

## Highlights

In March 2006, the SFC:

- prosecuted six persons
- disciplined 10 licensees
- settled with three licensees with no statutory sanction imposed

## Prosecution

### Two months' imprisonment for market manipulation

Mr Ng Hon Chung, Mr Ng Kwok Wing and Mr Cheung Joe Kin Cho were convicted of creating a false and misleading appearance of active trading in GP NanoTechnology Group Ltd shares in 2002 and were each sentenced to two months' imprisonment suspended for 12 months. Between January and June 2002, they engaged in suspicious trading, buying at a high price and selling at a low price and often conducted intra-group trades resulting in the significant increase in the market turnover of GP Nano. They pleaded guilty and were ordered to pay the SFC's investigation costs.

(Press release issued on 21 March 2006)

*Market manipulation is a serious offence. The SFC will take tough action to punish activities which undermine the integrity of the market. A licensed person has to protect the interest of the investing public. Offenders may face a custodial sentence, which will usually not be suspended if they are convicted after trial or it is a repeat offence.*

### Convictions for cold calling

Mr Chan Kei and Mr Yeung Wan Yiu were found guilty after trial of making unsolicited calls. Between August 2003 and September 2004, Chan and Yeung made unsolicited calls to and visited six persons who were not clients of their employer to induce them to enter into agreements for trading leveraged foreign exchange contracts. Chan and Yeung were fined a total of \$30,000 and ordered to pay the SFC's investigation costs.

(Press release issued on 21 March 2006)

*Unsolicited calls with the intention of inducing clients to purchase SFC regulated products is a criminal offence. Investors should not be pressured into buying unwanted products through unsolicited calls. Investors should be given time to make informed decisions and licensed representatives have to ensure that their marketing techniques comply with the law.*

### Unregistered dealing fined

Ms Chiu Chui Yi pleaded guilty to unregistered dealing in a mutual fund. Around February 2003, Chiu arranged an investor to enter into an agreement to subscribe for certain shares in a mutual fund although Chiu was unregistered at the time. Chiu was fined \$3,000 and ordered to pay the SFC's investigation costs.

(Press release issued on 9 March 2006)

*Engaging in unlicensed activities is a criminal offence. Those who do so 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.*

## Discipline

### **Licensee undertakes not to act as sponsor**

CSC Asia Ltd voluntarily undertook not to act as sponsor for any new listing application on the Main Board and the GEM Board for 13 months. Its responsible officers Mr Chiu Chi Kin Andrew and Mr Tang Ho Wai Howard voluntarily undertook not to act as principal supervisors of CSC for any new listing application for a period of eight months. The periods commenced from 7 March 2006. During the SFC's inspection of CSC's operations in 2005, it was revealed that, in two listing CSC-sponsored applications, CSC failed to act with due care, skill and diligence when performing due diligence to ensure that the prospectuses and submissions made to HKEx were of the required standard. In the first application, CSC and Tang failed to pay sufficient attention to advice from professional advisers and did not perform due diligence in various areas, including: (i) the major suppliers and customers of the listing applicant; (ii) the relationship between the directors and shareholders of the listing applicant and a supplier; (iii) whether the listing applicant had complied with PRC regulations in respect of social insurance; (iv) the renewal of a business licence of the previous owner of a subsidiary of the listing applicant and the capacity of this party in entering into a contract affecting the subsidiary in question; and (v) the expiry date of approval certificates of certain products of the listing applicant. In the second application, CSC and Chiu failed to do due diligence work in various areas, including: (i) the continuous ownership requirement of 24 months under the GEM Listing Rules in respect of the founders of the listing applicants; (ii) the "related party" relationship of the listing applicant and its agents; and (iii) the disclosure of the "connected" relationship between the listing applicant and its major customers. In addition, the SFC found internal control failings of CSC namely, inadequate audit trails, that principal and assistant supervisors were not sufficiently involved in the preparation work of the listing, the failures to prepare detailed due diligence plans and insufficient provision of training for new staff. The SFC considers settling the disciplinary action to be in the interest of the investing public and in the public interest. In deciding the sanctions, the SFC took into account that CSC, Chiu and Tang had co-operated extensively with the SFC and agreed to engage an accounting firm to conduct a review of its operations and procedures.

