

New SFC Chairman's priorities

Mr Eddy Fong, who has been appointed by the HKSAR Chief Executive as the Chairman of the SFC, has set out his priorities.

"I am honoured to be appointed Chairman of the Securities and Futures Commission," Mr Fong said at a press meeting on 20 October, his first day in the position.

The new Chairman has outlined four priorities.

"Firstly, as Chairman of the Board, my foremost task is to provide leadership to its members to ensure that all members participate and contribute fully in setting strategies and directions for the Commission."

"Secondly, as you are all probably aware, the role of the Chairman has been changed from an Executive to a Non-Executive one. Accordingly, one of my priorities will be to ensure that the CEO and I discharge our respective roles and responsibilities in a complementary manner. Equally importantly, I want to ensure that members of the Board and all SFC staff continue to work together as a team to carry out our duties effectively and efficiently and as laid down by the Securities and Futures Ordinance."

"Thirdly, while carrying out its regulatory duties, the Commission should be mindful that it has another important role to play, which is to facilitate Hong Kong's ongoing development as a leading international financial centre. The big picture is that the financial market is globalising and Hong Kong must be part of it. In this connection, the Commission cannot work in isolation. It must liaise with its stakeholders, both locally and internationally, by expanding the existing dialogue regarding regulatory policies and market



"I am pleased to note that the SFC has a dedicated and professional team. However, I do not underestimate the responsibilities and challenges that I will face in the role of Chairman."

issues of common interest."

"Lastly, and perhaps most importantly, the economic and market development in the Mainland will continue to fuel the growth of the Hong Kong market. Today over 40% of the market capitalisation in the

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Rapid growth of HK's hedge fund market

The hedge fund management market in Hong Kong has recorded remarkable growth over the past two years.

According to the SFC's first survey of hedge funds managed by licensed managers, the number of hedge fund managers doubled from 58 as at 31 March 2004 to 118 as at 31 March 2006. Meanwhile, the number of hedge funds surged from 112 to 296, with total AUM increasing by 268% to US\$33.5 billion.

The findings confirm Hong Kong's position

as a leading hedge fund management centre in Asia.

Among the top 20 hedge fund managers, 13 of them were affiliates of hedge fund managers from the US, the UK and Japan, while the remainder were local operations.

About one-third (34%) of the hedge funds adopted a simple equities long/short strategy, followed by multi-strategies (25%) and fund of hedge funds (20%).

40% of the hedge funds did not use any

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SFC Executive Directors



All Executive Director positions have been filled following several recent appointments. The newly appointed EDs include: [standing, left] Mr Paul Kennedy (ED / Chief Operating Officer - previously a partner with KPMG specialising in serving financial services clients; and most recently spending 4 1/2 years as the Managing Partner of KPMG's Shanghai office); [standing, right] Mr Mark Steward (ED of Enforcement - most recently being Deputy ED, Enforcement at the Australian Securities and Investments Commission; having been involved in corporate and securities regulation since 1987 in both Australia and the UK); [sitting, far left] Mr Brian Ho (ED of Corporate Finance - having been with the SFC for more than 12 years); and (sitting, far right) Mr Keith Lui (ED of Supervision of Markets - having been with the SFC for over 14 years). Also in the picture are Mr Martin Wheatley (Chief Executive Officer) and Mrs Alexa Lam (ED of Intermediaries and Investment Products).

New SFC Chairman's priorities

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Hong Kong Stock Exchange comes from companies originated from the Mainland. There is therefore a need to maintain close and regular ties with our counterparts in the PRC. I plan to build on the excellent relationship that the Commission has developed over the years with the China Securities Regulatory Commission, and address with the CSRC issues of mutual interest."

Mr Fong is a certified public accountant with rich and extensive business experience in Hong Kong and the international financial markets.

He has been a Non-Executive Director since 1 January 2005 and has participated actively in a number of the SFC's key committees including as Chairman of the Audit Committee. Mr Fong's term ends on 19 October 2009.

For details, please see press releases issued on 17 and 20 October 2006, available on the SFC website at: <http://www.sfc.hk/sfcPressRelease/EN/sfcAllPressReleaseServlet>.

