
REGULATORY NEWSLETTER

2019 Vol.6



Happy Dragon Boat Festival!

On top of the traditional dumplings and dragon boat races, consider relaxing over the long weekend with our latest issue of the Regulatory Newsletter...mm nothing says chill like catching up with SFC's latest enforcement actions and increasingly stringent requirements.

REGULATORY UPDATES

Online submission of Paragraph 12.5 Notifications

10 May 2019

Under paragraph 12.5 of the Code of Conduct for Persons Licensed by or Registered with the SFC, intermediaries must submit notification to the SFC upon, among other circumstances, any occurrence of material or suspected breach, infringement of non-compliance with any law, rules, regulations or codes administered by the SFC ("Paragraph 12.5 Notifications").

The SFC has introduced a new online service for licensed and registered person to submit "Paragraph 12.5 Notifications" electronically.

For details of the submission process, please refer to the [demonstration videos](#) and [user guides](#) prepared by the SFC.

The online service features standardised reporting templates for intermediaries to submit a notification to the SFC. It also facilitates the SFC's assessment of the impact of reported incidents on the fitness and properness of intermediaries, licensed representatives and responsible officers.

Recent inspection findings related to client facilitation

14 May 2019

The SFC has identified a number of conduct issues associated with client facilitation and provided guidance to the industry to address them.

The SFC listed out some expected standards

- Controls, monitoring and management supervision
 - Sufficient management oversight to ensure that trade exceptions and other matters related to client facilitation are review.
 - Policies and procedures should cover the key area relating to client facilitation and such policies and procedures should be review and update on a regular basis.
 - Established control functions to properly manage the risk associated with client facilitation and to ensure controls for detecting and addressing potential misconduct
- Segregation of agency and facilitation activities
 - Protect sensitive client information and avoid conflicts of interest, the physical work locations of agency and client facilitation should be segregated.
 - Protect client facilitation traders from accessing agency order flows in trading systems
 - Communications between agency and client facilitation traders should be recorded and monitored
- Consent and disclosure
 - When dealing with client facilitation activities, LCs should have prior consent obtained so that they are fully aware of the inherent conflicts of interest.
 - Client consent is required where wither client- facing staff who handle client facilitation orders or the client facilitation desk are located in Hong Kong
- Indications of interest (“IOIs”)
 - IOIs should only be disseminated when they are based on genuine client proprietary intent to trade.
 - IOIs should Implement controls and monitoring to ensure they are **accurate** and updated in a timely manner

LCs are advised to critically review existing policies and procedures and revise them to ensure that they are clear, in full compliance with the expected standards and have been properly implemented and communicated to all relevant staff.

Third-party deposits and payments

31 May 2019

The SFC reiterates the importance of mitigating the risks associated with third-party payments to or from accounts maintained by clients with LCs and associated entities AEs, and are reminded to enforce appropriate and effective control measures to address these risks.

Third-party deposits and payments may be used to facilitate the misappropriation of client assets, money laundering and other misconduct, as the arrangement may be used to disguise the true beneficial owner or the source of funds.

The SFC have listed some expected standards when handling third party deposit, LC and AEs should:

- put in place clear and detailed policies and procedures and receive approval from senior management.
- set out the control measures to be carried out before accepting any such deposits and designate the managers and staff members responsible for carrying out these control measures.
- put in place effective monitoring systems and controls to identify third-party deposits into their bank accounts and deal with them in accordance with their policies and procedures.
- conducted due diligence to determine: (a) the identity of the third-party payor; (b) the relationship between the client and the third-party payor; and (c) the reason for receiving the deposit from the third party.
- take reasonable measures on a risk-sensitive basis to verify the identities of third-party payors and ascertain their relationships with clients.
- Exercise extra caution when the relationship between the client and the third-party payor is hard to verify.
- critically evaluate the reasons and the need for third-party deposits
- conduct on-going monitoring of client accounts involving third-party deposits and pay special attention to red flags relating to third-party transactions.
- weigh financial crime and compliance risks when deciding whether to accept such a request

The SFC strongly encourages LCs to require their clients to designate bank accounts held in their own names or the names of acceptable third parties for the making of all deposits and withdrawals as this will make it easier to complete due diligence to determine the acceptability of a third-party payor or payee before effecting a third-party deposit or payment, and to ascertain whether deposits have originated from their clients or acceptable third parties.

A clear and sufficient guidance should be provided to the staff responsible for evaluating whether a third-party deposit or payment is reasonable and meets the criteria. Findings of inquiries made and corroborative evidence should be properly documented. LCs should inform their clients their policies for handling third-party deposits and payments in writing.

Senior management of LCs, including the MIC of AML/CFT, bear the primary responsibility for maintaining appropriate standards and adhering to proper procedures. The SFC will take action

against those who are responsible for failures to put in place appropriate and effective policies, procedures and controls for handling third-party deposits and payments.

[View Circular](#)

ENFORCEMENT NEWS

SFC reprimands and fines China Merchants Securities (HK) Co., Limited \$27 million for sponsor failures

The SFC reprimanded and fined China Merchants Securities(HK) Co.,Limited (“CMS”) \$27 million for failing to discharge its obligation as a joint sponsor in relation to the listing application of China Metal Recycling (Holdings) Limited (“China Metal”).

The SFC’s Investigation revealed that CMS and UBS failed in their due diligence as joint sponsors to address a number of unusual facts and finding on China Metal and its customers during the listing process. Inadequate due diligence with respect to a deregistered customer, on third party payments and on China Metal’s suppliers and customers.

[View News](#)

SFC reprimands and fines China Merchants Securities (HK) Co. Limited \$5 million for mishandling client money

The SFC found 800 incidents between 1st October 2011 to 30 September 2014, where China Merchants transferred funds ranging from \$68,000 to 308 million from client trust accounts for purposes other than those specifically allowed by the SFC (Client Money) Rules. It was found that China Merchants:

- transferred funds from client trust account to house account during segregation process;
- transferred funds from client trust accounts for repayment of China Merchants’s bank loans;
- transferred funds from client trust accounts for granting term loans to China Merchants’s clients;
- transferred funds from client trust accounts for purposes of funding proprietary investments of China Merchants’s fellow subsidiary company;
- transferred funds from client trust accounts for purposes of paying China Merchants's expenses;
- transferred a rounded amount from a client trust account for purposes of facilitating potential client withdrawal requests, settlement of securities dealing in overseas markets and fee payments for stock lending/borrowing;
- transferred from client trust accounts to two settlement accounts maintained with an affiliated broker in order to maintain minimum amounts of deposits to satisfy requirements for trading B-shares in the stock exchanges of Shenzhen and Shanghai; and
- transferred inaccurate amounts of money to/from client trust accounts during client money segregation.

[View News](#)



ComplianceDirect Consulting Limited

Address: Unit A, 21/F, Wing Hang Insurance Building, 11 Wing Kut Street, Central, Hong Kong

Phone: 2606 1800

Website: www.compliancedirecthk.com
