

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

**Annual Report**  
**for 2014-15**



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## Message from the Chairman

This is the third year that I served as the Chairman of the Process Review Panel ('PRP') for the Securities and Futures Commission ('SFC'). I am pleased to note the enhancements in various procedural matters introduced by the SFC over the past two years.

2014-15 is another very fruitful year. Members of the PRP have continued to devote enormous time and effort in reviewing completed cases, studying the operational manuals and the revised complaint handling procedure of the SFC. With the support and wise counsel of Mr Carlson Tong, our ex-officio member and the Chairman of the SFC, our recommendations reached the Executive Committee of the SFC very quickly and received their positive response.

During the year, Mr Benedict Lai, the representative from the Secretary for Justice and our ex-officio member, retired from the PRP after nine years' of dedicated service. I would like to pay my warmest tribute to Mr Lai for his unfailing support and guidance. I extend my warm welcome to Ms Christina Cheung who succeeded Mr Lai and joined the PRP in February 2015.

It is a great honor for me to serve as the Chairman of the PRP. The checks and balances provided by the work of the PRP are important in safeguarding and maintaining public confidence in the SFC and help to further enhance its transparency. Taking this opportunity, I wish to express my gratitude to the Secretary for the Financial Services and the Treasury and his staff members for the support given to the PRP.

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

I would like to express my gratitude to the PRP members for their time and efforts made in collating views from the industry and reflecting them to the PRP with a view to improving the current practices for the benefit of the market as a whole.

In reading this report, I hope that readers would appreciate that the PRP and the SFC are collaborators working towards the same goal of providing an ever improving and effective regulatory regime for the financial market of Hong Kong.

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

Dr Moses Cheng Mo-chi, GBS, JP  
Chairman

## Executive Summary

In 2014-15, the PRP reviewed 58 cases selected from monthly closed case lists submitted by the SFC. The PRP conducted in-depth deliberation on each case, both with the SFC's case officers and among the Chairman and Members. The PRP aimed to suggest practical recommendations for the SFC to consider in its procedural work.

2. The recommendations include –

### **Intermediaries Supervision**

- ✧ Improvement of the internal control and the case monitoring system

3. The PRP reviewed inspection cases that took three years and six months<sup>1</sup> to complete. During the processing period, the cases remained inactive for two years. Upon discussion, the PRP learnt that the inaction was due to an oversight when the responsible case officer resigned from the SFC. There was no stipulated guideline on handover of outstanding cases to successors although the SFC confirmed that there were established practices for handover in place. The case monitoring system in the Intermediaries Supervision Department ('ISD') at the time did not bring up the cases to the attention of the Directors or Senior Director of the ISD. There was neither internal audit nor external performance pledges governing case progress. The cases under review therefore went astray for two years.

4. Upon its own discovery in late 2013, the ISD took immediate action to follow up with the deficiencies previously

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<sup>1</sup> Counting from confirmation of the inspection commencement date to the closure of the case, the case took three years and six months.

identified in the licensed corporation. In early 2014, the ISD also enhanced its case monitoring system by escalating system alerts to Senior Director level. The ISD further strengthened its case monitoring by bringing up long outstanding cases to the attention of the Executive Director (Intermediaries) at the Divisional Steering Committee.

5. The PRP accepted the remedial action taken by the SFC and hoped that the ISD would continue its efforts to review its internal control and effectiveness on case monitoring.

### **Licensing of Intermediaries**

- ✧ Suggestions to expedite the processing of licensing applications, including considering the issue of an FAQ on outside directorship

6. The PRP studied eight licensing applications of different nature. The PRP was mindful that the Licensing Department ('LIC') was the gatekeeper for individuals and corporations seeking to join the securities and futures markets of Hong Kong. As such, the LIC was tasked with an important role in its function.

7. The PRP noted that the processing time for the cases under review had ranged from one month for a temporary licence application to two years and five months for the other seven licensing applications. After enquiring about monitoring mechanism imposed by the LIC, the PRP made various suggestions to the LIC which included reviewing the checklist of application materials promulgated to applicants, the effectiveness of escalating of cases to the senior management only when the cases had been processed for more than 15 weeks, the adequacy of training to equip staff with the knowledge to refuse non-compliant applications at



an early stage; and considering the issue of an FAQ on outside directorship. The SFC took on board the recommendation on issuing an FAQ and issued it in June 2015. On other recommendations, the SFC provided the PRP with general responses explaining the appropriateness and the adequacy of the current mechanism.

8. The PRP suggested that the LIC should take the recommendations as a starter to consider changing the current work models as and when circumstances arise. The PRP would continue providing recommendations and inviting the LIC to review its procedure in the future case reviews.

### **Authorisation of Investment Products**

- ✧ Extension of the six-month application time lapse policy to cover fund applications involving vetting from the Mandatory Provident Fund Schemes Authority ('MPFA') and suggestions to expedite the fund authorisation process

9. The SFC accepted the PRP's recommendation in 2012-13 to enhance its application time lapse policy by implementing a six-month application time lapse rule with effect from 1 January 2014. In this context, the SFC reported that after the introduction of the new policy, the processing time for applications in 2014 had been reduced by about 38% to less than four and a half months on average, while the number of funds which the SFC authorized in 2014 had increased by more than a third. The PRP was very pleased to note the positive outcome.

10. The PRP was mindful that with the introduction of the Mainland-Hong Kong Mutual Recognition of Funds Arrangement that took effect on 1 July 2015, the Investment Products Division

("IPD") would receive more fund applications from new applicants. The IPD should get prepared for the new challenge ahead. The PRP therefore recommended different suggestions, for example, preparing more guidelines to new applicants, introducing new measures to expedite the authorisation process, exploring effective ways to deter poor quality submissions. To this end, the SFC advised that it would launch a 'SFC Fund Process Revamp' with an objective of shortening the overall processing time for new fund applications. Under the proposed new process, the SFC had planned to process new fund applications adopting a two-stream approach whereby standard applications would be fast-tracked and authorized in two months at most, while the non-standard applications would be subject to additional measures to enhance the authorisation process. The SFC was engaging the industry and committed to publishing a detailed guidance note to the industry upon rolling out of the 'SFC Fund Process Revamp'<sup>2</sup>. The PRP was glad to note the proactive steps taken by the IPD.

11. The PRP suggested that the SFC should liaise with the MPFA on the extension of the six-month application lapse policy to the MPF products. The SFC reported that it had been actively discussing with the MPFA regarding the proposed pilot run workflow. The SFC planned to engage the industry jointly with the MPFA upon finalization of the workflow<sup>2</sup>. The PRP appreciated the progress and looked forward to the positive outcome of joint efforts by both the SFC and the MPFA.

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<sup>2</sup> The SFC issued a press release on 9 October 2015 announcing the launch of new initiatives to further enhance the authorization process for new fund applications and the extension of the six-month application lapse policy to the MPF products. Both initiatives will be implemented on 9 November 2015 for a six-month pilot period.

### **Enforcement**

- ✧ Suggestions on how investigation period might be shortened, including bringing in suitable IT programmes to assist in investigation

12. The PRP studied 14 completed cases and expressed appreciation towards the tremendous efforts made by the Enforcement teammates in the investigation work.

13. The PRP recommended the Enforcement Division ('ENF') to get ready a pool of external experts with different expertise, to bring in more suitable IT programmes to assist in the investigation work, to consider seeking voluntary waiver of the legal professional privilege from the licensee or legal advice on whether a ruling should be obtained from courts regarding the legal professional privilege claim for the investigation report submitted by the licensed entity under investigation and to conduct an early investigation into the licensed entity without waiting for the conclusion of the overseas regulators' investigation over the licensed entity on similar non-compliance of rules. The PRP was pleased that the ENF had made positive feedback to the recommendations. The PRP also looked forward to the ENF's new protocol with the Prosecutions Division of the Department of Justice ('DoJ').

### **Corporate Finance**

- ✧ Pleased to note the establishment of the Corporate Regulation Team on 1 January 2013 for regular reviewing of corporate announcements

14. The PRP reviewed six cases including one case which was handled by the Corporate Regulation Team. The Corporate Regulation Team established on 1 January 2013 was a specialised team for handling price sensitive information disclosure of listed companies. The team also monitored reports / announcements, media reports, annual financial statements to ensure the compliance of the listed companies with the Securities and Futures Ordinance (Cap. 571) ('SFO'). The PRP was glad to note the efforts made by the team.

