SFC Enforcement Reporter

A monthly summary of SFC enforcement action

November 2003

Highlights

This is the first anniversary issue of the *Enforcement Reporter*. We kick off this issue with a special review of enforcement cases and trends. We would also like to invite you to give us feedback on this publication. You will find the mailbox details at the end of this issue.

In October, the SFC:

- **convicted three people in relation to unregistered dealing;**
- **disciplined 11 licensees;**
- **fined a person for the first time under the Securities and Futures Ordinance (SFO);**
- **imposed its first prohibition order under the SFO; and**
- **saw its decision to suspend a licensee upheld in the first hearing of the Securities and Futures Appeals Tribunal.**

Special Review

In the year since October 2002, the SFC prosecuted a range of offences relating to market manipulation, short selling, failure to disclose interests in listed companies, unlicensed dealing, illegal investment promotion, breaches of financial resources rules and failure to co-operate with the SFC by lying or not attending interviews. SFC investigations also led to a successful Police prosecution of two market manipulators and a successful Insider Dealing Tribunal inquiry which punished two insider dealers. Furthermore, the SFC bankrupted one stockbroker after intervening to shut down his business and appoint administrators owing to client asset irregularities.

A significant trend that has emerged is a substantial increase in market manipulation prosecutions. Judged against a maximum two-year jail sentence under the old regulatory regime, the lengthy sentences of 13 months and 16 months on the market manipulators in the Gay Giano case show how seriously both the courts and the SFC view such misconduct. The courts have jailed two more manipulators (3 October 2002 press release), imposed five suspended sentences and one community service order, and fined others. In total, 13 manipulators have been convicted. Under the SFO, market manipulators can expect even tougher sentences: a maximum 10 years in jail and a $10 million fine.

A trend that has re-emerged after a period of decline is a surge in unlicensed dealing. That it is the representatives, and not firms, who carry out unlicensed dealing, suggests the firm's internal controls are at fault. To safeguard the integrity of the licensing system and ensure only licensed people can carry out regulated activities, the SFC will continue to prosecute unlicensed dealers and those who aid and abet them. In addition, firms and management who acquiesce in the unlicensed dealing will face heavier disciplinary sanctions. Unlicensed dealing jeopardises both investors and market integrity, and the SFC will use the new and more effective disciplinary penalties under the SFO to crack down on the crime.

The past few months have also seen an increase in the number of firms flouting the financial resources requirements. Prudential compliance is a fundamental duty of all firms to protect client interests. Those who do not comply will face prosecution and/or disciplinary sanctions. These sanctions will be tougher and harsher under the SFO.

The SFC has lost patience with people who lie or fail to co-operate with the SFC in its investigations. This can be seen from the recent conviction of two people who refused to attend SFC interviews (30 September 2003 press release) and the recent suspensions of two licensees who lied in SFC interviews (see case summary below). Those who refuse to co-operate for unacceptable reasons or lie can expect harsh treatment.

More than six months have passed since the commencement of the SFO on 1 April 2003. We believe the market is now beginning to see the emergence of the SFC's wider and more effective range of disciplinary penalties (see case summaries for first prohibition order and first fine below). One of the SFC's priorities has been to impose tougher disciplinary penalties for serious misconduct to better protect investors, as the previous penalties simply were not a sufficient deterrent. This trend will continue. We are pleased to note the media have reported the increased penalties and hope this will help licensees take note.

The SFC has refocused its disciplinary resources as outlined in the July 2003 *Enforcement Reporter*. This has resulted in a shift to bringing more disciplinary action against substantive misconduct.

Prosecution

Don't help unregistered dealing

Mr Lam Ka Yuk pleaded guilty to acting as a dealer's representative of Dashin Securities Limited and ICEA Securities Ltd without registration with the SFC. Mr Chan Kin Hung, a former dealer's representative of Dashin and ICEA, also pleaded guilty to aiding and abetting Lam by opening securities trading accounts for clients introduced by Lam. Both were fined and ordered to pay the SFC's investigation costs.

(Press release issued on 21 October 2003)

Mr Wong Chi Ho pleaded guilty to engaging in leveraged foreign exchange trading activities without a licence. Wong was fined and ordered to pay the SFC's investigation costs.

(Press release issued on 31 October 2003)

The SFC has repeatedly reminded the market that only licensed people can carry out regulated activities. Unlicensed people who deal in securities can seriously jeopardise client assets and market integrity. Licensees who assist them will face disciplinary action and likely prosecution. Investors are reminded to check whether a person is licensed before dealing with that person. You can do a free check on our website.

