

## HK to host IOSCO Annual Conference 2006

### International event boosts image of Hong Kong

The Annual Conference of the International Organization of Securities Commissions (IOSCO) will be held in Hong Kong for the first time in 2006. The SFC will be the host organiser.

IOSCO is the primary forum for international co-operation among securities regulators and is recognised as a body to set international standard for the securities sector. It has 181 members from more than 100 jurisdictions. During its Annual Conference in Seoul earlier this month, IOSCO selected the SFC as the 2006 host.

The Financial Secretary, Mr Henry Tang, welcomes the IOSCO decision: "This will be a wonderful opportunity for Hong Kong to showcase to the world our strengths as an international financial centre and a premier fund-raising centre for the Mainland and the region."

Hundreds of delegates, accompanying persons and observers will come to Hong Kong during the Annual Conference, tentatively scheduled for

early June 2006. This will bring considerable economic benefits to Hong Kong and reinforce Hong Kong's international image.

SFC Chairman, Mr Andrew Sheng, thanked the Financial Secretary and the Hong Kong securities community for their strong support, which was instrumental in securing Hong Kong's bid. The SFC will work together with everyone to make the event a success.

During the Seoul meetings, Mr Sheng was appointed Interim Chairman of the IOSCO Technical Committee until May 2004.

The SFC also welcomes IOSCO's announcement of a Multilateral Memorandum of Understanding Concerning Consultation and Co-operation and the Exchange of Information (MOU). Hong Kong is amongst the first securities regulators worldwide to have signed the MOU, which enhances co-operation to combat cross border securities fraud and other financial crimes.

## SFC Chairman re-appointed

The Chief Executive, Mr Tung Chee Hwa, has re-appointed Mr Andrew Sheng as the Chairman of the SFC for two years from 1 October 2003 to 30 September 2005.



In announcing the appointment, Financial Secretary Mr Henry Tang said Mr Sheng's re-appointment would provide continuity in the implementation of the newly commenced Securities and Futures Ordinance, as well as the rollout of various initiatives for enhancing corporate governance, protecting shareholder interests and modernising market infrastructure.

"We are pleased to have Mr Sheng's continued service and look forward to working with him and his colleagues at the SFC in upgrading the quality of our market," Mr Tang added.

Mr Sheng expresses his sincere thanks to the Chief Executive for the confidence shown in him and the recognition of his work. Mr Sheng also feels honoured to be able to continue to serve the community.

## SFC to develop regulatory approach on analysts

The SFC intends to consult the public and the industry early next year on how to regulate conflicts of interest of securities analysts.

The announcement came as the IOSCO released, on 25 September, a Statement of Principles and a set of Core Measures on sell-side securities analysts. The SFC has participated in its work.

In developing its own regulatory approach, the SFC will consider the IOSCO principles and core measures, as well as practices and needs of the Hong Kong market. It will consider the results of an intermediaries survey and an investors survey conducted on investment research in January and April 2003 respectively. A public consultation on regulatory proposals is planned for the first quarter of 2004.

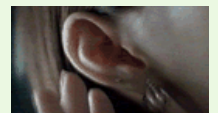
In setting out the principles, IOSCO recognises that, as a fundamental matter, addressing conflicts of interest requires mechanisms that eliminate or manage these conflicts. Consequently, securities regulators, self-regulatory organisations or firms should analyse the types of conflicts of interest that exist and adopt measures that eliminate, limit, manage or disclose these conflicts.

The principles are combined with a set of core measures that IOSCO considers are critical to achieving the high-level objectives and necessary to properly address the conflicts of interest securities analysts may face.

*The principles and core measures of IOSCO are available on its website at <http://www.iosco.org>.*

## Bank on facts, not rumours

In light of the increased activities in the market recently, we are taking the opportunity to remind investors again of the golden rule that they should do proper research on a stock before investing in it.



Since mid-September, we have been airing TV and radio Announcements of Public Interest (APIs) in which we use a creative concept of "ears" to emphasise the important message of "when you invest, bank on facts". Investors should not rely on rumours that they have heard. The APIs are aired frequently including at prime viewing time slots.

