

## A Healthy Market for Informed Investors

The SFC has proposed measures to make the derivative warrants (DW) market more efficient, fair and competitive. In a Six-Point Plan, the SFC addresses concern arising from some market practices.

Firstly, we propose strengthening the liquidity provider provisions by tightening the minimum service levels, requiring issuers to appoint in-house liquidity providers and requesting liquidity providers to make their intra-day DW activities more transparent. Secondly, we propose facilitating further issues and identical issues to alleviate price anomalies and enhance market competition.

We propose banning commission rebates and other incentive schemes. These tend to give a wrong impression of turnover and attract unsophisticated investors for the wrong reasons.

We propose issuing new marketing guidelines which adopt a principle-based approach and cover the whole spectrum of the marketing and promotion campaign for DW. We will work with the Broadcasting Authority to see how the activities of commentators who are not regulated by the SFC may also be covered.

We propose requiring issuers to use plain language in listing documents and to provide a summary of the key features, risks and benefits of each warrant. We also recommend that the industry and regulators agree on common definitions and standard terms for standard products.

Lastly, we propose enhancing investor education and improving dissemination of information. HKEx is already considering ways to enhance its website.

We invite comments before the end of January 2006. Specific proposals for amending the SFC's codes and guidelines and the Listing Rules will be put out for consultation in due course as appropriate.

*For details, see A Report on the Derivative Warrants Market in Hong Kong released on 25 November 2005, available on the SFC website at: <https://eapp01.sfc.hk/apps/som/dwreview.nsf/eng/main>.*

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At the HK Institute of Certified Public Accountants' Best Corporate Governance Disclosure Awards 2005 ceremony on 29 November, SFC Chairman Mr Martin Wheatley (right) received the Platinum Award in the Public Sector/Not-for-profit Organisations Category from the Secretary for Financial Services and the Treasury Mr Frederick Ma. The SFC also won the Gold Award in the Non-Profit Making and Charitable Organizations category and the Award of Citation for Achievement in Corporate Governance Disclosure in the 2005 HK Management Association Best Annual Reports Awards.

## Message from SFC Chairman



Dear Reader,

I wish you a happy Christmas and a prosperous 2006.

Since I took up this position in October, I have often been asked about my plan for the SFC. In fact we are finalising a three-year strategic plan, which we will announce when ready. Yet, one can rest assured that the SFC will always put the interests of investors first.

I will use this publication to keep you informed of our work and enhance our transparency. In addition to the reports in this issue, we have worked hard in the past few months to ensure business continuity of the Commission, the exchange and the intermediaries during the Sixth Ministerial Conference of WTO, which I am pleased to note has just ended with no disruption to the financial market.

Meanwhile, I am also pleased that market transaction cost has been reduced with the suspension of the investor levy from 19 December.

Martin Wheatley





# Senior management interview

**Mr Eugène Goyne, Senior Director, Enforcement**

## What is your role?

I manage a team of 18 staff under the Discipline arm of the Enforcement Division. 16 staff are lawyers and we have two hard-working support staff. We are responsible for disciplinary i.e. non-criminal enforcement work against regulated firms and individuals.

## Do you see any trend of misconduct?

In the last three to four years, we have seen some new areas growing, including sponsors' inadequacies in due diligence work, fund managers' misconduct like late trading, and investment advisers giving bad advice. Mis-selling and sponsors' misconduct are our key priorities. We still have the bread and butter cases like rat trading, FRR breaches and internal control failures.

## Has the SFO changed the SFC's disciplinary work?

It gives us the power to fine, making us more effective with greater flexibility, especially in disciplining firms. When we penalised firms in the past, we might need to choose between shutting their business down or publicly criticising them, with nothing in between. Shutting a business down involves handling of client assets with great disruption to clients; other innocent people including staff would suffer collateral damage. The fining power bridges the gap between taking away their licences and public reprimands. By

imposing a degree of pain, people should re-think before they commit misconduct.

## The SFC has also settled some cases.

Settlements can be useful as they encourage co-operation so enforcement actions are over more quickly. They help regulators to allocate resources better and improve efficiency. By offering a discount for co-operation, it gives people incentives to settle. They are rewarded for properly changing their behaviour, fixing problems, compensating investors, so they are reformed participants in the market and



able to develop a more healthy relationship with the regulator and may restore their reputation more quickly. We are not talking about letting people off, we are giving them incentives not to dispute. It is about striking a balance between adequate deterrence and reward for co-operation.

