

Adviser makes payments to fund investors following SFC negotiations

As a result of SFC negotiations, Towry Law (Asia) HK Limited has offered ex-gratia payments to over 1,000 investors of two unauthorised hedge funds. If the offer is fully accepted, the payments are estimated to amount to \$256 million.

The SFC instituted disciplinary proceedings against Towry Law following the collapse of the Global Diversified Trading Limited (GDT) and Global Opportunities Trading Limited (GOT) funds. Without admitting liability, Towry Law has agreed to make ex-gratia payments to eligible investors remaining in the two funds when they were suspended in September 2002.

GOT investors will receive an amount equal to 90% of the capital invested plus interest, whilst GDT investors will receive 80% plus interest.

Investors will receive a letter from Towry Law by the end of August setting out the terms. Investors are advised to consider their position and to take legal advice.

Towry Law has confirmed that its Hong Kong office will remain open until completion of the schemes. The SFC will monitor Towry Law's administration of the schemes.

The SFC believes it is in the public interest to settle its disciplinary proceedings by severely reprimanding Towry Law because the schemes amount to substantial mitigation; senior management responsible for Towry Law's involvement with the funds have been replaced; and the SFC received a high degree of co-operation from the current senior management.

The SFC reiterates that mis-selling is unacceptable and will attract tough disciplinary sanctions. At the same time, investors must play their part and consider carefully whether an investment is right for them.

For more details, please see press release issued on 17 August 2004, available on the SFC website at: <http://eapp01.hksec.org.hk/apps/cc/PressRelease.nsf/eng/lkupNewsCode/04PR142?openDocument>.

IPO refund cheques

The Hong Kong Association of Banks, the Hong Kong Monetary Authority, the Federation of Share Registrars and the SFC have jointly come up with a new measure to improve the security of IPO refund cheques. A refund cheque to an individual applicant will be printed with part of the applicant's HK identity card number (or passport number).

When the cheque is presented to a bank, the bank will cross-check both the name and the printed part of the HK identity card of the payee shown on the cheque against the bank's own record of the account holder. Therefore, investors should ensure that their identity information is accurately filled in on the IPO application form.

The new measure applies to all IPOs opened on or after 9 August 2004.

For more details, please see press release issued on 22 July 2004, available on the SFC website at: <http://eapp01.hksec.org.hk/apps/cc/PressRelease.nsf/eng/lkupNewsCode/04PR129?openDocument>.

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First quarterly Surplus

The SFC has just published its first quarterly result for 2004-2005. During the quarter to June, the SFC recorded a surplus of \$44.2 million, compared with a projected deficit of \$1.4 million in the approved budget.

Increased market turnover and higher fees and charges income boosted total revenue to \$145.1 million, 55% higher than the same period last year. Total expenditure amounted to \$101 million, same as last year's.

At the end of June, the reserves stood at \$735.2 million, equivalent to 1.7 times the approved annual operating expenditure of \$443 million.

The SFC will continue to keep a tight rein on expenditures. A surplus is expected in the second quarter based on current information.

For more financial details and a review of operations, please view the Quarterly Report on the SFC website under "Press Releases, Publications & Speeches" - "Publications" - "Quarterly Reports" at: http://www.hksec.org.hk/eng/press_releases/html/quarterly_report/apr_jun04.pdf.





Senior management interview

Mr Keith Lui, Senior Director of Supervision of Markets (SOM)

What is your area of responsibility?

I assist the Executive Director, SOM, in supervising the operations of our markets, the exchanges, clearing houses and share registrars. We focus on the financial infrastructure and facilitate market development.

What are your current projects?

We have been working on a scripless market for Hong Kong. We work with other Divisions to regularly update the market contingency plan. We work with the industry to promote better market infrastructure, e.g. FinNet. We approve and monitor new services and products by HKEx. An example of this is the recent enhancement of IP Account Service. (See Enhanced Investor Participant Account Service on p.6)

How do you supervise HKEx's new services and products?

We work closely with HKEx and meet regularly. When considering any proposed services or products, we assess their risk and regulatory implications for all market participants and the benefits they might bring. We need to balance market innovation with investor protection and systemic stability.



Are you also responsible for the Investor Compensation Fund?

We supervise the Investor Compensation Company, which administers claims against the Fund. We have started a review of the Fund, including the need to introduce a transaction levy adjustment mechanism for the Fund. We will consider the desirability of self-funding so that income generated by the Fund may cover its expenditure. We aim to brief the legislators by year-end and consult the

public later. (See Providing You with Security on p.4)

You have worked in several other positions previously?

