

# REGULATORY NEWSLETTER

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## Enforcement News

### **SFC reprimands and fines Ardon Maroon Fund Management (Hong Kong) Limited \$800,000 for cross trade related failures**

27 Dec 2018

<https://www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/doc?refNo=18PR146>

The SFC had reprimanded and fined Ardon Maroon Fund Management (Hong Kong) Limited (Ardon Maroon) (now known as China Silver Asset Management (Hong Kong) Limited) \$800,000 for cross-trade related failures in managing the Ardon Maroon Asia Master Fund (AM Fund) maintain proper documentary records of the investment advice or recommendations given to its clients.

Ardon Maroon was found to have given instructions to a brokerage to execute a cross trade for 15 million shares of a listed company on the Stock Exchange of Hong Kong on 8 August 2014, which resulted in the AM Fund conducting a wash trade. Ardon Maroon then instructed another brokerage to deliver the relevant shares to settle the wash trade.

The disciplinary action followed the SFC's investigation which found that Ardon Maroon failed to:

- act in the best interests of market integrity in accordance to Section 274 and 295 of the Securities and Futures Ordinance; and
- act in the best interests of the holders of the fund because by doing so, the fund incurred undue transaction costs of over \$133,000.



## Regulatory Updates

### **Review of internal controls for the protection of client assets and supervision of account executives**

19 Dec 2018

<https://www.sfc.hk/edistributionWeb/gateway/EN/circular/doc?refNo=18EC94>

The Securities and Futures Commission (SFC) has identified a number of cases of misconduct by account executives (AEs) which had jeopardised clients' interests. More serious cases involved unauthorised trading and misappropriation of client assets. These cases revealed serious internal control deficiencies in key operational areas and inadequate management supervision of AEs by licensed corporations (LCs).

Subsequently, the SFC conducted a high-level review of control measures for protecting client assets and a thematic review of brokers' internal controls, including their supervision of AEs. In the "Report on the review of internal controls for the protection of client assets and supervision of account executives", the SFC summarised the findings of these reviews and shared some good practices for LCs to consider in reviewing their control policies and procedures.

The report set out the SFC's key regulatory concerns identified in the reviews, which included:

1. Misaligned incentives in remuneration systems;
2. Insufficient segregation of duties;
3. Inadequate controls to protect client accounts; and
4. Insufficient compliance checks of client accounts.

Pursuant to the expected standards which the SFC imposed on the LCs, the report emphasised that LCs and their senior management, including Managers-in-Charge, bear the primary responsibility for maintaining appropriate standards of conduct and robust policies and procedures to adequately protect client assets and diligently supervise their staff. Failure to put in place effective supervisory and control systems for these purposes may subject LCs and their senior management to the SFC's regulatory action.

## **Circular on Leveraged and Inverse Products**

17 Dec 2018

<https://www.sfc.hk/edistributionWeb/gateway/EN/circular/doc?refNo=18EC87>

The SFC would consider authorising leveraged and inverse products structured as exchange traded funds (ETFs) for public offering in Hong Kong under sections 104 and 105 of the Securities and Futures Ordinance.

Hereafter, leveraged and inverse products structured as ETFs are referred to as "Leveraged Products" and "Inverse Products" respectively, and "L&I Products" collectively. To produce the specified leveraged or inverse return, these products have to rebalance their portfolios, typically on a daily basis.

L&I Products seeking SFC authorization for public offering in Hong Kong must meet the applicable requirements in the Overarching Principles Section (Overarching Principles Section) and the Code on Unit Trusts and Mutual Funds (UT Code) in the SFC Handbook for Unit Trusts and Mutual Funds, Investment-Linked Assurance Schemes and Unlisted Structured Investment Products (SFC Handbook).

In view of its' novelty and the technical complexity, to protect the interests of the investing public of Hong Kong and to maintain the integrity of the Hong Kong market, L&I Products that are seeking SFC authorization for public offering in Hong Kong should meet the additional requirements set out below,

1. Product naming;
2. Product Structure;
3. Offering documents disclosure;
4. Market making arrangements;
5. Performance simulator;

**SFC reprimands and fines  
SFM HK Management  
Limited \$1.5 million over  
naked short selling**

6 Dec 2018

<https://www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/doc?refNo=18PR134>

The Securities and Futures Commission (SFC) has reprimanded and fined SFM HK Management Limited (SFM) \$1.5 million for failures relating to the short selling of Great Wall Motor Company Limited (Great Wall) shares in 2015 on behalf of a fund it managed.

SFM erroneously treated 1,616,000 bonus shares as shares available for trading and subsequently placed an order to sell the shares even though Great Wall did not make any public announcement regarding the fulfilment of conditions of such bonus shares prior to the settlement date.

The disciplinary action followed the SFC's investigation which found that SFM failed to:

- act with due skill, care and diligence in dealing in the bonus shares; and
- diligently supervise its staff members and implement adequate and effective systems and controls to ensure compliance with the short selling requirements.

6. Distribution; and

7. Margin Financing.

The SFC understands that this is the first time that L&I Products may seek authorization from the SFC. If you wish to seek clarification of any aspects of this circular, please contact the team supervisor or case officer of the Investment Products Division who is responsible for overseeing the SFC-authorized funds of your fund group or client.

**Reminder of effective dates of new requirements under the Securities and Futures (Financial Resources) (Amendment) Rules 2018**

12 Dec 2018

<https://www.sfc.hk/edistributionWeb/gateway/EN/circular/doc?refNo=18EC90>

The circular reminds all licensed corporations of the effective dates of the different sections of the Securities and Futures (Financial Resources) (Amendment) Rules 2018, which was gazetted on 19 October and laid on the table of the Legislative Council meeting on 24 October.

1. New requirements to be effective on 1 January 2019

Sections 1, 2, 3(2) to (4) and 30 of these amendment rules will come into operation on 1 January 2019.

2. New requirements to be effective on 1 April 2019

With the exception of the sections mentioned above, the other sections will come into operation on 1 April 2019.

## **Distribution of complex and high-risk products**

7 Dec 2018

<https://www.sfc.hk/edistributionWeb/gateway/EN/circular/doc?refNo=18EC89>

The Securities and Futures Commission (SFC) reminds intermediaries to observe the requirements governing selling practices, including the suitability obligations under the Code of Conduct, when they distribute structured products and corporate bonds with complex features or high risks.

With effect from 6 April 2019, intermediaries will be required to ensure that a transaction in a complex product is suitable for the client in all circumstances irrespective of whether a solicitation or recommendation is made. Intermediaries will also be required to provide information and warning statements about the complex products to the client.

When distributing complex products, intermediaries should:

- a) conduct product due diligence taking into account, amongst other factors, their features, risks and any restrictions on their sale or target customers, and in what aspects they are considered suitable for clients;
- b) ensure that the products' risk-return profiles match the client's financial situation, investment objectives, investment experience, risk tolerance and other specific circumstances;
- c) provide clients with sufficient and accurate information about the products, including their features and risks, and always present balanced views and not focus solely on the products' advantages; and
- d) provide staff with adequate training on the products they distribute and how to appropriately disclose the products' features and risks to clients.

The SFC will be using a range of supervisory tools, including inspections, to monitor compliance and takes regulatory action against licensed corporations found to have breached the requirements.