

## Clamping down on misgovernance

Behind a seal of silence imposed by the law, the SFC has been quietly but steadily stepping up investigations

Corporate misgovernance is one of the major areas of enforcement for the coming year. The other two are serious misconduct by intermediaries, and general market misconduct such as market manipulation and insider dealing.

What exactly are these offences? The more spectacular examples of corporate misgovernance happen when the company's management is guilty of fraud or misfeasance. But misgovernance is not just about crime. "Misgovernance also includes misconduct towards the company or its members, or violation of fair disclosure principles," said Mr Alan Linning, the SFC's Executive Director of Enforcement.

Partnership with other law enforcement agencies is crucial in combating corporate fraud. In cases where fraud and/or corruption is suspected, the SFC will make referrals to the Financial Secretary, Commercial Crime Bureau and the Independent Commission Against Corruption for further investigation.

The SFC is also looking into intermediaries who misappropriate clients' assets, attempt to conceal their true financial positions, facilitate market manipulation by way, for example, of allowing unauthorised third parties to trade through client accounts.

"Market manipulation and insider dealing will continue to be targets for the SFC's enforcement team," Mr Linning added.

The SFC is hard at work investigating a number of cases. So why doesn't the public hear about what it's doing?

investigated. Then the fact that an investigation is taking place is in itself market sensitive information; if this is made public it may cause the company's share price to fall, hurting investors. The secrecy provision also ensures the companies and persons under investigation receive fair treatment.

The secrecy obligation will continue when the new Securities and Futures Ordinance becomes effective. The new law will also provide the SFC with a greater variety of sanctions to use against persons responsible for disclosure failures. In addition, the SFC will be able to ask third parties, including banks and auditors, for any information relevant to a corporate misgovernance investigation.

The SFC's enforcement power against corporate misgovernance

will also be boosted by new proposals to make it a statutory regulator of corporate information disclosure. On 6 May 2002, the SFC released for consultation proposals on statutory filing of listing application documents and listed company announcements. The proposals will allow the SFC to bring enforcement actions against false or misleading corporate information.

"We are committed to completing investigations into our three priority areas quickly and making public announcements when appropriate," Mr Linning concluded.

### Market manipulation is a serious offence

*Magistrate Peter White on 24 June 2002 sentenced two market manipulators, Lau Hing Nam and Wong Kwing Ming, respectively to 160 and 96 hours of community service for manipulating shares in Grand Field Group Holdings Limited.*

*The SFC found that Lau and Wong had traded almost exclusively with each other in Grand Field shares from 20 March to 7 June 2000. They accounted for 62.3% of the turnover on 38 days out of 52 trading days.*

*The SFC sees this latest sentence and the immediate custodial sentences on two market manipulators in March as encouraging signs in the continued battle against market misconduct. The Court's willingness to pass heavy sentences, together with the SFC's greater enforcement power under the Securities and Futures Ordinance, will help promote the integrity of Hong Kong's markets.*

"We are actively investigating a number of significant cases that have been subject of press comments over the last few months. But, we are legally obliged to keep the identities of the companies or individuals under investigation under wraps," Mr Linning explained. This secrecy obligation is imposed by section 59 of the SFC Ordinance.

There are several reasons why the SFC cannot say which companies and individuals are under investigation. First, there's the risk that disclosure may tip off the persons being

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## Old tricks, new firms

### Reminders keep investors alert

Investors and intermediaries are finding themselves the recipients of unwelcome scam emails and calls.

In one type of scam emails, the author introduces himself as a resident of an African country who had to flee his native land, usually for political reasons. He continues by explaining that he left behind a very large sum of money in the custody of a security company and needs help in getting the money out of the country. At the end of the email, the author asks recipients to provide details

of a bank account that the funds can be transferred to, offering a percentage of the monies involved as a reward.

