STATEMENT OF DISCIPLINARY ACTION

The Disciplinary Action

1. The Securities and Futures Commission (**SFC**) has taken the following disciplinary action against Sun Hung Kai Investment Services Limited (**SHKIS**), pursuant to section 194 of the Securities and Futures Ordinance (**SFO**):

   (a) publicly reprimanded SHKIS; and

   (b) imposed a financial penalty of $1,500,000 on SHKIS.

2. The disciplinary action relates to the trading activities conducted by SHKIS on 8 September 2011 in relation to the shares of China Life Insurance Company Limited (Stock Code: 2628.HK) (**China Life**).

3. SHKIS is a corporation licensed under the SFO to carry on Type 1 (dealing in securities) and Type 4 (advising on securities) regulated activities.

Summary of facts

<u>The erroneous order</u>

4. At 15:24 on 8 September 2011, an account executive of the Private Client Service Department of SHKIS (**AE**) received an order from a client to buy 25,000 shares of China Life.

5. The AE inputted the buy order at $18.82, the then current bid price, into the automated dealing system of SHKIS for execution on the Stock Exchange of Hong Kong (**SEHK**).

6. The AE mistakenly entered the order quantity (25,000) and price (18.82) together in the quantity field, resulting in the text value of "2500018." The symbol "." (i.e. decimal point) was a shortcut key in the system which was automatically translated to "000". As a result, the final quantity inputted to SHKIS became "2500018000". The last two digits "82" were ignored by the system as a maximum input space of ten digits was allowed for the quantity field.

7. Since the maximum order size accepted by SEHK is 3,000 board lots (1 board lot is 1000 shares for China Life), the system of SHKIS automatically split the erroneous order into 834 smaller lots and sent them to SEHK for execution.

8. The AE realized the error shortly after she inputted the order and immediately sought assistance from other dealing staff members to cancel the order.

9. The cancellation process was completed at or around 15:42. About 97% of the orders were cancelled while the remaining 3% (i.e. 81,978,000 shares) were filled and executed at the price of HK$18.82 each.

The wrong setting in the credit rules

10. According to SHKIS, their automated dealing system has a built-in credit checking system. All conditions set in the credit rules must be fulfilled before an order can be placed to the market.

11. On 29 August 2011, the Credit Department of SHKIS revised their credit rules to add a new checking condition. An Assistant Vice President of the Credit Department (**Credit Officer**) manually entered the revised credit rules into the system. The Credit Officer had inputted one of the credit conditions incorrectly.

12. As a result of the incorrect credit condition, the real-time credit check failed to filter the erroneous order input by the AE on 8 September 2011. If the credit rules had been set correctly, the erroneous order in question would not have been sent to the market as it failed to meet some of the credit conditions implemented by SHKIS at the time.

Internal control failures

13. The SFC's investigation revealed various weaknesses in SHKIS's systems and controls which contributed to the current incident:

(a) SHKIS did not impose a limit on the maximum number of splits allowed for large orders. In the current incident, the erroneous order of 2,500,018,000 shares was split into 833 smaller orders of 3,000,000 shares each and one order of 1,018,000 shares.

(b) For orders larger than the maximum board lot size per order allowed by the SEHK (i.e. 3,000 board lots), the dealing system of SHKIS would send a "Big Order Alert" message to the relevant account executive and require the account executive to confirm the submission of the order. The alert message could be closed by the account executive without it being overridden or approved by a manager.

(c) Amendments or changes to the credit rules were not migrated from the testing environment to the production environment directly, but were manually entered into the production environment by a staff member of the Credit Department, increasing the likelihood of input errors.

(d) There was a lack of segregation of duties between the "maker" and the "checker" for changes to the credit rules/policies. In the current incident, the Credit Officer deployed, checked as well as approved the changes. No post deployment validation was performed by any independent third party to ensure that the changes to the credit rules were implemented accurately and completely.

(e) Further, SHKIS did not perform periodic independent reviews of the daily audit trail reports on the update of credit rules.

14. In light of the matters set forth above, the SFC considers that SHKIS has failed to implement adequate internal controls, in breach of General Principle 3 and paragraph 4.3 of the Code of Conduct for Persons Licensed by and Registered with the SFC.

Conclusion

15. Having considered all the circumstances, the SFC is of the opinion that SHKIS is guilty of misconduct and its fitness and properness as a licensed person has been called into question.

16. In deciding the disciplinary sanction, the SFC has taken into account that SHKIS has:

    (a) informed the SFC about the error trade in a timely manner;

    (b) promptly investigated the incident to ascertain the factors which contributed to the error trade, and engaged an external audit firm to independently conduct a review and give recommendations for system and control enhancements;

    (c) taken remedial actions to prevent the same incident from re-occurring in the future;

    (d) cooperated with the SFC in resolving the disciplinary action; and

    (e) agreed to further engage an independent reviewer to review its order entry risk controls in relation to its cash equities dealing, and to implement all recommendations to be made by the reviewer.