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SFC reprimands and fines IMC Asia Pacific Limited \$1.5 million

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The Securities and Futures Commission (SFC) has reprimanded IMC Asia Pacific Limited (IMC) and fined it \$1.5 million for regulatory breaches and internal control failings (Note 1).

The disciplinary action follows an SFC investigation into IMC's use of short selling indicators for sales orders conducted for its options and proprietary trading.

The SFC found that, from May 2007 to July 2010, IMC:

- inputted the wrong short selling indicator to 298,228 sale orders out of a total of 1,088,692 sales orders which comprised about 34% of sale orders executed by IMC for its options trading and almost 10% of sale orders executed for its proprietary trading (Notes 2, 3, 4);
- failed to report short selling input errors to Hong Kong Exchange and Clearing Limited (HKEx) until June 2010 (Notes 2, 3, 6); and
- failed to implement adequate internal control procedures to detect and prevent the misuse of short selling indicators by traders (Note 7).

In June and July 2010, IMC executed 55 short selling orders (totalling 100,000 shares valued at HK\$4,324,680) below the prevailing best ask price when it was not a market maker for the corresponding stock option (Notes 2, 3, 5).

In deciding the penalty, the SFC has taken into account that the poor controls of IMC existed for over three years; IMC has no previous disciplinary record; the breaches involved no naked short sales; and IMC has strengthened its internal controls since then.

"IMC's failures spanned a period of over three years during a time of substantial market volatility when short selling controls were high on the regulatory agenda. IMC's negligent controls were well below the standards expected in Hong Kong. Market participants should be aware that short selling is tightly regulated in Hong Kong and any breaches of the rules will be strictly enforced," the SFC's Executive Director of Enforcement, Mr Mark Steward said.

End

Notes:

1. IMC is a licensed corporation under the Securities and Futures Ordinance (SFO) to carry on Type 1 (dealing in securities) and Type 2 (dealing in futures contracts) regulated activities.
2. General Principle 2 of the Code of Conduct for Persons Licensed by or Registered with the SFC (Code of Conduct) requires a licensed person to act with due skill, care and diligence, in the best interests of its clients and the integrity of the market.
3. General Principle 7 of the Code of Conduct requires a licensed person to comply with all regulatory requirements applicable to the conduct of its business activities.
4. Section 172 of the SFO requires an Exchange Participant or its representative who knows an order is a short selling order to, when passing the order to another person to input the order, disclose that the order is a short selling order and, when inputting the order into the trading system of a recognised stock market, to indicate that the order is a short selling order in accordance with the rules of the Stock Exchange of Hong Kong Limited (SEHK). Regulation 5 of the Eleventh Schedule of the Rules of the SEHK requires an Exchange Participant to, when inputting a short selling order into the system, indicate that the order is a short selling order in such manner as determined by the HKEx. Regulation 50 of the Fifteenth Schedule of the Rules of the SEHK provides that an options hedging short selling order must be entered into the HKEx system with a specific short sale indicator in the short sale indicator field in such manner as determined by the HKEx. Appendix IV of the HKEx's Explanatory Notes for the Application for Acquisition / Surrender of Options Market Maker Permits sets out the order input requirements for stock options market makers and options hedging participants.

5. Regulation 15 of the Eleventh Schedule of the Rules of the SEHK provides that a short sale of a designated security shall not be made on the HKEx below the best current ask price except where the designated security is a market making security.
6. Regulation 52 of the Fifteenth Schedule of Rules of the SEHK provides that market makers and options hedging participants should report all errors involving options hedging transactions to the HKEx in such manner as determined by the HKEx.
7. Paragraph 12.1 of the Code of Conduct requires a licensed person to comply with and maintain appropriate measures to ensure compliance with all applicable regulatory law, rules, regulations and codes administered or issued by the SFC, exchanges, clearing house and other regulatory authorities which apply to the licensed person.

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