

Application No. 8 of 2006

**IN THE SECURITIES AND FUTURES APPEALS TRIBUNAL**

IN THE MATTER OF a Decision made  
by the Securities and Futures  
Commission under 36 of the  
Commodities Trading Ordinance,  
Cap. 250 and 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

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BETWEEN

LEUNG WING

Applicant

And

SECURITIES AND FUTURES COMMISSION

Respondent  
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Tribunal: Hon Mr Justice Stone, Chairman

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Date of Hearing: 22 August 2006

Date of Determination: 25 April 2007  
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## DETERMINATION

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### *The application*

1. This is an application by Ms Leung Wing to review the decision of the SFC, the respondent herein, dated 24 April 2006, whereby her dealer's representative licence was ordered to be suspended for a period of 4 months and 1 week.
2. The applicant initially was registered as a dealer's representative under the now-repealed Commodities Trading Ordinance, and was accredited to Tanrich Futures Limited ('Tanrich') in July 2000.
3. Since 1 April 2003 she has been licensed as a representative in Type 2 regulated activity under the Securities and Futures Ordinance, Cap 571 ('SFO'), and since May 2004 she has been accredited to Sun Hung Kai Commodities Ltd.
4. The matters with which this case is concerned, and which formed the focus of the disciplinary action taken by the SFC against Ms Leung, took place when she was in the employment of Tanrich.
5. With the express consent of the parties, this review has been conducted by a Tribunal consisting of the Chairman sitting alone, pursuant to the power contained within section 31, Schedule 8, of the SFO.

*The procedural background*

6. On 16 January 2006 the respondent issued the applicant with a Notice of Proposed Disciplinary Action in which it was proposed to suspend the applicant's licence for a period of 5 months for the actions complained of, and giving the applicant an opportunity to be heard.

7. In response, Ms Leung submitted her representations on 28 February 2006, therein admitting in part to the failures alleged by the SFC.

8. Having considered her representations, the SFC gave credit to Ms Leung's admission to two out of the four failures alleged against her, and on 24 April 2006 issued Ms Leung with a Notice of Decision to suspend her licence as a representative for 4 months and 1 week pursuant to the SFC's powers under section 36 of the Commodities Trading Ordinance ('CTO') (which remained exercisable after 1 April 2003 pursuant to section 64 of Part 1 of Schedule 10 of the SFO), and under section 194 of the SFO.

9. Ms Leung is aggrieved at this decision, hence these proceedings.

*The facts*

10. This is not a complex case, nor has it been fought on all fronts.

11. The matters of which the SFC instituted disciplinary action against Ms Leung took place during the period when she was employed by Tanrich, which was the first firm she joined in June 2000 when she became employed in the securities industry in Hong Kong.

12. More specifically, the matters of which complaint was made related to Ms Leung's conduct as an account executive with reference to her client, one Mr Wong Chi Yuen, who had opened an account with Tanrich on 18 August 2003 in order to trade futures contracts.

13. In fact, Mr Wong had been approached by Ms Leung, as a licensed representative of Tanrich, by unsolicited 'cold call'; in this connection on 1 December 2005 Ms Leung subsequently pleaded guilty at Eastern Magistracy to one summons for contravention of section 174 of the Securities and Futures Ordinance.

14. But this is to get ahead of the story, and, in any event, this element of the SFC complaint is not a matter which Ms Leung seeks to dispute at the hearing of this review.

15. It seems that after opening his Tanrich account, Mr Wong conducted a number of futures trading transactions, in the course of which he was advised by Ms Leung.

16. It is said by the SFC that in this connection Ms Leung had advised Mr Wong to employ a trading practice known as 'locking', which is the simultaneous holding of equal long and short positions of the same futures contract for the same contract month; it is said that Ms Leung had advised this an acceptable method of 'freezing' trading losses, in contradistinction actually to closing out a position, which would thereby have crystallized any such loss.

17. Mr Wong, the client, ultimately suffered trading losses, and complained of such to the SFC, which duly investigated his complaint.

