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SFC reprimands and fines RHB Securities Hong Kong Limited \$6.4 million

2 Jan 2020

The Securities and Futures Commission (SFC) has reprimanded and fined RHB Securities Hong Kong Limited (RHBSHK) \$6.4 million for its failures to comply with regulatory requirements on conflicts of interest and supervision of account executives (Note 1).

The disciplinary action followed an SFC investigation which found that RHBSHK failed to:

- effectively implement its policy for avoiding actual and potential conflicts of interest between its research reports and investment banking relationships (Note 2);
- adequately disclose its investment banking relationship with the listed company covered in a research report (Note 3); and
- effectively monitor the trading activities of its research analysts (Note 4).

The SFC further found that RHBSHK did not have adequate controls to supervise its account executives. In particular, the frequency and extent of its sample checking procedures for ensuring that client orders received by account executives through telephone are tape-recorded are not commensurate with the size of RHBSHK's business. As a result, the discretionary trading activities without written authorization of an account executive went undetected for 23 months (Notes 5 & 6).

In deciding on the disciplinary sanctions, the SFC took into account all relevant circumstances, including RHBSHK's:

- failures were not detected until an SFC's inspection;
- steps to remediate its internal control deficiencies; and
- cooperation with the SFC to resolve the disciplinary proceedings.

End

Notes:

1. RHBSHK, formerly known as RHB OSK Securities Hong Kong Limited, is licensed under the Securities and Futures Ordinance (SFO) to carry on business in Type 1 (dealing in securities) and Type 4 (advising on securities) regulated activities.
2. Paragraph 16.7 of the Code of Conduct for Persons Licensed by or Registered with the SFC (Code of Conduct) requires a licensed corporation that issues research reports to establish, maintain and enforce a set of written policies and control procedures to eliminate, avoid or manage actual and potential analyst conflicts of interest.
3. Paragraph 16.5(d) of the Code of Conduct provides that a firm that has an investment banking relationship with the issuer or the new listing applicant should disclose that fact in the research report. Any compensation or mandate for investment banking services received within the preceding 12 months would constitute an investment banking relationship. Paragraphs 16.3(f) and 16.10 of the Code of Conduct require such disclosure to be complete, timely, clear, concise, specific and prominent.
4. Paragraph 16.4(b) of the Code of Conduct provides an analyst should not deal in or trade any securities in respect of an issuer that the analyst reviews: (i) in a manner contrary to his outstanding recommendation; or (ii) within 30 days prior to and 3 business days after the issue of investment research on the issuer.
5. Paragraph 4.2 of the Code of Conduct provides that a licensed corporation should ensure that it has adequate resources to supervise diligently and does supervise diligently persons employed or appointed by it to conduct business on its behalf.
6. Paragraph 7.1 of the Code of Conduct provides that a licensed person should not effect a transaction for a client unless before the transaction is effected: (i) the client has specifically authorized the transaction; or (ii) the client has authorized in writing the licensed person or any person employed by the licensed person (who must in turn be a licensed person) to effect transactions for the client without the client's specific authorization.

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

Page last updated : 2 Jan 2020

STATEMENT OF DISCIPLINARY ACTION

The Disciplinary Action

1. The Securities and Futures Commission (**SFC**) has publicly reprimanded and fined RHB Securities Hong Kong Limited (**RHBSHK**) \$6.4 million for its failures to comply with regulatory requirements on conflicts of interest and supervision of account executives pursuant to section 194 of the Securities and Futures Ordinance (**SFO**).
2. RHBSHK 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

Failure to effectively implement the policy on avoiding analyst conflicts of interest

3. Paragraph 16.7 of the Code of Conduct for Persons Licensed by or Registered with the SFC (**Code of Conduct**) requires a licensed corporation that issues research reports to establish, maintain and enforce a set of written policies and control procedures to eliminate, avoid or manage actual and potential analyst conflicts of interest.
4. RHBSHK's policies and procedures provide that no research report should be issued for a company on the research restricted list (**RRL**) to avoid conflicts of interest between its investment banking business and research reports.
5. In 2015, RHBSHK issued two research reports on a listed company which was on the RRL. RHBSHK claimed that it was the oversight of its head of research at the relevant time.
6. However, the former head of research and a former research analyst of RHBSHK claimed that they were never informed of the policy on RRL. The former head of research added that the regulatory compliance of research reports was the responsibility of the supervisory analysts at RHBSHK's head office in Malaysia.
7. RHBSHK's written policies and procedures state the supervisory analysts and the compliance department at RHBSHK's head office were responsible for regulatory compliance and the final approval of research reports before publication.
8. However, upon further inquiries, RHBSHK admitted that the supervisory analysts were not provided with the RRL and the compliance department was not involved in the approval of the research reports.
9. The findings explain why the violations of the RRL in 2015 were not identified until the SFC's inspection in 2016 and show that RHBSHK failed to effectively

implement the policy to avoid analyst conflicts of interest in breach of paragraph 16.7 of the Code of Conduct.