I was Commission Secretary between April 2001 and last May. In that position, I had to liaise and co-operate closely with external stakeholders such as the Administration and the LegCo. I have also worked in the Intermediaries Supervision Department and as Chairman's Personal Assistant. The Commission encourages staff to rotate to gain wider experience.

How do you like the SFC?

The SFC plays an important role in enhancing the quality of the Hong Kong market. Having been with the SFC for more than 10 years, I realise that every member of the staff can make an impact on the Commission's work and the Commission has always provided opportunities to staff who are committed and willing to take up the challenges.

Personal bio

- First Joined the SFC in 1991 and re-joined in 1995 after about one year in the private sector. Appointed Commission Secretary in April 2001 and became Senior Director, Corporate Affairs in January 2002.
- Previously worked in financial institutions in the US.
- BCom, Queen's University; MBA, York University; MA (Economics), University of Toronto; LLB, University of Ottawa, Canada.
- Enjoys swimming and light music for relaxation

Act now to get licence

The two-year transitional period for migration to the single licensing regime will end on 31 March 2005. If you miss the deadline, you would lose your licences. Pay special attention if you are one of the 42 sole proprietors who have not submitted migration applications. Under the new regime, only corporations may be licensed and two responsible officers are required of each corporation in respect of each type of regulated activity it is licensed for. In other words, sole proprietors will have to incorporate their businesses and look for at least one extra competent individual to become a responsible officer (in addition to the sole proprietor himself).

As of 30 June, around 12,000 licensees representing 70% of all those migrating had either migrated or lodged their applications. Over 10,400 have received their new licences.

For further information on migration, please refer to the Guidelines on Transitional Arrangements and the samples of completed migration application forms, available on the SFC website at: http://www.hksfc.org.hk/eng/licensing/html/intermediaries/guidelines_on_transitional_arrangements_eng.pdf and http://www.hksfc.org.hk/eng/licensing/html/LIC_Sample_Forms/migration_sample_eng.tif respectively.

Appointments

- The Financial Secretary has re-appointed Mr Raymond Kwok as a Non-Executive Director of the SFC for two years, until 31 July 2006. The SFC welcomes Mr Kwok's re-appointment.
- The Financial Secretary has appointed Mr Richard Gnodde and Mr Blair Pickerell to the Advisory Committee of the SFC from 1 July 2004 to 31 May 2005. The SFC welcomes the appointment of Mr Gnodde and Mr Pickerell and thanks Mr Mario Francescotti, who has retired from the Committee, for his contribution.

Survey confirms Hong Kong's fund management centre status

Last year saw strong growth in the fund management business in Hong Kong.

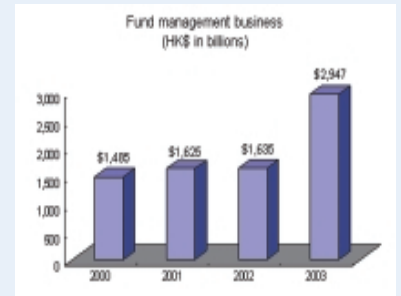
The SFC's Fund Management Activities Survey 2003 reveals that the total assets in the fund management business in Hong Kong amounted to \$2,947 billion as of 31 December 2003, which was substantially higher than the \$1,635 billion reported a year ago. The inclusion of Registered Institutions (essentially banks) in the survey for the first time and a 42% increase in asset management and advisory business by licensed corporations made up the increase.

Hong Kong is a magnet for overseas funds and possesses the expertise for managing investment in the Asian region. Of the total assets, 63% (\$1,860 billion) was sourced from overseas

investors. Hong Kong was regional headquarters to at least 37 licensed corporations and 10 registered institutions.

The buoyant fund market benefits local employment.

15,195 staff were employed in fund management activities. Licensed corporations hired an additional 1,053 staff in sales and marketing during the year.



For more details, please see press release issued on 6 July 2004, available on the SFC website at: <http://eapp01.hksec.org.hk/apps/cc/PressRelease.nsf/eng/IkupNewsCode/04PR120?openDocument>.

"Market timing" not prevalent in Hong Kong

An SFC Survey shows that market timing and late trading are not prevalent in the Hong Kong fund industry. However, because we are not immune to these practices, the SFC urges fund managers to be vigilant.

