
STATEMENT OF DISCIPLINARY ACTION

The Disciplinary Action

1. The Securities and Futures Commission (**SFC**) has reprimanded and fined Profitech Securities Limited (formerly known as Hang Sing China Securities Limited) (**Profitech**)¹ \$3,990,000 pursuant to section 194 of the Securities and Futures Ordinance (**SFO**).
2. The disciplinary action is taken because Profitech:
 - (a) failed to maintain its required liquid capital (**RLC**) pursuant to the Securities and Futures (Financial Resources) Rules (**FRR**) (**FRR Breach**);
 - (b) failed to notify the SFC of its change in shareholding structure within seven business days of the change (**Notification Failure**);
 - (c) improperly repledged client securities collateral to its execution broker for financial accommodation without a valid client standing authority, and failed to ensure that the aggregate market value of its repledged securities collateral does not exceed the repledging limit prescribed by the Securities and Futures (Client Securities) Rules (**CSR**) (**Improper Repledge**); and
 - (d) recklessly provided financial accommodation to two cash clients without implementing reasonable credit controls and risk management measures (**Reckless Lending**).

Summary of Facts

A. **FRR Breach 1**

3. Section 4 of the FRR provides that a licensed corporation must at all times maintain financial resources in the amount required of it under Part 3 of the FRR.
4. Section 6 in Part 3 of the FRR provides that, for the purposes of section 4, a licensed corporation must at all times maintain liquid capital which is not less than its RLC.
5. In April 2021, Profitech reported to the SFC three incidents of its failure to maintain its RLC of \$3 million between February and April 2021, which was rectified in June 2021, as set out below.
 - A(1). *RLC deficits of \$42,000 as of 28 February 2021 and \$421,000 as of 31 March 2021*
6. On 31 October 2020, Profitech entered into a custodian agreement (**Custodian Agreement**) with a supplier (**Supplier B**), pursuant to which Supplier B started to provide custodian services to Profitech on 1 November 2020. Under the Custodian Agreement, Profitech should pay Supplier B a monthly custodian fee of \$100,000, and therefore a total of \$500,000 accrued for the period from 1 November 2020 to 31

¹ Profitech is licensed to carry on Type 1 (dealing in securities) regulated activity under the SFO. Profitech's immediate holding company (**Holdco**) was wholly owned by Mr T until 1 March 2021.

March 2021. The monthly custodian fees should be reflected in the financial returns submitted to the SFC² (**FRR Returns**) since November 2020. Profitech only paid \$50,000 and \$250,000 to Supplier B in February and March 2021 while \$200,000 of the accrued fees for the period between November 2020 and March 2021 remained outstanding and were not reflected in Profitech's calculation of liquid capital.

7. The omission of the custodian fee payments from the calculation of liquid capital was only identified following the SFC's enquiry in April 2021. When the omitted custodian fees were paid and retrospectively recorded in the books for the months of February and March 2021, Profitech identified RLC deficits of \$42,000 as of 28 February 2021 and \$421,000³ as of 31 March 2021.
8. Another factor that contributed to Profitech's RLC deficit was that its business had been loss-making. Based on the evidence:
 - (a) Profitech's liquid capital had been tight between February and June 2021 due to recurring high operating expenses.
 - (b) Profitech had been relying on repayments from its debtors to cover its operating expenses and maintain its RLC. There were no repayment schedules for the debts due from its debtors. The debt repayments received in March 2021 were insufficient to cover its regular operating expenses.

A(2). RLC deficit of \$1.589 million as of 14 April 2021

9. Ms L was the sole bank signatory of Profitech's bank accounts. On 14 April 2021, she followed Mr T's verbal instruction and released \$1.715 million from Profitech's house bank account to Mr T (**Fund Withdrawal**). The Fund Withdrawal resulted in the firm's RLC deficit of \$1.589 million on that day. Ms L effected the Fund Withdrawal without informing the two responsible officers of the firm.
10. The Fund Withdrawal was caused by Mr T's sale of his interest in Holdco (**Disposal**):
 - (a) In or about February 2021, Mr T orally agreed to sell his shares in Holdco (**Shares**) to three new shareholders (**New Shareholders**) and receive payment for the Shares. Pursuant to the agreed payment terms, in settlement of part of the payment for the Disposal, Profitech's house account would release \$3.5 million to Mr T, and the New Shareholders would then deposit the same amount to the account.
 - (b) The bought and sold notes in respect of the Disposal show that Mr T transferred the Shares to the New Shareholders on 1 and 26 March 2021.
 - (c) On 14 April 2021, Mr T requested Ms L to make the Fund Withdrawal. However, the New Shareholders did not deposit any money into Profitech's house account as agreed. As a result, Profitech recorded an RLC deficit of \$1.589 million. Mr T claimed that he was not aware that Profitech did not have sufficient liquid capital at the material time.
11. The RLC deficit continued after the Fund Withdrawal and was rectified on 7 June 2021 following the New Shareholders' capital injection into the firm.

