

A landmark law

Standby for the most significant legislative reform in the history of securities regulation in Hong Kong - the Securities and Futures Ordinance

The Securities and Futures Ordinance (SFO), which consolidates and modernises the 10 existing ordinances regulating the securities and futures markets, was passed by the Legislative Council on 13 March 2002. As a result, Hong Kong's financial regulatory regime is poised to enter a new era.

Representing the culmination of nearly a decade of hard work, the SFO ensures Hong Kong's market regulation is on a par with international best practices, affording appropriate protection for investors on the one hand and leaving enough room for market development on the other.

Subsidiary legislation

The SFO was gazetted on 28 March 2002. We hope that the new legislation can be brought into operation before the end of the year. The SFC is consulting the public on 38 pieces of subsidiary legislation. About two thirds have been issued for public consultation and the rest will be released shortly.

After evaluating the comments received during consultation and making necessary amendments, the subsidiary legislation will be presented to a LegCo House Subcommittee for review. Once the Subcommittee has cleared each draft it will be gazetted and must pass the formal negative vetting procedure in LegCo. We expect the whole process will be completed by the end of this year. The SFO can be commenced when all the necessary subsidiary legislation is passed. In the meantime, the SFC will be amending the relevant

codes and guidelines and developing new regulatory forms in preparation for commencement of the Ordinance.

The SFO online

The SFC will create on its website (www.hksfc.org.hk) by the end of April a new "one-stop shop" section grouping together all SFO-related materials. It will include a link to the full text of the SFO on the Government website; various consultation and conclusions papers on subsidiary legislation; a derivation table which indicates from where in current legislation the various sections of the SFO have been derived; and all related press releases. Other information including updates and news on industry education leading up to the commencement of the SFO will be added in the future. With the launch of this new section, the public can simply click on an icon entitled "Securities and Futures Ordinance" on the homepage and learn all the essentials about this significant piece of legislation.

To learn more about the SFO, look for this icon on the SFC Website. ◆◆◆



The Path to Enactment

In March 1999, the then Financial Secretary Mr Donald Tsang announced in his Budget legislative reform of Hong Kong's securities and futures markets aimed to enhance investor protection and Hong Kong's competitiveness as an international financial centre.

The Securities and Futures Bill was published as a White Paper Bill for public consultation in April 2000. Taking into account comments on the White Paper Bill, a Blue Bill was gazetted in November 2000 and introduced into the Legislative Council in the same month.

A total of 55 submissions on the Blue Bill were made by 21 organisations and four individuals. About 140 hours were devoted to discussion of the Bill in 55 formal Bills Committee meetings. A total of about 300 papers explaining the Bill and its companion Banking (Amendment) Bill or providing relevant information were prepared by the Administration and put before the Bills Committee. More than 500 committee stage amendments were formulated to address technical and policy issues.

Briefing sessions

The SFC is committed to working with the industry to ensure a smooth transition to the new regime. Staff of the Commission have taken the opportunity to explain to market practitioners the various items of subsidiary legislation under consultation so as to enhance the market's understanding of them and to encourage responses from the industry. More briefing sessions will be planned for different stakeholder groups before the commencement of the SFO.

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Logo larceny

The SFC logo stands for independence and impartiality - it should not be used for marketing brokers' services

The SFC discovered the power of its brand in a devious way recently when it discovered that some brokerages were printing its logo on their name cards to advertise their SFC licensee status. The SFC returned the compliment with a warning letter to the firms involved.

The SFC has spent more than 10 years building a reputation for itself as an impartial and fair regulator of Hong Kong's capital markets. It does not endorse or promote any one market intermediary over another.

The logo was used by the brokers without authorisation from the Commission.

SFC licensees should refrain from using the SFC logo on their name cards or any other publications as the logo is a key component of the SFC's independent identity. It should not be used to indicate an intermediary's licensee status. Licensees are reminded that any unauthorised use of the SFC logo will be taken seriously by the Commission.

The investing public can easily verify the licensee status of an individual or a corporation by checking the public register on the SFC website.

Beware of fakes

Investors and intermediaries should be on their guard against fake financial instruments

Compared with banknotes, financial instruments such as share certificates and certificates of deposit are relatively easy to forge. With the recent discovery of a suspicious certificate of deposit bearing the name "Asia Funds Investment", the SFC would like to warn investors and intermediaries to be cautious when handling any suspected fakes.

The depositor's address on the certificate is located in Panama and it is stamped with an incomplete company name similar to an SFC registrant. Some financial intermediaries received overseas enquiries requesting details of the certificate and a person purporting to be a walk-in client even tried to discount it. The person could not be located afterwards and it is unknown whether that person is a swindler or a victim who purchased the certificate.

