

**Follow up actions to LegCo Panel of Financial Affairs Meeting on
3 April 2006**

Regulation of market misconduct

Question

To address members' concern about the need to review the Securities and Futures Commission's decisions on not taking any follow-up actions, investigations and/or enforcement actions in respect of possible breaches of the market misconduct provisions under the Securities and Futures Ordinance (Cap. 571), in particular upon receipt of complaints or referrals from the public, the Administration and SFC are requested to take the following actions and provide the Panel with written response:

- (a) The Administration and SFC are requested to clarify whether the Process Review Panel has the power to review the cases which SFC has decided not to take any follow-up actions, investigations and/or enforcement actions; if it has, to provide the number of such cases reviewed by PRP since its establishment in November 2000; and if not, to provide information on which party is responsible for reviewing SFC's decisions on such cases; and*
- (b) To enhance the transparency of SFC's decisions on not taking any follow-up actions, investigations and/or enforcement actions on certain cases and to ensure the impartiality and credibility of such decisions, the Administration is requested to improve the existing checks and balances mechanism by requiring all such cases be reviewed by an independent committee (e.g. PRP). In other words, the independent committee must review all such cases and does not have the discretion to review cases on a selective basis; and*
- (c) In connection with item (b) above, the Administration is requested to make reference to the Operations Review Committee appointed by the Chief Executive to oversee the work of the investigative arm of the Independent Commission Against Corruption.*

Reply

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

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

Our reply to questions (a) to (c) is set out below.

- (a) PRP has the power to review cases and complaints where the SFC has decided not to take further action. In accordance with the terms of reference (copy attached at Annex 2 to the Information Note to the LegCo Panel on Financial Affairs of 10 November 2000 at **Appendix**), the PRP may select any completed or discontinued SFC cases for review.

The cases involving enforcement or complaints reviewed by PRP since 2000 consisted of cases that were closed at different stages:

- cases with respect to which the SFC decided not to take any follow up action for reasons such as that they were outside its jurisdiction;
- cases closed after conducting a preliminary enquiry without further investigation;
- cases closed after investigation without taking any enforcement action for reasons such as insufficient evidence to bring any action against anyone; and
- cases that have resulted in some form of enforcement action after investigation.

The number of enforcement/complaints cases reviewed by the PRP since its establishment in November 2000 are as follows –

Nature of enforcement/ complaint cases	No of cases reviewed by PRP			
	2001	2002	2003	2004
Cases that the SFC decided not to take any follow up action for various reasons	0	1	2	2
Cases closed after conducting a preliminary enquiry without further investigation	0	0	3	6
Cases closed after investigation without taking any enforcement action	2	0	1	2
Cases that have resulted in some form of enforcement action after investigation	17	0	6	7
Total no of enforcement and complaint cases ^{note 1} reviewed by PRP	19 (43)	1 (48)	12 (51)	17 (47)
(Total of cases reviewed by PRP)				

Note 1 In the PRP Annual Reports for 2001, 2002 and 2003, complaint cases were subsumed under other items in accordance with the nature of the complaints. Starting from the Annual Report for 2004, complaints against intermediaries and listed companies have been grouped under the new item on complaints.

In reviewing cases, PRP members go through the relevant case files to ascertain whether the standard procedures set out in the SFC's internal operational manuals had been followed. In doing so, members have also assessed the adequacy of the procedures and suggested changes where they considered that these were required in the interests of fairness and reasonableness.

- (b) As mentioned in the reply to (a) above, the PRP may select any completed or discontinued SFC cases for review. On the modus operandi, the SFC provides the PRP with monthly reports on all cases completed within that month. PRP members then select individual cases from the monthly reports for review with a view to covering a cross section of cases of different type and stage at which they were completed or discontinued. In other words, all cases dealt with by the SFC can potentially become a subject for review by the PRP. This would serve as a check to ensure that

SFC deals with each and every case in accordance with the established internal operational procedures. The actual number of cases reviewed by the PRP would depend on the capacity of the PRP members.

The SFC also provides the PRP with monthly reports on on-going investigation and inquiry cases that had been outstanding for more than one year so that the PRP could monitor the progress of these cases.

- (c) As noted in the information note to the LegCo Panel on Financial Affairs of 10 November 2000 at **Appendix**, we have made reference to the terms of reference (ToR) for the ICAC's Operations Review Committee in drafting the ToR for the PRP.

Financial Services and the Treasury Bureau
Securities and Futures Commission
April 2006

For information
on 10 November 2000

**The Legislative Council
Panel on Financial Affairs**

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

Purpose

This paper informs Members that the Chief Executive has established a new non-statutory panel, to be called the Process Review Panel (PRP), to review the internal operations of the Securities and Futures Commission (SFC).

