

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 September to 31 December 2010, we sent out 72 compliance advice letters when we became aware of conduct presenting unnecessary risks or that might lead to crime or market misconduct.

During the same period, we completed 107 enforcement cases (including the issuance of 13 disciplinary notices of decision) and commenced 17 criminal and seven 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.

- A trial regarding the alleged disclosure of false or misleading information inducing transactions in the shares of Vongroup Ltd started in the District Court on 12 January 2011 and will end on 27 January 2011.
- Director disqualification hearings in respect of directors of Styland Holdings Ltd (Styland) were heard in the High Court (HC) in January 2011, and the HC's decision is awaited. The hearings in respect of directors of Warderly International Holdings Ltd (Warderly) will be held in the HC on 1 March 2011.

## Highlights

- From 1 September to 31 December 2010, the SFC completed 107 enforcement cases (including the issuance of 13 disciplinary notices of decision) and commenced 17 criminal and seven civil proceedings.
- The SFC successfully obtained disqualification orders against three more listed company directors for misconduct.
- A magistrate jailed an insider on sentence review.
- The Court of Appeal affirmed that criminal procedures are not applicable to disciplinary proceedings.
- A life ban on a dishonest licensee.
- The SFC continues to combat unlicensed dealing.

- A verdict regarding the creation of an artificial price for dealings in the shares of IRICO Group Electronics Company Ltd by one defendant will be given by the Eastern Magistracy on 1 March 2011.
- Appeals against the convictions regarding false trading of derivative warrants issued by Macquarie Bank Ltd will be heard in the Court of Final Appeal on 2 March 2011.
- 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 HC on 3 March 2011.
- A pre-trial review regarding the alleged false trading of shares of Shun Ho Resources Holdings Ltd and Shun Ho Technology Holdings Ltd will take place in the Eastern Magistracy on 14 March 2011.
- Appeals against the convictions regarding insider dealing in the shares of Egana Jewellery & Pearls Ltd will be heard in the Court of Final Appeal on 15 March 2011.

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

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## Action against company directors continues

In Issue No. 65, we reported that the SFC achieved a breakthrough in investor protection by obtaining orders in the HC to disqualify company directors on new grounds – failure to make timely disclosure of material information to shareholders. Recently, the SFC obtained three further disqualification orders, being the 13th to 15th orders obtained to date.

Two former executive directors of Warderly, Yeung Kui Wong and Yu Hung Wong, were disqualified from being directors or being involved in the management of any corporation, without leave of the court, for five years and two years respectively. Yeung is allowed to continue to be a director of a private company to conduct his business.

The SFC directed that trading in the shares of Warderly be suspended in May 2007 and focused on the events between July 2006 and April 2007 in its investigation. The SFC alleged that Warderly should have disclosed its substantially depleted financial position to the market.

Both Yeung and Yu accepted they:

- failed to manage the company with the necessary degree of skill, care, diligence and competence as reasonably expected of persons of their knowledge and experience holding their offices and functions within Warderly; and
- failed on a number of occasions to ensure Warderly complied with the disclosure requirements under the Listing Rules and to give shareholders all the information they might reasonably expect.

The SFC commenced proceedings to disqualify six directors of Warderly. To date, the court has made disqualification orders against four former directors as a result of their misconduct. The SFC is also taking similar action against the remaining two former directors.

In another recent case, a former executive director of Styland, Li Wang Tai, Steven, was disqualified from being a director or being involved in the management of any listed corporation, without leave of the court, for six years.

Li accepted, among other things, that he:

- failed to manage the company with the necessary degree of skill, care, diligence and competence as may reasonably be expected of a person of his knowledge and experience and holding his office within the company; and

- failed to equip himself with the necessary understanding of the Listing Rules, or to consider them when the company decided to enter into a number of transactions to acquire assets that resulted in significant losses.

Further, the business and affairs of Styland had been conducted in a manner involving misfeasance or other misconduct and resulting in its members not being given all the information as they might reasonably expect. The manner was unfairly prejudicial to the company's members.

The SFC commenced proceedings against Li, the former chairman and two current executive directors of the company in 2008. The SFC's petition in relation to the former chairman and the two current executive directors of the company was heard in January 2011. The court's decision is awaited.

Listed company directors are in positions of substantial trust and responsibility. As such, they have an obligation to ensure the market is properly informed. Directors who breach their obligations, commit misconduct or keep bad news to themselves when it should be disclosed, cause real damage to the company, their shareholders and the market. The SFC will continue to make directors accountable in actions like this.

