

SFC Reprimands and Fines Onshine Securities Limited for Failures Including FRR Breaches and its Responsible Officer Chan Sum Fat for Internal Control Weaknesses and Insufficient Supervision of Staff

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The SFC has reprimanded Onshine Securities Limited and fined it \$100,000 for breaches of the Securities and Futures (Financial Resources) Rules (FRR), internal control weaknesses and insufficient supervision of staff. It has also reprimanded Mr Chan Sum Fat, a responsible officer of Onshine, and fined him \$16,700 for the internal control weaknesses in Onshine and inadequate supervision of staff (Note 1).

Breaches of the FRR

An SFC investigation revealed that Onshine had a liquid capital deficiency on a total of five business days during the period from 9 to 15 December 2004. The deficiency arose when Onshine drew down a bank loan to finance its clients in an Initial Public Offering (IPO) subscription in December 2004. Onshine became aware of the deficiency on 8 December 2004 and reported this to the SFC by telephone and in writing on 9 December 2004. Onshine also reported to the SFC that it had already injected a subordinated loan of a total of \$50 million as of 9 December 2004 to rectify the breach. Pending the formal approval by the SFC of the subordinated loan, there was continuing breach of section 6(1) of the FRR. The SFC approved the subordinated loan on 17 December 2004. Onshine also failed to take steps to prevent the deficiency in spite of an SFC reminder on treatment of IPOs issued in a circular to licensed corporations and in a press release on 29 November 2004.

Internal control weaknesses and insufficient supervision of staff

In another investigation, the SFC found that a licensed representative of Onshine had input a bid order at the price of \$20 for the shares of PICC Property and Casualty Company Limited, raising the stock's nominal price from \$8 to \$20 during the pre-opening session on 6 November 2003. The order was cancelled in less than a minute. The licensed representative claimed that it was an erroneous order and did not report it to Onshine. Onshine had no procedures in place to require its staff to report erroneous orders and trades.

The SFC also found that another licensed representative of Onshine had input numerous bid and ask orders, each for one million PICC shares, which were cancelled almost immediately during the normal trading session on the same day. The licensed representative said that this was to "test his luck". He was under stress due to personal reasons at that time and believed that he would be lucky if he was able to cancel the orders before they were executed. He had no means and no intention to buy or sell those shares. He admitted that the trades might have misled investors. He also failed to submit "order journals" printed from his terminal to Onshine and hence failed to maintain an orderly audit trail (Note 2).

Onshine failed to have in place an internal control policy to require the reporting of erroneous orders. As a responsible officer, Chan was negligent in supervising the two licensed representatives because he did not review their "order journals" to check for any irregularities. Both Onshine and Chan breached the Code of Conduct and Management, Supervision and Internal Control Guidelines for Persons Registered with or Licensed by the Securities and Futures Commission.

The SFC concludes that Onshine and Chan have been guilty of misconduct and their fitness and properness has been called into question.

In deciding the penalty, the SFC has taken into account the Disciplinary Fining Guidelines (Note 3) and all the circumstances of the case, including the fact that:

- the FRR breaches were inadvertent;
- Onshine reported the FRR breaches to the SFC at the earliest possible time;
- Onshine rectified the position by the injection of a subordinated loan from a related company;
- Onshine has no record of prior FRR breaches;

- the licensed representative who input numerous orders to “test his luck” is no longer allowed to operate a terminal;
- Onshine has appointed an external auditor to conduct an internal control review;
- Chan who had a clean disciplinary record was remorseful; and
- Onshine and Chan co-operated fully with the SFC’s investigation and in settling the SFC’s disciplinary proceedings.

Mr Alan Linning, SFC’s Executive Director of Enforcement, said: “FRR compliance is vital to ensuring that a broker firm is adequately capitalised and can therefore meet its obligations to clients, other market participants and creditors. This is essential to the stability of the industry as a whole.”

“A broker firm should also put in place internal control guidelines to require reporting of erroneous orders input by its staff. Failure to do so would put the firm in an unfavourable position if there were disputes from clients about such orders. The firm should also ensure adequate supervision of orders input by its staff in order to detect any irregularities. The firm’s senior management bear primary responsibility for ensuring the maintenance of appropriate standards of conduct and adherence to proper procedures by the firm. Chan’s failure to supervise his staff and to detect the abnormal orders posed settlement risks to Onshine and misled other investors as to the demand for and the price of the stock in question. Chan deserves a reprimand and a fine for his negligence,” Mr Linning added.

Ends

Notes to Editor:

1. Onshine holds a deemed licence under the Securities and Futures Ordinance 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. Chan likewise holds a deemed licence to carry on Type 1, Type 4, Type 6 and Type 9 regulated activities.
2. Disciplinary proceedings are being taken against the two licensed representatives in question.
3. The [Disciplinary Fining Guidelines](#) were issued by the SFC in March 2003 under section 199(1)(a) of the Securities and Futures Ordinance.

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