

## STATEMENT OF DISCIPLINARY ACTION

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### The Disciplinary Action

1. The Securities and Futures Commission (**SFC**) has publicly reprimanded and fined Fulbright Securities Limited (**Fulbright**) \$3.3 million pursuant to section 194 of the Securities and Futures Ordinance (**SFO**).
2. The SFC has also suspended the licence of Fulbright's responsible officer (**RO**), Eric Liu Chi Ming (**Liu**), for six months from 29 October 2021 to 28 April 2022.
3. The disciplinary action is taken in relation to Fulbright's internal control failures relating to its placing activities and recording of client order instructions.

### Summary of facts

#### A. *Fulbright's placing activities*

*Failure to exercise due skill, care and diligence and continuously monitor its business relationship with clients when processing placement subscription applications*

4. In August 2018, Fulbright acted as a placing agent and sub-underwriter in the share placement (**Placement**) of a listed company (**Listed Company**). On 6 September 2018, an aggregate of 12,000,000 shares of the Listed Company were placed through Fulbright to 60 placees (**Placees**).
5. During the Placement, Fulbright's Equity Capital Market (**ECM**) Team received subscription applications (**Applications**) of 61 clients (**61 Clients**) from an account executive (**AE**). The evidence shows that after checking the 61 Clients' demand order forms<sup>1</sup> and confirming that there were sufficient funds in their accounts for the subscriptions, the ECM Team emailed a spreadsheet setting out the names and residential addresses of the 61 Clients and a placement order form specifying the 61 Clients' intended subscription amounts (collectively, **Investor Lists**) to one of the joint lead managers of the Placement (**Joint Lead Manager**).<sup>2</sup>
6. The SFC's investigation revealed that:
  - (a) the Investor Lists and the 61 Clients' account opening documents show four pairs of clients shared the same residential address and three pairs of clients have declared that they are siblings; and
  - (b) around the same time when the ECM Team received the Applications, 10 out of the 61 Clients had deposited funds into their accounts at Fulbright that were incommensurate with the financial positions stated in

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<sup>1</sup> According to Fulbright, it was the firm's practice during the period from 1 November 2017 to 31 July 2019 (**Relevant Period**) to require clients to sign a demand order form to confirm that they would be the beneficial owners of the placing shares and were independent of the new applicant company.

<sup>2</sup> The Joint Lead Manager later rejected one of the Applications because the applicant was a sibling and shared the same residential address as another applicant.

their account opening documents. Among them, the subscription amounts for nine clients were also incommensurate with their stated financial positions (**Incidents**).

7. At the material time, Fulbright's senior management was only aware that one pair of the clients were siblings and it had dismissed the Incidents without establishing the sources of funding. It was not until one year later in August 2019 that Fulbright reported the Incidents to the Joint Financial Intelligence Unit (**JFIU**).

*Failure to act in the best interests of clients during the placement*

8. On 24 August 2018, Fulbright issued an internal notice to all AEs about the Placement. The notice emphasised that the subscription of shares of the Listed Company involved high investment risks and subscribers should be professional or experienced investors with at least three years of investment experience, no less than HK\$2 million assets and the subscription amounts could not exceed 30% of their asset values (**Requirements**). Moreover, Fulbright might ask clients to complete a risk assessment questionnaire (**Questionnaire**) in order to confirm if they were suitable to participate in the Placement.
9. At the material time, Fulbright had requested 47 out of the 61 Clients to complete the Questionnaire because their accounts were opened shortly before the Placement and they had less than three years of investment experience. The SFC's review of Fulbright's internal records (including the completed Questionnaires) shows most of the 60 Placees could not meet the Requirements.
10. In particular:
  - (a) The 47 Questionnaires indicated that the investment goals of 10 clients (21.3%) were for stable and long-term gradual capital growth<sup>3</sup>, and 22 clients (46.8%) could only accept minor to moderate investment and market fluctuation risks<sup>4</sup>.
  - (b) Moreover, among the 60 Placees:
    - 45 Placees (75%) had a net asset value of no more than HK\$1 million;
    - 34 Placees' (56.7%) subscription amount exceeded 30% of his/her net asset value. Among them, nine Placees' subscription amount exceeded 100% of his/her net asset value; and
    - two Placees' (3.3%) net asset value was unknown.
11. Despite these clear indications that the Placement might not be suitable for the majority of the 60 Placees, Fulbright made no follow-up enquiry with the 47 clients after receiving their Questionnaires and readily accepted all the Applications.

