

## SFC reprimands and fines Sincere Securities Limited \$5 million for internal control failings

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The Securities and Futures Commission (SFC) has reprimanded and fined Sincere Securities Limited (SSL) \$5 million for a series of internal control failings and regulatory breaches (Note 1).

The disciplinary action followed an SFC investigation into an investor's complaint concerning the conduct of **a former account executive** of SSL. The SFC found that SSL did not require its account executives to obtain clients' written consent before transferring their funds maintained at SSL to their gold trading accounts opened with its associated company (Notes 2 & 3).

At the SFC's request, SSL engaged an independent reviewer to conduct a review of its internal control systems and procedures. The independent review and a separate review by the SFC identified deficiencies across 14 areas of SSL's business operations and internal controls for the period between October 2015 and December 2016 (Note 4).

Examples of the deficiencies include:

- The Compliance and Procedural Manual of SSL was outdated and failed to capture the regulatory requirements that came into effect after May 2009;
- SSL did not have specific procedures to filter, analyse and monitor staff dealing activities;
- SSL failed to segregate the sales, dealing and settlement functions effectively with the result that its account executives handling client orders also handled clients' fund deposits and withdrawals; and
- SSL had no written procedures to prohibit its staff from receiving client order instructions through mobile phone when they are on the trading floor. Some client order instructions were received through mobile phone applications, such as WhatsApp messenger, while they were in SSL's office but no contemporaneous record of the order details was maintained.

The SFC considers that SSL's systems and controls were inadequate and failed to ensure compliance with the applicable regulatory rules and requirements (Note 5).

In deciding the disciplinary sanctions, the SFC took into account all relevant circumstances, including:

- SSL's agreement to engage an independent reviewer to review its internal control systems and procedures;
- SSL has taken remedial actions to address the deficiencies identified;
- SSL had compensated the affected client in the complaint case, and there is no evidence suggesting other SSL's clients having suffered losses as a result of the identified deficiencies;
- SSL's cooperation with the SFC in resolving its concerns; and
- SSL's otherwise clean disciplinary record.

End

Notes:

1. Sincere Securities Limited is licensed under the Securities and Futures Ordinance to carry on Type 1 (dealing in securities), Type 4 (advising on securities) and Type 9 (asset management) regulated activities.
2. The SFC had taken disciplinary action against the relevant account executive. Please see the SFC's press release dated [25 September 2017](#).
3. The associated company of SSL is Allied Victory Gold and Silver Investment Limited.
4. The 14 areas of deficiencies include: (i) procedures and manuals; (ii) compliance surveillance programme; (iii) escalation policy; (iv) staff dealing activities; (v) discretionary trading; (vi) third-party authorization; (vii) handling of client funds; (viii) handling of client securities; (ix) client orders and dealing; (x) handling of returned mail; (xi) preparation and delivery of trading documents; (xii) customer due diligence; (xiii) credit and margin control procedures; and (xiv) books and records.
5. Please refer to paragraph 6 of the Statement of Disciplinary Action for the relevant rules and regulations.

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

## STATEMENT OF DISCIPLINARY ACTION

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### The Disciplinary Action

1. The Securities and Futures Commission (**SFC**) has publicly reprimanded and fined Sincere Securities Limited (**SSL**)<sup>1</sup> \$5 million pursuant to section 194 of the Securities and Futures Ordinance (**SFO**).
2. The disciplinary action is taken in relation to deficiencies identified across various areas of SSL's business operations and internal controls.

### Summary of facts

3. In around May 2015, an investor lodged a complaint with the SFC alleging that a former account executive of SSL had conducted unauthorized transactions in her securities account maintained with SSL. Following an investigation, the SFC found, among other things, that SSL did not require its account executives to obtain clients' written consent before transferring their funds maintained at SSL to their gold trading accounts opened with its associated company<sup>2</sup>.
4. At the SFC's request, SSL engaged an independent reviewer to conduct a review of its internal control systems and procedures. Separately, the SFC had conducted a limited review of SSL's business activities.
5. The reviews conducted by the SFC and the independent reviewer identified deficiencies in 14 areas of SSL's business operations and internal controls for the period between October 2015 and December 2016. The key deficiencies identified under each of the 14 areas, include, among other things:
  - (a) *Procedures and manuals* – The Compliance and Procedural Manual (**Manual**) of SSL was outdated and failed to capture the regulatory requirements that came into effect after May 2009. SSL did not have a formalised process for regular review and update of the Manual.
  - (b) *Compliance surveillance programme* – The compliance department of SSL did not maintain complete and proper records on the exceptions identified in the surveillance checking. Exceptions found and follow-up actions taken were not communicated to the board of directors.
  - (c) *Escalation policy* – Escalation reporting and issue discussions were not always formally documented.
  - (d) *Staff dealing activities* – SSL failed to properly identify all staff or staff related accounts and did not have specific procedures to filter, analyse and monitor staff dealing activities.
  - (e) *Discretionary Trading* – SSL did not have specific controls in place to monitor the trading activities of the discretionary accounts.

