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SFC reprimands and fines DBS Vickers (Hong Kong) Limited \$2 million for regulatory breaches and internal control failures

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The Securities and Futures Commission (SFC) has reprimanded DBS Vickers (Hong Kong) Limited (DBSVHK) and fined it \$2 million for regulatory breaches and internal control failings relating to under-segregation of client money (Note 1).

The disciplinary action follows an SFC investigation into three self-reports by DBSVHK about possible non-compliance with the Securities and Futures (Client Money) Rules (Client Money Rules) (Note 2).

During the period from June 2013 to September 2015, DBSVHK used aggregated client monies in segregated client accounts to meet settlement obligations. In doing so, DBSVHK effectively used excess margin deposits of some clients to fulfil the margin requirement of other clients with unmet margin calls, constituting a breach of the Client Money Rules as well as the SFC's Code of Conduct (Notes 3 & 4).

The SFC found that DBSVHK failed to have adequate internal controls and management supervision in place to prevent under-segregation of client money and to ensure that client assets were appropriately safeguarded. In particular, DBSVHK did not have sufficient controls governing certain processes as well as process change.

In deciding the disciplinary sanction, the SFC took into account that:

- there is no evidence that any client of DBSVHK has suffered loss as a result of the non-compliance;
- DBSVHK engaged an independent reviewer to review its client money handling process and has taken steps to remediate a number of its internal control deficiencies identified in the review;
- DBSVHK has co-operated with the SFC in resolving the disciplinary proceedings; and
- DBSVHK has an otherwise clean disciplinary record.

End

Notes:

1. DBSVHK is licensed under the Securities and Futures Ordinance (SFO) to carry on business in Types 1 (dealing in securities), 2 (dealing in futures contracts) and 4 (advising in securities) regulated activities.
2. Pursuant to section 5(1)(d) of the Client Money Rules, a licensed corporation that holds any amount of client money in a segregated account shall retain it there until it is required in order to meet the client's obligations to meet settlement or margin requirements in respect of dealing in securities or futures contracts carried out by the licensed corporation on behalf of the client, being the client on whose behalf it is being held.
3. Paragraph 11.1(a) of the Code of Conduct for Persons Licensed by or Registered with the SFC (Code of Conduct) provides that a licensed person should, in the handling of client transactions and client assets, act to ensure that client assets are accounted for properly and promptly. Where the licensed person is in possession or control of client positions or assets, the licensed person should ensure that client positions or assets are adequately safeguarded.
4. Paragraph 16(a) of Schedule 4 of the Code of Conduct provides that no licensed person should apply, permit or suffer any monies, securities or any other forms of collateral standing to the credit of any client's ledger account to be applied for the benefit of its own trading accounts, accounts of its directors or employees or for the benefit of trading accounts of any other clients.

[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 DBS Vickers (Hong Kong) Limited (**DBSVHK**):
 - (a) publicly reprimanded DBSVHK, pursuant to section 194(1)(iii) of the Securities and Futures Ordinance (**SFO**); and
 - (b) imposed on DBSVHK a financial penalty in the sum of \$2 million, pursuant to section 194(2) of the SFO.
2. The disciplinary action addresses DBSVHK's regulatory breaches and internal control deficiencies during the period between 11 June 2013 and 8 September 2015 (**Relevant Period**). Specifically, DBSVHK:
 - (a) failed to prevent under-segregation of client monies; and
 - (b) lacked adequate controls and effective supervision over firstly, change of process; and secondly, the process itself.