### INSIDE

- More boiler room tricks P.2
- Consultation on regulation of listing P.2
- Regulation of auditors P.2
- Prudent settlement urged for brokerages P.3
- Application for re-entry into the industry by persons with disciplinary records P.3
- Default of Yicko Futures P.3
- Are you affected by pooling risk? P.4
- Teachers' workshops P.4
- Shareholders Group P.4
- C. A. Pacific Securities P.4

## More boiler room tricks

### False information provided for checking "authenticity" of products

Investors are advised to look out for new boiler room tactics that are emerging in the US.

The US Securities and Exchange Commission has recently informed us of those new tricks to lure investors. Although we have not received similar complaints in Hong Kong, we are watching the situation closely.

If you receive unsolicited calls (usually from overseas) asking you to invest, and the caller has never met you face-to-face and cannot be reached once you have sent the money for the investment, you might have run into a boiler room operator.

The US SEC notices that some fraudsters recently claimed that their products had been authorised by an official agency, and invited investors to check the authenticity of the products. In some cases the agency identified was simply bogus and the tricksters would pose as officials. In other cases an official agency, such as the SEC, was named but investors were given phone numbers of the tricksters for the "authenticity" checking.

Another trap is the misuse of a regulator's seal. There have been cases in which boiler room operators copied the seal or a logo of a regulator and printed it on their documents or websites to

make their deals look legitimate. Investors should be aware that regulators, including the SFC, would not allow the use of their seal or logo for endorsement of investment products.

To avoid becoming a victim, you should try to:

- Deal only with real regulators: you may be well aware that the SFC is a regulator of the securities market in Hong Kong but you may not be familiar with the regulators in other countries. Check the website of the SFC-operated Electronic Investor Resources Centre (eIRC), click "eLibrary" - "Market Institutions" - "Regulators", or the IOSCO at <http://www.iosco.org> for verification.
- Be sceptical about government approval: it is unusual for governments or regulators to endorse a particular product.
- Check out the operator: check if the brokerages offering to buy or sell securities or other investment products are properly licensed in the countries they claim to be based in.
- Report to us if you have any doubts: the SFC encourages investors to report suspected boiler room operations by e-mailing to [investor.info@hksfc.org.hk](mailto:investor.info@hksfc.org.hk), submitting a complaint form on the SFC website, or calling the Investor Hotline at 2840 9333. We also maintain an Alert List of unlicensed overseas companies, of which some are possible boiler rooms, on the SFC website. Please click "Advice to Investors"- "Investor Alert" - "Alert List".

## Consultation on regulation of listing

The SFC welcomes the Government's publication of a Consultation Paper on Proposals to Enhance the Regulation of Listing. The consultation is to follow up the recommendations made in March by the Expert Group to Review the Operation of the Securities and Futures Market Regulatory Structure.

Public views are sought on proposals to give statutory backing to certain fundamental listing requirements. Views are also invited on ways to improve the regulatory structure governing the performance of listing functions.

The SFC agrees with the Government that as Hong Kong is the premier capital formation centre for Mainland issuers, it is critical that we enhance our regulatory regime for listing, with

a view to improving the quality of our equity market.

We also agree that maintaining the status quo would cost us lost opportunities in the long run. The consultation will be a valuable step towards agreeing on appropriate solutions for Hong Kong.

The SFC looks forward to the views of the market and the public. It will work closely with the Administration, HKEx and other parties to improve the quality of the Hong Kong market.

*The Consultation Paper can be downloaded from the Government website at <http://www.info.gov.hk/fstb>. Please click "Consultation/Policy Papers". The consultation period ends on 31 December 2003.*

## Shorts

### REITs

In order to help the market understand the regulatory requirements for the authorisation of Real Estate Investment Trusts (REITs), we have published on our website a set of Frequently Asked Questions (FAQs), an Application Form and a set of checklists to assist REIT applicants in assembling the relevant documents.

