Bills Committee on Insurance Companies (Amendment) Bill 2014

The Administration's Response to Members' Requests and Questions Raised at the Meeting on 21 July 2014

Purpose

This paper sets out the Administration's response to issues raised by Members at the Bills Committee meeting on 21 July 2014.

(a) Process Review Panel ("PRP") report

2. The latest PRP reports of the Securities and Futures Commission ("SFC") and Financial Reporting Council can be downloaded from the following websites –

- http://www.fstb.gov.hk/fsb/topical/preport12.htm
- http://www.fstb.gov.hk/fsb/topical/doc/frc_prp_report13_e.pdf

A copy of each of the reports is at **Annex A**.

(b) Disciplinary and appellate mechanism of other financial services regulators

3. The SFC's Disciplinary Proceedings at a Glance at **Annex B** exemplifies the disciplinary and appeal mechanism of a financial regulator. Key features to maintain transparency and fairness of the process are as follows –

(i) the regulator may conduct investigation when it has reasonable cause to believe that there may be any misconduct or contravention of the legislation concerned. Following the investigation, the regulator will consider whether there is sufficient evidence to commence disciplinary proceedings;

(ii) the regulator should give the regulatee concerned a reasonable opportunity to be heard before exercising any disciplinary power. The regulator should therefore set out in a notice its preliminary views on the conduct in question and the proposed sanctions, and invite the regulatee to

explain the matter and why the proposed sanctions are inappropriate;

(iii) on considering the regulatee's representations (if any), the regulator should issue a disciplinary decision notice which contains the reasons for, terms and the effective time of the decision; and

(iv) the regulatee concerned may appeal the disciplinary decision to an independent appeals tribunal within a specified period of time.

(c) Expert Panel for the disciplinary process

4. We propose that the IIA should establish an expert panel comprising insurance industry experts with in-depth knowledge of insurance practices and products. The panel can assist the IIA in making disciplinary decisions by allowing the IIA's expeditious access to external expertise and advice from industry practitioners as and when necessary. Members of the panel are to give expert advice on technical facts about industry practices or specific insurance products, which the IIA can rely on for making fair and reasonable disciplinary decisions. IIA remains the authority to make disciplinary decisions independently.

5. The insurance industry is diverse with a variety of products and many streams of business (there are nine statutory classes of long term business and 17 statutory classes of general business under the Insurance Companies Ordinance (Cap. 41)). In the circumstances that a disciplinary case involves a highly specialized stream of insurance business or a sophisticated product where the IIA considers that external expert advice is necessary to ensure that all relevant factors have been taken into consideration before making a fair and reasonable disciplinary decision, the IIA may consult members of the panel.

(d) Fining guidelines

6. The following fining guidelines are at **Annex C** for members' reference –

- Guideline on Exercising Power to Impose Pecuniary Penalty issued by the Office of the Commissioner of Insurance, pursuant to the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance (Cap. 615); and

- Disciplinary Fining Guidelines issued by the SFC, pursuant to the Securities and Futures Ordinance (Cap. 571).

Financial Services and the Treasury Bureau
September 2014

Process Review Panel

for the

Securities and Futures Commission

Annual Report

for 2012-13

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Chapter 1 General Information

Background

1.1 The Process Review Panel ("PRP") for the Securities and Futures Commission ("SFC") is an independent panel established by the Chief Executive ("CE") in November 2000. It is tasked to conduct reviews of operational procedures of the SFC and to determine whether the SFC has followed its internal procedures and operational guidelines to ensure consistency and fairness.

Functions

1.2 The PRP will review completed or discontinued cases handled by the SFC and advise the SFC on the adequacy of the SFC's internal procedures and operational guidelines governing the actions taken and operational decisions made by the SFC in the performance of its regulatory functions. These areas include licensing of intermediaries, inspection of intermediaries, authorization of investment products, receipt and handling of complaints, investigation and disciplinary action and processing of listing applications. The PRP does not judge the merits of the SFC's decisions and actions. It focuses on the process.

1.3 The terms of reference of the PRP are -

(a) 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 -

(i) receipt and handling of complaints;

(ii) licensing of intermediaries and associated matters;

(iii) inspection of licensed intermediaries;

(iv) taking of disciplinary action;

(v) authorisation of unit trusts and mutual funds and advertisements relating to investment arrangements and agreements;

(vi) exercise of statutory powers of investigation, inquiry and prosecution;

(vii) suspension of dealings in listed securities;

(viii) administration of the Hong Kong Codes on Takeovers and Mergers and Share Repurchases;

(ix) administration of non-statutory listing rules;

(x) authorisation of prospectuses for registration and associated matters; and

(xi) granting of exemption from statutory disclosure requirements in respect of interests in listed securities.

(b) To receive and consider periodic reports from the 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.

(c) 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.

(d) To call for and review the Commission's files relating to any case or complaint referred to in the periodic reports mentioned in paragraphs (b) and (c) above for the purpose of verifying that the actions taken and decisions made in relation to that case or complaint adhered to and are consistent with the relevant internal procedures and operational guidelines and to advise the Commission accordingly.

(e) To receive and consider periodic reports from the Commission on all investigations and inquiries lasting more than one year.

(f) 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.

(g) To submit annual reports and, if appropriate, special reports (including reports on problems encountered by the Panel) to the Financial Secretary which, subject to applicable statutory secrecy provisions and other confidentiality requirements, should be published.

(h) The above terms of reference do not apply to committees, panels or other bodies set up under the Commission the majority of which members are independent of the Commission.

1.4 The PRP will submit its annual reports to the Financial Secretary who may cause them to be published as far as permitted under the law.

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

Membership

1.6 Mr Anthony Chow Wing-kin chaired the PRP from 1 November 2006 to 31 October 2012. Since 1 November 2012, Dr Moses Cheng Mo-chi has taken up the chairmanship.

1.7 The PRP comprises nine members from the financial sector, academia, the legal and accountancy professions and the Legislative Council. In addition, there are two ex-officio members, including the Chairman of the SFC and the representative of the Secretary for Justice.

1.8 The membership of the PRP during 2012-13 was as follows:

Chairman:	
Mr CHOW Wing-kin, Anthony, SBS, JP	till 31 October 2012
Dr CHENG Mo-chi, Moses, GBS, JP	since 1 November 2012
Members:	
Mr CHAN Kam-wing, Clement	since 1 November 2012
Ms CHOW Yuen-yee	since 1 November 2010
Prof HO Yan-ki, Richard	since 1 November 2010
Dr HU Zhanghong	since 1 November 2012
Dr LAM Kit-lan, Cynthia	since 1 November 2010
Ms LEE Pui-shan, Rosita	since 1 November 2012
Mr LEE Wai-wang, Robert	since 1 November 2012
Dr the Honourable LEUNG Mei-fun, Priscilla, JP	since 1 February 2009
Mr MAK Chi-ming, Alfred	since 1 November 2012

Mr CHIU Chi-cheong, Clifton	till 31 October 2012
Mr FUNG Hau-chung, Andrew, JP	till 31 October 2012
Mr LEE Jor-hung, Dannis, BBS	till 31 October 2012
Mr LIU Che-ning	till 31 October 2012
Mr SUN Tak-kei, David, BBS, JP	till 30 June 2012
Ex officio Members:	
Chairman, the Securities and Futures Commission	
Dr FONG Ching, Eddy, GBS, JP	till 19 October 2012
Mr TONG Ka-shing, Carlson, JP	since 20 October 2012
Representative of the Secretary for Justice Mr LAI Ying-sie, Benedict, SBS, JP	since 4 May 2006
Secretariat:	
Financial Services Branch of Financial Services and The Treasury Bureau	

Chapter 2 Work of the PRP in 2012-13

Modus operandi

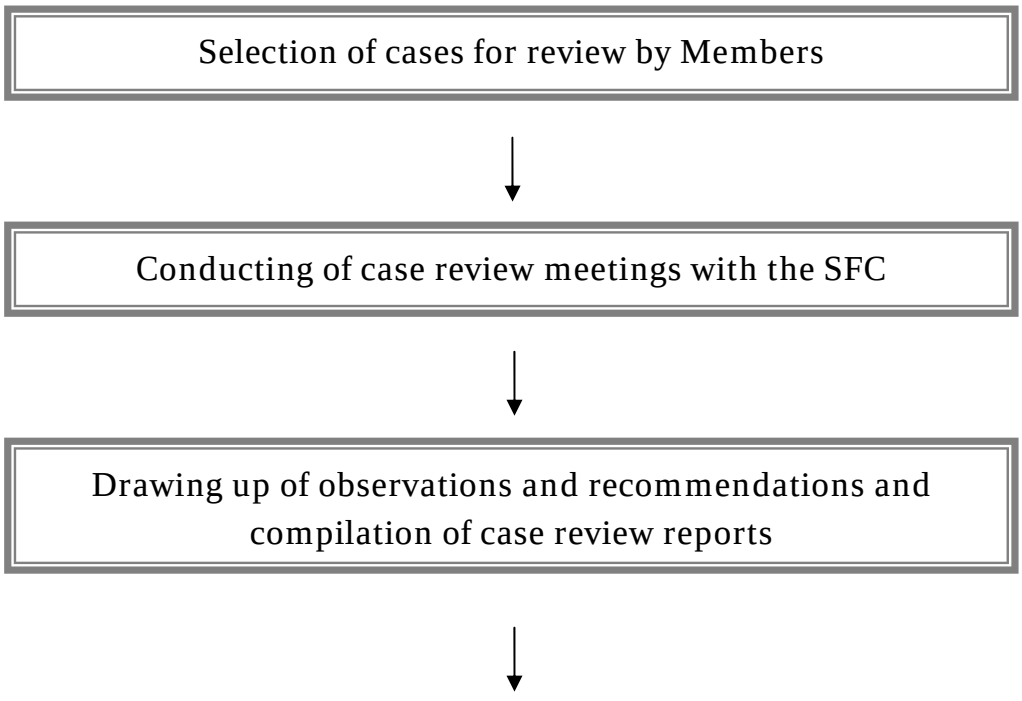
2.1 The SFC provides the PRP with monthly lists of completed and discontinued cases. Members of the PRP select individual cases from these lists for review with a view to examining cases encompassing different areas of the SFC's work. Members pay due regard to factors including processing time of the completed cases.

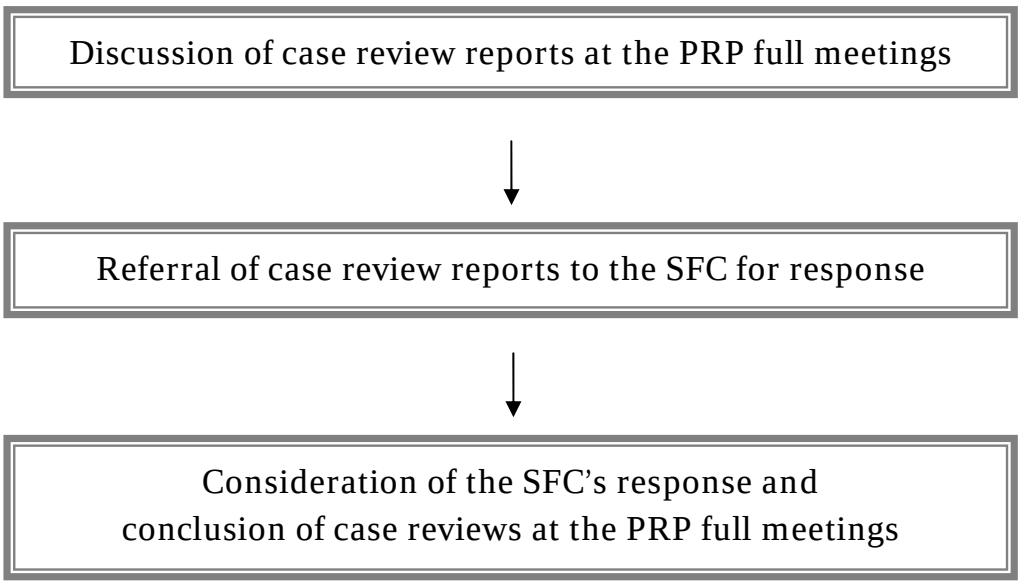
2.2 The SFC also provides the PRP with monthly lists of on-going investigation and inquiry cases that have lasted for more than one year for the PRP to note and consider for review upon the case completion or closure.

2.3 The PRP members are obliged to preserve secrecy in relation to information furnished to them in the course of the PRP's work, and to refrain from disclosing such information to other persons. To maintain the independence and impartiality of the PRP, all the PRP members are required to declare their interests upon commencement of their terms of appointment and before conducting each case review as appropriate.

Case review workflow

2.4 The workflow of the PRP case reviews is set out below –





Highlights of work

2.5 During the year, the PRP conducted a total of 12 meetings with the SFC's case officers on 58 selected cases that were completed or discontinued by the SFC. The PRP met four times in the year to discuss its modus operandi and the observations and recommendations of cases reviewed. The distribution of the 58 cases reviewed in 2012-13 is summarised below –

	No. of Cases
Authorisation of investment products	9
Licensing of intermediaries	7
Inspection of intermediaries	9
Investigation and disciplinary action	18
Handling of complaints	12
Corporate Finance including processing of listing applications	3
Total	**58**

2.6 Highlights of the PRP's observations and recommendations on selected cases and the SFC's response are set out in the following chapter.

Chapter 3 Observations and Recommendations

Authorisation of investment products

3.1 The PRP studied the processing time required to authorise investment products. The PRP noted that for completed cases under review, the application time ranged from 1 year & 2 months to 2 years & 3 months. The PRP made suggestions to streamline workflow and to review the application lapse policy as an ongoing initiative to improve the performance pledges.

(a) § Workflow and Performance Pledges

3.2 For four cases under review, the PRP had recommended measures to enhance the product authorization process.

The PRP's review (case one)

3.3 The PRP reviewed an application for authorisation of a fund that was related to Qualified Foreign Institutional Investor ("QFII"). The PRP noted there were multiple rounds of comments and responses between the SFC and the applicant during the application period, and queried the workflow process. The case took more than two years to be authorised after its submission.

3.4 The PRP recommended the SFC to arrange meetings and to engage active dialogue with applicants. This would help to resolve any outstanding issues and address applicants' concerns.

The PRP's review (case two)

3.5 In another application involving authorization of a Renminbi Qualified Foreign Institutional Investor ("RQFII") fund, the PRP noted that the SFC had again provided several rounds of comments to the applicant within a short period. The PRP considered the practice should be reviewed.

3.6 The PRP recommended the SFC to consolidate comments for applicants to respond. The SFC could arrange briefing sessions to all market participants when there was a new policy or a new type of investment product (like RQFII) to be launched to the market. The briefing should be held prior to receiving any application so that applicants knew what the SFC would require them to provide. This would expedite the application process.

3.7 Noting that the present performance pledges[1] included only time frames for acknowledging an application and issuing preliminary response, the PRP further recommended the SFC to formulate :

- a performance pledge for completing the authorization of an investment product; or

- internal guidelines on target timeframe for staff's compliance if the SFC considered it not feasible to announce to the market a pledged completion time.

The PRP's review (case three)

3.8 When reviewing another application involving authorization of a RQFII fund, PRP noted that the SFC had generally followed its operational guidelines. The long processing time (15 months) was due to the policy uncertainty in the Mainland, which was beyond the control of the SFC. The PRP again recommended the SFC to promulgate a performance pledge for an overall processing time in authorization of investment products under normal circumstance. This would enhance transparency of the SFC's operation.

The PRP's review (case four)

3.9 In accordance with prevailing guidelines, any application for an investment product authorization which was not completed within 12 months from the date of receipt, would lapse. The SFC had the discretion to grant time extension. As a reminder and notification to applicants, the SFC would issue a letter of mindedness nine months after the taking-up of the application.

3.10 In the case under review, the PRP noted that an applicant provided prompt response only after the SFC had issued the letter of mindedness. The case took 1 year and 2 months to complete.

3.11 The PRP recommended the SFC to review the 12-month application lapse policy. The SFC should consider approving time extension only under exceptional circumstance. Any change in the processing time policy should be clearly publicized to market participants.

The SFC's response

3.12 The SFC explained its overall process to the PRP. In brief, the SFC advised that its processing time on average constituted about one-third of the

[1] At present, the SFC' performance pledges for authorization of investment products are (a) taking-up of applications within 2 business days and (b) a preliminary response to applications after the take-up within 7/14 business days.

total processing time of applications for product authorization. The processing time attributable to applicants represented a significant portion of the total processing time.

3.13 Generally, authorization of QFII funds could only be granted after the relevant QFII quota was obtained from the State Administration of Foreign Exchange ("SAFE") of the Mainland. In the one case under review, the applicant took two years[2] to obtain the QFII quota from the SAFE. There were new disclosure requirements including the requirement to produce a product key facts statement that came into force in June 2010. In addition, the applicant made changes to the investment policy and dealing arrangements almost two years after the application date and repeatedly failed to properly address comments raised by the SFC. The above had resulted in multiple rounds of discussions and correspondence.

