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## STATEMENT OF DISCIPLINARY ACTION

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### The disciplinary action

1. Pursuant to section 194 of the Securities and Futures Ordinance (**SFO**), the Securities and Futures Commission (**SFC**) has:
  - (a) reprimanded Chee Tak Securities Limited (**CTSL**)<sup>1</sup> and fined it \$2,000,000; and
  - (b) suspended the licence of Chiu Koon Yu, Kevin (**Chiu**)<sup>2</sup>, a responsible officer (**RO**) of CTSL, for 10 months from 15 September 2023 to 14 July 2024.
2. The disciplinary action relates to CTSL's internal control deficiencies and regulatory breaches during the period between 1 July 2018 and 5 March 2020 (**Relevant Period**). Specifically, CTSL failed to:
  - (a) have in place an order recording policy and observe the order recording requirements;
  - (b) implement effective internal controls to monitor cross trades between staff members and clients and to ensure fair treatment of clients;
  - (c) establish and maintain an adequate and effective monitoring system to detect and assess suspicious transactions in client accounts;
  - (d) set up systems and controls to identify and assess third-party deposits (**TPDs**) into client accounts;
  - (e) require or obtain written third-party authorisation for the operation of client accounts; and
  - (f) institute internal controls to monitor employee dealings.
3. During the Relevant Period, Chiu was CTSL's director, substantial shareholder, RO and the manager-in-charge of all core functions<sup>3</sup>, namely Overall Management Oversight, Key Business Line, Operational Control and Review, Risk Management, Finance and Accounting, Information Technology, Compliance and Anti-money Laundering and Counter-Terrorist Financing.
4. The SFC considers that CTSL's failures were attributable to Chiu's failure to discharge his duties as an RO and a member of its senior management.

### Summary of facts and breaches

#### A. Background

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<sup>1</sup> CTSL is licensed under the SFO to carry on Type 1 (dealing in securities) regulated activity.

<sup>2</sup> Chiu has been accredited to CTSL and approved to act as its responsible officer for Type 1 (dealing in securities) regulated activity since 24 July 2004.

<sup>3</sup> See the "Circular to Licensed Corporations Regarding Measures for Augmenting the Accountability of Senior Management" issued by the SFC on 16 December 2016.

5. From July to September 2019, the SFC conducted a limited review of CTSL's business between 2016 and 2018 (**Limited Review**), which identified internal control deficiencies in relation to cross trades executed between CTSL's account executives (**AEs**) and clients, and wash trades within certain clients' accounts.
6. The SFC's investigation, which followed the Limited Review, found that during the Relevant Period:
  - (a) an AE of CTSL (**AE X**) placed 267 pairs of cross trades (**Cross Trades**) totalling around \$2.9 million in his account and the account of a client (**Client A**); and
  - (b) a client of CTSL (**Client B**) placed 617 pairs of wash trades (**Wash Trades**) totalling around \$97.5 million in 5 accounts held by Client B and 3 of Client B's family members (**Family Accounts**).

*B. Lack of order recording policy and breach of the order recording requirements*

7. A sample review of the trade and order records of 6 of the Cross Trades during the Limited Review revealed, among other things, that there were no timestamped order records for the sampled trades in Client A's account.
8. CTSL admitted during the SFC's investigation that it had no written manual, policy or procedure on recording order instructions, whether for agency orders or internally generated orders (such as proprietary accounts and staff accounts), during the Relevant Period.
9. The SFC's investigation also found that:
  - (a) while CTSL had a telephone recording system, it did not:
    - i. have a practice of checking client telephone orders against order recordings before the Limited Review; or
    - ii. require AEs to call back to CTSL's telephone recording system to make a contemporaneous record of order instructions received by mobile phone outside the trading floor, the trading room, usual place of business where the order is received or usual place where business is conducted (**Trading Floor**); and
  - (b) CTSL did not prohibit staff members from receiving client order instructions through mobile phones when they were on the Trading Floor.
10. CTSL's deficiencies as set out in paragraph 9 raise concerns. As the SFC had repeatedly pointed out in its circulars, the telephone recording requirement not only allows a licensed person to ascertain a particular client's order instruction in case of a client complaint or trade dispute, it is also a compliance monitoring tool for preventing or detecting irregularities or fraudulent activities<sup>4</sup>.

