SFC 證監會

ENFORCEMENT REPORTER

ISSUE NO. 62
April 2009

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:

- identifying risky conduct and circumstances that may lead to misconduct; and
- taking necessary enforcement action.

From 2 January to 15 April 2009, we sent out 25 compliance advice letters when we became aware of conduct that presented unnecessary risks or that might lead to crime or market misconduct.

During the same period, we completed 64 enforcement cases (including the issuance of 20 disciplinary notices of decision) and commenced six criminal and one civil proceedings.

Upcoming cases in courts and tribunals

Several trials and hearings arising from enforcement work of the Securities and Futures Commission (SFC) have been scheduled for the coming weeks. These cases deal with important issues, including insider dealing, market manipulation, false trading and corporate governance.

- An insider dealing trial regarding dealing in the shares of CITIC Resources Holdings Ltd will take place in the District Court on 4 May 2009.
- A pre-trial review and a trial concerning disclosure of interests regarding shares of Longlife Group Holdings Ltd and Warderly International Holdings Ltd will take place in the Eastern Magistracy on 4 May 2009.
- An SFC appeal against a High Court decision to discharge an interim injunction obtained to prevent dissipation of assets in an on-going insider dealing investigation will be heard in the Court of Appeal (CA) on 8 May 2009.
- A director disqualification hearing will be held in the High Court in respect of Shum Ka Sang, the former chairman, CEO and executive director of Wah Sang Gas Holdings Ltd,

Highlights

- From 2 January to 15 April 2009, the Securities and Futures Commission completed 64 enforcement cases (including the issuance of 20 disciplinary notices of decision) and commenced six criminal and one civil proceedings.
- The SFC concluded two Lehman Brothers Minibonds investigations. Two firms agreed to offer to purchase all outstanding Minibonds from eligible clients.
- The SFC intervened in court proceedings regarding proposals to delist and privatise PCCW Ltd.
- A disqualification order was obtained from the High Court against a former director of a delisted company. This was the third time that the SFC had obtained a disqualification order.
- The Securities and Futures Appeals Tribunal backed the first SFC's decision to revoke the licence of a corporation.
- Brokers were fined several million dollars for failing to implement proper controls to safeguard client securities and to put in place controls to protect market integrity.

on 22 May 2009.

- A pre-trial review in respect of the alleged provision of false or misleading statements regarding the shares of Green Energy Group Ltd (formerly known as China Nan Feng Group Ltd) will take place in the Eastern Magistracy on 22 May 2009.

For a complete list of upcoming prosecutions and trials in all courts, please see Upcoming Events and Calendar on the SFC website.

The first immediate jail term for insider dealing

In the past editions of the Enforcement Reporter (Issues. 58 - 60), we have explained that our strategy is to reduce the incidence of insider dealing by using the full range of powers and remedies available to us, including seeking criminal, civil and administrative sanctions.

The SFC has secured seven criminal convictions in three insider dealing cases in nine months. Three persons were sent to jail immediately in two of the cases.

The second insider dealing case which was brought to trial concerned trading in the shares of Egana Jewellery & Pearls Ltd (Egana). It marked the first indictable trial in the District Court for insider dealing under the Securities and Futures Ordinance (SFO).

The five defendants in the Egana case, Mr Ma Hon Yeung (Ma), Ms Lo Yuk Wah Ivy (Ivy Lo), Mr Ma Hon Kit Sammy, Ms Tso Kin Wah Cordelia and Mr Ma Chun Ho Ronald, were convicted of a total of 12 charges of insider dealing by the District Court.

Ma and Ivy Lo were jailed for 26 months and 12 months respectively. The other three defendants were each sentenced to 200 hours of community service. Fines were also imposed in amounts equal to the profits made by the defendants. They were ordered to pay investigation costs totalling $322,742.

Ma joined BNP Paribas Peregrine Capital Ltd (now known as BNP Paribas Capital (Asia Pacific) Ltd) (BNP) as a Vice President on 1 June 2006. BNP was involved in advising Egana on a proposal to privatise the company. Within days of becoming privy to the proposed deal, Ma tipped off his girlfriend (Ivy Lo) and three family members (the other defendants in this case) who all bought shares in Egana prior to the announcement of the proposed deal.

Between 1 June and 6 July 2006, trading in Egana's shares ranged between $1.35 and $1.61 with an average daily turnover of 636,630 shares. Trading in the shares was suspended on 7 July 2006 pending an announcement. On 11 July 2006, the proposed privatisation of Egana was announced. Following the announcement, the share price closed at $1.84 with substantially increased turnover of 25 million shares. A total profit of almost $900,000 was made by the defendants.

