

# SFC reprimands and fines Credit Suisse (Hong Kong) Limited, Credit Suisse Securities (Hong Kong) Limited and Credit Suisse AG \$39.3 million for regulatory breaches

8 Feb 2018

The Securities and Futures Commission (SFC) has resolved its concerns with Credit Suisse (Hong Kong) Limited (CSHK), Credit Suisse Securities (Hong Kong) Limited (CSSHK) and Credit Suisse AG (CSAG) (collectively, Credit Suisse) over internal control failures.

Under the resolution, the SFC reprimanded and fined Credit Suisse a total of \$39.3 million for regulatory breaches, including failures in segregating client securities, reporting direct business transactions, complying with short selling requirements, electronic trading requirements and contract notes rules as well as failures in internal controls designed to ensure that investment products sold to customers were suitable (Notes 1 & 2).

The SFC's disciplinary action followed independent reviews agreed by the SFC and Credit Suisse and an SFC investigation, which found that (Note 3):

CSHK had:

- failed to segregate client securities from house securities from February 2010 to May 2016, and used client securities on 672 occasions to settle proprietary transactions;
- failed to ensure compliance with short selling requirements following the restructuring of certain trading books, resulting in 159 oversold transactions between December 2014 and July 2015, of which 94 transactions were uncovered short sell orders;
- failed to ensure that a pre-trade control for its electronic algorithm trading systems was properly configured for all of its execution dealers; and
- failed to comply with the short position reporting requirements, which resulted in a failure of itself and three affiliate companies to report over 1,200 reportable short positions to the SFC between June 2012 and October 2014.

CSSHK had:

- failed to segregate client securities from house securities from February 2010 to May 2016, and used client securities on 171 occasions to settle proprietary transactions;
- failed to comply with the direct business transactions reporting requirements in respect of trading on 30 November 2010, resulting in the late reporting of over 120 transactions to The Stock Exchange of Hong Kong (SEHK) on 1 December 2010, and the failure to report or duplication of reporting of nearly 200 transactions to the SEHK between 2010 and 2015; and
- unnecessarily reported 78 cross trades to the SEHK from January 2015 to August 2015.

CSAG had:

- failed to ensure compliance with all regulatory requirements pertaining to the sale of investment products and ensure the effective operation of controls governing transactions where investment product risk classification exceeded client risk profile, in particular through the exclusion of transactions from post-trade risk mismatch supervisory reports between January 2010 and March 2016 and through insufficient policies, procedures and supervision;
- failed to ensure the suitability of six risk mismatch transactions for clients over the period between January 2010 and January 2013 (Note 4); and
- failed to provide and disclose certain information to clients pursuant to the contract notes requirements between April 2003 and April 2017.

The SFC considers that Credit Suisse's systems and controls were inadequate and failed to ensure compliance with the Securities and Futures (Client Securities) Rules, Securities and Futures (Short Position Reporting) Rules, Securities and Futures (Contract Notes, Statements of Account and Receipts) Rules, short selling provisions of the Securities and Futures Ordinance, Trading Rules of the SEHK, and various provisions of the Code of Conduct (Notes 5 & 6).

The SFC's Executive Director of Enforcement, Mr Thomas Atkinson, said: "In this instance, Credit Suisse's prompt and extensive co-operation have significantly expedited the effective resolution of the issues that caused the SFC's concerns. Otherwise, the sanctions for similar failures would have been substantially higher."

In reaching this resolution, the SFC took into account all circumstances, including:

- Credit Suisse self-reported their regulatory breaches and failings to the SFC and involved their senior management to address the SFC's regulatory concerns at an early stage;
- Credit Suisse's engagement of independent reviewers to conduct investigations into the SFC's regulatory concerns and to review their respective internal controls and systems;
- Credit Suisse's remedial actions to strengthen their internal controls and systems following the self-reported breaches;
- CSAG's agreement to fully compensate the affected clients (in a total amount of around \$7.6 million) in respect of 10 transactions that were found to be either unsuitable or inconclusive as to their suitability for the clients;
- Credit Suisse's full co-operation with the SFC to resolve the SFC's regulatory concerns; and
- CSHK and CSAG have no disciplinary record with the SFC.

