



SECURITIES AND FUTURES COMMISSION
證券及期貨事務監察委員會

**Responses to the issues arising from the hearing
on 26 March 2010**

13 April 2010



TABLE OF CONTENTS

Q1.	3
Q2.	4
Q3.	5
Q4.	6
Q5.	7
Q6.	8
APPENDIX 1	
Extracts of SFC's annual reports	9
APPENDIX 2	
SFC's Greivance Procedures	10



1. **Has the Securities and Futures Commission (SFC) sought any external legal advice on the legal basis for it to apply the eligibility requirements applicable to listed structured products under Chapter 15A of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited and require issuers/guarantors/swap counterparty/swap counterparty guarantors of unlisted structured products to comply with such requirements? If yes, please provide the details of such advice. If no, the reasons.**
 - 1.1 We do not see the need to seek legal advice (whether external or internal) as our Corporate Finance Division has been applying the eligibility requirement under Chapter 15A of the Main Board Listing Rules to unlisted structured product issuers, guarantors and swap guarantors through administrative means.
 - 1.2 As stated in paragraph 12 of my second written statement submitted to the Subcommittee on 8 March 2010, the market accepted that SFC imposed these administrative measures because the market was familiar with the requirements relating to issuers and guarantors of listed structured products under Chapter 15A of the Main Board Listing Rules, and could comply. It is also important to note that there was no dispute about compliance by any unlisted structured product issuers, guarantors or swap guarantors.

S57



2. **Has SFC sought external legal advice on its view that under section 342A(1) of the Companies Ordinance (Cap. 32), SFC may only impose conditions related to the requirement waived, instead of having wide discretionary powers to impose conditions (such as structural or other requirements) as it thinks fit? If yes, please provide the details; if no, the reasons.**
 - 2.1 We have sought external legal advice confirming our longstanding view that under section 342A(1) of the Companies Ordinance the SFC can agree to waive a requirement and impose a condition related to the requirement in the Third Schedule which is being waived. We do not think it appropriate to disclose the external legal advice to the Subcommittee as it is covered by legal professional privilege.



3. In connection with paragraph 27 of S57, please provide documentary proof which contains specific references or statements that investor protection has always been and will remain SFC's first priority and primary objective.
- 3.1 Please see extracts of SFC's annual reports from 2004/2005 to 2008/2009 marked as "Appendix 1" demonstrating very clearly that SFC has been always putting investors' interest first. We do so through regulation, enforcement and education as detailed in the extracts.



4. In connection with paragraph 17 of S57 stating that Lehman Brothers (LB)-related structured financial products were available for sale to retail investors in some overseas jurisdictions, please provide further information, with reference to some major international centres in North America, Europe and Asia as examples, on the following:
- (a) how the sale of structured financial products (such as LB-related products) to retail investors was regulated;
 - (b) the requirements, if any, applicable to the retail investors (e.g. their net worth, etc.) who purchased such products; and
 - (c) the protection accorded to these investors.
- 4.1 We will provide the response as soon as practicable.



5. Please provide a copy of SFC's internal grievance handling procedures for its employees, and whether there are any constraints on (a) their attendance at hearings conducted by authorities (such as the Legislative Council and its committees), and (b) their access to documentation in SFC's possession for the purpose of assisting such hearings.
- 5.1 Please find attached a copy of SFC's Grievance Procedures marked as "Appendix 2" that are publicly available on our corporate website <www.sfc.hk>.



6. In connection with paragraph 138 of S57 on the use of the term "quick wins", please advise:
- (a) whether SFC had used the term "quick wins" in any of its documents relating to the pursuit of its regulatory objectives. If yes, please provide the details; and
 - (b) the "quick-wins" that SFC has come up with and delivered since June 2002.
- 6.1 We will provide the response as soon as practicable.



Appendix 1

Extracts of SFC's annual reports



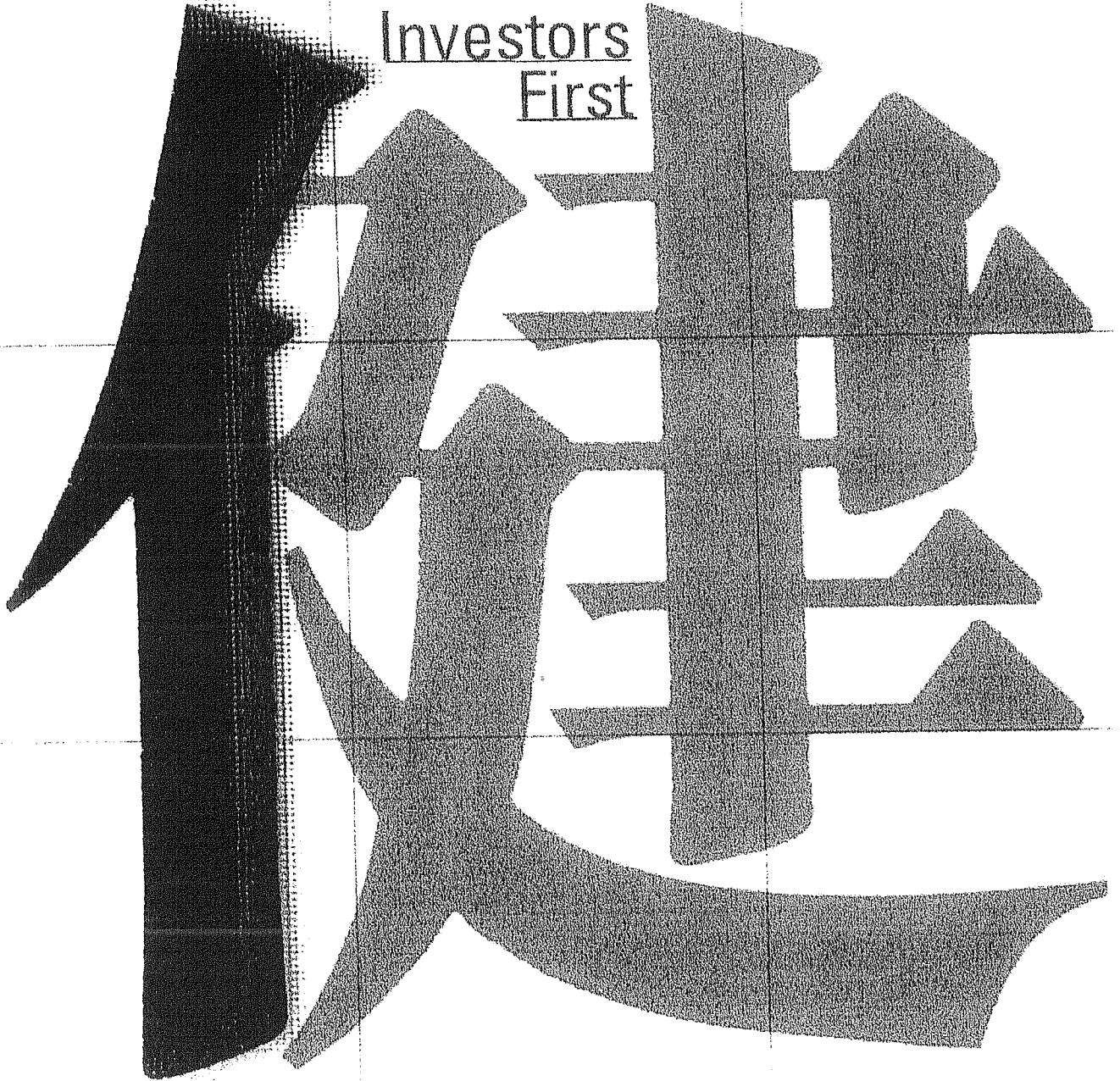
SECURITIES AND
FUTURES COMMISSION
證券及期貨事務監察委員會