The FAQs introduce the authorisation procedures, criteria and on-going compliance requirements under the Code on REITs, plus guidance on REIT applications.

Such FAQs are by no means exhaustive, and prospective REIT applicants are advised to

contact the SFC for further information and clarification prior to their submission of a formal application.

### Scriptless market

The SFC has published the Consultation Conclusions on Proposals for a Scriptless Securities Market. Comments were received from a range of market practitioners, who generally supported the proposed model under which listed companies' registers of members would comprise two parts: a scripless Central Clearing and Settlement System (CCASS) register and an Issuer register which would include both scripless and certificated holdings.

## Regulation of auditors

The SFC encourages the public to comment on a Government Consultation Paper on proposals to enhance the oversight of auditors and the quality of financial reporting.

The Consultation Paper, issued by the Financial Services and the Treasury Bureau in September, aims at promoting a more transparent and accountable regulatory regime for the auditing profession and to improve the quality of the financial statements of companies.

The Consultation Paper seeks public views on the proposal of the Hong Kong Society of Accountants (HKSA) to set up an Independent Investigation Board to monitor and consider complaints of alleged accounting, auditing and/or ethics irregularities committed by professional accountants involving listed companies. The areas about which the public are consulted include whether the Board should be responsible to the Administration, to the SFC or to the HKSA.

The public are also asked to express their views on whether an independent practice review oversight body comprising mainly lay members should be set up within the HKSA.

They are also asked if a Financial Reporting Review Panel should be established to examine the financial statements of companies to determine whether they comply with the accounting requirements of the Companies Ordinance, and whether the Panel should be set up as an independent statutory body or placed under the SFC.

*The Consultation Paper can be downloaded from the Government website at <http://www.info.gov.hk/fstb/fsb>. The consultation period ends on 31 October 2003.*

# Prudent settlement urged for brokerages

## Investors must understand the risks involved

We have noticed some brokers have reportedly allowed their cash clients to delay the payments for purchases of securities up to eight days after the transaction was conducted. According to the rules of the Hong Kong Exchanges and Clearing Limited, brokers are required to settle with the clearing house two days after transaction of Hong Kong stocks.

Allowing a prolonged period for client settlement increases the risk of default. Should a client default on his payment for the securities purchased, the broker concerned would have to absorb any loss that might occur. For example, the share price may have dropped or the broker may have difficulties in selling the securities if they are relatively illiquid.

Besides, the brokers should consider whether the cash client agreement contains adequate provisions to afford the firm sufficient protection against client default, as many standard agreements only give the firm a right of lien over the securities purchased pursuant to the prolonged settlement terms. This might restrict the firm's ability to seek recourse against the client's other stock holding with the firm.

The SFC reminds all licensed and registered

persons that they should employ adequate resources for running their business. Extending credits to clients without capital that is commensurate with the risk arising from such credits would not be acceptable. They are also required to institute proper credit policies so as to contain credit or default risk at an appropriate level. Non-compliance with these requirements posing undue risk to investors or the integrity of the market would not be tolerated.

Brokers should also observe the "Know Your Client" requirement for credit assessment of the clients and exercise caution in doing so.

They should also carefully evaluate if prolonged settlement terms and their consequential leverage effect are suitable in the light of a client's investment objective and financial situation. The firms should alert the clients to any risks arising from trading on such terms.

On the other hand, investors should also ensure they understand any conditions that may underlie the prolonged settlement policy. They should watch out for the risk of over-trading (i.e. trading for such amounts that exceed their readily available funds to settle) and take into account their financial ability in trading on such terms.

# Application for re-entry into the industry by persons with disciplinary records

Appropriate enforcement of rules and regulations by the SFC since its formation more than a decade ago has helped develop a more robust industry. This has also resulted in an increasing number of practitioners or former practitioners who have a disciplinary record.

In the last financial year, the SFC issued seven revocation notices, 25 suspension orders, 54 reprimands and 51 warning letters. The type of sanction reflects the gravity of the case.

