

STATEMENT OF DISCIPLINARY ACTION

The Disciplinary Action

1. The Securities and Futures Commission (**SFC**) has reprimanded and fined City International Futures (Hong Kong) Limited (**CIFHKL**)¹, now known as VERCAP Financial Services Limited, \$100,000 pursuant to section 194 of the Securities and Futures Ordinance (**SFO**).
2. The disciplinary action is taken because CIFHKL failed to:
 - (a) perform adequate due diligence on the customer supplied systems (**CSSs**)² used by clients for placing orders, and assess and manage the associated money laundering and terrorist financing (**ML/TF**) and other risks;
 - (b) conduct proper enquiries on client deposits which were incommensurate with the clients' financial profiles declared in their account opening documents; and
 - (c) establish effective ongoing monitoring system to detect and assess suspicious trading pattern in client accounts.

Summary of Facts

A. *Background*

3. The SFC received complaints from two complainants who alleged that they had opened accounts with CIFHKL through agents in China. One complainant claimed that an agent of CIFHKL operated her account through a remote software and conducted trades for her without her consent, while the other alleged that CIFHKL provided a software named Xinguanjia (**XGJ**) to Mainland clients to conduct futures trading in Hong Kong and the United States.
4. In addition, the SFC received a complaint against various licensed corporations (**LCs**) for allowing clients to place orders to their broker supplied systems (**BSS**)³ through XGJ. The complainant alleged that XGJ permitted the LCs' clients to create sub-accounts under their accounts maintained with the LCs, and the clients had solicited investors in mainland China to trade through the sub-accounts via XGJ without having to open separate securities accounts with the LCs in Hong Kong.

¹ CIFHKL is licensed to carry on Type 2 (dealing in futures contracts) regulated activities under the SFO. It changed its name to Kings International Financial Services Limited in August 2018, Veritas International Financial Services Limited in March 2020, and VERCAP Financial Services Limited in January 2021.

² CSSs are trading software developed and/or designated by the clients that enable them to conduct electronic trading through the internet, mobile phones and other electronic channels.

³ BSSs are trading facilities developed by exchange participants or vendors that enable the exchange participants to provide electronic trading services to investors through the internet, mobile phones, and other electronic channels.

5. Between March 2016 and October 2018 (**Relevant Period**), CIFHKL permitted 16 clients to use their designated CSSs for placing orders⁴. The number of futures contracts executed via the clients' CSSs accounted for around 98.5% of all the futures trades executed by CIFHKL clients.
 - B. *Failure to perform adequate due diligence on the CSSs and assess and manage the associated ML/TF and other risks*
6. Before allowing its clients to connect their CSSs to its BSS, CIFHKL would require its clients to complete: (a) an application form and risk disclosure statement; and (b) a due diligence form stating, among others, the reasons for the application (together, **Application Documents**).
7. CIFHKL conducted minimal due diligence on the CSSs before allowing them to be connected to its BSS:
 - (a) Apart from relying on the clients' confirmation in the Application Documents that the CSS is for the client's own use and not to conduct trades that are not in compliance with regulatory requirements, CIFHKL did not perform any due diligence on the CSSs used by the clients. The applications were approved even though the clients did not provide features of the software in the Application Documents.
 - (b) The testing on the CSSs performed by CIFHKL was limited to checking if the CSSs were compatible with CIFHKL's BSS. It was not aimed at ensuring all features and functions of the CSSs were identified and verified.
8. Without thorough knowledge of the features and functions of the CSSs, CIFHKL was not in a position to properly assess the ML/TF and other risks associated with the use of the CSSs and implement appropriate measures and controls to mitigate and manage such risks.
9. In the absence of proper control over the use of CSSs by its clients, CIFHKL has exposed itself to the risks of improper conduct such as unlicensed activities, money laundering, nominee account arrangement and unauthorized access to client accounts.
 - C. *Failure to conduct proper enquiries on client deposits which were incommensurate with the clients' financial profiles*
10. The SFC's investigation revealed that the amounts of deposits made into the accounts of two clients (**Two Clients**) were incommensurate with their financial profiles declared in their account opening documents.
11. CIFHKL claimed that it monitored the deposits and withdrawals in its clients' accounts on a daily basis, and that it was aware of the substantial deposits in the Two Clients' accounts and had made enquiries with the clients and obtained written confirmation from the clients that the deposits were their own money.
12. However, the measures allegedly taken by CIFHKL were inadequate:

⁴ The CSSs were connected to CIFHKL's BSS through application programming interface (a set of functions that allows applications to access data and interact with external software components or operating systems).

- (a) There are no records of the daily monitoring work allegedly conducted by CIFHKL, whether it identified any unusual fund movements, what enquiries were made, and whether it was satisfied with the explanation provided by the clients on the unusual amounts of deposits into their accounts. In the absence of any records, CIFHKL is unable to demonstrate that it has made proper enquiries with the Two Clients and satisfactorily addressed the concerns associated with these deposits.
- (b) While CIFHKL obtained declarations from the Two Clients confirming that the funds deposited into their accounts originated from them, these confirmation did not explain why the deposit amounts far exceeded their declared net asset value.
- (c) CIFHKL did not have any effective procedures in place for periodic review of client information. There was no system in place and no records of what review, if any, was done.

D. Failure to maintain effective ongoing monitoring system to detect and assess suspicious trading patterns in client accounts

- 13. The SFC's review of the transactions in sample client accounts (including the Two Clients' accounts) showed that (a) there were frequent, and large number of, trades in the Two Clients' accounts during the Relevant Period, and (b) there were many instances where buy and sell orders for the same futures contracts were placed by the same client in the same second at the same price (**same second buy/sell orders**).
- 14. Senior management of CIFHKL stated that they were aware of the same second buy/sell orders in the Two Clients' accounts. They claimed that the clients were conducting programme trading, and they understood from the clients that these trades were made according to the programme set by the clients and there could be micro-second differences in these trades.
- 15. However, CIFHKL admitted that it did not have information about the clients' programme trading (including the strategies and predetermined rules adopted by them) and it could not verify whether there were micro-second differences as such data was not available to the firm. In the absence of such information, CIFHKL was not in a position to properly monitor the trades and assess whether the volume of trades in the clients' accounts and the clients' explanation for the same second buy/sell orders were reasonable.
- 16. CIFHKL's systems and controls for monitoring and detecting suspicious transactions were neither adequate nor effective:
 - (a) CIFHKL did not have a system in place for monitoring and detecting suspicious trades. It claimed that its staff conducted real time monitoring of the trades on a daily basis. However, it is unclear precisely how they monitored the trades, and what criteria they adopted when conducting the review. One of the responsible officers responsible for monitoring trades stated that it was a random review, and he would have a look at the trades at day end (instead of real time).

- (b) CIFHKL only became aware of the same second buy/sell orders in the Two Clients' accounts due to enquiries from the Chicago Mercantile Exchange, and not because of its own monitoring.
- (c) There are also no records of any of the enquiries or review allegedly conducted by CIFHKL on these orders.