### **Complaints Handling**

- ✧ Informing persons being complained against of the SFC's findings when enquiry was completed

15. The PRP reviewed eight complaint cases against intermediaries and market activities. When conducting the case reviews, the PRP took the opportunity to review the two new sets of the SFC's complaint handling procedure which took effect in late 2014. For the complaint handling procedure against the Commission and its employees, the PRP noted that the SFC had introduced a new action timeframe for the issue of an interim reply and tightened its response time for providing substantive replies.

16. The PRP further appealed to the SFC to reconsider informing persons being complained against of the SFC's findings when the enquiry was completed. This was one of the recommendations made by the PRP in 2013-14. The PRP reiterated that the arrangement was important as persons being complained against might be put under undue pressure during the enquiry process and they should be informed of completion of the procedure.

17. The PRP was pleased that the SFC had subsequently reviewed its internal procedure and had put in place a policy to inform targets of complaints whom the SFC had contacted during the enquiry process on a 'without prejudice' basis when the SFC concluded that no further action would be taken in respect of the case.

## 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 in November 2000. It is tasked to conduct reviews of operational procedures of the SFC and to determine whether the SFC has followed its internal procedures and operational guidelines to ensure consistency and fairness.

### Functions

1.2            The PRP will review completed or discontinued cases handled by the SFC and advise the SFC on the adequacy of the SFC's internal procedures and operational guidelines governing the actions taken and operational decisions made by the SFC in the performance of its regulatory functions. These areas include inspection of intermediaries, licensing of intermediaries, authorisation of investment products, enforcement, corporate finance including processing of listing applications, and complaints handling.

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

1.4            The Terms of Reference of the PRP are -

- (a) To review and advise the Commission upon the adequacy of the Commission's internal procedures and operational guidelines governing the actions taken and operational decisions made by the Commission and its staff in the performance of the Commission's regulatory functions in relation to the following areas -
- (i) receipt and handling of complaints;
  - (ii) licensing of intermediaries and associated matters;
  - (iii) inspection of licensed intermediaries;
  - (iv) taking of disciplinary action;
  - (v) authorisation of unit trusts and mutual funds and advertisements relating to investment arrangements and agreements;

- (vi) exercise of statutory powers of investigation, inquiry and prosecution;
  - (vii) suspension of dealings in listed securities;
  - (viii) administration of the Codes on Takeovers and Mergers and Shares Buy-back (formerly known as the Codes on Takeovers and Mergers and Share Repurchases);
  - (ix) administration of non-statutory listing rules;
  - (x) authorisation of prospectuses for registration and associated matters; and
  - (xi) granting of exemption from statutory disclosure requirements in respect of interests in listed securities.
- (b) To receive and consider periodic reports from the Commission on all completed or discontinued cases in the above-mentioned areas, including reports on the results of prosecutions of offences within the Commission's jurisdiction and of any subsequent appeals.
- (c) To receive and consider periodic reports from the Commission in respect of the manner in which complaints against the Commission or its staff have been considered and dealt with.
- (d) To call for and review the Commission's files relating to any case or complaint referred to in the periodic reports mentioned in paragraphs (b) and (c) above for the purpose of verifying that the actions taken and decisions made in relation to that case or complaint adhered to and are consistent with the relevant internal procedures and operational guidelines and to advise the Commission accordingly.
- (e) To receive and consider periodic reports from the Commission on all investigations and inquiries lasting more than one year.
- (f) To advise the Commission on such other matters as the Commission may refer to the Panel or on which the Panel may wish to advise.
- (g) To submit annual reports and, if appropriate, special reports (including reports on problems encountered by the Panel) to the Financial Secretary which, subject to applicable statutory secrecy provisions and other confidentiality requirements, should be published.
- (h) The above terms of reference do not apply to committees, panels or other bodies set up under the Commission the majority of which members are independent of the Commission.

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

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

## Membership

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

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

1.9 The membership of the PRP in 2014-15 is as follows -

### Chairman:

Dr CHENG Mo-chi, Moses, GBS, JP	since 1 November 2012
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### Members:

Mr CHAN Kam-wing, Clement	since 1 November 2012
Ms CHOW Yuen-yee	since 1 November 2010
Ms DING Chen	since 1 November 2014
Prof HO Yan-ki, Richard, JP	since 1 November 2010
Dr HU Zhanghong	since 1 November 2012
Dr LAM Kit-lan, Cynthia	since 1 November 2010
Ms LEE Pui-shan, Rosita	since 1 November 2012
Mr LEE Wai-wang, Robert	since 1 November 2012
Mr MAK Chi-ming, Alfred	since 1 November 2012
Ms YUEN Shuk-kam, Nicole	since 1 November 2014



**Ex officio Members:**

Chairman, the Securities and Futures  
Commission

Mr Carlson TONG, SBS, JP

since 20 October 2012

Representative of the Secretary for Justice

Ms CHEUNG Kam-wai, Christina

since 26 February 2015

**Secretariat:**

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

## Chapter 2 Work of the PRP in 2014-15

### Modus operandi

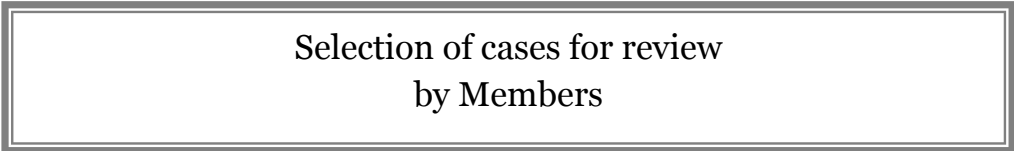
2.1 The SFC provides the PRP with monthly lists of completed and discontinued cases. Members of the PRP select cases from these lists for review with a view to examining cases encompassing different areas of the SFC's work. Members pay due regard to factors including processing time of completed cases, procedural steps taken by the SFC in arriving at its decisions and relevant checks and balances.

