



A new chapter

The Securities and Futures Ordinance will bring Hong Kong in line with international standards

The Securities and Futures Ordinance (SFO) is expected to commence on 1 April 2003, opening a new chapter in Hong Kong's regulation of the securities and futures market.

The Secretary for Financial Services and the Treasury, Mr Frederick Ma, announced the target date earlier this month. He said: "The new regulatory framework is on par with prevailing international standards with necessary adjustments to meet local market needs. It also brings clarity and convenience, facilitating both compliance and enforcement."

The largest ordinance

Enacted last March, the SFO modernises and consolidates 10 existing ordinances governing the securities and futures market into a composite piece of legislation. In fact, it is the largest ordinance on the statute book.

A total of 40 items of subsidiary legislation are required to enable commencement of the SFO. Nearly all of these have gone out to public consultation and have been considered by a Legislative Council Subcommittee. 37 sets of the subsidiary legislation have been published in the Gazette* and they are now subject to negative vetting by the Legislative Council.

Preparing the SFC and the industry

The SFC welcomes the Government's announcement of the target date. Mr Andrew

Sheng, SFC Chairman, said: "A law is only as good as the ability of the regulators to enforce it and the readiness of the market participants to comply with it." Therefore, the SFC has during the past year trained its staff and modified its systems to ensure we can work with the industry to implement the new law.

Since the enactment of the SFO in March, the SFC has also organised or taken part in 37 training sessions on the law for more than

SFST Mr Frederick Ma: "The new regulatory framework is on par with prevailing international standards ..."

7,900 intermediaries and other market participants. Early next year, the SFC will hold more seminars to familiarise the industry with the SFO-related subsidiary legislation.

If intermediaries or market participants anticipate any difficulties in complying with the legislation, they should act immediately to rectify the problems. The SFC stands ready to provide guidance.

Co-operation with HKMA

In the meantime, the SFC and the Hong Kong Monetary Authority (HKMA) have signed a new Memorandum of Understanding (MOU). This

replaces the MOU signed in October 1995 and sets out the respective roles and responsibilities of the SFC and HKMA in the regulation and supervision of Registered Institutions and their relevant staff. Registered Institutions are authorised institutions under the Banking Ordinance (most of them banks) which are registered with the SFC to conduct regulated securities activities.

Instead of being exempt dealers under the current legislation, authorised institutions will be required to seek registration from the SFC under the SFO in order to carry out the regulated activities.

Mr Joseph Yam, Chief Executive of the HKMA, said: "While the HKMA will remain the frontline supervisor of Registered Institutions, the regulatory standards set by the SFC in relation to the conduct of regulated activities will be applied to these institutions."

The commencement of the SFO will go a long way in levelling the playing field for intermediaries in the securities market, including the banks and brokers, while preserving the choice for investors and securing a reasonable level of protection for them.

* A table showing the 37 sets of subsidiary legislation gazetted so far is available on page 4. See also "The new law and you" on page 4 to find out how the SFO benefits investors.

CONTENTS

• A new chapter	P.1
• A message from the editor	P.1
• Easier entry to industry	P.2
• Fund questions answered	P.2
• Proposed conduct code revisions	P.2
• Getting ready for hedge funds	P.3
• Next generation investors	P.3
• Observe the rules or face discipline	P.3
• The new law and you	P.4
• SFO subsidiary legislation	P.4

A message from the editor

Dear Reader,

The SFC started publishing a monthly newsletter, the *SFC Enforcement Reporter*, in November 2002. It summarises the prosecution and disciplinary cases from the previous month and discusses their significance.

With the launch of the *SFC Enforcement Reporter*, we have also been reviewing the publication of the *SFC Alert*.

After consulting with readers and in line with the positive responses received, we have decided to change the *SFC Alert* to a bi-monthly publication, so as to concentrate our resources on bringing you the best articles and most useful information.

The *SFC Enforcement Reporter* will continue to be published monthly, providing you with the latest updates on the Commission's enforcement work.

