

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 April to 31 August 2010, we sent out 78 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 120 enforcement cases (including the issuance of 29 disciplinary notices of decision) and commenced 24 criminal and 3 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 allegations of false trading and disclosure of false or misleading information inducing transactions.

- Appeals against the convictions regarding insider dealing in the shares of Egana Jewellery & Pearls Ltd will be heard in the Court of Appeal on 9 September 2010.
- An appeal against acquittal regarding allegations of price rigging of Hang Seng China Enterprises Index futures contracts and Hang Seng Index futures contracts will be heard in the High Court on 5 October 2010.
- Director disqualification hearings will be held in the High Court in respect of Yeung Kui Wong (Mr) and Yu Hung Wong (Mr), former directors of Warderly International Holdings Ltd, on 8 October 2010.

Highlights

- From 1 April to 31 August 2010, the SFC completed 120 enforcement cases (including the issuance of 29 disciplinary notices of decision) and commenced 24 criminal and 3 civil proceedings.
- A multi-lateral approach is adopted to tackle the increase in complex cases.
- For the first time, manipulators of derivative warrants were jailed by the District Court.
- A resolution was reached to resolve issues arising from the distribution of Lehman Brothers-related Constellation Notes by a bank.
- Hong Kong courts affirmed our actions against unlicensed trading.
- Licensees were disciplined for failing to comply with know-your-client requirements.

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- A pre-trial review and trial regarding the alleged false trading of shares of Cardlink Technology Group Ltd will take place in the Eastern Magistracy on 11 October 2010 and 25 October 2010 respectively.
 - Appeals against the convictions and sentences regarding false trading of derivative warrants issued by Macquarie Bank Ltd will be heard in the Court of Appeal on 18 November 2010.
 - A pre-trial review and trial regarding the alleged disclosure of false or misleading information inducing transactions in the shares of Vongroup Ltd will take place in the District Court on 15 December 2010 and 12 January 2011 respectively.

For a complete list of upcoming prosecutions and related criminal hearings, please see "[Upcoming Events and Calendar](#)" on the SFC website.

Multi-lateral approach to tackle complex cases

The demands of our enforcement work have surged since 2007, as the number of cases we are taking on has risen by over 100%, and a higher percentage of these are complex cases involving:

- more than one issue;
- multiple resources and professional skills;
- novel or complex regulatory policies, legal issues, or innovative solutions;
- senior management playing a substantial role; and
- significant issues of public interest.

In response to the increase in demands, we have deliberately increased our work rate to make it more likely wrongdoers will be caught and identified:

- Our market surveillance team is initiating over 350 inquiries into suspicious trading activities every month;
- Our investigation, disciplinary and legal teams are handling double the number of cases in 2007; and
- Our international team is handling more requests for collaborative assistance with overseas agencies in our respective investigations.

Although fraud, crime and misconduct in the markets cannot be eliminated, the SFC is prepared to employ the full spectrum of remedies, both criminal and civil, not only to send deterrent messages but also to bring the law to bear on resolving the consequences of misconduct.

For a more comprehensive review of our recent work, please see a speech on "[SFC Enforcement and Fraud](#)" given by Mr Mark Steward, the SFC's Executive Director of Enforcement, at a conference on Fraud Risk Management on 24 May 2010.

Tackling market manipulation in full force

In Issue No. 64 and 65, we described the seriousness of market manipulation and our commitment to stamp it out. Recent enforcement actions show that the courts treat market manipulation as a serious offence.

Warrant traders jailed

Recently, the District Court jailed warrant traders Fu Kor Kuen Patrick (Mr) and Lee Shu Yuen Francis (Mr) for 33 and 36 months

respectively. These are the fifth and sixth indictable prosecutions of market manipulation under the Securities and Futures Ordinances (SFO) and the first indictable case for manipulation of derivative warrants.

Fu and Lee were convicted of creating a false and misleading appearance of active trading over 19 days in 20 derivative warrants issued by Macquarie Bank Ltd (Macquarie Bank) between January 2004 and January 2005. They were each ordered to pay the SFC's investigation costs of \$694,498.

The SFC's investigation found that Fu and Lee, through accounts at two brokerages, had traded with each other in a pre-determined manner, buying and selling the warrants in approximately the same quantities and prices repeatedly within very short time intervals. They received commission rebates offered by Macquarie Equities (Asia) Ltd for the trades, and their brokers discounted their commission for their high trading volume. The money they earned from commission rebates and the commission discounts exceeded the transaction costs incurred. As a result, they were able to earn a net profit of approximately \$1 million even though they were buying and selling at about the same price, which should not have been profitable otherwise.