Under the Securities and Futures Ordinance, the public disciplinary action records of licensed persons are published in an on-line register of licensed persons maintained on the SFC website.

We have seen a number of former practitioners who have been disciplined one way or the other applying for licences to re-enter the industry. In considering these applications, the SFC has adopted a firm but fair approach: the crux of the matter is whether the applicants are fit and proper to act as licensed intermediaries.

Each case has to be considered on its own

merits, and the SFC does not prejudge persons who have been disciplined (by the SFC or other regulators). However, full and frank disclosure by the applicant of any disciplinary record is always a must.

Apart from risks to investors and market integrity, other factors that are weighed up include: the remorse shown by the applicants; their conduct since being disciplined; the breach in question in light of current market development; their proposed role and function in the firms; the internal control measures within the firms, and their employers' support for them.

It may be added that where applicants have previously been warned by a regulatory organisation, it is the SFC's general view that a warning alone should not bar a person from practising in the industry, since a more severe sanction could have been applied if the breach were of a serious nature. The fact that a warning has been received, however, should be disclosed by the applicant to enable the SFC (or other relevant regulators as the case may be) to assess the application on a fully informed basis.

# Default of Yicko Futures

On 2 October, Yicko Futures Limited was suspended as an Exchange Participant by the Hong Kong Futures Exchange Limited after it failed to meet the margin calls by the HKFE Clearing Corporation Limited (HKCC). It was also not able to meet the minimum liquid capital requirement under the Securities and Futures (Financial Resources) Rules.

Yicko Futures failed to meet margin calls from HKCC and the capital requirement because a client defaulted on payment of margin monies on his open positions on Hang Seng Index options contracts.

The SFC requested Yicko Futures to ensure that all clients' withdrawal or transfer instructions would be dealt with promptly and documented properly. The SFC is closely monitoring the situation of Yicko Futures and its affiliated securities company, Yicko Securities Limited.

# Shorts

## Know your client

The SFC has recently issued a circular, available on the SFC website, to licensed corporations to ask them to watch out for frauds by walk-in clients. Firms should observe the "Know Your Client" rules and put in place effective control measures to guard against scams, which could lead to substantial financial losses.

## Conference on SFO

The SFC sponsored a one-day conference, entitled "The SFO: Impact on the Finance Industry and Its Players", on 27 August. Attended by about 300 people, it was jointly organised by the University of Hong Kong and a private sector event organiser. Picture shows Mark Dickens, SFC's Executive Director of Supervision of Markets, speaking at the conference.



## Subscribe to Quarterly Bulletin

The SFC Quarterly Bulletin comprises a collection of policy papers, research articles and speeches which highlight the latest developments of the securities and futures markets in Hong Kong. It also contains relevant timely statistical information. Subscription for the year ending September 2004 is now available by completing the subscription form, which is available on the SFC website. You will be receiving four quarterly issues at \$400 only.

INVESTOR FOCUS

## Are you affected by pooling risk?

### Watch out before opening a margin account

A brokerage providing margin account services normally requests authorisation from its clients to pool and re-pledge their securities as collateral to secure its bank borrowings. As an investor, have you ever thought about the implications of giving such authorisation?

Under the pooling and re-pledging arrangement, you, as a margin client, bear the risk that the brokerage may not be able to redeem the re-pledged securities collateral from the bank when the brokerage experiences very tight liquidity and a lot of margin clients request the return of their securities at the same time. Furthermore, if the brokerage becomes insolvent, the bank may liquidate the securities collateral in order to discharge the brokerage's indebtedness. In such a case, margin clients may not be able to get back all their securities. Such a risk is commonly known as "pooling risk".

Depending on the terms of the authorisation, your securities in your margin account may be re-

pledged even if you have fully paid for all your share purchases and have not used the margin facility, or even if the value of your securities collateral exceeds your margin position.

In contrast, the position of cash clients is better protected since their securities are required to be segregated in a trust account.