Be a smart investor

With some simple do's and don'ts, investors will be able to minimise the risk of being duped by fake financial instruments. If you are approached by someone trying to sell you a financial product:

- do ask the features, risks of the product and verify its authorisation status;
- do check whether the selling party is an SFC registrant; or whether it is registered in any other jurisdiction;
- do seek a second opinion from other market professionals if in doubt;
- do look for incomplete or suspicious names of issuer, sponsor and guarantor on the financial instrument. They may be a clue to something dubious;
- do not make any payment until you are sure

of its registration status and the authenticity of the product;

- do ask for more details on the product offered, e.g. fact sheets or offering documents.

These precautionary measures in fact led to the discovery of the suspicious certificate of deposit. The SFC received enquiries from US investors trying to verify its authenticity. The SFC found that it had no record of the product's authorisation and advised the investors to seek independent financial advice before investing in the product.

Be a watchful intermediary

It is also in the best interest of intermediaries to ensure that their staff exercise extra caution and act with due care and diligence when handling suspicious financial instruments, whether presented by clients or other intermediaries in Hong Kong or overseas. The SFC urges intermediaries who come across any suspicious financial instruments to obtain from relevant parties as much information as possible and report to the SFC. The Commission will take further action as appropriate.

The SFC also recommends intermediaries to issue clarifications and disclaimers to alert clients that they are neither the issuer nor the agent of any dubious financial instruments that emerge in the market.

Investors and intermediaries should contact the SFC if they have further questions or information on any doubtful financial instruments. Investors can call the Investor Hotline at 2840 9333 whereas intermediaries should contact their responsible licensing manager at the SFC.

ENFORCEMENT

Manipulators jailed

The first ever immediate custodial jail sentence for market manipulation demonstrates the seriousness of the offence

The share trading engaged in by Choy Wai Zak on 15 November 1999 seemed strange. He bought and sold shares of The Hong Kong Parkview Group Limited (Parkview) through two different brokers. These transactions involved no change in beneficial ownership.

On the same day, Yuen Sze Ning, accompanied by Choy, opened an account with one of the brokers used by Choy. Between 19 and 23 November 1999, they traded with each other in Parkview shares. These transactions accounted for a big portion of the total turnover of Parkview shares, and were conducted five minutes before the market close at prices higher than the last transaction price and the previous closing price.

These trading activities had the effect of inflating the price of Parkview shares and creating a false or misleading appearance of active trading in those shares. Under the Securities Ordinance, market manipulation is a criminal offence which carries a maximum sentence of two years' imprisonment and a fine of \$50,000.

The verdict

On 18 March 2002, Justice P.C. White at Western Magistracy convicted Choy and Yuen of intentionally creating a false and misleading appearance of active trading in the shares of Parkview. Choy was also convicted of effecting purchases and sales of Parkview shares which involved no change in the beneficial ownership of the shares. Choy was sentenced to four months' imprisonment on each count of conviction, to be served consecutively, and

SHORTS

- The SFC Shareholders Group held its fifth meeting in March 2002. Members discussed issues relating to "pennystocks". Members believed that in line with the need for entry requirements for initial listing, it would be useful to put in place a mechanism to sustain overall market quality. Promoting good corporate governance will also be an important aspect. For problematic companies, "warning signals" to the investing public at an early stage should be encouraged. The criteria and procedures for de-listing should also be reviewed.

- Following the ISO 9001 certification of the SFC's information technology helpdesk and computer operations in November 2000, its system development services function was also awarded the ISO 9001 certification in October 2001. The certification reflects the effectiveness of the SFC's information technology management in providing quality services and support to the business operations of the Commission and the financial community.

To ensure the quality of information technology services after certification, surveillance audits have been conducted on all services recently, with no reports of problems.

- To make the listing of derivative warrants more attractive in the Hong Kong market, the SFC has reduced the Securities (Disclosure of Interests) Ordinance (SDIO) waiver fee relating to the listing of derivative warrants.

Issuers of securities may apply for a waiver of the obligations placed on issuers under the SDIO. The fee for such a waiver was previously \$24,000. For the first derivative warrant issue launched in any calendar year, the SDIO waiver fee has been reduced by 25% to \$18,000. A further reduction to \$12,000 will be applicable for each subsequent issue relating to the same underlying company or instrument from the same issuer within the same calendar year, representing a 50% reduction.

Yuen was sentenced to four months. They were ordered to pay the SFC costs of \$39,128.

The Hong Kong courts had before only imposed fines and suspended sentences for cases of market manipulation. Justice White commented that these were serious offences which the defendants had carried out intentionally in the hope of gaining substantial profits without regard to how it would affect the financial position of the investing public. He also refused the application for suspended sentence because it would not properly reflect the seriousness of the crime or the need to sentence as a deterrent.

Choy and Yuen applied for bail pending appeals on sentence and conviction respectively. Both were granted bail.

