

Process Review Panel
for the
Securities and Futures
Commission

Annual Report
for 2017-18

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Abbreviations used in this Report

CCB	Commercial Crime Bureau
CEO	Chief Executive Officer
CSRC	China Securities Regulatory Commission
DoJ	Department of Justice
ENF	Enforcement Division
ESC	Enforcement Steering Committee
HKMA	Hong Kong Monetary Authority
HKP	Hong Kong Police
IPD	Investment Products Division
ISD	Intermediaries Supervision Department
LIC	Licensing Department
Listing Rules	Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited
LOM	Letter of Mindedness
LSD	Legal Services Division
MOU	Memorandum of Understanding
PRP	Process Review Panel
SEHK	Stock Exchange of Hong Kong Limited
SFC	Securities and Futures Commission
SFO	Securities and Futures Ordinance
SMLR	Securities and Futures (Stock Market Listing) Rules

Message from the Chairman

Time flies. By the time this report is published, I would have served as the Chairman of PRP for six years. When I assumed this role in 2012, I kept asking myself how PRP could contribute positively to improving the processes and procedures of the SFC. The clear sentiment of market practitioners was to seek for improvement on the long processing time involved in the various processes, which caused undue pressure on them. The tension of the SFC officers in responding to PRP's comments was very obvious at the initial stage. In almost every case review discussion, I had to remind them, "Hey guys, PRP is here to help". As the years went by, attitude changed. The tension was replaced by mutual appreciation as well as total collaboration, realising the objectives and functions that PRP was set up to achieve.

I must acknowledge with appreciation the efforts of all the panel members with whom I had worked in the past six years. Drawing on their expertise, the panel members of PRP had formulated a structured approach in reviewing the SFC's work. PRP had focused on the key areas of Due Compliance, Efficient Process, Effective Collaboration, and Appropriate Transparency. PRP would check whether the SFC had complied with its internal procedures and fulfilled its performance pledges. Specifically, PRP would study if there had been undue delay in the process, and if so, suggest improvements. PRP would also look for areas where the SFC divisions could have more effective collaboration among themselves and with other regulators. With such a structured approach, PRP could better evaluate the work process of the SFC, appreciate the challenges the regulator faced, whilst at the same time reflect on the market's views and practices. As a result, PRP was able to come up with pragmatic and effective ideas on improvement that would be of value to the SFC.

Message from the Chairman (continued)

Over the past six years, PRP had witnessed a series of process revamp and procedural enhancements in the SFC. Let me just name a few. For investment products, the SFC had introduced a six-month application lapse policy and revamped fundamentally its authorisation process. Standard applications for investment products can now be processed under a fast track mode and the processing time can be shorter than two months. Further, the SFC is receptive to PRP's recommendations for reviewing its procedures in handling enforcement cases. In 2016, the SFC conducted an Enforcement Strategic Review to enhance the efficiency and the effectiveness of its investigation process. The SFC had also changed its regulatory approach to one which is more proactive with real-time actions to tackle market misconducts. In 2017, the SFC started conducting a revamp on its long established licensing process to enhance its timeliness and transparency. In response to PPR's comments, the SFC was committed to strengthening its regulations over listing applications and sponsors, and would continue to strengthen its collaborations with other regulators.

In acknowledging the enhancements in the work processes of the SFC achieved in the past six years, I would like to pay a personal tribute and put on record my appreciation to the Chairman of the SFC at the time, Mr. Carlson Tong. He had been the key and strategic link between PRP and the SFC, facilitating and promoting the better understanding between them. I would also like to thank the efforts made and the commitments shown by the staff of the SFC in working with PRP. Every change accomplished is a testimony of deep understanding and tremendous goodwill.

Message from Chairman (continued)

Finally, I would like to give a vote of thanks to the Secretary for the Financial Services and the Treasury and his staff for their understanding and unfailing support during my tenure.

May I take this opportunity to extend my best wishes to PRP, the SFC, and everyone involved for more effective collaboration, continual successes, greater achievements, and many good and fruitful years to come!

Moses Cheng Mo-chi, GBM, GBS, JP
Chairman

Executive Summary

In 2017-18, PRP reviewed 60 cases selected from the monthly closed case lists submitted by the SFC.

2. PRP conducted comprehensive deliberation and discussion on each case being reviewed. PRP suggested practical recommendations for the SFC to enhance its processes and procedures. The recommendations are -

Listing Issues

- ✧ For a more effective working of the dual filing arrangement in respect of the listing applications, the SFC and the SEHK should have a clear delineation of their roles and responsibilities to avoid duplication of efforts when vetting a listing application.
- ✧ The SFC should apply the principles as laid down in the guidance letter issued to potential listing applicants on the standard expected of a listing application more stringently. The SFC should recommend the SEHK that any sub-standard applications be returned by the SEHK to the applicants for better resource management.
- ✧ The SFC should enhance the transparency of SFC-initiated trading suspension.

3. PRP suggested that the SFC should have a clear delineation on its roles and responsibilities with those of the SEHK as both parties were involved in reviewing listing applications under the dual filing arrangement. PRP also noted that some sub-standard listing applications went through substantive review by the SFC. PRP suggested that the SFC and the SEHK should apply the principles as laid down in the guidance letter issued to potential listing applicants on the required standard of a

listing application. Sub-standard applications should be returned to the applicants for better resource management.

4. The SFC advised that after the joint consultation on listing regulation with the SEHK, the SFC had focused its resource on more serious cases and engaged in targeted and early intervention in more serious listing matters that fell within the scope of the SFO and the SMLR. The SFC would directly intervene in those cases and reject their listing applications. For other cases, the SFC would leave them to the SEHK. Besides, the SEHK would return sub-standard listing applications upon initial review or if their documents were found to be not substantially complete.

5. PRP also studied the process involved in SFC-initiated trading suspension of listed companies. PRP suggested that the SFC should inform the market clearly why it had to direct a trading suspension and how the suspended companies could resume trading.

6. The SFC advised that trading suspension was to protect investors and to maintain a fair and orderly market. The SFC would clearly inform the companies being directed to suspend trading about the SFC's concerns. This should enable the companies to resume trading once they could address the concerns and make full disclosure of the issues.

Process Revamp

- ✧ The SFC should critically review its processes and procedures in handling enforcement cases and licensing applications.

Enforcement Strategic Review

7. PRP had in recent years been reviewing enforcement cases that took a relatively longer time to complete. PRP pointed out that there was room for improvement in work prioritisation and coordination within the Enforcement Division and amongst the divisions in the SFC. PRP suggested that the SFC should undergo a revamp of the enforcement process to enhance the efficiency and the effectiveness of its enforcement work.

8. The SFC advised that it had conducted an Enforcement Strategic Review. After the review, the SFC had changed its regulatory approach.

9. New initiatives imposed after the Enforcement Strategic Review included -

- (a) the promulgation of a new case intake process to prioritise the SFC's resource on high impact and serious cases;
- (b) closer cooperation with market practitioners so that minor enforcement cases could be dealt with and concluded more quickly;
- (c) the formation of specialised teams to handle investigations on key risk areas; and
- (d) the upgrade of the case management system to enable closer and more effective supervision by management.

Revamp of Licensing Process

10. PRP suggested that the SFC should review its licensing process with a view to improving the efficiency of the licensing process and for better resource management.

11. The SFC responded that it was conducting a revamp on its licensing process. The revamp would include the adoption of a flatter case team structure, the requirement of its assessment approach to be risk-based and outcome-oriented, as well as a revision of its publications and licensing forms. These should help enhance the efficiency of the licensing process.

Procedural Enhancements

- ✧ The SFC should strengthen its management over deployment of appropriate manpower for the handling of different types of cases and implement measures to minimise impacts resulting from personnel changes.

Manpower Deployment

12. In some cases reviewed, PRP noted that there had been problem in deploying sufficient manpower when the SFC handled complex enforcement, licensing and inspection cases. PRP invited the SFC to review its manpower deployment, which should be made more flexible by taking into consideration the complexity of each case and the amount of work required in handling a case. Besides, the SFC was encouraged to explore how an effective application of technology could enhance the efficiency of its work in such cases.

13. The SFC advised that it had taken into account a number of factors when allocating manpower for an investigation. The SFC was also prepared to adjust the manpower during the course of investigation, where necessary. Apart from the ENF, the SFC reported that the LIC had launched a new arrangement for allocating manpower in handling licensing applications. An “Application Pointers” arrangement was adopted in September 2017. The arrangement could facilitate case team leaders to first identify key risk areas of each application so that case officers with appropriate knowledge and experience would be assigned to handle the application.

