



SFC Enforcement Reporter

A monthly summary of SFC enforcement action

August 2004

Highlights

In July, the SFC:

- successfully prosecuted one company and one person
- disciplined 10 licensees
- entered into settlement with a voluntary payment with one licensee

Prosecution

Licensee turned market manipulator convicted

Mr Han Sze Chao Richard, a responsible officer of Lippo Securities Ltd, pleaded guilty to intentionally creating a false market in the shares of Fortuna International Holdings Ltd on behalf of himself and Super Glory International Ltd, a company he owned. The SFC found that Han, who had an interest in a large number of Fortuna shares, had on numerous occasions between January and May 2002 used small board lot orders to stabilise or peg the price of Fortuna shares just before market close. Han successfully pegged the price of Fortuna shares at around \$0.30 over an extended period. Han and Super Glory were fined a total of \$50,000 and ordered to pay investigation costs to the SFC.

(Press release issued on 28 July 2004)

When sentencing Han and Super Glory, the magistrate made it clear that a custodial sentence would normally be imposed on a market manipulator. In the present case, the magistrate chose to impose a fine instead of a custodial sentence because Han would face a real possibility of losing his licence and he had co-operated in the SFC's investigation.

As we have said in previous issues of the Enforcement Reporter, market manipulation is a serious crime and the maximum penalties have become more severe under the Securities and Futures Ordinance (SFO). We wish to remind licensees that, those who participate or assist others in market manipulation will not only face criminal conviction, but also likely have their licence suspended or revoked and/or be fined.

Discipline

Appeals Tribunal supports SFC's firm action on analyst conflicts of interest

The Securities and Futures Appeals Tribunal (SFAT) upheld the SFC's decision to suspend Mr Wong Wing Fai Eric, a former research analyst of Dao Heng Securities Ltd, for 18 months. The SFC found that, in August 2002, Wong purchased the shares of three listed companies at lower prices a few days before the publication of his "buy" recommendations on these companies, and sold these shares at a profit after the publication of his recommendations. He traded through his father's account at another brokerage firm where his girlfriend was a responsible officer. His conduct was in breach of Dao Heng's staff dealing policy and the conflicts of interest provisions under the SFC Code of Conduct.

The SFC decided to suspend Wong for 18 months. Wong appealed to the SFAT and his counsel argued that 18 months' suspension was too severe, because in his view, at the time when Wong committed the misconduct, frontrunning research reports was not considered to be serious misconduct. Accordingly, Wong's counsel argued that the SFC should not impose a lengthy suspension. The SFAT rejected these arguments and dismissed Wong's application on 9 July 2004.

The SFAT considered that research analysts act as a bridge between investors and listed companies. Many investors consider analysts an important source of information and couch their investment decisions according to analysts' recommendations. Therefore it is clearly vital to maintain investor confidence that research analysts act with integrity when producing their reports. Temporal trading



SFC Enforcement Reporter

A monthly summary of SFC enforcement action

August 2004

restrictions imposed upon analysts are crucial to maintaining the integrity of analysts and avoiding conflicts of interest. The SFAT believed that public interest demands the SFC to take firm action against frontrunning research reports by analysts.

The SFAT recognised that the SFC does not regulate in a “time-warp”. The SFC’s duty is to respond speedily and efficiently to regulatory infractions. When determining the appropriate penalty, the SFC is entitled to take into account the prevailing market conditions at the time of imposition of the penalty. The SFAT also emphasised that disciplinary actions are punitive and intended to have a deterrent effect. Therefore mitigating factors have less significance within domestic disciplinary regimes as compared with the influence of such factors within the criminal system.

(Press release issued on 2 August 2004)

This is the first disciplinary action against an analyst for frontrunning research reports. The SFC welcomes the SFAT’s confirmation that analyst conflicts of interest must be taken seriously. Analysts have a professional duty to provide objective, independent and unbiased views in their research reports which accurately reflect the prospects of the companies concerned. They must not place their own interests above those of the investing public by dealing in the stocks concerned too soon before or after their reports are issued.

