

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

## What Have We Been Doing?

We are committed to reducing crime and misconduct in our securities and futures markets by:

1. identifying risky conduct and circumstances that may lead to misconduct ; and
2. taking enforcement action where we believe it is necessary.

From 2 May to 31 July 2008, we sent more than 135 compliance advice letters, where we became aware of conduct which presents unnecessary risks or which may lead to crime or misconduct in our markets.

During the same period, we also completed 56 enforcement cases, issued 13 notices of decision in disciplinary cases, commenced 14 criminal proceedings and took civil action against listed company directors in one case.

### **SFC continues to improve investigation efficiency**

We continue to make progress in improving our investigation efficiency. We currently complete 79% of our investigations within seven months, compared with 71% at the end of last year and 36% at the end of 2006.

We will continue to focus on our investigation efficiency and take steps, whenever appropriate, with a view to achieving further efficiencies.

## Enforcement Policy and Practice

### **Criminal or Civil?**

There have been some suggestions that the commencement of criminal proceedings in insider dealing cases instead of civil proceedings represents a new strategy for the SFC.

## Highlights

- SFC secured first criminal conviction for insider dealing
- From 2 May to 31 July, completed 56 enforcement cases, issued 13 notices of decision in disciplinary cases, commenced 14 criminal proceedings and took civil action against listed company directors in one case.
- Former investment banker arrested and charged with insider dealing
- Commenced criminal proceedings against individuals for conspiracy to manipulate market
- Continued to stamp out "marking the close" trading activities

This is not the case, nor the practice of the SFC, when commencing criminal proceedings. The SFC prosecutes where the evidence supports criminal proceedings and it is in the public interest to prosecute.

The SFC consults the Department of Justice (DOJ) about the commencement of criminal proceedings. The purpose of this is, in part, to ensure the SFC applies an approach that is consistent with criminal justice administration in Hong Kong. Such consultation will also ensure that criminal cases are only started when there is a reliable and experienced basis to believe there is sufficient evidence to establish a case beyond reasonable doubt.

In other words, the SFC will start criminal insider dealing cases where the case is strong enough to justify a criminal proceeding and the criminal proceeding is in the public interest (in accordance with DOJ prosecution policy). The SFC considers it would be inappropriate to refer a criminal case to the government with a view to the commencement of civil proceedings before the Market Misconduct Tribunal (MMT) which is a civil tribunal with no power to impose deterrent sanctions.

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## Insider Dealing

In the last edition of the Enforcement Reporter we explained why we attach the highest importance to stamping out insider dealing. Our strategy is to reduce the incidence of insider dealing by using the full range of powers and remedies contained in the Securities and Futures Ordinance (SFO) including criminal, civil and administrative sanctions.

In applying this approach, the SFC has so far obtained interim orders in the High Court freezing approximately \$100 million in suspected insider dealing profits. For further details of these cases, please refer to our press releases dated [18 Dec 2007](#) and [2 May 2008](#) and the previous issue of [Enforcement Reporter](#). There are also four cases arising from SFC investigations which are presently before the MMT. Please follow this link to the [MMT](#) for further details of these cases, including hearing dates for anyone who wishes to attend.

In pursuit of this strategy, two significant events have occurred since the last edition. Both events involved the application of our powers to bring criminal proceedings for insider dealing.

### First Criminal Conviction for Insider Dealing

On 17 July 2008, Ms Hung Lai Mei was convicted of insider dealing. This marked the first criminal conviction since insider dealing was made a criminal offence under the SFO in 2003.

Our investigation revealed that Hung, a finance manager of Sino Golf Manufacturing Company limited, held 180,000 shares in her employer's holding company, Sino Golf Holdings Limited (Sino Golf).

In October 2004, Hung was informed that a major debtor of Sino Golf which owed Sino Golf \$11.9 million had filed for bankruptcy protection in the USA. She was aware that the debtor's inability to repay its debt to Sino Golf would affect the company's financial position and share price as Sino Golf would need to make bad debt provision.

