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## SFC reprimands and fines Delta Asia Securities Limited

4 Jun 2014

The Securities and Futures Commission (SFC) has issued a reprimand to Delta Asia Securities Limited (Delta Asia) and fined it \$4 million for failing to reasonably ensure that client securities were properly safeguarded (Note 1).

The SFC found that during the period from January 2010 to February 2013, Delta Asia used shares belonging to clients and held in segregated client accounts at the Central Clearing and Settlement System (CCASS) to settle transactions for its other clients who did not have sufficient shares in their accounts to discharge their respective settlement obligations on the settlement date. This occurred without the consent or authorization of the clients whose shares were used for settlement in contravention of the Securities and Futures (Client Securities) Rules on 36 occasions during the period (Notes 2 & 3).

The SFC also found that Delta Asia failed to implement proper controls to safeguard client securities and to supervise its staff in discharging its settlement function, thus allowing the unauthorized transfers of client securities from the CCASS segregated client accounts to its CCASS clearing account to have gone unchecked for more than three years.

Safe custody of client assets is a fundamental obligation of licensed corporations. Any transgression of this obligation, even if the relevant clients are made whole again, cannot be tolerated. In the present case, Delta Asia had clearly breached this fundamental obligation and prejudiced the interests of its clients.

In deciding the sanctions, the SFC took into account that Delta Asia has co-operated with the SFC in resolving these disciplinary proceedings.

End

Notes:

1. Delta Asia is licensed under the Securities and Futures Ordinance to carry on Type 1 (dealing in securities), Type 3 (leveraged foreign exchange trading) and Type 4 (advising on securities) regulated activities.
2. Sections 6 and 10 of the Securities and Futures (Client Securities) Rules respectively specifies the circumstances in which intermediaries may withdraw or otherwise deal with client securities received or held on behalf of clients and requires intermediaries to take reasonable steps to ensure that client securities are not deposited, transferred, etc, except in the manner specified in the rules.
3. In addition, the SFC found that on two occasions during the period, Delta Asia had transferred shares belonging to clients and held in the CCASS segregated client accounts to its CCASS clearing account, with a view to settling the transactions for Delta Asia's other clients who did not have sufficient shares in their accounts to discharge their respective settlement obligations on the settlement date. However, the transferred shares were eventually not sent to the Hong Kong Securities Clearing Company Limited for settlement purpose as a result of the netting of Delta Asia's positions in the same security on the same day. This occurred without the consent or authorization of the clients whose shares were transferred and were in breach of the Securities and Futures (Client Securities) Rules notwithstanding that the transferred shares were eventually not used for settlement purpose.
4. A copy of the [Statement of Disciplinary Action](#) in relation to the matter is available on the SFC website.

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## STATEMENT OF DISCIPLINARY ACTION

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### The Disciplinary Action

1. The Securities and Futures Commission (SFC) has publicly reprimanded Delta Asia Securities Limited (Delta Asia) and fined it \$4,000,000 pursuant to section 194 of the Securities and Futures Ordinance.
2. The disciplinary action is taken because Delta Asia has used client securities to settle the transactions of other clients and/or transferred client securities out of segregated client accounts at the Central Clearing and Settlement System (CCASS) without obtaining the prior consent of the relevant clients.

### Summary of facts

3. During the course of a limited review of Delta Asia's operation conducted by the SFC's Intermediaries Supervision Division (ISD) in April 2013, Delta Asia reported to ISD that there had been 35 incidents of settlement shortfalls between 17 March 2010 to 20 February 2013, with the shortfall temporarily covered by other shares or by purchase of the relevant shares on the next day.
4. The SFC conducted an investigation into the activities of Delta Asia, including but not limited to its internal policies and controls in relation to trade settlement. In the course of the investigation, Delta Asia reported 3 additional incidents of settlement shortfalls to the SFC.

### Use of client securities to settle the transactions of other clients

5. Delta Asia is a participant of the Central Clearing and Settlement System (CCASS) of the Hong Kong Securities Clearing Company Limited (HKSCC) and it maintains a number of stock accounts in CCASS, including the following:
  - (a) "01" Clearing account (for settling transactions in CCASS)
  - (b) "03" Margin Clients account (for holding margin clients' securities)
  - (c) "07" Custody account (for holding custodian clients' securities)
  - (d) "011" BDA-client account (an omnibus account for holding securities belonging to clients of Banco Delta Asia<sup>1</sup>).
6. The SFC found that the settlement shortfalls reported by Delta Asia arose as a result of late delivery of physical scrip for settlement / late registration of physical scrip delivered for settlement, or as a result of overselling due to a mistake made by the client / by Delta Asia's sales staff.

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<sup>1</sup> Banco Delta Asia is a Macao-based bank and it provides securities trading services to its customers through an omnibus client account maintained with Delta Asia. Both Banco Delta Asia and Delta Asia belong to the Delta Asia Financial Group.

