

## SHORTS

- LegCo resumed its detailed reading of the **Securities and Futures Bill** in September. The Bill is expected to be enacted by the end of 2001.
- The SFC welcomes the **appointments** of Mr Ashley Alder as Executive Director (Corporate Finance), Mr Alan Linning as Executive Director (Enforcement) on 1 November 2001 and Mrs Alexa Lam as Executive Director (Intermediaries and Investment Products) on 1 December 2001. They replace, respectively, David Stannard, Paul Bailey and Andrew Procter, to whom we offer our deepest thanks and best wishes.
- A new public register of **"licensed persons"** was launched in September to allow investors to check on the status of people acting as market intermediaries. To use this free service, go to the SFC web site ([www.hksec.org.hk](http://www.hksec.org.hk)) and look under "Intermediaries, Licensing & Investment Products". Or simply click on this URL ([www.hksec.org.hk/eng/licensing/html/index.html](http://www.hksec.org.hk/eng/licensing/html/index.html)) and look for "Licensed Persons".
- The **SFC Shareholders Group**, an independent advisory body appointed in May 2001, held its second meeting in early September.

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## Open for business

### Tragic and appalling as the events of September 11 were, they did not deter Hong Kong's markets from staying open

Like every major securities market around the world, Hong Kong took a battering after the recent terrorist attacks on New York and Washington. One week later, the Hang Seng Index had fallen 10.7% — from 10,417 to 9,308.

Hong Kong's performance was by no means the worst: major market indices in Malaysia, Singapore, Thailand and India all dropped between 12-17%, while those in Korea, Taiwan and Germany fell by 9-10%. To be fair, other closely watched indices, including the Dow, Nasdaq, S&P 500, FTSE 100, as well as other markets in Asia, performed better.

But from a local perspective, the main story here is not that markets fall in times of crisis. They always do. It was that Hong Kong's securities and derivatives markets remained open. Trading

was active and orderly, with virtually all clearing and settlement functions operating normally. The only minor exceptions were that dealing in the seven Nasdaq stocks available locally and the two "iShares" — MSCI's South Korean and Taiwan index funds — were suspended.

Across Asia, markets responded differently. Australia, New Zealand, Shanghai and Shenzhen also functioned as normal, whereas Malaysia, Thailand and Taiwan adopted a wait-and-see attitude and closed their markets.

Certain countries allowed their markets to trade, but took precautionary measures. Singapore suspended the trading of US-denominated securities. Japan delayed opening for 30 minutes and imposed a 50% fluctuation limit. And South Korea held off opening for three hours.

As these events show, Hong Kong has surely come a long way since the market closure of October 1987.

## The decline of the passive investor

### If Hong Kong retail investors are so passive, why do almost 80% of them want to know more about their rights?

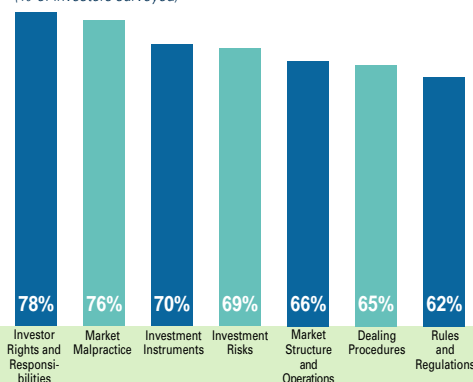
The minority shareholder in Hong Kong is a much-maligned figure. He allegedly does not attend annual meetings unless the buffet is sumptuous. She buys on rumour, not on knowledge. And when the roof starts to creak, they are the first to head for the exits (a charge levelled equally at institutional and retail investors).

Yet a new SFC survey offers a striking challenge to these assumptions. Over June and July of this year we contacted more than 4,000 people — 25% of whom were retail investors — and asked about their investment patterns, information sources and education needs. Encouragingly, retail investors told us the following:

- 78% want more information about investor rights and responsibilities.
- 76% are keen to understand market malpractice better.

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Topics investors want to know more about  
(% of investors surveyed)



## TRADING FLOOR

## Be wise before the event

**Misappropriation — the wrongful use of client assets in brokerage accounts — is a sickening experience for an investor. Here are some tips to prevent this.**

Bill Kei, a stockbroker, had been Johnny Park's secondary school classmate. When the local market began to boom in the mid-1990s, Park turned to Kei for advice in investing in shares.

For several years, all went well. Then Kei joined another brokerage firm. Park duly moved his account to the new firm, because he trusted his friend and knew Kei was familiar with his investment needs.

**That sinking feeling**

Initially, Park received contract notes and statements of account from the new brokerage as normal. But over time they took longer to arrive. Some never came at all. When Park asked about this, Kei told him that the firm was upgrading its computers and this was causing the delays. Kei assured his friend that he would follow up his complaint. Sure enough, he did and the statements arrived a few days later. Having been anxious at first about these problems, Park began to relax.