Background

2. Since its inception, the SFC has been subject to various checks and balances designed to ensure fairness and observance of due process. These include statutory rights of appeal, judicial review and scrutiny by the Ombudsman and the ICAC. To date, complaints against the SFC have been relatively few and minor in nature. Only a handful of its decisions have been challenged, unsuccessfully, by judicial review.
3. Nevertheless, the SFC acknowledges that these checks and balances are only applied in specific cases. The SFC considers that it would be preferable to improve the transparency of its internal processes across the board, so that the public is better able to see for itself that the SFC does indeed always act fairly and consistently in all cases.
4. SFC's ability to demonstrate that it already operates in this fashion is however constrained by statutory secrecy obligations which limit the extent to which the SFC can divulge information to the public regarding what it has or has not done when performing its regulatory functions.
5. In order to overcome this and enhance the transparency and public accountability of the SFC, the Administration proposes to establish an independent body to review the fairness and reasonableness of SFC's

operational procedures on an ongoing basis, ensure that those procedures are consistently adhered to by the SFC, advise the SFC accordingly and submit its reports to the Financial Secretary, who may cause them to be published as far as permitted under law. The SFC supports this proposal.

Establishment of the Process Review Panel

6. In the above light, the Chief Executive has established an independent, non-statutory panel, called the Process Review Panel, on 1 November 2000 to conduct reviews of SFC's operational procedures. The PRP is to ensure that such procedures are fair and reasonable, and to determine if, in handling cases or taking actions or decisions, the SFC has followed its internal due process procedures, including procedures for ensuring consistency and fairness. The PRP's function is not to conduct review of merits. It will only focus on process. It will make regular reports to the Financial Secretary on its review findings. Through the publication of such reports, to the extent permitted within the statutory constraints of secrecy and confidentiality, the public will be better able to judge SFC's performance of its regulatory functions.

7. The establishment of the PRP, ahead of the enactment of the Securities and Futures Bill, demonstrates the Administration's resolve to enhance the transparency of SFC's operations, and SFC's determination to win public confidence and trust. We also hope to assure market participants that adequate checks and balances are in place to ensure that the SFC exercises its regulatory powers in a fair and consistent manner.

Membership

8. The PRP consists of 12 members – 9 independent, prominent persons from the securities and futures industry, the academia and the legal and accountancy professions; and 3 ex-officio members, namely the Chairman and a Non-Executive Director of the SFC and Secretary for Justice (or her representative). The membership list, as approved by the Chief Executive, is at **Annex 1**. The current membership represents a good mix of knowledge, experience and expertise from relevant quarters which is conducive to the effective operation of the PRP.

Terms of Reference (TOR)

9. In drafting the TOR for the PRP, we have made reference to the TOR for the ICAC Operations Review Committee, which is an existing non-statutory operations review mechanism well accepted by the public.

10. Specifically, the PRP will review and advise the SFC upon the adequacy of SFC's internal procedures and operational guidelines governing the action taken and operational decisions made by the SFC and its staff in the performance of the SFC's regulatory functions, in relation to, for instance, receipt and handling of complaints, licensing and inspection of intermediaries, taking disciplinary actions, etc. The Panel will also 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. In addition, the Panel may call for and review SFC's files to verify that the action taken and decisions made in relation to that case or complaint adhered to and are consistent with the relevant internal procedures and operational guidelines and to advise the SFC accordingly.

11. The TOR for the PRP, as approved by the Chief Executive, is at **Annex 2**.

Financial Services Bureau
9 November 2000

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

Membership List

The Chief Executive has made the following appointments for a term of two years from 1 November 2000 to 31 October 2002 unless otherwise specified -

Chairman

Mr CHENG Hoi Chuen, Vincent

Members

The Honourable Bernard Charnwut CHAN

Mr CHEONG Ying Chew, Henry

Mr FONG Hup

Mr KOTEWALL, Robert George

Mr KWAN Pak Chung, Edward

Dr LEE Hon Chiu

Professor LIU Pak Wai

Mr PANG Yuk Wing, Joseph

Ex-officio members

Chairman, Securities and Futures Commission
(Mr Andrew L T SHENG)

Non-Executive Director, Securities and Futures Commission
(Mr FAN Hung Ling, Henry)

Secretary for Justice
or representative (Mr Ian G M WINGFIELD)

Secretary

An officer of the Financial Services Bureau, Government Secretariat

**Securities and Futures Commission
Process Review Panel**

Terms of Reference

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

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

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

November 2000