

**IN THE SECURITIES AND FUTURES APPEALS TRIBUNAL**

IN THE MATTER OF a Decision made  
by the Securities and Futures  
Commission Ordinance 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

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BETWEEN

PRUDENTIAL BROKERAGE LIMITED

1<sup>st</sup> Applicant

Mr. LAU SHING NGON

2<sup>nd</sup> Applicant

And

SECURITIES AND FUTURES COMMISSION

Respondent

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Tribunal: Hon Mr Justice Stone, Chairman

Mr. James Wilson Baird, Member

Ms. KO Yuk Yin, Teresa, Member

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Date of Hearing: 30 March 2006

Date of Determination: 19 April 2006  
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**DETERMINATION**  
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*The application*

1. This is an application for review by Prudential Brokerage Limited ('Prudential'), and by its responsible officer, Mr Lau Shing Ngon, of two decisions of the SFC, by Notices of Final Decision dated 6 December 2005, whereby the SFC decided to publicly reprimand both applicants, and to impose a fine upon the applicants of the sums of HK\$95,000 and HK\$45,000 respectively.
  
2. On 28 December 2005 the applicants applied to this Tribunal for review of these disciplinary sanctions by way of Notice of Application for Review under section 217 of the Securities and Futures Ordinance, Cap 571.
  
3. This is the Determination upon that review.

*The factual background*

4. The disciplinary action issued by the SFC arose in consequence of the trading activities with Prudential of one Sonia Cheung.

5. Miss Cheung had opened an account with Prudential on 28 January 2004, and had commenced trading through that brokerage.

6. Miss Cheung's complaint to the SFC centered upon one trade which took place on 1 March 2004.

7. This was the purchase of 500,000 #9283 warrants at the price of \$0.385 which she claimed was unauthorized. This was not a profitable trade; the price dropped precipitately, and Miss Cheung ultimately suffered significant loss on her open position, which Prudential eventually closed on 22 March 2004. There is some dispute about whether she should have been advised at an earlier stage to cut her position, and hence to mitigate her loss, but in the context of this review nothing turns upon this.

8. Consequent upon this unsuccessful trade there was a series of telephone calls and meetings between Miss Cheung and officials of Prudential, in particular the General Manager, Mr Chan

Wai Chuen, which appear to have been instituted by Prudential primarily in an endeavour to ascertain when and how Miss Cheung would be able to settle her brokerage account, which as the result of this trade substantially was in deficit.

9. Once again the details do not greatly matter. Suffice to say that Miss Cheung was upset and dissatisfied with the manner in which she perceived she had been treated; in one of her telephone conversations with Mr Chan she is recorded as saying, in response to a request for payment, that “This case must be investigated first to see if I have been deceived by anybody” and that “one hundred thousand dollars just vanished in the blink of an eye”. In the same telephone conversation, on 10 March 2004, she accepted that “if I can have a thorough understanding of everything and (know that) I have not been cheated or duped, I would then write a cheque.”

10. In the event settlement was not made by Miss Cheung.

11. On 7 April 2004 Prudential wrote to her demanding payment of the outstanding balance in her account, and on 8 April 2004, in a letter which has achieved some profile in this application, the SFC wrote to Prudential stating that a complaint had been made and requested documents in relation to the

complaints received from Miss Sonia Cheung and her friend, one Grace Tam.

12. This letter is headed 'Complaints from Ms Cheung Wei Lun Sonia ('Ms Cheung') and Ms Tam Mei Sheung, Grace ('Ms Tam'), and the opening paragraph thereof reads as follows :

"The Commission has recently received complaints from Ms Cheung and Ms Tam against Mr Ho Chi Wai ('Mr Ho') and Prudential Brokerage Limited ('PBL') for (i) unauthorized trades conducted by Mr Ho in the securities trading accounts opened at PBL in or around mid-February 2004 by Ms Cheung and Ms Tam respectively ('Accounts') and (ii) Mr Ho's failure to trade in the Accounts in accordance with the 'stop-loss' instruction as agreed."

13. On 28 April 2004 Prudential responded to the SFC's letter of 8 April, putting forward its version of events, and provided the documents which had been requested by the regulator in its earlier letter.

