

## STATEMENT OF DISCIPLINARY ACTION

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### The Disciplinary Action

1. The Securities and Futures Commission (**SFC**) has reprimanded and fined Nine Masts Capital Limited (**Nine Masts**) \$1,200,000 pursuant to section 194 of the Securities and Futures Ordinance (**SFO**).
2. The disciplinary action is taken in respect of a short selling incident in relation to the shares of Yuzhou Properties Company Limited (stock code: 1628, **Yuzhou Properties**).

### Summary of facts

#### *Background*

3. On 12 May 2015, Yuzhou Properties issued an announcement (**Announcement**)<sup>1</sup> regarding its proposed placing of new shares<sup>2</sup> (**Placing**). The Announcement stated that the Placing was subject to the fulfilment of certain conditions (**Conditions**), including the approval by the Listing Committee of the Hong Kong Exchanges and Clearing Limited (**HKEx**) for the listing of and dealing in the placing shares (**Placing Shares**). The Announcement reminded the investing public that the Placing might or might not proceed and also warned shareholders and potential investors to exercise caution when dealing in the shares.
4. Yuzhou Properties subsequently made a further announcement after market close on 21 May 2015 that the Conditions had been fulfilled and the Placing was completed. An aggregate of 36 million new shares had been placed to no fewer than six places at the price of HK\$2.2 per Placing Share. This represented approximately 10.42% of the issued share capital of the company immediately prior to completion and approximately 9.43% of the enlarged issued share capital of the company immediately after completion.

#### *Short selling incident on 13 May 2015*

5. On 12 May 2015, Nine Masts placed an order with one of the placing agents to subscribe for US\$10 million Placing Shares at HK\$2.2 per share.
6. Prior to the placing of the order on 12 May 2015, the placing agent had sent to the portfolio manager and trader of Nine Masts a deal launch Bloomberg message (**Bloomberg Message**) which clearly stated under the heading "timetable":

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<sup>1</sup> The Announcement was uploaded onto the website of the Hong Kong Exchanges and Clearing Limited on 13 May 2015 at 6:04 am

<sup>2</sup> Under the general mandate granted to the directors of Yuzhou Properties by the resolution of its shareholders passed at its annual general meeting held on 26 May 2014 (2014 AGM) to allot, issue and otherwise deal with securities of the company not exceeding 20% of the issued share capital of the company as at the date of the 2014 AGM.

*“19<sup>th</sup> May 2015 (T+5): Settlement date (Actual settlement date is subject to HKEx listing approval on the listing of new shares)”.*

7. In the evening of 12 May 2015, the placing agent sent an email to the portfolio manager and trader of Nine Masts confirming the allocation of 32 million Placing Shares at HK\$2.2 per share, with the Bloomberg Message forwarded again. The placing agent also sent a pricing sheet to Nine Masts, stating that the settlement date would be “T+5/6” and the “Actual settlement date is subject to HKEx listing approval on the listing of new shares”.
8. At around 8:55am on 13 May 2015, Nine Masts received a verbal confirmation that it would be allotted 32 million Placing Shares of Yuzhou Properties. At 9:04am, Nine Masts placed a sell order with its execution broker and sold 10,633,000 Yuzhou Properties shares. At the time of placing the sell order, Nine Masts had no existing Yuzhou Properties shares and the Placing had not been completed. As a result, Nine Masts had short sold 10,633,000 shares in Yuzhou Properties.
9. Nine Masts only realized the short sale on 15 May 2015, when it received an email from its settlement agent informing it that it did not have sufficient shares to settle the sale of 10,633,000 Yuzhou Properties shares. The settlement failure led to a share borrowing of 4,368,005 shares on 15 May 2015 and a forced buy-in of the remaining 6,264,995 shares from the market on 18 May 2015.

#### *The SFC findings*

10. The SFC found that:
  - (a) The trader who handled the pre-mature selling of the Placing Shares was acting under the instructions of the portfolio manager. The trader was under the mistaken belief that Nine Masts had sufficient shares of Yuzhou Properties on 13 May 2015, because Nine Masts had been allotted 32 million Placing Shares and he was instructed by his supervisor to sell the same. He also thought the settlement date of the Placing Shares was T+2 because he was instructed by his supervisor to sell, so he assumed it was a regular placement and that he could sell the shares on the usual T+2 basis.
  - (b) The portfolio manager, who instructed the trader to sell the Placing Shares on 13 May 2015, was not aware that the Placing was conditional upon and subject to HKEx’s listing approval. He thought the settlement date was on T+2 basis, because most placement transactions would be settled on this basis. He overlooked the fact that the Placing was a new share placement and the expected settlement date was 19 May 2015 subject to HKEx’s approval.
  - (c) At the material time, Nine Masts did not have any written policy in place to ensure compliance with the short selling requirements under section 170 of the SFO in respect of dealing with placement shares.

## The SFC's concerns

11. The SFC considers that Nine Masts had failed to:
  - (a) act with due skill, care and diligence in handling and dealing in the shares of Yuzhou Properties on or around 13 May 2015, in breach of General Principle 2 (Diligence) of the Code of Conduct for Persons Licensed by or Registered with the SFC (**Code of Conduct**); and
  - (b) implement adequate and effective internal systems and controls to ensure compliance with the short selling requirements, in breach of General Principle 7 (Compliance), paragraphs 4.3 and 12.1 of the Code of Conduct.

## Conclusion

12. The SFC is of the view that Nine Masts' fitness and properness has been called into question.
13. In deciding the disciplinary sanctions set out in paragraph 1, the SFC has taken into account all the circumstances of this case, including:
  - the incident is the second occurrence of a similar kind over a period of five years - Nine Masts' systems and controls for preventing naked short selling did not improve despite an advisory letter by the SFC for a similar incident in August 2013 whereby placing shares were sold before the completion of a placement in June 2010;
  - the dealing in Yuzhou Properties shares involved a single, unintentional short sale;
  - Nine Masts self-reported the regulatory breach to the SFC;
  - the costs relating to the settlement failure were borne by Nine Masts;
  - Nine Masts has taken remedial measures to strengthen its internal controls and systems following the Yuzhou Properties short selling incident;
  - Nine Masts' cooperation with the SFC in resolving its regulatory concerns and in accepting the disciplinary action and the SFC's findings; and
  - Nine Masts has an otherwise clean disciplinary record.