Mr Alan Linning, SFC's Executive Director of Enforcement, reiterates that the SFC takes cases of market manipulation very seriously and market manipulators will be prosecuted.

Another successful prosecution

On 18 February 2002, the SFC also successfully prosecuted Lau Kwai Ngor for intentionally creating a false market in the share price of Perfectech International Holdings Limited (Perfectech) during the period 3 January to 18 February 2000. Lau pleaded guilty to one summons of creating a false market in the shares of Perfectech during the period and was fined \$30,000 and ordered to pay costs of \$67,424 to the SFC.

Had it not been for Lau's guilty plea and had Lau been convicted after trial, the likely penalty would have been an immediate custodial sentence, the Magistrate told the court during sentencing.

Check the list

Avoid being lured into an investment scam - always check the SFC's "Warning List" of firms offering investments without a licence

Transactions these days are rarely made face to face. The increasing sophistication of communication technology may have resulted in greater convenience for potential investors in financial products, but it has also lent a dangerous anonymity to promoters of investment scams who can sound all too convincing on the phone, but vanish into thin air as soon as investors want to get their money back.

Firms exploiting the so-called "boiler room" fraud – using high pressure sales tactics to lure investors into investment scams – always use anonymous means of communication such as

cold calls and unsolicited e-mails and faxes. They also have many ways of giving the appearance that they are legitimate, such as creating an attractive website and using an overseas address to give the impression that they have a physical presence in their supposed country of origin.

Recently, a staff member of our Enforcement Division got several junk e-mails in the form of an investment newsletter which recommended investment in stocks purported to be traded on the over-the-counter market in the US. The unlicensed firm that sent the e-mails is now included in our "Warning List" of unlicensed overseas firms – available in the "Investors Alert" section of our website (www.hksfc.org.hk) – which should be the first port of call for investors who want to check the credentials of suspicious investment promoters.

The list includes more than 50 companies and new names will be added as they come to the SFC's attention. It will never be comprehensive, however, since the companies involved in boiler room fraud regularly change their contact details. The SFC therefore also recommends that investors never invest based simply on a telephone sales pitch, or an unsolicited e-mail, fax or mail-out.

As Mr Alan Linning, the SFC's Executive Director of Enforcement, has pointed out, a wise investor always asks questions and gets written information about the company whose stock he is interested in.

"Be firm and do not be taken in by flattery or claims that you are turning down the opportunity of a lifetime. Don't be afraid to hang up."

If a cold caller contacts you, ask about the background of the person and the firm recommending the investment. Be firm and do not be taken in by flattery or claims that you are turning down the opportunity of a lifetime. Don't be afraid to hang up.

Investors should check the SFC's public register to see if the company promoting the investment is licensed in Hong Kong, or, if it is an overseas company, whether it is properly accredited in its country of origin. Investors should also report cold callers, suspicious e-mails and faxes to the SFC. Reports should include names of the callers and their firms, their contact details, the date and time of the call, and the investment products offered.

Simply call the SFC Investor Hotline at: 2840 9333, or make use of the online complaint form available on the SFC website.

Regulators learn from Enron

IOSCO has set up a committee to consider lessons learnt from the Enron collapse

Since the collapse of Enron, the global financial markets have been watching with amazement as the official inquiry pieces together the story of how employees, investors, the press and regulators, were deceived as to the financial health of the company.

The drama and sheer magnitude of the disaster, however, might just prove to be fortuitous for corporate governance reform around the globe since it has led to an unprecedented level of concern about how to close the loopholes that allowed the disaster to happen.

The International Organisation of Securities Commissions (IOSCO) Technical Committee has set up a high level sub-committee called the Chair's Committee to co-ordinate and focus its response to the regulatory issues highlighted by the bankruptcy of Enron and other high-profile business failures around the world.

The SFC participates in the Chair's Committee, which also comprises Chairs and senior representatives of securities regulators from the following jurisdictions: Brazil, Canada, France, Germany, Italy, Japan, Mexico, the Netherlands,

Portugal, the UK and the US. The Committee is chaired by Mr David Brown, who is also Chairman of the IOSCO Technical Committee.

The Chair's Committee had its first meeting on 20 March 2002 and it will continue to meet over the coming months to identify and examine strategic issues of common interest to securities regulators. This will ensure that national regulators are able to benefit from each other's experiences. It will also assist in identifying new issues for study and re-prioritising IOSCO's work plan.

Further information on IOSCO is available on its website (www.iosco.org).

REGULATORY UPDATES

Guaranteed disclosure

The SFC strengthens provisions for guaranteed funds

Following the introduction of the new eligibility criteria for guarantors of guaranteed funds in January 2002 which took effect immediately, the SFC published on 21 March 2002 the revised provisions for guaranteed funds in the Code on Unit Trusts and Mutual Funds.

