

Win-win scenario for the Mainland and HK markets

Hong Kong is poised to play a more active role in the development of the overseas wealth management business conducted by Mainland commercial banks on behalf of their clients, generally known as the QDII (Qualified Domestic Institutional Investors) business of Mainland commercial banks.

The SFC welcomes the China Banking Regulatory Commission's (CBRC) announcement of a notice on 11 May 2007 that allows Mainland commercial banks to invest in a wider range of asset classes, including equities, equity funds and equity-linked structured products. When investing in overseas equities on behalf of their clients, Mainland commercial banks are required to invest in equity markets regulated by a supervisory authority with whom the CBRC has a Memorandum of Understanding (MOU). Similarly, when investing in equity funds, Mainland commercial banks must invest in equity funds authorised by a supervisory authority with whom the CBRC has a MOU. While investing directly in equities is subject to a maximum limit of 50% of the portfolio value, there is no upper limit when Mainland commercial banks invest in equity funds. The SFC is the first securities regulator with whom the CBRC has signed a MOU.

Under the MOU, which was signed on 10 April 2007, the SFC will, on request, provide the CBRC with certain information about the licensed intermediaries who provide services to Mainland commercial banks conducting QDII business (see photograph on page 3).

The SFC believes this widening of the scope of investment will result in a win-win scenario for both the Mainland and Hong Kong. This will enable Mainland investors to enjoy a wider choice of investment products available in Hong Kong, and will benefit Hong Kong's asset management industry.

Message from SFC CEO

Dear Reader,

The SFC is changing - we are placing more emphasis on our daily interactions with you on how to develop the market. We are looking closely at how we discharge our statutory role with a view to cutting back red tape and unnecessary bureaucracy. Our focus more and more is how we create a better market by simplifying processes and welcoming new products. To do this we must listen more. I and my senior team will be spending more time trying to understand the obstacles to innovation - whether they be in our process or in the law - and working out, with you, how to remove them. In this issue you will see a number of initiatives - position limits, UCITS III, Unit Trusts Code are three examples - where our focus is to help develop the market. There are a number of other initiatives in the pipeline to roll back obstacles to legitimate business growth.

If there are areas you feel we should address, please let me know at ceo@sfc.hk.

Martin Wheatley

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SFC launches Takeovers Bulletin

The SFC has recently published a new periodical, the Takeovers Bulletin, to provide guidance and interpretation on various matters relating to takeovers in Hong Kong. The Bulletin is designed to contain articles on topical issues as well as Practice Notes on issues under the Codes on Takeovers and Mergers and Share Repurchases.

The first issue of the Takeovers Bulletin, published on 17 May, includes a statement of the Takeovers Executive's ruling regarding whether certain parties were acting in concert in respect of the proposed sale of shares in PCCW Limited. The ruling was made after careful examination by the Takeovers Executive of the representations made by the relevant parties.

The Takeovers Bulletin is available under "Speeches, Publications & Consultations" of the SFC website. Comments are welcome and can be sent to takeoversbulletin@sfc.hk.

SFC meets with compliance officers

The SFC has recently met with a group of compliance officers to exchange views on a number of current regulatory and compliance issues. This was part of the SFC's ongoing effort to enhance communication with the industry and achieve the right balance between investor protection and market development.

At the meeting the SFC outlined its approach to facilitating the efficient processing of licence applications including the issue of provisional licences which allow applicants to start work as soon as possible; more than 3,000 such licences were issued last year. The SFC's extensive discussions with the industry were also highlighted; last year it addressed 25,000 enquiries from applicants and licensees. The group was also informed that the SFC had approved subordinated loans worth \$15 billion and granted modifications of certain statutory financial requirements in order to facilitate firms conducting international business.

During the meeting, the SFC called on the industry to continue

to be vigilant in detecting money laundering activities and to promptly report suspicious transactions. Firms engaging in outsourcing were also reminded to comply with all applicable legal and regulatory requirements. The SFC will continue to maintain an active dialogue with intermediaries on these issues.

Other regulatory matters discussed included the eligibility requirements for licences, the new sponsor regime, and the means to communicate research disclaimers to recipients of research reports issued electronically.

The views and opinions exchanged are very much appreciated and will assist the SFC in the formulation and direction of future regulatory policies. The SFC will continue to engage in open dialogue with the industry and market participants are encouraged to approach the Intermediaries and Investment Products Division of the SFC to discuss the above subjects.