End

Notes:

1. CSHK is licensed under the Securities and Futures Ordinance (SFO) to carry on business in Type 1 (dealing in securities), Type 2 (dealing in futures contracts), Type 4 (advising on securities), Type 5 (advising on futures contracts), Type 6 (advising on corporate finance) and Type 9 (asset management) regulated activities. CSSHK is licensed under the SFO to carry on business in Type 1 (dealing in securities), Type 4 (advising on securities) and Type 7 (providing automated trading services) regulated activities. CSAG is registered 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.
2. In respect of CSAG, the failures in question concerned the business activities of the Hong Kong branch of CSAG.
3. The SFC and Credit Suisse jointly engaged independent reviewers in the last quarter of 2016 in light of self-reports submitted by Credit Suisse and a referral from the SEHK. Prior to the engagement of the independent reviewers, the SFC had also investigated concerns in relation to CSHK's failure to report reportable short positions to the SEHK from June 2012 to October 2014.
4. As part of the independent reviews, the suitability of 123 risk mismatch transactions excluded from CSAG's monitoring reports which resulted in a loss to clients was reviewed. Six transactions were found to be unsuitable for the relevant clients while the suitability of four other transactions were inconclusive because CSAG failed to maintain adequate documentation of the sales process.
5. Details of the relevant regulatory requirements are set out in the Statement of Disciplinary Action.
6. Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (Code of Conduct).

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

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## STATEMENT OF DISCIPLINARY ACTION

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### The Disciplinary Action

1. The Securities and Futures Commission (**SFC**) has publicly reprimanded and fined Credit Suisse (Hong Kong) Limited (**CSHK**), Credit Suisse Securities (Hong Kong) Limited (**CSSHK**) and Credit Suisse AG (**CSAG**) and fined them \$18 million, \$9 million and \$12.3 million respectively (a total of \$39.3 million) pursuant to sections 194 and 196 of the Securities and Futures Ordinance (**SFO**) (CSHK, CSSHK, and CSAG collectively, **Credit Suisse**).
2. The disciplinary action is taken according to an agreement pursuant to section 201 of the SFO dated 6 February 2018 in relation to Credit Suisse's internal control failures in relation to the segregation of client securities, reporting of direct business transactions, short selling, electronic trading systems, reporting of short positions, the sale of risk mismatch investment products to clients, the disclosure of information in contract notes and the charging of commission to clients.
3. CSHK, CSSHK and CSAG are licensed (or, in the case of CSAG, registered) to carry on business in the following types of regulated activities:

<b>Regulated activity</b>	<b>Credit Suisse entity / entities</b>
Type 1 (dealing in securities)	CSHK, CSSHK, CSAG
Type 2 (dealing in futures contracts)	CSHK
Type 4 (advising on securities)	CSHK, CSSHK, CSAG
Type 5 (advising on futures contracts)	CSHK
Type 6 (advising on corporate finance)	CSHK, CSAG
Type 7 (providing automated trading services)	CSSHK
Type 9 (asset management)	CSHK, CSAG

### Summary of Facts

4. As a result of self-reports submitted by Credit Suisse to the SFC between January 2015 and September 2016, and a referral from The Stock Exchange of Hong Kong Limited (**SEHK**) in February 2016, the SFC had regulatory concerns in respect of:
  - (a) CSHK's and CSSHK's segregation of client securities pursuant to the Securities and Futures (Client Securities) Rules (**CSR**);
  - (b) CSSHK's control framework and governance processes in the reporting of direct business transactions pursuant to the Trading Rules of the Stock Exchange of Hong Kong (**SEHK Trading Rules**);
  - (c) CSHK's compliance with the short selling requirements under the SFO;
  - (d) CSAG's policies, procedures, systems and controls for handling risk mismatch transactions;

