

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

**Annual Report**  
**to the Financial Secretary**  
**for 2009-10**

**September 2010**



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## **Chapter 1      General Information**

### **Background and purpose of the Process Review Panel for the Securities and Futures Commission**

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

1.2            Since its inception, SFC has been subjected to various checks and balances designed to ensure fairness and observance of due process. These include statutory rights of appeal against the decisions of SFC, judicial review, and scrutiny by The Ombudsman and the Independent Commission Against Corruption.

1.3            In the course of reforming the regulatory regime for the securities and futures markets in 1999, there were comments that the checks and balances set out in paragraph 1.2 above might only be applicable to specific cases. The Administration, in consultation with SFC, concluded that it would be preferable to improve the transparency of SFC’s internal processes across the board, so that the public would be better able to see for themselves that SFC did act fairly and consistently in exercising its powers.

1.4            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 SFC can divulge information to the public regarding what it has or has not done when performing its regulatory functions.

1.5            In order to enhance the transparency and public accountability of SFC, without compromising its confidentiality, the Administration saw merit in establishing an independent body to review the fairness and reasonableness of SFC’s operational procedures on an on-going basis, to monitor whether its procedures are consistently followed and to make recommendations to SFC in relation to these objectives.

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

### **Terms of reference**

1.7 PRP is tasked to review and advise SFC on the adequacy of SFC's internal procedures and operational guidelines governing the actions taken and operational decisions made by 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.

1.8 To carry out its work, PRP receives and considers periodic reports from SFC in respect of the completed or discontinued cases, including complaints against SFC or its staff. In addition, PRP may call for, and review, SFC's files to verify that the actions taken and decisions made in relation to any specific case or complaint are consistent with the relevant internal procedures and operational guidelines.

1.9 PRP is required to submit its reports to the Financial Secretary ("FS") annually or otherwise on a need basis. FS may cause these reports to be published as far as permitted under the law.

1.10 The terms of reference of PRP, as approved by CE, are at **Annex A**.

### **Constitution of PRP and its Working Groups**

1.11 PRP comprises eleven members, including eight members from the financial sector, academia and the legal and accountancy professions, a Legislative Councillor and two ex officio members including the Chairman of SFC and the representative of the Secretary for Justice.

1.12 To facilitate execution of its roles and functions, PRP has set up two working groups. The Working Group on Licensing, Intermediaries Supervision and Investment Products focuses on cases involving application for registration, approval of investment products and inspection of intermediaries. The Working Group on Corporate Finance and Enforcement focuses on cases concerning investigation and disciplinary action, takeovers and mergers transactions and prospectus-related matters.

1.13 The membership of PRP and its two Working Groups is at **Annex B**.

## **Chapter 2          Work of PRP in 2009-10**

### **Mode of operation**

2.1            In accordance with its terms of reference, PRP may select any completed or discontinued cases for review to examine if the actions taken and decisions made by SFC are consistent with the relevant internal procedures and operational guidelines. Cases under review cover the following areas –

- (a)    licensing of intermediaries;
- (b)    inspection of intermediaries;
- (c)    authorisation of collective investment schemes;
- (d)    handling of complaints;
- (e)    investigation and disciplinary action; and
- (f)    processing of listing applications under the Dual Filing regime.

2.2            In practice, SFC provides PRP with monthly reports on all cases completed or discontinued within the month. Members of PRP then select individual cases from these monthly reports for review with a view to examining cases of different areas and having due regard to factors including the processing time required, etc.

2.3            SFC also provides PRP with monthly reports on on-going investigation and inquiry cases that have been outstanding for more than one year. PRP may also select these cases for review upon their completion or closure.

2.4            In addition to reports from SFC, PRP gathers and receives comments from market practitioners as well as the general public on the performance of functions by SFC with a view to identifying areas for review and improvement to the procedures and processes.

## Highlights of work

### *Meetings of PRP in 2009-10*

2.5 PRP members conducted two rounds of review in 2009-10<sup>1</sup> and held a total of 12 meetings with SFC's case officers on the 55 cases selected. In addition to seeking clarifications on selected cases at the review meetings, members also conducted file reviews as and when necessary to assess if SFC had complied with the standard procedures laid down in the operational manuals. Furthermore, members had taken the opportunity to review the adequacy of the manuals from the perspective of fairness and reasonableness.

2.6 Besides case review meetings, the full PRP had met to consider reports from members on the case reviews, set out observations and recommendations, and discussed specific issues relating to SFC's internal procedures. The distribution of the 55 cases reviewed in 2009-10 are summarised below—

	No. of Cases
Licensing	7
Intermediaries supervision ( <i>inspections</i> )	7
Investment products	8
Complaints	9
Enforcement	23
Corporate finance ( <i>processing of listing applications under the Dual Filing regime</i> )	1
<b>Total</b>	<b>55</b>

### *Meeting with securities industry associations*

2.7 In December 2009, PRP held an informal meeting with representatives from the securities industry associations to exchange views on the work of PRP and possible areas for review by PRP.

<sup>1</sup> The first round of review was conducted between May 2009 and February 2010, and the second round between November 2009 and July 2010.

## **Chapter 3            Observations and recommendations on review of individual cases**

### **Overview**

3.1            From the 55 cases reviewed in 2009-10, PRP concluded that SFC had generally followed its internal procedures and complied with operational guidelines in handling those cases. There were however several areas where PRP had made observations and recommendations to SFC for enhancement of procedures or guidelines. PRP noted that SFC had responded positively to these observations and recommendations through explaining in detail their prevailing arrangements and putting in place improvement measures where appropriate. The observations and recommendations made by PRP are summarised below. Details of SFC's responses made to PRP are at **Annex C**.

#### **(A)    Licensing of intermediaries**

3.2            PRP reviewed seven cases on licensing of intermediaries. PRP was satisfied that SFC had generally followed the standard procedures in processing those cases. The relatively long processing time taken in most cases was mainly attributable to the incomplete information provided by the applicants, and in some cases, the need to obtain compliance history or an assessment of the applicant from other regulators.

#### ***Processing of applications jointly with the Hong Kong Monetary Authority***

3.3            Under the Securities and Futures Ordinance ("SFO"), an authorised financial institution is required to register with SFC for conducting regulated activities as a registered institution ("RI"). SFO further requires that an RI must have at least two executive officers ("EOs") who have been registered with the Hong Kong Monetary Authority ("HKMA") under the Banking Ordinance. According to the Memorandum of Understanding ("MOU") between SFC and HKMA, SFC would consider an application for registration as an RI in consultation with HKMA who is the frontline regulator of such institutions.

