

## Fighting corporate misgovernance

**SFC Chairman talks about regulation of listed companies and enforcement against corporate misgovernance**

SFC Chairman Mr Andrew Sheng last month sent a clear message to those who break the securities law that the SFC would pursue them firmly.

The SFC has strengthened its co-operation with the Commercial Crime Bureau and the China Securities Regulatory Commission in the investigation of corporate misconduct in Hong Kong and the activities of Hong Kong listed companies in the Mainland.

"We will increase our vigilance and strive to complete our investigations as fast as we can, working together with our regulatory counterparts," Mr Sheng said.

"Those who break the securities law are now warned... They will be investigated and prosecuted in accordance with the law," he said.

The SFC is investigating a number of cases that have received a high media profile in recent months. With the help of 15 new staff in the Enforcement and Corporate Finance Divisions by the end of the year, we are confident the cases can be handled more effectively.

### United in goal

Mr Sheng noted the split responsibilities between Hong Kong Exchanges and Clearing Limited

(HKEx) and the SFC for regulating the listed sector. This regulatory division lacks clarity and adds complexity, thus increasing the costs to the whole process. The need to co-ordinate regulatory roles leads to delays in regulatory response because no one regulator has the total picture of what wrongdoers are up to.

Giving his personal views, Mr Sheng said Hong Kong should consider whether it should move to a statutory regime to improve corporate governance, and whether the present structure should be simplified to avoid duplication and delays in regulating market and corporate misconduct.

"Those who seek capital from the public have a fiduciary duty to the public - to be truthful, honest and fair."

The SFC will work closely with HKEx and all the other regulators in Hong Kong and abroad to tackle corporate misconduct as a top priority.

"We all share the same objective to protect the integrity of our markets and the rights of shareholders," said Mr Sheng.

*Mr Sheng's speech titled "Post-Enron impact on regulation of financial markets" was given at the Vocational Training Council's 20th Anniversary Distinguished Lecture Series on 23 September. A full version is available at [www.hksfc.org.hk/eng/press\\_releases/html/official\\_andrew\\_sheng.htm](http://www.hksfc.org.hk/eng/press_releases/html/official_andrew_sheng.htm).*

## A message from the editor

Dear reader,

This is the first anniversary of *SFC Alert*, a monthly newsletter prepared especially for you. I hope you have enjoyed the issues published so far.

The SFC strongly believes in communication and consultation with intermediaries and investors.

The more you understand our work, the easier it will be for you to help us develop policies that are appropriate for the Hong Kong market.

During the past 12 months, articles have included investment scams, enforcement action, new rules and guidelines, updates on the Securities and Futures Ordinance and other topics. More recently we introduced *Investor Focus* as a regular educational column in the newsletter.

Please tell me what you think of the newsletter and how it might better serve you. Your comments and suggestions are most welcome and may be sent to [ckchan@hksfc.org.hk](mailto:ckchan@hksfc.org.hk) or by fax on 2521 7836. I look forward to hearing from you.

Don't hesitate to tell your colleagues and friends about our newsletter. If you, or anyone else, would like extra electronic or printed copies, please let us know.

Thank you for your support of *SFC Alert*.

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## Bright young things

**The SFC is reaching out to students through two investor education initiatives**

No one doubts the wisdom of starting personal financial planning as early as possible. To help young people learn more about financial planning and investment, the SFC has rolled out two initiatives - a course on personal financial management for university students and a series of workshop for teachers.

### Outreaching to students

For the first time, the SFC has partnered with the General Education Unit of the University of Hong Kong (HKU) to offer a course titled "Financial Intelligence (FQ) - The Art of Personal Financial Management and Investment".

The course comprises seven lectures and features prominent commentators and market



Mr Shek Kang Chuen, a speaker of the course co-organized with HKU and famous market commentator, talks to a packed room of HKU students.

practitioners as speakers.

The SFC will also contribute speakers to the course. Mr Andrew Sheng, SFC's Chairman, Mr Eric Cheng,

*(continued on page 2)*

## Setting standards for funds

Our new Director of Investment Products discusses major initiative for this year

There are over 2,000 investment products for investors to choose from in Hong Kong. One of the SFC's responsibilities is to ensure that the products comply with its regulations and codes. Of equal importance is the formulation of policies that assist in developing the market.

Our recently appointed Director of Investment Products, Ms Tina So, pointed out that public confidence was the cornerstone of a progressive financial market. It is for this reason that the SFC stresses the importance of working with investors and the industry.

### Future work

This partnership approach also guides the SFC in facilitating wider product choices for both investment and industry development.

Hong Kong will become one of the first jurisdictions to introduce hedge funds in the retail market. In May 2002, the SFC released the Hedge Funds Guidelines. The SFC is currently reviewing hedge fund applications. Hedge funds are expected to be available in the market in the fourth quarter.

