

STATEMENT OF DISCIPLINARY ACTION

The Disciplinary Action

1. The Securities and Futures Commission (**SFC**) has publicly reprimanded and fined Ewarton Securities Limited (**Ewarton**)¹ \$1.5 million pursuant to section 194 of the Securities and Futures Ordinance (**SFO**).
2. The SFC found that, during the period from 15 May 2017 to 23 March 2018 (**Relevant Period**), Ewarton failed to diligently supervise its account executive (**AE**) and put in place adequate and effective internal controls to:
 - (a) detect and prevent unauthorized or improper activities; and
 - (b) ensure that orders of clients are given priorities over orders of its employees.

Regulatory requirements

3. General Principle (**GP**) 2 (Diligence) of the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (**Code of Conduct**) provides that in conducting its business activities, a licensed person should act with due skill, care and diligence, in the best interests of its clients and the integrity of the market.
4. GP 3 (Capabilities) 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.
5. GP 6 (Conflicts of interest) of the Code of Conduct requires a licensed person to try avoiding conflicts of interest, and when such conflicts cannot be avoided, the licensed person should ensure that his clients are fairly treated.
6. Paragraph 4.2 (Staff supervision) of the Code of Conduct requires a licensed person to ensure that it has adequate resources to supervise diligently and does supervise diligently persons employed by it to conduct business on its behalf.
7. Paragraph 4.3 (Internal control, financial and operational resources) of the Code of Conduct requires a licensed person to have internal control procedures and operational capabilities which can be reasonably expected to protect its operations and its clients from financial loss arising from theft, fraud, and other dishonest acts, professional misconduct or omissions.
8. As for paragraph 7.1 (Authorization and operation of a discretionary account) of the Code of Conduct:
 - (a) paragraph 7.1(a)(ii) stipulates that a licensed person should not effect a transaction for a client unless before the transaction is effected, the client has authorized in writing the licensed person or any person

¹ Ewarton is licensed under the SFO to carry on Type 1 (dealing in securities) regulated activity.

employed by it to effect transactions for the client without the client's specific authorization; and

- (b) paragraphs 7.1(b) to (e) of the Code of Conduct contain further requirements relating to the operation of discretionary accounts, in particular:
 - (i) paragraph 7.1(b) requires that, where a client wishes to grant an authority described under paragraph 7.1(a)(ii): (i) the licensed person should explain the terms of the authority to the client; (ii) the written authority should state that the authority has been granted to an employee of the licensed person, if that is the case; and (iii) the licensed person should confirm with the client at least on an annual basis whether the client wishes to revoke the authority;
 - (ii) paragraph 7.1(c) requires a licensed person who has received an authority described under paragraph 7.1(a)(ii) to designate such accounts as "discretionary accounts" on the client agreement and the licensed person's records;
 - (iii) paragraph 7.1(d) requires senior management to approve the opening of discretionary accounts; and
 - (iv) paragraph 7.1(e) requires a licensed person to implement internal control procedures to ensure proper supervision of the operation of discretionary accounts.
- 9. Paragraph 9.1 (Priority for client orders: order handling and recording) of the Code of Conduct provides that transactions to be undertaken on behalf of clients should have priority over orders for the account of the licensed person or its employees.
- 10. Paragraph 12.2 (Employee dealings) of the Code of Conduct requires a licensed person to communicate its staff dealing policy to employees in writing and specify the conditions on which they may deal or trade. The senior management of the licensed person should also actively monitor the transactions in employees' accounts and maintain procedures to detect irregularities and ensure the trades are not prejudicial to the interests of other clients.
- 11. Section V.4 of the Management, Supervision and Internal Control Guidelines for Persons Licensed by or Registered with the Securities and Futures Commission (**Internal Control Guidelines**) requires a licensed person to establish, maintain and enforce effective compliance procedures. These procedures should cover, amongst others, internal control matters and staff dealing requirements.
- 12. Section VII.4 of the Internal Control Guidelines requires a licensed person to establish specific policies and procedures to minimize the potential for the existence of conflicts of interest between the firm or its staff and clients.
- 13. Section VII.8 of the Internal Control Guidelines requires a licensed person to establish and maintain appropriate and effective procedures in relation to

dealing and related review processes to prevent or detect unauthorised or improper activities.

