

Better regulation on margin financing

The SFC is consulting the public on how to strengthen the regulation over securities margin financing (SMF) activities.

The collapse of C.A. Pacific in 1998 is a good example of the danger of excessive pooling and re-pledging of margin client collateral. If an SMF provider collapses, margin clients may lose their re-pledged collateral that are being held by the banks of the SMF provider. Hong Kong cannot afford to have another collapse like C.A. Pacific.

The SFC believes this is the right time to deal with the issue as the industry has been doing well - with a total net profit of nearly \$5 billion in the first half of 2004.

The proposed measures are designed to significantly reduce the pooling and credit risks arising from SMF activities and hence enhance the level of investor protection and safeguard Hong Kong's reputation as a premier international financial centre.

The principal proposals are based on the recommendations made by the SFC's Working Group on the Review of the Financial Regulatory Framework for Licensed Corporations. They include:

- limiting the amount of margin client collateral that an SMF provider can re-pledge as security to secure borrowings at a percentage of the aggregate margin loans; and
- adjusting the haircut percentages under the Financial Resources Rules so that margin client collateral may be more realistically valued.

The SFC is open minded to feedback and has no firm views on various key proposals. The public are invited to submit their views by 31 October.

For more details, please refer to SFC press release issued on 28 September 2004, available on the SFC website at: <http://eapp01.hksfc.org.hk/apps/cc/PressRelease.nsf/eng/1kupNewsCode/04PR177?openDocument>.

IOSCO consults on CRAs

The International Organization of Securities Commissions (IOSCO) has published a Consultation Report on *Code of Conduct Fundamentals for Credit Rating Agencies*.

The *Code* builds on the Statement of Principles Regarding the Activities of Credit Rating Agencies (CRAs) issued in September 2003 by IOSCO's Technical Committee. The Principles set out high level objectives aimed at protecting the integrity and analytical independence of the credit rating process while the *Code* provides more detailed guidance to CRAs on how to give effect to the objectives embodied in the CRA Principles.

The *Code* is comprised of practical measures which are designed to be incorporated voluntarily by CRAs into their own code of conduct to enhance transparency. It also addresses issues such as the basis for the forming of credit rating opinions and the

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We have, for the first time, partnered with Radio Television Hong Kong (RTHK) and The Salvation Army to tailor-make an investor education radio programme for senior citizens.

Invest Wisely for Seniors comprises 12 15-minute episodes. (From left) Mr Peter Au-

Yang, SFC's Executive Director and Chief Operating Officer; Major Alfred Tsang, General Secretary of The Salvation Army; Mr Philip Chow, Head of Chinese Programme Service of RTHK; and some guest speakers launched the programme on 16 September.



The programme, in Cantonese, is broadcast on RTHK Radio Five (at AM783) every Tuesday at 11:30am until 7 December 2004, with a simultaneous webcast on RTHK's website at www.rthk.org.hk. After that, the programme will be available at <http://www.rthk.org.hk/rthk/archive/>.



Senior management interview

Mr Eric Cheng, Senior Director of Surveillance, Enforcement

What are your responsibilities?

The Surveillance Department, consisting of 18 executives, is responsible for market surveillance. We look out for any unusual price movements or trading in stocks and derivatives that may be connected with market misconduct such as insider dealing and market manipulation, or misconduct by licensees. We rely on the powers under section 181 of the Securities and Futures Ordinance to get trade information from brokers. We make initial inquiries and pass suspicious cases to the Investigation Department for full investigation.

How do you conduct surveillance?

It is impossible for us to watch all market transactions, so we use various means to monitor the market. We may run data through a special computer program that generates alerts when unusual price or volume movements take place. The program can display every transaction order received by HKEx. We can create snapshots of the market environment at any given time, which proves very useful in our assessment.

We also monitor news media reports and act on complaints. Other law enforcement agencies, such as the Police and ICAC, also give us information.

How many cases do you handle each year?

We conducted over 1,000 inquiries last year. Fewer than 10% were passed to Investigation and some cases were dropped because there was not enough evidence.



Is your job finished after you pass a case to Investigation?

Sometimes we give expert testimony during a prosecution in court, or assist

outside experts to prepare their statements. It is difficult and expensive to find independent experts in the market, as many of them may have potential business connections with the defendants.

