

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

**Annual Report**  
**to the Financial Secretary**

**For 2007**



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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 2007, 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 2007**

### **Highlights of work**

2.1            This report covers the work of the PRP from 1 January 2007 to 31 December 2007.

2.2            In 2007, the PRP reviewed 60 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.

### **Selection of cases for review**

2.3            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. Members of PRP 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 PRP also assessed the adequacy of the manuals from the perspective of fairness and reasonableness.



2.4 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**

2.5 PRP members conducted 15 case review meetings with the SFC’s case officers. In addition, the full Panel met twice to discuss specific issues relating to the SFC’s internal procedures and considered reports from members, which set out the observations and recommendations arising from the review of cases. The distribution of cases reviewed are –

Table 1 – Distribution of cases reviewed by the PRP

	No. of Cases
Licensing	19
Intermediaries supervision ( <i>inspections</i> )	7
Investment products	6
Complaints ( <i>including 2 against the SFC</i> )	4
Enforcement	23
Corporate finance ( <i>processing of listing applications under the Dual Filing regime</i> )	1
<b>Total</b>	<b>60</b>

### **Engagement with the industry**

2.6 The PRP attaches great importance to the views from users of the market on issues within its terms of reference. The PRP received comments from an industry association on the internal operational procedures of the SFC and followed up on issues raised by market players.

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

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

By post to : 8<sup>th</sup> 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 were summarised below. Details of the SFC's responses to the recommendations accepted are at **Annex C**. Their responses to the recommendations that had not been accepted in full are at **Annex D**.

### **(A)    Licensing of intermediaries**

3.2            The PRP reviewed 19 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 waiting for their compliance records being vetted with overseas regulators.

#### ***Application with incomplete information***

3.3            The SFC very often receives applications with incomplete information and supporting documents. The PRP noted that in processing these applications, the SFC had to ask each applicant in writing for supplementing the outstanding documents. In one case, the SFC had to issue three such tailor-made letters until the applicant could provide all the necessary documents. As a way to rationalise the use of SFC's resources, the PRP suggested the SFC consider using standard proforma letter with checkboxes specifying the supporting documents required. While the SFC accepted the approach being viable, it had doubts about the benefits in terms of savings in resources and procedural efficiency. The SFC counter-proposed to look into the possibility of using a standard requisition letter for each type of regulated activities, instead of one letter encompassing all types of licence applications. As a pilot scheme, licence

applications for hedge fund managers had started using such standard requisition letters. The SFC would review the effectiveness of the scheme and consider enlarging its scope of application.

3.4 In another case, the applicant was slow in responding to the SFC's requests despite repeated reminders. The applicant had finally withdrawn the application after more than a year of processing. The PRP suggested the SFC consider putting in place a due process to deal with lukewarm response from applicants. The SFC was invited to consider whether an application could be deemed withdrawn if the applicant failed to provide a substantive response after a prolonged period of time. The SFC considered the suggestion not viable as it was obliged to follow a statutory procedure in refusing a licence application. The SFC proposed that alternatively, if an applicant failed to provide the required information within a specified period, the SFC would proceed with the refusal process on the grounds that the limited information received was not adequate to prove that the applicant was fit and proper to be licensed.

### ***Registration of registered institution***

3.5 In one case, the SFC received applications from an authorised financial institution for registration as a registered institution and for the appointment of executive officers. The SFC sought advice from the Hong Kong Monetary Authority ("HKMA") as to whether the applicants were fit and proper for registration<sup>2</sup>. The applications had taken a fairly long time to be processed, because the applicant had initiated some significant changes in its proposed business activities and in nominations for executive officers and members of management to be involved in the proposed business activities. The PRP invited the SFC to discuss with the HKMA with a view to expediting the processing of applications from authorised financial institutions. In response, the SFC advised that the HKMA had

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<sup>2</sup> The SFC is responsible for approving person and corporation including authorised financial institution to carry on a regulated activity. An authorised financial institution registered with the SFC to carry on regulated activities is known as registered institution. The HKMA is the regulator for authorised financial institutions and supervises all types of activities including securities-related business of authorised financial institutions. According to the Memorandum of Understanding between the SFC and the HKMA, the SFC will refer applications for registration as a registered institution to the HKMA for advice as to whether the applicant is fit and proper to be registered. On the other hand, it is a statutory requirement that registered institution will appoint at least two executive officers responsible for the supervision of the securities-related business. The executive officers are required to have obtained written consent from the HKMA.

started a new practice of updating the SFC on the status of outstanding cases quarterly.

### ***Putting an application on hold pending outcome of an investigation***

3.6 In an application for becoming a responsible officer, the SFC noticed that the applicant was under an on-going investigation by the SFC. The case had been put on hold for several months pending outcome of the investigation. In view of the significant role of a responsible officer, the PRP suggested the SFC consider apprising the employer of the investigation. The employer should also be reminded not to allow the applicant to conduct any regulated activities until the application had been approved. Moreover, the PRP invited the SFC to consider expediting its investigation work.

3.7 The SFC explained that it could not disclose information relating to an investigation to an employer under the secrecy provisions in the Securities and Futures Ordinance (“SFO”). Moreover, as the investigation was still on-going and the SFC had yet to establish a case of misconduct, disclosure of such information could adversely affect the interest of the applicant. For example, the employer might withdraw his support to the application. The SFC considered that it was important to strike a balance between the interest of the applicant and the need for the employer to be aware of the conduct issue. On the suggestion of reminding the employer of the statutory requirement that a person should not conduct regulated activity unless he/she was holding a valid licence, the SFC considered it not necessary since market practitioners should be aware of this. The SFC also indicated that it had improved its investigation time significantly. The percentage of investigation cases completed within seven months had increased from 36% in 2006 to 71% in 2007.

### ***Processing of application from discharged bankrupt***

3.8 Section 129(1)(a) of the SFO provides that in considering whether a person is fit and proper to be licensed, the SFC shall have regard to a number of matters including the applicant’s financial status or solvency and financial integrity. As provided in the Fit and Proper Guidelines, the SFC is unlikely to be satisfied that a person is fit and proper if he/she is recently discharged from a bankruptcy order. In this context, “recent” is

normally taken to mean within the past five years. The PRP reviewed several cases in which the applicants were discharged bankrupts, and made several observations and recommendations to the SFC for consideration.

3.9 In processing an application for licence from a person who had been discharged from bankruptcy for three years, the SFC contacted the employer sponsoring the application to ascertain that the company was aware of the solvency background of the applicant. The SFC explained to the employer that based on the Fit and Proper Guidelines, the application was unlikely to be approved. The applicant subsequently withdrew the application. The PRP considered the SFC's five-year rule too stringent, given that a bankruptcy order could be set aside after four years already. In this regard, the SFC explained that the five-year rule was only a guiding reference. In considering an application from a discharged bankrupt, it would take into account factors like circumstances leading to the bankruptcy and the person's current solvency, in addition to the time of discharge from bankruptcy. In fact, between April 2003 and December 2007, the SFC had approved a total of seven applications from persons discharged from bankruptcy within five years, and refused only one.

3.10 In another case, in assessing an application from a person whose bankruptcy order had been annulled only three months before making the application, the SFC requested the applicant to provide additional information relating to the bankruptcy. The applicant replied with only a brief explanation on the circumstances leading to the bankruptcy and that the order was annulled after he had settled all his debts. As the applicant could not produce the relevant bankruptcy papers, the SFC suggested the applicant obtain copies from the government authority or the court. The applicant subsequently withdrew his application.

3.11 The PRP considered that since the bankruptcy order had already been annulled by the court, the SFC might take a flexible approach and consider other information available such as employer's reference, instead of relying solely on empirical evidence to assess the applicant's solvency position. In response, the SFC explained that in this particular case, it was necessary to make an assessment on a fully informed basis since the applicant's duties involved making trading decisions. The circumstances leading to the bankruptcy were valid indicators of the

person's character and integrity. Nonetheless, the SFC agreed with the PRP that it was viable to adopt a flexible approach in considering the types of supporting evidence in certain circumstances but the SFC would remain vigilant as to the reliability of the evidence provided. Where necessary, the SFC would request additional proof to ascertain the circumstances leading to the bankruptcy.

3.12 The PRP noted that an application from a discharged bankrupt was approved by a Senior Manager whereas in another case, an application from a person with conviction record was approved by a Director. The PRP noted that for cases with adverse information, the SFC's procedural manual only required the case officer to discuss the matter with more senior officers but did not specify the level of the decision-makers. Since both bankruptcy and criminal conviction were matters that might impugn the integrity of an applicant, the PRP considered that there should be consistency in the approval process, and invited the SFC to review and designate the approving authority for such cases in the procedural manual. In response, the SFC explained that given the vast variation in the nature of adverse information, it was difficult to define the approving authority for each type of cases. Nonetheless, the SFC agreed to consider requiring the decision to be made by an officer not below Senior Manager level and to review the procedural manual to ensure consistency.