² Returns submitted pursuant to section 56 of the FRR.

³ These were the cumulative RLC deficits in February and March 2021 resulting from the settlement of the outstanding monthly custodian fee and the loss-making business.

B. Notification Failure

12. Under section 135 of the SFO and section 4 of the Securities and Futures (Licensing and Registration) (Information) Rules (**Information Rules**), where there is a change in certain specified information that has been provided to the SFC, a licensed corporation shall give notice in writing to the SFC of the change containing a full description of it within seven business days of the change. The changes to be notified include changes in the capital and shareholding structure of the licensed corporation.
13. On 21 April 2021, Profitech notified the SFC of the Disposal and change of shareholders of Holdco. The notification was made more than seven business days after the transfer of shares on 1 and 26 March 2021.

C. Lack of measures to ensure maintenance of RLC and compliance with notification requirements

14. Profitech was not able to provide policies and procedures for ensuring compliance with the liquid capital requirements under the FRR and notification requirement under the Information Rules during the SFC's investigation.
15. The responsible officer responsible for monitoring Profitech's liquid capital and ensuring its compliance with the regulatory requirements also stated that it did not put in place policies and procedures for ensuring sufficiency of operating capital.

D. Improper Repledge

16. Section 10(1) of Part 3 of the CSR requires an intermediary to take reasonable steps to ensure that its client securities and securities collateral are not deposited, transferred, lent, pledged, repledged or otherwise dealt with, except as provided in Part 2 of the CSR. Specifically:
 - (a) section 5(2)(a) provides that subject to section 6, an intermediary which receives any securities collateral shall ensure that the securities collateral is deposited in safe custody in a segregated trust account or client account and established and maintained for holding securities collateral of the intermediary with —
 - (i) an authorized financial institution;
 - (ii) an approved custodian; or
 - (iii) another intermediary licensed for dealing in securities; and
 - (b) section 6(1)(c) provides that an intermediary may deal with client securities or securities collateral that it receives or holds in accordance with a standing authority of a client.
17. Since July 2022, Profitech has improperly repledged to its execution broker securities collateral received from two margin clients (**Two Margin Clients**), for obtaining margin loan of up to \$15.8 million from the execution broker which was then used to finance the continuous holding or acquisition of stocks by two rolling balance cash clients (**Cash Clients**).

18. Specifically, on 4 and 19 July 2022, Profitech deposited in an omnibus margin trading account that it held with the execution broker stocks of the Two Margin Clients which were worth around \$236 million in total in late July 2022.
19. The standing authority which Profitech obtained from the Two Margin Clients only allowed it to deposit their securities collateral for loans with an authorized financial institution, but not a broker. Profitech's repledging of the securities collateral to its execution broker was therefore done without a valid standing authority.
20. Further, the amount of client securities collateral repledged by Profitech significantly exceeded the 140% repledging limit set out in sections 8A(2) and 8A(3) of the CSR⁴.
21. Despite the SFC's repeated reminders since September 2022 to Profitech to fully repay the execution broker and remedy its improper repledging of client securities collateral and its written commitments⁵ to do so, Profitech has failed to rectify the breach until 14 November 2023.
22. In light of Profitech's protracted breaches in relation to Improper Repledge and FRR requirements and the SFC's growing concern about its operational viability, the SFC issued a restriction notice (**RN**) to the firm on 7 November 2023. Under the RN, among others, Profitech is required to fully repay its debt to the execution broker within two business days and withdraw the repledged client securities in its margin trading account held with the execution broker within one business day after the debt repayment.
23. Profitech's practice of repledging the clients' securities collateral without a valid standing authority from the clients persisted for 17 months and only ceased when it withdrew all the repledged securities on 14 November 2023 after repaying the debt owed to the execution broker pursuant to the RN.

E. FRR Breach 2

24. Profitech's excessive financial accommodation obtained from its execution broker through the repledging of client securities collateral resulted in a further breach of the RLC requirement under the FRR since July 2022.
25. The excessive amount of the borrowing from the execution broker had significantly increased the ranking liabilities of Profitech resulting in RLC deficits of the firm since July 2022⁶. The RLC deficit was around \$1.9 million as of the end of July 2022 and inflated to around \$6.8 million as of the end of July 2023. Profitech's liquid capital remains below the required level.

⁴ (a) Section 8A(2) of the CSR requires an intermediary which repledges securities collateral to ascertain the aggregate market value of the repledged securities collateral on each business day.

(b) Section 8A(3) of the CSR requires that if the aggregate value of the intermediary's repledged securities collateral calculated pursuant to section 8A(2) exceeds 140% of its aggregate margin loans on a business day (**Relevant Day**), the intermediary shall withdraw from deposit an amount of the collateral by the close of business on the next business day such that the aggregate market value of the collateral does not exceed 140% of its aggregate margin loans on the Relevant Day.

⁵ In the Confirmation and Undertakings which Profitech provided to the SFC in December 2022 and September 2023, Profitech undertook to withdraw from the execution broker all pledged client securities and repledged securities collateral, but it did not honour such commitments.

