

STATEMENT OF DISCIPLINARY ACTION

The Disciplinary Action

1. The Securities and Futures Commission (**SFC**) has publicly reprimanded and fined Deutsche Securities Asia Limited (**DSAL**)¹ HK\$2.45 million pursuant to section 194 of the Securities and Futures Ordinance (**SFO**).
2. The disciplinary action is taken in respect of DSAL's issuance of incorrect periodic statements to its prime brokerage (**PB**) clients which contained positions regarding entitlements to bonus shares of listed companies that had not yet become tradable by the clients.

Summary of Facts

Design defect in systems deployed by DSAL

3. Since 2006, DSAL has booked information regarding corporate actions (**CA**) (including issuance of bonus shares) by listed companies which its PB clients hold shares in to its front office system (**FO System**). The FO System would transfer these CA details to another system responsible for the generation of periodic statements issued to the PB clients (**Statements**).
4. However, due to a design defect in the FO System, it did not distinguish between ex-entitlement dates (**Ex-Dates**) and settlement dates (**Pay Dates**) of bonus share events. The FO System only extracted the Ex-Dates when transferring the relevant data to the other system for generation of the Statements.

Issuance of incorrect Statements to the PB clients and the premature sale of bonus shares by a PB client

5. As a result, where there was an interval between the Ex-Dates and the Pay Dates, the transaction records and shareholding positions displayed in the Statements showed the bonus shares as settled and tradable as of the Ex-Dates, when in fact these shares had not become unconditional for long sale until the Pay Dates (**Error**). Disposing of such bonus shares during the interval without borrowing the requisite shares could constitute naked short selling.
6. One of DSAL's PB clients (**Client**) appeared to have relied on the Statements containing the Error (**Impacted Statements**) and oversold bonus shares issued by three Hong Kong-listed companies in July 2018, between the respective Ex-Dates and Pay Dates of the relevant bonus issuances².

¹ DSAL is licensed under the SFO to carry on Type 1 (dealing in securities), Type 2 (dealing in futures contracts) and Type 6 (advising on corporate finance) regulated activities.

² In addition, another PB client of DSAL might also have oversold bonus shares between the Ex-Date and Pay Date in one instance in June 2018, but DSAL was unable to definitely conclude if this had been the case, since this client executed the trade through another broker.

Impact of the Error

7. DSAL had likely issued Impacted Statements to some of its PB clients since the FO System was implemented in 2006, until the Error was remedied in November 2018:
 - (a) 34 PB clients received Impacted Statements from DSAL between January and October 2018;
 - (b) 75 PB clients likely received Impacted Statements between 2011 and 2017; and
 - (c) DSAL was unable to identify the number of PB clients who may have received Impacted Statements before 2011 since the data is no longer available.

Delay in reporting to the SFC

8. Although DSAL first discovered in July 2018 that Impacted Statements had been issued to the Client and became aware in the following month that the Error was attributable to a design defect in the FO System, it delayed reporting its failures to the SFC for over six months until February 2019 when it completed its internal investigation.

The SFC's concerns

9. By issuing the Impacted Statements to its PB clients, DSAL has exposed its clients to the risk of unknowingly conducting naked short selling in reliance on the information provided.
10. DSAL's failure constitutes breaches of the following provisions of the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (**Code of Conduct**):
 - (a) General Principle (**GP**) 2 (Diligence), which requires that in conducting its business activities, a licensed person should act with due skill, care and diligence, in the best interests of the integrity of the market;
 - (b) GP 3 (Capabilities), which stipulates that a licensed person should have and employ effectively the resources and procedures which are needed for the proper performance of its business activities;
 - (c) paragraph 2.1 (Accurate representations), which provides that where a licensed person advises a client, it should ensure that any representations made and information provided to the client are accurate and not misleading; and
 - (d) paragraph 4.3 (Internal control, financial and operational resources), which require a licensed person to have internal control procedures and financial and operational capabilities which can be reasonably expected to protect its operations, its clients and other licensed or registered persons from financial loss arising from theft, fraud, and other dishonest acts, professional misconduct or omissions.

11. In addition, DSAL's delay in reporting its failures to the SFC constitutes a breach of Paragraph 12.5(a) (Notifications to the Commission) of the Code of Conduct, which provides that a licensed person should report to the SFC immediately upon the happening of any material breach, infringement of or non-compliance with any law, rules, regulations and codes administered or issued by the SFC, or where it suspects any such breach, infringement or non-compliance.

Conclusion

12. The SFC is of the view that DSAL is guilty of misconduct and its fitness and properness to be or to remain the same type of regulated person have been called into question.
13. 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 finding that DSAL's failures lasted for 12 years, DSAL's remedial actions and cooperation with the SFC in resolving the SFC's concerns.