Summary of regulatory requirements

3. Section 5(1)(d) of the Securities and Futures (Client Money) Rules (**Client Money Rules**) provides that a licensed corporation that holds client money in a segregated account shall retain it there until it is required in order to meet the client's obligations to meet settlement or margin requirements in respect of dealing in securities or futures contracts carried out by the licensed corporation on behalf of the client, being the client on whose behalf it is being held.
4. Pursuant to paragraph 16(a) of Schedule 4 of the Code of Conduct for Persons Licensed by or Registered with the SFC (**Code of Conduct**), no licensed person should apply, permit or suffer any monies, securities or any other forms of collateral standing to the credit of any client's ledger account to be applied for the benefit of its own trading accounts, accounts of its directors or employees or for the benefit of trading accounts of any other clients.
5. The Code of Conduct also provides that a licensed person should:
 - (a) ensure that it has adequate resources to supervise diligently and does supervise diligently persons employed or appointed by it to conduct business on its behalf (paragraph 4.2);
 - (b) have internal control procedures and financial 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 (paragraph 4.3);

- (c) ensure that client assets are accounted for properly and promptly and adequately safeguarded (paragraph 11.1(a));
 - (d) comply with, implement and maintain measures appropriate to ensure compliance with the law, rules, regulations and codes administrated or issued by the SFC (paragraph 12.1); and
 - (e) comply with all regulatory requirements applicable to the conduct of its business activities so as to promote the best interests of clients and the integrity of the market (General Principle **(GP)** 7).
6. Under the Management, Supervision and Internal Control Guidelines for Persons Licensed by or Registered with the SFC (**Internal Control Guidelines**), a licensed corporation is required to:
- (a) ensure all staff are provided adequate and up-to-date documentation regarding the firm's policies and procedures (Part III paragraph 2); and
 - (b) establish, maintain and enforce effective compliance procedures (Part V paragraph 4).

Summary of facts and breaches

7. In March 2013, the SFC conducted a limited review of the business activities of DBSVHK (**Inspection**) and observed that DBSVHK did not have any controls in place to prevent the use of excess margin deposits of clients to fulfil the margin requirements of other clients with unmet margin calls (**Issue**). It was also found that DBSVHK co-mingled client monies for trading securities and client monies for trading futures products in a segregated client account.
8. In response, the Treasury Department of DBSVHK (**Treasury**) initiated a new workflow in June 2013 by, firstly, separating cash and margin account trading in respect of settlement with the Central Clearing and Settlement System (**CCASS**); and secondly, depositing house funds into existing clients' segregated bank accounts to meet settlement obligations with Hong Kong Futures Exchange Limited (**HKFE**), Stock Exchange Options Clearing House Limited (**SEOCH**); and CCASS.
9. Nonetheless, the new workflow failed to properly rectify the Issue. DBSVHK made two self-reports to the SFC in January and February 2015 respectively regarding its non-compliance with the Client Money Rules by under-segregating client monies for trading stock options, futures and cash equities in the following periods and manner:
- (a) Stock options: between 11 June 2013 and 3 November 2014

Prior to the Inspection, Treasury used to transfer funds from client accounts to meet margin calls from SEOCH. To address the Issue, since 11 June 2013, Treasury started depositing house funds in excess of the amount of margin calls into the designated client account for settlement with SEOCH. However, the then head of Treasury was unaware that the buffer amount in the designated client account would be transferred back to the house account through trust-rebalancing on the next day. As such, aggregated client funds were effectively used to settle option margin calls.

(b) Futures: between 31 January 2014 and 3 November 2014

Between June 2013 and January 2014, Treasury resolved the Issue by using house funds to settle margin calls from HKFE. In late January 2014, Treasury separated the client monies for trading futures from the client monies for trading securities in the bank client account and re-designated the account. Thereafter, Treasury unilaterally altered the workflow by transferring client funds from the re-designated futures client account to settle margin calls from HKFE. The then head of Treasury was under the misconception that client money could be used to settle client obligations of the same product.

(c) Cash equities: prior to 21 January 2015

After separating cash clients' and margin clients' settlement in June 2013, Treasury started using house funds to meet margin clients' settlement obligations but continued to use aggregated client funds to meet cash clients' settlement obligations with CCASS.