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<sup>1</sup> SSL is licensed under the SFO to carry on Type 1 (dealing in securities), Type 4 (advising on securities) and Type 9 (assets management) regulated activities.

<sup>2</sup> The associated company of SSL is **Allied Victory Gold and Silver Investment Limited**.

- (f) *Third-party authorization* – SSL had not enquired and retained any documentation in relation to the clients' reasons for granting authority to third parties to operate their accounts.
  - (g) *Handling of client funds* – SSL failed to segregate the sales, dealing and settlement functions effectively with the result that its account executives handling client orders also handled clients' fund deposits and withdrawals.
  - (h) *Handling of client securities* - SSL did not issue an acknowledgement slip to clients upon receiving the physical scrip from them.
  - (i) *Client orders and dealing* – SSL had no written procedures to prohibit its staff from receiving client order instructions through mobile phone when they are on the trading floor. Some client order instructions were received through mobile phone applications, such as WhatsApp messenger, while they were in SSL's office but no contemporaneous record of the time of receipt and order details was maintained.
  - (j) *Handling of returned mail* – SSL failed to segregate the duties of staff effectively as it allowed the account executives, who were responsible for the sale and distribution of investment products, to follow up on the returned mails with clients.
  - (k) *Preparation and delivery of trading documents* – Inaccurate information about the date on which the client deposited/withdrew physical stocks was found in some account statements issued by SSL to clients.
  - (l) *Customer due diligence (CDD)* – SSL did not have policies and procedures to conduct CDD reviews upon certain trigger events to ensure client information is up-to-date and relevant.
  - (m) *Credit and margin control procedures* – There was no system or manual solution to identify intra-day margin calls when they arose. Further, some of the account executives had failed to record their follow-up actions with their margin clients in the margin call reports.
  - (n) *Books and records* – SSL did not provide any written guidance on the minimal record retention period and the safe custody of, access to, and use of stationary bearing SSL's name and SSL's company chop.
6. The deficiencies identified constitute a breach of the following regulatory requirements:
- (a) paragraph 4.3 (internal control, financial and operational resources) of the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (**Code of Conduct**), which requires licensed corporations to 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;
  - (b) section VII (operational controls) of the Management, Supervision and Internal Control Guidelines for Persons Licensed by or Registered with the Securities and Futures Commission (**Internal Control Guidelines**), which

requires licensed corporations to establish and maintain effective policies and operational procedures and controls in relation to the firm's day-to-day business operations;

- (c) section VII(9) (operational controls) of the Internal Control Guidelines, which requires licensed corporations to ensure appropriate and effective procedures are established and followed to protect the firm's and its clients' assets from theft, fraud and other acts of misappropriation;
- (d) General principle 6 (conflicts of interest) of the Code of Conduct, which provides that licensed corporations should try to avoid conflicts of interest, and when they cannot be avoided, should ensure that its clients are fairly treated, and sections II(2) (segregation of duties and functions) and VII(4) (operational controls) of the Internal Control Guidelines, which require licensed corporations to effectively segregate its operational functions and establish specific policies and procedures to minimize the potential for conflicts, errors or abuses which may expose the firm or its clients to inappropriate risks;
- (e) sections V (compliance), V(2) and V(6) of the Internal Control Guidelines, which require licensed corporations to: (i) establish and maintain policies and procedures to ensure the firm's compliance with all applicable legal and regulatory requirements as well as with the firm's own internal policies and procedures; (ii) ensure the staff performing the compliance function possess the necessary skills, qualifications and experience to enable them to effectively execute their duties; and (iii) ensure staff performing the compliance function promptly report to the management all occurrences of material non-compliance by the firm or its staff with legal and regulatory requirements and the firm's own policies and procedures;
- (f) paragraphs 3.9(a) and (c) (order recording) of the Code of Conduct, which require licensed corporations to record and immediately time stamp records of the particulars of the instructions for agency orders and internally generated orders, and to prohibit its staff members from receiving client order instructions through mobile phones when they are on the trading floor, in the trading room, usual place of business where order is received or usual place where business is conducted, and have a written policy in place to explain and enforce this prohibition;
- (g) section VII(6) (operational controls) of the Internal Control Guidelines, which requires the management of licensed corporations to establish and maintain policies and procedures which ensure clear and comprehensive audit trails are created to precisely record all orders from the time of origination through order execution and settlement;
- (h) paragraphs 7.1(c) and (e) (authorization and operation of a discretionary account) of the Code of Conduct, which require licensed corporations to designate the client account as "discretionary accounts" if the client has authorized the licensed corporation or any person employed by it to effect transactions for the client without the client's specific authorization, and to implement internal control procedures to ensure proper supervision of the operation of discretionary accounts;
- (i) paragraphs 12.2(a) and (b) (employee dealings) of the Code of Conduct and paragraph 4 (dealing practices) of Appendix A to the Internal Control

