Application No. 2 of 2004

IN THE SECURITIES AND FUTURES APPEALS TRIBUNAL

IN THE MATTER OF a Decision made by the Securities and Futures Commission under section 194(1) of the Securities and Futures Ordinance, Cap. 571

AND IN THE MATTER of section 217 of the Securities and Futures Ordinance, Cap. 571

BETWEEN

PACIFIC SUN INVESTMENT MANAGEMENT (HONG KONG) LIMITED	1st Applicant
ANDREW PIETER MANTEL	2nd Applicant
and	
SECURITIES AND FUTURES COMMISSION	Respondent

Tribunal: Hon Mr Justice Stone, Chairman

Mr David Sun, Member

Mr K K Tse, Member

Date of Hearing: 2 June 2004

Date of Determination: 31 July 2004

DETERMINATION

The Applications

1. This are applications by Pacific Sun Investment (HK) Limited, the 1st applicant, and by Andrew Mantel, the 2nd applicant, whereby this tribunal is asked to review the decision of the respondent, the Securities and Futures Commission ('SFC') dated 26 January 2004 whereby (i) the 1st applicant's licence to carry on business in Type 4 (advising on securities) and Type 9 (asset management) regulated activities under the Securities and Futures Ordinance was revoked; and (ii) the 2nd applicant's licence and approval to act as Representative of and Responsible Officer of the 1st applicant under the Securities and Futures Ordinance was revoked.

2. The licence revocation was imposed by the SFC as the result of the finding that the 1st applicant was guilty of misconduct and was no longer fit and proper to remain licensed under the SFO by reason of breaches by Pacific Sun of the Securities and Futures (Financial Resources) Rules ('FRR'), and further was consequent upon the finding that, as the "directing mind of Pacific Sun" at the

time of these FRR breaches, the company's failures in this regard were attributable to Mr Mantel, and that therefore he personally was guilty of misconduct and was no longer fit and proper to remain licensed under the SFO.

The Background

3. These applications have engendered a certain amount of heat. There is some history.

4. The 1st and 2nd applicants were first registered with the SFC as Investment Advisers under the Securities Ordinance in May 2000, and are now deemed to be licensed persons under the SFO.

5. This is *not* the first occasion on which Pacific Sun and Mr Mantel have been subject to disciplinary action taken by the SFC concerning failure to comply with financial resources requirements.

(i) Earlier disciplinary action

6. On 15 February 2002 Letters of Mindedness were issued to the applicants wherein the SFC stated its contention that there had been a breach of the rules relating to the submission of audited annual accounts for the year ended 31 December 2000, that there

had been a failure to comply with section 8 of the FRR then applicable under the Securities and Futures Commission Ordinance, in that there had been a failure to comply with the minimum 'net tangible assets' position of HK$500,000, that there had been late notification of the inability to meet such minimum position, and that in addition there had been a failure to maintain proper records sufficient readily to establish whether there had been sufficient compliance with the FRR then in force.

7. On 15 May 2002 the SFC found that these allegations had been established on the part of Pacific Sun, and that Mr Mantel had failed to ensure the necessary compliance. As a result, the SFC revoked the respective registrations of both the 1st and 2nd applicants as Investment Advisers.

8. This decision to revoke the licences of Mr Mantel and Pacific Sun resulted in an appeal to the forerunner to this tribunal, the Securities and Futures Appeals Panel, in June 2002.

9. By its written Decision, dated 4 December 2002, the Panel varied the decision of the SFC, and substituted a public reprimand in respect of the breaches in question, and held that there was to be no revocation of the applicants' registrations if they

complied with the FRR requirements within 8 weeks of the date of the SFAP decision. In February 2003 the 1st applicant gave notice of its compliance consequent upon a capital injection of HK$500,000.00.

10. This earlier appeal effectively had been the subject of a compromise between the parties. The written Decision of the Panel recites that during the hearing that the appellants had confirmed breaches of the Rules cited in the SFC Notice of Decision, and that in turn the SFC had confirmed that the risks caused by the breaches in issue were less significant than those of a securities dealer, that apart from the breaches the appellants would otherwise be fit and proper persons for registration, that the appeals had been adjourned by consent for the appellants to remedy the non-compliance, and that if such was remedied and there was compliance with further conditions, that the SFC "would not oppose" the appeals.