Needless to say, nothing in these emails is true. Investors and intermediaries are reminded to be constantly on guard against emails from strangers soliciting their bank account details, and they should contact the Police if they receive this type of message.

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# Investors beware of high-rate deposit offers

**If your broker firm offered you a high interest-rate deposit, would you be tempted to give it a try?**

Sean opened an account at a broker firm where his good friend Jerry worked. Sean kept some money in his client account while he figured out where to invest, but nothing good turned up. So Jerry suggested that Sean invest his money in a one-month deposit scheme that yielded a whopping 12% interest per annum. Sean figured this sounded good, and signed up without giving the risks involved a second thought.

Sounds like Sean had nothing to lose? Well he did - his entire cash balance. He finally found out that his money had been lent to one of the broker's associates, a firm that had got into financial troubles and was unable to repay its debt.

## Deposit schemes

The deposit scheme described here is typically targeted at clients who hold large cash balances in their accounts at a broker firm. Once the clients agree to making a deposit, their money is lent to

an affiliate of the broker, which agrees to repay the loan while offering high interest rates.

## Legal status

According to the Securities Ordinance, client funds held by broker firms must be kept in trust accounts. However, once the money is withdrawn and lent to the broker firm's affiliate, the client changes from being owner of the money to becoming an unsecured lender of the affiliated company. This means that the broker firm is no longer responsible for safeguarding the money. And, as with any loan, the lender's ability to recover the money depends mainly on the borrower's ability to repay loans.

## Compensation Fund

Bear in mind that the Unified Exchange Compensation Fund only covers losses suffered from the default of a broker firm which is an

exchange participant. In Sean's case, while the broker was an exchange participant, the affiliated company borrowing the money was not, so he was not entitled to make a claim on the Compensation Fund.

## Investor Advice

Before signing up for any investment or deposit scheme, investors are advised to understand the relevant terms and conditions, and consider whether the investment product suits them. Do not rely merely on verbal agreement. It is important to sign a contract. Before signing a contract, read carefully the terms and conditions attached to it.

*For more information, please refer to an article titled "High-rate Deposit Offers can be Unsecured Loans" on the SFC's website at [www.hksfc.org.hk/eng/investor/html/alert.htm](http://www.hksfc.org.hk/eng/investor/html/alert.htm).*

# A/C opening made easier

## SFC allows flexible client identification procedure to help boost online trading

Online trading has opened up markets to a whole new generation of investors. But, keeping to the old adage of "knowing your customer" is still vital in the cyber age. In a move designed to balance risk management with client, and broker and client convenience, the SFC has approved one more alternative client identification procedure to the current process.

In the past, client identification for securities accounts mainly took place through a face-to-face meeting between the client and the intermediary, when an account opening document would usually be signed. Where clients could not meet their brokers face-to-face, they could ask a specified person (including licensed intermediaries, Justices of the Peace, bank managers, accountants, lawyers or notary public) to certify the signing of the client agreement and the sighting of all related identity documents.

Under the new procedure investors who wish to deal in securities, futures and options, unit trusts and mutual funds no longer have to visit intermediaries' offices, but can open an account online or by post more easily. In order to verify the identity of a new client, brokers can now ask their potential client to send them:

- a copy of the client's identity document;
- a copy of the signed client agreement; and
- a cheque for at least HK\$10,000, issued by the client and drawn on his/her account with a bank licensed in Hong Kong.

The intermediaries must make sure that the client's signatures on the cheque and the client agreement are the same. Once the cheque has cleared, the client account can be activated.

The procedure was gazetted on 28 June 2002 with immediate effect.

*The amendment to the Code of Conduct for Persons Registered with the Securities and Futures Commission is available on the SFC's website at [www.hksfc.org.hk](http://www.hksfc.org.hk), under the section of "Bills, Legislation and Codes - Regulatory Handbook".*

## SHORTS

### Hong Kong Financial Sector Exhibition

- The public learnt more about our financial system, regulatory work, recent reforms, and the latest market and product developments at the Hong Kong Financial Sector Exhibition last month. The exhibition titled "Quality of the Hong Kong markets" was organised by the Hong Kong Government and six other financial regulators and institutions including the SFC. It was held from 28 June to 2 July.

