

Follow-up questions raised by LegCo Financial Affairs Panel**Issues related to section 378 of Securities and Futures Ordinance (Cap 571) (“SFO”)**

4. **The Securities and Futures Commission (SFC) undertook to provide statistics and relevant information on the number of cases investigated by the SFC in the past five years and the time taken in completing the investigations.**

Time Taken for Closure of Investigations in last 5 years from 1/4/2003 to 31/3/2007

	Total No. of Investigations	Within 3Months	3 - 6Months	6 - 9Months	9-12Months	12 +Months
2002/3	344	35% (122)	22% (75)	11% (38)	12% (41)	20% (68)
2003/4	990	21% (206)	24% (240)	44% (434)	3% (29)	8% (81)
2004/5	553	23% (129)	16% (88)	11% (59)	21% (116)	29% (161)
2005/6	570	32% (183)	17% (99)	14% (79)	11% (60)	26% (149)
2006/7	664	45% (297)	18% (116)	8% (54)	6% (42)	23% (155)
Total 2002/7	3121	30% (937)	20% (618)	21% (664)	9% (288)	20% (614)

These figures show the total time from opening a case to the closing of the file rather than just the “time taken in completing the investigations”. For those completed within one year (80% of the total) the case is closed when the SFC reaches either a NFA (No Further Action) decision, a disciplinary action or a summary prosecution. The 20% of cases that took longer than 12 months for closure were generally those that involved more complex disciplinary actions or prosecutions, or referrals to outside bodies which could be to the Police/ICAC/other regulators or to the Financial Secretary for cases of insider dealing or market misconduct.

5. **To enhance the transparency and accountability of SFC’s decisions on the disclosure or otherwise of information regarding cases investigated by SFC, and to ensure the impartiality and credibility of such decisions, the Administration was requested to review the application of section 378 of the Securities and Futures Ordinance (SFO) with regard to disclosure of information.**

The secrecy provisions of section 378 of SFO were thoroughly debated back in 2001 before the Securities and Futures Bill was passed. They were closely based on section 59 of the repealed Securities and Futures Commission Ordinance dating from the inception of the SFC in 1989. Members noted that to protect the privacy and proper business interests of those regulated, the regulator had to operate to a certain extent in confidence, thereby restricting public scrutiny. The current section 378 has also addressed the concerns of the

Members of the Bills Committee on Securities and Futures and Banking (Amendments) Bill 2000, including the view that SFC's obligation to preserve secrecy should not be too relaxed.

Section 378 of SFO is comparable to the secrecy provisions applicable to other financial regulators in Hong Kong as well as to regulators in other international financial centres and complies with the international benchmark for cross-border co-operation: the International Organization of Securities Commission (IOSCO) Multilateral Memorandum of Understanding.

In applying section 378, the SFC is obliged to strike a balance between the need to preserve the secrecy of sensitive information on the one hand and the need to disclose information to the public to maintain and promote confidence in the securities and futures industry on the other hand. As explained in LC Paper No. CB(1)1476/06-07(04), the disclosure policy adopted by the SFC is in line with the practice adopted by other major regulators such as the UK Financial Services Authority and the Australian Securities and Investments Commission.

The impartiality and credibility of the SFC's decisions is ensured by the internal and external checks on its procedures and decision-making process as set out in the answer to Question (6) below.

The SFC appreciates Members' desire to see more disclosure of information regarding cases that it has investigated. In 2006, the SFC disclosed the fact that it was conducting an investigation on five occasions and most recently being the case concerning PCCW. The SFC will continue to disclose as much information as possible according to the parameters as set out in the law.

Further, to enhance transparency, the SFC will publish its policy statement to give an overview of the SFC's approach to disclosing publicly the fact that it is conducting an investigation into a corporation and highlights some of the key concerns and considerations that will usually affect the SFC's decision whether or not to make any such disclosure. The policy statement will be posted on the SFC's corporate website.

The SFC will also keep its disclosure policy under review.

- 6. To improve the existing checks and balances mechanism on the regulatory and investigatory powers of the SFC, the Administration was requested to review the operation, terms of reference and the composition of SFC's Process Review Panel with 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.**

The SFC is subject to the internal and external checks and balances on its procedures and decision-making which are designed to ensure fairness, consistency and observance of due process.

The SFC's internal procedures are subject to judicial review for any perceived unfairness in its processes and decision-making.

The SFC is also subject to scrutiny by the Ombudsman and by the ICAC under the Prevention of Bribery Ordinance.

Many of the SFC's decisions are subject to appeal to the independent Securities and Futures Appeals Tribunal ("SFAT"), which is chaired by a High Court judge who sits with two lay members chosen from a panel nominated by the Chief Executive of Hong Kong.

The SFC's detailed procedures, which set out how and by whom its statutory powers should be exercised, are subject to the review and advice of the Process Review Panel (PRP). This is an independent, non-statutory panel established by the Chief Executive in November 2000 to review the internal operational procedures of the SFC and to determine whether the SFC has followed its internal procedures, including procedures for ensuring consistency and fairness and to make recommendations to the SFC in relation to these objectives.

In drafting the terms of reference for the PRP at the time of its establishment, the Administration made reference to the terms of reference for the ICAC's Operations Review Committee (ORC) and measures adopted by overseas regulators to ensure accountability and transparency of enforcement actions. The Administration believed that the terms of reference of the PRP strikes an appropriate balance between the need for checks and balances and the SFC's ability to perform its functions properly, effectively and promptly to deal with exigencies in the financial markets.

The establishment of the PRP was considered by the Financial Affairs Panel at its special meeting held on 10 November 2000. The discussion paper is at **Appendix**.

The Administration would keep under review the adequacy of checks and balances including the operation of the PRP to ensure that the SFC discharges its statutory obligations (including those under section 378) in a consistent, fair and accountable manner.

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