18. After considering his evidence, one of the matters to which the SFC took exception was the practice of 'locking',

notwithstanding that Ms Leung apparently considered this to be an acceptable method of risk management, and in due course the SFC mounted the allegation against Ms Leung to the effect that in so advising the 'locking' of positions that Ms Leung had failed to give her client reasonable investment advice.

19. In fact, this constituted but one head of 4 allegations of misconduct levelled against Ms Leung by the SFC, which in its letter of 16 January 2006 informed Ms Leung that pursuant to section 36 of the CTO and section 194 of the SFO it was inquiring as to whether she had been guilty of misconduct or whether she was a fit and proper person to be registered or licensed.

20. After receiving Ms Leung's representations in her letter of 28 February 2006 on the matters thereby raised, by its Notice of Final Decision and Statement of Reasons dated 24 April 2006, the SFC found that on the information available it had concluded that Ms Leung indeed had been guilty of misconduct and was not a fit and proper person to remain licensed in that she:

- (i) had breached the legal prohibition against cold calling;
- (ii) had failed to make proper declarations of her interests in related accounts;
- (iii) had failed to give reasonable advice to her clients; and
- (iv) had failed to exercise due care, skill and diligence in the performance of her duties as licensed representative.

21. After considering Ms Leung's representations as to both substance and penalty the final decision was that Ms Leung should be suspended for a period of *4 months and 1 week* for the four matters of which complaint had been found to be substantiated.

*The ambit of this application*

22. In mounting this application for review of this SFC decision, Ms Leung, who was unrepresented and appeared in person, did *not* seek to disturb the SFC findings at (i) and (ii) above, namely in relation to ‘cold calling’ and in relation to her failure to properly declare interests in related accounts.

23. Ms Leung had admitted these two elements of the charge in her representations to the SFC by letter dated 28 February 2006, and she made it clear to the Tribunal that she did not attempt to resile from this position, and that the main thrust of her argument upon this application was that she had been unfairly treated by the SFC in terms of the allegation, at (iii) above, to the effect that she had failed to give reasonable advice, and to the consequent conclusion, at (iv) above, that she had failed to exercise due care and skill in the performance of her duties as a licensed representative.

24. The case she put forward is that the latter two counts should be set aside by the Tribunal, and that, in terms of the outstanding counts (i) and (ii), a period of suspension of 4 months and 1 week was excessive, and should be replaced by a maximum suspension of 2 months.

25. In substance, therefore, the scope of argument in this review was whether it could be said that the allegation of failing to give reasonable investment advice could be substantiated in the circumstances revealed on the evidence; parallel with this is the submission that, if the application to review the ‘failure to give reasonable advice’ count was to be successful, the penalty imposed in terms of the *admitted* infractions itself is sought to be reviewed.

26. As to the evidence before the Tribunal, this took the form solely of the assembled papers; no *viva voce* evidence was called.

*The argument*

27. It was clear that Ms Leung took strong exception to the allegation that in her dealings with her client, Mr Wong, whose complaint had precipitated the present case, that she had failed to give reasonable advice.

28. Ms Leung disputed that the concept of 'locking' was wrong or inappropriate to her client's interests.

29. She observed that there were no regulations promulgated by the SFC which stated that giving a 'locking' recommendation was not in the interests of investors and amounted to failure to offer reasonable investment advice; in this connection she asserted that there was investment literature stating that such a strategy was a means to fix investment risk, and that as such she had followed the instructions of her employer, Tanrich, in giving clients 'locking' advice as an alternative to executing a 'stop loss' order and to finally closing out a particular trading position.

30. Ms Leung's representations to the SFC had denied that she had failed to give reasonable investment advice.

31. She told the Tribunal that not only had she followed Tanrich's instructions in terms of 'locking' advice as an alternative to executing a stop-loss order by closing a position, but she had explained to Mr Wong, her client, the advantages/disadvantages of 'locking', that this had involved taking a new trading position, and that there were required transaction costs, and that the difference between closing out and 'locking' was that the latter may enable the client to continue with the same size of leveraged trading without having to make additional margin deposits.