3.14 The SFC agreed with the PRP's recommendation to arrange meetings and engage in active dialogue with applicants to resolve any outstanding issues. The SFC had in practice been applying this approach to all cases, where appropriate. The SFC would continue to follow its existing practice using a combination of meetings, briefings, telephone discussions, and written communications to encourage applicants to resolve all outstanding issues.

Reviewing the application lapse policy & providing a pledge on approval timing

3.15 The SFC remarked that the authorization process was a dynamic one. The time that was required from application to authorization depended on a number of variables, many of which were not in the control of the SFC. Examples included the application's compliance with the SFC's requirements in the Code on Unit Trusts and Mutual Funds, the quality of the submission and the time taken by applicants to respond to requisitions. The promulgation of a performance pledge to cover the total processing time might negatively impact the SFC's core statutory duty of investor protection if this were interpreted as a hard deadline to be met by the SFC on all occasions for granting authorization.

3.16 Former PRP members had made similar observations, including that some applicants might have taken advantage of the application system by submitting premature applications. There were also concerns about the resource implications for the SFC in dealing with inactive applications. Responding to these comments, the SFC implemented the current 12-month application lapse policy. This was a definite time-frame within which applicants must complete their applications. It aimed to weed out applications where there was no serious intention to proceed. However, since the implementation of this policy in June 2010, the SFC had still seen a significant number of applicants who had not responded to requisitions

[2] Counting from the date the SFC took up the application.

promptly until the SFC had issued a letter of mindedness, which was done 3 months before the end of 12-month period. Out of 111 funds authorized from January to July 2013, 28% of the total processing time was attributable to the SFC and 72% was attributable to the applicants (i.e. the time spent by the SFC and applicants dealing with the other's requisitions or responses).

3.17 In light of the PRP's comments, the SFC has examined how the 12-month application lapse policy could be improved. The SFC had reviewed the approach adopted in other major overseas fund jurisdictions such as the United Kingdom, Luxembourg and Ireland, which generally had a 6-month application processing policy. The SFC planned to examine how a similar policy could be adopted in Hong Kong. This would mean that an application would lapse if, for any reason, 6 months had elapsed from the date of take-up of an application, subject to the SFC's right to grant an extension in exceptional circumstances. The SFC would consider issuing a letter of mindedness to notify applicants of the imminent expiry date 4 months after the taking-up of the application.

3.18 Having regard to the balance of processing time experienced in recent years (with requisitions sitting with applicants for considerable periods), the SFC believed that a shorter 6-month application lapse policy would:

- instill greater discipline amongst applicants to only proceed with serious applications and to accelerate turn-around time;

- streamline the workload of the SFC so that it could spend more time on serious applications (i.e. ensuring that the system was not "clogged up" with tentative or delayed fund proposals); and

- signal to the market that a quality application complying with all relevant requirements, and where responses to requisitions were dealt with in a timely fashion, should be approved by the SFC within 6 months at the latest.

The above would mean that, in effect, the lapse policy also functioned as the SFC's own pledge on approval timing, provided that there was a quality application and a responsive applicant.

Approving time extension for application

3.19 The SFC's Answers to Frequently-asked Questions ("FAQs") set out exceptional circumstances in which the SFC might approve a time extension[3].

[3] As set out in the FAQs, in general, the SFC will only consider granting a time extension under exceptional circumstances upon the submission of satisfactory grounds by the applicant. Any extension of the application period may be granted by the SFC where there is no substantive outstanding issue at the time of the extension, except for the receipt of the following documents by the SFC:
(a) in the case of a fund primarily regulated by an overseas regulator, the formal written approval from the home regulator of the fund;

This had been notified to market participants and publicized online. The SFC agreed that it would continue to publicize any changes in the processing time policy.

Arranging briefing sessions to market upon launching of a new policy

3.20 The SFC advised that in general, it sought to review each single round of submission by applicants and communicate its comments as much as practicable in each single round of requisition instead of in batches. The vetting of fund applications, however, was a dynamic process. For example, where new issues arose from the applicant's responses to the SFC's enquiries or where regulatory developments (including those not initiated by the SFC) were emerging or evolving within a short period of time, very often the SFC was duty bound to raise further enquiries.

3.21 The two cases involving the RQFII pilot scheme were novel and evolved during the processing of the application. Close cooperation between the SFC and the Mainland authorities was required to enable the SFC to determine how the China Securities Regulatory Commission ("CSRC") and the SAFE would implement the RQFII rules. Shortly after the RQFII rules and regulations were promulgated by the Mainland authorities, and once the SFC obtained essential clarifications from the CSRC and the SAFE, the SFC called a "town hall meeting" with all RQFII fund applicants and their advisers to explain how the requirements of the CSRC and the SAFE would be implemented and how application documents should address these requirements.

3.22 The SFC agreed with the PRP that there should be sessions for all market participants when a new policy or a new type of investment product (like RQFII) was to be introduced to the market. The SFC has conducted some 150 meetings on product development and proposals during the 12-month period from 1 June 2012 to 31 May 2013; and over 13 industry wide briefings since 2010.

(b) in the case where overseas regulatory check has to be conducted on the management company or its delegate, the response from the relevant regulator; and/or

(c) the final signed version of the confirmation on compliance and/or Chinese translation confirmation(s).

(b) § Structured fund product

The PRP's review

3.23 The PRP noted that when the SFC reviewed an application involving an unprecedented structured fund product, the SFC had upon receipt of the application[4], assigned the case to its unit trust team for handling. The SFC engaged its structured products team to handle the application seven months after the receipt of the application. That might have lengthened the processing time.

3.24 The PRP recommended the SFC to:

- establish a mechanism to screen investment product applications upon receipt. Different experts/teams should be engaged in the early stage of the authorization process to speed up the process;

- review whether their subject officers had sufficient knowledge to understand the nature of new investment products which changed rapidly according to development of financial markets;

- consider if the SFC's Products Advisory Committee ("PAC") could provide guidance and assistance to the SFC's working level officers on new, hybrid and complex products; and

- take more proactive action, such as arranging meetings with applicants instead of having multiple rounds of comments and responses between the SFC and an applicant, to resolve issues identified by the SFC.

The SFC's response

3.25 The proposed product was "one of a kind" and, upon enquiry, it appeared that there was no precedent in any other major markets. The SFC believed that it was appropriate (not least from an investor protection perspective) to properly study and research the proposed product and, importantly, obtained essential clarifications from the applicant concerning the product.

3.26 The SFC agreed with the PRP's recommendation on the early engagement of different teams with the necessary expertise in processing applications, where appropriate. All structured fund applications were jointly reviewed by the funds and structured products teams from the

[4] Subject officers explained that the applicant marked on its application that it was "unit trust fund" and hence the application was assigned to the unit trust team.

take-up/beginning of an application.

3.27 The SFC had targeted its recruitment effort to employ market experts with the necessary range and diversity of skills and experience to complement its existing product authorization teams for the handling of a wide range of product applications. In order to keep up with market and technical changes in investment products, the SFC maintained regular dialogues with overseas regulators and the industry regarding market, regulatory and product trends.

3.28 The PAC had continued to be an advisory body that the SFC consulted in the wider context of market trends and policy development and implementation. The SFC had sought the views of the PAC on new product trends focusing on risk related issues. The SFC would continue to solicit the views of the PAC on more difficult product issues.

3.29 The SFC agreed with the PRP's recommendation that it would be useful to pursue a combination of engagement actions including meetings and written/oral communications to encourage applicants to resolve all outstanding issues. In the case under review, the SFC held a series of conference calls and meetings with the applicant to assist it to resolve outstanding issues.

Licensing of intermediaries

3.30 The PRP reviewed the licensing applications for different types of regulated activities and enquired how the SFC had monitored the case progress. The PRP recommended the SFC to review the performance pledge on licensing applications and made suggestion on how the SFC could deal with licensing agents to expedite the applications.

(a) § Performance pledge

The PRP's review

3.31 When reviewing a case involving an application to carry out Types 1 and 4 regulated activities and an application of Responsible Officers ("ROs"), the PRP noted that the case took 21 months' processing time which exceeded the pledged time. The SFC's subject officers had explained that the applicant was not keen in completing the application. The delaying factors[5] were beyond the control of the SFC.

3.32 The PRP also noted that the SFC had classified the case as "non-standard" type of application in which delays were occurred beyond the SFC's control. For all "non-standard" type of applications, the SFC would not include the result of the application in its performance pledge report.

3.33 When reviewing another application for an RO to carry out Type 6 regulated activity, the PRP considered the current performance pledge (10 weeks) could not keep pace with the speedy changes in the Hong Kong financial markets.

3.34 The PRP had recommended the SFC to:

- review the 10-week performance pledge for processing licensing application of RO;
- explain how the SFC had counted the 10-week pledged time for the application. Did it start upon the receipt of the application or the SFC counted it only after it had received all required information?

[5] One RO applicant had an accident that held up the application for 3 months. Another RO applicant resigned in the process that held up the application for 4 months.

- explain how the SFC defined "standard" and "non-standard" type of licensing application. The PRP noted that the SFC only include 'standard" type of licensing application in the performance pledge report to the public; and

- explain and review how the SFC had monitored the performance for those "non-standard" type of applications.

The SFC's response

Review of 10-week performance pledge

3.35 The SFC replied that the performance pledges were determined by reference to the relative complexity of the different types of applications to which they applied. The SFC did not regard its performance pledges as being fixed and incapable of change and reviews these from time to time. Currently, the SFC considered its performance pledges relating to licensing matters as being appropriate, bearing in mind the complexity of the different types of applications in question and the staffing resources within the Licensing Department ("LIC"). Accordingly, the SFC considers that there was an appropriate balance between serving the needs of the market, on the one hand, and the overall cost, in terms of the SFC resources, of achieving this, on the other hand.

3.36 With reference to its performance pledges generally, and the 10-week performance pledge for the processing of RO applications in particular, the SFC considered the integrity of the gatekeeping function that was performed by the LIC to be of paramount importance and something that should not be compromised. ROs played an important role in licensed corporations and it would be unwise, in the SFC's view, to relax the careful and detailed approach that the LIC took to the processing of the applications. Accordingly, any reduction in the 10-week performance pledge for the processing of RO applications could not be expected to result in any reduction in the time that was taken by the LIC to process them. It would more likely result in fewer RO applications being completed within the reduced performance pledge period, thereby giving RO applicants unrealistic expectations.

Counting 10-week pledged time

3.37 As regards the counting of 10-week processing time, the SFC explained that upon receiving any application, the LIC conducted a preliminary screening of it to ascertain whether it met the basic criteria, namely, of the applicant having answered all of the relevant questions in the application form, signed and dated the application, submitted all required supporting documents and paid the applicable application fee. If these basic criteria had not been met, the application was returned to the applicant as provided for in paragraph 7.8 of the SFC's Licensing Information Booklet.

3.38 Upon the submission of an application that met the basic criteria, it was formally accepted by the LIC and the performance pledge clock started running. It did not stop running until the application had been finally completed, irrespective of whether this occurred within the performance pledge period or outside it, and irrespective of whether any delays that had occurred during the processing of the application were outside the control of the LIC. The LIC did not turn the performance pledge clock off when delays occurred that were beyond its control because this would create an unacceptable administrative burden. Instead, the LIC conducted a retrospective monthly review of the relatively few cases in which the applicable performance pledges had not been met. This approach reduced the overall administrative burden, encouraged greater consistency and simplifies, and made more effective, the monitoring of this process. Because this procedure occurred after the event, it had no effect on the manner in which applications were processed.

3.39 The SFC reported that since the beginning of 2013, approximately 86% of new licence applications dealt with by the LIC met the relevant performance pledges and approximately 14% did not. It was this latter group of applications that the SFC reviewed monthly, after the event, in order to ascertain whether or not the failure to observe a relevant performance pledge resulted from matters beyond the control of the LIC or factors which require the SFC to subject an application to greater scrutiny than was normally the case. In almost all of the cases, such failure was the result of one or more factors that were beyond the control of the LIC. Those factors included applicants having requested a delay in the granting of their licences, the failure of applicants to provide information in a timely manner, delays by other regulators in responding to the SFC vetting requests, licence applications by individuals being delayed until the corporations to which these individual applicants were to be accredited have been licensed, concerns as to the fitness and properness of applicants and unpaid fees.

Monitoring "exceptional" cases

3.40 The SFC reiterated that a large majority of applications dealt with by LIC complied with the SFC's performance pledges. Of the relatively small number of other cases that were not completed within the applicable performance pledge period, most were "exceptional" cases, in which the processing of the applications was delayed by circumstances beyond the control of the LIC or factors which required the SFC to subject an application to greater scrutiny than was normally the case.

3.41 In the interest of clarity, the SFC preferred not to label licensing applications as "standard" and "non-standard". To enhance transparency, the LIC proposed that, in future, it would report the number of applications that were not completed within the applicable performance pledge period and that it would identify, within this group of cases, whether they were exceptional (meaning that factors beyond the control of the LIC or those

requiring greater scrutiny prevented the completion of the processing of the applications within the applicable performance pledge periods) or whether they were not exceptional (meaning that factors beyond the control of the LIC did not prevent it from complying with the applicable performance pledges).

3.42 The LIC staff were expected to deal with licensing applications, of a similar type, in a similar manner. No distinction was drawn between an application which remained uncompleted within the applicable performance pledge period and one in respect of which this period had already been exceeded.

3.43 Computer generated reports which listed the aging of all outstanding applications were issued to the LIC staff twice every month. Through these reports, each processing team was able to monitor the progress of the outstanding applications for which it was responsible. It was the obligation of the Senior Manager or Associate Director heading each LIC team to monitor the statistics and to intervene when any particular case appeared to be making slow progress.

(b) § Registered institutions

The PRP's review

3.44 In accordance with the Securities and Futures Ordinance (Cap. 571) ("SFO"), for a corporation to become a Registered Institution ("RI"), it should first be registered as an authorized financial institution ("AI") with banking licence approved by the Hong Kong Monetary Authority ("HKMA").

3.45 The PRP had reviewed one application for an RI to carry out Types 1, 4 and 9 regulated activities. The case took 17 months to complete. The SFC had no performance pledge for RI applications as it opined that the processing time for RI applications depended heavily on the HKMA's processing time. The SFC noted case progress of the HKMA by referring to a monthly list of outstanding cases submitted by the HKMA.

3.46 The PRP was concerned how the SFC had monitored the progress for RI applications and requested the SFC to provide the latest list of outstanding cases with relevant action party, i.e. the HKMA or the SFC. The PRP had recommended the SFC to:

- set up a pledge time to complete an RI application once the applicant had become an authorized financial institution;
- keep the applicant informed of the progress of application so that the applicant could make direct enquiry with the processing party.

This would avoid giving a false impression to the applicant that the SFC was holding up the application unduly; and

- enhance communication and coordination with the HKMA to monitor RI application progress. Apart from noting the progress from the HKMA's monthly list of outstanding cases, the SFC could make phone enquiry with the HKMA and chased up the HKMA to expedite the application.

The SFC's response

Setting up performance pledge

3.47 The SFC played a generally limited role in respect of RI applications. It received them and then referred them to the HKMA for assessment under section 119 of the SFO. By agreement with the HKMA, the SFC made these referrals within 7 days. After the HKMA had assessed an application and reported to the SFC concerning the merits of the application, the SFC must make a final decision as to whether the application for registration should be granted. Normally, this was a relatively routine matter because it was the role of the HKMA to carry out the detailed assessment of the application. Since the SFC's role in dealing with RI applications tended to be more procedural than substantive, and because the HKMA's role involved a detailed assessment of the merits of such applications, the SFC did not feel that publishing performance pledges concerning its role would be particularly helpful. The reason for this was that the SFC's performance pledges were intended to provide applicants with an indication of the length of time that their applications could be expected to take when the SFC played the substantive assessment role, and to serve as a constant reminder of this to the LIC staff.

3.48 In the case of RI applications, it was the HKMA's assessment that was time consuming. As this was a role that was imposed on the HKMA by statute and one which must be performed by the HKMA, the SFC was not in a position to publish a performance pledge with which, in effect, the HKMA would be expected to comply.

Enhancing communication with the HKMA to monitor case progress

3.49 The SFC remarked that it was important to recognize that the respective roles of the SFC and the HKMA were stipulated in section 119 of the SFO. Accordingly, it was not appropriate for one regulator to interfere in the performance by the other of the statutory functions that had been conferred on it. The monthly reports provided by the HKMA constituted a formal communication with the SFC concerning the status of RI applications that the SFC had previously referred to the HKMA. Telephone inquiries would likely be viewed as unwarranted interference on the SFC's part in the performance

by the HKMA of its statutory function and would probably not elicit any more information than was already contained in the monthly reports.

3.50 Senior staff of the SFC met periodically with their HKMA counterparts to discuss matters of mutual interest. At these meetings, the SFC had, on occasions, tactfully raised with the HKMA RI applications that appeared to be making unusually slow progress.

