

Enforcement

Our efforts to fight crime and misconduct in the securities and futures markets continued in the past year. We made robust use of all of our enforcement options to punish offenders, deter others from violating rules and seek redress for affected investors. Through firm enforcement action, we sent strong and clear messages that we would not tolerate market misconduct and abuse that undermine investors' interests.

Taking firm action against rule breakers

During the year, we successfully prosecuted 37 entities (25 persons and 12 corporations), two of whom were convicted of nine counts of market manipulation and another was convicted of one count of insider dealing. We obtained orders to disqualify six company directors who failed to perform their duties properly. We also have civil actions pending before the courts to seek disqualification and compensation orders against a total of 16 individuals, as well as 80 criminal charges against 18 persons still to be heard.

Deploying section 213

Developments in two cases brought under section 213¹ of the SFO were particularly noteworthy:

■ Tiger Asia: Insider dealing and market manipulation

The Court of Appeal (CA) ruled in February 2012 against Tiger Asia Management LLC, a New York-based asset management company, and three of its senior officers. The firm had sought to dismiss our proceedings seeking remedial orders against it and the three officers for allegedly insider dealing in the shares of Bank of China and China Construction Bank Corporation (CCB), and manipulating the shares of CCB. Earlier in June 2011, the Court of First Instance (CFI) had ruled that without a pre-existing criminal conviction or a determination by the Market Misconduct Tribunal (MMT), it had no jurisdiction to make findings that these provisions had been contravened.

Upon our appeal, the CA ruled that section 213 contained valuable tools and ammunition for us to protect the investing public, which is an important objective of the SFO. We had contended that section 213 was intended clearly to give the SFC independent and self-standing remedies, in addition to the criminal process and the MMT, and that the CFI has jurisdiction to determine whether a person had contravened the SFO.



■ Hontex: False or misleading information

In May 2011, we applied to the CFI for final orders to secure a return of funds to public shareholders who had subscribed for shares in the initial public offering (IPO) of Hontex International Holdings Co, Ltd or had bought the shares following the listing. We alleged that Hontex had issued and distributed a prospectus in December 2009 that materially overstated key financials of the Hontex Group for 2006, 2007, 2008 and the six months ended 30 June 2009. The proceedings were commenced under section 213.

The case was heard in June 2012. In March 2010, the CFI made orders against Hontex and its four subsidiaries freezing up to \$997 million. We are seeking orders to use the money frozen towards repurchasing the shares of the public shareholders.

Taking actions against former senior executives

- For the first time, the court ordered former executives of a listed company to pay compensation to the company under section 214 of the SFO. In the case against former executives of Styland Holdings Ltd, the CFI:
 - ordered Kenneth Cheung Chi Shing, Styland's founder and former chairman, and his wife Yvonne Yeung Han Yi, a former executive director, to pay more than \$85 million in compensation to the company for entering into a number of transactions that were not in the company's interests but which directly or indirectly benefitted Cheung and Yeung, accepting that the transactions amounted to misfeasance;

¹ Section 213 of the SFO gives the SFC the power to apply to the CFI for an injunction and other orders when there are contraventions of the provisions of the SFO and specified provisions of the Companies Ordinance.

- disqualified Cheung and Yeung for 12 years each from becoming directors of any company, the longest term ever imposed in such proceedings;
- also disqualified former directors Miranda Chan Chi Mei and Steven Li Wang Tai for seven and six years respectively.
- We prosecuted Chui Wing Nin, a former senior executive of CITIC Pacific Ltd, for allegedly selling 81,000 shares of CITIC Pacific while in possession of confidential, price sensitive information, ahead of the company announcing a profit warning stemming from foreign exchange losses in 2008.
- On 27 February 2012, Lam Kwong Yu, a former independent non-executive director of Hong Kong Aircraft Engineering Company Ltd (HAECO), was sentenced to five months' imprisonment, suspended for two years, and fined \$50,000 after we took him to court for insider dealing in HAECO shares. It was found that Lam dealt in the shares after he was told about a proposed deal in which Cathay Pacific Airways Ltd, a substantial shareholder of HAECO, would sell its entire stake in the company to Swire Pacific Ltd, that would trigger a general offer and the deal would proceed the following week.

