Application No. 3 of 2008

IN THE SECURITIES AND FUTURES APPEALS TRIBUNAL

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

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

BETWEEN

RADLAND INTERNATIONAL LIMITED — Applicant

and

SECURITIES AND FUTURES COMMISSION — Respondent

Tribunal: Hon Mr Justice Stone, Chairman

Date of Hearing: 10 July 2008

Date of Determination: 10 July 2008

Date of Reasons for Determination: 7 August 2008

REASONS FOR DETERMINATION

The application for review

1. By a Notice of Application for Review dated 27 March 2008, the applicant broker, Radland International Ltd ('Radland') applied for review of the decision of the Securities and Futures Commission ('SFC') as was contained in its Notice of Final Decision dated 26 February 2008.

2. The genesis of this application was that by letter dated 30 August 2007 the SFC had written to Radland giving Notice of Proposed Disciplinary Action under section 194 of the Securities and Futures Ordinance ('SFO'), wherein it was proposed (at paragraph 39 thereof) that Radland be publicly reprimanded and fined a sum of HK$1.5 million pursuant to sections 194(1)(iii) and 194(2) of the SFO.

3. On 11 October 2007, Radland's solicitors, Messrs Richards Butler, sent to the SFC Radland's representations in response to the Notice of Proposed Disciplinary Action, and on 26 February 2008 the SFC responded by letter of that date giving its Notice of Decision – which was to maintain the penalty as originally proposed by the regulator.

4. Radland was and is aggrieved by this Final Decision – hence this application, which, by consent, was heard by this Tribunal, consisting of the Chairman sitting alone, on 10 July 2008.

5. Immediately at the end of that hearing, with the exception of very minor variations made by consent to the Press Release which the SFC had intended to issue, Radland's application for review was dismissed, for reasons to be given, with the costs of and occasioned by the application ordered to be paid by the applicant, such costs to be taxed if not agreed.

6. It is these Reasons which I now give.

The factual background

7. The relevant facts are in relatively brief compass.

8. During the period between 1998 and 2006, two staff members of Radland's Central office –another office was situated in North Point – namely, one Leung Moon Tong and one Ma Ching Ning, misappropriated client securities in an amount exceeding HK$6.8 million.

9. Leung was the manager of the Central office, and was responsible for handling client orders, settlement, and general oversight of daily brokerage operations, whilst Ma was a settlement clerk who co-operated with Leung in this ongoing fraudulent conduct.

10. This Radland Central office nominally was supervised by one Lam Pun Tcheng, one of three directors of Radland, and one of that firm's two Responsible Officers.

11. Mr Lam was a gentleman of relatively advanced age, and at the time of the dishonest employee conduct with which this review was concerned he was, I understand, in his late seventies or early eighties; originally he had been the owner and sole proprietor of his own brokerage, which he had sold to Radland in or about September 1994, but he had remained with the new owner in the Central office in a consultative, and purportedly supervisory, capacity.

12. In fact the representations made by Radland to the SFC indicated that after completion of the Share Sale Agreement it had been the joint intention of Radland and of Mr Lam that the latter would solely be responsible for carrying on and managing the securities brokerage business at the Central office; it was further averred that Lam was highly experienced in securities broking, and that Radland had relied upon his knowledge and experience in managing the Central office.

13. Notwithstanding the presence in the office of Mr Lam, the fraudulent scheme which was operated by Leung, the office manager, and by Ma, the settlement clerk, worked in the following manner. After a client had purchased securities, Radland's computer records were manipulated to allocate such purchase to the account of Leung's daughter; thereafter, Leung

sold the securities, Radland issued a cheque to the daughter for the sale proceeds, and if the client who was the real owner of these shares, as now misappropriated, wished to sell them, Leung and Ma would allocate a like parcel of shares from another client account to cover for the missing client shares. Leung apparently kept a handwritten list of his 'allocation' of shares, and after manipulating the computer records, fictitious statements were sent to affected clients.

