

Mr Martin Wheatley appointed SFC Chairman

Mr Martin Wheatley has been appointed SFC Chairman, effective from 1 October 2005.

The SFC welcomes the appointment by the Chief Executive of Mr Wheatley as the SFC's fifth Chairman. We look forward to working with Mr Wheatley, who has extensive experience in the securities industry in a leading international financial centre.

Before joining the SFC as Executive Director of Supervision of Markets in June, Mr Wheatley had been with the London Stock Exchange for 18 years, his last position being Deputy Chief Executive. He had served on the Board of the London Stock Exchange for six years.

The SFC also expresses its most sincere gratitude to Mr Andrew Sheng, who stepped

down on 30 September at the end of his tenure. Mr Sheng joined the SFC in 1998.



"The challenge is for Hong Kong to develop its very strong financial services base to build its unique capital centre position for the whole of China. I look forward to playing a full part in developing and implementing that vision."

As the longest serving Chairman of the SFC, Mr Sheng has led the SFC in many reforms of the securities and futures market.

One of the most notable achievements was the making and implementation of the Securities and Futures Ordinance. Effective in 2003, the SFO modernised the regulatory framework in Hong Kong to international standards.

On 20 September, the SFC Board of Directors passed a vote of thanks to Mr Sheng for his leadership over the past seven years.

For details, please see press release issued on 30 September 2005, available on the SFC website at: <http://eapp01.sfc.hk/apps/cc/PressRelease.nsf/eng/lkupNewsCode/05PR226?openDocument>.

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Public Perception Survey

The findings of the SFC's first Public Perception Survey show that a great majority of the public knew the overall responsibilities of the SFC.

The SFC commissioned the Social Sciences Research Centre of the University of Hong Kong to conduct the survey.

65.7% of the 1,375 respondents said the SFC was an overall securities market regulator. But 8.1% and 4.9% mistook the SFC for authorities that approved listings and operated the stock exchange respectively.

The three functions that were recognised correctly as the SFC's responsibilities by most respondents were "Ensure the

securities and futures markets are fair, efficient, competitive, transparent and orderly" (96.9%), "Ensure proper disclosures of information by listed companies" (92.9%) and "Handle investors' complaints about market crimes/misconduct" (90%).

The two least recognised SFC functions were "Educate investors" (49.5%) and "Compensate investors in the event of broker failures" (40.8%).

The overall rating of the SFC's performance in fulfilling its statutory objectives was 6.5 points out of 10.

The SFC was seen to be more a "market
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Senior management interview

Ms Wang Yuan, Adviser, China Policy, Chairman's Office

Can you tell us about the China Policy Department?

A dedicated team to handle Mainland related issues was formed 10 years ago in light of increasing interaction between the Hong Kong and the Mainland markets as well as the regulators. It has always been a small unit, currently comprising just myself and one associate director. We study the development and policies of the Mainland capital markets in order to advise SFC colleagues on policy matters and in cases affecting Hong Kong market and companies. Our work involves close liaison with the China Securities Regulatory Commission.

The A-share reform proposal has received a lot of local attention.

The SFC has been monitoring closely the developments in the Mainland and implementation of the reform. The SFC's primary objective is to protect the interest of those investing in the Hong Kong market, and I am confident that the CSRC recognises this is important. The SFC will not interfere with the reform, but would give its views to the Mainland authorities if, for example, the interest of H-share

holders is affected.

What more can be done to strengthen cross-border enforcement?

The management and operations of many Hong Kong listed companies are based in the Mainland. Both the SFC and the CSRC are keen to co-operate in our bid to raise the quality of the market and the



enterprises. There is ongoing liaison under a memorandum of regulatory co-operation. Where necessary, our Enforcement colleagues may also contact their counterparts on particular cases. We must, however, acknowledge the fact that the legal systems of the two places are different. The CSRC has been assisting us to the extent it can. We have brought the matter to the attention of the HKSAR Government and will continue to work with the CSRC to further strengthen co-operation.

Do you also promote Hong Kong in the Mainland?