Informing applicants of progress

3.51 As explained in the above, applicants under section 119 of the SFO were well aware of the respective roles played by the SFC and the HKMA in relation to their applications. They also dealt directly with the HKMA during the course of its processing of such applications and were aware that this was the responsibility of the HKMA. Accordingly, applicants were aware that if there were delays or matters giving rise to concern during the processing period, their inquiries must be directed to the HKMA.

3.52 Since these applications were typically with the SFC for such short periods, and since applicants were aware of this, the SFC considered that little benefit would be gained from the SFC providing applicants with progress updates during these short periods. The approach that the HKMA adopted to updating RI applicants was entirely a matter for the HKMA and one in relation to which it would not be appropriate for the SFC to interfere. However, it would be reasonable to assume that the HKMA's approach was not unlike that of the SFC, which was generally not to provide regular updates. The reason why the SFC did not provide regular updates in all cases was that this would be time consuming and was normally unnecessary because the SFC constantly communicated with applicants during the processing of their applications. Accordingly, they were usually aware of the progress that the SFC was making. On this basis, it was reasonable to assume that RI applicants should have a good idea, at any given time, of the progress that was being made by the HKMA with their applications.

Outstanding RI application

3.53 The SFC supplemented that as of end May 2013, there were 3 outstanding RI applications, 4 applications for the addition of regulated activities, and 1 application for the removal of a registration condition that were under consideration by the HKMA. Accordingly, the RI matters constituted a small part of the work of licensing section in the SFC. RI applications had represented less than 5% of all the SFC's new corporate applications received each year since 2008. Since the beginning of 2013, the SFC had received no RI application.

3.54 The issues of the SFC taking a proactive role in chasing up the HKMA in order to expedite the processing of RI applications and coordinating with the HKMA to keep applicants informed, had been addressed in the SFC's

responses to the matters raised above. Briefly, and by way of summary, the SFC and the HKMA performed different statutory functions under section 119 of the SFO. Because of this, the SFC did not consider it appropriate for the SFC to interfere with the performance by the HKMA of its processing function or to be involved in informing applicants concerning the progress that was being made by the HKMA in the performance of this statutory function.

(c) § Agent for handling application

The PRP's review

3.55 The PRP noted that the SFC took nine months to process an application lodged by a firm for its RO to carry on Types 2 and 5 regulated activities. The applicant had appointed a legal advisor to handle the application.

3.56 The SFC explained that the application was delayed because of substandard work quality prepared by the legal advisor. As a result, the SFC had to make several rounds of requisition.

3.57 The SFC further explained that the applicant was involved in a bankruptcy petition during the application period. The SFC had to launch additional vetting from an overseas regulator to confirm the applicant's licensing criteria. In this aspect, the PRP appreciated the SFC's initiative to enquire the applicant about the bankruptcy petition without waiting for its disclosure.

3.58 The PRP recommended the SFC to:

- alert the applicant of the slow responses or substandard work quality submitted by its handling agent (say, legal/professional advisors) so that the applicant understood the delay was not due to the SFC and could take necessary remedial action;

- explain why the SFC had not communicated with the corporation directly on licensing application as stipulated in the SFC's Licensing Information Booklet;

- elaborate on the present rules and guidelines requiring an applicant to disclose any material changes and major events to the SFC during the application period; and

- advise how the SFC had enforced the rules for the above.

The SFC's response

3.59 The SFC advised that it was essential that there be one line of communication between the SFC staff and the applicant or, where the applicant chose to instruct a legal or compliance adviser, between the SFC staff and that adviser. The reason for this was that if communications were made variably between the SFC and the legal or compliance adviser on some occasions and between the SFC and the applicant on other occasions, confusion tended to occur as a result of the left hand sometimes not knowing what the right hand was doing. If an applicant chose to instruct a legal or compliance adviser, this was a matter for the applicant. It was not for the SFC to question this decision. It was not appropriate for the SFC to actively criticize the performance of an applicant's legal or compliance adviser. In those cases in which the SFC considered an adviser's conduct of the application to be deficient, the policy adopted by the SFC was to communicate its concerns to the adviser and to copy the correspondence to the applicant. It was then a matter for the applicant to decide whether it wished to continue availing itself of the services of the legal or compliance adviser. On some occasions, such as when the SFC was not satisfied with the adviser's responses, the SFC had no alternative but to communicate directly with the applicant and to request a direct response from the applicant.

Dealing with handling agents

3.60 The SFC explained that for the case under review, the SFC had voiced its concerns regarding the delay in the processing of the application in an e-mail, which was sent to the legal adviser and copied to the applicant. Following this, the applicant took a more active role in connection with the application by communicating directly with the SFC to address the outstanding concerns.

3.61 The SFC supplemented that dealing with incompetent legal and compliance advisers could be difficult. The SFC recognized that they were not doing the best by their clients, but at the same time it was not for the SFC to dictate to applicants who should and who should not advise them. When difficulties were experienced, as in the subject case, it usually did not take an applicant long to realize the difficulties being created by an incompetent adviser when the SFC copied correspondence to the applicant. Invariably, in the circumstances, the applicant made a decision to terminate the adviser's involvement or to restrict the adviser's role.

Direct communication with licensed corporation

3.62 Although not relevant to the case under review, in a case to which paragraph 7.5 of the Licensing Information Booklet applied, the licensed corporation might well wish to instruct a legal or compliance adviser to act for it in connection with the joint application. If this occurred, the SFC's communications would be conducted with the licensed corporation through

its legal or compliance adviser. This would not in any manner be inconsistent with paragraph 7.5, which required that for standalone applications made by individuals, the SFC's communications were to be with the licensed corporation, as distinct from being with the individual seeking to be licensed or approved as an RO.

3.63 In the case under review, paragraph 7.5 of the Licensing Information Booklet was of no relevance because the application was a corporate application in which the applicant corporation sought to be licensed. Notwithstanding this, during the course of processing the application, the SFC's communications were in fact with the applicant corporation through its legal adviser.

Rules requiring an applicant to disclose material changes and the SFC's enforcement to the rules

3.64 Section 4 of the Securities and Futures (Licensing and Registration) (Information) Rules required applicants to disclose any changes to the information provided in their applications within 7 business days after the changes took place. The SFC's application forms specifically reminded applicants of their obligation to notify the SFC of such changes.

3.65 Failure to comply with this obligation was a criminal offence under section 135 of the SFO. A conviction arising out of a failure of this type would be viewed seriously by the SFC and would call into question a licensee's fitness and properness to be, or to remain, licensed. A breach of section 4 might come to light during the licensing process, in which event the SFC might well refuse to grant the licence being sought. Alternatively, in the event of such a breach subsequently being revealed (e.g. during the course of the processing of a subsequent licence application or during an inspection or investigation), it would likely result in disciplinary action being taken, including the possibility of the licence in question being revoked.

3.66 It was a criminal offence, contrary to section 383 of the SFO, for an applicant to knowingly or recklessly make a representation in support of a licence application that was false or misleading in a material particular. The SFC's licence application forms also drew this to the attention of applicants. A conviction under section 383 was viewed seriously by the SFC and would also call into question the offender's fitness and properness to be, or to remain, licensed.

3.67 The processing of licence applications by the SFC was not a mechanical or box-ticking procedure. It involved the staff of the LIC thinking laterally, being familiar with market or other issues that might be relevant to, or influence, the outcome of the applications that they were processing, and raising issues of concern with applicants. The subject case was an example of this, but was by no means an isolated case.

Inspection of intermediaries

3.68 The PRP had reviewed a number of inspection cases involving "high-risk" firms and enquired how the SFC had planned its inspection on this kind of licensed corporation. The PRP also observed that the SFC had a practice issuing letter of deficiencies exactly four months after the SFC had inspected the intermediaries and enquired the rationale behind.

(a) § Inspection frequency – poor compliance history

The PRP's review

3.69 The PRP reviewed an inspection case on a firm's compliance with anti-money laundering ("AML") regulatory requirements. The SFC concluded "there were poor compliance culture and lack of awareness of AML controls". The SFC issued a letter of deficiencies to the firm eight months after the inspection. The case took nine months to complete.

3.70 The PRP noted that for this case, the SFC had issued a letter of exit without any follow up inspection. The PRP enquired why the SFC had not revisited the firm to confirm that all deficiencies had been duly rectified before it issued the letter of exit and closed the case involving inspection results of poor compliance.

3.71 Upon further enquiry, the SFC supplemented that it had not conducted or planned to conduct another inspection to the firm since it issued the letter of exit. The PRP noted that one year had lapsed since the SFC's last inspection. The SFC had not planned any further follow up inspection. The PRP recommended that the SFC should strengthen the monitoring and increase inspection frequency for firms with a history of poor compliance culture.

The SFC's response

3.72 The SFC pointed out that the SFC's inspection process included procedures for the inspection team to discuss any preliminary concerns with management of the firm shortly following the completion of fieldwork and set out the identified breaches of regulatory requirements and areas for improvement in a letter of deficiencies upon completion of the review. The firm was required to provide a written response stating the corrective actions which had been or would be taken.

3.73 In assessing the extent and nature of the corrective actions taken, the

inspection team might also require the firm to provide additional information and supporting documents to substantiate the actions taken. Whether this warranted a revisit to the firm would be determined on a case by case basis.

3.74 The SFC explained that on-site inspection (including routine, special and thematic inspections) was a key tool that complemented off-site monitoring in the SFC's risk-based supervision of licensed corporations. A balanced top-down (industry-wide and linked to the SFC's overall priorities) and bottom-up approach (firm-specific and linked to a risk and impact assessment framework for all licensed corporations) was adopted in the SFC's risk-based on-site inspection framework to identify overall inspection priorities, determine whether routine, special or thematic inspections should be conducted, and the targets of inspections.

3.75 The SFC confirmed that the risk and impact assessment of a licensed corporation took into account, among other inputs, inspection findings and history of compliance culture on the firm as important assessment factors. It would be updated on an ongoing basis by the off-site monitoring case officer. Relevant information was maintained in computer systems developed to automate some risk analyses. Licensed corporations assessed as requiring close monitoring would generally be inspected more frequently.

3.76 The PRP's emphasis on compliance culture as a key assessment factor was well noted. The SFC constantly re-assessed the use of various factors, compliance culture included, in order to obtain the best possible holistic risk assessment for a licensed corporation.

(b) § Hire of external consultant to conduct inspection

The PRP's review

3.77 The SFC engaged an external consultant to perform inspection on AML compliance. The external consultant had access to sensitive information of the inspected firms. Noting that external consultants were not the SFC staff and were not subject to the SFC's Code of Conduct, the PRP invited the SFC to elaborate on measures it had taken to avoid the leakage of sensitive information by external consultants.

3.78 The PRP further recommended the SFC to add a clause regarding "conflict of interests" in its appointment contract with external consultants. This would debar the external consultants from using the information gained during the inspection for their own purposes, which might be contrary to the interests of the SFC.

The SFC's response

3.79 The SFC confirmed that the external consultants engaged by the SFC to assist in performing inspection on licensed corporations, like the SFC's staff, were subject to the preservation of secrecy and avoidance of conflict of interests provisions of the SFO (ss 378 & 379), contravention of which was an offence punishable by imprisonment and fine. The statutory provisions were specifically drawn to the attention of the external consultant firm and were acknowledged in writing. Engagement letters with external consultants normally contained further provisions restricting the use of information.

(c) § Letter of deficiencies

The PRP's review

3.80 The PRP reviewed several intermediaries inspection cases and noted the SFC issued letter of deficiencies exactly four months after its inspections. Questions were raised as to whether the issue of letter of deficiencies was unnecessarily held up until four months after its inspections, which was exactly the SFC's internal pledged time. It should be noted that any undue delay in issuing the letter of deficiencies could cause relevant licensed persons unnecessary worries.

3.81 The PRP requested the SFC to:

- provide past 12-month statistics showing the duration required to issue letter of deficiencies after inspection; and
- explain the rationale why letter of deficiencies could not be issued earlier.

The SFC's response

3.82 In 2012-2013, there were a total of 242 completed inspection cases with the following breakdown on duration to issue the letter of deficiencies:

- between 0 to 3 months: 25 cases;
- between 3 to 4 months: 216 cases;
- more than 4 months: 1 case (An interim letter of deficiencies was issued within 4 months in this case).

3.83 The SFC explained that the total amount of time generally needed for the completion of a normal inspection counting from the start of the inspection work was between 3 and 4 months. However, this was not a performance pledge and it was not practicable for the SFC to set any rigid time frame for issuing a letter of deficiencies because the degree of cooperation from the firm under inspection and the number and complexity of issues arising from an inspection varies from case to case.

3.84 The SFC issued an interim letter of deficiencies to ensure that the firm was informed of interim findings if the inspection was expected to take longer to complete. A final letter of deficiencies was always sent to the firm upon the completion of the inspection. The issue of an interim letter within 4 months was an internal procedure adopted in light of the experience of inspections over many years; it recognized that even in difficult or protracted cases it should be possible to formally notify a firm of interim findings within 4 months, and this often followed early verbal notification.

(d) § Inspection frequency–high-risk company

The PRP's review

3.85 The PRP reviewed two cases involving the same company: (a) the Enforcement team conducted investigation and concluded that there were improper trading activities by staff in the company while (b) the Inspection team conducted special inspection on the firm's compliance on selling practices requirements. For both cases, the PRP noted respective teams of the SFC had generally followed their operational guidelines and procedures.

3.86 The PRP was concerned that for securities company which the SFC had concluded "there were improper trading", the SFC should classify the company as "high-risk" licensed corporation and step up its inspection.

The SFC's response

3.87 The SFC adopted a risk-based approach in the regulation of licensed firms. The SFC took into account the identified breaches and deficiencies in the inspection and the compliance history among other risk factors to evaluate and track the risk profile of individual licensed firms. Higher risk firms would generally be covered for inspection in a shorter timeframe under the risk-based approach.

Investigation and disciplinary action

3.88 The PRP studied cases with relatively long investigation time and made recommendations on the closure of case.

(a) § Investigation process – legal advice

The PRP Review

3.89 The PRP reviewed a suspected market manipulation case. The SFC took more than two years to complete the investigation, which included nine months[6] "waiting time" for legal advice from the SFC in-house and an external counsel. The case was subsequently closed with no action taken.

3.90 The PRP noted that Enforcement team had classified the case as "high priority" and had reported investigation progress to the Enforcement Steering Committee ("ESC") on a monthly basis. Notwithstanding that, the PRP was of the view that the ESC had not taken proactive action chasing up legal advice to expedite the investigation.

3.91 The PRP recommended the SFC to review management's supervision for "high priority" case and to consider:

- setting up internal guidelines on time required to offer in-house legal advice; and
- establishing a mechanism to monitor service of external counsel, namely, its response time and quality of advice. The PRP considered that four-month waiting time from a hired external counsel was totally unreasonable.

3.92 The PRP added that prolonged investigation time, let alone nine months spent for seeking legal advice, would hinder effective enforcement / prosecution action.

The SFC's response

3.93 There had been severe resourcing issues in the Legal Service Department ("LSD") that had created a backlog. These resourcing issues were addressed through increases in budgeted headcount and recruitment of

[6] Five months for SFC's in house legal advisor and four months for SFC's hired external counsel.

additional litigators.

3.94 External counsel were instructed to advise on factually or legally complex cases and on some other cases where it was considered necessary in order to improve turnaround time for legal advice. When external counsel were instructed, the LSD Counsel would agree a date for the provision of legal advice and would chase external counsel for their advice. However, specialist counsel tended to be in high demand and it was not always possible to secure a quick turnaround for their advice despite the SFC's efforts.

3.95 The SFC was unable to impose any performance pledge on external barristers/senior counsel. Despite this, the LSD did obtain estimated dates to monitor progress.

(b) § Referral of cases to other regulators

The PRP's review

3.96 The PRP had reviewed one case involving a licensed corporation's facilitation of unlicensed activities by employees of an unlicensed corporation. The unlicensed corporation was a member of the Hong Kong Confederation of Insurance Brokers ("HKCIB").

3.97 The SFC fined the licensed corporation and suspended the licence of its Responsible Officer. As for the unlicensed corporation, the SFC issued a compliance advice letter.

3.98 The PRP noted that the SFC had generally followed its internal procedures in handling the case. However, the PRP would like to know if the SFC had considered referring the unlicensed corporation, which was an insurance broker, to the Office of the Commissioner of Insurance ("OCI") for necessary follow-up.

The SFC's response

3.99 The SFC replied that it had not referred the case to the OCI. In future, if investigations revealed potentially problematic conduct on the part of the HKCIB's members, the SFC would seriously consider referring the matter to the OCI for appropriate follow-up action.

3.100 On the PRP's further comments that there should be a standard mechanism of referring cases to other regulators to avoid any regulatory loopholes for cases related to misconduct of persons/companies which were not under the SFC's regulatory ambit, the SFC reiterated that there was a

mechanism for referral. In the case under review, disciplinary action was not taken against the unlicensed corporation and therefore the case did not fall within the ambit of the referral mechanism.