14. This fraud was perpetrated for a period of some 8 years until it was discovered, at which stage Radland reported the situation to the regulator, and an investigation commenced, culminating in certain SFC findings which, in the view of the regulator, bespoke serious failings within Radland's internal controls, and a conspicuous lack of supervision.

15. The list of Radland's failures is set out in full in the relevant documentation consequent upon this investigation.

16. Overall, the SFC found that these events revealed that Radland had been responsible for failings in six specific areas: failing to segregate the duties of the front and back offices to avoid conflict of interests, failure diligently to supervise its employees, failing to establish policies and procedures to ensure proper security of computer data, failing to put in place adequate internal controls to prevent and to detect account executives' misconduct, failing to establish policies and procedures to ensure verification of the true and full identity of the account holder, and failing to

safeguard clients' assets – in each instance the regulator quoting chapter and verse to Radland in terms of breach of the relevant provision of the Code of Conduct or of the Internal Control Guidelines.

Radland's response to the SFC

17. Consequent upon the regulator's summary of its initial findings and proposed penalties within its Notice of Proposed Disciplinary Action of 30 August 2007, Radland responded with lengthy submissions of 11 October 2007, the thrust of which was that the SFC should in the circumstances withdraw all its allegations *in toto*.

18. These submissions speak for themselves. For present purposes it suffices to note that the issues as therein raised encompassed the burden and standard of proof, the applicability of regulatory guidelines, the language of the interviews, fairness and natural justice, and the regulator's dealings with independent experts.

19. It was further asserted that it was "inappropriate and inequitable" for the regulator to discipline Radland unless and until the relevant allegations had been the subject of disciplinary action against Lam, a view rejected by the SFC, whose view was that Radland, in the capacity of licensed person, "should be ultimately responsible for the acts and omissions of your staff in the course of performing your business functions."

20. Nor did the contention that the control systems at Radland's North Point office were more stringent than those at the Central office, and thus the speculation that the internal control systems at North Point "would not have allowed the fraudulent activities of Leung and Ma to have gone undetected" cut any ice with the SFC, the regulator pointing out that the matters complained of happened at the Central Branch: "the controls there are the issue, not those elsewhere".

21. Accordingly, by its Notice of Decision and Statement of Reasons of 26 February 2008, the SFC noted (at paragraph 57) that its views as initially formed regarding Radland's failings "remained unchanged", and thereafter concluded that Radland had been "guilty of misconduct for the purposes of section 194 of the SFO", a conclusion that also called into question Radland's fitness and properness to remain licensed.

22. Consequent upon this decision, therefore, the SFC imposed the penalty upon Radland of which complaint now is made in this review, namely that of a public reprimand and a fine of HK$1.5 million.

23. At the same time as the SFC communicated its Final Decision, it also sent to Radland within the same enclosure a Press Release which was intended to be issued and to be placed on the SFC website, unless an application for review was mounted within due time.

24. The wording of this Press Release – which represents the form of the SFC public reprimand of Radland in this case – also has come under scrutiny, and has been the subject of submission during the hearing of this review.

Ambit of the argument

25. At the hearing of this review the Tribunal had the considerable advantage of the parties respectively being represented by counsel experienced and well-versed in regulatory matters: for the applicant, Mr Jonathan Harris SC, and for the SFC, Mr Laurence Li.

26. On behalf of Radland, Mr Harris, in a succinct and thoughtful presentation, made his position clear at the outset.

27. His case was that in this review there was to be no challenge to liability, and that the applicant sought to review the SFC decision as to penalty only. This hearing thus took the form solely of a plea in mitigation.

28. In this context Mr Harris suggested that the fine imposed of HK$1.5 million was, in the circumstances, “manifestly excessive”, and that the proposed public reprimand, as manifested within the terms of the proposed Press Release, was inappropriate and misleading because it inaccurately described the reason why the misappropriation of client assets within the Radland Central office had been possible, namely, the suggestion

as made that this had been due to a failure adequately to separate front and back office operations.

