SFC Enforcement Reporter

A monthly summary of SFC enforcement action

November 2005

Highlights

In October, the SFC:

- **successfully prosecuted three persons and three companies**
- **disciplined 17 licensees**

Prosecution

Six months' imprisonment for failing to attend SFC's investigation interview

Mr Stephen Lee Sing Wai was issued with the SFC's notices to attend an interview regarding an investigation into market manipulation but failed to do so without reasonable excuse. A court summons was issued but Lee also failed to attend that summons. The Court issued an arrest warrant for Lee and he was subsequently arrested by the police. Lee pleaded guilty to failing to attend the summons and was fined $15,000 and ordered to pay investigation costs. As the offence was committed during the period of his prison sentence in relation to another market manipulation case which was suspended, Lee's suspended sentence was activated and he was sentenced to six months' imprisonment.

(Press release issued on 7 and 18 October 2005)

Failure to attend SFC interviews without a reasonable excuse is a serious offence. People can face a maximum fine of $50,000 and six months' imprisonment on summary conviction. Regulated persons who fail to co-operate with SFC investigations may also face serious disciplinary sanctions.

Prosecutions for failure to disclose interests

Mr Chu Yat Lam pleaded guilty to 13 summonses of breaching Part XV of the Securities and Futures Ordinance by failing to disclose to HKEx his 13 acquisitions and disposals of China Northern Enterprises Investment Fund Ltd's shares. The acquisitions and disposals caused Chu to have or cease to have a notifiable interest in China Northern. Chu was fined $13,000 and ordered to pay the SFC's investigation costs.

(Press release issued on 6 October 2005)

TingKong-RexCapital Holdings Ltd, Rexcapital Partners Incorporated and Tees Corporation each pleaded guilty to three summonses of failing to make timely disclosure to HKEx and eForce Holdings Ltd of their eForce share transfers on three occasions. TingKong-RexCapital, Rexcapital and Tees were fined $18,000 each and ordered to pay the SFC's investigation costs.

(Press release issued on 13 October 2005)

Disclosure of interests is vital to ensuring market transparency. Investors in listed companies are only able to make informed decisions on investments if complete, accurate and timely disclosure has been made. The SFC will prosecute for disclosure failures.

Conviction for misleading the SFC

Mr Ngai Leung Wai pleaded guilty to misleading the SFC. Ngai was identified as one of the traders in a market manipulation investigation. Ngai provided misleading information to the SFC regarding the operation of his account at a brokerage house. Sentencing has been adjourned to 22 December 2005.

(Press release issued on 27 October 2005)

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When attending SFC interviews, people are under a statutory duty to give complete, accurate and true answers. Failure to do so is a criminal offence. The maximum penalty is a fine of $50,000 and six months' imprisonment on summary conviction.

Discipline

SFAT upholds SFC's decision to suspend

Mr So Chi Ming was suspended for one month following an SFC investigation about the listing of Codebank Ltd on the Growth Enterprise Market in 2001. The SFC found that $3 million of the listing proceeds from the placement of Codebank's shares had been deposited into So's bank account. So claimed that the $3 million was obtained from a third party as compensation for his clients as a result of complaints by his clients regarding the fall of the share price of Codebank. This was later found to be inaccurate as So admitted that some of those who received payments were not his clients. So was unable to fully account for the compensation when questioned by the SFC. So appealed to the Securities and Futures Appeals Tribunal (SFAT) arguing that he did not handle the $3 million in his capacity as a registered person and therefore was not subject to the SFC's powers. The SFAT rejected So's argument and upheld the SFC's decision saying that So's application "manifestly [had] no merit whatsoever". The SFAT's reasons for dismissal of the application are to follow.

(Press release issued on 27 October 2005)

The SFC may consider all circumstances which it considers relevant in assessing fitness and properness. A regulated person must account for client assets and also for his/her conduct. The SFC will take into account not only acts done in the course of business but also any conduct that is closely related to regulated activities or even outside regulated activities if the conduct is clearly incompatible with that expected of a licensed person.