3.13 To ensure a right balance between protecting the interest of the investing public and denying the livelihood of an applicant who might have only the skills for a job in the financial industry, the PRP recommended the SFC to issue guidelines on dealing with applications from discharged bankrupts. It would be useful to set out the criteria and considerations such as the supporting documents required for assessment. Moreover, a database and statistics on applications with adverse information should be maintained to provide ready reference.

3.14 In response, the SFC said that the procedural manual required the case officer to fully document the reasons for the decision to approve or refuse an application. Having regard to the PRP's concern, the SFC agreed to issue a set of Frequently Asked Questions to the public and prepare internal guidelines on handling applications from discharged bankrupts. While the SFC would consider individual merits of each case, it

endeavoured to take on board measures that could achieve consistency in its approach. Regarding the suggestion of establishing a database on applications with adverse information, the SFC explained that it had already set up an electronic database of licensees and individuals about whom the SFC had concerns. Statistics on the number of applications approved, refused or withdrawn could be derived from the existing licensing system.

### ***Whether a provisional licence should have a validity period***

3.15 The SFC may grant a provisional licence to an applicant pending completion of the full assessment process, such as vetting with overseas regulatory authorities. It was revealed in one case that the SFC, in the absence of adverse information in the application form, had granted a provisional licence to an applicant but was advised later that the applicant had a disciplinary record with an overseas regulatory authority. After making further enquiries with the applicant and his employer, the SFC considered that the matters leading to the disciplinary action overseas and the applicant's failure to disclose the disciplinary record in the application were not sufficient to warrant refusal of the licence application. The SFC finally granted a full licence to the applicant, subject to several licensing conditions.

3.16 The PRP noted that persons issued with a provisional licence were included in the "Public Register of Licensed Persons and Registered Institutions" on the SFC's website. As investors might regard holders of provisional licence and full licence as equally competent and might overlook the risks in dealing with provisional licence holders, the PRP considered it useful for the SFC to put a marker against names holding provisional licences on the public register so as to avoid confusion. In this regard, the SFC advised that a remark would be maintained on the public register on its website to indicate the status of a provisional licence holder.

3.17 In response to the PRP's question on the mechanism to revoke a provisional licence, the SFC explained that a provisional licence did not have an expiry date and it would lapse either upon issue of a full licence or refusal of the application. Since the statutory process to refuse a licence



application might take a long time<sup>3</sup>, it was possible that a provisional licence might remain valid for some time even if the SFC was minded to refuse the application on the basis of new evidence brought to light subsequently. In order to ensure better protection to the investing public, the PRP invited the SFC to consider introducing a validity period for a provisional licence.

3.18 The SFC explained that it could not implement the suggestion without introducing legislative amendments. Notwithstanding, the SFC said that it was only permitted to issue a provisional licence when, on the basis of the information then available to it, it was satisfied that the applicant was fit and proper. Therefore, this requirement was already a safeguard to investor protection. In addition, the SFC might revoke a provisional licence in exceptional circumstances<sup>4</sup> having regard to the interest of the investing public. The SFC considered that the current system provided an appropriate balance between the interest of the investing public and the licence applicants.

## **(B) Inspection of intermediaries**

3.19 The PRP reviewed seven 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 respond to the SFC's enquiries in connection with issues identified in the inspections.

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

3.20 The PRP reviewed six 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.

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<sup>3</sup> The process for refusal of a licence application involves issue of a letter of mindedness to the applicant indicating the intention to refuse the application and advising the applicant to submit representation against the decision, where appropriate. The process could be further lengthened if the applicant appeals to the Securities and Futures Appeals Tribunal to review the SFC's decision.

<sup>4</sup> Section 120(10) of the SFO provides that the SFC may, after having regard to the interest of the investing public and in its absolute discretion, by notice in writing revoke a provisional licence.

3.21 In one case, the processing work took more than nine months because the applicant accorded priorities and resources to the other applications submitted to the SFC concurrently. The applicant could not provide a substantive response to the SFC's comments in time despite the issue of several reminders. The PRP was concerned about whether the applicant had taken advantage of the application system by ensuring that the application, which might have been submitted pre-maturely, would remain valid. The SFC advised that it was common for applicants to review priorities of their concurrent applications. There was no evidence in this case suggesting an abuse of the system. Notwithstanding, in order to rationalise the use of its resources, the SFC was considering a new approach to deal with lukewarm response from applicants. If an applicant failed to provide a substantive response after a reasonably long time, the SFC might refuse the application on the grounds that it could not be satisfied that the requirements in the relevant code on collective investment scheme had been met. The SFC was reviewing its standard reminder letters<sup>5</sup> to highlight the possibility that an application could be refused.

#### **(D) Handling of complaints**

3.22 The PRP reviewed four complaint cases and concluded that the SFC had generally followed the standard procedures in handling these cases.

#### ***Acknowledgement of enquiries from ex-licensee***

3.23 An ex-licensee wrote to the Licensing Department asking what he needed to do in order to be licensed again. As he had not received any response from the SFC for more than a month, he made an enquiry to the SFC's office in person. Since he had not made an appointment in advance, the case officer handling his enquiry could not meet him. The case officer called him on the following day and asked him to submit an application for assessment. The person lodged a complaint to the SFC about its failure to acknowledge his enquiry and to meet him when he visited the SFC's office. In line with established practice, the SFC reviewed the process adopted by

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<sup>5</sup> According to the SFC's standard procedures, the SFC issues reminder letters at different stages of the processing work if a response from the applicant remains outstanding for months. An application may be deemed to be withdrawn if a substantive response remains outstanding for three months from the SFC's last request for information.

the Licensing Department in handling the enquiry. The Licensing Department explained that an acknowledgement was not given because it had intended to issue a substantive reply instead. Although the case officer was unable to meet the complainant, he called to answer his enquiries and sent him a written reply on the following day. The review concluded that the Licensing Department had processed the enquiry according to the standard procedures and a reply was issued to the complainant accordingly.

3.24 In response to the PRP's questions, the SFC explained that since the questions were related to the enquirer's licensing history and compliance record, it was not regarded as a general enquiry to which the SFC's performance pledge<sup>6</sup> was applicable. The existing practice did not require the Licensing Department to issue an acknowledgement to such enquiries having regard to its administrative burden. The PRP considered that public enquires should be handled expeditiously to meet the rising expectation of the public. An acknowledgement was a useful means to notify the person that the matters had been directed to the right place and were receiving attention. It was a good practice to issue an acknowledgement upon receipt of an enquiry instead of making no response for a period of time. The PRP suggested the SFC consider developing clear guidelines and timeframe for handling public enquiries of all sorts, including a timeline for issue of an acknowledgment. In response, the SFC agreed that it would be a good practice to issue acknowledgement to enquiries promptly. Subject to the availability of resources, the Licensing Department would formalise its internal practice to bring the response time generally in line with the performance pledge, i.e. making preliminary response within four business days for telephone enquiries, and within two weeks for written enquiries.

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<sup>6</sup> The SFC's performance pledge in respect of complaints and enquiries are as follows –

<b>Service</b>		<b>Target</b>
Investor Enquiries	Preliminary response to telephone enquiries	4 business days
	Preliminary response to written enquiries	2 weeks
Public Complaints	Preliminary response to verbal and written complaints	2 weeks
General Enquires	Preliminary response via enquiry@sfc.hk	4 business days

### ***Procedures for handling complaints against the SFC***

3.25 Arising from the review of two complaint cases, the PRP noted the SFC's advice that there was no written procedures for handling complaints against the Commission itself. The PRP suggested the SFC review its complaint handling procedures and submit its findings to the SFC Audit Committee for consideration from a corporate governance angle. In response, the SFC explained that it had always followed a consistent approach in handling complaints, but agreed that it would take steps to formalise the existing practice in writing and submit the proposals to the SFC Audit Committee for consideration in due course.

### ***Response to time-critical issues***

3.26 The SFC received, one day before the launching of an initial public offering exercise ("IPO"), a complaint about the proliferation of off-market deals in which investors were assured that they would be allotted with certain number of shares being offered upon paying a premium. Investors entering such deals ran a high risk as the seller might not fulfil the promise to deliver the shares. The complaint was reported to the SFC's Complaints Control Committee<sup>7</sup> ("the Committee") and a senior officer of the SFC promptly spoke at a meeting with the media about the risks to investors in entering such off-market deals. The PRP noted that the complaint was actually discussed at the Committee one day after the close of the IPO. As the Committee met on a weekly basis and might not be able to cope with urgent or time-critical issues, the PRP invited the SFC to advise how it would deal with urgent or time-critical issues within or outside the Committee framework. The SFC explained that where the circumstances justified prompt action, the relevant operational division had the discretion to proceed and then seek retrospective endorsement and advice at the following Committee meeting.

