

Chung Nam Securities and responsible officers reprimanded and fined \$1.3 million for non-compliance in handling PCCW trades

26 Aug 2010

The Securities and Futures Commission (SFC) has issued a reprimand to Chung Nam Securities Limited (Chung Nam) and its two responsible officers Mr Cheng Wai Chung and Mr Ng Kwai Cho (Note 1) for non-compliance with the SFC's Code of Conduct (Note 2) and Internal Control Guidelines (Note 3) in handling client orders for the shares of Pacific Century CyberWork Limited (PCCW).

The SFC has also fined Chung Nam \$800,000 and Cheng and Ng \$250,000 each.

The client orders in this case were received in the period leading up to the court ordered meeting of PCCW shareholders held in February 2009.

The SFC found that during the period between 13 and 16 January 2009, Chung Nam received 132 single-board-lot buy orders from 132 clients for the shares of PCCW. Instead of promptly executing these 132 single-board-lot orders once each of them was received, Chung Nam aggregated 123 of them into bigger orders for execution (Note 4).

Chung Nam also failed to ensure that these 123 orders were promptly and fairly allocated to the accounts of the respective clients as there was no basis to determine the sequence of these orders (Note 5). This was because Chung Nam failed to maintain adequate records of order instructions. Specifically, the SFC found that:

- most of the relevant dealing tickets carried two identical time stamps, which made it impossible to distinguish an order's time of receipt from its time of execution;
- Chung Nam did not maintain taped recording of any telephone conversation between its clients and its account executives or between its account executives and its dealing staff in relation to the placing of orders to buy PCCW shares between 30 December 2008 and 3 February 2009 (Note 6).

Chung Nam failed to establish and maintain policies and procedures which ensure that it has clear and comprehensive audit trails, and that client orders would be handled in a fair and equitable manner and in all cases comply with order handling requirements (Note 7).

Cheng and Ng oversaw the dealing operations of Chung Nam and bore direct responsibility for Chung Nam's failures.

"Order recording and prompt execution of client orders are fundamental requirements which exist to protect the interests of clients and the market in general. These types of failures, when viewed in aggregate, demonstrate a propensity for conduct that is well below the standard expected of Hong Kong brokers," the SFC's Executive Director of Enforcement, Mr Mark Steward said.

In deciding on the penalty, the SFC took into account that Chung Nam did not take any remedial action to strengthen its internal control systems since the SFC started its investigation and that it was previously disciplined by the SFC for internal control failures (Note 8).

Chung Nam, Cheng and Ng subsequently filed an application with the Securities and Futures Appeals Tribunal (SFAT) for review of the SFC's decision one day after the prescribed deadline.

The SFAT today dismissed their application for an extension of time to lodge the application for review. Consequently, the application of Chung Nam, Cheng and Ng, which was filed out of time, is of no effect. The penalties imposed by the SFC are accordingly of full effect (Note 9).

End

Notes:

1. Chung Nam is licensed under the Securities and Futures Ordinance to carry on Type 1 (dealing in securities) regulated activity. Cheng and Ng are both licensed to carry on Type 1 (dealing in securities) and Type 2 (dealing in futures contracts) regulated activities.
2. Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission
3. Management, Supervision and Internal Control Guidelines for Persons Licensed By or Registered with the Securities and Futures Commission
4. Paragraphs 3.1 and 3.5 of the Code of Conduct requires respectively that client orders be promptly executed in accordance with clients' instructions and prohibits the withholding of client orders for convenience.
5. Paragraph 3.3 of the Code of Conduct requires licensed or registered persons to ensure that transactions executed on behalf of clients are promptly and fairly allocated to the accounts of the respective clients.
6. Chung Nam's telephone recording system was manually operated and staff could choose whether to record a particular conversation or not. Furthermore, Chung Nam's operation procedures did not require telephone conversations between its account executives and its clients to be recorded. Chung Nam's failure to maintain taped recording of relevant telephone conversations ran contrary to Paragraph 3.9 of the Code of Conduct and the SFC's circular to licensed intermediaries on telephone recording requirements dated 25 November 2004.
7. Chung Nam was in breach of Control Guidelines 6 and 8 under Part VII of the Internal Control Guidelines.
8. Chung Nam was fined \$700,000 for failing to institute proper or sufficient systems to safeguard client assets and to establish an effective procedure for ensuring client securities would be protected from misappropriation. For details, please refer to SFC press release dated [12 November 2008](#).
9. A copy of the SFAT's decision is posted on the SFAT's website at <http://www.sfat.gov.hk/english/determination/AN-6-2010-Determination.pdf>.