*C. Failure to implement effective internal controls to monitor cross trades between staff members and clients and to ensure fair treatment of clients*

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<sup>4</sup> See the "Circular to SFC's Licensed Intermediaries — Telephone Recording Requirements" issued by the SFC on 25 November 2004 and the "Circular to Licensed Corporations — Guarding against Risk of Client Asset Misappropriation" issued by the SFC on 1 February 2013.

11. The SFC's investigation revealed that the Cross Trades were conducted to enable AE X to delay the settlement of his personal trades:
  - (a) AE X bought certain shares on T and sold them to Client A on the following day (T+1) and immediately bought back the shares on the same day via a Cross Trade;
  - (b) instead of settling the full amount of the original transaction on T+2, AE X was only required to settle the difference between the purchase price (of the original transaction) and the sale price (of the Cross Trade);
  - (c) AE X was only required to settle the purchase price (of the Cross Trade) on T+3;
  - (d) AE X could repeat steps (a) and (b) above to further roll over payment of the purchase price of subsequent Cross Trades, thus effectively delaying settlement of his trades; and
  - (e) after one or multiple rounds of buying from and selling to Client A in this manner, AE X would sell the shares in the market.
12. The Cross Trades materialised in loss-making transactions in the sum of \$73,188. Such loss was borne by AE X and Client A was not affected.
13. The SFC's investigation found that CTSL allowed clients and AEs to conduct cross trades in the manner described above to delay settlement of their transactions. Such cross trades also enabled CTSL to increase its commission income. However, CTSL:
  - (a) had no policy or guideline governing cross trades between staff members and clients; and
  - (b) relied only on staff members' self-discipline to protect clients' best interests in cross trades between staff members and clients.
14. The SFC considers that CTSL has failed to establish and maintain any control which could effectively avoid or minimise conflicts of interest involved in cross trades between an AE and a client, and to ensure that clients would be fairly treated where actual or apparent conflicts of interest arising out of such cross trades could not reasonably be avoided.

*D. Failure to establish and maintain an adequate and effective monitoring system to detect and assess suspicious transactions in client accounts*
15. CTSL admitted during the SFC's investigation that it did not have in place any policy or procedure for ongoing monitoring and trade surveillance.
16. While Chiu would review Central Clearing and Settlement System reports, internally generated reports and trade journals generated by the Hong Kong Exchange and Clearing Limited on a daily basis, he accepted that CTSL did not have any policy or guideline on suspicious transactions monitoring. Instead, Chiu would only look out for transactions of significant amounts and error trades.
17. Some of the Wash Trades caught Chiu's attention because the amounts reached

close to \$1 million, but Chiu only monitored those trades to check that the amounts payable to CTSL under those trades would not get too large. It had not occurred to Chiu that the Wash Trades might be manipulative in nature.

18. The SFC considers that CTSL has failed to establish and maintain an adequate and effective monitoring system to detect and assess suspicious transactions in client accounts.

*E. Lack of systems and controls to identify and assess TPDs into client accounts*

19. Between July and September 2019, 7 TPDs totalling \$62,660.01 were made into 3 CTSL client accounts by parties other than the named account holders. The TPDs included 3 deposits by AE X into Client A's account, and a deposit by Client A into AE X's account.

20. There is no evidence that CTSL had monitoring systems and controls to identify and assess TPDs made into its clients' accounts. As a corollary of this, it could not have conducted any due diligence into TPDs before they were accepted into clients' accounts.

21. Chiu, who was responsible for checking deposits from clients, did not monitor the source of the deposits. Chiu only checked the amount(s) and bank(s) when receiving deposits and did not know about the TPDs between AE X and Client A.

22. The SFC considers that CTSL has failed to implement adequate and effective policies and procedures to mitigate the risk of money laundering / terrorist financing associated with TPDs.