The court found that:

- the trading was not genuine;
- Fu and Lee had acted in concert to manipulate the market; and
- they traded not only to earn rebates, but also to lure other investors to trade the warrants so it would be easier for them to sell the warrants and lower their risk.

The trading by Fu and Lee had falsely inflated the turnover of the warrants by 80% or over \$450 million in value. Potential investors were misled into thinking these warrants were heavily traded when in fact the trading was not real.

In passing the sentence, Deputy District Court Judge Sham Siu-man said, "When it comes to protecting the investors and restoring public trust in the financial markets, the court cannot pass the buck and should be very tough by passing sufficiently deterrent sentences against any market manipulators like [the defendants]...Market manipulation should not be tolerated if the law were really meant for the protection of individual investors. Unless the market manipulators are deterred, the investors cannot be said to be sufficiently protected."

Fu and Lee have appealed against their convictions and sentences. Their appeals will be heard in the Court of Appeal (CA) on 18 November 2010.

For further details, please see press releases dated 7 May 2010 and 13 May 2010, and verdict dated 7 May 2010 (DCCC 981-1020/2008) on the [Judiciary's website](#).

Market manipulators plead guilty

In the following cases, manipulators who had created false appearances of active trading and/or share price movements by employing different tactics pleaded guilty to summary charges in the Magistrate Court and received sentences ranging from fines to suspended jail terms.

The manipulators were:

- Szeto Kwok Kwan Credit (Mr), who had placed buy-and-sell orders for a derivative warrant at escalating prices in a closing auction session. He was sentenced to four weeks' imprisonment suspended for 12 months, fined \$25,000 and ordered to pay the SFC's investigation costs;
- Leung Kin Bon (Mr), who had placed buy orders shortly before market close for single board lots of a stock. He was sentenced to four weeks' imprisonment suspended for 12 months, fined \$30,000 and ordered to pay the SFC's investigation costs. The SFC revoked his licence and prohibited him from re-entering the industry for 12 months;

- Wong Chung Shun Johnson (Mr), who had raised and/or depressed the nominal price of a stock by buying and/or selling the stock in single board lots, using a “buy-high-sell-low” strategy and conducting wash sales. He was fined \$27,000 and ordered to pay the SFC’s investigation costs; and
- Tsui Hon Wai (Mr), who had placed a large number of matched trades and some wash sales for a few stocks among different securities accounts. He was sentenced to 120 hours of community service and was ordered to pay the SFC’s investigation costs.

For further details, please see press releases dated 22 April 2010, 13 May 2010, 31 May 2010 and 16 July 2010.

Account executive remanded in jail for placing manipulative orders for clients

In Issue No. 65, we reported that an arrest warrant was issued for a suspected manipulator. In that case, the SFC commenced criminal proceedings against three persons on allegations of market manipulation under section 295 of the SFO and fraud under section 300 of the SFO.

Recently, one of the three charged, Ng Kwok Leung (Mr), was found guilty of false trading after a trial and was remanded in jail custody pending sentencing. He was later sentenced to 240 hours of community service and ordered to pay the SFC’s investigation costs.

Ng, a former account executive of Sun Hung Kai Investment Services Ltd, agreed to a client’s instruction to fix a higher closing price of shares of IRICO Group Electronics Co, Ltd and placed 15 buy orders in the last three minutes of trading on a certain day. The bid price of each order was higher than the prevailing market price and had the consequence of ensuring the stock price closed 10% higher.

The SFC also charged Ng’s client with false trading and fraud offences. Ng’s client left Hong Kong after the summonses were issued and an arrest warrant has been issued.

Brokers should refuse instructions that require them to manipulate the market or they may face imprisonment and/or disciplinary action for facilitating manipulation.

For further details, please see press releases dated 4 February 2010, 27 May 2010 and 9 June 2010.

Disciplinary actions for manipulation-related conduct

The Securities and Futures Appeals Tribunal (SFAT) has affirmed the SFC’s decision to suspend Chu Kwok Shing Godwin (Mr) for manipulation. The SFAT suspended Chu’s licence for 18 months.

Chu was found to have engaged in “scaffolding,” together with Wong Hong Wah (Mr), by trading three stocks to facilitate their disposal at a more favourable price level. Shortly after they had placed a sell order, the two repeatedly placed, cancelled and re-input numerous buy orders, which substantially inflated the apparent demand for the stocks. They then cancelled all or most of the outstanding buy orders as soon as their sell orders were fully executed. These orders created a false and misleading impression about the supply-and-demand levels and misled investors who bought the stocks.