14. On 7 June 2004, in response to a telephone request from the SFC of 28 May 2004, Prudential provided the SFC with a disc containing certain post-transaction tape recordings of conversations which had been held between Prudential and Miss Cheung.

15. However – and this is the effective crux of the present review – on 17 June 2004, in response to a further request from the SFC of a week earlier, Prudential informed the SFC that it could *not* locate the relevant telephone records relating to the actual trade conducted by Sonia Cheung with that brokerage.

16. Consequent upon this revelation, by letter dated 12 August 2004 the SFC informed Prudential that it was commencing an investigation under section 182(1) of the Securities and Futures Ordinance. In the same letter, the SFC indicated that at the same time it was issuing a formal Notice to Produce “copies of records or documents in your possession which are or may be relevant” to the investigation.

17. There were in fact 11 categories of documents thus sought by the SFC covering all aspects of the commercial interaction between Miss Cheung and Prudential; in particular, subparagraph (f) requested “in respect of all orders placed by [Miss Cheung and Miss Tam] since the accounts were opened to 31 March 2004, full set of records of the order process from clients’ instruction to place orders to input of orders into the Stock Exchange trading system by your staff, *including but not limited to telephone tape records, order blotters, dealing tickets, trading system printout of trading journals and etc.*;”(emphasis added).

18. Notice of proposed disciplinary action under section 194 of the Securities and Futures Ordinance was given by the SFC to Prudential and Mr Lau Shing Ngon, as responsible officer, by letters dated 1 September 2005.

19. Subsequent to representations which were made by Prudential on 30 September 2005 and by letters dated 9 and 17 March 2005, the SFC by its letters dated 6 December 2005 sent to Prudential and to Mr Lau Shing Ngon its Notice of Final Decision, and the reasons underpinning that decision: in the case of Prudential a public reprimand and a disciplinary fine of HK\$95,000, and in the case of Mr Lau a public reprimand and a disciplinary fine of HK\$45,000.

20. As to the decision with regard to Prudential, paragraph 2 of the Notice of Final Decision recorded the SFC findings thus :

“As a result of our investigation, we found that Prudential had:

- (a) failed to put in place proper safeguards regarding telephone recordings of transactions conducted in clients' accounts in breach of General Principle 3 and paragraph 4.3 of the Code of Conduct for Persons Licensed by or Registered with the SFC (April 2003 version);

- (b) failed to produce telephone recordings relevant to clients' complaints and our inquiry in breach of paragraph 6 of Part IV of the Management, Supervision and Internal Control Guidelines for Persons Licensed by or Registered with the Securities and Futures Commission; and
- (c) failed to put in place written complaints handling procedures and handle clients' complaints in a timely and appropriate manner in breach of paragraph 12.3 of the Code of Conduct and paragraph V of the Internal Control Guidelines."

21. As responsible officer, Mr Lau received a like letter in terms of these three categories of finding, save that in instances (a) and (c) the paragraph was prefaced by the phrase "failed to ensure" and in paragraph (b) the prefatory phrase was "failed to procure"; the Notice in his case went on to record (at paragraph 3) that these failures "suggested that you did not act with due skill, care and diligence in the best interests of your clients and therefore you were in breach of General Principle 2 of the Code of Conduct" and that "Your fitness and properness as a licensed person is therefore called into question."

22. It is against these findings, and the penalties as thus handed down, that the 1<sup>st</sup> applicant, Prudential, and the 2<sup>nd</sup> applicant, Mr Lau Shing Ngon, now seek the review of this Tribunal.



23. In this connection, Mr Roger Beresford, for both applicants, asked that the decision and penalty of the SFC be formally set aside; this whole matter, he suggests, when seen in true context, has been “blown out of all proportion”, and at worst merited a warning by the regulator.

*Viva voce evidence*

24. In addition to the agreed documentation that was before the Tribunal, the applicants tendered for cross-examination the General Manager of Prudential, Mr Chan Wai Chuen, who had played a significant role in the handling of Miss Cheung’s case, and whose statements were included in the hearing bundles.

25. We are far from sure that calling Mr Chan was a wise move, although the applicants clearly had had this in mind from as early as the Directions Hearing, when their solicitor had stated that they were concerned that the records of the SFC interviews with Mr Chan did not “set out his full evidence”.

