STATEMENT OF DISCIPLINARY ACTIONS

The Disciplinary Actions

1. The Securities and Futures Commission (**SFC**) has:

   (a) publicly reprimanded and fined Xinhu International Futures (Hong Kong) Co., Limited (**Xinhu**)[1] $9,000,000; and

   (b) suspended the licence of Ngai Wai (**Ngai**), for nine months from 8 October 2024 to 7 July 2025,

   pursuant to section 194 of the Securities and Futures Ordinance (**SFO**).

2. The disciplinary actions are taken because:

   (a) Xinhu failed to:

      (i) perform due diligence on the customer supplied system (**CSS**)[2] used by clients for placing orders, and assess and manage the associated money laundering and terrorist financing (**ML/TF**) and other risks;

      (ii) conduct proper enquiries on client deposits which were incommensurate with the clients' financial profiles declared in their account opening documents and implement adequate systems and controls on monitoring and assessing large, unusual or suspicious fund deposits made by its clients into their accounts; and

      (iii) establish effective ongoing monitoring system to detect and assess suspicious trading pattern in client accounts; and

   (b) Ngai failed to discharge his duties as a responsible officer and a member of the senior management of Xinhu at the material time.

Summary of Facts

A. Background

3. The SFC received a complaint against various licensed corporations, including Xinhu, for allowing clients to place orders to their broker supplied systems (**BSS**)[3] through a software called Xinguanjia (**XGJ**). XGJ was developed and/or provided by Hengxin Software Limited.

4. The complainant alleged that XGJ permitted the licensed corporations' clients to create sub-accounts under their accounts maintained with the licenced

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[1] Xinhu is licensed to carry on Type 2 (dealing in futures contracts) under the SFO.

[2] A CSS is a trading software developed and/or designated by the clients that enable them to conduct electronic trading through the Internet, mobile phones and other electronic channels.

[3] BSSs are trading facilities developed by exchange participants or vendors that enable the exchange participants to provide electronic trading services to investors through the Internet, mobile phones, and other electronic channels.

corporations, and the clients had solicited investors in Mainland China to trade through the sub-accounts via XGJ without having to open separate securities accounts with the licensed corporations in Hong Kong.

5. Between December 2016 and March 2019 (**Relevant Period**), Xinhu has permitted 84 clients to use their designated CSS (namely Hengxin Software) for placing orders[4]. The number of futures contracts transacted by these clients accounted for 98.42%of the total trading volume of all of Xinhu's clients during the Relevant Period.

B. Failure to perform due diligence on the CSS and assess and manage the associated ML/TF and other risks

6. Before allowing its clients to connect their CSS to its BSS, Xinhu would require its clients to: (a) complete an application form (**Application Form**); and (b) apply for a connection authorisation code (**Authorisation Code**) from the supplier of its BSS (**BSS Supplier**). Upon receiving the Authorisation Code, Xinhu would enable the connection of the CSS to its BSS.

7. Xinhu did not perform due diligence or testing on the CSS used by its clients:

   (a) one of Xinhu's staff members claimed that he had assessed a simulated version of the CSS and conducted online research about the software. However, this is not supported by any evidence showing the checks or tests allegedly performed by the staff member on the CSS;

   (b) Xinhu approved the clients' Application Forms based solely on the BSS Supplier issuing the Authorisation Code; and

   (c) in generating the Authorisation Code, the BSS Supplier said it was simply providing a mechanism for Xinhu to manage the CSS connections, and Xinhu was ultimately responsible for deciding whether to allow a particular CSS to connect to its BSS. While Xinhu claimed that it relied on the BSS Supplier to conduct due diligence on the CSS, the BSS Supplier stated that it did not conduct any due diligence nor test the CSS to examine the software's design and functions and did not consider such due diligence to be its responsibility.

8. Without thorough knowledge of the features and functions of the CSS, Xinhu was not in a position to properly assess the ML/TF and other risks associated with the use of the CSS and implement appropriate measures and controls to mitigate and manage such risks.

