

# SFC reprimands and fines Lee's Securities Company Limited \$520,000 for internal control failings

15 Jul 2019

The Securities and Futures Commission (SFC) has reprimanded and fined Lee's Securities Company Limited (Lee's Securities) \$520,000 for internal control failings relating to segregation of duties and handling of client securities (Note 1).

The disciplinary action follows an SFC investigation into Lee's Securities' internal controls after an SFC inspection of the firm in 2015.

The investigation found that Lee's Securities:

- failed to segregate key duties of its front office and back office, which had first been identified by the SFC during an inspection in 2010, and allowed account executives who handled client orders to perform back office duties (Notes 2 to 7); and
- failed to obtain clients' written instruction before carrying out their instructions to transfer their securities to external brokerage accounts, and to withdraw their physical scrips from the Central Clearing and Settlement System (Notes 5 to 9).

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

- Lee's Securities' failure to obtain clients' prior written instructions for dealings in their accounts lasted around 10 years from 2004 to 2015;
- Lee's Securities' continuing failure to take remedial measures to rectify the inadequate segregation of its front office and back office functions which had first been identified by the SFC's inspection in 2010;
- Lee's Securities' co-operation in engaging an independent external accountant to conduct a client circularisation to confirm their stock and cash balances;
- there is no evidence of clients having suffered any losses;
- Lee's Securities' co-operation with the SFC in resolving the disciplinary proceedings; and
- Lee's Securities has no prior disciplinary history with the SFC.

End

Notes:

1. Lee's Securities is licensed under the Securities and Futures Ordinance to carry on Type 1 (dealing in securities) regulated activity.
2. During an SFC inspection in 2010, the SFC had advised Lee's Securities that its segregation of front office and back office functions was inadequate. However, during the 2015 inspection, the SFC found that Lee's Securities continued to allow account executives to verify trade details in clients' daily statements before dispatching to clients.
3. Part II of the Management, Supervision and Internal Controls Guidelines for Persons Licensed by or Registered with the SFC provides that key duties and functions shall be appropriately segregated. Specifically, paragraph 2 provides 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.
4. General Principle 2 of the Code of Conduct for Persons Licensed by or Registered with the SFC (Code of Conduct) provides that a licensed corporation should act with due skill, care and diligence, in the best interests of its clients and the integrity of the market in conducting its business activities.
5. General Principle 7 of the Code of Conduct provides that a licensed person should comply with all regulatory requirements applicable to the conduct of its business activities so as to promote the best interests of its clients and the integrity of the market.
6. Paragraph 12.1 of the Code of Conduct provides that a licensed corporation should comply with, and implement and maintain measures appropriate to ensuring compliance with the applicable regulatory requirements.
7. Paragraph 4.3 of the Code of Conduct provides that a licensed corporation should have internal control procedures and financial and operational capabilities which can be reasonably expected to protect its operations, its clients and other licensed or registered persons from financial loss arising from theft, fraud, and other dishonest acts, professional misconduct or omissions.
8. Section 6(1)(b) of the Securities and Futures (Client Securities) Rules (CSR) provides that a licensed

corporation should only withdraw client securities in accordance with the clients' written direction from designated segregated accounts in Hong Kong or registered in the name of the client on whose behalf the client securities have been received.

9. The "Suggested Control Techniques and Procedures for Enhancing a Firm's Ability to Comply with the CSR and the Securities and Futures (Client Money) Rules" issued by the SFC in April 2003 provides that a licensed corporation should ask its clients to give written instructions in all their dealings with the licensed corporation. Instructions written on paper should bear the client's signature. A licensed corporation should also require clients to give written instructions for any collection of their physical scrips and for clients to sign an acknowledgement of receipt upon collection.

[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 reprimanded and fined Lee's Securities Company Limited (**Lee's Securities**) \$520,000 pursuant to section 194 of the Securities and Futures Ordinance (**SFO**).
2. The disciplinary action relates to Lee's Securities' internal control failings.
3. Lee's Securities is licensed under the SFO to carry on business in Type 1 (dealing in securities) regulated activity.

### Summary of Facts

#### *Background*

4. In 2015, the SFC's Intermediaries Supervision Division (**IS**) conducted a limited review of Lee's Securities' risk management controls (**2015 Inspection**). The 2015 Inspection identified a number of internal control deficiencies including one that IS had previously identified in an earlier limited review in 2010 (**2010 Inspection**). Following the 2015 Inspection, the SFC investigated Lee's Securities' internal control systems and procedures.

