SFC 證監會

ENFORCEMENT REPORTER

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A bi-monthly communication between the SFC and the market about the SFC's enforcement work and current enforcement issues.

What Have We Been Doing?

We are committed to reducing crime and misconduct in our securities and futures markets by:

1. identifying risky conduct and circumstances that may lead to misconduct ; and
2. taking enforcement action where we believe it is necessary.

From 2 January to 30 April 2008, we sent more than 119 compliance advice letters, where we became aware of conduct which presents unnecessary risks or which may lead to crime or misconduct in our markets.

During the same period, we also completed 65 enforcement cases, issued 25 notices of decision in disciplinary cases, and took civil action to prevent money and other assets from dissipation.

Insider Dealing

We attach the highest importance to stamping out insider dealing because such conduct is disruptive and harmful to financial markets.

In a recent ruling, the Court of Final Appeal, the highest court in Hong Kong, described insider dealing as

> "…an "insidious mischief" which threatens the integrity of financial markets and public and investor confidence in the markets…"

and as

> "…a species of dishonest conduct…" (per Sir Anthony Mason NPJ in Koon Wing Yee v IDT, FACV No 19 of 2007, para 45-46)

Insider dealing attracts the stiffest maximum penalties under the Securities and Futures Ordinance (SFO). A criminal court can impose a fine of up to $10 million and/or a term of imprisonment of up to 10 years.

Highlights

- In first four months of 2008, completed 65 enforcement cases, issued 25 notices of decision in disciplinary cases, and took civil action to prevent money and other assets from dissipation
- Conducting 20 insider dealing investigations and commenced first criminal prosecution for insider dealing in Hong Kong
- SFC wins challenge to a court case involving misleading announcement by a listed company and its chairman
- Suspension of licence of a firm engaged in leveraged foreign exchange trading
- SFC starts action over Grey Markets to ensure proper protection for investors

We currently have 20 insider dealing investigations in progress involving suspicious trading by listed company directors, bankers, corporate lawyers and accountants.

Our strategy for attacking illegal insider dealing is a simple one. We aim to reduce the incidence of insider dealing by using the full range of powers and remedies contained in the SFO including criminal, civil and administrative sanctions.

In pursuit of this strategy, in the last three months:

1. the SFC started the first criminal prosecution for insider dealing in Hong Kong following an SFC investigation. This action was commenced by the SFC in January 2008 against five persons. After an application by the Department of Justice, it will now proceed as an indictable prosecution in the District Court. For further details, please follow this link to the SFC's press release dated 28 February 2008.
2. the SFC commenced a third injunction proceeding to restrain the dissipation of proceeds of suspected insider trading. (Since July 2007, we have commenced civil injunction proceedings restraining dissipation of almost $100 million in suspected insider dealing profits)
3. two proceedings (separate inquiries into share trading in China Overseas Land and Investment Limited and Sunny Global Holdings Limited) have been set down for hearing in the Market Misconduct Tribunal (MMT) and a fourth case (inquiry into share trading in Mobicon Group Limited) has just been referred to the MMT by the Financial Secretary. The SFC is not a party to these proceedings. However, the cases arise from investigations conducted by the SFC which are referred to the Financial Secretary for action.

Licence Suspended by the Securities and Futures Appeal Tribunal

In August 2007, we decided to revoke the license of Hong Kong Forex Investment Limited (HK Forex), a firm engaged in leveraged foreign exchange trading. This was the first time we had decided to take this kind of action against a firm based on misconduct following repeated failures by the company to implement reasonable and effective measures to prevent unlicensed activities by its staff.

HK Forex applied to the Securities and Futures Appeals Tribunal (SFAT) to review the SFC's decision and the SFAT commenced hearing the case in February 2008. HK Forex is not disputing the factual basis of the SFC's decision. However, HK Forex is arguing that the circumstances did not justify revocation of its licence.

In hearings conducted in February 2008, HK Forex proposed a penalty involving a suspension of its licence for one month and a fine of $10 million. The SFAT rejected this proposal and decided to adjourn hearing the case until July 2008 when a related case will also be heard by the SFAT. In the meantime, the SFAT imposed an interim suspension of HK Forex's license for 5.5 months and stayed the SFC's decision to revoke the licence.

In granting the interim order, the SFAT commented that the ultimate penalty would not in any case be reduced to a suspension of less than 5.5 months.