11. After the conclusion of this appeal process, by letter dated 23 December 2002 the SFC moved to impose a number of conditions upon the continuing registration under the Securities Ordinance of Pacific Sun as an Investment Adviser. Principal among these was that not only should Pacific Sun engage an

external professional firm for the purpose of monitoring ongoing compliance with FRR requirements and accounting requirements, but that from the week commencing 17 February 2003 Pacific Sun should submit a weekly report prepared by the professional firm thus engaged upon the weekly computation of the Net Tangible Assets and whether it was aware of instances of infringement of FRR rules.

12. With the coming into force on 1 April 2003 of the Securities and Futures Ordinance there was a statutory change to FRR requirements. Henceforth a corporation licensed to carry on business in Type 4 and Type 9 regulated activities which did not receive or hold client assets was required to maintain liquid capital of not less than HK$100,000.00, or 5% of its liabilities, whichever was higher. A six month grace period, until 1 October 2003, was extended to such entities, including Pacific Sun, in order to comply with this capital requirement.

(ii) The present disciplinary proceedings

13. The weekly reports which were submitted by Pacific Sun showed that its liquid capital had been in deficit since May 2003, and that in September 2003 this deficit went as high as HK$174,157.

14. From late August 2003 the SFC brought to the attention of Mr Mantel that Pacific Sun's financial position did *not* meet the new capital liquidity requirement, and made written requests that Pacific Sun rectify the deficiency.

15. The weekly liquid capital reports submitted by Pacific Sun's accountant for the month of October 2003 showed that it had failed to meet the minimum liquid capital requirement throughout that month, and that the capital deficiency in question amounted to HK$130,770.

16. As a consequence, the SFC told Pacific Sun that unless it rectified this deficiency it was intended to issue a restriction notice prohibiting it from carrying on business, a demand that shortly thereafter produced compliance.

17. By letters dated 25 November 2003 from the SFC, disciplinary action was proposed against the applicants. These letters set out the grounds for concern, including the relevant history and the reasons for the proposed revocation of the applicants' licences, which centered upon the failure of Pacific Sun to maintain the required level of liquid capital in breach of section

6 of the FRR, and to comply with the regulator's request forthwith to rectify such breach.

18. By letter dated 29 December 2003 Mr Mantel responded to the SFC. He made a number of points, in particular that from October 2003 onwards Pacific Sun in fact did maintain the required level of liquid capital – an assertion based upon the restatement of certain expenses incurred by the company on behalf of the funds it was advising, which expenses would now be borne by the funds – and that since March 2003 Pacific Sun had complied with the weekly reporting requirement, and that it was clear from those reports that Pacific Sun's financial position had been satisfactory and in fact was in the course of substantially improving due to a significant investment in the funds which in turn would secure management fee income for about two years. He noted that assets in the funds under management had grown to approximately US$30 million, that it was essential for an investment adviser of a China fund to be based in Hong Kong, and that if the licences were to be revoked this would have "major negative consequences" arising from the necessity to relocate.

(iii) The present SFC decision

19. By Notices of Final Decision, dated 26 January 2004 the SFC, after considering the representations, formally found that Pacific Sun, and Mr Mantel as the directing mind thereof, had failed to maintain the required level of liquid capital in accordance with section 6 of the FRR, had failed to comply with the request of the SFC of 10 October 2003 to forthwith rectify the breach, and had failed to notify the SFC in writing giving the reason for the FRR breach and the steps taken to rectify the deficiency.

20. Consequent upon these findings the SFC concluded that failure to comply with FRR requirements also constituted a breach of the Code of Conduct for Persons Licensed by or Registered with the SFC, and that such repeated breaches and continuous failures called into question Pacific Sun's fitness and properness to remain licensed by calling into question its financial status or solvency; its further conclusion was that Mr Mantel, as the sole Responsible Officer of Pacific Sun, had failed to discharge his duty and responsibility to ensure Pacific Sun's compliance with the FRR, which in turn was a breach of the Code of Conduct, and called into question his fitness and properness to remain licensed, by calling into question his financial integrity, reputation, character and reliability.

21. The penalties of revocation of the licence of Pacific Sun under section 194 of the SFO to carry on business in regulated activities, together with revocation of the licence of Mr Mantel as a licensed representative and revocation of the approval in respect of Mr Mantel as a responsible officer under the SFO, are strongly contested.

22. On 17 February 2004 the applicants herein lodged with this tribunal their application for review of these decisions. Hence these proceedings.