29. As to the quantum of the fine to be levied, leading counsel referred to a Schedule attached to his skeleton argument which summarized fines imposed by the regulator in that which were said to be essentially similar cases, and Mr Harris submitted that, in light of the lack of any prior disciplinary history on the part of the applicant, there was no apparent reason for the imposition of a fine which was "substantially greater" than that imposed in prior like cases.

30. With regard to the particular wording of the reprimand, Mr Harris proposed certain variations to the Press Release as intended to be issued; in this connection he stressed that the variations proposed made no attempt to downplay the seriousness of that which had occurred, but nevertheless sought to rectify the statement, viewed by his client as misleading and incorrect, to the effect that the misappropriations had been the result of a failure to segregate front and back office functions. There was, he said, no evidence to suggest that the losses had arisen from a *lacuna* within the applicant's administrative procedures; to the contrary, the real problem had been that in a small office, which clearly was not closely supervised by Mr Lam – the elderly former owner whom at the time was nominally in charge – it had become possible for the fraud to pass undetected for a considerable period, and that as long as Ma, the settlement clerk, had been willing to assist Leung, the manager, in his fraudulent and

fictitious transactions, “it mattered not” whether there was an administrative structure which would clearly have distinguished between front and back office functions.

31. In this regard, Mr Harris made reference to the witness statement of one Chan Shek Wah, which statement had been put in by consent, and upon which cross-examination was not required, in which the dimensions of this small office were described, as was the fact that when everyone in the office was present there were only five staff, so that if it were possible, as apparently it was, to operate brokerages of this dimension, it would, he said, always remain possible for frauds of the type that now had arisen to occur.

32. Accordingly, Mr Harris sought an order that the Decision of the SFC be varied in terms that the fine of HK$1.5 million be reduced to HK$500,000, and that the wording of the Press Release evidencing the public reprimand be amended in accordance with the applicant’s proposed draft.

33. For the regulator, Mr Li was unmoved by these arguments.

34. The thrust of his persuasive submission was that, in terms of the quantum of the fine considered appropriate by the regulator, as a matter of fundamental principle the SFC can, and indeed should, be able to determine the appropriate level of fine in each case after taking into account the

particular circumstances and the wider regulatory environment, and that the SFC should not be 'hamstrung' by precedent by being placed in a position of being unable adequately to respond to prevailing market conditions should it see fit so to do: and in this case the view of the SFC unequivocally was that current market conditions – taken together with the particular circumstances of this case – more than served to justify the level of the fine now imposed upon Radland, a fine which did *not* justify the soubriquet "manifestly excessive".

35. As to Radland's contentions as to the wording of the proposed Press Release, whereby the brokerage wished, through its proposed amendments, to delete all reference to 'internal control failures', Mr Li contended that Radland's argument mischaracterized the issue which, he said, was not that which singularly had caused the misappropriation, but that which had facilitated the misappropriation of client securities, and that it was not open to an intermediary in the position of Radland to rely upon personal supervision alone without putting in place internal controls, and thereafter, as appeared now to be the case, to seek to place the blame upon Mr Lam's failure of supervision at the same time as denying the failure of internal controls.

36. Accordingly, Mr Li argued, on the present facts Leung's dual involvement both in handling client orders and in the settlement process clearly had played a significant part in the misappropriation, indeed, it had 'facilitated' such fraudulent activity, which was precisely the word which

had been used in the intended Press Release of which the applicant now made complaint.

37. Nor, said Mr Li, was the emphasis which had been placed in argument, and in evidence, upon the small size of Radland's office in Central other than a 'smokescreen'. What had occurred was that Radland had purchased Mr Lam's existing business, and had expanded it by opening another office in North Point, leaving Mr Lam to continue to run his 'old' business in Central – but this patently did not excuse the approach which seemed to underpin the present application, which was that Radland should not be penalized in this manner because the small Central office *de facto* had remained Mr Lam's "separate domain", and thus that which had occurred predominantly was Mr Lam's responsibility.

