manual for the authorisation of investment-linked assurance schemes (as referred to in the case review report in question) currently states, among other things, that “... Staff should fill in the ‘Track Record of Processing Time of Scheme Application’ form shown in Appendix 6 ...” Under Appendix 6, specific guidelines are provided to staff for completing the form in question, including “Only the no. of WORKING days should be counted.”

In light of the foregoing, the SFC considered that there should be no confusion, externally or internally, about the performance pledges. Having said that, the SFC takes note of the PRP’s observation and would revisit the relevant clause in the procedural manual, namely “... All applications shall be taken up within two working days of their receipt, and requisitions to applicants shall be made within 1 week of take-up ...”, and consider amendment in the next revision exercise.

(C) Handling of complaints against intermediaries

Item (5)

Case findings/market views

The SFC received a complaint against a securities company for refusing to execute trading instructions made by the representative of the account holder; and for taking an unduly long time to process an authorisation for the representative to trade in the account. The PRP noted that the SFC had generally followed the established procedures in handling the complaint but its reply to the complainant did not address the issue about the long time taken by the securities company to process the authorisation. The SFC explained that the time taken to process the authorisation was a quality of service issue. Therefore, the SFC in its reply to the complainant explained that it would only look into possible breaches of the rules and regulations administered by the SFC and would not be able to resolve commercial dispute which was outside the SFC's jurisdiction.

PRP recommendation/observation

The PRP suggested that, where appropriate, the SFC consider providing additional information on the proper channels for the complainant to lodge a complaint about the quality of service of securities companies, which was outside the SFC's jurisdiction. (Para. 3.13 of Chapter 3)

SFC's response

The SFC noted the observation of the PRP members concerning reply to complainants. Upon lodging the complaint, the complainant has already been advised that the SFC would only look into possible breaches of the rules and regulations administered by the SFC and would not be able to order compensation or intercede with commercial disputes. Where possible, the SFC would suggest to the complainant the proper channels to file his complaint on issues that are not within our jurisdiction. As action taken by the SFC is non-public information, it is bound by the secrecy provisions under the SFO not to disclose any such information and we may not be able to reply to the complainant with the details as suggested. The SFC would consider reiterating the above message in the reply where the circumstances warranted.

Item (6)

Case findings/market views

The SFC informed the PRP that the SFC had introduced in March 2005 a new requirement to issue an interim reply to a complainant at quarterly intervals so as to keep the complainant informed that the case was receiving attention. The procedural manual would be updated to reflect the arrangement.

PRP recommendation/observation

The PRP considered that the new practice an improvement in the handling of complaints. (Para. 3.14 of Chapter 3)

SFC's response

An updated procedural manual was provided to the PRP in November 2006.

(D) Investigation and disciplinary action

Items (7) and (8)

Case findings/market views

A securities company reported to the SFC that it failed to maintain the level of liquid capital required by the FRR for several days due to the financing need of its clients in an initial public offering subscription. After reviewing the penalties in several cases of FRR breaches in the past, the SFC considered it appropriate to impose public reprimand and a fine on the company. The SFC invited the company to a without prejudice meeting for the purpose of resolving the matter by settlement.

The PRP noted the SFC's earlier advice as reported in the PRP Annual Report for 2004 that it was the SFC's standing policy that it was not appropriate for the regulator to actively solicit settlement. The SFC considered it a cardinal principle of settlement that settlement negotiations should be initiated by the person proposed to be disciplined unless the circumstances were exceptional and it was not appropriate for a regulator to actively solicit settlement as it would call into question the credibility of the regulator and any payment it sought.

PRP recommendation/observation

The PRP invited the SFC to clarify any change in their policy regarding settlement. (Para. 3.17 of Chapter 3)

SFC's response

The SFC advised that since 2005, they started on an experimental basis to approach persons proposed to be disciplined in certain circumstances to see if they were receptive to early settlement before starting formal disciplinary proceedings. The SFC pointed out that the relevant policy had been disclosed in the SFC Annual Report for 2005-06. Under the new policy, the SFC would "*actively make settlement approaches in suitable cases before starting formal action*", and "*chose to settle only those cases where defendants had co-operated in investigations, the facts were relatively clear and the likely penalty was relatively predictable because there were enough similar cases.*"

The SFC pointed out that the procedural manual includes a requirement that, prior to commencement of formal discipline, a brief statement of facts will be prepared when starting settlement negotiations. The statement of facts should summarise the allegations. The procedural manual also contains a pro forma letter to be used in such cases. The SFC considered that this process provides an appropriate underpinning when cases are settled prior to formal proceedings being commenced.

