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SFC reprimands and fines SynerWealth Financial Limited \$2.7 million

31 May 2016

The Securities and Futures Commission (SFC) has reprimanded SynerWealth Financial Limited (SynerWealth) and fined it \$2.7 million for internal control failures relating to short selling orders and for failing to report the deficiencies of its trading system to the SFC in a timely manner as required under the SFC's Code of Conduct (Notes 1 & 2).

The SFC's investigation found that from November 2012 to January 2014, there were at least 65 instances of short sales executed by SynerWealth which resulted from its failure to put in place effective internal control procedures to detect and prevent short selling.

The SFC also found that SynerWealth identified deficiencies in its self-developed trading system as early as January 2013, but it failed to report the material errors or defects of the system to the SFC.

In deciding the disciplinary sanction, the SFC took into account all relevant circumstances of the case, including that:

- adequate and effective internal control systems are fundamental to the fitness and properness of a licensed corporation;
- SynerWealth's failures lasted for about 14 months; and
- SynerWealth had an otherwise clean disciplinary record.

End

Notes:

1. SynerWealth is licensed under the Securities and Futures Ordinance (SFO) to carry on business in Type 1 (dealing in securities) regulated activity.
2. Under paragraph 12.5 of the Code of Conduct for Persons Licensed by or Registered with the SFC, a licensed or registered person is required to report to the SFC immediately on the happening of any material failure, error or defect in the operation or functioning of its trading, accounting, clearing or settlement systems or equipment.

[A copy of the Statement of Disciplinary Action is available on the SFC website](#)

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STATEMENT OF DISCIPLINARY ACTION

The Disciplinary Action

1. The Securities and Futures Commission (**SFC**) has taken the following disciplinary action against SynerWealth Financial Limited (**SynerWealth**):
 - (a) publicly reprimanded SynerWealth, pursuant to section 194(1)(b)(iii) of the Securities and Futures Ordinance (**SFO**); and
 - (b) imposed a financial penalty of \$2.7 million on SynerWealth, pursuant to section 194(2)(b) of the SFO.
2. The disciplinary action is taken because SynerWealth failed to:
 - (a) put in place effective system and control procedures to detect and prevent short selling¹; and
 - (b) report the material errors or defects of its trading system or equipment to the SFC in a timely manner.
3. The failures constitute a breach of General Principle 2 (Diligence) and paragraph 12.5 of the Code of Conduct for Persons Licensed by or Registered with the SFC (**Code of Conduct**).

Summary of facts

4. The Price Alert System (**PAS**) was a trading system developed by SynerWealth to facilitate day trading of derivative warrants which generated trade orders automatically based on market data and pre-set parameters. In July 2013, the SFC received complaints that SynerWealth's staff members and clients had engaged in uncovered short selling and the PAS was defective, in that it could not detect, prevent or reject short sales.
5. As a result of the complaints, the SFC made enquiries with SynerWealth and found that SynerWealth allowed its house accounts traders to use the PAS since August 2012 and its clients to use the PAS since February 2013.
6. In September 2013, the SFC conducted an investigation into SynerWealth's internal control systems and procedure in relation to short selling.
7. The SFC investigation found that the PAS had three design defects which led to the short selling:
 - (a) the first deficiency existed during the period from 3 December 2012 to 23 April 2013, but it was only identified on 9 January 2013. The deficiency was rectified on 23 April 2013, by making modifications to the PAS;

¹ For the purpose of this statement of disciplinary action, the terms "short selling", "short sales", or "short sell" orders refer to the selling of a stock which the seller does not own or have the sufficient number of stocks in his or her inventory to sell.

- (b) the second deficiency existed during the period from 3 December 2012 to 12 August 2013, but it was only identified on 24 July 2013. The deficiency was rectified on 12 August 2013, again by making modifications to the PAS; and
 - (c) the third deficiency existed during the period from 12 August 2013 to 10 October 2013, but it was only identified on 24 September 2013. The deficiency was rectified on 10 October 2013, by making adjustments to the configuration settings of the system network.
8. According to the independent IT contractor engaged by SynerWealth to develop the PAS (**IT contractor**), once the market data meets the user pre-set configurations in the PAS, a sell order message will be generated and sent to the Hong Kong Stock Exchange for execution through SynerWealth's network via its broker supplied system (**BSS**). In response, the BSS would send an acknowledgement message back to the PAS. The PAS would update the inventory status (with the selling amount frozen) after receiving a successful acknowledgement from the BSS. Under normal circumstances, the message would be returned instantly and users would not experience any time lag.
 9. The IT contractor informed the SFC that the design logic of the message flow was flawed and that the problem could have been cured if the inventory was frozen once the sell message is sent out. All of the three deficiencies (described in paragraph 7) are related to the timing when the inventory would be updated. Steps were taken to improve the PAS so that the inventory would be frozen once a selling message is sent from the PAS to the BSS. The deficiencies were finally rectified and no further short sell orders were reported or detected by SynerWealth since 1 February 2014.
 10. The investigation also found that since August 2012, SynerWealth has been using both the PAS and its BSS provided by Ayers (**Ayers**), which are two separate trading systems. SynerWealth decided to grant to six traders "short-selling rights", i.e. the right to sell stock through Ayers when there was inventory in PAS (which was not shown in Ayers). Given the PAS and Ayers were two unconnected systems, these traders had to calculate their stock positions manually. The "short selling rights" granted to the traders were cancelled by August 2013, with the exception of two of SynerWealth's responsible officers.
 11. The SFC's investigation revealed that during the period from November 2012 to January 2014, there were at least 65 instances of short sales executed by SynerWealth. Out of these 65 short sales, 52 were executed via the PAS and 13 were executed via Ayers.
 12. At all material time, SynerWealth did not report the deficiencies of the PAS to the SFC. The short selling incidents were uncovered by the SFC.

