

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 1 August to 30 November 2009, we sent out 77 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 81 enforcement cases (including the issuance of 26 disciplinary notices of decision) and commenced 13 criminal and 4 civil proceedings.

## Upcoming cases in courts and tribunals

Several trials and hearings arising from our enforcement work have been scheduled for the coming weeks. These cases deal with important issues, including allegations of insider dealing, false trading and failure to answer questions in an SFC investigation.

- Trials in respect of the alleged failure to answer questions raised in an SFC investigation into the market manipulation of shares of Asia Standard Hotel Group Ltd will take place in the District Court on 17 December 2009.
- A trial regarding the alleged false trading of four derivative warrants will take place in the Eastern Magistracy on 5 January 2010.
- A pre-trial review regarding the alleged insider dealing of shares of Universe International Ltd will take place in the Eastern Magistracy on 12 January 2010.

For a complete list of upcoming prosecutions and related criminal hearings please see "Upcoming Events and Calendar" on the SFC website.

## Highlights

- From 1 August to 30 November 2009, the Securities and Futures Commission (SFC) completed 81 enforcement cases (including the issuance of 26 disciplinary notices of decision) and commenced 13 criminal and 4 civil proceedings.
- The first indictable prosecution for conspiring to manipulate the market led to immediate jail sentences for four manipulators.
- The 10th insider dealer prosecuted under the SFO was sent to jail for seven years – the longest sentence ever passed for such an offence.
- The High Court disqualified two former directors of a delisted company in the sixth and seventh successful disqualification orders obtained by the SFC.
- The SFC continues to make full use of its civil powers.

# Milestone reached to combat market manipulation

## Market manipulators jailed

Market manipulation is a serious crime of dishonesty designed to defraud the investing public for illegal profit. Criminals who think they can take advantage of innocent investors by falsifying the market are on notice that the SFC will take action against them.

Recently, four people were sent to jail by the District Court for conspiring to manipulate the shares of Asia Standard Hotel Group Ltd (ASH). This marks the first indictable prosecution for false trading under section 295 of the SFO and is also the largest market manipulation case brought before a court in Hong Kong.

The SFC alleged that:

- the trading activities of Mr Chan Chin Yuen, his sister-in-law Miss Au Yeung Man Chun Elaine, his brother Mr Chan Chin Tat and a friend Mr Chui Siu Fung (Chui) created a false or misleading impression of the depth and liquidity in the market for ASH shares from 1 August to 5 September 2005. This raised the share price of ASH by 78% and ramped up the company's market capitalisation by \$4 billion, representing the largest market capitalisation ever falsified in a manipulation case commenced by the SFC;
- the trading was funded by Chan Chin Yuen while the others in the group traded largely among themselves; and
- the trading constituted more than 50% of ASH shares traded during the period on turnover of about \$190 million.

His Honour Deputy Judge Johnny Chan sentenced Chan Chin Yuen to 30 months in jail and the other three were each given a 26-month jail sentence. Each defendant was ordered to pay investigation costs of \$288,400 to the SFC.

In passing the sentences, the Deputy Judge remarked that the market manipulation undertaken by the defendants, if undeterred, would undermine the integrity of the stock market of Hong Kong. Hence, the court must pass a sentence that reflected public disapproval and with enough impact to deter other like-minded people.

Chan Chin Yuen previously evaded attending an SFC interview in the investigation and failed to do so on another date ordered by the court. Chan was found to be in contempt of court and was later arrested and imprisoned. He was released on the basis that he attended an SFC interview and surrendered his travel documents.

Chan Chin Tat and Chui are also charged with the offence of failing to answer questions during the SFC investigation without reasonable excuse. The trial of these charges is scheduled for 17 December 2009.

For further information, please see press releases dated 1 November 2007, 10 July 2008, 7 August 2008, 13 November 2009 and 26 November 2009.

