STATEMENT OF DISCIPLINARY ACTION

The Disciplinary Action

1. The Securities and Futures Commission (**SFC**) has publicly reprimanded and fined Potomac Capital Limited (**Potomac**) $800,000 pursuant to section 194 of the Securities and Futures Ordinance (**SFO**).

2. The disciplinary action is taken in respect of Potomac's failures to comply with the Securities and Futures (Financial Resources) Rules (**FRR**).

3. Potomac is licensed under the SFO to carry on Type 1 (dealing in securities) and Type 9 (asset management) regulated activities.

Summary of facts

The FRR requirements

4. Section 6(1) of the FRR stipulates that a licensed corporation shall at all times maintain liquid capital which is not less than its required liquid capital.

5. Under the FRR:

   (a) "Liquid capital" means the amount by which the liquid assets of a licensed corporation exceeds its ranking liabilities.

   (b) "Liquid assets" means the aggregate of the amounts required to be included in a licensed corporation's liquid assets under the provisions of Division 3 of Part 4 of the FRR.

   (c) "Required liquid capital deficit", in relation to a licensed corporation, means the amount by which its required liquid capital exceeds its liquid capital.

6. Section 35 under Division 3 of Part 4 of the FRR sets out a list of miscellaneous assets to be included by a licensed corporation in its liquid assets. In particular, section 35(a) provides that a licensed corporation must include in its liquid assets:

   "*(a) the amount of any fees, commissions, commission rebates and interest charges to which it is beneficially entitled which arise from the carrying on by it of any regulated activity for which it is licensed and—*

   (i) which have accrued and will first be due for billing or payment within the next 3 months; or

   (ii) which have been billed or fallen due for payment and remain outstanding for one month or less after the date on which they were billed or fell due."

Breach of the FRR

7. According to the financial returns submitted by Potomac to the SFC, Potomac had an excess liquid capital of over $5 million from November 2016 to May 2017.

8. A major component of its liquid capital, i.e. "other assets arising from asset management", was comprised solely of account receivables from two clients (**Clients**).

9. The evidence shows that Potomac had included in its liquid assets certain fees receivables from the Clients outstanding and accumulated since around April 2013, which fall outside the length of period (i.e. 1 or 3 months depending on whether the fee receivable has been accrued, billed or fallen due for payment) prescribed under section 35(a) of the FRR (**Aged Receivables**).

10. Had the Aged Receivables been excluded, the liquid capital of Potomac would have been much lower, and Potomac would have had a required liquid capital deficit, varying from $335,000 to $449,000, for 4 months from February to May 2017.

11. It appears that Potomac had incorrectly included the Aged Receivables in its liquid assets, and hence overstated its liquid capital, for more than 3 years as a result of its misinterpretation of section 35(a) of the FRR. Potomac rectified the breach after the SFC pointed that out to Potomac in or around June 2017.

Conclusion

12. Having considered all relevant circumstances, the SFC is of the opinion that Potomac has been guilty of misconduct, and its conduct was in 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 to act with due skill, care and diligence, in the best interest of its clients and the integrity of the market; and

    (b) General Principle 7 (Compliance) and paragraph 12.1 (Compliance: in general) of the Code of Conduct, which require a licensed person to comply with all law, rules and regulatory requirements applicable to the conduct of its business activities.

13. In deciding the disciplinary sanction set out in paragraph 1 above, the SFC has taken into account all relevant circumstances, including:

    (a) Potomac had incorrectly included the Aged Receivables in its liquid capital for more than 3 years;

    (b) Potomac has rectified the FRR breach; and

    (c) Potomac's otherwise clean disciplinary record.