

Enforcement

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COMBATING MARKET MISCONDUCT:

A Market Misconduct Tribunal has been established to build on the work of the Insider Dealing Tribunal by handling civil cases of market misconduct of all forms.



Our mission is to protect Hong Kong's markets and investors by detecting unlawful activity and unethical behaviour through effective surveillance and enforcement.

ACHIEVEMENTS

- **Concluded 344 investigations of which 276 were completed within 12 months**
- **Successfully prosecuted three cases of market manipulation and 33 entities for breaches of various ordinances**
- **Referred four cases of suspected insider dealing to the Financial Secretary for hearing by the Insider Dealing Tribunal**
- **Two cases were concluded before the Insider Dealing Tribunal resulting in penalties etc of \$21.3 million; a further two cases are currently before the Tribunal**
- **Concluded 90 disciplinary inquiries and disciplined 86 registrants or concerned persons**
- **Referred 15 cases of fraud and corruption to Police and ICAC and an additional 32 boiler room cases to Police**

THIS CHAPTER IS ABOUT

■ Surveillance

- Listed companies

■ Investigation

- Market misconduct including market manipulation and insider dealing
- Disclosure of interests compliance
- Unauthorised investment promotion
- Unregistered dealing and illegal short selling

■ Disciplinary actions

- **Co-operation with other law enforcement agencies**

What We Do

- **Enforce laws relating to the securities and futures industry, leveraged foreign exchange trading, and investment arrangements;**
- **Inspect books and records of listed companies if impropriety is suspected;**
- **Report suspected insider dealing to the Financial Secretary;**
- **Enforce disclosure of interests of substantial shareholders, directors and chief executives of listed companies;**
- **Suppress illegal or improper practices in trading, investment arrangements and the provision of advice or other financial services; and**
- **Co-operate with domestic and overseas regulatory bodies in investigations in Hong Kong and overseas.**

What We Did

This was another successful year. While the total number of cases handled has continued to rise, we have streamlined our investigative process further without compromising thoroughness and fairness. The result is that more cases are being completed within a shorter period of time. Unnecessary time and effort is not spent on non-priority, minor matters with the Division focusing its resources to address three areas of high risk in the financial markets in Hong Kong: corporate misconduct, serious misconduct by intermediaries, and market misconduct including insider dealing. These sectors will continue to be our priorities in the coming year under the SFO and the dual filing regime.

The High Court's decision to dismiss appeals by market manipulators against immediate custodial sentences sends an appropriate message to coincide with the tougher approach envisaged with the introduction of the SFO and should be an effective deterrent to those who might be tempted to break the law.

The Commission's focus on corporate governance has resulted in a marked increase in the number of company inspections; six such inspections in 2002-2003 compared with three a year ago. Our determination to fight corporate misgovernance has also resulted in the strengthening of our co-operation with the Hong Kong Police, the ICAC and the China Securities Regulatory Commission (CSRC) in the investigation of corporate misconduct in Hong Kong and the activities of Hong Kong listed companies in the Mainland. We have also successfully worked with the Police on matters ranging from corporate fraud and theft by brokerage staff, to boiler room fraud and market manipulation.

Surveillance

The Division's surveillance team is responsible for monitoring day-to-day trading in the stock and derivative markets in Hong Kong. We have recruited more market practitioners to improve our understanding of the market. With the help of sophisticated computer systems, we work to identify and make preliminary assessments of unusual price and turnover movements.

In cases of suspected market manipulation, insider dealing or any other market abuse, we obtain trading details from brokers, conduct preliminary inquiries and refer cases for full investigation. An Internet surveillance team has been formed to monitor and identify abnormal activities on websites.

As part of daily surveillance, we monitor the media for reports of improper activities and surf the Web to identify possible unregistered dealing or unauthorised advertising of investment products and services.

During the year, we obtained trading records from brokers on 122 occasions, and referred 23 cases for full investigation. We are satisfied that on many occasions our inquiries are sufficient to put a stop to potentially unethical behaviour. In recognition of this, we have initiated such inquiries earlier and canvassed a wider pool of brokers.