32. In addition, she represented, Mr Wong was both educated and highly numerate, an actuary graduate and a managing director, and an experienced investor; he had been aware of the 'locked' positions in his account and about the transaction costs involved; in this regard Ms Leung had maintained that Mr Wong's statements to the SFC had not been reliable and in fact were deceptive.

33. In substance, therefore, Ms Leung had complained to the SFC that in considering matters the regulator had failed to carefully consider her representations, she had trusted the instructions of her employer as to the viability of the 'locking' device, and that there were no clear regulatory guidelines as to 'locking' and thus, as to what constituted reasonable investment advice.

34. Admittedly, she had argued, 'locking' might have the effect of over-leveraging a position, but investors generally, and certainly Mr Wong, had understood that futures trading was highly risky and had geared up their trading in the hope of greater returns; in this regard she had said that Mr Wong had chosen to 'lock' as opposed to closing out his losing positions because he had intended to continue trading the same number of contracts without investing further funds, and that it was highly unfair for Mr Wong to have alleged that she had failed adequately to explain 'locking' when he had chosen to maximize his available funds, and had suffered increased trading losses as a result.

35. For the SFC Ms Jenny Chung submitted that as a matter of principle the SFC's decision should stand unless it could clearly be shown to be wrong.

36. On the issue of 'locking' *per se*, Ms Chung strongly criticized the practice. She pointed out that unlike closing out a position, 'locking' treats the two equal but opposite positions as two outstanding positions which artificially unrealize the profit or



loss, as the case may be, and that to put in place a pair of ‘locked’ positions did not change the fact that the trading loss was incurred and that such loss was permanently fixed once the ‘locked’ positions were in place.

37. She contended that to assert that ‘locking’ can be used to avoid margin calls is fallacious, and that the argument that holds that it is better to ‘lock’ instead of to close out provides the investor with a bigger chance to recover trading losses because a bigger number of contracts can be traded was wrong in principle, and that if the use of ‘locking’ was intended to enable an investor to circumvent margin requirements, and thus to leverage their trading in excess of what should be permitted, was neither in the interests of investors nor of market integrity.

38. Ms Chung actually went so far as to assert that ‘locking’ was a “trick” employed to induce investors to continue with an artificially inflated trading volume arising from the deferring of the realization of trading losses, the point being that by thus encouraging the practice representatives and their employers were “enriched” by higher commission returns at the expense of investors.

39. Accordingly, she argued, it was reasonable for the SFC to conclude, as it had in this case, that ‘locking’ is generally not advisable unless there is “good cause” for so doing, and that, as she put it, it was “harmful to insufficiently sophisticated investors as it perpetuates a misleading impression by artificially delaying the realization of their losses, when realization of their losses might prompt a more realistic assessment of the wisdom of continuing to trade so heavily or at all”.

40. She said that it was reasonable for Mr Wong to have acted on Ms Leung’s investment advice, and that it was clear that Mr

Wong had taken the applicant's 'locking' suggestion as a trading recommendation.

41. Ms Chung further contended that the fact that there were no regulatory 'guidelines' for 'locking' was no excuse for Ms Leung's failure to give reasonable investment advice, and that whether or not there should be some form of legal or regulatory sanction against the process was "not an issue for this review".

42. Accordingly, she asked that this review be dismissed.

### *Decision*

43. This case has generated a degree of reflection.

44. I have not found it satisfactory that the Tribunal has not had the benefit of seeing anyone in the witness box, so that what is occurring, as a matter of practical politics, is that the Tribunal is being asked to assess this case solely against the backdrop of the assessment earlier made by the SFC in its interviews with the original complainant, that is, the client Mr Wong, and the applicant herein, Ms Leung.

45. The gravamen of the 'locking' case advanced against Ms Leung, with its consequent conclusion as to her alleged failure to give reasonable investment advice, appears to be that whilst Mr Wong never denied knowing about the 'locked transactions', nevertheless he had not appreciated, or had had made plain to him, the financial effects of 'locking'.

