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SFC reprimands and fines Celestial Commodities Limited and Celestial Securities Limited \$6.3 million for mishandling client money

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The Securities and Futures Commission (SFC) has reprimanded Celestial Commodities Limited (CCL) and Celestial Securities Limited (CSL) and fined them \$4.9 million and \$1.4 million, respectively for regulatory breaches and internal control failures relating to mishandling of client money (Notes 1 & 2).

The SFC found that for the purpose of operational convenience, CCL transferred approximately \$44 million on about 180 occasions between January 2009 and December 2016 from its client accounts to pay monthly commission rebates to its account executives. The amounts involved in each transfer ranged from \$249,000 to over \$1 million.

CCL often replenished the shortfalls in the client funds days after the initial withdrawals from the relevant client trust accounts, and on one occasion it only replenished the shortfall 41 days after the withdrawal. CCL is unable to trace the exact time when such practice commenced, but the evidence suggests that the arrangement had likely prevailed for more than 20 years.

The SFC also found that CSL effected payments totalling \$40 million on 8 July 2015 from its client trust accounts into CCL's client trust accounts in an intra-day fund swap arrangement so that CCL could meet various margin calls from the Hong Kong Exchanges and Clearing Limited on time.

The evidence further revealed that CCL and CSL had failed to implement proper controls to safeguard client money and supervise its staff in handling it in that their accounting and treasury staff were effectively given a free reign in handling client money with little supervision, instructions or guidance.

Since safe custody of client assets is a fundamental obligation of licensed corporations, any transgression of this obligation cannot be tolerated, even if the client assets are made whole again. As such, the SFC is of the view that CCL and CSL have breached this fundamental obligation by virtue of their failures to comply with the Securities and Futures (Client Money) Rules (Client Money Rules) and the Code of Conduct for Persons Licensed by or Registered with the SFC (Code of Conduct) (Notes 3 & 4).

In deciding the disciplinary sanctions, the SFC took into account all relevant circumstances, including that:

- CCL's breach of the Client Money Rules in using client money to pay monthly commission rebates to its account executives lasted at least seven years based on the SFC's investigation findings (with some evidence suggesting that such practice had prevailed at CCL for over 20 years);
- CCL's breach of the Client Money Rules was only discovered when the SFC conducted an inspection on its practices and controls;
- CCL's substantial delays in making up the relevant shortfalls in the client funds;
- CCL and CSL's misconduct exposed client money to unnecessary risks;
- CCL and CSL cooperated with the SFC in accepting the SFC's findings and disciplinary actions;
- there is no evidence of client loss resulting from CCL and CSL's respective non-compliance; and
- CCL and CSL have agreed to commission an independent reviewer to review their internal controls and senior management supervision over the handling of client assets.

End

Notes:

1. CCL is licensed under the Securities and Futures Ordinance (SFO) to carry on business in Type 2 (dealing in futures contracts) regulated activity.
2. CSL is licensed under the SFO to carry on business in Type 1 (dealing in securities) regulated activity.
3. The Client Money Rules prescribe the manner in which licensed corporations shall treat and deal with client money received or held in Hong Kong.
4. General Principle 8 and paragraph 11.1 of the Code of Conduct provide that a licensed or registered person should ensure that client positions or assets are promptly and properly accounted for and adequately safeguarded.

[A copy of the Statement of Disciplinary Action is available on the SFC website](#)

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STATEMENT OF DISCIPLINARY ACTION

The Disciplinary Actions

1. The Securities and Futures Commission (**SFC**) has reprimanded Celestial Commodities Limited (**CCL**) and Celestial Securities Limited (**CSL**) (CCL and CSL together, **Celestial**) and fined them HK\$4.9 million and HK\$1.4 million respectively pursuant to section 194 of the Securities and Futures Ordinance.
2. The disciplinary actions are taken because of CCL and CSL's mishandling of client money and related internal control failings.

Summary of facts

3. In 2015, the SFC's Intermediaries Division conducted an inspection on CCL's business activities and noted, among other things, various payments made out of the client trust accounts of CCL and CSL¹ in circumstances which were not permitted under the Securities and Futures (Client Money) Rules (**Client Money Rules**).
4. The SFC therefore conducted an investigation into Celestial's practices and controls in relation to the handling of client money.
 - A. *CCL's mishandling of client money*
5. The SFC found that:
 - (a) from at least January 2009 to December 2015 (**Relevant Period**), CCL paid monthly commission rebates to its account executives (**Payments Out**) on around 180 occasions using money from its client trust accounts held with 2 banks (**Banks A & B**);
 - (b) CCL transferred amounts equal to the Payments Out from its house account to its client trust account at a third bank (**Bank C**) to replenish the shortfalls (**Payments In**);
 - (c) the time gap between the Payments Out and Payments In normally lasted 1 to 4 days but on 2 occasions lasted substantially longer (14 days and 41 days); and
 - (d) the Payments Out ranged from HK\$249,000 to over HK\$1 million each month and amounted to approximately HK\$44 million over the Relevant Period.
6. The evidence revealed that CCL had been paying commission rebates to its account executives through the above arrangement for operational convenience, i.e. so that it could pay directly into its account executives' accounts held at Banks A & B via the banks' electronic transfer system. This practice had prevailed at CCL for likely over 20 years and was only discovered when the SFC conducted an inspection at CCL in 2015.

¹ CSL is a subsidiary of CCL's parent company.

