SFC Enforcement Reporter

A monthly summary of SFC enforcement action

October 2004

Highlights

In September, the SFC:

- **successfully prosecuted two companies and 17 persons**
- **disciplined eight licensees**

Prosecution

First dual filing prosecution

Huafeng Textile International Group Ltd, a listed company on HKEx, and its director Mr Cai Yan Bo pleaded guilty to providing false and misleading information. The SFC found that, in response to an enquiry from HKEx on 23 July 2003 about untoward movements in the price and trading volume of Huafeng shares during the morning of that day, Huafeng issued an untrue announcement later in the day, stating that the board of directors of the company was not aware of any reasons for the untoward movements. In fact, Cai on 23 July 2003 sold 25.6 million Huafeng shares owned by him and other Huafeng directors, which caused the untoward price and trading volume movements. Cai received confirmation of the sale on the same day but did not disclose the sale to Huafeng until 25 July 2003. Owing to Cai's delay in disclosing the sale, Huafeng had to issue a clarification announcement dated 25 July 2003. This announcement was itself misleading and for that reason Huafeng issued a second clarification announcement dated 31 July 2003. Huafeng and Cai were fined a total of $100,000 and ordered to pay the SFC's investigation costs.

(Press release issued on 22 September 2004)

Dual filing was introduced on 1 April 2003 on the implementation of the Securities and Futures Ordinance (SFO). Dual filing establishes the SFC as the statutory regulator of listed company disclosure. All company disclosure and listing application materials are filed with both HKEx and the SFC. The SFC can exercise its enforcement powers against persons issuing false or misleading corporate information. Dual filing was introduced to enhance the quality of listed company disclosure by making clear that failure on the part of companies and their directors to keep the investing public properly informed can lead to serious legal sanctions.

Market manipulators convicted

Mr Wong Pui Ming, a former director of Ever-Long Securities Ltd, pleaded guilty to intentionally creating a false or misleading appearance of active trading in the shares of Fujikon Industrial Holdings Limited. Mr Ho Sze Man and Mr Yuen Kim Shing were also prosecuted for the same offences and they pleaded guilty too. The court found that, between 3 September and 31 October 2001, there had been unusual trading activities in the accounts of Ho and Yuen including buying and selling at the same price, buying high and selling low, and wash sales (transactions in which a person buys or sells securities without a change of beneficial ownership). Wong was given a suspended two-month custodial sentence. In addition, Wong, Ho and Yuen were fined a total of $25,000 and ordered to pay the SFC's investigation costs.

(Press releases issued on 1 and 15 September 2004)

When passing sentence, the Magistrate Mr Ian Candy stated that market manipulation was a serious offence that not only caused losses to the investing public but also damaged the image of Hong Kong as an international financial centre. He made it clear that, if Wong had been found guilty after trial, Wong would have been given an immediate three-month custodial sentence.

Cold calling is illegal

Ms Lam Suk Kuen, Mean, and Mr Lau Chun Kwok, licensed representatives of Tanrich Futures Ltd, were convicted of cold calling. The court found that between April 2003 and January 2004, Lam and Lau had made unsolicited calls inducing orders to enter into agreements for trading in futures contracts on various foreign currencies and commodities. Lam and Lau were fined a total of $12,500 and ordered to pay the SFC's investigation costs.

(Press release issued on 30 September 2004)

SFC licensees are reminded that it is a criminal offence to make an unsolicited call either to induce someone to invest in securities, futures or leveraged foreign exchange contracts, or if, as a result of the call, an agreement is reached to trade in these financial products. Cold calling is prohibited to prevent investors from being pressured into trading. The SFC has recently encountered several cases in which cold calling, accompanied by other misconduct, caused substantial losses to investors. The SFC views such conduct extremely dimly and will take severe disciplinary action and/or prosecute. See the press release issued on 27 September 2004 for more details.

Failing to co-operate with SFC investigations will be punished

Ms Xu Li pleaded guilty to failing to attend interviews with the SFC in connection with two investigations into market manipulation and short selling. Ms Wan Wai Chi, Katherine pleaded guilty to failing to attend interviews with the SFC in connection with another investigation into market manipulation. Xu and Wan were fined $40,000 and $30,000 respectively. Both were ordered to pay the SFC's investigation costs.

