

STATEMENT OF DISCIPLINARY ACTION

The Disciplinary Action

1. The Securities and Futures Commission (**SFC**) has reprimanded and fined Southwest Securities (HK) Brokerage Limited (**SSBL**)¹ \$5,000,000 pursuant to section 194 of the Securities and Futures Ordinance (**SFO**).
2. The disciplinary action is taken in respect of SSBL's internal control deficiencies and regulatory breaches in relation to anti-money laundering and counter-terrorist financing (**AML/CFT**) between January and December 2016 (**Relevant Period**). Specifically, SSBL failed to:
 - (a) implement adequate and effective policies and procedures to mitigate the risk of money laundering and terrorist financing (**ML/TF**) associated with third party deposits (**TPDs**); and
 - (b) establish proper internal systems and controls to monitor its clients' activities, and detect and report suspicious transactions to the Joint Financial Intelligence Unit (**JFIU**) in a timely manner.

Summary of Facts

Regulatory requirements

3. Under the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (**AMLO**) and Guideline on Anti-Money Laundering and Counter-Terrorist Financing (April 2015) (**AML Guideline**):
 - (a) Licensed corporations are required to take all reasonable measures to ensure that proper safeguards exist to mitigate the risks of 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 AML/CFT policies, procedures and controls.
 - (b) Licensed corporations must continuously monitor their business relationship with clients. The requirements include but are not limited to the following:
 - (i) Monitor the client activities (including cash and noncash transactions) to ensure that they are consistent with the client's nature of business, the risk profile and source of funds.
 - (ii) Identify 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

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

JFIU. The findings and outcomes of these examinations should be properly documented in writing and be available to assist the relevant authorities.

- (iv) In detecting unusual or suspicious transactions, licensed corporations should have regard to the relevant suspicious indicators set out in the AML Guideline which would assist them in identifying the types of activities or transactions that could be a cause of scrutiny and should prompt further enquiries.
4. Licensed corporations should also ensure sufficient guidance is given to staff to enable them to form suspicion or to recognise when ML/TF is taking place.

Inadequate policies and procedures to mitigate the risk of ML/TF associated with TPDs

5. Under SSBL's internal policy and procedures for handling TPDs:
- (a) TPDs were not encouraged unless the client could provide a valid reason to justify the TPDs.
 - (b) The brokerage department and the settlement department should take all reasonable steps to identify whether a deposit was made by a third party.
 - (c) If the deposit was made by a third party, the account executive should request the client to sign and submit a TPD application form (**TPD Form**) setting out the name of the third party depositor, the relationship between the depositor and the client, and the reason for using TPD, and provide the third party depositor's identification document.
 - (d) The settlement department should verify the client's account number and signature, and confirm the deposit instruction with the client over a tape-recorded telephone line.
 - (e) The compliance department should conduct background check on the third party depositor and random sample review of the relevant telephone recordings, and report any suspicions to the responsible officer (**RO**).
 - (f) The TPD application was subject to the RO's final approval.
6. During the Relevant Period, SSBL engaged a local bank to provide sub-account service to its clients. Clients who wanted to deposit money into their securities account with SSBL could deposit the money through the sub-accounts and/or the designated accounts maintained by SSBL with other banks. For clients who used the sub-account service, a unique sub-account number was assigned to each of these clients.
7. However, the SFC found that SSBL did not have adequate and effective systems and procedures in place to review the source of funds deposited into the sub-accounts during the Relevant Period.
8. As a result, SSBL failed to identify 164 TPDs (in the aggregate amount of \$110,130,686) made via the sub-accounts on behalf of its clients during the Relevant Period, ie, 89 per cent of a total of 184 TPDs. As these TPDs were not identified:
- (a) no TPD Form was obtained from the clients;

- (b) the clients' relationship with the third party depositors and the reasons for using the TPDs were unknown; and
 - (c) the TPDs were not subject to the review and approval process in accordance with SSBL's internal policies as set out in paragraph 5 above.
9. In respect of the 20 TPDs which SSBL had identified, the client's relationship with the third party depositor and the reason for the TPD were stated to be "*friend*" and "*busy at work*", respectively, in the TPD Forms of 12 TPDs. Whilst the relationship and reason provided did not explain the rationale for the third party transfers satisfactorily, SSBL did not critically evaluate these TPDs, and document the enquiries made and the reasons for approving the deposits. For example, in the account of Client A:
- (a) Client A received 15 TPDs from 11 different individuals for the total amount of \$2,397,465 within less than two months.
 - (b) TPD Forms were obtained for only 6 out of 15 TPDs. For the remaining 9 deposits, as SSBL was not aware that they were made by third parties, no TPD Form was obtained at the material time.
 - (c) In respect of the 6 deposits for which TPD Forms were obtained, the relationship between the client and the depositors and the reason for the TPDs were all stated to be "*friend*" and "*busy at work*", respectively.
 - (d) The frequency of the deposits, in particular, the 6 separate deposits made by 5 different third parties within the same day, was unusual and should have given rise to suspicions and prompted further investigation.
 - (e) There is no evidence that SSBL had reviewed and conducted any enquiries into the suspicious deposit pattern before approving the deposits.
 - (f) The RO's reasons for approving the deposits were not documented in the TPD Forms.