B. *CSL's mishandling of client money*

7. The SFC also found that CSL effected 3 payments totalling HK\$40 million on 8 July 2015 from its client trust accounts into CCL's client trust accounts at various banks in a fund swap arrangement (**Fund Swaps**):

Payments out of the client trust accounts	Payments into the client trust accounts
<i>Fund Swap 1</i>	
Transfer of HK\$20 million from CSL's client trust account at a certain bank (Bank D) to CCL's client trust account with Bank D	Transfer of HK\$20 million from CCL's client trust account at Bank C to CSL's client trust account at Bank D
<i>Fund Swap 2</i>	
Transfer of HK\$10 million from CSL's client trust account at Bank D to CCL's client trust account at Bank D	Transfer of HK\$10 million from CCL's client trust account at Bank C to CSL's client trust account at Bank D
<i>Fund Swap 3</i>	
Transfer of HK\$10 million from CSL's client trust account at Bank A to CCL's client trust account at Bank D	Transfer of HK\$10 million from CCL's client trust account at Bank C to CSL's house account at Bank C and subsequently to CSL's client trust account at Bank C

8. During the SFC's investigation, Celestial's accounting staff confirmed that the Fund Swaps were conducted to ensure that CCL's client trust account with Bank D, which was its designated settlement bank account with the Hong Kong Exchanges and Clearing Limited (**HKEx**) at the material time, would have sufficient funds to meet various margin calls made by HKEx to CCL on a timely basis. The evidence revealed that, at the material time, the funds held by CCL in client trust accounts at various banks, taken together, would have been sufficient to meet the margin calls in question, and the Fund Swaps were conducted primarily for operational convenience.

C. *Internal control failings*

9. The SFC also found that, during the Relevant Period, Celestial's accounting and treasury staff were effectively given a free reign in handling client money with little supervision, instructions or guidance from its responsible officers and senior management.

Breaches and reasons for action

A. *Regulatory requirements*

10. Safe custody of client assets is a fundamental obligation of licensed corporations. Under sections 4(1) and 5(1) of the Client Money Rules, a licensed corporation is required to hold client money in a segregated account and retain it there until it is paid to the client, or paid in accordance with a written direction or standing authority from the client, or used to meet the client's settlement or margin requirement. Further, section 5(3) of the Client Money Rules provides that a licensed corporation shall not pay any of its client money to any of its employees unless that employee is the client on whose behalf such client money is being held.

11. General Principles 2 and 8 of the Code of Conduct for Persons Licensed by or Registered with the SFC (**Code of Conduct**) also require, among other things, a licensed person to act with due skill, care and diligence, in the best interests of its clients and to ensure that client assets are promptly and properly accounted for and adequately safeguarded. Further, paragraph 11.1(a) of the Code of Conduct requires that a licensed person, in the handling of client transactions and client assets, act to ensure that client assets are accounted for properly and promptly.
12. Under paragraph 4.3 of the Code of Conduct, as licensed corporations, CCL and CSL are required to establish and maintain effective internal control procedures that can be reasonably expected to protect their operations and clients from financial loss arising from theft, fraud, and other dishonest acts, professional misconduct or omissions, and ensure that such procedure are complied with. They should also employ effectively the necessary resources and procedures for the proper performance of their business activities, as required under General Principle 3 of the Code of Conduct.
13. Further, under paragraph 4.2 of the Code of Conduct, CCL and CSL should ensure that they have adequate resources to supervise diligently and do supervise diligently persons employed by them to conduct business on their behalf.

B. *Celestial's breaches*

14. CCL's use of money from its client trust accounts to pay commission rebates to its account executives was in clear breach of sections 5(1) and 5(3) of the Client Money Rules. Although CCL had subsequently replenished the shortfalls in the client funds, the transfers exposed CCL's client money to unnecessary risks, particularly as the shortfalls were often only made whole days (and occasionally weeks) after the Payments Out.
15. CSL has also breached section 5(1) of the Client Money Rules by transferring money from its client trust accounts to CCL to enable the latter to meet its margin calls. The Fund Swaps exposed CSL's client money to unnecessary risks, and by utilising the client funds purely for their own operational convenience, CCL and CSL had put their own interests ahead of their clients' interests, contrary to General Principle 2 of the Code of Conduct.
16. CCL and CSL's respective failures to safeguard their client money were also contrary to General Principle 8 and paragraph 11.1(a) of the Code of Conduct. By failing to have proper controls and supervision to safeguard their client assets, they have also breached paragraph 4.2, paragraph 4.3 and General Principle 3 of the Code of Conduct.

Conclusion

17. The SFC has decided to take the disciplinary actions against CCL and CSL as described in paragraph 1 above, after taking into account all relevant considerations, including that:
 - (a) CCL's breach of the Client Money Rules in using client money to pay monthly commission rebates to its account executives lasted at least seven years based on the SFC's investigation findings (with some evidence suggesting that such practice had prevailed at CCL for over 20 years);
 - (b) CCL's breach of the Client Money Rules was only discovered when the SFC conducted an inspection at CCL;

- (c) CCL's delays in making up the shortfalls in the client funds;
- (d) CCL and CSL's misconduct exposed client money to unnecessary risks;
- (e) CCL and CSL cooperated with the SFC in accepting the SFC's findings and disciplinary actions;
- (f) there is no evidence of client loss resulting from CCL and CSL's respective non-compliance; and
- (g) CCL and CSL have agreed to commission an independent reviewer to review their internal controls and senior management supervision over the handling of client assets.