But everything changed when Park received a letter from an audit firm asking him to confirm his account statement with the brokerage. He was stunned to see that most of the blue chips he should have owned were simply not there. Even worse, a series of mysterious trades had been booked under his account. Park felt a fool.

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- 69% would like a better handle on investment risks.

These results do not imply that Hong Kong is about to witness a surge in shareholder activism in the near future. But they suggest that local investment behaviour could be on the cusp of change. Retail investors clearly want to increase their knowledge of the market and corporate governance.

**What to do**

While Kei had certainly abused Park's trust, Park had also been remiss in not protecting his investments better. At the very least, he should have notified the senior management of the brokerage firm as soon as the irregularities began occurring.

"Anyone who allows his account executive to receive contract notes and statements of account on his behalf must also understand the risk of dishonest people intercepting them," warns Stephen Po, SFC Director of Intermediaries Supervision.

To minimise the chances of misappropriation, investors should ask themselves the following questions:

- Am I taking a risk in letting my account executive handle everything?
- Do I understand the power of attorney that my account executive has asked me to sign?
- Should I make cheques out to my account executive?

*For a detailed list of guidance and tips on protection against misappropriation, investors should consult the leaflet, "Take Care of Your Money". The leaflet is available at the SFC office on 12/F, Edinburgh Tower, the Landmark, Central*

**Still offline**

In other ways, however, retail investors remain quite conservative. Only 10% had experimented with on-line trading — the proportion was higher for younger investors, those with higher education and income levels, and frequent traders—and most still turned to the mass media for their main source of market information.

## ENFORCEMENT

## Tell the market

**Directors and substantial shareholders who do not disclose their share dealings properly will find themselves in court**

In the less than two months between July 31 and September 11 of this year, three directors and three substantial shareholders were successfully prosecuted for contravening the Securities (Disclosure of Interests) Ordinance (SDIO).

In total, they paid fines amounting to HK\$119,000 and costs of a further \$66,000 to the SFC.

One of the directors was the chairman of a main board company. A second was linked to a major red chip. And the third was on the board of one of Hong Kong's biggest property developers. Meanwhile, two of the substantial shareholders were corporations.

In other words, all had little reason not to know the rules.

**By the book**

The SDIO states that substantial shareholders, directors and CEOs of listed companies must report changes in their holdings of stock to the listed companies and Stock Exchange within five days next following the day on which they become aware of those changes.

Substantial shareholders — defined as any person or corporation with a shareholding of 10% or more — must report whenever their percentage holding changes from one whole percentage figure to another. For example, if a substantial shareholder holds 10.9% of a company and purchases another 0.2%, he has to report this because his total stake

Banks are generally the intermediary of choice for investors with lower education and income levels, and for the less experienced or infrequent traders. In contrast, people with higher education and income levels, or who are more experienced or frequent traders, are more likely to use brokerage firms.

*The full survey results are available on our web site at: <http://www.hksfc.org.hk>.*

is now 11.1%. But if he sells the same amount, he does not have to report because his stake stands at only 10.7%. All such reporting ceases when holdings fall below 10%.

Directors and CEOs, however, must report all and any changes in their holdings; and this obligation extends to any "associated corporation", such as a subsidiary or holding company of the listed company, or a subsidiary of the listed company's holding company.

The penalties for those who fail to comply are \$10,000 and six months imprisonment on summary conviction; and \$100,000 and two years imprisonment on indictment.

**What's the big deal?**

Such disclosure may seem like a tedious waste of time, and of questionable value to the market. Can a fraction of a percentage point really matter?

On the contrary, buying and selling by substantial shareholders and directors provides important signals to the market about the state of the companies whose shares are being traded. To ensure an informed and highly transparent market, it is critical that all such transactions are reported and disclosed.

"Investors must and should be provided with all relevant information upon which to base their decisions," says Paul Bailey, Executive Director of Enforcement at the SFC.

The alternative is a badly informed market in which investors have, at best, only fragile confidence. And that would not be to Hong Kong's long-term advantage.

## EVENTS

The SFC will hold, in association with HKSI and City & Financial, a three-day conference from October 29-31 in Hong Kong. Conference topics will be corporate governance, the future of equity research and the regulation of hedge funds.

The SFC, HKMA, TDC and HKEx will hold a joint financial conference in Chongqing in November. The main purpose of the conference is to promote financial services and explain the regulatory structure of Hong Kong markets.

## Bailey busts bungling broker

**Touting is common practice in Hong Kong. But some touts are dumber than others**

If you wanted to offload some shares onto unsuspecting and unsophisticated investors while masquerading as an investment firm, who would you call? A few retail investors, maybe. People listed in the directory of a chamber of commerce, perhaps.

