

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

**Annual Report**  
**for 2011-12**

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A Terms of reference

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## **Chapter 1      General Information**

### **Background**

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

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

### **Terms of reference**

1.3            PRP is tasked to review and advise SFC on the adequacy of SFC’s internal procedures and operational guidelines governing the actions taken and operational decisions made by SFC and its staff in the performance of its regulatory functions, including the receipt and handling of complaints, licensing and inspection of intermediaries, and disciplinary action, etc.

1.4            PRP is required to submit its reports to the Financial Secretary (“FS”) annually or otherwise on a need basis. FS may cause these reports to be published as far as permitted under the law.

1.5            The terms of reference of PRP, as approved by CE, are at **Annex A**.

### **Constitution**

1.6            PRP is chaired by Mr Anthony Chow Wing-kin and comprises nine members from the financial sector, academia, the legal and accountancy professions and the Legislative Council. In addition, there are two ex-officio members, including the Chairman of SFC and the representative of the Secretary for Justice. PRP is serviced by the Financial Services Branch of the Financial Services and the Treasury Bureau. The membership of PRP is at **Annex B**.

## **Chapter 2      Work of PRP in 2011-12**

### **Mode of operation**

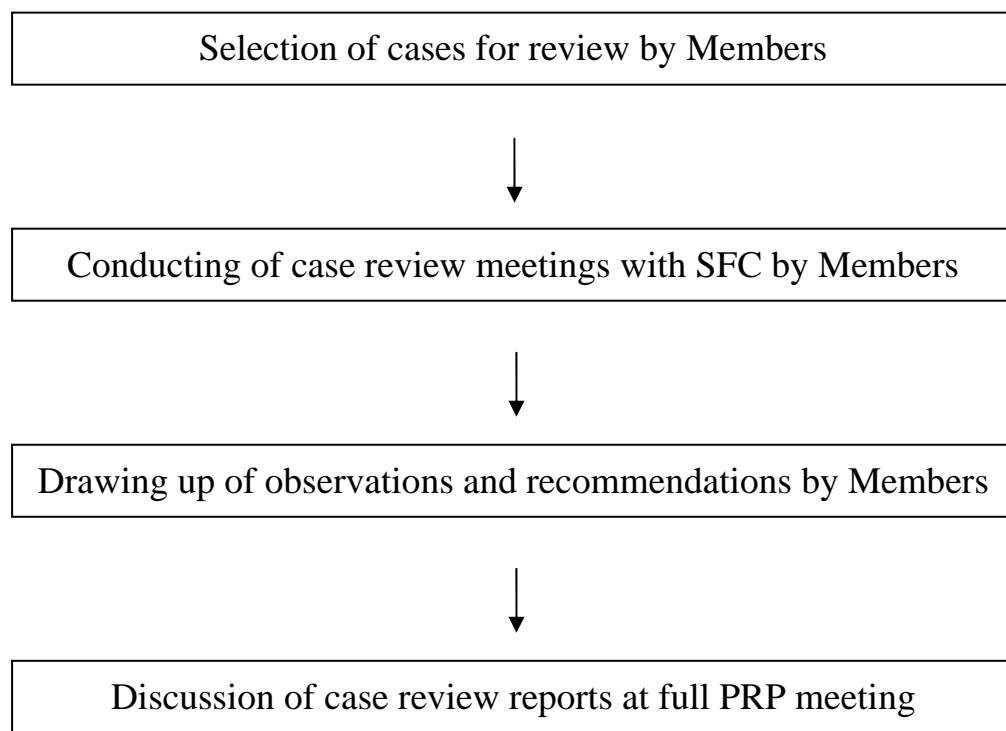
2.1            SFC provides PRP with monthly reports on all completed and discontinued cases. Members of PRP then select individual cases from these monthly reports for review with a view to examining cases encompassing different areas of SFC's work and having due regard to factors including the total processing time, etc.

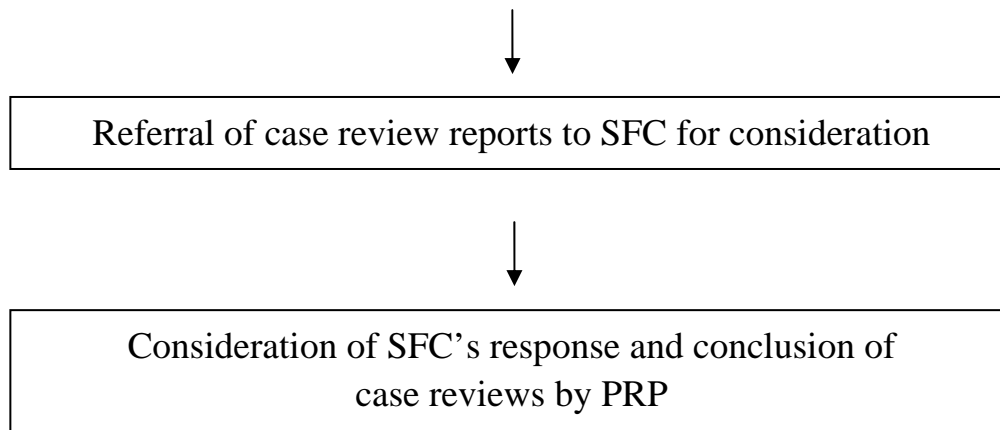
2.2            SFC also provides PRP with monthly reports on on-going investigation and inquiry cases that have been outstanding for more than one year. PRP may also select these cases for review upon their completion or closure.

