SFC 證監會

ENFORCEMENT REPORTER

A bi-monthly communication between the SFC and the market about the SFC's enforcement work and current enforcement issues.

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Highlights

What Have We Been Doing?

We are frequently asked about what sorts of cases we are investigating and how they are split across the spectrum of our enforcement responsibilities. The split of course depends on all sorts of factors including market conditions. We are starting to monitor these trends to help us in planning our work.

As at 30 September 2007, our current investigations are split as follows:

Type of Case	Major Cases	All Cases
Corporate governance	32%	13%
Insider dealing	26%	16%
Market manipulation	20%	32%
Intermediary misconduct	18%	25%
Unlicensed dealing	1%	4%
Disclosure of interests	Nil	9%
Others	3%	1%

Our total work load exceeds the number of current investigations because the latter does not include:

- current surveillance inquiries;
- completed investigations pending decision; and
- cases before a court or in a disciplinary process.

Some of you have commented about the increase in requests for information this year seeking client details and other information about trading. This reflects the increase in turnover this year. The breakdown of activity in surveillance, investigation and enforcement proceedings is as follows:

Surveillance Inquiries*	Current Investigations	Pending Decision**	Enforcement Proceedings***
2,623	86	60	61

Notes: * Number of inquiry letters we have issued under section 181 of the Securities and Futures Ordinance

** Completed investigations which are pending decision on whether prosecution or disciplinary proceedings should be commenced

*** This figure comprises prosecution and disciplinary proceedings which have been commenced but which are not yet concluded

We will publish updates on the breakdown of our enforcement work at regular intervals.

Market Manipulators Face Jail

The SFC has prosecuted three people for market manipulation recently. All three pleaded guilty, and were sentenced to suspended jail terms and ordered to pay fines. In one case the fine totalled $200,000.

A suspended jail term means the offender does not automatically go to prison to serve the sentence. Instead, the term of imprisonment is delayed and is only activated if the person commits another offence during the period of suspension. As a matter of law, both an immediate sentence and a suspended sentence are treated as sentences of imprisonment.

It is significant that in all three cases, the defendants pleaded guilty at the earliest proper opportunity. The advantage of pleading guilty is that it saves time and expense for both the criminal justice system and the public. For a defendant, it is the most reliable expression of genuine remorse. In return, Courts often give defendants substantial discounts on the sentence that would have been imposed, often as much as a one-third discount.

These three decisions (and pleas of guilty) are timely and follow on from the Court of Appeal's decision in *The Securities and Futures Commission v Zou Yishang* (HCMA No 859 of 2005) in June 2007 about the real prospect of jail terms in manipulation cases. (We discussed this case in the last Enforcement Reporter). The SFC will continue to prosecute manipulation cases.

If you would like to know more about these cases, please follow these links to our press releases dated 4 July 2007, 26 July 2007 and 5 September 2007.

Crackdown on Secret Accounts

The SFC has taken concerted action recently to clamp down on secret accounts operated by staff in brokerage firms.

In the SFC's view, there is no good reason for a person to operate or permit the operation of an account in a name that is different to the true owner. The use of fictitious names or the use of someone else's name, typically a friend or relative, is often connected to other harmful and illegal activity, such as market manipulation, insider dealing and front running.

This link was demonstrated in the recent conviction of Ms Mo Yuk Ping who was sentenced to three and a half years' jail for her involvement in a scheme to manipulate the market for shares in Shanghai Land Holdings Limited, a company acquired by an entity controlled by Mo's husband, Mr Chau Ching Ngai (see *Mo Yuk Ping and HKSAR* [2007] FACC No. 2 of 2007 (Criminal)).

The scheme involved the creation of 42 different trading accounts in the names of at least 12 persons, many of whom had no idea their names were used in this way. Mo orchestrated a series of trades through these fictitious accounts to maintain the share price of Shanghai Land at an artificial level. The purpose of doing so was to defraud Bank of China which had lent money to Chau's company taking shares in Shanghai Land as security for the loan. The case against Mo followed investigations conducted by the SFC and then the ICAC.

The Court of Final Appeal recently reviewed and upheld Mo's conviction. This decision confirms that, in certain cases, a scheme to manipulate the market for shares will also amount to conspiracy to defraud.

Importantly, the case demonstrates the clear link between fictitious accounts and market misconduct.

In the last three months, the SFC has taken action in four separate cases tackling fictitious or secret accounts operated by staff in trading firms. The SFC will continue to target this area to send a clear message to market participants that this kind of activity poses a serious risk to the integrity of Hong Kong's market and will not be tolerated.