9. In the absence of proper control over the use of CSS by its clients, Xinhu has exposed itself to the risks of improper conduct such as unlicensed activities, money laundering, nominee account arrangement and unauthorized access to client accounts.

[4] The CSS was connected to Xinhu's BSS through application programming interface (a set of functions that allow applications to access data and interact with external software components or operating systems).

C. *Failure to conduct proper enquiries on client deposits which were incommensurate with the clients' financial profiles and implement adequate systems and controls on monitoring and assessing large, unusual or suspicious client deposits*

10. The SFC's review of the fund movements in sample client accounts showed that the amounts of deposits made into the accounts of 6 clients (**6 Clients**) were incommensurate with their financial profiles declared in their account opening documents, which were unusual and/or suspicious (**Anomalies**).

11. Xinhu claimed that it monitored large fund deposits made by its clients into their accounts, and it would further make enquiries with clients where deposits made by them exceeded the amount of assets declared at their account opening.

12. However, Xinhu's systems and controls for monitoring and identifying large, unusual or suspicious fund deposits from its clients, and its purported enquiries with the 6 Clients were ineffective and inadequate. In particular:

    (a) there were no written procedures on monitoring and conducting enquiries on large, unusual or suspicious client deposits;

    (b) Xinhu did not have any internal controls in place to ensure its staff members followed up with clients to verify their source of funds in relation to large, unusual and/or suspicious deposits and that such enquiries were properly documented; and

    (c) Xinhu did not maintain any records of its enquiries allegedly made by Ngai with the 6 Clients and their responses to the enquires. In the absence of any record, Xinhu is unable to demonstrate that it has made proper enquiries with the 6 Clients and satisfactorily addressed the concerns associated with the Anomalies.

D. *Failure to maintain effective ongoing monitoring system to detect and assess suspicious trading patterns in client accounts*

13. During the SFC's investigation, Xinhu identified 12,413 self-matched transactions (ie, the client's order matched with his/her own order in the opposite direction) (**Matched Trades**) in 10 client accounts during the sample period between 1 November 2017 and 31 October 2018.

14. Xinhu failed to detect the Matched Trades at the material time and its systems and controls for monitoring, detecting and identifying suspicious transactions conducted by its clients were inadequate and ineffective:

    (a) there were no policies and procedures in place at Xinhu to guide its staff members on the monitoring of client trading activities to help them recognise suspicious transactions;

    (b) it relied on Ngai to manually review clients' trades who failed to identify the Matched Trades; and

    (c) since April 2018, Xinhu's BSS had a function to detect and prevent self-matched trades by its clients but Xinhu did not activate this function.

The SFC's findings

15. Xinhu's failures set out above constitute a breach of:

(a) General Principle 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 corporation to act with due skill, care and diligence, in the best interests of its clients and integrity of the market in conducting its business activities;

(b) General Principle 3 and paragraph 4.3 of the Code of Conduct, which provide that a licensed corporation should have and employ effectively the resources and procedures which are needed for the proper performance of its business activities and have internal control procedures and operational capabilities which can be reasonably expected to protect its operations and clients from financial loss arising from theft, fraud, and other dishonest acts, professional misconduct or omissions;

(c) Paragraph 5.1 of the Code of Conduct which requires a licensed corporation to take all reasonable steps to establish the true and full identity of each of its clients, and of each client's financial situation, investment experience, and investment objectives;

(d) 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 and March 2018 editions) (**AML Guideline**), which require a licensed corporation to mitigate the risks of ML/TF and prevent contravention of any client due diligence and record keeping requirements under the AMLO. To ensure compliance with this requirement, the licensed corporation should:

(i) establish and implement adequate and appropriate internal anti-money laundering (**AML**) and counter-financing of terrorism (**CFT**) policies, procedures and controls pursuant to paragraph 2.2 of the AML Guideline; and