Reprimand and suspensions for market manipulation

Lippo Securities Ltd was reprimanded and its former responsible officer Mr Han Sze Chao Richard was suspended for 18 months for manipulation of the shares of Fortuna International Holdings Ltd. Two of Lippo's licensed representatives, Mr Chan Ka Lok Cuthbert and Ms Angie Yeung were suspended for 10 weeks and five weeks respectively. Han placed buy orders for Fortuna shares via the account of Super Glory International Ltd held at Lippo Securities on 54 out of 86 trading days in 2002. On 47 out of the 54 days, the last order placed by Super Glory fell within the last minute of trading and set the closing price for Fortuna on 46 days. On 40 out of those days, single board lot orders were placed at existing ask prices shortly before market close. Han was the sole director and ultimate beneficiary of Super Glory and the only person authorised to place orders. Han knew his trading activities of pegging or stabilising the market price had the potential to distort the market price of the shares. Lippo Securities failed to detect Han's abusive trading activities and did not have sufficient measures in place to check for abusive trades in accounts despite having been monitoring excessive trading in staff accounts. Chan and Yeung facilitated Han's trading activities as they both executed Han's orders although they knew that the trades were questionable. Neither of them reported their concerns to Lippo Securities.

(Press release issued on 3 October 2005)

The SFC will punish activities which undermine the integrity of the market. A licensed person has a duty to protect the interest of the investing public. Market manipulation is a serious offence against which the SFC will take tough action.

Disciplinary action against short selling

Ms Lau Yin Mei Carmela, a licensed representative of Guotai Junan Securities (Hong Kong) Ltd was reprimanded and fined $53,000 for short selling and other misconduct. Lau confirmed to her client that she had bought three million shares of a stock but in fact at that time the order had not yet been completed as she was uncertain whether the shares could be delivered. A dealing director of Guotai Junan had advised Lau not to confirm the purchase order until the shares were delivered but Lau did not listen. Subsequently, the client told Lau to sell part of the shares purchased. Lau sold 350,000 shares knowing that the shares had not yet been delivered to her client. This resulted in a short sale.

(Press release issued on 5 October 2005)

Illegal short selling may constitute a criminal offence and also undermines market integrity. Licensees should ensure that orders are executed and completed before confirming the order with clients.

Breaching the Code of Conduct results in disciplinary action

The SFC settled its disciplinary action against Mr Lau Pak Tong with a suspension of five weeks for breaching the know-your-client rule. During a routine inspection, the SFC found that 15 of Lau's clients had authorised the same person to collect their statements of account. One of the 15 accounts was opened in the name of Lau's niece, who had no beneficial interest in the account which was in fact beneficially owned by Lau's parents. Lau's niece was also described as a financial consultant with an annual income of $200,000 but in fact was a student without income. Lau also lent money to another client for settlement purposes in breach of his employer's settlement rules and the SFC's Code of Conduct to avoid conflicts of interest.

(Press release issued on 7 October 2005)

TISCO Securities Hong Kong Ltd was reprimanded and its responsible officer Mr Lam Ho Chu Wilson and its licensed representative Mr Yam Shun Hung were suspended for nine months and six months respectively, for breaching the Code of Conduct. An SFC investigation found that the prices of certain warrants had risen rapidly after their issue to levels higher than that of their underlying stocks. As the conversion ratio was one warrant to one ordinary share, it was unlikely that investors would be interested in buying the warrants at those prices because apart from the costs of the warrants they would also have to pay the exercise price for converting the warrants into shares. However, four of TISCO's corporate clients traded actively in the warrants and the clients' acquisitions accounted for more than 90% of the daily market turnover of the warrants on 44 days. On receiving the clients' instructions, TISCO's staff did not obtain basic information relating to the warrants. Although Lam reviewed the clients' transactions, he failed to detect irregularities. As the main dealer responsible for executing the orders, Yam failed to inform the clients of the irregularities or report his observations to his supervisor despite knowing that the clients had been buying warrants at prices higher than those of the underlying stock.

(Press release issued on 7 October 2005)

Complying with the Code of Conduct is a fundamental and paramount duty of a licensee. The Code of Conduct seeks to ensure that the parameters of conduct in the industry are clearly defined and of good standard. In order to protect the investing public against possible losses and misconduct, regulated persons are required to strictly comply with the Code of Conduct.