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<sup>3</sup> As opposed to "maximum capital growth as soon as possible" or "very short-term capital growth similar to speculation".

<sup>4</sup> As opposed to "higher risks from market fluctuations".

*The SFC's findings*

12. In light of the matters set out in paragraphs 4 to 11 above, Fulbright had failed to comply with:
- (a) the Guideline to sponsors, underwriters and placing agents involved in the listing and placing of GEM stocks (**Placing Guideline**) and the Code of Conduct for Persons Licensed by or Registered with the SFC (**Code of Conduct**), which require placing agents to, among other things:
- act with due skill, care and diligence and in the best interests of their clients, and to assure the overall integrity of the market (paragraph 10 of the Placing Guideline and General Principle 2 of the Code of Conduct);
  - take all reasonable steps to establish the true and full identity of the client and to confirm whether a client intending to subscribe for the placing shares is the beneficial owner of the client's account (ie, not a nominee of some other person). Placing agents should also exercise caution when relying on the client's declaration of the client's independence and make further enquiries in cases of doubt, and are also generally expected to pay special attention to "red flags", which include subscribers who have familial relationships or share the same address with other placees (paragraphs 9 & 13(c) of the Placing Guideline, and paragraphs 5.1 & 5.4(a)(i) of the Code of Conduct); and
  - establish the sources of funding for the subscription of placing shares before acceptance of the client's subscription. Placing agents are expected to ensure that subscriptions are commensurate with the client's financial position (paragraph 13(d) of the Placing Guideline);
- (b) the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (**AMLO**) and the Guideline on Anti-Money Laundering and Counter-Financing of Terrorism<sup>5</sup> (**AML Guideline**), which require licensed corporations to continuously monitor its business relationship with clients, including (section 5(1) of Schedule 2 to the AMLO, and paragraphs 5.1, 5.10 and 5.11 of the AML Guideline):
- monitoring client activities to ensure that they are consistent with the nature of business, risk profile and source of funds;
  - identifying transactions that are complex, large or unusual, and examining the background and purpose of those transactions; and
  - reporting suspicious transactions to the JFIU in a timely manner.

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<sup>5</sup> The March 2018 version of this guideline was in force in August 2018.

## **B. Recording of client order instructions**

### *Failures relating to the recording of client order instructions*

13. During the SFC's investigation, it was revealed that the 61 Clients' accounts had placed a total of 389 orders to trade in the shares of the Listed Company between 7 September and 5 November 2018. However, Fulbright could not retrieve the order placing records for 212 (54.5%) of these orders.
14. Moreover, it was also revealed that Fulbright did not effectively implement its internal policies on recording of client telephone order instructions during the Relevant Period, which, among other things, required AEs to use the firm's recorded telephone lines when taking telephone order instructions from clients (**Telephone Order Requirements**).
15. The evidence shows that during the Relevant Period:
  - (a) Fulbright considered it was acceptable for AEs to record either order placing instructions or trade confirmations of telephone orders received from clients. No action would be taken against AEs for their failures to comply with the Telephone Order Requirements;
  - (b) it was not until early January 2019 that Fulbright began to require all telephone orders received from clients to have both order placing and trade confirmation recordings; and
  - (c) there was no established procedure for nor standardised approach to Fulbright's telephone order compliance reviews (**Reviews**) and a lack of coordination between the reviewers. For instance, not all non-compliance issues identified from the Reviews were reported to Compliance and/or Liu (who was the senior management in charge of Fulbright's regulated activities).
16. The Reviews records from the Relevant Period illustrate the ineffectiveness of Fulbright's internal controls in ensuring its operations and AEs comply with the applicable order handling regulatory requirements. In total, there were 369 client orders involving 82 AEs with missing telephone order placing recordings:
  - (a) 57 out of the 82 AEs (69.5%) had failed to comply with the Telephone Order Requirements multiple times but written warnings were only issued to two AEs; and
  - (b) 79 out of the 369 orders (21.4%) were placed between January and July 2019, ie, after Fulbright has supposedly fully implemented the Telephone Order Requirements.
17. Notwithstanding the findings of the Reviews, which revealed the misconduct of a large percentage of the firm's AEs<sup>6</sup>, Fulbright never reported the matter to the SFC as required.

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<sup>6</sup> During the Relevant Period, Fulbright had on average around 150 AEs per month who handled client orders.