Better Handover Arrangement

14. PRP noted a common factor which led to an increase in the processing time of enforcement cases, i.e. a change of handling officers in the process and the new officers had to start the processing work afresh. PRP recommended that the SFC should review its handover procedures for better transition and handover arrangements.

15. The SFC responded that it had imposed strict requirements on staff's handover, including preparing handover notes, arranging handover meetings, maintaining and onpassing of all relevant files. Therefore, the succeeding case officers normally did not need to process the work afresh.

Seeking Advice from Other Departments / Divisions in the SFC

16. PRP noted that another reason which led to long processing time of the cases was because of the long turnaround time for the investigation team to seek advice from other departments and divisions within the SFC. PRP suggested that the SFC should draw up an internal guideline as to how quickly advice should be provided to other departments and divisions within the SFC.

17. The SFC responded that it would consider the PRP's proposal.

Cooperation with Regulators, Law Enforcement

Agencies and Prosecutors

- ✧ The SFC should seek to better cooperate and collaborate with other regulators as the financial products are increasingly sophisticated.

18. PRP noticed that the SFC had to work with other regulators in inspections and in approving licences and investment products applications. Accordingly, a better cooperation with the regulators, as well as other law enforcement agencies and the prosecutors could enhance the integrity of the financial markets and expedite the enforcement actions, the process of licence applications and investment products authorisation. PRP recommended the SFC to seek to better collaborate with these parties.

19. The SFC reported that through entering into MOUs with the other regulators, its cooperation with them had greatly improved.

External Experts

- ✧ The SFC should regularly review and expand its pool of market experts and legal counsel for timely and quality advice.

20. PRP noted that in one case being reviewed, the SFC took a long time in appointing market experts. Further, PRP observed that it was not uncommon that the market experts and outside counsel took a long time to provide advice to the SFC. The overall process of the investigation had thus been prolonged. PRP suggested that the SFC should regularly review and expand its pool of market experts by inviting professional bodies to nominate experts and retired practitioners to join the pool. The SFC should also build up a local pool of counsel and identify more overseas counsel for representing the SFC.

21. The SFC advised that it had been trying to expand its pool of market experts. The SFC considered the number of experts at the moment sufficient but it would consider the use of retired industry professionals with suitable qualifications and experience as suggested by PRP. Besides, the SFC also instructed a wider group of local counsel with the appropriate experience and expertise and was trying to expand the pool of counsel.

Complaint Handling

- ✧ The SFC should enhance its internal guidelines on the classification of complaints to ensure consistency.

22. PRP noted that there had been no detailed guideline on how the SFC would classify the complaints against the SFC and its employees as “minor” or “serious” types. The two different types of complaints would be subject to very different handling process. The classification was dependent on the judgement of the Commission Secretary. PRP invited the SFC to consider setting out detailed guidelines to ensure consistency.

23. The SFC advised that the existing guidelines on the classification already set out the principles and it would be difficult to be more prescriptive as the nature of the complaints varied greatly. As a good corporate governance practice, the Commission Secretary, who was a Senior Director, would normally consult the CEO on his proposed classification of complaints. The existing procedure also catered for the escalation of complaints from “minor” to “serious”. Reports on complaints were submitted to the SFC Board quarterly.

Chapter 1 General Information

Background

1.1 PRP for the SFC is an independent panel established by the Chief Executive in November 2000. It is tasked to conduct reviews of operational procedures of the SFC and to determine whether the SFC has followed its internal procedures and operational guidelines to ensure consistency and fairness.

Functions

1.2 PRP reviews completed or discontinued cases handled by the SFC and advises 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 authorisation of investment products, licensing of intermediaries, inspection of intermediaries, enforcement, corporate finance including processing of listing applications, and complaint handling.

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

1.4 The Terms of Reference of PRP are -

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

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

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

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

Modus Operandi

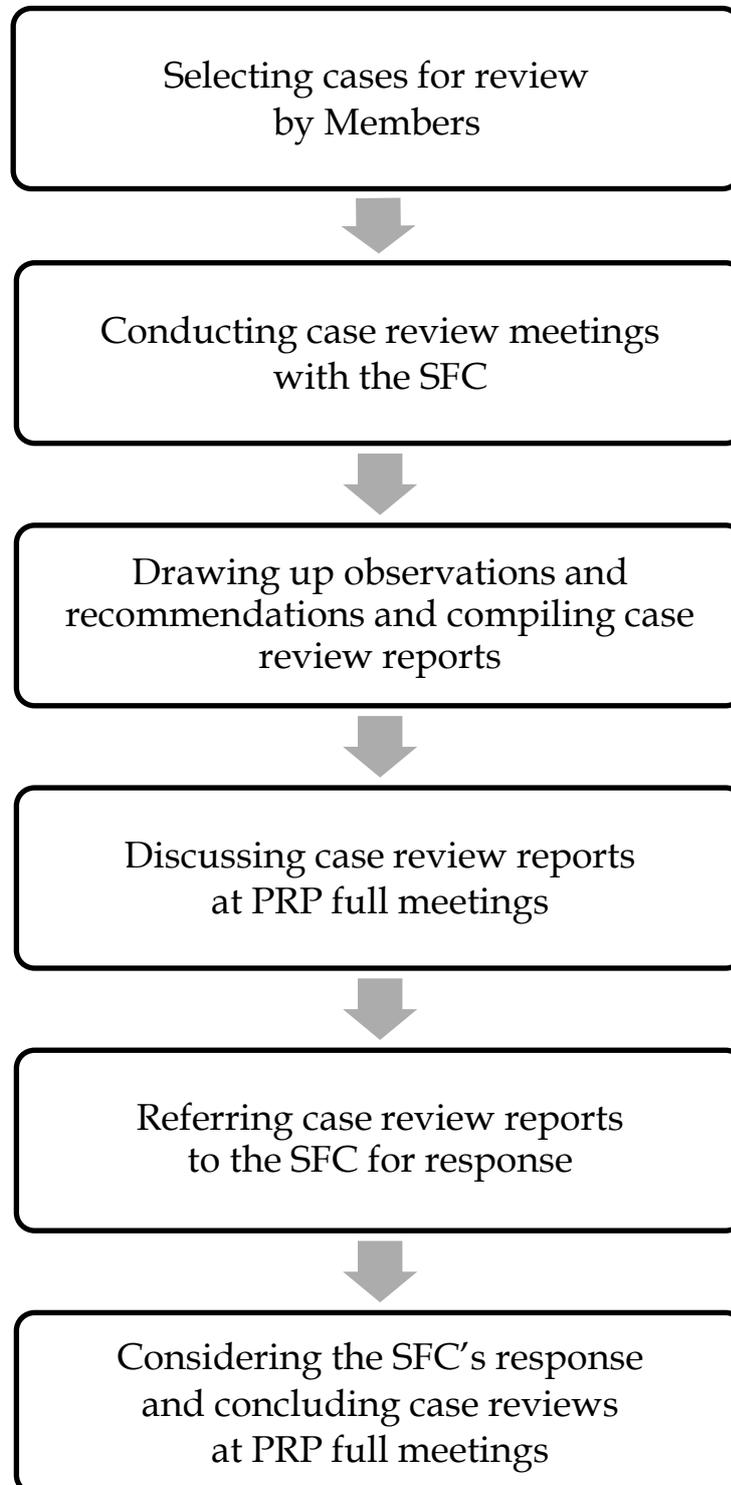
1.7 The SFC provides PRP with monthly lists of completed and discontinued cases. Members of PRP select cases from these lists for review. Members pay due regard to factors including processing time of completed cases, procedural steps taken by the SFC in arriving at its decisions and relevant checks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

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

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

Case Review Workflow

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



Membership

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

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

1.13 The membership of PRP in 2017-18 is as follows -

Chairman:

Dr. CHENG Mo-chi, Moses, GBM, GBS, JP since 1 November 2012

Members:

Mr. CHAN Kam-wing, Clement since 1 November 2012

Ms. Lena CHAN since 1 June 2016

Ms. DING Chen since 1 November 2014

Dr. HU Zhanghong since 1 November 2012

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

Ms. LEE Pui-shan, Rosita since 1 November 2012

Mr. LEE Wai-wang, Robert since 1 November 2012

Dr. MAK Sui-choi, Billy since 1 June 2016

Mr. TSANG Sui-cheong, Frederick since 1 November 2016

Ms. YUEN Shuk-kam, Nicole since 1 November 2014

Ex officio Members:

Chairman, the Securities and Futures Commission

- Mr. Carlson TONG, SBS, JP till 19 October 2018

- Mr. Tim LUI, SBS, JP since 20 October 2018

Secretary for Justice's Representative since 26 February 2015

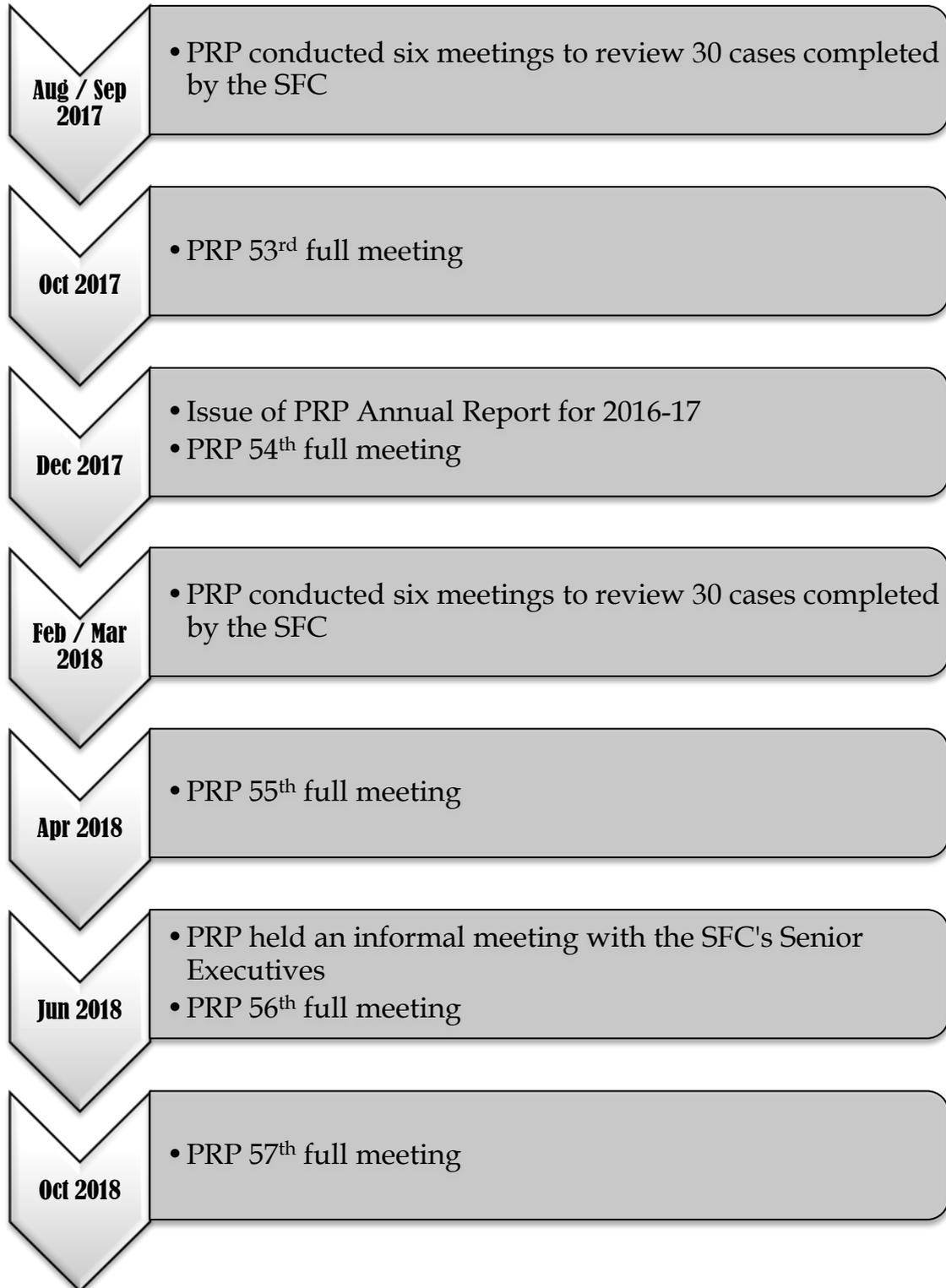
Ms. CHEUNG Kam-wai, Christina, JP

Secretariat:

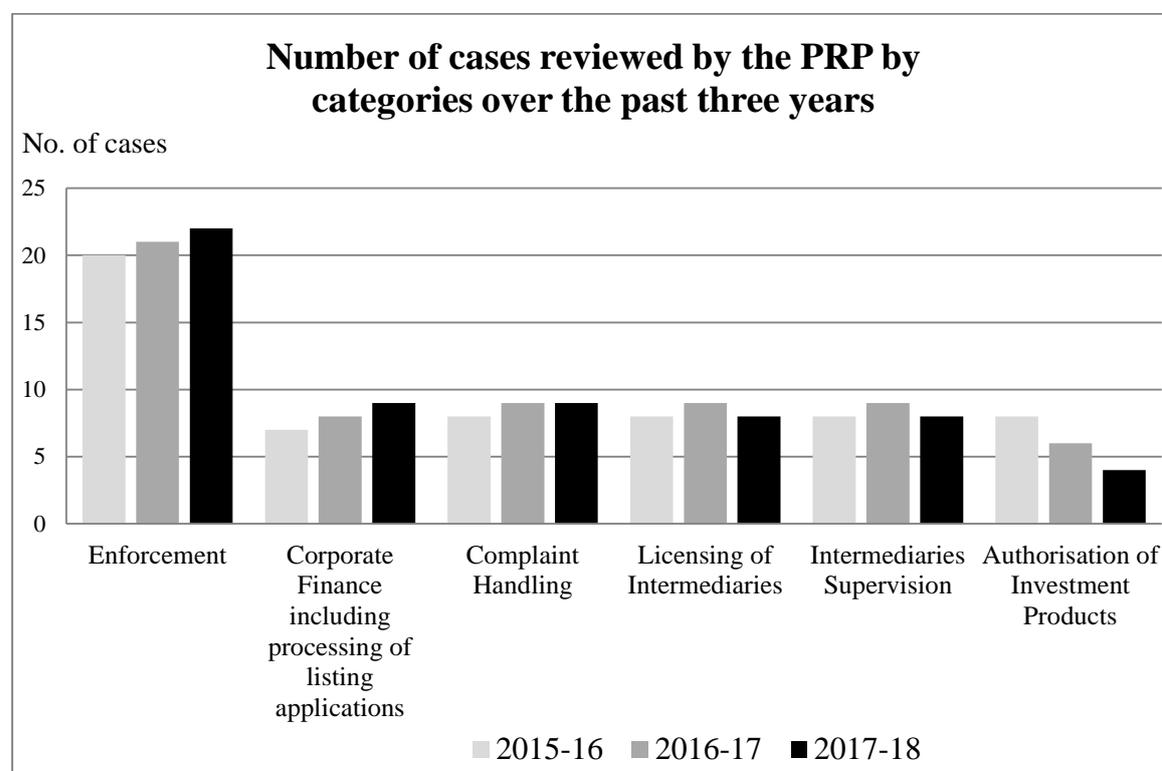
The Financial Services Branch of the Financial Services and the Treasury Bureau

