

A busy first quarter for 2005-2006

The SFC has published the first Quarterly Report for the financial year to 31 March 2006.

During the first quarter, the SFC completed or launched many initiatives that aim to strengthen the regulatory regime and protect investors, while facilitating market development.

The SFC has concluded the consultation on a review of the disclosure of interests regime and issued consultation papers on specific entry criteria for and ongoing compliance obligations on sponsors (please see "Better

sponsor regulation" on page 3) and on proposals to revise the Hedge Funds Guidelines.

Moreover, we have amended the Code on REITs to allow SFC-authorized REITs to invest in overseas properties and the Code on Unit Trusts and Mutual Funds to enable SFC-authorized funds to invest in REITs listed overseas.

Internationally, the SFC furthered co-operation with regulators in six jurisdictions



in the region and in Europe.

In the three months to 30 June, the SFC recorded a surplus of \$48.6 million, compared with a projected surplus of \$2.5 million in the approved budget.

For a review of operations and more financial details, please view the Quarterly Report on the SFC website under "Speeches, Publications & Consultations" - "Publications" - "Annual / Quarterly Reports" at: <http://www.sfc.hk/sfc/html/EN/speeches/public/annual/annual.html>.

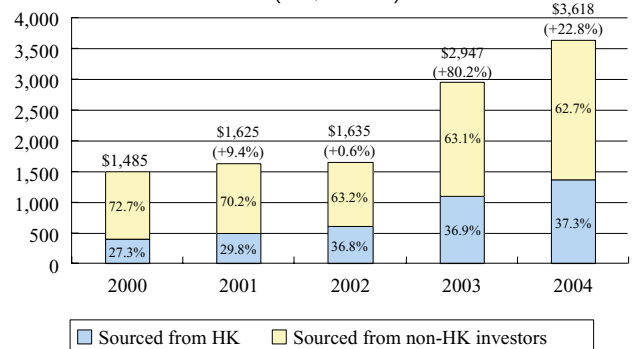
Robust fund industry development

The latest Fund Management Activities Survey has once again confirmed Hong Kong's status as the Asian fund management hub for investors worldwide.

The annual SFC survey covered two types of firms, namely SFC-licensed corporations and banks that engaged in asset management and other private banking activities (collectively "registered institutions") and which were subject to the SFO.

At the end of 2004, Hong Kong's combined fund management business recorded an increase of 23% to \$3,618 billion (Table), from \$2,947 billion in (continued on page 4)

Fund management business - total value of fund business (HK\$ billions)



Note:

1. Percentages in brackets represent year-on-year growth
2. Beginning 2003, Registered Institutions were included in the FMAS

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LOI with SC, Malaysia

The SFC has signed a Letter of Intent (LOI) with Malaysia's Securities Commission (SC) to enhance regulatory co-operation and mutual recognition of investment products authorised in their respective jurisdictions for cross-border distribution.

The LOI, the sixth signed by the SFC, is a milestone for the SC and the SFC in the development of a cohesive Asian market for investment products denominated in regional currencies, including mutual funds. We hope that both sides can facilitate the development of deeper and broader investment markets.



SFC Chairman Mr Andrew Sheng (left) and SC Chairman Tan Sri Md Nor Md Yusof signed the LOI in Kuala Lumpur, Malaysia last month.

Both the SFC and SC are members of the International Organization of Securities Commissions (IOSCO).

For details, please see press release issued on 15 July 2005, available on the SFC website at: <http://eapp01.sfc.hk/apps/cc/PressRelease.nsf/eng/lkupNewsCode/05PR163?openDocument>.



Senior management interview

**Mr Ian Johnston, Adviser,
Chairman's Office**

You are no stranger to the SFC and Hong Kong.

When I was still with the ASIC last year, the SFC invited me to look at the status of the regulation of investment advisers and how to avoid mis-selling. My first visit to Hong Kong was in 1985, when I visited some friends doing voluntary social services in the Walled City. I found that an incredible place. I have since been to Hong Kong many times. The people here are incredibly friendly. I feel very welcomed.

What were your responsibilities at ASIC and why did you join the SFC?