- (e) CSHK's compliance with the electronic trading requirements under the Code of Conduct for Persons Licensed by or Registered with the SFC (**Code of Conduct**); and
  - (f) CSAG's compliance with the requirements of the the Securities and Futures (Contract Notes, Statements of Account and Receipts) Rules (**CNR**).
5. In the last quarter of 2016, the SFC and Credit Suisse jointly engaged independent reviewers to review (**Independent Review**):
- (a) the cause(s) and extent of, and/or the adequacy of controls in relation to, Credit Suisse's non-compliance with regulatory requirements in relation to the segregation of client securities, reporting of direct business transactions, short selling, the assessment of suitability and sale of investment products to clients, its electronic trading system, and the disclosure of information in contract notes; and
  - (b) the suitability of 123 risk mismatch transactions identified by CSAG as excluded from its post trade risk mismatch monitoring reports from January 2010 to March 2016 and which resulted in a loss to clients (as well as the reasonableness of the filtering criteria applied to identify those transactions) (**Suitability Review**).
6. Prior to the engagement of the independent reviewers, the SFC had also investigated CSHK's internal controls and systems in the reporting of reportable short positions pursuant to the Securities and Futures (Short Position Reporting) Rules (**SPR Rules**).

*Segregation of client securities*

7. CSSHK is both an Exchange Participant of the SEHK and a Clearing Participant of the Hong Kong Securities Clearing Company Limited. CSSHK acts as an executing broker and provides both trade execution and clearing services to CS affiliated entities including CSHK.
8. The Independent Review identified segregation deficiencies in CSHK's and CSSHK's securities settlement processes from February 2010 to May 2016, for example CSHK's client securities were transferred to CSHK's house account on the settlement date before onward delivery to its client custodian account, which resulted in the co-mingling of client securities with CSHK's and CSSHK's house securities, and the use of client securities to settle their proprietary transactions in breach of the CSR. Between May 2014 and May 2016, CSHK and CSSHK used client securities on 672 and 171 occasions respectively to settle their house obligations. All client securities were subsequently settled, and there were no instances of customer complaints due to late settlement.
9. CSHK's and CSSHK's deficient securities settlement processes caused them to breach:
- (a) sections 5(1), 6 and 10 of the CSR, which require an intermediary (or its associated entity) to ensure that any client securities received are deposited for safe custody in designated segregated accounts as

soon as reasonably practicable, and to only deal with client securities in accordance with the client's direction or standing authority; and

- (b) General Principle 8 (client assets) of the Code of Conduct, which requires a licensed person to ensure that client assets are promptly and properly accounted for and adequately safeguarded.

#### *Reporting of direct business transactions*

10. Rule 526 of the SEHK Trading Rules requires Exchange Participants to report to the SEHK all direct business transactions<sup>1</sup> conducted via the SEHK through inputting the transactions into the Automatic Trading System (**AMS**) within the specific timeframes. Rule 526(1)(b) and (2) of the SEHK Trading Rules requires an Exchange Participant to report to the SEHK all direct business transactions conducted before the end of trading on a trading day but yet to be inputted into the AMS and cross trades conducted outside trading hours (**Late Cross Trades**). Such transactions were required to be reported within the first 15 minutes from the commencement of trading in the continuous trading session of the next trading day. As an Exchange Participant of the SEHK, CSSHK is required to comply with these requirements.
11. In December 2015 and July 2017, CSSHK self-reported to the SEHK and the SFC that it made the following incomplete and erroneous reports to the SEHK in relation to its direct business transactions over a five year period. In short, CSSHK:
  - (a) unnecessarily reported 78 "over the counter" cross trades from January 2015 to August 2015 which are not required to be reported under the SEHK Trading Rules; and
  - (b) in respect of cross trades entered into on 30 November 2010: (i) failed to report 128 Late Cross Trades on 1 December 2010, 10 of which remained unreported until December 2015, and (ii) duplicated the reporting of 188 Late Cross Trades between 1 December 2010 and 3 December 2010.
12. The Independent Review found that these reporting failures were caused by record trading volumes on 30 November 2010, a quarterly rebalancing date for the Morgan Stanley Capital International Index, and by deficiencies in CSSHK's control framework and governance processes in relation to the reporting of direct business transactions. These included (i) the lack of written policies and procedures to inform staff of the interpretation, operation and reporting scope of direct business transactions, and (ii) the lack of documentation of the exchange reconciliation process, escalation and contingency policies and procedures for late reconciliation and reporting processes to the SEHK.