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<sup>7</sup> The Complaints Control Committee comprises senior officers of the SFC's operational divisions to give directives on follow-up action to complaints and advise on strategies in dealing with policy or issues arising from the complaints.

### ***Misunderstanding on return from investment products that gives rise to complaints***

3.27 An investor complained to the SFC about an investment-linked assurance scheme offered by an insurance company. After inquiring into the case, the SFC concluded that there was no breach of the SFO nor of the Code on Investment-Linked Assurance Schemes, and the complaint was not substantiated. The complainant was not satisfied with the findings and had followed up with several complaints against the SFC for having failed to properly handle his case. The SFC reviewed the procedures for handling the complaint, and concluded that a thorough investigation with extensive consultation had been made and no further action would be taken.

3.28 The PRP noted that the SFC could only deal with breaches of rules and regulations but could not arbitrate disputes or order compensation. The PRP pointed out that the public might have a misunderstanding about the SFC's role since an investment product required the SFC's authorisation. Very often, investors could not fully understand the features of an investment product, such as illustrated return as opposed to guaranteed return of investment-linked assurance schemes. This misunderstanding often gave rise to complaints if the actual return from the investment could not meet up with the expectation. The PRP suggested the SFC consider strengthening the investor education programme.

3.29 The SFC agreed with the PRP that investor education was important. There were extensive publicity about the difference between guaranteed return and illustrated return through its InvestEd website and in printed media. Moreover, the External Relations Department of the SFC had been taking part in the SFC's Complaints Control Committee meetings where it could have first hand information about market sentiments and areas that might attract complaints. On the basis of these information, the External Relations Department would formulate its focus and strategy in investor education programmes.

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

3.30 In 2007, the PRP reviewed 19 enforcement cases relating to revocation or suspension of licence, settlement of disciplinary action, fining

and issue of warning letter. The PRP also reviewed four prosecution cases as a follow up on a recommendation made in 2006 for the SFC to put in place a due process to ensure consistency in the decision as to whether disciplinary action should be taken in addition to prosecution.

### ***Taking disciplinary action in addition to prosecution***

3.31 The PRP reviewed a case concerning a company dealing in futures contracts, which was associated with an authorised financial institution (a bank). The SFC found that a responsible officer of the futures company had instructed several officers in a branch of the bank to accept instructions from clients to trade in futures contracts and to convey the orders to the dealing room of the futures company for execution. These officers were licensed to deal in securities but not in futures contracts. The persons and the company concerned were prosecuted for performing a regulated function without a licence. The SFC subsequently entered into settlement with the parties in relation to the disciplinary proceedings. Under the settlement terms, the parties pleaded guilty to the summonses and accepted a public reprimand and a heavy fine of close to \$1 million; and the licences of the persons concerned were suspended for a period of time. Taking into account the settlement terms, the court granted absolute discharge to the parties.

3.32 In response to the PRP's enquiry about the reasons for taking prosecution in addition to a substantial fine, the SFC explained that they took a serious view in this case having regard to the fact that the misconduct perpetuated for several years. The amount of fine was determined in the light of similar precedent cases and the profits derived from the unlicensed activities. Also, in line with established policy, the amount had been reduced to reflect the cooperation of the parties in the investigation and that prosecution was taken concurrently.

3.33 In 2006, the PRP invited the SFC to put in place a due process and introduce 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 for the same misconduct<sup>8</sup>. The SFC had 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. Against this background, the PRP invited the SFC to advise on the progress.

3.34 The SFC advised that in general, it would consider taking disciplinary action against a licensee following a successful prosecution. In developing a formal policy in this regard, the SFC had sought advice from counsel in the United Kingdom on the issues of double jeopardy and proportionality. The counsel advice confirmed that there was no double jeopardy between criminal and disciplinary proceedings, but the SFC had to give due regard to the proportionality of the total penalty especially in imposing a fine after a criminal conviction. The SFC advised that officers dealing with enforcement matters had already been briefed and given training on the legal advice and the implications from a management perspective. The SFC aimed to address the issues in a formal policy document in due course.

### ***Raising awareness of the regulatory concerns***

3.35 Arising from the case described in paragraph 3.31 above, the PRP considered that market practitioners might have misunderstood that a licence was required only for a person who input an order into the trading system but not those who convey an order. The PRP suggested the SFC consider taking steps to clear up this misunderstanding and remind market practitioners of the statutory requirement that a licence would be required to convey an order from clients to the dealing room. Moreover, members pointed out that it was important for the SFC to cultivate a compliance culture through education. The SFC agreed to take steps together with the HKMA to remind banks and their management staff of their obligation to ensure those who had a role in handling client orders in SFC regulated products were properly licensed.

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<sup>8</sup> Arising from a case reviewed in 2006, the PRP noted that the SFC took prosecution and contemplated disciplinary action against a company and a responsible officer for failure to maintain the required level of liquid capital thereby breaching the Securities and Futures (Financial Resources) Rules (“FRR”). On the other hand, the PRP noted that the SFC did not take prosecution in two cases concerning breaching of FRR arising from the reviews in 2005. Paragraph 3.22 of the PRP Annual Report for 2006 is relevant.

3.36 In another case, a property developer and its agent placed advertisements on newspapers to promote investment in a property in the Mainland. On the basis of the features of the sales package, the SFC considered that the investment product was a collective investment scheme<sup>9</sup> and the issue of promotional materials required the SFC's authorisation under section 103 of the SFO. As no authorisation had been granted, the companies and the persons concerned were prosecuted for issue of unauthorised promotional materials on collective investment scheme.

3.37 The PRP noted that the companies had placed advertisements on the newspapers again during the investigation. The SFC explained that it could not stop the companies from issue of promotional materials before a case of misconduct was established. In order to better protect investors, the PRP suggested the SFC consider reminding the subject under investigation about the SFC's regulatory concerns at the beginning of an investigation and that engagement in suspected activities during an investigation could be taken as an aggravating factor in determining the penalty in the event that a breach was substantiated. Moreover, in line with the drive to promote compliance culture, the PRP suggested that efforts be made to raise awareness of both market practitioners and the public of the statutory requirement to obtain prior approval from the SFC for publicising promotional materials on collective investment schemes.

3.38 The SFC explained that it had already taken suitable steps to remind persons involved in an investigation about the regulatory concerns at the commencement of a formal investigation. It was a statutory requirement for the SFC to issue a notice to persons involved in an investigation and such notice would set out the scope of the investigation. The SFC would also interview the person concerned to explain the regulatory concerns and the reasons why he/she was identified as a person under investigation. In regard to protection to investor, the SFC said that in cases where a conduct could cause material harm to investors, the SFC could apply to the court for an injunction to restrain an activity<sup>10</sup> before

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<sup>9</sup> The SFC advised that not all advertisements of overseas properties require authorisation. The SFC will have to look at the facts of each case to determine whether the product fulfils the definition of collective investment scheme and if so, the statutory requirement under section 103 of SFO is applicable.

<sup>10</sup> Section 213(1)(i) of the SFO empowers the SFC to apply to the Court of First Instance to make orders to restrain or prohibit certain activities specified in the relevant section in the SFO.



conclusion of an investigation. Regarding the suggestion that engagement in suspected misconduct during an investigation be taken as an aggravating factor, the SFC said that in determining the disciplinary sanctions, it would take into account the particular facts and circumstances of a case, including the failure to observe the SFC's advice on its regulatory concerns.

3.39 Regarding the publicity on the requirement to obtain authorisation for promotional materials, the SFC advised that it had issued a press release immediately upon successful prosecution in the case described in paragraph 3.36 above. Moreover, upon the commencement of the SFO in April 2003, the SFC had already reminded property developers and agents about the statutory requirement through press release. Practitioners were advised to consult their legal advisor before issuing documents which contained an invitation or offer to the public to take part in a collective investment scheme.

### ***Imposing different penalties for the same misconduct***

3.40 Under the SFO, directors of a listed company are required to disclose their reduction of interest in the listed company within three business days of becoming aware that they have a notifiable interest<sup>11</sup>. The SFC's investigation revealed that two directors of a listed company had disposed of substantial number of shares but they filed the disclosure notices to The Stock Exchange of Hong Kong Limited ("SEHK") only five months later. The SFC prosecuted one director and gave a warning letter to the other. The PRP invited the SFC to clarify the rationale for imposing different penalties for the same misconduct.

3.41 The SFC explained that late reporting of notifiable interests were handled according to the procedural manual, which set out the factors governing the decision as to whether prosecution vis-à-vis warning letters should be taken for a breach of the disclosure requirement. The factors taken into account in the decision included value of the disposal, length of delay in making a report, location of the suspect and strength of evidence. In general, prosecution would be taken for cases with a disposal value and length of delay exceeding certain pre-determined thresholds whereas

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<sup>11</sup> Sections 313 and 341 of the SFO provide that, a director of a listed corporation has a duty to report notifiable interests in circumstances specified in the Ordinance. Section 348 of the SFO requires that the notification be made within three business days where the duty of disclosure arises.

warning letters would be issued for cases not meeting the thresholds. This explained the difference in penalty imposed on the two directors in the case described in paragraph 3.40 above.