I was Executive Director of Financial Services Regulation, so I was responsible for how we regulated brokers, fund managers, banks, insurers and all intermediaries. Over the past few years this included implementing the Government's wide-ranging financial reforms.

I had always looked forward to working overseas. There were opportunities to work in London or Paris but I did not wish to leave my young daughter behind. Hong Kong is more manageable in terms of distance from Australia. My daughter has visited me twice since I joined the SFC in April.

What is your role?

I have taken up some work of the Chief Operating Officer, who doubles up as Executive Director of Corporate Finance. I advise on regulatory and organisational issues. One key responsibility is to help develop the SFC's corporate strategic directions for the next few years.



How do you compare ASIC and the SFC?

There is something ASIC is doing better than the SFC, and vice versa. The jurisdictions are also different. My Australian colleagues are perhaps more relaxed, but in both places they get the work done.

However, there is no doubt that the international regulatory and business communities regard both ASIC and the SFC as among the top four securities regulators of the world.

Since 2001, I had represented ASIC on the Joint Forum. The chairmanship rotates among the three constituent bodies, namely the Basel Committee on Banking Supervision, the IOSCO, and the International Association of Insurance Supervisors. I have recently assumed the Chair as the IOSCO representative. The Forum has around 20 member countries. I think it's important for Hong Kong to be represented.

Personal bio

- Joined the SFC in April 2005
- Selected by the Money Management magazine as one of the Top 10 Most Influential People in the Australian financial sector for three consecutive years (2002 - 2004) for spearheading the financial reform
- Loves music and theatre. Previously adviser to the Salvation Army, the Australian String Quartet and the Bell Shakespeare Company
- Victoria University (Melbourne), Articled Clerks Course, 1981. Qualified as a lawyer in 1982; more than 10 years' private sector experience in senior management and international branding before joining ASIC in 1999; appointed COO and Executive Director of Financial Services Regulation of ASIC in 2000 and 2001 respectively

In brief

- The SFC has appointed five new members and re-appointed eight members to the **Public Shareholders Group** for a one-year term, effective 1 July 2005. The five new members are **Mr Vincent Chan, Prof. Stephen Cheung, Mr William Kerr, Mr Stuart Leckie, JP** and **Mr Karl Lung**. The SFC thanks **Mr Man**

Wing Chung, Mr David Lui, Mr Richard Mak, Mr Douglas Naismith and Mr David Sun, who have retired from the Group.

Last year, the Group held eight meetings. Members' views have assisted the Corporate Finance and other divisions of the SFC in considering issues relating to shareholders' interests and formulation of regulatory proposals.

- The SFC welcomes the findings in the **Process Review Panel's** Annual Report for 2004, published by the Government in June. The Panel reviewed 47 completed cases and SFC procedures covering various areas of SFC work. The Panel concluded that, in general, the SFC had been adhering to its established internal procedures in its decisions and actions.

Better sponsor regulation

The SFC is consulting on a set of specific entry criteria and ongoing compliance obligations on sponsors.

The proposals build on the existing licensing regime for corporate finance advisers. They aim to enhance investor protection through raising the overall standards of sponsors.

Under the proposals, sponsors must maintain effective systems and internal controls and have sufficient resources.

The management of a sponsor should bear the ultimate responsibility for the supervision of the sponsor's work. A sponsor should set up a transaction team of qualified people with at least one Principal for each sponsor engagement. The Principal should meet certain criteria on relevant experience.

A sponsor should also keep proper books and records, as well as audit trail for its work. The proposal requires it to conduct annual self-assessment of its internal controls and systems, and maintain a minimum capital of \$10 million.

The consultation will end on 31 August 2005. It is proposed that licensed corporate finance firms will have 12 months to prepare for their compliance with the new requirements after the publication of consultation conclusions.

About 70 licensed firms are estimated to have been conducting sponsor work in the past five years and are expected to be able to transit smoothly.