26. We do not wish to be unkind, but we were unimpressed with Mr Chan’s oral evidence, which, under the careful probing of Mr Lok for the SFC, appeared in substantial part to fortify the SFC findings the subject of this review.

*The issues*

27. As the Notices of Final Decision make clear, the disciplinary sanction meted out by the regulator to Prudential and to Mr Lau, the responsible officer, is underpinned by the three findings set out above.

28. It seems to us that category (b), the failure to produce the telephone recordings relevant to Miss Cheung's trading, in particular her instructions in relation to the all-important trade on 1 March 2004, represents the primary complaint against these applicants; we are minded to think that if these recordings had been able to be produced, this case would not have seen the light of day.

29. Accordingly, we propose to deal first with this element of the case, before briefly moving to categories (a) and (c).

*Failure to retain and produce telephone recordings relevant to clients' complaints and SFC inquiry*

30. The gravamen of the applicants' case, which was skilfully handled by Mr Beresford, was that so far as the brokerage, Prudential, was concerned, Miss Cheung in fact never

had made any 'complaint' as to unauthorized trading, and that all the exchanges which had taken place with her had been focused on settlement, and the mode of settlement, of the outstanding account. In this context, Mr Beresford sought to make this good by reference to transcripts of meetings and telephone conversations that had taken place with Miss Cheung.

31. If this was correct, said Mr Beresford, there had been no duty to retain the relevant telephone recording beyond the 3 month period required by paragraph 3.9 of the Code of Conduct, because the telephone recording was not relevant to any 'complaint' that was being advanced; and that even if the telephone recording was relevant, it was not a disciplinary matter, since the Code of Conduct does not require recordings to be kept for more than 3 months and, as a matter of fact, the SFC was well able to ascertain whether the complaint was made out on the other evidence available to them.

32. Whilst forensically adept, in our view this argument is fallacious. In this context we make the following observations.

33. First, and purely as a matter of fact, in the circumstances of this case we find it extraordinary that the relevant tape recordings of Sonia Cheung's instructions have not been

retained, and that measures were not taken by the brokerage to safeguard them.

34. We note that the only evidence as to what actually happened to these recordings come from Mr Chan Wai Chuen, who on 28 May 2004 had received a telephone call from one Philson Ho, of the SFC Licensing Department, who requested the relevant telephone records showing that the complainants Miss Cheung and Miss Tam indeed had given instructions for the transactions in their accounts be produced by 2 June 2004.

35. In the event, whilst Prudential provided recordings of telephone conversations which had taken place *after* the event, in the context of Prudential's requests to Miss Cheung for settlement, on 15 June 2004 Mr Chan told Mr Ho that the relevant recordings could *not* be produced as they had been overwritten by new recordings. However, no information is available as to the manner in which, or how this phenomenon had occurred, or was permitted to occur.

36. We consider that the argument as mounted on behalf of Prudential in this context is a classic 'bootstraps' argument, namely, that if it had been considered by Prudential that there was a 'complaint' properly so-called, the recordings would have been

preserved or retained, but that since it never had been divined that Ms Cheung in fact was complaining about what had happened, there was accordingly no necessity to preserve the evidence, and thus no regulatory infraction.

37. We take this opportunity to state, as firmly as we may, that in our view this approach is both ambitious and analytically flawed. The appropriate test in this regard cannot be subjective. It seems to us that if this were taken as representing the appropriate benchmark the task of the regulator would be difficult indeed; it is quite clear that the correct approach is, and can only be, an objective one in light of all the evidence.

38. In any event we consider, on the evidence before us, that in fact Mr Chan knew full well that Miss Cheung was complaining about what had happened to her money, and Prudential's attempt to characterize it otherwise, namely as simply a settlement issue, strikes us as disingenuous. Whilst Mr Chan consistently has declined to categorise Miss Cheung as a 'complainant', rather than as someone to whom Prudential merely was pursuing for settlement, he nevertheless did accept in cross-examination by Mr Lok that, at least that by mid-March 2004, he was aware that Miss Cheung was complaining about unauthorized trades.

