
STATEMENT OF DISCIPLINARY ACTION

The Disciplinary Action

1. The Securities and Futures Commission (**SFC**) has taken the following disciplinary action against Guosen Securities (HK) Brokerage Company, Limited (**Guosen**):
 - (a) publicly reprimanded Guosen, pursuant to section 194(1)(iii) of the Securities and Futures Ordinance (**SFO**); and
 - (b) imposed on Guosen a fine of HK\$15.2 million, pursuant to section 194(2) of the SFO.

2. The disciplinary action addresses Guosen's internal control deficiencies and regulatory breaches in relation to anti-money laundering and counter financing of terrorism (**AML/CFT**) during the period between 1 November 2014 and 31 December 2015 (**Relevant Period**). Specifically, Guosen failed to:
 - (a) implement adequate and proper internal controls to mitigate the risk of money laundering and terrorist financing (**ML/TF**) associated with third party deposits (**TPDs**). In particular, Guosen:
 - (i) did not have in place any policies or procedures to verify the identities of third party depositors, ascertain the relationship between its clients and third party depositors, and scrutinise the reasons for making TPDs;
 - (ii) did not have in place an effective approval process in respect of TPDs;
 - (iii) did not have in place any systems or controls to identify and monitor TPDs made into the bank sub-accounts maintained by Guosen for its clients; and
 - (iv) failed to effectively communicate its AML/CFT policies in relation to TPDs to its staff and ensure they took steps to enforce the same;
 - (b) identify and make enquiries about TPDs with AML red flags and report the same to the Joint Financial Intelligence Unit (**JFIU**) in a timely manner. In particular, Guosen:
 - (i) effected numerous TPDs which were incommensurate with the financial profile of its clients without making any enquiries;
 - (ii) failed to make enquiries in situations where TPD funds were withdrawn by clients shortly after receiving the funds without using the same for trading;

- (iii) failed to make any enquiries where a number of third party companies made a considerable number of TPDs to numerous clients; and
 - (iv) did not submit any suspicious transaction reports (**STRs**) to JFIU in relation to TPDs with AML red flags during the Relevant Period;
- (c) conduct adequate ongoing monitoring of its business relationship with clients. In particular, Guosen:
- (i) failed to maintain proper documentation of its assessment of clients' ML/TF risk levels;
 - (ii) did not monitor clients' fund movements to ensure they were consistent with the clients' nature of business, risk profiles and source of funds;
 - (iii) did not undertake periodic review of existing records of its clients; and
- (d) have in place an effective compliance function.

Summary of facts and breaches

- A. ***Failure to implement adequate and proper internal controls to mitigate the risk of ML/TF associated with TPDs***
3. Guosen allowed its clients, whether by themselves or via third parties, to deposit funds into its "main accounts" or "sub-accounts". "Main accounts" mean the designated client accounts maintained by Guosen with various banks, whereas "sub-accounts" mean the sub-accounts maintained by Guosen under one of its master bank accounts. Each client was assigned a unique sub-account number for making deposits.
 - (i) ***Lack of policies and procedures to verify the identities of third party depositors, ascertain the relationship between clients and third party depositors, and scrutinise the reasons for making TPDs***
 4. During the Relevant Period, Guosen accepted 221 TPDs via the main accounts totalling HK\$862.4 million, US\$10.7 million and RMB 6.8 million.
 5. Although Guosen's operational manual required clients receiving TPDs to submit a standard form declaring that the source and purpose of the funds were irrelevant to terrorist and criminal activities (**Declaration**), Guosen neither requested that clients provide nor made any enquiries about the reasons for the TPDs and the clients' relationships with the third party depositors. Guosen did not obtain copies of the identification documents of the third party depositors and had no procedures in place to verify their identities or to check if they were high-risk individuals or entities. There were no policies for the scrutiny and approval of TPDs. In effect, Guosen had no controls to mitigate the risks of ML/TF associated with TPDs.
 6. As early as 2013, some of the above internal control deficiencies had been pointed out by a staff member in an email which was copied to the former senior

management, including a responsible officer (**RO**) responsible for Guosen's retail brokerage business, and additional procedures had been suggested to address the deficiencies. Nonetheless, Guosen did not take any steps to ensure that the AML/CFT internal controls in relation to TPDs were effective during the Relevant Period.

