SFC 證監會

ENFORCEMENT REPORTER

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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 January to 30 April 2011, we sent out 43 compliance advice letters when we became aware of conduct presenting unnecessary risks or that might lead to crime or market misconduct.

We also completed 78 enforcement cases (including the issuance of eight disciplinary notices of decision) and commenced 21 criminal and two civil proceedings.

Upcoming cases in courts and tribunals

Several SFC enforcement-related trials and hearings are scheduled for the coming weeks. These cases deal with important issues, including allegations of market manipulation.

- An appeal against an acquittal regarding allegations of manipulation of Hang Seng China Enterprises Index futures contracts and Hang Seng Index futures contracts will be heard in the High Court on 3 June 2011.
- An application for leave to appeal to the Court of Final Appeal against the judgement of the Court of Appeal (CA) regarding manipulation of derivative warrants issued by Macquarie Bank Ltd will be heard on 7 June 2011.
- A trial regarding the alleged manipulation of four callable bull bear contracts (CBBCs) will take place in the Eastern Magistracy on 14 June 2011.

Highlights

- From 1 January to 30 April 2011, the SFC completed 78 enforcement cases (including the issuance of eight disciplinary notices of decision) and commenced 21 criminal and two civil proceedings.
- Two further resolutions were reached involving repurchase offers of Lehman Brothers (LB)-related structured products totalling approximately $1.489 billion.
- The approach of the SFC in resolving LB-related complaints paves way for the return of collateral of Minibonds.
- An injunction was obtained to freeze suspected insider dealing proceeds amounting to nearly $400 million.
- A broker was jailed for executing a client's manipulative order instructions.
- The SFC successfully obtained more orders from the High Court to disqualify company directors for misconduct.

- Appeals against the conviction and sentence regarding insider dealing in the shares of Universe International Holdings Ltd will be heard in the High Court on 22 June 2011.

- An appeal against conviction regarding false or misleading representations in an application to the SFC will be heard in the CA on 13 July 2011.

- A trial regarding the alleged manipulation of shares of Shun Ho Resources Holdings Ltd and Shun Ho Technology Holdings Ltd will take place in the Eastern Magistracy on 18 July 2011.

- A trial regarding the alleged manipulation of shares of VST Holdings Ltd will take place in the District Court on 14 September 2011.

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

SFC's strategy for LB-related products bears fruit

Return enhanced based on collateral recovery

PricewaterhouseCoopers (PwC), receivers of the collateral of the Lehman Brothers (LB) Minibonds, reached a conditional agreement with Lehman Brothers Special Financing Inc. (LBF). The agreement:

- will provide substantial recoveries from the underlying collateral for all customers who held Minibonds issued in series 10 to 12, 15 to 23 and 25 to 36, including those who were ineligible to receive repurchase offers under the resolution between the SFC, Hong Kong Monetary Authority (HKMA) and the 16 distributing banks of the Minibonds on 22 July 2009 (the Minibond Agreement); and

- will enable additional ex gratia payments be made by the banks to eligible customers under the Minibond Agreement. The payments will increase the level of recovery of eligible customers to 85% to 96.5% of their initial investment.

A relevant confirmation was obtained from the US Bankruptcy Court so as to fulfil the criteria for the conditional agreement reached between the receivers and LBF. The conditional agreement has also been approved by the noteholders of the Minibonds for each and every series who cast votes at special meetings in May 2011. This means that the agreement is effective. According to the receivers, payments are expected to be made to the noteholders in June 2011.

The outcome is the result of:

- the top-down strategy set in train by the SFC in investigating the complaints received following the collapse of Lehman Brothers Holdings. Instead of investigating tens of thousands of cases, the SFC investigated each distributor's sales processes and practices, including how well the financial circumstances of the customers were understood and how well advisory staff understood and matched the products they recommended to their customers. The strategy enabled the large volume of complaints to be dealt with efficiently, effectively and expeditiously, and the Minibond Agreement to be reached; and

- the Minibond Agreement, which the SFC negotiated with the banks, requires the banks to take reasonable steps to expedite the return of the collateral including creation of a fighting fund by using the commission income earned from the sale of the Minibonds. Accordingly, the banks provided a fund of up to $291 million that enabled the appointment of the receivers to take all necessary actions to recover the underlying collateral of the Minibonds.