Guidelines, which require licensed corporations to have a policy which has been communicated to employees in writing on whether employees are permitted to deal or trade for their own accounts in securities, futures contracts or leveraged foreign exchange contracts, and in the event that employees of a licensed corporation are permitted to deal or trade for their own accounts, among other things: (i) the written policy should specify the conditions on which employees may deal for their own accounts; (ii) employees should be required to identify all related accounts and report them to senior management; (iii) any transactions for employees' accounts and related accounts should be separately recorded and clearly identified in the records of the licensed corporation; and (iv) transactions of employees' account and related accounts should be reported to and actively monitored by the licensed corporation's senior management who should not have any beneficial or other interest in the transactions;

- (j) section VII(2) (operational controls) of and paragraph 2(a) (opening and handling of client accounts) of Appendix A to the Internal Control Guidelines, which provide that where the licensed corporation exercises discretionary authority over a client's account, procedures are used to ensure that the client's investment objectives and strategies and the precise terms and conditions under which such authority may be exercised are set out in a discretionary account agreement and effectively communicated to the client, and that only transactions which are consistent with the investment strategies and objectives of the relevant client, are effected on the client's behalf;
- (k) section IV(6) (information management) of the Internal Control Guidelines, which requires licensed corporations to establish and maintain effective record retention policies;
- (l) paragraphs 4.7.12 , 4.18.1 and 4.18.2 of the Guideline on Anti-Money Laundering and Counter-Terrorist Financing issued on July 2012 (**AML Guideline**), which require licensed corporations to review from time to time client data and information to ensure that they are up-to-date and relevant, and to perform CDD measures (i) when a transaction takes place with regard to a customer, which is, by virtue of the amount or nature of the transaction, unusual or suspicious; or is not consistent with the licensed corporation's knowledge of the customer or the customer's business or risk profile, or with its knowledge of the source of the customer's funds; (ii) when a material change occurs in the way in which the customer's account is operated; or (iii) upon certain other trigger events;
- (m) paragraph 5.6 of the AML Guideline, which requires licensed corporations to conduct an appropriate review of a business relationship upon the filing of a report to the Joint Financial Intelligence Unit and to update the CDD information where appropriate;
- (n) section 11(3)(e) of the Securities and Futures (Contract Notes, Statements of Account and Receipts) Rules (**Contract Notes Rules**), which provides that details of all movements of any client securities and collateral of the client during that monthly accounting period should be included in the statement of account issued to clients;
- (o) section 13(1) of the Contract Notes Rules, which requires licensed corporations to prepare a receipt and provide it to the client no later than

the end of the second business day after receiving the client assets or security provided in relation to a margined transaction;

- (p) paragraph 14 of the Suggested Control Techniques and Procedures for Enhancing a Firm's Ability to Comply with the Securities and Futures (Client Securities) Rules and the Securities and Futures (Client Money) Rules, which requires licensed corporations to issue an official receipt to the client upon receiving the physical script from the client;
- (q) paragraph 10 of Schedule 5 (additional requirements for licensed persons providing margin lending) to the Code of Conduct, which requires licensed corporations to develop, document and communicate to all relevant staff a clear margin lending policy;
- (r) section VIII(2) (risk management) of the Internal Control Guidelines, which provides that appropriate and effective procedures are established and followed to ensure that the licensed corporations' risks of suffering loss, financial or otherwise, as a consequence of client defaults or changing market conditions, are maintained at acceptable and appropriate levels; and
- (s) question 2 of the SFC's questions and answers on the margin lending policy and control requirements issued on 24 August 2009, which requires licensed corporations to document information including the initiation of each margin call, details of the calls made on the client and responses received, and follow-up actions taken to ensure that the case history of margin calls for each individual client can be readily established.

## **Conclusion**

7. The SFC has decided to take the disciplinary actions against SSL as described in paragraph 1 above, after taking into account all relevant circumstances, including:
  - (a) SSL's agreement to engage an independent reviewer to review its internal control systems and procedures;
  - (b) SSL has taken remedial actions to address the deficiencies identified;
  - (c) SSL had compensated the affected client in the complaint case, and there is no evidence suggesting other SSL's clients having suffered losses as a result of the identified deficiencies;
  - (d) SSL's cooperation with the SFC in resolving its concerns; and
  - (e) SSL's otherwise clean disciplinary record.