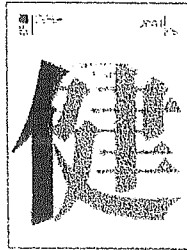
Annual Report

2004

05

Investors
First





健
Healthy 健康
Steady 穩健



We Regulate



We Enforce



We Educate

Investors First

The theme of this Annual Report is "Investors First". As market regulator we have a responsibility to educate the public and enable investors to protect their own interests. The well-being of the investors is key to the healthy development of the capital markets. The Chinese character 「健」, as in "Healthy" - 「健康」 and "Steady" - 「穩健」, is made up of 「人」 - "People" and 「建」 - "Develop" or "Establish". Three page dividers help explain how we put the interests of investors first: through "Regulation" - 「規」, "Enforcement" - 「行」, and "Education" - 「信」.

Contents

Corporate Review

02 - 05	Chairman's Statement
08	Whom and How We Regulate
09	How We Are Organised
10 - 13	Directors of the Commission
14 - 21	Corporate Governance and the SFC
24 - 25	Achievements and Work in Progress
26 - 27	Performance Comparisons
28 - 29	Significant Events 2004-2005
32 - 33	Investor Education and the SFC

Divisional Reports

34 - 39	Corporate Finance
40 - 51	Intermediaries and Investment Products
52 - 65	Enforcement
66 - 71	Supervision of Markets
72 - 75	Legal Services
76 - 85	Corporate Affairs
86 - 91	Cross-Border Regulatory Co-operation

Financial Statements

92 - 109	Securities and Futures Commission Financial Statements
110 - 121	Investor Compensation Fund Financial Statements
122 - 134	Unified Exchange Compensation Fund Financial Statements
135 - 143	Commodity Exchange Compensation Fund Financial Statements
144 - 153	Committees, Panels and Tribunal
154	Consultations, Codes and Guidelines
155 - 160	Index

(Currency is denominated in Hong Kong dollars unless otherwise stated.)

Chairman's Statement

"Our mission in 2005-2006 is to continue to implement the SFO effectively, with emphasis on raising the quality of the market. In our daily work, our staff motto is to remember: Investors First."



[This Statement Is About]

- Investors First
- The market in 2004-2005
- Operational review
- A world-class regulator
- A note of thanks

Investors First

This year's Annual Report delivers a concise message: the Commission puts the investors' interest first.

The Commission discharges its functions in accordance with the six statutory regulatory objectives. We aim to ensure Hong Kong's continued success and development as an international financial centre. In seeking to achieve these goals, we always remember that the investor is the reason why capital markets exist. The well-being of the investors is key to the health of the capital markets.

How do we protect investors? We do so through *Regulation, Enforcement and Education*.

We regulate through consultation and consensus with the market. Our regulations balance investor interest with market development. We balance the costs and benefits of regulation. We consider the possible impact of regulations on those whom we regulate, including the indirect costs. We focus our regulatory resources on matters that are important to the well-functioning of the market.

We enforce firmly and fairly against those who harm investors or damage market integrity. The Securities and Futures Ordinance (SFO) empowers the Commission to investigate, prosecute, and discipline using proportionate penalties. We

ensure that we are consistent in our actions while having regard to the specific circumstances of each case. Our actions are subject to checks and balances.

We educate investors to protect their own interests. Investor education provides investors with the tools and knowledge to make informed decisions. An informed investor is also the best defence against fraud. Intermediary education raises the professionalism and integrity of practitioners, which is important for building investors' confidence in the Hong Kong markets.

These are our guiding thoughts on putting investors first.

The Market in 2004-2005

In 2004-2005, the stock market advanced further, supported by improving economic fundamentals, a low interest rate environment, an inflow of funds and a continued recovery of the property market. Hong Kong's GDP growth was 8.1% in 2004. Deflation finally came to an end last July, and the unemployment rate fell to a 40-month low in March 2005.

During the year, the HSI receded to a year-low of 10,968 on 17 May 2004, but rebounded to the year-high of 14,266 on 29 December 2004. On 31 March 2005, the HSI closed at 13,517, rising 7% during the year. The average daily turnover on the Hong Kong market last year rose 13% to \$15.6 billion.

There were 61 IPOs raising \$81.7 billion (75 IPOs raising \$76.4 billion in the previous financial year). Of this, 65% was for Mainland enterprises (i.e. H-shares and red chips).

During the year, the H-share and red chip indices gained 0.3% and 7.7% respectively. The average daily turnover of H-shares and red chips was \$3.3 billion and \$2.3 billion respectively.

As at 31 March 2005, there were 1,096 companies listed on the stock exchange with a total market capitalisation of \$6,571.4 billion (US\$842.5 billion),

rising 14% from the year before. Hong Kong was the ninth largest market in the world by market capitalisation.

Hong Kong was one of the most active derivative warrants markets in the world by turnover last year. It contributed about 14% to the total market turnover. Trading of futures and options was also active, with 20.1 million contracts traded, 24% higher than the year before.

We do not make investment predictions, but we expect several concerns to linger over the markets in 2005-2006.

Between last June and March 2005, the US Federal Reserve raised its Fed Funds Target Rate (FFTR) seven times by a total of 175 basis points. Interest rate concerns, the possible return of inflation, higher oil prices and movements in major currencies all may affect investor confidence and add to market volatility.