By law, an authorisation for re-pledging should be renewed every year. The brokerage can be "deemed" to have renewed an authorisation as long as the client is reminded of the impending expiry at least 14 days in advance and does not object.

### Investor Tips

- If you have no intention of using the margin facility, don't open a margin account or sign the pooling and re-pledging authorisation.
- If you do need a margin account, make sure you fully understand the risk associated with pooling and re-pledging - that you may lose your securities even if you are making money

in your margin account or if you have not used the margin facility.

- If you have a margin account that you do not trade in, consider not leaving more securities than are required to cover the margin requirement or converting to a cash account and having your securities placed in safe custody.
- There are other risks associated with margin trading. Leveraging up to increase your purchasing power would magnify your losses. Besides, you may have to put up additional cash or securities to meet margin calls. You may also be forced to sell your securities to cover margin deficiencies.

*We have published a leaflet to explain the pooling risks which is available at the SFC office free of charge. It is supplemented by more educational material on the SFC-operated Electronic Investor Resources Centre.*



## Teachers' workshops

We believe investor education should be a continuous process that starts at an early age.

To help teachers enhance students' knowledge about the financial market and financial products, we have organised workshops for teachers for the fourth consecutive year. Our targets are secondary school teachers of Economics, Commerce and related subjects.

This year, 12 workshops are being held from 29 September to 11 November. The workshops are divided into six modules, of which three are new. Two are advanced modules covering *Stocks* and *Funds*, designed for teachers who have participated in previous workshops and would like to enhance their knowledge in these areas. The third one, *Alternative Investments*, has been

introduced to broaden teachers' understanding of bonds, warrants and equity linked instruments.

The other three modules cover *Options & Futures*, and elementary knowledge in *Stocks* and *Funds*.

Some 500 teachers have enrolled for the workshops. In the last three years, we organised a total of 42 workshops attended by 1,700 teachers.

*Invitation letters have been sent to secondary schools inviting their teachers to enrol for the free workshops. Interested teachers can also visit the "Teachers Corner" on the SFC website or contact us at 2842 7711 to enrol. The relevant educational materials are available at the "Teachers Corner" as well.*



### Investor Education Lectures

More than 600 people attended in the past two months a series of investor education lectures, jointly organised for the first time by the Open University of Hong Kong, the SFC and HKEx. The initiative aimed to help the public cultivate a healthy attitude towards investing. Picture shows a lecture on "Understanding Alternative Investment Instruments" on 15 September.

## Shareholders Group

At the 15th Shareholders Group meeting, the SFC reported to members on its practical experience gathered since the commencement of the dual filing regime on 1 April 2003. Members stressed that the key issue was the quality of disclosure. Listing applicants must present a coherent picture of its business model and past performance, and future prospects. Members were also supportive of the high-level vetting approach in identifying problem areas early and the SFC's efforts to improve the transparency of the dual filing process.

## C. A. Pacific Securities

Claimants of the Unified Exchange Compensation Fund against C.A. Pacific Securities Limited, which is currently under liquidation, are reminded that the SFC may exercise its subrogated rights to obtain the Commission's allocated shares if they do not take certain action by 28 October 2003.

The claimants can choose to repay the amount of compensation they have received to the SFC voluntarily, which will remove the SFC's subrogated rights. If they indicate they will not repay the SFC or they take no action by 28 October, the SFC may exercise its subrogated rights to obtain the Commission's allocated shares.

After the collapse of C.A. Pacific in 1998, the SFC made payments from the compensation fund to 3,922 claimants totalling about \$300 million. The SFC was then, on behalf of the fund, subrogated to the claimants' rights and remedies against the firm in the same amount as the compensation payment made.

Under the share redistribution plan ordered earlier by the Court in the winding up of the firm, the liquidators have allocated shares to the SFC proportional to its subrogated rights.

The SFC will instruct a broker to sell its allocated shares in the broker's careful discretion over a period of time and to endeavour to avoid impacting the market. The proceeds of sale will be used to reimburse the fund and will not affect the SFC's own resources.

Securities and Futures Commission

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