(Press release issued on 7 March 2006)

*It is crucial that sponsors carry out due diligence to the required standard expected by HKEx and the SFC. It is a sponsor's duty to take reasonable steps to procure that the listing applicant discloses all relevant information in its prospectus and that the disclosure accurately reflects the facts. Sponsors should not rely on HKEx or the SFC to verify the contents of prospectuses. The SFC makes it a priority to take action against sponsors who fail to reach the required mark.*

### **SFAT upholds SFC's decision to suspend**

Ms Chim Chai Shan Jovin was suspended for four months from 28 March to 27 July 2006 following a decision by the Securities and Futures Appeals Tribunal (SFAT) to uphold the SFC's initial decision. Following a routine SFC inspection of T G Holborn (Hong Kong) Ltd's accounts in August 2002, it was discovered that three of T G Holborn's investment representatives had received commission for selling unit trust products to their clients whilst unregistered. Subsequent investigation also revealed that Chim, at that time a securities investment representative and a branch manager of T G Holborn, had dishonestly signed on two internal client administration forms as the consultant to a client, when in fact one of the unregistered representatives was the consultant. On T G Holborn's compliance department's instructions, Chim substituted the genuine internal client administration forms with those that bore Chim's name as the registered representative, therefore covering up that an unregistered consultant had solicited clients. Chim appealed to the SFAT arguing that she was not dishonest but merely reckless. The SFAT rejected Chim's argument and upheld the SFC's decision.

(Press release issued on 29 March 2006)

*It is essential that licensees act honestly and in a fit and proper manner. All paperwork, whether for internal or external purposes, should be accurate and comply with the laws and regulations. Those who deliberately falsify documents will face harsher penalties and possible criminal sanctions. The SFAT ruled that merely following orders was not a defence in this case and warned that meritless appeals might lead to harsher cost orders than usual.*

## **Tanrich staff disciplined regarding cold calling and investment advice**

The SFC prohibited Mr Wong Yu Kit from re-entering the industry for six months from 11 March to 10 September 2006. Wong facilitated cold calling by failing to make reasonable enquiries about a representative's calling of prospective clients before assisting this representative to meet with and induce the client to open an account with Tanrich Futures Ltd. Wong also advised clients to simultaneously hold equal long and short positions in the same futures contract and misrepresented that it would reduce risk, which is not true. Wong failed to perform his functions as a licensed representative with due skill, care and diligence. In deciding the penalty, the SFC took into account that the clients Wong advised had suffered substantial trading losses and Wong is no longer licensed. If Wong were currently licensed, the SFC would have suspended his licence for six months.

(Press release issued on 13 March 2006)

The SFC prohibited Mr Lam Wing Chit from re-entering the industry for three months from 1 March to 31 May 2006. Lam was convicted after trial of cold calling a person to trade in futures contracts. Lam called this person asking to meet with him to induce him to open a futures trading account with Tanrich Futures Ltd. The person did not open an account as he knew that it was an offence to cold call. Lam also advised his client to simultaneously hold equal long and short positions in the same futures contract but was unable to reasonably explain his recommendation.

(Press releases issued on 17 November 2005 and 1 March 2006)

Ms Mak Wing Shun Agnes was suspended for four months from 31 March to 30 July 2006 for cold calling and failure to give reasonable advice to clients. Mak called prospective clients asking to meet with them to induce them into opening a futures trading account with Tanrich Futures Ltd, which the clients did. Mak also advised them to simultaneously hold equal long and short positions in the same futures contract and misrepresented that it would reduce risk and help recover trading losses. In deciding the penalty, the SFC took into account that Ma pleaded guilty to the criminal offences and was frank in admitting her cold calling activities during the investigation.

(Press release issued on 10 November 2005 and 31 March 2006)

*It is a licensee's duty to give reasonable advice to a client taking into account each client's circumstances. Cold calling with the intention of inducing clients to purchase SFC regulated products is a criminal offence. Licensed representatives may face prosecution and/or disciplinary sanctions if they are found to have breached the related laws and regulations.*

## **Suspension, reprimand and fines for breaching the Code of Conduct**

Ms Kou Kuen Katherine was suspended for one month from 28 March to 27 April 2006 and Victory Securities Company Ltd was reprimanded and fined \$50,000 for breaching the Code of Conduct. Victory Securities had: (i) recklessly pledged its cash clients' securities to its banks on two occasions without prior client approval and (ii) failed to implement an effective internal control system to ensure that client securities were properly allocated to the correct designated CCASS sub-accounts. Kou was a responsible officer at the time. In deciding the penalties, the SFC took into account: (i) Kou's and Victory Securities' guilty pleas to criminal charges; (ii) no loss to Victory's clients; (iii) Victory's co-operation with the SFC investigations; (iv) remedial action taken by Victory to strengthen its internal controls; and (v) their clean disciplinary records.

