
STATEMENT OF DISCIPLINARY ACTION

The Disciplinary Action

1. The Securities and Futures Commission (**SFC**) has reprimanded and fined Lion Futures Limited (**LFL**)¹ \$2,800,000 pursuant to section 194 of the Securities and Futures Ordinance (**SFO**).
2. The disciplinary action is taken because LFL failed to:
 - (a) perform adequate due diligence on the customer supplied systems (**CSSs**)² used by clients for placing orders, and assess and manage the associated money laundering and terrorist financing (**ML/TF**) and other risks; and
 - (b) establish effective ongoing monitoring system to detect and assess suspicious trading pattern in client accounts.

Summary of Facts

A. *Background*

3. The SFC received complaints against various licensed corporations (**LCs**), including LFL, for allowing clients to place orders to their broker supplied system (**BSS**)³ through a software called Xinguanjia (**XGJ**). XGJ was developed and/or provided by Hengxin Software Limited.
4. The complainants alleged that XGJ permitted the LCs' clients to create sub-accounts under their accounts maintained with the LCs, and the clients had solicited investors in Mainland China to trade through the sub-accounts via XGJ without having to open separate securities accounts with the LCs in Hong Kong.
5. Between May 2017 and July 2019 (**Relevant Period**), LFL has permitted five clients (**CSS Clients**) to use their designated CSSs (including XGJ) for placing orders⁴.

B. *Failure to perform adequate due diligence on the CSSs and assess and manage the associated ML/TF and other risks*

6. According to LFL, when the clients applied for API Connection and sought LFL's permission to use the CSSs, they were required to complete the relevant application documents (**API Application Documents**), including the Programme Trading Due Diligence Questionnaire (**PT Questionnaire**).

¹ LFL is licensed to carry on Type 2 (dealing in futures contracts) and Type 5 (advising on futures contracts) regulated activities under the SFO.

² CSSs are trading software developed and/or designated by the clients that enable them to conduct electronic trading through the Internet, mobile phones and other electronic channels.

³ BSSs are trading facilities developed by exchange participants or vendors that enable exchange participants to provide electronic trading services to investors through the Internet, mobile phones, and other electronic channels.

⁴ The CSSs were connected to LFL's BSS through application programming interface (a set of functions that allows applications to access data and interact with external software components or operating systems) (**API Connection**).

7. In the PT Questionnaire, clients were required to state their trading experience and usual trading volume and whether they had put in place policies, procedures and measures to monitor risks associated with trading via the CSSs. A responsible officer (**RO**) of LFL stated that the PT Questionnaires were for the purposes of enabling LFL to understand how the CSSs operated.
8. However, LFL approved the API Connection for the CSSs even though the CSS Clients did not submit all the required API Application Documents, including the PT Questionnaire, in respect of their use of the CSSs. Further, in respect of the PT Questionnaires that were submitted to LFL, there were no records showing that LFL had verified the information provided in the questionnaires and what factors it took into account when deciding to allow its clients to place orders via the CSSs to its BSS based on the information so provided.
9. The evidence shows that LFL had not conducted any due diligence on the CSSs before allowing them to be connected to its BSS:
 - (a) LFL had not put in place any guidelines and procedures, or taken any steps, for conducting due diligence and testing on the CSSs.
 - (b) Contrary to LFL's assertion that its two ROs and Assistant Information Technology Manager were involved in system due diligence and testing in respect of the CSSs, these staff stated that they were not involved in conducting due diligence on the CSSs.
 - (c) The RO responsible for approving the API Connection for four of the five CSSs used by the clients stated that (i) the only thing he had done on due diligence or testing of the CSSs was reviewing the PT Questionnaires and (ii) testing was merely conducted to ascertain whether the connection between the CSSs and LFL's system was smooth and whether there was latency.
10. Without thorough knowledge of the features and functions of the CSSs, LFL was not in a position to properly assess the ML/TF and other risks associated with the use of the CSSs and implement appropriate measures and controls to mitigate and manage such risks.
11. In the absence of proper control over the use of CSSs by its clients, LFL has exposed itself to the risks of improper conduct such as unlicensed activities, money laundering, nominee account arrangement and unauthorised access to client accounts.
- C. *Failure to maintain effective ongoing monitoring system to detect and assess suspicious trading patterns in client accounts*
12. The SFC's review of the transactions in sample client accounts showed that there were 1,098 self-matched trades (i.e. the client's order matched with his/her own order in the opposite direction) (**Matched Trades**) in five client accounts during the period from May 2017 to January 2019.
13. When asked to provide a description of how LFL identified and monitored suspicious transactions and its compliance monitoring process in respect of the trading orders placed in the accounts of the CSS Clients during the Relevant Period, LFL referred to its pre-trade and post-trade controls, including the following:

- (a) In terms of pre-trade controls, its BSS would check if the client account had sufficient funds and if the account is allowed to trade the intended products. Its BSS has set the maximum trade order value for each product.
 - (b) In terms of post-trade controls, since 22 October 2018, its Finance Department has started circulating to its ROs daily account statements prepared for facilitating submission of financial returns under section 56 of the Securities and Futures (Financial Resources) Rules. Its ROs would review the statements and the daily commission income to monitor the trading volume.
 - (c) If the daily commission income increased substantially, the ROs would check the causes of the increase and carry out follow-up actions, such as reviewing and monitoring the transactions of relevant clients closely.
 - (d) Manual orders by Dealing Department would be recorded on daily trade blotter to be reviewed by ROs. Settlement would generate large position report daily. Trading staff would monitor margin ratio of the clients and margin call reports would be reviewed by Dealing Department and ROs.
14. Although LFL claimed to have certain procedures in place to identify suspicious transactions during the Relevant Period, its failure to detect the Matched Trades demonstrates that its systems and controls for detecting and monitoring suspicious transactions were not adequate or effective.

The SFC's findings

15. LFL's failures set out above constitute a breach of:
- (a) General Principle (**GP**) 2 of the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (**Code of Conduct**), which requires an LC to act with due skill, care and diligence, in the best interests of its clients and integrity of the market in conducting its business activities.
 - (b) GP 3 and paragraph 4.3 of the Code of Conduct, which provide that an LC should have and employ effectively the resources and procedures which are needed for the proper performance of its business activities and have internal control procedures and operational capabilities which can be reasonably expected to protect its operations and clients from financial loss arising from theft, fraud, and other dishonest acts, professional misconduct or omissions.
 - (c) Section 23 of Schedule 2 to the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (**AMLO**) and paragraph 2.1 of the the Guideline on Anti-Money Laundering and Counter-Terrorist Financing (April 2015, March 2018 and November 2018 editions, respectively **AML Guideline (April 2015)**, **AML Guideline (March 2018)** and **AML Guideline (November 2018)**, collectively **AML Guideline**), which require an LC to mitigate the risks of ML/TF and prevent contravention of any client due diligence and record keeping requirements under the AMLO. To ensure compliance with this requirement, the LC should:
 - (i) establish and implement adequate and appropriate internal anti-money laundering (**AML**) and counter-financing of terrorism (**CFT**) policies, procedures and controls pursuant to paragraph 2.2 of the AML Guideline; and

- (ii) assess the risks of any new products and services (especially those that may lead to misuse of technological developments or facilitate anonymity in ML/TF schemes) before they are introduced and ensure appropriate additional measures and controls are implemented to mitigate and manage the associated ML/TF risks pursuant to paragraph 2.3 of the AML Guideline.
- (d) Section 5(1)(c) of Schedule 2 to the AMLO, paragraph 5.1(c) of the AML Guideline, paragraphs 5.10 and 5.11 of both the AML Guideline (April 2015) and the AML Guideline (March 2018), and paragraphs 5.13, 5.15, 5.16 and 5.17 of the AML Guideline (November 2018), which require an LC to identify transactions that are complex, large or unusual or patterns of transactions that have no apparent economic or lawful purpose, make relevant enquiries to examine the background and purpose of the transactions, document the enquiries made (and their results), and report the findings to the Joint Financial Intelligence Unit where there is any suspicion of ML/TF⁵.

Conclusion

- 16. Having considered all relevant circumstances, the SFC is of the opinion that LFL is guilty of misconduct.
- 17. In deciding the disciplinary sanction set out in paragraph 1 above, the SFC has taken into account all relevant circumstances, including:
 - (a) LFL's failures to diligently monitor its clients' activities and put in place adequate and effective AML/CFT systems and controls are serious as they could undermine public confidence in, and damage the integrity of, the market;
 - (b) LFL has taken remedial measures to enhance its internal systems and controls for continuous monitoring and identifying suspicious transactions;
 - (c) a strong deterrent message needs to be sent to the market that such failures are not acceptable;
 - (d) LFL cooperated with the SFC in resolving the SFC's concerns; and
 - (e) LFL has an otherwise clean disciplinary record.

⁵ Examples of situations that might give rise to suspicion are given in paragraphs 7.14 and 7.39 of both the AML Guideline (April 2015) and the AML Guideline (March 2018) and paragraphs 7.12 and 7.13 of the AML Guideline (November 2018), such as (a) transactions or instructions which have no apparent legitimate purpose and/or appear not to have a commercial rationale; (b) buying and selling of securities/futures with no discernible purpose or where the nature, size or frequency of the transactions appears unusual; and (c) the entry of matching buys and sells in particular securities or futures or leveraged foreign exchange contracts (wash trading), creating the illusion of trading. Such wash trading does not result in a bona fide market position, and might provide "cover" for a money launderer.