38. As Radland had accepted, he said, it was at all times open to that company to have combined the two offices' systems, thus segregating the front office function of handling client orders, which would remain the remit of account executives, and the back office function of settlement, which thus would have become centralized; in fact, observed Mr Li, ironically it was the eventual decision precisely to combine the two offices's systems – not hitherto done because of internal dissent – which had led to the discovery, in December 2005, of the defalcations of Messrs Leung and Ma.

39. Accordingly, Mr Li asked that Radland's application be dismissed.

Determination

40. Consequent upon that which was admirably brief and incisive argument by counsel on each side of the bar table, this Tribunal had little difficulty in forming the view that this application should be dismissed.

41. Thus, save for minor changes suggested by the Tribunal to the wording of the intended Press Release – amendments to which Mr Li readily acceded on behalf of the SFC – such dismissal was ordered immediately upon the conclusion of counsels' submissions.

42. In the Tribunal's view, the minor alterations as suggested to the wording of the Press Release, which seemed to the Tribunal to be appropriate in this instance, were relatively insignificant, in fact in substance little more than cosmetic, and, whilst no doubt welcomed by Mr Harris, did *not* meet his client's primary concern in terms of the deletion of any reference to failure to segregate front and back office functions, to which failure specific reference remained on the face of the document as amended.

43. In this connection, on the facts of this case I saw no reason to accede to the applicant's argument, and I agree with Mr Li's argument that the higher risk of collusion in a small office, such at the Radland Central office, served not only to heighten the need for better supervision but also

for clearer, and better defined, internal controls in terms of segregation of 'front office' and 'back office' functions. It seemed to me, therefore, that the manifest failure of supervision, and the failure of internal controls, in this instance necessarily went hand-in-hand.

44. As matters transpired, with Mr Li's acceptance of the suggested changes to the intended Release, there was no necessity for this Tribunal finally to decide upon the issue of its jurisdiction to order any such alterations to this document, which had been an issue upon which counsel on both sides had made submissions at the specific invitation of the Tribunal.

45. In this connection Mr Harris had argued that an order to pay a pecuniary penalty and to issue a public reprimand pursuant to section 194(1)(b)(iii) of the SFO fell within the rubric of a "specified decision" which may be reviewed by the SFAT pursuant to section 216(1) of the SFO, which lays down that the Tribunal has jurisdiction to "review specified decisions, and to hear and determine any question or issue arising out of or in connection with any review…" – thus, he said, just as a decision to impose a fine of a particular level can be reviewed, so may a decision to issue a reprimand in particular terms; if this were not to be the case, Mr Harris concluded, it would follow that the decision to issue a reprimand in specific terms would and could be challenged only by means of judicial review, which would be curious given that the SFAT statutorily had been established specifically to review disciplinary decisions of the regulator.

46. For his part Mr Li took a different view. His point was that when it came to the issue of a public reprimand the reviewable decision was the decision to reprimand, and this did not necessarily involve a Press Release: it could, for example, take another form entirely, such as a circular sent to the securities industry, or a digital posting on the SFC's website. Nor, he said, was there any standard form of such Release, if indeed this was chosen as the mode of placing any reprimand into the public domain.

47. In other words, said Mr Li, the Press Release, if that be the chosen mode of communication both with the market and the investing public in terms of the imposition and issuance of any public reprimand, followed and did not precede this sanction, and thus any Press Release did not form part of the 'specified decision' which the applicant for review desired to have reviewed – and thus, *qua* Press Release, it was not reviewable by the SFAT.

48. This was an interesting debate which for present purposes I do not have to decide, although I am inclined to the view that Mr Li's analysis is correct, and that the Tribunal has no power to order the regulator to issue a Press Release and nor, for that matter, to issue a Press Release in any given form.

49. However, almost certainly this represented a purely hypothetical discussion, given that, on behalf of the regulator, Mr Li was happy to accommodate the minor changes to the proposed Press Release

which the Tribunal had suggested – indeed, as Mr Li pointed out, the issue of jurisdiction aside, as a matter of practical politics it was extremely unlikely that *if* the SFAT took exception to, and/or expressed a view as to the desirability of framing an issue in a certain manner in the context of a public reprimand, that the SFC would be minded to disregard the express view of the Tribunal, and to continue with a Press Release which the SFAT considered to be inappropriate and/or incorrect on its face.

