SFC 證監會

SFC Alert

A monthly newsletter for investors and intermediaries

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SHORTS

- Individual licensees are given a one-month grace period until the end of January 2002 to accomplish the requisite continuous professional training (CPT) hours for the 2001 calendar year. With the implementation of the CPT requirement in April 2001, all individual licensees are expected to comply with 3.75 hours of training for the 2001 calendar year and five hours per calendar year thereafter. The requirements are applicable to individuals licensed under the Securities Ordinance, Commodities Trading Ordinance and Leveraged Foreign Exchange Trading Ordinance. The licensees are required to declare their number of training hours and the CPT activities in their annual returns. The SFC believes that licensed persons would be able to maintain and enhance their technical knowledge and professional expertise through CPT.
- The Financial Secretary has re-appointed Mark Dickens as Executive Director (Supervision of Markets) for a period of three years from 1 April 2002 to 31 March 2005. Mark Dickens first joined the SFC in March 1991 and was appointed Executive Director of Enforcement in January 1997. Since April 1999, he has headed the Supervision of Markets Division.
- The 52 investors who suffered losses due to the default of C K Securities Company in October 1996 received $1.96 million in compensation last month. After receiving this amount of money from the liquidation of the firm, these investors received fully the allowed amount of compensation claimed. In addition, a total of $8 million was already paid to the claimants in 1997 after the default.

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Building the third zone

Consolidation of Asian markets is vital if the region is to build a third financial time zone to rival those of America and Europe

Asia accounts for over half the world's population, one-third of global GDP and one-quarter of world exports. Countries in Asia save 25-50% of their national income, forming the largest concentration of foreign exchange reserves in the world - exceeding one trillion US dollars. Why, then, does the region only account for 16% of global market capitalisation, and why is Asia still so dependent upon growth from the US and Europe?

In a recent speech at the Asian Securities Analysts Federation 2001 Conference, SFC Chairman Andrew Sheng gave his personal views on why Asia is failing to realise its full potential in the emerging global financial network.

He noted that consolidation has become a global trend. Banks are now busy merging with insurance companies, buying up asset managers and becoming large, complex financial giants. The global economy is fast becoming a complex network trading 24 hours a day, seven days a week. The American time zone contains the largest and most important economic and capital market force in the world. In Europe, with the emergence of the Euro as the second largest currency, financial markets are beginning to consolidate with great speed.

Consolidation has the potential to create in Asia a third financial time zone of equal importance to those of the US and Europe, but the region needs to display much more unity before that becomes a reality. Sheng believes that effective consolidation will raise several issues for Asian countries:

- Common products - in order to have common products, Asian countries need to cross-list. Will Asian exchanges be willing to cross-list, allowing the same terms and conditions as domestic listing?
- Inter-operability - are Asian countries willing to share technology and standards?
- Common rules - are Asian countries willing to have common trading and clearing rules?
- Common networks and infrastructure - common networks and infrastructure will produce low transaction costs, but are Asian countries going to allow inter-connectivity? Are they willing to allow common custodians, common participants, and common intermediaries? Are they going to allow free flow of capital by residents and non-residents?

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Get registered

The SFC has secured its first successful prosecution for unregistered securities margin financing

Last month the SFC successfully prosecuted the first case of unregistered securities margin financing, 18 months after the law regulating margin financing came into effect. Roofer Finance and its managing director, Sabrina Ngan On Nang, pleaded guilty to the charge of unregistered securities margin financing in Hong Kong.

At Western Magistracy, Magistrate Ms Polly Lo fined Roofer Finance and Ngan $50,000 and $20,000 respectively and ordered them to pay costs totalling $44,050 to the SFC. Ms Lo noted that the offence had taken place over a period of five months and considered the offence to be very serious. She said that Ngan as the managing director of the company had a responsibility to know what the legal requirements were.

The requirement for those offering share margin financing services to be licensed by the SFC came into effect in June 2000 following a substantial rise in margin trading through largely unregulated finance companies. Many of these companies failed to undertake prudent risk management measures, leading to over-lending to margin clients. Under the Securities Ordinance, unregistered margin financiers are liable on conviction to a fine of $1,000,000 and to imprisonment of five years.

Investors who require margin finance should ensure they deal with either an SFC registered financier, a registered securities dealer, or an institution authorised and regulated by the Hong Kong Monetary Authority. Investors are advised to consult the Public Register of Licensed Persons on the SFC website (www.hksfc.org.hk) under the section "Intermediaries, Licensing and Investment Products" to obtain information on registered margin financiers. The register is also available for public inspection at the SFC's offices.