Summary of Facts

Background

14. Following an investigation into a client's complaint, the SFC found that, during the Relevant Period:
 - (a) Mung Wai Sun (**Mung**), who was then a licensed representative of Ewarton, operated a margin account (**Account**) for a client (**Client**) on a discretionary basis without obtaining written authorization from the Client to do so².
 - (b) The Client had never placed any specific order for any of the trades in the Account. Mung had been conducting trades in the Account on the basis of the Client's requests as he understood, ie, that he would trade for the Account by replicating the trades he would execute in his own account or whenever there were good prospects in the market.
 - (c) There were at least 542 pairs of transactions where orders placed for Mung's personal account were within 30 seconds ahead of orders in the same securities and same direction placed for the Account. 133 of these 542 pairs of transactions ended up with more favourable outcomes to Mung.
15. The SFC has suspended the licence of Mung for nine months for breaching the requirements under GP 2, GP 6 and paragraphs 7.1(a)(ii) and 9.1 of the Code of Conduct³.

Ewarton's failure to detect and prevent unauthorized or improper activities

16. During the Relevant Period, Ewarton has only been conducting regular checks on its telephone lines to ensure that its tape recording system was functioning properly. No checks were performed to satisfy itself that orders placed in client accounts could be traced back to specific instructions placed by the clients⁴. Had Ewarton performed such checks during the Relevant Period, it would likely have identified the lack of specific client instruction to all transactions carried out in the Account and uncovered the discretionary trading arrangement between Mung and the Client.
17. Ewarton submitted that all trading activities conducted through its firm were monitored by its Responsible Officers on a real-time basis during trading hours, and reports of all employees' personal account dealings were further reviewed by its senior management at the end of each trading day. However,

² Mung was a senior dealer and an AE of Ewarton's branch office at Sham Shui Po during the Relevant Period.

³ Please see the SFC's press release dated 21 September 2020.

⁴ In a circular issued by the SFC dated 5 February 2016, licensed corporations have been reminded to have measures in place to protect their clients' assets against the threat of internal misconduct. Appendix 2 to this circular sets out some key measures that licensed corporations should have regard when designing their internal control procedures, which specifically includes "sample checks" of "client transaction records against telephone recordings and other order placing records and vice versa to identify unauthorized or unrecorded client transactions".

there has been no guidance on the types of patterns or potential risks that had to be watched out for during these monitoring and review activities. The fact that Ewarton has failed to identify the numerous parallel trades executed for Mung's and the Client's accounts over a 10-month period demonstrates that its trade monitoring system was not adequate or effective.

18. The SFC is of the view that Ewarton has failed to:
- (a) diligently supervise the conduct of Mung and ensure his compliance with requirements under paragraph 7.1 of the Code of Conduct concerning the authorization and operation of discretionary accounts; and
 - (b) put in place adequate and effective internal controls to detect unauthorized or improper activities,

in breach of GP 2, GP 3, paragraphs 4.2, 4.3 and 7.1 of the Code of Conduct and section VII.8 of the Internal Control Guidelines.

Ewarton's failure to ensure priority for client orders

19. Under Ewarton's internal requirements:
- (a) client orders would be executed on a "first come, first served" basis. Upon receiving a client order, its dealers would immediately input the order into the trading terminal for the client; and
 - (b) AEs/dealers who wish to trade in securities for their personal accounts must either pass their orders to other dealers for execution or conduct the trades through Ewarton's online trading platform.
20. However, in the absence of specific guidance that the AEs/dealers must finish placing orders for clients before passing their personal orders to other dealers for execution, these requirements are not conducive to ensuring that priorities would be given to client orders.
21. Further, although Ewarton has performed post-trade reviews of employees' personal account dealings at the end of each trading day, such reviews did not include a comparison of the transactions in the AEs'/dealers' accounts with those in the client accounts under the care of the respective AEs/dealers to detect potential breaches of the client priority principle.
22. Ewarton's failure to diligently supervise Mung and implement adequate systems and controls to ensure that orders of clients are given priorities over orders of its employees constituted breaches of GP 2, GP 3, GP 6, paragraphs 4.2, 4.3, 9.1 and 12.2 of the Code of Conduct and sections V.4, VII.4 and VII.8 of the Internal Control Guidelines.

Conclusion

23. Having considered all the circumstances, the SFC is of the view that Ewarton has been guilty of misconduct and/or is not fit and proper to remain licensed.

24. In reaching the decision to take the disciplinary action set out in paragraph 1 above, the SFC has taken into account all relevant circumstances, including the duration of Ewarton's misconduct and the need to send a deterrent message to the industry that such failures will not be tolerated.