Failure to adequately disclose its investment banking relationship in research report

10. Paragraph 16.5(d) of the Code of Conduct provides that a firm that has an investment banking relationship with the issuer or the new listing applicant should disclose that fact in the research report. Any compensation or mandate for investment banking services received within the preceding 12 months would constitute an investment banking relationship. Paragraphs 16.3(f) and 16.10 of the Code of Conduct require such disclosure to be complete, timely, clear, concise, specific and prominent.
11. A member of RHBSHK's group of companies entered into a sponsorship agreement with a listed company in August 2015. The research report issued by RHBSHK in November 2015 merely disclosed that RHBSHK and its group companies may have received compensation and a mandate of an investment banking services from the listed company.
12. The disclosure made in the research report is incomplete and lacks specificities of the sponsorship agreement. For instance, it did not stipulate the amount of compensation and the agreement that RHBSHK would engage in the promotion of the listing shares, which includes issuing research reports before listing.

Failure to effectively monitor the trading of its research analysts

13. Paragraph 16.4(b) of the Code of Conduct provides an analyst should not trade any securities in respect of an issuer that the analyst reviews: (i) in a manner contrary to his outstanding recommendation; or (ii) within 30 days prior to and 3 business days after the issue of investment research on the issuer, except in special circumstances outlined in the firm's policy and pre-approved by the relevant legal or compliance function.
14. During the relevant period, the former head of research sold shares of a listed company before the issue of two research reports on the listed company by RHBSHK. Although the former head of research had followed RHBSHK's employee trading policy in obtaining trading approval and submitting trading statements to RHBSHK, RHBSHK failed to identify his disposals of the shares of a listed company within 30 days before the issue of two research reports.
15. RHBSHK's written policies and procedures provide that the compliance department would add a stock to the RRL for a period of 30 days after the stock has been traded by a research analyst. However, the RRL during the relevant period does not show that the shares disposed by the former head of research was being recorded or a breach of paragraph 16.4 of the Code of Conduct was identified despite the former head of research's trading records were submitted to RHBSHK.

Failures to adequately supervise account executives and implement effective controls to ensure account executive compliance

16. The Code of Conduct also provides that a licensed corporation should:

- (a) ensure order instructions received from clients should be recorded in writing or tape recorded (paragraph 3.9);
 - (b) ensure that it has adequate resources to supervise diligently and does supervise diligently persons employed or appointed by it to conduct business on its behalf (paragraph 4.2);
 - (c) be satisfied on reasonable grounds the identity of the person ultimately responsible for originating the instruction in relation to a transaction, and should not effect a transaction unless the identity of the person originating the order is satisfied (paragraph 5.4); and
 - (d) not effect a transaction for a client unless before the transaction is effected the client has specifically authorized the transaction or authorized in writing the licensed corporation to effect transactions for the client (paragraph 7.1).
17. During the SFC's inspection in 2016, RHBSHK was not able to produce telephone order records for the securities trading account of a client. Eventually, RHBSHK claimed that the account executive involved was verbally authorized at account opening to discretionarily trade for the client in July 2014.
18. RHBSHK explained that the discretionary trading went undetected because the client account and the account executive were not selected in its sample telephone recording checking. The sample checking only involved checking the order records of 10 trades each month.
19. The frequency and extent of review should be commensurate with the size of business. At the material time, RHBSHK had over 70 account executives, its sample checking of 10 orders each month is inadequate to offer any meaningful control for the detection and prevention of irregularities stemming from missing telephone recordings of order instructions. Further, RHBSHK's failure to detect the account executive's discretionary trading activities in the client account which lasted for 23 months also indicate that it had not taken adequate steps to satisfy itself about the identity of the person ultimately responsible for originating the order instructions in the client account.

Conclusion

20. Having considered all the circumstances, the SFC considers that the failures of RHBSHK constitute a breach of General Principles 2, 3 and 6 and paragraphs 4.2, 5.4, 7.1, 16.3, 16.4, 16.5, 16.7 and 16.10 of the Code of Conduct.
21. The SFC has accordingly decided to publicly reprimand RHBSHK and fine it \$6.4 million.
22. In deciding the appropriate sanction, the SFC took into account all the relevant circumstances of the case, including RHBSHK's:
- (a) failures were not detected until an SFC's inspection;
 - (b) steps to remediate its internal control deficiencies; and

(c) cooperation with the SFC to resolve the disciplinary proceedings.