## Two manipulators given suspended jail terms

In other cases involving false trading, Mr Zhu Li (Zhu) and Mr Chang Kar Hung (Chang) were:

- both jailed for two months, suspended for 12 months;
- ordered to pay fines of \$10,000 and \$9,000 respectively; and
- ordered to pay investigation costs of \$39,942 and \$28,263 to the SFC respectively.

Zhu submitted an application for immigration to Hong Kong under the Capital Investment Entrant Scheme, which required Zhu to acquire \$6.5 million worth of Hong Kong listed securities and to hold them. The valuation of securities held was based on the acquisition price of the securities concerned.

Zhu was found to have placed a series of sell-and-cancel orders and conducted a wash sale to inflate the transacted price of a stock. He admitted that by doing so, he could satisfy the investment requirement with less money.

Chang was found to have manipulated the closing prices of two derivative warrants to respectively dispose of his holdings at higher prices and secure a lower price for his purchase.

For further information, please see press releases dated 17 August 2009, 19 August 2009, 26 August 2009 and 2 November 2009.

### **Licensed persons disciplined for manipulative related misconduct**

Recently, the SFC disciplined the following firms and their staff who failed to prevent clients from trading in an abusive manner:

- Shun Loong Securities Co Ltd (Shun Loong) was reprimanded and fined \$2 million;
- Mr Wilhelm Soeharsono Budihardjo (Budihardjo), a responsible officer of Shun Loong and part of the senior management of Shun Loong, etc, was suspended for 12 months;
- Grand Investment (Securities) Ltd (Grand) was reprimanded and fined \$3 million;
- Mr Lee Tak Lun, a responsible officer of Grand, etc, was suspended for 12 months; and
- Ms Chung Wing Han Wendy, a responsible officer of Grand, etc, was suspended for 18 months.

The above actions stemmed from an SFC investigation into Macquarie Equities (Asia) Ltd'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. Two clients of Shun Loong and Grand were found to have traded abusively in some MB warrants.

The two clients received commission rebate that was more than the brokerage commission they paid. As a result, they generated risk-free profit by buying and selling the same warrant at the same price and at almost the same time. The clients' trading activities falsely inflated the turnover of the relevant warrants and gave an impression to other investors that the warrants were actively traded. However, Shun Loong and Grand failed to take any action to prevent the clients from trading in the abusive manner, so the firms' conduct was contrary to the interests of market integrity and was prejudicial to the investing public.

The above staff of Shun Loong and Grand also failed to monitor clients' trading activities and/or even failed to properly and actively participate in the firm's business.

For further information, please see press releases dated 19 August 2009 and 2 November 2009.

Separately, the SFC:

- suspended Mr Yenn Man Han Stephen (Yenn), a licensed representative of Corporate Brokers Ltd, for 12 months, for placing manipulative orders and conducting wash sales in pre-opening and closing auction sessions for a number of stocks. If Yenn had been successful with the strategy, the SFC would have commenced a criminal prosecution against him for market manipulation;

- suspended Ms Liu Yaying Lillian, the then licensed representative of Morgan Stanley Asia Ltd (Morgan Stanley), for six months, for failing to notice or otherwise turning a blind eye to the possibility that the matched trades that she carried out for one of her clients might result in wash sales and falsely inflated turnover; and
- prohibited Mr Chen Wei, a former responsible officer of ICEA Securities Ltd, from re-entering the industry for four months, for purchasing shares of a company to provide improper market support for its share price after listing. At the time, ICEA Capital Ltd was the sponsor and lead underwriter. The manipulative purchases had the effect of reducing the selling pressure on the shares, thus giving the market a misleading impression of the demand for and price of the shares.

Licensed persons should not facilitate abusive trading by clients or engage in conduct of a manipulative nature themselves.

For further information, please see press releases dated 17 August 2009, 26 August 2009 and 17 November 2009.

