



staying
on track



regulation

Control, co-ordination and strength are required to execute the series of swings, holds, releases and turns on the parallel bars.

observing
rules



monitoring
activities



keeping high
standards



As was the case with regulators elsewhere, we devoted substantial resources to local and international issues arising from the global financial crisis. We proposed regulatory reforms that were, in part, a response to some of the matters identified as a result of the turmoil experienced in financial markets. In proposing these reforms, we have sought the right balance between an appropriate level of protection for the investing public and scope for the market to operate efficiently and develop within a practical regulatory framework.

During the year, our operational divisions worked hard to set and uphold standards, monitor market activities, investigate possible violations and take disciplinary and enforcement action.

Enforcement actions

In addition to making sure that those who violate the rules pay the price for their actions, our enforcement action also helps send clear messages to the markets that we will not tolerate activities that undermine investor interests or market integrity. Last year, we continued to achieve positive results in combating misconduct. In the following section, we provide an account of the most significant enforcement actions, some of which are still ongoing.

Concluding investigation into Lehman Brothers Minibonds

The top-down approach we adopted to investigate investor complaints in relation to Minibonds continued to prove effective. We looked into the complaints against each selling institution collectively by examining their policies and practices. In so doing, we were able to address the maximum number of Minibond-related complaints in the shortest possible period.

Building on the success of the repurchase agreements reached with Sun Hung Kai Investment Services Ltd and KGI Asia Ltd, we reached similar agreements with 16 distributing banks¹, Grand Cathay Securities (Hong Kong) Ltd, and Karl Thomson Investment

Consultants Ltd in relation to Minibonds. Separate agreements were reached with Dah Sing Bank and Mevas Bank over their sales of certain Principal Protected Notes issued by a Lehman Brothers (LB) group entity. Besides repurchasing Minibonds and notes from their eligible customers, the distributors were also required to address and rectify inadequacies in their internal systems and controls, introduce new processes concerning the sale of investment products and enhance their complaint-handling procedures.

Under the agreements, eligible customers may, depending on the buyback scheme, recover from 60% to 100% of their original investments. The repurchase offer had a high acceptance rate and, as at end-March 2010, more than \$5.6 billion had been paid to about 30,000 investors.

Breakthroughs in enforcement actions

Using the powers under the Securities and Futures Ordinance (SFO), we took a series of actions and sought a range of legal remedies to achieve our enforcement objectives. During the year, we prosecuted three individuals for 12 counts of insider dealing, seven individuals for market manipulation offences and 24 individuals and companies for various other offences under the SFO. Fines in the total sum of \$25,032,535 were imposed in various of our criminal prosecutions. We also sought orders from the court to freeze assets being proceeds of suspected securities fraud in four cases.

¹ These banks are: ABN AMRO Bank N.V., Bank of China (Hong Kong) Ltd, Bank of Communications Co Ltd, The Bank of East Asia Ltd, Chiyu Banking Corporation Ltd, Chong Hing Bank Ltd, CITIC Ka Wah Bank Ltd, Dah Sing Bank Ltd, Fubon Bank (Hong Kong) Ltd, Industrial and Commercial Bank of China (Asia) Ltd, Mevas Bank Ltd, Nanyang Commercial Bank Ltd, Public Bank (Hong Kong) Ltd, Shanghai Commercial Bank Ltd, Wing Hang Bank Ltd and Wing Lung Bank Ltd.



We obtained various court orders for the first time in a number of civil matters. We also secured convictions in serious criminal cases in which the court imposed deterrent sentences:

- **First indictable conviction under the SFO for market manipulation in the largest market capitalisation falsified:** Four persons, Chan Chin Yuen, Elaine Au Yeung Man Chun, Chan Chin Tat and Chui Siu Fung, were sentenced to 26 to 30 months' imprisonment in the District Court for conspiring to manipulate the market in trading shares of Asia Standard Hotel Group Ltd. The false trading activities had the effect of raising the company's share price by 78% and ramping up the company's market capitalisation by \$4 billion.
- **Maximum sentence for insider dealing:** A former director of Morgan Stanley Asia Ltd, Du Jun, was sentenced to seven years' imprisonment, the maximum prison term within the powers of the District Court, for insider dealing in the shares of CITIC Resources Holdings Ltd during an acquisition deal in 2007. The defendant was also fined \$23,324,117, a sum equal to the notional profit made from his insider dealing activities. The defendant has lodged an appeal against his conviction and the sentence.
- **Court confirmation of the SFC's power to freeze assets:** The Court of Appeal allowed an appeal by the SFC and re-imposed interim injunctions against three defendants to prevent the dissipation of assets that had been frozen in an insider dealing investigation. The judgment provided authoritative guidance on the nature and scope of section 213² of the SFO, and paved the way for the SFC to bring substantive civil proceedings before the court. The three defendants have lodged an appeal with the Court of Final Appeal.

- **Largest interim assets freezing order:** We obtained an order from the Court of First Instance to freeze assets of up to \$1.6 billion against the former chairman of GOME Electrical Appliances Holding Ltd, Wong Kwong Yu, his wife Du Juan and two companies for allegedly having perpetrated an unlawful scheme, which resulted in a loss of about \$1.6 billion to the company. The interim injunction serves to prevent the dissipation of assets pending the conclusion of the SFC's investigation and to ensure that sufficient assets are preserved to satisfy any restoration or compensation orders which may be made by the court.
- **First director disqualification over failure to make timely disclosure of information:** The SFC obtained orders from the Court of First Instance to disqualify two directors, Ellen Yeung Ying Fong and John Lai Wing Chuen, of Warderly International Holdings Ltd for five years for failing to ensure that the company disclosed its substantially depleted financial position to the market as required under the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Ltd and to give shareholders all the information they might reasonably expect.
- **First court order to direct a listed company to commence proceedings against former directors:** The SFC obtained an order from the Court of First Instance directing Rontex International Holdings Ltd to bring legal proceedings against three of its former executive directors, Cheung Keng Ching, Chou Mei and Kevin Lau Ka Man, to seek the recovery of the compensation for the loss and damage suffered by the company as a result of the directors' misconduct.

² Section 213 of the SFO allows the SFC to apply to the Court of First Instance for various orders against any person who has contravened a provision of the SFO.

Sing Pao



Hong Kong Daily News

- **First prosecution in the District Court for failing to answer questions as required under the SFO:** Two persons, Chan Chin Tat and Chui Siu Fung, were convicted of failing to answer questions during an SFC investigation, and each was sentenced to one month's imprisonment, to be served concurrently with sentences imposed in earlier proceedings for market manipulation offences.

Enforcement activities	
Number of trading inquiries directed to brokers	4,141
Number of investigations started	275
Number of investigations completed	220
Number of investigations completed within seven months (%)	168 (76%)
Number of persons charged in criminal proceedings	33*
Number of criminal charges laid	181*
Number of Notices of Proposed Disciplinary Actions	59
Number of Notices of Final Decision	78
Number of persons against whom civil proceedings were commenced	34
Compliance advice letters issued	230

* We laid a total of 181 criminal charges against 33 persons, with 49 charges laid against 10 persons for market manipulation or insider dealing.

Firm actions taken

We prosecuted for the first time the offence of disclosure of false or misleading information inducing transactions. Vong Tat-leong David, was charged with and is being prosecuted for allegedly causing dissemination concerning a transfer of shares of Vonggroup Ltd and hence an increase of its trading volume and share price. The case was heard in the District Court.

We obtained orders from the Court of First Instance to appoint interim administrators and provisional liquidators and freeze assets of up to US\$90.6 million in relation to a private hedge fund, Descartes Athena Fund SPC, related entities and individuals. The applications were made as part of an ongoing investigation into the operations of the fund in Hong Kong, which raised over US\$90.6 million from overseas investors, and a number of related entities.