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<sup>1</sup> Direct business transactions are transactions transacted by an Exchange Participant which acts for both the buyer and seller i.e. cross trades.

13. CSSHK's failures to put in place effective systems and controls to ensure compliance with the relevant direct business transactions reporting requirements caused it to breach the SEHK Trading Rules and the following provisions of the Code of Conduct:
- (a) General Principle 2 (diligence), which requires a licensed corporation to act diligently when conducting business activities;
  - (b) General Principle 3 (capabilities), which requires a licensed corporation to employ effectively the resources and procedures needed for the proper performance of its business activities; and
  - (c) General Principle 7 (compliance) and paragraph 12.1 (Compliance: in general) of the Code of Conduct, which require a licensed corporation to comply with the applicable regulatory requirements.

*Compliance with short-selling requirements*

14. Section 170 of the SFO prohibits "naked" or "uncovered" short selling. A person can only sell securities through a recognized stock market if, at the time of the sale, they have a presently exercisable and unconditional right to vest the securities in the purchaser of them or they have reasonable grounds to believe that they have such a right. Section 171 of the SFO requires that the party selling shares (and its intermediary) must, at the time of placing an order, identify the relevant transaction as a short sell and provide confirmation that the sale is covered.
15. In August 2015, CSHK discovered 103 instances of oversold transactions between December 2014 and July 2015 (**SS Relevant Period**) in its aggregation unit 21 (**HK21**), which was the aggregation unit used for monitoring and reporting the short selling activities in its PS Desk, Equity Derivatives Desk, and APAC Cash Equity Desks.<sup>2</sup> The SS Relevant Period followed the restructuring of HK21 and the implementation of interim measures intended to comply with the short selling provisions of the SFO. The oversold transactions were caused by the failure of a designated gatekeeper, who was responsible for updating an Excel spreadsheet (**Gatekeeping Spreadsheet**), to ensure up-to-date inventory positions for HK21 were maintained, to properly operate the Gatekeeping Spreadsheet, and/or the failure of traders to take adequate steps to check the available stock with the designated gatekeeper.
16. The Independent Review identified a total of 159 oversold transactions in HK21 during the SS Relevant Period, and classified 94 of these as uncovered short sell orders.<sup>3</sup> The Independent Review found that the causes of the oversold transactions included the fact that CSHK:

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<sup>2</sup> Since 2012, CSHK has adopted the aggregation unit approach for determining whether it was long or short in a stock, for the purpose of monitoring and reporting its short selling activities. This refers to the aggregation of stock positions across a number of trading books/units belong to CSHK to determine whether it is having a net long or short position of a particular security.

<sup>3</sup> The oversold transactions did not result in any settlement failures.

- (a) did not have written procedures or training in place to explain to gatekeepers their role and responsibilities for the operation of the Gatekeeping Spreadsheet, nor controls to ensure the Gatekeeping Spreadsheet was updated at the start of each business day; and
  - (b) did not have adequate pre and post trade controls in place to ensure high touch sell orders could only be executed after the receipt of a good-to-go message to the trader from the gatekeeper.
17. CSHK has failed to put in place effective systems and controls to ensure compliance with sections 170 and 171 of the SFO.

*Handling of risk mismatch transactions*

18. Between January 2015 and April 2016, CSAG self-reported to the SFC its discovery of thousands of risk mismatch transactions that were excluded from its post trade business monitoring reports (**BMR Reports**) due to data extraction issues and other factors. The BMR Reports were part of CSAG's suitability framework – they were post-trade monitoring reports which formed part of the control framework designed to ensure the investment products sold to clients were suitable.
19. CSAG further identified 123 risk mismatch transactions that had been excluded from the BMR Reports and which resulted in a loss to clients from January 2010 to March 2016 (**Risk Mismatch Transactions**).
20. The Independent Review found a number deficiencies in CSAG's suitability assessment framework and controls for handling risk mismatch transactions.