The next issue of *SFC Alert* will be published in mid-February 2003.

If you are currently receiving *SFC Alert* electronically, we will also send you the *SFC Enforcement Reporter* via email (the SFC does not print the newsletter). Please let us know if you do not wish to receive it. If you are not currently receiving the electronic version of these two publications and would like to do so, please email us at ckchan@hksfc.org.hk.

We look forward to your continuing support of the publications.

Easier entry to industry

The SFC publishes new guidelines for exemptions from recognised industry qualification and local regulatory framework paper requirements

To make it easier for people to enter the securities and futures industry, the SFC has recently published new Guidelines for Exemptions from the Recognised Industry Qualification and Local Regulatory Framework Paper Requirements.

The Guidelines allow greater flexibility for new entrants, without compromising investor protection.

The SFC introduced the competence requirements in April 2001 to ensure that licensed persons are adequately equipped to carry out their functions and are aware of their legal responsibilities.

Applicants for SFC licences have to demonstrate competence by obtaining recognised industry qualification and by passing a local regulatory framework examination as specified in the Guidance Note on Competence.

Examples of Recognised Industry Qualifications include the Hong Kong Securities Institute's HKSI Diploma Programme Examination. Specific overseas courses and examinations are also recognised. As for Local Regulatory Framework Paper, the HKSI Financial Market Principal Programme Examination is an example.

The SFC believes that an applicant may be considered for licensing even without the recognised industry qualification and taking the applicable local regulatory framework paper. The SFC will take into account the following factors:

- the applicant's academic achievement
- years of relevant work experience
- scope of his/her responsibilities
- the internal control system of the applicant's firm and the compliance support in place

In general, experienced practitioners and

applicants who attended university courses in designated fields may apply for exemptions from industry qualification. Industry veterans with sound compliance support may apply for exemption from the local regulatory framework paper.

Meanwhile, requirements for representatives seeking additional licences for different product categories are relaxed. Previously, they would have to take the applicable regulatory framework paper, but they may now apply for exemption under the Guidelines.

It should be noted, however, that all individual applicants seeking exemption from the local regulatory framework paper have to fulfil, among other things, an additional five hours of Continuous Professional Training in the specific area.

The SFC may also put conditions on the firm and the applicant, or ask for undertakings.

As always, the SFC will work in partnership with the industry to facilitate compliance and to lower compliance costs. We hope that the above measures will attract more talented people to join the industry and to enhance Hong Kong's position as a major financial centre.

For details of the exemption criteria and other points to note, please refer to the Guidelines for Exemptions from the Recognised Industry Qualification and Local Regulatory Framework Paper Requirements, available on the SFC website under the section of "Intermediaries, Licensing and Investment Products - Licensing Related Matters".

Proposed conduct code revisions

On 21 November 2002, the SFC published a consultation paper on the proposed revisions to the existing Code of Conduct for Persons Registered with the SFC. The Code, as revised, would form part of the proposed amendments necessary for transition to the Securities and Futures Ordinance (SFO).

These revisions were proposed to rationalise the Code with the SFO and its subsidiary legislation and to create a uniform Code of Conduct for all intermediaries (including authorised institutions registered with the SFC

and licensed leveraged foreign exchange traders) and their representatives. Only minimal changes were proposed.

The consultation period ended on 21 December 2002. We will carefully study the submissions received and publish a consultation conclusion to summarise the market comments and the Commission's responses.

The new Code is expected to come into effect on 1 April 2003.

Fund questions answered

SFC publishes new FAQs and standard forms to help industry compliance

Whether you're a fund manager seeking SFC authorisation for your funds or an investor looking for more information on how we regulate the fund industry, you'll find the SFC's new set of Frequently Asked Questions (FAQs) a useful point of reference.

The FAQs deal with fund authorisation procedures and criteria, and on-going compliance issues under the Code on Unit Trusts and Mutual Funds. They aim to help existing industry practitioners, potential fund applicants, and investors understand the Code's requirements for funds.