⁶ In calculating its RLC, Profitech had to deduct its total ranking liabilities from its total liquid assets. Pursuant to section 42(2) of the FRR, Profitech shall include in its ranking liabilities the amount by which such financial accommodation exceeds 80% of the aggregate of amounts receivable from its margin clients.

F. Reckless Lending

26. Profitech has since July 2022 recklessly provided financial accommodation to the Cash Clients without implementing reasonable credit controls and risk management measures:
- (a) In the case of the first client, while a credit facility of \$1.9 million was drawn down by the client on 11 July 2022, Profitech allowed the outstanding balance to be settled by 30 September 2022 (ie, a settlement period of more than two months). The client further drew down the credit facility to around \$4.1 million as of 15 September 2022 but Profitech did not stipulate any specific timeframe for the repayment of the additional credit.
 - (b) In the case of the second client, while a credit facility of \$11.5 million was drawn down by the client on 1 September 2022, Profitech allowed the outstanding balance to be settled by instalments until 11 January 2023 (ie, a settlement period of more than four months).
27. Such financial accommodation was made even though Profitech had to borrow money from its execution broker by improperly repledging other clients' securities collateral and recorded RLC deficits. Further, the financial accommodation was used to finance the acquisition of stocks by the two Cash Clients. Although the two Cash Clients deposited the stocks with Profitech to secure the financial accommodation, the stocks were illiquid.
28. It appears that when granting credit facilities to the Cash Clients, Profitech did not take into account the following during the credit approval process:
- (a) the Cash Clients were new clients with no prior settlement and credit history at the firm; and
 - (b) the information provided by the Cash Clients in their account opening forms shows that they had limited liquid assets and the proof of finance they provided suggests weak financial position.
29. Although the Cash Clients repeatedly failed to repay by their agreed deadlines, Profitech did not take effective measures to ensure that they settle their loans promptly, such as by taking timely legal actions.
30. Profitech still had outstanding account receivables from the Cash Clients in the amount of \$2.3 million in April 2024 following some repayments made by the clients and Profitech's liquidation of the stocks.
31. Profitech's Reckless Lending which was effectively financed by the Improper Repledge (a) jeopardised the interest of the Two Margin Clients, whose collateral were improperly repledged to finance the lending to the Cash Clients, thereby exposing the firm to litigation risk; and (b) imperiled its financial soundness. Profitech's recklessness in providing financial accommodation to clients demonstrated its failure to put in place proper credit controls and properly manage the risks associated with its business.

G. The SFC's findings

32. Profitech's failures set out above constitute a breach of:

- (a) sections 4 and 6 of the FRR as it failed to maintain its RLC;
- (b) section 135 of the SFO and section 4 of the Information Rules as it failed to give the SFC notice in writing of the change of the shareholding structure of its immediate holding company, containing a full description of it, within seven business days of the change;
- (c) sections 5(2) and 10(1) of the CSR as it repledged the securities collateral of the Two Margin Clients to its execution broker without a valid standing authority given by the clients;
- (d) section 8A(3) of the CSR as it failed to ensure that the aggregate market value of its repledged securities collateral does not exceed the prescribed 140% repledging limit;
- (e) General Principle 2 (Diligence) of the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (**Code of Conduct**) as it failed to act with due skill, care and diligence, and in the best interest of its clients when it repledged its clients' securities collateral without a valid standing authority and not adhering to the prescribed repledging limit;
- (f) General Principle 7 (Compliance) and paragraph 12.1 (Compliance: in general) of the Code of Conduct as it failed to comply with, and implement and maintain measures appropriate to ensuring compliance with, the FRR, the SFO, the Information Rules, the CSR and the Code of Conduct;
- (g) General Principle 8 (Client Assets) and paragraph 11.1(a) (Handling of client assets) of the Code of Conduct as it failed to ensure that securities collateral of the Two Margin Clients were properly repledged in accordance with a valid standing authority given by them thereby failing to ensure that client assets were properly accounted for and adequately safeguarded; and
- (h) paragraph 14.1 (Responsibility of senior management) of the Code of Conduct as its senior management failed to put in place proper credit controls and risk management process to prevent Profitech from making reckless lending to its clients thereby failing to properly manage the risks associated with the business of the firm.

Conclusion

- 33. Having considered all the circumstances, the SFC is of the opinion that Profitech is guilty of misconduct.
- 34. In deciding the disciplinary sanction set out in paragraph 1 above, the SFC has taken into account all relevant circumstances, including:
 - (a) Profitech's repeated and prolonged failures to maintain the RLC;
 - (b) the gravity of the improper repledge of client securities and Profitech's failure to rectify such irregularities despite repeated reminders from the SFC and its express undertakings to do so;

- (c) Profitech's cooperation in resolving the SFC's concerns, including its agreement to engage an independent reviewer to conduct a review of its relevant internal controls; and
- (d) Profitech's otherwise clean disciplinary record.