10. In September 2015, DBSVHK made another self-report to the SFC concerning re-occurrence of under-segregation of client monies for settlement in stock option products due to its financing programme, under which house funds were transferred to the trust account to finance stock option clients' margin requirements (**Financing Programme**). However, since the client book balances of DBSVHK did not reflect the financing amount provided to clients under the Financing Programme, the financing amount would be transferred back from the trust account to the house account following the next-day trust-rebalancing process. As a result, surplus funds from clients were effectively used to settle margin obligations of clients who availed themselves of the Financing Programme. The situation was not rectified until 8 September 2015.
11. During the Relevant Period, DBSVHK did not have adequate controls to ensure client assets were appropriately safeguarded. This resulted in client monies being used to set-off the margin shortfall of other clients in the settlement of margin calls from HKFE and SEOCH. DBSVHK's failure to ensure that client monies were segregated and accounted for properly was in breach of section 5(1)(d) of the Client Money Rules as well as paragraph 11.1(a) and paragraph 16(a) of Schedule 4 of the Code of Conduct.
12. The repeated occurrence of under-segregation of client monies during the Relevant Period was attributable to DBSVHK's lack of sufficient policies and controls governing process change as well as certain processes:
 - (a) Firstly, the internal manual which governed Treasury's day-to-day work procedures neither covered specific workflow with the clearing houses nor specified how client money should be used and how funding should be applied to settle margin calls.
 - (b) Secondly, DBSVHK had no documentation setting out the requirement of prior management approval for any changes to processes or procedures. As such, the then Head of Treasury, who lacked adequate knowledge about the Client Money Rules, was able to alter the settlement process

unilaterally on various occasions without approval from the senior management.

- (c) Thirdly, there was a lack of communication between the relevant departments in relation to the Financing Programme. No procedures were in place for identifying the financing amount to the staff in charge of trust-rebalancing, rendering the process inaccurate. Consequently, the Financing Programme did not work as it was intended to.
 - (d) Lastly, DBSVHK did not have any policy on how each of its departments should assess and review their controls and policies that was clearly formulated, communicated to its employees and enforced by its compliance department or senior management.
13. The above failures by DBSVHK to properly manage the risks associated with its business was in breach of Part III paragraph 2 of the Internal Control Guidelines as well as paragraph 4.3 of the Code of Conduct.
14. Furthermore, DBSVHK lacked effective management supervision to guard against regulatory breaches during the Relevant Period. It merely relied on each individual department to assess and certify their own compliance with the relevant regulatory requirements without further verification or sample checking. It was also common practice for DBSVHK to rely upon its head office in Singapore (**DBSV Singapore**) to supervise day-to-day work of each department and to review departmental policies and procedures. However, it is doubtful whether DBSV Singapore could act as reviewer as it lacked local regulatory expertise. As such, DBSVHK has failed to comply with Part V paragraph 4 and paragraph 4.2 of the Code of Conduct.
15. In failing to prevent under-segregation of client monies, DBSVHK has also breached GP 7 and paragraph 12.1 of the Code of Conduct.

Conclusion

16. Having considered all relevant circumstances, the SFC is of the opinion that DBSVHK has been guilty of misconduct, and its internal control failures set out above have called into question its fitness and properness to remain a licensed corporation.
17. In deciding the disciplinary sanction set out in paragraph 1, the SFC has had regard to its Disciplinary Fining Guidelines and has taken into account all relevant circumstances, including:
- (a) there is no evidence that any client of DBSVHK has suffered loss as a result of the non-compliance;
 - (b) DBSVHK is remorseful and has instructed an independent reviewer in March 2015 to perform a review of its client money handling process for futures, listed options and cash securities regulated activities and provide recommendations for rectification of key weaknesses in its controls;
 - (c) DBSVHK has already taken steps to remediate a number of the internal control deficiencies identified in the review;

- (d) DBSVHK has co-operated with the SFC in resolving the disciplinary proceedings; and
- (e) DBSVHK has no disciplinary history with the SFC.