Operational Review

Our finances improved in 2004-2005 and expenditure remained under control. The SFC achieved a surplus of \$169 million (\$125 million in the previous year). The reserves at the end of March 2005 stood at \$860 million.

Total revenue increased by 13%, or \$74 million, from the previous year to \$625 million. Levy income, our primary source of revenue, increased by 15% or \$55 million to \$435 million owing to the higher market turnover.

Total expenditure was \$456 million, \$30 million higher than 2003-2004. The increase was mainly because of variable pay awarded to staff who performed well. This is necessary in order to retain performing staff in view of an increased staff turnover rate as competitive demand for skilled staff increased with market recovery. We also spent more on areas considered necessary to improve market quality. Meanwhile, we continued to hold back on a general fixed pay increase, suspended since April 2001, so as to keep down

Chairman's Statement

our fixed cost. Variable pay in the future will be subject to budgetary consideration, staff performance and prevailing market conditions.

We made significant achievements in the four priorities set for 2004-2005: upkeeping market standards, facilitating market development, enforcing the law, and protecting and educating investors.

I would like to highlight some points, which are detailed in the divisional reports.

- Corporate governance standards for listed companies and regulation of listing sponsors were put in place, beginning 1 January 2005;
 - We worked with the Government to give statutory backing to major listing requirements to strengthen listing regulation;
 - We are tackling investment advisers' selling practices, on the back of a disciplinary settlement with a firm to pay \$255 million to investors;
 - We proposed measures to address risks arising from securities margin financing;
 - We issued guidelines on analyst conflicts of interest;
 - We consulted on a review of the disclosure of interests regime;
 - We proposed to relax the geographical restriction of investment by SFC-authorized REITs;
 - We agreed with HKEx on its proposed model for a scripless securities market;
 - A total of 76 entities were successfully prosecuted, including a record number of market manipulation prosecutions;
 - We successfully prosecuted a company disclosure offence in the first dual filing case;
 - We cleared much of the backlog of discipline cases, and used settlements where appropriate;
- Dr Wise's Column, our investor education (IE) TV dramas and radio programmes were popular; and
 - Teachers' IE workshops were fully subscribed, while IE became credit courses for undergraduates.

In addition, the Commission won several awards and recognition for its corporate affairs activities. You will find these and description of our staff social services in the later chapters. You will also find a review of our investor education and communications work in the past years.

Our mission in 2005-2006 is to continue to implement the SFO effectively, with emphasis on raising the quality of the market. In our daily work, our staff motto is to remember: Investors First.

A World-Class Regulator

In the past year, we signed Letters of Intent (LOIs) with our counterparts in Indonesia, Thailand and Sri Lanka to strengthen regulatory co-operation relating to investment products. We are working on similar arrangements with several other jurisdictions. These bilateral LOIs will facilitate more Asian financial products to be traded within the region, building on the regional efforts to develop Asian Bond Fund II. We also signed a Memorandum of Understanding on regulatory co-operation with the Philippines commission.

SFC staff have made significant contributions to the committee and taskforce activities of International Organization of Securities Commissions (IOSCO), leading to some landmark initiatives such as the code of conduct fundamentals for credit rating agencies, and the blueprint on combating financial fraud.

In May 2004, during the IOSCO Annual Conference in Amman, Jordan, I was privileged to be elected Chairman of the IOSCO Technical Committee.

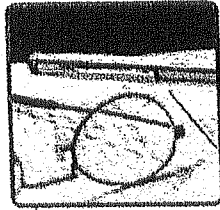


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Annual Report 2006-07

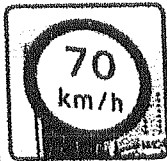
Investors First
Regulate, Facilitate & Educate



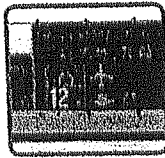


Operational Review

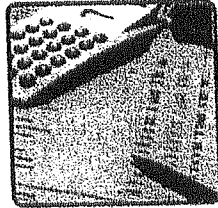
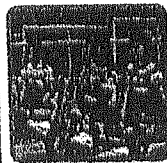
34 Regulation



44 Facilitation



52 Education

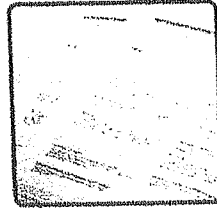


Financial Review

57 Securities and Futures Commission Financial Statements

77 Investor Compensation Fund Financial Statements

92 Unified Exchange Compensation Fund Financial Statements



Others

104 Activity and Market Data

111 Committees, Panels and Tribunal

120 Index

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Investors First

The continued success of our financial services market, a key and growing part of Hong Kong's economy, can be attributed to many factors including effective regulation. Effective regulation allows both local and international market participants to conduct their business in accordance with an accepted and transparent set of rules. This in turn provides investors with confidence when making their investment decisions and thus facilitates greater levels of market activity. We execute our responsibilities under the law through three inter-related activities: Regulation, Facilitation and Education.

Who We Are and What We Do

- ii) to promote understanding by the public of the operation and functioning of the securities and futures industry;
- iii) to provide protection for members of the public investing in or holding financial products;
- iv) to minimise crime and misconduct in the securities and futures industry;
- v) to reduce systemic risks in the securities and futures industry; and
- vi) to assist the Financial Secretary in maintaining the financial stability of Hong Kong by taking appropriate steps in relation to the securities and futures industry.

We execute our responsibilities under the SFO through three inter-related activities:

Regulation

In carrying out our regulatory responsibilities we adopt a philosophy of considering the interest of investors first. However, in establishing and maintaining the regulatory environment we aim to achieve an appropriate balance between facilitating the efficient functioning and continuing development of the securities and futures markets and at the same time providing adequate, but not absolute, protection to investors. In considering what regulations to put in place we also pay close attention to the rules and regulations in other international financial centres to ensure that our regulatory environment is of a similar standard.

In enforcing regulations it is not our aim to identify and prosecute all minor breaches but rather to encourage compliance and good business ethics through the selective sanctioning of malpractices and enforcement action. However, in the most serious cases of abuse or fraud we seek to remove participants from the industry in order to maintain overall market standards and to protect investors.

While we rigorously pursue those who defraud investors we have no legal powers to order an intermediary to pay compensation. However, a separate investor compensation fund exists to compensate investors in cases of broker default and we work closely with this fund to facilitate the processing of relevant claims.