Discipline

First life ban from industry for attempted theft

The SFC has banned Mr Do Yu Lun, a licensed representative until being sacked by his employer, from ever working again in the securities industry for attempting to steal $12,000 from a client. Do had tried to steal the money by writing his name and securities account number on his client's deposit slip so that the money paid by his client would be credited to his own securities account. His then employer, Phillip Securities (HK) Ltd detected Do's action and prevented it. Do also attempted to mislead the SFC during the investigation.

(Press release issued on 17 October 2003)

This is the first time the SFC has imposed a prohibition order under the SFO. It should now be clear to the market that the SFC does not want dishonest people in the industry. Had Do remained licensed, we would have also revoked his licence. All thieves and cheats can expect similar treatment and possible criminal prosecution too.

Revocation for theft and other serious misconduct

The SFC revoked the licence of Mr Li Hon Kay, a dealer's representative of HT Securities Ltd, who sold a client's shares without the client's knowledge and consent. Li misappropriated the proceeds from the sale. Li also conducted trading activities for HT Securities before the SFC had approved his accreditation to the firm. He also breached HT Securities' internal procedures regarding client accounts and failed to deposit client monies into designated trust accounts.

(Press release issued on 2 October 2003)

We will not hesitate to revoke the licences of any licensees who steal from clients. They may also be prosecuted. Even if you are no longer licensed with us, under the Securities and Futures Ordinance (SFO), we can still ban you from re-entering the industry, as seen in the above case.

SFC continues its crackdown on trading malpractices

The SFC revoked the licence of Mr Tam Siu Ki Simon, a dealer's representative of Prudence Securities Company Ltd, for rat trading. Tam had used manual cross trades between his wife's account maintained at Prudence and other client accounts to benefit his wife by denying those clients best execution in terms of time priority and execution price. Tam was also found guilty of a variety of other failures.

In a related disciplinary action, Mr Chan Sum Kiu, a former dealer's representative of Prudence who was under the supervision of Tam, was reprimanded for failing to take sufficient and reasonable steps to verify the identity of a client and establish the client's financial background, investment experience or investment strategy.

(Press releases issued on 30 October 2003)

Brokerages should vigilantly monitor manual cross trades as these are often used to conduct market manipulation or cheat clients, either of which may irreparably damage a brokerage's reputation. The SFC views rat trading extremely seriously and will take severe disciplinary action against any licensee who breaches the fundamental duty to act honestly, fairly and in the best interests of clients and the integrity of the market.

Although it may be tempting to cut corners to secure a client account, the basic requirements to check a client's identity and assess the client's financial background are necessary as the first line of defence in keeping out market manipulators and preventing money laundering activities. Those licensees who flout these requirements will be in future suspended or fined, or both.

First SFO fine imposed

Mr Richard John Patterson, a licensed representative of Citigroup Global Markets Asia Ltd, carried out dealings in securities for two months this year before the SFC approved his licence in May. Patterson was reprimanded and fined $287,372.

(Press release issued on 23 October 2003)

This is the first time the SFC has fined a licensee under the SFO. As more cases after 1 April 2003 are now under consideration, the industry is likely to see more fines. Such decisions are made in accordance with the SFC's Disciplinary Fining Guidelines.

Suspension upheld by Securities and Futures Appeals Tribunal

The Securities and Futures Appeals Tribunal upheld a decision to suspend Mr Wong Pui Hey Duncan, a responsible officer of Victory Enterprises (Investment) Ltd, for six weeks. Wong failed to put in place effective internal controls to protect Victory and its clients from financial loss. This resulted in the failure to detect misappropriation of client assets by two former dealer's representatives from June 1998 to June 2001 (see the SFC's press release about Ms Leung Fung Ling and Ms Ho Suk Jan on 15 November 2001). Wong also facilitated their misconduct by improperly arranging financial accommodation to certain of their clients' accounts, which delayed discovery of their activities. During the review hearing on 25 September 2003, the Tribunal said they could not discern any merit in Wong's application for review and dismissed his application.

(Press release issued on 20 October 2003)

The SFC welcomes the first Tribunal decision, which set clear parameters for review cases. The Tribunal made it clear that it would not interfere in an SFC decision unless it can be demonstrated that a good and cogent reason exists for doing so. Unless clear error can be demonstrated, the Tribunal is unlikely to change a decision made by the SFC. The SFC also welcomes the speed with which the Tribunal dealt with the appeal. This should give faster justice to appellants and serve to better protect the investing public.