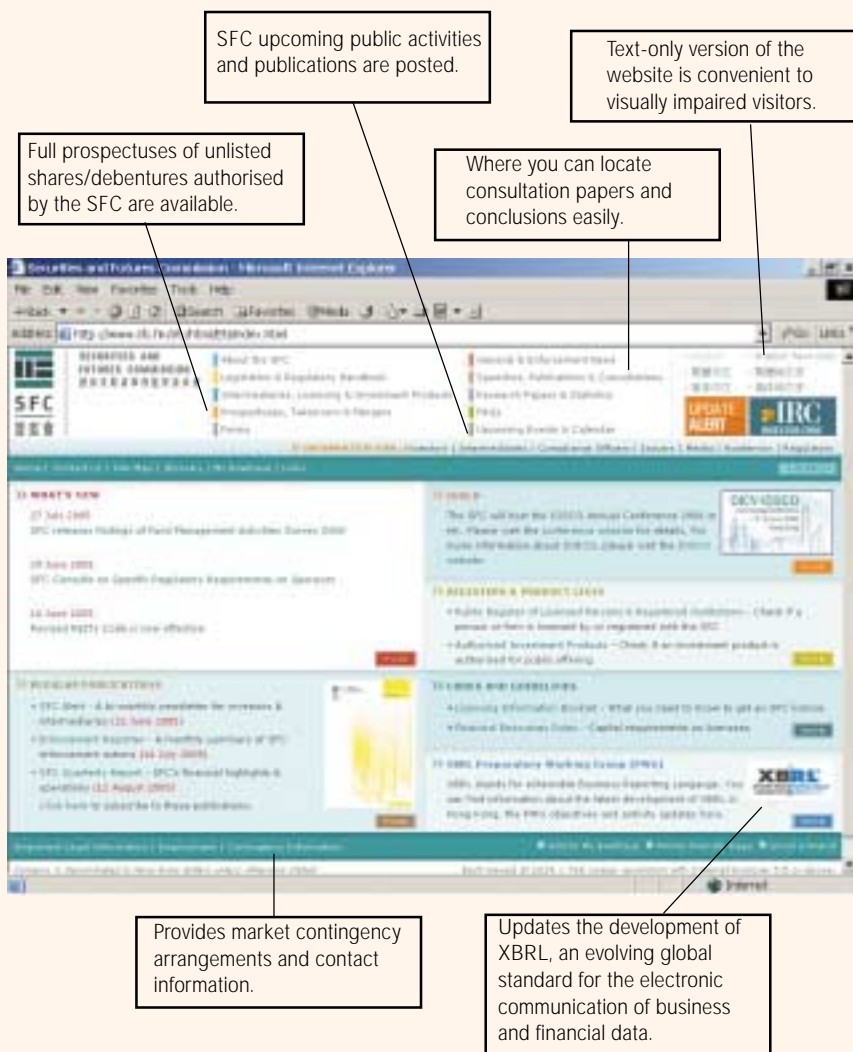
The Consultation Paper is available at the SFC office and on the SFC website.

For details, please see press release issued on 29 June 2005, available on the SFC website at: <http://eapp01.sfc.hk/apps/cc/PressRelease.nsf/eng/ikupNewsCode/05PR146?openDocument>.

SFC website enhancement

The SFC has further enhanced its corporate website (www.sfc.hk). The major improvements are shown below.

The new functions and contents, introduced continuously since the first phase of the website revamp last November, make the website more accessible and informative to the public and market practitioners, including visually impaired people. If you have any comments, please send to enquiry@sfc.hk.



For details, please see press release issued on 5 August 2005, available on the SFC website at: <http://eapp01.sfc.hk/apps/cc/PressRelease.nsf/eng/ikupNewsCode/05PR173?openDocument>.

Boiler room scam

The SFC alerts investors to a boiler room operator, Bernard Simpson Consultants, that targets the Hong Kong public.

The company is operating under a new website URL "www.bsccmail.net". It mainly cold calls investors by phone to lure them to buy U.S. stocks. It also uses the tactic of "forced invoicing" by issuing invoices to investors even though they had never agreed to purchase the stocks.

The SFC has received 11 complaints against the company since November 2003, nine of which from local investors. In two of the worst cases, the victims lost \$540,000 in total.