Chu submitted that, in order to establish grounds for disciplinary action, it was necessary for the SFC to establish, to the appropriate standard of proof, that he had engaged in the criminal offence or civil wrong of false trading under the SFO. The SFAT rejected this submission.

The SFAT confirmed that:

- when market trading activities are alleged in disciplinary proceedings, it is not necessary to prove a criminal offence or a contravention of the market misconduct provisions under the SFO; it is sufficient to establish misconduct liable to disciplinary

action if, to the appropriate standard of proof, the SFC established that Chu's conduct was in breach of the Code of Conduct for Persons Licensed by or Registered with the SFC (Code of Conduct); and

- false trading could never be described as an honest or fair act, or in the best interests of the market. If false trading is established, those who engage in such trading will be liable to disciplinary action for misconduct.

Wong was prohibited from re-entering the industry for three years.

Other recent disciplinary actions involved licensed persons who failed to detect or prevent manipulative conduct as follows:

Failure to prevent abusive warrant trading

- Tsun Chi Yuen Securities Co, Ltd (TCY) was reprimanded and fined \$2 million, while Tsun Chi Shing Alfred (Mr) was suspended for 12 months.
- TCY had failed to take action to prevent one of its representatives from trading warrants issued by Macquarie Bank in an abusive manner, which falsely inflated their turnover. By trading in an abusive manner, the representative received commission rebates that were more than the brokerage commissions he paid. As a result, he generated risk-free profit from the trading.
- Tsun, as a responsible officer of TCY, had failed to properly and actively monitor the trading, and to look into the abusive trading manner, knowing that the representative's trading was only made profitable by the commission rebates and discounts.
- TCY and Tsun had failed to act with due skill, care and diligence, in the best interests of clients and the integrity of the market, contrary to General Principle 2 of the Code of Conduct.

Negligence in order handling

- Frank Hu (Mr), Peony Ng (Ms) and Chang Pui Chun Jenny (Ms) of UBS AG Hong Kong (UBS) were reprimanded and fined \$800,000, \$600,000 and \$400,000 respectively for negligence in handling a client's trade orders. Both Hu and Ng are executive directors and Chang is an associate director.
- The client faced margin calls from UBS and decided to transfer part of his portfolio at UBS to his account at Morgan Stanley Asia Ltd (Morgan Stanley) in order to ease his margin position. UBS and Morgan Stanley co-ordinated a series of on-exchange matched sales and purchases, which constituted wash sales and might have misled the market to believe that independent trading interest in the shares was involved. Indeed, the margin position could have been eased by a simple delivery versus payment arrangement, such as by using the Central Clearing and Settlement System.
- The SFC also took disciplinary action against the responsible account executive at Morgan Stanley.

For further details, please see press releases dated 25 February 2009, 31 March 2010, 17 August 2009, 2 June 2010 and 5 July 2010, and the [SFAT's determination](#) dated 30 June 2010 (Application No. 1 of 2009).

Takeover insider convicted

Issue No. 64, we reported that the SFC had commenced criminal proceedings against Chan Pak Hoe Pablo (Mr) for insider dealing in connection with the proposal by Goldwyn Management Ltd (Goldwyn) to acquire shares in Universe International Ltd (Universe) from the majority shareholder.

On 5 August 2010, Chan was convicted of one charge of insider dealing and on 19 August 2010, sentenced to serve 240 hours of community service.

Chan represented the majority shareholder in the negotiation of the proposed acquisition. He purchased 3.88 million Universe shares between 2 May and 19 June 2008 while 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 resumed and the share price rose about 40%. Chan made a profit of about \$120,000 on selling all his Universe shares.

Insider dealing is a serious crime that causes direct damage to the investing public and undermines confidence in the market. Chan's offence involved obviously price-sensitive information at the heart of a proposed major transaction and a serious breach of trust that allowed him to take an unfair advantage over the investing public. Under the community service order, Chan does not have to repay or disgorge any profit from his insider dealing and is able to retain it. The SFC will first seek a review of the sentence by the Magistrate before deciding whether to appeal the decision to the High Court.

For further details, please see press releases dated 24 September 2009, 5 August 2010 and 19 August 2010.

Further resolution regarding LB-related structured products

In Issue No. 65, we reported that the SFC had entered into agreements with 19 distributors and a non-distributor of Lehman Brothers (LB) Minibonds (Minibonds). Two of the distributors also sold LB-related structured products.