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

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

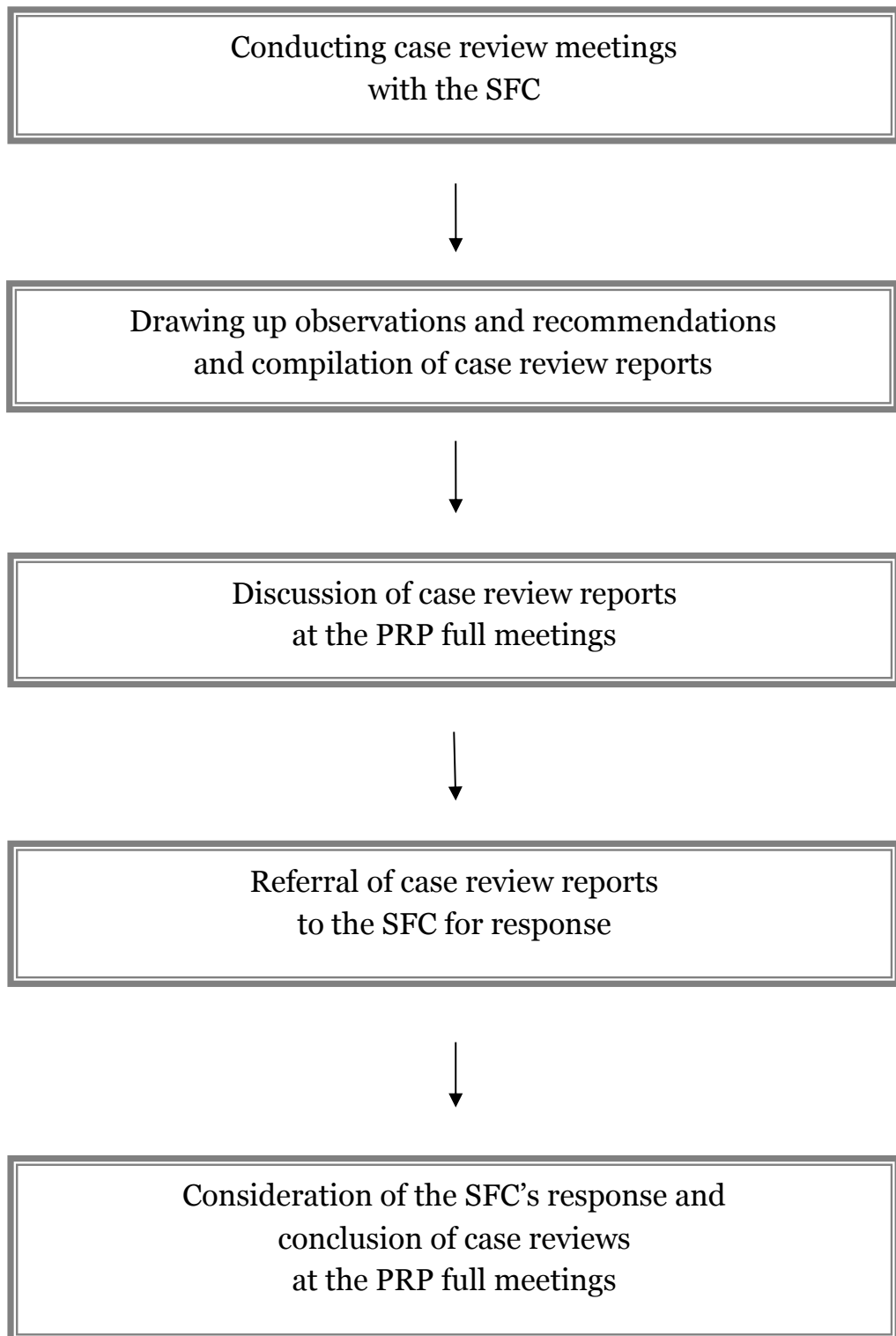
### Case review workflow

2.4 The workflow of the PRP case reviews is set out below -



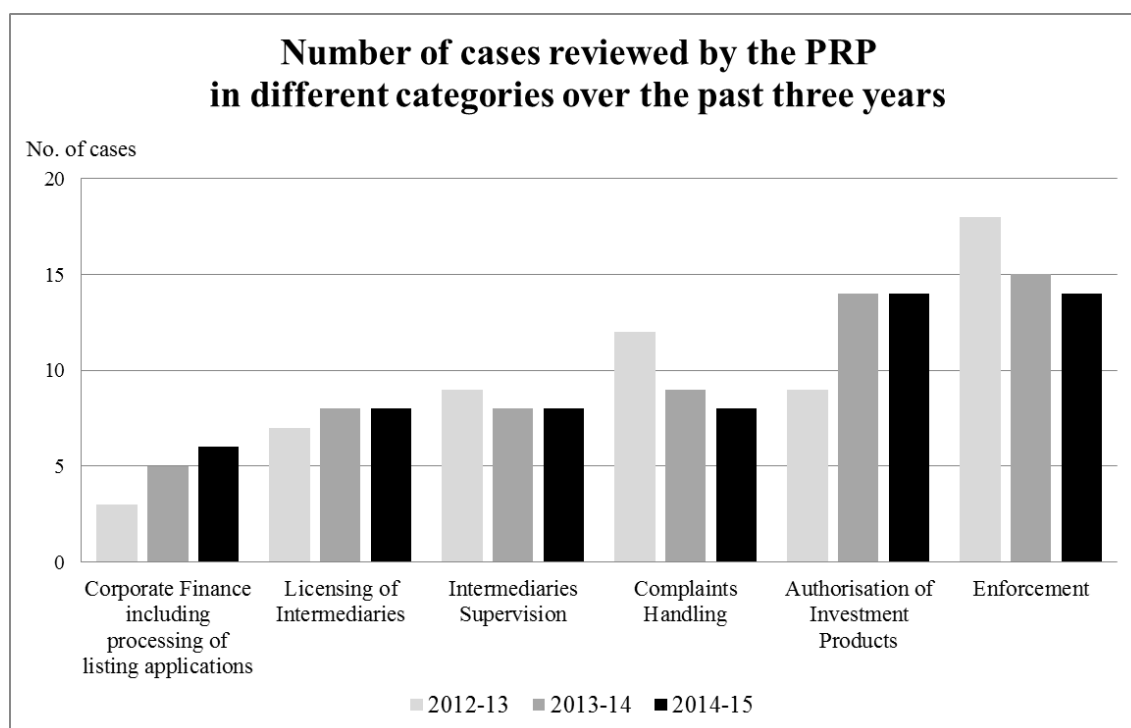
Selection of cases for review  
by Members





## Highlights of work

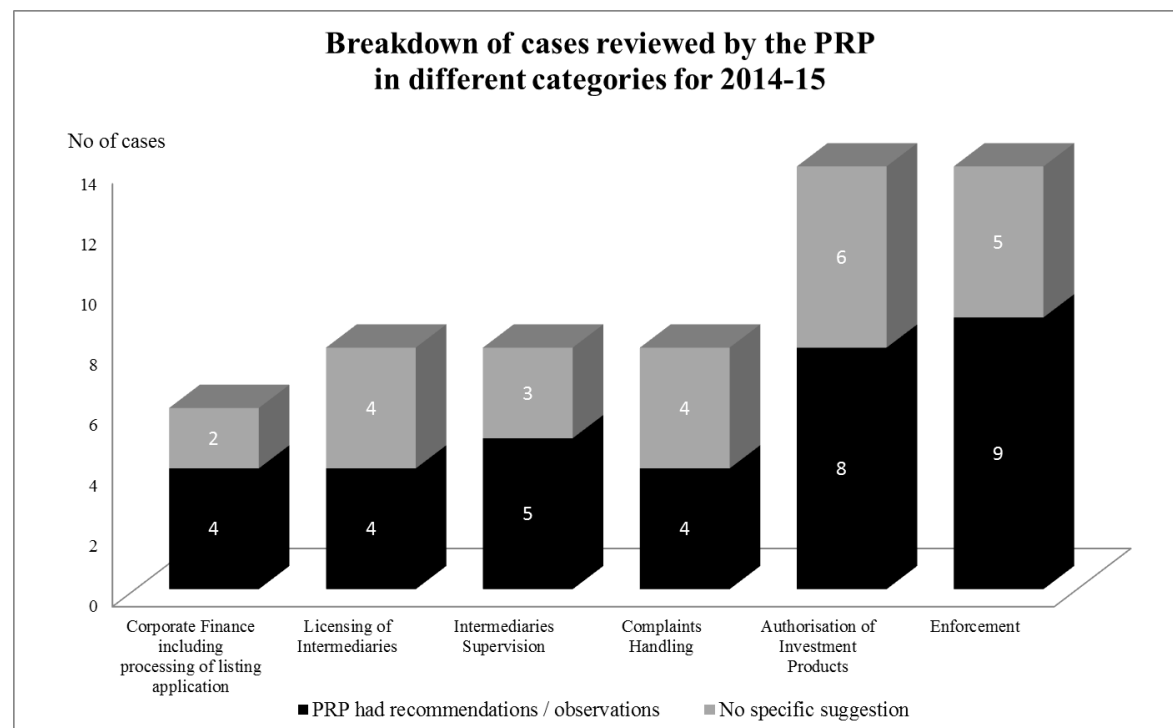
2.5 The PRP reviewed completed cases that fell under six categories of the work of the SFC. The distribution of the cases over the past three years is shown below -



2.6 During the year, the PRP conducted 11 meetings with the SFC's case officers on 58 selected cases that were completed or discontinued by the SFC. The PRP met four times in the year to discuss its observations and recommendations of cases reviewed. The distribution of the 58 cases reviewed in 2014-15 is summarised below -

	No. of Cases
Corporate Finance including processing of listing applications	6
Licensing of Intermediaries	8
Intermediaries Supervision	8
Complaints Handling	8
Authorisation of Investment Products	14
Enforcement	14
<b>Total</b>	<b>58</b>

2.7 Among these 58 cases reviewed, the PRP had made recommendations or observations on 34 cases representing 59% of the cases under review.



2.8 The PRP, after reviewing the completed cases, had offered to the SFC a number of recommendations. The recommendations cover procedural matters, the SFC's operational manuals and information and guidance to the market in the form of frequently-asked questions ('FAQs').

2.9 Highlights of the PRP's observations and recommendations are set out in Chapters 3 and 4. Follow-up actions taken by the SFC in response to the PRP's recommendations in the Annual Report for 2013-14 are set out in Chapter 5.

## Chapter 3      Observations and Recommendations – Case Reviews

### Intermediaries Supervision

3.1            The PRP reviewed eight cases relating to the work of the ISD. Among the inspection cases of intermediaries conducted by the ISD, most of them were completed within one year. However, the PRP noted that two inspection cases which were concurrent inspections of two companies in the same group had lasted for more than three years due to an oversight when the responsible case officer resigned from the SFC. Once it had discovered this delay, the ISD took immediate action to complete the cases and implemented improvement measures on its case monitoring system. The PRP made several recommendations relating to the internal control and monitoring system of the ISD.



#### (a)            *SFC's Monitoring Mechanism*

3.2            The PRP reviewed two inspection cases which took three years and six months<sup>3</sup> to complete. The PRP noted that the SFC had completed the fieldwork inspection and sent an interim letter of deficiencies to the licensed corporations within four months of the commencement of the inspections. The SFC summarized its findings in the letter of deficiencies and requested the licensed corporations to improve upon its internal control. The SFC also paid visits to the corporations and had conference calls with the corporations' officers in charge in the next five months. The PRP noted that the cases had then remained inactive for two years.

