SFC reprimands and fines HPI Forex Limited $2 million for regulatory breaches

22 Aug 2018

The Securities and Futures Commission (SFC) has reprimanded and fined HPI Forex Limited (HPI) $2 million for mis-handling client money (Note 1).

The SFC's disciplinary action came after an admission by HPI that it had transferred client money up to $8 million to the accounts of its overseas brokers between March 2013 and April 2014.

The SFC found that HPI:

- transferred client money from its segregated client account maintained at a bank in Hong Kong to its accounts with two overseas brokers on six occasions;
- used the client money transferred to one of the two overseas brokers to conduct proprietary transactions; and
- remitted all client money from its overseas brokers' accounts back to the segregated client account in Hong Kong after discovering that the conduct might constitute a breach of the Securities and Futures (Client Money) Rules (CMR).

In doing so, HPI breached the Code of Conduct and the CMR by failing to maintain client money in a segregated client account in Hong Kong with an authorized financial institution (Notes 2, 3 & 4).

HPI's use of the client money to conduct proprietary transactions also constitutes a breach of its fundamental duty as a licensed intermediary to ensure that client assets are promptly and properly accounted for and adequately safeguarded (Note 5).

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

- HPI remitted the client money back to the segregated client account upon discovery of this matter and engaged an auditor to review its compliance with the CMR;
- HPI cooperated with the SFC in accepting the disciplinary action;
- there is no evidence that HPI's clients have suffered losses; and
- HPI has an otherwise clean disciplinary record.

Safe custody of client money and client securities is a fundamental obligation of all intermediaries. Intermediaries are reminded to carefully review their internal control procedures for compliance with the CMR and the Securities and Futures (Client Securities) Rules. The SFC will continue to take action against intermediaries which mis-handle client assets.

End

Notes:

1. HPI Forex Limited is licensed under the Securities and Futures Ordinance (SFO) to carry on business in Type 3 (leveraged foreign exchange trading) regulated activities.
2. Code of Conduct for Persons Licensed by or Registered with the SFC (Code of Conduct).
3. The Securities and Futures (Client Money) Rules (CMR) prescribe the manner in which licensed corporations shall treat and deal with client money received or held in Hong Kong.
4. According to Schedule I of the SFO, authorized financial institution means an authorized institution as defined in section 2(1) of the Banking Ordinance, i.e. a bank, a restricted licenced bank or a deposit taking company.
5. General Principle 8 and paragraph 11.1 of the Code of Conduct provide that a licensed or registered person should ensure that client positions or assets are promptly and properly accounted for and adequately safeguarded.

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 reprimanded and fined HPI Forex Limited (**HPI**) HK$2 million pursuant to section 194 of the Securities and Futures Ordinance.

2. The disciplinary action is taken because HPI has:

   (a) failed to maintain client money in a segregated client account in breach of sections 4 and 5 of the Securities and Futures (Client Money) Rules (**CMR**); and

   (b) used client money for proprietary transactions in breach of section 5 of the CMR, as well as General Principle 8 and paragraph 11.1 of the Code of Conduct for Persons Licensed by or Registered with the SFC (**Code of Conduct**).

Summary of facts

3. On 23 July 2014, HPI made a self-report to the SFC that:

   (a) During the periods from 4 March 2013 to 18 February 2014 and from 28 February 2014 to 20 April 2014 (**Relevant Period**), HPI had transferred client money from its segregated client account in Hong Kong to its "client accounts" with overseas external brokers.

   (b) The cause of the breach was HPI's mistaken belief that client money could be maintained with the brokers as long as the accounts were specifically designated as "client accounts".

4. According to HPI's auditor, Ernst & Young (**EY**), among other things:

   (a) HPI failed to hold client money in a segregated account established and maintained with an authorized financial institution or any other person approved by the SFC.