7. In 36 of the 38 incidents of settlement shortfall reported by Delta Asia, which occurred between January 2010 to February 2013 (**Relevant Period**), Delta Asia transferred securities belonging to other clients and held in its CCASS "03" Margin Clients account or "07" Custody account or "011" BDA-client account to its CCASS "01" Clearing account to enable it to settle the relevant transaction with HKSCC. The securities so transferred were then sent to HKSCC for settlement purpose.
8. With respect to the 2 remaining reported incidents of settlement shortfall, Delta Asia had transferred client securities from its CCASS segregated client accounts to its CCASS clearing account, with a view to covering the settlement shortfall, but the securities so transferred were ultimately not sent to HKSCC for settlement purpose as a result of the netting of Delta Asia's positions in the same security on the same day.
9. There is no evidence that Delta Asia had obtained the consent of the clients whose securities had been so used or transferred.
10. Although there is no evidence that Delta Asia's clients have suffered any loss as a result of its practice of using client securities to settle, or transferring client securities from its CCASS segregated client accounts to its CCASS clearing account with a view to settling, other clients' transactions, such practice clearly and fundamentally jeopardizes its clients' interests. Such practice also breaches sections 6 and 10 of the Securities and Futures (Client Securities Rules) (**CSR**), which respectively specifies the circumstances in which intermediaries may withdraw or otherwise deal with client securities received or held on behalf of clients and requires intermediaries to take reasonable steps to ensure that client securities are not deposited, transferred, etc, except in the manner specified in the CSR.

#### Internal Control and Supervisory Failures

11. During the Relevant Period, Delta Asia had no written manual, guidelines, policy or procedure as to how settlement shortfalls should be handled.
12. According to the information provided by Delta Asia's Operations Officer, during the Relevant Period, when a settlement shortfall was identified, Delta Asia's then Operations Manager would instruct him to check whether Delta Asia had the relevant stocks in its CCASS client accounts. If so, he would use the stocks Delta Asia held for other clients in its CCASS account to settle the transactions.
13. The evidence of Delta Asia's Operations Officer was consistent with the way in which Delta Asia handled the 38 incidents of settlement shortfall it reported, as revealed by the documentary evidence provided by Delta Asia. As such, during the Relevant Period, the practice of using client securities to cover the settlement shortfalls of other clients pending the latter delivering and/or buying back the requisite securities seems to have been well established.
14. The above suggests that Delta Asia did not have adequate internal controls and procedures in place in relation to the handling of shortfalls during the settlement process, thus allowing the practice of using client assets (securities)

to settle other clients' transactions to have gone unchecked for at least more than 3 years.

15. Further, although Delta Asia had a Stock Short Summary Report which identified the short positions of its clients, neither the management nor the compliance function reviewed this report. The settlement staff was left to review, and resolve issues arising out of, the report with little, if any, guidance and supervision from management. This shows that Delta Asia's management took no active steps to supervise or monitor the operation of the settlement functions, and they simply relied on the settlement staff to identify and report any settlement issues to them.

### **Breaches and reasons**

16. In addition to the specific requirements under the CSR set out in paragraph 10 above, Delta Asia, as a licensed corporation, has a duty:
  - (a) under General Principle 2 of the Code of Conduct<sup>2</sup>, to exercise due skill, care and diligence and to act in the best interests of its clients;
  - (b) under General Principle 3 of the Code of Conduct, to have and employ effectively the resources and procedures which are needed for the proper performance of its business activities;
  - (c) under General Principle 7, to comply with all regulatory requirements applicable to the conduct of its business activities so as to promote the best interest of clients and the integrity of the market;
  - (d) under General Principle 8 of the Code of Conduct, to ensure that client assets are promptly and properly accounted for and adequately safeguarded;
  - (e) under paragraph 4.3 of the Code of Conduct, to have internal control procedures and financial and operational capabilities which can be reasonably expected to protect its operations, its clients and other licensed or registered persons from financial loss arising from theft, fraud, and other dishonest acts, professional misconduct or omissions;
  - (f) under paragraph 11.1(a) of the Code of Conduct, in handling of client transactions and assets, to act to ensure that client assets are accounted for properly and promptly;
  - (g) under paragraph 12.1 of the Code of Conduct, to comply with, and implement and maintain measures appropriate to ensure compliance with the law, rules, regulations and codes administered or issued by the SFC; and
  - (h) under Part VII of the Management, Supervision and Internal Control Guidelines for Persons Licensed by or Registered with the SFC (**Internal**

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<sup>2</sup> Code of Conduct for Persons Licensed by or Registered with the SFC

**Control Guidelines**), to establish, maintain, and ensure compliance with effective policies and operational procedures and controls in relation to the firm's day-to-day business operations, and the effectiveness of such operational procedures and controls will be evaluated in the light of whether they serve to ensure, amongst other things, the safeguarding of both the firm's and its clients' assets.

17. In this case, in addition to the breaches set out in paragraph 10 above, Delta Asia has also breached:
  - (a) General Principles 2 and 8 and paragraph 11.1(a) of the Code of Conduct in using one client's securities to settle another client's transaction and in transferring client securities out of its CCASS client segregated accounts into its CCASS clearing account without the relevant clients' prior consent;
  - (b) General Principle 3 and paragraphs 4.2 and 4.3 of the Code of Conduct, as well as Part VII of the Internal Control Guidelines in failing to have in place and implement proper internal control procedures in relation to the handling of settlement shortfalls and in not having adequate management supervision over its settlement function in relation to the handling of settlement shortfalls; and
  - (c) General Principle 7 and paragraph 12.1 of the Code of Conduct in failing to comply with, and implement and maintain measures appropriate to ensuring compliance with, the law, rules, regulations and codes administered or issued by the SFC.

## **Conclusion**

18. Having considered all the circumstances, the SFC is of the view that Delta Asia's fitness and properness as a licensed corporation has been called into question.
19. In deciding the disciplinary sanction, the SFC has had regard to the SFC Disciplinary Fining Guidelines and taken into account all relevant circumstances, including the duration of Delta Asia's malpractice, Delta Asia has no previous disciplinary record and that Delta Asia has co-operated with the SFC in resolving these disciplinary proceedings.