What is the most difficult part of your work?

We need to exercise judgement, for example when deciding whether market misconduct has taken place. It is also not easy to prove the intention of the people involved. I hope my experience in the private sector has given me a better understanding of market practices and enables me to make better judgements.

Is the SFC more focused on combating corporate misconduct?

The SFC is digging deeper into suspicious transactions related to listed companies. This can be illustrated by the increase in the number of new investigations into listed companies. It nearly doubled from six in 2002-03 to 10 in 2003-04. We have initiated six more since April this year.

Personal bio

- Joined the SFC as Senior Director of Surveillance, Enforcement in March 2002.
- Previously worked in the private sector including Vickers da Costa International, James Capel Far East Limited, and Worldsec International Limited. Primarily responsible for securities and futures broking.
- BSocSc, University of Hong Kong
- Enjoys golf, basketball, swimming, and reading.

In partnership with the fund industry

SFC Chairman Mr Andrew Sheng has pledged to work with the fund management industry in partnership to maintain and strengthen Hong Kong's leading position in asset management.

In his speech delivered at a luncheon of Hong Kong Investment Funds Association

on 27 September, Mr Sheng said the role of SFC was to maintain a level playing field in terms of competition. With international standards of transparency and market regulation, the SFC enforced the regulations firmly and fairly, he said.

He said the SFC should work closely with

the market in removing obsolete regulations that deterred innovation and change. Any regulatory changes would be subject to rigorous market consultation, he added.

For more details, please refer to the speech available on the SFC website at: http://www.hksfc.org.hk/eng/press_releases/html/speech/04/as_040927_hkifa.pdf.

First prosecution under *Dual Filing*

The SFC will not tolerate listed companies and their directors misleading the public. In September, we successfully prosecuted a listed company and its director for providing false or misleading information, in the first prosecution under Dual Filing.

Huafeng Textile International Group Ltd issued untrue and misleading statements in July 2003 in connection with its director Mr Cai Yang Bo's sale of Huafeng shares owned by him and other Huafeng directors. Huafeng and Cai were fined \$50,000 each

and ordered to pay total investigation costs of \$28,000 to the SFC.

The case demonstrates that both the SFC and the Courts are serious about corporate transparency and honesty.

Since the statutory Dual Filing rules came into effect last year, we have been working on a number of disclosure cases.

Listed companies are reminded that the disclosure requirements have teeth and that

a failure to fulfil them may result in criminal prosecution.

Looking forward, we plan to enhance the Dual Filing regime through statutory backing to important listing rules. We hope to ease the regulatory burden on those who adhere to high standard of disclosure, and to ensure that there is a serious sanctioning regime for those who do not.

For details, please see press release issued on 22 September, available on the SFC website at: <http://eapp01.hksec.org.hk/apps/cc/PressRelease.nsf/eng/ikupNewsCode/04PR171?openDocument>.

Cold calling is **illegal**

We notice that recently there has been an increase in unsolicited calls by intermediaries to induce the public to invest in financial products. Intermediaries, including brokers and banks, are reminded not to engage in cold calling which is illegal.

Cold callers often contact people through door-to-door visits or telephone calls using information obtained from public directories or other means, such as contact details gathered from questionnaires or seminar registrations.

Intermediaries are reminded that they should not use such information to contact the people concerned to induce them to invest in securities, futures or leveraged

foreign exchange contracts unless requested by the people to do so.

Firms should have internal control measures to prevent cold calling. They should also ensure their staff understand the law on cold calling, and closely supervise and monitor their marketing or promotional efforts.

The SFC may prosecute and discipline intermediaries and their staff who permit or engage in cold calling.

For more details, please see press release issued on 27 September 2004, available on the SFC website at: <http://eapp01.hksec.org.hk/apps/cc/PressRelease.nsf/eng/ikupNewsCode/04PR174?openDocument>.

In brief

The **Public Shareholders Group** held its 21st meeting in August. The SFC presented its disciplinary procedures and enforcement strategy to members of the Group.

At the Group's 22nd meeting in September, the SFC solicited feedback from members on a paper on the review of Part XV of the Securities and Futures Ordinance.