## Who normally initiates a settlement?

Settlements used to be initiated by the defendants only, but there has been a change in approach since early this year. In certain appropriate cases, we will invite the potential defendants to talk to us on a 'without prejudice' basis to reach a resolution before taking any enforcement action. We pick cases where we think that circumstances are obvious, not disputable and the outcome is predictable because of previous similar cases.

We see a rising number of cases completed, which means more investor protection. In the seven months to October this year, we took actions against 63 entities, compared to 38 in the same period last year. Our settlement policy is published in the 'Disciplinary Proceedings at a Glance' pamphlet. We are also open about which cases we settle; our press releases specifically mention this.

## Personal bio

- Joined the SFC in March 1998
- LLB (Hons) and BEc, Australian National University
- Worked in the public and private sectors in Hong Kong and Australia, giving legal advice

on companies and securities law enforcement, privatisation, corporate governance, fund raising and corporate transactions and compliance

- Enjoys working-out, kendo, yoga, films and reading

## In brief

- In the three months to September, we commented on 17 of the 36 listing applications received under the **Dual Filing** arrangements. We noted two serious disclosure deficiencies. One was that the business model of the applicant and the commercial rationale

of its key business were not clearly explained. The other was that disclosure of the relationship between the controlling shareholders and the listing applicant was often incomplete.

- At the request of market practitioners, the SFC has extended the consultation period on the proposals regarding Possible Reforms to the **Prospectus Regime** in the Companies Ordinance

to 31 December 2005.

- The Financial Secretary has re-appointed **The Hon Jasper Tsang** and **Mr Christopher Cheng** as Non-executive Directors of the SFC for two years from 15 November 2005 to 14 November 2007. Mr Tsang and Mr Cheng have been SFC NEDs since 15 November 2001 and 15 November 2003 respectively.

# Notification of interests in REITs

The SFC has announced its policy to require that provisions substantially equivalent to those in Part XV (Disclosure of Interests) of the Securities and Futures Ordinance be adopted in trust deeds of REITs.

The SFC has adopted this policy in view of recent market developments concerning substantial acquisitions of units of SFC-authorized REITs and widespread market interest in information about substantial interests in REIT units.

As a result, holders of REIT units have to notify the relevant REIT manager and the Stock Exchange of their interests in a REIT upon the attainment of a 5% threshold and changes to the holdings according to the provisions of the relevant trust deed.

To enhance transparency of and public access to information regarding interests in REIT units and to promote orderly trading, notifications of interests received by the Stock Exchange will be posted on its website, in the same manner as the disclosure of interests in shares of listed companies.

As a responsible regulator, the SFC considers it appropriate and necessary to respond to the developments in the market and continue to monitor market developments and enhance the regulatory regime relating to this new product.

*For details, please see press release issued on 15 December 2005, available on the SFC website at: <http://eapp01.sfc.hk/apps/cc/PressRelease.nsf/eng/lkupNewsCode/05PR298?openDocument>.*

## HK: world class investor protection

Hong Kong's Listing Rules and securities legislative infrastructure provide world class investor protection, SFC Chairman Martin Wheatley has recently told a regional conference.

He said Hong Kong was able to attract PRC firms for listing not because Hong Kong had adopted lower listing standards.

In addition to the strong regulatory framework, Mr Wheatley said the Hong Kong market offered other advantages such as proximity to the Mainland, good research coverage of Mainland firms, and access to institutional and retail investors worldwide.

Mr Wheatley said Hong Kong had been a prime listing venue for major PRC enterprises since the first H-share company was listed here in the early 90s.

*For details of Mr Wheatley's speech at the Conference on SEC Regulation, please see press release issued on 15 November 2005, available on the SFC website at: <http://eapp01.sfc.hk/apps/cc/PressRelease.nsf/eng/lkupNewsCode/05PR271?openDocument>.*



SFC Chairman Mr Martin Wheatley in October paid his first visit to Beijing since his appointment, and discussed matters of mutual interests with CSRC Chairman Mr Shang Fulin (left). He also met Governor of The People's Bank of China Mr Zhou Xiaochuan and Chairman of the China Banking Regulatory Commission Mr Liu Mingkang.