3.42 Starting from July 2007, the SFC issued compliance advice letters for cases that warranted warning previously. In other words, a breach of the disclosure requirement would result in either prosecution or compliance advice letters. Noting that a compliance advice letter would be much more lenient compared to prosecution, the PRP invited the SFC to consider whether the thresholds should be reviewed. In response, the SFC said that the existing system provided a suitable safeguard to ensure market integrity. A change in the thresholds could mean more prosecutions. An increase solely arising from a change from warning letters to compliance advice letters was not justified.

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

3.43 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”.

3.44 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 SEHK in early 2004 of its commitment to forwarding listing applications and related documents to the SFC as soon as practicable.

3.45 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            In addition to the review of completed cases, the PRP also examines specific areas of the SFC's procedures. The aim is to identify areas for improvement with a view to reducing unnecessary compliance burden without compromising the quality and integrity of regulation.

4.2            The PRP attaches great importance to views from the industry on possible areas for improvement to the SFC's procedures. In 2007, the PRP received several comments and suggestions from market practitioners and had referred them to the SFC for consideration and response. The issues that the PRP had discussed are –

- (a)    expediting the return of clients' assets arising from broker misconduct cases;
- (b)    developing a communication protocol with the SEHK in the vetting of announcements and circulars; and
- (c)    improvement to the SFC website to facilitate retrieval of practice notes.

4.3            The PRP also followed up on a request asking the Panel to review the SFC's procedures in handling several cases relating to misappropriation of clients' assets by securities brokers. The PRP reviewed one case<sup>12</sup> and provided the SFC with its observations and comments. In addition, the PRP deliberated on the SFC's new policy introduced in July 2007 on using compliance advice letters in lieu of warning letters. .

4.4            The PRP's discussions and views on these issues are summarised below. Details of the SFC's response are at **Annex C**.

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<sup>12</sup> The PRP was requested to conduct review on three cases involving broker misconduct. As the PRP's terms of reference provide that it may call for and review the SFC's files relating to completed cases, the PRP reviewed only one case that was concluded in the year. The PRP will review the remaining two cases in due course.

**(A) Expediting the return of clients' assets arising from broker misconduct cases**

4.5 Some market practitioners pointed out that when a broker firm was found to have misappropriated clients' assets and when administrators or liquidators were appointed to deal with clients' assets, these assets were often locked up in custodian accounts. It usually took a very long time before the clients affected could recover their shares or money. In one case, the administrator was appointed in July 2006 but the winding up process was still in progress in early 2008. The market practitioners suggested the SFC expedite the process for returning assets to clients so as to minimise the potential loss to clients.

4.6 The SFC explained that when a broker firm holding clients' assets was liquidated, the SFC might apply to the court to appoint administrators to deal with clients' assets including adjudicating claims and ultimately returning assets to clients. In this respect, the SFC maintained only an overview of the progress of the administration. In general, administrators could return assets to clients in a few months' time. For more complicated cases, the speed at which the administrators could complete the tasks would depend on factors such as the number of clients involved and the reliability of the books and records kept by the brokers concerned. In the case mentioned in paragraph 4.5, the process was comparatively long since the accounting records and statements kept by the broker were found to be false or unreliable. The administrators had to conduct extensive consultation with the clients to ensure that the calculation of entitlement was agreeable to the clients.

**(B) Developing a communication protocol with the SEHK in the vetting of announcements and circulars**

4.7 There are occasions when the SFC and the SEHK are required to vet announcements and circulars that fall into the ambits of both the Codes on Takeovers and Mergers and Share Repurchases ("Takeovers Codes") and the Listing Rules, which are administered respectively by the SFC and the SEHK. There was a comment from market practitioners that listed issuers and/or their professional advisers had difficulties in finalising the documents when the two regulators held different views. It was

suggested that a clear communication protocol be established between the SFC and the SEHK for the vetting of announcements and circulars that required clearance from both regulators.

4.8 In response, the SFC pointed out that the Listing Division of the SEHK and Takeovers Executive<sup>13</sup> for the Takeovers Codes (of the SFC) were responsible for the Listing Rules and Takeovers Codes respectively. Documents that were subject to both sets of rules would be dealt with by both the SEHK and the SFC. The liaison and co-ordination practices between the two regulators were well established and there were no major problems in the past. As a general practice, the Takeovers Executive would copy its comments on draft documents to the Listing Division. In cases where there were different views between the Takeovers Executive and the Listing Division, the Takeovers Executive would discuss the matter with the parties concerned and, if necessary, the Listing Division. A pragmatic approach would be taken after careful consideration of the underlying rationale for the requirements of each of the Listing Rules and Takeovers Codes in order to resolve the issues speedily and effectively.

**(C) Improvement to the SFC website to facilitate retrieval of practice notes**

4.9 The SFC has been publishing the quarterly Takeovers Bulletin on its website since May 2007. The Takeovers Bulletin serves as periodic newsletters from the Takeovers Executive to market practitioners. It contains short informative articles, practice notes and information relating to takeovers in Hong Kong providing guidelines on how the Takeovers Executive normally interprets and applies certain provisions of the Codes. As the volume of information in the SFC website is building up, it is difficult to search for information. Some market practitioners suggested that a user friendly search function be established on the SFC website to enable users to search for practice notes and panel decisions by various searching strings such as date, topic or rule number.

4.10 In response, the SFC said that a search function had already been provided on the SFC website and users might input keywords to search

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<sup>13</sup> “Takeovers Executive” refers to designated officers of the Corporate Finance Division of the SFC, who are responsible for administering the Takeovers Codes on a day-to-day basis.

for the relevant rules or topics. In addition, the SFC set up in April 2008 a new dedicated page called “Practice Notes” under the section of “Takeovers and Mergers” to provide quick reference to the relevant details such as issue time and the related rules of each practice notes.

**(D) Handling of a case involving misappropriation of clients’ assets**

4.11 The PRP reviewed the SFC’s procedures in handling a case of broker misconduct involving misappropriation of clients’ assets. In this case, the SFC conducted a round of theme inspection in the second quarter of 2006 on selected broker firms to review their risks of possible misappropriation of assets and financial problems. The inspection revealed that a broker firm maintained false accounts to enable disposal of securities without clients’ authorisation and sent false statements to clients to cover up the misappropriation. The SFC promptly issued a Restriction Notice within two weeks from the inspection to prohibit the broker firm from carrying on any regulated activities. The SFC also obtained a court order for the appointment of independent administrators to administer the assets of the broker firm and an injunction order to prevent dissipation of assets. A person involved in the misconduct was subsequently prosecuted.

4.12 There was concern as to whether the misconduct could have been uncovered earlier and hence, investors’ interests could be better protected. The SFC advised that it had taken an active role in the inspection of intermediaries and the misappropriation of assets in this case was actually uncovered during a theme inspection. The broker firm was last inspected a couple of years earlier. It was selected as a target in the theme inspection having regard to its financial position and poor compliance record.

4.13 The PRP noted that the SFC took prompt action once the misconduct was uncovered and appropriate measures were taken within a couple of weeks to protect clients’ assets. The PRP concluded that the SFC had followed its established procedures in processing the case.

## **(E) SFC's policy on issue of compliance advice letter**

4.14 The PRP had raised the issue about warning letters with the SFC since 2004. In gist, the SFC could issue warning letters to its regulatees without commencement of a formal disciplinary process. The purpose was to advise a regulatee of his compliance failings in an informal manner. The response or representation made by the person concerned would be kept on file only for internal reference. The PRP received comments from market users that warning letters could be taken as a stigma and could impose adverse impact on a licensee's career because most employers would make reference to a job applicant's compliance history. Unlike formal disciplinary action for which statutory appeal channels (such as an application to the Securities and Futures Appeals Tribunal for a review of the SFC's decisions) were available, there was no proper channel for an aggrieved person to appeal against the SFC's decision to issue a warning letter.

4.15 In June 2007, the SFC advised the PRP that it had decided to issue compliance advice letters for breaches that warranted only a warning in the past. In other words, where there were minor and technical breaches that deserved a warning in the past, the SFC would notify the person concerned about the breach and the SFC's concern by a compliance advice letter so that the person could take steps to ensure compliance with the regulatory requirements and prevent recurrence of similar breach in future. At the same time, the SFC would take steps to raise public awareness of current enforcement by strengthening its communication with the market through its regular publications, in particular, the Enforcement Reporter. The SFC aimed to promote and encourage the adoption of best practice by regulated persons, thereby reducing improper conduct.