3.4 In one case, an application for registration as an RI to carry out Type 1 regulated activity (dealing in securities) remained outstanding for nearly one year. PRP noted that upon receipt of the application, SFC conducted an initial screening and referred the application to HKMA. HKMA reviewed a parallel application for registration of three EOs and noted that they did not meet the competence requirements. HKMA followed up with the applicant on the nomination of EOs and its management oversight in the subsequent months. Following the global financial crisis, the applicant eventually withdrew its application and the case was thus closed.

3.5 PRP noted that the application had been with HKMA for a substantial period of time. A similar situation was observed in November 2007<sup>2</sup>. PRP suggested SFC consider exploring with HKMA possible ways to shorten the overall processing time and inviting HKMA to consider drawing up performance pledges. HKMA advised that this was an exceptional case with the interwoven restructuring proposal concurrently pursued by the applicant during the onset of global financial crisis. In general, HKMA would advise SFC on the fitness and properness of the RI applicant within ten weeks upon receipt of adequate supporting documents. HKMA assured that they would continue to process the applications in an efficient manner.

3.6 As mentioned in paragraph 3.3 above, SFC and HKMA are respectively responsible for the registration of RIs and EOs. An applicant is therefore required to submit separate applications to the two regulators. PRP suggested SFC consider providing a one-stop service. SFC advised that under the current regime, HKMA is the frontline regulator of authorised financial institutions carrying out regulated activities. Since the appointment of EOs, in particular, is governed by the Banking Ordinance, it would make sense for any such appointment to be directed to HKMA. The MOU entered between SFC and HKMA has already set out clearly the referral and consultation procedures regarding applications for registration as RIs. HKMA shared the view that applicants are clear about the current arrangements.

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<sup>2</sup> Arising from the case, SFC advised that HKMA had started in April 2008 a new practice of updating SFC on the status of outstanding cases quarterly. For details, please see para. 3.5 and Item (3) in Annex C of PRP Annual Report for 2007.

### *Applications with incomplete information*

3.7 PRP noted that in another case, an application from an investment services company for a licence to conduct online fund marketing and distribution business had taken more than one year to complete. PRP made an observation in May 2007<sup>3</sup> of possible abuse of the application system by applicants who failed to provide complete information. PRP noted that SFC had since introduced enhancement measures to prevent possible abuse, e.g. by issuing reminder letters carrying a warning that an application could be refused after an unduly long period of non-response from the applicants.

3.8 In this case, SFC explained that the processing time was relatively long because the company's online platform had remained outstanding. SFC added that incomplete applications would normally be returned to the applicant but it had not done so in this case because the significance and unusual complexity of the platform was not unveiled in the business plan of the applicant in the first instance.

### **(B) Inspection of intermediaries**

3.9 PRP reviewed seven cases on inspection of intermediaries. PRP noted that SFC had generally followed the standard procedures in processing those cases. The relatively long processing time in some cases was attributable to the slow response of firms in providing the required documents.

### **(C) Authorisation of collective investment schemes**

3.10 PRP reviewed eight cases on authorisation of collective investment schemes and noted that SFC had generally followed the standard procedures in processing these cases.

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<sup>3</sup> For details, please see para. 3.3 to 3.4 and Item (1) and Item (2) in Annex C of PRP Annual Report for 2007.

### ***“Fast track” arrangements for authorisation of products***

3.11 PRP noted that two applications for authorisation of equity-linked deposit schemes (“ELDs”)<sup>4</sup>, which have features similar to the products that have been authorised, had been processed relatively quickly. SFC explained that it required less time to examine such applications because offering documents of these products were largely modelled on the previously authorised products. PRP enquired whether any “fast track” arrangement existed in dealing with these applications and if so, the criteria.

3.12 SFC confirmed that there is no “fast track” arrangement, and the same set of procedures is applicable to applications for authorisation of investment product. The actual processing time of each application would, however, vary depending on factors like completeness of information provided, response time of applicants and the structure of products, etc. In practice, the actual processing time could be reduced if the product concerned is substantially similar to those recently authorised by SFC.

### ***Disclosure of past disciplinary records in offering documents***

3.13 In an application for authorisation of a collective investment scheme, the applicant disclosed that its parent company had been subjected to disciplinary action by an overseas regulator. SFC noted that the said disciplinary action involved a minor non-compliance matter, and conducted an inspection on the applicant. Noting no adverse findings save for a few internal control issues, which were later rectified, SFC approved the application.

3.14 PRP considered that past disciplinary action is a relevant indicator of the compliance level of an applicant, and invited SFC to consider whether such information should be required to be disclosed in the offering documents to help investors make informed decisions. After review, SFC commented that compliance record is only one of the factors for consideration in processing an application. Having regard to the nature and timing of the breach, severity of the sanctions, etc., it is the duty of the

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<sup>4</sup> An equity-linked deposit is a structured product embedded with equity derivatives issued by an authorised financial institution.

applicant to consider making an appropriate disclosure. SFC would take appropriate regulatory action if the applicant fails to do so.

#### **(D) Handling of complaints**

3.15 PRP reviewed nine complaint cases and concluded that SFC had generally followed the standard procedures in handling these cases.

##### ***Handling of request for access to telephone records and the public's awareness of the secrecy provision governing SFC's disclosure of information***

3.16 In one case, a complainant requested for recordings of his telephone conversation with SFC staff. SFC refused his request on the ground that such recordings were audit trails for internal use only. The complainant then lodged a complaint with the Ombudsman who accepted SFC's explanation and closed the case.

3.17 Noting that there were no written guidelines on the handling of requests for telephone recordings, PRP suggested SFC draw up such guidelines for staff. SFC replied that it is an established policy that telephone recordings are for internal use only. After the incident, SFC had briefed its staff on the handling of such requests and set out the policy in the internal "Procedural Manual on Handling Public Enquiries and Complaints".

3.18 Arising from this case, PRP also observed that the public might not be fully aware of the statutory secrecy obligation which limits the extent to which SFC could divulge information to the public. PRP suggested SFC consider strengthening its publicity in this regard.

3.19 SFC explained that it would inform the complainants about SFC's statutory secrecy obligation in its responses. Furthermore, to clarify the application of the law, it had publicised SFC's role, powers and procedures in handling complaints through its pamphlet on "How to make a complaint". SFC also uploaded a set of "Frequently Asked Questions" on the secrecy provisions on its website. In addition, a new section had been

added to its online complaint forms in November 2009 about SFC's restriction in the disclosure of information.