39. Moreover, howsoever Mr Chan had elected to deal with, or otherwise to regard the matter, in his interactions with Miss Cheung after the event, the hard fact is that the SFC letter of 8 April made it clear beyond peradventure that a ‘complaint’ indeed had been made by Miss Cheung, and it matters not whether such complaint was considered by Prudential to be well-founded.

40. And upon receipt of this SFC letter – which we accept was in relatively general terms – we find it hard to understand why steps were not immediately taken by Prudential to preserve the relevant evidence for the attention of the regulator, which by this stage clearly had been seized with this matter. It can only have been in Prudential’s interests to proceed thus; if and in so far as the trades indeed were authorized, the best evidence of such authorisation must be contained within the contemporaneous tape recordings, evidence which a regulator tasked with investigation of such allegation clearly would regard as highly germane.

41. Accordingly, we are unable to, and do not, accept the contentions made on behalf of Prudential in this regard. To the contrary, we take the view that Prudential was under a clear duty to retain these recordings, pursuant to the Internal Control Guidelines, Part IV, the Objective of which reads :

“Policies and procedures shall be established to ensure the integrity, security, availability, reliability and thoroughness of all information, including documentation and electronically stored data, relevant to the firm’s business operations”,

whilst paragraph 6 thereof further states :

“Management establishes and maintains effective record retention policies which ensure that all relevant legal and regulatory requirements are complied with, and which enable the firm, its auditors and interested parties, eg. Exchanges, clearing houses and the Commission, to carry out routine and ad hoc comprehensive reviews and investigations.”

42. It seems to us that Prudential was in obvious breach of such duty as is laid down in the Internal Control Guidelines; indeed, Mr Beresford went so far as to concede that in the particular circumstances raised by Miss Cheung’s case that it would have been eminent “common sense”, and a far better course, for steps to have been taken to have preserved the missing recordings. We agree. It is unclear to us how this apt observation happily can mesh with the submission that in the circumstances of this case there was no breach of duty to retain these recordings for subsequent submission to the regulator. It seems to us that the standard of prevailing duty certainly cannot be lower than the ‘common sense’ benchmark to which Mr Beresford has made reference.

43. Finally, we consider that the fact that the 2 June 2004 – the date specified by Philson Ho to produce the relevant recordings – technically fell outside the 3 month period provided by clause 3.9 of the Code of Conduct is nothing to the immediate point; infraction of this clause has not been the subject of disciplinary change, and we consider that this aspect has been used as a forensic smokescreen.

44. Clearly Miss Cheung had complained, clearly Prudential knew or was fully aware of the situation, and clearly Prudential had failed to keep and produce the telephone recordings relevant to the client's complaints and to the SFC inquiry.

45. Accordingly, notwithstanding Mr Beresford's staunch efforts to convince us otherwise, we reject the arguments under this head, and consider that the regulator was entirely justified in coming to its conclusion in this regard.

*Failure to put in place proper safeguards regarding telephone recordings*

46. In one sense we find it difficult to see how in the circumstances this allegation legitimately can be gainsaid, given that on Prudential's own case the relevant recordings were not safeguarded, with this particular tape, containing Miss Cheung's instructions, apparently having been over-recorded.



47. We appreciate, however, that Prudential say that it did have in place adequate safeguards had it been appreciated that these recordings should have been preserved, and in this connection we have been treated to evidence of the Prudential system regarding the protection of such tapes, which, we are told, individually last at least 3 months for the purposes of contemporaneous voice recording, notwithstanding the huge number of telephone lines employed by the brokerage, and the vast numbers of telephone conversations which would have taken place over such period.

48. We are not convinced, however, on the basis of Mr Chan's evidence, that adequate safeguards indeed were in place to protect these tapes; there appears to have been access thereto by a significant number of different people, and we bear in mind also Mr Chan's description of the length of time needed to locate any particular part of a tape which may contain relevant information; perhaps this was one of the reasons for his very obvious reluctance – “locating the tape needs time” – to actually locate and listen to any tape in order to verify whatever may be being asserted by an aggrieved client.

49. We note that there was no labelling system on the tapes, and although much effort has gone into demonstrating that the tape system had within it a digital read out of date and time, it strikes us with some force that, at least on the system as explained to us, that locating any relevant passage on such a tape was very much akin to locating the veritable needle in a haystack, bearing in mind the time periods, the number of telephone lines being recorded, and the number of brokers' conversations per day.