What you wouldn't do is enter the lion's den by calling Paul Bailey, Executive Director of Enforcement at the SFC. That is, unless your alleged name happens to be Robert Tankai or Maxwell Kane and you work for Kearns Investment Inc, supposedly based in Japan.

Over the space of two days in late September, these sharp salesmen offered Mr Bailey a deal that was just too good to accept: 100,000 shares in a Nasdaq company priced at US\$0.50 each, yet trading at US\$0.75. Messrs Tankai and Kane were willing to offer Mr Bailey this instant profit of US\$25,000 in order to attract him, a total stranger, as a client.

Mr Kane assured Mr Bailey that Kearns normally advised its clients to invest in blue chips and fixed income products, although it also offered investments in venture capital funds. But their interest in the Nasdaq firm stemmed from some inside information they had received: the company, which sold fire-resistant building materials, was about to win a huge contract to rebuild the area around the World Trade Center in New York. When the New York market dropped 100 points on September 25, Kearns had managed to buy a few million shares at US\$0.50 each. Hence they were in a position to offer Mr Bailey such a good deal.

**Check the facts**

A check on the Nasdaq-listed company showed that, while it existed, its daily turnover between September 20-25 never exceeded 200,000 shares and at no time did its price even hit US\$0.50.

This event raises a number of issues:

1. It is illegal for a person to attempt to induce others in Hong Kong to purchase, or deal in any way, in securities without being

registered with the Commission. Neither Kearns nor Mr Tankai nor Mr Kane are registered with the Commission.

2. The representations made in this case appear factually incorrect, especially with regard to the source of the shares.

3. Looking at the trading pattern of the Nasdaq company, and given the large number of shares apparently available from Kearns, anyone seeking to sell could have a considerable downward impact on the share price.

"It is important that investors, or any member of the public, receiving such calls make proper inquiries," said Mr Bailey. At the very least they should:

- Check whether the company soliciting business is licensed in both the jurisdiction in which it operates and the country where it does business;
- Check the background of the company whose shares are being offered, and whether or not the sales pitch is true. Many financial websites quote shares traded on overseas markets and give information and news about these companies;
- Beware of people who claim to have inside information. Insider dealing is a criminal offence or civil wrongdoing in all major financial markets;
- Beware of any offer that promises immediate profit; and
- Do not remit money, or agree to anything, until you have made these inquiries.

**Coming soon**

- Regulation of on-line trading of securities and futures
- Survey on the business activities of intermediaries
- Update on development of Hong Kong's financial infrastructure

## GET THE FACTS BEFORE YOU INVEST

*Watching babies learning to walk is joyful, and we know it will take time for them to learn to be steady on their feet. For the investor, however, it is important to gain stability from the outset.*

*We feel that the best way to go about investing is to ensure having all the facts at your disposal. Here are some suggestions to help you:*

- 1. Learn how to buy and sell by understanding how the market works.*
- 2. Learn how to choose products and services suitable for your budget and goals.*
- 3. Know what kind of firms and products you are investing in.*
- 4. Know with whom you are dealing.*
- 5. Above all, learn the risks of making investments.*

*For more information, visit our Electronic Investor Resources Centre at [www.hkeirc.org](http://www.hkeirc.org) and pick up some investor brochures or call our Investor Hotline: 2840 9333.*

### LEGAL UPDATES

## Code of Conduct

In April, the SFC introduced a revised Code of Conduct for Persons Registered with the Securities and Futures Commission. While the majority of the provisions in the new code are already in force, several others came into effect recently on October 1. The relevant sections are:

- 3.9 Order recording;
- 5.1 Know your client (regarding certain accounting opening procedures);
- 6.1 Client agreement in writing (regarding certain content requirements);
- 6.2 Minimum content of client agreement; and Paragraph 1A in Schedule 4 (regarding recording of confirmations).

Of these, section 3.9, order recording, covers the requirement to immediately record and time stamp the particulars of instructions for both agency and internally generated orders. Where registrants receive order instructions from clients over the phone, they must use a telephone recording system to record those instructions.

From October 1, registrants must start using a telephone recording system and must keep all recordings made for a period of three months.

While the market has already indicated its willingness to recognise voice recordings as being helpful when trying to settle disputes, there is no need to go to any great expense, says SFC Director of Intermediaries Supervision, Stephen Po. "There are several relatively simple and inexpensive telephone recording devices available and individual firms can choose what is most appropriate for them. The main thing is to make sure they can make and keep the audio records.

Should you have any practical or logistical hurdles to overcome, we will be happy to work with you to help you conform to the Code. Please contact us as soon as possible."

*A copy of the revised Code of Conduct for Persons Registered with the Securities and Futures Commission is available from: <http://www.hksfc.org.hk> and SFC office on 12/F, Edinburgh Tower, the Landmark, Central.*

### Securities and Futures Commission

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Electronic Investor Resources Centre: [www.hkeirc.org](http://www.hkeirc.org)