*(i) Lack of policies and procedures*

- (a) Relationship managers (**RMs**) were permitted to recommend certain investment products to clients that did not have an assigned product risk classification (**PRC**) rating. However, there were no formal policies and procedures in place to govern how RMs should perform the pre-trade suitability checks for these products nor any requirement for RMs to obtain the PRC ratings from CSAG's product specialists.
- (b) CSAG's pre-trade supervision and monitoring of risk mismatch transactions recommended to clients were also inadequate. While RMs were permitted to recommend risk mismatch investment products to clients if considered suitable for their client's circumstances, there were no documented procedures to guide RMs on how to exercise this discretion.
- (c) In relation to the recommendation of accumulators and/or decumulators to clients, CSAG did not introduce additional policies and procedures to prevent RMs from recommending risk mismatch accumulators and/or decumulators without a strong justification for the

transaction and without the prior approval of senior management or an independent control function<sup>4</sup>.

- (d) CSAG also did not implement stricter pre-trade controls and supervision for assessing the suitability of transactions involving serious risk mismatch from July 2014 to December 2015 to ensure the supervision level in risk mismatch transactions was commensurate with the seriousness of risk mismatch transactions in accordance with regulatory requirements<sup>5</sup>.
- (e) CSAG also did not have procedures in place to guide RMs on how to handle situations where the RM considers a risk mismatch product to be unsuitable for the client's circumstances but the client insists on investing in the product.

*(ii) Inadequate post-trade monitoring of risk mismatch transactions*

The coverage of risk mismatch transactions reviewed by CSAG's independent control function was based on a fixed sample and not by reference to the volume of risk mismatched transactions during the review period. The BMR Reports generated on a weekly basis were reviewed by business line managers but not also by an independent control function.

*(iii) Inadequate training*

CSAG did not monitor the training attendance of relevant staff members or take follow up action against non-attendees, such as escalating their non-attendance to management.

21. The Suitability Review found that 6 of the Risk Mismatch Transactions were unsuitable for the relevant clients and CSAG did not comply with the following paragraphs of the Code of Conduct:

- (a) paragraph 5.1 (know your client: in general) of the Code of Conduct, which requires licensed corporations and registered institutions to take all reasonable steps to establish the true and full identify of each of its clients, and of each client's financial situation, investment experience, and investment objectives;
- (b) paragraph 5.1A (investor characterization), which requires a licensed or registered person to, as part of the know-your-client procedures,

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<sup>4</sup> HKMA Circular "Selling of Accumulators" dated 22 December 2010 states that "given the nature and structure of accumulators, there will be very little room to justify risk-mismatch transactions. If there are any risk-mismatch transactions at all, they need to be strongly justified and reviewed by a senior officer and/or an independent internal control unit (other than a credit control unit)."

<sup>5</sup> HKMA Circular "Issues and Good Practices in Relation to the Sale of Investment Products" dated 30 July 2014 requires, among other things, more stringent controls over transactions having serious or multiple mismatches or exceptions. The level of controls and supervision should reflect the seriousness of mismatch or exception involved in the transaction.

assess the client's knowledge of derivatives and characterize the client based on his knowledge of derivatives;

- (c) paragraph 5.2 (Know your client: reasonable advice), which requires a licensed or registered person to ensure that, through the exercise of due diligence, the investment recommendation or solicitation for the client is reasonable in all the circumstances; and
- (d) paragraph 5.3 (understanding the nature and risks of the product), which requires a licensed or registered person to assure itself, that the client understands the nature and risks of the products and has sufficient net worth to be able to assume the risks and bear the potential losses of trading in the products when providing services to a client in derivative products, including futures contracts or options, or any leveraged transaction.