(ii) assess the risks of any new products and services (especially those that may lead to misuse of technological developments or facilitate anonymity in ML/TF schemes) before they are introduced and ensure appropriate additional measures and controls are implemented to mitigate and manage the associated ML/TF risks pursuant to paragraph 2.3 of the AML Guideline;

(e) Section 5(1)(a) of Schedule 2 to the AMLO and paragraphs 4.7.12 and 5.1(a) of the AML Guideline, which require a licensed corporation to review from time to time client information to ensure that they are up-to-date and relevant when a significant transaction is to take place or a material change occurs in the way the client's account is operated;

(f) Section 5(1)(b) of Schedule 2 to the AMLO and paragraph 5.1(b) of the AML Guideline, which require a licensed corporation to continuously monitor its business relationship with the clients by monitoring their activities to ensure that they are consistent with its knowledge of the clients and the clients' nature of business, risk profile and source of funds; and

(g) 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 a licensed corporation to identify transactions that are complex, large or unusual or patterns of transactions that have no apparent economic or lawful purpose, 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 where there is any suspicion of ML/TF. Pursuant to paragraph 7.11 of the AML Guideline, where a transaction is inconsistent in amount, origin, destination, or type with a client's known, legitimate business or personal activities, the transaction should be considered as unusual and the licensed corporation should be put on alert[5].

16. During the Relevant Period, Ngai was a responsible officer, an executive director, and the Manager-In-Charge for Overall Management Oversight, Compliance, Information Technology and Risk Management between 10 July 2017 and 7 February 2020.

17. Ngai was responsible for managing the overall operations of Xinhu, including its internal controls to ensure its operations were compliant with the relevant rules and regulations. He was also responsible for:

(a) the decision to allow Xinhu's clients connect their CSS to Xinhu's BSS to conduct trading, and was involved in approving clients' Application Forms for the CSS connections;

(b) following up and enquiring with clients on unusual or suspicious fund movements and deposits in their accounts; and

(c) monitoring clients' trading activities, including those conducted through the clients' CSS.

18. The SFC found that Xinhu's failures as set out in paragraphs 6 to 14 above were attributable to Ngai's failure to discharge his duties as a responsible officer and a member of the senior management of Xinhu, including his failure to:

(a) ensure the maintenance of appropriate standards of conduct and adherence to proper procedures by Xinhu, in breach of General Principle 9 of the Code of Conduct; and

(b) properly manage the risks associated with the business of Xinhu, in breach of paragraph 14.1 of the Code of Conduct.

[5] Examples of situations that might give rise to suspicion are given in paragraphs 7.14 and 7.39 of the AML Guideline, such as: (a) transactions or instructions which have no apparent legitimate purpose and/or appear not to have a commercial rationale; (b) buying and selling of securities/futures with no discernible purpose or where the nature, size or frequency of the transactions appears unusual; and (c) the entry of matching buys and sells in particular securities or futures or leveraged foreign exchange contracts (wash trading), creating the illusion of trading. Such wash trading does not result in a bona fide market position, and might provide "cover" for a money launderer.

Conclusion

19. Having considered all relevant circumstances, the SFC is of the opinion that Xinhu and Ngai were guilty of misconduct for the purpose of section 194(1)(a) of the SFO and Ngai's fitness and properness to carry on regulated activities have been called into question.

20. In deciding the disciplinary sanctions set out in paragraph 1 above, the SFC has taken into account all relevant circumstances, including:

    (a) Xinhu's failures to diligently monitor its clients' activities and put in place adequate and effective AML/CFT systems and controls are serious as they could undermine public confidence in, and damage the integrity of, the market;

    (b) a strong deterrent message needs to be sent to the market that such failures are not acceptable;

    (c) Xinhu and Ngai cooperated with the SFC in resolving the SFC's concerns; and

    (d) Xinhu and Ngai have otherwise clean disciplinary records with the SFC.