For further details, please see press releases dated 8 October 2010 and 23 November 2010, and reasons for decisions dated 27 October 2010 (HCMP 1742/2009) and 23 November 2010 (HCMP 1702/2008) on the [Judiciary's website](#).

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## Courts support SFC in stamping out insiders

We have from time to time noted the gravity of insider dealing and our strategy to curb it by using the full range of powers and remedies available to us, including seeking criminal, civil and administrative sanctions. Recent decisions of the courts and the Market Misconduct Tribunal (MMT) show further support for the SFC's enforcement action against insider dealing. The SFC has also commenced civil proceedings in the HC against four suspected insiders, including two solicitors.

### **Magistrate jailed an insider on sentence review**

In Issue No. 66, we reported that Chan Pak Hoe, Pablo was convicted of insider dealing in connection with the proposal by Goldwyn Management Ltd (Goldwyn) to acquire shares in Universe International Ltd (Universe) from the majority shareholder. Chan made a profit of about \$120,000 on selling all his Universe shares while in possession of confidential and price-sensitive information about the proposal. Chan was sentenced to serve 240 hours of community service.

Under the community service order, Chan was not required to repay or disgorge any profit. The SFC thus sought a review of the magistrate's sentence.

On 14 September 2010, at the review hearing, the Eastern Magistracy substituted the original sentence with a term of four-month imprisonment and a fine of \$120,000 (the amount of profit made). The magistrate stated that "... on the facts as found, the defendant has abused his position [Chan represented the majority shareholder in the negotiation of the proposed acquisition] and it was well planned. Therefore it would be wrong to impose a community service order ... I also agree that there should be a fine, which is not less than the profits earned."

Chan was granted bail pending his appeal against the magistrate's decision.

### **Appeals against insider dealing convictions heard**

In Issue No. 62, we reported the first indictable trial in the District Court for insider dealing concerning the shares of Egana Jewellery & Pearls Ltd (Egana) under the Securities and Futures Ordinance (SFO).

The five defendants in the case were convicted of a total of 12 charges of insider dealing by the District Court. Two of them were jailed for 26 months and 12 months respectively. The other three defendants were each sentenced to 200 hours of community service.

The three defendants, Ma Hon Kit, Sammy, Tso Kin Wah, Cordelia and Ma Chun Ho, Ronald, applied for leave to appeal against their convictions. The Court of Appeal (CA) upheld the insider dealing convictions for Sammy Ma and Tso and quashed the conviction for Ronald Ma.

Sammy Ma and Tso have applied for leave to appeal against their convictions to the Court of Final Appeal (CFA). The two insiders who are now in jail have not pursued any appeals.

### **Ex-trainee solicitor and licensee found culpable of insider dealing**

The MMT recently submitted reports to the Financial Secretary in relation to dealing in the shares of Mirabell International Holdings Ltd (Mirabell). The MMT determined that Liu Yan Yan and Zhang Bi Jia had engaged in insider dealing.

Between 18 and 22 February 2008, Liu was a trainee solicitor of Norton Rose, Hong Kong (Norton Rose), which advised Belle International Holdings Ltd (Belle) on a general offer to acquire all the shares of Mirabell. As a result of her employment, Liu possessed specific non-public price-sensitive information that Belle and Mirabell would jointly announce the general offer on or about 28 February 2008. Liu disclosed the information to Zhang. Zhang bought a total of 182,000 Mirabell shares on behalf of Liu and/or his own account before trading in the shares was suspended. Zhang later sold the shares and made a profit.

The MMT ordered:

- Liu to pay a total of \$1,158,678 of costs and expenses to the Government and the SFC. Also, the Law Society of Hong Kong was recommended to take disciplinary action against her;
- Zhang to pay \$74,474 (i.e., profit gained by the market misconduct) and compound interest on this sum to the Government, and a total of \$642,185 of costs and expenses to the Government and the SFC. Also, the SFC was recommended to take disciplinary action against Zhang, who was an SFC licensee at the time.

The MMT said that Liu was in gross breach of the trust reposed in her by Norton Rose. She had been entrusted to work in a small team on the proposed conditional general offer by Belle to acquire all the shares of Mirabell. It was intended that she kept that information confidential were she to discover it in the course of her work. She did not do so but disclosed it to Zhang instead.