### *Avenues for staff opinion and grievance*

3.20 PRP noted that SFC had received an anonymous complaint from a group of staff alleging about an internal staff management issue. While PRP made no specific comment on the handling of the complaint by SFC, it suggested SFC consider additional avenues for staff to voice their opinions on or grievances about their work or workplace. SFC agreed to take PRP's observation into account when it reviewed its relevant procedures. PRP subsequently noted that in addition to regular staff sharing sessions, SFC had introduced an intranet channel "Your Voice" which provides a further means for staff to share their views and suggestions on work-related issues<sup>5</sup>.

### **(E) Investigation and disciplinary action**

3.21 In 2009-10, PRP reviewed 23 enforcement cases relating to prosecution, fining, revocation or suspension of licence, disqualification order on directorship of listed companies, issuance of compliance advice letter and settlement of disciplinary action. PRP noted that SFC had generally followed the prescribed procedures in handling these cases.

### *Consistency in the level of punishment*

3.22 PRP reviewed two cases involving suspension of licences. While it appeared that one case which involved forgery and deception was more serious than the other one, the length of suspension in both cases ended up the same. In the first case, SFC proposed banning an account executive from entering the industry for life<sup>6</sup> for concealing his trading in his relatives' accounts and forging the signatures on account opening documents. He appealed to the Securities and Futures Appeals Tribunal ("SFAT"). SFC eventually reduced the prohibition period to 18 months.

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<sup>5</sup> Source: SFC 2009-10 Annual Report

<sup>6</sup> The account executive was also alleged to have engaged in market manipulation and short-selling.

3.23 In the second case, an account executive and his client placed suspicious orders near market close which could have the effect of raising or stabilising the closing price of a thinly-traded stock. SFC considered it appropriate to impose an 18-month suspension on the account executive's licence in the circumstances.

3.24 Noting that possible inconsistency in the level of punishment could be an argument used to challenge SFC's decisions, PRP enquired whether SFC had any guidelines on setting the level of punishment, and suggested SFC consider establishing a sanction framework on the reference standard of penalties for different types of misconduct.

3.25 SFC replied that the two cases are not strictly comparable. In the first case, SFC reduced the proposed penalty from a life ban to a prohibition period of 18 months primarily because there were new findings which mitigated the seriousness of the misconduct of the account executive concerned. SFC further explained that in deciding the level of punishment to be imposed, it would consider the individual circumstances of the particular case and make reference to past decisions on similar misconduct. As each case has to be considered on its own merits, it would not be appropriate to have a rigid framework setting out 'standard' penalties for different types of misconduct. The current practice enables SFC to exercise flexibility in response to changes in market practices and in considering relevant factors in individual cases.

3.26 As for financial penalties, which SFC regards as a more severe type of sanction than a reprimand, SFC would make reference to the "SFC Disciplinary Fining Guidelines" gazetted under section 199 of SFO when making a decision. These guidelines set out general and specific considerations that SFC should take into account in imposing financial penalties. Among them include the nature and consequences of the conduct and likely effect of a fine, etc. The guidelines also require SFC to make reference to past action taken by SFC in similar cases, adopting a guiding principle that similar cases should be treated consistently.

### ***Sanction through “probationary suspension”***

3.27 In assessing an application for listing on the Growth Enterprise Market, SFC raised concerns about the completeness and accuracy of statements in the draft prospectus prepared by the sponsor. The application was eventually rejected by the Hong Kong Exchanges and Clearing Limited (“HKEx”). SFC followed up and found that the sponsor had not properly conducted its due diligence work, resulting in inaccurate and/or misleading information in the application. In addition to suspending the licences of and/or fining the persons concerned, SFC reached an agreement with the sponsor that the firm’s licence would be suspended if it committed similar misconduct within a specified period.

3.28 PRP noted that “probationary suspension” is a relatively new sanction approach adopted by SFC. Through the prospect of a tougher sentence against recurrence of misconduct within the specified period, the new approach aims at encouraging better compliance and forestalling recurrence in a forward looking manner.

3.29 Since “probationary suspension” appears to be a less severe sanction, PRP considered that intermediaries might seek to avoid an immediate enforcement action through “probationary suspension”, and suggested SFC consider laying guidelines to ensure consistency in application.

3.30 SFC elaborated that under this new approach, SFC would suspend or postpone the imposition of formal disciplinary sanctions unless there is a repeated occurrence of the misconduct, and the intermediary concerned would be subject to an independent review of its activities without any prior notice. Probationary suspensions are available, in SFC’s discretion, usually in cases where the firm demonstrates an awareness of SFC’s concerns and cooperates with SFC. A probationary suspension is often accompanied by a fine to send a deterrent message, and there is still a potential for suspension. It is not the case that someone can escape censure more easily for serious misconduct.

3.31 PRP invited SFC to clearly document the rationale in applying this new approach to specific cases and to ensure consistency. Since each

case turns on its own facts, SFC considered it inappropriate to prescribe detailed criteria in the application of disciplinary sanctions, including the “probationary suspension”. The rationale of the new approach has also been explained in press releases for individual cases as well as subsequent issues of the “Enforcement Reporter”.

### ***Regulation of market commentaries made through the mass media***

3.32 In a case under review, a financial columnist and his associates were suspected to have accumulated some stocks and sold them at a profit after publishing favourable articles on the relevant stocks. However, expert and legal advice indicated that the articles did not contain false or misleading information and the persons concerned had not conducted any irregular trading activities. Furthermore, there was insufficient evidence to prove that the articles led to unusual increases in the share prices. SFC concluded that there were insufficient grounds to initiate prosecution or other proceedings, and decided not to take further action.

3.33 PRP noted that SFC had reached the above conclusion after reviewing the evidence in the light of relevant laws, rules and regulations. PRP suggested SFC consider issuing compliance advice letters in appropriate cases for sending a clear message to forestall any irregular behaviour. SFC explained that taking all circumstances into account, the issue of compliance advice letter was not warranted in this case. SFC assured PRP that it would issue compliance advice letters to address areas of regulatory concern and to raise standards of conduct and compliance in appropriate cases.

### ***Educational messages on enforcement actions***

3.34 A securities company provided facilitation service which aimed at reducing execution time by trading directly with its clients on a principal basis rather than on an agency basis. During the investigation, SFC discovered that the company had not kept proper records of client order instructions to explain whether the allocation prices were fair and reasonable. SFC publicly reprimanded and fined the company for not being able to identify and resolve potential conflicts of interest and internal control deficiencies.