3.3            Upon enquiry, the PRP was told that the lapse of the two year period was the result of an oversight when the responsible case officer resigned from the SFC. Upon its own discovery of the delay in late 2013,

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<sup>3</sup> Counting from confirmation of the inspection commencement date to the closure of the case, the case took three years and six months.

the SFC took immediate action to review the deficiencies identified and followed up with the corporations on the inspection findings and issued a final management letter to the corporations within the next four months. The licensed corporations responded to the final management letter and the SFC took further follow-up action with the corporations and issued a conclusion letter two months afterwards.

## § PRP's recommendations

### *The internal control system*

3.4 At the case review meeting, the PRP observed that there were over 200 inspection cases to be handled annually involving some 50 staff in the ISD comprising levels at Directors, Associate Directors, Senior Managers, Managers, Assistant Managers and Associates. As such, there should be a case monitoring system providing timely alerts on outstanding cases to case officers, supervisors and senior management for action and monitoring. The PRP felt that in the case monitoring system, there should be an alert message on each key step for the inspection. The alert messages should reach appropriate levels for timely advice and monitoring, instead of just sending the alert to the case officers concerned.

### *Proper handover procedures*

3.5 The PRP members were given to understand that hitherto there was no written handover procedure for staff changes in the ISD. When a staff of the ISD left, there were no stipulated steps on how to handover his / her duties to the successor. There were no stipulated requirements for supervisory checking or discussion on outstanding cases when a staff left the ISD.

3.6 The PRP recommended that the SFC should have proper handover procedure in which supervisors should be held accountable to smooth transition of jobs upon staff changes.

### *Setting up internal audit*

3.7 The PRP further enquired if the outstanding cases had been spotted by the internal audit system in the SFC. Noting from the subject officers' reply that inspection cases handled by the ISD were not covered by the internal audit system, the PRP requested the SFC to confirm firstly the accuracy of such reply and invited the SFC to consider extending its internal audit system to cover inspection cases so that problematic cases could be picked up and dealt with in a timely manner.

3.8 The PRP also pointed out that it was important to instil a good time sense among staff in the ISD. Any deficiency spotted in intermediaries should be rectified as soon as possible. This is important as the SFC regulatory work aims to protect investors, among others. Intermediaries concerned would also expect the inspections be concluded the soonest possible. Any unnecessary holding up of inspection would cause undue pressure to intermediaries.

### *Performance pledges for inspection*

3.9 The PRP further noted that there was no performance pledges promulgated by the ISD on the completion of an inspection. At the case review meeting, the SFC officers informed the PRP that there were only internal guidelines stipulating that an interim letter of deficiencies should be issued to intermediaries concerned when the inspection was likely to remain outstanding four months after commencement. The PRP recommended the SFC to draw up performance pledges and comprehensive guidelines on timeframe in handling each step of inspection.

### *§ SFC's responses*

3.10 The SFC conducted an immediate review of the recommendations made by the PRP after the case review meetings.



3.11 The SFC explained that the cases under review were isolated incidents and it had taken immediate remedial action to prevent occurrence of similar incidents. Prior to the PRP's case review, the ISD had implemented system and procedural enhancements for its case monitoring. The SFC had enhanced to its case monitoring system by phases since early 2014 for additional alerts and reports. The enhanced case monitoring system would provide alerts to Directors and Senior Director level. Outstanding cases, which were defined as 'long dated matters' by the SFC, would be tabled at the weekly Divisional Steering Committee chaired by the Executive Director (Intermediaries).

3.12 The SFC would continue to review the effectiveness of the case monitoring system and the procedure, and would take prompt actions to make enhancements as and when necessary.

3.13 The SFC explained that it had since provided written guidelines to ISD staff in relation to handover arrangement. Staff who were soon to depart would be reminded by the HR to complete proper handover prior to his/her departure.

3.14 The SFC advised that it was not feasible to set any rigid time frame or performance pledges for issuing a letter of deficiencies and completing the whole inspection process as the number and complexity of issues arising from an inspection varied widely between firms.

#### *§ PRP's further comments to the SFC's responses*

3.15 The PRP noted that the SFC had reservations about extending its internal audit system for inspection work, formulating performance pledges and drawing up formal handover procedure. The PRP would continue to monitor the SFC's handling procedure in inspection cases of intermediaries and raise the issues with the SFC when appropriate.



*(b) Issuing Closure Letters*

3.16 In reviewing another inspection case, the PRP noted in the internal guideline that the ISD would issue closure letters or letters of deficiencies to intermediaries within four months of the commencement of inspections. The PRP raised concerns on whether the ISD would hold up the issue of the letters until the lapse of four months of the commencement of the inspection. The PRP recommended the SFC to issue the letters forthwith upon completion of the inspection to avoid undue pressure on intermediaries.

3.17 For the current case under review, the PRP accepted the SFC's explanation that there were specific factors that led to the issue of closure letter four months after the inspection.



*(c) Referral to Enforcement Division*

3.18 The PRP reviewed two inspection cases which the ISD had identified serious problems in the intermediaries. The PRP noted very different conclusions made by the ISD: in one case, the ISD decided to refer the case to the ENF whereas in the other, it was concluded with the issue of a letter of deficiencies. While the PRP was mindful that its review should not touch on merits of the cases, the PRP opined that the ISD should have internal guidelines for its staff to base upon in deciding whether inspection findings should be referred to the ENF for follow up action.

*§ PRP's recommendations*

3.19 The PRP invited the ISD to elaborate its guidelines on referring cases to the ENF. To ensure consistency among all ISD staff, the PRP recommended the ISD to prepare a bulletin on the SFC's electronic

platform for sharing decisions on follow up action on inspection; and promulgating guidelines on arriving at decisions and follow-up actions of cases. This would ensure that the ISD exercised its regulatory powers in a fair and consistent manner.

### § *SFC's responses*

3.20 The ISD explained that whether cases would be referred to the ENF was based on an internal assessment of the case merit. Examples of factors to be considered included (a) factors affecting the 'fit and proper' test of licencees; (b) whether clients' interests were adversely affected; (c) the licencees' financial position; and (d) whether the event posed a systemic risk to the market. As circumstances might vary, each case had to be carefully considered.

3.21 As regards channels for sharing knowledge of cases referred to the ENF among ISD colleagues, the ISD reported that there were established communication channels, namely, regular ISD staff meetings, inspection training workshops and an electronic intranet system that facilitated the dissemination and sharing of referral cases.

### § *PRP's further comments to the SFC's responses*

3.22 The PRP looked forward to seeing the effectiveness of these channels in ensuring consistency in the ISD case processing.



#### *(d) Special Inspection on Sponsor Business*

3.23 The ISD conducted a special inspection of a sponsor company and selected three listing applications handled by the company to assess its compliance with regulatory requirements as the sponsor.

3.24 The fieldwork lasted for three months. One month after completion of the fieldwork, the ISD issued a letter of deficiencies to the company. The company provided responses which were unsatisfactory to the issues raised by the ISD. After studying the responses, the ISD referred the case to the ENF for further action.

3.25 At the case review meeting, the PRP was told that a specialised team comprising staff with expertise in legal, accounting, financial and exchange house was established to conduct special inspection for assessing compliance with regulatory requirements by sponsor. The specialised team selected targets of inspection having regard to the number and size of listing applications handled by the companies.

3.26 The PRP was pleased to note the efforts made by the SFC in monitoring sponsor activities.



**§ Concluding Remarks**

3.27 The PRP noted a two-year delay in the reviewed inspections, which suggested problems in the internal control system of the ISD. Nevertheless, the SFC forthwith took step to review and rectify the same. The PRP was satisfied with the enhancement made by the SFC to the case monitoring system.

3.28 The SFC had reservations about the PRP’s recommendations in formulating performance pledges, setting up internal audit to monitor inspection cases and establishing formal handover procedure upon staff changes. The PRP will continue to monitor the SFC’s handling procedure in inspection cases of intermediaries and raise the issues with the SFC when appropriate.

## Licensing of Intermediaries

3.29 The PRP reviewed eight licensing applications for different types of regulated activities. Among the cases, there were applications involving withdrawals or refusal in the end and an application for a temporary licence. The processing time for these cases ranged from one month for the temporary licence to two years and five months for the other seven licensing applications.