For example, you can find out in the FAQs whether a fund can be domiciled in an overseas jurisdiction and how the "Acceptable Inspection Regime" concept works in our regulation of funds. You can also learn about procedures for seeking fund authorisation and the various levels of fees.

The publication of the FAQs is part of the SFC's on-going effort to improve communication with market participants and to increase the transparency of its fund authorisation work.

In fact, since September this year, the SFC has been streamlining its fund authorisation procedures. Our Investment Products Department is actively engaging the fund industry and the investing public in open dialogue to find the best way forward.

To further facilitate compliance, the SFC has also published standardised forms to assist fund managers in reporting to the SFC ongoing compliance matters such as mergers of funds or pricing errors.

These forms are now available on the SFC website and should help fund managers prepare their submission of information to the SFC when necessary.

Ms Tina So, Director of Investment Products, says that market participants should use the FAQs as the first port of call to obtain a basic understanding of our procedures and requirements. The FAQs are not designed to be exhaustive, so prospective fund applicants are encouraged to contact us for further information and clarification regarding their application.

The SFC is happy to answer enquiries from market participants. Investors are also welcome to contact us at our Investor Hotline.

The FAQs and compliance forms are available on the SFC website at www.hksfc.org.hk, under the section "Bills, Legislation and Codes - Regulatory Handbook - Volume 2, Part C".

Getting ready for hedge funds

The SFC sets out guidelines for the on-going reporting requirements of hedge funds

Hong Kong is one of the first jurisdictions in the world to introduce hedge funds to the investing public. The SFC has by now authorised several hedge funds, following the introduction of the Hedge Funds Guidelines for authorisation earlier this year.

In addition to the authorisation guidelines, the SFC has also recently published the Guidelines on Hedge Funds Reporting Requirements. The aim of these ongoing disclosures requirements by hedge funds is to give investors accurate and relevant information with which to manage their investment and make informed decisions.

The Reporting Guidelines have been prepared in consultation with the market. Alexa Lam, Executive Director of Intermediaries and Investment Products, said: "We have actively engaged the industry in finalising the Guidelines. With the help of industry input, we believe the Guidelines strike a proper balance between investor protection and market development. We will continue to maintain a close dialogue with the industry and seek ways to enable Hong Kong to continue to grow as Asia's premier fund management centre."

The reporting requirements

A hedge fund manager has to publish three periodic reports; namely annual, semi-annual and quarterly reports under the hedge funds reporting requirements. Disclosures in terms of types of assets, geographical distribution or strategies used are required. Investors of a single hedge fund will be able to see the fund's top five long positions and top five short positions from the fund's semi-annual and annual reports. If it is a fund of funds, the top five underlying funds will be shown.

Taking into account market comments, the SFC

will not mandate the use of International Accounting Standards (IAS). However, the Guidelines require hedge fund managers to provide qualitative information and commentaries explaining the market outlook and important risk factors to the fund. Managers are also required to present standardised performance statistics and risk measurements so that investors can easily make comparisons and gain a more consistent overview of a fund's operations.

Conduct on fund marketing

In the meantime, the SFC has issued a Circular to Registered Persons Regarding the Marketing of Hedge Funds to remind financial intermediaries of their obligations to assess whether hedge funds are suitable for their clients. The Hong Kong Monetary Authority has also issued a Circular to those it regulates, to remind them of the requirements in this regard.

Investor education

To help investors understand more about hedge funds, the SFC has published a new leaflet entitled "Ten Questions to Ask Before Investing in a Fund". It offers a checklist of questions that investors should always ask before investing in a fund and, in particular, before investing in hedge funds. This leaflet complements the leaflet entitled "How Much Do You Know About Hedge Funds?" published earlier this year.

Mrs Lam also issued an open letter to investors explaining in plain language the major features of the hedge funds reporting requirements.