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## Insider dealing not tolerated

### Former investment banker jailed for seven years

A former managing director of Morgan Stanley, Mr Du Jun (Du), was jailed for seven years in September by the District Court for insider dealing in the shares of CITIC Resources Holdings Ltd (CITIC). Du is the 10th insider that the SFC has successfully prosecuted under the SFO within 14 months; he also became the sixth insider jailed since the first such conviction in July 2008. Du's jail term is the longest ever imposed on an insider and the maximum sentence available to the trial judge.

The SFC's investigation found that Du purchased a total of 26.7 million CITIC shares at an average price of \$3.2625 per share between 15 February and 30 April 2007. At the time, he was part of the Morgan Stanley team advising on a proposed deal by CITIC to acquire oil field assets in China. He traded on price-sensitive information not known to the market. When CITIC made an official announcement of the proposed deal on 9 May 2007, the share price closed at \$4.19. Du made a profit of about \$33.4 million from selling the first block of shares in July 2007.

In addition to the seven-year jail term, his Honour Judge Andrew Chan:

- imposed on Du a fine of \$23,324,117, reflecting the notional profit he earned rather than the realised profit. He subsequently made a loss of about \$31.3 million in selling a block of shares from December 2008 to January 2009. In determining the fine, the court referred to the reason in *The Insider Dealing Tribunal vs Shek Mei Ling* [1999] 2 HKCFAR 205. "Subsequent changes in market prices are irrelevant ... because such changes are not to be regarded as flowing from the original improper purchase of shares. Rather, they flow from the insider dealer's decision to retain the shares ...";
- banned Du from being a director or manager of any listed corporation or from taking part in the management of any listed corporation for five years, without court approval;
- banned Du from dealing in securities, futures contracts, leveraged foreign exchange contracts or interests in any collective investment scheme (whether directly or indirectly) for five years, without court approval;
- ordered Du to pay the SFC investigation costs of \$933,340; and
- recommended that any professional body of which Du was a member to discipline him.

In passing the sentence, his Honour Judge Andrew Chan cited the guidance given to judges in the case of *R vs Christopher McQuoid* [2009] EWCA Crim 1301 in England, in which he judge considered (among other things) the following:

- Du acted deliberately and dishonestly in utilising the information for his own financial benefit and that he had breached the trust placed on him by his employer, colleagues, and clients. This constituted a serious breach of trust.
- The scale of Du's insider dealing was unprecedented as a total purchase cost of about \$87 million was involved.
- Du's unlawful conduct seriously undermined the integrity of the market in Hong Kong as a financial centre.

The verdict underscores the SFC's dedication and commitment to protect investors from insider dealing and to ensure Hong Kong is protected from this kind of market misconduct. The sentence sends the strongest possible message that insider dealing is not tolerated in Hong Kong and those found guilty can expect lengthy terms of imprisonment.

Du has appealed against his conviction and sentence. No date has been fixed for the hearing of the appeal.

For further information, please see press releases dated 11 July 2008, 5 September 2008, 10 September 2009 and 18 September 2009, and the "Reasons for the Sentence" dated 18 September 2009 (DCCC 787/2008) on the Judiciary's website.

### **Prosecution for alleged insider dealing continues**

The SFC has commenced criminal proceedings against Mr Chan Pak Hoe, Pablo (Chan) for alleged insider dealing in connection with a proposed acquisition by Goldwyn Management Ltd (Goldwyn) of shares in Universe International Ltd (Universe) from the majority shareholder.

Chan was alleged to have represented the majority shareholder and to have purchased 3.88 million Universe shares between 2 May and 19 June 2008, whilst in possession of confidential and price-sensitive information about the proposal.

On 19 June 2008, Universe announced the proposed acquisition and trading in its shares was suspended. On the following day, trading was resumed and the share price rose about 40%. Chan made a gross profit of about \$120,000 on selling all his Universe shares.

On 24 September 2009, Chan pleaded not guilty to one count of insider dealing in the Eastern Magistracy. A pre-trial review will be held on 12 January 2010. Trial will commence on 12 April 2010.