New appointments and re-appointments

The SFC welcomes the re-appointment by the Financial Secretary of *Dr York Liao* as a Non-Executive Director for two years from 26 May 2007 to 25 May 2009, and the Financial Secretary's appointment and re-appointment of members to the SFC Advisory Committee for two years from 1 June 2007 to 31 May 2009. The new appointed members are *Mr Chew Fook-aun*, *Mr Douglas Eu*, *Dr Frederick Hu*, *Mr Christophe Lee*, *Mr Wong Kwai-lam* and *Mr Thomas Wu*, and the re-appointed members are *Mr Henry Chan*, *Mr Jack Maisano*, *Mr Blair Pickerell*, *Mr Peter Sullivan*, *Ms Ada Tse* and *Mr Yip Lai Shing*.

The SFC is pleased to announce that *Mr Sun Jie* joined the SFC as Senior Vice President - China Affairs on 17 May 2007. Mr Sun was previously Director-General, Department of Investment Funds Supervision of the China Securities Regulatory Commission, and he will help the SFC with its response to the development of the Mainland financial markets and play a key role in the SFC's liaison with the various governmental and regulatory bodies in the Mainland.

The SFC is also pleased to announce the appointment and re-appointment of members of some of its committees, all for a term of one year from 1 April 2007 to 31 March 2008.

The new members of the Investor Education Advisory Committee are *Mr Ronald Chiu*, *Mr Simon Ho*, *Mr Kennedy Liu*, *Mr Sin Tak Wah*, *Mr Kenneth So* and *Mr Calvin Tai*, and the re-appointed members are *The Honourable Choy So Yu*,

Mr Anthony Espina, *Mr Eric Fu*, *Mrs Francine Fu* and *Mr David Lam*.

The new member of the SFC (HKEC Listing) Committee is *Mr Tony Tsoi*, and the re-appointed market representatives are *Mr Stephen Clark*, *Ms Teresa Ko*, *Mr Michael Lee* and *Mr Carlson Tong*.

The re-appointed Chairman of the Takeovers and Mergers Panel is *Mr Kevin Westley*, and the re-appointed Deputy Chairmen are *Mr Clifton Chiu*, *Mr Stephen Clark*, *The Honourable Henry Fan*, *Mr David Graham* and *Ms Teresa Ko*.

The new Chairman and Deputy Chairman of the Takeovers Appeal Committee are *Ms Teresa Ko* and *Mr Jim Baird* respectively.

The new members of the Dual Filing Advisory Group are *Mr Alex Fong*, *Mr Christopher Howe* and *Ms Eirene Yeung*, and the re-appointed members are *Mr Ashley Alder*, *Mr David Cheung*, *Mr Raymond Lee*, *Mr Gavin Nesbitt*, *Mr Terry Ng*, *Mr James Siu*, *Mr Frank Slevin*, *Mr Carlson Tong* and *Mr V-Nee Yeh*.

The SFC is grateful to all members for their valuable contributions to the functioning of the above committees.

For the full membership lists of the above, see press releases issued on 28 and 30 March, and 11 and 16 May 2007.

Cross-border enforcement enhanced

The SFC and the China Securities Regulatory Commission (CSRC) have enhanced cross-border enforcement co-operation.

Side letters to the Memorandum of Regulatory Co-operation and the Memorandum of Regulatory Co-operation Concerning Futures between the SFC and the CSRC have been exchanged to enhance the ability of the two regulatory agencies to co-operate in the investigation of cross-border crimes and regulatory breaches.

Under the new arrangements, the SFC may request assistance from the CSRC in obtaining information in the Mainland for SFC investigations. A person may face sanctions if he refuses to comply with a request to provide details. This power for the CSRC to compel the provision of information has been made possible by amendments to the Mainland securities laws last year. Previously, the SFC had to rely on the CSRC seeking voluntary co-operation from persons from whom information was sought.

The SFC will also be able to exercise its investigatory powers to help the CSRC in its investigations that have a Hong Kong element.

The SFC stresses that while the side letter will enhance the SFC's ability to gather evidence, there are many other factors that influence successful regulatory outcomes.



CSRC Chairman, Mr Shang Fulin (left), and SFC Chairman, Mr Eddy Fong, exchange the side letters in Beijing on 30 March 2007.



On 10 April, the SFC signed a MOU with the CBRC to establish co-operation regarding the QDII business of Mainland commercial banks. The photograph shows CBRC Chairman, Mr Liu Mingkang (left), and SFC Chairman, Mr Eddy Fong, exchanging the MOU in Hong Kong.