Liars risk suspension, or worse

Mr Fan Yee Wai Richard, an employee of KGI Asia Ltd, was suspended for one year for deliberately giving the SFC false and misleading information in his interviews. In breach of KGI's internal guidelines, Fan also failed to obtain the firm's prior consent and his clients' written authorisation before placing orders for himself and a third party in three client accounts at KGI. He failed to report his trades to KGI thus exposing KGI to the risk of litigation had the orders been disputed.

(Press release issued on 17 October 2003)

The SFC suspended Mr Ho Yui Kwong Kenny's licence and his approval as a responsible officer of Quam Securities Company Ltd and Quam Futures Ltd for six months for lying during an SFC interview about an unauthorised third party trade when he was a licensed representative of BNP Paribas Peregrine Securities Ltd. The SFC also found that Ho had taken client orders on his mobile phone in breach of BNP's internal procedures.

(Press release issued on 24 October 2003)

Lying to the SFC shows a grave lack of integrity and honesty. The ramifications of such lies may delay or even deny justice for investors. The SFC views such conduct extremely seriously and will impose severe disciplinary sanctions and/or prosecute.

Be alert to suspicious transactions

The SFC suspended Mr Chan Nap Kee Joseph, accredited to Oriental Patron Asia Ltd, for four months. Chan was acting as a sponsor to the listing of a company on the Growth Enterprise Market Board when he accepted $2.8 million from the company which was paid into one of his own company's accounts. Chan also received $3 million from a friend for safekeeping. Chan then transferred the money received from the company to his friend's bank account and gave his friend's cash to representatives of a shareholder of the company. Chan had no authority from either party to make these transfers. Chan should not have accepted the payment of $2.8 million. He should have paid the money into the company's account at Oriental Patron, if he was satisfied with the source of the money. Chan also failed to have regard to the Guidance Note on the Prevention of Money Laundering then in force. In particular, he failed to make adequate enquiries as to the source and origin of the $2.8 million and $3 million, whether the transactions involving these monies were suspicious and required to be reported to the Joint Financial Intelligence Unit. Chan also negligently failed to conduct due diligence into one of the placees in the listing although he knew that this placee had received money from a director of the company.

(Press release issued on 30 October 2003)

All licensees should handle client money properly and only in accordance with client instructions. They should understand their money laundering reporting obligations. Licensees should familiarise themselves with the SFC's new Guidance Note entitled Prevention of Money Laundering and Terrorist Financing. Failure to adhere to these guidelines will result in disciplinary action.

Weak internal controls on short selling are still being found

The SFC suspended the licence of Mr Chan Wai Chow for four weeks. It reprimanded Lei Shing Hong Securities Ltd (LSH) and Ms Lau Shun King Susanna. The SFC found LSH did not have adequate internal controls and procedures to prevent and detect short selling of securities and to monitor discretionary account activities nor diligently supervise its employees. Both Chan and Lau are responsible officers of LSH. Both failed to exercise due care and diligence in discharging their duties to the standards expected of responsible officers. Chan received a heavier penalty due to his previous disciplinary record.

(Press release issued on 13 October 2003)

Short selling and unsupervised discretionary trading harms both the investing public and market integrity. Such trading is often a feature of market manipulation. Sound internal controls are vital to detect and eradicate such behaviour.

General Enforcement Statistics

Since 1 April 2003, the SFC has successfully prosecuted 36 people and disciplined 55 licensees.

Readers' Feedback

Back in November 2002, we issued the first *Enforcement Reporter*. It was part of the SFC's efforts to increase the transparency of its enforcement work and strengthen investor confidence in the SFC's determination and ability to fight market crimes and misconduct.

In particular, we created the *Enforcement Reporter* to fulfil three aims:

- to better educate investors about the types of misconduct that may arise and to allow them to identify intermediaries found to have engaged in such misconduct so investors can make decisions as to whom to deal with;
- to better educate intermediary management and legal or compliance staff about the types of misconduct that may occur in their firms and the likely penalties that may arise if problems are not addressed; and
- to increase the deterrent effect of SFC penalties through appropriate publicity.

We hope the *Enforcement Reporter* meet the above aims and has been useful to investors and licensees. Nevertheless, we would welcome your comments on how you think the *Enforcement Reporter* can be improved. Please send your comments to **enfreporter@hksfc.org.hk** .