4.16 The PRP welcomed the change and commented that it was imperative for the SFC to convey a clear message to the industry and to the recipients of compliance advice letters about the implication of the letter, such as its impact on the person's compliance record and whether the person was obliged to disclose it to an employer. The SFC advised that it had promulgated the new policy in the Enforcement Reporter in July 2007 regarding the use of compliance advice letters. The SFC clarified that it would no longer issue warning letters, which in any case were never a



sanction in disciplinary proceedings. The compliance advice letters would become a factor that the SFC would take into account when deciding whether to take formal action against a regulated person only when the person committed a similar breach in future. Nonetheless, the SFC would not take into account the events leading to the issue of the compliance advice letter in a formal disciplinary action, or in deciding the appropriate penalty for that breach. Since compliance advice letters were private, recipients of the letters would not need to disclose them to anyone unless they wished. The above features of the compliance advice letter were also explained in the body of the letter. On the suggestion of the PRP, the SFC would update its procedural manual and would provide training to its staff on the procedural changes.

## **Chapter 5      Way forward**

5.1            In 2007, the PRP performed its functions through the review of completed cases and selected topics of the SFC's operational procedures and made its observations and 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 2008, the PRP will follow up on a number of the recommendations made in 2007 in relation to the SFC's internal procedures. The areas include handling of licence applications with incomplete information and enquiries on licensing issues, handling of complaints against the SFC, and the development of a compliance culture to raise awareness of the SFC's regulatory concerns.

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.



**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**  
*(as at 31 December 2007)*

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, JP

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

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

## **Membership of Working Groups**

*(as at 31 December 2007)*

### **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, GBS, 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, JP



**Securities and Futures Commission's responses<sup>14</sup>  
to the observations and recommendations  
that are accepted**

**(A) Licensing of intermediaries**

<b>Item (1)</b>
<p><u>Case findings/market views</u></p> <p>The SFC very often receives applications with incomplete information and supporting documents. The PRP noted that in processing these applications, the SFC had to ask each applicant in writing for supplementing the outstanding documents. In one case, the SFC had to issue three such tailor-made letters until the applicant could provide all the necessary documents.</p>
<p><u>PRP recommendation/observation</u></p> <p>As a way to rationalise the use of SFC's resources, the PRP suggested the SFC consider using standard proforma letter with checkboxes specifying the supporting documents required (Para. 3.3 of Chapter 3).</p>
<p><u>SFC's response</u></p> <p>It will not be difficult to prepare a standard form of requisition using check-boxes, but it is questionable how much time and effort will in fact be saved by this. It is fairly routine to request a business registration certificate or curriculum vitae in a requisition letter if an applicant has failed to provide these when making application. Having check-boxes is really not going to make this any easier in practice.</p> <p>As an alternative, the SFC has been looking at the possibility of preparing a more comprehensive standard requisition letter for each type of regulated activity, with the intention of covering all contingencies. The SFC is initially looking at this approach in relation to licence applications by hedge fund managers to see whether it is feasible. If the SFC finds it effective, it would anticipate expanding this to all other regulated activities.</p>
<b>Item (2)</b>
<p><u>Case findings/market views</u></p> <p>In a case, the applicant was slow in responding to the SFC's requests despite repeated reminders. The applicant had finally withdrawn the application after more than a year of processing.</p>

<sup>14</sup> Editorial changes are made mainly to remove case specific information.

PRP recommendation/observation

The PRP suggested the SFC consider putting in place a due process to deal with lukewarm response from applicants. The SFC was invited to consider whether an application could be deemed withdrawn if the applicant failed to provide a substantive response after a prolonged period of time (Para. 3.4 of Chapter 3).

SFC's response

The SFC explained that there is a statutory (and time-consuming) procedure by which a licence application is rejected. Accordingly, the SFC considers it not open to it to effectively reject an application by saying that it will be deemed to have been withdrawn if required information is not provided within a stipulated time. If the SFC were to do so, it would, in effect, be circumventing the provisions of the SFO.

The SFC's normal procedures will be to allow a specified period for the applicants to respond. This period can be extended if the applicant asks for extension or provides part of the information only. The SFC is considering a more vigilant approach in that if the applicant fails to provide all the required documents within a deadline, it will proceed with the refusal process on the ground that without sufficient information, the Commission cannot be satisfied that the person is fit and proper to be licensed.

**Item (3)**

Case findings/market views

In one case, the SFC received applications from an authorised financial institution for registration as a registered institution and for the appointment of executive officers. The SFC sought advice from the Hong Kong Monetary Authority ("HKMA") as to whether the applicants were fit and proper for registration. The applications had taken a fairly long time to be processed, because the applicant had initiated some significant changes in its proposed business activities and in nominations for executive officers and members of management to be involved in the proposed business activities.

PRP recommendation/observation

The PRP invited the SFC to discuss with the HKMA with a view to expediting the processing of applications from authorised financial institutions (Para. 3.5 of Chapter 3).

SFC's response

It is possible that there was justification for the one year period that it took HKMA to respond to the SFC in this case. However, the SFC agrees that any means by which the processing of such applications can be accelerated should be encouraged. The SFC has discussed this issue with the HKMA, which has agreed to provide quarterly status reports in relation to all outstanding registered institution applications so that SFC is kept informed of their progress. This took effect in April 2008.

#### Item (4)

##### Case findings/market views

In an application for becoming a responsible officer, the SFC noticed that the applicant was under an on-going investigation by the SFC. The case had been put on hold for several months pending outcome of the investigation.

##### PRP recommendation/observation

The PRP invited the SFC to consider expediting its investigation work (Para. 3.6 of Chapter 3).

##### SFC's response

The Enforcement Division has already halved the investigation time from 36% completed within 7 months in 2006 to 71% completed within 7 months in 2007.

#### Items (5), (6), (7) and (8)

##### Case findings/market views

In processing an application for licence from a person who had been discharged from bankruptcy for three years, the SFC contacted the employer sponsoring the application to ascertain that the company was aware of the solvency background of the applicant. The SFC explained to the employer that based on the Fit and Proper Guidelines, the application was unlikely to be approved. The applicant subsequently withdrew the application.

##### PRP recommendation/observation

The PRP considered that the SFC's five-year rule too stringent, given that a bankruptcy order could be set aside after four years already (Para. 3.9 of Chapter 3).

##### SFC's response

The five years recency test serves as a guideline only. In practice, the application from a discharged bankrupt will be considered on its own merits, taking into account the relevant information such as recency of discharge, reasons for bankruptcy and current solvency. The reasons for the decision to approve or refuse were documented and carefully considered in accordance with the procedural manual of Licensing Department. Since the commencement of the SFO in April 2003 up to December 2007, seven "recent" discharged bankrupts have been granted licences, and one was refused. Taking into account the PRP members' recommendation to develop specific guidelines, the SFC will issue a Frequently Asked Question to provide guidance to the public.

##### PRP recommendation/observation

To ensure a right balance between protecting the interest of the investing public and denying the livelihood of an applicant who might have only the skills for a job in the financial industry, the PRP recommended the SFC to issue guidelines on dealing with applications from discharged bankrupts (Para. 3.13 of Chapter 3).

PRP recommendation/observation

The PRP considered it useful to set out the criteria and considerations such as the supporting documents required for assessment (Para. 3.13 of Chapter 3).

SFC's response

Internal guidelines concerning the processing and consideration of applications from discharged bankrupts are being prepared in the light of the more flexible approach that is now being adopted in these types of cases. In principle, the SFC very much favours any measure that creates more certainty as to its approach in any particular circumstances, and which promotes consistency in its approach in cases that are similar.

PRP recommendation/observation

The PRP suggested that a database and statistics on applications with adverse information should be maintained to provide ready reference (Para. 3.13 of Chapter 3).

SFC's response

The SFC already maintains electronic databases of individuals in relation to whom the SFC may have concerns (e.g. targets in enforcement action and bankrupts). The Licensing application system is linked to these databases. Once an application is recorded on the Licensing system, the system will automatically conduct a search of all relevant databases to identify whether the applicant has been listed on any one or more of the databases. If records are found, they will be highlighted in the electronic application checklist. The case officers must review and consider any such exception before making a decision in relation to the application. A licence will be granted, sometimes subject to conditions, if we are satisfied that this is the appropriate course of action. Where there are material concerns, the case officers may need to ask the applicant to provide information to address those concerns. Some applicants may decide to withdraw their applications after we raise such concerns with them. The withdrawal will be recorded in the system, together with the reason for the withdrawal. In other cases, the SFC may need to refuse an application if the applicant cannot provide information to satisfy it that he is fit and proper to be licensed. Any approval, withdrawal or refusal is recorded in a person's licence history in the Licensing system, and statistics concerning the number of approvals, withdrawals or refusals within a specified period can be extracted as required.