This year up to 10 August, we have received 57 complaints of boiler

rooms, involving losses of \$6.1 million. We have added 44 suspected boiler rooms to our Alert List.

Tips to investors:

- verify the legitimacy of the persons or companies you are dealing with from a reliable source of information;
- beware of too-good-to-be-true investment offers;
- don't make investment decisions hastily based solely on unsolicited phone calls or e-mail; and
- firmly refuse to pay for what you have not bought.

For details, please see press release issued on 23 June 2005, available on the SFC website at: <http://eapp01.sfc.hk/apps/cc/PressRelease.nsf/eng/ikupNewsCode/05PR142?openDocument>.



Investor focus

What happens in a share consolidation?

When a listed company conducts a capital re-organisation, it may propose consolidating its shares. How does a share consolidation affect your investment in the company?

A share consolidation means combining a number of shares into a single new share. Sometimes, the board lot size for shares trading may also be changed. As a consolidation of shares decreases the number of authorised shares but proportionally increases the par value of each share, neither the authorised nor issued share capital of the company will be affected.

A share consolidation will not reduce your shareholding in the company. This is because

the relative proportion of shareholdings amongst all the shareholders will remain unchanged.

Since the par value of each share increases proportionally in a share consolidation, there will also be no change in the total par value of your holding.

However, you should note that the par value and market value of shares are not correlated. The par value is a fixed value predetermined by the company concerned. The market value is constantly changing in relation to market demand and supply. Therefore, these two values do not correspond with each other (except when the company has an initial public offering and it can fix the initial offer price) or change simultaneously.

A share consolidation often follows a share capital reduction (see the link below for more information) during a capital restructuring of listed companies. A company has to publish an announcement with details about the proposal.

Capital re-organisations are commercial decisions of listed companies. Once the conditions of the proposal and the requirements of the laws are met, a capital restructuring may go ahead. As a shareholder, you must watch closely the company's latest developments and exercise your right to vote in such proposals.

For details, please visit the eIRC's "Features & Dr Wise / Shareholder Basics - FAQs" section at: http://www.eirc.hk/eirc/html/EN/features/share/features_86_224_295.htm#Q13.

Robust fund industry development

(continued from page 1)

2003. Asset management, advisory business and other private banking activities respectively accounted for \$2,741 billion, \$241 billion and \$636 billion.

Funds sourced from overseas investors took up 63% or \$2,269 billion of the combined fund business, while SFC-licensed corporations accounted for 80% or \$2,896 billion.

53% of out the \$2,741 billion worth of assets under management were managed onshore. Industry workforce also expanded 12% from

15,195 to 17,039.

At end 2004, the size of fund management business was 54% of Hong Kong's stock market capitalisation.

A separate review by the SFC showed that the value of retail funds offered to the public had grown 15 times to \$4,300 billion over 15 years to 2004. Moreover, the types of retail funds had increased substantially.

For details, please see press release and the survey issued on 27 July 2005, available on the SFC website at: <http://eapp01.sfc.hk/apps/cc/PressRelease.nsf/eng/lkupNewsCode/05PR167?openDocument>

In brief

A joint working group of the Basel Committee on Banking Supervision and the IOSCO has prepared a paper entitled **The application of Basel II to trading activities and the treatment of double default effects**.

The paper sets out the capital requirements for banks' exposures to certain trading-related activities and for the treatment of double default effects.



Circulars

The following recently published circulars are available on the SFC website under "Legislation & Regulatory Handbook" - "Regulatory Handbook" - "Codes, Guidelines and Circulars" at: <http://eapp01.sfc.hk/apps/cc/RegulatoryHandbook.nsf/eng/GenerateHTMLTB?openAgent>.

