

## STATEMENT OF DISCIPLINARY ACTION

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### The Disciplinary Action

1. The Securities and Futures Commission (**SFC**) has publicly reprimanded and fined China Everbright Securities (HK) Limited (**CESL**)<sup>1</sup> HK\$3.8 million pursuant to section 194 of the Securities and Futures Ordinance (**SFO**).
2. The disciplinary action is taken in respect of CESL's failure to implement adequate and effective internal anti-money laundering and counter-financing of terrorism (**AML/CFT**) systems and controls to guard against and mitigate the risk of money laundering and terrorist financing (**ML/TF**) associated with third party deposits (**TPDs**) between January 2015 and February 2017 (**Relevant Period**). In particular, CESL failed to effectively identify and monitor the TPDs made through the sub-accounts maintained by it with a local bank (**Sub-Accounts**) and detect suspicious client fund deposits.

### Summary of Facts

#### *Failure to identify TPDs made through the Sub-Accounts*

3. During the Relevant Period, CESL's clients could deposit money to their securities accounts through CESL's designated pool accounts maintained with various banks (**Pool Accounts**) and / or the Sub-Accounts.
4. CESL had procedures in place to identify TPDs made through the Pool Accounts such as requiring clients to provide supporting documents of the depositors' identities. However, the procedures did not apply to client deposits made through the Sub-Accounts.
5. The SFC reviewed 234 samples of client deposits made through the Sub-Accounts. Amongst these deposits, 179 of them (76%) were deposited by third parties, but none except one of them was identified by CESL as TPDs during the Relevant Period. The unidentified TPDs amounted to over HK\$250 million.
6. According to CESL, while it did not require its clients to provide supporting documents for the deposits made through the Sub-Accounts, it implemented a monthly assessment process (**Monthly Review**) since March 2016 whereby its compliance team would randomly select up to 25 client deposits in the Sub-Accounts and request the local bank to provide supporting documents for these deposits.
7. However, the Monthly Review was deficient and ineffective in identifying TPDs, in that:
  - (a) the review was performed after the deposits had already been accepted and on a limited sampling basis;

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<sup>1</sup> CESL is licensed under the SFO to carry on business in Type 1 (dealing in securities), Type 4 (advising on securities), Type 6 (advising on corporate finance) and Type 9 (asset management) regulated activities.

- (b) CESL was not able to produce any written replies from the local bank to its requests for information for the selected samples;
- (c) according to two CESL's former compliance officers responsible for conducting the Monthly Review, CESL received only two or no replies from the local bank to their requests for information about the depositors' identities; and
- (d) one of the former compliance officers also confirmed that, although the results of the Monthly Review were stated to be "satisfactory" in the record, the reviews were in fact unfinished given the lack of response from the local bank.

*Failure to detect suspicious client fund deposits*

- 8. The SFC identified suspicious fund deposits in some CESL's client accounts, for instance:
  - (a) 11 clients received five or more deposits from multiple third parties, whose relationships with the clients were unknown.
  - (b) The amount of net deposits received by seven clients were not commensurate with their estimated net assets. In two cases, the net amount of funds deposited into the client accounts exceeded 12 and 14 times their estimated net assets.
  - (c) In one instance, five clients, who did not appear to have any relationship with each other, received a total of approximately HK\$5 million from the same third party within four days, and they used the funds to trade in the same stock.
- 9. Despite the presence of the above red flags, CESL did not detect the suspicious client fund deposits and make appropriate enquiries during the Relevant Period.

*The SFC's findings*

- 10. CESL's failures set out above constitute a breach of:
  - (a) Section 23 of Schedule 2 to the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (**AMLO**) and paragraph 2.1 of the Guideline on Anti-Money Laundering and Counter-Terrorist Financing (April 2015 edition) (**AML Guideline**), which require licensed corporations to implement appropriate internal AML/CFT policies, procedures and controls and take all reasonable measures to ensure that proper safeguards exist to mitigate the risks of ML/TF and prevent a contravention of any customer due diligence and record keeping requirements under the AMLO.
  - (b) General Principle 3 of the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (**Code of Conduct**), which requires licensed corporations to have and employ effectively the resources and procedures which are needed for the proper performance of their business activities.

- (c) Section 5(1)(b) of Schedule 2 to the AMLO and paragraph 5.1(b) of the AML Guideline, which require licensed corporations to continuously monitor their business relationship with the clients by monitoring their activities to ensure that they are consistent with their knowledge of the clients and the clients' business, risk profile and source of funds.
- (d) Section 5(1)(c) of Schedule 2 to the AMLO and paragraphs 5.1(c), 5.10 and 5.11 of the AML Guideline, which require licensed corporations to identify transactions that are complex, large or unusual, make relevant enquiries to examine the background and purpose of the transactions, document the enquiries made (and their results), and report the findings to the Joint Financial Intelligence Unit (**JFIU**) where appropriate.
- (e) Paragraphs 7.11, 7.14 and 7.39 of the AML Guideline, which require licensed corporations to identify situations that might give rise to a suspicion of ML/TF and make appropriate disclosure to JFIU.
- (f) The "*Circular to Licensed Corporations and Associated Entities – Anti-Money Laundering/Counter Financing of Terrorism – Suspicious Transactions Monitoring and Reporting*" published by the SFC on 3 December 2013, which requires licensed corporations to take reasonable steps to guard against and mitigate the ML/TF risks associated with third party fund transfers.
- (g) General Principle 7 and paragraph 12.1 of the Code of Conduct, which require licensed corporations to comply with, and implement and maintain measures appropriate to ensure compliance with, the relevant regulatory requirements.

## **Conclusion**

- 11. The SFC is of the view that CESL is guilty of misconduct and its fitness and properness to carry on regulated activities have been called into question.
- 12. In deciding the disciplinary sanction set out in paragraph 1 above, the SFC has taken into account all relevant circumstances, including:
  - (a) a strong deterrent message needs to be sent to the market that AML/CFT failures are not acceptable;
  - (b) CESL has taken remedial actions to enhance its AML/CFT internal controls and systems; and
  - (c) CESL cooperated with the SFC in resolving the SFC's concerns.