### The Hay Report

- On 28 June 2002, the Hong Kong Government released the Hay Group Report on the review of remuneration of senior executives in statutory and other bodies. The existing remuneration practices of the SFC are generally in line with the recommendations in the report. The pay levels of SFC staff under review - the Chairman, Executive Directors and Senior Directors - are also all in line with the report's recommended remuneration ranges.

## Old tricks, new firms *(continued from page 1)*

Another type of scams typically involves unlicensed overseas companies recommending to investors overseas stocks on the phone or via email. Recipients of these emails and calls should refer to the SFC's list of unlicensed overseas companies.

The SFC has regularly updated its list of unlicensed overseas companies. In the past four weeks, six new companies - AG Securities Ltd, Abacus Group Ltd, Commodity and Currency Global Co Ltd, Foreign Trade

International, KRD Europe Management LLC and Parkside Investments Limited - have been added to the list.

The list is by no means exhaustive. So, it is best for investors to make sure that among the precautions they take when dealing with an overseas investment company, they find out if the company is licensed in the country where it operates and run a background check on any stocks being offered by it.

The SFC has become aware of these unlicensed overseas companies through investor complaints, referrals from other law enforcement agencies, and its own surveillance. Investors are welcome to report to the SFC any securities companies suspected of operating in Hong Kong without a proper licence.

*The list of unlicensed overseas companies is available on the SFC's website at [www.hksfc.org.hk/eng/investor/html/alert.htm](http://www.hksfc.org.hk/eng/investor/html/alert.htm).*

## Here's the money

### Hong Kong: a powerful magnet for overseas funds

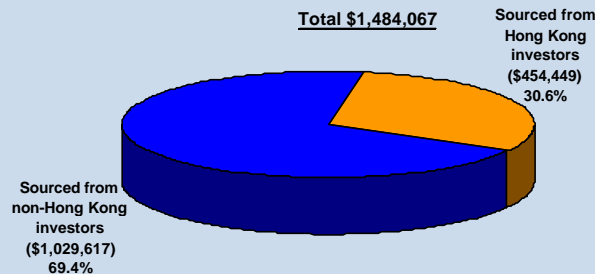
Hong Kong is the premier fund management centre for the region and continues to attract overseas funds for investment, according to the results of the latest annual Fund Management Activities Survey\* (FMAS).

The FMAS is an annual survey carried out by the SFC to gauge the health of the fund management industry and to help us identify the latest industry trends, a vital part of formulating regulatory policies and market development initiatives.

Highlights of the survey are as follows:

- As of 31 December 2001, a total of HK\$1,484 billion worth of fund assets were managed in Hong Kong. Of this total amount, \$1,030 billion or 69% came from overseas investors.
- Dominating the industry were institutional funds and pension funds which respectively accounted for 61% and 22% of total assets under management.
- Survey respondents revealed for the first time that around 20% of the \$1,484 billion worth of total assets under management were invested in Hong Kong and the

Total Assets Under Management in 2001 – by Source of Funds (HK\$ in Millions)



remaining 80% were invested overseas.

- Respondents had disclosed that they provided portfolio and investment advice on assets worth \$140 billion.

These findings are very encouraging and the SFC will spare no effort in ensuring that Hong Kong retains its position as a leading fund management centre.

To promote growth, the SFC is currently working to achieve recognition status for local fund

managers with overseas jurisdictions having comparable regulatory standards.

At the same time, the SFC will continue to facilitate the introduction of new and innovative types of investment products to give investors more choices and to cater to their different needs.

\*FMAS is an annual survey that invites responses from intermediaries or exempt persons who:

- have declared fund management to be their primary business;
- have provided advice on funds; or
- generated gross operating income from either fund management or providing advice on funds.