1. Circular to Licensed Corporations and Associated Entities - Anti-Money Laundering / Combating Terrorist Financing (1) New Regulation under United Sanctions Ordinance (Cap. 537); (2) US President's Executive Order 13224 (08.08.2005)
2. Circular to Licensed Corporations and Associated Entities - Anti-Money Laundering Seminar for Compliance Officers (05.08.2005)
3. Circular to Licensed Corporations and Associated Entities - Anti-Money Laundering / Combating Terrorist Financing - US President's Executive Order 13224 (20.07.2005)
4. Circular to Licensed Corporations and Associated Entities - Anti-Money Laundering / Combating Terrorist Financing - United Nations (Anti-Terrorism Measures) Ordinance & United Nations Sanctions (Afghanistan) Regulation (19.07.2005)
5. Circular to Licensed Corporations and Registered Institutions - Settlement of Disciplinary Cases (13.07.2005)
6. Circular to Licensed Corporations and Registered Institutions - Intermediaries Activities Survey 2004/05 (30.06.2005)
7. Circular to Licensed Corporations which are Participants of the Stock Exchange of Hong Kong Limited and/or Hong Kong Futures Exchange Limited - Compliance with the Securities and Futures (Insurance) Rules (22.06.2005)

Licensing of fund managers - nine frequently asked questions

The licensing regime serves an important gatekeeping function to ensure that only fit and proper persons can deal with investors and participate in the market. The licensing requirements are minimum standards expected of licensed persons, which must be upheld. They are not meant to be entry barriers; in particular, these should not pose a problem to experienced practitioners with the proper set up.

The licensing regime is crucial to maintaining confidence in the Hong Kong market and protecting the reputation of Hong Kong as an international financial centre. To this end, the SFC has been working in partnership with the industry, consistently pursuing a balanced approach. While we maintain market integrity and investor protection, we also ensure that there is sufficient room and facilitation for healthy market development.

Nine questions from fund managers

The SFC values industry comments and is happy to respond to licensing queries from fund managers.

Q: Do fund managers need to be licensed for multiple regulated activities?

A: Fund managers who only undertake asset management activities will need to be licensed for ONE regulated activity - Type 9 (asset management). Should you want to do more than managing funds such as giving investment advice or selling securities, you would need to be additionally licensed for the relevant type(s) of regulated activity. Legislative amendments are currently in motion to seek to further allow fund managers to give investment advice for the purpose of the funds under their management without a Type 4 (advising on securities) licence.

Q: Being an experienced practitioner in other markets, why am I only exempted from the technical exams but not the regulatory exams?

A: You need to take licensing exam(s) when you want to carry out regulated activities in any serious markets. Hong Kong is of no exception. However experienced a person is, it is unlikely that he will be conversant with the local regulations of the new market that he is entering into. It is therefore incumbent upon you to equip yourself with local regulatory knowledge and carry out the regulated functions in strict compliance of the law.

Q: How often are the licensing exams held? Would six months be sufficient for taking the exam(s)?

A: The licensing exams are run by the Hong Kong Securities Institute (HKSI) on a monthly basis. Candidates can enrol in the relevant exam(s) at their convenience. The SFC may consider extending the grace period for taking exams based on the merits of each case.

A: The regulatory exams aim to test a person's understanding and application of the relevant rules and regulation. The recent pass rates, for instance for Paper 1 (core regulatory paper), have been around 50%, which is comparable to the licensing exams in other major markets. The HKSI provides various means to assist candidates, which can be found at its website www.hksi.org. With appropriate preparation, even newcomers can pass, let alone experienced practitioners.

Q: If I change job to another firm, do I need to apply for a licence afresh and would that take long?

A: NO, you need not submit a new application. The SFO provides 180 days for applying for a change of employment. For normal cases, our performance pledge is seven working days. In the event that you seek to join a completely new set up, then the licence of the new corporate will have to be cleared first.

Q: Then how long does it take to get a new corporate licence?

A: For normal cases, our performance pledge is 15 weeks. The processing time would depend very much upon the quality of the application. Our tip for you is to submit complete information upfront including shareholding structure, compliance history, business plan and corresponding risk management and internal controls systems. This saves everybody's time. The SFC is happy to discuss with applicants their particular circumstances.

Q: Why does the licence not "follow" the person but is tied to the firm?

A: An individual cannot operate without corporate support such as risk management, compliance and back office administration. Vice versa, a firm must have qualified staff to carry out its business. A person's qualification and the firm's infrastructure including its internal controls and compliance culture must be considered together when determining the person's competence and fitness to be licensed.

