

## STATEMENT OF DISCIPLINARY ACTION

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### The Disciplinary Action

1. The Securities and Futures Commission (**SFC**) has publicly reprimanded Central Wealth Securities Investment Limited (**Central Wealth**) and fined it HK\$1 million pursuant to section 194 of the Securities and Futures Ordinance (**SFO**).
2. The disciplinary action is taken in respect of Central Wealth's failure to comply with the Securities and Futures (Financial Resources) Rules (**FRR**).
3. Central Wealth is licensed under the SFO to carry on business in Type 1 (dealing in securities) and Type 4 (advising on securities) regulated activities.

### Summary of Facts

- A. *Errors in the FRR Returns*
  4. Central Wealth had made various accounting and calculation errors in the monthly financial returns (**FRR Returns**) submitted to the SFC under the FRR, which led to overstatements of its liquid assets or understatements of its ranking liabilities reported to the SFC between February 2019 and December 2020 (**Relevant Period**). The key errors are set out in sections A1 to A5 below.
  5. As a result of the errors in the FRR Returns, Central Wealth overstated its liquid capital in the FRR Returns for 15 months during the Relevant Period. After eliminating the errors, it came to light that Central Wealth's required liquid capital was in deficit, ranging from HK\$1.62 million to HK\$49.08 million, for 8 months from December 2019 to June 2020 and in November 2020, contrary to section 6 of the FRR which provides that a licensed corporation must at all times maintain liquid capital which is not less than its required liquid capital<sup>1</sup>.
- A1. *Incorrect haircut percentages applied to listed shares and non-qualifying and non-special debt securities in its proprietary positions*
  6. Section 27(1) of the FRR requires a licensed corporation to include in its liquid assets certain assets that it beneficially owns, including (among others) listed shares, qualifying debt securities and special debt securities, at market value less the haircut amounts in relation to the securities concerned. The haircut percentages for different types of securities and investments are set out in Schedule 2 of the FRR.
  7. During the Relevant Period, Central Wealth held various securities and bonds in its proprietary account. Central Wealth included them in its liquid assets but failed to apply the appropriate haircut percentages to them in its liquid capital computation. For instance:

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<sup>1</sup> Under the FRR, "liquid capital" means the amount by which the liquid assets of a licensed corporation exceeds its ranking liabilities and "required liquid capital deficit" means the amount by which the required liquid capital of a licensed corporation exceeds its liquid capital.

- (a) Central Wealth did not apply any haircut percentage to 4 Hong Kong-listed shares it owned when haircut percentages of 15% to 30% should have been applied to these shares according to Table 1 in Schedule 2 of the FRR; and
- (b) Central Wealth wrongly applied haircut percentages of 0% to 2% (instead of 100%) to 6 bonds it owned. These bonds do not fall within the definition of qualifying debt securities or special debt securities under section 2 of the FRR and should have been classified as miscellaneous investments and subject to a 100% haircut in the liquid capital computation according to section 2E and Table 9 in Schedule 2 of the FRR.

A2. *Incorrect haircut percentages applied to the securities collateral provided by margin clients*

8. Section 22(1) of the FRR provides that a licensed corporation licensed for Type 1 or Type 8 regulated activity must include in its liquid assets any net amount receivable from margin clients, calculated as the amount by which the amount receivable from the margin client exceeds the amount payable by it to the margin client arising from the securities margin financing provided by it, after deducting the higher of:

*“(a) any specific provision for bad or doubtful debts made in respect of such net amount receivable; and*

*(b) the margin shortfall amount, calculated as the amount by which the net amount receivable exceeds the aggregate of –*

*(i) the market value of collateral, other than illiquid collateral, provided by the client, less the haircut amount in relation to such collateral;*

*(ii) the market value of all illiquid collateral provided by the client, multiplied by –  
(A) in the case of listed shares, 20%; and  
(B) in the case of listed warrants, 0%;*

*(iii) the amount of cash deposited as security by the client; and*

*(iv) in the case of a licensed corporation licensed for Type 1 regulated activity, the maximum amount that it can draw under a bank guarantee provided to it by the client and issued by an authorized financial institution or an approved bank incorporated outside Hong Kong.”*

9. Pursuant to section 2 of the FRR, “collateral” means (among others) any listed shares, qualifying debt securities or special debt securities, which are deposited as security with the licensed corporation by another person and are unencumbered in its possession and readily realisable.

10. Central Wealth started providing margin financing service to its clients for bond trading since July 2020. Between July and December 2020, 6 clients traded in 5 bonds through their margin accounts maintained with Central Wealth. These bonds do not fall within the definition of qualifying debt

securities or special debt securities under section 2 of the FRR and should have been classified as miscellaneous investments and subject to a 100% haircut in the liquid capital computation according to section 2E and Table 9 in Schedule 2 of the FRR. However, Central Wealth had applied wrong haircut percentages to these bonds for the purpose of calculating the haircut amount under section 22(1)(b)(i) of the FRR.