Chapter 2 Highlight of the Work of PRP

2.1 Major events in 2017-18 are set out below –



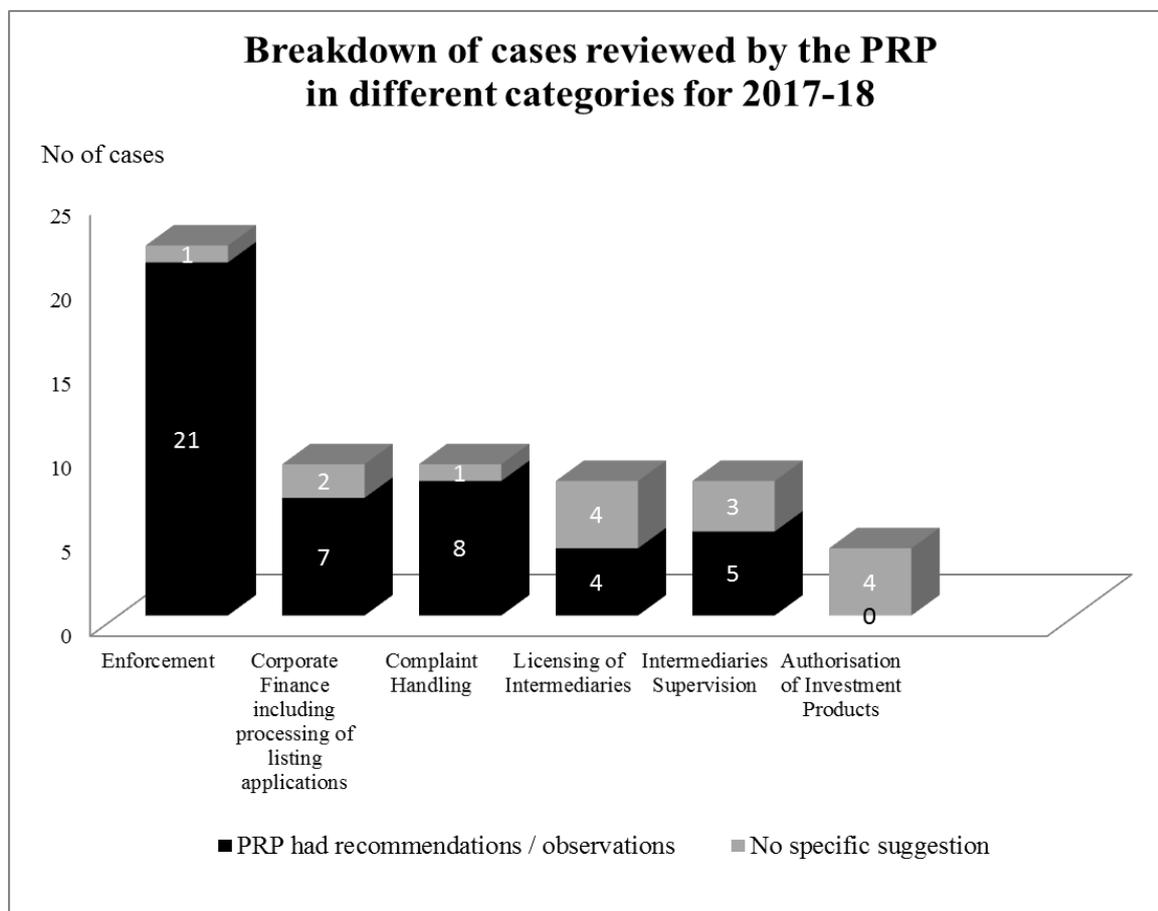
2.2 Distribution of the cases reviewed by PRP in the past three years is as follows–



2.3 Distribution of the 60 cases reviewed by PRP in 2017-18 is as follows -

	No. of Cases
Enforcement	22
Corporate Finance including processing of listing applications	9
Complaint Handling	9
Licensing of Intermediaries	8
Intermediaries Supervision	8
Authorisation of Investment Products	4
Total	60

2.4 Among these 60 cases, PRP made recommendations or observations on 45 cases, representing 75% of the cases being reviewed.



2.5 Highlight of PRP's observations of and recommendations is set out in Chapter 4. Follow-up actions taken by the SFC in response to PRP's recommendations in the last Annual Report (i.e. for 2016-17) are set out in Chapter 3.

Chapter 3 Follow-up Actions taken by the SFC on PRP's Recommendations in 2016-17

3.1 In response to the Annual Report of PRP for 2016-17, the SFC was committed to reporting progress in the following areas –

- (a) Strategic Review of the ENF;
- (b) Enhancing Communication; and
- (c) Effectiveness of the Fund Process Revamp.



A. Strategic Review of the Enforcement Division

3.2 In 2016-17, PRP pointed out a number of areas for the ENF to improve in order to enhance the effectiveness and efficiency of its investigation.

3.3 In response, the ENF launched a Strategic Review in late-2016. New initiatives introduced after the review included adopting a new case intake process, establishing specialised teams, reviewing the case management framework and upgrading the electronic case management system. In mid-2018, the SFC reported the effectiveness of the initiatives implemented as a result of the review as follows –

- (a) the average time taken to complete an investigation had been substantially reduced;
- (b) a vast majority of the investigations completed after the Strategic Review met the SFC's Key Performance Indicator;
- (c) the new case intake process had reduced the number of active enforcement cases by around 30%; and

- (d) different specialised teams had been functioning well. Major achievements included –
- (i) the Intermediaries Misconduct Team handled different cases of the same corporate group together. This new approach expedited the overall process, allowing early announcements of fines and sanctions to protect the market. During 2017-18, the SFC took enforcement action involving six corporate groups. The total fines imposed was more than \$93 million; and
 - (ii) the Corporate Fraud Team targeted to complete most of the high priority investigations within a year.

3.4 More details on the new initiatives introduced after the Strategic Review are provided in Chapter 4.

B. Enhancing Communication

3.5 In 2016-17, PRP pointed out that the SFC should establish and maintain close working relationships with other regulators and the prosecutors to facilitate its regulatory work. The SFC noted the advice and undertook to continue enhancing its working relationships with the parties concerned.

3.6 In 2017-18, PRP was informed of the various achievements made by the SFC in fostering closer collaborations with different organisations -

- (a) the working relationship between the SFC and the CSRC had continued to improve. The SFC would prioritise its requests regarding assistance sought for enforcement cases to facilitate the CSRC's early response;

- (b) since the signing of the MOU between the SFC and the DoJ in March 2016, there had been noticeable improvement in the lead time required for provision of legal advice by the DoJ on potential criminal prosecutions regarding market misconduct cases submitted by the SFC; and
- (c) the SFC entered into an MOU that set out the protocol for case handling with the HKP in August 2017. With the arrangements in place, the cooperation between the SFC and the HKP in combating financial crime would further strengthen.

3.7 More details on the SFC's working relationships with other regulators, law enforcement agencies and the prosecutors are provided in Chapter 4.

C. Effectiveness of Fund Process Revamp

3.8 The IPD launched the fund process revamp in May 2016. In June 2018, the SFC reported its progress as follows –

- (a) for retail fund applications completed after the fund process revamp, the processing time for standard applications was 1.3 months and that for non-standard applications was 2.7 months; and
- (b) overall speaking, the processing time had been reduced by 56% since the launch of the fund process revamp.



Chapter 4 Observations and Recommendations of Cases Reviewed in 2017-18



4.1 In 2017-18, PRP reviewed 60 cases which were concluded by the SFC during the period from November 2016 to October 2017. The processing time of these cases, which were of different nature and complexity, ranged from two weeks to several years.

4.2 PRP fully understood that the SFC's work took time. Processing applications, conducting inspections and performing investigations must be done in a prudent manner in order to safeguard market integrity and protect investors. This notwithstanding, PRP had been constantly reminding the SFC the need to process cases in a timely manner. As a financial regulator responsible for handling listing applications, granting licences, authorising investment products and conducting inspections, the SFC had been expected to provide comments, complete the vetting and finish the inspections as soon as practicable without compromising the protection to investors. As an enforcement regulator to safeguard market integrity, the SFC has been expected to conclude the investigations in a fair and reasonable manner as quickly as possible to avoid putting undue pressure on the persons being investigated and to send a strong deterrent message to the market that misconduct would not be condoned.

4.3 This year, the focus of PRP's review was on the SFC's process revamp in enforcement case handling and licensing application processing, as well as the procedural enhancements in the different divisions. Moreover, PRP studied some new procedures adopted by the SFC in dealing with listing applications and provided comments on how the SFC could improve the transparency of its work related to the trading suspension and the complaint handling. There were also comments on the SFC's cooperation with other regulators, law

enforcement agencies and the prosecutors, as well as the engagement of external experts. PRP's observations and recommendations are highlighted in the ensuing paragraphs.



A. Listing Issues

4.4 PRP reviewed five cases relating to listing applications and disciplinary actions on sponsors. Noting that a listing application would be handled by both the SFC and the SEHK, PRP raised concerns on whether there was a clear delineation of responsibilities to avoid duplication of efforts.

4.5 PRP also commented that the due diligence work conducted by the sponsors for the listing applications had not been satisfactory. When handling a listing application, the SFC had to spend more resources in providing rounds of comments. This could have been avoided if the sponsors had done their jobs well. PRP discussed with the SFC how it might regulate the work of the sponsors in a more effective manner.

4.6 Besides, in response to changing market conditions and risks, PRP noted that the SFC had taken proactive steps to intervene in serious cases at an early stage so as to better protect the market and investors. One of the measures that the SFC had adopted was to initiate trading suspension of listed companies, as the circumstances might warrant. PRP invited the SFC to enhance the transparency on this measure and keep the market informed of the progress of trading resumption.



(a) New Approach in Handling Listing Applications

4.7 Under the dual filing regime as required under the SMLR of the SFO (Cap.571), a listing applicant must file its application with and disclose the required materials to the SFC via the SEHK. The SFC would provide comments to ensure that the listing application had complied with the statutory requirements while the SEHK was the primary front-line regulator and the contact point for the listing

application. The SFC and the SEHK would copy each other the correspondences with the listing applicant and the sponsors.