3.35 PRP considered that enforcement and education are equally important and it would be useful to review completed enforcement cases so as to identify the lessons learned and share the educational message with the industry. SFC agreed and explained that following enforcement action, it would typically publish a press release on the background, action taken and significance of the case, and educational messages would be included in the press releases as appropriate. In addition, enforcement cases (and wider enforcement issues) are addressed in SFC's periodic publications including the "Enforcement Reporter" and the "Annual Report".

#### **(F) Processing of listing applications under the Dual Filing regime**

3.36 The Securities and Futures (Stock Market Listing) Rules ("the Rules") require a corporation applying for listing of its securities to file copies of the application with SFC after the same is submitted to a recognised exchange company. To facilitate compliance and minimise any additional cost to a listing applicant, the Rules enable the applicant to fulfil this obligation by authorising the exchange company to file the material with SFC on its behalf. This arrangement is known as "Dual Filing".

3.37 PRP reviewed one case relating to the processing of listing applications under the Dual Filing regime. PRP noted that in the case, SFC had provided its comments to HKEx within the statutory timeframe and followed the established procedures in processing the case. PRP also noted that SFC had engaged lawyers outside Hong Kong on regulatory issues in a foreign jurisdiction. In this regard, SFC explained that there are well established internal guidelines on the engagement of lawyers, including those outside Hong Kong.

## **Chapter 4      Observations on specific areas**

4.1            In the course of reviewing individual cases, PRP would also bring up specific areas of SFC's procedures for examination. The aim is to identify areas for improvement with a view to enhancing compliance processes and maintaining the quality and integrity of regulation. In 2009-10, PRP identified individual issues for examination through case reviews, and furnished SFC with its observations and comments. PRP's deliberations and considerations are summarised below. Details of SFC's response are at **Annex C**.

### **(A) Decision making process of enforcement actions**

4.2            In 2008-09, PRP reviewed a couple of enforcement cases in relation to the handling of suspected market misconduct cases and SFC's decision to take no further action in certain cases. SFC advised that enforcement cases were monitored closely by its Enforcement Division, which would take into account a number of factors in reaching a decision on the appropriate action to follow up in a specific case, including the nature of the breach, loss to investors and sufficiency of evidence. In 2009-10, PRP continued to review the processes of SFC in deciding how a case should be taken forward.

4.3            In one case, at about the time when a company issued false or misleading announcements concerning a business deal, the Chairman (also the controlling shareholder) of the company had offloaded nearly half of the issued shares. Other staff were found to have sold their shares pursuant to inside information about the poor interim results. After obtaining internal legal advice, SFC referred the case to FS to institute an inquiry by the Market Misconduct Tribunal ("MMT"). MMT inquired into the case, concluded that some specified persons had engaged in market misconduct and made various orders, including disqualifying some of these persons from being directors and disgorging the profits made.

4.4            PRP noted that under SFO, there are dual routes to deal with market misconduct, i.e. under Part XIV thereof where SFC may report its investigation findings to the Department of Justice ("DoJ") to consider

4.5 SFC advised that it has established referral arrangements with DoJ in dealing with these cases. Where there are good grounds to believe the evidence gathered by SFC is sufficient to establish each of the elements of the contravention to the criminal standard of proof, i.e. beyond reasonable doubt, the practice of SFC is to prosecute the contravention as a criminal offence. SFC follows the published policy of DoJ (The Statement of Prosecution Policy and Practice, Code for Prosecutors, 2009) which sets out the Government's policy and practice in criminal prosecutions.

4.6 In determining whether there is sufficient evidence to prosecute, SFC consults with DoJ about whether the prosecution should be conducted by SFC in the Magistrates Court as a summary matter or whether it should be transferred to the District Court or the High Court, as an indictable prosecution, to be conducted by DoJ.

4.7 If the evidence is insufficient to establish each element of the contravention beyond reasonable doubt but there is sufficient evidence to establish the case on the balance of probabilities (the civil standard of proof), SFC will consider whether to initiate a civil case under SFO in relation to the contravention. The range of options includes proceedings before MMT and proceedings under sections 213 or 214 of SFO, if applicable. PRP noted this ensures that there is a consistent approach in decisions about SFC's enforcement action.

## **(B) Regulation of comments on market performance**

4.8 As a related issue to the case mentioned in para. 3.32 and 3.33, PRP noted that licensed persons making comments on a specific stock would have to disclose whether they have any interest in that stock but persons making forecasts on stock indices are not required to disclose whether they have any interest in any stock or index futures. In addition, institutions conducting stock analysis or publishing price estimates might at the same time trade related stocks. These would give rise to concerns on

possible conflict of interest. PRP enquired whether SFC regulates comments/advice on market/stock performance made by analysts through the media and the relevant rules and guidelines.

4.9 SFC explained that in general, a person is not allowed to provide any investment advice to his client on disposing or acquiring securities unless he is licensed or registered to carry on such a regulated activity. A licensed or registered person is required to comply with the relevant regulatory requirements including the Code of Conduct for Persons Licensed by or Registered with SFC (“the Code of Conduct”), which addresses possible conflicts of interest and helps avoiding, minimising and managing such conflicts. The Code of Conduct also seeks to strike a balance between protecting investors’ interests and facilitating legitimate free flow of market information. It also sets out various requirements for an analyst who prepares and/or publishes investment research findings.

4.10 SFC further elaborated that the Code of Conduct stipulates specific disclosure requirements for analysts including disclosure of his or his associate’s financial interest in specific securities. While the act of giving general market comments may not constitute a regulated activity, an analyst is still required to observe the general principles set out in the Code of Conduct, including those on honesty and avoidance of conflicts of interest. With regard to the conduct of other persons who are not SFC’s licensees, SFC advised that their conduct is subject to regulation by the provisions relating to market misconduct under SFO<sup>7</sup>.

4.11 PRP noted that SFC’s Code of Conduct addresses the issue of possible conflicts of interest of analysts who are licensed by SFC, and took note of the provisions under SFO to deal with misconduct of unlicensed persons. In view of the possible influence that media commentaries would have on the public as potential investors, PRP invited SFC to consider stepping up its investor education efforts in this respect. SFC responded that it has carried out on-going investor education work with respect to

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<sup>7</sup> Sections 298 and 300 of SFO respectively provides that disclosure of false or misleading information to induce transactions, and employment of fraudulent or deceptive devices in securities or futures contract transactions are criminal offences. Section 277 provides for civil liability in respect of disclosure of false or misleading information to induce transactions. Section 279 requires every officer of a corporation to take all reasonable measures to ensure that proper safeguards exist to prevent the corporation from perpetrating market misconduct.

analysts' conflicts of interests and is happy to continue its efforts in this area.

