

## STATEMENT OF DISCIPLINARY ACTION

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### The Disciplinary Action

1. The Securities and Futures Commission (**SFC**) has reprimanded and fined Zheshang International Financial Holdings Co., Limited (**Zheshang**)<sup>1</sup>, \$2.66 million pursuant to section 194 of the SFO.
2. The disciplinary action is taken because Zheshang failed to:
  - (a) establish an effective ongoing monitoring system to detect and assess suspicious trading patterns in client accounts; and
  - (b) keep proper records of the enquiries it made on client deposits which were incommensurate with the clients' financial profiles declared in their account opening documents.

### Summary of Facts

- A. *Background*
  3. **The SFC received a complaint against various licensed corporations (LCs), including Zheshang, for allowing clients to place orders to their broker supplied system (BSS)<sup>2</sup> through a software called Xinguanjia (XGJ).**
  4. The complainant alleged that XGJ allowed the LCs' clients to create sub-accounts under their accounts maintained with the LCs, and the clients solicited investors in Mainland China to trade through the sub-accounts via XGJ without having to open separate securities accounts with the LCs in Hong Kong.
  5. **Between June 2016 and October 2018 (Relevant Period), Zheshang has permitted 32 clients to use their designated customer supplied systems (CSSs)<sup>3</sup> to place orders to its BSS(s).**
- B. *Failure to establish an effective ongoing monitoring system to detect and assess suspicious trading patterns in client accounts*
  6. During the Relevant Period, there was a total of 23,370 self-matched trades (ie, trades of the same product executed by the same client at the same price in the same second but in opposite buy and sell directions) (**Matched Trades**) in three client accounts.

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<sup>1</sup> Zheshang is licensed to carry on Type 1 (dealing in securities), Type 2 (dealing in futures contracts), Type 4 (advising on securities), Type 5 (advising on futures contracts) and Type 9 (asset management) regulated activities under the Securities and Futures Ordinance (**SFO**).

<sup>2</sup> 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.

<sup>3</sup> A CSS is a trading software developed and/or designated by the clients that enables them to conduct electronic trading through the Internet, mobile phones and other electronic channels.

7. Zheshang claimed that it monitored client's trading activities on a daily basis, and prepared monthly trade surveillance reports (**Surveillance Reports**). It had identified some of the Matched Trades and had made enquiries with the clients in this regard.
  8. However, the Surveillance Reports were prepared through a manual sampling method using Excel, and Zheshang failed to detect most of the Matched Trades in the three client accounts during the Relevant Period. This demonstrates that Zheshang's systems and controls for monitoring and detecting suspicious transactions were neither adequate nor effective.
- C. Failure to keep proper records of the enquiries it made on client deposits which were incommensurate with the clients' financial profiles declared in their account opening documents*
9. The SFC's review of the fund movements in sample client accounts showed that the amounts of deposits made into the accounts of two clients (**Selected Clients**) were incommensurate with their financial profiles declared in their account opening documents, which were unusual and/or suspicious.
  10. According to Zheshang and its staff, it made enquiries with the Selected Clients in respect of the large deposits. However, there are no records of such discussions.

### **The SFC's findings**

11. Zheshang's failures set out above constitute breaches 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 an LC to act with due skill, care and diligence, in the best interests of its clients and the integrity of the market in conducting its business activities.
  - (b) GP 3 and paragraph 4.3 of the Code of Conduct, which provide that an LC 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 its clients from financial loss arising from theft, fraud, and other dishonest acts, professional misconduct or omissions.
  - (c) Section 5(1)(c) of Schedule 2 to the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (**AMLO**) and paragraphs 5.1(c), 5.10 and 5.11 of the Guideline on Anti-Money Laundering and Counter-Terrorist Financing (April 2015 and March 2018 editions) (**AML Guideline**), which require an LC 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, properly document in writing the enquiries made (and their results), and make them available to assist the relevant authorities, and report the findings to the Joint Financial Intelligence Unit where there is any suspicion of money laundering and terrorist financing. Proper records of decisions

made, by whom, and the rationale for them will help an LC demonstrate that it is handling unusual or suspicious activities appropriately. 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 LC should be put on alert<sup>4</sup>.

## Conclusion

12. Having considered all relevant circumstances, the SFC is of the opinion that Zheshang is guilty of misconduct.
13. In deciding the disciplinary sanction set out in paragraph 1 above, the SFC has taken into account all of the circumstances, including:
  - (a) Zheshang's failures to diligently monitor its clients' activities and put in place adequate and effective anti-money laundering/counter-financing of terrorism 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) Zheshang's co-operation in resolving the SFC's concerns, including its agreement to engage an independent reviewer to review its internal controls; and
  - (d) Zheshang has an otherwise clean disciplinary record.

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<sup>4</sup> 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.