There were 173 occasions of trading suspension in listed securities due to unusual price or volume movements resulting in the imminent release of price sensitive information and full information disclosure. On 167 occasions, the suspensions were initiated by the companies concerned as a result of surveillance staff discussing the matter with them. Four suspensions were directed by the Stock Exchange and

two were directed by the SFC under Rule 9 of the Securities (Stock Exchange Listing) Rules. These suspensions were usually lifted on the day after the concerned company released news which might have an impact on its stock, or statements that it was unaware of the reason for the unusual price or volume movements in its shares.

■ Listed Companies

Under section 29A of the SFCO, the SFC might inspect books and records of a listed company if its directors and officers were suspected of impropriety in the management of its affairs. We continued two ongoing investigations from a year ago and conducted six new investigations during the year: two were referred to the Police for further investigation, one was concluded with no further action, and five are still in progress.

Euro-Asia Agricultural (Holdings) Company Ltd was directed by the SFC to suspend trading on the Stock Exchange under Rule 9 as a result of a section 29A investigation. The case has put under the spotlight the quality and suitability of sponsors and other professionals helping Mainland enterprises to list in Hong Kong. We are determined to contribute to the improvement in the quality of new listings by ensuring sponsors realise we will take action against those whose work falls short of the standard expected of them.

Under the SFO, our inspection powers will be more extensive. Coupled with dual filing, we anticipate conducting considerably more investigations of listed companies.

Investigations

Corporate misgovernance, serious misconduct by intermediaries and general market misconduct such as market manipulation and insider dealing have been major areas of enforcement work.

We continued 266 ongoing investigations from 2001-2002. Another 391 new cases were referred during the year by sources including the public, foreign regulators, law enforcement agencies in Hong Kong, the Exchanges and other SFC departments. Out of these 657 cases handled, 344 have been concluded and the remaining 313 are subject to continuing investigations, hearings or prosecutions.

■ **Market Misconduct**

The enforcement programme continued to focus on the fundamentals of maintaining a fair and open market by fighting corporate misgovernance and serious market misconduct.

□ **Market Manipulation**

Combating market manipulation continued to be a priority. Our enforcement efforts were justified by the successful prosecution of four people in the Courts for manipulating the shares of Grand Field Group Holdings Ltd (Case 1 in Table 1), Climax International Company Ltd (Case 2) and China Mobile (Hong Kong) Ltd (Case 3).

We have concluded investigations in an additional nine cases and are confident that most of these will be in Court in the coming year.

Successful Prosecutions - Market Manipulation (Table 1)
1 April 2002 to 31 March 2003

Case	Defendants	Date of Conviction	No. of Summonses Involved	Penalty	Costs of Investigation Awarded (\$)
1)	Lau Hing Nam	24 June 2002	1	160 hours of Community Service	36,556
	Wong Kwing Ming, George	24 June 2002	1	96 hours of Community Service	36,556
2)	Hung Daniel	11 November 2002	1	160 hours of Community Service	45,885
3)	Chan Shing Chun	25 March 2003	1	\$15,000 fine	3,653
Total: 4 entities					122,650

In addition, two persons convicted in the previous year for manipulation in the Hong Kong Parkview case had their appeals against immediate prison sentences dismissed in the High Court. Mr Justice Lugar-Mawson commented: “[Market manipulation] is an offence that strikes at the fair and honest operation of the securities market. It is not a victimless crime; its victims are all other members of the investing public.”

Furthermore, we assisted in the successful prosecution in the District Court by the Police of two individuals for manipulating the shares of Gay Giano International Group Ltd. One defendant was sentenced to nine-month imprisonment, suspended for three years and the other to a 240-hour Community Service Order. Both were disqualified from being a director for five years. This was the first time the Court has disqualified a person from directorship following a conviction for market manipulation.

