
STATEMENT OF DISCIPLINARY ACTION

The Disciplinary Action

1. The Securities and Futures Commission (**SFC**) has reprimanded Zhongtai International Securities Limited (formerly known as Qilu International Securities Limited) (**Zhongtai**) and fined it \$2.6 million pursuant to section 194 of the Securities and Futures Ordinance (**SFO**).
2. The SFC found that:
 - (a) between January 2013 and December 2014 (**Relevant Period**), Zhongtai failed to:
 - (i) monitor and/or conduct sufficient and timely enquiries and scrutiny on numerous deposits made by third parties to its clients' sub-accounts maintained at Industrial and Commercial Bank of China (Asia) Limited (**ICBC Sub-Accounts**); and
 - (ii) establish adequate and implement appropriate internal procedures and controls to detect and timely report suspicious third party fund deposits and to ensure that there was clear delineation of duties among staff and senior management of Zhongtai in handling third party deposits; and
 - (b) when steps were taken by Zhongtai in January to February 2015 to re-assess certain third party deposits made in September to November 2014, it failed to maintain proper and accurate records of senior management's and compliance officer's assessment of such deposits. The records failed to show the dates of assessment and gave the inaccurate and misleading impression that the third party deposits were approved or assessed contemporaneously at the time the deposits were made.
3. Zhongtai failed to comply with:
 - (a) sections 5(1) and 23 of Schedule 2 to the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance (**AMLO**);
 - (b) paragraphs 2.1, 5.1, 5.10 and 5.11 of the Guideline on Anti-Money Laundering and Counter-Terrorist Financing (**AML Guideline**); and
 - (c) General Principles 2, 7 and 12.1 of the Code of Conduct for Persons Licensed by or Registered with the SFC (**Code of Conduct**).

Summary of regulatory requirements

4. Under the AMLO and the AML Guideline:
 - (a) Section 23 of Schedule 2 to AMLO and paragraph 2.1 of AML Guideline: Licensed corporations are required to take all reasonable measures to ensure that proper safeguards exist to mitigate the risks of money laundering

and terrorist financing (**ML/TF**), and to prevent a contravention of any customer due diligence and record-keeping requirements under the AMLO. To ensure compliance with this requirement, licensed corporations should implement appropriate internal anti-money laundering and counter-terrorist financing (**AML/CTF**) policies, procedures and controls.

- (b) Section 5(1) of Schedule 2 to AMLO and paragraphs 5.1, 5.10 and 5.11 of AML Guideline: Licensed corporations must continuously monitor their business relationship with their clients. The requirements include but are not limited to the following:
 - (i) Conducting appropriate scrutiny of transactions (including cash and non-cash transactions) carried out for the client.
 - (ii) Identifying transactions that are complex, large or unusual or patterns of transactions that have no apparent economic or lawful purpose and which may indicate ML/TF.
 - (iii) Where transactions that are complex, large or unusual, or patterns of transactions which have no apparent economic or lawful purpose are noted, licensed corporations should make relevant enquiries, examine the background and purpose, including where appropriate the circumstances, of the transactions. Where there is any suspicion, a report must be made to the Joint Financial Intelligence Unit (**JFIU**). The findings and outcomes of these examinations should be properly documented in writing and be available to assist the relevant authorities.
 - (c) Paragraph 8.2 of AML Guideline: Licensed corporations should maintain client, transaction and other records that are necessary and sufficient to meet the record-keeping requirements under the AMLO.
 - (d) Section 20(1)(a) of Schedule 2 to AMLO and paragraph 8.5 of AML Guideline: Licensed corporations should maintain records sufficient to permit reconstruction of individual transactions and establish a financial profile of any suspected account or client.
5. Under the “Circular to Licensed Corporations and Associated Entities – Anti-Money Laundering / Counter Financing of Terrorism – Suspicious Transactions Monitoring and Reporting” issued by the SFC on 3 December 2013, licensed corporations are reminded to be vigilant in monitoring the activities of clients and detecting unusual or suspicious transactions which may indicate ML/TF. Specifically, to guard against the ML/TF risks associated with third party fund transfers, licensed corporations should pay attention to the following:
- (a) Third party payments should be discouraged and should only be accepted after approvals have been obtained from the designated senior staff member.
 - (b) Reasonable steps should be taken to identify funds from third party sources.
 - (c) Special attention should be paid to monitoring any frequent and/or large third party fund transfers or cheque payments involved in the transactions of their client.
 - (d) Enhanced customer due diligence and ongoing monitoring should be undertaken and additional risk-sensitive measures be adopted to mitigate the ML/TF risks involved in cases where, for instance, the client requests

payment to a third party or money is paid by a third party having no apparent connection with the client.