The SFC will focus its enforcement resources on this area and take a strong stance against analysts who abuse the trust that the investing public reposes in them, including by using their research reports to further their personal or a third party’s interests. The SFC is currently finalising its conclusions from its public consultation on analyst conflicts of interest, which will expand the existing SFC Code of Conduct and set out more specific guidelines that licensed analysts must follow.

Appeals Tribunal varies SFC’s decisions on FRR breaches by investment advisers

Pacific Sun Investment Management (Hong Kong) Ltd and its responsible officer, Mr Andrew Pieter Mantel, were each suspended for one month and each fined \$50,000 for breaching the liquid capital requirements under the Financial Resources Rules (FRR). The SFC found that Pacific Sun’s liquid capital was in deficit throughout October 2003 despite the fact that it was already forewarned by the SFC of its inability to maintain the required liquid capital. Pacific Sun was given the opportunity to rectify its liquid capital deficiency, but failed to do so until the SFC threatened to shut down its business immediately by imposing a restriction notice. In view of the fact that this was not the first occasion on which Pacific Sun and Mantel were disciplined for similar misconduct, the SFC decided to revoke their licences. They applied to the SFAT for a review of the SFC decision.

The SFAT made its decision on 31 July 2004. The SFAT recognised that Pacific Sun and Mantel were repeat offenders in relation to FRR breaches who made little effort to avoid the liquid capital deficiency despite repeated warnings by the SFC, and that Mantel failed to appreciate the importance of the liquid capital requirements. However, the SFAT attached weight to the fact that, since the coming into force of the SFO, there has been a statutory change of FRR requirements which reduced the liquid capital requirements for licensees who only engage in advising on securities or asset management and do not hold client funds. Therefore, the SFAT decided that Pacific Sun and Mantel should be fined and their licences suspended but not revoked. The SFAT made it clear that the decision would have been different for licensees who hold client assets.

(Press release issued on 2 August 2004)

Asian Capital Partners (HK) Ltd and its sole responsible officer, Mr Andrew John Peregrine Korner, were publicly reprimanded for: (i) failing to maintain the required level of net tangible assets between 2001 and April 2003; (ii) failing to notify the SFC in writing; and (iii) failing to file its annual returns and audited financial statements on time.

Korner applied to the SFAT for a review of the SFC decision. The SFAT delivered its determination on 23 July 2004. Similar to the Pacific Sun and Mantel case, the SFAT gave much weight to the fact that since 1 April 2003, a lower capital requirement was established for investment advisers like Korner who do not hold client assets. As such, the SFAT considered that the appropriate penalty for Korner should



SFC Enforcement Reporter

A monthly summary of SFC enforcement action

證監會 August 2004

be a reprimand. Notwithstanding this, the SFAT stated that compliance with FRR was important and would assume a greater profile in situations in which a transgressor holds client assets.

(Press release issued on 2 August 2004)

The SFC respects the decisions of the SFAT. It is clear that the intended checks and balances in the SFO are working.

The existing level of FRR requirements for investment advisers and fund managers that do not hold client assets was an important factor in the SFAT's decisions. The SFC is studying the decisions carefully for future reference in making decisions on FRR breaches by licensees who do not hold client assets. The SFC also appreciates the SFAT's confirmation of the general importance of FRR compliance, in particular for licensees who hold client assets.

Do not promote your services by making illegal unsolicited calls

Mr Li Man Hin, a licensed representative of Refco Hong Kong Ltd, settled disciplinary action brought by the SFC and paid \$195,000 into government revenue. The SFC found that, from around October to December 2002, account executives under Li's supervision made unsolicited phone calls to prospective clients giving them information about Refco with a view to inducing them to open accounts with Refco to trade futures contracts on exchanges in the US and Japan. Li also accompanied the account executives to meet the clients. Li was convicted of hawking of futures contracts at the Western Magistracy. The SFC decided to suspend Li for six months for failing to comply with the relevant laws and failing to supervise his subordinates adequately.