Brokers and custodian banks for institutional investors use **settlement instructions** (SIs) to settle transfers of securities among themselves in the Central Clearing and Settlement System (CCASS). Currently they confirm with their counterparts details of the SIs by phone, fax or email before inputting them into CCASS (pre-matching process) to ensure a smooth settlement. Such manual pre-matching disrupts the straight through processing of a trade and increases processing costs.

Hong Kong Securities Clearing Company Limited in October enhanced the SI matching process in CCASS in order to improve the overall efficiency of settlement instruction matching. One of the major enhanced features is to automate the pre-matching process and allow it to be conducted in CCASS. All enhancements will help to enable straight through processing in the Hong Kong securities market.



FAQs

Q: Can I open a stock account without going to the broker's office?

A: Yes, brokers may open an account for a client without a personal visit. However, in such case, the signing of the client agreement and sighting of related identity documents must be certified by another licensed or registered intermediary, or a professional person (such as a certified public accountant, a lawyer, or a notary public).

Alternatively, you can return the client agreement with a copy of your identity document for verification, plus a cheque of not less than \$10,000 bearing your own name and drawn on your account with a licensed bank in Hong Kong. Your signature on the cheque should be the same as that on the client agreement. The new account will not be activated until the intermediary has cashed your cheque.

Disciplinary process explained

The SFC has explained its disciplinary process and settlement policy to enhance public understanding.

A new pamphlet, *Disciplinary Proceedings at a Glance*, explains in plain language our disciplinary process and describes the procedural rights of persons who are subject to disciplinary proceedings.

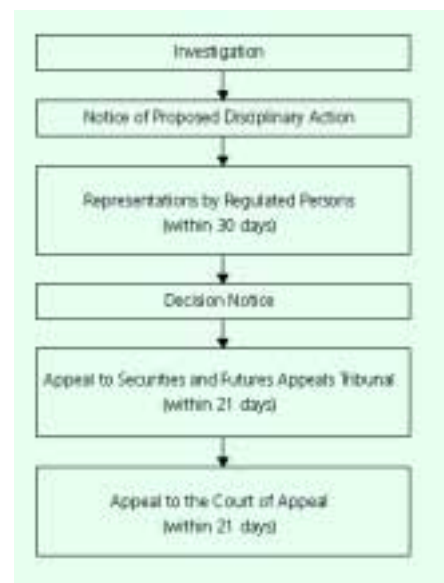
It also summarises the reasons why such proceedings are necessary, the factors which we will consider in deciding whether to start the proceedings and the level of sanctions, the disciplinary measures available, our policy of settlement, and licensees' rights of appeal to the Securities

and Futures Appeals Tribunal and the Court of Appeal.

Separately, the August issue of the Dr Wise's Column is *Why Does the SFC Settle Disciplinary Cases?* The SFC has recently settled several disciplinary cases. Dr Wise explains that the SFC considers the public interest first and foremost in settlement. An offer of monetary payment, however large, may not be acceptable in certain circumstances.

The pamphlet is available at the SFC office and on the SFC website at: http://www.hksfc.org.hk/eng/press_releases/html/publications/disciplinary_proceedings_eng.pdf, while Dr Wise is available at: http://www.hksfc.org.hk/eng/investor/html/dr_wise/aug04.htm.

SFC's disciplinary process



Robust regulation for hedge funds

We have seen increasing interest from overseas fund management professionals wishing to set up hedge fund management operations in Hong Kong.

A hedge fund manager is required to be licensed by the SFC regardless of whether he manages a fund offered to the public or to professional investors only. While we will facilitate and encourage market players to enter the industry, hedge fund managers must meet the same high regulatory standards like other licensed persons.

We have designated a focus team to handle licence applications of hedge fund managers and deal with their enquiries (hedgefund@hksfc.org.hk).

Where a hedge fund is offered to the public, SFC authorisation of the product is generally required. We will review the Guidelines on Hedge Funds that set out the authorisation criteria for retail hedge funds within this financial year. The review aims to strengthen the present disclosure standards to improve transparency. We also hope to be flexible, such as accepting a wider range of experience as qualifying experience in respect of the management companies of retail hedge funds. We will discuss with market groups before issuing a consultation paper.