HK Forex objected to the interim suspension order and sought an urgent stay of the suspension in the Court of Appeal. The Court of Appeal refused to intervene and upheld the power of the SFAT to make an interim order suspending HK Forex's license.

In doing so, the Hon Justice Rogers VP stated (at para 2):

> "I have had a chance of reading through the decision of the Securities and Futures Commission and one thing is absolutely clear, this is a very serious breach of the Ordinance; not only a serious breach of the Ordinance, but it was a deliberate breach of the Ordinance. The appellant in this case [HK Forex] had very good reason to know what was going on and, apparently, breaches of the Ordinance were going on whilst previous complaints were being dealt with."

For further information about the SFAT's interim suspension order, follow the link to the Court of Appeal's decision.

This was also the first time the SFAT had exercised a power to make an interim order pending a final hearing.

For further details, please follow this link to the SFC's press release dated 29 January 2008.

SFC Commences Action over Grey Markets

The SFC has recently started a proceeding under s213 of the SFO seeking orders restraining unlicensed persons from dealing in grey market securities.

The proceeding is based on allegations that the defendants were involved in grey market dealing of H shares of Bank of China Limited prior to the listing of these shares in Hong Kong on 1 June 2006. This IPO, which was heavily over-subscribed at the time, was one of the biggest listings in the world.

The SFC will argue that grey market trading constitutes dealing in securities and is an activity that is required to be licensed by the SFC.

In taking this action, the SFC is seeking to prevent the defendants from continuing to carry on grey market dealing without a license and to ask the court to clarify the issue so that investors are properly protected.

For further information, please follow this link to the SFC's press release dated 31 March 2008.

The SFC Wins Challenge to a Case involving Misleading Announcement

In April 2007, the SFC prosecuted successfully Daido Group Limited (Daido) and its chairman Mr To Shu Fai for making a false or misleading statement to the SFC in an announcement filed by Daido with the Stock Exchange of Hong Kong.

Both Daido and To appealed their convictions in the High Court.

In a decision handed down in February 2008, the High Court rejected the appeals and upheld the SFC's arguments.

This was an important case because it was the first successful trial of a case involving allegations of false or misleading information to the market under the dual filing regime.

The SFC alleged that Daido submitted a false or misleading statement to the Stock Exchange when responding to a query by the Stock Exchange about a sudden surge in turnover of Daido's shares on the market. The company claimed it knew of no reason for the sudden increase in turnover. In reality, the turnover had increased because To, the chairman of the company, was selling 200 million shares.

The case demonstrates that:

1. responses to official inquiries by the Stock Exchange must be truthful and accurate and that false or misleading responses can be prosecuted as criminal offences under the dual filing regime;

2. company directors will also be liable for false or misleading statements made by a company where there is evidence that the director is knowingly involved in the commission of the offence by the company;
3. company directors have obligations to make proper inquiries and to inform themselves about the affairs of the company, especially when responding to an official question. In this case, the chairman To claimed he did not know that the sudden rise in turnover was attributable to the sale of his shares and he did not know that his shares were being transferred in the market that day. The evidence showed he knew the sale was being made and he made no inquiry to check whether the rise in turnover was linked to the sale of his shares. The court found his failure to make a proper inquiry was reckless and, in these circumstances, recklessness was enough to create criminal liability for the false or misleading response to the Stock Exchange.

For further information, please follow the attached link to To Shu Fai and Daido Group Limited v SFC HCMA 547/2007, 1 February 2008.

SFC Resolves Compliance Issues using New Approach

In the last SFC Enforcement Reporter, we commented on a new approach to resolving serious compliance issues with licensed firms in circumstances where a firm faces the risk of having its license suspended immediately.

The new approach was first used to resolve a number of issues with South China Capital Limited and South China Research Limited.

Core Pacific-Yamaichi Capital Limited and two related firms entered into similar arrangements with us to resolve compliance issues. This is the second time we have adopted this approach.

Under these arrangements, firms are able to expiate earlier wrongdoing (or alleged wrongdoing) by:
1. agreeing to pay a fine in combination with a series of forward-looking undertakings about future conduct;
2. agreeing to independent and random tests and reviews; and
3. agreeing not to dispute the nature and level of disciplinary sanction if these same problems arise again in a specified period of time (usually several years).

The SFC is only interested in discussing these types of arrangements where:
1. the misconduct in issue is serious and the range of potential disciplinary sanctions includes a suspension (or worse); and
2. the firm, through its senior management, has already demonstrated to the SFC a commitment to remediation and compliance in the future.