To enhance the transparency of hedge funds, the SFC seeks to come up with the most appropriate set of disclosure requirements. We have therefore invited the public and the industry to comment on the proposed Hedge Funds Reporting Guidelines. Submissions are being studied.

A consultation paper on the concept and viability of introducing real estate investment trusts (REITs) in Hong Kong is also targeted for release in the fourth quarter. If the market is in favour of bringing in REITs, the SFC will issue proposed authorization guidelines for public consultation in the first half of 2003.

Other projects under study include the facilitation of exchange-traded funds and the introduction of best practice for the marketing of funds.

At a macro level, the SFC continues to take part in a Government taskforce responsible for policy proposals for the development of the fund management industry.



Ms Tina So (centre) explains to reporters the work of the department.

### Strengthening investor protection

On the international front, the SFC intends to broaden regulatory co-operation and establish mutual recognition of fund managers and investment schemes operating in jurisdictions with similar regulatory standards.

In considering new policies and product regulations, the SFC regards investor protection as a paramount guiding principle. "A strong three-way partnership between the regulator, investors and the industry is essential towards achieving a robust and enterprising investment market," said Ms So.

## Manipulators lose appeals

**The Court's decision to maintain heavy sentences on market manipulators should serve as an effective deterrent**

On 3 October 2002, the High Court dismissed appeals by two market manipulators against immediate custodial sentences imposed on them. The Court's decision has once again confirmed the seriousness of market manipulation.

On 18 March 2002, Choy Wai Zak and Yuen, Cyril Sze Ning were convicted of manipulating the shares of Hong Kong Parkview Group Limited. The Magistrate sentenced them, for the first time in Hong Kong for market manipulation, to immediate terms of imprisonment. Choy and Yuen were given eight months' and four months' respectively.

Choy and Yuen appealed against the sentences and their cases were dismissed by the High Court Judge. Mr Justice Lugar-Mawson stressed that market manipulation was an offence involving deception and dishonesty and struck at the heart of honest operation of the securities and futures market. As such it was not a victimless crime, he said.

The SFC is encouraged by the High Court's confirmation of the original sentences. Market manipulation carries a maximum sentence of two years' imprisonment and a maximum fine of \$50,000.

## SHORTS

### • Regulated short selling made easier

The SFC has brought forward the effective date of new measures to facilitate regulated short selling. The new rules introduce exemptions for market makers registered with stock and futures exchanges. The exempted market makers will be able to carry out uncovered short selling in performing market making obligations and hedging market positions. The rules also introduce alternative means to comply with certain reporting and record keeping requirements for sellers placing short selling orders pursuant to a stock borrowing and lending agreement. The rules were

*(continued from page 1)*

### Bright young things

Senior Director of Enforcement, and Ms Tina So, Director of Investment Products, will speak on various subjects including financial regulation, market pitfalls, and fund investment.

The course for HKU students commenced on 26 September and will run for seven consecutive Thursdays (excluding 24 October). Subject to the availability of seats, Mr Sheng's session on 14 November will be open to the public.

### Training the trainers

University students aside, the SFC has reached out to secondary school students by running a series of "train-the-trainer"

gazetted on 11 October and, if passed by Legislative Council, will become effective on 15 November 2002, much earlier than the original schedule of early 2003.

### • New Licensing Exam for March 2003

The Hong Kong Securities Institute (HKSI) has received approval from the SFC to replace its Foundation Programme Exam and Financial Market Principal Exam with a new Licensing Exam. The Licensing Exam to be launched in March 2003 will offer subject specialization papers in accordance with the licensing requirements under the new Securities and Futures Ordinance. For enquiries, please call HKSI at 3120 6100.

Teachers' Workshops from October to December 2002. The annual teachers' workshops comprise three modules: stocks; funds; options and futures. This year more than 450 teachers have signed up.

Each participating teacher will receive a teaching aid kit consisting of teaching materials. Teachers who cannot attend the workshops but still wish to obtain the teaching kit may call our Investor Education and Communications Department at 2842 7711.

*The enrolment form to the workshops is accessible under the Teachers' Corner on the SFC website at [www.hksec.org.hk/eng/investor/html/teachers.htm](http://www.hksec.org.hk/eng/investor/html/teachers.htm).*

# Broker consolidation continues

**Fierce competition and a sluggish market are putting more pressure on brokers**

The local securities broking industry has traditionally been characterized by the dominance of small and medium sized enterprises, many of which family owned. As of today, there still remain 74 sole-proprietor dealers and one dealing partnership.

The SMEs have managed to flourish in the past decades by serving niche markets in the retail sector. However, increasing competition against a background of adverse economic conditions has taken its toll.

Figures released by Hong Kong Exchanges and Clearing Limited show that the turnover on the main board and the GEM for the first half of this year decreased by 20% as compared with the same period last year. In recent months, daily turnover has dwindled to as low as \$5 billion from around \$7 billion earlier this year.