**Item (9)**

Case findings/market views

In assessing an application from a person whose bankruptcy order had been annulled only three months before making the application, the SFC requested the applicant to provide additional information relating to the bankruptcy. The applicant replied with only a brief explanation on the circumstances leading to the bankruptcy and that the order was annulled after he had settled all his debts. As the applicant could not produce the relevant bankruptcy papers, the SFC suggested the applicant obtain copies from the government authority or the court. The applicant subsequently withdrew his application.

PRP recommendation/observation

The PRP considered that since the bankruptcy order had already been annulled by the court, the SFC might take a flexible approach and consider other information available such as employer's reference, instead of relying solely on empirical evidence to assess the applicant's solvency position (Para. 3.11 of Chapter 3).

SFC's response

Although the solvency of a licence applicant is of relevance to the SFC, it is principally concerned to obtain documentation relating to an applicant's previous bankruptcy for the purpose of ascertaining the reason for the bankruptcy. This might be relevant to the applicant's fitness and propriety. The SFC now takes a flexible approach to the type of evidence that is provided by the applicant in this connection. However, the SFC must remain vigilant as to the reliability of the evidence provided by the applicant and will request additional information in appropriate circumstances where the SFC is not satisfied as to the reliability of the evidence that has been supplied by the applicant.

**Item (10)**

Case findings/market views

The PRP noted that an application from a discharged bankrupt was approved by a Senior Manager whereas in another case, an application from a person with conviction record was approved by a Director. The PRP noted that for cases with adverse information, the SFC's procedural manual only required the case officer to discuss the matter with more senior officers but did not specify the level of the decision-makers.

PRP recommendation/observation

Since both bankruptcy and criminal conviction were matters that might impugn the integrity of an applicant, the PRP considered that there should be consistency in the approval process, and invited the SFC to review and designate the approving authority for such cases in the procedural manual (Para. 3.12 of Chapter 3).

SFC's response

Given the circumstances of the two cases quoted, the two decisions in question appear to have been taken at the appropriate levels. Approving the application from the person with conviction record is rather more challenging and potentially controversial than would normally be so in a case involving the approval of the application of a discharged bankrupt.

It is not a simple matter to define the different levels at which decisions revolving around the existence of adverse information should be taken because of the vast variation in the nature of adverse information, ranging from inconsequential to serious. Accordingly, the SFC does not believe that the procedural manual can be amended in a manner that will clearly dictate the level at which a decision should be taken in every case.

The procedural manual currently states that where there is adverse information in relation to an application (whether corporate, responsible officer or representative), the person handling the matter (Assistant Manager, Manager or Senior Manager) should raise the matter for discussion with officers at a higher level. The SFC will review this with the intention of giving clearer direction to as to the level at which decisions should be taken

in cases involving adverse information. Requiring that decisions in these cases must be taken at the level of Senior Manager or above, might well be the appropriate approach to be adopted.

## (B) Authorisation of collective investment schemes

Item (11)
<p><u>Case findings/market views</u></p> <p>In one case, the processing work took more than nine months because the applicant accorded priorities and resources to the other applications submitted to the SFC concurrently. The applicant could not provide a substantive response to the SFC's comments in time despite the issue of several reminders.</p>
<p><u>PRP recommendation/observation</u></p> <p>The PRP was concerned about whether the applicant had taken advantage of the application system by ensuring that the application, which might have been submitted pre-maturely, would remain valid (Para. 3.21 of Chapter 3).</p>
<p><u>SFC's response</u></p> <p>The SFC maintains its view that there is no evidence to suggest a serious abuse of the application system at present. However, the SFC is reviewing the procedures with a view to revising the reminder letters, where permissible, to the effect that an application for authorisation would be refused if an applicant did not respond after a long period.</p>

## (C) Handling of complaints

Item (12)
<p><u>Case findings/market views</u></p> <p>An ex-licensee wrote to the Licensing Department asking what he needed to do in order to be licensed again. As he had not received any response from the SFC for more than a month, he made an enquiry to the SFC's office in person. Since he had not made an appointment in advance, the case officer handling his enquiry could not meet him. The case officer called him on the following day and asked him to submit an application for assessment. The person lodged a complaint to the SFC about its failure to acknowledge his enquiry and to meet him when he visited the SFC's office.</p>
<p><u>PRP recommendation/observation</u></p> <p>The PRP considered that public enquires should be handled expeditiously to meet the rising expectation of the public. An acknowledgement was a useful means to notify the person that the matters had been directed to the right place and were receiving attention. It was a good practice to issue an acknowledgement once upon receipt of an enquiry instead of making no response for a period of time. The PRP suggested the SFC consider developing clear guidelines and timeframe for handling public enquiries of all sorts, including a timeline for issue of an acknowledgment (Para. 3.24 of Chapter 3).</p>

SFC's response

The SFC agrees that it is a good practice to issue prompt acknowledgements to enquiries. The SFC has performance pledges in respect of preliminary response times to public enquiries received by the External Relations Department. In the case of investor enquiries, these performance pledges call for preliminary responses to telephone enquiries within 4 business days and to written enquiries within 2 weeks. In the case of general enquiries to the External Relations Department, the SFC's performance pledge is to provide preliminary responses within 4 business days.

In view of the length of time that it took to respond to the enquiry in the case under review and the concerns expressed by the PRP in relation to that case, LIC intends, subject to its resource constraints, to formalise its internal practices concerning response times to bring them generally in line with the performance pledges referred to in the preceding paragraph.

**Item (13)**

Case findings/market views

Arising from the review of two complaint cases, the PRP noted the SFC's advice that there was no written procedures for handling complaints against the Commission itself.

PRP recommendation/observation

The PRP suggested the SFC review its complaint handling procedures and submit its findings to the SFC Audit Committee for consideration from a corporate governance angle (Para. 3.25 of Chapter 3).

SFC's response

While the SFC does not have formal written procedures for handling complaints against itself, it has always followed a consistent approach in handling such complaints. The SFC will take steps to formalise its practice and submit the proposals for the consideration of the Audit Committee in due course.

**Item (14)**

Case findings/market views

The SFC received, one day before the launching of an initial public offering exercise ("IPO"), a complaint about the proliferation of off-market deals in which investors were assured that they would be allotted with certain number of shares being offered upon paying a premium. Investors entering such deals ran a high risk as the seller might not fulfil the promise to deliver the shares. The complaint was reported to the SFC's Complaints Control Committee ("the Committee") and a senior officer of the SFC promptly spoke at a meeting with the media about the risks to investors in entering such off-market deals. The PRP noted that the complaint was actually discussed at the Committee one day after the close of the IPO.

PRP recommendation/observation

As the Committee met on a weekly basis and might not be able to cope with urgent or time-critical issues, the PRP invited the SFC to advise how it would deal with urgent or time-critical issues within or outside the Committee framework (Para. 3.26 of Chapter 3).

SFC's response

At present, when an operational division has deemed it necessary to take urgent action in relation to an external complaint, it can do so and the action taken should be provided to the secretariat of the Committee (i.e. External Relations Department) for inclusion in the complaint logs for tabling at the next available Committee meeting.

The Committee will then consider the report of action already taken by an operational division in respect of a complaint which was deemed by that division to require urgent action and advise the respective division whether the Committee endorses the action taken.

**Item (15)**

Case findings/market views

An investor complained to the SFC about an investment-linked assurance scheme offered by an insurance company. After inquiring into the case, the SFC concluded that there was no breach of the SFO nor of the Code on Investment-Linked Assurance Schemes, and the complaint was not substantiated. The complainant was not satisfied with the findings and had followed up with several complaints against the SFC for having failed to properly handle his case. The SFC reviewed the procedures for handling the complaint, and concluded that a thorough investigation with extensive consultation had been made and no further action would be taken.

PRP recommendation/observation

Very often, investors could not fully understand the features of an investment product, such as illustrated return as opposed to guaranteed return of investment-linked assurance schemes. This misunderstanding often gave rise to complaints if the actual return from the investment could not meet up with the expectation. The PRP suggested the SFC consider strengthening the investor education programme (Para. 3.28 of Chapter 3).

SFC's response

The SFC agrees that it is important to educate investors about the difference between the guaranteed return and the illustrated return for investment-linked assurance schemes ("ILAS"). Accordingly, it has kept reminding investors to pay attention to this point in its various education initiatives on ILAS. For example, the SFC has highlighted this point in its article on reading an illustration document of ILAS posted on its InvestEd website. The SFC has also published articles highlighting this point in the printed media, e.g. Headline Daily in January 2007. The SFC will continue to cover this point in its investor education work on ILAS.



## (D) Investigation and disciplinary action

### Items (16) and (17)

#### Case findings/market views

The PRP reviewed a case concerning a company dealing in futures contracts, which was associated with an authorised financial institution (a bank). The SFC found that a responsible officer of the futures company had instructed several officers in a branch of the bank to accept instructions from clients to trade in futures contracts and to convey the orders to the dealing room of the futures company for execution. These officers were licensed to deal in securities but not in futures contracts. The persons and the company concerned were prosecuted for performing a regulated function without a licence. The SFC subsequently entered into settlement with the parties in relation to the disciplinary proceedings. Under the settlement terms, the parties pleaded guilty to the summonses and accepted a public reprimand and a heavy fine of close to \$1 million; and the licences of the persons concerned were suspended for a period of time.