### **Civil proceedings against solicitors and others**

The SFC alleges that Young Bik Fung and Lee Kwok Wa, while working as solicitors in different firms, obtained information about a tender offer on Hsinchu International Bank Company Ltd (Hsinchu Bank) and the proposed privatisation of Asia Satellite Telecommunications Holdings Ltd (Asia Satellite) respectively. The information was non-public, confidential and materially price-sensitive. The SFC also alleges that before the respective announcement of the tender offer and proposed privatisation, Young bought Hsinchu Bank shares and tipped off her boyfriend Lee and his two sisters to buy the shares, while Lee tipped off Young and his two sisters to buy Asia Satellite shares.

The SFC alleges that the above persons have contravened in various capacities:

- section 300 of the SFO by engaging in fraudulent or deceptive schemes to trade and by misusing confidential information to acquire Hsinchu Bank shares; and
- section 291 of the SFO by using insider information to deal in Asia Satellite shares.

The SFC therefore applied for court orders to:

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- declare the relevant transactions to be contraventions of SFO provisions, that the defendants were involved in those contraventions and that the transactions be void or voidable;
  - restrain the above defendants from disposing of the profits (allegedly \$2.9 million) or traceable proceeds;
  - appoint an administrator to receive the profits or traceable proceeds and distribute them appropriately; and
  - require the defendants to:
    - disgorge or account for the profits or traceable proceeds;
    - restore the positions of their counterparties to those before the transactions took place; and/or
    - pay damages to any person as the court directs.

For further information, please see press releases dated 14 September 2010, 12 October 2010 and 22 December 2010, and the MMT's press release dated 5 November 2010 and report dated 13 October 2010.

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## Interim injunction discharged

The CFA has dismissed an interim injunction obtained by the SFC. The SFC commenced proceedings against four parties and obtained interim injunctions freezing profits of alleged insider dealing in shares of Asia TeleMedia Ltd between April and June 2007.

The case before the CFA was only brought by one party, Kayden Ltd. The issue was whether the CA was correct in allowing the SFC leave to pursue proceedings against Kayden, given that it does not have any business or assets in Hong Kong.

The consequence of the CFA's decision is that the initial interim injunction against Kayden has been discharged and there is no more interim order against it. However, the decision does not affect interim injunctions against the other three parties. The SFC will continue to prosecute this proceeding.

For details, please see the CFA's judgment dated 6 December 2010 on the [Judiciary's website](#) (FACV No. 1 of 2010) and the SFC's press release dated 6 December 2010.

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## Non-criminal nature of disciplinary process

Recently, the CA has allowed the SFC's appeal against a decision of the Securities and Futures Appeals Tribunal (SFAT) and decided that criminal procedures are not applicable to SFC disciplinary proceedings.

The case stemmed from the SFAT's decision on Li Kwok Keung, Asser. Li was first convicted of providing misleading information to the SFC in contravention of section 184 of the SFO. In the course of his criminal trial, Li gave an undertaking to the court and the SFC that he would co-operate with the SFC in relation to another ongoing investigation but subsequently refused to co-operate. The SFC revoked his licence and banned him from re-entering the industry for 10 years.

The SFAT altered the SFC's decision to a suspension of 18 months for Li lying to the SFC and breaching his undertaking to co-operate. In its determination, the SFAT equated the obligations of the SFC in disciplinary proceedings with that of a prosecutor in criminal proceedings.

The SFC appealed to the CA against both the penalty imposed by the SFAT and its analogy drawn between the SFC's disciplinary process and criminal procedures.

The CA unanimously allowed the SFC's appeal and increased the penalty for Li from a suspension of licence for 18 months to a prohibition order for three years. In particular, the CA said the SFO is intended to be a "self-sufficient statutory code for dealing with regulatory disciplinary matters" and importation of criminal law analogies "manifestly are inappropriate and unhelpful."

The CA also referred to an earlier determination of the SFAT in SFAT Application No. 4 of 2007 (dated 9 November 2007) Lee On Ming, Paul and the SFC. In that case, the SFAT held that:

- the civil standard of proof, allowing for flexibility in respect of the seriousness of the issue, should be used before the SFAT and in any SFC disciplinary proceedings; and
- SFC disciplinary proceedings are civil in nature for the purposes of the Hong Kong Bill of Rights.

For details, please see press releases dated 23 March 2010 and 29 November 2010, and the CA's judgment dated 26 November 2010 on the [Judiciary's website](#) (CACV 85/2010, SFC v Li Kwok Keung, Asser).

