

SFO - effective now

SFC pledges to crack down on market misconduct

With the commencement of the long-awaited Securities and Futures Ordinance (SFO) on 1 April 2003, the SFC has renewed its pledge to crack down on market misconduct and protect investors.

The law has enhanced the powers of the SFC and introduced more effective deterrents. For example, listing applicants and listed companies are required to file their disclosure and listing application materials with the SFC. The SFC can exercise its investigative and prosecution powers against persons filing false or misleading information.

In addition to criminal prosecution, a Market Misconduct Tribunal has been set up to handle a wide range of market misconduct through civil means. Other measures include enhancing transparency of shareholders' interest in listed companies.

The SFO was enacted on 13 March 2002. At a press conference on 31 March 2003, SFC Chairman Andrew Sheng said the SFC would enforce the new law to protect investors.

New initiatives

A number of initiatives are introduced by the SFC upon the SFO's implementation to help intermediaries in complying with the law and enable investors to get useful information to protect their interests.

These include a revamped SFC Infoline service (tel 2840 9393) which is an interactive telephone enquiry service for the public with particular emphasis on intermediaries licensing and supervision, and investment products authorisation.

A new investor booklet *SFO & You* highlights the



SFO and You

features of the SFO. *When and How to Make a Complaint* explains how an investor can make a complaint in order to protect his or her own interests.

In addition, a new public register is available on the SFC website to enhance the transparency of intermediaries whom investors deal with. The complaint channels of firms licensed with the SFC and all public disciplinary actions that have been

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The biggest statute

Ordinances replaced	10
Pages (in each language)	Nearly 600
Parts	17
Sections	409
Schedules	10
Items of subsidiary legislation	40

Deficit for 2002-03 half of original estimate

Cost control measures to continue

The SFC was set to record a deficit for 2002-03 which was about half of the approved original estimated deficit, due to tight cost control measures, the SFC told legislators last month.

Presenting the SFC's budget estimates at the Legco Panel on Financial Affairs, Chairman Andrew Sheng said the Commission had originally forecast the deficit for 2002-03 to be \$117.6 million. It was later revised to \$78.7

million. But with the cost cutting measures like salary and hiring freeze, the deficit recorded for the 11 months to the end of February 2003 was \$48.6 million.

Based on this, the deficit for the whole year was projected to be \$59 million, which would be only half of the original forecast deficit.

The projected deficit for \$59 million is roughly comparable with last year's actual deficit of \$54.2 million even though revenue for 2002-03 was expected to be 7.5%, or \$27.3 million, lower than the total income a year ago.

Total operating expenditure after depreciation was forecast to decrease by 5.4% or \$22.4 million. Nearly half of the savings, or \$10.7 million, came from personnel expenses. Capital expenditure dropped 43.6% to this year's \$15.1 million.

No fee rises

Despite the deficit, for the 11th consecutive year the SFC has not asked for government funding for 2003-04. The total grant forgone by the SFC so far has reached \$876 million.

Not only has the SFC not asked for government funding, it has decided not to raise fees. Instead, licensing fees for intermediaries have been

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New office

SFC moving to Chater House

Visitors to the SFC will have to walk across Chater Road from July.

The SFC signed a lease for four floors, from 6th to 9th floors, of the Chater House last month. The lease is for 10 years starting from 1 July 2003.

The SFC began a search for new office premises after it was asked by its landlord Hong Kong Land to vacate the present office at Landmark by the end of June.

In choosing the appropriate office building, the SFC has considered the following factors: an attractive rental package; an efficient office building with good location, security and service management; comparable floor area requirement; and availability by 30 June 2003.

The new office can be conveniently accessed by investors and market practitioners, and will enable us to continue to discharge our responsibilities effectively.

The SFC can save 10% in rental expenditure after moving to its new office in the Chater House in July. We will adopt modest fitting out standards and reuse existing furniture and equipment where possible.

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Securities offering made easier

Proposals will streamline procedures and requirements on prospectuses

To facilitate the public offering of shares and debentures, the Government and the SFC, in a three-phase approach, are taking steps to streamline the procedures and requirements relating to the registration and issue of prospectuses.

First phase

In February the SFC issued three sets of guidelines relating to:

- the issue of awareness advertisements to increase investors' awareness of public offers, and the publication of mini-prospectuses and fact sheets to facilitate understanding of the full prospectus;
- repeat offers of shares or debentures using separately registered "programme" documents to enable issuers to better seize market opportunities; and

- the use of faxed copies of experts' consent letters and bulk print proof prospectuses for registration purposes to ease the administrative burden of issuers.

