SFC Enforcement Reporter

A monthly summary of SFC enforcement action

January 2005

Highlights

In December 2004, the SFC:

- **successfully prosecuted two people**
- **disciplined 11 licensees**
- **settled with three licensees**

Prosecution

High Court dismisses unlicensed dealing appeal

The High Court dismissed an appeal brought by Hong Kong Forex Investment Ltd against its conviction for allowing a person to conduct unlicensed activities.

(Press release issued on 7 December 2004.
See also the earlier press release issued on 16 March 2004)

Unlicensed leveraged foreign exchange trader convicted

Ms Tsang Wai Lin was convicted of opening accounts for people to become clients of Hong Kong Forex Investment Ltd and advising clients on making leveraged foreign exchange investments between March 2001 and March 2003 when unlicensed. Tsang was fined $60,000.

(Press release issued on 13 December 2004)

The SFC has zero tolerance for people who engage in unlicensed activities. Firms that condone unlicensed activities can expect to be prosecuted. Licensed corporations and their management should review their internal controls to ensure that unlicensed activities are detected and eradicated. Investors are reminded that they can check a person's licence status for free, using the online Register of Licensed Persons on the SFC's website at www.sfc.hk.

Continuing enforcement of disclosure of interests laws

Mr Shu Kwan Long pleaded guilty to failing to initially notify both the Hong Kong Exchanges and Clearing Limited (HKEx) and Sino Technology Investments Company Ltd of his 5.89% interest in Sino Technology when the Securities and Futures Ordinance came into effect on 1 April 2003. Shu only notified Sino Technology and HKEx on 11 July 2003 and 16 July 2003 respectively. Shu was fined and ordered to pay the SFC's investigation costs.

(Press release issued on 16 December 2004)

We remind investors again that since 1 April 2003, the disclosure threshold for notifiable securities interests has been reduced to 5% and the reporting period to three business days in line with international standards. The timely disclosure of securities interests is necessary for the operation of an open and transparent market. The SFC will continue to bring prosecutions against people who fail to comply with these requirements.

Discipline

Joint action by SFC and HKEx against a sponsor for withholding relevant information

The SFC entered into a settlement agreement with Oriental Patron Asia Ltd and its Principal Supervisor, Mr Rabo Leung Chin Sing. The SFC agreed not to take further disciplinary action against Oriental Patron and Leung given their respective undertakings not to perform or carry out sponsor and compliance adviser functions on behalf of any sponsor or compliance adviser in relation to any listing applicant or issuer respectively during the same respective periods as agreed with HKEx subject to the same exceptions.

HKEx also removed Oriental Patron from its approved list of sponsors under the Growth Enterprise Market (GEM) subject to certain exceptions. Oriental Patron also agreed not to act as a sponsor under the Main Board for five months. Leung voluntarily withdrew from acting as a Principal Supervisor of Oriental Patron for nine months. He also agreed not to perform any activities relating to any GEM or Main Board listing applicant or listed issuer for the same period.

This joint SFC and HKEx action was a result of Oriental Patron's withholding of material information from HKEx that a GEM listing applicant's original auditors had resigned due to concerns and irreconcilable differences with the listing applicant over its stated sales transactions. Oriental Patron was the listing applicant's sponsor. Oriental Patron also separately confirmed to HKEx that the revised accountants' report prepared by the listing applicant's new auditors contained no material change from the original accountants' report apart from an extension of the financial period and that, apart from the issues disclosed in the prospectus, there were no other major issues that needed to be brought to HKEx Listing Division's attention. After making specific enquiries with Oriental Patron, HKEx discovered that the original auditors had resigned at the request of the listing applicant and that their resignation was prompted by concerns and unresolved differences regarding the listing applicant's sales transactions. The Listing Application was eventually rejected as the listing applicant failed to address the Division's concerns regarding its sales.

The SFC decided the settlement was in the public interest as the removal of Oriental Patron and Leung from sponsor and compliance adviser functions achieved its primary aim of protecting the investing public.

(Press release issued on 17 December 2004)

HKEx, its Listing Committees and the investing public all rely on sponsors to ensure a new applicant is suitable for listing. It is therefore vital for sponsors to diligently discharge their duty to provide complete and accurate information to HKEx about a listing applicant. Sponsors who fail to carry out their duties diligently can expect to face lengthy suspensions.

Sponsor failings remain an SFC enforcement priority

The co-operation between the SFC and HKEx has resulted in better use of resources and faster results in dealing with sponsors' failings.

Misuse of client assets likely to result in exclusion from industry

The SFC found that Mr Tong On Jimmy, the sole responsible officer and sole proprietor of Chung Tak and Company, had charged as much as $33 million worth of cash clients' securities to a bank as security for an overdraft facility. Tong also gave the SFC documents containing inaccurate information during investigation. Tong appealed the SFC's decision to revoke his licence to the Securities and Futures Appeals Tribunal (SFAT). In a compromise, Tong subsequently ceased business, surrendered his licence and undertook never to reapply for a licence or similar regulatory approval from the SFC and withdrew his appeal. The SFC therefore decided not to pursue the matter.

(Press release issued on 23 December 2004)

The use of client assets for any purpose other than the purpose authorised by the clients is unacceptable in any circumstances. The SFC will take strong regulatory action against any licensee who misuses client assets.

Further crackdown on account opening failures

The SFC suspended Ms Wong Lee Man's licence as a representative for eight months for account opening failings. Wong failed to take reasonable steps to establish a client's true identity, financial situation, investment experience and objectives; knowingly allowed the client to open an account under the name of another person for trading of his own shares; and falsely declared that she had witnessed a person signing an account opening document when in fact she had neither met nor known that person.