Winning first case against futures market manipulation

- The CFI ruled in our favour and granted a retrial of a case against Tsoi Bun, a futures trader, for manipulating the calculated opening prices of index futures contracts, following his acquittal of five charges at the Eastern Magistracy in January 2010.

After the re-trial of this first prosecution for manipulating Hong Kong's futures market, Tsoi was sentenced to six months' imprisonment, suspended for two years and fined \$500,000. A cold shoulder order also was imposed on him upon our request to prevent him for 12 months from dealing in futures contracts in the pre-market opening periods without the court's leave.

The SFC sought a review of the sentence because the fine was substantially less than the \$949,350 profit earned by Tsoi in committing the manipulation offences for which he was convicted. The magistrate declined to vary the fine imposed.

Enforcing information disclosure

- The CFI gave orders under section 214 to disqualify Li Xinggui, Zheng Yingsheng and Zhou Li Yang, former executive directors of Pearl Oriental Innovation Ltd, from being directors or being involved in the management of any corporation, without the leave of the court, for one year. The three failed to disclose material information to shareholders involving an unauthorized payment of RMB64.5 million, which amounted to about 25% of the company's total assets.

Combating market misconduct

With the enactment of the Securities and Futures (Amendment) Ordinance 2012 on 4 May 2012, we can combat market misconduct in a more streamlined and efficient manner by directly bringing proceedings before the MMT.

Since the establishment of the MMT in 2003, cases of suspected market misconduct have been brought before it indirectly via the Financial Secretary. So far, the MMT has concluded six cases and found that 18 entities (15 persons and three corporations) have engaged in market misconduct. This year, the MMT heard three cases and handed down its determination against one person.

In October 2011, the MMT determined that Vincent Sze Chun Ning had engaged in insider dealing in that while contemplating a takeover offer of ABC Communications (Holdings) Ltd (ABC), he disclosed relevant information to another person who he believed would use the information to deal in ABC shares. The MMT ordered that Sze shall not be a director of a listed company or take part in the management of any listed corporation for four years. Further, the MMT ordered Sze to pay the Government and the SFC a sum of more than \$4 million for the costs and expenses incurred. Sze has lodged an appeal against MMT's ruling, which is scheduled to be heard before the CA in early 2013.

In February and March 2012, the MMT held a substantive hearing regarding suspected insider dealing in the shares of Chaoda Modern Agriculture (Holdings) Ltd (Chaoda) in June 2009. In April 2012, the MMT found that George Stairs, a portfolio manager at Fidelity Management & Research Co, (a company based in the US that managed US-based Fidelity retail mutual funds), had engaged in insider dealing in that he sold Chaoda shares held by the fund he managed to avoid a loss while in possession of material and non-public price-sensitive information concerning the company. In May 2012, the MMT imposed a cold shoulder order on Stairs, banning him from dealing in any securities in Hong Kong without the leave of the court, for two years.

Disciplining licensees for infractions

During the year, we disciplined 38 licensees for various misconduct and imposed fines amounting to \$35.2 million. As can be seen from the major disciplinary cases summarised below, the infractions ranged from control and/or procedural inadequacies of licensed corporations to lack of integrity of licensed individuals.