4.8 During the year, PRP reviewed an unsuccessful listing application. The SFC issued seven rounds of comments on the application during the one-year processing time. The SFC explained that the Listing Department of the SEHK had concern on the sustainability of the company's business, and the SFC found that the sponsor of the application had failed to provide sufficient quantitative information for the SFC to understand the company's accounts and to explain satisfactorily the outstanding matters raised by the previous auditor of the company. Finally, the application lapsed in accordance with the established application lapse rule.

§ PRP's recommendations

4.9 PRP pointed out that for the dual filing arrangement to work more effectively, the SFC and the SEHK should have a clear delineation of their respective responsibilities when handling a listing application. PRP invited the SFC to explain its established practice when working with the SEHK.

§ SFC's response

4.10 The SFC explained that after the reform of the listing regime in March 2018, the responsibilities between the SFC and the SEHK for the processing of listing applications had been clearly defined. The SFC played the role of the statutory regulator in administering the SFO and the SMLR, whereas the SEHK played its frontline regulatory role in administering and enforcing the Listing Rules which were referred to in the SFO and were approved by the SFC.

4.11 After the reform of the listing regime, where there were concerns under the SMLR for a listing application, the SFC would write directly to the listing applicant and its advisers on its concerns instead

of passing them to the applicant through the SEHK. By doing so, the applicant would be able to communicate directly with the SFC regarding the SFC's concerns. This would make the process more efficient. Further, if the SFC was of the view that it was more likely than not that, given the known facts and circumstances, it would object to a listing application, the SFC would directly issue a formal LOM to the listing applicant setting out its concerns together with detailed reasons. If the applicant's response to the LOM failed to address the SFC's concerns, the SFC would issue a final decision notice to object to the application under the SMLR. In 2017, the SFC issued the LOMs in respect of nine listing applications. Two of them were eventually rejected.

4.12 For a listing application that the SFC did not have any apparent concerns under the statutory requirement, the SEHK would handle the application. The SFC would cease to review and comment on the application.



(b) Quality of Listing Applications

4.13 A listing application submitted to the SFC and the SEHK should comply with the relevant laws, rules and requirements of a recognised exchange company. It should also contain information which could enable an investor to make an informed assessment of the activities, assets and liabilities, and financial position of the listing applicant at the time of the application. Sponsors played a very important role in preparing the listing application. As a sponsor, it guided and advised the applicant through the initial public offering process, assessed the applicant's suitability for listing and ensured there had been sufficient disclosure in the prospectus. A sponsor was expected to carry out an extensive due diligence on the listing applicant in order to assess the applicant's suitability for listing and to ensure that the prospectus had contained sufficient disclosure for the investors to

form a valid and justifiable opinion on the applicant's financial condition and profitability.

§ PRP's recommendations

4.14 In reviewing some listing applications, PRP observed that the work done by the sponsors had not been satisfactory. Notwithstanding the sub-standard quality of those applications, the SFC still conducted a substantive review on them. PRP questioned if the SFC had considered rejecting an application of poor quality. PRP commented that the SFC should apply the principles as laid down in the guidance letter issued to the potential listing applicant on the quality of a listing application more stringently, and should recommend the SEHK that any sub-standard application should be returned by the SEHK to the applicant for better resource management.

§ SFC's response

4.15 The SFC responded that a listing application would be returned if the information in the Application Proof and the related documents was not substantially complete under the Main Board Rule or the GEM Rule. In this aspect, the SEHK had issued the guidance letter to sponsors providing guidance on the extent of disclosure required in the Application Proof in order for it to be accepted.



(c) Due Diligence Steps and Scope

4.16 PRP made some comments on the work of the sponsors when it reviewed a disciplinary case relating to the sponsors' work. PRP discussed with the SFC on its regulatory approach towards sponsors, emphasising the sponsors' responsibilities over the due

diligence work with respect to the listing applications.

§ PRP's comments

4.17 PRP commented that a sponsor's due diligence was important to enable it to gain knowledge and understanding of the application and to be satisfied that the applicant had complied with the Listing Rules. The due diligence steps helped ensure that the prospectus had contained sufficient disclosure for the investors. Such requirements as expected from the sponsors were prescribed by the Listing Rules and the SFC's Codes.

4.18 PRP enquired about "the scope of reasonable due diligence", to which the SFC would make reference when deciding whether a sponsor had violated the SFC's Codes and the statutory requirements. For consistency in the investigation, PRP also asked if the SFC had considered drawing up a checklist or indicators for assessing a sponsor's due diligence work.

§ SFC's response

4.19 The SFC advised that when evaluating a sponsor's conduct, it had to pay due regard to the entire framework of rules, regulations, principles of conduct and guidance governing the discharge of a sponsor's duties. These included the Code of Conduct for Persons Licensed by or Registered with the SFC, the Corporate Finance Adviser Code of Conduct, the Listing Rules (in particular, Practice Note 21), etc.

4.20 The SFC further explained that it was difficult, and indeed inappropriate, to draw up a comprehensive checklist or guideline in evaluating a sponsor's work. This was because, as noted in paragraph 3 of Practice Note 21, "Each new applicant is unique and so will be the due diligence steps necessary for the purpose of its listing application". The adequacy of a sponsor's work for a listing application must be assessed with regard to the business of the listing applicant and the unique risks

and challenges that such business might face. The evaluation of the sponsor's work required a judgment call of the SFC officers, and it would be highly undesirable to turn such an evaluation into a mechanical exercise of checking a sponsor's due diligence work against a checklist or guideline that could not take into account the particular circumstances of a listing application.



(d) Sponsor's Professional Verification and Reliance on Other Third Parties

4.21 PRP commented that a sponsor should not merely accept the statements produced and the representations made by a listing applicant at face value. The sponsor should examine them with "professional scepticism", ensuring the accuracy and completeness of the statements, representations and all other information. The sponsor should perform verification procedures, such as reviewing source documents, consulting knowledgeable persons, or checking against independently sourced information.

§ PRP's comments

4.22 PRP noted that there had been an increasing trend that a sponsor would assign specific due diligence tasks to third parties, such as lawyers, accountants, consultants, etc. PRP commented that a sponsor should not evade its responsibilities on the due diligence work by engaging third parties. The SFC was invited to pay more attention on the background and the qualification of the third parties, the reports that these third parties produced, and the reasons that the due diligence work had not been taken up by the sponsor itself. A sponsor should not rely blindly on the work of the third parties.

§ SFC's response

4.23 The SFC explained that the current regulatory framework did not prohibit a sponsor from engaging third parties to conduct due diligence work. The SFC took the view that the reasonableness of the engagement and the sponsor's reliance on the external parties' work should be considered in light of the circumstances of the engagement and the quality of the due diligence work prepared by the third parties. In any event, even when a sponsor had outsourced a part of the due diligence work to a third party, the sponsor was expected to take responsibility for the quality of the work done.

§ PRP's remarks

4.24 The SFC should consider setting up a framework to assess the due diligence work done by the sponsors.



(e) Trading Suspension Initiated by the SFC

4.25 Under the new regulatory approach, the SFC had been more proactive in the regulation of the listed companies. The SFC had been more active in utilising its powers under the SMLR, including that to direct the suspension of the trading of the shares of the listed companies. Such preventive measure aimed at taking prompt action to deter any market misconduct and to protect investors' interest at the earliest instance.

§ *PRP's recommendations*

4.26 PRP raised concerns about the impact of trading suspension directed by the SFC on the shareholders (in particular the minor shareholders) of the listed companies. PRP suggested that the SFC should provide more information to the market as to –

- (a) why the SFC needed to direct a trading suspension of the companies; and
- (b) how the suspended listed companies could resume trading.

4.27 PRP further recommended that as any trading suspension could have far-reaching impact on all the shareholders of the listed company, the SFC should take a very cautious approach in initiating a trading suspension.

§ *SFC's response*

Reasons to Suspend Trading

4.28 Suspension was meant to protect the investors. There could be different underlying reasons leading to a trading suspension irrespective of whether it was initiated by the SFC or not. For example, if there had been an apparent leak of unpublished price sensitive information, a short suspension might allow the company time to prepare a suitable announcement to the market to make publicly available all the information that the investors needed to know for making their investment decisions. In the case of a potential takeover, the Takeovers Code required parties to give serious consideration to requesting a suspension if there was any possibility that an uninformed market for the shares of the target company or offeror could develop prior to publication of an announcement about a possible offer under the Takeovers Code.

Statutory Basis of directing a Trading Suspension

4.29 The SFC was required to meet a statutory threshold before it could direct a trading suspension. In broad terms, the SFC would do so if it appeared to the SFC that the trading suspension was –

- (a) in the interest of maintaining an orderly and fair market and of the investing public; or
- (b) appropriate for the protection of investors generally.