Two class exemptions issued by the SFC in March, subject to negative vetting by the Legislative Council, are expected to become effective in May. For listed and unlisted debentures, prospectuses will enjoy automatic exemptions from contents requirements which are considered irrelevant for investors to make an informed investment decision. For listed debentures, prospectuses will also be exempt from contents requirements which are similar to those in the Listing Rules.

Second phase

In March, we consulted the public on proposed amendments to the Companies Ordinance. The

proposals aim to provide a statutory basis for the guidelines, and to make other improvements to the prospectus regime such as excluding offer documents for certain types of offers (e.g. offers to not more than 50 persons and offers to professional investors) from the definition of "prospectus". They also seek to achieve a level playing field for local and overseas companies by removing certain discrepancies in prospectus requirements. The consultation period ended on 31 March and comments received were in general strongly supportive of the proposals.

Third phase

A comprehensive review of the securities offering regime is being undertaken by the SFC and consultation proposals are expected in 18 months.

The guidelines and consultation paper are available on the SFC website.

INVESTOR TIPS

Read the fee details

As an investor, you should watch out for potentially misleading promotion on brokerage commission offered by securities dealers with effect from 1 April.

Dealers may be offering competitive rates and reward schemes to attract investors. Investors should study carefully the details of any such promotional offers including the method of calculation, the period for which such promotional offer will be available, any minimum charges, any eligibility conditions or restrictions, and whether there are other hidden charges.

Should any dealer be found to have issued a false, misleading or deceptive advertisement, the SFC will immediately review that dealer's fitness and propriety to remain registered and take appropriate disciplinary action.

Investors can call the SFC at 2840 9333 if they feel they have been misled by dealers. (Also

see Investor Focus on Page 4)

About bonds

A smart investor should always first understand an investment product before making an investment. If you plan to invest in bonds, the following materials published by the SFC may help you make an informed decision.

A new leaflet entitled *Getting into Bonds* explains the basic features and risks of bonds, how to evaluate the merit of bonds and where to get information.

There is also a series of feature articles: *Bonds ABC*, *Choosing a Bond*, *Finding Information on Bonds* and *Buying and Trading Bonds*.

The publications are available at the SFC office. On-line education resources can also be found in the "Features" section of the Electronic Investor Resources Centre at www.hkeirc.org.



Appointments

IEAC

For one year until 31 March 2004 to the SFC's Investor Education Advisory Committee: (appointed) Mr Ho Chun Yan, Albert; Ms Lin Yoke Seetoh; Mr Wilfred Wong; Mr Robert Chow; Mr Howard Sou; Mr Roger Luk and Dr Saimond Ip; (re-appointed) Mr Lawrence Fok; Mr Li Kai Ming; Professor Lui Yu Hon and Mr Edward Chow.

SFC (HKEC Listing) Committee

For one year until 31 March 2004: Mr Stephen Clark and Mr Carlson Tong; Without a fixed

term being SFC representatives: Mr Eric Cheng and Ms Tina So.

AAAC

For two years until 18 February 2005 to the Academic and Accreditation Advisory Committee: (appointed) Mr Albert T. da Rosa, Jr and Professor Charles D. Booth; (re-appointed) Professor Stephen Cheung and Professor Paul B McGuinness.

Executive Director

Alexa Lam has been re-appointed as Executive Director (Intermediaries and Investment Products) for two years to 28 February 2005.

Expert Group releases report

The Expert Group reviewing the securities and futures market regulatory framework released its report in March.

The Group, appointed by the Government last September after the penny stocks incident, was chaired by Mr Alan Cameron. The other two members were Dr Raymond Ch'ien and Mr Peter Clarke.

The Group has arrived at its conclusions and recommendations with due regard to the Government's stated objective of developing the Hong Kong market into the "premier capital formation centre of China", "the Asian-time-zone pillar of the global futures and derivative markets" and "one of the top five equities markets in the world".

One of the Group's recommendations is the set up of a Hong Kong Listing Authority under the SFC to be responsible for stock market listing function.

On 10 April, the Financial Secretary Mr Antony Leung announced to conduct public consultation on the regulation of listing matters.

The SFC welcomes the statement of Mr Leung that the general direction recommended by the Group is appropriate and will enhance the quality of the market.

The SFC will work closely with the Government and Hong Kong Exchanges and Clearing Limited.

The Group report can be downloaded from the webpage <http://www.info.gov.hk/info/expert/expertreport-e.htm>

Real estate funds for more choices

The public are consulted on proposed safeguards

In response to market demand, and to allow investors to have access to a broader range of investment products, the SFC has drafted a code on Real Estate Investment Trusts (REITs). The public are invited to comment by 23 April 2003.

A REIT is a collective investment scheme that owns and manages income-generating real estate, such as shopping malls, offices and residential properties. It focuses on property investments and pays dividends to scheme holders. After years of evolution, REITs have gained recognition in major financial markets such as Australia and the US.