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

### **Case review workflow**

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





### Highlights of work

2.5 PRP conducted two rounds of review in 2011-12 and held a total of 12 meetings with SFC's case officers on the 55 selected cases that were completed/discontinued by SFC during 1 July 2010 to 30 June 2011. The full PRP met twice in the year to discuss related observations and recommendations. The distribution of the 55 cases reviewed in 2011-12 is summarised below –

	No. of Cases
Licensing of intermediaries	6
Inspection of intermediaries	10
Authorisation of collective investment schemes	6
Handling of complaints	10
Investigation and disciplinary action	22
Processing of listing applications under the Dual Filing regime	1
<b>Total</b>	<b>55</b>

## Chapter 3 Observations and recommendations

### Overview

3.1 From the cases reviewed in 2011-12, PRP concluded that SFC had generally followed its internal procedures and complied with operational guidelines in handling those cases. Highlights of PRP's observations and recommendations on individual cases and SFC's responses are set out below.

#### (A) Licensing of intermediaries

##### *Application of performance pledges*

###### PRP's review

3.2 In reviewing a complaint against SFC's licensing practices, PRP noted that SFC might indicate to the applicants in some cases that its performance pledges would not apply to the cases concerned. PRP invited SFC to elaborate under what circumstances such indication would be given and how it would affect the processing of cases.

###### SFC's response

3.3 SFC explained that when handling some applications where there were delays from applicants to provide related information/clarification or the application itself had to be vetted by an overseas regulator, some of the processing teams had advised applicants that performance pledges would not apply to their cases. SFC considered that performance pledges were intended to operate as yardsticks to measure the performance of the Licensing Department ("LIC"). There was no distinction between applications for which the performance pledges had expired and those that had not. LIC staff were required to deal with all applications of a similar type in a similar manner, and once LIC received the requisite information, the application would be dealt with accordingly. After a review, in order not to generate misinterpretation, SFC considered that there was no need to make references to performance pledges in their correspondence with applicants but SFC would continue to work to fulfill the performance pledges<sup>1</sup>. This has since been consistently applied to all cases.

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<sup>1</sup> Performance pledges in respect of processing of licensing applications are as follows- Provisional licences and transfer of accreditation: 7 business days; normal licences: 8 weeks; responsible officers: 10 weeks; and corporations: 15 weeks. In 2011-12, 94% to 99% of the pledges were met.

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

### ***Risk-based approach in selecting inspection targets***

#### PRP's review

3.4 At the case review meeting for an inspection focusing on compliance with anti-money laundering requirements, PRP observed that SFC had adopted a risk-based approach in selecting the inspection target. PRP would like to be briefed on the criteria, both generally and in particular to anti-money laundering inspections, in selecting targets for inspection by SFC.

#### SFC's response

3.5 SFC elaborated that it adopted a risk-based approach in the regulation of intermediaries, by directing more regulatory attention to medium- to high-risk areas, and to those having a significant impact on SFC's regulatory objectives. A designated Director was responsible for overseeing the selection of inspection targets/areas. In identifying inspection targets/areas, reference was generally made to the information and intelligence obtained from different sources, some of which was maintained with the aid of computer systems. In the case of anti-money laundering inspections, reference was also made to the information obtained from financial intelligence agencies as well as past inspection and compliance records kept in SFC's internal systems.

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

### ***Late response of applicants***

#### PRP's review

3.6 PRP noted that the relatively long time in processing an application for authorisation of a fund and two-subfund(s) was mainly attributable to the late response of the applicant, and as a result, SFC's authorisation took more than a year to complete. PRP had earlier raised similar concerns on resource implications on the part of SFC to deal with inactive applications.

#### SFC's response

3.7 SFC advised that in response to PRP's earlier comments, it had devised guidelines to deal with long outstanding or inactive applications in order to achieve better deployment of resources. Under the guidelines,



applications for authorisation of unit trusts and mutual funds not completed within 12 months from the date the application is taken up would lapse, subject to SFC's discretion to grant an extension. Such guidelines have been made available on SFC's homepage since June 2010 through Frequently Asked Questions on Application Procedures for Authorization of Unit Trusts and Mutual Funds.