Reprimands and fines for internal control failings and FRR breaches

The SFC reprimanded Mr Lui Chi Chung Josaphat, a former dealing director of Top Equity Brokerage Ltd for supervisory failings. In November 2002, an independent accounting firm conducted a review of Top Equity's internal controls and identified a number of internal control deficiencies, including the following: (i) settlement of clients' trades by third parties was tolerated; (ii) account executives were allowed to handle client contract notes without client authorisation; (iii) the client database contained a large number of errors; and (iv) Top Equity's management failed to take action about clients' late settlement of trades and allowed an account executive to take up the long outstanding liabilities of his clients. Lui was the responsible officer at the relevant time and so bore responsibility for the failings.

(Press release issued on 20 October 2005)

The SFC reprimanded Onshine Securities Ltd and fined it $100,000 for breaching the Financial Resources Rules (FRR), internal control weaknesses and inadequate staff supervision. Onshine's responsible officer Mr Chan Sum Fat was also reprimanded and fined $16,700. Onshine's liquid capital was deficient on five business days as a result of a bank loan drawn down by Onshine to finance its clients in an IPO. Onshine reported the deficiency to the SFC the day after it became aware of the deficiency. Onshine injected a subordinated loan to rectify the breach. Pending the SFC's formal approval of the subordinated loan, the FRR breach continued.

In another investigation, the SFC found that a licensed representative of Onshine had input a bid order at $20 for PICC Property and Casualty Co Ltd shares raising the stock's nominal price from $8 to $20 during the pre-opening session on the Stock Exchange. The licensed representative cancelled the order in less than a minute claiming that it was an erroneous order. Another licensed representative input numerous bid and ask orders, each for one million PICC shares which were cancelled almost immediately during the trading session on the same day. The licensed representative said that he was "testing his luck" because due to personal reasons he was suffering from stress and believed that if he was able to cancel the orders before they were executed he would be lucky. He admitted that the trades might have misled investors. He also failed to submit order journals printed from his terminal to Onshine and therefore failed to maintain a proper audit trail. Onshine failed to have in place proper internal control policies to require erroneous orders be reported, and Chan was negligent in failing to review the order journals of the licensed representatives. Both Onshine and Chan breached the Code of Conduct.

(Press release issued on 25 October 2005)

Compliance with the FRR ensures that a brokerage can meet its obligations to its clients. Adequate internal controls are also vital to the early detection of irregularities and misconduct as is close supervision of staff.

<u>Unlicensed dealing and aiding and abetting unlicensed dealing will be punished</u>

Bright Smart Securities International (HK) Ltd and its responsible officer Mr Chan Pang were reprimanded and fined $75,000 and $60,000 respectively, for aiding and abetting unlicensed dealing, posting misleading information on Bright Smart's website and failing to supervise unlicensed customer services officers. Chan knowingly allowed an unlicensed staff to deal in securities. The staff member and Chan were both convicted of unlicensed dealing and aiding and abetting respectively. Chan also approved misleading information on Bright Smart's website by stating that one of the duties of Bright Smart's customer services officers, who were unlicensed, was to provide investment analysis. Therefore it appeared that the customer services officers were carrying on a Type 4 regulated activity. Chan failed to supervise the customer services officers' work despite being responsible for assigning job duties to them.

(Press release issued on 24 October 2005)

Ms Wong Yuen Sze Angel and Ms Lo Po Wah Julie were suspended for 12 weeks each for their failures to comply with applicable laws and regulations. The suspensions were a result of settlement between Wong, Lo and the SFC and followed Wong's conviction for unlicensed dealing and Lo's conviction for aiding and abetting unlicensed dealing by Wong. Wong performed regulated activities whilst unlicensed and Lo as Wong's supervisor failed to supervise Wong but facilitated Wong's misconduct instead. Lo also failed to explain the risk disclosure statement to a client during the client's account opening process.

(Press release issued on 31 October 2005)

Carrying on regulated activities without a licence is a criminal offence. Those who engage in unlicensed activities and those who aid and abet such activities will face prosecution and disciplinary action. It is essential that brokerages ensure that their staff are licensed to perform regulated activities as this is an integral part of the regulatory regime.

General Enforcement Statistics

From 1 April 2005 to the end of October 2005, the SFC has successfully prosecuted 39 entities and offered no evidence against three entities. In the same period, the SFC took action against 59 licensees for various regulatory breaches, of which three cases were settled with voluntary payments and with no statutory sanction imposed. Another four licensees settled with a voluntary payment with a statutory sanction.

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

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