As competition intensifies and their niche markets are eroded, some brokers are being forced to contemplate whether to continue business or to close shop. If brokers choose to battle it out, they will have to increase investment and provide more value added services to keep up with the competition. As investors become more sophisticated, they will demand services above and beyond pure order execution, and a more convenient means of delivery.

How are brokers affected by the current operating environment? Figures available from the SFC's records suggest that market consolidation has continued. In 2001, 73

intermediaries closed down compared to 68 in 2000. In the first 9 months of this year, 51 intermediaries ceased business (See table). The SFC has further received exit notifications from another 35 intermediaries.

**Cessation statistics**

	2002	2001	2000
	Jan-Sep	Jan-Dec	Jan-Dec
Securities Dealing Firms	16	28	19
Securities Advisory Firms	25	31	34
Commodities Dealing Firms	6	6	6
Commodities Advisory Firms	4	8	9
<b>Total</b>	<b>51</b>	<b>73</b>	<b>68</b>

Owing to the uncertain outlook in this competitive field, the trend towards consolidation may well continue into next year. The positive side to this restructuring could be that the industry will emerge leaner and stronger, and that investors will benefit from higher levels of service and professionalism. These in turn may lead to added investor confidence and greater participation in the industry.

Meanwhile, the SFC will continue its efforts to facilitate the provision of investment services by intermediaries, provided that investors' interest is not compromised. These include the reduction of compliance costs (e.g. the reduction of licensing fees under the new regime and simplification of procedural requirements in various areas), as well as enhancement of communication with the industry to discuss current and compliance issues.

# Log your interests

**Directors' interests in equity-linked instruments (ELIs) are also subject to disclosure**

Timely disclosure of directors' dealings in securities of their companies is an essential component of our disclosure-based regulatory regime. The disclosure obligations, as enshrined in the Securities (Disclosure of Interests) Ordinance, give investors a more complete picture of dealings by directors.

On 17 September 2002, Hung Siu Lin Katherine, a Non-Executive Director of Cheung Kong (Holdings) Limited, was prosecuted for failing to comply with the Ordinance.

On 16 February 2001 Hung acquired 34,000 units of equity-linked instruments called Return or Discount Equity Options (RODEO) warrants in respect of shares held in Hutchison Whampoa Limited, an associated company of Cheung Kong. Neither Hong Kong Exchanges and Clearing Limited (HKEx) nor Cheung Kong was notified of the acquisition within the statutory five-day notification period as required under the Ordinance.

Reporting obligations again arose when Hung exercised the warrants and obtained 34,000 shares of Hutchison Whampoa on 25 April 2001. She did not, however, notify HKEx or Cheung Kong until four months after the expiration of the statutory notification period.

The Western Magistrate fined Hung \$24,000 and ordered her to pay costs of \$18,802 to the SFC.

## Reporting obligations

Listed company directors, both executive and non-executive, should report the acquisition of ELIs, whether conditional or unconditional, and the subsequent take-up of securities to both HKEx and the listed companies concerned within five business days of the original transaction and physical take-up of the shares. The disclosure obligations extend to any interests they have in the shares of associated companies.

## ENFORCEMENT

# Internet policing mobilized

**Ongoing monitoring of the Internet keeps scam websites in check**

The Internet has proved an invaluable channel through which to conduct business activities. However, its efficiency and relatively low cost structure has also made it a convenient tool for fraudsters operating cross-border scams. Partnership with overseas regulators is key to effective enforcement against crime conducted through the Internet.

## Internet Surf Day

To strengthen international co-operation against illegal investment websites, the Asia-Pacific Regional Committee of the International Organisations of Securities Commissions (IOSCO) organises an annual Internet Surf Day. On 30 September, the SFC surfed the Internet for possible fraudulent or abusive activities. This is the third time the SFC has taken part in this joint effort. Other participants included regulators from Mainland China, Australia, Thailand and Singapore.

The SFC has successfully identified five suspicious websites which are suspected of offering unregistered dealing or investment services to the Hong Kong public. The SFC is conducting enquiries into these sites and enforcement action will be taken if appropriate.

## Surveillance

The Internet Surf Day is not the only occasion where the SFC patrols the Internet. We carry out daily monitoring of websites, chat rooms and bulletin boards and take appropriate action when we come across suspicious websites. The SFC has prosecuted nine entities and disciplined a registered intermediary over the past years.

If the SFC detects potentially illegal activity aimed at another jurisdiction, the information will be passed on to the regulator in that jurisdiction.

## Beware of scams

Investors should take care before committing to any investment. You can find out whether you are dealing with a registered intermediary on the SFC website. The "Register Section" provides a full list of registrants as well as authorized investment products. Investors should also note that the "Investor Alert" section provides a list of unregistered firms.