### **(C) Meeting with securities industry associations**

4.12 To gauge the views of the market on the work of PRP, an informal meeting between PRP and representatives of securities industry associations was held in December 2009. PRP considered that the informal meeting provided a good opportunity for the exchange of views on the work of PRP in reviewing SFC's operation in various aspects, including licensing, authorisation of collective investment schemes, inspection of intermediaries and enforcement action.

4.13 PRP took note of the comments raised by representatives of the industry associations and would consider selecting cases in the relevant areas for future reviews. Issues that are not directly related to the work of PRP have been relayed to SFC. PRP noted that SFC has regular contacts with the securities industry associations for exchange of views on relevant issues. PRP would also maintain regular dialogue with the industry associations.



## **Chapter 6      Acknowledgement**

6.1            PRP would like to express its gratitude to SFC and its staff for their assistance in facilitating the review work, and their co-operation in responding to PRP's enquiries and recommendations in the past year.



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

**Terms of reference**

1. To review and advise the Commission upon the adequacy of the Commission's internal procedures and operational guidelines governing the actions taken and operational decisions made by the Commission and its staff in the performance of the Commission's regulatory functions in relation to the following areas -
  - (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 actions taken and decisions made in relation to that case or complaint adhered to and are consistent with the relevant internal procedures and operational guidelines and to advise the Commission accordingly.
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.

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

Chairman: Mr CHOW Wing Kin, Anthony, SBS, JP

Members: Prof CHAN Yuk Shee, BBS, JP

Mr CHIU Chi Cheong, Clifton

Mr FUNG Hau Chung, Andrew

Dr KAM Pok Man (*up to 30 March 2010*)

Mr LEE Jor Hung, Dannis, BBS

Dr the Honourable LEUNG Mei Fun, Priscilla

Mr LIU Che Ning

Mr SUN Tak Kei, David, BBS, JP

Ex officio members: Chairman, Securities and Futures Commission  
(Dr FONG Ching, Eddy, GBS, JP)

Representative of Secretary for Justice  
(Mr LAI Ying Sie, Benedict, JP)

## **Membership of Working Groups**

### **Working Group on Corporate Finance and Enforcement**

Chairman: Prof CHAN Yuk Shee, BBS, JP

Members: Mr CHOW Wing Kin, Anthony, SBS, JP

Dr FONG Ching, Eddy, GBS, JP

Mr LEE Jor Hung, Dannis, BBS

Mr LIU Che Ning

### **Working Group on Licensing, Intermediaries Supervision and Investment Products**

Chairman: Dr KAM Pok Man (*up to 30 March 2010*)

Members: Mr CHIU Chi Cheong, Clifton

Mr FUNG Hau Chung, Andrew

Mr LAI Ying Sie, Benedict, JP

Dr the Honourable LEUNG Mei Fun, Priscilla

Mr SUN Tak Kei, David, BBS, JP

## Securities and Futures Commission's responses<sup>1</sup> to PRP's observations and recommendations

### (A) Licensing of intermediaries

Items (1) and (2)
<p><u>Case findings</u></p> <p>An application for registration as an RI to carry out Type 1 regulated activity (dealing in securities) remained outstanding for nearly one year. PRP noted that upon receipt of the application, SFC conducted an initial screening and referred the application to HKMA. HKMA reviewed a parallel application for registration of three EOs and noted that they did not meet the competence requirements. HKMA followed up with the applicant on the nomination of EOs and its management oversight in the subsequent months. The applicant withdrew its application due to the onset of the global financial crisis and the case was closed.</p>
<p><u>PRP's recommendation/observation</u></p> <p>PRP suggested SFC consider exploring with HKMA possible ways to shorten the overall processing time and inviting HKMA to consider drawing up performance pledges (para. 3.5 of Chapter 3).</p>
<p><u>SFC's response</u></p> <p>SFC noted PRP's comments and would pass those comments to HKMA for its consideration.</p>
<p><u>HKMA's response</u></p> <p>Upon receipt of the Registered Institution ("RI") application of a bank referred by SFC in December 2007, HKMA conducted a review of the application and noted that none of its three proposed EOs was fully able to meet the applicable competence requirements and therefore its management oversight was somewhat insufficient. The bank was at that time heavily involved in preparatory work for the proposed merger between the bank and another bank, and thus was unable to spare resources to resolve the outstanding matters relating to its RI application. HKMA expected the bank to resolve the outstanding matters upon the completion of the proposed merger. Due to the onset of the global financial crisis, however, the proposed merger took much longer to complete than originally thought. During this time, HKMA followed up on the outstanding matters with the bank from time to time. Eventually, the bank withdrew its RI application in June 2009.</p> <p>This was an exceptional case. Generally, HKMA would advise SFC on the fitness and properness of an RI applicant within 10 weeks upon receipt of adequate supporting</p>

<sup>1</sup> Editorial changes are made mainly to remove case specific information.

documents for the application. Any delay was usually due to incomplete information submitted by the applicants and failure of the applicants to provide additional information requested by HKMA on time. HKMA was unable to draw up any performance pledge as per PRP's recommendation but HKMA wished to assure that it would continue to process the relevant applications in an efficient manner and if HKMA needed to follow up on outstanding matters with applicants, it would continue to require the applicants to provide it with the requisite information within a reasonable period of time.

PRP's recommendation/observation

SFC and HKMA are respectively responsible for the registration of RIs and EOs. An applicant is therefore required to submit separate applications to the two regulators. PRP suggested that SFC consider providing a one-stop service (para. 3.6 of Chapter 3).

SFC's response

SFC stated that under the current regime, HKMA was the frontline regulator of banks carrying out regulated activities. In particular, the appointment of EOs was governed under the Banking Ordinance (s.71D) so it would make sense for any such appointment to be considered by HKMA. The Memorandum of Understanding entered between SFC and HKMA already set out clearly the referral and consultation procedures regarding applications for registration by authorised institutions.