Stakeholder scorecard

The SFC responds to its first stakeholder survey

About 60% of the respondents to the SFC's first stakeholder survey said they do not have a full overall understanding of all the functions of the SFC. This is just one of the findings the Commission is now studying in order to improve its effectiveness as a regulator.

The landmark survey, conducted between June and September 2001, interviewed more than 300 stakeholders, including securities/futures brokers, financial advisers, asset/fund managers, insurance companies, investment banks, banks, listed companies, accounting firms, law firms, Hong Kong Exchanges and Clearing, investor advocates, financial media, LegCo aides and share registrars.

The survey respondents generally regard the SFC as approachable, easy to deal with and one of the best securities regulators in Asia. They believe that the SFC's programmes have had a positive impact on the securities and futures markets in Hong Kong. The survey also found that those with a high understanding of the SFC's programmes evaluated the SFC's overall effectiveness more favourably (6.9) than those with a lower understanding (6.1).

Know your regulator

The low level of full overall understanding of the SFC's activities was similarly related to the degree to which stakeholders deal or liaise with the Commission, with lower scores in this area coming from stakeholders who deal with the SFC on a limited and infrequent basis.

"Many of the stakeholders don't understand all the things that we do, but they do understand some of the things that we do," said Alexa Lam, the SFC's Executive Director of Intermediaries and Investment Products. "We are thankful that they have been so frank with us. The message is very clear - we must go out and tell them more about what we do. In regulating the market, we have to work in partnership with the market - we understand them and they understand us."

Since the survey was conducted the SFC has taken a number of steps, such as publishing this newsletter to get news and topical issues to stakeholders and investors in a user-friendly way and to encourage dialogue and better understanding of the SFC's thinking and philosophy. The SFC also started to publish on its website consultation responses received on its consultation papers on policies and rules. This enhances transparency and also encourages debates. To get its regulatory messages across clearly, the SFC has also refocused its press releases.

Room for improvement

The SFC is working closely with the market and other regulatory organisations to find appropriate solutions to address other findings of the survey in the most appropriate way. Chant Link and Associates Pty Ltd, the Australian market research firm appointed by the SFC to carry out the stakeholder survey, found that stakeholders generally wanted the SFC to:

- be more transparent in how it decides on policy positions following public consultation
- increase dialogue with stakeholders and make better use of existing channels to pass on its regulatory messages
- do more to enhance corporate governance in Hong Kong
- enhance enforcement
- reduce compliance costs in a number of areas, and
- focus on training its staff to meet the demands of a changing market.

The SFC intends to repeat the survey at two-year intervals with a view to tracking how stakeholder perceptions about its work and performance change over time.

A copy of the SFC Stakeholder Survey 2001 is available on the SFC website (www.hksfc.org.hk) under the section "Press Releases, Publications and Speeches".

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"If we are willing to begin this process of discussion, we will be able to build a larger pool of Asian capital," Sheng said. Failure to consolidate, however, is likely to lead to a liquidity crisis. "Fragmented Asian liquidity is now under threat. If we do not try and consolidate Asian liquidity, more and more of our liquidity will drift to other markets."

As a major step in the direction of regional consolidation, Sheng praised the concept of AsiaClear - the proposal to create an Asia-wide trading infrastructure first suggested in 1992 by Mr Hayakawa, the former Treasurer of the Asian Development Bank. The concept failed to take off largely due to misguided rivalry over where AsiaClear would be based. Sheng pointed out that AsiaClear would not require a central hub, but could enable everyone to be a hub in a network with common standards. All Asian economies would therefore benefit from its creation.

"A robust, efficient and inter-operable financial infrastructure is key to Asian market development," concluded Sheng. "If we do not develop common standards in Asia, we will all be connecting towards America or Europe. In sum, common standards and shared technology will reduce excessive fixed investments, reduce risks and promote efficient functioning of markets."

ENFORCEMENT

Crime and punishment

The Magistrates' Court has handed down its first jail sentence for market manipulation

Market manipulation is not a crime to be taken lightly. At its simplest, it involves creating a false or misleading impression about the price of a security, or futures contract, by artificially raising, lowering or stabilising that price, or creating a false appearance of active trading in the shares of a company.

Under the Securities Ordinance, the maximum penalty for the offence is a fine of $50,000 and imprisonment for two years. While the District Court has in the past imposed suspended prison sentences for cases of market manipulation, the Magistrates' Court has to date relied solely on fines to punish such conduct.

However, in a manipulation case decided last month in Western Magistrates' Court, Yeung Yik Cheung was sentenced to three months imprisonment suspended for twelve months, and ordered to pay the SFC's investigation costs of $66,080.

