

A regular communication about the SFC's enforcement work

Welcome to the new series

With this issue, the Securities and Futures Commission (SFC) relaunches its *Enforcement Reporter* as a biannual newsletter to provide the market with regular updates on our current enforcement work and priorities.

Each issue of the *Enforcement Reporter* will highlight specific issues that are the focus of our enforcement efforts. We hope that you find the newsletter useful.

Highlights

- New enforcement approach and priorities
- Notable recent cases
- Collaboration with Mainland regulators
- Tips for market players

The SFC's new enforcement approach

Strategic review

During a comprehensive strategic review of our enforcement priorities, tools, policies and organisational structure, we identified a number of initiatives to make us more responsive and focused. Among them, we will focus our resources on high-priority cases that pose the greatest risks to our markets and adopt a specialist team structure which is fully aligned with our key priorities.

Notable enforcement priorities

Corporate fraud and misfeasance

Our top priority is listed company-related fraud and misfeasance, which in recent years has wiped out billions in market capitalisation and caused significant damage to the integrity and reputation of our markets. We formed a specialised team to focus on these cases as they pose one of the greatest threats to investors.

Anti-money laundering

SFC licensees are vulnerable to being used to launder the proceeds of crime and to finance terrorism. We rely on licensees to implement effective anti-money laundering (AML) measures to prevent and detect these criminal activities and we expect them to take their AML responsibilities seriously. Licensees and their senior management must ensure their AML internal controls comply with the requirements under the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance and the SFC Guideline on Anti-Money Laundering and Counter-Terrorist Financing.

Satisfactory completion of customer due diligence before commencing each business relationship is particularly important, as thorough customer due diligence is the cornerstone of effective AML controls.

A specialised team is investigating a number of cases involving licensed brokers whose AML internal controls are suspected to be inadequate and we may bring enforcement proceedings. We will impose tough sanctions on licensees if our investigations confirm regulatory breaches.



Growth Enterprise Market

We noted significant volatility in the share prices of newly listed Growth Enterprise Market (GEM) companies. In addition, we have observed possible shell creation on GEM, a concern that was also reported in recent media commentaries. Such concerns may be putting investors' interests at risk and could undermine Hong Kong's status as a leading financial centre. We are seeking to prevent the creation and use of listed shells and have been conducting inquiries into possible shell companies. We formed a specialised team to investigate suspected misconduct in this space, and where we can prove that such activities are taking place, we will take appropriate action to address the problem.

We recognise and give credit for cooperation and value timely, open and transparent disclosure of material misconduct.

Market surveillance

There is a rising trend of cyber-hacking customer accounts to profit by trading into the volatility created, especially with less liquid counters. Our surveillance team has detected a pattern among these incidents and we have shared intelligence with the Hong Kong Police and international agencies to curb these activities.

For all transactions and orders reported on the exchanges in Hong Kong, measures are in place to monitor untoward market behaviour in real time and retrospectively across the equities and derivatives markets.

This year, we detected a rise in incidences of extreme high shareholding concentrations, even for many newly listed companies. We are closely monitoring this situation and other market irregularities.

Focusing on systemic problems

It is common for industry participants to conduct their businesses via various group companies. Going forward, if the SFC identifies multiple failings within a company or corporate group, it will consider them together to assess whether they are attributable to systemic weaknesses. Companies and corporate groups with serious, extensive or repeated failings will be targeted for enforcement actions.

We believe that taking a holistic enforcement approach focused on tackling systemic issues is an effective way to send clear and strong deterrent messages to the public and promote a good compliance culture amongst major market players. As part of this approach, we may consider the use of independent reviewers to ensure that firms have identified and addressed all systemic problems. The use of independent reviewers should not be seen as a compromise of our standards. Their role is to provide us with assurance that all underlying causes of a firm's regulatory failings have been addressed.





Cooperation

To encourage cooperation and possible settlement negotiations in appropriate cases, towards the end of our investigations we may notify the parties under investigation of our intention to take enforcement action. We would not do this automatically in every case. Rather, we would do it when we think it would be useful in disciplinary, civil and Market Misconduct Tribunal proceedings.

The parties, either directly or through their legal advisers, would have an opportunity to make submissions, which may be on the record, to bring any additional relevant facts to our attention, set out any legal reasons as



to why the proposed enforcement action should not proceed or propose a settlement.