A full copy of the FMAS 2001 is available on the SFC's corporate website at [www.hksfc.org.hk/eng/bills/html/surveys-reports-research/fmas2001\\_eng.pdf](http://www.hksfc.org.hk/eng/bills/html/surveys-reports-research/fmas2001_eng.pdf).

## Curbing risks

### Sound regulatory framework boosts industry's health

A sound financial regulatory framework is key to the continued development of the financial industry. To meet the challenges of a constantly changing environment, the SFC has formed a Working Group on Review of Financial Regulatory Framework for Intermediaries to review the adequacy of the existing framework.

The SFC regularly monitors the financial positions of intermediaries to ensure that they have the necessary resources for conducting their business. Monthly Financial Resources Rules (FRR) returns are subject to detailed analysis to help us identify potentially risky intermediaries for appropriate remedial action.

A recent example was Prosperous Securities Limited. Since the SFC's detection of its failure to meet the minimum liquid capital requirement under the FRR, Prosperous has voluntarily suspended its trading on the Stock Exchange of Hong Kong. To protect client interests, the SFC has carried out a stock reconciliation exercise and has been closely monitoring the orderly return of stocks and cash to the clients of Prosperous.

Though the recent incident has proved that the monitoring and supervision systems are working, certain fundamental issues in relation to the

financial regulatory framework should be addressed and hence the need for the formation of the Working Group.

"Partnership with the industry will ensure that the future framework will be conducive to the operation of intermediaries engaged in different activities. Sound risk management attracts more clients and creates a win-win situation for both intermediaries and investors," said Alexa Lam, SFC's Executive Director of Intermediaries and Investment Products and Chairman of the Working Group.

The Working Group, which comprises mainly representatives from the industry, academia, media and Consumer Council, will analyze intermediaries' major risk areas. A focus will be risks inherent in securities margin financing under the current regulatory structure. The SFC has recently tightened financial requirements on intermediaries engaging in margin financing. The Group's aim is to develop a robust risk-based financial and capital regulatory framework suitable for the Hong Kong's securities and market intermediaries.

The Working Group aims to incorporate its findings in a White Paper to be issued for public consultation by the SFC later this year.

"The framework should help industry and market development while ensuring adequate investor protection," said Mrs Lam.

## SHORTS

### Keeping intermediaries up to date

- As cross-border securities trading grows in popularity, it is more important than ever before for Hong Kong's intermediaries to keep abreast of the latest rules and regulatory initiatives in other international markets.



FinNet, a secure and private network for regulators and intermediaries, now offers a new service for all its users. Called the "Securities Regulator Info Alert", this bulletin summarizes a selection of the latest important regulatory developments, policies, speeches, new laws and publications from regulators in leading financial markets including the US, UK and Australia.

### IOSCO Internet Roundtable

- The SFC hosted the Asian Roundtable for the IOSCO Internet Project Team on 24 and 25 June 2002. High on the agenda were the trends and risk profile of securities trading on the Internet. The 51 representatives from 12 jurisdictions and 13 panel speakers from Hong Kong and the region also discussed cross-border trading, investor education and enforcement issues in relation to internet service providers.

## Bagging the quick wins

### Recommendations made by the Financial Market Development Task Force will give impetus to market development

On 28 June 2002, the Financial Market Development Task Force submitted its first phase recommendations to the Financial Secretary Antony Leung.

The Task Force provides a high-level forum to co-ordinate new initiatives on the development of Hong Kong's financial markets. Five Working Groups - on debt markets, banking, securities and futures markets, fund management and insurance - were formed under the Task Force.

To promote the development of Hong Kong's debt, equity and futures markets, the Task Force has proposed to streamline procedures and facilitate the public offering of debt and equity, and relax short selling rules.

The SFC will work with the Government and Hong Kong Exchanges and Clearing Limited to implement the following "quick win" proposals.