(ii) ***Lack of systems and controls to identify and monitor TPDs made into the sub-accounts***

7. During the Relevant Period, funds could be deposited into the sub-accounts by cash, cheque, telegraphic transfer (**TT**), internal bank transfer, or inter-bank transfer (**RTGS**). For deposits made by TT or RTGS, Guosen would receive a remittance advice from the bank about a week after the deposit had been accepted.

Deposits by TT & RTGS

8. Guosen accepted over 9,000 TPDs in the aggregate amount of HK\$4 billion made by TT and RTGS into the sub-accounts of more than 3,500 clients. Contrary to the provisions in its operational manual, Guosen did not require its clients to submit any Declaration in respect of these TPDs. Instead, Guosen's IT system automatically processed all deposits in the sub-accounts, regardless of the source and amount of the deposits. Although Guosen's then Head of Settlement kept records of these TPDs, nothing had been done to check whether they were consistent with the clients' respective financial profiles as there were no procedures to either scrutinise or approve these TPDs.

Deposits by cash, cheque & internal bank transfer

9. There were over 3,000 deposits in the aggregate amount of HK\$750 million made into the sub-accounts by cash, cheque and internal bank transfer. Since Guosen did not receive any remittance advice from the bank in relation to these deposits, it was unable to discern if they were TPDs. This issue had been pointed out in an email which was copied to the former senior management, including an RO responsible for Guosen's retail brokerage business, by a staff member as early as 2013. Nevertheless, no steps had been taken by the former senior management and the former RO to ensure compliance with the AML/CFT regulatory requirements.

(iii) ***Failure to communicate and enforce AML/CTF policies in relation to TPDs***

10. Guosen failed to ensure that its internal AML/CTF policies were effectively communicated to and properly understood by its staff. None of the staff signed the form of acknowledgement to confirm that he/she had read the AML/CTF policies and would abide by their contents. Some of the settlement staff could not recall having seen or received Guosen's compliance manual and AML/CTF policies. They did not know the proper channel to report suspicious transactions and what were the trigger events for review of client records.
11. Guosen also failed to enforce its policy to discourage TPDs. On the contrary, some of its staff members had advised and assisted clients to make TPDs and none of them had taken steps to ascertain if a TPD was commensurate with the client's profile. Furthermore, staff members responsible for verifying clients' signatures on the Declaration failed to leave a proper audit trail in accordance

with Guosen's procedures. The then Head of Settlement, who was held out by Guosen as the approver for TPDs, appeared to have no authority to reject TPDs and funds were made available for the client's disposal even before the relevant Declaration reached him. Guosen in effect facilitated 10,000 TPDs totalling approximately HK\$5 billion made via the main accounts and sub-accounts.

12. Guosen's failures summarized in paragraphs 3 -11 above were in breach of:
- (a) the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (**AMLO**) and the Guideline on Anti-Money Laundering and Counter-Terrorist Financing (**AML Guidelines**):
 - (i) under section 23 of Schedule 2 to the AMLO and paragraph 2.1 of the AML Guidelines, a licensed corporation is required to take all reasonable measures to ensure that proper safeguards exist to mitigate ML/TF risks;
 - (ii) under paragraph 2.2 of the AML Guidelines, a licensed corporation should establish and implement adequate and appropriate AML/CFT systems;
 - (iii) under section 5(1)(b) of Schedule 2 to the AMLO and paragraph 5.1(b) of the AML Guidelines, a licensed corporation must continuously monitor the activities of a client to ensure that they are consistent with the licensed corporation's knowledge of the client and the client's business, risk profile and source of funds; and
 - (iv) under paragraph 9.6(c) of the AML Guidelines, staff should be made aware of the licensed corporation's policies and procedures relating to AML/CFT, including suspicious transaction identification and reporting;
 - (b) the "Circular to Licensed Corporations and Associated Entities – Anti Money Laundering/Counter Financing of Terrorism – Suspicious Transactions Monitoring and Reporting" published by the SFC on 3 December 2013 (**AML Circular**), which provides that a licensed corporation should:
 - (i) discourage third party payments and only accept the same after approvals have been obtained from the designated senior staff member;
 - (ii) take reasonable steps to identify funds from third party sources;
 - (iii) pay special attention to monitor any frequent and/or large third party funds transfers; and
 - (iv) undertake enhanced due diligence and ongoing monitoring to mitigate the ML/TF risks involved in cases where money is paid by a third party having no apparent connection with the client;
 - (c) paragraphs 1 and 4 of Part I of the Management, Supervision and Internal Control Guidelines for Persons Licensed by or Registered with the SFC