The heavy sentences reflect that the Courts view market manipulation as a serious crime. The SFC welcomes this. Under the SFO, the maximum penalty is increased to 10 years’ imprisonment and a \$10 million fine. These increased penalties and the tougher judicial stance of the last year should represent a significant deterrent.

□ Insider Dealing

The Division investigated 11 cases carried forward from a year before and two new cases. We referred four cases to the Financial Secretary for consideration of the appointment of an Insider Dealing Tribunal (IDT). We concluded five cases with no further action being taken and investigations continue in the remaining four cases.

During the year, two insider dealing cases were heard by IDTs. As a result, seven insider dealers were ordered to pay a total of \$21.3 million comprising penalty, disgorgement and costs (Table 2).

In addition to fines etc, the two insider dealers in the Stime Watch International Holdings Ltd (now renamed Medtech Group Company Ltd) inquiry were also disqualified from holding any directorship in any Hong Kong listed company or its subsidiaries for four and three years respectively.

Case	Insider Dealers	Shares of Listed Company Involved	Date of Judgement	Disgorgement of Profit (\$)	Penalty (\$)	Cost (\$)
1)	Lau Chan Wing, Raymond	China Apollo Holdings Ltd	6 June 2002	746,986	746,986	682,434
	Zhang Tie Cheng			755,997	377,998	383,870
	Lok Fai			0	2,425,448	1,407,522
	Tseung Wai Lok			922,465	461,232	383,870
2)	Chung Ming Chee, Arthine	Stime Watch International Holdings Ltd	14 February 2003	793,360	1,190,040	1,407,522
	Tsang King Hung			2,000,000	1,000,000	500,000
	Wong Wing Shing, Wilson			1,605,943	2,000,000	1,500,000
Total: 7 persons				6,824,751	8,201,704	6,265,218

During the year, IDT started the Siu Fung Ceramics Holdings Ltd inquiry and the hearing continues. Two more inquiries are about to start : HKCB Bank Holdings Company Ltd/Lippo China Resources Ltd/Lippo Ltd and Firststone International Holdings Ltd. Eight cases previously referred to the Financial Secretary are awaiting his decision.

■ Disclosure of Interests Compliance

An essential element to the improvement of corporate governance is disclosure of the shareholdings of substantial shareholders and directors. The Securities (Disclosure of Interests) Ordinance (SDIO) required directors, chief executives and substantial shareholders of listed companies to disclose, on a timely basis, their shareholdings, including subsequent changes. Prompt and full disclosure helps investors assess the direction of a corporation and corporate insiders' views of its prospects. It also helps prevent market misconduct and enhances market transparency.

The Division continued to commit resources to ensuring strict compliance. During the year, we prosecuted 15 people and six companies (as against 14 people and eight companies in the previous year) for material SDIO breaches (Table 3). We issued 69 warning letters for minor and inadvertent breaches.

Case	Defendants	Date of Conviction	No. of Summonses Involved	Fine (\$)	Costs of Investigation Awarded (\$)
1)	Ng Cheong Lam	9 April 2002	16	32,000	13,240
2)	Wong Chung Pak Thomas	9 April 2002	4	20,000	15,135
3)	Yung Kwok Kee Billy	15 April 2002	7	35,000	34,771
4)	Best Fortune Capital Ltd	13 May 2002	2	2,400	9,318
	Zhang Daxiang	13 May 2002	4	4,800	9,318
5)	March Match Ltd	20 June 2002	4	12,000	3,838
6)	Zhong Jianqiu	16 July 2002	1	5,000	11,696
7)	Founder Holdings Ltd	13 August 2002	1	5,600	14,809
8)	Chow Wai Wai John	27 August 2002	2	10,000	17,516
9)	China United Holdings Ltd	29 August 2002	2	1,000	15,354
10)	Hung Siu Lin Katherine	17 September 2002	4	24,000	18,802
11)	Chan Kwan Shat	15 October 2002	6	30,000	8,176
	Wong Wei Gin Lydia	15 October 2002	6	30,000	8,176
12)	Lam Kin Hing Kenneth	22 October 2002	2	10,000	12,504
13)	Top New Finance Ltd	5 November 2002	6	36,000	6,751
	Wu Kezhong	5 November 2002	6	36,000	6,751
14)	Pong Kam Wah	24 December 2002	2	10,000	16,419
15)	Khattar Sat Pal	24 December 2002	2	7,000	6,668
16)	Yip Kwong	11 March 2003	1	5,000	9,210
17)	Leong On Mei Angela	25 March 2003	2	10,000	3,919
	Maxwick Investment Ltd	25 March 2003	2	10,000	3,919
Total: 21 entities			78	335,800	246,290