Message from SFC CEO

Dear Reader,

You may have read from the page one story that Mr Eddy Fong has become the SFC's Chairman. On behalf of the Commission staff, I warmly welcome Mr Fong. Meanwhile, I am also pleased that, with the recent appointments by the Financial Secretary of Mr Keith Lui, Mr Brian Ho, Mr Mark Steward and Mr Paul Kennedy as Executive Directors, the SFC now has a full team of EDs [see photograph on the left].

In the past month, we published the first SFC survey of hedge funds managed by licensed managers. The findings confirm Hong Kong's position as a leading hedge fund management centre in Asia.

We are moving ahead on two projects to respectively modernise Hong Kong's prospectus regime and further improve the regulation of marketing materials for listed structured products, notably derivative warrants.

We continue to enhance investor protection against broker fraud under a 3-pronged action plan. In September, I had the opportunity to explain the measures at the Legislative Council Panel on Financial Affairs.

Martin Wheatley

Enhancing investor protection against broker fraud

On 29 September, SFC Chief Executive Officer, Mr Martin Wheatley, presented to the Legislative Council Panel on Financial Affairs a report outlining plans to enhance the protection of client assets held by brokers.

In the wake of several broker failures, under a 3-pronged plan the SFC will:

- continue its rigorous supervision of

brokers;

- continue to encourage investors to make greater use of Investor Participant accounts and take proactive measures to detect irregularities in their accounts; and
- discuss with the Hong Kong Institute of Certified Public Accountants the circularisation of client accounts.

In the longer term, the SFC intends to review the existing asset custody arrangements. The SFC will also work with HKEx to explore further enhancements of IP accounts, and consider tougher disciplinary sanctions against firms for misconduct and deficiencies.

For more details, please see press release issued on 29 September 2006, available on the SFC website at: <http://www.sfc.hk/sfcPressRelease/EN/sfcOpenDocServlet?docno=06PR210>.

Modernising HK's prospectus regime

The SFC has received broad support for the majority of the proposed initiatives to modernise the regime of public offering of shares and debentures.

The SFC will take forward the following:

- The public offering provisions in the Companies Ordinance (CO) will be moved to the Securities and Futures Ordinance (SFO).
- The regime will regulate the act of offering rather than any document containing the offer. Offerors will also be regulated without regard to place of incorporation or their legal form.
- Prospectus liability will be imposed on (i) the issuer and/or the offeror of the shares or debentures; and (ii) each person who accepts responsibility for the prospectus.
- The red-herring prospectus may be made available to the public after the listing application has been approved in principle by the SEHK; and the Code of Conduct will be extended to ensure independence and objectivity of analysts in relation to pre-IPO research.
- The prospectus issuer needs to publish

a supplemental prospectus and allow successful applicants to withdraw their allocations and be repaid in full where materially adverse new developments occur before the announcement of allocation results.

The SFC will discuss with stakeholders to refine the specific initiatives, and work on the proposed legislative amendments to the CO and the SFO.

For details, please see press release issued on 22 September 2006, available on the SFC website at: <http://www.sfc.hk/sfcPressRelease/EN/sfcOpenDocServlet?docno=06PR204>.

Bulletin board - licensing matters

It has come to our attention that certain persons may not have obtained the SFC's prior approval before becoming **substantial shareholders of licensed corporations**.

Under section 131 of the Securities and Futures Ordinance (SFO), a person shall not become or continue to be a substantial shareholder of a licensed corporation without first being approved by the SFC under section 132 of the SFO. Any person who fails to comply with the requirement commits an offence. The highest penalty on conviction is a fine of \$1 million and an imprisonment for 2 years. A further fine of \$5,000 per day may also be imposed for continuous breach. Furthermore, if a person becomes a substantial shareholder of a licensed corporation without the SFC's prior approval, the voting rights conferred by the shares concerned are not exercisable.

In this regard, the SFC reminds proposed

substantial shareholders of licensed corporations to obtain the SFC's prior approval before the transfer of shares takes place. The definition of "substantial shareholder" can be found in Schedule 1 to the SFO. Depending on the circumstances of each case, whether an acquisition of shareholding, directly or indirectly, constitutes a change in substantial shareholding, could be complex. Licensed corporations and their prospective shareholders are strongly recommended to seek legal advice if in doubt.