The SFC notes that in the US, abusive fund trading practices involving market timing and late trading have been uncovered and there has been a series of enforcement actions by the US Securities and Exchange Commission as well as other US regulators and exchanges. This year, we asked fund managers to tell us if similar problems exist in Hong Kong.

Market timing refers to a trading strategy involving the frequent buying and selling of

units/shares in open-ended funds to take advantage of a time lag between a change in the value of a fund's portfolio securities and the reflection of the change in the fund price.

The Survey does not find market timing a widespread phenomenon. Among the firms that manage or advise on open-ended funds that invest in global securities and therefore open to abuses by market timers, half of them, representing 90% of the total assets under management, have formal systems monitoring market timing.

Late trading also is not prevalent as nearly all firms confirmed strict adherence to the collection deadlines for subscriptions and

redemption orders.

Nevertheless, the SFC urges fund managers to exercise vigilance in detecting and preventing possible abusive practices. They are expected to put in place effective risk control measures to safeguard investors' interests.

The SFC will further review fund trading practices and discuss with the industry possible means to guard against trading malpractices.

For more details of the Survey, which also covers selective disclosure of non-public information, etc, please see press release issued on 8 July 2004, available on the SFC website at: <http://eapp01.hksec.org.hk/apps/cc/PressRelease.nsf/eng/IkupNewsCode/04PR124?openDocument>.



FAQs

Q: I have two stock accounts with my brokerage. I understand that the maximum compensation under the Investor Compensation Fund is \$150,000 per investor. Am I entitled to receive a maximum compensation of \$300,000 in case my brokerage defaults, because I have two accounts?

A: Under the Investor Compensation Fund, the maximum compensation limit is \$150,000 per investor for trading stocks. Each investor may only receive a maximum compensation of \$150,000 as the limit is applied on a per-investor basis regardless of how many stock accounts he has with the defaulting brokerage. However, the investor may also receive a compensation of up to \$150,000 if he also maintains a futures account with the brokerage. (For more information on the Investor Compensation Fund, see Providing you with security on p.4.)

Dual filing promotes quality of disclosure

The SFC has noted two serious disclosure deficiencies in some listing applications it received under the Dual Filing arrangement.

In the latest quarterly update on the operation of Dual Filing, the SFC reported that between April and June, it had received, via the Stock Exchange, 32 applications and commented on 15 cases.

There were two serious disclosure deficiencies common to several recent cases.

Firstly, some companies claimed that they had introduced or would introduce new products which were expected to be very successful. But there was insufficient disclosure on related research, development work and marketing activities to enable investors to understand why the new products might be so successful.

Secondly, several applicants had unusual relationships with their suppliers or customers. Volumes of supplies or sales were volatile; financial statements suggested significant financing transactions; and descriptions of corporate restructuring suggested that supply and sales operations had been part of the applicants' own business. The overall disclosure did not clearly explain these relationships to investors.

The SFC's emphasis in Dual Filing is on the quality, not quantity of disclosure by listing applicants and listed companies. Information disclosure should be material and meaningful to enable investors to make an informed decision on whether or not to invest.

For more details, please see press release issued on 21 July 2004, available on the SFC website at: <http://eapp01.hksec.org.hk/apps/cc/PressRelease.nsf/eng/lkupNewsCode/04PR128?openDocument>.

Providing you with security

As a retail investor, you know that when you trade securities and futures on HKEx, you are provided with a certain level of security.

The Investor Compensation Fund (ICF), established under the Securities and Futures Ordinance, pays compensation to investors who suffer a loss as a result of default of intermediaries in relation to securities or futures contracts traded on HKEx. All brokers licensed by and banks registered with the SFC are covered.

The ICF provides a maximum compensation limit of \$150,000 per investor per default case. A claimant can be compensated up to \$150,000 for securities and another \$150,000 for futures contracts.

From 1 April 2003, the Investor Compensation Company Limited (ICC), a wholly-owned subsidiary of the SFC, accepts claims, determines the appropriate compensation and pays compensation out of the fund. Ms Anna Wu is the Chairperson of the Board of Directors of the ICC.

Looking ahead, the ICC aims to promote public awareness of the compensation arrangements and the role of the ICC, especially amongst retail investors, so that the public can have greater confidence in the Hong Kong markets.

For more details, please visit the ICC's website at www.hkicc.org.hk. Also see FAQs on p.3.