The senior management of Core Pacific have demonstrated their strong commitment to prevent misconduct in the future. This agreement produces positive outcomes for the firm, its clients, the market and the SFC.

For further information, please follow the link to our press release.

Market Manipulator Avoids Immediate Jailing

The SFC has successfully prosecuted another market manipulator. On 6 March 2008, the Eastern Magistracy convicted Mr Yeung Fong Shui for manipulating the market. In this case, the Court took into account the fact that the defendant pleaded guilty at the first opportunity and co-operated with the SFC during their investigation. As a result, the Court handed down a suspended jail sentence.

Yeung was the sixth person to have been given a jail sentence in the past 12 months for market manipulation. In five out of the six cases, the manipulators were sentenced to suspended jail terms, from one month to four months. The suspended sentences handed down by the court appear to reflect the benefit of co-operation and pleading guilty at the earliest opportunity.

As mentioned in the last issue of the Enforcement Reporter, the SFC encourages co-operation in respect of its disciplinary proceedings. It appears from the sentences handed down following the recent market manipulation convictions that co-operation can be the difference between going to jail and receiving a suspended sentence.

The conviction of Yeung in March related to events which occurred in May 2007. The charges in this case were laid only 6 months after the SFC's investigation started. The speed with which the SFC was able to detect, investigate and prosecute this manipulator shows the resolve of the SFC to proceed to take action quickly against manipulators where there is proper evidence to do so.

If you would like to know more about the cases, please follow these links to our press releases dated 4 July 2007, 26 July 2007, 5 September 2007, 7 December 2007, 3 January 2008 and 6 March 2008.

Secret Accounts Again

The SFC continues its efforts to crack down on the operation of secret accounts. In this regard, the SFC recently suspended the licence of a regulated person for three months.

The SFC's investigation found that Mr Wong Ho Fei signed three client account opening documents as witness. In doing so, Mr Wong was confirming that he had witnessed the clients signing these documents and that he had explained the contents of the documents and the risk disclosure statements to the clients. In fact, Mr Wong had never met these clients.

Previous action by the SFC in tackling secret accounts has focused mainly on the use of nominee accounts. On this occasion, the SFC has addressed conduct which can facilitate the opening and operation of secret accounts. Such conduct can facilitate serious crimes like market manipulation and insider dealing.

The SFC will continue to take action against similar misconduct.

The SFC will continue to take action against similar misconduct which can facilitate the creation of secret accounts and more serious crimes like market manipulation and insider dealing.

For further details of Mr Wong's case, please follow the link to the SFC's press release dated 4 February 2008. For details of previous action in the operation of secret accounts, please follow the link to previous issue of Enforcement Reporter.

Disclosure of Interests

The SFC continues to highlight the importance of the obligation on directors and substantial shareholders to make timely disclosure of their interests in listed companies. Under Part XV of the SFO, listed company directors, chief executives and substantial shareholders are required to disclose and notify the listed company and the Hong Kong Stock Exchange of changes of interest.

From 2 January to 30 April 2008, the SFC prosecuted 5 entities for disclosure of interest breaches. In each case, the defendant pleaded guilty. Fines were imposed ranging from $4,000 to $20,000.

Disclosure of Interests Systems – A Commendable Approach

We recently conducted an investigation into suspected breaches of disclosure of interests by a licensed firm. The way in which the firm tackled the issues that it faced was commendable. We thought it may be useful to briefly outline the approach adopted by the firm as an example to other licensees.

By way of background, and in anticipation of the introduction of the SFO in 2003, the firm developed and implemented a system (" Hong Kong system") to aggregate positions in Hong Kong stocks held by related entities globally, for the purpose of disclosing their interests under Part XV of the SFO. Following the discovery of a failure to make timely disclosure in 2006, the firm reported its failure to us and instituted a review of the Hong Kong system. The review was comprehensive involving critical examination by business, legal and information technology staff within the firm. Having devised and implemented enhancements to the system, the firm then subjected the enhanced system to rigorous testing over a period of several months by establishing a test environment which mirrored the live system.

During the test period, the firm identified a number of stocks which had been omitted from the aggregated position, resulting in non-disclosure. These errors occurred because the same stock had been differently described by related entities with the result that the aggregate positions on that stock were not reported. In response to this, the firm reported the failure to us and continued to enhance its system to prevent any recurrence.