In July, the SFC and the Hong Kong Monetary Authority reached an agreement with DBS Bank (Hong Kong) Ltd (DBS) regarding the bank's distribution of LB-related Constellation Notes under section 201 of the SFO. The agreement enables:

- about 2,160 eligible customer accounts to receive the investment back, together with interest less the coupon payments received; and
- other investors to obtain a full review of their cases under enhanced complaint-handling procedures.

The SFC raised the following concerns during the investigation:

- DBS had rated the LB-related Constellation Notes as a low to medium risk product when selling them. However, a different division in DBS assessed the same product as having a higher risk level, and the relevant prospectuses stated that prospective investors might lose all of their investment; and
- LB-related Constellation Notes might not have been suitable for customers who were classified by DBS as having a low to medium risk profile at the time of purchases (collectively referred to as low-risk customers).

Under the resolution scheme, DBS would:

- offer to pay approximately \$651 million to the low-risk customers, who would receive an amount equal to the total value of their investment in the LB-related Constellation Notes plus an amount equal to interest less the amount of coupon payments already made to them. Those low-risk customers who had entered into prior settlement agreements with DBS would receive top-up payments so that they could be treated in the same way as other low-risk customers under the scheme;
- review in accordance with the enhanced complaint-handling procedures complaints of LB-related Constellation Notes customers who were classified as having a higher risk profile; and
- review in accordance with the enhanced complaint-handling procedures complaints in relation to the distribution of unlisted structured products other than the LB-related Constellation Notes.

In entering into the agreement, the SFC took into account the following:

- Constellation Notes were a sound product likely to have been suitable for customers with a higher risk tolerance and the necessary experience and knowledge of trading in derivatives;
- the review of complaints of the customers with a higher risk profile should address any other possible irregularities in the distribution of the product;

- DBS undertook to conduct an independent review of its distribution systems and controls to ensure that distribution of unlisted structured products to customers is appropriate in the future;
- the agreement would bring the case to an appropriate end for the benefit of DBS and its customers, without the need for the latter to initiate their own legal action, prove loss or damage or otherwise incur legal costs;
- the result could not have been achieved through disciplinary action by the SFC against DBS and its staff;
- this outcome would guide other distributors of LB-related Constellation Notes in resolving customer complaints; and
- differences between the sales of LB-related Constellation Notes and Minibonds. Since the LB-related Constellation Notes did not involve distributable collateral, DBS did not need to fund action to expedite the return of any collateral as in the case of the 16 distributing banks of Minibonds. Unlike Minibond customers who accepted a repurchase offer, holders of LB-related Constellation Notes will not receive any additional payment or dividend. Payments from DBS would be the only return payable to the low-risk customers.

The resolution scheme is reasonable and appropriate in light of our regulatory concerns and public interest. We will not take further enforcement action against DBS and its staff in relation to the distribution of LB-related Constellation Notes save for any acts of dishonesty, fraud, deception or conduct that is criminal in nature.

The SFC is determined to reduce the risk of mis-selling in the market. Intermediaries should comply with the Code of Conduct which underpins the regulatory standards in providing investment advice to customers. Knowing the product, understanding the customer and giving clear, accurate information to customers are key components of the requirements. Not only will this protect the interest of clients, but also intermediaries themselves. Intermediaries who fail in meeting these standards will face a high price, as seen from the resolutions reached in relation to Minibonds and other LB-related structured products.

For further details, please see press release dated 14 July 2010.

Challenges to SFC actions against unlicensed leveraged forex trading dismissed

Recent decisions of the High Court (HC) and CA support the SFC's enforcement actions in combating unlicensed leveraged foreign exchange (forex) trading.

The HC's decisions stemmed from the appeals of Chung Wai Wa Alan (Mr) and Yeung Lai Ping Choko (Ms) against their convictions. The SFC's investigation revealed that both had, whilst unlicensed with the SFC, solicited client(s) to open accounts in Hong Kong with an unlicensed entity known as Glory Sky Global Markets Investment Ltd (Glory Sky Macau) and conducted leveraged forex trading for client(s). Glory Sky Macau was a subsidiary of Glory Sky Group Ltd, which was an unlicensed entity controlling Glory Sky Global Markets Ltd, a licensed corporation under the SFO.

The Eastern Magistracy convicted Chung and Yeung of unlicensed leveraged forex trading under section 114 of the SFO. They were fined a total of \$3,500 and ordered to pay a total of \$14,204 in investigation costs to the SFC. Their appeals against the convictions were dismissed by the HC.

Chung has applied for leave to appeal to the Court of Final Appeal.

An appeal against the SFAT's decision by Ng Chui Mui (Ms) and Law Kai Yee (Mr), two former responsible officers of Hantec International Ltd (Hantec), was unanimously dismissed by the CA. The SFAT upheld the SFC's disciplinary actions against them for facilitating an unlicensed leveraged forex trading operation.