Circulars

The following recently published circulars are available on the SFC website under "Bills, Legislation and Codes" - "Regulatory Handbook" - "Codes, Guidelines and Circulars" at: <http://eapp01.hksec.org.hk/apps/CC/RegulatoryHandbook.nsf/GenerateHTMLTBEnglish?openAgent&1>.

1. Circular to Licensed Corporations and Associated Entities - Anti-Money Laundering / Combating Terrorist Financing (1) United Nations Sanctions (Afghanistan) Regulation (2) United Nations (Anti-Terrorism Measures) Ordinance (3) US President's Executive Order 13224 (4) United Nations Security Council Resolution (UNSCR) 1483(2003) (28.07.2004)
2. Circular to Licensed Corporations which are licensed for Types 1, 2, 3 and/or 8 regulated activities - Information request (14.07.2004)
3. Circular to Licensed Corporations and Associated Entities - Anti-Money Laundering / Combating Terrorist Financing Non-cooperative Countries and Territories (12.07.2004)
4. Circular to Licensed Corporations which are licensed for Types 1, 2, 3 and/or 8 regulated activities - Information request (30.06.2004)
5. Circular to Licensed Corporations and Associated Entities - Anti-Money Laundering / Combating Terrorist Financing US President's Executive Order 13224 (30.06.2004)
6. Circular to Licensed Corporations which are licensed solely for Types 4, 5, 6 and/or 9 regulated activities and subject to the specified licensing condition - Compliance with the Securities and Futures (Financial Resources) Rules (25.06.2004)
7. Circular to Licensed Corporations - Ways to combat fake websites (24.06.2004)
8. Circular to Licensed Corporations and Associated Entities - Anti-Money Laundering / Combating Terrorist Financing US President's Executive Order 13224 (16.06.2004)



Lock-in return vs Average return warrants

Locked-in return and average return warrants are longer-term exotic derivative warrants (e.g. 12 - 18 months) signified by "XC" or "XP" in their names. Their final payouts are calculated differently.

Both have a series of fixing dates in the life of the warrants. On each fixing date, a "periodic reference price" is established by averaging the closing prices of the underlying instrument (usually a stock) on the five trading days immediately before that fixing date.

A locked-in return warrant will "lock-in" the profit if it is in-the-money (periodic reference price > exercise price for a call warrant; periodic reference price < exercise price for a put warrant). The locked-in profit, called periodic cash settlement amount in the warrant documentation, is the difference between the periodic reference price and the exercise price. If the warrant is at-the-money or out-of-the-money, a "zero" profit is recorded. The final payout will be the average of locked-in profits (including zero returns) on all the fixing dates.

An average return warrant just establishes periodic reference prices (which may be higher or lower than the exercise price) on fixing dates. On maturity, it takes the average of all the periodic reference prices and compares it with the exercise price to calculate the payout. It will have a lower final payout than a locked-in return

warrant with the same underlying, exercise price, expiry date and fixing dates if the warrant is out-of-the-money on one or more fixing dates.

Performances in previous fixing periods matter

A warrant's listing document is the best place to find comprehensive information on its terms. You can download the document from the HKEx website.

A warrant issuer has to publish the periodic cash settlement amount (cumulative to date) for locked-in return warrants or the periodic reference price (cumulative to date) for average return warrants after each fixing date on the HKEx website. Always check the performance in previous fixing periods.

Whether an average return call warrant with lower periodic reference prices (compared to the exercise price) recorded in previous fixing dates would produce profit upon maturity depends on whether higher prices recorded in subsequent fixing dates are sufficient to offset the earlier effect. Therefore, the warrant price may not necessarily rise with an increase in value of the underlying.

To find out more about exotic warrants, read the two articles "Basics of Exotic warrants" and "Trading exotic warrants" on the Electronic Investor Resources Centre at www.hkeirc.org.

Online game result

The winner of an online investment simulation game to promote the SFC-RTHK TV drama series *All About Stock Investing* has made a 7% profit in five weeks, or an annualised return of 73%.

The profit is theoretical only. At the start of the game, each participant was given a theoretical \$1 million to invest in Hang Seng Index stocks. There were over 300 entrants. At the market close on 16 July, the

top winner's portfolio was worth \$1.07 million, with the second and third places finishing at around \$1.06 million. They each received an SFC corporate watch.

Screening of *All About Stock Investing* on TVB and ATV ended in early August. Since 30 July, the drama series has been shown every Friday to Sunday on FirstVision of New World First Bus.