In December 2004, Hung sold her entire shareholding in Sino Golf before the market was made aware of the impact of the debtor's bankruptcy on Sino Golf's financial position. This information was not made known to the public until Sino Golf announced its financial results on 18 April 2005 which included a bad debt of \$9.5 million and recorded a 35% drop in net profit. The market reacted to the negative news and the share price of Sino Golf dropped by 23% on the 19 April 2005. It's estimated Hung's early disposal of shares enabled her to avoid a loss \$63,333.

sentenced to six months imprisonment, suspended for two years. She was also fined \$200,000 (\$50,000 on four separate charges) and ordered to pay \$20,523 in costs to the SFC.

This sentence sends a clear message that insider dealing is an offence which can result in imprisonment. On this occasion, the sentence of imprisonment was suspended in recognition of the fact that Ms Hung entered a plea of guilty. It is likely that the early guilty plea saved Ms Hung from an immediate custodial sentence. This should serve as a reminder of the benefit of making admissions and pleading guilty at the earliest opportunity, whenever it is appropriate to do so.

For further information about this case, please follow the link to our [press release](#) dated 17 July 2008.

### **Former Investment Banker Arrested and Charged with Insider Dealing**

In another notable event, Mr Du Jun, a former managing director at Morgan Stanley Asia Limited (Morgan Stanley) was arrested and charged with nine counts of insider dealing and one count of counselling or procuring another person to deal in the shares of a listed company prior to the announcement of an acquisition deal.

Mr Du Jun was detained at the Hong Kong International Airport on July 10, 2008 after arriving from Beijing. He appeared at the Eastern Magistracy the following day. No plea was taken and Du was granted bail on the condition that he paid cash bail of \$500,000 and surrendered all of his travel documents.

This case was adjourned to 5 September for a further hearing at the Eastern Magistracy.

For further information, please follow the link to our [press release](#) dated 11 July 2008.

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## **SFC Continues to Resolve Compliance Issues Using New Approach and Imposes its Highest Ever Disciplinary Fine**

In the January and May 2008 editions of the Enforcement Reporter, we commented on a new approach to resolving serious compliance issues with licensed firms in circumstances where a firm faces the risk of having its licence suspended immediately. This approach was first used in disciplinary proceedings involving South China Capital Limited and South China Research Limited and more recently in disciplinary proceedings involving Core Pacific-Yamaichi Capital Limited and two related firms.

The SFC has adopted the same approach to resolve compliance issues with ICEA Capital Limited and ICEA Securities Limited. As part of the agreement with the two firms, the SFC imposed the highest ever disciplinary fine against a licensed entity.

In the ICEA cases, agreements were concluded under which:

1. the SFC fined ICEA Capital Limited and ICEA Securities Limited a total of \$38 million,
2. the firms are required to engage an independent audit firm to conduct internal control and compliance reviews within three years, as directed by the SFC, without prior notice, and
3. if material breaches or failures are found within three years similar to those found before, the licenses of the two firms may be revoked.

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There is considerable value in seeking to change the behaviour of licensed firms through the application of this positive and forward-looking regulatory approach, which reflects the commitment of the firms concerned, and their senior management, to enhancing their compliance.

For further information, please follow the link to our [press release](#) dated 6 June 2008.

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## SFC Lays Charges for Conspiracy to Manipulate Market

The SFC has commenced criminal proceedings against four individuals for conspiring to manipulate the market to trade in shares of Asia Standard Hotel Group Limited (ASH Group), a company listed on the Stock Exchange of Hong Kong.

The SFC alleges that four individuals conspired to create a false or misleading impression of the market for ASH Group shares, in breach of section 295 of the SFO, raising the share price of ASH Group by 78%, ramping up the company's market capitalisation by HK\$4 billion and creating a false or misleading impression of depth and liquidity in the market for ASH Group shares. Two of the four individuals are also alleged to have failed to answer questions as required under the SFO without reasonable excuse during the SFC's investigation into the trading of ASH Group shares.

On 7 August 2008, the Eastern Magistracy granted the application by the Department of Justice to transfer the case to the District Court for trial. This case is the second indictable prosecution under the SFO and the first for market manipulation. The defendants will appear in the District Court for a plea hearing on 26 August 2008.

For further details please follow this link to our [press release](#) dated 7 August 2008 and 10 July 2008.