Proceedings were commenced in the Court of First Instance for an injunction to freeze assets of Tiger Asia Management LLC, a New York-based management company, and three of its senior officers, Bill Sung Kook Hwang, Raymond Park and William Tomita, up to \$29.9 million, a sum equivalent to the notional profit gained in suspected insider dealing and manipulation in the shares of China Construction Bank Corporation. (In April 2010, we amended the proceedings to seek orders to freeze an additional \$8.6 million of Tiger Asia's assets and to prohibit it from dealing in all listed securities in Hong Kong in the light of further insider dealing allegations in respect of the shares of the Bank of China Ltd.) We are also seeking orders to unwind the relevant transactions to



South China Morning Post



The Standard

Sing Tao Daily



restore the affected parties to their pre-transaction positions and to prevent Tiger Asia and the three officers from trading in listed securities and derivatives in Hong Kong when in possession of relevant information.

During the year, we obtained orders from the Court of First Instance to disqualify Shum Ka Sang and Shen Yi, former directors of Wah Sang Gas Holdings Ltd, and Fung Chiu and Lian En Sheng, former directors of GP Nano Technology Group Ltd from acting as directors of any company for periods ranging from six to seven years. Separately, we issued proceedings in the Court of First Instance to seek orders to disqualify Hung Kwok Wa Godfrey (a current executive director), Yeung Kui Wong, Yu Hung Wong, John Lai Wing Chuen and Ellen Yeung Ying Fong (all former executive directors) and Hermann Leung Ping Chung (a former non-executive director) of Warderly International Holdings Ltd for suspected misconduct involving persistent failure to comply with disclosure requirements under the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Ltd. Orders were made to disqualify John Lai Wing Chuen and Ellen Yeung Ying Fong each for a period of five years and the proceedings are continuing against the other four.

To encourage compliance, we reached agreements with four licensed corporations, requiring them to rectify deficiencies we had identified, and cautioned them that more severe disciplinary action would be taken if the deficiencies were not rectified satisfactorily.

These entities were fined a total of \$7.7 million and their implicated responsible officers disciplined and/or fined. Separately, we reprimanded eight licensed corporations for various breaches and fined them a total of \$13.74 million. Five licensed persons from these brokerages, which included responsible officers, had their licences revoked or suspended.

Enforcement powers under the SFO affirmed

During the year, several provisions under the SFO have been successfully invoked in our enforcement actions taken to tackle regulatory breaches.

- In a civil action, the Court of First Instance granted a declaration order that effectively affirmed the powers of the SFC to take action against unlicensed persons who had engaged in "grey market" trading of securities.
- We obtained an order from the Court of First Instance to require Lehman Brothers Asia Ltd, which was in liquidation, to disclose to us, pursuant to section 185³ of the SFO, all records and documents, not covered by legal professional privilege connected to our investigation of the offer and marketing of Minibonds.

Last year, the Securities and Futures Appeal Tribunal upheld five disciplinary appeal decisions in which disciplinary sanctions were imposed, including a lengthy prohibition order, a licence suspension and a heavy fine.

³ Under section 185 of the SFO, the SFC has the power to apply to the Court of First Instance in respect of any failure by a person to produce any records or documents upon being required to do so by the SFC under provisions of the SFO, for an order that the person comply with the requirement within a specified period.

Regulatory enhancements

In the past year, we reviewed various aspects of our regulatory regime to identify areas in which we believed investor protection measures should be enhanced, or in which changes should be made to accommodate market developments, or in which we could increase efficiencies. To this end, we conducted public consultations on various proposals on different subjects.

Investor protection measures proposed

In our report to the Financial Secretary in December 2008 (the FS Report), in light of the global financial crisis and its impact in particular on unlisted structured products offered to the public, we recommended a number of measures to restore investor confidence in the financial markets and to address issues relating to selling practices and complex investment products. After its review of the FS Report and a report prepared by the Hong Kong Monetary Authority, the Financial Services and the Treasury Bureau formulated an action plan⁴ to take forward various recommendations.