### ***Monitoring of cases with the Mandatory Provident Fund Schemes Authority***

#### PRP's review

3.8 In two applications for authorisation of Global Emerging Market Equity Fund under a Mandatory Provident Fund scheme, PRP noted that the Mandatory Provident Fund Schemes Authority ("MPFA") who was the primary regulator had taken time to review the risks of the sub-funds investing in emerging markets, and the authorisation was granted by SFC after six months. PRP suggested SFC review the mechanism for it to detect and review outstanding cases with MPFA, and consideration could be given to inviting MPFA to provide regular reports to SFC and to convene regular review meetings between the two regulators.

#### SFC's response

3.9 SFC supports measures to enhance information exchange between SFC and MPFA and to keep both sides informed and regularly updated on the status of all relevant applications. To this end, SFC has implemented in conjunction with MPFA a mutual exchange of salient information on a monthly basis from April 2012 in respect of all new applications concerning MPF schemes, constituent funds and pooled investment funds for purposes of effective monitoring and application processing.

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

### ***Prompt closure of cases***

#### PRP's review

3.10 PRP noted that SFC's action in one complaint case referred by another regulator had been completed quickly in less than a month, but the file was only closed 10 months later. PRP suggested SFC consider bringing up similar cases to check, in say three months, whether there was any outstanding action by the other regulator, and if not, to close the case promptly.

### SFC's response

3.11 SFC has adopted the suggested approach of closing files promptly in similar cases where SFC's action was complete and there was no update/response from relevant regulators for three months.

### ***Referral of complaint cases***

#### PRP's review

3.12 In one complaint against manipulation of share price of a listed company which was referred by the Complaints Control Committee ("CCC") to the Corporate Finance Division ("CFD"), PRP noted that the case was closed after analysis by CFD that no breach of rules or fraud was found. PRP would like to be advised if and when these types of complaints would be referred to the Enforcement Division ("ENF") for investigation.

#### SFC's response

3.13 SFC explained that under the current complaints handling procedures, CCC would conduct a preliminary review to determine whether the matter required further assessment or action. In light of the vague allegation in this case, CCC concluded that this part of the complaint did not warrant further investigation by ENF. SFC assured that investigation of suspicious market manipulation activities was not solely driven by complaints received. The Surveillance Department of ENF would continue to proactively monitor the daily trading activities in the market, and where there were signs of untoward activities, ENF would initiate an inquiry.

### ***Central database maintained by SFC***

#### PRP's review

3.14 Arising from a review of an anonymous complaint, SFC issued letters of advice to a licensed person and a licensed corporation which were found to have deficiencies in maintaining proper records of order placing and handling trade amendments. PRP enquired if the central database on disciplinary actions would also register complaints against or letters of advice issued to intermediaries, and whether such information was made available to different departments or divisions in SFC to facilitate performance of their respective regulatory functions.

### SFC's response

3.15 SFC advised that it maintained a central database known as Investigation Management System which registered public complaints against intermediaries lodged with SFC. As far as compliance advice letters issued by Intermediaries Supervision Department (“ISD”) were concerned, they were filed in the Document Management System and accessible by ISD staff as well as senior staff of other departments/divisions. The letters would also be made available to other staff of other departments/divisions on a need-to-know basis.

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

#### ***Provision of in-house expert opinion and legal advice***

### PRP's review

3.16 After investigation of suspicious trading behaviour of an internet client in one case, SFC sought in-house expert opinion on the trading pattern and legal advice on the case for prosecution. PRP observed that more than two months were respectively required for in-house expert opinion and legal advice to be provided. In two other cases of suspected market misconduct reviewed by PRP, in-house legal advice was provided after more than four months.

3.17 While appreciating that workload would be an issue, PRP invited SFC to elaborate on the existing arrangements in monitoring the response time for provision of in-house expert and legal advice, and consider drawing up internal performance pledges to facilitate monitoring of these cases.

### SFC's response

3.18 SFC elaborated that with a limited number of in-house experts, they had to prioritise their work among competing commitments. SFC considered that the time spent on preparing the expert opinion in this case was acceptable, but it reckoned that in appropriate cases, external experts might be engaged to alleviate the heavy workload of its in-house experts and to speed up the process.

3.19 SFC also pointed out that an Enforcement Steering Committee chaired by Executive Director (Enforcement) was tasked to closely monitor the progress of enforcement cases. Generally, cases accorded with high priority were reviewed every four to six weeks, while other cases were reviewed every

six weeks. In this connection, the preparation of opinions by in-house experts was already kept under review, and SFC did not consider that there was a need to draw up an internal performance pledge.

3.20 SFC further explained that when a case of suspected market misconduct was referred to the Legal Services Division for in-house legal advice, the responsible counsel would have to obtain a thorough understanding of the case and advice would be given as quickly as possible taking into account other work priorities. SFC reassured that there was close liaison between the case officer and the responsible counsel about the progress in preparing the legal advice.