4.30 The SFC could direct trading suspension based on concerns that arose during an investigation of a listed company. In those circumstances, the SFC took great care in deciding whether to suspend the trading of the shares of the listed company. The decision was usually made by the Executive Director (Enforcement) or Executive Director (Corporate Finance) in conjunction with the CEO. Furthermore, the SFC would usually suspend trading of the company's shares after giving the company an opportunity to be heard by making written submissions to address the reasons for the proposed suspension.

4.31 In live market situations, the SFC might direct the suspension without prior notice when it considered that maintenance of an orderly and fair market was of the principal concern. For these situations, the suspension would most likely be temporary and relatively short.

Resumption of Trading by Suspended Listed Company

4.32 The SFC would often issue a LOM to the company, stating the reasons why it was minded to suspend the trading of the shares of the company. In the letter, the SFC would make it clear to the company the matters that it had to address to resume trading.

4.33 Trading might be resumed when the company had addressed the SFC's concerns and made full disclosure.

Transparency of Suspension Decision

4.34 The SEHK would always issue an announcement to the market when the SFC had directed a trading suspension. The SEHK's website would also clearly show that the company's shares had been suspended from trading.

4.35 However, it should be noted that if the SFC had directed a suspension as part of an ongoing investigation, it would not be appropriate for the SFC to provide any ongoing status reports since doing so would breach the statutory secrecy obligation under the SFO.

4.36 To allow the public to be made aware of the SFC's regulatory action, including the direction of trading suspensions in a number of cases, the SFC had issued Newsletters (Regulatory Bulletin: Listed Corporations - July 2017 and May 2018 editions) highlighting details of anonymised cases for illustrating the circumstances and considerations as to why suspensions had to be triggered.



B. Process Revamp

4.37 PRP's work focused on the process and the procedures taken by the SFC in carrying out its regulatory functions. Over the years, PRP had been reviewing cases that took a relatively longer time to complete with a view to understanding why the processing had taken so long, whether the processing could have been expedited, and if so, how to do it.

4.38 PRP had observed that certain cases handled by the ENF and the LIC took years to complete. While the SFC had shown its drive to improve on the individual procedures, the overall process in handling the cases should be reviewed in a holistic manner in light of changing market conditions and circumstances. PRP was glad to note that the ENF conducted a Strategic Review in late 2016 to revamp its work process. The LIC also reported that it had started a process revamp in 2017 taking into account the issues raised by PRP over the years. This part highlights some key areas of the process revamp that had taken place in the ENF and the LIC.



(a) Enforcement Strategic Review

4.39 In 2017-18, PRP reviewed 22 enforcement cases. The processing time taken by the SFC to handle these cases ranged from two years seven months to some six years. PRP noted some common issues that contributed to the long processing time of the cases reviewed, as summarised below –

- (a) resource management – an investigation team might be overloaded with a number of cases, both minor and serious. The difficulty for a team to focus its resource on the handling of the more important and serious

cases might cause unnecessary delay. Meanwhile, there might also be delay in the completion of the less serious cases, which should have been dealt with earlier or concluded within a shorter period of time;

- (b) underutilisation of staff expertise in the absence of case specialisation - this arrangement would not be conducive to the development of skills and experience of the staff. It would also reduce work efficiency since staff with less experience in a particular field would need extra time and efforts to understand the subjects under investigation; and
- (c) communication between the Investigation Department of the ENF and the LSD when handling potential court case - the two divisions could have worked closer. The Investigation Department completed its investigation and prepared an evidence matrix to the LSD. The LSD then reviewed the case and provided legal advice to the Investigation Department. During the process, the LSD might suggest collecting additional evidence for further investigation. Such process, if not properly managed, could lead to inefficiencies and waste of resource.

§ PRP recommendations

4.40 PRP recommended the SFC to critically review its processes and procedures with a view to improving the effectiveness and efficiency of the enforcement work.

§ *SFC's response*

4.41 The SFC conducted an Enforcement Strategic Review in late 2016 and implemented various new initiatives.

Resource Management

4.42 The SFC formulated a new case intake process to decide on the importance and priority of a case. The SFC would allocate more of its resource to the high priority and high impact cases and handle the less serious cases through a summary process. The resource had been more effectively utilised on the serious cases.

4.43 Furthermore, the SFC had highlighted to the market the importance and benefits of cooperating with the SFC in its investigations, civil proceedings and Market Misconduct Tribunal proceedings. With the cooperation from market practitioners, the process of investigation would be smoother and the whole process could be expedited. This would consequentially lead to a reduction in cases with outstanding actions on the part of the SFC. Resource could then be allocated to the most serious and imminent threats to the market.

Specialised Teams

4.44 To focus on the key risk areas that posed a particularly serious threat to the integrity of the Hong Kong market, the ENF set up various specialised teams. They included the Corporate Fraud Team, the Corporate Mifeseance Team, the Intermediaries Misconduct Team and the Insider Dealing and Market Manipulation Team.

4.45 The SFC noted that the handling of case of different nature required slightly different skills and experience. It would be more cost-effective for the officers to have some specialisation for skill development and experience accumulation. Team leaders could also have a more comprehensive overview of all active cases of a similar nature.

Assignment of Counsel to Specialised Teams

4.46 The SFC also acknowledged that the time for the LSD to provide legal advice took longer than expected. To improve the situation, each specialised team had been assigned a dedicated legal counsel as a contact point so that investigators might have access to timely legal advice. This had fostered closer cooperation between the ENF and the LSD, allowing the counsel in the LSD to get familiar with each case earlier.

Effective Monitoring

4.47 To reduce the efforts spent by the ENF staff on progress reporting, the SFC reviewed the case management framework and upgraded the electronic case management system. With a new case management framework and an upgraded electronic case management system that allowed the management to have a near real-time tracking of case progress in place, case officers could spend less time on compiling “conventional” progress reports. The management could also focus its time and efforts on high priority and high impact cases.

4.48 Furthermore, the SFC had formulated a new portfolio review case management process to ensure effective monitoring and management of all types of cases. High priority cases would be managed by the ESC whereas low to moderate priority cases would be managed by middle management. Notwithstanding this delegation, important issues would still be required to be promptly escalated to the ESC for discussion and monitoring. Under the new management process, the management team would ensure that all cases would be monitored by staff members with appropriate skills and experience.

§ *PRP's remarks*

4.49 PRP expected with the assignment of a dedicated legal counsel to each specialised enforcement team, the enforcement officers

would receive more timely legal advice, which in turn would enhance the quality of investigation work. PRP looked forward to the SFC's further report on how the new strategy could enhance efficiency and effectiveness.



(b) Revamp of Licensing Process

4.50 In 2017-18, PRP reviewed eight licensing cases. The processing time for these cases ranged from six months to 15 months.

§ PRP's recommendations

4.51 PRP considered that the LIC had taken longer time to process an application. PRP suggested that the LIC should review its process in light of the changing circumstances in the financial market. Also, the LIC should streamline its workflow in order to cope with the workload arising from the growth in the number of licensees and a wider range of regulated activities carried out by the licensees.

§ SFC's response

4.52 The SFC responded that the LIC was conducting a holistic review to revamp its licensing process. The revamp included the adoption of a flatter case team structure, the refinement of its assessment approach to be more risk-based and outcome-oriented, and a revision of its publications and licensing forms.

4.53 Since May 2018, the LIC had flattened the hierarchy of the processing team. In the past, Assistant Managers reported to Managers and the Managers reported to Senior Managers. After the revamp, both Assistant Managers and Managers reported directly to

Senior Managers. Assistant Managers handled routine cases and Managers handled complex cases. Senior Managers and Directors could provide more guidance and be involved at an earlier stage of the assessment process for all cases. The new team structure would facilitate the communication between the senior management and the case officers.

§ PRP's remarks

4.54 PRP welcomed the LIC to conduct a holistic revamp of the licensing process. PRP looked forward to an expedited process for the handling of the licensing applications.



C. Procedural Enhancements

4.55 Apart from the process revamp, the SFC had enhanced its procedures in light of PRP's recommendations.

4.56 PRP observed unnecessary delay in processing cases by the various divisions. Common factors causing the delays included-

- (a) complex cases requiring a series of interviews or a lot of manual checking on the evidence were processed by only one case officer;
- (b) much time had been spent on the process to engage a suitable market expert in an investigation; and
- (c) there were staff departures when a case was being processed and the new comers had to start the work afresh.

4.57 PRP commented that refinement of some procedures and strengthening of management supervision might help address the above situations and expedite the process. Among the suggested improvements, PRP pointed out the need to be able to deploy manpower flexibly, put in place a comprehensive handover arrangement and promulgate internal guidelines on the timeliness for a division to provide advice to the other divisions. This part highlights the SFC's response to the above findings.



