

Enforcement Actions

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1 September 2005

SFC Reprimands and Fines Cheung's Securities Brokers Limited for Internal Control Failures and Suspends Lun Han Yuk for Breaching the Client Money Rules

The SFC has reprimanded Cheung's Securities Brokers Limited and suspended its responsible officer, Ms Lun Han Yuk, for two months from 1 September 2005 to 31 October 2005. Cheung's has also been fined \$50,000 (Note 1).

In February 2003, Cheung's agreed to be a liquidity provider for the transactions in structured products for a securities firm. Cheung's was required to ensure that there were sufficient funds in its bank accounts to settle the transactions and there was no limit to Cheung's liability for the liquidity provision. Between April and September 2003, the securities firm's average daily net long position was about \$10 million. However, on 28 and 29 October 2003, the securities firm's net long position suddenly jumped to \$37 million and \$30 million respectively and there were insufficient funds in Cheung's account to settle the transactions on T+2.

Lun, who was responsible for monitoring the securities firm's transactions, noticed the liquidity problem and arranged funds to meet the settlement demand on T+2. Before the pre-arranged funds were deposited to the house account of Cheung's, Lun transferred \$12.3 million from Cheung's clients' trust account to the house account as a safety measure. The transfer from the clients' trust account to the house account breached section 5 of the Securities & Futures (Client Money) Rules. The transfer further gave rise to concerns that Lun placed the interests of Cheung's ahead of the clients' interests. Cheung's compliance manager identified the breach, which was then immediately rectified by transferring the same amount from the house account to the clients' trust account on the same day.

Further, although the settlement date for the 29 October 2003 transactions was Saturday, 1 November 2003, Cheung's staff mistakenly thought that it was Monday, 3 November 2003 and arranged for the funds to be made available on 3 November 2003. Therefore, when CCASS demanded Cheung's to settle the securities firm's 29 October 2003 transactions, the demand was rejected due to an insufficient balance in Cheung's account on 1 November 2003. The demand was only met on the next business day. There was a lack of care when Cheung's failed to make available sufficient funds to meet CCASS' demand for settlement payment. Further, Cheung's did not implement a policy to handle a sudden increase in net purchases by the securities firm, despite Cheung's agreement to provide liquidity without limit.

The SFC concludes that both Cheung's and Lun have been guilty of misconduct and that their fitness and properness has been called into question.

In deciding the penalty, the SFC has taken into account the Disciplinary Fining Guidelines (Note 2) and all the circumstances of the case including the following:

- the breach of the Client Money Rules was unintentional and Lun took immediate action to rectify the breach;
- Cheung's immediately injected funds as soon as it was informed of the liquidity deficiencies; and
- Cheung's and Lun co-operated with SFC's investigation, frankly admitted their responsibilities and resolved the disciplinary action by settlement.

Further, Cheung's appointed an independent auditor to review its internal control system. Cheung's is also upgrading its computer system and has employed additional staff as Responsible Officers.

Mr Alan Linning, SFC's Executive Director of Enforcement, said: "Client money must always be segregated and kept separately in trust accounts. Transfer of client money should not have taken place under any circumstances except as allowed under the Client Money Rules. To use client money to meet the company's financial obligations is a breach of trust and put clients' interests at risks. A suspension of the licence of those involved is appropriate to reflect the seriousness of the breach."

Ends

Notes to Editor:

1. Cheung's is licensed to carry on business in Type 1 (dealing in securities), Type 2 (dealing in futures contracts) and Type 4 (advising on securities) regulated activities. Lun is licensed to carry on business in Type 1 and Type 4 regulated activities.
2. In March 2003, the SFC issued the [Disciplinary Fining Guidelines](#) under section 199(1)(a) of the SFO.

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