To date, the top-down strategy has enabled the SFC to enter into agreements with:

- 19 distributors (including the banks) of the Minibonds;
- two non-distributors of the Minibonds;
- two of the Minibond distributors in relation to their sale of certain Equity Index-linked Fixed Coupon Principal Protected Notes issued by LB; and
- two other distributors in relation to their respective distribution of LB-related Constellation Notes and equity linked structured notes issued and guaranteed by LB (LB ELNs).

The latest agreements were reached with Standard Chartered Bank (Hong Kong) Ltd (Standard Chartered) and Core Pacific-Yamaichi International (H.K.) Ltd (CPYI) (see below).

Latest agreements reached on LB-related structured products

The SFC and the HKMA had reached an agreement with Standard Chartered in relation to its distribution of LB ELNs.

Standard Chartered agreed to:

- make a repurchase offer to eligible customers holding an outstanding LB ELN distributed by it. The total value of the repurchase offer is estimated to be approximately $1.48 billion and will cover over 95% of the outstanding transactions in LB ELNs by Standard Chartered customers; and
- pay top-up payments to customers with whom Standard Chartered has already entered into settlement agreements but would otherwise have been eligible to receive a repurchase offer, to the extent that such payments are needed to ensure these customers are treated in the same way as other customers participating in the repurchase scheme.

When recommending or advising on securities, firms have an obligation to ensure products are suitable for their clients. Assessing the right level of concentration is a necessary part of the suitability assessment. The SFC and the HKMA were concerned that Standard Chartered may have exposed its customers to higher levels of risk than were suitable for them by not adequately considering concentration risk when assessing the suitability of LB ELNs for customers.

In entering into the agreement, the SFC took into account, the following, among other factors:

- Although LB ELNs were high-risk products, they were less complex than Minibonds and likely to have been suitable products for most customers as part of a diversified portfolio.
- Unlike Minibonds, LB ELNs had no distributable collateral. As unsecured creditors, the chance was slim that holders of LB ELNs would receive a substantial payment or dividend in the bankruptcy of LB so the payments from Standard Chartered might be the only possible return.
- The repurchase offer would enable the vast majority of LB ELN customers to obtain a reasonable recovery without the costs and associated risks of separate litigation.
- The agreement would bring the LB ELN matter to an end for the benefit of Standard Chartered and its customers willing to participate in the repurchase scheme. The result could not have been achieved through the SFC's disciplinary action.
- Standard Chartered has undertaken to engage an independent reviewer to review its systems and processes relating to the sale of unlisted structured investment products and will commit to the implementation of all recommendations.

The scheme is reasonable and appropriate in light of the regulatory concerns and public interest. The SFC agreed not to take disciplinary action against Standard Chartered and its staff in relation to the distribution of LB ELNs, save for any acts of dishonesty, fraud, deception or conduct of a criminal nature.

In the latest agreement reached between the SFC and CPYI, the SFC raised a number of concerns with CPYI's internal systems and controls regarding the sale of the Minibonds and other LB-related structured products. The SFC's concerns were related to the adequacy of product due diligence, adequacy of training and guidance given to its sales staff, and establishment and implementation of proper guidelines and monitoring procedures on the sale and marketing of these products.

CPYI acknowledged the seriousness of the concerns and agreed to, among other things, offer to repurchase from all its eligible customers outstanding Minibonds and LB-related structured products and to pay compensation to all its eligible former customers for their previous holding(s) in these products. The total amount of repurchase and compensation is approximately $9.6 million.

For further details, please see press releases dated 22 January 2009, 5 April 2009, 2 July 2009, 22 July 2009, 17 December 2009, 23 December 2009, 13 January 2010, 14 July 2010, 1 March 2011, 27 March 2011 and 12 May 2011, announcements made by the receivers from PwC on 28 March 2011, 14 April 2011, 18 May 2011, 19 May 2011 and 21 May 2011, and the speech delivered by Mr Mark Steward, the SFC's Executive Director, Enforcement, at the seminar on Prevention of Financial Crime, Management of Risk and Corruption.

Injunction obtained to freeze suspected insider dealing proceeds

Following the announcement made by China Forestry Holdings Co, Ltd (China Forestry) on 31 January 2011 that its auditors had identified possible irregularities in the audit process in respect of the financial year ended 31 December 2010, the SFC started investigating.

Top Wisdom Overseas Holdings Ltd (Top Wisdom), a company of Li Han Chun (the former chief executive officer (CEO) of China Forestry), was found to have entered into a placing agreement to place 119 million shares of China Forestry to a number of institutions and funds at $3.35 per share. The SFC obtained an interim injunction on an ex parte basis to freeze assets up to nearly $400 million, which represents the proceeds of the placement. In the proceedings, the SFC alleges that Li and Top Wisdom engaged in insider dealing through the placement.