(c) § Closing of completed case

The PRP's review

3.101 The PRP noted that the SFC Enforcement Team had held up one case for three years before closing. No further action was taken during the three-year period. The case involved a complainant and the SFC's referral to an overseas regulator.

3.102 The PRP recommended the SFC should:

- establish proper procedures to monitor cases involving referral to overseas regulators; and

- arrange proper and timely closure of cases.

3.103 The PRP invited the SFC to clarify if it had complied with its internal procedures.

The SFC's response

3.104 The SFC advised that this case was left open due to an administrative oversight. It did not involve any investigation. The file was opened to handle an administrative liaison issue with the overseas regulator. In the normal case, all cases had a closing protocol and checklist to ensure they were closed properly. This was not a factor in this file because it was not an investigation file.

Timely closing and proper authority to close a case

3.105 There was a protocol and process governing the management of investigation cases that followed a project management methodology of assessment, planning, reporting and closure. The Enforcement Steering Committee approved the closure of investigation cases.

3.106 Investigatory assistance under the Multilateral Memorandum of Understanding ("MMOU") or a bilateral Memorandum of Understanding ("MOU") with foreign regulators was a very limited exercise that usually might not require investigation. In most cases, the request was for a single piece of information. The foreign regulator not only identified what it wanted but also where the information could be located. Under MMOU and bilateral MOU arrangements, the SFC complied with these requests routinely. They

might not involve the investigation of any HK subject. The relevant investigation was one being conducted by the foreign regulator and not by the SFC. These files recorded the SFC's administration of the request for assistance. Given the routine nature of these cases, a Director was authorized to close cases involving requests for assistance. A Senior Director also reviewed a list of foreign assistance requests on a monthly basis to ensure that progress was satisfactory. Accordingly, there was already a responsible process for such cases.

Handling of complaints

3.107 The PRP reviewed completed cases involving complaints lodged against staff and listed companies. The PRP made recommendations to the procedures of handling complaints in the SFC.

(a) § Complaint involving listed companies

The PRP's Review

3.108 The PRP reviewed three closed complaint cases involving listed companies. For the first two cases, the complainants had directed their claims to the Hong Kong Exchanges and Clearing Ltd ("HKEx") or the Stock Exchange of Hong Kong ("SEHK"), with copies to the SFC. For the third case, the complainant sent two emails to the SFC on two consecutive days, which were Thursday and Friday.

3.109 Upon enquiry, the PRP learnt that the Complaints Control Committee of the SFC ("CCC") convened its meeting every Friday and issued its agenda every Wednesday. For cases which were received by the SFC on Thursday and Friday (including the third case), the case had to be discussed at the CCC and be referred to the SEHK on the following Friday as the agenda of the meeting had already been issued.

3.110 The PRP commented that all the cases were relatively straightforward. It was evident the HKEx / SEHK were action parties, but not the SFC. The PRP invited the SFC to review if such kind of cases needed to go through CCC vetting. Given the CCC met only once a week, its role to endorse the SFC's action, which was simply a referral back to the HKEx / SEHK for follow up, might give an impression that the SFC had held up the cases for days to go through the CCC without added values. The PRP recommended the SFC to:

- consider passing such cases to relevant regulators immediately upon receipt; and notify the CCC of the case background and action taken subsequently; and

- review the SFC's definition of a "complaint" that required routing via the CCC before taking action, for example, differentiating "complaints" from enquiries or other categories.

3.111 When reviewing one of the above-mentioned cases, the PRP was told that the SFC had followed up the case progress with the SEHK. The PRP would like to know how the SFC had followed up with the SEHK.

The SFC's response

3.112 The SFC agreed that for clear cut or urgent cases, immediate action could be taken by regulatory unit immediately with the CCC being advised. The SFC's existing complaints handling procedures also allowed such flexibility in handling complaints.

3.113 The SFC commented that for the case reviewed by the PRP, the case did not appear to be very straightforward. Accordingly, the SFC followed the established procedures for the CCC to conduct a preliminary assessment and decide on the next course of action.

Screening Mechanism before routing to the CCC

3.114 The SFC agreed that it was useful to have a mechanism to differentiate incoming correspondence by its nature. The SFC currently had an initial screening process in order to distinguish whether correspondence should be treated as a complaint, an enquiry or another category. CCC only reviewed complaints (versus enquiries) that fell within the SFC's jurisdiction. In general, when a complaint was determined to fall within the SFC's jurisdiction, the SFC would proceed to prepare reports for the CCC's consideration.

Follow up monitoring action

3.115 The SFC advised that under the SFC's complaints handling procedures a complaint would be closed once it was referred to an external body (e.g. the SEHK).

3.116 As part of the SFC's oversight of the SEHK, the SFC received a monthly report which included a "List of complaints referred by the SFC and received by the SEHK directly". This list contained a summary of the complaints received by the SEHK and its assessment and decision in respect of them. If the SFC had concerns or questions about the way a complaint was handled, the SFC would raise the matter with the SEHK.

(b) § Staff complaint

The PRP's review

3.117 The PRP reviewed a complaint case lodged against a SFC's staff regarding her attitude and manner when handling an enquiry.

3.118 In accordance with the "Procedures for Handling Complaints against SFC staff", the SFC had referred the case to an Executive Director ("ED") for investigation and decision-making. Six months after the receipt of the complaint, the ED informed the complainant that investigation had to be held up as the staff would proceed on maternity leave. The ED subsequently interviewed the staff five months afterwards when she resumed from her leave and concluded that "there was no basis for further action". The ED then informed the complainant of the decision. The whole process took 11 months.

3.119 The PRP invited the SFC to elaborate on:

- why the case investigation had to be held up; and
- how it had monitored the progress of complaint case investigation against staff.

3.120 The PRP understood that the long processing time taken in this case (11 months) was partly attributable to the three-month maternity leave of the staff. Nevertheless, the PRP considered that the complaint was relatively straightforward and could have been handled earlier. The PRP was concerned that the delay would pose undue pressure on the staff being complained.

The SFC's response

3.121 There was currently an established process adopted by the SFC for the Commission Secretary to monitor progress of complaint cases against staff and reported to the Audit Committee on a quarterly basis.

(c) § Case involving regulators in the Mainland

The PRP's review

3.122 The PRP reviewed one case involving a group of clients of a firm in the Mainland, alleging that their offices in the Mainland were sealed by the Security Bureau of the Mainland and that they could not locate the person-in-charge of the firm. Enforcement Division of the SFC considered that the information was insufficient for any investigation. Intermediaries Supervision Department of the SFC made enquiry with the firm regarding the operation of its offices in the Mainland and its dealing with clients in the Mainland. Finally, the case was closed with no further action.

3.123 The PRP asked the SFC if it had taken steps to confirm with the

Security Bureau or relevant regulators of the Mainland about the allegation of the closure of the offices in the Mainland. The allegation appeared serious. There were possible concerns that the clients' money were at risk.

3.124 The PRP recommended the SFC to consider taking more proactive action when it investigated similar cases in future, including:

- to liaise/seek clarification direct with the relevant Mainland counterparts; and

- to adopt a more interactive approach, e.g. meeting with the firm concerned, in order to minimize the turnaround time in written communication.

The SFC's response

3.125 The SFC elaborated that based on the SFC's enquiry with the complaint target, the complaint target's two representative offices in the Mainland solely engaged in advisory, liaison, market research and other non-business related activities and did not handle client assets. The firm denied the allegation about the close down of its two representative offices by the Mainland authority. The SFC also did not receive any referral from the CSRC in relation to the complaint.

3.126 Since there was no evidence to substantiate the complainants' allegations or for further investigation, it was not necessary to seek assistance from Mainland authorities in respect of an unsubstantiated complaint.

3.127 The SFC appreciated the PRP's recommendation. The SFC and the CSRC had cooperation arrangements in relation to various aspects, including securities enforcement cooperation. The SFC's Enforcement Division had frequent dialogue with the CSRC's Enforcement Bureau, and both parties may notify or seek investigatory assistance from each other if there was suspected misconduct on the part of the SFC licensees in the Mainland.

3.128 The SFC thanked the PRP for their recommendation. In the current case, the SFC met with the senior management of the complaint target shortly after the case was referred to it. In that meeting, the SFC made enquiry about the operation of the complaint target's two representative offices in the Mainland and the complaint target confirmed that the two Mainland representative offices had no client servicing function. The SFC's enquiry continued after the meeting by conducting further review on the complaint target's books and records and controls and procedures pertaining to safeguard of client assets in order to ascertain its compliance.

3.129 The SFC would continue to adopt appropriate strategy and approach with a view to handling complaints expeditiously.

(d) § *Reply to Complainant*

The PRP's review

3.130 In reviewing another complaint case against a listed company, the PRP noted that the SFC only replied to the complainant with a short response, like "*the case being evaluated and appropriate action to be taken as necessary*". The PRP raised concern if such simple and standard reply was adequate. The PRP noted that there had been accusations from industry members on the lack of transparency in the SFC's replies to complainants.

3.131 At the case review meeting, the subject officers of the SFC explained that a simple reply was appropriate as the SFC had to balance between the secrecy of any information involving potential disciplinary case and a reply to complainant on its allegations.

3.132 The PRP could not fully agree to the above. The PRP recommended the SFC to devise a better complaint handling mechanism to deal with complaints. The guiding principle was that complainants should be aware of progress and result of their complaints.

The SFC's response

3.133 The SFC noted the PRP's views on the complaint handling mechanism. Under the existing complaint handling procedures, the SFC would inform complainants the status of their cases periodically and the result after completion of the review to the extent permitted under the secrecy provision of SFO.

3.134 The SFC advised that it had established procedures to deal with complaints received from external sources, which included responding to complainants at different stages of the process. The SFC was mindful of the expectation of a deserving complainant (who might be the victim of the subject of the complaint) to be informed of the progress and outcome of the case. The SFC was however restrained by the overriding secrecy provisions set out in section 378[7] of the SFO which, together with overriding fairness consideration for all involved – including any person against whom a complaint was made – limited how much information the SFC could give to a complainant.

3.135 The SFC had plans to review its complaints handling procedure, with a

[7] Section 378 prohibits the Commission and its staff from divulging details of the progress of a complaint (in particular but not limited to the fact that an investigation is underway) unless the information is already in the public domain, or any other specific exemption in that section applies.

view to minimizing overlaps and gaps and enhancing transparency and consistency. The review was expected to include the classification of complaints, to whom they should be referred and under what circumstances, whether any exceptions were justifiable, and the extent to which the SFC could keep complainants informed of progress bearing in mind the secrecy obligations.

3.136 For the case under review, the SFC reiterated that an announcement was issued following the SFC's review of the matter. After that, the SFC noted that the complainant commented that the listed company had published an announcement as a result of the complaint. Given this, the SFC took the view that it was not necessary to write to the complainant to inform him/her of the outcome of the SFC's review.

Corporate Finance including processing of listing applications

3.137 The PRP had reviewed a number of completed cases on corporate finance and concluded that the SFC had generally followed its operational guideline in the process. In the course of reviews, the PRP had recommended the SFC to enhance publicity on disclosure obligations by the listed companies and invited the SFC to elaborate on the difference of cessation between "beneficiary interest" and "legal interest" in the declaration of interest.

(a) § Regular reminder on disclosure obligations

The PRP's review

3.138 The PRP reviewed a case relating to a firm's failure to make public disclosure of dealings as required by the Takeovers Code. The PRP recommended that the SFC should consider more measures reminding fund managers of the disclosure obligations. Examples included (a) annual reminder via the Takeovers Bulletin and (b) publishing message in the Hong Kong Investment Funds Association publication.

The SFC's response

3.139 The SFC thanked the PRP for the helpful suggestions. In going forward, the SFC would issue an annual reminder in the Takeovers Bulletin. The SFC would also liaise with the Hong Kong Investment Funds Association and other similar bodies with a view to publishing a similar reminder in their publications.

(b) § Publicity on disclosure of interest

The PRP's review

3.140 The PRP had reviewed one investigation case involving the late disclosure of interest by a non-executive director of a company listed on the SEHK.

3.141 While the PRP noted the SFC had generally followed its operational guideline in processing the investigation, the PRP recommended the SFC to enhance its publicity on directors' responsibility to disclose interests and to

liaise with the HKEx on how to promote education among listed corporations.

The SFC's response

3.142 The SFC responded that it had not issued media releases for these cases for some years.

3.143 The obligation on listed company directors to disclose changes of interests was one that was well-known. The SFC applied a policy to avoid prosecuting the most trivial kind of cases. The SFC would consider what means there were to educate listed company directors as to their responsibilities. However, the number of these cases was relatively low suggesting the vast majority of listed company directors were well aware of their obligations.

(c) § Declaration of Interest

The PRP's review

3.144 The PRP noted another investigation case involving the breaches of disclosure of interest. There were complicated situations in declaration of interest arising from time difference of cessation between "beneficiary interest" and "legal interest".

3.145 The PRP invited the SFC to elaborate, with inputs from the HKEx, the following –

- the requirements to report cessation of interest on:

  (a) entering into a contract of an intention to transfer/sell the shares to a third party at a future date, i.e. transfer of beneficiary interest; and

  (b) conducting the actual transaction of transfer/sale of the shares, i.e. transfer of actual interest; and

- the timing when the shares concerned were regarded to have been legally transferred/sold under (a) and (b) above, and hence the change in the shareholding position which would affect the shareholder's status, e.g. of being a substantial shareholder.

The SFC's response

3.146 The SFC elaborated that for requirements to report cessation of interest:

- Where a duty of disclosure arose under section 310(1)(b) of the SFO in the circumstances specified in section 313(1)(d) of the Ordinance (e.g. where there is a change in nature of an interest on a person entering into a contract for the sale of shares) then if the change in the nature of his interest was due to his entering into a contract for the sale of shares under which he was required to deliver the shares to the purchaser within 4 days from the date of the contract the vendor was not required to give a notification under section 324 of the SFO (see section 5 of the Securities and Futures (Disclosure of Interests – Exclusions) Regulation). If a person contracted to sell shares with a settlement date (the day when he delivers the shares to the purchaser) 5 or more trading days after the date of the contract, then he must file a notice within 3 business days after the date of the contract.

- In each case the purchaser must file a notice within 3 business days of the day that he first acquired an interest in the shares (i.e. within 3 business days of the date of the contract) (see section 310(1)(a) in the circumstances specified in section 313(1)(a) or (c) of the SFO).

- In each case the vendor must file a notice within 3 business days after the date that he ceased to be interested in the shares (the date on which he delivers/transfers the shares to the purchaser) (see section 310(1)(a) in the circumstances specified in section 313(1)(b) or (c) of the SFO).

3.147 The SFC elaborated that for timing when the shares concerned were regarded to have been legally transferred/sold:

- Under (a) above, when a person entered into a contract of an intention to transfer/sell shares to a third party at a future date, the shares had been legally "sold" but only the beneficial interest of the shares (not legal interest) passed to the purchaser. Both the purchaser and the vendor were interested in the shares during this period. The purchaser should file a notice within 3 business days after he acquired an interest in the shares (i.e. within 3 business days of the date of the contract).

- Under (b) above, on settlement date (when the shares are delivered/transferred to the purchaser) the legal interest of the shares would be transferred to the purchaser and hence there would be a change in the nature of the purchaser's interest. This change in the nature of the purchaser's interest need not be notified to the Exchange if his equitable interest in those shares had been notified to the Exchange and the listed corporation concerned (see section 310(1)(b) of the SFO in the circumstances specified in section 313(1)(d) of the Ordinance but see the exception in section 313(13)(i)

therein). However, the vendor must file a notice within 3 business days after the date that he ceased to be interested in the shares (the date on which he delivered/transferred the shares to the purchaser).

Chapter 4 Way forward

4.1 In the year ahead, the PRP would continue its work with a view to ensuring that the SFC adheres to its internal procedures consistently.

4.2 The PRP welcomes and attaches great importance to the views from market practitioners. Comments on the work under the PRP's terms of reference could be referred to the PRP through the following channels[8] –

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

By email to: prp@fstb.gov.hk

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

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

Chapter 5 Acknowledgement

5.1 The PRP would like to express its gratitude to the SFC and its staff, in particular the Commission Secretary Ms Christine KUNG and Mr Paul YEUNG, for their assistance in facilitating the review work, and their co-operation in responding to the PRP's enquiries and recommendations in the year.

5.2 The PRP would also like to express its gratitude to the outgoing Chairman and members for all the years of hard work with the PRP. They are Mr CHOW Wing-kin, Anthony, Mr CHIU Chi-cheong, Clifton, Dr FONG Ching, Eddy, Mr FUNG Hau-chung, Andrew, Mr LEE Jor-hung, Dannis, Mr LIU Che-ning and Mr SUN Tak-kei, David. With their expertise and efforts, the PRP has managed to recommend practical measures for the consideration by the SFC.

5.3 The PRP would also like to place on record its appreciation to the support rendered by the outgoing Secretary, Ms Sanny CHAN, to the PRP's operation in the past three years.