3.30 The PRP focused on the procedure and time spent. The PRP made some recommendations on streamlining the SFC's procedure, including processing applications for different regulated activities concurrently, arranging for more direct communication with the applicants, reviewing checklists to applicants, monitoring long processing cases by senior management and refusing non-compliance applications in a timely manner.

3.31 The PRP also asked the SFC to provide more guidance to applicants relating to their engagement with outside directorship.



### *(a) Concurrent Processing of Applications*

3.32 The PRP reviewed an application for a licence to carry on a Type 1 regulated activity (dealing in securities) and a Type 4 regulated activity (advising on securities). At the case meeting, it was observed that the LIC had appeared to handle applications for the two types of regulated activities separately. The LIC started with the Type 1 application and issued six rounds of requisitions. The process took one year and six months. The applicant finally decided to withdraw its application for the Type 1 regulated activity in view of the LIC's concerns that its proposed business model might be a potential breach of the SFO. After the withdrawal of the Type 1 application, the LIC proceeded with processing the Type 4 application. The LIC studied the revised business plan on the Type 4 application. The whole process for handling the Type 4 application took another 11 months.

### § *PRP's recommendations*

3.33 While the PRP noted that the LIC had generally followed its operational guidelines in processing the case, it questioned if the SFC could process the applications for the Type 1 and Type 4 regulated activities concurrently. This might shorten the overall processing time.

3.34 The PRP also noted of the substantial written correspondence between the LIC and the applicant. Appreciating the case officer's explanation on the importance of having the applicants' written responses as documentation of the application, the PRP enquired if the LIC could arrange meetings and telephone conference with the applicant to supplement written communication. This might enhance the communication and overall efficiency of processing the application.

### § *SFC's responses*

3.35 The SFC replied that the LIC had been dealing with both applications concurrently. The applicant, after withdrawing the Type 1 application, substantially revised its business plan for the Type 4 application. The SFC was only then in a position to make requisition arising from the revised business plan on the Type 4 application following then.

3.36 The SFC reiterated that although it required written representations from the applicants, it also arranged meetings or telephone calls with the applicants, where appropriate.

### § *PRP's further comments to the SFC's responses*

3.37 The PRP looked forward to effective communication between the LIC and applicants to facilitate licensing process.



**(b) *Reviewing Checklists of Application Materials***

3.38 At a case review meeting, the PRP was told that apart from the published checklist, the LIC might ask for more comprehensive information for vetting. The PRP recommended the LIC to review the published checklist so that applicants could better appreciate the expected quality of the application documents.

**§ *SFC's responses***

3.39 The SFC clarified that its general licensing requirements, as well as details of information and documents to be submitted for licensing applications, were all set out in its published materials. The SFC publicised the FAQs and circulars on its website from time to time setting out its views on some common licensing issues and provided guidance to the public.

**§ *PRP's further comments to the SFC's responses***

3.40 The PRP would continue to monitor the adequacy of the published checklist in future case reviews.



**(c) *Monitoring Cases by Senior Management***

3.41 At a case review meeting, the PRP asked if the SFC senior management was aware of an outstanding application which lasted for two years and five months. The PRP opined that timely directives from the senior management would assist case officers to consider how to deal with the applications.

### § *PRP's recommendations*

3.42 The LIC advised that, amongst other things, all cases which were processed for more than 150 days (i.e. 21 weeks), were passed on to the senior management. In this aspect, the PRP recommended the LIC to review and assess the effectiveness of bringing up outstanding cases to the senior management only after the cases had been processed for over 21 weeks. The PRP pointed out that the SFC's performance pledges for processing licensing applications ranged from seven business days for a provisional licence of representative to 15 weeks for a licensed corporation. Apparently, it was too late to escalate 21-week outstanding cases to the senior management for monitoring, if the 15-week pledged time was considered as appropriate timeframe to complete an application.

### § *SFC's responses*

3.43 The SFC considered its current application monitoring mechanism effective as licence applications were monitored by supervising Directors. Complicated cases would be escalated to the Directors and the Senior Directors. The senior management was involved in complicated applications from an early stage.

3.44 The SFC also reported that as at 30 April 2015, there were less than 5% of total licence applications that lasted for over 150 days. The outstanding cases were passed on to the Executive Director monthly for monitoring and policy reviewing.

### § *PRP's further comments to the SFC's responses*

3.45 The PRP noted that the SFC considered its application monitoring mechanism effective. In this aspect, the PRP would continue to monitor the effectiveness of the mechanism and put forth recommendation to effectively discharge the ISD supervisory role in future case reviews, as and when necessary.





(d) *Refusing Licensing Applications in a Timely Manner*

3.46 At a case review meeting, the PRP discussed with the case officers if they had considered refusing an application upon noting that the application did not comply with the SFC's regulatory requirements and might breach the SFO. The PRP noted that the SFC had spent a lot of resources to review and amend the applicant's business model so that the applicant could comply with the regulatory requirements. The PRP enquired if that was intended to be part of the role of the SFC in processing licensing applications as it might have posed an unnecessary drain on the SFC's resources.

3.47 In another case review, the PRP was told that the SFC did have a mechanism refusing an application on the ground that *'inadequate information / documentation or unwillingness or inability to provide the requested information by an applicant might lead to a refusal if the applicant hinders the SFC's ability to assess the fitness and properness of the applicant.'* In this aspect, the PRP was also told that the LIC was required to go through a long process in refusing applications. This included writing to the applicant indicating the SFC's intention to refuse the application, inviting the applicant to make representations in response to the SFC's grounds of refusal. The applicant might lodge an appeal to the Securities and Futures Appeals Tribunal. Apparently, the above procedural steps deterred the LIC staff from refusing applications.

§ *PRP's recommendations*

3.48 The PRP recommended the LIC to provide more detailed guidelines to its staff to assist them to determine if applications complied with the SFC's regulatory requirements. More training should be provided to equip staff members with necessary knowledge on refusing non-compliance applications in a timely manner.

3.49 The PRP also recommended that the SFC should critically review the processes and procedure for handling outstanding or procrastinating applications. This would in turn reduce pressure on manpower requirement in the LIC.

### § *SFC's responses*

3.50 The SFC reiterated that it would return a licence application if the applicant's business model was apparently not complying with the regulatory requirements. However, if upon initial examination the business model did not seem to be in breach of the requirements, the SFC would accept the application and proceed with the processing work. Given that a record of refusal by the SFC might create an unfavourable track record for the applicant, when an applicant was willing to revise its business model to comply with the regulatory requirements, the SFC would give them an opportunity to demonstrate their fitness and properness to be licensed.

### § *PRP's further comments to the SFC's responses*

3.51 The PRP noted that the SFC had provided general responses explaining the working mechanism in the LIC. The PRP commented that the LIC should take the recommendations as a starter to consider changing current work models as and when circumstances arise.



#### (e) *Frequently-asked Questions on Outside Directorships*

3.52 The PRP reviewed a licence application for Responsible Officer ('RO') to carry on Type 4, 5, 6 and 9 regulated activities. The applicant was a chairman and a director of an overseas company. The LIC had serious concerns on the applicant's dual capacity of the RO and being the chairman/director of another company. The LIC considered that the applicant was not fit and proper to be licensed and issued a Notice of

Decision to refuse the application.

### § *PRP's recommendations*

3.53 The PRP suggested that the LIC should provide more guidance in terms of its FAQs to publicise its principles and criteria in handling individual applications concerning outside directorship. This would provide applicants with better understanding on outside directorship that was not conducive to his position as a licensed person to obviate such applicants submitting inappropriate applications.

### § *SFC's responses*

3.54 The LIC agreed to the recommendation. A new set of FAQ to clarify the LIC's general approach in handling such kind of situation was issued on 19 June 2015.

### § *PRP's further comments to the SFC's responses*

3.55 The PRP was pleased to note the SFC's follow-up.



### § *Concluding Remarks*

3.56 The PRP noted the LIC had provided general responses explaining the appropriateness and the adequacy of the prevailing mechanisms adopted in the division. The PRP commented that the LIC should take the recommendations as a starter to consider changing the current work models as and when circumstances arise. The PRP would continue providing recommendations and inviting the LIC to review its procedure in the future case reviews.

## **Authorisation of Investment Products**

3.57 The PRP reviewed a total of 14 completed authorisation cases handled by the IPD. Most of the applications were received by the IPD before 1 January 2014 and were yet to be subject to the enhanced six-month application lapse policy as recommended by the PRP in 2012-13. The processing time of the authorisation cases ranged from four months to one year and five months. Among the cases, four cases involved withdrawal of applications at the end.