We encourage firms to continuously review their existing systems with a view to enhancing them, taking steps (such as, a rigorous testing programme over a reasonable period of time) to detect deficiencies, undertaking further enhancements and refinements if deficiencies are identified, and self-reporting any errors to us in a timely manner. Aside from aiding compliance with disclosure obligations, this approach is likely to influence the way in which we decide to proceed in the event of any breach.

Enforcement Policy and Practice

International Co-operation and Assistance

As financial markets around the world become increasingly inter-connected/inter-dependant through advances in communication technology, opportunities for cross-border market misconduct abound. Individuals intent on perpetrating misconduct on markets have scant regard to the jurisdictional boundaries between one country and another. This presents obvious challenges to regulators who are charged with the responsibility of regulating markets and seeking to minimize crime and misconduct.

One of the statutory functions of the SFC is to co-operate with and to provide assistance to regulatory authorities or organizations, whether they are formed or established in Hong Kong or elsewhere.
This means we are obligated to provide assistance to overseas regulators. The SFC has been working closely with its counterparts worldwide by entering into bilateral co-operative arrangements with 40 foreign authorities. A full list of these authorities can be found on the SFC's website.

Furthermore, the SFC is one of the 47 signatories to the IOSCO Multilateral Memorandum of Understanding ("IOSCO MMOU"), which is a global information sharing arrangement among securities regulators. Under the IOSCO MMOU signatories are to provide reciprocal assistance to one another in the following ways:

1. providing information and documents to the requesting authority;
2. obtaining information and documents regarding the matters set out in a request (including contemporaneous records sufficient to reconstruct all securities and derivatives transactions, and records that identify the account holder(s) and beneficial owner(s)/controller(s)); and

3. taking or compelling a person's statement regarding the matters set out in the request.

In the absence of a relevant co-operative arrangement, informal assistance is possible where the information requested is publicly available or where voluntary assistance is provided. But, if non-public information or compulsory investigative assistance is requested of the SFC, the conditions under sections 378(5) and (6) and/or 186(3) and (5) of the SFO must be satisfied in order for the SFC to be able to assist. The SFC has to be satisfied that:

1. the requesting authority performs a function similar to a function of the SFC and is subject to adequate secrecy provisions; and
2. it is desirable or expedient that the information should be disclosed in the interest of the investing public or in the public interest, or the disclosure will enable or assist the authority to perform its functions.

The statutory secrecy provisions which apply to our investigations preclude us from disclosing details of the particular assistance rendered to overseas regulators in specific cases.

The type of assistance can, however, be explained by way of hypothetical example.

The SFC may be contacted by an overseas regulator investigating alleged misconduct which has occurred in its own jurisdiction but where the alleged perpetrators of that misconduct reside in Hong Kong. Under those circumstances, the overseas regulator will seldom have any legal basis to compel those persons to travel to the overseas country to be interviewed. Equally, the overseas regulator will have no power to require those persons to be interviewed in Hong Kong. In such circumstances, the overseas regulator will be largely dependent upon the SFC and will typically contact us and seek our assistance. In some cases, this assistance may extend simply to the provision of information which may already be in our possession. At the other end of the spectrum, we may be asked to aid an overseas investigation by conducting an investigation ourselves under our own authority.

This type of co-operation enables the SFC to contribute to the international effort to counter misconduct on world markets and ensures that Hong Kong is not a safe haven for those who may have breached the laws of other jurisdictions. Likewise, we can, and do, seek reciprocal assistance in appropriate cases. This means that those who breach the SFO may not necessarily be out of our reach simply because they are not in Hong Kong.

During 2007, the SFC received 63 requests for enforcement related assistance and made 50 requests to overseas regulators. This can be contrasted with previous years:

	2004	2005	2006	2007
Enforcement related requests for assistance:				
- Into the SFC	55	47	74	63
- Out from the SFC	5	10	25	50

The Enforcement Reporter is available under 'Speeches, Publications & Consultations' – 'Publications' of the SFC website at http://www.sfc.hk.

Feedback and comments are welcome and can be sent to enfreporter@sfc.hk. We will consider the comments and, where called for, provide a response.

If you want to receive the Enforcement Reporter by email, simply register for the Update Email Alert service at http://www.sfc.hk and select Enforcement Reporter. Intermediaries licensed by the SFC receive the Enforcement Reporter via their FinNet email accounts.

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