

## SFC reprimands and fines Chang Chyi

6 Jan 2017

The Securities and Futures Commission (SFC) has reprimanded and fined Mr Chang Chyi, an employee of Core Pacific – Yamaichi International (HK) Limited (Core Pacific), \$50,000 for breach of the SFC’s Code of Conduct (Notes 1 & 2).

The SFC’s investigation into suspected uncovered short selling of the shares of China Agri-Products Exchange Limited (China Agri-Products) found that Chang had incorrectly represented to a customer that shares allocated by China Agri-Products through a rights issue could be sold before 4:00pm on 21 March 2014 without violating the short selling restriction under section 170 of the Securities and Futures Ordinance, when in fact, that was not the case (Notes 3 & 4).

Relying on Chang’s misrepresentation, the customer placed an order to sell 320,000 rights shares and bonus shares on 21 March 2014 before 4:00pm, which were subject to conditions until 4:00pm that day and could not be sold at that time.

The SFC considers it is important that all licensed representatives understand the short selling restriction because short selling may carry serious consequences for the uncovered short seller.

Chang did not have an adequate understanding of the short selling restriction and had failed to take reasonable steps to verify the date on which the relevant rights issue would become unconditional.

In deciding the sanction, the SFC considers that Chang’s misconduct had subjected the customer to legal and regulatory risks and fell short of the standard expected of a licensed representative under the Code of Conduct (Notes 5, 6 & 7).

End

Notes:

1. Code of Conduct for Persons Licensed by or Registered with the SFC (Code of Conduct).
2. Chang is licensed under the Securities and Futures Ordinance (SFO) to carry on Type 1 (dealing in securities) and Type 2 (dealing in futures contracts) regulated activities. He is accredited to Core Pacific – Yamaichi International (HK) Limited for Type 1 regulated activity and Core Pacific – Yamaichi Futures (HK) Limited for Type 2 regulated activity.
3. Section 170(1) of the SFO provides that a person shall not sell securities at or through a recognised stock market unless at the time he sells the securities, he or his principal has, or believes and has reasonable grounds to believe that he or his principal has, a presently exercisable and unconditional right to vest the securities in the purchaser of them. Illegal short selling is a criminal offence which carries a maximum penalty of \$100,000 fine and two years’ imprisonment upon conviction.
4. Paragraph 7 of the Guidance Note on Short Selling Reporting and Stock Lending Record Keeping Requirements (published in 2003) sets out, amongst other things, an agent’s responsibility under section 170 of the SFO. Where a person is acting as an agent for a seller, ie the agent receives a sell order from his principal for execution or for passing onwards for execution, the agent should know or believe and have reasonable grounds to believe that his principal has a presently exercisable and unconditional right to vest the securities in the purchaser of them. An agent seller should either know that the principal has the securities or if not, he should seek a confirmation from the principal as to whether the principal owns the securities that are being sold. Where the principal confirms that he owns the securities, the agent will have complied with his obligations under section 170 of the SFO.
5. General Principle 2 of the Code of Conduct provides that a licensed person should act with due skill, care and diligence in conducting business activities.
6. Paragraph 2.1 of the Code of Conduct provides that where a licensed or registered person advises or acts on behalf of a client, it should ensure that any representations made and information provided to the client are accurate and not misleading.
7. Paragraph 3.4 of the Code of Conduct further provides that when providing advice to a client a licensed person should act diligently and carefully in providing the advice and ensure that its advice and recommendations are based on thorough analysis and take into account available alternatives.

[A copy of the Statement of Disciplinary Action is available on the SFC website](#)

## STATEMENT OF DISCIPLINARY ACTION

### The Disciplinary Action

1. The Securities and Futures Commission (**SFC**) has publicly reprimanded Mr Chang Chyi (**Chang**) and fined him \$50,000 pursuant to section 194 of the Securities and Futures Ordinance (**SFO**)<sup>1</sup>.
2. The SFC conducted an investigation into suspected short selling of the shares of China Agri-Products Exchange Limited (stock code: 149) (**Company**). The SFC found that Chang made an incorrect representation to a customer. Chang told the customer that shares allocated to the customer by the Company through a rights issue could be sold before 4:00pm on 21 March 2014 without violating the short selling restriction under section 170 of the SFO, when in fact, that was not the case.
3. Chang's misconduct fell short of the standards set out in General Principle 2, paragraphs 2.1 and 3.4 of the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission.