Reinforcing compliance at corporate level

- Oasis Management (Hong Kong) LLC (Oasis) and its chief investment officer were reprimanded and fined \$7.5 million each for trading in shares of Japan Airlines Corporation on the Tokyo Stock Exchange. We alleged that Oasis adopted a trading strategy originated in Hong Kong, which appeared to have been designed to drive down the shares' closing price.
- We reprimanded and fined Citigroup Global Markets Asia Ltd (Citigroup) \$6 million for supervisory failures and delay in reporting to us a fraudulent scheme operated by a former licensed representative, Ramesh Kumar Chuharmal Sadhwani. Sadhwani was banned from re-entering the industry for 10 years following the determination of the Securities and Futures Appeals Tribunal (SFAT). Lisa Chan Sin Man, supervisor of the former licensed representative, had her licence suspended for eight months for failing to take sufficient action even though a number of "red flags" were brought to her attention. Citigroup agreed to compensate affected customers and engage an external auditor to review its internal control procedures.
- HSBC Trinkaus Investment Management Ltd was reprimanded and fined \$3 million and its licence was partially suspended for two years for having inadequate procedures to ensure client suitability, product due diligence and record keeping related to its distribution of equity-linked notes.
- Merrill Lynch (Asia Pacific) Ltd was reprimanded and fined \$3 million for inadequate systems, resulting in its failure to properly assess the financial situation and investment objectives of its customers and for not adequately documenting the investment advice and recommendation given to customers who invested in two index-linked notes.

Calling to task individual licensees

- Tang Siu Fong was banned from re-entering the industry for life for stealing clients' assets.
- We revoked the licence of Paco Ng Kar Lun and prohibited him from re-entering the industry for 10 years and banned Adrian Fong Wai Lap from re-entering the industry for three years. We found that Ng, in collaboration with Fong, attempted to profit from trading shares of Metallurgical Corporation of China Ltd in the grey market prior to its listing. Although the scheme eventually fell through, the conduct of Ng and Fong fell short of the standards of integrity and honesty expected of licensees.
- Philip Wan Ten Lok and Sunny Yan Kwok Ting were banned from re-entering the industry for six years and four years respectively for sponsor failures and misleading the SFC by an extensive fabrication exercise, following a determination by the SFAT. Both were accredited to Core Pacific-Yamaichi Capital Ltd (CPY), which was the sponsor for the listing of Tungda Innovative Lighting Holdings Ltd from 2002 to 2003. Wan, who supervised preparing a response to SEHK's request to address a complaint that Tungda had falsified invoices and overstated sales figures in its listing prospectus, was found to have given a false impression that CPY had conducted sufficient due diligence. Wan also undertook an extensive fabrication with Yan's assistance.

Enforcement activities	
Number of trading inquiries issued under S181 ¹	4,034
Number of investigations started	303
Number of investigations completed	220
Number of investigations completed within seven months (%)	142 (65%)
Number of persons charged in criminal proceedings	38*
Number of criminal charges laid	207*
Number of Notices of Proposed Disciplinary Action ²	39
Number of Decision Notices ³	38
Number of persons subject to ongoing civil proceedings	57
Compliance advice letters issued	240

¹ Section 181 of the SFO gives the SFC the power to require information from intermediaries about trading transactions, including the identity information of the ultimate clients, the particulars and instructions relating to the transactions.

² A Notice of Proposed Disciplinary Action is a notice issued by the SFC to regulated persons that it proposes to exercise its disciplinary powers, on grounds that they appear to be guilty of misconduct or not fit and proper.

³ A Decision Notice sets out the SFC's decision and its reasons to take disciplinary action against regulated persons.

* We brought a total of 207 criminal charges against 38 persons, with 22 charges laid against six for insider dealing or market manipulation.

For more statistics on our enforcement activities, please see SFC Activity Data on pages 53-54 and Breakdown of SFC Activity Data from pages 116-129.

Resolving more LB-related cases

Over the last 12 months, we made further progress to resolve issues stemming from the sale of Lehman Brothers (LB)-related structured products by reprimanding publicly two brokerages and reaching agreements with these brokerages as well as a bank involving repurchase offers of over \$1.2 billion.

Citibank (Hong Kong) Ltd agreed with the SFC and the HKMA to make a repurchase offer equal to 80% of the total value of each eligible client's investment in outstanding market-linked notes and equity-linked notes issued by LB and distributed by the bank. The total value of the repurchase offer was around \$1.06 billion, covering about 92% of clients holding the outstanding notes.

