

SFC reprimands and fines Deutsche Securities Asia Limited HK\$2.5 million for regulatory breaches

18 Dec 2012

The Securities and Futures Commission (SFC) has reprimanded Deutsche Securities Asia Limited and fined it HK\$2,500,000 for regulatory breaches and internal control failings relating to position limit failures (Note 1).

The disciplinary action follows an SFC investigation into the holding of Deutsche Securities Asia Limited on behalf of its client, Deutsche Bank AG London (Deutsche Bank London), of 57,403 contracts in China Construction Bank stock options in breach of the prescribed position limit of 50,000 contracts on 1 September 2011 (Notes 2, 3, 4 and 5).

The SFC found that Deutsche Securities Asia Limited failed to enforce its internal control procedures to ensure that all open positions in stock options contracts it held or controlled were in compliance with the prescribed position limits (Notes 6 and 7).

In particular, the SFC found that Deutsche Securities Asia Limited:

- failed to appoint replacement gatekeepers from March 2011 to September 2011 to replace its primary and secondary gatekeepers who were on administrative leave even though the two gatekeepers were the only people who were granted access to the real time monitoring system of Deutsche Securities Asia Limited for the purpose of monitoring position limits (Note 8); and
- failed to enforce a “zero tolerance” policy communicated to its trading staff in March 2006 and April 2007 requiring them to execute Hong Kong futures and options contracts via itself only.

The SFC considers the failings of Deutsche Securities Asia Limited more serious because it had already been told by an independent reviewer in 2007 that its real time monitoring system for position limits could not capture proprietary trades executed via external brokers. Although Deutsche Securities Asia Limited was aware of the limitation to its monitoring system and had put in place a policy and procedures to address this, it failed to implement and enforce the policy and procedures.

In deciding the penalty, the SFC has taken into account Deutsche Securities Asia Limited has co-operated with the SFC in respect of its disciplinary proceedings and has since strengthened its internal controls on monitoring position limits.

End

Notes:

1. Deutsche Securities Asia Limited is a licensed corporation under the Securities and Futures Ordinance to carry on Type 1 (dealing in securities), Type 2 (dealing in futures contracts), Type 4 (advising on securities), Type 5 (advising on futures contracts), Type 6 (advising on corporate finance) and Type 7 (providing automated trading services) regulated activities.
2. Rule 4(1) of the Securities and Futures (Contracts Limits and Reportable Positions) Rules provides that no person, except persons authorized by the SFC or the Hong Kong Exchanges and Clearing Limited, may hold or control futures contracts or stock options in excess of the prescribed limit.
3. Section 5(b) of the Rules provides that the limit on the number of contracts that may be held or controlled, in the case of stock options contracts, is specified in Schedule 2 of the Rules.
4. Schedule 2 of the Rules provides that the prescribed limit for stock options contracts on shares listed on the Stock Exchange of Hong Kong is 50,000 open contracts per option class in any one market direction for all expiry months combined.
5. Although Deutsche Bank London was a client of Deutsche Securities Asia Limited in name, traders at Deutsche Securities Asia Limited had discretion to make trading decisions for Deutsche Bank London. As Deutsche Securities Asia Limited was the entity that controlled the trading of the stock options contracts, it had a duty to ensure compliance with the

prescribed position limits.

6. General Principle 7 of the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (the Code of Conduct) requires a licensed person to comply with all regulatory requirements applicable to the conduct of its business activities.
7. Paragraph 12.1 of the Code of Conduct requires a licensed person to comply with and maintain appropriate measures to ensure compliance with all applicable regulatory law, rules, regulations and codes administered or issued by the SFC, exchanges, clearing houses and other regulatory authorities which apply to the licensed person.
8. "Gatekeepers" are traders appointed by Deutsche Securities Asia Limited to monitor and ensure compliance with the prescribed position limits. Deutsche Securities Asia Limited's policy required all employees trading futures and contracts to: (i) check the position limits of Deutsche Securities Asia Limited with the gatekeepers before opening positions in the name of Deutsche Bank in Asian futures and options contracts; (ii) conduct transactions through Deutsche Bank entities only; (iii) conduct the trade only after receipt of the gatekeeper's approval; and (iv) notify the gatekeeper immediately after the trade is executed.

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