The draft code on REITs emphasises on: proper management experience and expertise; clear description of investment policy and objective; segregation of management and safekeeping of assets; and independent valuation for the assets regularly.

There should also be a transparent and convenient exit mechanism - listing or annual redemptions for unlisted REITs; adequate and timely disclosure of financial reports and scheme activities; and voting by scheme-holders on connected party transactions.

Alexa Lam, SFC's Executive Director of Intermediaries and Investment Products, says the proposed introduction of REITs is part of SFC's continuous effort to reinforce Hong Kong's position as an international financial hub.

Following the consultation, the SFC will prepare a consultation conclusions document. It is expected the code can be published in the third quarter of 2003.

The consultation paper can be downloaded from the webpage: <http://eapp01.hksfc.org.hk/apps/ip/reit.nsf/Main?openform>

Contingency plans on atypical pneumonia

Every sector of Hong Kong has been taking precautions against the atypical pneumonia. The SFC has issued a circular requesting intermediaries to ensure that they have contingency plans in place in case their staff contract the disease.

The SFC takes a serious view of the potential disruption of this illness.

Intermediaries should notify the SFC promptly if any staff member is either suspected of having atypical pneumonia symptoms or has been diagnosed as being infected. They should devise policies and procedures to prevent serious disruption to the operation of the firm if any staff is infected.

These procedures may include: a) having a back-up office at unaffected premises; b) having staff members working at remote premises; c) arranging with counterparts or exchanges on contingency closing out of positions, clearing and settlement matters; d) encouraging clients to use telephone or online facilities instead; and e) notifying clients of suspected staff infection and advising clients on what measures have been put in place. In this context, the SFC will flexibly address any intermediary's compliance issues that may arise.

The SFC has also taken precautionary measures for the prevention of respiratory tract infections, including disinfecting its office, distributing of masks for all staff and encouraging their use in office. All individual divisions and departments have developed contingency work plans.

Certain aspects of the Commission's business activities may be slowed down but investor protection will not be compromised.

Licensees must observe fiduciary duties

A bankruptcy order was obtained by the SFC in March against Law Siu Kong, Christopher, the sole proprietor of Lawsons Securities Company.

According to the Securities and Futures Commission Ordinance, the SFC may file a petition for a bankruptcy order against a registered person if it appears to be expedient in the public interest to do so and if grounds exist for a creditor to present such a petition.

The bankruptcy petition was filed following a series of regulatory actions taken by the SFC to protect investors and Lawsons' clients. These actions included a restriction notice on Law last June prohibiting him from dealing in securities and disposing of his assets. A

mareva injunction was obtained to prevent Law from breaching the terms of the restriction notice. The High Court in July allowed the appointment of administrators to deal with the property of Law and Lawsons.

The SFC had earlier had concerns on the internal control of Lawsons and instructed it to appoint an independent accountant to check account balances with clients. A significant discrepancy between stock records of Lawsons and the Central Clearing and Settlement System was identified.

We wish to remind the industry of the importance of safeguarding client assets. The SFC will not hesitate to take any necessary action against breaches of the fiduciary duties.

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Deficit for 2002-03 half of original estimate

reduced by 3% under the Securities and Futures Ordinance. In addition, a 5% discount is offered to existing licensees who switch to the new system during the first year of the two-year transitional period.

2003-04 estimates

For 2003-04, the SFC has projected a deficit of \$93.3 million (please see the table on the right).

Total income is estimated to be \$339.9 million, about 3.5% or \$11.6 million higher than the revised estimated revenue of \$328.3 million for 2002-03. On the other hand, we project a total

operating expenditure of \$407.9 million, about 6.5% or \$25 million above the revised estimate for 2002-03.

The SFC has been watching closely its financial position, particularly its budgetary deficit. It will continue its various measures in reducing expenditures.

SFC's Annual Report for the year ended 31 March 2003 will be published on 14 May. The report will contain audited financial figures.

	Proposed Estimates <u>2003-04</u> HK\$M
Revenue	339.94
Operating Expenditure	407.88
Depreciation	25.40
Operating Deficit	93.34
Projected reserves at beginning of the year	545.25
Reserves at end of the year	451.91
Capital Expenditure	23.10

INVESTOR FOCUS

Watch out for fees and charges

Types and rates of fees that you need to pay attention to

A recent survey conducted by the Consumer Council reveals that investors may be subject to more than 70 types of fees, in addition to trading commissions, in the use of securities trading services. The terminology for fees and charges used by banks and brokerages also differs extensively. Here, we explain some of these charges and their implications to you.