The SFC is often invited to join seminars organised by the Government etc. I have been to Beijing, Nanjing, Tianjin, Jinan, Fujian and, in the west, Chongqing and Chengdu. Our role is mainly to explain the regulatory framework in Hong Kong to potential issuers and users of the Hong Kong market. We also stress that the SFC will vigorously enforce the rules.

Personal bio

- Joined the SFC in August 2001
- Served in various financial institutions in China, including China Development Bank, The People's Bank of China and The World Bank
- MBA, China Europe International Business School, Shanghai, China; MSc (Economics), Bradford University, UK
- Loves hiking, reading and music

Appointments

The SFC has appointed **Mrs Susan Chow, Mr Stephen Hui** and **Mr Kelvin Westley**, and re-appointed **Mr F K Au, Mr Henry Cheong, Mr Martin Cubbon, Mr Heung Shu Fai, Mr C Y Leung, Mr Alastair Murray, Mr David Richardson** and **Mr Brian Stevenson** to the Committee on Real Estate Investment Trusts for the year from 1 September 2005 to 31 August 2006. The SFC thanks **Mr Roger Hepper** for his valuable contribution to the Committee in the past two years.

In brief

- In view of general support to the proposals in the Consultation Paper on Proposed Amendments to **Schedule 5** to the Securities and Futures Ordinance, the SFC has proposed to amend Schedule 5 by extending the definition of "asset management" to include management of REITs and amending the definitions of "dealing in securities", "advising on securities" and "advising on futures contracts".

Subject to the legislative process, the amendments will come into effect on 9 December 2005.

- In the three months to June 2005, the SFC received 23 listing applications via the Stock Exchange and issued comments on 12 cases under the **Dual Filing** arrangement. We note with concern that certain sponsors failed to exercise due care and skill for the preparation of the Chinese translation of prospectuses, resulting in errors of or inconsistencies between the English and the Chinese versions.

LOI with Jersey

The SFC signed a Letter of Intent (LOI) with Jersey's Financial Services Commission (JFSC) to enhance regulatory co-operation on 9 September.

Under the LOI, the two regulators aim to work towards mutual recognition and the establishment of cross-border distribution of mutually acceptable investment products that are regulated by each authority.

The LOI, the seventh signed by the SFC and the second signed with a non-Asian partner, takes the SFC a step forward in dismantling the barriers to cross-border trading of investment products.

The various LOIs would help to forge a more cohesive Asian market for investment products, including mutual funds, and in enabling the distribution of Hong Kong

investment products in Europe and vice versa.



Director General of the JFSC Mr David Carse (left) and former SFC Chairman Mr Andrew Sheng signed the LOI in London.

For details, please see press release issued on 13 September 2005, available on the SFC website at: <http://eapp01.sfc.hk/apps/cc/PressRelease.nsf/eng/lkupNewsCode/05PR202?openDocument>.

Public Perception Survey

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regulator" or a "market facilitator", than a "law enforcer" or "a partner with investors" that educates investors.

We will consider appropriate publicity or investor education responses in areas of misconception or relatively low recognition levels, and study how we may more effectively get our messages across to the public.

We notice that despite the large amount of investor education work done, there was relatively low level of recognition of our investor education role. To further highlight this role, we have included in SFC newspaper columns, articles and seminars a message to remind readers and participants that those are SFC investor education initiatives.

For details, please see press release issued on 28 September 2005, available on the SFC website at: <http://eapp01.sfc.hk/apps/cc/PressRelease.nsf/eng/lkupNewsCode/05PR222?openDocument>

IOSCO update

The 31st Annual Conference of the International Organization of Securities Commissions (IOSCO) to be held in Hong Kong on 5-8 June 2006 is open for registration.

Interested parties can register online at www.iosco2006.org or print out the registration form and return it by post or fax. The conference website provides information on the conference venue, preliminary programme, registration fees and choice and rates of hotels.

Enquiries about logistics can be made to the Conference Secretariat, International Conference Consultants Limited, by phone (852) 2559 9973, fax (852) 2547 9528 or via email iosco2006@icc.com.hk.

In addition, IOSCO has published for public consultation a Consultation Report on the International Disclosure Principles for Cross-Border Offerings and Listings of Debt Securities by Foreign Issuers. Interested parties are invited to submit comments on this Consultation Report to IOSCO by 22 December 2005.

