

New regulatory framework Better quality of market

Implementing the Securities and Futures Ordinance is the SFC's top priority in 2003

Ensuring a seamless transition to the new regulatory framework under the Securities and Futures Ordinance (SFO) is the top priority of the SFC this year. Chairman Mr Andrew Sheng told the media last week.

Mr Sheng was outlining the priorities of the Commission's work in 2003. Besides implementing the new law, which represents significant improve-

ments in securities and futures regulation and better protection for investors, the SFC will also toughen its enforcement activities to tackle listed corporate crime and market misconduct.

"We will enforce the law to protect investors," Mr Sheng said. There will likely be more listed company investigations and enforcement action arising from dual filing. The SFC will take stern action against IPO sponsors whose work falls short of the high standards expected of them. There will also be a tougher disclosure regime for interest in listed companies under the SFO.



SFC Chairman Mr Andrew Sheng (Centre) and Executive Directors (from left) Mr Alan Linning, Mrs Alexa Lam, Mr Mark Dickens and Mr Ashley Alder outline the SFC's priorities.

Another major undertaking is moving the SFC office by the end of June 2003. No decision has been made where the new premises will be. The SFC's primary objective is to keep the rental down and at a level commensurate with the current economic environment.

In addition, the SFC will continue to work on investor education, improvement of market quality, market development and building up the infrastructure.

Mr Sheng also took the opportunity to review the work and achievements of the SFC in 2002, including the Commission's enforcement work.

The SFC started 360 inquiries in 2002, leading to five formal listed company investigations and 134 formal market investigations. The SFC also successfully prosecuted 44 persons and firms for market crimes, and conducted 81 disciplinary inquiries, resulting in eight licence revocations, 24 suspensions and 36 public reprimands.

Budget deficit contained

The SFC's stringent cost control measures pay off

By keeping a tight rein on expenditure, the SFC expects to keep the deficit for the full year within budget projection, SFC Chairman Mr Andrew Sheng said in the Commission's third Quarterly Report for the financial year 2002-2003.

Mr Sheng reported that during the quarter October to December 2002, the SFC recorded a total operating expenditure of \$97 million, \$2 million below that for July to September.

However, total income dropped to \$81.5 million from \$85.8 million owing to lower market turnover. As a result, the SFC registered a quarterly deficit of \$15.5 million, \$2.5 million higher than the previous quarter's.

The accumulated deficit for the three quarters to the end of 2002 was \$35 million, well below the projected deficit of \$87 million in the approved budget. It also compared favourably with a \$43.6 million deficit for the same period last year.

In fact, revenue for the three quarters was 6% lower than last year, at \$258.3 million. The

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Commitment to partnership

Opportunities remain in the financial services sector and the SFC is doing its best to help brokers

The SFC has been working closely with stockbrokers to enhance their competitiveness and at the same time improve the business environment. These are priorities of the SFC in 2003.

Despite the challenging market conditions, there are opportunities in the industry. The SFC notes a net increase of 25 securities advisory firms in 2002. In the futures sector, 11 dealing and 13 advisory firms entered the industry during the year.

The SFC will actively participate in the tripartite forum set up by the Government to help industry practitioners. The SFC will pursue this objective with the following initiatives:

- Market development through better corporate governance and products;

- Streamlining of regulatory requirements and facilitation of brokers' compliance;
- Ensuring a level playing field; and
- Training and continuous development.

According to an HKEx Retail Investor Survey conducted in 2001, 41% of the responding investors cited good brokerage services as the reason for using a brokerage firm. The SFC believes that brokers of all sizes will be able to find their niche and provide services tailored to the needs for their clients. The SFC will continue to help the industry as far as it can.

For details, please refer to a statement made by SFC's Executive Director of Intermediaries and Investment Products Alexa Lam on 16 January. It is available on the SFC website under the "Press Releases, Publications & Speeches" section.

Hand in hand

SFC and SEHK sign a new MOU to prepare for the dual filing regime under the Securities and Futures Ordinance

The SFC and the Stock Exchange of Hong Kong Limited (SEHK) signed a new Memorandum of Understanding (MOU) in January 2003 on their respective roles, responsibilities and supervisory relationship.

New features provided in the MOU include the dual filing arrangement and the establishment of a high level liaison group comprising senior representatives of the two regulators.