3.58 Although most cases under review were not subject to the enhanced six-month application lapse policy, the PRP members continued to follow up closely on the effectiveness of the new policy with the SFC subject officers at the case review meetings. The PRP learnt that there were noticeable improvements in processing time. With the introduction of the new policy, the authorisation time in 2014 was reduced by about 38% to less than four and a half months on average. The PRP was delighted to note the enhancement on the authorisation efficiency. The PRP invited the SFC to liaise with other regulators on extending the six-month application lapse policy to co-regulated investment products.

3.59 With the introduction of the mutual recognition of funds arrangement which took effect on 1 July 2015, the PRP noted that there would be more overseas fund houses applying for authorisation in Hong Kong. In this regard, the PRP recommended the IPD to continue to improve upon its authorisation procedure, to provide for more briefings to potential applicants and to enhance communication with overseas applicants.

3.60 The PRP recommended various improvement measures for the SFC's consideration. The measures were set out in the ensuing paragraphs. In this context, the IPD advised that it would conduct a 'SFC Fund Process Revamp' to enhance the authorisation process. The PRP was glad to note the proactive action taken by the IPD.



(a) *Expedited Closing Procedure*

3.61 The PRP suggested that the SFC should take the initiative to chase applicants or even consider early closing of applications if applicants did not respond in a timely manner. In this context, the PRP was informed that the SFC had implemented an expedited closing procedure: with effect from 17 June 2014, if applicants did not respond to or provide substantive responses within one month of the SFC's requisition, the SFC might inform the applicant where appropriate that the SFC intended to issue letters of mindedness to refuse the application unless applicants properly addressed all the SFC's requisitions within a month's time. The PRP was pleased to note the new measure.



(b) *Extension of six-month application lapse policy to funds involving Mandatory Provident Fund Schemes Authority*

3.62 The PRP reviewed two applications for authorisation of funds which were constituent funds of the mandatory provident fund schemes. Approval from the MPFA was required. The two cases were not subject to the six-month application lapse policy and took more than one year to complete.

§ *PRP's recommendations*

3.63 The PRP recommended the IPD to contact other regulators, like the MPFA, to set up a similar lapse policy. This would enhance overall efficiency in product authorisation which required approval from different regulators.

### § SFC's responses

3.64 The SFC conveyed the PRP's views to the MPFA and reported that as at June 2015, the SFC was actively discussing with the MPFA on a pilot run workflow to implement a six-month application lapse policy for the authorisation of funds which required approval by the SFC and the MPFA. The SFC also planned to engage the industry jointly with the MPFA upon the finalization of the workflow<sup>4</sup>.

### § PRP's further comments to the SFC's responses

3.65 The PRP was pleased to note that the SFC had taken active follow up action and invited the SFC to report further.



#### (c) *Arranging more Briefings for Applicants and Enhancing Communication with Overseas Applicants*

3.66 The PRP reviewed three applications: one was an application for an exchange traded fund under the Renminbi Qualified Foreign Institutional Investor program while the other two were applications from new overseas applicants. The processing time of these applications ranged from eight to 11 months.

3.67 The PRP was told that the IPD had spent much time to process the applications as the applicants gave only partial responses to the SFC's comments, provided late confirmation of information and submitted documents in a piecemeal fashion. Moreover, the submission of applications contained inconsistent and incorrect information. This further delayed the authorisation process.

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<sup>4</sup> The SFC issued a press release on 9 October 2015 announcing the application of six-month application lapse policy to the new MPF and PRF products. The initiative will be implemented on 9 November 2015 for a six-month pilot period.

### § *PRP's recommendations*

3.68 The PRP invited the IPD to consider mechanisms to enhance the authorisation process. The PRP suggested that the IPD should set a more stringent response time for applicants to provide proper and substantive responses to the IPD's requisitions. The IPD was also invited to consider introducing a demerit point system or other effective deterrent measures for non-compliant applicants.

3.69 To help applicants comply with the SFC's requirements, the PRP recommended the IPD to arrange for more direct communication with market participants. Examples included organizing workshops and briefings, especially to new applicants and fund distributors. Through the briefing sessions, the SFC could directly explain the requirements as promulgated in the SFC circulars and FAQs to the new applicants.

3.70 The PRP suggested that the IPD could enhance communication with applicants, especially those from overseas, by inviting applicants and their local agents for joint meetings, telephone conferences etc.

### § *SFC's responses*

3.71 The IPD responded positively towards the recommendations.

3.72 In 2015, the IPD formulated further enhancement measures under a proposed revamp process with a view to shortening the overall processing time for new fund applications ('SFC Fund Process Revamp'). As at mid-2015, the IPD was consulting the industry on the SFC Fund Process Revamp. Under the proposed new process, the SFC planned to process new fund applications adopting a 'two-stream approach' whereby standard applications would be fast tracked and authorized in two months at most while the non-standard applications would be subject to additional measures to enhance the authorisation process. Collaborative efforts from the applicants to provide proper, substantive and timely response to the

IPD's requisitions were crucial for enhancing the overall processing time. The IPD formed a technical working group with the industry to work on the streamlined documentary requirements and disclosure templates as part of the 'SFC Fund Process Revamp' and planned to publish a detailed guidance note including minimum disclosure requirements upon the implementation of the enhancement measures<sup>5</sup>. The IPD would keep in view the introduction of appropriate deterrent measures. When considering such measures, the IPD would work closely with the industry and strive to maintain a balance between effective deterrent on non-compliant applicants and the overall competitiveness of the asset management industry in Hong Kong.

3.73 The IPD provided guidance to industry participants from time to time through publication of circulars, FAQs, workshops and briefings. These workshops and briefings were primarily targeted for market participants, involving application for authorisation and ongoing compliance matters. Depending on the subject matter of the workshops, the IPD would generally invite all managers of the SFC-authorized funds and other industry participants including fund distributors, trustees and lawyers to attend.

### § *PRP's further comments to the SFC's responses*

3.74 The PRP looked forward to the IPD's further report on the launch and implementation of the 'SFC Fund Process Revamp'.



### § *Concluding Remarks*

3.75 The PRP appreciated the efforts made by the IPD in improving the fund application process. The PRP looked forward to the SFC's further report on the 'SFC Fund Process Revamp'.

<sup>5</sup> The SFC issued a press release on 9 October 2015 announcing the launch of a new initiative to further enhance the authorization process. The initiative will be implemented on 9 November 2015 for a six-month pilot period.



## Enforcement

3.76 The PRP studied 14 completed cases handled by the ENF. The PRP made an in-depth study on the procedure taken in each case.

3.77 The PRP appreciated the tremendous efforts made by the ENF in the investigation work of cases under review. The PRP had nevertheless raised concerns on two areas: (a) the investigation time for some of the cases; and (b) the measures taken by the ENF to protect investors during the investigation.

3.78 For the cases under review, the PRP noted that the processing time ranged from 10 months to 11 years. Among the 14 cases, five took more than five years to complete. The PRP was concerned about the long processing time. The PRP also enquired whether the ENF had taken effective precautions to protect investors during the investigation. Against the above background, the PRP made several recommendations to the ENF.



(a) *Establishing a Pool of External Experts*

3.79 The PRP reviewed a case in which the Surveillance Department of the ENF had identified untoward price and volume movements of certain stocks during the closing auction sessions. The Investigation Department of the ENF took over the case and engaged four market experts at different juncture of the investigation period to provide opinion. Much time had been spent on acquiring external expert opinion and the investigation took five years and seven months to complete.

### § *PRP's recommendations*

3.80 Noting that the long processing time of the case was partially attributed to the engagement of four experts to provide opinion at different stages, the PRP enquired about how the ENF selected external experts and more importantly, what measures had been taken by the ENF to ensure that appointed experts would provide timely opinion so that investigation progress would not be delayed unnecessarily. The PRP also recommended the SFC to get ready a pool of external experts with different expertise in order to expedite processes of identifying and engaging appropriate experts.

### § *SFC's responses*

3.81 The SFC explained that the biggest challenge was the identification of suitable persons who were prepared to give evidence. Many experts were unwilling to assist in the SFC cases especially if the case involved a substantial or large institution. The difficulty in engaging market experts was not specific to Hong Kong. Choices were limited and suitably qualified experts might not wish to act for the prosecution.

3.82 The ENF already had a list of external experts who were prepared to work for the SFC. In order to encourage market experts in the financial industry to work for the SFC and to make it more difficult for licensed firms to veto their staff from serving as experts, the SFC had added a special provision in the Code of Conduct for Persons Licensed by or Registered with the SFC that the licensed firms should not without reasonable excuse prohibit their employees from performing expert witness services for the SFC.