We place considerable emphasis on market monitoring and analysis to detect prohibited trading activities utilising techniques and systems which are some of the most sophisticated in the world. Where insider dealing or other market misconduct is identified we will where appropriate refer cases for prosecution or to the Market Misconduct Tribunal which is an independent tribunal established by the Government and led by a Judge.

We review all applications made by companies seeking a listing on HKEx, to ensure there is full and proper disclosure. For companies that are already listed, we take action against the release of false or misleading information, transactions that harm minority shareholders' interests, or other misconduct involving the companies or their officers. Cases involving fraud are referred to the Police.

Facilitation

We recognise the importance of effective regulation to the success of the financial markets and our role in supporting Hong Kong's continued development as an international financial centre. In the execution of our regulatory functions and in considering market developments and regulatory changes, we therefore aim to achieve a balance between innovation and appropriate levels of investor protection.

In considering the authorisation of new products, and especially structured products, we consider the interest of investors first. However, we also recognise that the provision of additional products can be to the advantage of investors and that it is not our role to create a risk-free market. Innovative investment products are therefore authorised for sale to retail investors provided that the managers and distributors make proper disclosure and have in place sound management and controls.

We also oversee the stock and futures exchanges' introduction of new products, including derivatives, where we are also concerned about the market's ability to handle large volumes, especially in times of volatility. We therefore work with the exchanges to consider the implications of new products for the stability of the market in times of stress and to ensure the adequacy of trading and clearing systems.



We Regulate

In carrying out our regulatory responsibilities we adopt a philosophy of considering the interest of investors first. However, in establishing and maintaining the regulatory environment we aim to achieve an appropriate balance between facilitating the efficient functioning and continuing development of the securities and futures markets and at the same time providing adequate, but not absolute, protection to investors.

Last year, we

- introduced a new sponsor regime
- published consultation conclusions informing the market of the latest approach to giving statutory backing to certain listing rules
- implemented measures to strengthen the regulation of derivative warrants
- revised the rules on securities margin financing
- successfully prosecuted 51 firms and persons and disciplined 80 licensees or their management
- concluded disciplinary action with an investment adviser which agreed to make record ex-gratia payments to investors

Regulation

Of each of our primary roles, Regulation, Facilitation and Education it is the first which is our core responsibility and which occupies the majority of our time and effort. As with any regulator, much of our time is spent on day-to-day monitoring, supervising and enforcing activities. However, we are also conscious of the need to constantly review the application of the existing regulatory regime to ensure that it continues to be appropriate for the market which we regulate. In order to do this we work closely with the industry, Mainland authorities and overseas regulators to keep ourselves abreast of regulatory and enforcement issues and international best practices.

From time to time market developments require us to make changes to regulations and changes are also made where opportunities are identified to improve the existing regulatory regime. Where this involves changes in the legislation we need to work with the Government and legislature in order to ensure the passage of new laws. However, there are also occasions where we are able to enhance the regulatory regime by modifying codes and guidelines alone. In these circumstances we will usually conduct a public consultation before implementing any changes.

In considering any changes to rules and regulations we always consider the needs of investors first. However, we also try to put in place rules and regulations that are conducive to market development. We also try to encourage compliance with regulations through selective enforcement action. This is intended to demonstrate to the market that the small proportion of participants who do not conduct their activities appropriately will not profit from their behaviour. We also try and assist market participants comply with regulations by issuing guidance to them through circulars, Frequently Asked Questions (FAQs) and other means.

We are pleased to highlight below some of the major initiatives and actions taken last year in strengthening our regulatory regime.

Market standards

To enhance the quality of listing, we introduced eligibility criteria and ongoing **requirements for sponsors/compliance advisers** under a new sponsor regime, which became effective on 1 January 2007. Under this new regime, firms have to demonstrate that they have appropriate levels of expertise and meet other eligibility requirements, in order to be confirmed as sponsors, or they will have a licensing condition imposed restricting them from acting as sponsors. As at 31 March 2007, 190 out of the 267 relevant intermediaries had such restrictions imposed; most of these firms had been inactive or had not previously acted as sponsors and indicated to us they did not wish to act as sponsors. The majority of those who wished to continue to act as sponsors have been confirmed although we are still assessing a small number of applications.

For some years there has been a debate concerning how to provide **statutory backing** to certain listing rules relating to the responsibilities of companies listed in Hong Kong. These rules are currently included in a contractual agreement between Hong Kong Exchanges and Clearing Ltd (HKEx) and listed companies, but they have no basis in Hong Kong law. As a result of this, HKEx does not have full investigative powers with which to examine breaches of the Listing Rules. It also lacks a broad range of disciplinary responses to deal with breaches when they occur. In order to provide protection for shareholders, it is necessary that both of these deficiencies are addressed. Within the current structure, the SFC is also unable to properly investigate potential breaches or take action in the event of non-compliance by listed companies with reporting and disclosure obligations under the Listing Rules. This is because the breaches would only be of the Listing Rules which are effectively breaches of a contract with HKEx, and they would not be breaches of the SFO where the SFC can use its investigatory powers.



SECURITIES AND
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證券及期貨委員會

2007-08
Annual Report



Informed Investors Quality Markets



We seek to achieve these objectives in three key areas:

Regulation

The SFC believes in putting investors first, while aiming to strike a balance between investor protection and the continuing needs of an efficient market. We are also mindful of keeping our regulatory framework in step with standards in other major financial centres.

The SFC aims to reduce crime and misconduct by fostering a culture of compliance and by raising standards of good conduct and probity. We do this through effective communication, education and where necessary through enforcement. Our enforcement programmes are directed to attack serious abuses threatening harm to investors and the integrity of the market.

Companies looking to list on the Stock Exchange will have their applications reviewed by both the Stock Exchange and the SFC to ensure full and proper disclosure. Companies already listed are subject to action by the SFC for false or misleading information, transactions detrimental to shareholder interests or other misconduct by companies or their officers. Cases involving fraud are referred to the Police. We also ensure that takeovers and mergers of public companies are conducted within a proper regulatory framework.

We keep a close eye on the activities of intermediaries as well as the trading and clearing systems to identify possible risks and make sure on-going regulatory requirements are complied with. The SFC conducts site visits and meets with management of licensed corporations to discuss issues of concern and detect potential misconduct.

Market monitoring and analysis receives considerable emphasis. We take action to combat dishonest market practices including insider dealing, manipulation and other market misconduct.

Criminal proceedings are launched against these abuses where there are good prospects of conviction and the prosecution is in the public interest. In appropriate cases, we will refer cases to the Financial Secretary to consider whether civil proceedings before the Market Misconduct Tribunal should be commenced. A licensee who breaches a non-statutory requirement such as a conduct code provision is subject to our disciplinary proceedings which may result in administrative penalties.

