SFC reprimands and fines Promising Securities Company Limited $3.5 million

10 May 2017

The Securities and Futures Commission (SFC) has reprimanded and fined Promising Securities Company Limited (Promising) $3.5 million for breach of the Code of Conduct and the Management, Supervision and Internal Controls Guidelines (Notes 1 to 3).

The SFC's disciplinary action arose from a self-report by Promising in 2014 that a settlement staff had misappropriated client assets following an enquiry by a client that 1,600 HSBC shares had gone missing from her trading account.

The SFC's investigation found that Promising:

- employed and allowed the settlement staff, who was unlicensed, to perform regulated functions for its business in regulated activities, such as introducing clients to open trading accounts and handled and took orders from clients (Note 4); and
- failed to implement adequate internal control procedures that ensure effective segregation of its operational functions, and allowed the same individual to perform both sales and settlement functions, which gave the settlement staff the opportunity to misappropriate around $8 million worth of client assets affecting 24 client accounts over a four-year period, which went undetected by Promising until the client enquired about her missing shares (Notes 5 & 6).

In determining the sanction, the SFC took into account all the circumstances, including:

- Promising has taken steps to return the misappropriated assets to all of the affected account holders;
- Promising agreed to engage an independent reviewer to conduct a review of its internal controls to ensure client assets are adequately protected against internal misconduct;
- Promising self-reported to the SFC about the misappropriation;
- Promising cooperated with the SFC in resolving the SFC's concerns;
- Promising has an otherwise clean disciplinary record with the SFC; and
- The SFC wishes to send a clear message to the market that investor protection is one of the SFC's regulatory objectives and the SFC will not hesitate to take necessary actions against those who fail to put in place appropriate internal controls to protect the firms and their clients.

End

Notes:

1. Promising is licensed under the Securities and Futures Ordinance (SFO) to carry on business in Type 1 (dealing in securities) regulated activities.
2. Code of Conduct for Persons Licensed by or Registered with the SFC (Code of Conduct).
3. The Management, Supervision and Internal Controls Guidelines for Persons Licensed by or Registered with the SFC published under the SFO.
4. Under section 114(3) of the SFO, no person shall perform any regulated function in relation to a regulated activity except a licensed representative. General Principle 7 of the Code of Conduct provides that a licensed corporation should 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. Paragraphs 12.1 and 4.1 of the Code of Conduct provide that a licensed corporation should ensure compliance with the relevant law and regulations, and should ensure that any person it employs to conduct business is fit and proper and qualified to act in the capacity so employed.
5. General Principle 2 and paragraph 4.3 of the Code of Conduct provide that a licensed corporation should conduct its business activities with due skill, care and diligence, and in the best interests of its clients, and should have internal control procedures to protect its operations and clients from financial loss arising from dishonest acts.
6. Section II of the Internal Control Guidelines provides that key duties and functions shall be appropriately segregated. Specifically, paragraph 2 stipulates that operational functions, including sales and settlement, should be effectively segregated to minimise the potential for conflicts, errors or abuses which may expose the firm or its clients to inappropriate risks.

A copy of the Statement of Disciplinary Action is available on the SFC's website

Page last updated : 10 May 2017

STATEMENT OF DISCIPLINARY ACTION

The Disciplinary Action

1. The Securities and Futures Commission (**SFC**) has reprimanded and fined Promising Securities Company (**Promising**) a total of $3.5 million pursuant to section 194 of the Securities and Futures Ordinance (**SFO**) for:

   (a) employing and allowing an unlicensed person to perform regulated functions for its business in regulated activities from 1 April 2003 to 14 November 2014[1], in breach of General Principle 7, and paragraphs 12.4 and 4.1 of the Code of Conduct[2]; and

   (b) failing to implement adequate internal control procedures that ensure effective segregation of its operational functions, which allowed the same individual to perform both sales and settlement functions from 1 January 2011 to 30 November 2014, in breach of General Principle 2 and paragraph 4.3 of the Code of Conduct, and Section II of the Management, Supervision and Internal Controls Guidelines for Persons Licensed by or Registered with the SFC (**Internal Control Guidelines**).

2. Promising is licensed to carry on business in Type 1 (dealing in securities) regulated activities.

Summary of facts

3. On 8 November 2014, a client notified Promising about 1,600 HSBC shares that had gone missing from her trading account held at Promising (**Missing Shares**). Promising reported to the SFC on 14 November 2014 that its settlement staff had misappropriated client assets.