## In brief

The SFC has published the second **Quarterly Report** for the financial year to 31 March 2006. In July - September, we proposed changes to keep the rules and codes up-to-date with market developments and international practice, to increase investor protection, and to combat money laundering. We posted a surplus of \$87 million for the quarter. Reserves at the end of September stood at \$996 million.

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Investors are now not required to pay the investor compensation levies in respect of securities and futures transactions on the Hong Kong stock exchange and futures exchange. The suspension of the levies, effective from 19 December 2005, will remain in force as long as the net asset value of the **Investor Compensation Fund** exceeds \$1.4 billion. They will be re-instated if the fund falls below \$1 billion. As of the end of September 2005, the net asset value of the ICF stood at \$1.59 billion.

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The SFC is amending the Securities and Futures (Contracts Limits and Reportable Positions) Rules to implement HKEx's proposal to increase the **stock options position limits**. We consider that the increase in the position limits will benefit market development in the long term. Under the proposal, the stock options position limits, currently under a two-tier system, will be standardised at 50,000 contracts in any one market direction for all expiry months combined. The large open position reporting levels for the stock options contracts will be standardised at 1,000 contracts per expiry month. Subject to the legislative process, the amendments are expected to be effective in February 2006.



## Investor focus

# How much do you know about REITs?

A Real Estate Investment Trust (REIT) is a collective investment scheme investing in a portfolio of income-generating real estate, such as shopping malls, offices or service apartments in Hong Kong and/or overseas.

An SFC-authorized REIT

- enables holders to achieve diversification through its portfolio of properties with different lease expiries and tenant types;
- must distribute at least 90% of net income after tax to its unit holders as dividends at regular intervals;
- cannot borrow over 45% of its gross asset value;
- is managed by a SFC-licensed

intermediary, with its properties held on trust by an independent trustee; and

- has its units traded in board lots like a listed stock on the Stock Exchange

In picking a REIT, do not just look at the yield offered. You also have to consider the types and quality of the underlying properties such as their location, maintenance conditions, tenancy mix, lease terms and rental payments in arrears, as these will affect the income generation potential of a REIT.

The liquidity of the underlying properties and the qualifications, experience and track record of the REIT manager are also crucial.

In addition, you have to understand the

dividend policy, e.g. the frequency and timing of dividend payment, circumstances where the dividends may not be paid, as well as the fees and charges a REIT has to pay to outside parties.

A REIT may trade at a premium or discount to its respective net asset value, depending on factors like market conditions and investors' perceptions.

After a REIT has been listed, you can look up its latest information in its public announcements and financial reports.

*For details, read our leaflet "Real Estate Investment Trusts" which can be downloaded at [http://www.eirc.hk/eirc/doc/EN/publications/REIT\\_2005\\_E.pdf](http://www.eirc.hk/eirc/doc/EN/publications/REIT_2005_E.pdf).*

## "My Investment Story" competition

Investors may write their successful or unsuccessful investment experiences to the SFC before 16 January 2005 to compete in the first "My Investment Story" competition.

Jointly organised with Radio 5 of the Radio Television Hong Kong and The Salvation Army, the story competition is divided into two categories: (1) HK stock; and (2) any warrants, SFC-regulated investment products or a portfolio of SFC-regulated investment products.

Results will be announced in mid-February. The top three winners of the two categories will obtain cash prizes totalling \$14,000 while 14 other short-listed winners will each get an SFC corporate souvenir. The best 10 stories will be adapted into Cantonese dramas for broadcast on Radio 5 and published in newspapers.

*For details, please see press release issued on 22 November 2005, available on the SFC website at: <http://eapp01.sfc.hk/apps/cc/PressRelease.nsf/eng/lkupNewsCode/05PR279?openDocument>.*

The SFC has given six more **Smart Investor Awards** to citizens who reported financial scams to the SFC. Three winners were cold-called by suspicious boiler room operators. The others reported "phishes" (emails) that lured them to reveal personal data. Their reports have resulted in seven dubious entities added to the Alert List on the Electronic Investor Resources Centre (eIRC). We have also revamped the Alert List so the public can search by name or the type of scams.