While we do not have legal powers to order an intermediary to pay compensation to victims of market misconduct or malpractices, we work closely with the Investor Compensation Fund which is established to compensate investors who suffer a loss due to the default of an intermediary.

Facilitation

A flourishing financial market needs effective regulation and the SFC strives to support Hong Kong's continued development as an international financial centre and key financial market in China.

As a regulator alert to the evolving nature of markets, we aim to balance innovation with an appropriate level of investor protection.

When reviewing possible new products for sale to retail investors, particularly structured products, we will first consider how this affects investors' interests. However, we recognise that additional products can benefit investors and that it is not our role to create a risk-free market. Innovative retail investment products will therefore not normally be prohibited from being sold if managers and distributors adhere to proper disclosure and maintain sound management and controls.

Employee awards

Individual award winners

Clarence Chan	Manager, Corporate Finance
Lisa Chen	Counsel, Legal Services
Carmen Kwok	Senior Administrator, Licensing
Veronica Lee	Senior Secretary, Corporate Finance
Linda Yiu	Senior Manager, Intermediaries Supervision

Team award winners

Broker Frauds Combats Core Team

The Broker Frauds Combats Core Team, a cross-divisional team consisting of staff from the Intermediaries Supervision, Enforcement and Legal Services Divisions, successfully uncovered two broker fraud cases in 2007, in which fraud and actions of the wrongdoers were detected. The Team upheld the value 'Investors First' and exhibited excellent team spirit, dedication and innovation.

Hedge Fund Streamlining Team

The Hedge Fund Streamlining Team, comprising staff from the Licensing Department, has made a big effort to engage overseas hedge fund managers and has contributed to a

significant increase in the number of hedge fund managers being licensed in Hong Kong in 2007. It has also shortened time needed to process licensing applications from foreign hedge fund managers who are able to provide the required documentation. The feedback from the market concerning the initiatives taken by the Team has been very positive and has reflected well on the Commission.

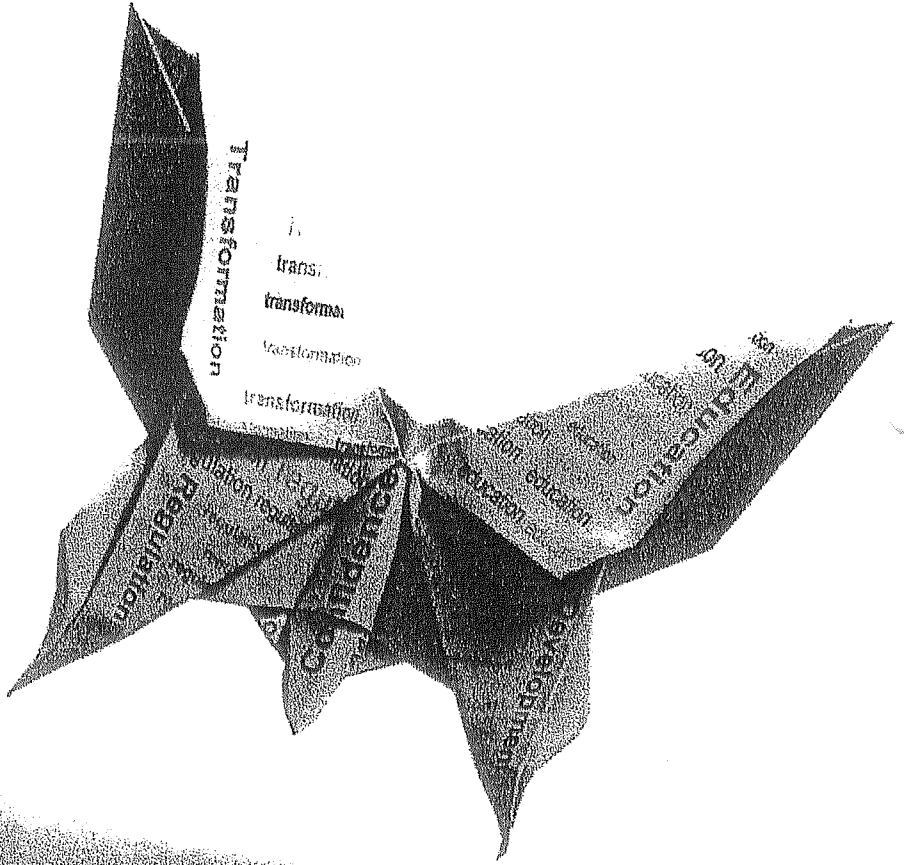
Work-life balance

While demanding high levels of performance, the SFC also recognises the importance of staff welfare and aims to promote a healthy balance between work and home life. We organise talks by health professionals as part of our 'Health Month,' which includes activities for staff such as yoga and tai chi. Seminars are held to increase awareness about work-life balance and free professional consultations are offered to staff and their families for emotional or stress-related issues.

Social activities are held on a regular basis, such as table tennis, bowling, barbecues, basketball and Baduanjin classes. Staff also have access to work premises on request for activities such as reading groups and tai chi classes.



SECURITIES AND
FUTURES COMMISSION
證券及期貨事務監察委員會



20 Years of Transformation

2008-09
Annual Report



regulatory framework to ensure that their regulators can identify and handle macro-prudential risks across the financial system.

In addition, hedge funds or their managers will be required to be registered and to report appropriate information periodically to the relevant authorities. Institutions that have hedge funds as their counterparties must also adopt effective risk management.

The G-20 also raised the need to strengthen transparency of credit derivatives markets and reduce their systemic risks and to subject credit rating agencies to regulation.

Recommendations made by G-20 will have implications for all regulators around the world. In the near future, the SFC will be closely monitoring international efforts to implement reforms for the benefit of Hong Kong, a key international market.

Corporate priorities ahead

In line with our statutory obligations of protecting the investing public and ensuring market stability, we have set our corporate priorities to address these main areas in the year ahead.

We shall continue to promote Hong Kong's development as an international financial centre and a key financial market in Mainland China. Besides maintaining dialogue with Mainland regulators for possible co-operation, we shall keep pace with international regulatory developments to ensure that changes to Hong Kong's regulatory environment are consistent with its standing as an international financial centre.

Active support and supervision of an efficient, fair and orderly securities market is necessary. It can be achieved by close supervision and firm enforcement. We will increase resources to step up monitoring and enforcement work to combat and minimise market misconduct while allowing adequate flexibility for market growth.