In the third criminal case which was brought to trial, Mr Andy Lam King Hung (Lam) was convicted on two charges of insider dealing in the shares of Chi Cheung Investment Co, Ltd (Chi Cheung). Lam, whilst employed as an accountant by a subsidiary of Chinese Estates Holdings Ltd, learned of a price sensitive proposal about Chi Cheung in around August 2007. Lam placed orders in his and his wife's accounts to buy Chi Cheung shares before the proposal was announced publicly. Following the announcement, the share price of Chi Cheung increased by some 30%.

Lam and his wife made a profit of $209,000 from the alleged insider trading.

Lam was jailed for eight months and was ordered to pay a fine of $130,000 and investigation cost of $54,394. Lam's wife was acquitted of all charges.

The above cases are particularly serious because they involved professionals misusing confidential information gained in the course of their employment. The SFC will continue to prosecute insider dealing and seek jail terms wherever appropriate to serve

as a credible deterrent. The immediate jail sentences, which were handed down for the first time for insider dealing, signal the community's strongest condemnation of this type of misconduct and serve as a warning against such illegal conduct.

For further information, please see press releases dated 28 February 2008, 17 March 2008, 23 October 2008, 11 March 2009, 27 March 2009, 1 April 2009 and 20 April 2009, and the judgment dated 11 March 2009 (DCCC 229-240/2008) on the Judiciary website.

Conclusion of two Minibonds investigations

In January 2009, the SFC concluded the first investigation into the sale of Lehman Brothers Minibonds (Minibonds). The SFC reprimanded Sun Hung Kai Investment Services Ltd (Sun Hung Kai) in respect of internal systems and controls relating to its sales of Minibonds to its clients since 2002 and imposed a probationary suspension. It was a triple-win resolution for investors, Sun Hung Kai and the SFC.

The SFC raised the following concerns with Sun Hung Kai:

- the adequacy of product due diligence on Minibonds before they were distributed to eligible clients;
- the adequacy of training given to Sun Hung Kai retail sales staff on Minibonds to enable them to understand the product and all its material risks;
- the assessment of the level of risk for each particular series of Minibonds, the communication of those risk ratings to its retail sales staff and the measures that ought to have been taken to ensure that its sales staff gave reasonably suitable advice by matching the risk-return profile of each series of Minibonds with the personal circumstances of each eligible client; and
- the record-keeping of investment advice given to eligible clients and queries raised by them, if any.

Sun Hung Kai did not admit any liability or wrongdoing but acknowledged the seriousness of the SFC's concerns. By an agreement under section 201 of the SFO, Sun Hung Kai agreed:

- to offer to its eligible clients to purchase all outstanding Minibonds bought through it;
- to engage an independent audit firm to conduct a review of its internal control and compliance systems;
- if, within 18 months from the completion of Sun Hung Kai's current enhancement exercise, the SFC finds the same concerns of a materially serious nature as those identified by it in this investigation, Sun Hung Kai's licence will be partially suspended for three years to the extent that it will not be allowed to sell or distribute unlisted or structured products to clients and to provide advice to clients in relation to these products; and
- to continue to support and cooperate fully with the SFC.

Recently, the SFC concluded another investigation into the sale of Minibonds. By an agreement under section 201 of the SFO, KGI Asia Ltd (KGI) agreed to purchase from its clients all outstanding Minibonds bought through it without admission of liability. The SFC reprimanded KGI in respect of internal systems and controls relating to its sale of Minibonds and imposed a probationary suspension.

Faced with a vast number of complaints (more than 29,000 as at 31 March 2009) on the sale of Minibonds, the SFC had to decide how best to proceed with the Minibonds investigations. The options were to investigate each complaint individually or to investigate the selling practices and policies of each bank or firm by using a top-down approach. We decided, in the first instance, to adopt a systemic top-down approach, taken with the objective of ensuring that allegations arising from the complaints are investigated efficiently, effectively and expediently.

In investigations, one size does not fit all. Not every complaint we decide to investigate is investigated in the same way. The speedy and successful conclusion of our investigations into Sun Hung Kai and KGI reflects the merits of adopting a top-down approach in these instances.

