



Regulatory Update – SFC reprimands and fines Potomac Capital Limited for breaching Financial Resource Rules (June 2020)

On 8 June 2020, the SFC announced that Potomac Capital Limited (Potomac) were reprimanded and fined HK\$800,000 for failures to comply with the Securities and Futures (Financial Resource) Rules (the “Rules”).

Potomac was found to have overstated its liquid capital in its Financial Resource Returns (FRR) from November 2016 to May 2017 by including in its liquid capital aged receivables. Such aged receivables should not have been included in the liquid capital computation as they do not qualify as liquid capital under the Rules.

As a reminder, the relevant definitions under the Rules are:

1. Liquid capital is the amount by which the liquid assets of a licensed corporation (“LC”) exceeds its ranking liabilities.
2. Liquid assets are the aggregate of the amounts required to be included in a licensed corporation’s liquid assets under the provisions of Division 3 of Part 4 of the FRR. Those rules in turn state that an LC must include in its liquid assets the amount of any fees, commissions, commission rebates and interest charges to which it is beneficially entitled which arise from the carrying on by it of any regulated activity for which it is licensed and (i) which have accrued and will first be due for billing or payment within the next 3 months; or (ii) which have been billed or fallen due for payment and remain outstanding for one month or less after the date on which they were billed or fell due
3. Required liquid capital deficit is the amount by which its required liquid capital exceeds its liquid capital.

FRR Breach

During the period in question, Potomac stated in its submitted FRRs that it had an excess liquid capital of over HK\$5 million and the major component of this was in the category of “other assets arising from asset management” and was solely made up of account receivables from 2 clients.

Potomac included fees outstanding from about April 2013 which is clearly outside the permitted period of 1 or 3 months.

Potomac would have had a liquid capital deficit if it excluded the aged receivables from its FRRs. The deficit would have varied from HK\$335,000 to HK\$449,000 from February to May 2017. Potomac clearly misinterpreted section 35(a) of the Financial Resource Rules by including the aged receivables in its liquid capital calculations and did not correct this until it was pointed out by the SFC in 2017.

This was a clear breach of section 35(a) of the Financial Resource Rules as Potomac should have only included such aged receivables that were accrued and first due for billing or payment within the next three months following April 2013.



Conclusion

In deciding its disciplinary sanctions, the SFC took into account Potomac’s clean disciplinary record and the fact that Potomac immediately rectified the FRR breach. The SFC took the view that by overstating its liquid capital Potomac breached General Principles 2 (Diligence) and 7 (Compliance) of the Code of Conduct as well as paragraph 12.1 (compliance).

This case demonstrates again how important it is that LCs in Hong Kong fully understand how the SFC interprets the FRR and that they calculate their SFC returns in accordance with the FRR which may differ in various areas from general accounting principles. If you have any questions about the FRR or your SFC financial resources returns our team of FRR experts can assist you to review or prepare the returns.

About ComplianceAsia

ComplianceAsia is the longest established compliance consulting firm in Asia Pacific established in 2003 with key offices in Hong Kong, Shanghai and Singapore. We have an unmatched track record of completing complex compliance consulting projects for financial firms in the APAC region.

With over 70 staff, including compliance experts with experience in dealing with the SFC, HKMA, MAS, CSRC, JFSA and Asian exchanges, we provide independent, unbiased advice on Asian financial industry legislation and regulations. Our international client base consists of asset managers, hedge funds, private equity funds, family offices, broker-dealers, insurers, wealth managers and investment banks.

Contact Us Today

HONG KONG

Suite 1102, ChinaChem Tower
34 - 37 Connaught Road
Central

T: +852 2868 9070

SINGAPORE

137 Telok Ayer Street #03-06
Singapore
068602

T: +65 6533 8834

MAINLAND CHINA

Room 4205 - 4207
42/F, Shanghai Tower
No.479 Lujiazui Ring Road
Pudong New Area, Shanghai

T: +86 147 1431 1859

W: www.complianceasia.com

Philippa Allen

CEO

E: philippa.allen@complianceasia.com

Alex Duperouzel

Managing Director

E: alex.duperouzel@complianceasia.com

Gerallt Owen

Regional Head of Client Relations

E: gerallt.owen@complianceasia.com

Lachlan Chubb

Regional Head of Advisory and Projects

E: lachlan.chubb@complianceasia.com



ComplianceAsia