The SFC will partner with the Li Ka Shing Institute of Professional and Continuing Education of The Open University of Hong Kong to launch two more **investor education seminars** on 14 and 15 January 2006, after positive response to the 13 seminars and workshops held earlier. Excerpts of the previous seminars are being broadcast on Cable TV News Channel 1 and published in the Hong Kong Economic Journal.



## 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) US President's Executive Order 13224; (2) United Nations Sanctions (Democratic Republic of Congo) Regulation 2005; (3) United Nations (Anti-Terrorism Measures) Ordinance; (4) Blocking Property of Proliferators and Supporters of Weapons of Mass Destruction (19.12.2005)
2. Circular to Licensed Corporations and Associated Entities - Anti-Money Laundering / Combating Terrorist Financing (19.12.2005)
3. Circular to Licensed Corporations and Associated Entities - Further Reminder of Business Continuity Arrangement during the 6th Ministerial Conference of the World Trade Organization (25.11.2005)
4. Circular to All Licensed Corporations - Reminder to comply with certain Code and Internal Control Guidelines requirements (11.11.2005)
5. Circular to Licensed Corporations and Associated Entities - Anti-Money Laundering / Combating Terrorist Financing United Nations (Anti-Terrorism Measures) Ordinance (08.11.2005)
6. Circular to Licensed Corporations and Associated Entities - Business Continuity Plan during the 6th Ministerial Conference of the World Trade Organization (04.11.2005)
7. Circular to Licensed Corporations and Associated Entities - Anti-Money Laundering / Combating Terrorist Financing Non-cooperative Countries and Territories (20.10.2005)
8. Circular to Licensed Corporations and Associated Entities - Anti-Money Laundering / Combating Terrorist Financing (1) US President's Executive Order 13224; (2) United Nations (Anti-Terrorism Measures) Ordinance; (3) United Nations Sanctions (Afghanistan) Regulation (14.10.2005)

# Licensing of fund managers - more frequently asked questions

We published answers to nine commonly asked questions in the July/August issue to guide fund managers, including hedge fund managers, through some important aspects of the licensing process. Market practitioners have told us that they find such information very useful. The SFC is pleased to provide further guidance to fund managers.

## Three questions concerning responsible officer (RO)

**Q:** For each regulated activity that the firm is licensed for, at least one RO must be available at all times to supervise the business. Does he have to be physically present in the office?

**A:** At least one RO must be based in Hong Kong to supervise the business on a full time basis. Even if he or the other RO(s) goes abroad temporarily or is otherwise not available in Hong Kong, they should still be contactable.

**Q:** I have been issued with a conditional RO licence subjecting me to the advice of another RO who does not have this condition. However, whilst I am a board director, the other RO may not necessarily be on the board. Why is this so, and when can the condition be removed?

**A:** Whilst a board director has the necessary authority to

oversee the business, he may not have fully complied with the necessary licensing requirements for a RO. Thus, a conditional licence may be granted to enable him to assume the role of a RO by acting under the advice of a fully qualified RO.

For example, an experienced person who applies for a licence may not be conversant with the local regulatory framework and has not taken the relevant exams. By this conditional arrangement, that person can gain the required understanding of the local regulations from the fully-qualified RO, and is also given a grace period within which to pass the exams.

Another example is where a person may have extensive experience in a certain regulated activity but insufficient management or direct experience in fund management, he can work closely with or under the support of the other RO until he has gained sufficient experience. Once he has passed the exams or gained the requisite experience, he may apply to uplift the condition.

**Q:** As a RO in a fund management company, I am more concerned in the overall management of the business than carrying out actual portfolio management. Shouldn't other

skills and experience in finance, risk management, compliance or business management be counted?

**A:** Underpinning the regulatory framework that only fit and proper persons can deal with investors and participate in the market are ROs who bear primary and ultimate responsibility for the conduct of regulated activities of a firm. The RO of a fund management company is not only required to be academically qualified or technically competent in fund management, but should also be well versed in the relevant rules and regulations and have practical experience in their application and supervision of fund management activities. The conditional approach mentioned above may bridge the experience gap.

## Three questions from fund managers

**Q:** You mentioned in the July/August issue that legislative amendments were underway to allow fund managers to give investment advice on the funds under their management without a Type 4 (advising on securities) and/or Type 5 (advising on futures contracts) licence. When will these happen?