The following items of investor resources have been made available to the investing public recently. They can be found on the SFC website or the Electronic Investor Resources Centre (eIRC) at the URLs provided.

Investor Alert Updates (<http://www.hksfc.org.hk/eng/investor/html/alert.htm>):

16 unlicensed companies including "Citibank Online" (not related to Citibank, N.A.) (04.08.2004), "Richardson Resources" (03.08.2004), "Bradley Chen & Associates", "International Options Management", "Irvine North Credit Union", "JPM Investments International" (28.07.2004), "Mc Kenzie King", "Oxford Trading (1978) Limited", "Pan-Index Limited", "Premium Alliance", "Quincy Ellerton", "R J MacAllister Ltd", "Rosenthal International" (30.06.2004), "First Federal Banking Corporation" (23.06.2004), "HongKong UBC Investment Funds Limited" (14.06.2004), and "Advance Management Services (Asia) Limited" (10.06.2004) have been added to the Alert List.

Dr Wise's Column (http://www.hksfc.org.hk/eng/investor/html/dr_wise.htm)

Derivative Warrants Are Not For Everyone (27.07.2004), and *Understand the Companies You Invest In* (29.06.2004)

Others:

Educational articles on "Stock Trading", "Shareholder's Basic Rights" and "Corporate Actions of Listed Companies" (<http://www.hksfc.org.hk/eng/investor/html/questions.htm>).

Educational materials used in Teachers Workshop 2004 (<http://www.hksfc.org.hk/eng/investor/html/teachers.htm>).

Enhanced investor participant account service

Investors will find it more convenient to use an Investor Participant (IP) account as HKEx will introduce new features in August.

Introduced in May 1998, the Central Clearing and Settlement System's (CCASS) IP account is a custody account for investors' stocks. With the enhanced features, you may:

1. access your IP account and input instructions by phone and via the Internet almost 24 hours a day;
2. use self-assigned user ID and password to access the CCASS Internet System instead of using an e-Certificate issued by Hongkong Post;
3. complete a stock transfer more efficiently without the need of an affirmation, if the transfer does not involve money settlement;
4. submit electronic requests via the CCASS Phone and Internet Systems to demand a poll at shareholders' meetings;
5. receive SMS alert messages on your mobile phone whenever there are activities in your account requiring action (such as settlement instructions);
6. receive electronic statements over the CCASS Internet System

in a more timely manner;

7. submit electronic share withdrawal forms over the CCASS Internet System instead of submitting a paper form in person.

The SFC approved the HKEx rule amendments in July.

For more details, please visit HKEx's website at www.hkex.com.hk.

Public Shareholders Group

The Shareholders Group was renamed Public Shareholders Group in June to reflect more accurately its role in representing public shareholders' interests.

Mr Chung Man Wing and Mr Douglas Naismith have been appointed to the Group for a one-year term, effective 1 July. Mr Heung Shu Fai has retired.

At the Group's 20th meeting in July, HKEx presented to members its disciplinary procedures and enforcement strategy towards listed companies breaching the Listing Rules.

Other publications



The following publications have been published since the release of the last *SFC Alert*. They are available on the SFC website under "Press Releases, Publications & Speeches" - "Publications" at: http://www.hksfc.org.hk/eng/press_releases/html/publication.htm.

1. Enforcement Reporter (16.08.2004)
2. SFC Quarterly Report - April to June 2004 (13.08.2004)
3. Enforcement Reporter (09.07.2004)
4. Report of the Survey on Fund Trading Practices (Market Timing, Late Trading and Selective Disclosure) for the Period 2002 - 2003 (08.07.2004)
5. Fund Management Activities Survey 2003 (06.07.2004)



Recruitment

The following SFC positions are open. For application and details of the openings, please visit the SFC website under "Employment & Miscellaneous" at: <http://www.hksfc.org.hk/eng/miscellaneous/html/employment.htm>.

- **Director - Intermediaries & Investment Products**
- **Manager - Investor Education & Communications**
- **Executive Trainee**



Subscription information

The bi-monthly *SFC Alert* forms part of our range of regular publications; others include the monthly *SFC Enforcement Reporter*, the *Quarterly Report*, the *Quarterly Bulletin* and the *Annual Report*. All these publications are posted on the SFC website.

Free subscription to the electronic version of the *SFC Alert* (and other publications) can be made to sfcalert@hksfc.org.hk.



Feedback

Tell us what you think of the *SFC Alert*. Questions and comments can be sent to sfcalert@hksfc.org.hk.

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