The SFC is required to consider the interest of the investing public or public interest in reaching an agreement with any party under section 201 of the SFO. In the cases of Sun Hung Kai and KGI, there was considerable merit in reaching an agreement with them:

- investors' interests are best protected through the repurchase offers made by Sun Hung Kai and KGI since the SFC does not have the power to make any compensation order under the SFO;
- there is a high public interest in resolving the case quickly as the agreement avoids delay, and unnecessary costs and expenses for all concerned; and
- the agreement is positive and forward-looking as the SFC can achieve regulatory effect by changing Sun Hung Kai's and KGI's behaviour through the use of probationary penalty and the continuous enhancements made to their systems and controls.

The SFC is continuing its investigations into more than 20 other Minibonds distributors. Consistent with the obligation to preserve secrecy contained in the SFO, it is our policy not to comment on ongoing investigations.

For further details, please see press release dated 22 January 2009 and 5 April 2009.

SFC intervenes in PCCW privatisation proceedings

The SFC wasted no time in addressing concerns expressed about the privatisation of PCCW Ltd (PCCW). For the first time, the SFC sought and obtained permission from the Court of First Instance (CFI) to intervene and be heard in proceedings commenced by PCCW for court approval of a scheme of arrangement proposing the delisting and privatisation of PCCW.

The SFC's application to intervene was made under section 385 of the SFO. This section allows the SFC to intervene in civil proceedings between private parties, so that it can provide its regulatory perspective in a matter provided for in the SFO or a matter in which the SFC has an interest because of its statutory role. Before making an application, the SFC must be satisfied that it is in the public interest to do so and must consult the Financial Secretary.

This is the first time the SFC has exercised its statutory power to apply to intervene and be heard in court proceedings.

On 6 April 2009, the CFI approved PCCW's scheme to privatise the company. The SFC appealed against the decision to the CA. On 22 April 2009, the CA ruled in favour of the SFC's appeal. We await the written reasons of the CA.

For further information, please see press releases dated 24 February 2009 and 6 April 2009.

Conduct of listed companies and their directors remains firmly on agenda

To ensure high standards of listed companies' corporate governance, the SFC takes action against company directors who provide misleading information to the market and breach their duties to the company at the expense of shareholders. This includes seeking disqualification orders and commencing prosecutions, where appropriate. Two recent decisions, described below, are the latest outcomes.

Third listed company director disqualified for misconduct

In the last issue of the Enforcement Reporter (Issue No. 61), we reported the disqualification order obtained by the SFC against a former director of GP NanoTechnology Group Ltd (GP Nano).

Recently, the SFC obtained an order in the High Court against Mr Chow Chun Kwong (Chow), another former director of GP Nano, to disqualify him from being a director or being involved in the management of any listed company without court approval for a period of six years. This is the third disqualification order obtained by the SFC against a listed company director.

The SFC complained that Chow had acted with gross incompetence by:

- providing misleading information to the market in two announcements;
- abdicating responsibility as director of GP Nano;
- failing to exercise reasonable skill, care and diligence and/or to act in the best interests of the company;
- misrepresenting or misstating his own duties as executive director in the company's prospectus and annual reports; and
- failing to ensure the company complied with the Rules Governing the Listing of Securities on the Growth Enterprise Market of The Stock Exchange of Hong Kong Ltd (SEHK) and the Code on Takeovers and Mergers.

Chow argued, that in accepting appointment as an executive director of the company, he was assured by a representative of major shareholders that his role would simply be talking to and liaising with fund managers and brokers to prepare the company for listing, and that the management of the company would be looked after by other executive directors. The court did not accept these as mitigating factors.

In delivering her judgment in the case, Madam Justice Kwan cited with approval that, "it is of the greatest importance that any individual who undertakes the statutory and fiduciary obligations of being a company director should realise that these are inescapable personal responsibilities."

The period, and the less stringent scope, of the disqualification order (which only applies to listed companies rather than to any company) reflected Chow's co-operation with the SFC, in particular, the admission of the complaints against him in the form of agreed facts presented to the court.

In the same proceedings, the SFC seeks disqualification orders against three other former directors of GP Nano. These hearings are yet to be scheduled.

For further details, please see press releases dated 30 March 2007, 30 May 2007, 4 December 2008 and 30 January 2009, and the judgment dated 30 January 2009 (HCMP 2524/2006) on the Judiciary website.

Court confirms SFC's power to prosecute listed companies and their directors for making false or misleading statements to investors

The Court of Final Appeal (CFA) dismissed an appeal by Mr To Shu Fai (To), former chairman of Daido Group Ltd (Daido).

In April 2007, the SFC prosecuted successfully Daido and To for making a false or misleading statement to the SFC in an announcement filed by Daido with SEHK. Both Daido and To appealed their convictions and their appeals were rejected by the High Court.