Educating and protecting investors continues to be a priority. The LB bankruptcy has further highlighted the importance of investors understanding the features and risks of a financial product. Well-informed and financially-literate investors are the first line of defence against fraud and malpractice. We shall continue to upgrade efforts to educate retail investors with multiple investor education initiatives.

Improving corporate effectiveness and efficiency is another focus. Apart from maintaining high professional standards, we will continue to look for more direct and meaningful ways to perform our regulatory functions. We will review the effectiveness of our gatekeeping role in licensing and product authorisation and propose enhancements where appropriate. An on-line portal is already being developed to facilitate the submission of licensing forms, along with a comprehensive revamp of our licensing functions to further enhance the overall efficiency and effectiveness of our processes.

Finally, I would like to take this opportunity to thank the staff of the SFC for their hard work and commitment over the past busy year. In the past 20 years, we have expanded our role as a regulator of the securities and futures markets but more and more challenges are ahead. I am confident that with their continued commitment and support, we can take the organisation another step forward at this juncture of regulatory reforms.

Martin Wheatley
Chief Executive Officer

Our Roles and Responsibilities

Development

As the regulator of the securities and futures markets, we are conscious of the need for us to support Hong Kong's continued development as an international financial centre. However, as market regulators, we also recognise the need to balance the desire of industry participants for innovation and expansion with the need for trust and confidence in our markets and our role in educating and protecting investors.

Over the years, we have therefore encouraged appropriate development and technological advancement by relaxing restrictions but without compromising investor protection. We are also streamlining our own administrative procedures to simplify the compliance burden for the industry. However, in considering any regulatory amendments, we continue to follow our philosophy of only introducing significant changes after fully consulting all key stakeholders via public consultation.

We also oversee the launch of new products by SEHK and HKFE. In close collaboration with the exchanges, we monitor the impact of new products on market stability and the adequacy of trading and clearing systems to deal with these in times of volatility.

International participation is a key element to our role as a leading regulator and our ability to stay abreast of global developments relevant to Hong Kong. We actively take part in the International Organization of Securities Commissions forum to provide input to set global regulatory standards.

In recent years, we have significantly expanded contacts and cooperation with our Mainland counterparts. We share knowledge and market information through meetings and seminars and give briefings to high-level officials during their visits to Hong Kong. We also actively support the development of financial products for the Qualified Domestic Institutional Investor Scheme.

Education

We strongly believe that knowledge is the best protection for investors. We launch education initiatives, on a continual basis, to enhance investors' understanding of the markets, products and investment risks.

Nevertheless, it is not possible to create a risk-free market; nor is it part of our mission. All investments carry risk and an important part of investor education is to help individuals understand how to identify the risks in investments and the need to make a rational decision. We thus emphasize the need to ask the right questions before making investment decisions. In view of the increasingly complex nature of products, we also conduct proactive educational programmes to help investors better understand product features and associated risks.

We reach out to the general public via various channels. In the earlier years, we mainly used leaflets, newspaper articles as well as radio and television programmes. More recently, we have also introduced extensive advertising campaigns, short videos on buses, competitions and game shows. In addition, we regularly organise seminars for the community and run courses jointly with universities, which are designed to cultivate a proper investment attitude among the younger generation.

The SFC's investor website, InvestEd (www.InvestEd.hk), regularly posts up-to-date, practical information on products and market developments. It also provides an on-line channel for investors to ask questions and lodge complaints. Our monthly Dr Wise education column explains investment topics that are of interest to the public. We constantly encourage investors to make good use of our educational materials to raise their financial knowledge.

Also using our website, we issue alerts to investors about scams and malpractices that come to our attention. To help us focus our educational efforts on areas of greater need, we conduct surveys every two years to gauge public awareness of investment risks, the growing sophistication of products as well as the investment attitude of retail investors.



Appendix 2

SFC's Grievance Procedures

Grievance Procedures – Public Interest Grievances

1.1 Introduction

The Commission, as a public body, has a duty to conduct its affairs in a responsible and transparent manner. It is committed to the highest standards of openness and accountability. This part of the Grievance Procedures is intended to assist persons who are engaged by or to work in/with the Commission who believe that they have discovered improper practices or misconduct relating to the running of the Commission or work related activities of employees of the Commission to report these in a constructive manner.

The policy is designed to provide a framework which will assist persons who are engaged by or to work in/with the Commission so that they will feel confident about raising grievances or disclosing information which is believed to show malpractice or misconduct, and assist in investigating and acting on grievances raised.

1.2 Who does this policy cover?

This policy is for any person who has an employment contract with the Commission, is on secondment to the Commission, is engaged as an independent consultant by the Commission or is a contractor or supplier of services to the Commission.

1.3 What grievances does it cover?

This part of the Grievance Procedures is only intended to cover grievances related to the public interest. Such grievances might include:

- Criminal activity, such as accepting a bribe;
- Financial or administrative malpractice;
- Misconduct or improper behaviour;
- Failure to comply with legal obligations such as those set out in the Securities and Futures Ordinance;
- Endangering occupational health or safety;
- Attempts to suppress or conceal information relating to any of the above.

1.4 Principles and safeguards

- 1.4.1 The Commission will treat all disclosures made to it in a confidential manner to the extent that keeping the identity of the person making the disclosure confidential does not hinder a fair investigation (e.g., normally fairness would require that the person about whom the allegation is made be informed of the identity of his/her accuser).
- 1.4.2 All persons concerned (including those assisting in connection with and those handling the grievance) are reminded to keep the matter confidential.
- 1.4.3 This policy does not release the person from his/her statutory duty of confidentiality under the Securities and Futures Ordinance. Please refer to section 378 of the Securities and Futures Ordinance for details and note that any person who contravenes this provision is committing an offence and may be prosecuted.
- 1.4.4 Concerns that are raised anonymously will only be considered at the discretion of the Audit Committee who will take into account the seriousness of the allegations raised, the credibility of the allegation and the likelihood of confirming the allegation from sources that can be verified.
- 1.4.5 The person about whom a grievance has been raised, must be informed of the allegation and the evidence in support of the allegation and must be allowed to state his/her position and make comments prior to the conclusion of any investigation or inquiry.
- 1.4.6 The person who raises a grievance must provide those who are investigating the matter internally or as part of an inquiry with all reasonable assistance.
- 1.4.7 An employee, whether the person lodging the grievance or against whom it is lodged, may be accompanied at any interview or meeting by one companion, provided that the employee makes the request in advance and it is reasonable and appropriate (which is to be decided at the sole discretion of the Commission). The companion must be an employee of the Commission. When choosing a companion, it should be kept in mind that it is not appropriate to ask to be accompanied by a colleague whose presence at an interview or meeting would prejudice the investigation, who might have a conflict of interest or who is involved in the investigation. It should be noted that an employee is not under any obligation to act as a companion. However, if the employee does act as a companion, he/she should keep the matter confidential.