Process Review Panel
for the Securities and Futures Commission
October 2013

Process Review Panel for the Financial Reporting Council

2013 Annual Report

Process Review Panel for the Financial Reporting Council

2013 Annual Report

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Chapter 1 : Background

Overview

1.1 The Process Review Panel for the Financial Reporting Council (PRP) is an independent and non-statutory panel established by the Chief Executive of the Hong Kong Special Administrative Region in 2008 to review cases handled by the Financial Reporting Council (FRC), and to consider whether actions taken by FRC are consistent with its internal procedures and guidelines. The establishment of PRP reflects the Administration's continuing commitment to enhance the accountability of FRC.

1.2 FRC was established under the Financial Reporting Council Ordinance (Cap. 588) (FRC Ordinance) in 2006 as an independent statutory body to investigate auditing and reporting irregularities and enquire into non-compliance with accounting requirements of listed corporations and collective investment schemes in Hong Kong. FRC plays a key role in upholding the quality of financial reporting, promoting the integrity of the accounting profession, enhancing corporate governance and protecting investors' interest.

1.3 Under the FRC Ordinance, FRC is empowered to conduct independent investigations into possible auditing and reporting irregularities in relation to listed entities and is assisted by the statutory Audit Investigation Board (AIB) comprising officers from the FRC Secretariat. FRC is also tasked to conduct independent enquiries into possible non-compliance with accounting requirements on the part of listed entities, and is assisted by the Financial Reporting Review Committees (FRRC), whose members are drawn from the statutory Financial Reporting Review Panel comprising individuals from a wide range of professions in addition to accountants.

Functions of PRP

1.4 The terms of reference of PRP are as follows –

(a) to receive and consider periodic reports from FRC on completed or discontinued cases;

(b) to receive and consider periodic reports from FRC on investigations and enquiries which have lasted for more than one year;

(c) to receive and consider periodic reports from FRC on complaints against FRC or its staff;

(d) to call for files from FRC to review the handling of cases to ensure that the actions taken and decisions made adhere to and are consistent with internal procedures and guidelines and to advise FRC on the adequacy of its internal procedures and guidelines where appropriate;

(e) to advise FRC such other matters relating to FRC's performance of statutory functions as FRC may refer to PRP or on which PRP may wish to advise; and

(f) to submit annual reports to the Secretary for Financial Services and the Treasury.

1.5 The above terms of reference apply to the main Council of FRC (the Council). The internal procedures which PRP would make reference to in reviewing FRC's cases include guidelines on the handling of complaints, initiation and processing of investigations and enquiries, review of modified auditor's reports and financial statements under its risk-based financial statements review programme, working protocols with other regulatory bodies, preservation of secrecy and identity of informers, and relevant legislative provisions.

1.6 PRP is tasked to review and advise FRC on its handling of cases, not its internal operation or administrative matters. Therefore, the work of the committees set up under FRC is not subject to direct review by PRP.

Modus operandi of PRP

1.7 At its first meeting held in mid-November 2008, PRP decided that except for the first review cycle that should start from July 2007 (when FRC became fully operational) until end December 2008, all case review cycles thereafter should run on a calendar year basis.

1.8 Based on FRC's caseload during the relevant review cycle,

PRP would select cases for review at the end of the cycle, and all PRP members would join the case review session(s). The approach for case selection could be reviewed or fine-tuned as PRP proceeds with the case review work.

1.9 PRP members are reminded to preserve secrecy in relation to information furnished to them in the course of PRP's work, and to refrain from disclosing such information to other persons. To maintain the independence and impartiality of PRP, all PRP members would declare their interests upon the commencement of their terms of appointment and before conducting each case review.

Composition of PRP

1.10 At the time of the present review, PRP comprised six members, including the Chairman who is a lay person (i.e. non-accountant) to avoid conflict of interests, the FRC Chairman as an ex-officio member, a member from the accountancy sector, and three other members from the financial and legal sectors.

1.11 The membership of PRP is at **Annex**.

Follow-up on PRP's recommendation made in the 2012 Annual Report

1.12 In its 2012 Annual Report, PRP recommended that FRC should consider the need to outsource its translation work to relevant professionals in future if internal resources and capabilities are challenged and to invite an appropriate person with relevant expertise to vet the translation work. In response to PRP's recommendation, FRC has introduced a new procedure requiring a complaint officer to consider the need to outsource the translation work when a Chinese translation of the request for information was sought by a listed entity.

1.13 In the same Annual Report, PRP also recommended that if there was a need for FRC to make informal requests for information before a formal investigation was initiated, it should put down a marker in its requests to the effect that if the party concerned was unable to provide the requested information by a specified deadline, the Council may consider initiating an investigation to compel the party to provide the information by law. In response to the recommendation, FRC has

amended its operations procedures to the effect that if a complaint officer was satisfied that there was no reasonable excuse for the relevant party not to comply with the request for information within two months or that the repeated demands by the relevant party for extension of the deadline for complying with the request for information was a delaying tactic, the complaint officer shall take into account such "non-cooperation" as one of the factors in deciding whether to recommend the Council to initiate an enquiry and/or investigation to compel the relevant party to provide the information by law.

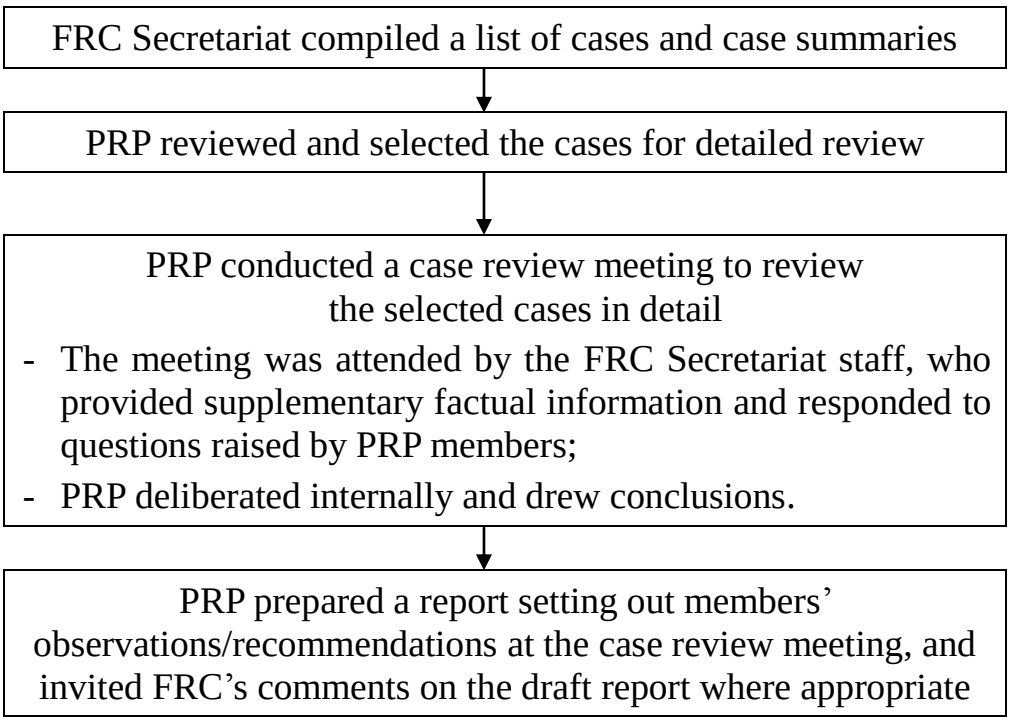
1.14 PRP has noted the follow-up actions taken by FRC in the light of its recommendation made in the 2012 Annual Report.

Chapter 2 : Work of PRP in 2013

2.1 This Annual Report covers the work of PRP in 2013, which reviewed reports from FRC on cases completed by it during the fifth review cycle (i.e. from January to December 2012).

Case review workflow

2.2 The workflow adopted by PRP in reviewing the cases is set out below –



Selection of cases for consideration/review

2.3 The FRC Secretariat advised PRP that FRC had completed 25 cases during the fifth review cycle. The PRP members were provided with summaries of all the 25 cases for review. The distribution of the 25 cases is as follows –

Distribution of cases	Total number
Completed investigation cases	7
Completed cases which involved both investigation and enquiry	2

Distribution of cases	Total number
Unsubstantiated cases	11
Cases referred to other regulatory bodies for follow-up	3
Cases that FRC directly followed up with the relevant listed entity/auditor	2

2.4 Out of the 25 cases, PRP selected nine cases for review –

(a) two completed investigation cases arising from the review of complaints;

(b) a completed case arising from the review of complaints which involved both an enquiry and an investigation;

(c) a completed case which was referred to another regulatory body for follow-up;

(d) two completed investigation cases arising from the proactive review of financial statements concerning the same listed entity but involving different auditors;

(e) a completed case arising from the proactive review of financial statements which involved both an enquiry and an investigation;

(f) an unsubstantiated case arising from the proactive review of financial statements; and

(g) a completed case followed up directly by FRC with the listed entity.

PRP considered that the selection of these nine cases reflected a good mix of the cases which fell within the fifth review cycle.

Case review session

2.5 After PRP has selected the nine cases for review, and with the assistance of FRC, the PRP Secretariat made preparation for the case review meeting which was held in September 2013 to review the selected cases.

2.6 The PRP Secretariat had invited all members to declare interest before the meeting. Two PRP members had declared their potential conflict of interests with regard to the cases under review. At the start of the case review meeting, the PRP Chairman further reminded members to declare any possible conflict of interest in the cases to be reviewed. The meeting agreed that for one of the members who had declared interest, since neither the member nor the member's relatives had been personally involved in the cases concerned, there was no apparent conflict of interest and it was not necessary for the member to withdraw from the review. As for the other member, the meeting noted that the member had volunteered to abstain from both the discussion and voting in respect of one case to avoid any perceived conflict of interests having regard to the fact that the Independent Non-Executive Director of a listed entity involved in the case was a family member of the member.

2.7 PRP's observations in respect of the selected cases and its recommendations to FRC are set out in the following chapters.

Chapter 3 : PRP's review of cases handled by FRC

3.1 On the whole, having considered the nine cases reviewed in the fifth cycle, PRP was of the view that FRC had followed its internal procedures in handling the cases.

(1) Review of a completed investigation case arising from a review of complaint

Case facts

3.2 PRP reviewed a complaint case which led to a formal investigation into a suspected auditing irregularity in relation to the audits of the consolidated financial statements of a former listed entity for the years ended 31 March 2001 and 31 March 2002 respectively. The complainant alleged that the auditor concerned had issued audit reports with unmodified audit opinion but failed to identify fictitious documentation and irregular issues during the course of the audits. FRC took 26 months to complete the case and the time taken by FRC to process the case was the longest amongst all cases completed during the fifth review cycle.

FRC actions

3.3 The Council had examined the case and directed AIB to investigate the alleged auditing irregularity. Based on its findings, AIB was of the view that the auditor had not obtained sufficient appropriate audit evidence and had not prepared sufficient and appropriate audit documentation in relation to the audit procedures performed. The Council adopted the investigation report by AIB and referred it to the Hong Kong Institute of Certified Public Accountants (HKICPA) to determine if any disciplinary actions were warranted.

PRP's areas of review

3.4 Based on the case facts outlined above, PRP reviewed the following steps taken by FRC in handling the case –

(a) initial screening;

(b) liaising with the listed entity and the audit firm to review the allegations;

(c) preparing and submitting a complaint assessment report to the Council;

(d) initiating a formal investigation;

(e) directing AIB to conduct the investigation;

(f) preparing and issuing the investigation report by AIB;

(g) adoption of the investigation report by the Council; and

(h) referring to another regulatory body for follow-up.

3.5 Noting that some of the audit working papers of the listed entity in question were kept by the Commercial Crime Bureau of the Police Force (CCB), PRP questioned whether there were any existing guidelines on the procedures to follow in respect of the sharing of information between CCB and FRC, and whether such sharing of information might jeopardise the investigation conducted by either party. FRC clarified that CCB had subsequently passed the audit working papers to the complainant, and therefore there was no need for FRC to obtain them from CCB. Nonetheless, the complainant had been informed of FRC's earlier request to CCB for the audit working papers.

3.6 PRP noted that FRC had sent the first requirement to the auditor requesting for information only after more than two months from the receipt of complaint, and asked if there were any reason causing the delay. FRC explained that time was used to ascertain the scope and legal basis of the investigation as the case involved accounts which were audited prior to the establishment of FRC in 2006. PRP also noted that FRC had arranged telephone conversation with the complainant for the purpose of obtaining more background information on the complaint and his allegation, and opined that in future FRC might consider obtaining such information in writing where appropriate to protect the interests of both parties.

3.7 In response to PRP's question on the standard practice for consultation on a draft investigation report, FRC said that it would normally send a draft investigation report to all relevant parties named in the report for comments. FRC would also circulate the draft for comments by an honorary adviser, its in-house legal counsel and, for complex/contentious cases, an external legal adviser engaged by FRC. In response to PRP's question on what information would be passed by FRC to HKICPA for follow-up action, FRC said that all supporting information relating to the findings identified in the investigation would be passed to HKICPA for its consideration on whether to initiate disciplinary actions.

Conclusion

3.8 Having reviewed FRC's handling of the case and taking into account the above clarifications, PRP took the view that, in view of the complexity of the case and the multiple issues involved, it was reasonable for FRC to have taken more than two years to complete the case and concluded that FRC had handled the case appropriately and in accordance with its internal procedures.

(2) Review of a completed investigation case arising from a review of complaint

Case facts

3.9 PRP reviewed a complaint case leading to a formal investigation into a suspected auditing irregularity in relation to the audit of the consolidated financial statements of a listed entity for the year ended 31 December 2008. It was alleged that the auditor had not obtained sufficient appropriate audit evidence and had not prepared audit documentation sufficiently. The case was selected by PRP for review because HKICPA had identified the relevant irregularity during its practice review programme and informed FRC of the same while the Disciplinary Committee of the HKICPA had at the same time initiated proceedings against the auditor concerned notwithstanding that FRC had not yet completed its investigation.

FRC actions

3.10 The Council had examined the case and directed AIB to investigate the alleged auditing irregularity. Based on its findings, AIB was of the view that the auditor had not obtained sufficient appropriate audit evidence and had not prepared sufficient and appropriate audit documentation in relation to the audit procedures performed. Besides, AIB opined that both the auditor and the engagement director of the audit had not fully complied with the Code of Ethics for Professional Accountants. The Council adopted the investigation report by AIB and referred it to HKICPA to determine if any disciplinary actions were warranted.

PRP's areas of review

3.11 Based on the case facts outlined above, PRP reviewed the

following steps taken by FRC in handling the case –

(a) initial screening;

(b) liaising with the listed entity and the audit firm to review the allegations;

(c) preparing and submitting a complaint assessment report to the Council;

(d) initiating a formal investigation;

(e) directing AIB to conduct the investigation;

(f) preparing and issuing the investigation report by AIB;

(g) adoption of the investigation report by the Council; and

(h) referring to another regulatory body for follow-up.

3.12 PRP noted that HKICPA had made the decision of referring the case to its Disciplinary Committee on the basis of the findings of its practice review programme pursuant to section 32D(5) of the Professional Accountants Ordinance (Cap. 50), without waiting for the completion of FRC's investigation. PRP also noted that to avoid the same situation from happening again, FRC and HKICPA had subsequently reached an agreement in 2012 under which HKICPA would refrain from referring any relevant irregularity identified during its practice review to its Disciplinary Committee for disciplinary action before FRC had completed its investigation into the irregularity.

3.13 In response to PRP's question on the reason for the one-month gap between the receipt of legal advice by FRC and the Council's approval for the initiation of investigation, FRC replied that it was solely due to the time gap before the next Council meeting was scheduled to be held. While it was possible to seek Council's decision to initiate the investigation by circulation of papers, FRC considered it appropriate for the case to be discussed by the Council at a meeting in view of its unique nature.

3.14 PRP noted that the auditor had failed to provide its comments on the draft investigation report within the deadline as required by FRC, and asked if the auditor had applied for an extension of deadline. FRC replied that the auditor had provided its comments within one week after the deadline, and since it was heavily engaged in auditing financial statements during the relevant period, FRC considered that the delay was acceptable.

Conclusion

3.15 Having reviewed FRC's handling of the case and taking into account the above clarifications, PRP took the view that FRC had handled the case appropriately and in accordance with its internal procedures.

(3) Review of a completed case arising from the review of complaints which involved both an enquiry and an investigation

Case facts

3.16 PRP reviewed a complaint case leading to both a formal enquiry into possible non-compliances with accounting requirements and a formal investigation into suspected auditing irregularities in relation to the consolidated financial statements of a listed entity for the year ended 31 December 2008 as well as its audits for the years ended 31 December 2008 and 31 December 2009 respectively.

FRC actions

3.17 Having examined the case, the Council appointed a FRRC to conduct an enquiry. FRRC considered that there were non-compliances with accounting requirements in the relevant financial statements. Based on the results of the enquiry, the Council adopted the report of FRRC. To follow-up on the non-compliances, FRC issued a notice under section 49 of the FRC Ordinance to the listed entity requiring the removal of the relevant non-compliances.

