

## SFC reprimands and fines CLSA Limited \$9 million over internal control failures

13 Mar 2018

The Securities and Futures Commission (SFC) has reprimanded and fined CLSA Limited (CLSA) \$9 million after resolving concerns over CLSA's internal control failures in relation to its client facilitation services and reporting obligation under the Code of Conduct (Notes 1 & 2).

In November 2016, the SFC and CLSA jointly engaged an independent reviewer to conduct a review of CLSA's internal controls from the period between 2014 and 2016. The independent review covered, among other areas, CLSA's facilitation trading business and notifications to the SFC concerning material or suspected material breach of legal and regulatory requirements.

The review found that CLSA did not:

- put in place until March 2016 controls to prevent co-mingling of agency execution and client facilitation trading despite having introduced client facilitation services in 1986 (Note 3); and
- immediately notify the SFC until February 2015 despite having learnt as early as April 2013 that its licensed representatives were suspected of violating overseas regulatory requirements and were being investigated by an overseas regulator (Note 4).

In reaching this resolution, the SFC took into account that CLSA:

- took initiative to bring this matter to a conclusion by cooperating fully with the SFC in resolving the regulatory concerns; and
- undertook a review with the SFC to address the regulatory concerns and identify the deficiencies in its internal controls.

The SFC also took into consideration the undertaking of CLSA's board of directors that reasonable steps will be implemented within the next 12 months to rectify CLSA's internal control failures in relation to avoidance of conflicts of interest.

End

Notes:

1. CLSA is licensed under the SFO to carry on business in Type 1 (dealing in securities), Type 4 (advising on securities) and Type 7 (providing automated trading services) regulated activities.
2. The Code of Conduct for Persons Licensed by or Registered with the SFC (Code of Conduct).
3. General Principles 2 and 6 of the Code of Conduct provide that a licensed corporation should act in the best interests of clients and avoid conflicts of interest. Paragraph 8 of the Appendix to the Management, Supervision and Internal Control Guidelines for Persons Licensed by or Registered with the SFC indicates that a firm should avoid apparent and potential conflicts of interest by establishing and maintaining adequate "Chinese Walls", such as the separation of dealers handling discretionary orders from those handling proprietary accounts.
4. Paragraph 12.5 of the Code of Conduct requires a licensed corporation to report to the SFC immediately about any suspected or actual material breach of any applicable legal and regulatory requirements by itself or persons it employs or appoints to conduct business with clients.

[A copy of the Statement of Disciplinary Action is available on the SFC website.](#)

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## STATEMENT OF DISCIPLINARY ACTION

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### The Disciplinary Action

1. The Securities and Futures Commission (**SFC**) has publicly reprimanded and fined CLSA Limited (**CLSA**) \$9 million pursuant to section 194 of the Securities and Futures Ordinance (**SFO**).
2. The disciplinary action is taken according to an agreement pursuant to section 201 of the SFO dated 12 March 2018 in relation to CLSA's internal control failures in relation to its client facilitation services and reporting obligation under the Code of Conduct for Persons Licensed by or Registered with the SFC (**Code of Conduct**).
3. CLSA is licensed under the SFO to carry on business in Type 1 (dealing in securities), Type 4 (advising on securities) and Type 7 (providing automated trading services) regulated activities.

### Summary of facts

#### *Background*

4. In November 2016, the SFC and CLSA jointly engaged an independent reviewer to conduct a review of CLSA's internal controls from the period between 2014 and 2016. The independent review covered, among other areas, CLSA's facilitation trading business and notifications to the SFC concerning material or suspected material breach of applicable legal and regulatory requirements by CLSA and/or persons employed or appointed by CLSA to conduct business with clients (**Review**).

#### *Potential conflicts of interest*

5. General Principles 2 and 6 of the Code of Conduct provide that a licensed corporation should act in the best interests of clients and avoid conflicts of interest.
6. The Management, Supervision and Internal Controls Guidelines for Persons Licensed by or Registered with the SFC (**Internal Control Guidelines**) provide that key duties and functions shall be appropriately segregated, particularly those duties and functions which when performed by the same individual may result in undetected errors or may be susceptible to abuses which may expose the firm or its clients to inappropriate risks.
7. Paragraph 8 of the Appendix to the Internal Control Guidelines indicates that a firm should avoid apparent and potential conflicts of interest by establishing and maintaining adequate "Chinese Walls", such as the separation of dealers handling discretionary orders from those handling proprietary accounts.

8. CLSA introduced its client facilitation services in 1986 without segregation between the agency execution and facilitation trading functions. CLSA only started to segregate its client facilitation business and agency business in September 2015, when designated traders who were prohibited from accessing agency order and trading information were assigned to conduct facilitation trading activities (Designated Traders).
9. However, the access rights of the Designated Traders in the order management and execution systems were not properly defined until 30 March 2016, such that there were instances where the Designated Traders were granted access rights to trading information for both agency orders and facilitation orders. Further, CLSA's procedural manual governing facilitation trading activities was only issued in March 2016.
10. In short, CLSA failed to put in place controls to prevent the co-mingling of agency execution and facilitation trading functions until March 2016 and breached the Code of Conduct and the Internal Control Guidelines.

*Notification to the SFC under paragraph 12.5 of the Code of Conduct*

11. Paragraph 12.5 of the Code of Conduct requires a licensed corporation to report to the SFC immediately any suspected or actual material breach of any applicable legal and regulatory requirements by itself or persons it employs or appoints to conduct business with clients.
12. In 2013, CLSA learnt that its licensed representatives were being investigated by an overseas regulator in relation to certain trades that might have violated the relevant overseas regulatory requirements. The Review found that CLSA's senior management was formally informed of the overseas investigations in the monthly compliance report in April 2013 and a memorandum setting out findings of the incident and the potential sanctions was issued by CLSA's legal team in June 2013.
13. However, CLSA did not report the matter to the SFC until February 2015, after it had received notices from the overseas regulator proposing to take disciplinary action against the relevant licensed representatives.
14. The Review noted that the failure to report to the SFC in 2013 appears to be an oversight of CLSA's legal and compliance team and that its senior management might have either underestimated the possibility of the overseas investigations turning into disciplinary action, or were unaware of the regulatory reporting requirements under paragraph 12.5 of the Code of Conduct.
15. The SFC does not consider oversight to be an excuse for a failure to properly discharge the reporting duty of a licensed corporation under paragraph 12.5 of the Code of Conduct.

## **Conclusion**

16. In coming to the decision to resolve the abovementioned failures concerning CLSA's internal controls, the SFC took into account all relevant circumstances, including that they:
  - (a) took initiative to bring this matter to a conclusion by cooperating fully with the SFC in resolving the regulatory concerns; and
  - (b) undertook a review with the SFC to address the regulatory concerns and identify deficiencies in its internal controls.
17. The SFC also took into consideration the undertaking of CLSA's board of directors that reasonable steps will be implemented within the next 12 months to rectify CLSA's internal control failures in relation to avoidance of conflicts of interest.