Suitability obligations of investment advisers

The SFC has issued guidance to help investment advisers meet the conduct requirements on giving suitable advice.

The guidance concerns suitability obligations of investment advisers, who should know their clients, understand the investment products they recommend, and provide suitable recommendations by matching the risk return profile of each product with their clients' personal circumstances, etc.

The board of directors and senior management of investment

advisory firms should set a strong governance culture within the firms and ensure there are adequate management supervision, risk management and internal controls.

The SFC will continue to take rigorous regulatory action against those who commit serious breaches of the law, code and rules, and to enhance investor education.

The guidance, in the form of frequently asked questions (FAQ), is available on the SFC website.



Circulars

The following recently published circulars are available on the SFC website under "Legislation & Regulatory Handbook" - "Regulatory Handbook" - "Codes, Guidelines and Circulars".

1. Circular to Licensed Corporations and Associated Entities - Anti-Money Laundering Training Seminar (10.05.2007)
2. Circular to All Licensed Corporations - Questions and Answers on Suitability Obligations (08.05.2007)
3. Circular to Licensed Corporations - Investor Leaflet "How to Make a Complaint" (24.04.2007)
4. Circular to Licensed Corporations which are Participants of the Stock Exchange of Hong Kong Limited and/or Hong Kong Futures Exchange Limited - Fidelity Insurance for Exchange Participants (04.04.2007)
5. Circular to Fund Management Companies of SFC-authorized Funds - Streamlined Measures for Processing UCITS III Schemes with Special Features (30.03.2007)

SFC consults on position limits

The SFC proposes to introduce greater flexibility to the holding limits of Hang Seng Index (HSI) and H-share Index futures and options contracts, in a move to better meet market needs and promote the growth of the markets.

A consultation paper has recently been published discussing proposed amendments to the Securities and Futures (Contracts Limits and Reportable Positions) Rules, and to the Guidance Note on Position Limits and Large Open Position Reporting Requirements.

It is proposed that the SFC be empowered to authorise Exchange Participants or their affiliates to exceed the position limits for HSI and H-share Index futures and options contracts by up to 50% provided such excess is needed to serve clients' needs.

The SFC believes the proposed change will facilitate greater transparency and enable the SFC to better assess the potential implications for market stability, and help maintain Hong Kong's leading position in the face of competition from other exchanges keen to develop derivative products on Mainland related equities.

The amendments are also in line with measures proposed in the Report of the Focus Group on Financial Services under the Economic Summit on "China's 11th Five-Year Plan and the Development of Hong Kong".

The public is invited to submit comments by 18 June 2007. The consultation document is available at the SFC office and on the SFC website.

Authorisation of UCITS III funds simplified

The SFC has streamlined the authorisation process of UCITS III funds with special features including UCITS III funds of funds, guaranteed funds and index funds. This aims to facilitate the processing of a growing number of authorisation applications for these funds.

The SFC now accepts and processes applications for authorisation in respect of UCITS III funds from Luxembourg, Ireland and the UK with special features that fall under Chapter 8 of the Code on Unit Trusts and Mutual Funds on the basis

that, in substance, these funds already comply with the code. UCITS III funds seeking SFC authorisation are primarily from the above three jurisdictions. Those domiciled in other jurisdictions will continue to be considered on a case-by-case basis.

The SFC believes that investors would benefit from having more investment choices of SFC-authorized funds. The SFC has issued the details of the streamlined measures in a circular to fund management companies.

For details, see the circular issued on 30 March 2007.

Significant increase in exchange-traded funds

The number of exchange-traded funds (ETFs) authorised by the SFC has been substantially increased to 15 with the recent approval of six products, including the first ETF that tracks an index on commodities futures.

The SFC has in recent years facilitated the introduction of ETFs which cater to the needs of the market. These include the first ETF in Hong Kong tracking the performance of the China A-share market in 2004, Asia's first bond index tracking ETFs in 2005 and the first ETF in Hong Kong tracking the India stock market last year.

The ETF that tracks an index on commodities futures provides a convenient and efficient way for investors to gain exposure to the commodities market, an asset class that was previously difficult to access. The SFC will work closely with the industry to enhance investors' understanding commodities-related products. Frequently asked questions (FAQs) on these products are available on the InvestEd website at www.InvestEd.hk.

SFC reviews Unit Trusts Code

The SFC has commenced a review of the approval process for marketing materials of SFC-authorized funds as part of the ongoing initiative to facilitate development of the fund industry and to reduce the regulatory burden on the market.