#### PRP recommendation/observation

The PRP invited the SFC to explain the reasons for taking prosecution in addition to a substantial fine (Para. 3.32 of Chapter 3).

#### SFC's response

A serious view was taken because of the prolonged period over which this very basic breach occurred. The SFC took the view that there was no policy or legal basis to restrict our action to either disciplinary or criminal processes and, in this case, the criminal court took into account the fact and the outcome of the disciplinary process.

#### PRP recommendation/observation

The PRP considered that market practitioners might have misunderstood that a licence was required only for a person who input an order into the trading system but not those who convey an order. The PRP suggested the SFC consider taking steps to clear up this misunderstanding and remind market practitioners of the statutory requirement that a licence would be required to convey an order from clients to the dealing room (Para. 3.35 of Chapter 3).

#### SFC's response

The SFC will take steps together with the Hong Kong Monetary Authority to ensure that banks and bank management are reminded of their obligations to ensure those who have any role in handling client orders in SFC regulated products (subject to clerical, accounting and cashier exceptions) are licensed or have relevant individual status.

### Item (18)

#### PRP recommendation/observation

In 2006, the SFC had 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. The PRP invited the SFC to advise on the progress (Para. 3.33 of Chapter 3).

#### SFC's response

In early 2007, the SFC sought advice from UK counsel on the issues of (1) criminal/disciplinary double jeopardy and (2) proportionality, when a defendant may be subject to both criminal and disciplinary penalties. Advice was received in May 2007. This was circulated to all SFC staff in the disciplinary team.

The advice addressed such matters as when it would be appropriate for the SFC to take disciplinary action, for example to suspend or revoke a licence, where conduct had already been the subject of criminal proceedings. The factors relevant to the question of proportionality were also discussed in the advice.

Disciplinary staff were also advised at that time of the implications of the advice from a management perspective. Staff were informed, in short, that there is no double jeopardy between criminal and disciplinary proceedings, but they must have due regard to the proportionality of the total penalty especially in imposing a fine after a criminal conviction.

Further training was provided to disciplinary staff in the course of disciplinary staff team meetings.

Counsel later reconfirmed his advice and this was again communicated to all staff in the disciplinary team and the advice was discussed again at disciplinary staff team meetings. The final advice was also posted on the SFC intranet.

Counsel's advice, together with training of disciplinary staff, currently constitutes the internal policy and training on this issue. The SFC has therefore developed a policy to guide staff in deciding when to take or recommend criminal proceedings in lieu of or in addition to disciplinary proceedings, notwithstanding the policy has not been reduced to a single document. With the appointment of the first Director of Policy within Enforcement in the last quarter of 2007, this is likely to be a subject that will be addressed in a formal policy document in due course.

### **Items (19) and (20)**

#### Case findings/market views

In a case, a property developer and its agent placed advertisements on newspapers to promote investment in a property in the Mainland. On the basis of the features of the sales package, the SFC considered that the investment product was a collective investment scheme and the issue of promotional materials required the SFC's authorisation under section 103 of the SFO. As no authorisation had been granted, the companies and the persons concerned were prosecuted for issue of unauthorised promotional materials on collective investment scheme. The PRP noted that the companies had placed advertisements on the newspapers again during the investigation. The SFC explained that it could not stop the companies from issue of promotional materials before a case of misconduct was established.

### PRP recommendation/observation

In order to better protect investors, the PRP suggested the SFC consider reminding the subject under investigation about the SFC's regulatory concerns at the beginning of an investigation and that engagement in suspected activities during an investigation could be taken as an aggravating factor in determining the penalty in the event that a breach was substantiated.

Moreover, in line with the drive to promote compliance culture, the PRP suggested that efforts be made to raise awareness of both market practitioners and the public of the statutory requirement to obtain prior approval from the SFC for publicising promotional materials of collective investment schemes (Para. 3.37 of Chapter 3).

### SFC's response

This recommendation raises 2 issues:

- (1) that the SFC consider advising the subject of an investigation the regulatory concerns when it issues the section 182 direction; and
- (2) failure to comply with such advice could be considered as an aggravating factor in subsequent disciplinary action if the breach is substantiated.

Addressing these in turn:

- (1) As explained at the case review meeting, the SFC is not typically in a position to require the subject of an investigation to cease the activities under investigation, pending the conclusion of the investigation.

In any event, the SFC attaches to any notice of interview a copy of the section 182 direction, which informs the interviewee of the scope of the investigation. During the interview, the SFC reminds the interviewee of the scope of the investigation, and a person under investigation ("PUI") will also be told why he has been identified as a PUI. An interviewee (particularly a PUI) should therefore be well aware of the purpose of the investigation and the SFC's regulatory concerns. Providing additional advice of the SFC's regulatory concerns in every investigation, at the time the s182 direction is issued, would seem to be unnecessary.

That said, the SFC does consider providing specific advice of its regulatory concerns and, on occasion, does provide such advice. In some cases this may be sensible e.g. where the interviewee is licensed and thought to be more compliance minded than not, so that the breach might be reckless or inadvertent rather than deliberate or obstinate. In other cases, this might prejudice the investigation. (Incidentally, this particular case did not relate to a licensee).

In those cases where advice is provided the advice may not necessarily be heeded. In an appropriate case an injunction may be sought to restrain offending activities pending the conclusion of an investigation. These cases are likely to be rare. Such cases would be likely to include those where the conduct was continuing, was causing material harm to investors and was a breach of a statutory provision or other requirement that the SFC could lawfully obtain an injunction to compel compliance with (see section 213(1) of SFO).

(2) Determining the appropriate sanction(s) to be imposed following disciplinary action can be complex and will be dependent upon the particular facts and circumstances of a case. It is conceivable that, in an appropriate case, regard could be given to a failure to heed any advice provided to an interviewee as to the SFC's regulatory concerns, in arriving at suitable sanctions.

## Items (21) and (22)

### Case findings/market views

The SFC's investigation revealed that two directors of a listed company had disposed of substantial number of shares but they filed the disclosure notices to The Stock Exchange of Hong Kong Limited ("SEHK") only five months later. The SFC prosecuted one director and gave a warning letter to the other.

### PRP recommendation/observation

The PRP invited the SFC to clarify the rationale for imposing different penalties for the same misconduct (Para. 3.40 of Chapter 3).

### SFC's response

The SFC advised that the procedures for handling late reports on disclosure of interests are set out in the procedural manual. The relevant factors that are taken into consideration in deciding the appropriate course of action (prosecution, compliance advice letter or no further action) include the time delay in making a report, the value of interests involved and other factors such as location of suspect and the strength of the evidence.

The SFC believes that it has created a clear, transparent and rational approach to deciding whether a disclosure of interest prosecution should commence. The process which has been established is one that calibrates the duration of the non-disclosure with the size of the interest that is undisclosed to ensure that only those cases where the non-disclosure has been or should be seen to be serious are prosecuted. The SFC thinks that the disclosure of interests regime is an important part of Hong Kong's market and that there should be redress as provided for in the SFO for these kinds of matters. While the contravention is only a summary one, the SFC does not think it is technical. The contravention does not require evidence of any intention. It is a strict liability offence.

### PRP recommendation/observation

Starting from July 2007, the SFC issued compliance advice letters for cases that warranted warning previously. In other words, a breach of the disclosure requirement would result in either prosecution or compliance advice letters. Noting that a compliance advice letter would be much more lenient compared to prosecution, the PRP invited the SFC to consider whether the thresholds should be reviewed (Para. 3.42 of Chapter 3).

SFC's response

The threshold for a consideration of whether to prosecute is the fact of a late disclosure of interest. Unless there are public interest factors that would mean that a prosecution is inconsistent with the Department of Justice's policy, we will continue to prosecute these cases in accordance with the system referred to in our response above. The balance of cases are treated as if they are technical matters, but given the importance to the market of disclosure by directors and substantial shareholders the SFC thinks it has set the right guidelines. The SFC does not think it appropriate to prosecute more cases owing to the change from warning letters to compliance advice letters alone.

**(E) Expediting the return of clients' assets arising from broker misconduct cases**

**Item (23)**

Case findings/market views

Some market practitioners pointed out that when a broker firm was found to have misappropriated clients' assets and when administrators or liquidators were appointed to deal with clients' assets, these assets were often locked up in custodian accounts. It usually took a very long time before the clients affected could recover their shares or money. The market practitioners suggested the SFC expedite the process for returning assets to clients so as to minimise the potential loss to clients (Para. 4.5 of Chapter 4)

SFC's response

It should be pointed out at the outset that court appointed administrators (usually professional accountants) rather than the SFC are responsible for adjudicating client claims and returning assets to clients. They are accountable to the court. The SFC maintains only a general oversight of the progress of the administration.