22. The Suitability Review further found that:

- (a) the suitability of 4 Risk Mismatch Transactions were inconclusive because CSAG failed to maintain adequate documentation of the sales process; and
- (b) a significant number of the Risk Mismatch Transactions failed to comply with a number of regulatory requirements<sup>6</sup> and/or CSAG's own internal policies and procedures for handling risk mismatch transactions.

23. By failing to have in place adequate internal controls and procedures governing the recommendation and sale of risk mismatched products to clients and to ensure the suitability of risk mismatch transactions for clients, and by failing to diligently supervise and perform post trade monitoring of risk mismatch transactions and to ensure compliance with all regulatory requirements, in addition to breaching the Code of Conduct provisions mentioned in paragraph 211 above, CSAG has also breached the following provisions of the Code of Conduct:

- (a) General Principle 2 (diligence), General Principle 7 (compliance) and paragraph 12.1 (Compliance: in general), as to which see paragraph 13 above; and
- (b) paragraph 4.2 (Staff supervision), which requires a licensed corporation to 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.

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<sup>6</sup> For example, the requirement to provide a copy of the rationale underlying the recommendation of the investment product to the client pursuant to the *Questions and answers on suitability obligations of licensed and registered persons who are engaged in financial planning and wealth management business* issued in 2007.

*Complying with the electronic trading requirements*

24. On 18 December 2015, CSHK received an order to purchase 24.14 million shares of Beijing Enterprises Clean Energy Group (**1250.HK**) on behalf of a client. The client's instruction was "on close target" with no specific price limit. 18 December 2015 was an index rebalancing day on which 1250.HK was scheduled for deletion from the FTSE indices at market close.
25. Two CSHK execution dealers executed the client's order using two different algorithms over the last 5 minutes of the trading session.
26. The actual trading volume for 1250.HK on 18 December 2015 was smaller than estimated by CSHK. The client's order was partially filled and pushed up the price of 1250.HK to a day high of HK\$1.3 (up 97% from previous day's close) in the last 3 minutes of the trading hours.
27. CSHK's pre-trade control, the AES<sup>7</sup> Circuit Breaker, identified the price dislocation in 1250.HK caused by the algorithmic orders but did not pause the orders because it was not properly configured for the two execution dealers.
28. The Independent Review found that CSHK's trading strategy was reasonable but that CSHK failed to:
  - (a) configure the AES Circuit Breaker for the two relevant execution dealers when they joined the HK Dealing Desk in May 2014 and March 2015 respectively;
  - (b) implement formal written procedures to govern the on-boarding process required to configure the AES Circuit Breaker for new users on the HK Dealing Desk;
  - (c) conduct sufficient periodic reviews to ensure its pre-trade controls for its AES Circuit Breaker was appropriately configured across all relevant users and desks; and
  - (d) establish a clear framework and defined scope for periodic pre-trade control reviews mandating the required level of involvement from each relevant function and specifying their respective responsibilities.
29. CSHK's deficiencies breached the electronic trading requirements under paragraphs 18.3, 18.4 and 18.11 of the Code of Conduct and paragraphs 1.1.1 and 3.3.1 of Schedule 7 to the Code of Conduct, which require a licensed person to, among others:
  - (a) implement policies, procedures and controls to supervise the orders sent through its electronic trading system in accordance with applicable regulatory requirements;
  - (b) effectively manage and adequately supervise the design, development, deployment and operation of the electronic trading system it uses;

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<sup>7</sup> AES is the primary algorithmic trading engine used by CSHK.

- (c) have controls that are reasonably designed to ensure its algorithmic trading system operates in the interest of the integrity of the market;
- (d) ensure that there are clearly identified reporting lines with supervisory and reporting responsibilities assigned to appropriate staff members and there are managerial and supervisory controls that are designed to manage the risks associated with the use of the electronic trading system; and
- (e) have controls that are reasonably designed to monitor and prevent the generation of or passing to the market for execution order instructions from its algorithmic trading system which may be erroneous or interfere with the operation of the a fair and orderly market.