46. I find this a little difficult to accept at face value; this was in no sense 'widow and orphan' investing, but apparently was an educated investor punting on the futures markets. Ms Leung is adamant in her contention that she had explained the alternative courses of closing out and of 'locking' to Mr Wong, and that in so

doing she had not hidden or distorted anything. I make this point because I can see no evidence or other indication of the alleged “trick”, with its overtones of dishonesty, to which Ms Chung expressly referred in her submission.

47. I also note, as appears undisputed, that not only did Mr Wong choose to ‘lock’ as opposed to closing out a loss-making position, but that he appears specifically to have opted for the latter for in order to achieve a certain trading flexibility.

48. Ms Leung says in her submission that Mr Wong had told her, in terms, that “it would be a pity if topping up of deposit was required at a certain price but he was forced to close out his position because his funds were momentarily held up, [and] he asked what he could do if he did not want to close out the position”, and that as a consequence she had outlined the ‘locking’ procedure, an alternative procedure which in fact was elected for by Mr Wong. I interpret this to mean that in his particular circumstances Mr Wong perceived a potential personal financial advantage enuring to him by reason of having the option to ‘lock’ rather than immediately to close out his losing position, and I see no reason why this should not have been taken at face value, and why Mr Wong’s protests (after the losses) appear to have been accepted, and acted upon by the SFC, at the expense of Ms Leung’s account of the situation as it had transpired with her client. As I have indicated, it would have assisted the Tribunal greatly if both these persons had given evidence, but this did not opportunity did not occur, and in these circumstances the Tribunal simply must do the best that it can on that which the Tribunal perceives as the inherent probabilities.

49. Ms Leung also observed that Mr Wong had chosen to lock the position on two quite separate occasions, and had never indicated that he had not understood or had been dissatisfied with that approach, particularly since there was a month gap between

the initial 'locking' (on 2 October 2003) and the second incident of such (on 6 November 2003).

50. Presumably, also, it cannot be gainsaid as a matter of fact that during the transaction process the brokerage had sent Mr Wong four monthly statements and four statements of account, which set out his positions and the fees and charges, so that it is difficult to maintain that Mr Wong had not been aware of the financial implications of that which was happening, including the further margin calls generated by the trading volume he apparently was able to maintain.

51. In these circumstances I consider this time-line to be revealing, and in itself not indicative of a situation of an investor being faced with unreasonable or manifestly inappropriate advice.

52. At the end of the day, in weighing the merits of this application I also give weight to two matters in particular:

*first*, that there is something in Ms Leung's suggestion that in its judgment in terms of the allegation of unreasonable investment advice that the SFC view comes close to a 'heads I win, tails you lose' stance, and that, in effect, the conclusion drawn as to Ms Leung's alleged failure to give reasonable investment advice depends in substantial part upon that much desired investment aid, hindsight, which by definition is never wrong; had, for example, Mr Wong subsequently been successful, because the futures market had moved in his favour, and he had been able to take advantage of the increased trading volume apparently facilitated by virtue of the 'locked' position than would have been the case if he had simply closed the existing losing position, doubtless he would have considered Ms Leung's proffered 'locking' option to have been highly advantageous, and no complaint subsequently would have been forthcoming;

*second*, and perhaps more significant, it seems to me that if indeed the concept of ‘locking’ is as inappropriate and/or as incorrect a practice as the SFC now would have it, it is surprising that the regulator has not taken steps to outlaw it, or at the very least to make it explicit to market participants that this practice will not be tolerated save in exceptional circumstances (whatever such may be specified to be). Ms Leung has submitted that her employer, Tanrich, had been using as standard practice the method of ‘locking’ positions for more than a decade, and it appears not in dispute that at the time of the ‘offence’ the subject of this review that the SFC had *not* issued to licensees any guidelines on the practice of ‘locking trading positions’; apparently it was not until March 2005, that is, well after the matters presently in question, that on the SFC website there appears a statement (far from any form of prohibition) to the effect that “clients should think twice before locking a position”, and Ms Leung notes that this site pointedly does *not* say that so advising a client to ‘lock’ in itself represents an act of reckless disregard for investor/market interests.