#### PRP's further comments

3.21 PRP considered it generally reasonable that legal opinion and advice was made available within six weeks but it was of the opinion that for complicated cases it should be kept within eight weeks. SFC took note of this.

#### ***Review on Notice of Proposed Disciplinary Action***

#### PRP's review

3.22 PRP reviewed a case of misconduct relating to the listing of a company through placement of shares. As a result of SFC's investigation, a senior officer of the company was served a Notice of Proposed Disciplinary Action ("NPDA") proposing to ban him from the industry for life. After considering his representations, SFC drastically reduced the penalty and decided to prohibit him from re-entering the industry for 12 months.

3.23 To avoid the possible perception that SFC's disciplinary action proposed in NPDA might be materially different from the final decision, PRP suggested that SFC should review if the issue of NPDA should be made after all factors, including the stories of all sides, had been taken into account. The purpose of NPDA would then serve more as a notice to the affected persons to hear their last word and any mitigating factor, but not to argue on the facts of the case.

#### SFC's response

3.24 SFC explained that section 198(1) of the Securities and Futures Ordinance required that SFC should not exercise any disciplinary power without giving the regulated person a reasonable opportunity of being heard. An NPDA was intended to set out the preliminary views of SFC on the

questionable conduct. It also stated the sanctions SFC considered appropriate to impose on the basis of the facts as it understood them at the time. This allowed the regulated person to make representations and comments on the appropriateness of the proposed sanctions. Several parties might be involved in a case. Representations made by individual parties, which might include mitigating factors and new evidence, could affect SFC's views on the entire matter and hence disciplinary decisions. It was therefore inevitable that the final penalty imposed by SFC might deviate from the proposed penalty after representations/submissions that reveal information previously unknown to SFC were made.

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

3.25 The Securities and Futures (Stock Market Listing) Rules ("the Rules") require a corporation applying for listing of its securities to file copies of the application with 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 Stock Exchange of Hong Kong Ltd to file the material with SFC on its behalf. This arrangement is known as "Dual Filing".

3.26 PRP reviewed one case relating to the processing of listing applications under the Dual Filing regime. PRP observed that this case had taken considerable time to complete. It was however found that the applicant was relatively slow in response and there were numerous outstanding issues to be resolved. PRP noted that SFC had generally followed its operational guidelines and established procedures in processing the case.

## **Chapter 4      Way forward and acknowledgement**

4.1            In 2012-13, PRP would continue its work to ensure that SFC adheres to its internal procedures consistently. It would maintain dialogue with market players to gauge their views about the work of PRP.

4.2            PRP welcomes and attaches great importance to the views from market practitioners as well as the public on SFC's operational procedures which fall within PRP's terms of reference<sup>1</sup>. Suggestions and comments could be referred to PRP through the following channels –

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

4.3            PRP would like to express its gratitude to SFC and its staff for their assistance in facilitating the review work, and their co-operation in responding to PRP's enquiries and recommendations in the past year.

### **Process Review Panel For the Securities and Futures Commission September 2012**

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<sup>1</sup> Enquiries or complaints relating to non-procedural matters could be directed to SFC –  
By post to            : The Securities and Futures Commission, 8th Floor, Chater House, 8 Connaught Road Central, Hong Kong  
By telephone to     : (852) 2840 9222  
By fax to             : (852) 2521 7836  
By email to          : enquiry@sfc.hk (for general enquiries, comments and suggestions, etc.)  
                             : complaint@sfc.hk (for public complaints)

**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 actions taken and operational decisions made by the Commission and its staff in the performance of the Commission's regulatory functions in relation to the following areas -
  - (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 actions taken and decisions made in relation to that case or complaint adhered to and are consistent with the relevant internal procedures and operational guidelines and to advise the Commission accordingly.
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  
(1 November 2010 – 31 October 2012)**

Chairman:	Mr CHOW Wing-kin, Anthony, SBS, JP
Members:	Mr CHIU Chi-cheong, Clifton
	Ms CHOW Yuen-yee
	Mr FUNG Hau-chung, Andrew, JP
	Prof HO Yan-ki, Richard
	Dr LAM Kit-lan, Cynthia
	Mr LEE Jor-hung, Dannis, BBS
	Dr the Honourable LEUNG Mei-fun, Priscilla, JP
	Mr LIU Che-ning
	Mr SUN Tak-kei, David, BBS, JP (up to 30 June 2012)
Ex officio members:	Chairman, Securities and Futures Commission (Dr FONG Ching, Eddy, GBS, JP)
	Representative of Secretary for Justice (Mr LAI Ying-sie, Benedict, SBS, JP)
Secretary:	Financial Services Branch of Financial Services and the Treasury Bureau