(a) *Manpower Deployment*

4.58 When asked why the cases had taken such a long time to process, the SFC case officers often explained that the procedures

involved a lot of manual work, including interviews, vetting of documents, and physical inspections of firms with many branch offices. However, there were only one or two case officers responsible for handling all the work. Inevitably, a case would take a long time to complete.

4.59 PRP understood that there was always resource issue in every public organisation. The SFC should try to make use of technology to help its regulatory work as far as possible. The SFC should also strengthen its management over the deployment of appropriate manpower for the handling of different types of cases. Below highlighted the specific recommendations made by PRP for the different divisions in the SFC.

(i) Enforcement Division

4.60 PRP reviewed two enforcement cases that took more than four years to conclude. In both cases, PRP noted that there had been problems in manpower deployment. There was only one investigation officer with the support of two staff to review boxes of documents and to conduct a series of interviews. As a result, the investigation officer took one year to finish the interviews. PRP invited the SFC to review its manpower deployment, which should be flexible and commensurate with complexity of cases and amount of work required. The SFC was also encouraged to explore how the application of technology could help enhance the efficiency of its work on handling complex cases.

§ SFC's response

4.61 The SFC explained that the ENF took into consideration a number of factors when assigning cases to officers, including priority and complexity of a case, required expertise and workload of officers. The management team would review and adjust the required manpower during the course of an investigation should circumstances change. Through ongoing training and accumulation of expertise

following the formation of specialised teams after the Strategic Review, it was expected that officers would be more efficient in handling cases.

(ii) Licensing Department

4.62 In September 2017, the LIC introduced an “Application Pointers” arrangement to facilitate the deployment of manpower for handling complex corporate applications.

4.63 Under the “Application Pointers” arrangement, team leaders would first assess and identify the key risk areas of the application so that staff with appropriate knowledge and experience would be assigned to handle the case. Complex cases would be brought to the attention of the relevant Case Director for closer monitoring and guidance. The SFC had assured PRP that the new arrangement would help ensure that complex cases could receive adequate management oversight.

(iii) Intermediaries Supervision Department

4.64 PRP noted that the ISD took six months to complete an inspection on a global investment bank. The inspection was targeted to review the process and the controls over the research, the risk management, the corporate finance, the asset management and the futures and options position monitoring of the bank. A total of seven ISD staff were involved. PRP noted that the ISD had followed its internal policy on the timeline, which was four months from the commencement of the inspection, to issue an interim letter of deficiencies. This notwithstanding, PRP reminded the SFC that the industry had expected the ISD to complete the inspection work quickly. PRP invited the SFC to review its manpower allocated for an inspection.

§ *SFC's response*

4.65 The SFC responded that the ISD conducted regular review of its systems and processes so that it could discharge its regulatory duties more efficiently and effectively.

4.66 Each inspection team handled a number of inspections concurrently whilst each inspection might be at different stages. This arrangement allowed an efficient and effective use of resource. The ISD identified the key risk areas before the onsite visit so that the inspection team could focus on the key risk areas during the visit.

4.67 In addition, the ISD used data analytics for inspections of some large investment banks. The ISD was formulating a strategic roadmap of deploying advanced data analytics to facilitate the analysis of high volume trading data with a view to reducing the time required for an inspection.



(b) *Better Handover Arrangement*

4.68 PRP noted that cases with long processing time were commonly associated with a change of case officers during the process. The new case officer had to review the case afresh, instead of relying on the work prepared by his predecessor who had already left the SFC. In one of the cases being reviewed, the new officer took around nine months to study all the records when his predecessor had already been working on the case for more than one year. In another case that in the opinion of PRP was rather straightforward, the process had been unnecessarily held up for five months when the case was handed over to the new case officer.

4.69 The change of the LSD staff also contributed to a prolonged investigation time of an enforcement case. In one enforcement case being reviewed, PRP found that the LSD case officer had been changed four times during a five-year processing period. Each new LSD case officer had to repeat the case study again. The time required for obtaining legal advice on the merits of this particular case was unavoidably extended.

4.70 In view of the above observations, PRP suggested that the SFC should impose measures to minimise the impact on the effectiveness of its work in the event of changes in case officers during the processing period. The SFC should establish a comprehensive handover procedure for better transition and handover arrangements.

§ *SFC's response*

4.71 The SFC explained that it had proper case handover and staff handover procedures so that a new case officer would become familiar with the case as quickly as possible. The handover of a case usually involved the passing of files (including work-in-progress) and a brief introduction of the case background prepared by the previous case officer. This mitigated the risks of discontinuity in the event of staff turnover or reassignment of cases. Besides, the SFC imposed strict requirements on staff to responsibly hand files over when they changed hands. These included preparing handover notes, arranging handover meetings, and maintaining and passing over complete files such as evidence matrices and progress reports. The SFC would continue to monitor and evaluate the existing mechanisms and review them as necessary to ensure that they were operating as effectively as possible.



(c) *Seeking Advice from Other Departments / Divisions in the SFC*

4.72 PRP reviewed an enforcement case which took more than five years to complete. In view of the complexity of the case, the Investigation Team of the ENF had invited the Surveillance Team of the ENF to provide market expert opinion and also referred the case to the LSD for legal advice. The Surveillance Team spent three months to study the case and finally advised that it could not provide any expert opinion due to resource constraint. Further, the LSD also took five months to decide that the SFC should seek external counsel's advice instead of relying on in-house legal advice. The whole process of the investigation had thus been lengthened because of the waiting time to obtain the replies from the Surveillance Team and the LSD. PRP suggested that the SFC should draw up an internal guideline specifying how quickly advice should be provided by a division/department to another within the SFC.

§ *SFC's response*

4.73 The SFC noted and would consider the above suggestion.



D. Cooperation with Regulators, Law Enforcement Agencies and Prosecutors

4.74 The financial market has been increasingly sophisticated. There are new financial products and services that straddle across the purview of different regulators. To ensure the efficiency and effectiveness of the regulatory work, there should be more collaboration among the regulators.

4.75 PRP noted that the SFC had been working closely with other regulators, law enforcement agencies and the prosecutors. The SFC sought advice from the DoJ and cooperated with the HKP on criminal prosecution cases relating to market misconduct. The SFC and the HKMA worked together in granting registrations for regulated activities of Registered Institutions. The SFC and the Mandatory Provident Fund Authority handled the applications for the authorisation of mandatory provident funds. During the year, PRP also reviewed an enforcement case in which the SFC sought assistance from the Immigration Department for a case related to the Capital Investment Entrant Scheme. PRP commented that closer cooperation of the SFC with other regulators, law enforcement agencies and the prosecutors was necessary to maintain the integrity of the financial market and expedite the process of the relevant cases/applications.



(a) Cooperation with DoJ and HKP

§ PRP's recommendations

4.76 In an enforcement case being reviewed, PRP noted that the DoJ took some time to provide the SFC with its advice. PRP invited the SFC to provide more information about its working relationship with the DoJ and elaborate how the relationship had changed after the

signing of an MOU by both parties in March 2016.

4.77 PPR reviewed another enforcement case that took some nine years to complete. Both the SFC and the CCB of the HKP were involved in the investigation of the case at different stages, and the DoJ was involved in providing legal advice on the merit of the prosecution. PRP noted that the processing time was long because the DoJ needed to consider the evidence provided by both the SFC and the CCB before it could offer its views to the SFC.

4.78 PRP recommended the SFC to work closely with the HKP in cases involving criminal prosecution. PRP suggested that it would be better for the SFC to assign some experienced officers to provide an initial assessment of a case, in particular on whether the case would require support by other regulators or government departments. This way, the relevant parties could be engaged earlier to speed up the whole process.

§ SFC's response

4.79 The SFC advised that its working relationship with the DoJ had been improving -

- (a) after the signing of the MOU, there had been noticeable improvement in the lead time required for provision of legal advice by the DoJ; and
- (b) to further improve the cooperation in the area of criminal prosecution, the SFC and the DoJ had explored the possibility of providing training to each other's staff. The SFC would invite the DoJ to join training sessions on topics which might be of interest to the DoJ's staff. An example was how the SFC's surveillance systems worked.

4.80 The SFC advised that it had signed an MOU setting out the protocol for case handling with the HKP in August 2017. Under the MOU, the SFC and the HKP would decide on which one should be responsible for handling the case with a view to avoiding duplication of effort. The MOU also stipulated that the SFC and the HKP should consider early involvement of the DoJ when they carried out joint or parallel investigations. With those arrangements in place, the coordination work among the SFC, the HKP and the DoJ should improve.