Li offered to settle the disciplinary action with the SFC. In view of Li's frank admission of his liabilities and acceptance that his actions warranted punishment, the SFC considered that it was in the public interest to settle the disciplinary proceedings with Li by his payment of \$195,000.

(Press release issued on 26 July 2004)

Ms Yau Oi Yi, another licensed representative of Refco, was suspended for three months for hawking futures contracts. From around October to December 2002, Yau made unsolicited phone calls to prospective clients, giving them information about Refco with a view to inducing them to open accounts with Refco to trade futures contracts on exchanges in the US and Japan. Yau met with the clients and provided them with information about Refco and its commission charges. Yau was convicted of hawking of futures contracts at Western Magistracy. The SFC decided to suspend Yau for three months for failing to comply with the relevant laws and failing to exercise due skill and diligence. The SFC reduced Yau's suspension to take into account her frank admission and genuine remorse.

(Press release issued on 27 July 2004)

Under the SFO, it is a criminal offence to make any unsolicited call with a view to inducing the recipient of the call to enter into agreement to trade regulated investment products. This is to protect the investing public from pressure sales strategies, which may cause harassed investors to make ill-informed and hasty investment decisions. Licensed representatives must ensure that their marketing efforts and strategies comply with the law, or they will both be criminally prosecuted and disciplined.

Settlement

The disciplinary proceedings against Li were resolved by settlement. The SFC cannot fine licensees who engaged in improper conduct before the commencement of the SFO on 1 April 2003. For improper conduct engaged in since 1 April 2003, besides the usual penalties of public reprimand, suspension and revocation of licence, the SFC may also fine. It is expected that fines will eventually replace suspensions in many cases under the new disciplinary regime. Settlement by payment of money provides a bridge between the old disciplinary regime and new disciplinary regime in appropriate cases where the subject of the decision agrees, so that the same outcomes may be achieved regardless of when the conduct occurred.



SFC Enforcement Reporter

A monthly summary of SFC enforcement action

證監會 August 2004

The SFC is open to settlement offers by licensees in disciplinary cases and will consider each offer carefully. However, it is in the SFC's sole discretion whether to accept any settlement offer. The SFC is not legally bound to enter into any settlement agreements with licensees. The SFC will settle a case only when it considers that it is in the public interest to do so. For example, the SFC will not settle for a voluntary payment in exchange for a suspension if dishonesty is involved or the person's conduct or attitude suggested that they would be a continuing risk to the investing public. In such circumstances, the SFC is likely to insist on the suspension in order to protect the investing public from the person by excluding them from the industry. The SFC is also unlikely to agree to settle a case by receiving a payment in circumstances serious enough to warrant revocation.

Know your clients and handle their account opening properly

Mr Chu Sung Hei, a licensed representative of Stockwell Securities Ltd, was suspended for 15 weeks. The SFC found that Chu signed as a witness on the accounting opening documents of a client when in fact he never met the client. Chu also failed to verify the identity of a person who gave him instructions over the phone and accepted the instructions. During an interview with the SFC, Chu provided false and misleading information to the SFC by saying that he witnessed the account opening process and he knew that it was his client who gave him instructions over the phone. Later in the same interview, he admitted that this was not the case. Chu received a shorter suspension than originally proposed due to his subsequent admission of his wrongdoings and his co-operation with the SFC.

(Press release issued on 20 July 2004)

Ms Sy Pan Pan, a licensed representative of Core Pacific-Yamaichi Securities (HK) Ltd, was suspended for three months. The SFC found that, in May 2003, Sy signed as a witness on the account opening documents of a client confirming that she had checked the client's identity documents and assessed his financial status, when in fact she had not. Sy recommended to her employer that a margin facility be granted to that client when she did not know the client's financial circumstances. Sy also knew that the person who operated her client's account was a licensed person, but failed to obtain any written consent from the employer of the licensed person. Sy received a shorter suspension than originally proposed because she did not dispute the SFC's findings.