50. We hope that we are not being unfair, but the impression that we have formed upon hearing Mr Chan's evidence as to the prevailing system was that this brokerage was doing the bare minimum in order to comply with its regulatory recording obligations; we have formed the further view that the system in place was relatively rudimentary.

51. There appears to have been no designated staff member assigned to change the tapes, and there were apparently up to eight staff members sitting near to the recording system, any one of whom would replace the tapes, which appear to have been kept in an unlocked drawer, with no extrinsic system to show the period of time recorded, so that when a tape was full it seems it was randomly replaced by using another tape in the drawer.

52. In this regard we make the observation that if, as Mr Beresford has argued, “in normal course the back-up tapes would always be more than 3 months old when used”, we wholly fail to grasp why Prudential appears to have been unable to comply with Philson Ho’s request to Prudential, on 28 May 2004, to produce the relevant recording, and why there had been the over-recording which now has been stated to have taken place.

53. Our view as to the nature of the recording system as then prevailing accords with the evidence from Prudential to the effect that subsequent to this incident an attempt appears to have been made to update and to improve the system in place at the time of Miss Cheung’s involvement; this is laudable no doubt, but it serves to highlight our view that at the material time there was very considerable scope for improvement.

54. Once again therefore, in light of all the evidence, and in particular the evidence proffered by Mr Chan, we decline to differ from the conclusions as reached by the regulator, which we consider to be justified, and which should not be varied on the facts as established in evidence before us.

*Failure to handle clients' complaints in a proper manner*

55. On the basis of Mr Chan's evidence, the applicants seem to have no room whatever for manoeuvre under this head.

56. It was specifically accepted by Mr Chan that at the time there was no written complaints procedure, although Prudential are keen to point out that this deficiency now has been corrected.

57. On this basis, therefore, there is again no scope for interference with the SFC finding under this head, and for present purposes we need say no more about it.

58. This element seems to us to be part and parcel of the overall penalty invoked against Prudential and Mr Lau; had this flaw stood on its own doubtless it would have merited a warning only, but of course this was not the case and was part and parcel of the wider picture which emerged consequent upon the SFC investigation.

*The position of Mr Lau Shing Ngon*

59. Mr Beresford says that the evidence shows that the 'problem cases', including that of Sonia Cheung, were reported to Mr Lau, and that he retained the power of overall control.

60. However, Mr Beresford submitted, Mr Lau was entitled to rely upon Mr Chan and his staff to deal with Sonia Cheung, and upon their reports to him as to what was involved; accordingly, in the absence of any history of anything going wrong with the retention of records, Mr Lau was justified in trusting the system in place, “however informal”, to work properly, and as such he personally should not have been subject to the reprimand and fine which was visited upon him.

61. We understand this submission, but in the circumstances of this case disagree with it. We take the view that as the responsible person Mr Lau cannot avoid what is essentially ministerial responsibility for the clear defects which existed within Prudential, defects which this case graphically has exposed, and after reflecting on the matter we are not minded to interfere with the conclusions of the SFC with regard to Mr Lau, nor with the penalty attributed to those conclusions.

*Order*

62. It follows from the foregoing that in our view the applications for review mounted by the 1<sup>st</sup> and 2<sup>nd</sup> applicants must be dismissed.

63. We so order.

64. As to costs, we make an order *nisi* that the costs are to follow the event, and are to be paid by the applicants to the respondent, such costs to be taxed if not agreed.

65. We take the view that this was an application bordering upon the egregious, and we have considered whether an order for costs to be taxed on a higher scale than the normal party and party basis would be appropriate. In the event, we have decided not to follow this course, but we take this opportunity to state that unmeritorious appeals in future will run the risk of attendant costs' sanction.

Hon Mr Justice Stone	Ms Teresa Ko Yuk Yin	Mr James Baird
Chairman	Member	Member

Mr Roger Beresford, instructed by Messrs Richards Butler,  
for the 1<sup>st</sup> and 2<sup>nd</sup> applicants

Mr Alex Lok, of the SFC, for the respondent