#### *Inadequate segregation of front office and back office duties*

5. IS found during the 2010 Inspection that there was inadequate segregation of front office and back office duties at Lee's Securities, and account executives who handled client orders were also involved in performing back office duties including the verification of trade details in clients' daily statements before their onward dispatch to clients. Despite being alerted to this failing in 2010, the 2015 Inspection found Lee's Securities continued to allow account executives to verify clients' daily statements. The 2015 Inspection further identified that account executives were involved in other back office functions including inputting executed trades into Lee's Securities' settlement system, and the printing and despatching of account statements to clients by post.
6. During our investigation, Lee's Securities' account executives and a responsible officer admitted that account executives handled both client orders and performed back office functions until the 2015 Inspection.
7. Part II of the Management, Supervision and Internal Control Guidelines for Persons Licensed By or Registered with the Securities and Futures Commission (**Management Supervision Guidelines**) provides that key duties and functions shall be appropriately segregated, particularly those duties and functions which when performed by the same individual may result in undetected errors or may be susceptible to abuses which may expose the firm or its clients to inappropriate risks.
8. General Principle 2 of the Code of Conduct for Persons Licensed by or Registered with the SFC (**Code of Conduct**) provides that a licensed corporation should act with due skill, care and diligence, in the best interests of its clients and the integrity of the market in conducting its business activities.

9. Paragraph 4.3 of the Code of Conduct provides that a licensed corporation should have internal control procedures and financial and operational capabilities which can be reasonably expected to protect its operations, its clients and other licensed or registered persons from financial loss arising from theft, fraud, and other dishonest acts, professional misconduct or omissions.
10. The evidence suggests Lee's Securities has failed to comply with General Principle 2 and paragraph 4.3 of the Code of Conduct, and part II of the Management Supervision Guidelines.

*Failure to implement adequate procedures for the transfer and withdrawal of client securities*

11. Section 6(1) of the Securities and Futures (Client Securities) Rules (**CSR**) requires, among others, that a licensed corporation should only withdraw client securities in accordance with the clients' written directions from designated segregated accounts.
12. According to the "Suggested Control Techniques and Procedures for Enhancing a Firm's Ability to Comply with the CSR and the Securities and Futures (Client Money) Rules" (**Guidance Note**) issued by the SFC in April 2003, a licensed corporation should ask its clients to give written instructions in all their dealings with the licensed corporation. Instructions written on paper should bear the client's signature. A licensed corporation should also require clients to give written instructions for any collection of their physical scrips and for clients to sign an acknowledgement of receipt upon collection.
13. Our investigation revealed that while Lee's Securities had in place procedures requiring clients to sign an acknowledgement of receipt when collecting their physical scrips, there were no procedures requiring clients to provide a prior written instruction before the transfer of their securities to another brokerage account or the withdrawal of their physical scrips from the Central Clearing and Settlement System.
14. The evidence shows that Lee's Securities' failure to have proper procedures in place to obtain prior written direction from the clients as required by section 6(1)(b) of the CSR and the Guidance Note lasted more than 10 years from 2004 to 2015.
15. Lee's Securities' failings have also breached General Principle 7 and paragraph 12.1 of the Code of Conduct which require a licensed corporation to comply with, and implement and maintain measures appropriate to ensuring compliance with, the applicable regulatory requirements.

**Conclusion**

16. Having considered all the circumstances, the SFC is of the view that the fitness and properness of Lee's Securities as a licensed corporation has been called into question.
17. In deciding the disciplinary action against Lee's Securities in paragraph 1 above, the SFC has taken into account all relevant circumstances including:
  - (a) the Disciplinary Fining Guidelines made under section 199(1)(a) of the SFO;
  - (b) Lee's Securities' continuing failure to rectify the inadequate segregation of its front office and back office functions which had first been identified by the SFC in the 2010 Inspection;

- (c) the duration of Lee's Securities' failure to implement adequate internal controls to ensure clients' written instructions were obtained prior to the transfer of their securities and withdrawal of their physical scrips i.e. around 10 years from 2004 to 2015;
- (d) Lee's Securities' co-operation in engaging an independent external accountant to conduct a circularisation on its clients to confirm their stock and cash balances<sup>1</sup>;
- (e) there is no evidence of clients having suffered any losses;
- (f) Lee's Securities' co-operation with the SFC in resolving the disciplinary proceedings; and
- (g) Lee's Securities has no prior disciplinary history with the SFC.

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<sup>1</sup> At the SFC's request, Lee's Securities engaged an independent external accountant in or around January 2016 to conduct a client circularization following a client complaint that certain assets were misappropriated from her account maintained with Lee's Securities. The SFC's investigation found insufficient evidence to support the client's complaint.