4. In December 2014, Promising and the SFC jointly engaged an independent reviewer to conduct reviews on client circularisation, the misappropriation by the settlement staff and Promising's internal controls and procedures. The review findings were published on 27 July 2016.

Employing and allowing an unlicensed person to perform regulated functions

5. Under the SFO, only licensed individuals can perform regulated function in relation to a regulated activity. General Principle 7 of the Code of Conduct provides that a licensed corporation should 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. Paragraph 12.1 of the Code of Conduct provides that a licensed corporation should ensure compliance with the laws and regulations, and paragraph 4.1 of the Code of

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[1] excluding the period from May to December 2009

[2] Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission

Conduct provides that licensed corporations should ensure that any person it employs to conduct business is fit and proper and qualified to act in the capacity so employed.

6. The settlement staff began her employment with Promising in 1987. Between January 2003 and mid-November 2014, she was only granted a licence to perform regulated functions in Type 1 regulated activities for six months from 21 May to 22 December 2009.

7. The SFC's investigation found that the settlement staff introduced clients to open trading accounts and handled and took orders from clients when she was not licensed to perform regulated functions. The account opening documents produced by Promising show that the settlement staff introduced around 289 clients to open trading accounts at Promising from 1 April 2003 to 7 May 2015.[3] Nine of these trading accounts are believed to have been opened after the settlement staff's misappropriation was reported to the SFC.

8. The evidence shows Promising was fully aware at the time that the settlement staff did not hold any licence for any type of regulated activities. Nevertheless, Promising allowed the settlement staff to perform such regulated functions. It is clear that Promising had breached General Principle 7, and paragraphs 12.1 and 4.1 of the Code of Conduct.

Failing to implement adequate internal control procedures that ensures effective segregation of its operational functions

9. General Principle 2 and paragraph 4.3 of the Code of Conduct provide that a licensed corporation should conduct its business activities with due skill, care and diligence, and in the best interests of its clients, and should have internal control procedures to protect its operations and clients from financial loss arising from dishonest acts.

10. Section II of the Internal Control Guidelines provides that key duties and functions shall be appropriately segregated. Specifically, paragraph 2 stipulates that operational functions, including sales and settlement, should be effectively segregated to minimize the potential for conflicts, errors or abuses which may expose the firm or its clients to inappropriate risks.

11. The evidence shows the settlement staff handled multiple tasks and functions at Promising, including handling cheques payable by Promising to clients for settlement of trades, posting account statements, depositing cheques into Promising's bank account for clients, taking order instructions from clients and passing those orders to the dealers for execution in the market, during the period from 1 January 2011 to 30 November 2014.

12. Promising's failure to segregate key functions and duties allowed the settlement staff the opportunity to dishonestly misappropriate client assets. It is particularly concerning that the settlement staff was able to continue her dishonest act for four years undetected by Promising and the matter did not come to light until the client enquired about the Missing Shares.

13. The evidence shows for the period from January 2011 to November 2014, around $8 million worth of client assets affecting 24 account holders had been misappropriated by the settlement staff.

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3 Excluding the period from 21 May to 22 December 2009

14. It is clear that Promising had breached General Principle 2 and paragraph 4.3 of the Code of Conduct, as well as the Internal Control Guidelines. This failure is particularly serious given the Internal Control Guidelines took effect in April 2003, yet until November 2013, Promising was still permitting its staff to carry out different key duties and functions that ought to have been segregated.

Conclusion

15. The SFC considers that the sanction of a public reprimand and a total fine of $3.5 million is commensurate with the seriousness of Promising's failures after taking into account all the circumstances, including:

(a) Promising has taken steps to return the misappropriated assets to all of the affected account holders;

(b) Promising agreed to engage an independent reviewer to conduct a review of its internal controls to ensure client assets are adequately protected against internal misconduct;

(c) Promising self-reported to the SFC about the misappropriation;

(d) Promising cooperated with the SFC in resolving the SFC's concerns;

(e) Promising has an otherwise clean disciplinary record with the SFC; and

(f) The SFC wishes to send a clear message to the market that investor protection is one of the SFC's regulatory objectives and the SFC will not hesitate to take necessary actions against those who fail to put in place appropriate internal controls to protect the firms and their clients.