To report suspicious activities or possible scams, investors can call the SFC's hotline on 2840 9333.

INVESTOR FOCUS

# Leveraging up can hurt

**Borrowing to invest in investment-linked assurance schemes can be costly and risky**

John wanted to live comfortably during his retirement, so his investment adviser, Mark, came up with a product called investment-linked assurance scheme (ILAS). John liked the scheme as it allowed him to invest in a range of underlying funds whilst also providing life insurance.

To "leverage up" the returns, John borrowed money from a bank to make a bigger initial investment. Unfortunately, market conditions turned sour and John ended up taking a loss as the scheme did not even generate enough money to cover the interest on the loan.

**ILAS are long-term investments**

ILAS are insurance policies where part of the premium is invested in funds chosen by the insured while the rest provides life insurance protection. These schemes are usually established for a minimum of 5 years to a longer and predetermined period of time.

Currently, we authorise ILAS and their marketing materials. The Insurance Authority regulates insurance companies that offer these schemes as well as insurance agents or brokers selling these schemes.

Investors should read the Principal Brochure and Illustration Document before they commit. The Principal Brochure sets out important information you should know. The Illustration Document demonstrates the surrender values over the term of the policy based on assumed rates of return.

Investors can also choose to withdraw from the plan within a cooling off period of either 21 days

after the application form has been signed or 14 days after the policy has been issued (whichever deadline expires later). A written notice must be sent to the insurance company in the case of a withdrawal.

**Factors to consider if you borrow to invest**

Consider the following before you take out a loan to invest in ILAS:

- Interest on loans often accounts for most of the financing cost, thus reducing your investment return.
- There are handling fees and annual renewal fees when you borrow. Some lenders may impose a break fee for repayment of the loan before maturity.
- Benefits on the insurance policy will be assigned to the lender until you pay off the loan.

Finally, it is wise to work out with your investment adviser a written proposal based on your financial position, investment objectives and risk tolerance level. Ask your adviser to disclose all the charges on the schemes and the credit facilities, as well as any fees that he earns for the recommended product (usually proportional to the value of the portfolio). This will provide you with a clearer picture of the costs and risks involved.

*For more information, please refer to "Questions Corner" of the "Advice to Investors" section on the SFC website at [www.hksfc.org.hk/eng/investor/html/questions.htm](http://www.hksfc.org.hk/eng/investor/html/questions.htm).*

# A new chapter

**The SFC welcome the establishment of an Expert Group to review the securities and futures market regulatory structure**

A three-man Expert Group appointed by the Financial Secretary will review the lines of communication and delineation of roles and functions under the three-tier structure, particularly in relation to the regulation of listing matters.

The SFC welcomes the establishment of the Expert Group and looks forward to working with it on this important review.

Meanwhile, we have taken up the recommendations of the Report of the Panel of Inquiry on the Penny Stocks Incident in the following areas:

- We will consult our Shareholders Group and Advisory Committee on HKEX's draft consultation papers sent to us for comments [See paragraph 14.8 of the Report].
- The SFC is examining its Memorandum of Understanding with HKEX to see how the respective functions and responsibilities can be clarified [14.9].
- The SFC is proposing to establish a new high-level liaison body to examine regulatory policy and procedures with specific responsibility to improve the protection of shareholder rights [14.19].

*For more background, please refer to Issue No. 12 of the SFC Alert or the Report of the Panel of Inquiry which is accessible on the Government website at [www.info.gov.hk/info/pennystock-e.htm](http://www.info.gov.hk/info/pennystock-e.htm).*

# SFO updates

**LegCo Subcommittee meetings**

The LegCo Subcommittee on draft subsidiary legislation to be made under the Securities and Futures Ordinance held four meetings in the past month to consider the last 11 items of the subsidiary legislation required for commencement of the Ordinance. All items of subsidiary legislation will be published in the Government Gazette for tabling before the Legislative Council later this year.

**Assisting compliance**

The SFC has eased certain proposals in the draft financial resources rules under the SFO

to help compliance by intermediaries. Among the amendments made in the draft rules are: the implementation of a transitional period for advisers; the extension of grace period for exempt dealers and exempt investment advisers; the expansion of categories of liquid assets; and the removal of the requirement on mandatory electronic filing of financial returns. For details, please refer

to the consultation conclusions accessible at [www.hksfc.org.hk/eng/bills/html/consultation.htm](http://www.hksfc.org.hk/eng/bills/html/consultation.htm).

**Consultation and Conclusions**

Two consultation conclusions have been issued in the last month. All documents are available under the SFO section of our website.

Consultation Conclusions on the following have been issued since 15 September 2002:	Issue Date
S&F* (Financial Resources) Rules	11 October
S&F (Fees) Rules	16 September

\*S&F stands for Securities and Futures