A working group has been formed with industry representatives and the Hong Kong Investment Funds Association to review the advertising guidelines in the Code on Unit Trusts and Mutual Funds and to consider streamlining the authorisation process of marketing materials.

The SFC has also recently engaged an external consultant to study the retail funds authorisation regime and processes in overseas jurisdictions. The study will allow the SFC to benchmark Hong Kong's regime and to ensure the regulatory environment is appropriate for Hong Kong's role as an asset management hub in Asia.

Robust IPO performance

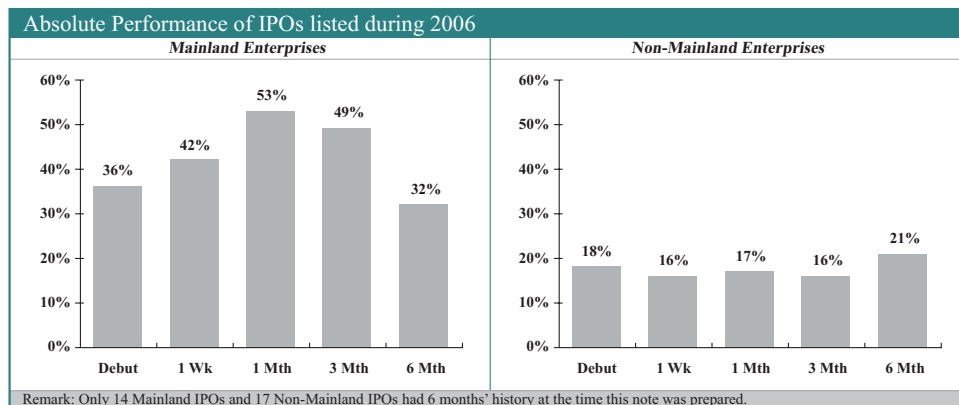
Prices of IPO stocks last year gained an average 26% on debut and nearly one-third a month after listing, according to an SFC information note. The average gain of the 59 IPOs was 28% higher than that of the HSI one month after their listings.

Although the overall performance of IPOs during 2006 was strong, nine IPOs traded below their IPO prices and 12 IPOs underperformed the HSI one month after their listings, according to the note entitled "IPO Activities during 2006 and their Performance".

However, investors must not get carried away by the strong performance of IPO stocks in 2006, and that "bumper" year might not be indicative of future performance. Also, the underperformance of some IPOs should remind investors that they need to consider the downside risks, even in a bumper year.

There appears to be no direct relation between IPO performance and size of company or the sector it belongs to. However, the average performance of IPOs of Mainland enterprises (i.e. H-shares and red chips) was significantly better, reflecting the strong investor interest in these stocks and the robust economic growth in the Mainland.

For details of the information note, see "Research and Statistics" on the SFC website.



Preventive measures against multiple IPO applications

A new measure to deter multiple applications for IPOs was implemented on 2 April.

In the past, the 5th and 6th digits of applicants' identity numbers printed on the refund cheques for unsuccessful IPO applications were masked. However, it was noted that some applicants had attempted to circumvent the arrangement and submitted multiple applications.

To enhance the integrity of the IPO application process, the SFC, the Federation of Share Registrars Limited, the Hong Kong Monetary Authority, and the Hong Kong Association of Banks

have worked closely together to devise the new measure.

The positions of the two masked digits in each IPO are now randomly selected. People submitting multiple applications will encounter difficulties in depositing and encashing refund cheques bearing an identity number which is different from their own.

The SFC will continue to monitor the effectiveness of the new measure and work with the industry to identify ways to further improve the operation and the integrity of the IPO application process.



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.

Investor Alert Updates:

36 unlicensed companies have been added to the Alert List: "Apex Trade Group Pte Ltd", "Art Max Technology Limited", "Ashton Trading Worldwide Limited", "Asiaclear Trading Limited", "Balesc Holdings Limited", "Carver Brooks and Associates Limited", "Cromwell Associates Pte Ltd", "Crown Lane Limited", "Eagle Faith Corporation Limited", "Global Wealth Corporation Limited", "Harvard Moore Pte Ltd", "Jade Dragon Fund Limited", "Leberman Steine Limited", "McBain Baxter Holdings Pte Ltd", "Montesiore & Lutz Limited", "Morley Thompson", "Nelson Burke Holdings Limited", "Phoenix Biologicals Inc. Ltd", "Phoenix Biologicals Limited", "Pollack Quinn", "Premium Placements Holdings Limited", "Prime Source Limited", "Sinoclear Trading Limited", "State Capital Limited", "Stratford International Limited", "The Danier Group Limited", "The Roth Group Limited", "Valesc Holdings Limited", "Warner Beck Pte Ltd", "Wessner Group Limited", "Winsdor Capital Limited", "World Ever International Limited", "Yardly Holdings Limited" (15.05.07); "Grand Capital Incorporated" (08.05.2007); "Olympia King Wealth Group" (02.04.2007); "Shixin Investments Holdings Ltd" (27.03.2007).