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## Recent dishonesty cases

The SFC requires people who apply for licences and those who are already licensed to be honest. To protect investors, the SFC only allows people who demonstrate the required level of integrity and honesty as well as expertise to perform regulated activities. Dishonesty of any nature will not be tolerated.

### Misleading a client

Pauline Ellen Cousins, a former managing director and responsible officer of Crown Asset Management Ltd, was banned from re-entering the industry for life.

During an SFC investigation, Cousins was found to have produced four false portfolio valuation summaries to a client between 2002 and 2006 to mislead the client into believing that he had invested \$1.75 million in an investment-linked assurance scheme. In the absence of the client's authority, she had invested the money in a hi-tech company, which was subsequently put into administration.

The disciplinary action follows Cousins' conviction in the District Court on four counts of furnishing false information. She was sentenced to 21 months' imprisonment in December 2009 in proceedings commenced by the Police's Commercial Crime Bureau following a referral by the SFC.

### Misleading the SFC

Section 383 of the SFO prohibits people from making false or misleading representations in applications to the SFC. Recently, the Eastern Magistracy convicted two persons of giving false or misleading information to the SFC in applications for a licence to carry on regulated activities and for an extension of the deadline to submit audited accounts.

In the first case, Lam Ying Kam was fined \$10,000 and ordered to pay investigation costs to the SFC. In the second case, Able Alliance International Ltd and its director, Chan Ping Keung, Thomas, were fined a total of \$40,000 for failing to submit the required records for two financial years within the specified period contrary to section 156 of the SFO. Chan was also convicted of making false or misleading representations to the SFC. They also were ordered to pay investigation costs to the SFC.

The SFC requires people to make full and accurate representations to it in all circumstances. The same principle also applies to the submission of audited accounts, which must be timely, in order not to hinder the SFC's ability to assess the financial soundness of licensed corporations.

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## Forging signatures

Yam Chin Yui, Peggy, a former employee of CITIC Ka Wah Bank Ltd, was banned from re-entering the industry for 18 months for forging her colleagues' signatures on banking documents. She forged her colleagues' initials to speed up processing of certain transactions in breach of her employer's internal control procedures in relation to verification of banking documents. Although Yam did not profit from her forgery, her act was dishonest.

For details, please see press releases dated 8 November 2010, 9 November 2010, 15 November 2010 and 29 December 2010.

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## Managing risks through proper internal controls

Recently, the SFC disciplined Merrill Lynch (Asia Pacific) Ltd and Merrill Lynch Futures (Hong Kong) Ltd (collectively referred to as Merrill Lynch) and a managing director and senior trader at Merrill Lynch for conduct associated with mis-marking activities in a trading book.

From December 2007 to October 2008, Jugurtha Harchaoui had mis-marked a trading book in exotics options (the Book) by manipulating the volatility marks in the valuation model, and accessed the computer system without authority to alter pricing parameters on various occasions. He sought to cover up his action by instructing a junior trader in his team to use a manipulated computer programme to mark the Book during his sick leave. The mis-marking activities resulted in the value of the Book being inflated by approximately US\$25 million and caused the actual loss to be wrongly reported to Merrill Lynch. He was dishonest and had abused his seniority by instructing his subordinate to implement his mis-marking activities. He was banned from re-entering the industry for life.

Merrill Lynch was fined \$3.5 million for not having adequate internal systems and controls in place to manage the risks associated with mis-marking.

Merrill Lynch's misconduct was not intentional and it has taken remedial steps to address the compliance weaknesses. The proper implementation of an effective risk management framework could have enabled Merrill Lynch to detect the mis-marking earlier.

Licensed corporations, therefore, must have effective procedures in place to manage risks of their trading books. For books that deal in illiquid assets with low price transparency, more robust measures must be installed.

For details, please see press releases dated 31 May 2010 and 9 September 2010.

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## Action continues against unlicensed dealing

The last edition of the Reporter explained how recent decisions of the HC and CA support the SFC's enforcement actions in combating unlicensed dealing. The SFC continues to combat unlicensed dealing through criminal prosecutions and disciplinary actions.

Recently, the SFC prosecuted the following entities for carrying on a business of dealing in securities without being licensed by the SFC:

- Ma Siu Kwan and a company under his control, Hong Kong Business Agency Group Ltd, had made offers to the general public to sell shares held by clients. The offers, which did not exist, were made through advertisements on a website and made also to a potential buyer; and
- Lee Chi Ying had provided dealing services including price quotes and placing orders with a licensed firm. However, Lee was not employed or authorised by it.