(Internal Control Guidelines), which require the management of a licensed corporation to:

- (i) assume full responsibility for the development, implementation and on-going effectiveness of the firm's internal controls and the adherence thereto by its staff; and
 - (ii) ensure that detailed policies and procedures pertaining to approvals are clearly defined and communicated to and followed by staff; and
- (d) General Principle 3, paragraphs 4.2 and 4.3 of the Code of Conduct for Persons Licensed by or Registered with the SFC (**Code of Conduct**), which provides that a licensed corporation should:
- (i) have and employ effectively the resources and procedures which are needed for the proper performance of its business activities;
 - (ii) supervise diligently persons employed by it to conduct business on its behalf; and
 - (iii) have internal control procedures and operational capabilities to protect its operations, its clients and other licensed or registered persons.

B. *Failure to identify and make enquiries about TPDs with AML red flags and report the same to JFIU in a timely manner*

13. During the Relevant Period, Guosen processed a significant number of TPDs with AML red flags without making any enquiries in situations including the following:

- (a) At least 102 clients received TPDs which were incommensurate with the net worth as declared in their respective account opening forms. The total number and value of TPDs involved were 780 and approximately HK\$990 million respectively. The evidence shows that this prevalent situation about TPDs being incommensurate with clients' net worth was known to one account executive who helped some of her 300 clients deposit funds. However, no enquiries had been made to examine the background and purpose of those transactions. In short, Guosen did not take any steps to ascertain whether the TPDs were consistent with existing profiles of the relevant clients.
- (b) At least 10 clients appeared to have used their trading accounts with Guosen as conduits for transfer of funds. They withdrew funds shortly after receiving TPDs without using the same for trading. Guosen did not have any systems in place to monitor such abnormal funds transfers in the clients' trading accounts, which lacked apparent economic purpose. The relevant staff made no attempts to identify these transactions or make appropriate enquiries.
- (c) Numerous third parties made considerable numbers of TPDs to multiple clients of Guosen. The top seven third party depositors (by number of TPDs made) made a total of 255 TPDs in the aggregate amount of over HK\$320 million. There were no apparent relationships between these

frequent third party depositors and the clients receiving the funds. Although such frequent and large amount fund transfers from unrelated and/or unverified third parties should have prompted further investigation, no enquiries or evaluations were conducted.

14. The various transactions summarised in the preceding paragraph were clearly unusual or appear to have used Guosen's accounts as a conduit for transfers and should have given rise to suspicion on the part of Guosen, which was obliged to report the same to JFIU as soon as reasonably practicable. Nevertheless, it was not until March 2016 that Guosen started to retrospectively report suspicious transactions which occurred during the Relevant Period. 2,293 TPDs were eventually deemed suspicious by Guosen and included in the 472 STRs filed with JFIU. It transpired that the then Head of Settlement had from time to time submitted TPD data to the Legal and Compliance Department (LCD) but the then Money Laundering Reporting Officer (MLRO) did not review the relevant emails. This showed that there was a complete breakdown in Guosen's suspicious transactions reporting procedures.
15. Guosen's failures summarized in paragraphs 13 -14 above were in breach of:
 - (a) section 5(1)(c) of Schedule 2 to the AMLO and paragraphs 5.1(c), 5.10 and 5.11 of the AML Guidelines, which require a licensed corporation to:
 - (i) identify transactions that are complex, large or unusual; or patterns of transactions that have no apparent economic or lawful purpose;
 - (ii) make relevant enquiries to examine the background and purpose of these transactions, and report to JFIU where appropriate; and
 - (iii) properly document in writing the findings and outcomes of these examinations;
 - (b) the AML Circular and paragraphs 7.5(b) and 7.11 of the AML Guidelines, which provides that where a transaction is inconsistent in amount, origin, destination, or type with a client's known, legitimate business or personal activities, the transaction should be considered as unusual and the licensed corporation should be put on alert and make a disclosure to JFIU as soon as is reasonably practical after suspicion of ML/TF was first identified; and
 - (c) General Principle 2 of the Code of Conduct, which requires a licensed corporation to act with due skill, care and diligence, in the best interests of its clients and the integrity of the market.