The Argument

23. At the outset Mr Pascutto, appearing on behalf of Pacific Sun and Mr Mantel, informed the tribunal that as the result of information which had just come to light, he was in a position to demonstrate that there in fact had been no breach. However, this line of argument ultimately was not pursued given that this would have necessitated an adjournment for the SFC to consider such new case, a prospect Mr Pascutto wished to avoid, and accordingly these applications proceeded, in effect, as a plea in mitigation.

24. At bottom, the essence of Mr Pascutto's submission was that all this was much ado about nothing. Never in his 25 year experience, he said – he reminded the tribunal of his former position as Deputy Chairman of the SFC – had he come across anything as draconian as the penalty of license revocation for such a relatively minor offence. He asserted that this was the equivalent of a capital penalty for a parking ticket, and declared that no reasonable regulator could have come to the conclusion which had been arrived at by the SFC.

25. Once the subsequent accounting adjustments had been completed to the accounts for the relevant date it could be demonstrated that in fact there had been no substantive breach of the FRR, he submitted, and his clients, the 1st and 2nd applicants, were clearly 'fit and proper' persons who had acted honestly and openly and had sought to co-operate with the SFC. A fair consideration of the mitigating factors, he said, should have led to the conclusion that but a minimal penalty, if any, was justified, that the penalty as imposed was inconsistent with prior decisions of the SFC, and that the revocation as pronounced was not in the best interests of Hong Kong as a financial centre.

26. During his wide-ranging submission Mr Pascutto went so far as to question the good faith of the SFC, noting that the assertion in the Decisions that this temporary FRR breach for a small amount of money by an investment advisor holding no client funds constituted "a serious threat to the public interest and to market integrity" was not based upon any evidence and constituted "a misrepresentation of the true facts".

27. For the SFC, Mr Roger Beresford was unmoved by this litany of complaint.

28. He maintained that on the evidence the SFC were perfectly entitled to find misconduct. It was indisputable, he said, that Pacific Sun did not at all times maintain the requisite level of liquid capital in contravention of section 6 of the FRR rules, and a subsequent receipt, represented by an accounting adjustment, could not and did not affect that proposition. Moreover, this misconduct clearly was intentional or reckless. The applicants had been warned by the SFAP during the earlier appeal, and had expressly been warned by the SFC on several occasions during the six month grace period prior to 1 October 2003.

29. No steps had been taken to redress the deficiency, said Mr Beresford, until the SFC had given notice of 3 November 2003 of its intent to issue a restriction notice, and it was clear, he submitted, that no effort had been made to give notice under section 146 of the Securities and Futures Ordinance, Cap 571 and section 54 of the FRR to provide details of the deficiency, the reasons for such, and of any steps that were being taken to remedy the situation. Nor had there been any cessation of regulated activities whilst in breach, as required by section 146(1)(b), Cap 571, and Mr Beresford maintained that it was obvious, in terms of liquid capital deficiency, that the applicants had had the mindset to "brazen it out" pending receipt of additional income which would rectify the situation.

30. In these circumstances, counsel submitted, this tribunal should not hesitate to dismiss these applications for review. Against the background of previous disciplinary action for the like offence the applicants blatantly had refused to comply with what were minimal liquid capital requirements, and had chosen to treat with disdain the fundamental importance of such requirements within the regulatory scheme.

Decision

31. Few cases can have provoked such dramatic divergence of view. There is no middle ground. On the one hand the applicants argue for the setting aside of the SFC decision, and the substitution of an order allowing these applications, with costs to be awarded to the applicants on a solicitor and own client basis; on the other the regulator seeks confirmation of the licence revocations, with an order for costs in its favour.

32. Whom, then, is right? The short answer, it seems to us, is neither.

33. We have little sympathy with the high-profile attack made on behalf of the applicants against the SFC, and in particular the imputation of lack of good faith on the part of the regulator, an imputation which seems to us to be unwarranted. Nor, if we may say so, have we been attracted during the submissions on behalf of the applicants by a tone bordering upon righteous indignation.

34. The hard point and inescapable point is that this was a *repeat* offence in terms of the statutory capital liquidity requirement – and under the recently amended FRR a significantly less demanding requirement at that – and we reject the notion,

given the history of these applicants, that this infraction simply should have been laughed off and accorded minimal regulatory attention.

35. We bear in mind, also, that little effort appears to have been made to avoid the liquid capital deficiency at the expiry of the six month grace period, notwithstanding repeated warnings from the SFC, and it has been difficult to avoid the impression that the infraction as did occur evinced little concern.