1.5 Procedures

- 1.5.1 Stage 1 – A person covered by this policy should prepare a written statement of his/her grievance and ensure that the Commission Secretary or the Chief Counsel receives it and also provide a copy to the Chief Operating Officer (COO). If the person requires assistance to prepare a written statement, he/she can approach the Commission Secretary or the Chief Counsel in the first instance for advice. The recipient will acknowledge receipt of the written statement normally within 5 working days. The recipient will:
- a) Explain this part of the Grievance Procedures to the person.
 - b) Refer the case to the appropriate person (the *Case Handler*) for further consideration as set out below:
 - If it relates to an employee who is at the level of Senior Director or below, or if it concerns some matter which is not about an employee or member of the Commission¹, then the matter will be referred to a committee of all of the Executive Directors for further action.
 - If it relates to a member of the Commission, then the matter will be referred to the Audit Committee (excluding any Non-Executive Director about whom the grievance has been raised, if applicable) for further action.

1.5.2 Stage 2 – Process

- a) The Case Handler will conduct an initial review of the information provided and determine whether the grievance warrants further action. If it is decided that the grievance warrants further action, the Case Handler will decide on the type of investigation to be undertaken, e.g. internal investigation, independent inquiry and/or referral of the matter to the law enforcement and/or regulatory agencies. Once a decision is reached, the Case Handler will inform the person raising the grievance in writing whether further action is proposed.
- b) Where the Case Handler is the Committee of all of the Executive Directors but it considers that an independent inquiry is necessary due to the complexity or seriousness of the matter, then the grievance is to be referred to the Audit Committee to consider the scope of the inquiry, who should carry out such an inquiry and the terms of reference.

¹ See section 1 of Schedule 2 to the Securities and Futures Ordinance (SFO) and also the definition of “member” in Schedule 1 to the SFO. Member of the Commission includes any executive director (including the Chief Executive Officer) and also any non-executive director of the Commission.

1.5.3 Stage 3 – Investigation

- a) If the matter is to be the subject of an internal investigation, the Case Handler may nominate members of staff or engage external consultants to investigate the matter further, i.e. to gather and assess the information and to produce a report on the findings. The investigation will take place as soon as possible.
- b) Investigations should not be carried out by any party who has an interest in the matter.
- c) Once the relevant facts have been established, a report will be prepared. The Case Handler will then make a decision on the matter.

1.5.4 Stage 4 – Feedback

- a) A summary of the investigation report which is prepared for consideration by the Case Handler will be made available to the person who raises the grievance after completion of Stage 3. The person against whom the grievance is raised shall also be informed of the main findings of the investigation.
- b) The Case Handler will inform the person who raised the grievance and the person against whom the grievance is raised of the action to be taken, if any, the reasons and the right to appeal. Once the Case Handler makes a decision on the matter, the person(s) concerned will be informed in writing, normally within 10 working days.

1.5.5 Stage 5 – Appeals

- a) If the person who raised the grievance or the person against whom the grievance is raised is dissatisfied with the decision because he/she believes that the procedures have not been followed properly or that the decision reached by the Case Handler was one which no reasonable person could have reached, then he/she may appeal in writing within 10 working days of the date of receipt of the written decision as follows:
 - If the Case Handler was a committee of all of the Executive Directors, to the Audit Committee;
 - If the Case Handler was the Audit Committee, to the Commission Board except that where the grievance has been raised about a member of the Commission, that person will recuse himself/herself.
- b) Appeals may be submitted directly or via the Commission Secretary or the Chief Counsel.

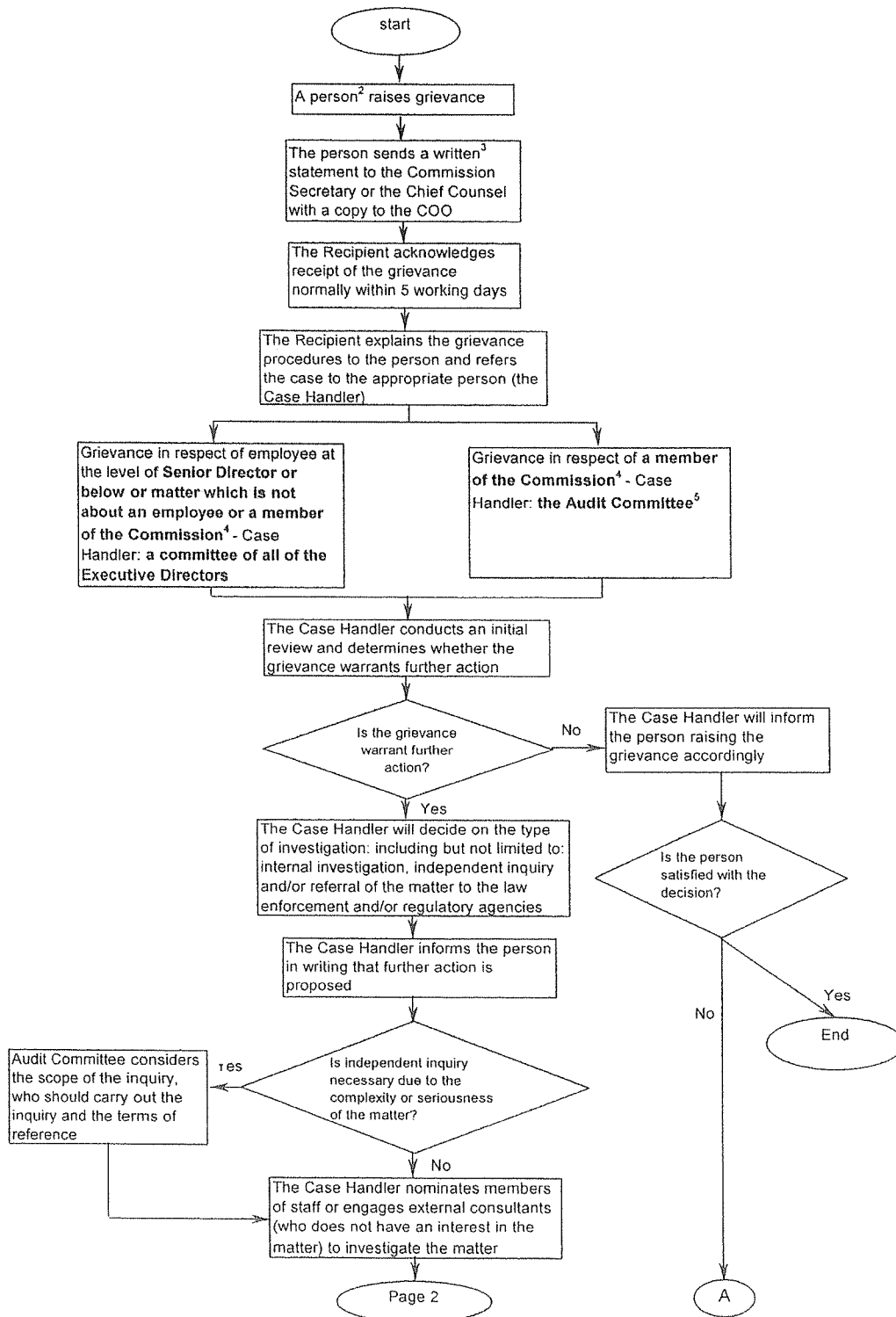
- c) Decisions made at the appeals stage shall be final.
- d) The person(s) concerned will be informed in writing of the decision with a copy to the COO.