The court has also allowed the SFC:

- to amend its proceedings to seek final orders, including permanent injunctions and orders to restore parties to any transaction to the positions they were in before the transaction was entered into; and
- to serve the proceedings on Li and Top Wisdom in the Mainland and the British Virgin Islands respectively.

For further details, please see press releases dated 11 February 2011 and 4 March 2011.

Action against market manipulators continues

Recent decisions by the courts and the Securities and Futures Appeals Tribunal (SFAT) demonstrate further action by the SFC against market manipulators, who may be brokers executing orders from clients or following the firm's instruction.

In the following cases, the Eastern Magistracy imposed terms of imprisonment or suspended sentences on these manipulators:

- Pan Ming, a responsible officer of Guotai Junan Securities (Hong Kong) Ltd was sentenced to an immediate five-month imprisonment after being convicted of market manipulation. Instructed by a client to fix a higher closing price for the shares of IRICO Group Electronics Co Ltd, Pan directed his colleague to place buy orders in the last two minutes of trading. As the prices for these orders were higher than the prevailing market price, the share price closed 14% higher. This facilitated a subsequent off-market transaction at a price higher than the closing price. Pan's client was charged with market manipulation and fraud offences. He left Hong Kong after the summons was issued and a warrant for his arrest is in force;

- Fong Ka Lai was sentenced to one-month imprisonment, suspended for 12 months after pleading guilty to manipulating the price of three CBBCs during the pre-opening session. Fong's orders caused the final indicative equilibrium price of the CBBCs to swing widely on three days; and

- Yu Yau Ki, Tony was sentenced to four-week imprisonment, suspended for 18 months after pleading guilty to market manipulation. He placed a series of buy and sell orders for the shares of WLS Holdings Ltd, which did not involve any change of beneficial ownership, and had caused the nominal price of the shares to rise about 5%.

In a disciplinary case, the SFAT dismissed the application by Zhang Xiaoming, formerly CEO of ICEA Group and a responsible officer of ICEA Capital Ltd (ICEA Capital), and affirmed the SFC's decision to prohibit him from re-entering the industry for 12 months.

The SFC found that, on the first two days of listing of a company in 2004, ICEA Capital – the sponsor and lead underwriter – provided improper market support for the share price. Zhang was the person who decided to provide market support and instructed his subordinate to buy the shares. These purchases reduced the selling pressure of the shares and gave the market a false and misleading impression of the natural supply of, demand for, and the price of the shares.

The SFAT:

- confirmed that "the SFC was perfectly entitled to find that Mr Zhang's conduct amounted to the offence of false trading under section 295 of the Securities and Futures Ordinance (SFO). It is not necessary for there to be a criminal finding by a court …, for the SFC to conclude that conduct equivalent to that offence has taken place, and to rely upon that conduct for disciplinary purposes;"

- confirmed that it is the responsibility of the licensed person to refuse to undertake activity, which constitutes a breach of the SFO, even if instructed to do so by the company and at the cost of his job; and

- refused to accept Zhang's submission that there were no victims in false trading. The SFAT decided: "The primary victims of false trading are those who may have purchased shares believing that the trading activity demonstrated was genuine trading activity and that there was a genuine interest in the shares … The secondary victims of the conduct complained are, first, the integrity of the market, second, the public's confidence in the market, and the cost of equity in the market."

Previous decisions by courts have sent a very strong message to the market that manipulators are not tolerated. Further, brokers may face immediate custodial sentences or disciplinary sanctions for carrying out suspicious or manipulative instructions from clients, or following the firm's instructions.

For further details, please see press releases dated 21 February 2011, 1 March 2011 and 24 March 2011, and the SFAT's determination dated 18 February 2011 (Application No. 13 of 2009).

Timely disclosure deemed vital to fair, informed market

Two more listed company directors disqualified for misconduct

In Issues No. 65 and 67, we reported on the disqualification orders obtained by the SFC against company directors of Warderly International Holdings Ltd (Warderly). Recently, the SFC obtained further orders in the High Court to disqualify two other directors of Warderly, which brought an end to the SFC's proceedings against a total of six directors of Warderly. The two orders are the 16th and 17th orders obtained to date.

The two directors of Warderly, among other things, had failed to make timely disclosure of material information to the market:

- Hung Kwok Wa, Godfrey, former executive director, was disqualified for five years; and
- Leung Ping Chung, Hermann, former alternate non-executive director, was disqualified for two years.