■ **Unauthorised Investment Promotion**

We prosecuted five companies and three persons under the Protection of Investors Ordinance for issuing unauthorised documents on the Internet, and possessing or issuing unauthorised advertisements and documents in relation to investment arrangements with guaranteed returns (Table 4). Such arrangements related to the sale of securities or property where investors' interests were pooled and returns guaranteed.

Successful Prosecutions – Protection of Investors Ordinance (Table 4)					
1 April 2002 to 31 March 2003					
Case	Defendants	Date of Conviction	No. of Summonses Involved	Fine (\$)	Costs of Investigation Awarded (\$)
1)	GlobalLinkAsia.com.Ltd	5 June 2002	5	150,000	0
2)	Joyplace Inc	9 July 2002	2	20,000	9,053
	Lin Chih Chieh Sidney	9 July 2002	2	14,000	9,053
3)	Ho Sze Man	16 July 2002	3	9,000	9,053
4)	Hong Kong Characteristic Medicine (International Group) Co	10 September 2002	2	30,000	8,980
5)	Hong Kong Real Estate Exchange Co Ltd	8 October 2002	5	50,000	6,125
	Li Chi Hong	8 October 2002	5	25,000	6,125
6)	Midland (China) Property Development Ltd	14 February 2003	5	50,000	32,990
Total: 8 entities			29	348,000	81,379

■ **Unregistered Dealing and Illegal Short Selling**

We noted a decline in unregistered dealing and illegal short selling prosecutions. During the year, one person was prosecuted for unregistered dealing in securities and three for short selling (Table 5).

Successful Prosecutions – Unregistered Dealing and Illegal Short Selling (Table 5)					
1 April 2002 to 31 March 2003					
Case	Defendants	Date of Conviction	No. of Summonses Involved	Fine (\$)	Costs of Investigation Awarded (\$)
Unregistered Dealing					
1)	GlobalLinkAsia.com.Ltd	5 June 2002	1	30,000	14,178
Illegal Short Selling					
2)	Heng Hian Mok	26 November 2002	24	48,000	8,355
3)	Chan Shing Chun	25 March 2003	3	45,000	10,959
4)	Choy Tin Woo Johnnie	25 March 2003	1	25,000	22,429
Total: 4 entities			29	148,000	55,921

Disciplinary Actions

For Hong Kong to remain an international financial centre it is essential that tough disciplinary action is taken against intermediaries who put their clients' interests and the integrity of the market at risk.

In 2002-2003 we conducted 163 disciplinary inquiries. Of these we concluded 90 resulting in the disciplining of 86 entities:

- Disciplined 12 registrants for serious misconduct.

Of these, we revoked the licences of seven for: conducting unauthorised trades in client accounts causing substantial losses; creating false documents to cover up; making false representations to SFC to get licences; and lacking the necessary financial integrity.

Suspended the licences of five people for eight months to three years for: conducting discretionary trades in breach of licensing conditions; breaching an undertaking to repay the outstanding balance in a client's account; failing to establish clients' identities; assisting a person trading through nominee accounts; and breaching the Code on Takeovers and Mergers.

- Suspended the licences of 20 registered persons for one week to six months for: contravening HKEx's Placing Guidelines for Derivative Warrants; failing to obtain written authorisations from clients before accepting third parties' orders; providing misleading information; improper debt collection, unregistered portfolio management; delay in executing clients' orders; circumventing HKEx's rules; facilitating potentially improper or illegal clients' trade; and window dressing the company's financial position.