Yeung created a false and misleading appearance of active trading in the shares of the Good Fellow Group in August 1999. He opened accounts with four different brokers and used three of these accounts to sell Good Fellow shares, while at the same time giving a discretion to the fourth broker to trade in Good Fellow shares on his behalf which resulted in a number of "wash sales" — transactions in securities which involve no change in the beneficial ownership of those securities — between the four accounts.

Undermining the market

Magistrate C.R. Mackintosh underlined the gravity of the crime when sentencing Yeung. "The defendant must understand that market manipulation is an insidious attack on the principles of the stock exchange which relies on the forces of genuine supply and demand. Market manipulation undermines those principles and if it goes unchecked it will undermine the confidence of the public and institutions who invest and it will ultimately damage Hong Kong," he said.

Mr Mackintosh added that Yeung's offence was too serious for a fine. The imposition of fines for this offence have been regarded by some market participants as an insufficient deterrent against market manipulation.

Since 1999, the SFC has successfully prosecuted nine persons, including Yeung, in eight separate cases of market manipulation. In addition, the Department of Justice brought two market manipulators to court after an SFC investigation in the early 1990s. The District Court sentenced the two defendants to four and six months' imprisonment respectively, suspended for twelve months.

Market manipulation penalties since 1993

Magistrates' Court		
Date of conviction	**Defendant**	**Penalty**
18.12.01	Yeung Yik Cheung	Three months imprisonment, suspended for 12 months, and costs of $66,080
20.3.01	Lu Wing Lin Hung Fan Lau	Each fined $30,000 and costs totalling $23,972
16.1.01	Chan Kiu Chi	Fined $20,000 and costs of $28,600
5.12.00	Wang Fang	Fined $30,000 and costs of $51,490
31.10.00	Lo Yiu Man	Fined $45,000 and costs of $31,343
14.12.99	Ngai Man Sang	Fined $40,000 and costs of $257,987
24.8.99	Yung Wai Shun, Sidney	Fined $45,000 and costs of $45,000
3.8.99	Lau Kin Chung	Fined $80,000 and costs of $50,000
District Court		
15.6.94	Chan Kam Wing	Six months imprisonment, suspended for 12 months, and costs of $100,000
10.9.93	Wong Ho Reginald	Four months imprisonment, suspended for 12 months, and costs of $476,858

Coming soon

- Revised Takeovers Code and Share Repurchase Code
- Guaranteed fund provisions
- Boiler room updates

Thirst for knowledge

Teachers in Hong Kong get asked some tough questions on the stock market - the SFC teachers' workshops hope to ensure they have the answers

"What is market manipulation? What is margin trading? Why do some share prices rise so sharply? Are share tips in the newspapers reliable?"

Hong Kong teachers often face a barrage of tough questions relating to the stock market. This level of interest among students is not perhaps surprising in a city so preoccupied with the vicissitudes of the local stock market. Students will often have parents who are investors, and they can read about the fluctuations of markets in the media everyday.

Attendees at the SFC teachers' workshops, however, are anxious to ensure that students are properly informed about the opportunities and risks of investment. "We do not aim to familiarise our students with specific products which would probably be outdated by the time they graduate. It is more important that they know where to find the resources to do their own research and how to analyse the information they have obtained," one workshop participant said. Getting familiar with useful information resources in Hong Kong, including the SFC's own publications and websites, was therefore the most valuable part of the workshop for him.

Another participant, Ms Kwok, hoped to obtain user-friendly teaching materials in the workshops for use in student discussions. She enjoyed most the exercise on how to read fund offering documents. "It is easier for students to grasp investment concepts if we give them interesting and concrete examples. It will be helpful if the SFC can produce videos or CD-ROMS on real life situations such as the marketing of funds by bank staff, with advice on what investors should pay attention to in such situations," she said.

The latest round of teachers' workshops started in November 2001 and has 15 sessions running up to the end of January 2002. Questionnaires completed by participants of the first seven sessions show that teachers generally find the workshops useful in enhancing their understanding of investment in stocks, funds and futures. All of them have indicated that they would recommend other teachers to attend the workshops. Nearly 40% of the participants of the stock module said they liked the visit to the viewing gallery of the SEHK best.

The SFC is exploring the feasibility of producing CD-ROMS containing interactive games and multi-media materials on relevant topics. "I hope that teachers will find such interactive materials useful as tools for teaching their students about investment," said Ivy Lai, Associate Director of Investor Education and Communications. Mrs Lai said meanwhile presentation materials used in the workshops would be posted on SFC's website.

She added that the last few sessions of the funds module would include an exercise dedicated to analysing fund advertisements. The exercise will explain how funds are sold in the market and why it is not sufficient to read the advertisements alone.