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## Marking the Close

"Marking the close" is a form of market manipulation. This involves the placing of orders to buy small quantities of shares at prices higher than the prevailing market prices near the market close. The late placing of orders does not allow sufficient time for the market to respond. These orders are therefore left unmatched and result in an inflated closing price.

Typically, a person intent on manipulating the market will place buy orders without any genuine desire to acquire the shares, but rather with the intention to create a false impression of an active market for those shares. The resulting inflated closing price is an artificial price that does not reflect the genuine forces of demand and supply. In most cases, "marking the close" in this way, is intended to facilitate the sale of the shares at higher prices on the following day.

Since 2 January 2007, we have prosecuted 5 individuals and disciplined 4 individuals for "marking the close" activities. The SFC will continue to take appropriate enforcement action against market manipulators and licensed persons who fail to preserve the integrity of the market in executing client instructions. The relevant laws, rules and regulations which prohibit "marking the close" activities, are equally applicable to the closing auction sessions.

For further information, please follow the links to our [press releases](#) dated 5 March 2007, 9 March 2007, 26 July 2007, 20 December 2007, 3 January 2008, 6 March 2008, 12 June 2008 and 7 July 2008.

## Suspected Scams

The SFC receives regular complaints about suspected scams (often described as “boiler rooms”) where fraudsters seek to take advantage of multiple jurisdictions to defraud the public without detection.

The SFC learns about suspected scams in a number of ways, including through complaints by investors and our own surveillance. We take these complaints seriously and devote resources to investigating them where they relate to matters which fall within our own statutory power.

In this regard, the SFO prohibits the carrying on of any regulated activity (or holding out as carrying on any regulated activity) without the requisite SFC licence and the offering of products to the public in Hong Kong without SFC approval. These prohibitions are contained in sections 103 and 114 of the SFO. Anyone who breaches these provisions commits an offence and is liable to a fine of up to HKD 500,000 and/or a term of imprisonment of up to 3 years for an offence under section 103 and a fine of up to HKD 1,000,000 and/or 2 years imprisonment for an offence under section 114.

In a recent case, the SFC learned about a suspicious operation at an early stage following an enquiry about a website. The website was maintained by a Hong Kong registered company with contact details in Hong Kong. The company claimed to be regulated by the Financial Services Authority in the UK (which it was not). The company also claimed in its website that it offered trading in foreign exchange, bullion and other financial products. A copy of a standard form client agreement was available on the website.

The website contents led us to suspect that the company was engaging in leveraged foreign exchange trading without an SFC licence.

The SFC launched an investigation, including a search of the company premises in Hong Kong. Fund tracing was also undertaken which showed that the company’s bank accounts in Hong Kong had received remittances from PRC residents and had been used to make payments to various PRC accounts. Following the investigation, the offending website was shut down.

In this case, our prompt and thorough investigation prevented prospective investors from suffering loss at a time when it appeared that the company was at an advanced stage of preparing to commence unlawful activities.

When the SFC becomes aware of suspected scams such as this, it will, in appropriate cases:

1. seek court orders to restrain the company from undertaking unlawful activities in Hong Kong and/or to freeze its assets;
2. seek assistance from overseas regulators under various co-operative arrangements;
3. seek assistance from the Commercial Crime Bureau of the Hong Kong Police; and
4. inform other interested bodies so as to share the intelligence about suspected scams and those who may be behind them.

The SFC would like to remind investors to stay vigilant and not to transfer money to any company without a full understanding of its business and operations. Investors should look out for unlicensed firms by visiting the [Alert List](#) and [Public Register of Licensed Persons and Registered Institutions](#) on the SFC’s website.

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## Disclosure of Interests

The SFC continues to attach a great deal of importance to the obligation of directors and substantial shareholders to make timely disclosure of their interests in listed companies.

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Under Part XV of the SFO, listed company directors, chief executives and substantial shareholders are required to disclose and notify the listed company and the Hong Kong Stock Exchange of changes of interest.

From 2 May to 31 July 2008, the SFC prosecuted two entities for disclosure of interest breaches. In each case, the defendant pleaded guilty. Fines were imposed ranging from \$12,000 to \$18,000.

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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](mailto: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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