- Publicly reprimanded 44 registered persons for: contravening HKEx's Placing Guidelines for Derivative Warrants; poor internal controls; failure to supervise staff to conduct businesses properly; and other misconduct.
- Privately reprimanded 10 registrants

Table 6 shows our significant disciplinary actions.

Significant Disciplinary Actions			(Table 6)
1 April 2002 to 31 March 2003			
Registrants	Date of Action	Misconduct	Disciplinary Action
1) Ngai Tsz Keung	4 April 2002	Made false representation of his educational qualification for obtaining registration	Revocation
2) Fung Hing Chiu Herman	8 April 2002	Conducted unauthorised trades in a client's account and issued a dishonoured cheque	Revocation
3) Chan Siu Ping	31 May 2002	Conducted unauthorised trades in clients' accounts and forged a client's signature to withdraw funds for her own use	Revocation
4) Leung Lam Yuen Ching Juanita	18 July 2002	Conducted unauthorised trades in clients' accounts and created false documents to clients	Revocation
5) Tam Hau Lok	20 September 2002	Failed to honour his financial obligations and did not have the necessary financial integrity	Revocation
6) Chan Hing Fung Katie	21 October 2002	Conducted unauthorised trades in clients' accounts and created false documents to clients	Revocation
7) Leung Yuen Yee Winnie	17 March 2003	Making preferential allocation of trades to the detriment of clients	Revocation
8) Tse Hon Pan	27 May 2002	Conducted numerous discretionary trades in clients' accounts in breach of his licensing conditions	3 years' suspension
9) Chan Kin Sun	10 June 2002	Breached the Code on Takeovers and Mergers	2.5 years' suspension
10) Ng Yin Hing	16 April 2002	Conducted unauthorised trades in a client's account and breached the undertaking to repay	2 years' suspension
11) Ng Kwun Wing	27 May 2002	Failed to establish the identities of the persons placing orders and making settlement instructions	9 months' suspension
12) Yeung Ching Kwong	9 May 2002	Assisted a dealer's representative to trade through 2 nominee accounts and created false records to deceive his employer	8 months' suspension

In addition to the discipline, we also issued 51 warning letters in cases of less serious nature.

Failure to check the identities of third parties placing orders in client's accounts remains prevalent. This puts clients' assets at risk, makes market misconduct easier and damages market integrity. We will continue to focus on this area over the coming year.

HKEx's Placing Guidelines for Derivative Warrants

We publicly reprimanded three brokerages and seven individuals, and suspended two individuals' registrations for contravening HKEx's Placing Guidelines for Derivative Warrants.

Some intermediaries provided names of clients to placing agents to ostensibly satisfy the Placing Guidelines in force at the times. These schemes created the false appearance that there were sufficient independent persons holding the warrants at the time of listing, and could have misled investors as to the real state of movement for the warrants and the viability of the post-listing market.

Some intermediaries failed to understand the Placing Guidelines before acting as placing agents.

If intermediaries operate without being fully conversant with all relevant rules and regulations, we will take action even in situations where the rules are no longer in force.

We started late last year to publish a monthly digest of enforcement actions, the *SFC Enforcement Reporter*. We have received positive feedback from the market. In the coming year, we intend to provide the industry with more information regarding matters that concern us and to use disciplinary actions and prosecutions as examples to reinforce regulatory messages.

The cases on the next page have been highlighted in the *SFC Enforcement Reporter* and are important messages to intermediaries.

Lessons to Learn

Case 1. Phoenix Capital Futures Ltd

We discovered that Phoenix had window-dressed its financial position in order to report compliance in its monthly Financial Resources Rules (FRR) returns. In March, we suspended Phoenix's registration for two weeks. Chan Siu Man, Kirby, the dealing director responsible for finance and compliance functions, was also suspended for two weeks.