Statistics on enforcement actions

	2001	2000
Successful prosecutions (persons)	47	33
SFC registrants disciplined	103	153
Warning letters issued	128	236
Cases under investigation	212	201
Disciplinary inquiries in progress	22	43

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GET THE FACTS

Derivative warrants

Recent amendments to the Stock Exchange's Listing Rules should increase the liquidity of the derivative warrant market

Following a market consultation in May last year, the Stock Exchange has introduced a new requirement for issuers of derivative warrants to provide liquidity for warrants they have listed. It is important that investors can get in and out of a warrant position quickly. Thus, the new Listing Rules changes require every issuer to appoint an exchange participant as the liquidity provider for each derivative warrant issued on or after 10 December 2001.

Each liquidity provider has a unique broker number, which will start with the number 95. These brokers are to provide liquidity by responding to requests for quotes, or by continuously inputting bids and offers into the trading system.

Normally, an issuer's obligation to provide liquidity, via the designated liquidity provider, starts from 10:05am until the market close on each trading day. A liquidity provider must meet all the requirements regarding the maximum spread, the minimum lot size (the Stock Exchange requires at least 10 board lots) and maximum response time (applicable for quote request only) spelt out in the listing document. However, the issuer may specify certain circumstances under which it can suspend its obligation to provide liquidity.

An issuer must report trading in a derivative warrant by itself and its group of companies to the Stock Exchange:

- on the first listing date of the warrant - reports trading in the grey market before listing, and
- after listing - reports all dealings in the warrant by itself and its group of companies and also provides additional information on cross trades.

The above trading information will be available from Teletext, information vendors and HKEx's website. If a warrant adopts a quote request approach and there are no bid or ask quotes provided by the liquidity provider, investors can call the liquidity provider at the phone number shown on the listing document and the relevant page of the warrant in Teletext to ask for a quote.

Strategic advice

Some tips on how to choose a derivative warrant and control risk

Derivative warrants are relatively complex investment vehicles and it is essential that potential investors know how to choose a warrant and control the risks associated with them. There can be a series of warrants on the same underlying asset, which may be provided by different issuers and carry different terms. Below are some suggestions to bear in mind before investing in derivative warrants.

- Choose the underlying asset and form your own view on its potential movement. Then pick an appropriate warrant to match your strategy. Choose call warrants if you believe the underlying asset price will go up, and select put warrants if you think the price will fall. For hedging against the downside risk of an underlying asset that you hold, choose put warrants.
- Use implied volatility, not warrant price and premium, to evaluate whether a warrant is expensive or cheap. For a series of warrants on the same underlying asset, the lower the implied volatility, the cheaper the warrant. That said, make sure the warrant you choose matches your investment strategy. It is more important to choose a warrant with a "reasonable" rather than a "cheap" price. Always remember to exercise your own judgment.
- Select a warrant that has sufficient time to expiry to match your expectations. An out-of-the-money warrant close to expiry leaves limited time for the underlying asset price to move to your expected level. It becomes worthless if it remains out-of-the-money by expiry.
- Informed investment decisions should be based on the pricing, such as the implied volatility and spread, and the terms of a warrant, not on any short-term active trading activities. A warrant with high turnover does not necessarily mean it is a good buy.
- Look behind the hype. While some warrant issuers may offer certain benefits to investors as a sweetener, make sure that the pricing is good and the terms meet your strategy. Beware of any costs hidden behind such benefits as there is normally no free lunch.
- Leverage works both ways. Remember, even though the potential gain of buying a warrant can be substantial, you can still lose your entire capital if the price of the underlying asset goes against your view.
- Be very clear when to take profit or stop loss, or when to close your position before the warrant expires. Be realistic when setting your target levels and, more importantly, act on your strategy.
- Holding too many warrants in your portfolio could expose you to undue risk. Indeed, the first step to control risk is to pre-set an appropriate proportion of your portfolio for investing in warrants, based on your investment objectives and risk tolerance.

Submission deadlines

- **A Consultation Paper on the Draft Securities and Futures (Disclosure of Interests - Securities Borrowing and Lending) Rules**

Closing Date: 26 January 2002

Address for submission via e-mail: **SBLRulesconsult@hksfc.org.hk**

- **A Consultation Document on the Draft Securities and Futures (Accounts and Audit) Rules**

Closing Date: 31 January 2002

Address for submission via e-mail: **accounts_and_audit_rules@hksfc.org.hk**

Securities and Futures Commission

12/F Edinburgh Tower, The Landmark, 15 Queen's Road Central, Hong Kong

Telephone: (852) 2840 9222 Facsimile: (852) 2521 7836 Website: www.hksfc.org.hk

Electronic Investor Resources Centre: www.hkeirc.org