IOSCO is also establishing arrangements for regulators to share decisions on the

application of the International Financial Reporting Standards with a view to achieving convergence towards high quality global accounting standards that provide transparent and comparable information in general purpose financial reports. Participating regulators will also contact each other to discuss particular decisions.

For details, please see press releases issued on 2 September and 12 October 2005, available on the SFC website respectively at: <http://eapp01.sfc.hk/apps/cc/PressRelease.nsf/eng/lkupNewsCode/05PR195?openDocument> and <http://eapp01.sfc.hk/apps/cc/PressRelease.nsf/eng/lkupNewsCode/05PR238?openDocument>.

FAQs

Q: How does a licensed brokerage handle the securities in my margin account?

A: If you hold a margin account, you may be asked to give your brokerage an upfront authorisation to re-pledge your securities. The brokerage can then "pool" your securities with other clients' securities and re-pledge all or part of the pool as collateral to secure bank borrowings for itself. Your right of return of your securities may depend on the brokerage's ability to repay the bank borrowings, whether or not you have borrowed from the brokerage. It should be noted that the law does not require a margin client to give such an authorisation.

Hedge Fund Guidelines revised

The SFC has revised the Hedge Fund Guidelines contained in Chapter 8.7 of the Code on Unit Trusts and Mutual Funds.

The revisions became effective on 30 September 2005. They follow a public consultation during which 11 submissions were received. The respondents generally supported the SFC proposals:

1. to adopt a holistic approach in assessing a management company and provide greater flexibility in recognising the experience of fund manager's key personnel;
2. to increase the transparency of the management company's operations through additional disclosures in the offering documents of its risk monitoring and due diligence process; and
3. to consolidate and codify existing SFC regulatory practices in the application of the Guidelines by issuing additional notes.

A principles-based approach has been adopted in the revised guidelines to set out the general principles for fair and independent valuation, including the need to ensure proper segregation of the functions of investment management from those of valuation and the need to maintain proper checks and balances when valuation is carried out.

For details, please see press release issued on 26 September 2005, available on the SFC website at: <http://eapp01.sfc.hk/apps/cc/PressRelease.nsf/eng/lkupNewsCode/05PR215?openDocument>.

Prospectus regime consultation

The SFC is consulting on the third and final phase of a reform to modernise the regime governing the public offering of shares and debentures in the Companies Ordinance (CO).

Among the 21 proposals in the Consultation Paper is the introduction of a unified offering regime for all regulated investments falling within either the CO or the SFO.

The paper also discusses whether sponsors should be liable for untrue statements in a prospectus and whether the "reasonable belief" defence should be confined to cases where all reasonable inquiries have been made. This would enhance investor protection.

The SFC also consults on the ways to tackle the issue of different sets of information circulating in the market, e.g. by banning all written pre-deal research by analysts connected to the sponsors, managers or underwriters, or, if leakage results in media coverage, by requiring publication of the research and commentary in the prospectus on all non-prospectus information.

Besides, to encourage shorter prospectuses without compromising the availability of information, the SFC proposes to allow information lodged with a central online document repository to be treated as part of a prospectus under certain conditions.

The consultation will end on 30 November 2005.

For details, please see press release issued on 29 August 2005, available on the SFC website at: <http://eapp01.sfc.hk/apps/cc/PressRelease.nsf/eng/lkupNewsCode/05PR188?openDocument>.

Takeovers Code revised

The SFC has recently revised the Codes on Takeovers and Mergers and Share Repurchases. Under the revised codes, with effect from 1 October 2005:

- a voluntary offer at a discount of over 50% to the market price of the shares will not normally be allowed to proceed;
- once a successful offeror calls a general meeting to appoint directors of the offeree company, the existing board must co-operate fully and will be restricted to take any frustrating action; and
- a broad framework will be created to deal with telecom mergers that are subject to review by the Telecommunications Authority.

Meanwhile, the SFC has appointed **Ms Julia Charlton, Mr Stephen Cheung, Mr Herbert Hui, Mr Bill Kwok, Mr Michael Palin, Mr Gregory Terry, Mr Kenneth Willman, Ms Christine Wong** and **Mr Harold Wong** as new members of the Takeovers and Mergers Panel and the Takeovers Appeal Committee for the period from 1 October 2005 to 31 March 2006.