This is the first time an alternate non-executive director has been disqualified for this type of misconduct.

Both Hung and Leung accepted that 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; 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 complaints against Hung and Leung are similar. In view of Leung's position and lesser responsibility for the day-to-day management of Warderly's affairs, and the failings identified by the SFC, Leung's disqualification period was shorter than Hung's.

Shareholders are entitled to expect competent governance from listed company directors. In particular, material events concerning the financial positions of listed companies should be disclosed to shareholders in a timely fashion.

For further information, please see press releases dated 16 September 2009, 17 March 2010, 8 October 2010 and 1 March 2011, judgment dated 1 March 2011 (HCMP 1742/2009) on the Judiciary's website.

Other disqualification proceedings commenced

The SFC has also commenced proceedings in the High Court to disqualify two former senior executives of Sunlink International Holdings Ltd (Sunlink).

The SFC alleged that Wong Shu Wing Andy (a former chairman and executive director) and Lee Chak To (a former chief financial officer):

- failed to manage Sunlink with the necessary degree of skill, care, diligence and competence as is reasonably expected of persons of their knowledge and experience and holding their offices and functions; and
- failed to ensure Sunlink complied with disclosure requirements under the Listing Rules.

The SFC alleged that the breaches centred on a number of material events in 2008 concerning the deteriorating financial position of Sunlink, which should have allegedly been disclosed to its members, the general investing public and The Stock Exchange of Hong Kong Ltd (SEHK).

For further information, please see press release dated 20 January 2011, summary of the material events and the SFC's allegations on the SFC website.

Disqualification-related appeals dismissed

In Issues No. 60 and 65, we reported that the SFC commenced proceedings against Rontex International Holdings Ltd (Rontex) (now known as Siberian Mining Group Company Ltd). The High Court granted orders to, among other things, disqualify three former executive directors, and direct Rontex to commence legal proceedings against them to seek recovery of compensation resulting from their misconduct. This was the first case in which the SFC obtained an order in the High Court directing a listed company to commence civil proceedings to seek recovery of compensation for the loss and damage suffered by the company as a result of directors' misconduct.

Cheung Keng Ching and Chou Mei (Chou), two former directors, appealed against the length of their disqualifications and complained that the company should be able to settle its claim against them without having to obtain court approval of the settlement.

Recently, the CA ruled that any settlement should be approved by the court and reduced Chou's disqualification period from five years to four years.

For further information, please see press releases dated 25 September 2008, 18 March 2010 and 17 May 2011.

Secret accounts remain on regulatory radar

The SFC has been waging a campaign against the use of secret accounts since May 2007.

This misconduct typically involves:

- facilitation of the opening and operation of secret accounts;
- non-disclosure of the existence of secret accounts contrary to the requirements of the Code of Conduct for Persons Licensed by and Registered with the SFC, which requires licensed firms to have policies banning trading by employees unless it is fully disclosed to the firms;
- the use of fictitious names or names of others (usually a friend or relative) to hide accounts; and
- concealment of illegal activity, such as market manipulation, insider dealing and front running by trading through these accounts.

Recently, the SFAT affirmed the SFC's stance on secret accounts:

"Unless a[n] …employee discloses the existence of an outside securities trading account and … submit details of the trading it is simply impossible for the employer to monitor the employee's trading activities. Unless it is able to monitor an employee's trading activities it will not be able to ensure proper compliance with the regulatory requirement, which … is properly aimed at ensuring that there is no conflict of interest between an employee and the client with which the employee deals, and that no advantage is being taken by an employee of inside information."

In this case, the SFAT dismissed Sham Pik Yan, Winda's appeal against the SFC's decision. By deliberately hiding her secret account from her previous employer, Sham failed to act honestly and fairly or in the best interests of her customers and the integrity of the market. She was suspended for seven months.

Two others, Chan Yin Chun and Law Ting Pong, were also suspended for conducting personal trading through secret accounts and failing to disclose them to their previous employer.

There is no valid reason for anyone to operate a secret account. The SFC regards such conduct as dishonest and will continue to clamp down on secret accounts.

For further details, please see press releases dated 8 and 22 February 2011, and the SFAT's determination dated 18 February 2011 (Application No. 5 of 2010).

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 January to 30 April 2011, the SFC prosecuted 10 entities and people for not disclosing their interests or disclosing them late. Fines ranging from $2,000 to $42,000 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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