SFC Reprimands CLSA Limited

20 May 2004

The SFC has reprimanded CLSA Limited, a securities dealer licensed under the Securities and Futures Ordinance (SFO).

The reprimand stems from an SFC inquiry into the effectiveness of the internal controls at CLSA which was initiated following CLSA's discovery in November 2002 that a former employee of CLSA, Yeung Tsz Chung (Yeung) had misappropriated more than HK$22 million over a period of more than 10 years (Note 1).

The SFC and CLSA engaged an independent accounting firm to conduct an investigation into the activities of Yeung and to review CLSA's internal controls and procedures. That review has shown that, at the relevant times, there were internal control weaknesses at CLSA (which CLSA has since remedied) which were exploited by Yeung to enable him to commit and conceal his fraudulent activities. In particular:

- there should have been a segregation of duties so that Yeung was not responsible for both processing transactions and reconciliation of positions;
- staff should have been reminded of the importance of ensuring strict adherence to procedural guidelines, and in particular those relating to computer access and security;
- staff should have been required to take their full holiday entitlement as it can provide the employer with an opportunity to detect fraudulent conduct;
- CLSA should have ensured that the stock reconciliations and calculation of dividend and bonus share entitlements of clients which were conducted by Yeung were independently verified;
- CLSA's own pool of securities, securities holdings at other locations and infrequently traded accounts should have been monitored on a regular basis. Yeung's access to these enabled him to steal stock from CLSA and cover up the theft;
- transfers of stock by staff members for their personal account should have been more closely monitored as this could have indicated Yeung's wrongful activities;
- the internal audit controls, as well as the resources committed by CLSA to supervision of certain settlement staff at the relevant times, were not adequate as a result of which the fraudulent activities of Yeung went undetected for too long;
- due to system limitations, CLSA failed in certain instances to maintain an audit trail of changes to client standing data, these limitations have since been rectified;
- CLSA should have examined and evaluated the adequacy and effectiveness of its internal controls to detect fraud; and
- CLSA should have ensured at the relevant times, more adequate planning, control and recording of all audit and review work performed and should have also ensured that risks highlighted in internal reports were followed up and resolved satisfactorily.

The SFC concludes that the fitness and properness of CLSA has been called into question. In deciding its action, the SFC has taken into account the fact that CLSA has implemented the recommendations proposed by the independent accounting firm to additionally improve its internal control systems as well as the supervision and monitoring of the work of its employees. The independent review notes that since the company began its system upgrades in 2000, a number of system and operational changes were in process, which if implemented would have rectified most if not all the weaknesses. CLSA has notified the 32 known staff, affiliate, client and inactive accounts affected and also pledged to notify any additional clients affected by the misappropriation and credit their accounts with the shortfall amounts and has undertaken to the SFC to compensate future claimants for loss caused by Yeung's theft. The SFC acknowledges that CLSA has taken internal disciplinary action against individuals whose failings unwittingly facilitated the misappropriation by Yeung (Note 2).

Mr Alan Linning, SFC's Executive Director of Enforcement, said: "Intermediaries must ensure that they have effective internal control procedures and that their staff are properly supervised and monitored in order to adequately safeguard client assets. With proper internal control, fraud and misconduct such as misappropriation can be detected at an earlier stage or prevented altogether. We will take disciplinary action against companies that fail to put in place adequate internal controls."

"For a long time, the SFC has reprimanded brokerages for similar failings. Yet, we continue to come across this type of cases all too often. It therefore appears that reprimands are proving to be an inadequate deterrent. Under the SFO, the SFC may fine and partially suspend or revoke licences. In future, in cases of internal control and supervision failings facilitating serious misconduct harming clients, the SFC will consider imposing heavier sanctions. In the most severe cases, we will consider suspending a brokerage's licence for a long period or even revoking it. Investor protection demands this," he added.

Ends

Notes to Editor:

1. Following a disciplinary investigation by the SFC, Yeung's licence was revoked on 29 March 2003. See SFC's press release of 7 April 2003. Yeung was convicted of theft on 2 February 2004 and sentenced to 42 months' imprisonment on 17 February 2004 by the District Court. The SFC found that Yeung had abused his position in CLSA and the trust reposed in him by CLSA, and that he had deceived CLSA by making false entries in the books of CLSA, and using the passwords of other staff to gain access to computers. He also defied CLSA's internal rules.

2. These people are not licensed by the SFC.