3.18 In respect of the investigation, FRC examined the case and directed AIB to investigate the alleged auditing irregularity. Based on its findings, AIB was of the view that the auditor had failed to plan and perform the audits with an attitude of professional skepticism, and had not obtained sufficient appropriate audit evidence to draw reasonable conclusions on which his audit opinions were based. The Council adopted the investigation report by AIB and referred it to HKICPA to determine if any disciplinary actions were warranted.

PRP's areas of review

3.19 Based on the case facts outlined above, PRP reviewed the following steps taken by FRC in handling the case –

(a) initial screening;

(b) liaising with the listed entity and the audit firm to review the allegations;

(c) preparing and submitting a complaint assessment report to the Council;

(d) initiating a formal enquiry and a formal investigation;

(e) appointing and working with FRRC to conduct the enquiry and directing AIB to conduct the investigation;

(f) preparing and issuing the enquiry report by FRRC and investigation report by AIB;

(g) adoption of the enquiry and investigation reports by the Council; and

(h) referring to another regulatory body for follow-up.

3.20 PRP asked whether FRC had any objective guidelines on the relevant parties to be consulted on a draft investigation report. FRC replied that it would normally send a draft investigation report to all relevant parties named in the report for comments. FRC would also circulate the draft for comment by an honorary adviser, its in-house legal counsel and, for complex/contentious case, an external legal adviser engaged by FRC. In case FRC had any queries on the interpretation of accounting standards, it would also seek comments from HKICPA pursuant to a Memorandum of Understanding signed between the two parties. PRP recommended setting out the arrangements between HKICPA and FRC on the interpretation of professional standards in the operations manual for the sake of clarity.

3.21 PRP further noted that a revised draft investigation report had been prepared and circulated for comment in this case. It queried why the auditor, who had been given the opportunity to comment on the draft report previously, was granted a time extension of one month for commenting on the revised draft report. FRC explained that the revised draft investigation report involved substantive changes, e.g. it included a more serious auditing irregularity which was not identified in the earlier draft. Therefore, FRC considered it reasonable to allow more time for the auditor to prepare its response to FRC's findings.

Conclusion

3.22 Having reviewed FRC's handling of the case and taking into account the above clarifications, PRP took the view that FRC had handled the case appropriately and in accordance with its internal procedures.

(4) Review of a completed case which was referred to another regulatory body for follow-up

Case facts

3.23 PRP reviewed a complaint case received by FRC which alleged that there was non-compliance with accounting requirements. Besides, it was alleged that the auditor of the listed entity had failed to obtain sufficient appropriate audit evidence and prepare sufficient and appropriate audit documentation.

FRC actions

3.24 FRC had examined the complaint and issued informal requests to both the listed entity and the auditor for information in relation to the complaint.

3.25 Based on the information and explanations obtained, FRC considered that there was no evidence suggesting that there was any non-compliance with accounting requirements. Besides, FRC considered that there was no evidence suggesting that the auditor had not obtained sufficient appropriate audit evidence to draw reasonable conclusion in relation to the consolidation of the subsidiary in question. Both allegations were not pursued further.

3.26 However, FRC considered that the auditor had not prepared sufficient and appropriate audit documentation to enable another experienced auditor to understand the results of the audit procedures and the audit evidence obtained. Therefore, after considering the complaint assessment report, the Council agreed to refer the identified irregularity to HKICPA for follow-up action.

PRP's areas of review

3.27 Based on the case facts outlined above, PRP reviewed the following steps taken by FRC in handling the case –

(a) initial screening;

(b) liaising with the listed entity to review the potential non-compliances and with the auditor on the potential irregularity;

(c) preparing and submitting a complaint assessment report to the Council; and

(d) concluding the review and referring the case to another regulatory body for follow-up.

3.28 PRP noted that the Council did not initiate any formal investigation into the identified audit irregularity concerning insufficient audit documentation, but had decided to refer the irregularity to HKICPA for follow-up actions after considering the complaint assessment report. PRP asked if it was because the irregularity was so apparent that a formal investigation was deemed not necessary. FRC said that the Council had decided that it was not necessary to initiate a formal investigation as it considered that the irregularity was apparent and noting the fact that the Practice Review Committee of HKICPA had already looked into the issue. FRC added that it had informed the auditor of FRC's findings and follow-up actions upon completing the case.

3.29 In response to PRP's query on whether FRC might be challenged for not having gone through the statutory due process to initiate an investigation to look into the potential irregularities before referring them to HKICPA, FRC said that under section 9 of the FRC Ordinance, it was empowered to refer cases which it had considered to HKICPA with or without initiating an investigation, while section 51 of the Ordinance allowed FRC to share its findings with HKICPA.

Conclusion

3.30 Having reviewed FRC's handling of the case and taking into account the above clarifications, PRP concluded that FRC had handled the case in accordance with its internal procedures.

(5) Joint review of two completed investigation cases arising from the proactive review of financial statements concerning the same listed entity but different auditors

Case facts

3.31 PRP conducted a joint review on two investigation cases arising from FRC's proactive review of financial statements. The investigation cases related to the financial statements of a listed entity for the years ended 31 December 2007 and 31 December 2008 respectively which were audited by two different auditors. It was alleged that there were possible non-compliances with accounting requirements in the preparation of financial statements, and that the non-compliances were so material that the two auditors might not have formed an appropriate auditor's opinion on the financial statements.

FRC actions

3.32 The Council had examined the cases and directed AIB to investigate the alleged auditing irregularities. AIB was of the view that the issues of non-compliance would have a significant impact on the relevant financial statements and both auditors should have modified their reports on the relevant financial statements in these respects. AIB also identified certain audit documentation issues committed by both auditors in relation to the audits of the relevant financial statements. The Council adopted the two investigation reports by AIB and referred them to HKICPA for follow-up action.

PRP's areas of review

3.33 With the above background, PRP reviewed the following steps taken by FRC in handling the case –

(a) initial screening;

(b) liaising with the listed entity and the audit firms to review the allegations;

(c) preparing and submitting a review assessment report to the Council;

(d) initiating formal investigations;

(e) directing AIB to conduct the investigations;

(f) preparing and issuing the investigation reports by AIB;

(g) adoption of the investigation reports by the Council; and

(h) referring to another regulatory body for follow-up.

3.34 FRC advised that since the listed entity involved had changed its auditor, two separate investigations were initiated into the previous and subsequent auditors. PRP enquired about the previous auditor's request for consent from FRC for disclosure of information to the listed entity. FRC explained that the auditor had considered itself duty-bound to inform the listed entity that information pertaining to the audit engagement would be disclosed to FRC, and it had accordingly requested FRC's consent for making such disclosure pursuant to section 51 of the FRC Ordinance, which imposes a statutory requirement of preservation of secrecy except, among others, with FRC's consent.

3.35 On PRP's question about the reason for granting a number of time extensions to the two auditors, FRC explained that most of the accounting issues involved were judgmental and complicated, and it was reasonable to allow more time to the auditors to furnish the information requested by FRC.

Conclusion

3.36 Having reviewed FRC's handling of the cases and taking into account the above clarifications, PRP concluded that FRC had handled the cases in accordance with its internal procedures.

(6) Review of a completed case arising from the proactive review of financial statements which involved both an enquiry and an investigation

Case facts

3.37 PRP reviewed a completed case leading to both a formal enquiry into possible non-compliance with accounting requirements and a formal investigation into a suspected auditing irregularity, which arose from FRC's proactive review of a listed entity's financial statements for the year ended 31 March 2010. Since the enquiry was completed in 2011 and had been reviewed by PRP in the last review cycle, PRP had focused its review on the completed investigation concerning the audits of the consolidated financial statements of the listed entity for the years ended 31 March 2008 and 31 March 2009 respectively in the present review.

FRC actions

3.38 FRC had examined the case and the Council had directed AIB to investigate the alleged auditing irregularity. Based on its findings, AIB was of the view that there was non-compliance with accounting requirements which was material to the relevant financial statements. Therefore, the auditor's reports on the relevant financial statements should have been modified in this respect. Besides, AIB considered that the auditors had not prepared sufficiently detailed audit documentation. The Council adopted the investigation report by AIB and referred it to HKICPA to determine if any disciplinary actions were warranted.

PRP's areas of review

3.39 Based on the case facts outlined above, PRP reviewed the following steps taken by FRC in handling the case –

(a) initial screening;

(b) liaising with the listed entity and the audit firm to review the allegations;

(c) preparing and submitting a review assessment report to the Council;

(d) initiating a formal investigation;

(e) directing AIB to conduct the investigation;

(f) preparing and issuing the investigation report by AIB;

(g) adoption of the investigation report by the Council; and

(h) referring to another regulatory body for follow-up.

3.40 After FRC's brief presentation of the case, PRP noted FRC's handling of this case and had raised no question.

Conclusion

3.41 Having reviewed FRC's handling of the case, PRP took the view that FRC had handled the case appropriately and in accordance with its internal procedures.

(7) Review of an unsubstantiated case arising from the proactive review of financial statements

Case facts

3.42 Among the 11 completed cases whereby the allegations were unsubstantiated, PRP selected one case for review to consider if the case had been handled in accordance with FRC's internal procedures. The chosen case involved –

(a) possible non-compliance in the fair value measurement of the convertible notes; and

(b) possible auditing irregularity in the audit of fair value measurement and disclosures, and the use of the work of an expert and the audit opinion.

FRC actions

3.43 FRC had sought clarification from the listed entity and the auditor regarding the accounting treatment used in the financial statements and the audit procedures performed. Taking into account their observations, FRC considered that there was no apparent non-compliance with accounting requirements in the financial statements. FRC also considered that there was no apparent auditing irregularity. The Council decided not to pursue the case further.

PRP's areas of review

3.44 With the above background, PRP reviewed the following steps taken by FRC in handling the case –

(a) initial screening;

(b) liaising with the listed entity and the auditor to review the allegations;

(c) preparing and submitting a review assessment report to the Council; and

(d) closing the case.

3.45 FRC highlighted that a time extension was granted to the listed entity for preparing information requested by it because the director of the listed entity concerned had been out of town when the request was issued. PRP enquired about the reason for FRC to spend almost two months to prepare the review assessment report. FRC advised that

under its standard procedures, a draft report would be considered by Operations Oversight Committee (OOC) before it was submitted to the Council for consideration. In this particular case, FRC had taken some time to revise the report having regard to OOC members' comments before submission to the Council.

Conclusion

3.46 Having reviewed FRC's handling of the case and taking into account the above clarification, PRP concluded that FRC had handled the case in accordance with its internal procedures.

(8) Review of a completed case directly followed up by FRC with the listed entity

Case facts

3.47 The case arose from a proactive review of financial statements by FRC. It involved a potential non-compliance with accounting requirements in the financial statements of a listed entity concerning an acquisition made by the entity.

FRC actions

3.48 FRC had sought clarification from the listed entity and considered that there was no apparent non-compliance with accounting requirements and the issue was not pursued further. FRC also noted that there was a minor non-compliance issue which had been restated in the subsequent financial statements. Accordingly, the issue was not pursued further.

3.49 In respect of a disclosure deficiency in the financial statements, FRC had reminded the listed entity that it should have provided further information in its financial statements.

PRP's areas of review

3.50 PRP noted the issues involved in the selected case and reviewed the following steps taken by FRC in handling the case –

(a) initial screening;

(b) liaising with the listed entity to review the potential

non-compliance with accounting requirements;

(c) preparing and submitting a review assessment report to the Council; and

(d) following up directly with the listed entity with advice.

3.51 PRP asked whether it was appropriate to only draw the attention of the listed entity to the disclosure deficiency instead of taking formal follow-up actions. FRC explained that since the identified non-compliance only represented a deficiency in disclosure and had no impact on the financial information presented in the financial statements, FRC had decided that it was not necessary to initiate an enquiry case. In response to PRP's query on the reason for FRC to spend almost two months to submit the review assessment report to the Council for consideration, FRC advised that the time was required for preparation of the report and for seeking OOC's endorsement in accordance with its standard procedures.

Conclusion

3.52 Having reviewed FRC's handling of the case and taking into account the above clarifications, PRP concluded that FRC had handled the case in accordance with its internal procedures.

Chapter 4 : Recommendations and way forward

4.1 During the review, PRP performed its functions through reviewing reports from FRC on nine completed cases during the review cycle. PRP concluded that FRC had handled the cases in accordance with its internal procedures, but recommended FRC to consider setting out in its operations manual the procedural arrangements between HKICPA and FRC on the interpretation of professional standards in case FRC had any queries.

4.2 FRC accepted PRP's recommendation above and will take appropriate follow-up actions. While the procedural arrangements between HKICPA and FRC have been set out in the Memorandum of Understanding between the two parties, FRC agreed to set out these arrangements in its operations manual.

4.3 PRP will continue its work on the review of completed cases to ensure that FRC adheres to its internal procedures consistently. For 2014, PRP will select cases that FRC has completed during the period between January and December 2013 for review.

4.4 Comments on the work of PRP can be referred to the Secretariat of PRP for FRC by post (Address: Secretariat of PRP for FRC, 15th Floor, Queensway Government Offices, 66 Queensway, Hong Kong) or by email (email address: frcprp@fstb.gov.hk)[1].

[1] For enquiries or complaints not relating to the review work of FRC, they should be made to FRC directly –
By post : 29th Floor, High Block, Queensway Government Offices, 66 Queensway, Hong Kong
By telephone : (852) 2810 6321
By fax : (852) 2810 6320
By email : general@frc.org.hk

Chapter 5 : Acknowledgement

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

Secretariat of the Process Review Panel
for the Financial Reporting Council
April 2014

Annex

Process Review Panel
for the Financial Reporting Council

2013 Membership

Chairman

Mr. Edmund K H LEUNG, SBS, JP (梁廣灝)

Members

Ms. Angelina Agnes KWAN (關蕙)

Ms. Elizabeth LAW, MH, JP (羅君美)

Mr. Peter LO Chi-lik (羅志力) (until 31 October 2013)

Mr. Joseph PANG Yuk-wing, JP (彭玉榮) (until 31 October 2013)

Mr. Vincent KWAN (關永盛) (from 1 November 2013)

Mr. Anthony CHOW, SBS, JP (周永健) (from 1 November 2013)

Mr. John POON, JP (潘祖明), ex-officio member

(With Secretariat support provided by
the Financial Services and the Treasury Bureau)

Annex B
附件 B

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

SFC
證監會

Disciplinary Proceedings at a Glance
紀律處分程序概覽

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SFC Disciplinary Proceedings at a Glance

This pamphlet is intended to provide a brief overview of our disciplinary process. Under Part IX of the Securities and Futures Ordinance ("SFO"), the SFC is given power to discipline those that it licenses or registers, comprising firms and those who perform functions for them which require a licence or registration including those involved in their management[1] (together referred to as "regulated persons"). If the SFC finds that a regulated person's conduct suggests it is guilty of misconduct or not fit and proper, the SFC may impose sanctions selected from a range set out in the SFO. This pamphlet explains how we go about this process.

This pamphlet is not about other actions that the SFC may take such as civil proceedings before the High Court, criminal proceedings before the Magistrates' Court or proceedings before the Market Misconduct Tribunal.

Why does the SFC discipline?

Under the SFO, one of the SFC's functions is to protect the interests of investors and to maintain market integrity. One of the ways we do this is by enforcing the law through imposing disciplinary sanctions on regulated persons. Through discipline, the SFC ensures firm and appropriate action is taken against those who harm investors or damage market integrity, regardless of their position and status. The threat of sanctions being imposed by the SFC serves to deter non-compliance with regulatory requirements.

It is of paramount importance to us that all regulated persons are treated fairly in the disciplinary process. When making disciplinary decisions, the SFC will have regard to its previous decisions while taking into account the specific circumstances of each case. However, the Securities and Futures Appeals Tribunal[2] has ruled that the SFC may disregard previous decisions where changed circumstances warrant it. The SFC will adjust its penalties from time to time in light of various considerations it deems relevant to the discharge of its statutory duties and to changing market circumstances, particularly market participants' behaviour. The SFC aims at all times to impose sanctions which are proportionate to the gravity of the improper conduct.

Who is subject to SFC disciplinary action?

- As noted above the SFC has power to take disciplinary action against regulated persons only. This means: licensed or registered corporations; representatives and responsible officers of licensed corporations; executive officers and relevant individuals of registered corporations; and those who are not licensed or otherwise given a regulatory approval but are involved in the management of a licensed or registered corporation.

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1 The SFC also disciplines under the old law in relation to conduct which occurred before the commencement of the SFO on 1 April 2003 by virtue of certain transitional provisions in Schedule 10 of the SFO. This is likely to continue for some years to come.