For details, please refer to press release issued on 7 October 2004, available on the SFC website at: <http://eapp01.hksfc.org.hk/apps/cc/PressRelease.nsf/eng/lkupNewsCode/04PR182?openDocument>.

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CRA consultation

elimination of conflicts of interest in arriving at such opinions.

The Chairmen's Task Force of the Technical Committee, in which the SFC actively participates, is particularly interested in receiving views on how the *Code* advances the goals of investor protection, fairness, efficiency and transparency in securities markets, and the reduction of systemic risk.

The SFC urges the public, including issuers, investors and the industry, to submit comments to the IOSCO by 8 November 2004.

For details, please refer to IOSCO Press Release and the Consultation Report issued on 7 October 2004, available on the IOSCO website at: <http://www.iosco.org/news/pdf/IOSCONEWS74.pdf>. Comments can be sent by several means to IOSCO including by email to mail@oicv.iosco.org.



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.hksfc.org.hk/apps/CC/RegulatoryHandbook.nsf/GenerateHTMLTBEnglish?openAgent&1>.

1. Circular to Licensed Corporations and Associated Entities - Anti-Money Laundering / Combating Terrorist Financing - US President's Executive Order 13224 (30.09.2004)
2. Circular to Licensed Corporations and Registered Institutions - Intermediaries Activities Survey 2003/04 (10.09.2004)
3. Circular to Certain Deemed Licensed Corporations (Sole Proprietors) - Migration into the New Regime under the Securities and Futures Ordinance (31.08.2004)
4. Circular to Licensed Corporations and Associated Entities - Anti-Money Laundering / Combating Terrorist Financing - (1) United Nations (Anti-Terrorism Measures) Ordinance (2) United Nations Sanctions (Afghanistan) Regulation (3) United Nations Sanctions (Libya) (Repeal) Regulation 2004 (20.08.2004)
5. Circular to Licensed Corporations and Associated Entities - United Nations Security Council Resolution 1532 (17.08.2004)



Investor focus

Does **nominee arrangement** suit you?

When buying a fund, you may register your holdings in your name or have the units held via a nominee company. A nominee arrangement may offer convenience. For instance, the nominee company can handle for you most of the documentation like application forms and reports, and consolidate the information for your easy reference. However, there are drawbacks:

- Even though you are the beneficial owner of the fund units, legal ownership of the units is registered in the name of the nominee company. If the nominee company cannot provide its services, you may not have direct recourse on the fund or the fund manager. This is because fund managers do not assume any direct legal responsibility towards investors who do not have any direct contractual relationship with the fund.
- The nominee company alone will receive information of your investment, fund performance reports and the fund manager's forecast. If you do not ask your nominee company to re-direct information to you, you may not be able

to obtain up-to-date information.

- Since the fund manager does not have your personal particulars under the nominee arrangement, it might be difficult for it to identify and contact you directly if emergencies arise, or for you to enquire about your fund investment directly with your fund manager.
- In most instances, nominee companies are not subject to any regulation or prudential oversight. So, there may be risks attached to entrusting your investments with a nominee company. Investors may not be protected if a nominee company defaults.

Therefore, before signing up for nominee services, you should carefully consider whether they are suitable for you.

For more details, please read an article entitled Can units in a fund be registered in an investor's own name?, available on the SFC website at: <http://www.hksfc.org.hk/eng/investor/html/questions/efund-nominee.htm>.

In brief

All About Stock Investing, a television programme jointly produced by the SFC and Radio Television Hong Kong, will be re-aired on News Channel One of Cable Television on every Sunday, at 8:55pm starting from 28 November 2004. Alternatively, you can view it at 4:55pm, also on Sundays, starting from 5 December 2004. Don't miss it!