Settlement can be initiated by a person at any stage. The early settlement process can be invoked by the SFC but the SFC will not do so unless the factual basis of the case is clear, the subject has cooperated with the SFC throughout the process and there is a body of precedent supporting an appropriate penalty range. The same policy applies whether or not the process is initiated by SFC or by the affected party. This is what is described in

the SFC Annual Report 2005-06. If it is the PRP's recommendation to include this policy approach in the procedural manual, the SFC will follow.

PRP recommendation/observation

The PRP considered that the criteria for the SFC to initiate settlement negotiation under the new policy should be set out properly in the procedural manual in order to ensure consistency in application. (Para. 3.19 of Chapter 3)

SFC's response

The SFC will include the criteria in the procedural manual subject to a current review of the settlement practices.

Item (9)

Case findings/market views

The SFC entered into settlement agreement with a securities company and its two responsible officers for breaching the FRR and failed to report to the SFC within the required time limit. Under the terms of settlement, the company and its two responsible officers were given a public reprimand and one of the responsible officers was fined. The PRP noted that it was difficult to see a consistent pattern on the amount of fines in this case and the two cases reviewed in 2005, notwithstanding the nature of the misconduct in all the three cases were the same, i.e. breaching the FRR and there could be inherent difficulty in specifying the amount of fines for each type of misconduct having regard to the difference in circumstances in each case.

PRP recommendation/observation

The PRP considered it imperative for the SFC to make reference to a database of precedent cases in considering the penalty and to maintain proper audit trails of such comparison and deliberation. The database could be refined in the light of experience with a view to developing a benchmark to determine the level of fines for different types of misconduct. In case the proposed penalty would deviate from the benchmark of precedent cases, the reasons for such deviation should also be properly documented. (Para. 3.20 of Chapter 3)

SFC's response

The SFC agrees with the tenor of this recommendation. In fact, the SFC has all along kept a database of precedent cases. The SFC has also been requiring its staff to make reference to similar precedent cases before making any penalty proposal and document the process on file. However, it would not be helpful to require earlier decisions to become benchmarks in the sense of binding precedents. Every case is different and each case has to be decided on its own merits. That is not to say earlier cases cannot act as guides. Instead the SFC is aiming to achieve greater consistency in our penalties by adopting the same approach and a consistent set of criteria to our decisions.

Item (10)Case findings/market views

In the case mentioned in item (9) above, the SFC had prosecuted the company and one of the responsible officers for failure to maintain the required level of liquid capital and for breaching the FRR. Following conviction of the persons concerned, the SFC considered disciplinary action and initiated settlement negotiation with the persons. The PRP noted that in two cases reviewed in 2005 concerning breaches of FRR, the SFC did not initiate prosecution.

PRP recommendation/observation

The PRP invited the SFC to consider putting in place a due process and introducing working tools such as a checklist of considerations to ensure consistency in the decision as to whether disciplinary action should be initiated in addition to prosecution or vice versa. (Para. 3.22 of Chapter 3)

SFC's response

The SFC will develop a policy that will guide its staff in deciding when to take or recommend criminal proceedings in lieu of or in addition to disciplinary proceedings.

Item (11)Case findings/market views

The SFC found that a securities company had several internal control deficiencies. The SFC took disciplinary action against the company and several persons concerned. The PRP noted that the disciplinary process took 18 months to complete. One of the reasons for the delay was that the solicitors of the persons proposed to be disciplined had made repeated requests for documents of all kinds and sought extension for submission of representations.

PRP recommendation/observation

The PRP invited the SFC to consider introducing suitable steps in the procedures to guard against delaying tactics used by defendants causing inordinate delay in the disciplinary procedures. (Para. 3.23 of Chapter 3)

SFC's response

The SFC agreed.

Item (12)

Case findings/market views

An account executive of a securities company was found to have used clients' accounts to place personal orders and discretionary orders without authorisation from the clients. The SFC's investigation revealed that a responsible officer of the company was aware of the misconduct but did not report to the SFC until nearly a year later. The responsible officer was subsequently given a public reprimand.