53. I am disinclined to overlook this aspect of the matter, and I am bound to say that I disagree with Ms Chung’s assertion that absence of regulatory sanction is something which is not relevant to this review; to the contrary, in my view this is an aspect which clearly is germane, and must reflect, in some part at least, upon any evaluation as to whether a licensee can be said to have failed to offer his client reasonable advice.

54. At the end of the day, of course, it must be recognized that the concept of ‘failure to give reasonable investment advice’, together with its concomitant of lack of fitness and properness, is necessarily a difficult notion practically to administer in terms of the fair and just regulation of the market and market participants, which obviously is the benchmark to which the SFC aspires.

55. I have found this to be a difficult case in the particular circumstances. Having said that, however, I am left with the uneasy feeling that the SFC decision to the effect that Ms Leung indeed was responsible for such failure to give reasonable investment advice to her client, Mr Wong, by reason of her advice as to the availability of this 'locking' option, ultimately is a conclusion which is *not* well-founded, not least given in the absence of any prohibitory regulatory guideline or regulation regarding the invocation of such strategy, and notwithstanding the *post facto* criticisms that Ms Chung has now so persuasively espoused on behalf of the SFC.

56. If the SFC *qua* regulator takes such exception to this practice, it should inform the market in terms; yet, at the time of Ms Leung's alleged offence, this view does not appear to have been promulgated in any form by the regulator, and in this regard I am bound to say that in this regard I do not accept that general duties within the Code of Conduct will suffice, which was one of Ms Chung's submissions.

57. Accordingly, having reached this conclusion on such evidence as is available before the Tribunal, and Ms Leung having established to my satisfaction that I should disturb the SFC decision (iii) as found against her, namely, that Ms Leung had failed to give reasonable investment advice, this is a decision which in these circumstances in my judgment should not be permitted to stand, and thus it follows that this particular decision is to be quashed and set aside.

58. I so order.

59. It must follow, also, that SFC decisions (i) and (ii), as outlined in paragraph 20 above, have not been challenged and must remain place, as must also decision (iv), which remains by virtue

of the matters which the applicant herein, Ms Leung, has chosen not to contest on this review.

*The issue of sentence*

60. The original sentence the SFC was minded to hand down upon Ms Leung was a period of 5 months suspension, this being reduced to 4 months and 1 week consequent upon Ms Leung's representations to the regulator in response to the Letter of Mindedness.

61. The position now had further changed, given that the decision of this Tribunal now is to quash the SFC decision in terms of her alleged failure to give reasonable investment advice.

62. What therefore is the appropriate sentence of that which is undisputed against Ms Leung?

63. For her part Ms Leung maintains, both in her representation to the SFC and to this Tribunal, that her sentence for that which remains should be reduced to 2 months only.

64. On behalf of the SFC Ms Chung says that in any event, and whatever the result, the 'cold calling' charge alone – which is admitted – merits 3 months suspension.

65. This is not an area in which this Tribunal can claim particular expertise. Doing the best that I can, it seems to me that in light of this judgment, and the quashing of the count relating to failure to give reasonable investment advice, and after factoring in the initial starting point of 5 months suspension, as subsequently reduced, that the fairest result in the circumstances is that the period of suspension to which Ms Leung now is to be subject is to be varied from 4 months 1 week to a period of *nine calendar weeks*, such period of suspension to commence, absent agreement to the

contrary between the SFC and Ms Leung, upon the day following publication of this Determination.

66. I so order.

67. As to costs, Ms Leung is, of course, unrepresented, and I make an order *nisi*, which order is to become absolute unless subject to written objection within 21 days from the date of this determination, that there is to be no order as to costs.

Hon Mr Justice Stone  
(Chairman)

Ms Leung Wing, Applicant, in person

Ms Jenny Chung, of the Securities & Futures Commission, for the  
Respondent