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## STATEMENT OF DISCIPLINARY ACTION

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### The Disciplinary Action

1. The Securities and Futures Commission (**SFC**) has reprimanded and fined Tung Tai Securities Company Limited (**Tung Tai**)<sup>1</sup> HK\$900,000 pursuant to section 194 of the Securities and Futures Ordinance (**SFO**).
2. The disciplinary action is taken in respect of Tung Tai's failure to ensure that client assets were adequately safeguarded between 6 September 2019 and 18 February 2020 (**Relevant Period**).

### Summary of Facts

#### A. *Background*

3. The case stemmed from a self-report by Tung Tai to the SFC on 26 June 2020 about suspected fraudulent activities and unauthorised transactions in the account of one of its clients (**Client**)<sup>2</sup>.
4. The Client has maintained a securities trading account with Tung Tai (**Account**) since 20 October 2007. The Client authorised the director of its general partner, Mr. B, to operate the Account since its opening.
5. In late April 2020, the Client made an inquiry with Tung Tai regarding the discrepancies between the Client's records and the monthly statements of the Account provided by Tung Tai. Tung Tai then discovered that it had executed instructions for the Account sent from a bogus email account during the Relevant Period. In June 2020, Tung Tai reported the matter to the SFC.

#### B. *Failure to adequately safeguard client assets*

6. During the Relevant Period, pursuant to instructions from an email address similar to but in fact different from that of the Client in Tung Tai's records (**False Email Address**), Tung Tai executed the sale of 474,000 shares in a Hong Kong listed stock (**Stock X**) in the Account and transferred the sale proceeds totalling US\$3,301,740 to three overseas bank accounts (**False Bank Accounts**) that were not designated by the Client.
7. According to Tung Tai, since the Client was based in Canada and was Tung Tai's only overseas client and given the time difference, Tung Tai and the Client agreed at account opening in October 2007 to adopt the following discrete arrangement on giving instructions for both execution of trade orders and fund transfers (**Arrangement**):

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<sup>1</sup> Tung Tai is licensed under the Securities and Futures Ordinance to carry on Type 1 (dealing in securities) and Type 4 (advising on securities) regulated activities.

<sup>2</sup> The Client is a limited partnership company.

- (a) Mr. B would call the relevant responsible officer (**RO**) of Tung Tai, RO1, to place order usually late at night (Hong Kong time) and send an email confirmation to RO1 the next working day.
  - (b) RO1 would then forward the email instructions (**Email Instructions**) to the Accounting Department of Tung Tai (**A/C Department**), which would ask another RO, RO2, to execute the relevant orders.
- 8. Following the execution of the relevant trade orders, A/C Department would print the Email Instructions and pass them to another RO, RO3, for approving remittance of sale proceeds to the Client as instructed.
- 9. According to Tung Tai, the first deviation from the Arrangement occurred when Mr. B sent an email directly to the staff of the A/C Department on 13 February 2019, with sale of shares and fund transfer instructions, without first calling RO1. Tung Tai executed the instructions accordingly.
- 10. On 6 September 2019, Tung Tai received the first email from the False Email Address containing instructions to sell Stock X. Pursuant to the instructions (**False Instructions**) received from the False Email Address during the Relevant Period, Tung Tai sold Stock X in the Account on 4 occasions (collectively, **Trades**) and made 9 attempts to remit the proceeds to the False Bank Accounts by telegraphic transfer (**TT**). Specifically, the sales orders and remittance of funds were processed as follows:
  - (a) A staff of A/C Department, Ms. C, received emails from the False Email Address and passed the emails with the False Instructions to RO2 and RO3. RO2 executed all the Trades, and RO3 approved the relevant vouchers and TT forms for the remittance of the sales proceeds to the False Bank Accounts accordingly.
  - (b) The False Bank Accounts were maintained in the name of the Client's general partner but were not the bank accounts designated in the Client's account opening documents. Further, the beneficiary addresses for the TTs set out in the False Instructions are different from that of the Client as provided in the Client's account opening documents.
  - (c) Tung Tai initiated 9 TTs for remitting the sales proceeds to the False Bank Accounts during the Relevant Period, amongst them:
    - (i) 4 TTs were rejected by the relevant overseas banks, including 2 TTs to a bank in Mexico and 2 TTs to a bank in Canada;
    - (ii) 1 TT to a bank in Belgium was cancelled pursuant to the False Instructions; and
    - (iii) 4 TTs were eventually executed, resulting in withdrawal of US\$3,301,740 from the Account and remittance of the funds to 3 False Bank Accounts held with 3 different banks in the United States.
- 11. The evidence shows that Tung Tai lacked proper and written procedures to safeguard client assets:
  - (a) Tung Tai did not put in place a written procedure for the Arrangement agreed with the Client and failed to ensure that the terms of the Arrangement were made known to, and/or effectively communicated to, all existing and new staff. In particular, RO2 did not know that Mr. B should call