In furtherance of measures recommended in the FS Report and identified in the action plan, we began a three-month consultation in September 2009 to solicit public comment on proposals to enhance the current regulatory regime governing the sale of investment products in Hong Kong. Covering each stage of the investment life cycle, the key proposals addressed pre-sale documentation, disclosure at and after the point of sale, selling practices, and certain post-sale requirements, including consideration of the feasibility of a “cooling-off” or “unwind” period for certain investment products.

One of the key proposals is the use of a single SFC products handbook containing a revised Code on Unit Trusts and Mutual Funds, a revised Code on Investment-Linked Assurance Schemes and a brand new Code on Unlisted Structured Investment Products together with guiding principles to be applied on a cross-product basis.

Public views were also sought on proposals relating to intermediary selling practices, including whether intermediaries should, as part of their “know your client” procedures, assess a client’s knowledge

of derivatives and characterise the client based on this knowledge to help the intermediaries provide appropriate services. The public was also consulted on the definition of “professional investor,” not just in terms of revisiting the applicable asset test, but also as to the requirement for knowledge of and expertise in relevant products. To address potential conflict of interests issues, it was also proposed that intermediaries be required to disclose, pre-sale, the benefits they receive from product issuers.

In formulating the proposals, we closely examined the regulatory regimes in other major jurisdictions and consulted the market widely. Following the release of the consultation paper, we conducted over 50 briefings with various stakeholders, including Legislative Council members, market participants, industry bodies, media representatives, consumer representatives and academics, to explain issues and respond to any related enquiries. To help the industry better understand the implications of certain proposals, such as the proposed disclosure of monetary and non-monetary benefits and the imposition of a “cooling-off” or unwind right, we hosted a forum for some 240 industry representatives at which experts from the United Kingdom’s Financial Services Authority and the Australian Securities and Investments Commission shared their experiences in their respective markets.

To encourage the general public to submit comments on the consultation paper, we launched a public awareness campaign immediately after the paper was released. This included a TV commercial to publicise the consultation, print advertisements in major newspapers and other promotional items placed in public transport vehicles and on the Internet. We also explained the objectives underpinning the proposals in our consultation in various articles and segments in the print and radio media. To facilitate submission of feedback on the consultation, we posted for the first time an interactive questionnaire on the SFC website.

At the close of the three-month consultation period, we had received over 100⁵ submissions representing comments from a diverse group of stakeholders such as banks, brokers, financial advisors, fund managers, insurance companies, professional firms, representative bodies and the general public. We carefully analysed the comments received. We also held a number of follow-up

⁴ Action Plan on Recommendations in the Reports Prepared by the HKMA and the SFC on the Lehman Brothers Minibonds Incident prepared by the Financial Services Branch of the FSTB was submitted to the LegCo in February 2009.

⁵ The responses received included a considerable number of suggestions concerning banks’ selling practices on structured products, which were not direct responses to the proposals. These suggestions were carefully reviewed and taken into consideration if they were deemed to be relevant.



meetings with market practitioners to discuss feedback and suggestions we had received and to explore practicable alternatives that would further our objectives in balancing an appropriate level of protection for investors with scope for the market to operate efficiently and develop within a practical framework of regulation. We released our consultation conclusions in respect of these proposals in the second quarter of 2010, retaining the majority of the proposals.

During the same period, we consulted the public on statutory reform proposals to enhance the regulatory regime governing public offers of unlisted structured products in Hong Kong. The reforms proposed would operate to transfer the regulation of public offers of structured products that currently fall within the scope of the Companies Ordinance prospectus regime to the offers of investments regime under the SFO. If implemented, the proposals would require unlisted structured products proposed to be offered to the public in Hong Kong, together with the related offering documents and marketing materials, to be authorized under the SFO, unless an exemption applies. The consultation conclusions in respect of these proposals were published in April 2010.

Other regulatory changes tabled

In view of the robust regulatory regime in place, Hong Kong did not impose any additional restrictions on short-selling activities as a result of the financial crisis. We did, however, take the opportunity to review the regime last year to identify possible areas for improvement. After taking into account the domestic market situation and industry feedback collected from a two-month public consultation, we announced a new short-position reporting regime to enhance transparency of short-selling activities. We believe that the new reporting regime will not only complement Hong Kong's existing requirements with respect to short sales but will also enable us to monitor systemic risks more effectively. The new reporting requirements will need to be implemented in subsidiary legislation, and we intend to consult the public on this in due course.