- (e) Licensed corporations should conduct appropriate enquiries and evaluate what they know about the client and the third party, and whether the third party fund transfers are consistent with the clients' known legitimate business or personal activities.
 - (f) Where upon evaluation, licensed corporations conclude that there are grounds for suspicion, they should file a suspicious transaction report to the JFIU.
6. General Principle 2 of the Code of Conduct requires licensed corporations to act with due skill, care and diligence, in the best interests of their clients and the integrity of the market, in conducting their business activities.
7. General Principle 7 and paragraph 12.1 of the Code of Conduct require licensed corporations to comply with, and implement and maintain measures appropriate to ensuring compliance with, all regulatory requirements applicable to the conduct of their business activities.

Summary of facts

Failure to monitor and scrutinise third party deposits made via ICBC Sub-Accounts

8. Under Zhongtai's internal policies:
- (a) its staff should make proper enquiries with its clients and take reasonable steps to understand the clients' source of funds;
 - (b) if Finance or Settlement Departments found out that a deposit was from a third party, they had to notify Compliance Department immediately. The third party deposit could only be processed after it had been approved by Compliance Department;
 - (c) clients who received third party deposits were required to fill in a Third Party Fund Deposit Request Form (**Third Party Deposit Form**) setting out, among others, the relationship between the client and the depositor and the reason for the deposit;
 - (d) in principle, third party deposits would be rejected and returned. However, if there was reasonable explanation with supporting evidence, Zhongtai might accept the third party deposit upon approval from the Compliance Department and the consent of at least one responsible officer; and
 - (e) if Zhongtai could not return or determine the source of the third party deposit, it could accept such deposit after consulting the Compliance Department and obtaining written approval from the responsible officer in charge and at least half of Zhongtai's senior management personnel.
9. During the Relevant Period, Zhongtai engaged ICBC to provide sub-account service to its clients. Clients who wanted to deposit money into their securities accounts with Zhongtai could deposit the money through the ICBC Sub-Accounts.
10. Evidence from settlement staff and responsible officers of Zhongtai shows that there were deficiencies in the handling of third party deposits made through the ICBC Sub-Accounts:

- (a) Zhongtai could not immediately detect the ultimate identity of the party who deposited the funds into the sub-account. It would only find out the identity of the depositor when it received the remittance advice from ICBC one to two weeks later.
 - (b) Settlement staff did not know during the Relevant Period that they could have access to information on the source of funds made to the ICBC Sub-Account. Relevant settlement staff who the SFC interviewed stated that he did not know until 2015 that ICBC would provide remittance advice (which identified the depositors) to Zhongtai's Finance Department.
 - (c) Clients who received third party deposits through their ICBC Sub-Accounts were not required to provide the relevant deposit slips or fill in a Third Party Deposit Form to inform Zhongtai about the fund deposits. The funds would shortly and automatically be deposited into the clients' securities accounts.
 - (d) As Zhongtai could not immediately ascertain whether the funds deposited to the sub-account originated from the client or a third party, the funds might have already been transferred to the client's account, and might have already been used by the client, before Zhongtai knew that the money might come from a third party.
 - (e) Some Third Party Deposit Forms were filled in after the third party deposits had already been accepted and transferred to the clients' securities accounts.
11. During the Relevant Period, Zhongtai handled numerous third party deposits and approximately 329 third party deposits were made via the ICBC Sub-Accounts. Due to the failure to detect whether the deposits were third party deposits, such deposits were processed without the monitoring or scrutiny by the Compliance Department and senior management as required under its internal policies.
- (a) Zhongtai's records show that there were no assessment or no conclusion being made in respect of 325 of these third party deposits, in that:
 - (i) there was either no Third Party Deposit Form;
 - (ii) there was a Third Party Deposit Form but it was not endorsed by personnel of the Compliance Department;
 - (iii) the deposit was not recorded in the relevant AML register of Zhongtai at the time; or
 - (iv) the deposit was recorded in the relevant AML register of Zhongtai at the time but the register shows that there was no information relating to the assessment for that deposit, or it appears from the register that the relevant deposit was pending further assessment.
 - (b) Among these 325 third party deposits where no assessment or no evidence of assessment was made, they were accepted when:
 - (i) the origins of the deposits and/or the identities of the third parties have not been clarified or identified;
 - (ii) on occasions where a Third Party Deposit Form was filled in, the

reasons provided for the deposit and/or the relationship between the depositor and the client did not appear to be sufficient to show that the third party fund was reasonable and/or the risk of money laundering was negligible. For instance, “friend” was a common relationship between the third party and the client and “friend helping to deposit” was a common reason for the deposit; and/or

- (iii) some of the deposits appeared particularly unusual as the same third party deposited large sums of money to various clients of Zhongtai for different reasons within a short period of time. For instance, Company K deposited a total sum of HK\$70,789,280 to three clients in the last two weeks of October 2014:
- HK\$1,253,908, HK\$7,523,500 and HK\$1,005,015 to client A on around 16, 17 and 30 October 2014. The relationship given was “friend” and the reason for the deposit was “friend helping to deposit”;
 - HK\$10,000,000, HK\$20,000,000 and HK\$30,000,000 to client B on 20 October 2014. The relationship given was “business partner” and the reason for the deposit was “repayment”; and
 - HK\$1,006,857 to client C on 30 October 2014. The relationship given was “friend” and the reason for the deposit was “friend helping to deposit”.¹

12. Zhongtai’s failure to monitor third party deposits made via the ICBC Sub-Accounts constitutes a failure to comply with the regulatory obligations under section 5(1) of Schedule 2 to the AMLO and paragraphs 5.1, 5.10 and 5.11 of the AML Guideline.