(Press release issued on 28 March 2006)

*In order to protect the investing public against possible losses and misconduct, it is vital that regulated persons strictly comply with the Code of Conduct. Compliance with the Code of Conduct is a cornerstone to ensure the fitness and properness of those who partake in the industry.*

## **Internal control failures attract reprimands and fines**

The SFC reprimanded Grand Cathay Securities (Hong Kong) Ltd and its responsible officer Mr Kwan Pok Tat and fined Grand Cathay \$60,000 for internal control failings. From November 2002 to April 2003, an account executive of Grand Cathay placed personal orders and discretionary orders without

authorisation in six client accounts. The account executive also allowed an unauthorised party to place orders in two clients' accounts and whilst placing such orders, breached Grand Cathay's policy regarding telephone recording of orders. Kwan was the responsible officer at the relevant time and was aware of the account executive's misconduct but did not report it to the SFC until February 2004. There was an inadequate internal system at Grand Cathay to ensure breaches were reported to management and the SFC for follow-up action. From November 2003 to October 2004, two other account executives placed orders in three client accounts but failed to follow Grand Cathay's telephone recording policy. Kwan discovered the omissions in late 2003 and early 2004. Despite warnings, the account executives continued to breach the policy until they left Grand Cathay in October and December 2004 respectively. Had Kwan been vigilant, the misconduct could have been prevented. Grand Cathay also lacked adequate measures to stop and prevent the account executives from continuously breaching the policy. In deciding the penalties, the SFC took into account the Disciplinary Fining Guidelines as well as: (i) Grand Cathay's failure to enforce the telephone recording policy resulting in repeated omissions by employees and losses to Grand Cathay of about \$80,000; (ii) the failure to report the breach of misconduct to the SFC immediately; (iii) Grand Cathay's and Kwan's promise to improve and adhere to Grand Cathay's internal control procedures to prevent a re-occurrence of the failures; (iv) their co-operation in settling the action; and (v) their clean disciplinary records.

(Press release issued on 9 March 2006)

Sarasin Rabo Investment Management Ltd and its responsible officer, Mr Simon John Ruckert, were reprimanded for inadequate internal controls. Ruckert agreed to make a voluntary payment of \$400,000 in settlement of the action against him. Following an inquiry by Sarasin that one of its relationship managers had from October 2002 to March 2003 conducted unauthorised transactions in three client accounts which resulted in losses in one account of around US\$1 million, the SFC found several internal control failings including: (i) failure to adequately monitor and supervise staff activities; (ii) failure to implement controls to ensure clients with hold mail accounts were notified of uncollected mail by independent staff and not by their relationship managers; (iii) failure to put in place measures to ensure margin call letters were sent independently rather than through relationship managers; (iv) inadequate reporting procedures to ensure that relationship managers disclosed client account details at the time they placed an order for the London market instead of the following day; and (v) failure to conduct regular reviews of recordings of telephone conversations of its relationship managers. Sarasin's internal control failings facilitated the representative to withhold margin call letters from the client and disregard reminders from Sarasin to inform the client to collect his hold mail. As the dealing director responsible for compliance at the time, Ruckert failed to implement adequate internal controls for Sarasin to detect and prevent the misconduct. In deciding penalties, the SFC considered: (i) Sarasin and Ruckert's co-operation with the SFC's investigation; (ii) that Sarasin has strengthened its internal controls and management supervision; (iii) that Sarasin reported the representative's misconduct and conducted a compliance review; (iv) that Sarasin compensated the client; and (v) Ruckert's co-operation in settling the matter.

(Press release issued on 30 March 2006)

*If those engaging in private banking business are licensed under the Securities and Futures Ordinance to carry on regulated activities, they must have in place the same anti-fraud controls applicable to any other broker or investment adviser. The mere discreet nature of client relationships in this line of business doesn't justify a lesser degree of protection.*

## General Enforcement Statistics

In the financial year from 1 April 2005 to 31 March 2006, the SFC has successfully prosecuted 72 entities, offered no evidence against five entities while one was acquitted after trial. In the same period, the SFC took action against a total of 98 licensees<sup>1</sup> for various regulatory breaches. Among these actions, the SFC entered into settlements with no formal sanction imposed with six licensees, of which three were settled with voluntary payments and another seven licensees settled with a voluntary payment and a statutory sanction. The SFC also took disciplinary actions against five licensees which were eventually concluded with no formal sanction imposed, and also issued 54 private warnings.

<sup>1</sup> The total number of licensees disciplined has been adjusted for an entry that should have been included in the November 2005 issue.



# SFC Enforcement Reporter

A monthly summary of SFC enforcement action

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**CONTACT US** – Media Enquiry: (852) 2840 9287 / Investor Hotline: (852) 2840 9333 / Email: [enquiry@sfc.hk](mailto:enquiry@sfc.hk) / Feedback: [enfreporter@sfc.hk](mailto:enfreporter@sfc.hk)