50. Accordingly at the end of the day the issue of jurisdiction is probably no more than an interesting conceptual argument, with no real practical ramification.

51. Clearly, however, it was the issue of the quantum of the fine which was the driver of this application for review; in this regard Mr Li may well have been correct in his surmise that the issue of the wording of the Press Release had been raised primarily to lend substance/gravitas to the first and primary ground of appeal, which was to argue for a reduction in the fine as imposed by the regulator upon Radland.

52. For my part, I did not consider that the fine levied on Radland was in any sense ‘out of whack’, to adopt the useful, if somewhat colloquial, phrase often utilized by this Tribunal, and thus to justify interference on the part of the SFAT.

53. As statutory successor to the former Securities and Futures Appeal Panel, this Tribunal has now been established well in excess of five years, and practitioners within the ever-burgeoning area of securities' law by now will be tolerably familiar with the guiding principles which the SFAT has sought to establish since its creation by the Securities and Futures Ordinance.

54. That the SFC, as the market regulator, should be permitted to regulate the market as it professionally sees fit is, I trust, by now accepted as a given – indeed, that is its statutory mandate, assuming always that such regulation is conducted *intra vires* the SFC powers, and in good faith.

55. It follows inexorably from this that the SFAT will *not* interfere *unless* it is convinced, for example, that the regulator has acted outwith its statutory powers, or oppressively, or that in its disciplinary decision-making it has taken into account matters which it should not, or that it has not taken into account matters which should have been placed within the relevant discretionary 'mix' – or that, in the most general descriptive sense, it can be established that something clearly has gone badly wrong in terms of any specific disciplinary action.

56. In its published decisions over the past 5 years the SFAT has time and again emphasized that it does not exist in order to 'second-guess' the regulator by attempting to impose its own (frequently uneducated) view of what should, or should not, take place within any particular market

activity – viewed thus, the SFAT is not in any sense to be regarded by applicants for review as an 'alternative regulator', or as a 'regulator of last resort', but represents an arbiter of fundamental fairness within the context of regulatory disciplinary decision-making, no more and no less, the Tribunal being minded to interfere with any particular regulatory disciplinary decision *only if and when* it is clear that something obviously has gone wrong, and thus requires to be rectified.

57. It has also frequently been made clear, as a matter of primary philosophy, that the SFAT does *not* regard its function as that of forming an independent view as to what is, or is not, happening in the market at any given time. It simply is in no position to know. Formation of such a view must lie within the purview of the market regulator, which professionally oversees the infinite variety of securities' market practices upon a daily basis, and chooses to act in regulating those practices on the basis of its published regulatory guidelines, and at all times in a manner perceived to be in the best interest of maintaining the fundamental integrity of the markets.

58. The view taken by this Tribunal as to the justice, or injustice, of any particular fine levied by the regulator upon a market participant such as Radland, the present applicant, must therefore take place against this conceptual backdrop, and notwithstanding the usual persuasiveness with which Mr Harris invested his argument, I was wholly unconvinced that any basis for interference had been established by the applicant in this case.

59. Mr Harris mounted his argument in the only way that logically was open to him, in the form of putting together a schedule of fines imposed in allegedly analogous cases, and complaining that when viewed in this light his client had been unfairly and excessively financially penalized: up to the present, Mr Harris said, the highest fine that he had been able to locate as recorded for this type of infraction was HK$800,000, and the present figure imposed of HK$1.5 million was almost double that, and thus could not be justified upon the basis of past practice. No doubt he expressed the point rather more elegantly, but that at any rate was the thrust of his argument.