*F. Failure to require or obtain written third-party authorisation for the operation of client accounts*

23. CTSL admitted during the SFC's investigation that it:

- (a) did not have any written manual, policy or procedure in respect of third-party authorisation of clients' accounts during the Relevant Period; and
- (b) merely required verbal confirmation of third-party authorisation granted by its clients before accepting trade instructions from third parties on clients' behalf.

24. CTSL claimed to only allow close relatives (e.g. parents, siblings, spouse, descendant, etc) to be authorised in that manner.

25. The SFC's investigation revealed that during the Relevant Period:

- (a) a third party (the **TP**), a long-time friend of Client A, had given order instructions to CTSL on behalf of Client A without the latter's written authorisation;
- (b) Client B had operated 2 of the Family Accounts that were not held in his name without the account holders' written authorisation; and
- (c) Client B had conducted personal trading in another of the Family Accounts that was not held in his name.

26. With respect to the TP's operation of Client A's account, Client A resided in

Mainland China and had entrusted the operation of her account (as well as her bank account in Hong Kong) to the TP. She had verbally authorised the TP to operate her account at CTSL but did not sign any third-party authorisation in this regard.

27. With respect to Client B's operation of the Family Accounts:

- (a) Chiu was aware of this and claimed that CTSL had obtained the relevant account holders' verbal confirmation of Client B's authority to operate their accounts. However, CTSL did not retain any note or record of the authorisations purportedly obtained; and
- (b) while Client B claimed that he had the consent of the holder of one of the Family Accounts to conduct his personal trading in the latter's account and had notified CTSL of such consent, Chiu was unaware that Client B had used any of his relatives' accounts to conduct personal trading.

28. The matters set out in paragraphs 25 to 27 show that:

- (a) CTSL was prepared to effect transactions for a client on instructions given by a third party designated orally by the client;
- (b) while CTSL claimed that it only allowed third-party authorisation given to close relatives, this did not seem to be the case in practice in light of the operation of Client A's account by the TP (who was not a relative of Client A); and
- (c) CTSL's practice had enabled Client B to give order instructions in two of the Family Accounts without the account holders' written authorisation and conduct personal trading in one of the Family Accounts without being detected.

*G. Failure to institute internal controls to monitor employee dealings*

29. In addition to having no written manuals, policies and procedures in relation to ongoing monitoring and trade surveillance, CTSL also admitted during the SFC's investigation that it had no written manuals, policies and procedures in relation to employee dealing during the Relevant Period.

30. According to AE X, CTSL did not have any guideline / requirement for staff to make any declaration of interest in any personal transactions, or spot-checking mechanism to monitor staff trading activities, or restrictions on staff trading.

31. Chiu also confirmed that CTSL did not:

- (a) have any policy or guideline which governed the personal trades of its AEs, nor did it monitor staff trading activities;
- (b) impose any restriction against having other investment accounts outside of CTSL, or require staff to report to CTSL if they did;
- (c) conduct sample checking of staff trades; and
- (d) have any separate report identifying employee dealings.

32. In short, CTSL had no controls over staff trading. CTSL failed to ensure that employee dealings would be subject to active monitoring for the purpose of detecting irregularities and to avoid prejudicing the interests of its clients. The risk

which it faced in failing to have a staff dealing policy and to monitor trading activities in staff accounts materialised in the Cross Trades.