The MOU details the administrative arrangements of the dual filing regime that will come into force with the commencement of the Securities and Futures Ordinance (SFO) on 1 April. Listing applicants and listed companies will need to file listing application materials and company announcements with the SFC under the Securities and Futures (Stock Market Listing) Rules, a set of subsidiary legislation under the SFO.

The two organisations also signed a Deed under which SEHK agrees to pay to the SFC \$20 million a year, for a period of three years. This is to help cover the additional costs incurred in administering and enforcing the dual filing requirements. About 15 employees will be hired by the SFC and recruitment is under way. The SFC and SEHK will review the cost recovery arrangement at the end of the term of the Deed.

This arrangement will be cost-neutral to listed companies and the market because there will be no adjustment of HKEx's listing fees as a result of the fee reimbursement to the SFC.

The High Level Group will review systemic and policy issues concerning listing-related matters.

SFC Chairman, Mr Andrew Sheng, said that the SFC and SEHK would work closely together to implement the dual filing regime, while the High Level Group would further strengthen mutual understanding and communication between the two organisations.

HKEx's Chief Executive, Mr Kwong Ki-chi, said dual filing would strengthen the credibility of the existing disclosure-based mechanism and listing regulatory structure, and would help improve market quality.

The SFC and HKEx will review the status of the MOU in light of the conclusions of the Expert Group appointed by the Financial Secretary to review the three-tier regulatory structure.

The MOU can be found on websites of the SFC and SEHK at www.hksfc.org.hk and www.hkex.com.hk respectively.

ENFORCEMENT

Cold shoulder order

The Takeovers and Mergers Executive has imposed an order denying Lai Kam Wing Jimmy access to the Hong Kong securities markets for six months from 30 January 2003, because of his breach of the Takeovers Code.

The Executive also publicly censured Lai, and Raffles International Holdings Limited, a company solely owned by Lai.

Raffles breached Rule 26.1 of the Takeovers Code, because on 20 January 2003, it increased its shareholding in FT Holdings International Limited from 34.99% to 36.05% without making a general offer.

The old 35% threshold for triggering a mandatory general offer applies because the company had held between 30% and 35% interest in FT Holdings since before the trigger was reduced to 30% on 19 October 2001.

The Executive considers that the conduct of Lai and Raffles has resulted in a clear breach of a fundamental provision of the Takeovers Code, which merits strong disciplinary action.

The Cold Shoulder Order can be found on the SFC website together with a press release issued on 29 January 2003.

Survey on investment research

The SFC sent a questionnaire to all securities dealing and advising firms (including those engaging in securities investment research) in January, asking questions on the scope of their research operations, existing practices, and views on the issues involved.

The survey aimed to assess the state of the industry, particularly with regard to possible conflicts of interest of securities analysts. In

tandem with this exercise, the SFC will also survey investors to seek their views.

The SFC will consider the results of these surveys and other factors in formulating policy proposals on issues relating to investment research that are most suitable for Hong Kong. We will consult the public on any regulations that may be proposed.

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Budget deficit contained

fall was mainly the result of the reduction of the average daily market turnover from \$8.1 billion to \$7.1 billion.

But our stringent cost control measures, including salary and headcount freeze (other than new recruits for the dual filing initiatives) paid off by reducing the operating cost by 8% from a year ago to \$293.6 million.



At the end of December 2002, the SFC's reserves stood at \$588.7 million, equivalent to 1.31 times the approved annual operating expenditure estimate of \$450 million.

The Quarterly Report is available on the SFC website at www.hksfc.org.hk, under the section of "Press Releases, Publications & Speeches".

Engaging the market

The SFC started 2003 with a series of consultation exercises, honouring its commitment to keeping the market abreast of its regulatory work.

1. Revised Guidance Note on Money Laundering

On 23 January, the SFC published proposed revisions to the existing Guidance Note on Money Laundering to extend the application to all associated entities (except those which are authorised financial institutions) and rationalise the Guidance Note with the SFO and its rules. The public consultation period will end on 22 February.

2. ePO Guidelines

On 28 January, the SFC published the draft Guidelines for Persons Using the Internet to Collect Applications for Securities in a Public Offering (ePO Guidelines). These update the eIPO Guidelines published in July 2000 and widen the existing ones to cover follow-on offerings in addition to initial public offerings. They have also been extended to cover all issuers, sponsors, share registrars and intermediaries who take part in an ePO. The public consultation period will end on 26 February.

All consultation papers are available at the SFC office and on the Commission's website at www.hksfc.org.hk.