Improper internal systems and controls to monitor clients' activities, and detect and report suspicious transactions to JFIU promptly

10. During the Relevant Period, SSBL did not have systems and controls to generate exception reports to identify suspicious transactions. It relied on the front and back office staff to manually review the client transactions to identify any suspicious circumstances. However, the evidence shows that:
- (a) SSBL's staff members did not have a clear and consistent understanding of their respective roles and responsibilities in the monitoring and identification of suspicious transactions; and
 - (b) SSBL did not diligently supervise its staff and provide sufficient guidance to the staff to enable them to form suspicion or to recognise when ML/TF is taking place.
11. SSBL had filed only 1 suspicious transaction report (**STR**) to JFIU during the Relevant Period. It was only after the SFC requested SSBL to review all client deposits and trading activities for the Relevant Period that SSBL submitted an additional 31 STRs to JFIU between December 2016 and November 2017.
12. The transactions reported by the 31 STRs displayed one or more of the red flag indicators set out in the AML Guideline. For example:

- (a) Some clients received TPDs through the sub-accounts and were not willing to disclose their relationship with the third party depositors.
 - (b) A third party depositor issued 3 bank drafts for a total amount of \$38,032,000 to 3 clients. The 3 clients used the funds to purchase shares, and transferred the physical shares to other third parties shortly afterwards. The relationship among the 3 clients and the third party depositor could not be verified.
 - (c) A client deposited \$10,000,000 to SSBL's designated bank account on 20 September 2016. The client withdrew the fund on 27 September 2016 without conducting any securities transactions and closed the account on 5 October 2016. The deposit amount was incommensurate with the client's net worth (below \$500,000).
13. Despite the presence of red flags, SSBL did not identify the suspicious transactions, and conduct appropriate scrutiny of the transactions and report them to JFIU in a timely manner.

The SFC's findings

14. The failures of SSBL set out above constitute a breach of:
- (a) Section 23 of Schedule 2 to the AMLO and paragraph 2.1 of the AML Guideline, which require licensed corporations to take all reasonable measures to ensure that proper safeguards exist to mitigate the risks of ML/TF and to prevent a contravention of any customer due diligence and record keeping requirements under the AMLO.
 - (b) Paragraph 2.2 of the AML Guideline, which requires licensed corporations to establish and implement adequate and appropriate internal AML/CFT policies.
 - (c) General Principle 3 of the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (**Code of Conduct**), which requires licensed corporations to have and employ effectively the resources and procedures which are needed for the proper performance of their business activities.
 - (d) Section 5(1)(b) of Schedule 2 to the AMLO and paragraph 5.1(b) of the AML Guideline, which require licensed corporations to continuously monitor their business relationship with the clients by monitoring their activities to ensure that they are consistent with their knowledge of the clients and the clients' business, risk profile and source of funds.
 - (e) Paragraph 5.9 of the AML Guideline, which requires licensed corporations to implement effective ongoing monitoring systems which are commensurate with, among others, the size and complexity of their business and the nature of the products and services they offered, to facilitate them in monitoring client transactions and activities.
 - (f) Section 5(1)(c) of Schedule 2 to the AMLO and paragraphs 5.1(c), 5.10 and 5.11 of the AML Guideline, which require licensed corporations to identify transactions that are complex, large or unusual, make relevant enquiries to examine the background and purpose of the transactions, document the enquiries made (and their results), and report the findings to JFIU where appropriate.

- (g) Paragraphs 7.11, 7.14 and 7.39 of the AML Guideline, which require licensed corporations to identify situations that might give rise to a suspicion of ML/TF and make appropriate disclosure to JFIU.
- (h) Paragraph 7.7 of the AML Guideline, which requires licensed corporations to ensure sufficient guidance was given to staff to enable them to form suspicion or to recognise when ML/TF is taking place, taking account of the nature of the transactions and instructions that staff is likely to encounter, the type of product or service and the means of delivery.
- (i) Paragraph 4.2 of the Code of Conduct, which requires licensed corporations to ensure that they have adequate resources to supervise diligently and does supervise diligently persons employed or appointed by them to conduct business on their behalf.
- (j) Paragraph 5.12 of the AML Guideline, which requires licensed corporations to make further enquiries on cash transactions (including deposits and withdrawals) and transfers to third parties that are not in accordance with the customer's known reasonable practice and make an STR to JFIU accordingly.
- (k) 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), which requires licensed corporations to take reasonable steps to guard against and mitigate the ML/TF risks associated with third party fund transfers.
- (l) General Principle 7 and paragraph 12.1 of the Code of Conduct, which require licensed corporations to comply with, and implement and maintain measures appropriate to ensure compliance with, the relevant regulatory requirements.

Conclusion

15. Having considered all relevant circumstances, the SFC is of the opinion that SSBL is guilty of misconduct and its fitness and properness to carry on regulated activities have been called into question.
16. In deciding the disciplinary sanction set out in paragraph 1 above, the SFC has taken into account all relevant considerations, including:
 - (a) adequate and effective internal control systems are fundamental to the fitness and properness of a licensed corporation;
 - (b) the necessity of a strong deterrent message that AML/CFT failures are not acceptable;
 - (c) SSBL has taken remedial steps to enhance its AML/CFT policies and procedures; and
 - (d) SSBL's otherwise clean disciplinary record with the SFC.