Core Pacific-Yamaichi (HK) Ltd (CPY) was reprimanded for failings in its internal systems and controls regarding the sale of Minibonds, Octave Notes and Constellation Notes. CPY agreed to, among other things, offer to repurchase from all its eligible clients all outstanding LB-related structured products at their original values and to compensate all its eligible former clients, whose holding(s) in LB-related structured products were mandatorily redeemed or sold after LB's bankruptcy. The total amount of repurchase offers and compensation was approximately \$9.6 million.

We issued a reprimand to Sun Hung Kai Investment Services Ltd and fined it \$4.5 million for deficiencies regarding the sale to retail clients of LB-related equity-linked notes. Thus a strong deterrent message was sent to the market on the importance of ensuring suitability of investment products and disclosing material information to clients.

Bringing cases to appellate courts and tribunal

Last year, we were met with a number of challenges to our enforcement actions and powers. We stood firm and succeeded in defending our actions in the appellate courts and the SFAT.

Criminal appeals

The CFI dismissed three individuals' appeals against their convictions.

- Pablo Chan Pak Hoe, for insider dealing in the shares of Universe International Holdings Ltd. The original sentence of a 240-hour community service was reinstated on technical ground;
- Thomas Chan Ping Keung, a director of Able Alliance International Ltd, for making false or misleading representations in seeking from us an extension of the deadline to submit audited accounts and financial books and records; and
- Chan Chun Wai, the director of Billion Global Asset Management Ltd, for holding out that he was carrying on and advertising a business in asset management without a licence.

Civil appeals and disciplinary appeals

As mentioned, we were successful before the CA in overturning the restrictive interpretation of section 213 of the SFO argued by Tiger Asia and its staff, which would have significantly hampered our ability to obtain relief for victims of market misconduct.

Cheung Keng Ching and Chou Mei, both former directors of Rontex International Holdings Ltd (now known as Siberian Mining Group Company Ltd), appealed against an order of the CFI requiring the company to obtain court approval for any compromise or settlement of its proceedings against Cheung, Chou and another former director, and the length of disqualification order imposed on Chou. Save that the CA reduced Chou's disqualification period from five to four years, the appeal was dismissed. This was the first case in which the CFI had ordered a listed company to bring compensation proceedings against former directors as a result of their misconduct.

Separately, the CFI dismissed a leave application for judicial review by Real Gold Mining Ltd seeking to challenge the process of the SFC in obtaining and dealing with information/documents concerning the company from third parties in our investigation of the company.

The SFAT upheld our decisions to impose lengthy prohibitions in three disciplinary review applications.

Keeping pace with volume expansion

We monitor the trading activities of Hong Kong's securities and futures market on a daily basis. In the fourth quarter of 2011, we upgraded our real-time securities trading monitoring system to cope with growth in trading volume. The maximum capacity of the upgraded system was boosted by about tenfold to handle 30,000 orders per second, 200 million orders and 13.3 million trades per trading day.

Monitoring for unusual market movements

We keep a close eye on the market to identify and inquire into unusual price and turnover movements that signal insider dealing, market manipulation and other market misconduct.

We made 4,034 inquiries relating to erratic share price and volume movements, seeking trading records from intermediaries in the process. On many occasions, our early inquiries stopped improper trading activities from perpetuating.

Flagging high shareholding concentration

Over the past year, we posted on the SFC site six announcements regarding a small number of shareholders holding a large number of shares of a given company. The announcements were meant to remind investors to exercise extreme caution when dealing in such shares as their price might fluctuate substantially even with a few shares changing hands.

Seeking leads for enforcement inquiries

In October 2011, we launched on the SFC site a new section entitled "Have You Seen These People?" to encourage the public to help us locate individuals who are sought in relation to enforcement inquiries but cannot be traced using traditional methods. The section contains details of individuals who are either the subjects of arrest warrants or who we believe have important information that may assist in other enforcement inquiries.