### § *PRP's further comments to the SFC's responses*

3.83 The PRP accepted the ENF's explanation.



*(b) Effective Precautions to Protect Investors*

3.84 In a case review, the PRP noted that an overseas regulator had informed the SFC that it had commenced legal proceedings against companies and their shareholders, who were the SFC's licensees. The overseas regulator announced sanctions after two years. After the sanctions by the overseas regulator were announced, the ENF initiated disciplinary proceedings against the relevant parties.

*§ PRP's recommendations*

3.85 The PRP noted that the ENF had waited for the announcement of the sanctions by the overseas regulator before it took its enforcement action. From an investors' protection point of view, the PRP opined that the ENF should have conducted its investigation as early as possible. The PRP therefore enquired why the ENF had to wait for the conclusion of the proceedings by the overseas regulator.

3.86 For the case under review, the PRP noted that the companies had volunteered to cease the practices in question when the overseas regulator conducted the investigation. The interests of investors were therefore protected. The PRP nevertheless recommended that if the ENF considered that there was an absolute need to wait for the conclusion of the enforcement actions by the overseas regulator before proceeding with its own enforcement action, the ENF should ensure it would take effective precaution in the interim to protect investors interests.

*§ SFC's responses*

3.87 The ENF clarified that it started its investigation after receiving the referral from the overseas regulator. However, as the disciplinary proceedings against the relevant companies and officers were based on their infringement of overseas law and regulations, the ENF

considered it prudent to take action only after the announcement of sanctions by the overseas regulator.

3.88 The ENF assured the PRP that if the company under investigation did not cease its business during the investigation period, the ENF would have had considered various measures under the SFO to protect investors' interests.

*§ PRP's further comments to the SFC's responses*

3.89 The PRP accepted the response.



*(c) Protocol with Department of Justice*

3.90 The PRP reviewed a potential market misconduct case handled by the ENF in 2009 and noted that the ENF had followed the protocol as agreed with the DoJ. It was stated in the protocol that the SFC should refer potential market misconduct prosecutions to the Prosecutions Division of the DoJ to assess whether the cases should be criminally prosecuted and if so, whether the cases should be prosecuted on indictment by the DoJ in the higher courts or summarily by the SFC in the magistrates' courts.

3.91 The PRP learnt that the ENF was discussing with the DoJ a new protocol and invited the ENF to report to the PRP when the protocol was finalised.



*(d) Enforcement Steering Committee as effective monitoring*

3.92 In the PRP Annual Report for 2013-14, it was reported that there was an Enforcement Steering Committee ("ESC") which formed an

integral part of the case management process. The ESC ensured that the senior management of the SFC was kept informed of the investigation progress.

3.93 In reviewing a case involving an investigation in 2014-15, the PRP commented that the ESC had served as a good monitoring mechanism to ensure consistent handling of enforcement cases.



(e) *Reacting to Legal Professional Privilege Claims and Bringing in New Technology*

3.94 In a case under review, the ENF explained that it had taken long and tedious efforts to handle over 2,000 trading records in order to check for any irregularities in allocations of executed trades. The investigation had been further complicated as the licensed corporation claimed legal professional privilege on its investigation report on its staff. The whole process took four years and nine months to complete.

§ *PRP's recommendations*

3.95 The PRP recommended that should the ENF consider that the material or reports provided by a licensee was crucial to its investigation but the materials were claimed to be subject to legal professional privilege, the ENF should consider taking further action including seeking voluntary waiver of the legal professional privilege from the licensee or legal advice on whether a ruling should be obtained from courts regarding the legal professional privilege claim.

3.96 The PRP noted that the ENF had spent a lot of resources in checking huge volume of trading records in this case. To facilitate investigation work, the PRP recommended the ENF to apply a suitable IT programme to assist in the sorting of trading records.

### § *SFC's responses*

3.97 The SFC replied that it would seek to challenge claims of legal professional privilege in appropriate cases.

3.98 The SFC was also actively looking for suitable IT programmes to assist it in analysing bank records and trading data, and identifying trade patterns.

### § *PRP's further comments to the SFC's responses*

3.99 The PRP looked forward to the ENF's report in this aspect.



<h3>§ <i>Concluding Remarks</i></h3>
<p>3.100 The PRP appreciated the remarkable efforts made by the ENF in the investigation work. The PRP looks forward to the ENF's new protocol with the Prosecutions Division of the DoJ.</p>

## Corporate Finance

3.101 The PRP reviewed six cases relating to the work of the CFD, including one case handled by the Corporate Regulation Team established on 1 January 2013.



(a) *Proactive Follow-up with Applicants*

3.102 The PRP noted that the CFD had implemented the PRP's recommendation in its Annual Report for 2013-14 by making active follow-up with applicants whose responses remained outstanding for more than one month. The PRP was pleased to note that the additional measure had been implemented effectively and had expedited the process.



(b) *The Corporate Regulation Team*

3.103 The PRP reviewed a case handled by the Corporate Regulation Team established on 1 January 2013. This was a specialized team for handling price sensitive information disclosure of listed companies. The team also monitored the listed companies reports / announcements, media reports, annual financial statement to ensure that the companies complied with the SFO.

3.104 For the case under review, the company issued announcements under heading 'Voluntary Announcement' thrice. The CFD, having reviewed the announcements, issued a guidance letter reminding the company that disclosure of inside information labelled as 'voluntary' disclosure might risk non-compliance with the requirements of information disclosure.

### § PRP's recommendations

3.105 The PRP was concerned of whether the 'voluntary announcement' was accurate, and more importantly, if the announcements were intentionally made by the companies to mislead investors. In this respect, the PRP noted that the announcements needed no prior clearance from the SFC.

3.106 The PRP recommended that the CFD should provide clear guidelines on the issue of 'voluntary announcements' and take immediate advisory or disciplinary action if irregularities were spotted.

### § SFC's responses

3.107 The CFD explained that in deciding whether an announcement made under 'voluntary announcement' was inappropriate and potentially misleading, it would take into consideration of particular facts, circumstances and context in which the information was disclosed. The CFD was monitoring corporate announcements daily.

### § PRP's further comments to the SFC's responses

3.108 The PRP accepted the CFD's response.



### § Concluding Remarks

3.109 The PRP was pleased to note the efforts made by the Corporate Regulation Team in reviewing corporate announcements.



## Complaints Handling

3.110 The PRP reviewed eight cases related to complaints against intermediaries and market.



### (a) *Closing Complaint Cases without Sufficient Evidence*

3.111 The PRP reviewed a complaint against a bullion company which was not licensed by the SFC. The complainant alleged that the company was conducting a leveraged foreign exchange business which should be regulated by the SFC. The SFC tried to contact the company and the complainant for further details of the complaint but without success. The SFC closed the case after eight months.

#### § *PRP's recommendations*

3.112 The PRP noted that the SFC had spent much time and resources handling anonymous complaints whereby complainants could not be reached or did not provide sufficient evidence. The PRP recommended that the SFC should take prompt action closing the cases in case of insufficient evidence. This would better utilize the SFC resources.

#### § *SFC's responses*

3.113 The SFC responded that it went through a due diligence process in handling a complaint, including fact finding and basic investigation. During the process, the SFC might be able to contact the complaint target and provided the target with opportunities to respond to the allegation. The fact that the target was not a licensed entity should not be considered as a factor to expedite the case closure given that the allegation was that the target was conducting unlicensed activities, which was a criminal offence.



### § *Concluding Remarks*

3.114 The PRP suggested the SFC to regularly review its utilization of resources. The PRP had also reviewed the SFC complaint handling procedures and put up its recommendations, which are set out in Chapter 4.

## **Chapter 4            Observations and Recommendations - the SFC procedural guidelines**

4.1            When conducting the case reviews, the PRP took the opportunity to review the SFC's procedural guidelines which included performance pledges, FAQs, complaint handling procedure promulgated by the SFC to market participants, as well as internal working guidelines adopted by the SFC. In making recommendations to these guidelines, the PRP has strived to balance interests of various stakeholders including: (a) licensees and regulatees who should have understood sufficiently the requirements of the SFC work; and (b) the SFC who should have the authority and flexibility in deploying the guidelines to master its regulatory work effectively.

### **Handling of complaints**

4.2            The SFC updated two new sets of complaint handling procedure in 2014, namely,

- (a) the Procedure for Handling Complaints ("Complaint Procedure against Intermediaries and Markets"); and
- (b) the Procedure for Handling Complaints against the Commission or its Employees.

