

## STATEMENT OF DISCIPLINARY ACTION

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### The Disciplinary Action

1. The Securities and Futures Commission (**SFC**) has publicly reprimanded and fined Interactive Brokers Hong Kong Limited (**IBHK**)<sup>1</sup> HK\$4.2 million pursuant to section 194 of the Securities and Futures Ordinance (**SFO**).
2. The disciplinary action is taken because IBHK has loaned client securities pursuant to a securities borrowing and lending agreement without valid standing authorities from its clients, in breach of:
  - (a) sections 7 and 10 of the Securities and Futures (Client Securities) Rules (**CSR**); and
  - (b) General Principles 7 (Compliance) and 8 (Client assets), and paragraphs 11.1(a) (Handling of client assets) and 12.1 (Compliance: in general) of the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (**Code of Conduct**).

### Summary of Facts

3. In November 2020, IBHK made a self-report to the SFC regarding its failure to renew its clients' standing authorities between December 2017 and October 2020 due to a programming error. The SFC has conducted an investigation into the incident.

*IBHK's lending of client securities pledged as collateral without valid standing authorities<sup>2</sup>*

4. During the account opening process, applicants for an IBHK account who wish to apply for margin finance are requested to provide IBHK with standing authorities with respect to applicable securities and monies held with IBHK in accordance with the requirements in the CSR.
5. In particular, all such clients of IBHK are required to sign a letter called "Client Securities Standing Authority" (**SLOA**), which, among others, authorises IBHK to apply any of their securities or securities collateral pursuant to a securities borrowing and lending agreement. The SLOAs are stated to remain valid for a period of 12 months from the date that the clients sign the letter.
6. The SFC's investigation found that, during the period from 3 December 2017 to 23 October 2020 (**Relevant Period**):

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<sup>1</sup> IBHK is licensed under the SFO to carry on Type 1 (dealing in securities), Type 2 (dealing in futures contracts) and Type 3 (leveraged foreign exchange trading) regulated activities.

<sup>2</sup> Section 4(1) of the CSR provides that a standing authority is a written notice that, among other things, is given to an intermediary to authorise it to deal with client securities or securities collateral from time to time received or held on behalf of the client in one or more specified ways. Unless the client giving the standing authority is a professional investor, the standing authority shall not be valid for a period exceeding 12 months.

- (a) IBHK relied on the SLOAs of 7,911 clients (**Clients**) which had expired on various dates during the Relevant Period and loaned the Clients' securities listed on the Stock Exchange of Hong Kong Limited (**SEHK**) in accordance with a securities borrowing and lending agreement (**Agreement**)<sup>3</sup>; and
- (b) the aggregate market value of client securities lent by IBHK pursuant to the Agreement without valid standing authorities from the Clients amounted to around HK\$586 billion.

7. IBHK explained that:

- (a) in order to comply with the standing authority renewal requirements under the CSR, IBHK's systems are designed to automatically distribute to clients who have signed the SLOAs (i) a renewal notice at least 14 days in advance of the 12-month anniversary of the date of the SLOA, informing clients that the current standing authority will soon expire, and unless revoked, will automatically be renewed for an additional 12 months; and (ii) a post-confirmation notice within one week following the expiry of the SLOA, confirming that the standing authority has been renewed for an additional 12 months (together the **Renewal Notices**);
- (b) templates of the Renewal Notices were created and maintained by IBHK in its system (**System**). There were multiple versions of Renewal Notices templates stored within the System and each version of the Renewal Notices templates was marked with a status, namely "active", "inactive", "reserved" or "deactivated". Only Renewal Notices with an "active" status would be distributed to IBHK's clients by the System;
- (c) on or around 27 October 2020, IBHK became aware of a programming error (**Error**) which hindered the distribution of Renewal Notices to its clients from December 2017 to October 2020 (**Incident**). The cause of the Incident was that in December 2017, IBHK reviewed and updated the Renewal Notices templates in the System, but the relevant staff of IBHK did not change the status of the new templates to "active". Consequently, Renewal Notices were not sent to any clients from December 2017 to October 2020 under the System; and
- (d) as a result of the Error, IBHK had relied on expired standing authorities given by the Clients to lend the Clients' SEHK-listed securities pursuant to the Agreement.

*Remedial action*

- 8. On 27 October 2020, IBHK activated the revised Renewal Notices in the System after it became aware of the Error. In the second quarter of 2021, IBHK completed the process of obtaining updated standing authorities from Clients who could continue to trade margined securities in their accounts.

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<sup>3</sup> The Agreement is a securities borrowing and lending agreement between IBHK and its clients, which allows a party (lender) to transfer to the other party (borrower) securities and financial instruments against the transfer of collateral for loans provided by the lender.

9. IBHK has taken further remedial actions with respect to the Incident. In particular, IBHK has:
- (a) created a new process under which the Renewal Notices are distributed to clients every 11 months so that the clients will renew their standing authority one month prior to the expiry date;
  - (b) purged all expired or deactivated Renewal Notices templates from the System in order to mitigate the risk of confusion or manual error when activating and deactivating standing authority document templates, and to ensure that only the current “active” versions of the Renewal Notices are distributed to clients; and
  - (c) implemented enhancements to its compliance assurance program to ensure that correct versions of Renewal Notices are sent to clients on schedule.
10. IBHK confirmed that the Clients did not suffer any loss from the Incident.

### **Conclusion**

11. The conduct of IBHK set out above constitutes a breach of:
- (a) Sections 7 and 10 of the CSR as it has loaned the Clients’ SEHK-listed securities pursuant to a securities borrowing and lending agreement without valid standing authorities from the Clients during the Relevant Period;
  - (b) General Principle 7 (Compliance) and paragraph 12.1 (Compliance: in general) of the Code of Conduct as it failed to comply with, and implement and maintain measures appropriate to ensuring compliance with the CSR and the Code of Conduct; and
  - (c) General Principle 8 (Client assets) and paragraph 11.1(a) (Handling of client assets) of the Code of Conduct as it failed to ensure that client assets were adequately safeguarded.
12. The SFC is of the view that IBHK is guilty of misconduct.
13. In deciding the disciplinary sanction, the SFC has taken into account all relevant circumstances, including:
- (a) IBHK’s remedial actions and self-report to the SFC regarding its breach of the CSR;
  - (b) IBHK’s conduct was not deliberate and there is no evidence of client loss as a result of such conduct; and
  - (c) IBHK’s cooperation in resolving the SFC’s concerns and accepting the SFC’s findings and disciplinary action.