The above Guidelines, SFC circular, leaflets and open letter are all available on the SFC website. Additional educational articles on hedge funds are also available on the SFC-operated Electronic Investor Resources Centre at www.hkeirc.org.

Next generation investors



A free teaching kit given to participants of the teachers workshops

The SFC believes that smart investors are those who learn everything they can about investment. To this end we have worked hard to impress the right investment attitude on the public and provide them with relevant investment knowledge.

We would particularly like to groom youngsters in the field of smart investment and, to reach them, we need to enlist the help of teachers. We have been organising workshops for secondary school teachers since 2000 to encourage them to share with their students the key concepts of investing.

These workshops aim to help secondary school teachers of Economics, Commerce and related subjects become more aware of the latest market developments and investment products so as to facilitate their teaching work.

The latest series of 11 workshops was completed in early December, covering the areas of stocks, funds, and options & futures. About 500 teachers enrolled in the workshops and they all received a free teaching kit and other SFC investor education materials to generate discussions in class.

All the materials used in the workshops are now available on the "Advice to Investors - Teachers' Corner" section of the SFC website.

ENFORCEMENT

Observe the rules or face discipline

• From time to time, the SFC may grant licences to financial intermediaries with strings attached. Taking into account the specific circumstances of each licence application, we may impose conditions on a licensee to protect the interests of investors and the market.

This means that what one licensee is allowed to do under his/her licence may be different from others similarly licensed. It is important that SFC licensees comply with the conditions imposed.

However, Lou Tak Ki, a licensed leveraged foreign exchange trader's representative,

registered investment representative and commodity dealer's representative, breached the licensing condition which disallows him from conducting discretionary forex trades. He also signed as a witness on the account opening documents for two clients even though he was not present at the signing.

The SFC has suspended Lou's licence and registrations for three weeks, due to these breaches.

• Under the Code of Conduct for Persons Registered with the SFC, if a licensee is to conduct discretionary trades for a client, written authorisation must be obtained from the client in advance.

Verbal authorisation is not acceptable because it cannot provide sufficient protection to both the client and the licensee when disputes arise.

Between October 2001 and February 2002, Tsui To Kwong, a dealer's representative of Phillip Securities, breached the Code of Conduct by conducting more than 20 discretionary trades in a client's account without the client's written authorisation.

What's more, Phillip Securities prohibited staff from exercising discretion for clients. In other words, Tsui also violated his employer's internal policies.

As a result, the SFC has reprimanded Tsui.

The new law and you

What does the Securities and Futures Ordinance mean to you as an investor?

The Securities and Futures Ordinance (SFO) and its subsidiary legislation aims to protect your interests and defend your rights through the introduction of a number of key initiatives.

New and improved investor compensation arrangements: A new single Investor Compensation Fund will be established, based on a per-investor compensation limit of \$150,000. Coverage will be extended to an increased number of intermediaries, including both exchange and non-exchange participants, banks and securities margin financiers.

More transparent market disclosure: The disclosure threshold for shareholders (who are not directors of the company) will be lowered from 10% to 5%, and the time limit for disclosure by shareholders and directors will be reduced from five days to three business days.

Combating market misconduct: A Market Misconduct Tribunal (MMT) will be set up to handle civil cases of all forms of market misconduct. It will examine cases on the civil standard of proof and have a range of civil sanctions. As an alternative to civil proceedings, market misconduct will be subject to criminal prosecution. Offenders face severe penalties on conviction, including up to 10 years' imprisonment or a maximum fine of \$10 million.

Redress through civil courts for market misconduct: As a shareholder you will have new statutory rights of action for damages through the civil courts if you have suffered financial loss caused by market misconduct or false or misleading public statements concerning securities or futures contracts. Findings of the MMT in relation to market misconduct proceedings will be admissible as evidence in private civil actions.

Private action for false public communication: Investors suffering a loss as a result of false or misleading public statements concerning securities made fraudulently or negligently will have a right of action against those involved in issuing such statements.