If you wish to apply for approval as a substantial shareholder, please complete Form 4 - Miscellaneous Applications, which can be downloaded from the SFC website under "Licensing Related Matters" of the "Intermediaries, Licensing and Investment Products" section.

If you have any questions about licensing matters, please contact us via the enquiries hotline - 2840 9393.

Beware of callers impersonating SFC staff

The SFC has recently received reports from licensed corporations that they had received calls from persons claiming to be SFC staff asking for information about their companies.

Some suspicious callers said that they were conducting a survey on behalf of the SFC.

The SFC has issued a circular to remind all licensed corporations to be vigilant to these calls.

If licensed corporations have any doubts about the identity of the callers, they should ask the callers to provide more information about themselves or contact the SFC directly by phone (2840 9222) or email (enquiry@sfc.hk) for clarification.

Rapid growth of HK's hedge fund market

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leverage as at 31 March 2006. Among those that used leverage, most had an external leverage of less than two times NAV.

20% of hedge funds had an annualised return of more than 20% over the past two-

years, whereas 16% reported negative returns.

The SFC encourages the hedge fund industry to be more transparent and provide investors with timely and useful information.

Hedge funds' senior management and counterparties should also put in place rigorous risk management measures.

For details, please see press release issued on 18 October 2006, available on the SFC website, at <http://www.sfc.hk/sfcPressRelease/EN/sfcOpenDocServlet?docno=06PR221>.

Rate hikes shrink the retail structured notes market

According to SFC research, rising interest rates may have dampened investors' appetite for retail structured notes and caused the market to shrink.

During the 12 months ended June 2006, 147 retail structured notes, with an aggregate issue size of \$9,755 million, were issued. This represented a 53% increase by number, but a 52% decrease by issue size from a year ago.

Retail structured notes are complex financial instruments but a common attraction is yield enhancement. Their attractiveness is likely to fade with rising interest rates. An interest rate hike cycle began in late March 2005.

The SFC research also analyses the tendency of equity

linked notes, the dominant type of retail structured notes, to lower market volatility. Some equity linked notes are structured so that, upon maturity, investors receive either a predetermined amount in cash or a predetermined number of the underlying stock if the

price of that stock falls below a predetermined level. Therefore, the likelihood of the issuers having to deliver stocks on maturity decreases in a rising market. As a result, issuers are likely to sell more shares of the underlying stocks, thus helping to cool down the market. The opposite occurs in a falling market, helping the market to pick up.

It is observed that volatilities of the HSI and major HSI stocks have rebounded since mid 2005. Among other factors, this might be due to the rising interest rate environment which reduced the relative attractiveness of equity linked notes.

For details, please see the research paper issued on 28 September 2006, available on the SFC website at: <http://www.sfc.hk/sfc/doc/EN/research/research/rs%20paper%2034.pdf>.

Hong Kong leads in competitiveness as a financial centre

Hong Kong takes the lead in Asia in most factors which are considered as important to a financial centre.

A study conducted for the Corporation of London listed 14 competitive factors as most important to a financial centre. An SFC research categorised them into six groups and compared the competitiveness of Hong Kong with 12 other economies in Asia.

The result is that Hong Kong is clearly ahead of the other markets in most of these factors.

Hong Kong has a critical mass of expertise in the financial services and related professional sectors. Its regulatory framework is sound and of international standards, and it also has a responsive government. It has ready access to international financial markets and customers. The business infrastructure is advanced and sophisticated, and the business environment open and competitive. In addition, tax rates in Hong Kong are low and the tax system is simple and efficient.

However, Hong Kong must also improve other areas such as enhancing competition, ensuring ease of doing business, improving quality of life, and addressing environmental issues in order to stay ahead of the competition.

For details, please see the research paper issued on 31 August 2006, available on the SFC website at: <http://www.sfc.hk/sfc/doc/EN/research/research/rs%20paper%2033.pdf>.



Circulars

The following recently published circulars are available on the SFC website under "Legislation & Regulatory Handbook" - "Regulatory Handbook" - "Codes, Guidelines and Circulars" at: <http://eappo1.sfc.hk/apps/cc/RegulatoryHandbook.nsf/eng/GenerateHTMLTB?openAgent>.