HKMA's response

HKMA stated that given that SFC and HKMA were respectively responsible in law for the registration of RIs and EOs, it appeared logical for applicants to make separate submissions to different regulators. Furthermore, the current arrangement had been set out clearly in the relevant circulars and supervisory guidelines issued by SFC and HKMA, and it was clear to the applicants. Experience had also shown that applicants did not seem to have much problem with making separate application to SFC and HKMA. Hence, HKMA did not see a need to change the current practice by providing a one-stop service to RI/EO applications. This could result in delay as whoever received the application would have to forward it to the other regulator for processing.

**Item (3)**

Case findings

An application from an investment services company for a licence to conduct online fund marketing and distribution business had taken more than one year to complete. SFC explained that the processing time was relatively long because the company's online platform had remained outstanding. SFC added that incomplete applications would normally be returned to the applicant but it had not done so in this case because the significance and unusual complexity of the platform was not unveiled in the business plan of the applicant in the first instance.

<p><u>PRP's recommendation/observation</u></p> <p>PRP made an observation in 2007 of possible abuse of the licence application system by applicants who failed to provide complete information. PRP noted that SFC had since introduced enhancement measures to prevent possible abuse, e.g. by issuing reminder letters carrying a warning that an application could be refused after an unduly long period of non-response from the applicants (para. 3.7 of Chapter 3).</p>
<p><u>SFC's response</u></p> <p>SFC noted PRP's observation and did not have any further comments.</p>

## **(B) Authorisation of collective investment schemes**

<b>Item (4)</b>
<p><u>Case findings</u></p> <p>Two applications for authorisation of equity-linked deposit schemes (“ELDs”), which have similar features to the products that have been authorised, had been processed relatively quickly.</p>
<p><u>PRP's recommendation/observation</u></p> <p>PRP enquired whether any “fast track” arrangement existed in dealing with these applications and if so, the criteria (para. 3.11 of Chapter 3).</p>
<p><u>SFC's response</u></p> <p>SFC replied that the applications for authorisation of the documents of ELDs (including the one reviewed by PRP members) had been processed in accordance with the procedures manual. The processing time of each application would depend on its circumstances, including but not limited to, structure of products, completeness of information provided to SFC and response time of applicants etc. SFC further supplemented that there was no “fast track” arrangement in respect of equity linked deposits but processing time of a new application could be reduced if it was substantially similar to those recently authorised by SFC.</p>

<b>Item (5)</b>
<p><u>Case findings</u></p> <p>In an application for authorisation of a collective investment scheme, the applicant disclosed that its parent company had been subjected to disciplinary action by an overseas regulator. SFC noted that the said disciplinary action involved a minor non-compliance matter, and conducted an inspection on the applicant. Noting no adverse findings save for a few internal control issues, which were later rectified, SFC approved the application.</p>

<p><u>PRP's recommendation/observation</u></p> <p>PRP considered that past disciplinary action is a relevant indicator of the compliance level of an applicant, and invited SFC to consider whether such information should be required to be disclosed in the offering documents to help investors make informed decisions (para. 3.14 of Chapter 3).</p>
<p><u>SFC's response</u></p> <p>SFC replied that in processing a fund application, one of the factors that SFC considered was the qualification and compliance record of the management company of the fund. In this case, the relevant disciplinary action occurred in 2005. It did not result in any public reprimand or serious penalty of the management company. Further, the overseas regulator had informed SFC that the case was considered as a relatively minor non-compliance/violation.</p> <p>SFC's view was that depending on the nature of the breach/conduct that led to the disciplinary action, the severity of the sanctions, and how long ago the action was taken, the disciplinary action might or might not be relevant information in the context of a fund and its offering document. It was the duty of the fund manager to make the assessment and to make appropriate disclosures. If SFC found that the manager had failed to do so, SFC would take appropriate regulatory action.</p>

### (C) Handling of complaints

Items (6) and (7)
<p><u>Case findings</u></p> <p>A complainant requested for recordings of his telephone conversation with SFC staff. SFC refused his request on the ground that such recordings were audit trails for internal use only. The complainant then lodged a complaint with the Ombudsman who accepted SFC's explanation and closed the case.</p>
<p><u>PRP's recommendation /observation</u></p> <p>Noting that there are no written guidelines on the handling of requests for telephone recordings, PRP suggested SFC draw up such guidelines for staff (para. 3.17 of Chapter 3).</p>
<p><u>SFC's response</u></p> <p>Immediately after the incident, SFC had conducted a briefing to all staff concerned on how to handle similar requests by complainants in future. SFC further advised that the policy on access to telephone recordings had been applied consistently since recording was first established, which was that these were for internal use only. A single and limited exception was made to this policy in this case, being a matter investigated by the Ombudsman, in order to deal pragmatically with the issue under review. The policy had now been formally documented. However, SFC could preclude a one-off exception might be granted in the future under very exceptional circumstances. Under such</p>

exceptional circumstances, the facts and circumstances leading to the complainant's request would be reviewed by the responsible director upon legal advice as necessary.

PRP's recommendation/observation

PRP also observed that the public might not be fully aware of the statutory secrecy obligation which limits the extent to which SFC could divulge information to the public. PRP suggested SFC consider strengthening its publicity in this regard (para. 3.18 of Chapter 3)

SFC's response

SFC had published a "*How to make a complaint*" leaflet in which it explained to the public their role, powers and procedures in handling complaints as well as the secrecy provision imposed by law. An electronic version of this leaflet was also available on the SFC InvestEd website. Further, in its written preliminary responses to complainants, SFC would inform complainants that it was restricted by law from disclosing details of the progress of its review or information. SFC would continue its efforts to increase the public's awareness of the legal constraints through different channels.

SFC had also published a *Frequently Asked Questions ("FAQ") on the Secrecy Provisions of the Securities and Futures Ordinance ("SFO")* to clarify the application of the secrecy provisions under SFO and to provide guidance from SFC's perspective on certain practical aspects. The FAQ explained the scope of the secrecy obligation, exceptions to it, penalties for breaching the secrecy provisions etc. The FAQ can be found on the SFC website.

In addition, those from whom SFC sought to compel information (whether by the production of documents or by answering questions at an interview) were informed in detail of the applicable secrecy provisions.

SFC had also added a new section on its on-line complaint forms about SFC's restriction on disclosure of information under the statutory secrecy provision to the public. The new complaint forms were uploaded to the SFC corporate and InvestEd websites in mid-November 2009.

**Item (8)**

Case findings

SFC received an anonymous complaint from a group of staff alleging about an internal staff management issue.