C. *Failure to conduct adequate ongoing monitoring of its business relationship with clients*

16. Guosen failed to use the risk assessment form prescribed by its internal policy to assess the ML/TF risk level of clients prior to acceptance of their account opening applications. As there were no records or other audit trails, it was unclear how and whether client risk assessment was in fact carried out during the Relevant Period. Without documentation on the risk assessment process, it is also doubtful how Guosen could effectively adopt a risk based approach to

determine the appropriate extent of client due diligence and ongoing monitoring to be performed on each client.

17. Guosen did not have any systems or procedures in place to continuously monitor activities in its clients' accounts. Nor did Guosen take any steps to check whether a client's activities were consistent with that client's financial profile. The lack of ongoing monitoring had contributed to Guosen's failure to recognise the large number of unusual and suspicious transactions during the Relevant Period.
18. Further, Guosen failed to enforce its internal policy to review the information of its clients at least annually to ensure that the same was up-to-date. Reviews were conducted on an ad hoc basis rather than periodically. There were no systems or procedures for the identification and monitoring of the occurrence of trigger events as defined in its compliance manual. But for the above internal control failures, Guosen should have found out the significant amount of unusual and suspicious transactions which constituted trigger events. This signaled that a review of client records was likely long overdue.
19. Guosen's failures summarized in paragraphs 16 -18 above were in breach of:
 - (a) paragraph 3.8 of the AML Guidelines, which provides that a licensed corporation should keep records of client risk assessment to demonstrate that the extent of client due diligence and ongoing monitoring is appropriate;
 - (b) section 5(1)(a) of Schedule 2 to the AMLO and paragraphs 4.7.12 and 5.1(a) of the AML Guidelines, which require a licensed corporation to undertake periodic reviews of existing records of client to ensure that they are up-to-date and relevant; and
 - (c) section 5(1)(b) of Schedule 2 to the AMLO and paragraph 5.1(b) of the AML Guidelines (see paragraph 12(a)(iii) above).

D. *Failure to have in place an effective compliance function*

20. During the Relevant Period, Guosen's LCD merely performed an advisory function and did not exercise supervisory or review function. It neither conducted any compliance checking on the TPD workflow nor carried out any reviews of Guosen's AML/CFT controls. As a result, Guosen was unable to ensure that the staff had complied with its internal AML/CFT policies and the relevant regulatory requirements when processing TPDs.
21. Guosen also failed to ensure that all staff members were made aware of the identity of the MLRO and the procedures for making internal disclosure reports. Its then MLRO did not only fail to actively identify and report suspicious transactions, but also turned a blind eye to the TPDs reported by the then Head of Settlement from time to time. There was a lack of oversight and continuous review of Guosen's AML/CFT systems to ensure the same were up-to-date and met the regulatory requirements.
22. Guosen's failure to have in place an effective compliance function was in breach of:

- (a) paragraphs 2.13 and 2.17 of the AML Guidelines, which provide that the Compliance Officer as well as the compliance and audit function of a licensed corporation should regularly review the AML/CFT systems and continuously monitor their effectiveness to ensure they meet statutory and regulatory requirements;
- (b) paragraphs 2.15, 7.21 and 7.23 of the AML Guidelines, which require a licensed corporation to ensure that all staff are made aware of the identity of the MLRO, who should play an active role in the identification and reporting of suspicious transactions; and
- (c) paragraphs 1 and 4 of Part V of the Internal Control Guidelines, which requires the management of a licensed corporation to establish, maintain and enforce appropriate and effective compliance function and procedures.

Conclusion

- 23. Having considered all relevant circumstances, the SFC is of the opinion that Guosen has been guilty of misconduct, and its internal control failures and regulatory breaches set out above have called into question its fitness and properness to remain a licensed corporation.
- 24. 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 all relevant circumstances, including:
 - (a) there were more than 2,200 unusual or suspicious TPDs in the aggregate amount of over HK\$2.3 billion during the Relevant Period which covers a period of 14 months;
 - (b) the former senior management and a former RO of Guosen, who have now been replaced, turned a blind eye to the ML/TF risks associated with TPDs during the Relevant Period;
 - (c) Guosen has engaged an independent reviewer to conduct a review of its internal controls and taken steps to remediate the deficiencies identified, including implementing new AML/CFT policies and TPD procedures;
 - (d) Guosen cooperated with the SFC in resolving the SFC's concerns and accepting the disciplinary action; and
 - (e) Guosen has no disciplinary history with the SFC.