RO1 to give instructions before sending email written instructions to Tung Tai, and Ms. C had no knowledge of the Arrangement at all. Without knowing or checking whether the Client (through Mr. B) had placed an order to RO1 by telephone, Ms. C simply passed the False Instructions to RO2 and RO3 for order execution and remittance approval whenever she received them.

- (b) Tung Tai did not put in place any measures to ensure that the Arrangement was adhered to before processing instructions for the Client.
  - (c) The management personnel responsible for executing orders and approving fund withdrawals as instructed by the Client were not required to take steps to ensure that the instructions indeed originated from the Client.
  - (d) While the Arrangement required Mr. B's verbal instructions to RO1 to be supplemented by a subsequent email to RO1, Tung Tai did not require the handling staff to check the email address from which the relevant email instructions originated against that of Mr. B's in the firm's records. This exposes the Client to serious risk of unauthorised operation of the Account by way of fraudulent emails.
12. Further, the TT rejections and inconsistent beneficiary addresses were red flags of potential irregularities but Tung Tai did not act on the red flags. Tung Tai continued to process the TT transactions for fund withdrawals to different banks despite the multiple TT rejections and took no steps to make any inquiries with the Client by other means of communications, such as telephone call with Mr. B, to verify its instructions.
13. In the circumstances, Tung Tai failed to:
- (a) ensure that client assets were adequately safeguarded; and
  - (b) establish an effective procedure to protect client assets from theft, fraud and other acts of misappropriation.

### **The SFC's findings**

14. Tung Tai'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 a licensed corporation (**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 and Part VII of the Management, Supervision and Internal Control Guidelines for Persons Licensed by or Registered with the Securities and Futures Commission, which require an LC to have, maintain and ensure compliance with internal control procedures which can be reasonably expected to protect its clients from financial loss arising from theft, fraud and other acts of misappropriation.
  - (c) GP 8 and paragraph 11.1(a) of the Code of Conduct, which provide that an LC should, in the handling of client transactions and client assets, act to ensure that client assets are accounted for properly and promptly. Where

the LC is in possession or control of client positions or assets, the LC should ensure that client positions or assets are adequately safeguarded.

## **Conclusion**

15. Having considered all relevant circumstances, the SFC is of the opinion that Tung Tai is guilty of misconduct.
16. In deciding the disciplinary sanction set out in paragraph 1 above, the SFC has taken into account all relevant circumstances, including:
  - (a) Tung Tai's failures to put in place adequate internal controls to safeguard client assets are serious as they could expose clients to risk of substantial loss arising from theft, fraud and other acts of misappropriation;
  - (b) Tung Tai has taken remedial measures to enhance order placing and trading execution procedures for the Client to avoid similar incidents in the future;
  - (c) Tung Tai has made compensation to the Client;
  - (d) Tung Tai engaged a firm of independent reviewers to review its internal controls in respect of safeguarding of client assets and cooperated with the SFC in resolving the SFC's concerns; and
  - (e) Tung Tai has an otherwise clean disciplinary record.