1. Circular to Licensed Corporations and Associated Entities Anti-Money Laundering / Combating Terrorist Financing (1) United Nations (Anti-Terrorism Measures) Ordinance (2) US President's Executive Order 13224 (3) Combating Financing of Weapons of Mass Destruction Activities (17.10.2006)
2. Circular to Fund Management Companies of SFC-authorized Funds - FAQs on SFC Authorisation of Unit Trusts and Mutual Funds (5.10.2006)
3. Circular to All Licensed Corporations - Requirements under Certain Amendment Rules and Amended Code of Conduct will come into effect on 1 October 2006 (28.09.2006)
4. Guidelines on Marketing Materials for Listed Structured Products (19.09.2006)
5. Guidelines on Marketing Materials for Listed Structured Products - Frequently Asked Questions (19.09.2006)
6. Circular to Licensed Corporations and Registered Institutions - Emergency Contact Person (8.09.2006)
7. General Circular to Licensed REIT Managers - Frequently Asked Questions on Disclosure of Distribution Composition (8.09.2006)
8. Circular to Intermediaries Licensed or Registered for Type 6 Regulated Activity - Sponsor Regime (5.09.2006)
9. Securities and Futures (Financial Resources) (Amendment) Rules 2006 for Sponsors (5.09.2006)
10. Circular to All Licensed Corporations - Be Alert to Individuals Pretending to be SFC Staff (4.09.2006)

Marketing guidelines for listed structured products

New guidelines for the marketing of listed structured products have come into effect after receiving positive public response in a consultation.

The Guidelines is one of the proposals in SFC's Six-Point Plan which aims to strengthen the derivative warrant market and enhance investor protection.

The Guidelines adopts a principles-based approach rather than a prescriptive

approach and covers all forms of marketing of listed structured products irrespective of the media used. The overriding principle is that marketing materials should not be false, biased, misleading or deceptive, and should include appropriate risk warnings.

Listed structured products issuers and all persons responsible for marketing materials are required to comply with the

Guidelines.

The Guidelines came into effect on 1 October 2006.

The SFC has published on its website frequently asked questions to clarify certain issues about the Guidelines.

For details, please see press release issued on 19 September 2006, available on the SFC website at: <http://www.sfc.hk/sfcPressRelease/EN/sfcOpenDocServlet?docno=06PR200>.

A reminder to warrant investors

It appears from warrant related complaints that some investors do not fully understand the mechanics of derivative warrants and factors affecting warrant prices. The SFC has also noted the recent increases in turnover of derivative warrants. Therefore, we believe a reminder on some key warrant price characteristics is timely.

- Changes in the demand for and supply of a warrant could cause short-term divergence between the warrant price and its underlying price.
- Further issues of the same warrant could lead to a shift in the demand and supply of the warrant, and hence, the warrant price.
- Different issuers may use different implied volatilities to price their warrants, resulting in different prices of similar warrants.
- Deeply out-of-the-money warrants, particularly short-dated ones, are usually less sensitive to movements in the underlying price.
- The obligations of a liquidity provider are stated in the listing documents for the respective warrants and may vary amongst different warrants.

Visit the "Alternative Investments - Understanding Warrants" subsection of the SFC's investor education portal - "InvestEd" at www.InvestEd.hk for more information.

Ombudsman's Award

Ms Judith Yuen, a Senior Manager of SFC's Licensing Department, has been given an Ombudsman's Award 2006.

The Ombudsman's Awards are presented annually to recognise public organisations' support towards the Ombudsman's investigations of complaints. The Awards have also been extended to recognise the efforts of individual public officers for their display of fairness, impartiality and efficiency in the performance of their duties.

Ms Yuen, who has been with the SFC for 14 years, said patience and communication were vital to our interaction with intermediaries. "I have always borne in mind that when supervising our intermediaries, we must understand and take into account their specific circumstances," said Ms Yuen.

It is the second Ombudsman Award to an employee of the SFC.



Ms Yuen [left] receives the Award from Ms Alice Tai, the Ombudsman.