Compliance reminder

Fund managers and intermediaries must observe the law when marketing funds

The SFC has recently reminded fund managers and intermediaries that a fund that has applied for authorisation might not necessarily obtain SFC approval. Any public discussion that implies authorisation of a fund or its timing would be inappropriate.

The SFC issued the reminder in January after it noted that certain information about funds that were applying for SFC authorisation, including their names and investment features, had appeared in the media.

Unless a fund has been authorised by the SFC, no promotion or marketing of the fund or its features to the public is allowed under

the law. This restriction is in the public interest, and helps ensure appropriate protection for investors.

At present, the Protection of Investors Ordinance prohibits any person from issuing any advertisement or invitation to the public to acquire units in a unit trust or shares in a mutual fund corporation that has not been authorised by the SFC.

Failure by a registered or licensed fund manager or intermediary to comply with the requirements might reflect on their fitness and probeness.

While it is one of the SFC's tasks to facilitate market innovation, the SFC must also ensure that investors are being protected. All fund managers and SFC registrants must comply with applicable law and regulation.

The fund industry has generally acted professionally and responsibly. It would be unfortunate if the integrity of the industry is damaged by the misconduct of a few practitioners.

Investors are also encouraged to visit the SFC website to view a regularly updated Register and check whether the product in which they plan to invest has been authorised by the SFC.

No hesitation

The SFC is committed to protecting investors' interests

The SFC will not tolerate breaches by registered persons of their fiduciary duties to hold and protect client assets.

This was the regulatory message we sent to the market clear and loud, when we filed a bankruptcy petition against Mr Law Siu Kong, Christopher, trading as Lawsons Securities Company.

Last year in an inspection of Lawsons the SFC found deficiencies in internal control and settlement procedures. The independent accountant appointed by Lawsons reported a significant discrepancy between the firm's stock records and those of the Central Clearing and Settlement System.

The SFC kept in close contact with Law, who later confirmed that he could not make good the shortfall in clients' securities.

At present, Law is the subject of a restriction notice served by the SFC on 7 June 2002 which prohibits him from dealing in securities and disposing of or dealing with any assets held by himself or Lawsons.

A *mareva* injunction obtained by the SFC on 18 July 2002 restrains him from breaching the terms of the restriction notice.

The SFC's petition, presented under the Securities and Futures Commission Ordinance, will be heard on 19 March 2003. Police investigation continues into the matter. The SFC is monitoring developments.

Alexa Lam, SFC's Executive Director of Intermediaries and Investment Products, said: "The SFC will not hesitate to exercise the full force of its powers under the law to protect the interests of the investing public."



Get connected

As a market practitioner, you would want to reduce the costs and risks of your business operations and to improve efficiency. What you want is FinNet, a business-to-business private network built to support the financial communities in Hong Kong.

FinNet has been in full operation since February 2002, providing users with a single connection to multiple financial services and market information. Current major users include the Hong Kong Monetary Authority, Hong Kong Exchanges and Clearing Limited, the SFC, local banks, and securities and derivatives brokerage firms.

You can join FinNet as a member or a service provider*. Through this secure network, members gain access to a whole range of services offered by application/information providers and regulators. Via FinNet, you will enjoy significant cost and manpower savings with fully managed network service with 24 x 365 support; reliable electronic transactions; and peer-to-peer communication with other industry participants.

Becoming a FinNet *service provider* gives you competitive advantage in service provision in terms of time to market and cost of delivery; instant reach to numerous potential customers in the financial sector; and connection with other service providers on FinNet to make straight-through processing possible.

Interested in joining FinNet? Contact FinNet by email (info@finnet-hk.net), by phone (2283 6883) or by fax (2293 5824). To find out more, visit its website at <http://abouffinnet-hk.net>.

**As a B2B network, FinNet membership is not for retail customers.*

Updates on Shareholders Group

The SFC Shareholders Group held its tenth meeting last month. Members were consulted on possible changes to the Guidelines for Persons Using the Internet to Collect Applications for Securities in a Public Offering (the ePO Guidelines, formerly known as eIPO Guidelines). The proposals were then released for public consultation.

The Group also looked at some of the corporate governance codes used in overseas markets. These are often single documents which summarise the core governance standard for each market. Members felt that, because the Hong Kong rules and guidelines are to be found in a variety of different documents, it was not easy for companies to comply. If the fundamental provisions were brought together

in a single document, it would clarify what was required and make it more user-friendly for investors, issuers, and market practitioners. Members also voiced concerns about how the Hong Kong rules and guidelines measure up to international standards, and urged that there should be further reviews of our corporate governance regime in the light of developments overseas.