36. In this connection we feel obliged to observe that Mr Mantel, whom at Mr Pascutto's insistence was permitted to give evidence, signally failed to make a good impression upon this tribunal. Some degree of apparent contrition, we should have thought, would have been advisable in these circumstances of a repeat offence, but we saw and heard little to convince us that Mr Mantel either appreciated the importance of the statutory requirements at issue, nor that he was particularly exercised about that which had transpired.

37. We do not wish to be unfair, but we further register surprise, in light of the previous infraction, that at the time Mr Mantel did not see fit to take every possible step to ensure that this

relatively modest liquidity requirement was met, and could be seen by the regulator to be met, after receipt of the SFC warnings that repeatedly were given.

38. This said, we nevertheless have formed the view that this licence revocation is a penalty too far, and that it should be varied by this tribunal. We appreciate, given the particular history of these applicants, that the SFC perhaps felt themselves constrained given that which had gone before: having handed down the like penalty of revocation upon the first occasion of breach, no doubt it was particularly uninviting to be seen to impose a lesser penalty on the second. We assume, also, that this was the reason for the rejection by the SFC of the documented efforts made by and on behalf of the applicants to compromise this matter, and to submit themselves to a substantially lesser penalty.

39. Be that as it may. There is no requirement upon the SFC to effect a compromise, sensible though this may be in the vast majority of cases, and the regulator is entitled to seek to uphold its position upon review.

40. This tribunal, albeit differently constituted, has previously stated that it is unlikely to be persuaded to interfere

with a decision of the regulator operating in its specialist field save in those instances wherein the tribunal is satisfied that something clearly has gone wrong, in principle or fact, which would merit variation of the judgment of the professional entity charged with overseeing market behaviour and compliance with statutory remit.

41. We have concluded that the present case indeed represents such an instance in which interference is justified. Even factoring in the history and record of these applicants, we have difficulty in accepting that a full licence revocation nevertheless is appropriate in the circumstances of this case, and consider that the existing penalty is excessively severe and ought not to be permitted to stand. In reaching our decision, we have carefully considered all the matters placed before us, and we attach weight, also, to the fact that, under the terms of the amending legislation, the legislature has seen fit specifically to reduce this capital liquidity requirement very significantly for entities which, as in the present case, do *not* hold client funds. Had the position been otherwise, and had the breaches in question concerned capital liquidity requirements relevant to the holding of client assets, we apprehend that our reaction to the case would have been very different.

42. This, then, begs the question as to what should be the appropriate penalty for this repeat offence, a question which the tribunal posed to Mr Pascutto at the outset of the hearing of this application. It is fair to record that this question produced no real assistance from either side.

43. Mr Pascutto noted that whilst it was true that his clients had been willing to enter into a compromise at an earlier stage, solely for the purpose of placing this incident behind them, now that they had had to come to this tribunal their position was that the existing decision should be quashed, with costs, given that his clients already had "suffered enough" as the result of this whole incident. For his part Mr Beresford, no doubt upon instructions, sought to uphold the existing sentence and suggested no alternative course. Both sides thus remained entrenched in their respective positions.

44. After extended reflection upon the circumstances of what is an unusual and possibly unique case, wherein little if any assistance is to be garnered from existing decisions, this tribunal has decided to vary the decision of the SFC, and to substitute therefor an order that there be a suspension of the licences both of Pacific Sun and Mr Mantel for a period of one month, such

suspension to take effect 14 days after the date of this Determination, and further to order that Pacific Sun and Mr Mantel are each to be fined the sum of HK$50,000, payment thereof to be made within 14 days of the date of this Determination.

45. We are constrained also to state that should there be a third such offence involving breach of FRR by either Pacific Sun or Mr Mantel, we think it unlikely to say the least that any renewed plea in mitigation would be met with any form of sympathetic response on the part of this tribunal.

46. Although the penalty initially imposed by the regulator has been varied, this remains a case which the applicants peculiarly have brought upon themselves, and a case moreover in which neither side has succeeded in its contentions. In these circumstances we are not minded to make any provision for costs, and we make an order *nisi* that there is to be no order as to the costs of this application. Each side will therefore bear its own costs.

Hon Mr Justice Stone	David Sun	K K Tse
(Chairman)	(Member)	(Member)

Mr Ermanno Pascutto, of Messrs. Troutman Sanders, Solicitors for the Applicant

Mr Roger Beresford, instructed by the Securities and Futures Commission, for the Respondent