(Press releases issued on 8 and 30 September 2004)

People who deliberately attempt to thwart the SFC's investigations will be prosecuted. If convicted, offenders can face a maximum fine of $100,000 and six months' imprisonment. Licensees who fail to co-operate with the SFC will also be disciplined.

Short selling conviction

Mr Suen Chi Keung, a dealer's representative of Master Trademore Securities Ltd, pleaded guilty to 15 summonses in relation to short selling of securities between 17 April and 15 September 2003. He was fined a total of $75,000 and ordered to pay the SFC's investigation costs.

(Press release issued on 15 September 2004)

Section 170(1) of the SFO prohibits the sale of securities when the person does not have a presently exercisable and unconditional right to sell them. A licensee who participates in illegal short selling may face criminal prosecution and/or disciplinary action.

Offenders, aiders and abettors will be punished alike

Mr Yip Sheung Chi pleaded guilty to aiding and abetting Mr Lam Hon Wing in carrying on a business of leveraged foreign exchange trading whilst not licensed under the Leveraged Foreign Exchange Trading Ordinance. He was fined $8,000 and ordered to pay the SFC's investigation costs.

Mr Chiang Chip Man pleaded guilty to holding himself out as carrying on a business of advising on securities whilst unlicensed, and Mr Lai Dick Wai pleaded guilty to aiding and abetting Chiang in carrying on such a business. Chiang and Lai were fined a total of $10,000 and ordered to pay the SFC's investigation costs.

(Press releases issued on 1 September 2004)

The licensing system is intended to protect the public from dishonest, incompetent or financially unstable intermediaries. Unlicensed activities can harm both clients and market integrity. People engaged in or assisting others in these activities may be criminally prosecuted and/or disciplined.

Disclose your listed company interests on time or face prosecution

Summers Overseas Ltd and its director, Mr Choo Yeow Ming, pleaded guilty to failing to make initial disclosure to both HKEx and China Strategic Holdings Ltd of Summers' 5.97% interests in China Strategic on commencement of the SFO on 1 April 2003 and timely disclosure of its subsequent disposal of interests in China Strategic. Summers and Choo were fined a total of $8,000 and were ordered to pay the SFC's investigation costs.

(Press release issued on 1 September 2004)

Mr Cheung Choi Chuen pleaded guilty to failing to make initial disclosures to both HKEx and KPI Company Ltd of his 9.13% interest in KPI on commencement of the SFO. He was fined $7,000 and ordered to pay the SFC's investigation costs.

(Press release issued on 1 September 2004)

Mr Ng Kwok Kuen, the sole director of Victory Move Technology Ltd, pleaded guilty to the failure of Victory Move to make disclosure to both HKEx and GP Nano Technology Group Ltd of its initial 6.58% interests in GP on commencement of the SFO and the subsequent reduction of its interests in GP. Ng was fined $15,000 and ordered to pay the SFC's investigation costs.

(Press release issued on 22 September 2004)

Mr Yeung Ka Sing Carson pleaded guilty to failing to disclose his holdings in Cedar Base Electronic (Group) Ltd. The SFC found that on five occasions, Yeung held more than 20% of the total issued shares in Cedar Base and on 1 June 2001, he held 25%. Yeung was fined $43,000 and ordered to pay the SFC's investigation costs.

(Press release issued on 27 September 2004)

Mr Lee Shi Tat Caric pleaded guilty to failing to make initial disclosure to both HKEx and First Asia Capital Investment Ltd of his 5.79% interest in First Asia on commencement of the SFO . He was fined $3,000 and ordered to pay the SFC's investigation costs.

(Press release issued on 30 September 2004)

The disclosure of interests regime aims to increase the transparency of the stock market by better informing investors about the ownership of listed companies and the views of insiders to those companies of the companies' prospects, hence reducing the scope for insider dealing. Company officers and those with large enough interests should have systems in place to disclose what the law requires.

Discipline

Reprimand for inadequate supervision and internal control failings

The SFC severely reprimanded EAA Securities Ltd for internal control failures and reprimanded its managing director, Mr Robert Fuyuan Wu, for inadequate supervision. Wu failed to ensure adequate internal controls at EAA, in particular segregation of duties and credit controls between 2000 and 2001, which facilitated misdeeds by a former dealing director, Ms Anita So Tai Fai. The misdeeds included the conduct of unauthorised trades in clients' accounts and the dispatch of forged statements to clients. Wu left EAA's operation almost entirely to the dealing directors and the staff, without exercising sufficient reasonable supervision over them. When he became aware of large receivables in the clients' accounts in the third quarter of 2000, he accepted advice from So and another dealing director to stall collection pending a market recovery. He submitted to So's refusal for EAA to directly collect debts from her clients. In the process, Wu failed to exercise objective judgement and adequately inquire into the situation or take appropriate action. He failed to discharge his duties with due care and diligence and put EAA and its clients at financial risk. In the end, EAA had to write off bad debts of about $27.3 million.