A streamlined licensing regime: There will be a universally applicable single licensing system. An intermediary may get just one licence to conduct all regulated activities such as stockbroking, giving investment advice, providing securities margin financing, asset management or providing automated trading services. You only have to check what regulated activities a licensee is allowed to conduct.

Improving the regulation of intermediaries: The SFC will be empowered to fine a rule-breaking intermediary up to \$10 million. We can also

suspend or revoke a licence in respect of only part of a licensee's business. This will result in greater flexibility in tailoring appropriate sanctions. Banks' securities businesses, their frontline and supervisory staff and others involved in management will be subject to SFC discipline, although the Hong Kong Monetary Authority will remain the frontline regulator of banks.

Enhancing the SFC's inspection and investigatory powers: Our power to obtain documents and explanations from listed companies will extend to their connected parties such as banks, auditors and transaction counterparties. We will therefore be able to conduct our inquiries more effectively. Our supervisory powers will also cover associated entities of intermediaries.

Greater accountability of the SFC: The existing checks and balances on the SFC will be enhanced. These include the establishment of the Securities and Futures Appeals Tribunal, an independent full-time appeals tribunal chaired by a judge. A wide range of our decisions will be subject to appeal before the Tribunal.

Please visit the SFC web site and our Electronic Investor Resources Centre for more information on how the SFO will benefit you.

SFO Subsidiary Legislation Gazetted as of 13 December 2002 (*S&F stands for Securities and Futures)

Gazetted on 29 November

1. S & F (Unsolicited Calls - Exclusion) Rules
2. S & F (Recognized Counterparty) Rules
3. S & F (Registration of Commission Disciplinary Orders) Rules
4. S & F (Professional Investor) Rules
5. S & F (Leveraged Foreign Exchange Trading - Exemption) Rules
6. S & F (Leveraged Foreign Exchange Trading (Arbitration)) Rules
7. S & F (Exempted Instruments - Information) Rules

Gazetted on 6 December

8. S & F (Client Securities) Rules
9. S & F (Client Money) Rules
10. S & F (Associated Entities - Notices) Rules
11. Companies Ordinance (Exemption of Companies and Prospectuses from Compliance with Provisions) (Amendment) Notice 2002
12. S & F (Collective Investment Schemes) Notice
13. S & F (Registration of Market Misconduct Tribunal Orders) Rules
14. S & F (Registration of Appeals Tribunal Orders) Rules

Gazetted on 13 December

15. S & F (Short Selling and Securities Borrowing and Lending (Miscellaneous)) Rules
16. S & F (Contracts Limits and Reportable Positions) Rules

17. S & F (Price Stabilizing) Rules
18. S & F (Disclosure of Interests - Securities Borrowing and Lending) Rules
19. S & F (Financial Resources) Rules
20. S & F (Keeping of Records) Rules
21. S & F (Accounts and Audit) Rules
22. S & F (Contract Notes, Statements of Account and Receipts) Rules
23. S & F (Investor Compensation - Claims) Rules
24. S & F (Stock Market Listing) Rules
25. S & F (Licensing and Registration) (Information) Rules
26. S & F (Miscellaneous) Rules
27. S & F (Levy) Order
28. S & F (Levy) Rules
29. S & F (Investor Compensation - Levy) Rules
30. S & F (Investor Compensation - Compensation Limits) Rules
31. S & F (Transfer of Functions - Investor Compensation Company) Order
32. Securities and Futures Ordinance (Amendment of Schedule 10) Order 2002
33. S & F (Transfer for Functions - Stock Exchange Company) Order
34. S & F (Fees) Rules
35. S & F (Disclosure of Interests - Exclusion) Regulation
36. S & F (Offences and Penalties) Regulation
37. Securities and Futures Ordinance (Amendment of Schedule 8) Order 2002

All gazetted items are available on the SFC website under the section of "Securities and Futures Ordinance".