2 See page 6 for a discussion of the role of the Tribunal

Criteria for determining whether to take disciplinary action and the level of sanctions

The SFC will consider all the circumstances of a case, including:

- The nature and seriousness of the conduct
  - impact of the conduct on market integrity
  - costs imposed on/losses caused to clients/market users/investing public
  - nature of the conduct (eg whether it is intentional/reckless/negligent; whether prior advice was sought from advisors/supervisors)
  - duration and frequency of the conduct
  - whether the conduct is widespread in the industry
  - whether the conduct was engaged in by the firm/individual alone or as a group and the role in that group
  - whether there is a breach of fiduciary duty
  - (for firms) revelation of serious/systematic management system or internal control failures
  - whether the SFC has issued any guidance concerning the conduct

- The amount of profits accrued or loss avoided

- Other circumstances of the firm/individual
  - manner of reporting the conduct by the firm/individual
  - degree of co-operation with the SFC and other authorities
  - remedial steps taken since the identification of relevant conduct
  - previous disciplinary record
  - (for individuals) experience and position

- Other relevant factors
  - SFC's action in previous similar cases (note: usually similar cases would be treated consistently. However, if the misconduct has become prevalent or widespread in the market, the SFC may impose a heavier sanction than in the past)
  - punishment/regulatory action by other authorities

The criteria listed above are **not exhaustive**.

Disciplinary measures available to the SFC

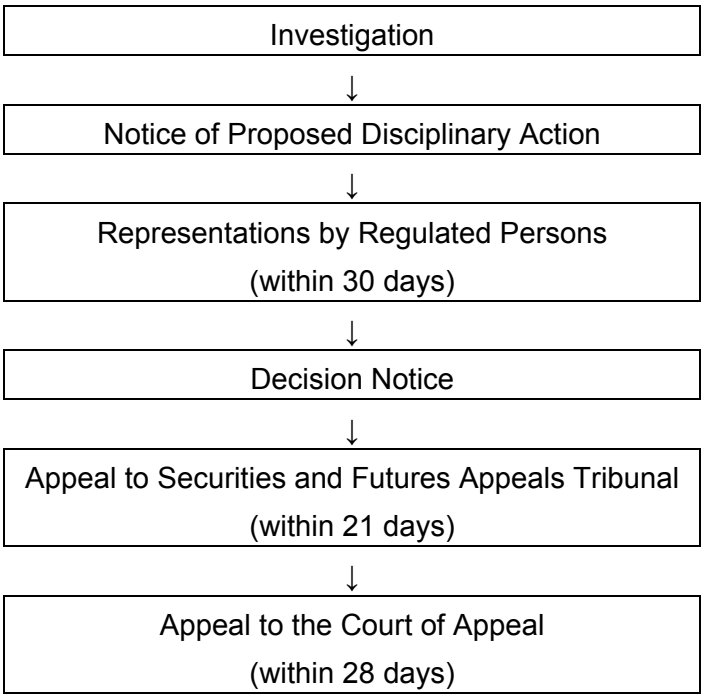
The SFC is empowered to impose one or more of the following sanctions:

- **revocation** or **partial revocation** of licence or registration
- **suspension** or **partial suspension** of licence or registration
- **revocation** of approval to be a responsible officer
- **suspension** of approval to be a responsible officer
- **prohibition** of application for licence or registration
- **prohibition** of application to become a responsible officer, executive officer or relevant individual
- **fine** (up to the maximum of $10 million or 3 times of the profit gained/loss avoided, whichever is the higher)
- **reprimand** (private or public)

All the SFC's sanctions, other than a private reprimand, will be published by means of a press release. All press releases on SFC enforcement actions, including disciplinary actions, are available on the SFC website (www.hksfc.org.hk) under "Enforcement News".

To better understand the considerations of the SFC when imposing a fine, please refer to the SFC Disciplinary Fining Guidelines published in March 2003, which can be found on the SFC website under "Regulatory Handbook" - "Codes, Guidelines and Circulars".

Disciplinary process



Investigation

The SFC investigates acts that suggest misconduct or that call into question the fitness and properness of a regulated person. The SFC may initiate an investigation on the basis of information from any source, including the public, other regulators or law enforcement agencies in Hong Kong, such as the Hong Kong Monetary Authority and the Police, foreign regulators, Hong Kong Exchanges and Clearing Limited, and internal referrals. Internal referrals may arise from the SFC's monitoring of day-to-day trading in the stock and derivatives markets, from the SFC's inspections of intermediaries or from investigations into other matters, such as civil market misconduct or criminal offences. Following the investigation, the SFC will consider whether or not there is sufficient evidence to commence disciplinary proceedings.

The SFC's disciplinary investigations should not be confused with those of other bodies, such as the Hong Kong Police or the ICAC, who investigate suspected criminal behaviour, or other bodies with the power to discipline, such as Hong Kong Exchanges and Clearing Limited.

Notice of proposed disciplinary action (NPDA)

An NPDA is sent to the regulated person if the SFC decides to start disciplinary proceedings. The NPDA sets out the preliminary views of the SFC on the misconduct and/or conduct that calls into question the fitness and properness of the regulated person. It also states the sanctions the SFC considers appropriate to impose on the basis of the facts as it understands them at the time.

Representations by regulated persons

In the NPDA, the SFC invites the regulated person to explain the matter and why the proposed sanctions are not appropriate. Representations should be made in writing to the person who signed the NPDA. Representations should not be made to other SFC directors or officers, as they will not be involved in making the decision.

The SFC expects representations on the facts and proposed sanctions to be made at the same time.

An opportunity to be heard

Before exercising any power to discipline, the SFC must first give the regulated person a reasonable opportunity to be heard by allowing the regulated person to make representations explaining the matter and commenting on the appropriateness of the proposed sanctions. Under normal circumstances, the regulated person is given 30 days to make representations. However, the SFC will consider reasonable requests for further extensions (eg to consider complex evidence).

If a response is not provided before the deadline stated in the NPDA, the SFC will make a final decision on the sanctions based on the evidence before it and it is likely that the SFC will impose the sanctions proposed in the NPDA. The SFC will then send another letter informing the regulated person of the decision and the reason for imposing the sanctions.

Legal representation

A regulated person may wish to get legal advice, which may include instructing their lawyer to make representations to the SFC on their behalf.

Request for evidence when making representations to the SFC

When the SFC issues an NPDA to the regulated person setting out the proposed sanctions, the SFC will also provide the regulated person with a list of documents that are relevant to the facts and matters set out in the NPDA. The regulated person may ask for a copy of documents on the list from the SFC.

Meeting the SFC

Disciplinary proceedings are normally determined on the basis of written submissions. However, a regulated person may ask for a meeting with the SFC to make oral submissions. If a regulated person wants to have a meeting with the SFC, he must apply to the SFC in writing explaining why he thinks it is necessary. The SFC will hold a meeting with the regulated person if it considers fairness in the circumstances requires a meeting.

In the course of disciplinary proceedings, if fairness in the circumstances demands, the SFC may invite the regulated person to attend a meeting to clarify certain issues even without an application from that person. The SFC may notify a regulated person of its decision to hold a meeting in these circumstances in the NPDA or after receiving written submissions.

Decision notice

The SFC will review all information submitted by the regulated person in their representations together with all the evidence it already possesses. The SFC will then send a decision notice in writing to the regulated person detailing the SFC's decision. The decision notice will set out:

- the reasons for the decision;
- the time at which the decision is to take effect;
- the duration and terms of any revocation, suspension or prohibition to be imposed;
- the terms of any reprimand under the decision; and
- the amount of any fine that may be imposed as well as the date by which it must be paid.

The decision notice will also include information on the regulated person's right to appeal to the Securities and Futures Appeals Tribunal against the decision.

Resolving disciplinary proceedings by agreement

A regulated person may make a resolution proposal to the SFC. The SFC has power to resolve disciplinary proceedings by agreement when the SFC considers it appropriate to do so in the interest of the investing public or in the public interest. Whether the SFC will resolve a case by agreement depends on the facts and circumstances of individual cases. Normally, the SFC will consider resolution proposals after it has received representations from the regulated person. The SFC will consider every resolution proposal very carefully, and will agree to enter into resolution negotiations if the SFC considers it appropriate and in the interest of the investing public or in the public interest to do so. All discussions about resolution proposals will be treated as "without prejudice", unless the regulated person and the SFC agree otherwise. "Without prejudice" means that neither the SFC nor the regulated person may refer to those discussions in the disciplinary proceedings or subsequent legal proceedings.

Co-operation with the SFC

In deciding on the final sanctions, the SFC will consider whether the regulated person co-operates with the SFC. In appropriate circumstances, the sanctions may be reduced depending on the degree of co-operation.

Appeal to the Securities and Futures Appeals Tribunal

The decision of the SFC is subject to appeal to the Securities and Futures Appeals Tribunal which is an appellate body independent of the SFC and chaired by a High Court judge. A regulated person, if aggrieved by the decision of the SFC, may appeal the decision by submitting a notice in writing to the Securities and Futures Appeals Tribunal within 21 days after a decision notice is served or given. The time for appealing may be extended by applying to the Securities and Futures Appeals Tribunal and demonstrating good cause.

The notice to the Securities and Futures Appeals Tribunal must set out clearly the grounds for the appeal.

The notice to the Securities and Futures Appeals Tribunal should be delivered to the Secretary to the Securities and Futures Appeals Tribunal at:

The Securities and Futures Appeals Tribunal
38th Floor, Immigration Tower
7 Gloucester Road, Wan Chai
Hong Kong
(Tel: 2827 1470)
(Fax: 2507 2900)
Website : www.sfat.gov.hk

Effective date of a decision

If the regulated person does not appeal the SFC's decision within 21 days, the decision will take effect at the time when the period expires.

If, within the 21 days appeal period, the regulated person informs the SFC, whether in writing or orally, that they will not appeal the decision, the decision will take effect at the time the SFC receives the notification.

If, within the 21 days appeal period, the regulated person appeals, the decision will not take effect until the Securities and Futures Appeals Tribunal makes a final decision. However, if the regulated person withdraws his appeal, the SFC’s decision will take immediate effect.

Appeal to the Court of Appeal

If the regulated person is dissatisfied with the Securities and Futures Appeals Tribunal’s decision, an appeal can be made to the Court of Appeal. The regulated person must appeal within 28 days from the date on which the Securities and Futures Appeals Tribunal makes a final decision. The regulated person may appeal only on a point of law and not on whether the Securities and Futures Appeals Tribunal's decision was the right one to make or if the Securities and Futures Appeals Tribunal misinterpreted the facts.

Paying a fine

If the regulated person is ordered to pay a fine, the fine must be paid to the SFC by the deadline specified in the decision notice, by cheque made payable to the "Securities and Futures Commission" and sent to:

The Securities and Futures Commission
(Attn: Director of Finance and Administration)
8th Floor, Chater House
8 Connaught Road Central
Hong Kong

Please quote the SFC's case reference which is quoted on the SFC correspondence relating to matter (eg 508/EN/123).

Summary only, not legal advice

This is a summary for reference only. It is not legal advice. A regulated person should seek their own legal advice.

證監會紀律處分程序概覽

本小冊子旨在提供有關證監會的紀律處分程序的簡單概要。根據《證券及期貨條例》第IX部，證監會獲賦權對其所發牌或註冊的人士，包括商號及代表該等商號履行須獲發牌照或註冊才能執行的職能的人士（包括參與其管理的人士）（統稱爲受規管人士）進行紀律處分[1]。假如證監會認爲受規管人士的行爲顯示其犯有失當行爲或並非繼續獲得發牌或註冊的適當人選，則證監會可能會對該名受規管人士施加其從載列於《證券及期貨條例》的一系列制裁中所挑選的制裁。本小冊子說明我們如何進行有關的程序。

本小冊子並非關於證監會可能採取的其他行動，例如在高等法院席前進行的民事法律程序、在裁判法院席前進行的刑事法律程序或在市場失當行爲審裁處席前進行的研訊程序。

證監會爲何要採取紀律處分行動?

根據《證券及期貨條例》，證監會的其中一項職能是保障投資者的權益及維持市場的廉潔穩健。證監會在履行上述職能時所採用的其中一個方法是對受規管人士施加紀律處分制裁以執行有關法律。透過紀律處分，證監會便能確保可以對損害投資者利益或市場的廉潔穩健的人士（不論該等人士的職位及身分），採取堅定而適當的行動。證監會施加制裁是要對不符合監管規定的行爲產生阻嚇作用。

每位受規管人士在紀律處分的過程中都必須得到公平的待遇，這點對我們來說至關重要。證監會在作出紀律處分行動的決定時，會考慮其以往的決定，同時亦會顧及到每宗個案的具體情況。然而，證券及期貨事務上訴審裁處[2]已裁定，若情況有變以致證監會不適合參照以往的決定，則以往的決定可不予理會。證監會將根據其認爲與履行其法律責任及改變中的市場環境有關的多項考慮因素（尤其是市場參與者的行爲），不時就其罰則作出調整。無論何時，證監會的目標是要能夠按照有關失當行爲的嚴重性作出相稱的制裁。

證監會可對甚麼人士採取紀律處分行動？

- 如上文所述，證監會僅有權對受規管人士採取紀律處分行動，即：持牌或註冊法團；持牌法團的代表及負責人員；註冊法團的主管人員及有關人士；以及沒有領有牌照或以其他方式獲得監管機構的批准，但有份參與持牌或註冊法團的管理的人士。

1 證監會亦會憑藉《證券及期貨條例》附表 10 的若干過渡性條文，根據舊有的法律對在《證券及期貨條例》於 2003 年 4 月 1 日實施前出現的違規行爲進行紀律處分。這情況在未來數年很可能仍會持續。

2 有關審裁處的角色的討論，見第 6 頁。

決定是否採取紀律處分行動及釐定制裁的輕重程度的準則

證監會將考慮到個別個案的全部情況，包括：

- 有關行爲的性質及嚴重性
  - 該行爲對市場的廉潔穩健的影響
  - 對客戶／市場使用者／投資大眾帶來的成本／造成的損失
  - 該行爲的性質（例如是否蓄意／罔顧後果的／因疏忽而導致的；有否事先尋求顧問／上司的意見）
  - 該行爲持續的期間及頻密程度
  - 該行爲在業內是否相當普遍
  - 從事該行爲的是有關商號／個人本身，還是以集團的方式行事，以及有關商號或個人在以集體方式行事時所擔當的角色
  - 有否違反受信責任
  - (就商號而言）顯示出有嚴重／系統性的管理制度問題或內部監控缺失
  - 證監會有否就有關的行爲發出任何指引

- 累積的利潤或所避免的損失的數額

- 商號／個人的其他情況
  - 商號／個人舉報有關行爲的方式
  - 與證監會及其他有關當局的合作程度
  - 自識別出有關行爲後所採取的補救措施
  - 過往的紀律處分紀錄
  - （就個別人士而言）經驗及職位

- 其他相關的考慮因素
  - 證監會在過往類似個案中的行動（註：通常會以貫徹一致的方針對待類似的個案。然而，若涉及的失當行爲在市場內已變得普遍或有蔓延的情況，證監會可能會施加較以往更爲嚴厲的制裁。）
  - 其他有關當局所施加的罰則／監管行動

上文載列的準則**並非詳盡無遺**。

證監會可採取的紀律措施

證監會獲授權施加以下一項或多項制裁：

- **撤銷**或**局部撤銷**牌照或註冊
- **暫時吊銷**或**局部暫時吊銷**牌照或註冊
- **撤銷**核准成爲負責人員
- **暫停**核准成爲負責人員
- **禁止**申請牌照或註冊
- **禁止**申請成爲負責人員、主管人員或有關人士
- **罰款**（最高罰款爲 1,000 萬元或所賺取的利潤金額／所避免的損失金額的三倍，以較高者爲準）
- **譴責**（私下或公開）

除私下譴責外，證監會的各項制裁均會以新聞稿方式公布。與證監會的執法行動（包括紀律處分行動）有關的所有新聞稿均可於證監會網站(www.sfc.hk)的〈與執法有關的新聞〉部分內閱覽。

如欲更清楚了解證監會在施加罰款時所考慮的因素，請參閱本會在 2003 年 3 月刊發的《證監會紀律處分罰款指引》。該指引可於證監會網站的〈監管手冊〉－〈守則、指引及通函〉部分內閱覽。

紀律處分程序

調查

證監會就顯示受規管人士曾犯有失當行爲或其適當人選資格受到質疑的行爲展開調查。證監會可根據來自任何方面的資料展開調查，有關的資料來源包括公眾人士、香港的其它監管機構或執法機構（例如香港金融管理局及警方）、海外監管機構、香港交易及結算所有限公司，及內部轉介。內部轉介可能是源自證監會就股票及衍生產品市場的日常交易進行的監察、對中介人進行的視察或就其它事宜（例如民事市場失當行爲或刑事罪行）所進行的調查。証監會在進行調查後，會考慮是否有充分的證據支持展開紀律處分程序。

請不要混淆證監會爲採取紀律處分而進行的調查與其它機構（例如調查涉嫌刑事行爲的香港警務處或廉政公署）或其它具有紀律處分權力的機構（例如香港交易及結算所有限公司）所進行的調查。