(Press release issued on 7 September 2004)

The SFC reprimanded Infast Brokerage Ltd for failing to exercise sufficient supervision over its staff, to implement internal control measures to prevent unauthorised trades and to promptly handle a client's complaint. The SFC found that a former dealer's representative of Infast had conducted unauthorised trades on more than 200 occasions in two clients' accounts. Infast admitted that there was no system to regularly monitor the dealing activities of staff through listening to the tape recordings of clients' instructions.

(Press release issued on 8 September 2004)

The SFC reprimanded China Southern Securities (Hong Kong) Ltd (formerly known as South Capital Brokerage Limited) and Mr Cheung Tung Woon, a responsible officer of China Southern, for internal control failings. Between August 1998 and June 2001, China Southern did not have any written guidelines or policies in place. This led to a staff member breaching HKEx's Placing Guidelines For Derivative Warrants and conducting personal trades which China Southern could not monitor to prevent conflicts of interest. In addition, between May 1999 and February 2001, another account executive continued to execute trades in five of his clients' accounts when the margin call values exceeded the margin limits for prolonged periods of six to 14 months. As a result of this lax approach to credit control, the debit balances of these clients' accounts grew substantially.

(Press release issued on 14 September 2004)

The SFC reprimanded Hantec International Ltd, a licensed leveraged foreign exchange trader, which had failed to prevent unlicensed and cold calling activities by staff due to inadequate supervision. Hantec also failed to supervise adequately and diligently certain licensed representatives who held non-discretionary licences but used clients' passwords to conduct discretionary trades in those clients' accounts. Although Hantec provided training to its staff members and issued internal circulars and guidelines from time to time, the SFC found that the above problems were caused by inadequate supervision by Hantec's responsible officers and senior management over its staff members who did not comply with company policy. Hantec's delegation of supervisory duty to its team leaders was also not satisfactory as the team leaders facilitated or condoned unlicensed activities conducted by their team members.

(Press release issued on 14 September 2004)

The SFC reprimanded Hantec International Finance Group Ltd (HIFGL) (formerly known as HT Securities Ltd) following the SFC's findings that HIFGL had failed to: supervise its account executives adequately; ensure its employees were fit and proper; and put in place internal controls to detect and prevent improper conduct of account executives, etc.

(Press release issued on 14 September 2004)

A licensed corporation and its directors must closely supervise and monitor the conduct of its staff. While directors are entitled to delegate particular functions to others and trust their competence and integrity to a reasonable extent, delegation does not absolve a director from the duty to supervise the discharge of delegated functions. Weak internal controls may not only facilitate employees' misconduct and prejudice clients' interest, but also put the corporation itself at risk. Firms with poor internal controls and lax supervision will not be tolerated.

Licensee must handle client's account opening properly

Mr Chung Chi Yip, a former licensed representative of ICEA Securities Ltd, was suspended for nine weeks. The SFC found that Chung, without having met or known a client, had filled in the personal particulars of that client in the account opening forms and signed as a witness to the client's signatures and to signify that he had explained to the client the risk disclosure statement.

(Press release on 20 September 2004)

Opening an account for a client whom the licensed person has never met or known is unacceptable as this may facilitate unlawful activities and will be punished. Chung's suspension was reduced from three months to nine weeks because he co-operated by not disputing his misconduct.

General Enforcement Statistics

Since 1 April 2004, the SFC has successfully prosecuted 41 entities. Summonses were withdrawn against eight entities resulting in their acquittals and a further five entities were acquitted after trial. In the same period, the SFC disciplined 35 licensees for various regulatory breaches and entered into settlements with voluntary payments with two licensees. The SFC also took disciplinary action against nine licensees which were eventually concluded with no formal sanction imposed, although six of them received private warnings. Disciplinary proceedings were also commenced and discontinued against three deemed licensees who left their firms 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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