We will not be using this process in criminal proceedings so as not to fetter the Department of Justice's prosecutorial discretion.

Notable recent cases

Directors of Freeman FinTech Corporation Limited

In October 2016, we commenced legal proceedings in the Court of First Instance to seek disqualification orders against 10 directors of Freeman FinTech Corporation Limited for allegedly breaching director duties. This case shows our intention to take proceedings against senior management where appropriate.

State Street Global Advisors Asia Limited

We reprimanded and fined State Street Global Advisors Asia Limited (SSGA) \$4 million in June 2016 for its failure to manage and minimise the conflict between its interests and the interests of the investors of the Tracker Fund of Hong Kong, an exchange-traded fund under its management. This failure led to the Tracker Fund of Hong Kong receiving interest payments at a rate lower than the prevailing commercial rate, for a deposit of that size and term, on its cash balances from a connected person of SSGA.

In deciding the sanctions, we gave credit for SSGA's cooperation and for its agreement to engage an independent reviewer to conduct an internal control review of the cash management policy and procedures of SFC-authorized funds managed by SSGA.

BNP Paribas Wealth Management

In an example of granting credit for cooperation during an investigation, we reprimanded and fined BNP Paribas Wealth Management \$4 million in August 2016 for taking monetary benefits in excess of the levels stated in its client documentation. In determining the sanction, we considered that BNP had actively cooperated in resolving our concerns and agreed to engage an independent reviewer to ensure the return of all overcharged amounts to affected clients.

Morgan Stanley Hong Kong Securities Limited

Also in August 2016, we resolved our concerns with Morgan Stanley over its internal control failures. In reaching the resolution with Morgan Stanley, which was reprimanded and fined \$18.5 million, we took into account its cooperation during our investigation and its willingness to engage an independent reviewer to ensure ongoing compliance with regulatory requirements. In this case, we considered multiple breaches together with a view to assessing whether the firm is suffering from systemic weaknesses.

Unicorn Securities Company Limited and its former responsible officer

In March 2016, we reprimanded Unicorn Securities Company Limited and fined it \$3 million and its former responsible officer, Chan Hoi Shu, \$200,000 for their failures in handling clients' money and securities. Chan was also suspended for 15 months. This case demonstrates that we stand ready to take enforcement actions against both the corporate group and its senior management.

J.P. Morgan Group

This case clearly illustrates how we have holistically handled multiple breaches across a corporate group and given credit for cooperation. We reprimanded three companies in the J.P. Morgan Group in December 2015 for failing to implement adequate systems and controls to comply with the rules and regulations applicable to short selling activities, client facilitation and principal trading business, and dark liquidity pool trading services. We also fined them a total of \$30 million. In determining the sanctions, we took into account the group's early cooperation in resolving our concerns and its agreement to engage an independent reviewer to examine its internal control systems.

Collaboration with Mainland regulators

Following the expansion of the Mainland-Hong Kong Stock Connect programme, trading between the Hong Kong and Mainland stock markets is expected to increase. The China Securities Regulatory Commission (CSRC) and the SFC have long maintained a very close strategic enforcement partnership. The two regulators will continue to strengthen their collaboration in surveillance and joint investigations in order to tackle cross-boundary trading misconduct affecting markets in both Hong Kong and the Mainland.

From 2 to 4 November 2016, the CSRC and the SFC jointly held a conference in Xi'an to discuss market manipulation issues. Experts from the US, Canada, UK and Australia shared their views on new and emerging techniques employed by wrongdoers to manipulate our markets, including those involving high frequency and algorithmic trading.





Tips for market players

- We recognise and give credit for cooperation – cooperate with us as early as possible during our enforcement actions.
- We value timely, open and transparent disclosure of misconduct – contact us when you discover any material misconduct.
- Have in place effective internal control systems and procedures – internal control failure is a very common issue observed in our investigations.
- Ensure that senior management (whether or not licensed by us) are fully aware that they are accountable for the misconduct of their firms.

If you want to receive the *Enforcement Reporter* by email, simply subscribe at the SFC website at www.sfc.hk and select *Enforcement Reporter*.

The SFC published the first series of *Enforcement Reporter* from 2002 to 2011. This second series was launched in 2016.

All issues of the *Enforcement Reporter* are available under 'Published resources – Industry-related publications – *Enforcement Reporter*' on the SFC website.

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