The former chairman challenged the SFC all the way to the CFA. The CFA confirmed the SFC's power to take enforcement action under the SFO against offences alleging false or misleading statements regarding announcements and information made by listed companies to SEHK. The conviction is the first of its kind for providing false and misleading information under the dual filing regime.

For further details, please see press releases dated 12 April 2007, 4 February 2008 and 26 March 2009, and the judgments dated 1 February 2008 (HCMA 547/2007) and dated 26 March 2009 (FACC No. 3 of 2008) on the Judiciary website.

Court winds up company engaged in unlicensed futures dealing

The SFC obtained orders in the court to wind up Gartlett Investments Ltd (Gartlett). This action stemmed from an investigation into unlicensed futures trading by Gartlett.

The investigation revealed that mainly commodity futures contracts were traded on the London Metals Exchange and that a total value of over US$950 million was involved in a sample of over 2,400 contracts executed in the last two weeks of August 2008.

In September 2008, the SFC successfully applied to the court to appoint interim administrators to take control of Gartlett's affairs. The court also ordered the company to stop its dealing business.

The SFC sought court orders to wind up Gartlett because it appeared to be insolvent and needed to be subject to formal administration by an insolvency expert who could trace assets and, if possible, return money to creditors.

For further information, please see press releases dated 12 September 2008, 19 September 2008 and 26 March 2009.

SFAT upholds SFC's decision to revoke licence of a licensed corporation

The Securities and Futures Appeals Tribunal (SFAT) confirmed the SFC's decisions to:

- revoke the licence of Hong Kong Forex Investment Ltd (Hong Kong Forex);
- ban Tse Shiu Hoi (Hong Kong Forex's major shareholder) from re-entering the industry for life and; and
- prohibit Eddie Ng Chit Chung (Hong Kong Forex's former responsible officer) from becoming licensed or registered for a period of three years.

This was the first time the SFC exercised its disciplinary power to revoke the licence of a corporation, following a failure by Hong Kong Forex to implement systems and controls to prevent unlicensed activities and cold calling. The SFC considered that Hong Kong Forex and its senior management facilitated, encouraged and turned a blind eye to continuing misconduct.

After reviewing the SFC's decisions, the Honourable Mr Justice Stone agreed with them and said that:

- Hong Kong Forex "continued to embody a culture which is (or was) rotten to the core";
- "it is clear that the SFC took the view, upon entirely justified grounds, that it had lost all confidence in Hong Kong Forex … The regulator carefully considered the whole case, including its extensive history, and in the exercise of its discretion came to a decision with which this Tribunal emphatically declines to interfere upon this application"; and
- "a sanctioned party should not expect to achieve its aim of a variation of severe disciplinary sanction simply by waiving its chequebook in the Tribunal's face".

For further details, please see press releases dated 29 January 2008 and 24 March 2009.

Safe custody of client assets mandatory

Safe custody of client assets is a mandatory obligation for licensees. As illustrated in the last issue of the Enforcement Reporter (Issue No. 61), the SFAT and the SFC will not tolerate sloppy and negligent behaviour as to the safeguarding of client assets.

Recently, the SFC reprimanded and fined BOCI Securities Ltd (BOCI) $3 million for failing to implement proper controls to safeguard client securities.

The SFC found that a settlement staff member of BOCI had transferred shares belonging to cash and margin clients to BOCI's clearing account with the Central Clearing and Settlement System without clients' authorisations. In 2006, on over 30 occasions, the client shares were used to settle transactions for BOCI's institutional clients who were late in delivering scrip for settlement. The share transfers were not detected for almost a year.

The transfers did not result in any client loss and were the result of acts by one staff member. BOCI reported the matter to the SFC and cooperated with the SFC's disciplinary proceedings. The SFC took into account these factors and entered into an agreement with BOCI under section 201 of the SFO. The fine was reduced accordingly.

For further information, please see press release dated 18 February 2009.

Liquidity provider disciplined for failing to preserve market integrity

The SFC reprimanded Macquarie Equities (Asia) Ltd (Macquarie) and fined it $4 million following an investigation into Macquarie's operation of a commission rebate scheme in relation to derivative warrants issued by Macquarie Bank Ltd (MB warrants).

Under the rebate arrangement, Macquarie agreed to reimburse investors, through their participating brokers, the brokerage costs for trading specified warrants, thus reducing transaction costs for investors and stimulating trading in certain MB warrants.