*Disclosure of information in contract notes and charging of commission to clients*

- 30. Between October 2015 and September 2016, CSAG self-reported 7 incidents of non-compliance with the CNR.
- 31. The Independent Review performed a look-back review on these incidents of non-compliance with the CNR. It found that they were caused by various factors such as CSAG's incorrect input of client/trade information, insufficient testing following certain IT changes, and the absence of a contract note template review. The instances of non-compliance went unnoticed, on occasions for prolonged periods, due to ineffective control oversight. As a result of these failures, clients received delayed contract notes (i.e. not within T+2), or there were insufficient or incorrect disclosures under the CNR.
- 32. Subsequent to the commencement of the Independent Review, CSAG reported 8 further instances of non-compliance with the CNR between December 2016 and July 2017. CSAG's investigation reports showed they were caused by various reasons including the use of incorrect templates, system issues, and software logic error.
- 33. The instances of non-compliance with the CNR span across a 14-year period between April 2003 and April 2017 and affected over 22,000 transactions.
- 34. In summary, CSAG's deficiencies breached sections 5 and 11 of the CNR which requires an intermediary that enters into a relevant contract with, or on behalf of, a client to, among others:
  - (a) provide contract notes to clients no later than the end of the second business day after entering into the relevant contract;
  - (b) include certain information in the contract note including whether the relevant contract is for the opening or closing of a position; where the relevant contract is not a leveraged foreign exchange contract and the intermediary is acting as principal, an indication that it is so acting; the rate or amount of commission payable in connection with the relevant contract; and for a purchase or sale in respect of a relevant contract for securities dealing, the price per unit of the securities; and
  - (c) provide and include in monthly statement of accounts to client, details of all income credited to and charges levied against that account during that monthly accounting period.

35. One of the incidents of non-compliance with the CNR involved 56 clients being charged incorrect commission amounts. The overcharged amounts were refunded by CSAG to those clients, and a further review was commissioned to detect whether CSAG had charged clients incorrect commission amounts in other transactions.
36. CSAG's review concluded that, amongst the equities and mutual funds transactions conducted on behalf of its private banking clients in the first quarter of 2017, there were five transactions where the commission rate charged was higher than what it should have been. The commission overcharged in all five transactions were caused by human input error. CSAG has since refunded the overcharged commission to the respective clients.
37. By overcharging its clients, CSAG failed to act with due skill, care and diligence, in the best interests of its clients and the integrity of the market, in breach of General Principle 2 of the Code of the Conduct. The overcharging incidents also suggest that CSAG failed to supervise its staff diligently and have in place adequate and effective internal controls, in breach of paragraphs 4.2 and 4.3 of the Code of Conduct.

#### *Reporting of short positions*

38. Between March and May 2013, CSHK self-reported to the SFC that, from June 2012 and March 2013, CSHK and three offshore Credit Suisse entities, had failed to report over 900 reportable short positions to the SFC as required under the SPR Rules.
39. CSHK's large shareholding reporting team (**LSR Team**) based in Singapore was responsible for the monitoring and reporting of reportable short positions held on behalf of the relevant entities to the SFC.
40. In October 2014, CSHK informed the SFC that the London short positions of the dual listed shares of HSBC Holdings PLC (**HSBC**) and Standard Chartered PLC (**Standard Chartered**) were erroneously included in the short positions reports submitted to the SFC prior to October 2012. CSHK submitted amended short positions reports to the SFC in October 2012, but in doing so, inadvertently removed the Hong Kong short positions from the amended reports<sup>8</sup>. As a result, between October 2012 and October 2014, CSHK and two of its offshore affiliates failed to report around 373 reportable short positions in Hong Kong listed shares of HSBC and Standard Chartered across 108 trading days.
41. The SFC found deficiencies in CSHK's internal controls for the reporting of reportable short positions. In particular:

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<sup>8</sup> The SFC's FAQs on short position reporting dated 18 February 2013 provides that, for shares dually listed on a Hong Kong exchange and a non-Hong Kong exchange, reporting of a "short position" is required for a position that results from a short sale of the specified shares at or through the SEHK or by means of an authorized automated trading services.