Breaches and reasons

Failure to prevent and detect short sales

13. As a licensed corporation, SynerWealth is under a duty to exercise due skill, care and diligence to ensure it carries on business in the best interest of market integrity.

14. Short sales or short selling orders may potentially result in illegal short sales in contravention of section 170 of the SFO. SynerWealth should therefore implement adequate system and controls to prevent and detect short selling.
15. SynerWealth took the following control measures to prevent and detect the short sales:
 - (a) SynerWealth's responsible officers monitored the trading activities of its traders on a real-time basis and randomly checked the accounts, by looking at the trading reports at the day-end; and
 - (b) SynerWealth gave verbal and written warnings to the traders upon uncovering any short sell orders; and
 - (c) SynerWealth relied on its traders to follow the pre-defined steps in using the PAS and to report any short sales.
16. The random monitoring by SynerWealth could not effectively prevent and detect the short sales, given the significant number of trades and house accounts. The random day-end checking by SynerWealth also failed to detect any short sales. In fact, SynerWealth failed to identify short sales which were subsequently found by the SFC during its monitoring, other than those reported by its traders.
17. The oral warnings and written memos issued by SynerWealth to the traders were ineffective in deterring and preventing the short sales from continuing. Despite the repeated warnings, SynerWealth never suspended or stopped its traders or staff members from using the PAS.
18. SynerWealth in effect relied upon its traders to self-report any short selling by completing an error trade report, but SynerWealth could not ensure that the relevant trader would submit an error report. In fact, the SFC found that a significant number of short sales were not reported by SynerWealth's traders.
19. In light of the above, SynerWealth's lacked a control system for detecting short sales. In October 2013, the SFC made a request for SynerWealth to produce a complete list of its short sell orders. However, SynerWealth stated that it needed a computer programme as well as manual checking to generate a list of the orders. After repeated requests by the SFC, SynerWealth eventually supplied a list of short sales in April 2014. However, the SFC found that the list understated the number of short sell orders and was therefore inaccurate in relation to the number of short sales.
20. Lastly, SynerWealth failed to implement any effective controls over the six traders who had access to both the PAS and Ayers. Although SynerWealth claimed that it had monitored their trading activities, such monitoring was ineffective as it failed to prevent the 13 instances of short sales executed in Ayers.
21. SynerWealth did not take any effective measures to prevent short sales. Instead, SynerWealth allowed its traders to continue to use the PAS after the deficiencies were identified and before they were rectified, ie from November 2012 (when the first short sale was discovered) to October 2013 (when its management finally rectified the last of the three deficiencies).

Failure to report to the SFC

22. As a licensed corporation, SynerWealth is under a duty under the Code of Conduct to report to the SFC immediately upon being aware of any material failure, error or defect in the operation or functioning of its trading system or equipment.
23. SynerWealth did not consider reporting or believed it was unnecessary to report the short sales or defects of the PAS to the SFC. In July 2013, the SFC made enquiries with SynerWealth as to whether any short selling orders were executed via the PAS during the period from September 2012 to February 2013. Only then did SynerWealth provide the SFC the error trade reports in relation to the short selling incidents which took place during the period from 7 January 2012 to 24 July 2013. A significant number of further short selling incidents were subsequently uncovered during the SFC's investigation.
24. Short selling activities have the potential to affect the orderly functioning or stability of the market and as such, restrictions and regulations are in place in most jurisdictions including Hong Kong.

Conclusion

25. Having considered all the circumstances, the SFC is of the view that SynerWealth is guilty of misconduct and is not a fit and proper person to remain licensed.
26. The SFC has decided to publicly reprimand SynerWealth and to fine it \$2.7 million because of the gravity of the failures.
27. A breakdown of the fine in paragraph 1(b) is as follows:
 - (a) \$1.7 million for the failure referred to in paragraph 2(a) above; and
 - (b) \$1 million for the failure referred to in paragraph 2(b) above.
28. In coming to the decision to take disciplinary action against SynerWealth, the SFC has taken into account all the circumstances of this case, including:
 - the Disciplinary Fining Guidelines made under section 199(1)(a) of the SFO;
 - adequate and effective internal control systems are fundamental to the fitness and properness of a licensed corporation;
 - SynerWealth's failures lasted about 14 months; and
 - SynerWealth has a clean disciplinary record.