

Fraud and Corruption Asia Pacific Summit Keynote Address

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Opening

Thank you for inviting me here to this inaugural summit.

The program and the issues are as ever both topical and timely.

The reason, I suspect, is that fraudsters deceive not only the gullible, the greedy and the susceptible but also the prudent and the careful.

Dante personifies fraud as a monster with a scorpion's tail and the face of an honest man. We can protect ourselves against theft but how can we protect ourselves against the cunning of the apparently honest face? Who has not, at some stage, trusted and been deceived by this apparently honest face?

The point is that fraud can beat all of us. We can protect our property from theft. But we can't insure ourselves against deception.

General deterrence is not enough

The traditional enforcement approach is to identify and prosecute the wrongdoer. This is and will remain an important goal and general deterrent outcomes must remain a priority for all securities regulators, like the Securities and Futures Commission (SFC).

But general deterrence alone is not enough. Market misconduct is a special kind of fraud causing diffuse damage across a spectrum of priorities, interests and persons. Unlike the theft of valuable property, the damage caused by fraud may not even be detectable. Or if there is loss, its cause in fraud is unlikely to be discernible. And damage may well continue to impair the investment. That is why identifying the nature and extent of damage caused by fraud is a necessary component in any anti-fraud strategy.

Market misconduct

There are at least three distinctive components to market fraud.

First, market misconduct is perpetrated almost anonymously by market participants whose identities are shielded from other market participants by the automated matching systems of our exchanges. How can any person know whether they are dealing with a manipulator?



If you knew the managing director of the company was selling his shares, you might be on your guard but it is impossible to be on your guard like this in an anonymous market.

Market participants are not absolutely anonymous because regulators like the SFC have the means to identify participants and strip away the anonymity when there is reason to do so. This is important and I will come back to it in a moment.

The second distinction is the way market fraud undermines the market's distinct function as a place where reliable prices are set, a storehouse of value for savings and investments and a place upholding high standards of fairness.

Market misconduct or fraud not only prejudices these functions and impairs the confidence needed to support them but may also give rise to tangible losses to hundreds if not thousands of innocent investors.

The losses may be small and diffuse but nonetheless they are real.

The anonymity of victims is a third distinguishing feature that makes the problem of fraud in our markets an acute one.

No doubt it is also easier to perpetrate a fraud if you don't have to look your victim in the eye.

The prescription

Given the nature of market misconduct, we are deeply engaged in not only sending deterrent messages, where appropriate, but also in remedying the consequences of securities market fraud and misconduct on the well-being of the market's important functions and to protect the interests of all market participants.

This means that, in tandem with our traditional deterrent remedies, we are also actively pursuing civil sanctions to tackle not only the wrongdoer but also the consequences of the wrongdoing so that the reputation of the market as a safe and fair place and a reliable guide to price and value can be restored.

The prescription for tackling securities fraud requires broad civil and criminal remedies to identify wrongdoers, to chase down assets and proceeds wherever they may be, to identify the nature and quantify the extent of damage or loss, to identify victims, to secure remedial outcomes as well as to ensure those who perpetrate and assist in fraud and misconduct, including those who help to hide it from detection, are made to pay for the costs of rectification.

Criminal prosecution of perpetrators, where appropriate, is by no means last but it ought not to be the only measure.

The need for civil remedies is also necessary because criminal sanctions are not always available especially if perpetrators are not in the jurisdiction or cannot be brought into the jurisdiction. This is a real issue in a market as international as Hong Kong's.



All forms of misconduct

Our approach means that we are also dedicated to uprooting market misconduct in all its forms. Insider dealing is perhaps the most notorious market fraud but it is by no means the most difficult to detect and to address.

A problem for market regulators is over-concentrating resources on insider dealing rather than root and branch examination of market misconduct in all its forms, especially manipulation.

The anonymity of the market together with the subtlety of manipulative techniques can combine to mask fraud in a very convincing way and manipulation that affects prices and other market data influencing investment decisions is arguably more prevalent and more costly to participants than insider dealing.

The challenge of remedial sanctions

Our means of tackling the consequences of market fraud is in its earliest stages. We have several cases on foot. And some of them have led to what I would call technical or collateral attacks. Most of these challenges have been defeated.

The Court of Appeal unanimously ruled that the Court of First Instance, in the exercise of its civil jurisdiction, is able to determine whether a person has contravened a market misconduct provision and that the function of making these types of findings is not the sole preserve of a criminal court or the Market Misconduct Tribunal. The defendants in that case, Tiger Asia Management, a New York based hedge fund, is appealing this decision to the Court of Final Appeal. We are confident the Court of Appeal decision will be upheld.

And today, one of our earliest civil cases reached a milestone conclusion.

Hontex

In 2010, we commenced urgent action to freeze the IPO proceeds of the then recently listed Hontex International Holdings Company Limited (Hontex). Hontex, a Cayman Islands entity with a Mainland business, listed in late 2009 raising approximately \$1 billion in capital from both institutional and retail investors. It had no Hong Kong resident directors and is controlled by Taiwanese interests.

We were concerned that a number of statements made in its IPO prospectus were not true.

Our initial action led to orders freezing approximately \$832 million which derived from subscriptions to the IPO prospectus.

We then alleged the IPO prospectus included false or misleading statements and that the company's turnover, profitability and cash and cash equivalent balances were grossly overstated in the IPO prospectus. We initiated action to recover the balance and to obtain orders requiring the company to repurchase shares issued or bought by the public shareholders.



The trial started over two weeks ago and today the company conceded that its prospectus contained materially false or misleading statements. The company also acknowledged that it contravened section 298 of the Securities and Futures Ordinance (SFO). This provision prohibits the disclosure of information likely to induce a person to subscribe for or purchase shares if the information is materially false and the person knows or is reckless as to whether the information is false. It is a market misconduct provision.

The company has also agreed to pay the sum of approximately \$197 million into court so that, together with the \$832 million, there is a total of a little over \$1 billion to fund a full repurchase offer to all public shareholders – approximately 7,700 investors - at the suspension price.

This outcome, once executed and accepted by the shareholders, will effectively repair the damage caused to those shareholders who were in no position to be able to detect the false information in the prospectus for themselves and who were victims of this serious contravention by the company.

Under our remedial measures, the company will be obliged to return all of the paid up capital it received from its public shareholders as a consequence of the false statements contained in its prospectus at its last traded price.

This is a terrific outcome and demonstrates that sometimes there is an antidote to misconduct.

I wish you a successful summit.