PRP's recommendation/observation

While PRP made no specific comment on the handling of the complaint by SFC, it suggested SFC consider additional avenues for staff to voice their opinions on or grievances about their work or workplace (para. 3.20 of Chapter 3).

SFC's response

SFC noted PRP's observation and would take it into account as and when SFC reviewed its relevant procedures.

**(D) Investigation and disciplinary action**

**Item (9)**

Case findings

PRP reviewed two cases involving suspension of licences. In the first case, SFC proposed banning an account executive from entering the industry for life for concealing his trading in his relatives' accounts and forging the signatures on account opening documents. He appealed to the Securities and Futures Appeals Tribunal ("SFAT"). SFC eventually reduced the prohibition period to 18 months. In the second case, an account executive and his client placed suspicious orders near market close which could have the effect of raising or stabilising the closing price of a thinly-traded stock. SFC imposed an 18-month suspension on the account executive's licence.

PRP's recommendation/observation

While it appeared that one case which involved forgery and deception was more serious than the other one, the length of suspension in both cases ended up the same. Noting that possible inconsistency in the level of punishment could be an argument used to challenge SFC's decisions, PRP enquired whether SFC had any guidelines on setting the level of punishment, and suggested SFC consider establishing a sanction framework on the reference standard of penalties for different types of misconduct (para. 3.24 of Chapter 3).

SFC's response

SFC stated that there are existing guidelines on financial penalties in relation to disciplinary cases. SFC is required to have regard to the "*SFC Disciplinary Fining Guidelines*", (gazetted under section 199 of SFO) when imposing a fine under section 194 or 196 of SFO. The guidelines set out the general and specific considerations, e.g. nature and consequences of the conduct, likely effect of a fine, that SFC will take into account. When considering whether to impose a disciplinary fine and the size of any fine, SFC will consider all the circumstances of the particular case including the past decisions involving conduct of a similar nature.

Since each case turns on its own facts, SFC does not follow a rigid framework in applying penalties for different types of misconduct. This enables SFC to retain flexibility in response to changes in market practices and to consider relevant factors in each specific case. That said, one of the (many) factors SFC would have regard to in arriving at the appropriate penalty is the penalty imposed in previous cases involving similar circumstances.

In the first case, SFC reduced the proposed penalty from a life ban to a prohibition period of 18 months primarily because the allegation of forgery could not be made out and this

impacted upon the seriousness of the conduct of the account executive concerned. The fact that SFC volunteered to reduce the proposed penalty before SFAT conducted the substantive hearing indicated that SFC is prepared to review its penalty decisions in appropriate cases.

## Item (10)

### Case findings

In assessing an application for listing on the Growth Enterprise Market, SFC raised concerns about the completeness and accuracy of statements in the draft prospectus prepared by the sponsor. The application was eventually rejected by the Hong Kong Exchanges and Clearing Limited (“HKEx”). SFC followed up and found that the sponsor had not properly conducted its due diligence work resulting in inaccurate and/or misleading information in the application. In addition to suspending the licences of and/or fining the persons concerned, SFC reached an agreement with the sponsor that the firm’s licence would be suspended if it committed similar misconduct within a specified period. SFC called it “probationary suspension”.

### PRP’s recommendation/observation

Since “probationary suspension” appears to be a less severe sanction, PRP considered that intermediaries might seek to avoid an immediate enforcement action through “probationary suspension”, and suggested SFC consider laying guidelines to ensure consistency in application (para. 3.29 of Chapter 3).

### SFC’s response

The use of a “probationary suspension” reflects a different approach to the way in which SFC will give effect to its regulatory objective of minimizing misconduct. Under this approach, SFC will suspend or postpone the imposition of formal disciplinary sanctions if the firm agrees to an independently conducted review of its activities without prior notice. The formal disciplinary sanctions are postponed unless misconduct of the same kind that led to the disciplinary proceedings can be established.

This kind of agreement is positive and forward-looking. SFC pursues this kind of option where it is appropriate and where it appears to SFC there is a real commitment to ensure past mistakes are not repeated.

The rationale for the imposition of a “probationary suspension” has been explained in subsequent issues of the Enforcement Reporter.

By way of elaboration, probationary suspensions are available in SFC’s discretion, usually in cases where the firm accepts and demonstrates an awareness of SFC’s concerns, has and will cooperate, and suspension is "on the cards" otherwise. This means the cases will be serious ones, by dint of the potential for suspension, but it is not the case that someone can escape censure more easily for serious misconduct and a probationary suspension is often accompanied by a fine to send a deterrent message.

The probationary suspension was also applied by SFC in subsequent cases. Press releases explaining the rationale for the probationary sentences being applied in each case were published. These press releases, together with the explanations provided in the Enforcement Reporters, provide sufficient guidance.

## Item (11)

### Case findings

A financial columnist and his associates were suspected to have accumulated some stocks and sold them at a profit after publishing favourable articles on the relevant stocks. However, expert and legal advice indicated that the articles did not contain false or misleading information and the persons concerned had not conducted any irregular trading activities. Furthermore, there was insufficient evidence to prove that the articles led to unusual increases in the share prices. SFC concluded that there were insufficient grounds to initiate prosecution or other proceedings, and decided not to take further action.

### PRP's recommendation/observation

PRP noted that SFC had reached the above conclusion after reviewing the evidence in the light of relevant laws, rules and regulations. PRP suggested SFC consider issuing compliance advice letters in appropriate cases for sending a clear message to forestall any irregular behaviour (para. 3.33 of Chapter 3)

### SFC's response

This case was referred to the Legal Services Department ("LSD") of SFC for advice upon completion of the investigation. LSD considered there was insufficient evidence to suggest that the publication of the articles and the trading created a false or misleading appearance in terms of trading volume, market or market price for the particular shares, hence there was insufficient evidence to initiate any prosecution or an inquiry by the Market Misconduct Tribunal ("MMT").

In appropriate cases, SFC will issue compliance advice letters to address areas of regulatory concern and to raise standards of conduct and compliance.

## Item (12)

### Case findings

A securities company provided facilitation service which aimed at reducing execution time by trading directly with its clients on a principal basis rather than on an agency basis. During the investigation, SFC discovered that the company had not kept proper records of client order instructions to explain whether the allocation prices were fair and reasonable. SFC publicly reprimanded and fined the company for not being able to identify and resolve potential conflicts of interest and internal control deficiencies.