建議紀律處分行動通知書（行動通知書）

如證監會決定展開紀律處分程序，便會向受規管人士發出行動通知書。行動通知書內載列證監會對導致該名受規管人士的適當人選資格受到質疑的失當行爲及／或行爲的初步意見，亦會列明證監會根據其當時所理解的事實認爲適宜施加的制裁。

受規管人士的陳述

證監會在行動通知書內邀請受規管人士就有關事宜作出解釋，及說明爲何本會所建議的制裁並不恰當。有關陳述應該以書面方式向負責簽署該行動通知書的人士作出，而不應向證監會的其他董事或高級人員作出，原因是他們並不會參與作出有關決定。

證監會要求受規管人士同時提交有關事實及建議制裁的陳述。

陳詞的機會

證監會在行使作出紀律處分行動的任何權力之前，必須事先給予受規管人士合理的陳詞機會，允許受規管人士作出陳述以解釋有關事宜，以及就建議制裁是否適當發表意見。在一般情況下，受規管人士會獲得 30 日的時間作出陳述。然而，如所提供的理由是合理的話（例如須就複雜的證據進行研究），證監會亦會考慮進一步延期的請求。

假如受規管人士在行動通知書所列明的限期前仍未作出回應，證監會將根據其當時擁有的證據就有關制裁作最後決定，而證監會相當可能會施加該行動通知書內所建議的制裁。證監會隨後會向受規管人士發出另一封函件，就有關決定及施加制裁的理由通知該名受規管人士。

法律代表

受規管人士可以徵詢法律意見，當中可能包括指示其律師代表向證監會作出陳述。

在向證監會作出陳述時要求提供證據

當證監會向受規管人士發出行動通知書列明建議制裁時，亦會同時向受規管人士提供與行動通知書載列的事實和事宜有關的一系列文件的清單。受規管人士可要求證監會提供該清單所列的文件的副本。

與證監會進行會見

有關紀律處分程序的決定通常是以書面陳述作爲基礎的。然而，受規管人士可要求與證監會進行會見，以便作出口頭陳述。如受規管人士希望與證監會進行會見，便須以書面向證監會申請，說明其認爲需要進行會見的原因。如證監會認爲在有關情況下爲公平起見需要進行會見，便會安排與該受規管人士會見。

在進行紀律處分程序的過程中，如在有關情況下爲了公平起見，即使受規管人士沒有作出會見申請，證監會亦會邀請該受規管人士出席會見，以澄清若干事宜。證監會可以在行動通知書中或在收到規管人士的書面陳述後，將其在該情況下擬進行會見的決定通知該受規管人士。

決定通知書

證監會在審閱受規管人士在其陳述書內所提交的所有資料時，會連同其已持有的所有證據一併加以研究。證監會隨後會以書面方式向受規管人士發出決定通知書，詳述證監會的決定。決定通知書將載列：

- 作出該項決定的理由；
- 該項決定生效的時間；
- 將予施加的任何撤銷、暫時吊銷牌照或禁止申請的措施的持續期間及條款；
- 在該項決定下的任何譴責的條款；及
- 可能判處的罰款數額以及須繳付有關罰款的最後限期。

決定通知書內亦包括關乎該名受規管人士就有關決定向證券及期貨事務上訴審裁處提出上訴之權利的資料。

透過協議解決紀律處分程序

受規管人士可向證監會提出解決建議。證監會有權在其認爲就維護投資大眾的利益或公眾利益而言是適當的情況下，透過協議解決紀律處分程序。證監會是否透過協議解決某一個案，將視乎個別個案的事實及情況而定。一般而言，證監會在收到受規管人士的陳述書後才會考慮解決的建議。證監會將會非常審慎地考慮每項解決建議，並會在其認爲適當及符合投資大眾利益或公眾利益的情況下同意進行解決磋商。所有就解決建議進行的商討都是在“無損權利”的基礎上進行，除非受規管人士與證監會另有協議。“無損權利”的意思是指證監會及該名受規管人士都不能在紀律處分程序或在以後的法律訴訟中，提述有關商討的內容。

與證監會合作

證監會在決定最終的制裁時，會考慮到受規管人士有否與證監會合作。在適當的情況下，有關的制裁或會視乎受規管人士的合作程度而有所減輕。

向證券及期貨事務上訴審裁處提出上訴

受規管人士是可就證監會的決定向證券及期貨事務上訴審裁處提出上訴。該審裁處是獨立於證監會的上訴機關，並由高等法院的法官擔任主席。受規管人士如因證監會的決定而感到受屈，可在獲送達或發出決定通知書後的 21 日內，向證券及期貨事務上訴審裁處提交書面通知書就有關的決定提出上訴。受規管人士可以向證券及期貨事務上訴審裁處提出充分的理由，申請將提出上訴的時限延展。

向證券及期貨事務上訴審裁處發出的通知書必須明確列明提出上訴的理由。

向證券及期貨事務上訴審裁處發出的通知書應送交證券及期貨事務上訴審裁處秘書，地址爲：

證券及期貨事務上訴審裁處
香港灣仔告士打道 7 號
人民入境事務大樓 38 樓
（電話：2827 1470）
（傳真：2507 2900）
網址：www.sfat.gov.hk

決定的生效日期

假如受規管人士並無在 21 日內就證監會的決定提出上訴，該決定將於有關限期屆滿之時生效。

假如受規管人士在 21 日的上訴限期內通知證監會（不論是以書面或口頭方式）其不會就該決定提出上訴，則該決定將於證監會收到該通知之時生效。

假如受規管人士在 21 日的上訴限期內提出上訴，則該決定將不會生效，直至證券及期貨事務上訴審裁處作出最後決定爲止。然而，假如受規管人士撤回其上訴，則證監會的決定將會即時生效。

向上訴法庭提出上訴

假如受規管人士對證券及期貨事務上訴審裁處的決定感到不滿，可向上訴法庭提出上訴。受規管人士必須在證券及期貨事務上訴審裁處作出最後決定當日起計的 28 天內提出上訴。受規管人士只可就法律論點提出上訴，而不得就證券及期貨事務上訴審裁處所作出的決定是否適宜或證券及期貨事務上訴審裁處有否誤解有關事實一事提出上訴。

繳付罰款

假如受規管人士被命令繳付罰款，則有關罰款須於決定通知書內指定的限期前以支票方式繳付（抬頭人爲“證券及期貨事務監察委員會”）。上述支票應送交至以下地址：

證券及期貨事務監察委員會
（致：財務及行政科總監）
香港中環
干諾道中 8 號
遮打大廈 8 樓

請列明證監會的檔案編號。該檔案編號列於證監會就有關事宜發出的來往書信（例如 508/EN/123）。

此乃摘要，並不構成法律意見

本概覽純屬摘要，只供參考之用，及並非法律意見。受規管人士應自行徵詢法律意見。

G.N. 4418

Guideline on Exercising Power to Impose Pecuniary Penalty

(For authorized insurers, reinsurers, appointed insurance agents and authorized insurance brokers carrying on or advising on long term business)

June 2012

Office of the Commissioner of Insurance

Guideline on Exercising Power to Impose Pecuniary Penalty

Introduction

This Guideline is issued by the Insurance Authority ("IA") pursuant to section 23(1) of the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance (Chapter 615) (the "Ordinance"). Under section 21 of the Ordinance, the IA may impose a pecuniary penalty either on its own or together with other disciplinary sanctions on an authorized insurer, appointed insurance agent or authorized insurance broker carrying on or advising on long term business ("insurance institution") if the insurance institution contravenes a specified provision as defined by section 5(11) of the Ordinance.

In exercising the power to impose pecuniary penalty referred to in section 21(2)(c) of the Ordinance, the IA shall have regard to this Guideline which indicates the manner in which it proposes to exercise that power.

Considerations in exercising the IA's power to impose pecuniary penalty

1. As a matter of policy, the IA will usually publicize all his decisions to impose pecuniary penalty.

2. When considering whether to impose a pecuniary penalty and the amount of the penalty, the IA will consider all of the circumstances of the particular case, including the relevant factors described below.

3. A pecuniary penalty imposed by the IA should act as a deterrent to the insurance institution concerned from contravening a specified provision as defined by section 5(11) of the Ordinance. It should also act as a general deterrent to other insurance institutions from contravening the same or similar specified provisions.

4. Although section 21(2)(c)(ii) of the Ordinance states that one alternative maximum level of the pecuniary penalty that can be imposed is three times the amount of the profit gained, or costs avoided, the IA will not automatically link the penalty imposed in any particular case with the profit gained, or costs avoided.

5. A pecuniary penalty should not have the likely effect of putting the insurance institution concerned in financial jeopardy. In considering this

factor, the IA will take into account the size and financial resources of the insurance institution.

6. The more serious the contravention, the greater the likelihood that the IA will impose a pecuniary penalty and that the size of the penalty will be larger. In determining the seriousness of a contravention, the IA will consider all of the circumstances of the case and take into account but not limited to the factors set out below.

(a) The nature, seriousness and impact of the contravention, including:

(i) whether the contravention is intentional or reckless or negligent – a contravention caused merely by negligence or conduct which only results in a technical breach is generally regarded as less serious;
(ii) the duration and frequency of the contraventions;
(iii) whether the contravention is potentially damaging or detrimental to the integrity and stability of the insurance industry, and/or the reputation of Hong Kong as an international financial centre;
(iv) whether the contravention caused or potentially caused loss to, or imposed costs on, any other person;
(v) whether the contravention was committed by the insurance institution alone or whether as part of a group and the role the insurance institution played in that group;
(vi) whether the contravention reveals serious or systemic weaknesses of the management systems or internal controls in respect of the customer due diligence and record-keeping procedures relating to all or part of that insurance institution's business;
(vii) whether the contravention was indicative of a pattern of contraventions;
(viii) whether there are a number of smaller issues, which individually may not justify a pecuniary penalty, but which do so when taken collectively; and
(ix) the nature and extent of any financial crime facilitated, occasioned or otherwise attributable to the contravention.

(b) The conduct of the insurance institution after the contravention,

including:

(i) whether the insurance institution attempted to conceal its contravention;
(ii) any remedial steps taken since the contravention or the possible contravention was identified, and any action taken by the insurance institution against those involved and any steps taken to ensure that similar contraventions will not occur in future;
(iii) the degree of cooperation with the IA, other relevant authorities and/or law enforcement agencies during the investigation of the contravention; and
(iv) the likelihood that the insurance institution will commit the same type of contravention in the future if no or a lighter penalty is imposed.

(c) The previous disciplinary record and compliance history of the insurance institution, including:

(i) the relevant previous disciplinary record of the insurance institution, including its previous similar contraventions particularly that for which it has been disciplined before;
(ii) whether the insurance institution has previously undertaken not to engage in that particular conduct that results in the contravention; and
(iii) any punishment imposed or regulatory action taken or likely to be taken by other relevant authorities on the same incident.

(d) Other factors, including:

(i) whether the IA has issued any guidance in relation to the conduct in question – generally the IA will not take disciplinary action against an insurance institution for conduct that is in line with the guidance which was current at the time of the conduct in question;
(ii) what action the IA and/or other relevant authorities have taken in previous similar cases – in general similar cases should be treated consistently;
(iii) the amount of any benefit gained or costs avoided by the insurance institution or any of its directors or employees as a result of the contravention; and
(iv) as a mitigating factor, whether the insurance institution has promptly, effectively and completely brought the

contravention or possible contravention to the attention of the IA.

June 2012
Insurance Authority

G.N. 1410

SECURITIES AND FUTURES ORDINANCE (Chapter 571)

Pursuant to section 199(1) of the Securities and Futures Ordinance, the Securities and Futures Commission published the SFC Disciplinary Fining Guidelines in the Schedule for information.

28 February 2003

Alan Linning
Executive Director, Enforcement
Securities and Futures Commission

Schedule

SFC Disciplinary Fining Guidelines

Securities and Futures Ordinance
Considerations relevant to the level of a disciplinary fine

These guidelines are made under section 199(1)(a) of the Securities and Futures Ordinance to indicate the manner in which the Securities and Futures Commission (SFC) will perform its function of imposing a fine on a regulated person under section 194(2) or 196(2). Section 199(1)(b) requires the SFC to have regard to these guidelines in performing its function of fining under section 194(2) or 196(2). Section 199(2) sets out some factors that the SFC should take into account in exercising its fining power among other factors that the SFC may consider. These factors are included in the considerations set out below.

Under section 194 or 196 of the Ordinance, the SFC may impose a fine either on its own or together with other disciplinary sanctions. The SFC regards a fine as a more severe sanction than a reprimand (and a public reprimand more severe than a private reprimand). The SFC will not impose a fine if the circumstances of a particular case only warrant a public reprimand. As a matter of policy, the SFC will publicise all fining decisions. This means that the SFC will never impose both a fine and a private reprimand.

When considering whether to impose a fine under section 194(2) or 196(2) and the size of any fine, the SFC will consider all the circumstances of the particular case, including the Specific Considerations described below.

A fine should deter non-compliance with regulatory requirements so as to protect the public.

Although sections 194(2)(ii) and 196(2)(ii) state that one alternative maximum level of fine that can be imposed is three times the profit made or secured, or loss avoided or reduced, the SFC will not automatically link the fine imposed in any particular case with the profit made or secured, or loss avoided or reduced.

The more serious the conduct, the greater the likelihood that the SFC will impose a fine and that the size of the fine will be larger.

In determining the seriousness of conduct, in general, the SFC views some considerations as more important than others. The General Considerations set out below describe conduct that would be generally viewed as more or less serious. In any particular case, the General Considerations should be read together with the Specific Considerations in determining whether or not the SFC will impose a fine and, if so, the amount of the fine.

General considerations

The SFC generally regards the following conduct as more serious:

- conduct that is intentional or reckless
- conduct that damages the integrity of the securities and futures market
- conduct that causes loss to, or imposes costs on, others
- conduct which provides a benefit to the firm or individual engaged in that conduct or any other person.

The SFC generally regards the following conduct as less serious and so generally deserving a lower fine:

- negligent conduct – however, the SFC will impose disciplinary sanctions including fines for negligent conduct in appropriate circumstances
- conduct which only results in a technical breach of a regulatory requirement or principle in that it:
  + causes little or no damage to market integrity and
  + causes little or no loss to, or imposes little or no costs on, others

- conduct which produces little or no benefit to the firm or individual engaged in that conduct and their related parties.

These are only general considerations. These considerations together with the other circumstances of each individual case including the Specific Considerations described below will be determinative.

Specific considerations

The SFC will consider all the circumstances of a case, including:

The nature and seriousness of the conduct

- the impact of the conduct on the integrity of the securities and futures market
- whether significant costs have been imposed on, or losses caused to others, especially clients, market users or the investing public generally
- whether the conduct was intentional, reckless or negligent, including whether prior advice was sought on the lawfulness or acceptability of the conduct either by a firm from its advisors or by an individual from his or her supervisors or relevant compliance staff of the firm or group that employs him or her
- the duration and frequency of the conduct
- whether the conduct is widespread in the relevant industry (and if so, for how long) or there are reasonable grounds for believing it to be so widespread
- whether the conduct was engaged in by the firm or individual alone or whether as part of a group and the role the firm or individual played in that group
- whether a breach of fiduciary duty was involved
- in the case of a firm, whether the conduct reveals serious or systematic weaknesses, or both, in respect of the management systems or internal controls in relation to all or part of that firm's business
- whether the SFC has issued any guidance in relation to the conduct in question

The amount of profits accrued or loss avoided

- a firm or individual and related parties should not benefit from the conduct

Other circumstances of the firm or individual

- a fine should not have the likely effect of putting a firm or individual in financial jeopardy. In considering this factor, the SFC will take into account the size and financial resources of the firm or individual. However, if a firm or individual takes deliberate steps to create the false appearance that a fine will place it, him or her in financial jeopardy, eg by transferring assets to third parties, this will be taken into account
- whether a firm or individual brings its, his or her conduct to the SFC's attention in a timely manner. In reviewing this, the SFC will consider whether the firm or individual informs the SFC of all the conduct of which it, he or she is aware or only part, and the manner in which the disclosure is made and the reasons for the disclosure
- the degree of cooperation with the SFC and other competent authorities
- any remedial steps taken since the conduct was identified, including any steps taken to identify whether clients or others have suffered loss and any steps taken to sufficiently compensate those clients or others, any disciplinary action taken by a firm against those involved and any steps taken to ensure that similar conduct does not occur in future
- the previous disciplinary record of the firm or individual, including an individual or firm's previous similar conduct particularly that for which it, he or she has been disciplined before or previous good conduct
- in relation to an individual, his or her experience in the industry and position within the firm that employed him or her

Other relevant factors, including

- what action the SFC has taken in previous similar cases – in general similar cases should be treated consistently
- any punishment imposed or regulatory action taken or likely to be taken by other competent authorities
- result or likely result of any civil action taken or likely to be taken by third parties – successful or likely successful civil claims may reduce the part of a fine, if any, that is intended to stop a person benefiting from their conduct.