(b) Cooperation with HKMA

4.81 PRP noted the collaborative efforts made by the SFC and the HKMA to conduct joint inspections on financial institutions. PRP appreciated the arrangement and encouraged the SFC to arrange more joint actions. This would facilitate the sharing of knowledge among the regulators, which in turn would enhance investor protection.

4.82 The SFC advised that it would continue its collaborative efforts with the HKMA.



E. External Experts

4.83 In the past years, PRP noticed that a lack of external experts to provide timely advice to the SFC had caused some delays in the processing of the enforcement cases. The external experts included both market experts (to provide case specific advice) and external counsel (to provide legal advice). Generally speaking, the SFC had to take a long time to engage these external experts. The external experts also took a long time to respond to the SFC's assignments. PRP had therefore invited the SFC to monitor the work of external experts closely.



4.84 For the case reviews conducted this year, PRP observed situation similar to that as described in paragraph 4.83 above still occurred. Further, depending on the specific circumstances of each case, the SFC might have to seek several market experts to advise on one single case. This further drained the pool of external market experts. As regards seeking advice from external counsel, PRP noted that the SFC was facing difficulty in identifying suitable counsel in the local pool and needed to engage overseas counsel. PRP recommended that the SFC should regularly review and expand its pool of market experts and legal counsel for timely and quality advice.

§ PRP's recommendations

- 4.85 In a case review conducted this year, PRP noted that -
- (a) the SFC had taken nearly five months to identify a suitable external market expert;
 - (b) the first external market expert had spent nearly one year to provide four drafts of advice to the SFC but

these drafts were not up to the expected standard of the SFC; and

- (c) the SFC subsequently needed to appoint another external market expert to provide advice.

4.86 PRP suggested that the SFC should set up a mechanism to monitor response time and quality of advice provided by external experts. PRP also recommended the SFC to consider the following measures to expand its pool of external market experts -

- (a) inviting retired industry practitioners to join the pool;
- (b) recruiting external market experts through open invitation or referrals by the professional bodies; and
- (c) arranging free refresher courses on new regulatory requirements to the industry practitioners and through that identifying potential market experts.

4.87 PRP noted that the SFC took a long time in appointing counsel. PRP suggested that the SFC should build up a local pool of counsel and explore more overseas counsel to represent the SFC.

§ SFC's response

4.88 The SFC advised that it had been looking into ways to expand its pool of market experts. This included inviting members of the professional bodies to serve as the SFC's external market experts. Notwithstanding the above, the SFC noted that many of the newly-appointed experts were found to have little experience in the regulatory context, especially in legal proceedings. It would take some time for the experts to accumulate the relevant experience.

4.89 The SFC had been arranging refresher courses for industry practitioners and to invite retired industry professional to become the SFC's external market experts.

4.90 As for seeking advice from the external counsel, the SFC responded that it instructed local or overseas counsel with the relevant experience and expertise. On one hand, it was trying to expand the local pool of external counsel suitable for the SFC cases. On the other hand, the SFC continued to choose the most appropriate overseas counsel based on their experience and expertise. This was to ensure that the SFC got good quality legal advice in a timely manner.

§ PRP's remarks

4.91 PRP understood the difficulties faced by the SFC in recruiting suitable market experts and counsel. Taking this opportunity, PRP appealed to all suitable experts to join the SFC pool. PRP also looked forward to the improvement in the efficiency of the process of enforcement cases after the SFC had implemented the new measures to expand its pool of external experts.



F. Complaint Handling

4.92 PRP reviewed nine completed cases handled by different divisions and noted that the SFC had generally followed its guidelines and procedures. PRP had recommended that the SFC should enhance its internal guidelines on the classification of the complaints and provided some observations on the supervision of the complaint handling process.



(a) Guidelines on the Classification of Complaints

4.93 PRP reviewed a complaint case against the SFC's staff. In accordance with the established complaint handling procedures, all these complaints would be classified as "serious" or "minor" cases. Serious cases would be referred to a Senior Director or above of another division for investigation, while minor cases would be handled by the division itself. It was the responsibility of the SFC's Commission Secretary to decide whether the complaint was serious or minor. PRP questioned how the SFC could ensure consistency in the classification.

§ PRP recommendations

4.94 PRP noted that there had been no detailed guidelines on how the SFC would classify the complaints. PRP recommended the SFC to enhance its internal guidelines, which should set out all principles and considerations as to how a complaint should be classified. PRP reminded the SFC that the classification should not solely rely on the judgement of a particular staff. It was important to maintain consistency in the classification even when there was any temporary absence of staff or upon staff change.

§ SFC's response

4.95 The SFC reiterated that under the "Procedure for Handling Complaints against the Commission or its Employees" ("the Procedure"), the Commission Secretary would consider each complaint to determine whether the complaint -

- (a) was covered by the Procedure; and
- (b) involved the professional standards, competence and behaviour of employees.

4.96 For cases involving the professional standards, competence and behaviour of employees, the Procedure further provided for different processes applicable to "minor" or "serious" cases respectively-

- (a) for serious cases, there was a requisite test, i.e. whether an employee had fallen short of the professional standards, competence and behaviour reasonably expected of a person in such capacity. Examples set out in the Procedure included misuse of confidential information, intimidation and using one's office for personal gain; and
- (b) cases that did not fall into category as stated in (a) would be treated as "minor" cases. Examples set out in the Procedure included a minor administrative error or an inadvertent delay in response. In handling minor cases, a more streamlined process would be adopted.

4.97 The processes were also set out on the SFC's website - <https://www.sfc.hk/web/EN/lodge-a-complaint/against-the-sfc/>.

4.98 In formulating the Procedure, the SFC had made reference to the practices of the UK Financial Conduct Authority and the Australian Securities and Investment Commission. The principles and the non-exhaustive examples quoted above were consistent with those of the overseas jurisdictions.

4.99 The SFC further explained that the Commission Secretary, being a Senior Director, would classify a complaint having regard to its particular circumstances. As a good governance practice, he would normally consult the CEO of the SFC on the proposed classification of a complaint before making his determination. In any event, the determination by the Commission Secretary was not necessarily final, as the Procedure set out that the supervisor of the relevant team in the Division concerned might seek to escalate the complaint to a “serious” case in consultation with the Division Head or the CEO even if the complaint was classified as “minor” by the Commission Secretary.



(b) Supervision

4.100 In 2016-17, PRP reported that arising from an oversight, there had been a delay of one and a half year for closing a complaint in one case under reviewed. In 2017-18, PRP noted a three-month delay when the SFC made a reply to the complainant. PRP invited the SFC to take a critical review on the communication among divisions when handling a complaint. There should be closer supervision by management in processing complaints to avoid delays.

4.101 The SFC responded that it would conduct a review and all divisions had implemented the enhanced divisional complaint handling procedures. The review aimed to clarify the division of labour among the different divisions and enhance the monitoring of the complaint handling process. In November 2017, PRP noted that the SFC had completed the review and revised the divisional complaint handling

procedures. PRP also learnt that the SFC had put in place a “bring up” report system in November 2017. Complaint cases that had been outstanding for over six months would be included in a report which would be submitted to the Executive Director of the respective division for reference on a monthly basis. The “bring up” report would also be circulated to the Executive Committee of the SFC on a quarterly basis. The report system would help strengthen the management’s oversight over complaint handling.



Chapter 5 Way Forward

5.1 In going through its work done in recent years, PRP realised that there was noticeable improvement in the collaboration and understanding between officers of the SFC and PRP. PRP could better appreciate the SFC's processes and challenges. With that, PRP's comments and recommendations were more constructive and acceptable to the SFC.

5.2 PRP had over the years gradually developed a more structured approach in its review of the work of the SFC. This approach has been set out by the Chairman in his message in this Annual Report (page 1). This should lay a solid foundation for a more efficient and effective PRP in the years to come.

5.3 The closer collaboration between PRP and the SFC would assist PRP in better discharging its function of providing an independent assurance of adherence to its internal procedures by the SFC, thus enhancing the transparency of the latter's workings and accountability.

5.4 PRP welcomes and attaches great importance to the views from market practitioners. Comments on the work under PRP's terms of reference can be referred to PRP through the following channels¹-

By post to: The Secretariat of the Process Review Panel
for the Securities and Futures Commission
24th Floor, Central Government Offices
2 Tim Mei Avenue
Tamar
Hong Kong

By email to: prp@fstb.gov.hk

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

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

Chapter 6 Acknowledgement

6.1 PRP would like to acknowledge with appreciation the support and cooperation of the SFC in its review work. Special thanks must go to the Commission Secretary Mr Paul YEUNG and his team, for their assistance in coordinating the review work and responses from different divisions within the SFC.

**Process Review Panel
for the Securities and Futures Commission
October 2018**