



## Hong Kong Regulatory Update – SFC reprimands and fines China Everbright Securities (HK) Limited over Expired Standing Authorities (September 2020)

On 29 September 2020, the Securities and Futures Commission (SFC) announced that it had reprimanded and fined China Everbright Securities (HK) Limited (CESL) HK\$2.5 million for pledging its clients' securities to banks without having the proper authorisations in place. The SFC took action as it views that safe custody of client assets is a fundamental obligation of licensed corporations.

CESL who hold Type 1 (dealing in securities), Type 4 (advising on Securities), Type 6 (advising on corporate finance) and Type 9 (asset management) SFC licenses realised in August 2018 that its clients' standing authorities expired on 31 March 2018. Following this realisation, CESL immediately self-reported to the SFC its failures to renew its clients' standing authority. After receiving the self-report from CESL, the SFC commenced an investigation to identify the full scope of the breach.

### SFC Investigation

The SFC found that from 1 April 2018 to 19 August 2018, CESL pledged the securities of 6,841 clients to three different banks in Hong Kong to obtain credit lines whilst relying on expired standing authorities. As a result, CESL were found have breached the Securities and Futures (Client Securities) Rules (CSR) and General Principal 8 of SFC's the Code of Conduct for Licensed Persons.

The combined market value of the securities pledged by CESL amounted from approximately HK\$189 million to HK\$1.2 billion. CESL obtained financial accommodation for HK\$100 to HK\$490 million which worked out at around 9 to 51% of the market value of the client securities pledged. On 20 August 2018, CESL repaid the total outstanding loan balances under the secured banking facilities with the relevant financial institutions and redeemed all pledged client securities.

During the investigation CESL claimed that the breach was due to administrative errors and confusion following an internal reorganization. The internal reorganization was a result of the amalgamation between CESL and Everbright Sun Hung Kai Group (EBS) which started late 2017.

Following the amalgamation, in late February 2018 the compliance department of EBS took over CESL's compliance function. CESL compliance function typically handled the standing authority exercise around March each year where at EBS the process was handled by its operations team around August each year. This key fact was not highlighted to EBS compliance team during the handover process.

### Conclusion

In deciding an appropriate sanction, the SFC took into account that CESL self-reported the breach, that the breach was due to miscommunication, that there was no evidence of client loss, and that CESL had worked to co-operate with the SFC to address its concerns. However, the SFC noted that before allowing EBS Compliance to take over its compliance function, CESL should have ensured that EBS Compliance was familiar with its operation and internal control procedures, so that it would be in the position to ensure the compliance with all applicable legal and regulatory requirements by CESL.



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## How we can help

As an SFC Licensed Corporation you have a number of obligations to the regulator to fulfill on an ongoing basis. During times of management change, merger or when compliance team turnover, these responsibilities can be overlooked or misunderstood particularly if you are based outside of Asian time zones. Our dedicated team of professionals can help you understand your obligations, create a plan of action, and deliver support to help you and your organisation meet regulatory expectations in the region.

ComplianceAsia's dedicated projects team provide mock inspections and compliance healthchecks for financial industry firms across Asia Pacific to ensure that your firm is prepared for regulatory inspections, investor due diligences and post regulatory inspection remedial support. During our mock inspections / healthchecks we examine your existing compliance policies. Procedures, monitoring and systems, and undertake an operation review of the compliance integrity of the business processes in place.

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ComplianceAsia is the longest established compliance consulting firm in Asia Pacific established in 2003 with key offices in Hong Kong, Shanghai, Singapore, Tokyo and London. 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.

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