For further information, please see press release dated 24 September 2009.

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## **Listed companies to ensure competent and honest governance**

### **Sixth and seventh listed company directors disqualified for misconduct**

In past issues of the Enforcement Reporter (Issue No. 61-62), we reported the disqualification orders obtained by the SFC against two former directors of GP NanoTechnology Group Ltd (GP Nano).

Recently, the SFC obtained orders in the High Court (HC) against two other former directors of GP Nano, Mr Fung Chiu (Fung) (former chairman and executive director) and Mr Lian En Sheng (Lian) (former executive director), disqualifying them from being directors or being involved in the management of any company for seven and six years respectively. These are the sixth and seventh disqualification orders obtained by the SFC against company directors.

The SFC alleged that Fung and Lian had:

- provided misleading information to the market in two announcements regarding five questionable transactions, which involved large sums of money relative to the paid-up capital of GP Nano;
- abdicated their responsibilities as directors of a listed corporation. They took no interest in and did not concern themselves with the affairs, finances and management of the company. They followed the instructions of a person who was neither a director nor an officer of the company. That person was allowed to have unchecked control over the finances and affairs of the company;
- failed to exercise reasonable skill, care and diligence and/or to act in the best interests of the company, which was contrary both to their common law of duty of care and fiduciary duty and to Rule 5.01 of the Rules Governing the Listing of Securities on the Growth Enterprise Market of The Stock Exchange of Hong Kong Ltd (GEM Listing Rules);
- mis-represented or mis-stated their own duties as executive directors in the company's prospectus and annual reports. They were described as persons responsible for strategic planning, corporate policy, overall management or daily operations but they took no charge of the company; and
- failed to ensure the company complied with the relevant rules and regulations, involving numerous breaches of the GEM Listing Rules and the Codes on Takeovers and Mergers and Share Repurchases. These failures had resulted in disciplinary actions taken by the Takeovers and Mergers Executive and the GEM Listing Committee of the Hong Kong Exchanges and Clearing Ltd.

His Honour Judge C Chu:

- did not consider it necessary to limit the scope of the disqualification orders, which should therefore apply to all companies (not only listed companies); and
- considered that the disqualification period should not be less than five years, which is the period imposed on a former director of the company. That director co-operated with the SFC and admitted the complaints against him in the form of agreed facts presented to the court.

In the same proceedings, the SFC sought disqualification orders against a total of five former directors of the company. Four directors (including Fung and Lian) were disqualified and the proceedings against the fifth were discontinued following his death.

Shareholders are entitled to expect competent and honest governance from listed company directors. The SFC will continue to take action against directors who provide misleading information to the market, breach their duties to the company and abuse the trust placed on them.

For further details, please see press releases dated 4 December 2008, 30 January 2009 and 6 October 2009 and the judgment dated 13 October 2009 (HCMP 2524/2006) on the Judiciary's website.

### **Proceedings commenced to seek disqualification of other directors**

The SFC has commenced proceedings in the High Court to disqualify as company directors six current and former directors of Warderly International Holdings Ltd (Warderly).

The SFC alleges that the six directors:

- failed to manage Warderly with the necessary degree of skill, care, diligence and competence as is reasonably expected of persons of their knowledge. In particular, one of the former directors is alleged to have breached his fiduciary duty by obtaining a profit and/or placing himself in a position of conflict through lending to Warderly's subsidiaries at an excessively high interest rate; and

- failed persistently to ensure that Warderly fully complied with disclosure requirements under the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Ltd. The alleged non-disclosure was centred on a number of material events during July 2006 to April 2007 concerning the financial position of Warderly.

For further details, please see press release dated 16 September 2009.

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## SFC continues to make full use of civil powers

In the last edition of the Enforcement Reporter (Issue No 63), we reported that the Court of Appeal has confirmed the SFC's power to seek orders to freeze assets as stipulated under section 213 of the SFO.