Trading commission: Brokerages and banks charge this on each trade. The commission rate varies widely from firm to firm and is subject to such factors as transaction channels (e.g. online or offline), transaction amount, trading frequency and client relationship. Usually, there is a minimum charge for each trade though the rate charged could be higher than the stated rate for small transactions.

Transaction levy, trading fee and stamp duty. These are standard fees collected by brokers and banks on behalf of the SFC (0.007% of the transaction amount, of which 0.002% is for the compensation fund), the Stock Exchange (0.005%) and the Inland Revenue Department (0.1%).

Settlement fee: The Central Clearing and Settlement System (CCASS) charges 0.002% of the transaction amount for providing a settlement service in each trade (minimum \$2; maximum \$100). Brokerages and banks usually recover the settlement fee from their clients and are at liberty to increase it.

Custody fee: Some firms charge clients for safekeeping their shares, usually every six months (e.g. in May and November). The fee is usually calculated on a per board lot basis. Alternatively, some firms charge a flat fee.

Stock withdrawal fee: Some firms seek reimbursement from their clients of the \$3.5 per board lot charge on the withdrawal of shares from CCASS. Other firms may also impose administrative charges on top of this fee.

Scrip fee: This is charged by CCASS for registering securities in the name of HKSCC (Nominees) Limited at \$1.5 per board lot on book close dates (e.g. on the distribution of dividends and rights issues) or \$0.75 per board lot on deemed book close dates (i.e. 31 December if there was no book close date declared during

the year). CCASS charges brokerage participants the scrip fee based on the net increase of a stock held between book close dates (including deemed book close dates). For example, if a stock had no book close dates during the year, the scrip fee charged on the deemed book close date for a net increase of 30,000 lots of shares (1,000 shares per lot at a price of \$0.03) from the last book close date will be \$22,500 or 2.5% of the market value of the stock. Brokerages and banks usually recover the scrip fee from their clients and may impose additional charges.

Corporate action fees. These are charged on the collection of dividends, bonus shares, rights issue entitlements and warrant conversion etc. Corporate action fees are charged in addition to scrip fees for rights issues and the distribution of dividends.

You should not focus solely on the trading commission, but be prepared to compare all the costs involved. Take into account what kind of services you want and choose a service provider that suits your needs.

Shareholders Group

The SFC Shareholders Group held its 11th meeting in March. Members were consulted on proposals regarding the cold calling prohibitions on brokers and banks. Members generally supported that the cold calling rules should apply to selling of funds in the same way as they apply to selling of other securities. The SFC is working on certain guidelines to be issued to intermediaries and will take into account members' views.

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taken against the intermediaries in the past five years are also shown.

Furthermore, the second edition of the bilingual glossary *An English-Chinese Glossary of Securities, Futures and Financial Terms* has been published. It is an updated version of the glossary published by the SFC in April 1999, of which about 2,800 copies have been sold. This version contains Chinese translations for over 13,800 English financial terms and phrases - nearly doubling the first edition.

Last but not least, a regulatory handbook which contains updated SFC codes and guidelines is available on the SFC website.

More guidelines

Meanwhile, the SFC published in March several

Exam bodies

The Academic and Accreditation Advisory Committee (AAAC) of the SFC decided in February to appoint the Hong Kong Securities Institute as an independent exam body to run the industry and local regulatory framework exams in securities and futures. The Financial Services Development Centre of the Vocational Training Council will continue to run the leveraged foreign exchange trading exams.



SFC Chairmen Andrew Sheng and Chief Counsel Andrew Young introduce the new initiatives at the press conference.

important guidelines for the SFO including those on disclosure of interests in listed companies and transitional arrangement for intermediaries.

All the above publications are available on the SFC website. A 20% discount to the regular price of \$100 is available for bulk purchase of the Glossary. Please contact us at 2283 6860.

SFC consults on exchange traded funds

The SFC's recently released draft guidelines for regulating passively managed index tracking Exchange Traded Funds (ETFs) represents the first step to create a regulatory framework to facilitate the development of Hong Kong as a regional ETF market.

A typical ETF comprises a basket of securities that represents the constituents of the index; as such its composition and pricing are highly transparent. Examples of ETFs are the Tracker Fund of Hong Kong and iShares MSCI China Tracker.

Given the relatively simple investment objective and strategy for ETFs, the SFC considers that passively managed index tracking ETFs should be given relief from strict compliance with certain requirements of the Code on Unit Trusts and Mutual Funds.

The draft ETF Guidelines aim to achieve three objectives: to provide appropriate regulation; to enhance the disclosure and transparency of ETF documentation; and to create a platform for the admission of overseas ETFs based on the principle of regulatory equivalence.

The consultation period is extended to 2 May 2003. The document is available on the SFC website.

Securities and Futures Commission

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