The above persons pleaded guilty. They were fined a total of \$15,000 and ordered to pay investigation costs to the SFC.

The SFC also took disciplinary action against people who facilitated unlicensed activities:

- Tam Sak Man, a former account executive of Hantec International Ltd, was reprimanded and fined \$816,220 by the SFC. Tam assisted a number of Hong Kong residents to open leveraged foreign exchange trading accounts at Cosmos Hantec Investment (NZ) Ltd (Cosmos Hantec), an unlicensed entity that operated leveraged forex trading in New Zealand. Tam received commission income from the trading of these Hong Kong residents, who suffered losses in their trading. To date, the SFC has taken disciplinary actions against six persons (including Tam) in connection with the unlawful operations of Cosmos Hantec. The sanctions ranged from reprimand to revocation and prohibition from re-entering the industry for 10 years.
- Noble Apex Advisors Ltd was reprimanded and fined \$1 million pursuant to a resolution entered into with the SFC under section 201 of the SFO. Noble Apex had allowed an unlicensed person to head a team of representatives and to engage in regulated activities. The team operated at different premises and its activities were not properly supervised. Noble Apex had breached the Code of Conduct for Persons Licensed by or Registered with the SFC (the Code) by disregarding its regulatory duties to ensure adequate controls and systems were in place.

Investors should not deal with unlicensed firms or persons. They can visit the SFC's website ([www.sfc.hk](http://www.sfc.hk)) to check whether a firm or a person is licensed.

For details, please see press releases dated 3 October 2007, 31 March 2008, 2 June 2009, 26 May 2010, 7 October 2010, 25 October 2010, 8 November 2010 and 25 November 2010.

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## Enforcement policy and practice

The Securities and Futures (Contract Limits and Reportable Positions) Rules (the Rules) require any person who holds or controls an open position in futures contracts or stock options contracts to lodge a notice in writing with The Stock Exchange of Hong Kong Ltd (SEHK) or Hong Kong Futures Exchange Ltd (as the case may be) when a position reaches a reporting level. The Rules also prescribe the limit on the number of futures contracts or stock options contracts that may be held or controlled by any person. Any person who, without reasonable excuse, fails to comply with these requirements is liable:

- on conviction on indictment to a fine at level 6 (i.e., \$100,000) and to imprisonment for two years; or
- on summary conviction to a fine at level 3 (i.e., \$10,000) and to imprisonment for six months.

Recently, we have become aware of firms trading in excess of the prescribed limit or failing to report the open position in accordance with the Rules.

The SFC would like to remind firms that:

- they should understand the requirements of the Rules, including the prescribed limit on the number of contracts held or controlled by any people and the reporting obligations:



- the prescribed limits apply to all positions held or controlled by any person including positions held by the person for his own account and positions belonging to other persons but under the control of such person. If a person holds or controls positions in accounts at more than one firm, the person is obliged to aggregate positions for purposes of applying the prescribed limits and reportable position requirements. Such obligation extends to persons who are not beneficiaries of the account but merely acting as an investment manager;
  - the notice of a reportable position may be submitted by a person acting as principal for the reportable position; or a person (e.g., the Exchange Participant) acting as an agent for the principal to carry the account of the reportable position. However, no matter which party is chosen to submit the notice, it is the responsibility of each person holding or controlling the reportable position to fulfill its obligations. Where the person acting as principal trades through various agents, and as long as the aggregated position results in a reporting obligation, the principal should ensure that each of the agents or one designated agent submits all positions held by each agent even though individual positions may not exceed the reporting threshold;
- systems must be in place to monitor their open positions, such as through the use of internal reports, requiring persons in control to ascertain the open positions before finalising the transactions. Licensed persons are obliged to comply with General Principle 7 of the Code, which requires them to “comply with all regulatory requirements applicable to the conduct of its business activities so as to promote the best interests of clients and the integrity of the market;” and
  - arrangements should be made to ensure that timely and accurate reports are made under the Rules.

For details, please refer to the Guidance Note on Position Limits and Large Open Position Reporting Requirements gazetted under s399(1) of the SFO on 20 April 2004.

## Failure to disclose interests prosecuted

The SFC regards as important 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 SEHK of changes in their interests.

From 1 September 2010 to 31 December 2010, the SFC prosecuted eight entities for breaches in disclosure of interests. Fines ranging from \$6,000 to \$20,000 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](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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