The SFC's findings

17. CIFHKL's failures set out above constitute a breach of:
- (a) General Principle (**GP**) 2 of the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (**Code of Conduct**), which requires an LC to act with due skill, care and diligence, in the best interests of its clients and integrity of the market in conducting its business activities.
 - (b) GP 3 and paragraph 4.3 of the Code of Conduct, which provide that an LC should have and employ effectively the resources and procedures which are needed for the proper performance of its business activities and have internal control procedures and operational capabilities 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.
 - (c) Paragraph 5.1 of the Code of Conduct, which requires an LC to take all reasonable steps to establish the true and full identity of each of its clients, and of each client's financial situation, investment experience, and investment objectives.
 - (d) Section 23 of Schedule 2 to the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (**AMLO**) and paragraph 2.1 of the Guideline on Anti-Money Laundering and Counter-Terrorist Financing (April 2015 and March 2018 editions) (**AML Guideline**), which require an LC to mitigate the risks of ML/TF and prevent contravention of any client due diligence and record keeping requirements under the AMLO. To ensure compliance with this requirement, the LC should:
 - (i) establish and implement adequate and appropriate internal anti-money laundering (**AML**) and counter-financing of terrorism (**CFT**) policies and procedures pursuant to paragraph 2.2 of the AML Guideline; and
 - (ii) assess the risks of any new products and services (especially those that may lead to misuse of technological developments or facilitate anonymity in ML/TF schemes) before they are introduced and ensure appropriate additional measures and controls are implemented to mitigate and manage the associated ML/TF risks pursuant to paragraph 2.3 of the AML Guideline.
 - (e) Section 5(1)(a) of Schedule 2 to the AMLO and paragraphs 4.7.12 and 5.1(a) of the AML Guideline, which require an LC to review from time to time client information to ensure that they are up-to-date and

relevant when a significant transaction is to take place or a material change occurs in the way the client's account is operated.

- (f) Section 5(1)(b) of Schedule 2 to the AMLO and paragraph 5.1(b) of the AML Guideline, which require an LC to continuously monitor its business relationship with the clients by monitoring their activities to ensure that they are consistent with its knowledge of the clients and the clients' nature of business, risk profile and source of funds.
- (g) Section 5(1)(c) of Schedule 2 to the AMLO and paragraphs 5.1(c), 5.10 and 5.11 of the AML Guideline, which require an LC to identify transactions that are complex, large or unusual or patterns of transactions that have no apparent economic or lawful purpose, make relevant enquiries to examine the background and purpose of the transactions, document the enquiries made (and their results), and report the findings to the Joint Financial Intelligence Unit where there is any suspicion of ML/TF. Pursuant to paragraph 7.11 of the AML Guideline, where a transaction is inconsistent in amount, origin, destination, or type with a client's known, legitimate business or personal activities, the transaction should be considered as unusual and the LC should be put on alert⁵.
- (h) Section 6(1) of Schedule 2 to the AMLO and paragraph 4.18.1 of the AML Guideline, which require a LC to perform client due diligence measures when a transaction takes place which is by virtue of the amount or nature of the transaction, unusual or suspicious, or is not consistent with the LC's knowledge of the client or the client's business or risk profile, or with its knowledge of the source of the client's funds.

Conclusion

- 18. Having considered all relevant circumstances, the SFC is of the opinion that CIFHKL is guilty of misconduct and its fitness and properness to carry on regulated activities have been called into question.
- 19. In deciding the disciplinary sanction set out in paragraph 1 above, the SFC has taken into account all of the circumstances, including:
 - (a) CIFHKL's failures to diligently monitor its clients' activities and put in place adequate and effective AML/CFT systems and controls are serious as they could undermine public confidence in, and damage the integrity of, the market;
 - (b) CIFHKL's senior management has changed after the Relevant Period;

⁵ Examples of situations that might give rise to suspicion are given in paragraphs 7.14 and 7.39 of the AML Guideline, such as: (a) transactions or instructions which have no apparent legitimate purpose and/or appear not to have a commercial rationale; (b) buying and selling of securities/futures with no discernible purpose or where the nature, size or frequency of the transactions appears unusual; and (c) the entry of matching buys and sells in particular securities or futures or leveraged foreign exchange contracts (wash trading), creating the illusion of trading. Such wash trading does not result in a bona fide market position, and might provide "cover" for a money launderer.

- (c) CIFHKL's financial position, its cessation of business since 31 March 2021 and request to the SFC to revoke its licence – but for these factors, the SFC would have imposed a significantly heavier fine against it;
- (d) a strong deterrent message needs to be sent to the market that such failures are not acceptable;
- (e) CIFHKL cooperated with the SFC in resolving the SFC's concerns; and
- (f) CIFHKL's otherwise clean disciplinary record.