For details of the revised codes, please see press release issued on 22 August 2005, available on the SFC website at: <http://eapp01.sfc.hk/apps/cc/PressRelease.nsf/eng/lkupNewsCode/05PR181?openDocument>.



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 - Suspicious Transactions Reports Classification (05.10.2005)
2. Circular to Licensed Corporations and Associated Entities - Anti-Money Laundering / Combating Terrorist Financing - US President's Executive Order 13224 (30.09.2005)
3. Circular to Licensed Corporations and Associated Entities - Section 311 of the USA Patriot Act (20.09.2005)
4. Guidelines on revised procedures for applications for Exempt Fund Manager status under the Code on Takeovers and Mergers by fund managers that form part of complex international financial groups (26.08.2005)
5. Guidelines on revised procedures for applications for Exempt Principal Trader status under the Code on Takeovers and Mergers by Principal Traders that form part of complex international financial groups (26.08.2005)

Business Activities Survey

To better understand the developments in the securities industry in Hong Kong, the SFC has been conducting annual Intermediaries Business Activities Surveys since 1996. The Business Activities Survey 2003/2004 was the first survey conducted under the new licensing regime following the implementation of the SFO on 1 April 2003. It confirmed the healthy growth of the securities industry in the 12 months ended 31 March 2004.

87% of securities dealers (2002: 75%) reported "stockbroking" as their main business, whilst 2% (2002: 12%) reported "securities underwriting" as their primary business activity.

Favourable market conditions contributed to a 62% surge in gross operating income of securities dealers to \$38.3 billion. This was in line with the 57% increase in turnover in the stock market to \$2,584 billion.

The favourable market environment also attracted more investors. This was reflected by a 19% increase in the number of active clients (over 610,000) serviced by securities dealers. The number of retail clients increased with the total number of clients, so did their contribution to securities dealers'

income. Yet, institutional and high net-worth individual clients remained the main income contributors (69%). More than 79% of clients were local investors. Although the percentage of overseas clients increased to 21%, the contribution of local clients to securities dealers' income was more significant (66%).

In contrast to the improving market, the total workforce of securities dealers fell by 7% to 11,683, mainly due to a drop in the number of sales and marketing staff. But sales and marketing still accounted for the largest workforce (45%) of securities dealers. The total number of individuals licensed by the SFC also fell from 20,152 in 2002 to 19,212 in 2003/04 at the early stage of economic recovery. Yet, this had reached 23,113 as of 31 August 2005 as the economy improved further.

Overall, the securities industry improved with an increase in income supported by a rise in clientele in the year ended 31 March 2004. This improvement continued in the following 12-month period, which saw the Hang Seng Index climb from 12,682 as at 31 March 2004 to 13,517 at the end of March 2005.

The 2004/05 survey is underway and its findings will be released in due course.

In brief

- In the 2005/06 academic year, the SFC will have a series of **investor education** activities with universities: credit-based courses at Lingnan University (for the second year), guest lectures to students at The Hong Kong University of Science and Technology and Hong Kong Baptist University, public lectures with The Open University of Hong Kong, and "Meet-the-SFC" sessions for various universities' finance or investment societies.



Lingnan University students and an SFC representative continued their discussions after a *Foundations of Financial Investing* course on 12 October 2005.

- The SFC has put new interactive games on its investor portal **Electronic Investor Resources Centre** at www.eirc.hk. The games are on warrants, IPOs, hedge funds, parallel trading and transaction costs. There are also new feature articles on investment-linked assurance schemes and an online user survey. To complement the text information, we plan to launch flash videos in early 2006.

