

SFC reprimands and fines China Merchants Securities (HK) Co., Limited \$5 million for mishandling client money

30 May 2019

The Securities and Futures Commission (SFC) has reprimanded China Merchants Securities (HK) Co., Limited (China Merchants) and fined it \$5 million for regulatory breaches and internal control failings related to mishandling of client money (Note 1).

The SFC found that there were around 800 incidents between 1 October 2011 to 30 September 2014, where China Merchants transferred funds ranging from \$68,000 to \$308 million from client trust accounts for purposes other than those specifically allowed by the Securities and Futures (Client Money) Rules (Client Money Rules) (Note 2).

China Merchants also failed to employ fit and proper staff to conduct its business and have proper internal controls and procedures in place to ensure compliance with the Client Money Rules and safeguard client assets.

Since safe custody of client assets is a fundamental obligation of licensed corporations, any transgression of this obligation, even if clients' funds were subsequently returned to the client trust account on the same day, cannot be tolerated. By doing so over a three-year period, China Merchants clearly breached this fundamental obligation and failed to comply with the Client Money Rules and the Code of Conduct (Note 3).

In deciding the penalty, the SFC took into account all relevant circumstances including that China Merchants:

- self-reported the matter to the SFC;
- conducted a review to examine its operational processes and controls governing the segregation of client money during the relevant period;
- commissioned an independent compliance and control review on its client money handling process during the relevant period; and
- co-operated with the SFC in resolving its concerns and accepting the SFC's findings and disciplinary action, and there is no evidence of client loss as a result of its non-compliance.

End

Notes:

1. China Merchants is licensed under the Securities and Futures Ordinance to carry on Type 1 (dealing in securities), Type 2 (dealing in futures contracts), Type 4 (advising on securities), Type 6 (advising on corporate finance) and Type 9 (asset management) regulated activities.
2. The Securities and Futures (Client Money) Rules prescribes the manner in which licensed corporations shall treat and deal with client money received or held in Hong Kong.
3. Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission.

[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 China Merchants Securities (HK) Co., Limited (**China Merchants**) HK\$5 million pursuant to section 194 of the Securities and Futures Ordinance.
2. The disciplinary action is taken because China Merchants failed to segregate client money in accordance to the Securities and Futures (Client Money) Rules (**Client Money Rules**).

Summary of facts

3. In September 2014, China Merchants self-reported to the SFC regarding its failure to segregate client money in accordance with section 5(1) of the Client Money Rules.
4. Subsequently, China Merchants:
 - (a) performed a look-back review (**Look-back Review**) to examine its operational processes and controls governing the segregation of client monies during the three-year period from 1 October 2011 to 30 September 2014 (**Relevant Period**); and
 - (b) engaged an independent reviewer (**Reviewer**) to conduct an independent compliance and control review on its client money handling process during the Relevant Period (**Review Report**).
5. The Look-back Review identified around 800 incidents of non-compliance with the Client Money Rules with individual transaction amounts ranging from HK\$68,000 to HK\$308 million. These incidents were classified into six categories:
 - (a) Transfer of funds from client trust accounts to house accounts during client money segregation process. For instance, on 29 December 2011 and 26 August 2013, a total sum of HK\$250,000,000 and HK\$300,000,000 were transferred from China Merchants's client trust account to its house account respectively.
 - (b) Transfer of funds from client trust accounts for repayment of China Merchants's bank loans. For instance, on 22 July 2013 and 16 July 2014, total sums of HK\$75,000,000 and HK\$100,263,948 were transferred from China Merchants's client trust account to its house account respectively.
 - (c) Transfer of funds from client trust accounts for granting term loans to China Merchants's clients. For instance, on 20 January 2012 and 31 October 2013, total sums of HK\$308,460,000 and HK\$27,167,740 were transferred from China Merchants's client trust account to a client respectively.
 - (d) Transfer of funds from client trust accounts for purposes of funding proprietary investments of China Merchants's fellow subsidiary company. For instance, on 3 February 2012 and 11 December 2012, total sums of HK\$30,000,000

and HK\$60,000,000 were transferred from China Merchants's client trust account to its brokers respectively.

- (e) Transfer of funds from client trust accounts for purposes of paying China Merchants's expenses. For instance, on 2 July 2013 and 30 May 2014, total sums of HK\$4,000,000 and HK\$6,000,000 were transferred from China Merchants's client trust account to its house account respectively.
 - (f) Transfer of a rounded amount from a client trust account for purposes of facilitating potential client withdrawal requests, settlement of securities dealing in overseas markets and fee payments for stock lending/borrowing. For instance, on 13 October 2011 and 4 July 2013, total sums of HK\$7,000,000 and HK\$1,000,000 were transferred from China Merchants's client trust account to its house account respectively.
6. Based on the results of the Look-back Review, the Reviewer confirmed that the incidents mentioned in paragraph 5 above were intra-day only.
7. Apart from the six categories of non-compliance incidents identified in the Look-back Review, further incidents in which China Merchants failed to comply with the Client Money Rules were identified by the Reviewer and also in the course of the SFC's investigation. For example:
- (a) According to SFC's investigation, between 2 January 2008 and 30 May 2014, there were 75 transfers in which funds ranging from HK\$1 million to HK\$245 million were transferred from client trust accounts to two settlement accounts maintained with an affiliated broker in order to maintain minimum amounts of deposits to satisfy requirements for trading B-shares in the stock exchanges of Shenzhen and Shanghai.
 - (b) A sample check conducted by the Reviewer revealed at least 12 instances where China Merchants transferred inaccurate amounts of money to/from client trust accounts during client money segregation.
8. According to Review Report, there were procedural and control weaknesses which contributed to China Merchants's failure to segregate client money. These include:
- (a) incorrect interpretation and misunderstanding of the Client Money Rules requirement by its staff;
 - (b) insufficient qualified staff with relevant industry experience within its Finance Department; and
 - (c) inadequate controls within its Finance Department pertaining to the identification of Client Money Rules regulatory obligations and managing compliance with those regulations.

Conclusion

9. The conduct of China Merchants set out above constitutes a breach of:
- (a) section 5(1) of the Client Money Rules for failing to segregate client monies in that it transferred funds from client trust accounts for purposes other than those specifically allowed by the Client Money Rules;

- (b) general principle 3 (Capabilities) and paragraphs 4.1 (Fit and proper staff) and 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**) for failing to employ fit and proper staff to conduct its business and have proper internal controls and procedures in place to ensure its compliance with the Client Money Rules;
- (c) general principle 8 (Client assets) and paragraph 11.1 (Handling of client assets) of the Code of Conduct which require licensed corporations to ensure that client assets are promptly and properly accounted for and adequately safeguarded; and
- (d) general principle 7 (Compliance) and paragraph 12.1 (Compliance: in general) of the Code of Conduct which require licensed corporations to comply with, and implement and maintain measures appropriate to ensuring compliance with, relevant regulatory requirements.

10. In deciding the sanctions, the SFC took into account that China Merchants:

- (a) self-reported the matter to the SFC;
- (b) conducted the Look-Back Review and commissioned the Review Report;
- (c) according to the Review Report, ceased the practice of applying client money on an intra-day basis for house purposes;
- (d) has taken remedial actions to enhance its systems and controls on the handling of client money; and
- (e) co-operated with the SFC in resolving its concerns and accepting the SFC's findings and disciplinary action, and there is no evidence of client loss as a result of its non-compliance.