## The SFC's findings

33. CTSL's failures set out above constitute a breach of:

- (a) General Principle (**GP**) 2 of the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (**Code of Conduct**) which requires a licensed or registered person to act with due skill, care and diligence, in the best interests of its clients and the integrity of the market.
- (b) GP 6 of the Code of Conduct which requires a licensed or registered person to try to avoid conflicts of interest, and when they cannot be avoided, should ensure that its clients are fairly treated.
- (c) Paragraph 3.9(c) of the Code of Conduct which requires a licensed or registered person to prohibit its staff members from receiving client order instructions through mobile phones when they are on the Trading Floor, and to have a written policy in place to explain and enforce this prohibition.
- (d) Paragraph 4.3 of the Code of Conduct which requires a licensed or registered person 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.
- (e) Paragraph 7.1(a)(i) of the Code of Conduct which requires a licensed or registered person not to effect a transaction for a client unless before the transaction is effected, the client, or a person designated in writing by the client, has specifically authorized the transaction.
- (f) Paragraph 12.2(a) and (b)(vi) of the Code of Conduct which requires, among other things:
  - i. a licensed or registered person to have a policy which has been communicated to employees in writing on whether employees are permitted to deal or trade for their own accounts in securities, futures contracts or leveraged foreign exchange contracts; and
  - ii. in the event that employees of a licensed or registered person are permitted to deal or trade for their own accounts in securities, futures contracts or leveraged foreign exchange contracts:
    - (1) The written policy should specify the conditions on which employees may deal for their own accounts.
    - (2) Transactions of employees' accounts and related accounts should be reported to and actively monitored by senior management of the licensed or registered person who should maintain procedures to detect irregularities and ensure that the handling by the licensed or registered person of these transactions or orders is not prejudicial to the interests of the licensed or registered person's

other clients.

- (g) Paragraph 2 of Part III of the Management, Supervision and Internal Control Guidelines for Persons Licensed by or Registered with the Securities and Futures Commission (**Internal Control Guidelines**) which requires that all staff and other persons performing services on the firm's behalf are provided adequate and up-to-date documentation regarding the firm's policies and procedures which should include those relating to internal controls and personal dealing.
  - (h) Paragraphs 4 to 6 and 8 of Part VII of the Internal Control Guidelines which require that:
    - i. Specific policies and procedures are established to minimize the potential for the existence of conflicts of interest between the firm or its staff and clients, and further, in circumstances where actual or apparent conflicts of interest cannot reasonably be avoided, that clients are fully informed of the nature and possible ramifications of such conflicts and are in all cases treated fairly.
    - ii. Management establishes and maintains policies and procedures which ensure that whenever the firm or its staff member(s) have a material interest in a transaction with a client, this fact is disclosed, where practicable, to the client prior to the execution of the relevant transaction.
    - iii. clear and comprehensive audit trails be created to precisely record all orders (both client and internally generated) from the time of origination, including the time the order was received or initiated, through order execution and settlement, e.g. through use of sequential numbering on order tickets and the use of time stamping facilities.
    - iv. Management establishes and maintains appropriate and effective procedures in relation to dealing and related review processes to prevent or detect errors, omissions, fraud and other unauthorised or improper activities, and which ensure the fair and timely allocation of trades effected on behalf of clients.
  - (i) Paragraphs 1 to 5 and 7 to 10 of the Appendix to the "Circular to licensed corporations and associated entities — Third-party deposits and payments" issued by the SFC on 31 May 2019, which, among other things:
    - i. provide that firms which accept TPDs should put in place clear and detailed policies and procedures for scrutinising them and ensure that the acceptance of a TPD is subject to stringent management approval; and
    - ii. give guidance on the due diligence process for assessing TPDs.
34. CTSL's breaches were attributable to Chiu's failure to discharge his duty as responsible officer and a member of its senior management, including his failure to:
- (a) ensure the maintenance of appropriate standards of conduct and adherence to proper procedures by the CTSL, in breach of GP 9 of the Code of Conduct;

- (b) properly manage the risks associated with the business of CTSL, including performing periodic evaluation of its risk management processes, in breach of paragraph 14.1 of the Code of Conduct; and
- (c) ensure the development, implementation and on-going effectiveness of the firm's internal controls and the adherence thereto by its directors and employees, in breach of paragraph 1 of Part I of the Internal Control Guidelines.

## **Conclusion**

35. Having considered all the circumstances, the SFC is of the opinion that CTSL and Chiu are guilty of misconduct and that Chiu's fitness and properness to carry on regulated activities have been called into question.
36. In deciding the disciplinary sanction set out in paragraph 1 above, the SFC has taken into account all relevant circumstances, including:
- (a) CTSL's financial situation;
  - (b) CTSL's cessation of business<sup>5</sup>;
  - (c) CTSL and Chiu's cooperation with the SFC in resolving its concerns; and
  - (d) CTSL and Chiu have otherwise clean disciplinary records with the SFC.

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<sup>5</sup> CTSL's last day of trading was 31 July 2023.