60. In my view this did not suffice to get him home, for the following reasons.

61. First, I accepted Mr Li's immediate riposte that prevailing market conditions served to justify the higher fine in the instant case, and that misappropriation of client assets had become a serious problem in recent years: to this end he produced an annex to his skeleton argument intituled 'Misappropriation Cases from 2006 to the Present' which listed 12 instances (including that of Radland, the subject of the present review) wherein firms and/or individuals therein had been disciplined for misappropriation, and wherein punishments had varied from individual life bans from the industry and the appointment of administrators of defaulting brokerage firms to public reprimands and fines.

62. True it was, he said, that the present fine of HK$1.5 million was higher than in the other two instances of fine and reprimand, namely, Hang Tai Securities [$800,000 plus public reprimand, on 23 October 2007] and Lucky Securities Ltd [HK$470,000 plus public reprimand, on 22 February 2007], but these cases clearly were distinguishable on their facts in that the loss to clients had been less, the period of misappropriation was less, the clients had been compensated, and in any event the Hang Tai case had been a settlement case, also a significant factor.

63. Second, I also accepted the proposition advanced by Mr Li that the SFC is not in any sense fettered by past decisions based upon differing facts, and that if it can be shown that a certain form of conduct (such as client asset misappropriation) is becoming more widespread, it was and is open to the regulator to set a higher tariff for such behaviour, and that the SFC was *not* in any sense hidebound by precedent, and thus unable to respond to prevailing market conditions.

64. In this regard Mr Li cited the earlier decision of the SFAT in *Kwok Wai Shun v. SFC, SFAT No 3 of 2004,* Determination dated 11 June 2004, wherein the Tribunal in that case, consisting of the Chairman and two lay members, had stated (at paragraph 23):

> *"Absent clear error, it is no part of this tribunal's function to substitute another view for that of the regulator which, seized with all the relevant facts of a particular case, has exercised its professional judgment on the appropriate penalty for a particular market infraction occurring at a particular time. Whilst it is clearly desirable to attempt to maintain consistency of treatment in like disciplinary situations, it cannot be the case, as Mr Tse came*

> *perilously close to suggesting, at least by necessary implication, that the regulator is in a sense 'hamstrung' by precedent, and thus is unable to respond to prevailing market conditions by subsequently adopting a different disciplinary approach towards types of market misconduct."*

I see no reason today to differ from this earlier view, expressed fully some 4 years ago.

65. In this connection Mr Li further drew the attention of the Tribunal to two SFC publications which have been disseminated within the market, namely *'Disciplinary Fining Guidelines'*, gazetted on 28 February 2003, and its in-house publication *'Disciplinary Proceedings at a Glance'*, dated September 2005, wherein it is emphasized that one of the factors for determining the level of penalty in a particular case is "whether the conduct is widespread in the industry", and that "if the misconduct has become widespread or prevalent in the market, [the SFC] may impose a heavier penalty than in the past."

66. Third, and finally in terms of the reasons underpinning the decision to dismiss this application, is the fact that, on any basis, this is a case in which the facts demonstrate a serious level of neglect and defalcation over a substantial period of time: as counsel for the regulator has pointed out, the client asset misappropriation in this case represented a pattern of conduct which lasted for 8 years without detection, that the loss to clients exceeded the sum of HK$6.8 million, and that, last but not least, the clients thus far remain *un*compensated – unlike the situation in the other two cases cited by the applicant, wherein the firms in question had compensated their clients.

67. Accordingly, it was for the matters outlined in these Reasons that this Tribunal saw fit immediately to dismiss the application, save for minor amendments to the press release, which, as earlier noted, were amendments effected consensually by the SFC upon the Tribunal indicating its view.

68. In light of the fact that this application had failed virtually *in toto*, Mr Harris sensibly did not seriously dispute that the costs of and occasioned by this application were to be paid by the applicant to the SFC, such costs to be taxed if not agreed, and the Tribunal accordingly so ordered.

Hon Mr Justice Stone
(Chairman)

Mr Jonathan Harris SC, instructed by Messrs Richards Butler, for the Applicant

Mr Laurence Li, instructed by the SFC, for the Respondent