Separately, proposals were made to extend the Codes on Takeovers and Mergers and Share Repurchases to cover real estate investment trusts (REITs) and strengthen regulation of market

conduct regarding dealings in listed collective investment schemes. Given the development of the REIT industry in Hong Kong and other parts of Asia and rising interest in merger and acquisition activity among REITs, we considered it an appropriate time to augment the regulatory infrastructure in this area to better protect the interests of minority unitholders and to aid the further development of the REIT market.

In line with the Government's proposals to give statutory backing to the obligation of listed corporations to make timely disclosure of price-sensitive information, we began a public consultation on a draft set of guidelines explaining the type of information and uses covered and how applicable exemptions and safe harbours would be applied. We believe that this proposal would further enhance transparency and the quality of Hong Kong's securities markets.

Market supervision and standards

Monitoring market activities and maintaining industry standards are important aspects of our work. We set standards for both industry practitioners and the securities and futures markets through licensing requirements, codes of conduct, rules and regulations. We monitor industry participants, market operators and market activities to detect possible deviations from such standards. We review the standards we set from time to time, working closely with fellow regulatory bodies where appropriate, to ensure that they accommodate changing circumstances and developments.

Monitoring market and industry activities

We monitor industry practitioners and other market participants in various ways. We require intermediaries to file certain information with us regularly, and conduct on-site inspections or off-site monitoring of their operations. We communicate frequently with industry participants to raise awareness of compliance matters and to gauge their resilience in adverse market conditions.

We extend our supervisory work to monitoring the market for incidents such as unusual movements in prices, volumes or other markers and take action against those found breaching applicable rules. In addition, we plan for contingencies or emergencies that may disrupt trading activities.

Stressing compliance

- At two seminars organised jointly with the Government, we updated 600 management and compliance officers from intermediaries on the latest international and local developments in anti-money laundering regulation. We also met with over 20 representatives from six brokerages to exchange views on regulatory developments and other compliance matters.
- We reminded brokerages to be vigilant in managing their securities margin financing risks and to conduct regular stress tests to ascertain the adequacy of their financial resources. We issued a new set of Frequently Asked Questions to provide further guidance on requirements for margin lending policies and controls. This was prepared based on the findings of an independent review, conducted by an accounting firm in 2009, of the securities margin financing businesses of a sample of brokerages, offered.
- We issued a circular to remind brokerages of their compliance obligations in light of the conditions imposed on the listing of United Company RUSAL Ltd and the need for prudent risk management when providing margin financing to clients to take up shares of the company.
- For the fourth consecutive year, we conducted a joint seminar with the Hong Kong Institute of Certified Public Accountants to share with their members our experience in reviewing certain internal control systems employed by stockbrokers and sponsors of initial public offerings.
- During the year we held 279 meetings with representatives of licensed corporations and industry bodies to discuss their business operations and market developments. We also conducted 200 risk-based, on-site inspections of licensed corporations to assess their level of compliance. From these inspections and from our ongoing supervisory work, we identified 441 control deficiencies, rule infractions and/or violations. Among these, 35 cases involving serious breaches by licensed corporations and/or individuals warranted further investigation.