   (b) HPI failed to segregate client money for amounts ranging:

      i. from HK$775,510 to HK$8,025,620 during the period from 4 March 2013 to 18 February 2014; and

      ii. from HK$10,644 to HK$311,405 during the period from 28 February 2014 to 25 April 2014.

Breaches and reasons for action

A. Regulatory requirements

5. With respect to client assets, General Principle 8 and paragraph 11.1 of the Code of Conduct provide that:

   *"**GP8. Client assets***

   A licensed or registered person should ensure that client assets are promptly and properly accounted for and adequately safeguarded.

   11.1 Handling of client assets

   (a) A licensed or registered 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 or registered person or a third party on behalf of the licensed or registered person is in possession or control of client positions or assets, the licensed or registered person should ensure that client positions or assets are adequately safeguarded."

6. In respect of client money, the CMR prescribes the manner in which licensed corporations shall treat and deal with client money received or held in Hong Kong. Salient requirements of the CMR, in so far as relevant to the present case, include:

   (a) Licensed corporations that receive or hold client money shall establish and maintain in Hong Kong one or more segregated accounts for client money with an authorized financial institution[1] or any other person approved by the SFC and designate each account as a trust account or client account. (Sections 4(1) and (2))

   (b) Licensed corporations should deposit client money into the segregated accounts within one business day after receipt of the client money. (Section 4(3))

   (c) Licensed corporations shall retain client money in the segregated accounts until it is:

      - paid to the client on whose behalf it is being held;
      - 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;
      - required to pay money that the client owes to the licensed corporation in respect of regulated activity; or
      - paid in accordance with a written direction or standing authority by the client. (Section 5).

7. In the *Frequently Asked Questions about the "Client Money Rules"*[2], the SFC specifically reminds licensed corporations that CMR requires segregation of client money in a segregated account maintained in Hong Kong with an authorized financial institution. Client's written direction or standing authority must be obtained if client money received or held in Hong Kong is to be transferred and segregated outside Hong Kong.

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[1] According to Schedule I of the SFO, an "authorized financial institution" means an authorized institution as defined in S.2(1) of the Banking Ordinance, i.e. a bank, a restricted licenced bank or a deposit taking company.
[2] See the FAQ at http://www.sfc.hk/web/EN/faqs/intermediaries/supervision/client-money-rules/2003-12-23.html

B. HPI's breaches

8. The SFC's investigation revealed that, during the Relevant Period, HPI had transferred client money up to HK$8 million from its segregated client account at DBS Bank (Hong Kong) Limited (**DBS**) to the accounts of its overseas brokers, Forex Capital Markets Limited (**FXCM**) and Interactive Brokers LLC (**Interactive Brokers**).

9. HPI's accounts at FXCM and Interactive Brokers, albeit designated as "client accounts", were not accounts established and maintained with an authorized financial institution or any other person approved by the SFC. Therefore, HPI has breached sections 4 and 5 of the CMR by transferring the client money from its segregated client account at DBS in Hong Kong to the overseas accounts of FXCM and Interactive Brokers.

10. The SFC also found that HPI had used client money that it transferred to its FXCM account to conduct proprietary transactions. Such conduct jeopardized the interests of its clients, and was in breach of sections 4 and 5 of the CMR, GP8 and paragraph 11.1 of the Code of Conduct.

11. After HPI discovered this matter, HPI remitted the client money back to its segregated client account in Hong Kong and instructed EY to review its compliance with the CMR.

Conclusion

12. The SFC has decided to take the disciplinary action against HPI as described in paragraph 1 above, after taking into account all relevant considerations, including:

    (a) safe custody of client money is a fundamental obligation of all intermediaries and the failures committed by HPI jeopardized the interest of its clients;

    (b) HPI remitted the client money back to the segregated client account upon discovery of this matter and engaged an auditor to review its compliance with the CMR;

    (c) HPI cooperated with the SFC in accepting the disciplinary action;

    (d) there is no evidence that any client of HPI has suffered losses; and

    (e) HPI has an otherwise clean disciplinary record.