We have updated an article *Investment-linked Assurance Schemes* on our website, explaining what **with-profits funds** are. These are funds managed by an insurance company, the declared returns of which do not directly match the performance of the funds' underlying assets. The article explains how the returns of such funds are determined. (http://www.hksfc.org.hk/eng/investor/html/questions/eilas_features.htm)

Investors who would like to know more about **investor participant (IP) accounts** service in the Central Clearing and Settlement System (CCASS) may refer to an article *Why Not Consider Investor Participant Accounts?* published in September in Dr Wise's Column. Dr Wise explains that by putting shares in IP accounts, investors may enjoy the convenience of electronic book-entry settlement and have full control of their shares. He also highlights several enhanced features that have been introduced recently. (http://www.hksfc.org.hk/eng/investor/html/dr_wise/sept04.htm)



Investor resources

The following items of investor resources have been made available to the investing public or updated 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>):

14 unlicensed companies including "Global Mercantile Advisors Ltd" (05.10.2004), "Axa St John", "Emerald Worldwide Holdings Inc Limited" (28.09.2004), "Warren Futures Limited" (21.09.2004), "Goldmany (Hong Kong)", "Steel Mercantile Portfolio" (07.09.2004), "Citibank's Citi Identity Theft Solutions" (not related to Citibank, N.A.), "McBain Baxter Holding Limited", "Smart Port Asset Management" (01.09.2004), "zqgroups.com" (24.08.2004), "Breakthrough Incorporated", "DKM Global Management, Inc", "General Mercantile Advisors Ltd" and "Glebe Investment Holdings" (17.08.2004) have been added to the Alert List. Information of five companies including "General Mercantile Advisors Ltd" (05.10.2004), "Bernard Simpson Consultants" (28.09.2004), "International Options Management" (15.09.2004), "Emmerson Bennett" (24.08.2004) and "Citixpress Finance & Security Co Ltd" (11.08.2004) have been updated on the list.

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

Why Not Consider Investor Participant Accounts? (28.09.2004) and *Why Does the SFC Settle Disciplinary Cases?* (31.08.2004)

Others:

Educational article *Investment-linked Assurance Schemes* has been updated (02.08.2004). (<http://www.hksfc.org.hk/eng/investor/html/questions.htm>)

Investor education course for university students

Investor education should start at school so that students will become smart investors in future. We have recently partnered with Lingnan University to launch, for the first time, a credit-based course on foundations of investing for undergraduates.

The Craft of Financial Investing helps students acquire fundamental knowledge of market infrastructure and investment risks, and develop a proper attitude towards financial management. The course, consisting of two levels, covers investments in stocks and funds, complicated corporate activities of listed companies, and characteristics and trading know-how of complex products. The Elementary Level course started in October while the Advanced Level course will be offered next March. Lingnan undergraduates can contact their Student Services Centre at 2616 7304 for details.

For details, please see press release issued on 6 September 2004, available on the SFC website at: <http://eapp01.hksec.org.hk/apps/cc/PressRelease.nsf/eng/lkupNewsCode/04PR158?openDocument>.



Five more members of the public have received the **Smart Investor Awards** for reporting boiler rooms and Internet scams. They led to the posting of five dubious entities on the Alert List of unlicensed overseas companies and suspected scam websites on our website. The award is still open and investors are welcome to submit reports to us. Pictures shows (from right) SFC's Executive Director and Chief Operating Officer Mr Peter Au-Yang, award winners Mr Clive Rigby and Mr Franklin Heng, and the representative of Mr Kwok Yat Cheung, the third winner. They each received a certificate of recognition and an SFC corporate watch.

For more details, please see press release issued on 3 September 2004, available on the SFC website at: <http://eapp01.hksec.org.hk/apps/cc/PressRelease.nsf/eng/lkupNewsCode/04PR156?openDocument>. The Alert List is available at: http://www.hksec.org.hk/eng/investor/html/unlicensed_overseas_comp.htm.

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.hksec.org.hk/eng/press_releases/html/publication.htm.

1. Consultation Paper on Proposed Measures to Address Risks Arising from Securities Margin Financing (28.09.2004)
2. SFC Enforcement Reporter - September 2004 (13.09.2004)
3. Disciplinary Proceedings at a Glance (06.09.2004)
4. Quarterly Bulletin - Summer 2004 (20.08.2004)
5. Consultation Paper on the Proposed Repeal of Certain Class Exemptions made under section 38A(2)/342A(2) of the Companies Ordinance (18.08.2004)



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.hksec.org.hk/eng/miscellaneous/html/employment.htm>.

- **Manager - Licensing**
- **Manager / Assistant Manager - Intermediaries Supervision**



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@hksec.org.hk.



Feedback

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

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