In one case, the SFC banned a former responsible officer for life from re-entering the industry. This was a serious case because the secret accounts hid:

- the responsible officer's personal options trading and caused a margin deficit of over $13 million; and
- unauthorised trading in two other clients' accounts resulting in further margin deficits of over $1.5 million.

In three other cases, the SFC imposed banning orders and suspensions of between three months and one year.

If you would like to find out more about these four cases, please follow these links to our press releases dated 17 May 2007, 26 June 2007, 30 July 2007 and 28 August 2007.

If you would like to know more about the Court of Final Appeal's decision, please follow this link.

Poor Internal Controls and Fraud

The SFC has taken action recently to remind firms about their obligations to ensure their systems and controls provide adequate checks to ensure client assets and money are safe and not at risk of fraud or misappropriation.

Under the Code of Conduct, a licensed or registered person is responsible for the acts and omissions of staff and agents in the conduct of its business. This requirement does not make a firm responsible for the fraud by an employee. However, a firm is still required to ensure that it has internal control procedures which can reasonably be expected to protect clients from financial loss arising from theft, fraud and professional misconduct, and that client assets are accounted for properly and safely.

Given the ingenuity of fraudsters, licensed corporations should undertake regular reviews of their internal controls to make sure these remain adequate and effective to detect and prevent staff misconduct and to safeguard client assets. In addition, this will help the licensed corporation avoid questions on its fitness and properness, and disciplinary action because of internal control failings.

In recent cases, the SFC has taken action where poor internal controls contributed to client losses through fraud and misconduct. One case involved the misappropriation of client assets of $1.2 million which had remained undetected by the firm for two years. The kinds of lax controls in that case included the following:

- no systems to monitor clients' trades;
- no systems to check periodically orders against tape-recorded phone records even on a sample basis;
- allowing traders to deliver share certificates to their own clients outside the office and to obtain a written receipt from their clients which made it easier for unscrupulous staff to steal the share certificates and to forge client signatures on receipt forms; and
- allowing traders to deliver monthly trading statements to their own clients making it easier for them to conceal their misconduct from clients and other staff members by withholding the trading statements.

If you would like to know more about these cases, please follow these links to our press releases dated 20 July 2007 and 8 August 2007.

Disclosure of Interests

In the last issue of the Enforcement Reporter, the SFC highlighted the importance of the disclosure of interests obligations. Under Part XV of the Securities and Futures Ordinance, listed company directors, chief executives and substantial shareholders are required to disclose and notify the listed company and the exchange about the prescribed changes of interest.

From 1 July to 30 September 2007, the SFC has prosecuted eight entities in which:

(a) seven defendants pleaded guilty, receiving fines of $1,500 to $16,000; and

(b) the SFC offered no evidence in respect of one defendant.

Enforcement Policy and Practice

Also in the last issue, we explained the introduction of compliance advice letters in place of warning letters formerly issued by the SFC. By the end of September 2007, the SFC had issued 62 compliance advice letters. These letters addressed a variety of issues including disclosure of interests and internal control weaknesses. One particular issue addressed in recent compliance advice letters concerns a practice which we think exposes firms to the risk of prosecution.

Under the Securities and Futures Ordinance, an investment adviser issuing unauthorised materials containing an invitation to the public to invest in unauthorised investment funds runs a serious risk of contravening section 103(1).

We have seen firms obtaining disclaimers from prospective clients that purport to permit the firm to offer unauthorised investment products to them. The argument put to us is that if a prospective client (who has never been a client of the firm) agrees to be called a client, the firm can offer unauthorised products to the person even though such products cannot be offered to the person as a member of the public.

A person is either a client or not. A prospective client is not a client. A document that claims the person agreed he or she was a client when the person was in fact not a client may be viewed as a sham.

In some of these cases, there was no assessment of the person's financial position, investment needs, risk tolerance, profile, or whether authorised investment products are more suitable investment vehicles than unauthorised ones for the person.

These kinds of agreements and disclaimers do not protect the firm from liability under the SFO and provide no protection to the prospective client, and are not accetable to the SFC.

We will continue to let you know about key issues and risks that are addressed in our compliance advice letters.

The Enforcement Reporter is available under 'Speeches, Publications & Consultations' – 'Publications' of the SFC website at http://www.sfc.hk.

Feedback and comments are welcome and can be sent to enfreporter@sfc.hk. We will consider the comments and, where called for, provide a response.

If you want to receive the Enforcement Reporter by email, simply register for the Update Email Alert service at http://www.sfc.hk and select Enforcement Reporter. Intermediaries licensed by the SFC receive the Enforcement Reporter via their FinNet email accounts.

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