Failure to establish adequate and implement appropriate internal procedures and to ensure clear delineation of duties among staff and senior management

13. The lack of adequate monitoring of deposits made via the ICBC Sub-Accounts demonstrates that there were deficiencies in Zhongtai’s internal controls at the material time. Zhongtai’s policies on the handling third party deposits as summarised in paragraph 8 above were not properly implemented, in that:
- (a) there were no procedures and controls in place at all to review, scrutinise and identify third party deposits made via the ICBC Sub-Accounts;
 - (b) as such, a majority of these third party deposits were processed without the relevant approval by the Compliance Department; and
 - (c) the requirement that third party deposits should in principle be rejected and returned unless (i) the client provided a reasonable explanation for the deposit, and (ii) it was approved by the Compliance Department and at least one responsible officer was not strictly adhered to by its staff members.
14. Evidence of relevant Compliance staff and responsible officers further shows a lack of mutual understanding of their respective roles and responsibilities in the handling of third party deposits. For instance:

¹ The relationship between the third party and the clients and the reasons for these deposits were obtained in around January to February 2015, several months after the deposits were made. See paragraphs 17 to 18 below.

- (a) The Compliance Manager considered that he had clearly expressed his view that all third party deposits should be rejected, and if the responsible officers wanted to accept the deposits despite his advice, they had to approve the deposits.
 - (b) Responsible officers who had signed on Third Party Deposit Forms claimed that they signed the forms as a matter of procedure, and their signing the forms did not necessarily mean that they approved the deposits. They considered that the Compliance Department should assess the deposits and report the matter to JFIU if appropriate.
15. The SFC also found that there was inadequate communication between Settlement and Finance staff, and a lack of procedure for Finance staff who received remittance advice from ICBC (which identified the person who deposited funds to the ICBC Sub-Account) to provide such information to Settlement staff.
16. In light of the above, the SFC concluded that Zhongtai's internal controls for ongoing monitoring of clients' activities and the handling of third party deposits were insufficient, and Zhongtai failed to comply with the regulatory requirements set out in section 23 of Schedule 2 to the AMLO and paragraph 2.1 of the AML Guideline.

Failure to maintain proper records of senior management's / compliance officer's assessment and/or approval of third party deposits

17. During its investigation, the SFC obtained from Zhongtai a number of Third Party Deposit Forms in relation to deposits made during the Relevant Period. Those forms merely stated the deposit dates, but the dates on which the forms were handled by the relevant Customer Service staff, and the dates on which they were reviewed and/or approved by senior management and Compliance officer were not specified.
18. Evidence of Zhongtai's staff revealed that most of the Third Party Deposit Forms in relation to deposits made via the ICBC Sub-Accounts from September to November 2014 were in fact completed in January to February 2015, after the SFC made enquiries about the firm's handling of third party deposits and Zhongtai took steps to re-assess such deposits. Whilst there is no evidence to show that it is the intention of Zhongtai to create any misleading impression by not specifying the dates of review and approval, the forms may give an inaccurate and misleading impression that they were completed contemporaneously at the time the deposits were made.
19. The SFC found that Zhongtai failed to maintain proper and accurate records of senior management's and compliance officer's assessment of the third party deposits. Records which Zhongtai were required to maintain under section 20(1)(a) of Schedule 2 to the AMLO and paragraphs 8.2 and 8.5 of the AML Guideline should be accurate to assist relevant authorities (including the SFC) in the discharge of their duties. Zhongtai has failed to comply with its obligation under General Principle 2 of the Code of Conduct to act with due skill, care and diligence in conducting its business activities.
20. In light of the matters set out in paragraphs 8 to 19, the SFC further found that Zhongtai has failed to comply with General Principle 7 and paragraph 12.1 of the Code of Conduct which require the firm to comply with, and implement measures appropriate to ensuring compliance with, all relevant AML/CTF requirements when handling third party deposits for clients.

Conclusion

21. Having considered all the circumstances, the SFC is of the view that Zhongtai is guilty of misconduct and its fitness and properness to carry on regulated activities have been called into question.
22. In deciding the disciplinary sanction set out in paragraph 1, the SFC has had regard to its Disciplinary Fining Guidelines and has taken into account that Zhongtai:
 - (a) co-operated with the SFC in resolving the SFC's concerns;
 - (b) took remedial steps and enhanced its policies and procedures after discovering its failures in the handling of third party deposits via the ICBC Sub-Accounts;
 - (c) agreed to engage an independent reviewer to conduct a review of the internal controls and systems of Zhongtai in relation to AML/CTF and the handling of third party deposits; and
 - (d) has an otherwise clean disciplinary record.