We attach great importance to registrants' observance of the FRR since it is the cornerstone of prudential regulation. We will not tolerate window-dressing activities. FRR breaches are serious enough to warrant suspension or even revocation, even if there is no loss to investors.

Case 2. Chan Kin Sun

Chan Kin Sun was suspended for 30 months after the SFC Takeovers Executive imposed an order denying him access to the securities market (a cold shoulder order) for 15 months for breaching the Code on Takeovers and Mergers. The length of the suspension took into account not only his conduct in relation to the Takeovers Code breach but also his recidivism – Chan had been suspended for 30 months in 1997. Repeat offenders should expect to receive much tougher penalties.

Case 3. Chiang Yuk Oi

We expect co-operation and assistance from intermediaries at all times. Following the successful prosecution of an individual for manipulating the shares of Good Fellow Group Ltd, we suspended the registration of Chiang Yuk Oi for six months for giving materially inconsistent answers in SFC interviews and to the Court during the prosecution. Actions that attempt to jeopardise our investigation and court proceedings will be punished.

Co-operation with other Law Enforcement Agencies

In order to combat financial and corporate crime effectively, we keep in close contact with domestic enforcement agencies and our counterparts in other jurisdictions.

We have referred 47 cases during the year to the Hong Kong Police and ICAC for further investigation and action. To create a better understanding of how our respective organisations work, two officers from the Commercial Crime Bureau were seconded to the SFC's

Enforcement Division for a three-month period. It is hoped that secondments will become a regular occurrence so that benefits can be brought to both organisations through an exchange of experience, expertise and training.

Boiler Rooms

During the year, we received 68 complaints in relation to boiler room fraud, compared with 106 in 2001-2002.

"Boiler rooms" refer to groups of professional-sounding salespersons who cold call and use high pressure sales tactics to urge potential investors to buy real or bogus investments. Very often, they are located in one country and approach investors in another by telephone, email, fax or post. Once the investors send money, often overseas, the salesperson disappears.

Out of the 68 cases which we handled, 33 involved boiler rooms using the facilities of business centres or secretarial firms in Hong Kong to disguise the real jurisdictions in which they operate. They had no real operations in Hong Kong. This year, we are stepping up measures to discourage business centres and secretarial firms in Hong Kong from innocently or knowingly facilitating boiler room operators.

Some complaints were referred to us from overseas regulators. In September 2000, following a referral from the UK's Financial Services Authority, we started investigating the operations of a company called FCS Fund Management. The company was suspected of having operated in Hong Kong without an SFC licence. The SFC then referred the case and its initial findings to the Police and we worked closely together on it. The former chairman of FCS, Graham Hammond, surrendered himself to the Serious Fraud Office in London and was then convicted of 20 counts of furnishing false information and jailed for eight years in August 2002. This case illustrates the success and importance of continuing co-operation between the SFC, domestic enforcement agencies and our counterparts in other jurisdictions.



**With the
Additional SFO
Powers, We
Expect to :**

**Investigate
More Listed
Company
Malpractice**

- ▶ The new provisions extend the SFC's power to obtain documents and seek explanations from parties closely connected with the listed corporations, namely their banks, auditors and transaction partners.

**Use the Dual
Route to Combat
Misconduct**

- ▶ A Market Misconduct Tribunal (MMT) is created to handle civil cases of market misconduct. The MMT can impose a greater range of civil sanctions. As an alternative to civil proceedings, market misconduct will also be subject to criminal prosecution which may result in more severe penalties on conviction.

**Raise Disclosure
Quality**

- ▶ The tighter disclosure of interests law ensures equal and timely access for investors to information about controlling interests in listed companies.

**Impose More
Proportionate
Punishments
on Intermediaries**

- ▶ We have a broader range of sanctions to deal with intermediaries' misconduct. We can fine up to \$10 million or three times the gains or losses avoided, whichever is higher. We can impose partial suspensions and revocations of licences. To impose proportionate sanctions where they are due, we propose to fine in combination with suspensions and other disciplinary sanctions.