Dr Wise's Column:

"Dating with Callable Bull / Bear Contracts" (24.04.2007) and "Pump and Dump Schemes" (27.03.2007).



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".

1. A Consultation Paper on Proposed Amendments to the Securities and Futures (Contracts Limits and Reportable Positions) Rules and Proposed Corresponding Amendments to the Guidance Note on Position Limits and Large Open Position Reporting Requirements (18.05.2007)
2. Takeovers Bulletin (17.05.2007)
3. How to Make a Complaint (24.04.2007)
4. SFC Enforcement Reporter - April 2007 (23.04.2007)
5. SFC Enforcement Reporter - March 2007 (22.03.2007)



How to make a complaint

“Frank worked in a listed company. One day, he noticed that Alex, a senior executive of his company, traded the company’s shares before the announcement of its impressive annual results. He suspected that Alex was conducting insider dealing and had made profits by buying the shares before the announcement and selling them at higher prices afterwards. Frank reported the case to the SFC.”

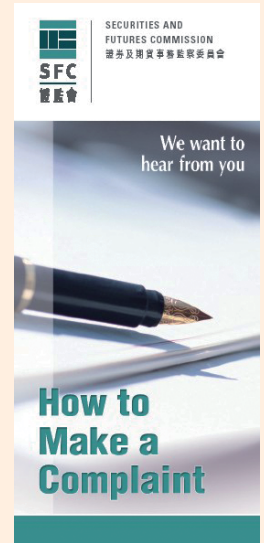
Insider dealing and other types of misconduct could well be taking place around you. By reporting any malpractice that you happen to notice, you can assist the SFC in maintaining the fairness and integrity of the securities and futures markets.

Our assessment of complaints received focuses on determining whether the target of a complaint has breached the rules or regulations the SFC administers. The SFC can investigate complaints and prosecute or discipline wrongdoers.

The public should report to the SFC cases of misconduct including unlicensed trading or advising; unauthorised trading, misappropriation and mis-selling; market manipulation and insider dealing; sale of unauthorised investment products to the public; and breaches of the Takeovers Code.

When making a complaint, you should give your contact details so that where necessary we can ask you for more information or clarify the nature of your complaint.

For more details about making a complaint with the SFC, read “How to Make a Complaint” under the “Publications” section on our investor portal, the InvestEd website (www.InvestEd.hk).



In brief

- The SFC has started its first 30-minute weekly radio programme, “**Investing 101**”, on Commercial Radio One to enhance the public’s risk awareness in investment. The programme covers some of the hottest questions raised by investors, such as IPOs and structured products. Market professionals and SFC representatives give investor education advice, and at the end of the show the first caller who correctly answers a question related to the episode will receive an SFC souvenir.
- Highlights of the Cantonese TV drama series “**Wising up with Experience**” are being screened on the 1,200 buses operated by KMB and Citybus. Adapted from real-life stories, the TV series warns investors against malpractices, reminds investors of the importance of knowing their brokers and clarifies misconceptions on derivative warrants. An English-dubbed version of the series can now also be viewed in the “Studio” section of the InvestEd website.
- 14 new **animation videos** are now available under the “Features & Dr Wise” section of the InvestEd website to complement the existing educational text on IPO subscription, company announcements and annual reports, bonds, real estate investment trusts, options, etc.
- The Report on the SFC’s 2006 **Annual Review of the Exchange’s Performance** in its Regulation of Listing Matters was published by the Government in April. The exchange’s operational procedures and decision-making processes were considered appropriate to enable the exchange to maintain an orderly, informed and fair market in 2005. The SFC also recommended the Exchange to review certain areas to enhance its performance. The report is available on the SFC website.



Recruitment

The following SFC positions are open. For application and details of the openings, please visit the Employment Opportunities section of the SFC website.

- **Assistant Counsel - Legal Services Division**
- **Manager - Information Technology**
- **Temporary Clerk**



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 and Enforcement Reporter. Questions and comments can be sent to sfcalert@sfc.hk and enforeporter@sfc.hk respectively.

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