The SFC will convey Members' views to the Government and other relevant parties and will, together, consider the best way forward.

In December 2002, the Shareholders Group also met with the Expert Group to Review the Operation of the Securities and Futures Market Regulatory Structure. Members shared their views on the regulatory structure.

INVESTOR FOCUS

Trading a stock with two codes

Parallel trading occurs when a stock uses two codes for trading during a capital restructuring

Occasionally you may find a stock trading with two codes on the Stock Exchange. It is called parallel trading and happens when a listed company announces capital restructuring - such as a share split or consolidation - and there is a need to issue new share certificates. The word "parallel" implies that two codes appear at the same time for the same stock.

To minimise inconvenience to investors and to facilitate continual trading, a stock is not suspended during a capital restructuring. Instead, a temporary counter and stock code is set up for trading the old shares while the original stock code is used for trading the new shares.

For example, when company A (e.g. stock code: 1312) announces a 1-to-5 share split, the following happens:

- Generally, on the day after the share split is approved in a shareholders' meeting, the original stock code (1312) becomes ineffective for the time being and a temporary stock code (e.g. 2996) is used for dealing in the new split shares. If you are holding one board lot of 1,000 old shares of

company A with a brokerage before the share split, your stock balance will be adjusted and you will have five board lot of 1,000 shares each afterwards, assuming that the board lot size remains unchanged.

- Parallel trading kicks in after a certain time when the original stock code is used simultaneously with the temporary stock code (see table) to trade the new split shares. At this time, old share certificates are used for settlement of trades using the temporary stock code and the new certificates are used for settlement of trades using the original stock code. Both old and new certificates are valid. During this period, the share registrar is also gradually replacing old share certificates with new ones.

Stock Code	Stock Name
1312 (original)	Company A - New (settled with new share certificates)
2996 (temporary)	Company A - Old (settled with old share certificates)

- After the transitional period, the temporary stock code is cancelled. The original stock code is used for trading in the new split shares with settlement in new share certificates. From that time, shareholders who have not yet submitted the old share certificates to the share registrar would not be able to trade until they replace them with the new ones.

A company will provide details of its trading arrangement when it announces the capital restructuring. If the old certificates need to be replaced, shareholders will have to submit the certificates to the share registrar for new ones during the specified time period announced. Otherwise, the share registrar may impose a fee for the replacement after the prescribed period.

Note: If you hold your shares with a brokerage or bank, there is no physical transformation of shares involved. Your stockholding will be adjusted automatically and shown on your account statement.

For more information, please refer to the article "A Stock with Two Codes" under "Case Stories" of the "Advice to Investors" section on the SFC website.

SFO updates

Training for all

The market is gearing up for the imminent implementation of the Securities and Futures Ordinance (SFO). Investors, brokers, listed issuers, lawyers, corporate finance advisers and accountants will want to know more about the new law.

To help the market and the public prepare for and familiarise themselves with the SFO, the SFC has been providing related training since the enactment of the Ordinance in March 2002.

By mid-February 2003, a total of 41 sessions have been conducted for 10,619 attendees. Each seminar covered the specific parts of the Ordinance that were relevant to the audience (see table on the right).

New SFO training webpage

If you are interested in any particular parts of the SFO but have missed the relevant seminars, you may review the presentation materials used in the seminars that have been posted on the SFC website under the SFO section. Just pick, click and learn more about how the new law will affect you.

In addition, you will be able to find details of



About 1,000 market practitioners attended a seminar on the SFO in January 2003.



any forthcoming seminars and workshops as well as information on enrolment.

Consultation continues

On 24 January, the SFC published a draft Guidance Note on Position Limits and Large Open Position Reporting Requirements. The SFC proposes to issue the Guidance Note to

explain the compliance requirements of the Securities and Futures (Contracts Limits and Reportable Positions) Rules and clarify issues raised by the industry. The public consultation period will end on 25 February.

For details, please visit the SFO section on the SFC website. For SFO related enquiry, please email to sfoenquiry@hksfc.org.hk.

Target audience	Number of seminars conducted so far
Members of the Hong Kong Securities Institute and the Public	13
Exchange Participants	11
Accountants & Legal Practitioners	8
Investment Advisers, Exempt Dealers and Exempt Investment Advisers	5
All Registered Persons and Interested Market Practitioners	2
Police	1
Insurance Intermediaries	1