



Regulatory Update – Ewarton Securities Limited fined HK\$1.5 million for misconduct (May 2021)

Introduction

On 27 May 2021, the Securities and Futures Commission (“SFC”) announced that it has reprimanded and fined Ewarton Securities Limited (“Ewarton”) HK\$1.5 million for internal control failures and breaching of the SFC’s Code of Conduct (“CoC”). Ewarton holds an SFC licence for Type 1 (dealing in securities) Regulated Activities. In this regulatory update we will summarise the key failures and breaches that have resulted in this disciplinary action.

Facts

The SFC commenced disciplinary action against Ewarton after taking initial sanctions against a former Ewarton licensed representative, Mr. Mung Wai Sun (“Mr. Mung”) in September 2020. From 15 May 2017 to 23 March 2018 (the “relevant period”) Ewarton were found to have failed to adequately supervise Mr. Mung, and failed to put in place suitable and effective internal controls to detect and prevent unauthorised or improper activities and to ensure that orders of clients were given priority over orders of employees.

The SFC commenced an investigation into Ewarton following the receipt of a client complaint.

The SFC investigation found that during the relevant period:

- Mr. Mung was operating a margin account for a client and was doing so on a discretionary basis without obtaining written authorisation from the client to do so.
- Mr. Mung claimed that he was conducting trades in the account on request of the client but the client has never placed any specific orders for any of the trades in the account. In reality, Mr. Mung would trade for the client account by replicating the trades he had executed in his personal account or whenever he believed he had identified a good trade in the market.
- There were at least 542 pairs of transactions where orders were placed for Mr. Mung’s personal account within 30 seconds ahead of orders in the same securities and same direction for the client account. 133 of these transactions resulted in a more favourable outcome for Mr. Mung.

Employee Misconduct

Mr. Mung’s license was ultimately suspended by the SFC for a 9-month period. The suspension was due to his breaching the following requirements of the CoC:

- General Principle (“GP”) 2 (Diligence) requires a licensed person to act with due skill, care and diligence, in the best interest of its clients and the integrity of the market.
- GP 6 (Conflicts of Interest) requires a licensed person to try to avoid conflicts of interest, and when such conflicts cannot be avoided the licensed person should ensure that the clients are fairly treated.
- Paragraphs 7.1(a)(ii) stipulates that a licensed person should not affect a transaction for a client unless before the transaction is effected, the client has authorised in writing the licensed person or any person employed by it to effect transactions for the client without the client’s specific authorisation.

- Paragraph 9.1 (Priority for client orders: order handling and recording) requires licensed persons undertaking transactions on behalf of clients to ensure clients have priority over orders for accounts of the licensed person or its employees.

Ewarton Internal Control Failures

During the Relevant Period, Ewarton were only found to have performed regular checks on its telephone lines to ensure that the recording systems were functioning correctly. No checks were done to assess whether the orders placed in client accounts could be traced back to specific instructions placed by the clients. If Ewarton performed this type of check during the relevant period, the SFC was of the view that Ewarton would have been likely to identify the lack of specific client instructions for any of the transactions carried out in the account and uncovered the discretionary trading arrangement between Mr. Mung and the client.

Ewarton claimed that all trading activities were closely monitored by its Responsible Officers on a real-time basis during trading hours, and reports of all employees' personal account dealings were further reviewed by senior management at the end of each trading day.

The SFC noted that it was clear that there has been no guidance on the types of patterns or potential risks that had to be watched out for during these monitoring and review activities. This was highlighted in the fact that Mr. Mung continued to trade in parallel to his client's account over a 10-month period without this being detected during the daily trade reviews.

It was clear to the SFC from its inspection that Ewarton failed to appropriately supervise the conduct of Mr. Mung and ensure he complied with the requirements under paragraph 7.1 of the CoC as outlined earlier in this update. Ewarton also failed to put in place adequate internal control systems to detect unauthorised or improper activities such as Mr. Mung's.

Ewarton's internal policies and procedures stated that:

- a) Client orders would be executed on a first come, first served basis. Upon receiving a client order, its dealers would immediately input the order into the trading terminal for the client; and
- b) Account executives / dealers who wish to trade in securities for their personal accounts must either pass their orders to other dealers for execution or conduct the trades through Ewarton's online trading platform.

Without having clear guidance that Account executives / dealers must finish placing orders for clients before passing personal orders for execution, the above requirements are not clear enough to ensuring client orders were always given priority.

Compounding this issue was the fact that when Ewarton was performing post-trade reviews of employees' personal account dealing at the end of each trading day, such reviews did not include a comparison of the transactions in the employee's accounts and those in the client accounts under the direct oversight of these employees. Without the inclusion of the comparison review it would be much harder for Compliance Departments reviewing personal trades to detect potential breaches of the client priority principles.

The SFC has taken the conclusion that these circumstances have called into question whether Ewarton is fit and proper to remain licensed, and that Ewarton was guilty of misconduct. In reaching its decision to reprimand and fine Ewarton HK\$1.5 million, the SFC wants to send a clear message to the industry that these failures will not be tolerated.



About ComplianceAsia

ComplianceAsia is the longest established compliance consulting firm in Asia Pacific established in 2003 with 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.

Contact Us Today

HONG KONG SAR

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 132, Unit 1301-1308
13/F, Shanghai Tower
No.479 Lujiazui Ring Road
Pudong New Area Shanghai

T: +86 147 1431 1859

JAPAN

Level 2
Marunouchi Nijubashi Building
3-2-2 Marunouchi Chiyoda-ku
Tokyo 100-0005

T: +81 3 6837 5483

UNITED KINGDOM

1 St. Andrew's Hill
London
EC4V 5BY

T: +44 (0) 20 072360921

M: +44 (0) 7310 972435

Philippa Allen

CEO
E: philippa.allen@complianceasia.com

Alex Duperouzel

Managing Director
E: alex.duperouzel@complianceasia.com

Cherry Chan

Regional Head of Ongoing Support
and Client Services
E: cherry.chan@complianceasia.com

Lachlan Chubb

Regional Head of Regulatory Advisory
and Projects
E: lachlan.chubb@complianceasia.com

Rachel Wu

Head of Mainland China Client Engagements
E: rachel.wu@complianceasia.com

Hanae Kuroda

Compliance Consultant
E: hanae.kuroda@complianceasia.com

www.complianceasia.com



ComplianceAsia