Investor resources

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

Investor Alert Updates (<http://eapp01.sfc.hk/apps/ie/eIRCAAlertList.nsf/eng/alert?openpage>):

Four unlicensed companies have been added to the Alert List: "Jameson West Associates Ltd" (26.10.2006), "Warren Group" (11.09.2006), "P E Hess / Phillip Edward Hess", "The Xenon Group" (05.09.2006). Information of one entity "Pan-Index Limited" (18.10.2006) has been updated on the list.

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

"What Role Do Independent Non-Executive Directors Play in Companies?" (31.10.2006), "Investor Participant Account and Stock Segregated Account" (26.09.2006) and "Investor Compensation Fund - Your Safety Net" (29.08.2006).

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. SFC Enforcement Reporter - October 2006 (24.10.2006)
2. Report of the Survey on Hedge Funds Managed by SFC Licensed Managers (for the Period 31 March 2004 - 31 March 2006) (18.10.2006)
3. Consultation Conclusions on the Consultation Paper on Possible Reforms to the Prospectus Regime in the Companies Ordinance (22.09.2006)
4. SFC Enforcement Reporter - September 2006 (21.09.2006)
5. Survey on Engagement of Investment Advisers (20.09.2006)
6. Consultation Conclusions on the Draft Guidelines on Marketing Materials for Listed Structured Products (19.09.2006)
7. SFC Quarterly Bulletin - Summer 2006 (7.09.2006)
8. Fit and Proper Guidelines (1.09.2006)



Investor focus

Investors want suitable product recommendations

According to an SFC survey, nine out of 10 investors were satisfied with their investment advisers' (IA) services, notably on customer services, but wanted more suitable product recommendations from them.

The survey indicates that, in choosing an IA firm, most investors looked at reputation (79%) and service quality (66%). At the IA representative level, investors considered the individuals' product/market knowledge (74%), willingness to understand client's circumstances and address client's concerns (68%), as well as their ability to explain matters clearly (62%).

Nearly half of the investors set their investment goals before meeting their IAs. 32% set their goals based on the financial health analysis conducted by their IAs.

When making investment decisions, most investors relied on their IAs' verbal explanations/financial plans (72%) and/or the product's offering documents/fact sheets (63%).

88% of investors were satisfied with their IAs' services and 63% agreed that "IA services are a good value for money".

However, 44% of investors said they did not receive a written financial plan from their IAs and only 7% said that their IAs disclosed commissions or rebates arising from product recommendations.

More than half of investors (57%) expected their IAs to provide more suitable product recommendations.

The SFC advises investors that while SFC-licensed IAs should always put their clients' interests first, investors should also protect their own interests by finding out all they can about a product before committing to it. In other words, "Before you invest, ask the right questions".

For details, please see press release issued on 20 September 2006, available on the SFC website at: <http://www.sfc.hk/sfcPressRelease/EN/sfcOpenDoc.Servlet?docno=06PR202>.

In brief

- For the first time, the SFC has partnered with The Chinese University of Hong Kong to launch a **general education course** on Personal Financial Management for non-business-major students. The 13-session course covers topics from the fundamental concepts of stock and fund investments, corporate activities of listed companies, derivatives, market malpractices to personal financial planning. With the CU course, in the 2006/2007 academic

year, the SFC has expanded its investor education efforts to all local universities to help young people develop the right attitude towards personal financial management.

- Many visitors obtained investor education leaflets at the SFC's exhibition booth at the **Financial World Expo 2006**, held from 6 to 8 October at the Hong Kong Convention and Exhibition Centre. The Expo was an annual consumer education event organised by the Institute of Financial Planners of Hong Kong.



FAQs

Q: Do I have control of my stocks kept at my Stock Segregated Account (SSA) with Statement Service?

A: No. Although your broker needs to segregate your stockholding at the Central Clearing and Settlement System into your SSA from those of other clients, your stocks at the SSA remain under the full control of your broker. However, you will receive an account statement from the Hong Kong Securities and Clearing Co whenever there are changes in the stock balance of your SSA.



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 Manager - Corporate Finance**
- Senior Manager - Intermediaries and Investment Products Division (Licensing Department)**
- Manager - Intermediaries and Investment Products Division (Investment Products Department)**
- Manager - Intermediaries and Investment Products Division (Intermediaries Supervision Department)**



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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