Court orders may be obtained under this provision either as a stand-alone remedy or in conjunction with other enforcement action (as in the Du Jun case in which assets were frozen under section 213 of the SFO and criminal proceedings also brought).

The SFC may even seek orders under section 213 when assets are situated outside Hong Kong and will continue to do so in appropriate cases. The following cases from recent enforcement exercises illustrate how this provision can be applied to a wide variety of situations.

### **Injunction obtained in case involving alleged fraud or deception**

Recently, the SFC obtained interim orders from the High Court under section 213 of the SFO, freezing assets of up to \$1,655 million — the largest amount that the SFC has ever applied to the court to freeze.

Interim injunction orders were made against:

- Mr Wong Kwong Yu (Wong), former chairman of GOME Electrical Appliances Holdings Ltd (GOME);
- Ms Du Juan, Wong's wife; and
- Shinning Crown Holdings Inc and Shine Group Ltd, two companies owned and controlled by the couple.

The SFC alleges that:

- Wong and Du masterminded a share repurchase by GOME in 2008 with a view to using GOME company funds to buy shares originally held by Wong so that Wong could use the proceeds to repay a \$2.4 billion personal loan;
- the share repurchase had a negative impact on GOME's financial position and was not in the best interests of the company and its shareholders; and
- the share repurchase was a fraud or deception, resulting in a loss of about \$1.6 billion to GOME and its shareholders.

The High Court later ordered the two companies — Shinning Crown Holdings Inc and Shine Group Ltd — not to dispose of, deal with or encumber about 779 million GOME shares pending further order. The two companies deposited with the court share certificates representing shares pursuant to the asset freezing orders. Accordingly, the interim injunctions against the two companies were discharged while those against Wong and his wife remain effective.

The interim injunctions serve to prevent the dissipation of assets pending the conclusion of the SFC's investigation and to ensure that assets are sufficient to satisfy any orders that might be made (eg to restore GOME to the position in which it was before the share repurchase.)

For further details, please see press releases dated 7 August 2009 and 8 September 2009.

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## Court undertaking given to prevent futures trader from placing orders

The SFC alleges that a futures trader, Mr Tsoi Bun (Tsoi), placed orders between February 2007 and July 2009 to manipulate the final calculated opening price (COP) on the futures exchange. A COP is calculated during the Pre-market Opening Period and serves as the market opening price for the corresponding futures product.

To preserve the integrity of the market, the SFC applies a combination of its powers under the SFO. The following proceedings have commenced:

- to seek orders against Tsoi, restraining him from placing orders on the futures market during the Pre-Open Allocation Sessions (9:41:00 am to 9:42:59 am and 2:26:00 pm to 2:27:59 pm inclusive) pursuant to section 213 of the SFO. The court adjourned the application on Tsoi giving an enforceable undertaking to the court that he will not place any order on the futures markets during these sessions; and
- to prosecute Tsoi for price rigging arising from the allegedly manipulative orders that he placed between February 2007 and September 2007. The trial commenced on 8 December 2009 in the Eastern Magistracy.

For further details, please see press release dated 1 September 2009.

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## Investors urged to seek advice on securities trading from SFC licensees

The Eastern Magistracy convicted RC Trading Education Ltd (RC) and its director, Mr Cheung Wing On Rickey (Cheung) of issuing unauthorised advertisements and carrying on regulated activities without being licensed by the SFC. They were fined a total of \$9,000 and ordered to pay investigation costs of \$38,532 to the SFC.

In 2008, RC advertised courses about trading Standard and Poors 500 index futures. The advertisements promoted free seminars that were followed by practical training sessions at different prices. The defendants represented that the courses would guarantee performance or students would receive 110% of their money back. Students received trading instructions, tips and real time advice from Cheung, but some suffered losses.

Investors should seek securities-trading advice only from SFC licensees and should be wary of free seminars in securities-trading followed by overpriced courses promising quick rewards.