In previous cases, the administrators had endeavoured to return assets to clients as promptly as possible, and in most cases were able to seek the necessary directions and orders from the court to do so in a matter of months. Obviously, the speed at which the administrators are able to complete the adjudication of client claims and the return of available assets to clients depends on the complexity of the case and other factors (e.g. number of clients involved and the reliability of the books and records kept by the brokers).

During 2006/07, three risky securities brokers were put under administration by the court upon the SFC's application. In one case, the administrator started to return available securities and trust money to their beneficial owners within two months from its appointment. In another case, the administrators were able to start returning securities to clients about five months after their appointments.

The process of adjudicating client claims and returning assets to clients in the third case took longer than the other two cases due to its complexity. In particular, the process of adjudicating clients' entitlement and deciding the appropriate basis for the return of assets to clients were more time consuming as a result of the false and/or unreliable accounting

records and statements kept by the broker firm. Also, a specific mechanism was ordered by the court (following principles established in previous cases) to tailor to the particular circumstances of this case. The administrators had to issue several circulars to clients before they could start returning assets to clients. The objective was to ensure that the clients concerned would be kept properly informed of the process and be given ample time to respond to each of the circulars and to raise objections (if any).

**(F) Developing a communication protocol with the SEHK in the vetting of announcements and circulars**

**Item (24)**

Case findings/market views

There are occasions when the SFC and the SEHK are required to vet announcements and circulars that fall into the ambits of both the Codes on Takeovers and Mergers and Share Repurchases (“Takeovers Codes”) and the Listing Rules, which are administered respectively by the SFC and the SEHK. There was a comment from market practitioners that listed issuers and/or their professional advisers had difficulties in finalising the documents when the two regulators held different views. It was suggested that a clear communication protocol be established between the SFC and the SEHK for the vetting of announcements and circulars that required clearance from both regulators (Para. 4.7 of Chapter 4).

SFC’s response

Given the Listing Division of the SEHK is responsible for the Listing Rules and the Takeovers Executive of the SFC is responsible for the Takeovers Code, it is inevitable that parties issuing documents which are subject to both sets of rules need to deal with both the Listing Division and the Takeovers Team. As a matter of practice, the Takeovers Team copies its comments on draft documents to the relevant teams in the Listing Division of the SEHK handling the case. Although infrequent, in cases where there are differing views between the Takeovers Team and the SEHK, the Takeovers Team discusses the matter with the parties and, if necessary, the Listing Division in order to resolve the issue. This enables issues to be dealt with speedily and effectively.

**(G) Improvement to SFC website to facilitate retrieval of practice notes**

**Item (25)**

Case findings/market views

The SFC has been publishing the quarterly Takeovers Bulletin on its website since May 2007. The Takeovers Bulletin serves as periodic newsletters from the Takeovers Executive to market practitioners. It contains short informative articles, practice notes and information relating to takeovers in Hong Kong providing guidelines on how the Takeovers Executive normally interprets and applies certain provisions of the Codes. As the volume of information in the SFC website is building up, it is difficult to search for

information. Some market practitioners suggested that a user friendly search function be established on the SFC website to enable users to search for practice notes and panel decisions by various searching strings such as date, topic or rule number (Para. 4.9 of Chapter 4).

SFC's response

The SFC set up in April 2008 a page entitled "Practice Notes" under "Takeovers and Mergers" in its website listing each practice note, the issue time and the related rules to give users a quick reference. Currently, if users want to search materials in a certain topic or rule, there is a search function icon on the right of the blue tool bar that appears on every page. Once a user clicks into that, he can input the keywords (e.g. the rule or topics etc) and then restrict the search to the relevant page in the drop-down menu, one of which is "Takeovers and Mergers". If the search results show too many items, the user can further refine the search by inputting another related keyword.

## (H) SFC's policy on issue of compliance advice letter

### Item (26)

PRP recommendation/observation

The PRP commented that it was imperative for the SFC to convey a clear message to the industry and to the recipients of compliance advice letters about the implication of the letter, such as its impact on the person's compliance record and whether the person was obliged to disclose it to an employer (Para. 4.16 of Chapter 4).

SFC's response

Compliance advice letters are clear about the effect on the recipient's compliance history (they do not contain findings of breaches, but they do form part of their compliance history) and that they need not be disclosed (the letters are stated to be private and that the recipient need not disclose them to anyone unless the recipient chooses to).

### Item (27)

PRP recommendation/observation

The PRP invited the SFC to consider updating its procedural manual and providing training to its staff on the procedural changes (Para. 4.16 of Chapter 4).

SFC's response

The procedural manual is being updated and the changes will be incorporated. In the meantime, all staff have been made aware in writing of the procedural changes and trained on them and compliance advice letters are cleared at the director level or above.





**Securities and Futures Commission's responses<sup>15</sup>  
to the observations and recommendations  
that have not been accepted in full**

**(A) Licensing of intermediaries**

Item (1)
<p><u>Case findings/market views</u></p> <p>In an application for becoming a responsible officer, the SFC noticed that the applicant was under an on-going investigation by the SFC. The case had been put on hold for several months pending outcome of the investigation.</p>
<p><u>PRP recommendation/observation</u></p> <p>In view of the significant role of a responsible officer, the PRP suggested the SFC consider apprising the employer of the investigation. The employer should also be reminded not to allow the applicant to conduct any regulated activities until the application had been approved (Para. 3.6 of Chapter 3).</p>
<p><u>SFC's response</u></p> <p>Difficulties arise in relation to informing an applicant's employer/principal about conduct issues by the SFC. Due to the secrecy provisions of the SFO and concerns as to the applicant's privacy, the SFC can only disclose limited information to an employer/principal. Moreover, the SFC is reluctant to disclose information to an employer/principal that might prejudice an applicant. Ultimately, this information might be proven inaccurate or unreliable, but disclosure of it to the employer/principal while the licence application is pending might result in the withdrawal of its support of the applicant and, as a result, in the applicant losing his job. It is important to strike a balance between the applicant's interest and the need for the employer/principal to be aware of the conduct issue. In general, the SFC considers it fairer to err on the side of the applicant in these types of cases.</p> <p>The law is very clear that persons cannot conduct regulated activities if they are not appropriately licensed. All employers/principals and licence applicants are aware of this. Were they not aware of this, there would have been no licence application in the first place.</p>

<sup>15</sup> Editorial changes are made mainly to remove case specific information.

## Item (2)

### Case findings/market views

In the absence of adverse information in the application form, the SFC had granted a provisional licence to an applicant but was advised later that the applicant had a disciplinary record with an overseas regulatory authority.

### PRP recommendation/observation

A provisional licence did not have an expiry date and it would lapse either upon issue of a full licence or refusal of the application. Since the statutory process to refuse a licence application might take a long time, it was possible that a provisional licence might remain valid for some time even if the SFC was minded to refuse the application on the basis of new evidence brought to light subsequently. In order to ensure better protection to the investing public, the PRP invited the SFC to consider introducing a validity period for a provisional licence (Para. 3.17 of Chapter 3).

### SFC's response

The SFC does not have the power under the SFO to impose a validity period for a provisional licence. A provisional licence is deemed to be revoked upon the refusal of the full licence application or upon the grant of the full licence under section 120(9) of the SFO. It follows that the SFC is prevented by the law from imposing a validity period for a provisional licence. Accordingly, it is not possible to implement this recommendation without amending the SFO. However, the SFC does not favour such an amendment because the imposition of a period of validity would be somewhat arbitrary and might, for example, result in a provisional licence lapsing while the substantive licence application is being considered. This would be inappropriate because it would be disruptive and unfair in a case in which the licence is ultimately granted. Such applications can face delays for a considerable variety of reasons, which cannot always be predicted. Accordingly, the imposition of a validity period could operate arbitrarily and, in some cases, harshly insofar as the licence applicant is concerned.

A provisional licence can only be granted if the applicant satisfies the SFC that he is fit and proper. As a matter of general principle, therefore, this should ensure a high level of investor protection. However, checks and balances are incorporated into the law. Under section 120(10) of the SFO, the SFC may, after having regard to the interest of the investing public and in its absolute discretion, revoke a provisional licence by giving notice in writing to that effect. This is a decision that cannot be reviewed by the Securities and Futures Appeals Tribunal and revocation in those circumstances would only be considered in cases in which there is a clear reason for concern that is sufficient to justify revocation. Accordingly, the interests of the investing public can be protected by the use of section 120(10) in those exceptional cases in which evidence emerges that justifies the revocation of a provisional licence. The SFC considers that the current law strikes an appropriate balance between the interests of the investing public, where there is clear justification for revocation, and the interests of licence applicants, where there is not.