1.5.6 Stage 6 – Reporting

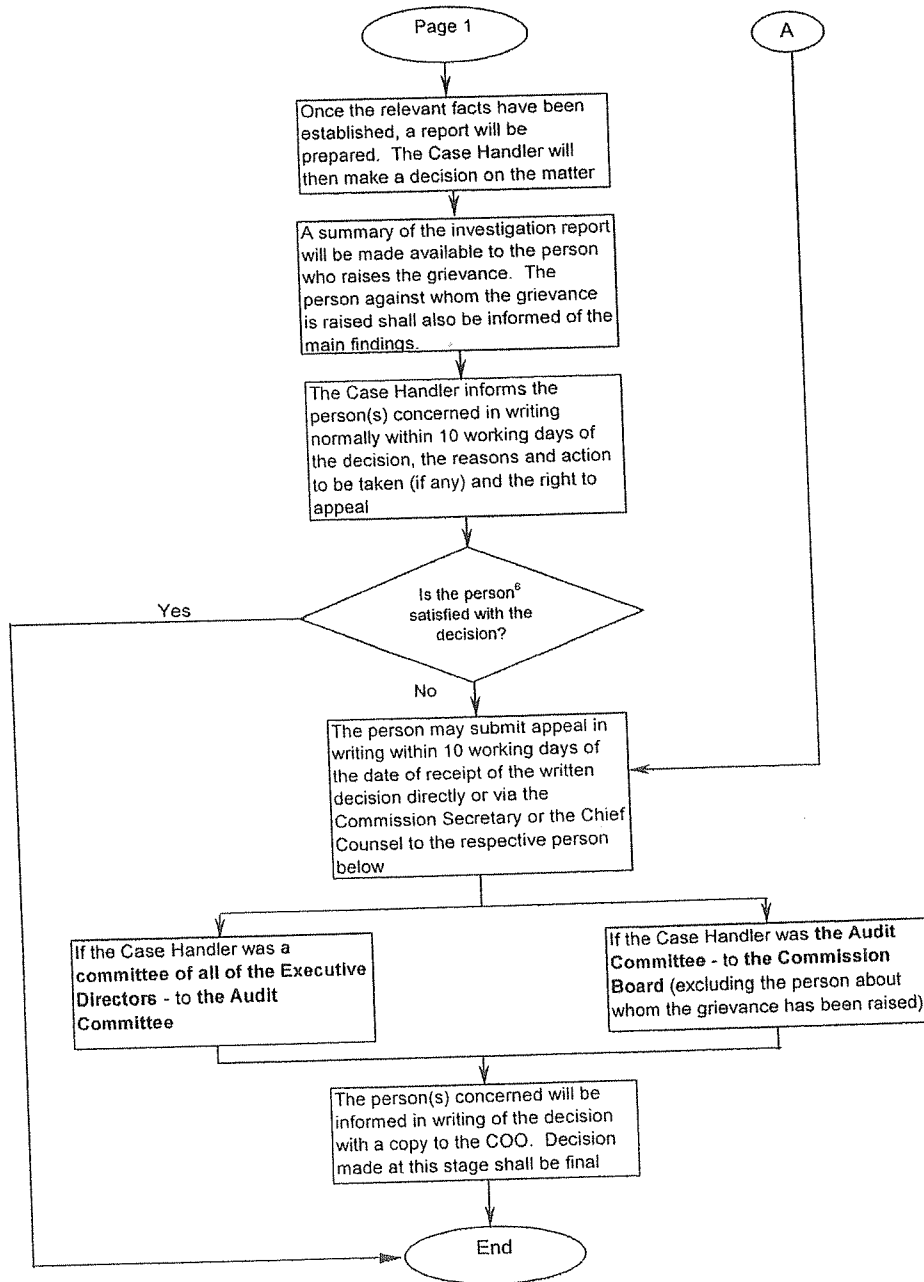
A quarterly report will be made to the Audit Committee providing information on any grievances raised and any decisions taken in respect of them under this part of the Grievance Procedures. Any matter requiring immediate attention will be brought to the Audit Committee by the Case Handler as soon as possible.

The flow chart illustrating the procedures is at Annex for reference.

Grievance Procedures (Public Interest)¹



Grievance Procedures (Public Interest)¹



Remarks:

- ¹ Grievances might include 1. Criminal activity, such as accepting a bribe; 2. Financial or administrative malpractice; 3. Misconduct or improper behaviour; 4. Failure to comply with legal obligations such as those set out in Securities and Futures Ordinance; 5. Endangering occupational health or safety; 6. Attempts to suppress or conceal information relating to any of the above.
- ² This policy is for any person who has an employment contract with the Commission, is on secondment to the Commission, is engaged as an independent consultant by the Commission or is a contractor or supplier of services to the Commission.
- ³ If the person requires assistance to prepare a written statement, he/she can approach the Commission Secretary or the Chief Counsel in the first instance for advice.
- ⁴ Member of the Commission includes any executive director (including the Chief Executive Officer) and any non-executive director of the Commission.
- ⁵ Excludes any Non-Executive Director about whom the grievance has been raised, if applicable.
- ⁶ Either the person who raised the grievance or the person against whom the grievance is raised.