In another case, the SFC suspended Mr Cheng Wai Shan's licence for six months for certifying on account opening documents that he had witnessed a client's signature and had explained its contents to the client when he had not. Cheng also allowed a subordinate to take orders from a client despite knowing the subordinate's licence did not allow him to do so. The subordinate conducted trades on behalf of the client without authorisation. Cheng's suspension was reduced on appeal to the SFAT from the SFC's initial penalty of nine months.

In a third case, the SFC suspended Mr Kam Chun Wah Dickson's licence as a representative for three months for certifying that he had witnessed a client's execution of the client agreement and explained its contents to the client when he had not. Kam did not meet the client at all during the account opening process.

(Press releases issued on 9, 15 and 24 December 2004)

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Knowing your clients well is a fundamental requirement for all licensees. Licensees should, as a matter of course during the completion of the account opening documents, ask their clients to provide information on their identity, financial situation, investment experience and objectives. These questions are also vital to deterring market manipulators and money launderers from entering the market. Licensees who fail to comply with these requirements will likely face suspension.

Liquid capital breaches attract both prosecution and suspension

Following their convictions, the SFC reprimanded Tiffit Securities (Hong Kong) Ltd and suspended its responsible officer, Mr Kwok Wood Yan, for seven months for providing misleading information to the SFC, failing to maintain the required level of liquid capital and failing to notify the SFC of its liquid capital deficiencies. Another responsible officer, Ms Fong Shik Yee, was suspended for three months and 15 days for breaches relating to the keeping of trust accounts, also after court conviction. Kwok's suspension will start after Fong's has ended to allow the company to remain in business.

(Press release issued on 24 December 2004.
See also the earlier press release issued on 18 August 2003)

Maintaining adequate liquid capital forms one of the cornerstones of investor protection. Prompt reporting of a company's liquid capital deficiencies is a legal requirement and is necessary to allow the SFC to assess the potential risks to investors and the market. A company may first notify the SFC by telephone, followed by a written notification. Companies who fail to comply with this simple reporting requirement can expect to be prosecuted and disciplined.

Unsolicited calls are illegal

The SFC suspended Mr Shiu Yau Wah's licence as a representative for four months for hawking futures contracts on commodities exchanges in Japan to prospective clients. Shiu made unsolicited calls, made promotional visits, dispensed promotional materials and recommended futures contracts to prospective clients. Shiu had earlier been convicted of illegal hawking.

(Press release issued on 15 December 2004.
See also the earlier press release issued on 21 April 2004)

It is a criminal offence to make unsolicited calls or promotional visits with the intention of inducing a person to buy SFC regulated financial products. Investors should not be pressured into making hasty investment decisions. Licensees who fail to ensure their marketing strategies comply with the law will face both criminal prosecution and disciplinary sanctions.

Internal control failings still found in firms

The SFC reprimanded Grand Onward Securities Ltd for internal control deficiencies. These included: the use of client securities without proper written authorisation to settle other clients' transactions; inadequate measures to prevent illegal short selling; failing to properly segregate settlement and dealing functions; failing to implement effective compliance and clearing and settlement procedures and failing to monitor staff activities. A representative of Grand Onward, Mr Wong Tin Fuk Alex, was suspended for nine weeks for, among other things, using client securities to settle other clients' transactions without their authorisation. The SFC also suspended Grand Onward's then sole responsible officer, Mr Tsang Chi Suen Trini, for nine weeks for the firm's internal control failings, his turning a blind eye to Wong's borrowing of client securities and on at least one occasion, his borrowing of client securities without proper authorisation.

Both Tsang and Wong applied to the SFAT to review the SFC's original decision to suspend their licences for three months. In a compromise, Tsang and Wong withdrew their review applications and admitted their misconduct and the SFC suspended their licences for nine weeks each.

(Press release issued on 17 December 2004)

It is essential for all licensed corporations to have in place strong internal controls. This will not only ensure that regulatory requirements are properly complied with but also minimise opportunities for staff to commit fraud and other misconduct that may prejudice their clients. Weak internal controls harm the investing public and the SFC will not hesitate to impose heavy penalties in appropriate circumstances.

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The SFC suspended Mr Shum Lik Keung's licence for one month for failing to properly supervise two account executives and other misconduct. One of the account executives engaged in cold calling and unlicensed activities while the other conducted unauthorised trades and unlicensed activities.

(Press release issued on 22 December 2004)

This case demonstrates that lax supervision facilitates staff misconduct and harms the investing public. It is incumbent on the management to ensure that staff are properly supervised. Unreasonable failure by responsible officers to discharge this primary responsibility will result in disciplinary sanction.

General Enforcement Statistics

Since 1 April 2004, the SFC has successfully prosecuted 62 entities. Summonses were withdrawn against eight persons. Five persons were acquitted after trial. In the same period, the SFC disciplined 58 licensees for various regulatory breaches and entered into settlements with voluntary payments with three licensees. The SFC also took disciplinary actions against 18 licensees which were eventually concluded with no formal sanction imposed, although 15 of them received private warnings. Disciplinary proceedings were also commenced and discontinued against four deemed licensees who left their firms before the conclusion of the actions. (A person's deemed licence is effectively revoked on the day they leave their firm. Under the transitional arrangements, which came into force on 1 April 2003, the SFC has no jurisdiction to continue with disciplinary proceedings against these people. However, they would be required to answer the SFC's concerns about them if they re-apply for a licence or other regulatory approval.)

If you want to know more, the SFC's press releases are available at www.sfc.hk.

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