Head ups for hedge fund managers

It is fundamental to our assessment that the following business information be provided in your first submission, failing which, you run the risk of having your application rejected or delayed:

- detailed business plan setting out the proposed business scope, name of the fund(s) that you will manage, asset classes that the fund(s) will invest in, description of the investment strategies to be adopted, targeted investors of the fund(s) and expected asset under management size;
- risk management policies and internal control procedures;
- policies and procedures relating to the valuation of the fund(s);
- custody arrangement to demonstrate whether or not you will hold (or be in a position to control) client assets;
- names of prime broker, fund administrator and custodian; and
- details of outsourcing arrangement, if any.

Q: Does it mean that I can't get a licence before I pass the regulatory exam(s)?

A: If there is no particular compliance issue with you or the firm in which you are to be engaged, and that all other licensing requirements are met, the SFC will normally grant you a licence on the condition that you complete the requisite exam(s) within six months. You can then start working without further ado while preparing for the exam(s).

Q: Can I take the licensing exams in my home country?

A: Currently, there is no regular arrangement for candidates to take the licensing exams outside Hong Kong, except for the PRC. However, depending on the number of enrolments and the location, the HKSI may accommodate such requests on a case-by-case basis. You may telephone the HKSI at (852) 3120-6220 or e-mail to exam@hksi.org.

Q: Are the regulatory exams difficult? I heard that the pass rates were not that encouraging.



The following items of investor resources have been made available to the investing public or updated recently. They can be found on the

Electronic Investor Resources Centre (eIRC) at the URLs provided.

Investor Alert Updates (<http://www.eirc.hk/eirc/html/EN/alert/alert.htm>):

13 unlicensed companies/entities have been added to the Alert List: "Woodson Ross & Associates" (10.08.2005); "Bentley International Management Ltd", "Morgan Lansky Inc.", "The Prestige Perspective" (03.08.2005); "Devlin Stern & Associates", "Landmark Trade Services Ltd" (21.07.2005); "Guardex Holdings", "First Swiss Financial Management AG", "Opus Financial Group", "The Kaikatsu Group" (06.07.2005); "LaSalle Bank (not related to LaSalle Bank, USA)", "The Stockton Group" (29.06.2005); and "eBay (not related to eBay Inc., USA)" (22.06.2005). Information of three entities including "Mission Finance Ltd" (10.08.2005); "The Kaikatsu Group" (21.07.2005); and "Bernard Simpson Consultants" (06.07.2005 and 21.07.2005) has been updated on the list.

Dr Wise's Column (<http://www.eirc.hk/eirc/html/EN/features/index.htm>):

"Should You Invest in Structured Notes?" (26.07.2005) and "Have You Gambled Your Life Away?" (28.06.2005)



The following publications have been published since the release of the last *SFC Alert*. They are available on the SFC website under "Speeches, Publications & Consultations" - "Publications" at: <http://www.sfc.hk/sfc/html/EN/speeches/public/public.html>.

- SFC Enforcement Reporter - August 2005 (16.08.2005)
- SFC Quarterly Report - April to June 2005 (12.08.2005)
- Fund Management Activities Survey (27.07.2005)
- SFC Enforcement Reporter - July 2005 (14.07.2005)
- Consultation Paper on the Regulation of Sponsors and Compliance Advisers (29.06.2005)



Recruitment

The following SFC positions are open. For application and details of the openings, please visit the SFC website at: <http://www.sfc.hk/sfc/html/EN/aboutsfc/employment/employment.html>.

- Senior Director - Enforcement (Disciplinary Function)



Subscription information

The bi-monthly *SFC Alert* forms part of our range of regular publications; others include the monthly *SFC Enforcement Reporter*, the *Quarterly Report*, the *Quarterly Bulletin* and the *Annual Report*. All these publications are posted on the SFC website.

Free subscription to the electronic version of the *SFC Alert* (and other publications) can be made to sfcalert@sfc.hk.



Feedback

Tell us what you think of the *SFC Alert*. Questions and comments can be sent to sfcalert@sfc.hk.

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