

Bills Committee on Securities and Futures (Amendment) Bill 2011

Information on Prosecutions and Convictions of Financial Analysts relating to Release of False, Misleading or Deceptive Information

Purpose

This paper responds to Members' request made at the meeting of 17 October 2011 for information on prosecutions and convictions of financial analysts relating to release of false, misleading or deceptive information.

Regulation of Analysts

2. Analysts' conduct is regulated by the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission ("the Code"). General Principle 6 of the Code restricts conflicts of interest behaviour: *"[a] licensed or registered person should try to avoid conflicts of interest, and when they cannot be avoided, should ensure that its clients are fairly treated"*.

3. Paragraph 16 of the Code provides more detailed guidance on the conduct of analysts and their employers. It requires, among other things:

- firms that employ analysts to establish dealing policies and internal control procedures for managing any actual or potential conflicts of interest arising from personal trading by analysts;
- analysts to comply with certain trading restrictions, including prohibitions on trading contrary to outstanding recommendations and on trading during the blackout period; and
- analysts to disclose whether they have any relationship with or financial interests in the subject companies they review.

4. Analysts and their employers that breach the applicable provisions in the Code may be subject to disciplinary actions of the Securities and Futures Commission ("SFC"). Sections 194 and 196 of the Securities and Futures Ordinance ("SFO") empower the SFC to impose disciplinary sanctions on licensed and registered persons that are not fit and proper or are guilty of misconduct. These disciplinary sanctions include:

- public reprimand
- fine (up to HK\$10 million or 3 times of profit gained or loss avoided, whichever is higher);
- suspension of licence for a specified period;
- revocation of licence; and
- prohibition from returning to the securities industry for a specified period.

Recent Disciplinary Cases

5. The SFC is not aware that any financial analyst has been prosecuted under section 298 (offence of disclosure of false or misleading information inducing transactions) or section 384 (provision of false or misleading information) of the SFO. In the last few years, the SFC has disciplined a number of analysts:

First action against Wong Wing Fai Eric (August 2004)

Wong, a research analyst, was found to have made “buy” recommendations on three companies in research reports in August 2002. He purchased the shares of these companies at lower prices a few days prior to the publication of his research reports and sold these shares when the share prices increased after the publication. By frontrunning his research reports, he put himself in a conflict of interest position. The Securities and Futures Appeals Tribunal affirmed the SFC's decision to suspend his licence for 18 months.

Second action against Wong Wing Fai Eric (November 2005)

Wong was found to have put himself in a position of a conflict of interest again in late 2003 to early 2004 by trading securities which were the subject matter of the research reports he prepared. Some of his trades were contrary to the recommendations in his research reports. He was banned from re-entering the industry for five years.

Action against Pong Kwok Hung Patrick (May 2007)

Pong, a research analyst of South China Research Ltd (“South China”) was found to have placed himself in a position of conflict by: (a) purchasing securities days before he prepared a research report recommending clients to buy the same securities without disclosing his interest; and (b) buying shares days after South China issued a research report which he had prepared and in which he recommended clients to sell the same shares. He was reprimanded and fined by the SFC.

Action against Teoh Tean Chai Anthony (May 2007)

Teoh, Head of Research of South China at the relevant time, was found to have placed himself in a conflict of interest position by subscribing for securities that a South China research report had recommended, and selling the securities on their debut trading day. He also allocated the preparation of a research report to his subordinate who had a pre-existing interest in the securities, resulting in the subordinate contravening the Code. He was reprimanded and fined by the SFC.

Action against South China Research Ltd (December 2007)

South China was found to have failed to adequately enforce its staff dealing policy which resulted in two of its analysts to have failed to avoid conflicts of interest. South China entered into an agreement with the SFC and undertook to engage an independent audit firm to carry out an internal control review within three years of the agreement. South China also agreed to be suspended for a minimum of three months if it was found to have committed similar failures within three years.

Action against Chau Shuk Man Emilie (October 2011)

Chau, a research analyst, was found to have failed to avoid conflicts of interest. From May 2006 to September 2007, she failed to disclose her financial interests in two listed corporations that were the subjects of 19 research reports prepared by her. She also dealt in the securities of listed corporations that were the subjects of research reports prepared by her within the dealing blackout period imposed on analysts by the Code. She was banned from re-entering the industry for two years.

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