**A:** Subject to the legislative process, the amendments will take effect on 6 January 2006.

**Q:** To set up a business, we need certainty in obtaining a licence before committing to a lease, hiring people, injecting capital etc. Why can't the SFC issue us a licence subject to the condition that certain requirements be fulfilled later?

**A:** The SFC is statutorily required to be satisfied with a person's fitness and properness BEFORE granting the licence. However, we will consider giving "approval in principle" which means that the application is approved subject to clarification of certain issues, receipt of further information or evidence of compliance. The applicant will be advised of the specific outstanding matters and thus is assured of a licence provided that these matters are resolved. Please note that it is important to submit an application of high quality to enable us to form such a view.

**Q:** I am licensed/regulated in a recognised jurisdiction overseas and would like to join certain client events conducted in Hong Kong. How long would it take for me to get a temporary licence accredited to a licensed dealer/adviser?

**A:** Assuming that you fully satisfy the licensing requirements for a temporary licence and a complete application is submitted, a temporary representative licence can be issued within a few business days.



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>):

17 unlicensed companies/entities have been added to the Alert List: "Brinks Holdings Limited", "China Union Group Limited", "Firstmax Trading Limited", "FX Millenia Limited", "Gather Business Forex Investments Limited", "Holdings Universal", "Wang Lee Mergers and Acquisitions", "Yinkou Securities Co Ltd" (08.12.2005); "Fong & Marcus Mergers and Acquisitions" (02.12.2005); "Price Stone Group S1" (30.11.2005); "Pinnacle Global Corporation" (09.11.2005); "Factor Ten Financial", "Hong Kong and Shanghai Securities Ltd" (01.11.2005); "Global Commodities Inc." (26.10.2005); "Beacon Capital Management", "Global Strategy Management" (17.10.2005); "Mercury Global Ltd." (14.10.2005). Information of 6 entities including "Fong & Marcus Mergers and Acquisitions", "Landmark Trade Services Ltd" (08.12.2005); "Landmark Trade Services Ltd" (30.11.2005); "Landmark Trade Services Ltd", "Rockwell & Bond S A" (16.11.2005); "Bernard Simpson Consultants", "Rockwell & Bond S A" (01.11.2005); "Beacon Capital Management", "Global Options Group" (26.10.2005) has been updated on the list.

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

"How Deeply and Silently Can a Takeover Predator Run?" (29.11.2005); and "Protecting Your Interests Starts with Asking the Right Questions" (25.10.2005)



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>.

1. SFC Enforcement Reporter - December 2005 (19.12.2005)
2. Revised Notes 1 and 2 to Rule 8 of the Takeovers Code (1.12.2005)
3. SFC Quarterly Bulletin - Autumn 2005 (30.11.2005)
4. A Healthy Market for Informed Investors - A Report on the Derivative Warrants Market in Hong Kong (25.11.2005)
5. SFC Enforcement Reporter - November 2005 (21.11.2005)
6. SFC Quarterly Report - July to September 2005 (14.11.2005)
7. Introducing the SFC (28.10.2005)
8. Consultation Conclusions on the Proposed Revised Prevention of Money Laundering and Terrorist Financing Guidance Note (27.10.2005)
9. SFC Enforcement Reporter - October 2005 (19.10.2005)
10. Report on the Securities and Futures Commission's 2005 annual review of the Exchange's performance in its regulation of listing matters (17.10.2005)



## 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>.

- Executive Director / Chief Operating Officer
- Manager - Training & Development



## 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](mailto:sfcalert@sfc.hk).



## Feedback

Tell us what you think of the *SFC Alert*. Questions and comments can be sent to [sfcalert@sfc.hk](mailto:sfcalert@sfc.hk).

**Securities and Futures Commission**  
**Office:** 8/F Chater House, 8 Connaught Road Central, Hong Kong  
**Phone:** (852) 2840 9222  
**Fax:** (852) 2521 7836  
**Investor Hotline:** (852) 2840 9333  
**Media:** (852) 2840 9287  
**SFC website:** [www.sfc.hk](http://www.sfc.hk)  
**E-mail:** [enquiry@sfc.hk](mailto:enquiry@sfc.hk)  
**Electronic Investor Resources Centre (eIRC):** [www.eirc.hk](http://www.eirc.hk)