For the debt and equity markets, the proposals include providing for awareness advertisements before and after registration of a prospectus, fact sheets and mini-prospectuses for distribution with prospectuses during the offer period, new application channels (such as the Internet, ATMs or by telephone), simplifying the prospectus contents requirements for certain types of issue, and implementing a structure for programme offerings.

To increase liquidity in the markets, short selling regulations will be relaxed. There will be naked short selling exemptions for additional categories of market makers, exemption from covered short selling reporting requirements, tick rule exemptions for certain market neutral transactions, and T+3 compulsory buy-in exemptions for settlement failure arising from a delay in the stock lending recall process.

The quick wins proposed by the Task Force are expected to be implemented from the 3rd and 4th quarter and in phases where necessary.

## Tapping the China market

### Hong Kong intermediaries are set to benefit from China's new rules on JV securities companies

The China Securities Regulatory Commission (CSRC) has recently introduced new rules on joint venture securities companies. These rules took effect from 1 July 2002.

Under the new rules, amongst other requirements, a joint venture securities company must have a minimum registered capital of RMB500 million. Its foreign shareholder must operate in a jurisdiction with a sound securities, legal and regulatory system and the host regulator must have entered into a memorandum of understanding with the CSRC.

In addition, the foreign shareholder should have been in the financial business for more than 10 years and not have been subject to any serious penalty over the past three years. Furthermore, the foreign shareholder should have sound internal control system and a good reputation in the international market.

These joint venture securities companies can:

- underwrite A and B share issues and bond issues
- provide B-share trading services to clients
- deal in government and corporate bonds on behalf of clients
- conduct proprietary trading in government and corporate bonds
- engage in any other business approved by CSRC

Given that the new rules only set requirements on relevant experience and compliance history and do not prescribe any minimum capital requirements for the foreign shareholder, the SFC believes that many of our registered intermediaries can fulfil these criteria and are eligible for application to set up joint venture securities businesses in China if they so desire.

Please refer to CSRC website at [www.csrc.gov.cn/CSRCsite/ywzd.htm](http://www.csrc.gov.cn/CSRCsite/ywzd.htm) for the details of the rules (available in Chinese only).

public. For details of the seminars, please contact Ms Clara Tang of the HKSI at 3120-6160 or refer to its website at [www.hksi.org](http://www.hksi.org).

### Consultations and Conclusions

In the past four weeks, the SFC has continued to consult the public on various subsidiary legislation under the SFO. Nine consultation conclusions were also released. All the consultation papers and conclusions can be found on the SFC website under the SFO section.

## SFO updates

### SFO Briefings

The SFC and the Hong Kong Securities Institute (HKSI) have jointly organised over 14 seminars on the Securities and Futures Ordinance from July to December 2002. The seminars will help market practitioners familiarise themselves with the new regulatory requirements under the SFO. The speakers are mainly SFC staff. The seminars are open to HKSI members and the

Consultation Papers on the following have been issued since 14 June 2002:	Issue Date	Closing Date
S&F* (Miscellaneous) Rules	2 July	26 July
S&F (Insurance) Rules	26 June	25 July
S&F (Financial Resources) Rules	14 June	12 July
Consultation Conclusions on the following have been issued since 14 June 2002:	Issue Date	
S&F (Disclosure of Interests - Securities Borrowing and Lending) Rules	12 July	
S&F (Disclosure of Interests - Exclusions) Regulation	12 July	
S&F (Short Selling Exemption and Stock Lending) Rules	11 July	
S&F (Leveraged Foreign Exchange Trading - Exemption) Rules	11 July	
S&F (Accounts and Audit) Rules	11 July	
S&F (Client Money) Rules	11 July	
S&F (Client Securities) Rules	11 July	
S&F (Keeping of Records) Rules	11 July	
S&F (Price Stabilizing) Rules	9 July	

\* S&F stands for Securities and Futures