The revised provisions formally incorporate the new guarantor eligibility criteria into the Code and at the same time enhance the disclosure requirements of the offering documents and advertisements with an aim to increase investor protection.

Guaranteed funds are collective investment schemes where a guaranteed amount will be paid to investors who hold units/shares in the scheme at a specified date in the future.

Given the sluggish stock market turnover and the prevailing low interest rates, it is perhaps no surprise that guaranteed funds are becoming increasingly popular in Hong Kong. In mid-March 2002, there were 68 SFC authorised guaranteed funds, with a total net asset value exceeding HK\$40 billion.

Quality information disclosure

The revised provisions codify the existing disclosure practices, which require detailed disclosures in the offering documents and advertisements as follows:

- **Guarantor** – Information about the guarantor, such as its name, nature of its business and information on its financial position should be provided;
- **Guarantee** – As the primary purpose of investing in a guaranteed fund is to participate in the guarantee, it is important that the offering documents clearly state the terms of the guarantee, the requisite conditions for eligibility, as well as the circumstances for variation or termination of the guarantee. An illustration to demonstrate the mechanism of the guarantee should also be included;
- **Underlying investments** – Given the increasingly complex investment strategies now adopted by guaranteed funds, the offering documents should include a more detailed description of the underlying investments, including the counterparties and nature of the investments;
- **Risk warning statements** – The offering documents must also carry statements on

investment risks and counterparty risks. Special features with respect to fees charging should also be brought to the attention of the potential investors; and

- **Reference to offering document** – It may not be practical to impose all the above disclosure requirements on advertisements. So, to ensure that potential investors obtain sufficient information on the guaranteed funds, advertisements should direct readers to the offering documents for details.

Suitable guarantor

The new eligibility criteria introduced in January specify that the guarantor of a guaranteed fund must be either a licensed banking institution authorised under the Banking Ordinance, or an authorised insurer authorised under the Insurance Companies Ordinance. The SFC will consider other substantial financial institutions to be guarantors on a case-by-case basis, subject to the presence of sufficient regulatory supervision and acceptable financial standing.

The revised provisions have been positively received and supported by market practitioners and it is expected that market participants will encounter no compliance difficulties.

The SFC has incorporated the revised provisions, which come into effect immediately, into Chapter 8.5 of the Code on Unit Trusts and Mutual Funds. A copy of the Code is available on the SFC website (www.hksec.org.hk).

Test yourself

How much do you know about investing? Join the quiz to find out

What should you do if you receive a statement of account that is handwritten? Is a contract note a proof of your shareholdings with a broker? What are the differences between a cash account and a margin account? Are your stocks still deposited with your brokers if you, as a margin client, have not borrowed any money from the broker? If you know the answers, join a radio quiz competition and you may win cash prizes.

Members of the public who know their rights and understand their responsibilities when investing in stocks, funds and warrants have a chance to collect cash prizes totalling \$12,000 in a radio quiz competition jointly organised by the SFC and Radio Television Hong Kong (RTHK).

The competition was launched in March 2002. It was originally scheduled to run for five weeks in the "Investment Life Show" section of the "Bucket of Gold" programme on the Cantonese speaking RTHK Radio 1 (FM 92.6 or 94.4). Due to the audience's overwhelming response to the competition, the SFC and RTHK have decided to extend the programme until 17 May 2002. Winners of the competition will receive a cash prize of \$500, and runners-up will get a handsome SFC corporate briefcase.

The "Investment Life Show" is aired every Monday, Wednesday and Friday between 12:30–1:00 pm. It is simultaneously broadcast on RTHK's website (www.rthk.org.hk).

You can participate in the competition by calling RTHK during show time at: 187 2311.

Submission deadlines

Consultation Papers on:

| | Closing Date |
|--|---------------|
| The Securities and Futures (Information) Rules | 16 April 2002 |
| The Securities and Futures (Contracts Limits and Reportable Positions) Rules | 16 April 2002 |
| The Securities and Futures (Leveraged Foreign Exchange Trading - Arbitration) Rules | 16 April 2002 |
| The Securities and Futures (Associated Entities) Rules | 19 April 2002 |
| The Securities and Futures (Gold Purchase) Notice | 22 April 2002 |
| The Securities and Futures (Registration of Commission Disciplinary Orders) Rules | 24 April 2000 |
| The Securities and Futures (Investor Compensation) Rules | 25 April 2002 |
| The Securities and Futures (Investor Compensation - Compensation Limits) Rules | 25 April 2002 |
| The Securities and Futures (Transfer of Functions - Investor Compensation Company) Order | 25 April 2002 |
| The Securities and Futures (Investor Compensation - Miscellaneous) Rules | 25 April 2002 |
| The Securities and Futures (Levy) Order and the Securities and Futures (Levy) Rules | 30 April 2002 |

Please refer to the Consultation Papers for the submission methods.

Securities and Futures Commission

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