### Summary of Facts

4. On 19 December 2013, the Company announced, amongst other things, a proposal to effect a capital reorganization (**Capital Reorganisation**) of its issued share capital which included a proposed share consolidation (**Share Consolidation**) whereby every 40 shares of nominal value of \$0.01 each in the Company's issued share capital would be consolidated into one share of nominal value of \$0.40 (**Consolidated Share**).
5. The Company also proposed to raise proceeds by way of a rights issue (**Rights Issue**) by allotting and issuing rights shares (**Rights Shares**) at the subscription price of \$0.465 each, on the basis of 15 Rights Shares for every 1 Consolidated Share held on the record date of 21 February 2014. The Rights Issue was conditional on, amongst other things, the Capital Reorganisation becoming effective.
6. Subject to the satisfaction of the conditions of the Rights Issue, bonus shares (**Bonus Shares**) would be issued on the basis of one Bonus Share for every 15 Rights Shares taken up under the Rights Issue<sup>2</sup>. Qualifying shareholders are entitled to apply for any unsold entitlements (ie, excess Rights Shares) of the excluded shareholders and any Rights Shares provisionally allotted but not accepted by the qualifying shareholders.
7. On 22 January 2014, the Company issued an announcement which set out an expected timetable for, amongst other things, the Capital Reorganisation, the Rights Issue and the Bonus Issue. The timetable informed the investors of the

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<sup>1</sup> At the material time, Chang was licensed as a representative accredited to Core Pacific-Yamaichi International (HK) Limited (**Core Pacific**) and Core Pacific-Yamaichi Futures (HK) Limited to carry on Type 1 and Type 2 regulated activities respectively under the SFO.

<sup>2</sup> To qualify for the Rights Issue and the Bonus Issue, a shareholder must be registered as a member of the Company and not be an excluded shareholder on 21 February 2014.

dates of the different stages including the latest time for the Rights Issue to become unconditional was 4pm on 21 March 2014.

8. There were different ways a person could be entitled to the Rights Shares (and corresponding Bonus Shares). One way was through buying nil-paid Rights Shares. For those investors who bought nil-paid Rights Shares, before the Rights Issue became unconditional, these investors were entitled to the Rights Shares (and corresponding Bonus Shares) on a provisional basis only. Once the Rights Issue became unconditional, the investors would have assured entitlement. Accordingly, such investors would only have sufficient grounds to believe that they had a right, title or interest in the Rights Shares if the investor sold their Rights Shares after the Rights Issue became unconditional. In other words, the short selling restriction under section 170 of the SFO prohibited any person from selling Rights Shares before 4pm on 21 March 2014.
9. At the relevant time, Chang's job responsibilities included servicing client accounts of Core Pacific, taking orders from clients and placing their orders for execution.
10. On 12 March 2014, Chang's customer (**Customer**) bought 300,000 nil paid Rights Shares (and as a result, was also provisionally entitled to 20,000 Bonus Shares).
11. Chang represented to the Customer on 21 March 2014 that the 320,000 Rights and Bonus Shares that the Customer was provisionally entitled to could be sold before 4:00pm on 21 March 2014 without violating the short selling restrictions under section 170 of the SFO. He apparently thought that the relevant short selling restrictions would not be violated if the Customer was able to deliver the shares on the settlement date. However, the applicable short selling restriction applied at the moment when the shares were being sold and not at the time when the shares were settled. Chang admitted that firstly, he did not know that the Rights Issue only became unconditional after 4pm on 21 March 2014 and secondly, he was careless and made a mistake.

## **Conclusion**

12. Chang should not have just assumed that if the Customer received the shares in time to deliver them for settlement, the Customer would be entitled to sell the shares on 21 March 2014 before 4pm. He failed to take reasonable steps to verify the date on which the Rights Issue would become unconditional before advising the Customer.
13. The SFC considers the sanction of a public reprimand and a fine of \$50,000 is commensurate with the gravity of Chang's misconduct after taking into account all relevant circumstances.