

Process Review Panel for the Securities and Futures Commission 2010-11 Annual Report

Executive Summary

Introduction

The Annual Report of the Process Review Panel (“PRP”) for the Securities and Futures Commission (“SFC”) covers the work of PRP in 2010-11 relating to the review of cases completed or discontinued by SFC.

Background and Terms of Reference of PRP

2. PRP is an independent panel established by the Chief Executive in November 2000 to review and advise SFC on the adequacy of SFC’s internal operational procedures governing the actions taken and operational decisions made in the performance of its regulatory functions.

3. PRP receives and considers periodic reports from SFC in respect of the completed or discontinued cases, including complaints against SFC or its staff. In addition, PRP may call for, and review, SFC’s files to verify that the actions taken and decisions made in relation to any specific case or complaint are consistent with the relevant internal procedures and operational guidelines. PRP is required to submit its reports to the Financial Secretary annually or otherwise on a need basis.

Constitution of PRP

4. PRP comprises twelve members and is chaired by Mr Anthony Chow Wing-kin. They come from the financial sector, academia, and the legal and accountancy professions. There are also a Legislative Councillor and two ex officio members, including the Chairman of SFC and the representative of the Secretary for Justice.

Work of PRP in 2010-11

5. In 2010-11, PRP reviewed 57 completed or discontinued cases of SFC in the following areas –

- (a) licensing of intermediaries;
- (b) inspection of intermediaries;
- (c) authorisation of collective investment schemes;

- (d) handling of complaints;
- (e) investigation and disciplinary action; and
- (f) processing of listing applications under the Dual Filing regime.

6. PRP concluded that SFC had generally followed its internal procedures and complied with the operational guidelines in handling these cases.

Observations and recommendations

7. PRP made a number of observations and recommendations, to which SFC has responded positively. SFC has provided elaborations and explanations and introduced corresponding measures where appropriate. The following is a summary of the key issues considered by PRP –

- (a) inspection of intermediaries – PRP noted that in conducting surprise inspections, SFC would usually give an advance notice of seven calendar days to the company concerned. A shorter notice might however be given where circumstances warranted. As for the mechanism in following up the deficiencies identified in inspections, SFC would assess the adequacy of a company’s response in addressing the concerns raised, and would request the company to take further action if the remedial measures proposed or taken were not satisfactory (paras. 3.4 – 3.7);
- (b) authorisation of collective investment schemes – in response to PRP’s suggestion, SFC explained that though the obtaining of Qualified Foreign Institutional Investor (“QFII”) quota by the applicant might take time, SFC would accept and process these applications before a QFII quota was obtained to facilitate the process. SFC noted that there was no issue of particular concern in respect of the several outstanding applications (paras. 3.9 – 3.10);
- (c) handling of complaints –
 - (i) PRP suggested that SFC review the need for drawing up guidelines for timely handling and proper monitoring of complaints referred by the Hong Kong Exchanges and Clearing Limited (“HKEx”). SFC explained that they would follow the arrangements set out in the Memorandum of Understanding

Governing Listing Matters between SFC and HKEx (paras. 3.12 – 3.14); and

- (ii) PRP considered that an earlier review could have been conducted by SFC to close a complaint case in a prompt manner. SFC explained that due to some internal communication issues, the closing of the case was only recorded after ten months. PRP noted that this was an isolated incident, and that SFC would strive to complete the review of future cases as soon as practicable (paras. 3.15 – 3.17); and
- (d) investigation and disciplinary action –
- (i) PRP suggested that SFC consider if further publicity to the Court’s decision on “unissued shares” which were regarded as “securities” should be made. SFC explained that following the issue of press releases, SFC had given further coverage to the Court’s decision in the Enforcement Reporter. SFC would include lessons learnt from this case in its ongoing investor education work (paras. 3.19 – 3.21);
 - (ii) in a case of suspected market manipulation by a company, SFC found that there was no clear reporting line in the company and in the absence of his supervisor, a junior trader handled orders of a huge amount by himself and there was no methodology for the junior trader to follow in selecting the price levels. PRP considered that proper control and supervision of junior traders was an issue that needed to be duly attended to. SFC would consider publicising this case as a case study or an example for experience sharing in the industry (paras. 3.22 – 3.24);
 - (iii) PRP noted that in a case, the chairman of a listed company had not informed other executive directors of a loss arising from equities and derivatives investment until after one week. PRP considered that the case revealed possible common corporate governance concerns, and SFC undertook to raise this with HKEx on further steps to raise awareness of the listed companies on related issues (paras. 3.25 – 3.27);
 - (iv) PRP suggested that to prevent unauthorised trading or other illegal transactions on the internet, SFC should examine if existing measures were adequate, and whether additional safeguards and investor education efforts were to be introduced.

SFC assured PRP that it would review the need to update its codes and guidelines regularly, taking into account market developments and views from stakeholders. In terms of investor education, SFC would continue to remind investors of the issues that they should note when conducting on-line trading (paras. 4.2 – 4.4); and

- (v) in response to PRP’s enquiry on regulation of high frequency trading, SFC advised that it had established a cross division team to work on updating its internet trading policy. In addition, the International Organisation of Securities Commissions (“IOSCO”) had recently commenced a study on potential regulatory issues arising from high frequency trading. SFC had been participating in the IOSCO discussions on this aspect (paras. 4.5 – 4.6).

Way forward

8. Looking ahead, PRP would continue its work on the review of completed or discontinued cases, and maintain dialogue with market players and engage the industry to gauge their views.

9. PRP welcomes and attaches great importance to views from market practitioners as well as the public on the work of PRP. Suggestions and comments can be referred to PRP through the following channels –

By post to: Secretariat of the Process Review Panel
 for the Securities and Futures Commission
 Room 1801, 18th Floor, Tower 1, Admiralty Centre
 18 Harcourt Road
 Admiralty
 Hong Kong

By email to: prp@fstb.gov.hk