<p><u>PRP's recommendation/observation</u></p> <p>PRP considered that enforcement and education are equally important and it would be useful to review completed enforcement cases so as to identify the lessons learned and share the educational message with the industry (para. 3.35 of Chapter 3).</p>
<p><u>SFC's response</u></p> <p>SFC stated that it did share educational messages with the industry in respect of completed enforcement cases. Following enforcement action, SFC would typically publish a press release explaining the background on the case, the action taken and the significance of the case. Educational messages would be included in the press release, as appropriate.</p> <p>In addition, enforcement cases (and wider enforcement issues) were addressed in SFC's periodic publications including the Enforcement Reporter and the Annual Report. As regards the case in question, it the case was covered in the Enforcement Reporter following issue of the press release.</p>

## **(E) Dual Filing**

<b>Item (13)</b>
<p><u>Case findings</u></p> <p>In the processing of a listing application, SFC engaged lawyers outside Hong Kong on regulatory issues in a foreign jurisdiction.</p>
<p><u>PRP's recommendation/observation</u></p> <p>PRP enquired about the guidelines in this respect (para. 3.37 of Chapter 3).</p>
<p><u>SFC's response</u></p> <p>The guidelines for the appointment of external legal advisers are to be found in an internal financial control binder. The procedures do not distinguish between appointing external legal advisers which are qualified to advise on Hong Kong law and those qualified to advise on the law of other countries. These procedures and guidelines adequately cover the engagement of lawyers outside Hong Kong.</p>

## (F) Decision making process of enforcement actions

Item (14)
<p><u>Case findings</u></p> <p>At about the time when a company issued false or misleading announcements concerning a business deal, the Chairman (also the controlling shareholder) of the company had offloaded nearly half of the issued shares. Other staff were found to have sold their shares pursuant to inside information about the poor interim results. After obtaining internal legal advice, SFC referred the case to FS to institute an inquiry by the MMT. MMT inquired into the case, concluded that some specified persons had engaged in market misconduct and made various orders, including disqualifying some of these persons from being directors and disgorging the profits made.</p>
<p><u>PRP's recommendation/observation</u></p> <p>PRP noted that under SFO, there are dual routes to deal with market misconduct, i.e. the criminal prosecution route under Part XIV; or the MMT inquiry route under Part XIII. Given the heavier penalty and stronger deterrent effect, PRP considered that criminal prosecution route should be pursued in cases where there is sufficient evidence (para. 4.4 of Chapter 4)</p>
<p><u>SFC's response</u></p> <p>Where there are good grounds to believe the evidence gathered by SFC is sufficient to establish each of the elements of the contravention to the criminal standard of proof i.e. beyond reasonable doubt, the practice of SFC is to prosecute the contravention as a criminal offence, provided there is no countervailing public policy reason against prosecution. SFC follows the published policy of the Department of Justice (The Statement of Prosecution Policy and Practice, Code for Prosecutors, 2009) which sets out the Government's approach to criminal prosecutions and the public policy issues that are relevant to prosecution decisions. SFC has followed this guidance for many years.</p> <p>In determining whether there is sufficient evidence to prosecute, SFC consults with the Department of Justice about whether the prosecution should be conducted by SFC in the Magistrates Court as a summary matter or whether it should be transferred to the District Court or the High Court, as an indictable prosecution, to be conducted by the Department of Justice, on behalf of the Hong Kong Special Administrative Region.</p> <p>If the evidence is insufficient to establish each element of the contravention beyond reasonable doubt but there is sufficient evidence to establish the case on the balance of probabilities (the civil standard of proof), SFC will consider whether to initiate a civil case under SFO in relation to the contravention. The range of options includes proceedings before MMT and proceedings under sections 213 or 214 of SFO, if applicable. This approach ensures there is a consistent approach in decisions about SFC's enforcement action.</p>

## (G) Regulation of comments on market performance

### Item (15)

#### PRP's recommendation/observation

PRP noted that licensed persons making comments on a specific stock would have to disclose whether they had any interest in that stock but persons making forecasts on stock indices were not required to disclose whether they had any interest in any stock or index futures. In addition, there could be concerns on conflict of interest when institutions conduct stock analysis or publish price estimates and at the same time trade such stocks. PRP enquired whether SFC regulates comments/advice on market/stock performance made by commentators through the media and the relevant rules and guidelines (para. 4.8 of Chapter 4).

#### SFC's response

In general, a person is not allowed to provide any investment advice on disposing or acquiring securities unless he is a person licensed by or registered with SFC. Such person is required to comply with the relevant regulatory requirements including the Code of Conduct for Persons Licensed by or Registered with SFC ("the Code of Conduct").

Para. 16 of the Code of Conduct came into effect in 2005. It addresses analysts' conflicts of interest and aims to remove, reduce and manage them. It also seeks to strike a balance between protecting investors' interests and facilitating flow of legitimate market information. Para. 16 set out various requirements for an analyst who prepares and/or publishes investment research on securities that are listed in Hong Kong. If an analyst makes commentaries or recommendations on specific securities in the mass media in his personal capacity, he is required to comply with specific disclosure requirements including disclosure of the fact that he and/or his associate have a financial interest in the specific securities (such as investment in the securities in respect of a listed corporation, or financial accommodation arrangement between the listed corporation and the firm or analyst, but it does not include commercial lending conducted at arm's length, or investments in any collective investment scheme notwithstanding the fact that the scheme has investments in securities in respect of a listed corporation).

When a person licensed by or registered with SFC only gives views on general market performance rather than commenting and/or making recommendations on any specific securities, he might not be required to comply with the disclosure requirements under the Code of Conduct since such act of giving general market comments may not constitute a regulated activity as such. Nevertheless, as a person licensed by or registered with SFC, he is still required to observe the general principles set out in the Code of Conduct including those on honesty and conflicts of interest at all times.

The Code of Conduct only applies to persons licensed by or registered with SFC. Persons who are not licensed by or registered with SFC and who publish research or recommendations in the media do not fall within SFC's licensing regime if they do not conduct regulated activities. Although these commentators are not licensed and are therefore not governed by the Code of Conduct, they are still subject to other provisions of SFO relating to market misconduct, such as the following:

- Section 298 and 300 of SFO respectively provides that disclosure of false or misleading information to induce transactions, and employment of fraudulent or deceptive devices in securities or futures contract transactions are criminal offences;
- Section 277 provides for civil liability in respect of disclosure of false or misleading information to induce transactions; and
- Section 279 requires every officer of a corporation to take all reasonable measures to ensure that proper safeguards exist to prevent the corporation from perpetrating market misconduct.