Securities Dealers		2003/04	2002
Total gross income		\$38.3 billion	\$23.6 billion
Breakdown by clients	Retail	31%	23%
	Institutional & high net-worth	69%	77%
Breakdown by clients	Local	66%	49%
	Overseas	34%	51%
Total active clients		612,754	516,901
Breakdown by clients	Retail	89%	86%
	Institutional & high net-worth	11%	14%
Breakdown by clients	Local	79%	84%
	Overseas	21%	16%
Total workforce		11,683	12,559
Front office		64%	67%
Back office		36%	33%



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>):

11 unlicensed companies have been added to the Alert List: "Cahill & Audleman", "Cheoy Lee Asset Management Asia", "Lee Andrews Wright & Associates" (06.10.2005); "Bedford Investments Inc.", "Crossino Holdings Limited" (05.10.2005); "ABN Assets", "Decatur International, Inc." (21.09.2005); "Private Equity Traders", "Bloomberg & Associates" (12.09.2005); "Whitman Pearce & Partners" (07.09.2005); "Youngson International Holdings Limited" (17.08.2005). Information of eight entities including "Bentley International Management Limited" (06.10.2005); "Guardex Holdings", "Youngson International Holding", "Youngson International Holdings Limited" (05.10.2005); "SpartaMatrix" (26.09.2005); "The Kaikatsu Group" (03.09.2005); "Goldmill Wagner Associates" (31.08.2005); "Bernard Simpson Consultants" (18.08.2005) has been updated on the list.

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

"Never Lend Your Account" (30.08.2005) and "Warrants: If In Doubt, Stay Out" (27.09.2005)

Others:

Educational leaflet: "Protecting Your Interests Starts with Asking the Right Questions" (21.09.2005) and New article series "Considering Analysts' Advice" (14.09.2005)



It is a common misconception that derivative warrants are simply a geared substitute of their underlying stocks. In fact, derivative warrants are far more complicated.

Take **pricing** as an example. Apart from the underlying stock price, a warrant's price is also affected by the exercise price, expected volatility of the underlying stock price, time to expiry, interest rates, expected underlying stock dividends, and market supply of and demand for the warrant. Thus, warrant prices may not rise even though the underlying stock prices have moved in the right direction.

Warrants with the same underlying stock may have different valuations and features.

The most actively traded warrant is not necessarily the best. You should compare the **implied volatility** of different warrants: a warrant with a higher implied volatility is more expensive and vice versa.

Gearing of a warrant may vary as the underlying stock price changes. This explains why warrant prices may not go up at a rate represented by the gearing ratio. Further, the price of a warrant is always subject to changes in short-term demand for and supply of the warrant.

It is highly risky to speculate on short-dated or deeply out-of-the-money warrants. Unlike stocks, warrants have a limited life and their **time value** reduces quickly towards their

expiry date. Deeply out-of-the-money warrants are less sensitive to underlying price movements because they will unlikely become in-the-money upon expiry.

Derivative warrants are not for everyone. **Recommendations** on warrants and trading strategies in newspaper columns, TV and radio programmes often do not take into account individual investors' personal circumstances. Besides, some recommendations are given by warrant issuers in their own sponsored programmes instead of by independent market practitioners. It is important to know the assumptions behind any investment recommendations. Never rely solely on them.

Other

publications



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. Revised Codes on Takeovers and Mergers and Share Repurchases (01.10.2005)
2. Revised Code on Unit Trusts and Mutual Funds (Hedge Fund Guidelines) (30.09.2005)
3. Report of Findings of Public Perception Survey (28.09.2005)
4. Consultation Conclusions on Consultation Paper on the Review of Chapter 8.7 of the Code on Unit Trusts and Mutual Funds (Hedge Fund Guidelines) (26.09.2005)
5. Consultation Conclusions on Proposed Amendments to Schedule 5 to the Securities and Futures Ordinance (21.09.2005)
6. SFC Enforcement Reporter - September 2005 (16.09.2005)
7. SFC Quarterly Bulletin - Summer 2005 (31.08.2005)
8. Consultation Paper on Possible Reforms to the Prospectus Regime in the Companies Ordinance (29.08.2005)
9. Consultation Conclusions on a Review of the Codes on Takeovers and Mergers and Share Repurchases (22.08.2005)



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>.

- **Director - Enforcement (Intermediary Discipline)**
- **Manager / Assistant Manager / Executive Trainee - Intermediaries and Investment Products Division**
- **Manager / Assistant Manager - Enforcement (Surveillance)**
- **Manager / Assistant Manager - Enforcement (Investigation)**



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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