4.3            The new procedure was revamped from three sets of previous complaint procedure. The Executive Committee vetted the procedure and endorsed the issue of the new procedure in August and November 2014. The SFC sent a set of the new procedure to the PRP in March 2015 as the PRP had recommended the SFC to review the procedure in its Annual Reports for 2012-13 and 2013-14.



(a) *Complaint Procedure against Intermediaries and Markets*

4.4 The set of procedure applied to all complaints received from external sources, except for the complaints related to the SFC and its staff.

4.5 The PRP noted that there were some enhancements in the internal process of reviewing complaints and content of replies to complainants. There was no change in action timeline for replying complainants.



(b) *Complaint Procedure against the Commission or its Employees*

4.6 The PRP noted that the SFC had categorised complaints against the Commission and its employees into (a) cases involving professional standards, competence and behaviour of employees and (b) those not involving the above-mentioned in (a). For the former category, the SFC further categorized cases into minor and serious nature. The former included minor administrative errors or inadvertent delay in response while the latter involved misuse of confidential information, intimidation, using one's office for personal gain. The SFC assigned different levels of investigation parties for different categories of complaints. The PRP found the arrangements appropriate.

4.7 The PRP noted that the SFC had added a new action timeline on the issue of an interim reply and beefed up the action timeline for the issue of a substantive reply.

4.8 The SFC's also reported that it had updated information about its process for handling complaints on its website, the relevant links were as follows-

<http://www.sfc.hk/web/EN/lodge-a-complaint/against-intermediaries-and-market-activities.html> *and*

<http://www.sfc.hk/web/EN/lodge-a-complaint/against-the-sfc/>



#### § PRP's comments

4.9 The PRP invited the SFC to review its complaint handling procedure after reviewing 21 completed complaint cases in 2012-13 and 2013-14. Major observations/recommendations made in the previous case reviews included –

- (a) Content of reply letters to complainants was too brief;
- (b) Communication between the External Relations Department and the operational divisions should be enhanced; and
- (c) Subjects of complaints (in particular those anonymous complaints against intermediaries and markets) should be informed of results of investigations/fact finding processes.

4.10 The PRP noted that the SFC had generally taken into account the PRP's recommendations in (a) and (b) above in the revised complaint handling procedure.

4.11 The PRP however noted that the SFC would not consider informing the targets of complaints when its enquiries were completed. The PRP requested the SFC to further consider the recommendation.

4.12 The PRP understood that the SFC was concerned that any positive confirmation by the SFC to the targets of complaints that the SFC had completed its enquiries arising from a complaint and that the SFC would take no further action at the material time might jeopardize the SFC's future disciplinary action. The SFC therefore considered inappropriate to inform the targets of complaints. In this context, the PRP could not fully agree. The PRP pointed out that it was crucial for the targets of complaints to be kept informed of the SFC's finding once the enquiries were completed. The targets of complaints should not be put under unnecessary pressure.

4.13 The PRP was pleased that the SFC had subsequently reviewed its internal procedure and had put in place a policy to inform the targets of complaints who had been contacted by the SFC during the enquiry process on a 'without prejudice' basis when the SFC concluded that no further action would be taken.

4.14 The PRP was glad to note the SFC's response.



## Chapter 5 Follow-up action by the SFC on the PRP's Recommendations in 2013-14

5.1 In the PRP Annual Report for 2013-14, the SFC committed to exploring the following areas -

- (a) Improvement measures for circularization exercises in inspection of intermediaries;
- (b) Measures to enhance transparency of authorisation process for investment products; and
- (c) Internal guidelines to expedite process of waiver applications for general offer obligations.

5.2 The SFC also undertook to review and report the effectiveness of the enhanced application lapse policy on authorisation of investment products in overall processing time.



### (a) Improvement measures for circularization exercise

5.3 In the PRP Annual Report 2013-14, it was stated that the SFC should -

- (a) provide detailed and specific conditions in engagement contracts for appointment of outsourced agents to ensure that the agents would provide sufficient manpower resources to complete the inspection without delay (para. 4.39);
- (b) consider developing a database template for the circularization exercise so that more audit firms could be assigned to conduct inspections (para. 4.41); and

- (c) publish the lesson learnt from circularization exercises in order to educate other broker firms on internal controls (para. 4.45).

*SFC's commitment*

5.4 The SFC would -

- (a) explore with outsourced agents bidding for future exercises whether the agent could commit to providing reasonable additional manpower as and when the circumstances required, and work with its Legal Services Division to ensure that appropriate protections and expectations were included in contractual documents;
- (b) explore the feasibility of requiring outsourced agents to adopt a standard database template developed by the SFC in future exercises; and
- (c) assess the appropriateness of publishing conclusions and findings of circularization exercises in the future.

*Progress reported*

5.5 The SFC had adopted the practice of discussing with outside agents appointed for inspection the possibility of committing reasonable additional manpower as and when the circumstances required, and whenever possible, to include such commitment in the engagement contract.

5.6 When handling similar exercises in the future, the SFC would explore the feasibility of requiring outsourced agents to adopt a standard database template developed by the SFC and assess the appropriateness of publishing the conclusions and findings.





**(b) Measures to enhance transparency of authorisation process**

5.7 In the PRP Annual Report 2013-14, the PRP recommended the SFC to consider providing a breakdown of time spent by the SFC, applicants and other regulators in its authorisation letters to applicants to enhance transparency of the authorisation process (para. 4.148).

*SFC's commitment*

5.8 The SFC was considering other approaches for communicating important messages to the public in the way which could help the industry as a whole.

*Progress reported*

5.9 To enhance the transparency of fund authorisation process, the SFC provided key information on new fund applications processing time to the public at an industry forum<sup>6</sup>, including the following information-

- (a) the processing time for new fund applications was reduced by about 38% to less than four and a half months on average since the SFC put in place a six-month lapse period for new fund applications in 2014, while the number of funds authorized in 2014 increased by more than a third;
- (b) 15% of the applications that the SFC received in 2014 were not taken up due to non-compliance issues; and
- (c) for those applications that were taken up by the SFC, the processing time attributable to applicants consistently exceeds 60% of the total processing time.

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<sup>6</sup> Source: ED(IPIC)/DCEO Alexa Lam's speech at the HKSI Institute's SFC Executive Directors Series

5.10 The above information was also made available to the public on the SFC website-

[http://www.sfc.hk/web/EN/files/ER/PDF/Speeches/Alexa\\_20150210.pdf](http://www.sfc.hk/web/EN/files/ER/PDF/Speeches/Alexa_20150210.pdf)



**(c) Performance pledges or internal guidelines for applications under the Takeovers Code**

5.11 In the PRP Annual Report 2013-14, the PRP recommended that the SFC should consider devising performance pledges or internal guidelines for applications under the Codes on Takeovers and Mergers and Share Buy-backs for waiver on the general offer obligation (para. 4.110).

*Progress reported*

5.12 The SFC actively followed up with applicants who did not respond to its requisitions within one month. Depending on the circumstances of the case, the SFC would then decide whether the case should be closed or more time provided for the response.



**(d) Effectiveness of the enhanced application lapse policy on processing time of investment product applications**

5.13 In the PRP Annual Report 2013-14 (para. 5.6), the PRP invited the SFC to report the effectiveness of the enhanced application lapse policy on the overall processing time of investment product applications.

*Progress reported*

5.14 Since adoption of the six-month application lapse policy on 1 January 2014, the processing time for applications in 2014 was reduced by about 38% to less than four and a half months on average while the number of funds authorized in 2014 increased by more than a third.



*PRP's remarks*

5.15           The PRP noted the progress made by the SFC.



## Chapter 6      Way forward

6.1            In the year ahead, the PRP would continue its work with a view to ensuring that the SFC adheres to its internal procedure. The PRP would also keep in view various procedural enhancement programmes being launched by the SFC, including the 'SFC Fund Process Revamp', and the extension of six-month application lapse policy to co-regulated fund products.

6.2            The PRP welcomes and attaches great importance to the views from market practitioners. Comments on the work under the PRP's terms of reference could be referred to the PRP through the following channels<sup>7</sup>-

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](mailto:prp@fstb.gov.hk)

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<sup>7</sup> For enquiries or complaints relating to non-procedural matters, they could be directed to the SFC by the following channels –

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

## **Chapter 7      Acknowledgement**

7.1            The PRP would like to express its gratitude to the SFC and its staff, in particular the Commission Secretary Mr Paul YEUNG and his team, for their assistance in facilitating the review work and in coordinating the responses from different divisions in the SFC.

7.2            The PRP would continue to play its role to review completed cases and the operational procedure of the SFC to ensure their consistency and fairness.

**Process Review Panel  
for the Securities and Futures Commission  
October 2015**