For further details, please see press release dated 17 September 2009.

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## Lehman Brothers Minibonds

### 99% responding accept repurchase offer

On 22 July 2009, the SFC, the Hong Kong Monetary Authority and 16 distributing banks jointly announced that they had reached an agreement whereby the banks would repurchase Lehman Brothers Minibonds (Minibonds) from eligible customers. Since August 2009, the banks have issued offer letters to about 25,000 eligible customers. As at 2 December 2009, 24,669 customers had responded to the repurchase offers, with 24,399 customers or 99% accepting the offer.

For further details, please see press release dated 22 July 2009.



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## **Lehman Brothers Asia Ltd ordered to turn over documents to SFC**

In the last edition (Issue No 63), we reported that the SFC had applied to the High Court for an order directing Lehman Brothers Asia Ltd (LBA) (in liquidation) to comply with a statutory notice the SFC issued to produce certain records in connection with its investigation into the offering and marketing of Minibonds. LBA lawyers objected to submitting some of the requested documents on the grounds of legal professional privilege.

On 19 August 2009, the High Court ruled that LBA must disclose certain records to the SFC and pay the SFC's costs in bringing the application before the High Court.

While respecting valid claims of legal professional privilege, the SFC will not hesitate to challenge claims that do not have a valid foundation. Investigation into LBA continues.

For further details, please see press releases dated 10 June 2009 and 21 August 2009.

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## **Enforcement policy and practice**

### **Brokerage practises proper compliance culture**

During the course of its daily surveillance, the SFC identified unusual price movements in relation to a third-liner stock. In response to this, the SFC issued notices under section 181 of the SFO to various firms requesting information about the transactions concerned. Upon further analysis, there was insufficient evidence to suggest that manipulative activities had occurred.

The SFC found that the account executive who placed the relevant orders had reported the case to the responsible officer immediately after the market closed on the trading day. The brokerage had reviewed the client's instructions, telephone conversations between the account executive and the client, etc, which did not discern any manipulative activities.

The brokerage approach is commendable. Its timely review enabled it to provide a prompt and thorough response to the SFC's inquiry. The SFC would like to remind licencees the importance of establishing a proper compliance culture that will ensure that they are able to respond promptly and substantively to SFC inquiries.

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## **Disclosure of interests**

### **Failure to disclose interests prosecuted**

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 Stock Exchange of Hong Kong of changes in their interests.

From 1 August to 30 November 2009, the SFC prosecuted 11 entities for breaches in disclosure of interests. In all these cases, 10 defendants pleaded guilty and one defendant was convicted by the court. Fines ranging from \$2,500 to \$80,000 were imposed.

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## Appeal against convictions for disclosure of interests dismissed

On 2 June 2009, Mr Liu Su Ke (Liu) was convicted of failing to disclose to the Stock Exchange of Hong Kong Ltd and Warderly International Holdings Ltd (Warderly) his interest of 231.8 million shares in Warderly within three days of becoming aware of his holding, as required by the SFO. Liu appealed against his conviction.

The Honourable Mr Justice Michael Lunn dismissed the appeal and upheld the convictions. In delivering the judgement, Justice Lunn considered a number of important legal issues concerning the disclosure of notifiable interests in listed securities. His judgement explains (among other things) that:

- the legislation is aimed at providing the whole market with relevant information and transparency; and
- an evidential burden is imposed upon the appellant to point to evidence that raised the issue of a reasonable excuse for his failure to make the requisite disclosure.

In dismissing the appeal, the judge concluded that the magistrate was correct in determining that there was no evidence whatsoever as to why the appellant failed in his duty to disclose and that he had no reasonable excuse in not making the requisite disclosure.

For further information, please see press release dated 26 November 2009 and the Judgement dated 25 November 2009 (HCMA 518/2009) on the Judiciary's website.

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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 appropriate, 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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