- A3. *Incorrect market values and percentages applied to securities held by Central Wealth in the calculation of ranking liabilities*
11. Section 44 of the FRR provides that where a licensed corporation holds for its own account listed shares, qualifying debt securities, special debt securities, specified securities or specified investments, and the net market value of any such securities or specified investments is 51% or more of its required liquid capital, it must include in its ranking liabilities 10% of the net market value of such securities. Net market value means the market value that remains after netting each long and short positions in securities of the same description.
12. It was found that the net market values of the securities held by Central Wealth from December 2019 to November 2020 was 51% or more of its required liquid capital but Central Wealth had applied incorrect net market values and percentages (i.e. not 10% as prescribed in section 44 of the FRR) to such securities in calculating its ranking liabilities relating to concentrated proprietary positions.
- A4. *Incorrect inclusion of balance sheet items in “other assets arising from others”*
13. Section 7 of the FRR requires a licensed corporation, for the purposes of calculating its liquid capital and required liquid capital, to account for all its assets, liabilities and transactions in accordance with Part 4 of the FRR.
14. Section 35(c) of the FRR requires a licensed corporation to include in its liquid assets prepaid operating expenses which will be incurred within the next 3 months.
15. In calculating “other assets arising from others” in the FRR Returns, Central Wealth wrongly included the following items in its liquid assets:
- (a) investments in subsidiaries and other deposits which do not constitute miscellaneous assets under section 35 of the FRR or any other type of assets under Part 4 of the FRR; and
  - (b) prepaid operation expenses which would be incurred beyond the 3-month period prescribed in section 35(c) of the FRR.
- A5. *Incorrect set-off of assets against liabilities in “amounts receivable from clients for subscription of securities” and “amounts payable to group companies or other related parties”*
16. Section 11 of the FRR provides that the assets and liabilities of a licensed corporation must be treated separately on a gross basis and must not be set-off against each other.
17. Central Wealth failed to treat the following assets and liabilities on a gross basis as required by section 11 of the FRR by wrongly setting-off:

- (a) the amounts receivable from clients for initial public offering subscription against the accruals, amounts payable and other liabilities other than approved subordinated loan; and
- (b) the amounts receivable from two affiliated companies against amounts payable to group companies or other related parties.

*B. Incompetent staff involved in FRR reporting*

18. Central Wealth's failure to ensure the accuracy of the FRR Returns was mainly attributable to its failure to appoint qualified and competent persons to prepare and review the financial returns. In particular, its finance managers responsible for preparing the FRR Returns did not have sufficient knowledge and experience to perform their roles, and its responsible officers responsible for reviewing and signing off the FRR Returns were not familiar with the FRR requirements and failed to identify the errors in the FRR Returns submitted to the SFC.

**Conclusion**

19. Having considered all relevant circumstances, the SFC is of the opinion that Central Wealth has been guilty of misconduct in that it has:
- (a) breached sections 6(1), 7, 11, 22(1)(b)(i), 27(1), 35(c) and 44 of the FRR; and
  - (b) failed to act with due skill, care and diligence and employ qualified and competent staff to ensure compliance with the FRR, in breach of General Principle (GP) 2 (Diligence)<sup>2</sup>, GP 3 (Capabilities)<sup>3</sup>, GP 7 (Compliance), paragraph 4.1 (Fit and proper staff)<sup>4</sup> and paragraph 12.1 (Compliance: in general)<sup>5</sup> of the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (**Code of Conduct**).
20. In deciding the disciplinary sanction set out in paragraph 1 above, the SFC has taken into account all relevant circumstances, including:
- (a) the duration and extent of Central Wealth's failures;
  - (b) Central Wealth engaged an independent reviewer upon the SFC's request to assess its systems and controls over financial reporting and to verify the accuracy of the financial returns it prepared;

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<sup>2</sup> GP 2 of the Code of Conduct requires a licensed corporation to act with due skill, care and diligence, in the best interests of its clients and the integrity of the market in conducting its business activities.

<sup>3</sup> GP 3 of the Code of Conduct requires a licensed person to have and employ effectively the resources and procedures which are needed for the proper performance of its business activities.

<sup>4</sup> Paragraph 4.1 of the Code of Conduct requires a licensed person to ensure that any person it employs or appoints to conduct business is fit and proper and otherwise qualified to act in the capacity so employed or appointed.

<sup>5</sup> GP 7 and paragraph 12.1 of the Code of Conduct require a licensed person to comply with all law, rules and regulatory requirements applicable to the conduct of its business activities.

- (c) Central Wealth's remedial measures;
- (d) Central Wealth's cooperation with the SFC in resolving the SFC's concerns; and
- (e) Central Wealth's otherwise clean disciplinary record.