Maintaining high standards in matters related to listed companies

- In reviewing the listing application made by United Company RUSAL Ltd under the dual filing regime, we took the view that the applicant's complex debt restructuring arrangement and other areas of uncertainty were unlikely to be readily comprehensible to retail investors. In the interest of the investing public, we exercised our power under the Securities and Futures (Stock Market Listing) Rules to impose certain conditions in respect of the listing.
- We monitored complaints, press reports and announcements in respect of listed companies, and identified and handled instances of potential false or misleading disclosures.
- We continued to supervise the performance of The Stock Exchange of Hong Kong in its regulation of listing matters.
- The Executive⁶ issued a "cold shoulder order" and a public reprimand in respect of Koo Ming Kown, the only non-executive director of Nam Tai Electronic & Electrical Products Ltd (NTEEP) and the only executive director of Nam Tai Electronics, Inc (NTEI), for announcing NTEEP's proposed voluntary winding-up in full knowledge of the fact that that such proposal constituted a serious breach of the Takeovers Code. The cold shoulder order had the effect of denying Koo direct or indirect access to the Hong Kong securities markets for two years.
- During the year, our Takeovers team handled 96 transactions, including general offers, privatisations, whitewashes and share repurchases, and 267 applications under the Codes on Takeovers and Mergers and Share Repurchases. The Takeovers Panel met four times to rule on issues relating to live transactions and/or policy issues.

Maintaining orderly markets

- Following sharp movements in the stock price of Asian Citrus Holdings Ltd upon its trading debut, we worked with Hong Kong Exchanges and Clearing Ltd (HKEx) to identify measures to enhance dissemination of information and orderliness of trading in cases of listing by introduction.

⁶ The Executive refers to the Executive Director of the Corporate Finance Division of the SFC or any delegate of the Executive Director.



- In January, a technical glitch rendered Hang Seng Indexes Company Ltd's (HSIL) system incapable of updating and disseminating indices for about 30 minutes, and HSIL activated its contingency arrangements for distribution of indices. We worked closely with HSIL and HKEx to review the effectiveness of the contingency measures.

International co-operation

To keep Hong Kong abreast of developments in international financial markets and regulatory standards and initiatives in other markets, we participate regularly in international discussions and reviews of various regulatory issues, mainly through forums such as the International Organization of Securities Commissions (IOSCO).

In October 2009, the head of our Intermediaries Supervision Department was appointed to chair the IOSCO's Standing Committee 3 on the Regulation of Market Intermediaries. This appointment allows the SFC to further contribute to initiatives on improving global market standards; for example, we hosted a meeting in Hong Kong to discuss key regulatory issues such as direct electronic access to securities markets, insolvency and liquidity management, and requirements for intermediaries to assess suitability when selling investment products.

Led by the SFC's Chief Executive Officer, the IOSCO's Task Force on Short Selling published recommended principles for the effective regulation of short selling and subsequently provided a progress report to the IOSCO with respect to implementation of the recommendations in major markets.

The SFC also represents Hong Kong in the Standing Committee on Standards Implementation (SCSI), established by the Financial Stability Board (FSB). In this role, the SFC co-ordinates Hong Kong's participation in the SCSI initiatives to promote implementation of international standards and improve information sharing and regulatory co-operation. The SFC also participates in two sub-working groups of the SCSI: the Expert Group, which promotes adherence to international co-operation and information exchange

standards, and the Implementation Monitoring Network, which provides the Group of Twenty (G-20) with periodic updates on implementing the recommendations of the G-20 and the FSB in their respective member countries.

Public concerns

During the year, we received 2,742 public complaints, of which 672 were related to the collapse of the LB group. We referred 627 complaints about alleged mis-selling by banks to the Hong Kong Monetary Authority for preliminary review.

Our various operational divisions reviewed 731 non-LB related complaints and investigated 143 cases. A further 164 matters were referred to HKEx or other financial regulators where the subject matter fell within their purview.

Public complaints overview

Nature of complaints	2009-10	2008-09	% change
Conduct of licensed intermediaries and registered institutions	616	513	+20%
Listing-related matters and disclosure of interests	716	505	+42%
Market misconduct	321	422	-24%
Products	19	37	-49%
Other financial activities	386	294	+31%
Miscellaneous	12	47	-74%
Subtotal	2,070	1,818	+14%
Complaints related to Lehman Brothers	672	8,252	-92%
Total	2,742	10,070	-73%

Under our supervision, the Investor Compensation Co, Ltd (ICC) continued to process claims from clients of three brokerages that had gone into default in previous years. It also processed claims against five brokerages relating to individual disputes. In the past year, the ICC completed the processing of 73 claims and paid out \$2.74 million in compensation to 31 clients.