

## STATEMENT OF DISCIPLINARY ACTION

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### The Disciplinary Action

1. The Securities and Futures Commission (**SFC**) has publicly reprimanded SFM HK Management Limited (**SFM**)<sup>1</sup> and fined it \$1,500,000 pursuant to section 194 of the Securities and Futures Ordinance (**SFO**).
2. The disciplinary action is taken in respect of a short selling incident in relation to the shares of Great Wall Motor Company Limited (stock code: 2333) (**Great Wall**).

### Summary of facts

#### *Background*

3. On 28 August 2015, Great Wall issued an announcement (**Announcement**) regarding its proposed bonus issue of shares (**Bonus Shares**) of 200% of its existing issued shares (**Bonus Issue**). The Bonus Issue was subject to the fulfilment of certain conditions (**Conditions**). According to the timetable set out in the Announcement, the Bonus Shares were expected to be despatched on 13 October 2015 (**Settlement Date**).
4. Prior to the Settlement Date, Great Wall did not make any public announcement regarding the fulfilment of the Conditions. The public did not have reasonable grounds to believe that they had presently exercisable and unconditional rights to vest the Bonus Shares in the purchaser of them before the Settlement Date<sup>2</sup>.

#### *Disposal of the Bonus Shares before the Settlement Date*

5. As at 30 September 2015, i.e. the ex-entitlement date of the Bonus Issue, a fund managed by SFM (**Fund**) owned 808,000 shares of Great Wall. Pursuant to the Bonus Issue, the Fund was entitled to an additional 1,616,000 Bonus Shares of Great Wall.
6. Due to human error, SFM's trade support team (**Trade Support**) booked the 1,616,000 Bonus Shares into SFM's trading system (**System**) without segregating them into a restricted account within the System as required by SFM's internal policy. Consequently, the System indicated that a total of 2,424,000 shares of Great Wall were available for trading as of 30 September 2015 when in fact only 808,000 shares were available for trading at that point in time.
7. On 2 October 2015, based on the erroneous information shown in the System, one of the Fund's portfolio managers placed an order to sell 2,424,000 Great Wall shares on behalf of the Fund (**Disposal**). The Disposal caused the Fund to become short by 1,616,000 shares in Great Wall (**Net Short Position**).

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<sup>1</sup> SFM is licensed to carry on business in Type 1 (dealing in securities), Type 2 (dealing in futures contracts) and Type 9 (asset management) regulated activities under the SFO.

<sup>2</sup> Section 170(1) of the SFO prohibits "naked" or "uncovered" short selling. It is a criminal offence for a person to sell securities at or through a recognized stock market unless at the time of the sale, he has a presently exercisable and unconditional right to vest the securities in the purchaser of them, or believes and has reasonable grounds to believe that he has such a right.

8. On 6 October 2015, the Fund's custodian identified the Net Short Position and automatically lent 1,616,000 shares to the Fund so that the trade was settled in the normal settlement cycle.
9. SFM identified the Net Short Position on 9 October 2015 and reported the incident to the SFC on 12 October 2015.

*SFM's explanations*

10. At the relevant time, SFM required Trade Support to perform daily review on all corporate actions to confirm whether shares are eligible for immediate resale under relevant local law. To the extent that shares were determined to be ineligible for immediate resale under local law, Trade Support would place the shares into a restricted account pending processing.
11. SFM explained that when processing the Bonus Shares, the relevant Trade Support team member did not recognize the need to segregate the Bonus Shares into a restricted account as the settlement cycle for receipt of bonus/dividend shares was typically T+3 from the record date but in the Great Wall case, the Settlement Date for the Bonus Shares was on 13 October 2015, i.e. 11 days after the record date of 2 October 2015.
12. SFM's explanation is not acceptable:
  - (a) The Settlement Date was clearly set out in the Announcement issued on 28 August 2015 as well as in the email sent from the Fund's custodian to SFM on 30 September 2015.
  - (b) SFM had previously handled three other bonus issues between January 2011 and October 2015. Contrary to SFM's assertions that the settlement cycle for receipt of bonus/dividend shares was typically T+3 from the record date, the settlement date of all three bonus issues was more than 3 days after the record date.
  - (c) SFM had in fact encountered a similar short selling incident in 2010 where SFM short sold the bonus shares of another issuer before the settlement date. At that time, SFM assured the SFC that it had implemented procedures to prevent future occurrence of similar incidents, and the SFC had reminded it to take all appropriate measures to ensure full compliance with the short selling requirements under section 170 of the SFO.

*The SFC's concerns*

13. The SFC considers that SFM had:
  - (a) failed to act with due skill, care and diligence in handling and dealing in the Bonus Shares; and
  - (b) failed to diligently supervise its staff members and implement adequate and effective systems and controls to ensure compliance with the short selling requirements.

14. SFM's failures constitute a breach of:
- (a) General Principle 2 (diligence) of the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (**Code of Conduct**), which requires a licensed person, in conducting its business activities, to act with due skill, care and diligence, in the best interests of its clients and the integrity of the market;
  - (b) paragraph 4.2 (staff supervision) of the Code of Conduct, which requires a licensed person to ensure that it has adequate resources to supervise diligent and does supervise diligently persons employed or appointed by it to conduct business on its behalf;
  - (c) General Principle 3 (capabilities) and paragraph 4.3 (internal control, financial and operational resources) of the Code of Conduct, which require a licensed person to employ effectively the resources and procedures which are needed for the proper performance of its business activities and to have internal control procedures which can be reasonably expected to protect its operations, its clients and other licensed persons from financial loss arising from theft, fraud, and other dishonest acts, professional misconduct or omissions; and
  - (d) General Principle 7 (compliance) and paragraph 12.1 (compliance: in general) of the Code of Conduct, which require a licensed person to comply with, and implement and maintain measures appropriate to ensure compliance with, relevant regulatory requirements.

### **Conclusion**

15. The SFC is of the view that SFM's fitness and properness has been called in question.
16. In deciding the disciplinary sanctions set out at paragraph 1, the SFC has taken into account that:
- (a) there is no evidence to suggest that SFM had acted in bad faith in short selling the Bonus Shares;
  - (b) this incident is the second occurrence of a similar kind over a period of five years;
  - (c) SFM has taken remedial measures to strengthen its internal controls and systems; and
  - (d) SFM has an otherwise clean disciplinary record.