- (a) CSHK's supervision of the LSR Team and the measures in place for monitoring, capturing and reporting reportable short positions was inadequate;
  - (b) CSHK did not take steps to review or test the adequacy of its established procedures on short positions reporting despite the occurrence of a number of error reports; and
  - (c) the written procedures or guidelines in place to guide the LSR Team in reporting reportable short positions to the SFC were inadequate.
42. With respect to the reporting of reportable short positions of dual listed shares, the SFC found that:
- (a) CSHK's Legal and Compliance database system (**LCD System**)<sup>9</sup> could not distinguish between primary and secondary listings and therefore all shares traded in Hong Kong were aggregated to their London listings and the LSR Team did not recognize this, and therefore, when an officer of the LSR team removed the code used to identify the London-listed HSBC and Standard Chartered shares from the data used to generate the holding summary report, both the London and Hong Kong short positions were excluded.
  - (b) CSHK did not conduct any tests on its system following the removal of the London short positions.
43. Rule 3(1) of the SPR Rules provides that a person has a reportable short position if the person has a net short position value in a specified share that is equal to or more than the threshold specified in the SPR Rules. Rules 4(1) and (2) of the SPR Rules require a person to file a report to the SFC of its reportable short position within two business days after the reporting day. The reporting day is the close of trading on the last trading day of each week (usually a Friday). Rules 4(3) and (4) of the SPR Rules require a person to file a report to the SFC, if a daily reporting requirement is in place, of its reportable short position within 1 business day<sup>10</sup>.
44. CSHK's failures to put in place effective systems and controls to ensure compliance with the requirements for reporting reportable short positions has breached the SPR Rules, as well as General Principle 2 (diligence), General Principle 7 (compliance) and paragraph 12.1 of the Code of Conduct (see paragraph 13 above).

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<sup>9</sup> The LCD system fed data into the Global Positions Limit Monitoring system and was used by the LSR team to generate a shareholding summary to monitor and report substantial shareholdings held by Credit Suisse entities in the Asia Pacific Region.

<sup>10</sup> The SPR Rules came into effect in June 2012.

## Conclusion

45. Having considered all the circumstances, the SFC is of the opinion that it is in the interest of the investing public and in the public interest to resolve the above concerns with Credit Suisse and take the disciplinary action as set out in paragraph 1.
46. A breakdown of the total fine of \$39.3 million in paragraph 1 is as follows:
  - (a) CSHK has been fined a total of \$18 million - \$6 million attributable to the failings concerning segregation of client securities, \$4 million attributable to the failings in relation to its short selling activities, \$4 million attributable to the failings in relation to its electronic trading systems, and \$4 million attributable to the failings in relation to its reporting of short positions;
  - (b) CSSHK has been fined a total of 9 million - \$6 million attributable to the failings concerning segregation of client securities, and \$3 million attributable to the failings in relation to its reporting of direct business transactions; and
  - (c) CSAG has been fined a total of 12.3 million - \$7 million attributable to the failings in its suitability assessment framework and controls for handling risk mismatch transactions, and \$5.3 million attributable to the failings concerning the disclosure of information in contract notes and charging of commission to clients.
47. In coming to the decision to resolve the failures concerning Credit Suisse's internal controls and systems, the SFC took into account all relevant circumstances including that:
  - (a) Credit Suisse self-reported their regulatory breaches and failings to the SFC and involved their senior management to address the SFC's regulatory concerns at an early stage;
  - (b) Credit Suisse's engagement of independent reviewers to conduct investigations into the SFC's regulatory concerns and to review their respective internal controls and systems;
  - (c) Credit Suisse's remedial actions to strengthen their internal controls and systems following the self-reported breaches;
  - (d) CSAG's agreement to fully compensate the affected clients (in a total amount of around \$7.6 million) in respect of 10 transactions that were found to be either unsuitable or inconclusive as to their suitability for the clients;
  - (e) Credit Suisse's full co-operation with the SFC to resolve the SFC's regulatory concerns; and
  - (f) CSHK and CSAG have no disciplinary record with the SFC.