The SFC identified heavy trading activities in MB warrants between two clients from two participating brokerages from January 2004 to January 2005. The two clients repeatedly traded the MB warrants at or near the same prices within short time intervals and created substantial amounts of turnover. As a result of the heavy trading, the clients received a significant amount of commission rebate from Macquarie. Together with the discounts on brokerage costs from the brokerages, which were more than the commission rebate, the two clients were then able to generate profit from the trading.

Macquarie had put in place some controls to deal with market integrity and monitored the rebate arrangement. However, it failed to check whether the commission rebate paid was higher than the actual brokerage costs. This contributed to conditions that created a distorted market for the relevant MB warrants, and investors may have been misled that certain MB warrants were more actively traded than was actually the case.

In deciding on the disciplinary sanctions, the SFC considered that Macquarie took some steps to supervise its rebate arrangement, it was not itself a party effecting any abusive trading, it co-operated with the SFC in the disciplinary proceedings and had a clean disciplinary record.

Licensed intermediaries, especially those entrusted with the function of providing liquidity in a derivative warrant market, have an obligation to help protect market integrity.

For further information, please see press release dated 19 March 2009.

Market Misconduct Tribunal finds four persons culpable of market misconduct

The Market Misconduct Tribunal (MMT) recently submitted reports to the Financial Secretary in relation to dealing in the shares of QPL International Holdings Ltd. The MMT determined that four persons were culpable of market misconduct:

- Chau Chin Hung (Chau), acting as a director and responsible officer of Sun Hung Kai, had engaged in false trading and price rigging by placing a significant number of bid orders through the account of Cheeroll Ltd (an associated company of Sun Hung Kai) over a period of five weeks. The bid orders were never executed, and were generally immediately cancelled, reduced in size, cancelled later on the same day and re-issued at the same price shortly thereafter;
- Cheung Sau Lin Connie (Cheung), acting as an employee or agent of Sun Hung Kai, had assisted Chau to engage in the market misconduct; and
- Cheeroll Ltd and Sun Hung Kai were vicariously liable for the above market misconduct of Chau and/or Cheung.

The MMT ordered, among other things, that Chau and Cheung shall not be a director, liquidator, receiver or manager of the property or business of a listed company (or any subsidiary company of Sun Hung Kai & Co. Ltd, including Sun Hung Kai), or be involved in the management of such company for a period of 18 and six months respectively.

Further, the MMT ordered that the SFC be recommended to take disciplinary actions against them and Sun Hung Kai, because persons licensed with the SFC have been found culpable of market misconduct. This is the first case decided by the MMT involving false trading and price rigging.

For further information, please see the MMT's reports dated 22 January 2009 and 25 February 2009.

Enforcement policy and practice

Governance in relation to the issue of research reports

The SFC recently completed an investigation into the suspected disclosure of false or misleading information inducing transactions under the SFO.

An investment bank issued a research report about a purported economic stimulus package of a discernible size. The report did not contain any reference as to the source or basis for the statements concerned. Readers were unable to identify whether the statements were facts, or were merely views of the author and/or the investment bank.

We recognise that the impact of economic research reports on the stock markets may not be as direct as stock analysis reports. However, economic research reports containing sensitive issues may be reported by the media and may have considerable impact on the local stock market.

Investment banks should adequately review their research reports, including economic research reports, to ensure that statements contained in the reports are based on reliable sources or reasonable analysis. Further, the presentation of the reports should not confuse estimates or personal views of authors and house views with facts and information from reliable sources, in order to avoid misleading the investing public.

Spam from unknown source

The SFC received complaints relating to spam purportedly issued by a professor through different e-mail accounts. The spam

claimed that the share price of a thinly traded stock would increase more than 100% in a week's time due to the availability of steady income generated by certain instruments.

Following the issue of the spam, the share price and trading volume of the stock increased substantially on the next trading day. The SFC issued notices pursuant to section 181 of the SFO to gather information about the transactions concerned. Further, the assistance of overseas regulators was sought to obtain the registration details of the e-mail accounts through which the spam was sent. The SFC did not find any connection between the spam and the traders involved.

In fact, the "certain instruments" were disclosed by the listed company prior to the issue of the spam and the description contained in the spam did not appear to be false or misleading. However, the bullish target price expressed in the spam might have induced investors to buy the stock.

Investors should be wary of relying upon the content of e-mail coming from unknown sources.

Disclosure of interests

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

Under Part XV of the SFO, listed company directors, chief executives and substantial shareholders are required to disclose and notify their company and the SEHK of changes in their interests.

From 2 January to 15 April 2009, the SFC prosecuted eight entities for breaches in disclosure of interests. In all these cases, the defendants pleaded guilty. Fines ranging from $2,000 to $10,000 were imposed.

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.

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