PRP recommendation/observation

The PRP considered that the penalty should be proportionate to the gravity of the misconduct which, in the case in question, could possibly amount to harbouring of misconduct. The PRP invited the SFC to clarify whether the process in determining the penalty included comparison with precedent cases. If the penalty in the case in question was more lenient compared to similar cases in the past, the reasons for such deviation should be documented properly. (Para. 3.28 of Chapter 3)

SFC's response

The SFC did not view this as a harbouring case because of conflicts in evidence with the relevant compliance officer. Accordingly, the case was treated as a lack of due diligence. A comparison was made with another case involving diligence failings. The penalty in that case was harsher because it concerned systemic failings involving the responsible officer. Penalty decisions are made in light of earlier cases where relevant. However, it is not always possible to find cases so alike that a comparison of outcome or penalty is helpful or meaningful. Each case must be determined on its own merits and in light of prevailing circumstances. Accordingly, the SFC believes earlier cases can offer guidance but they cannot fetter the discretion that needs to be applied in each case.

(E) Audit trail of decision to take no further action

Item (13)

Case findings/market views

A listed company announced that arising from an incorrect application of a new accounting standard, the unaudited profits given in its earlier announcement had been overstated. There were comments made to the PRP that profit was an indicator of performance and could materially affect the share price of a listed company. Disclosure of incorrect information in this respect could potentially mislead investors. To proceed with the review of the case, the PRP invited the SFC to provide the relevant case files. The SFC advised that the matters were discussed and assessed amongst senior members of the Surveillance Department who decided that the matters did not warrant a formal inquiry or investigation. Since no follow up action was required, no case file had been opened. Nonetheless, for the purpose of PRP review, the SFC provided a chronology of events of the case.

PRP recommendation/observation

The PRP however considered that in this case, the SFC had actually taken a decision that no further action was required. The PRP recommended that, as far as the decision making process was concerned, a proper audit trail on the considerations leading to the SFC's decisions should be maintained. (Para. 4.4 of Chapter 4)

SFC's response

That decisions to open and close investigation cases are well-made and reasoned is of paramount interest and concern to the SFC. For this reason, it is an area that the SFC is keen to refresh and improve and will do so. This process will be added to the procedural manual in due course.

(F) Handling of complaint on alleged improper disclosure of price sensitive information

Item (14)

Case findings/market views

The SFC received several complaints about the remarks made by a person who was the chairman of a listed company regarding his plan to inject assets to that company. The company concerned subsequently issued an announcement denying such plan. The complainants alleged that the person might have improperly disclosed price sensitive information. The PRP noted that the SFC's consideration of the complaint was primarily based on a paper review of media reports about the person's remarks and the company announcements.

PRP recommendation/observation

The PRP commented that it would be useful if the SFC could also conduct interview with the subject of the complaint to obtain clarifications. (Para. 4.7 in Chapter 4)

SFC's response

The SFC took note of the PRP's suggestion.

**Securities and Futures Commission’s responses⁶
to the observations and recommendations
that have not been accepted in full**

(A) Authorisation of Collective Investment Schemes

Item (1)
<p><u>Case findings/market views</u></p> <p>In the case of Investment-Linked Assurance Schemes, an applicant was required to fill in a standard compliance checklist. However, there was no such requirement for application for unit trusts and mutual funds.</p>
<p><u>PRP recommendation/observation</u></p> <p>The PRP considered it a good practice to use a standard compliance checklist so that the relevant considerations could be captured in a standard template. (Para. 3.10 of Chapter 3)</p>
<p><u>SFC’s response</u></p> <p>By way of background, it is a requirement under the Code on Investment-Linked Assurance Schemes to file a checklist of compliance. However, there is no such requirement under the Code of Unit Trusts and Mutual Funds (the “UT Code”).</p> <p>Under the UT Code, an applicant for authorisation of a scheme must submit a completed Application Form as set out in Appendix B of the UT Code. In addition, all fund documentation submitted have to be comprehensively annotated against the applicable requirements of the UT Code and the senior executives/compliance officers/legal advisers of the fund or fund manager shall also confirm in writing that these documents have been checked against compliance with the relevant UT Code requirements.</p> <p>The SFC consider that the current practice is sufficient to ensure full compliance with the UT Code and serve the same purpose of requesting for a checklist of compliance which may create additional cost and burden to the applicants.</p>

⁶ Editorial changes are made mainly to remove case specific information.