The SFC found that:

- Ng had participated in the management of illegal operations, encouraged account executives of Hantec, an SFC licensee, to solicit business from Hong Kong residents for a related unlicensed entity that operated leveraged forex trading in New Zealand and assisted it in distributing its commission payments to the account executives; and
- Law had encouraged Hantec account executives to solicit business from Hong Kong residents for the unlicensed entity, and requested them to refer clients to the unlicensed entity through nominees to cover up their illegal activities.

Pursuant to the determination of the SFAT, the SFC had earlier:

- revoked the licence of Ng and prohibited her from re-entering the industry for 10 years; and
- suspended the licence of Law for two years and three months.

In affirming the SFAT's decision, the CA ruled that:

- the conduct of Ng and Law had facilitated illegal activities of the overseas unlicensed entity; and
- the misconduct involved was serious and detrimental to the integrity of the market in that it included blatant attempts to conceal the unlawful activities that Ng and Law condoned, the effect of which was to deprive the Hong Kong clients of their statutory protection under Hong Kong law and to expose them to unnecessary risks.

Investors should not deal with unlicensed firms or persons. To verify if an entity or a person is licensed, please visit www.sfc.hk.

For further details, please see press releases dated 2 June 2009, 7 September 2009, 8 December 2009, 10 May 2010, 26 May 2010 and 13 July 2010, and the Reasons for Judgment dated 26 May 2010 (CACV 141/2009) on the [Judiciary's website](#).

Know your client

Recently, firms and individuals were disciplined by the SFC for failings in relation to the SFC's "know-your-client" requirements.

Pursuant to resolutions reached under section 201 of the SFO, the SFC reprimanded Christfund Securities Ltd, Christfund Futures Ltd (collectively referred to as Christfund) and their respective responsible officers, and fined them a total of \$2.5 million in relation to internal control deficiencies in handling Mainland clients' accounts.

The SFC's investigation period ran from August 2007 to July 2008. Hang Fung Investment Consultants (Shenzhen) Co Ltd (HF Shenzhen), an affiliate of Christfund based in Shenzhen, had provided marketing services for Christfund on the Mainland and made available account opening forms for Mainland investors to open accounts with Christfund.

Christfund had failed to handle the account opening process in accordance with the know-your-client requirements. It had failed to:

- establish the full identities and addresses of the Mainland investors. Clients were allowed to use the office address of HF Shenzhen and the address of a client of Christfund as their correspondence address. 1,000 clients had authorised an individual amongst them to operate their accounts; and
- check the operation of two client accounts. This enabled the accounts to be used to transfer funds to settle transactions by Mainland clients.

The failings show that Christfund had taken insufficient steps to address the potential regulatory issues arising from inadequate records and the safe custody of client assets, including cash.

Failure to comply with the know-your-client and record-keeping requirements may make any potential misconduct and money-laundering activities harder to detect. To protect the interest of clients, licensees should comply with the relevant regulatory standards.

An SFC licence only permits the holder to carry on regulated activities in Hong Kong. Therefore, the act of soliciting clients or opening accounts outside Hong Kong does not fall within the ambit of regulated activities under the SFO. Licensees who carry on such activities outside Hong Kong should ensure that they comply with the relevant legal and regulatory requirements of that jurisdiction. Licensed corporations that have agents conducting business activities on their behalf outside Hong Kong are likely to be regarded by the SFC as responsible for their conduct.

In another case relating to the know-your-client requirements, the SFC reprimanded and fined Julius Baer (Hong Kong) Ltd (Julius Baer) \$3 million pursuant to a resolution reached under section 201 of the SFO.

Julius Baer, licensed to provide services only to professional investors, had failed to take adequate steps to identify clients as professional investors before treating them as such. One of the consequences of being treated as a professional investor is that certain provisions of the Code of Conduct designed to protect investors can be waived. This includes the requirement to ensure that the product is suitable for the investor. Thus, firms that do not classify professional investors properly may impose undue risks on investors.

For further details, please see press releases dated 17 June 2010 and 28 June 2010, and “[Circular clarifying the licensing obligations of corporations and individuals and more particularly those conducting business outside Hong Kong](#)” issued by the SFC on 1 April 2010.

Failure to disclose interests prosecuted

The SFC places great importance on 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 April 2010 to 31 August 2010, the SFC prosecuted 13 entities for breaches in disclosure of interests. In all these cases, the defendants pleaded guilty. Fines ranging from \$3,000 to \$16,000 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.

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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