*The SFC's findings*

18. In light of the matters set out in paragraphs 13 to 17 above, Fulbright had failed to comply with:
- (a) the Code of Conduct, which requires licensed corporations to, among other things:
- record and immediately time stamp records of the particulars of order instructions, and ensure that client order instructions received through the telephone are recorded (paragraph 3.9);
  - ensure that they diligently supervise persons employed or appointed to conduct business on their behalves (paragraph 4.2);
  - have internal control procedures 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 (paragraph 4.3);
  - comply with, and implement and maintain measures appropriate to ensuring compliance with, all applicable legal and regulatory requirements (General Principle 7 and paragraph 12.1); and
  - immediately report to the SFC any material or suspected material breach, infringement of or non-compliance with any laws, rules, regulations and codes administered by the SFC by themselves or their employees (paragraph 12.5);
- (b) the Management, Supervision and Internal Control Guidelines for Persons Licensed by or Registered with the SFC, which provide that, among other things:
- the management<sup>7</sup> of licensed corporations should establish and maintain:
    - policies and procedures to ensure client orders are handled in compliance with the order handling regulatory requirements. In particular, clear and comprehensive audit trails are created to precisely record all orders from the time of origination through order execution and settlement. Further, adequate and reliable audit trails should be maintained to enable the firm to prevent, detect and investigate suspected improprieties (paragraphs 6 & 9 of Section VII);
    - appropriate and effective procedures in relation to dealing and related review processes to prevent or detect errors, omissions, fraud and other unauthorised or improper activities (paragraph 8 of Section VII);
  - regular compliance reviews and audits are conducted to detect activities or conditions which may violate, or contribute to non-compliance by the firm and its staff with, legal and regulatory requirements, as well as with the firm's own policies and procedures (paragraph 21 of the Appendix); and

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<sup>7</sup> "Management" in this context includes the licensed corporation and its senior management.

- staff performing compliance function should promptly report to management all occurrences of material non-compliance by the firm or its staff with legal and/or regulatory requirements, as well as with the firm's own policies and procedures. In turn, the management should promptly notify the SFC of occurrences of these incidents (paragraph 6 of Section V); and
- (c) the Securities and Futures (Keeping of Records) Rules, which require licensed corporations to, among other things:
- keep such accounting, trading and other records that are sufficient to account for all client assets that they receive or hold, and enable all movements of client assets to be traced through their account systems. These include records showing particulars of all orders or instructions concerning securities that they receive or initiate (section 3(1) and section 1 of the Schedule); and
  - give notice in writing to the SFC within one business day after they became aware of their non-compliance of the abovementioned requirements (section 11).

**C. Senior management responsibilities**

19. During the Relevant Period, Liu was Fulbright's RO, director, deputy general manager, manager-in-charge (**MIC**) (Overall Management Oversight) and MIC (Key Business Line), and he was responsible for managing and supervising Fulbright's business operations in regulated activities.
20. More specifically, Liu approved and signed the Placement documents, and was the key decision-maker in Fulbright's acceptance of the Applications. He was also involved in the Reviews and should have been aware that Fulbright did not effectively implement the Telephone Order Requirements. However, he took no step to rectify the situation.

*The SFC's findings*

21. The SFC considers that Fulbright's failures were attributable to Liu's failure to discharge his duties as an RO and a member of Fulbright's senior management. Therefore, Fulbright's misconduct shall also be regarded as Liu's misconduct under section 193(2) of the SFO<sup>8</sup>. As a member of the firm's senior management, Liu has not ensured that Fulbright maintained appropriate standards of conduct and adhered to proper procedures, in breach of General Principle 9 of the Code of Conduct.
22. In the circumstances, the SFC also has serious doubts over Liu's reliability and his ability to carry on regulated activities competently, which call into question his fitness and propriety to be a licensed person.

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<sup>8</sup> Section 193(2)(a) provides that where an intermediary is, or was at any time, guilty of misconduct as a result of the commission of any conduct occurring with the consent or connivance of, or attributable to any neglect on the part of a person involved in the management of the business of the licensed corporation, the conduct shall also be regarded as misconduct on the part of that other person.

## **Conclusion**

23. Having considered all the relevant circumstances, the SFC is of the opinion that Fulbright and Liu have been guilty of misconduct and their fitness and properness to carry on regulated activities have been called into question.
24. In deciding the disciplinary sanction set out in paragraphs 1 and 2 above, the SFC has taken into account Fulbright's and Liu's cooperation in resolving the SFC's concerns. In addition, Fulbright has also agreed to engage an independent reviewer to conduct a review of its relevant internal controls and undertaken to implement the reviewer's recommended rectification measures.