(Press release issued on 28 July 2004)

Mr Lau Wai Lun, also a licensed representative of Core Pacific-Yamaichi, was suspended for 15 weeks. The SFC found that, between May and September 2001, Lau failed to obtain sufficient information from his client and made up some information about the client in the account opening documents. Lau did not obtain written authorisation from the client before he allowed a third party to operate the client's account. He also transferred \$2.28 million from the client's account to another party's account in accordance with a third party's instruction without directly verifying with the client. Finally, he deposited a third party's cheque in the client's account in breach of his employer's rules. Lau received a shorter suspension than originally proposed because he did not dispute the SFC's findings.

(Press release issued on 28 July 2004)

Licensees must know their clients well. When handling account opening procedures for a new client, licensees must verify the true identity of the client and check their financial situation, investment experience and objectives. Licensees must ensure that they have obtained genuine and adequate information from the new client. Opening an account for a person whom the licensee has never met, accepting instructions from someone whom they did not know is serious misconduct which normally warrants a suspension.

When a client authorises another person to operate his account, oral authorisation is insufficient. Written authorisation must be obtained from the client to avoid any later dispute and to avoid nominee arrangements that may frustrate subsequent investigations. When the authorised person who operates the client's account is an employee of another licensee, written consent must also be obtained from the other licensee. This enables the other licensee to supervise its employee's dealings and to detect if there are any possible trading malpractices by the employee. The conduct of Wong Wing Fai Eric (see p.1) shows how important this rule is.



SFC Enforcement Reporter

A monthly summary of SFC enforcement action

證監會 August 2004

It is worth noting that Chu, Sy and Lau all received shorter suspensions than originally proposed. The SFC looks favourably on frank admissions and co-operation by a licensee when deciding what penalty to impose, and is willing to reduce the proposed penalty, where appropriate, in accordance with the degree of co-operation and admission.

Do not hold yourself out as a licensed investment adviser when you are not

Mr Andrew Gregory Eden, a responsible officer of Ernest Maude Investment Services Ltd, was suspended for seven weeks for falsely and misleadingly holding out an unregistered firm as a registered investment adviser. The SFC found that in April 1999, Eden, on behalf of Ernest Maude Continental Investment Ltd (EMCIL), entered into an agreement with a client to provide investment advisory services for remuneration. The service agreement expressly stated that EMCIL was registered as an investment adviser, when in fact it was not. When deciding the penalty, the SFC took into account that Eden accepted that he did not exercise the required care at the relevant time.

(Press release issued on 7 July 2004)

The licensing regime is the cornerstone of the securities and futures regulatory system. It acts as a gatekeeper to ensure that only fit and proper people are allowed to carry on business in regulated activities. Only people properly licensed by the SFC can say or suggest that they are licensed. We may prosecute and discipline any person who illegally holds out to be an SFC licensee when in fact they are not.

General Enforcement Statistics

Since 1 April 2004, the SFC has successfully prosecuted 20 entities. Summonses were withdrawn against five persons resulting in their acquittals and a further three persons were acquitted after trial. In the same period, the SFC disciplined 25 licensees for various regulatory breaches and entered into settlements with voluntary payments with two licensees. The SFC also took disciplinary action against six licensees which were eventually concluded with no formal sanction imposed, although five of them received private warnings. Disciplinary proceedings were also commenced and discontinued against one deemed licensee who left his firm before the conclusion of the action. (A person's deemed licence is effectively revoked on the day the person leaves his or her firm. Under the transitional arrangements, which came into force on 1 April 2003, the SFC has no jurisdiction to continue with disciplinary proceedings against such a person. However, the person would be required to answer the SFC's concerns about him or her if he or she re-applies for a licence or other regulatory approval.)

If you want to know more, the SFC's press releases are available at www.hksfc.org.hk.

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