

# SFC reprimands and fines Guotai Junan Securities (Hong Kong) Limited \$25.2 million for breaches relating to anti-money laundering and other regulatory requirements

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The Securities and Futures Commission (SFC) has reprimanded and fined Guotai Junan Securities (Hong Kong) Limited (Guotai Junan) \$25.2 million for multiple internal control failures and regulatory breaches in connection with anti-money laundering, handling of third party fund transfers and placing activities, as well as detection of wash trades and late reporting (Note 1).

## *Third party fund transfers*

The SFC investigation found that, **between March 2014 and March 2015**, Guotai Junan failed to take reasonable measures to ensure that proper safeguards were put in place to mitigate the risks of money laundering and terrorist financing in **processing 15,584 third party deposits or withdrawals for its clients, totalling approximately \$37.5 billion.**

Despite **red flags suggesting some of the third party fund transfers were unusual or suspicious**, Guotai Junan failed to adequately monitor the activities of its clients, conduct appropriate scrutiny of the fund transfers, identify transactions that were suspicious and report them to the Joint Financial Intelligence Unit in a timely manner (Note 2).

Guotai Junan also did not ensure that its policies and procedures regarding anti-money laundering and counter-financing of terrorism (AML/CFT) were properly and effectively implemented with respect to third party fund transfers. Specifically, the SFC found that there were:

- a number of occasions where the reasons for the third party fund transfers, the relationship between the client and the third party, and/or the identity of the third parties were not documented and identified;
- inadequate guidance to its staff on the extent of enquiries they had to make with clients in relation to the third party fund transfers;
- inadequate procedures requiring its money laundering reporting officer to play an active role in identifying suspicious transactions; and
- inadequate communication between its operations and compliance staff to ensure effective monitoring of client activities.

In addition, Guotai Junan processed **5,406 third party deposits from July 2015 to June 2016 without always documenting the identity of the depositors, their relationship with the account holders, and the reasons for these third party deposits**, contrary to the firm's written policies and procedures.

It further failed to identify that **two deposits totalling \$38.2 million for a share subscription in December 2015 did not come from the relevant client but a third party**, nor did it have written procedures for the identification of third party deposits until around September 2016.

## *Placing activities*

While acting as the **placing agent for the global offering of a Hong Kong-listed company's shares between December 2015 and January 2016**, Guotai Junan failed to take reasonable steps to ascertain whether the clients' subscription applications were consistent with its knowledge of their background and source of funds, and make appropriate enquiries when there were grounds for suspicion.

In particular, the **funds used by five clients to subscribe for \$28.8 million worth of the listed company's shares were deposited by the same third party into the respective client accounts in amounts far exceeding their self-declared net worth.**

Despite such red flags, Guotai Junan did not take reasonable steps to verify the ultimate beneficial owners of the clients' accounts and their source of funds, nor make appropriate enquiries to ascertain whether the clients were independent of the listed company. In the end, **three of the five places, who were allotted 11% of the listed company's shares of the total placing under the international tranche,**

turned out to be the listed company's employees (Note 3).

#### *Detection of wash trades and reporting obligation*

The SFC further found that Guotai Junan failed to detect 590 potential wash trades in a timely manner between January 2014 and July 2016 due to a lack of adequate written trade monitoring procedures or guidelines and technical failures of its transaction pattern monitoring system.

However, despite becoming aware in July 2016 of 210 potential wash trades which could not be detected in a timely manner as a result of the system failure, Guotai Junan did not report these 210 trades to the SFC until seven months later in February 2017.

The above-mentioned findings led the SFC to come to the view that Guotai Junan's conduct failed to comply with regulatory requirements under the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance, the Guideline on Anti-Money Laundering and Counter-Terrorist Financing, the Internal Control Guidelines and the Code of Conduct (Notes 4 & 5).

In deciding the disciplinary sanction, the SFC took into account that:

- there were multiple AML/CFT related failures and Guotai Junan was handling a substantial number or amount of third party fund transfers;
- Guotai Junan's failures in complying with AML/CFT requirements lasted for an extensive period of time, including its failure to put in place written procedures to identify third party deposits from September 2009 - when the Prevention of Money Laundering and Terrorist Financing Guidance Note came into effect - to around September 2016;
- while the failures in the transaction pattern monitoring system were primarily attributable to the third party vendor, Guotai Junan failed to detect wash trades for more than two years and around 590 potential wash trades were not detected;
- the SFC has sent a clear message in previous disciplinary cases that licensed corporations are required to report misconduct to the SFC immediately upon discovery of such misconduct;
- a strong message is necessary to deter similar misconduct;
- Guotai Junan has taken prompt remedial measures to rectify the deficiencies in its trade monitoring system and procedures once identified, and has proactively enhanced its policies and procedures in relation to AML/CFT; and
- in resolving the SFC's concerns, Guotai Junan undertook to provide the SFC with a report prepared by an independent reviewer within 12 months confirming that all the identified concerns were properly rectified.

"The disciplinary action against Guotai Junan for serious systemic deficiencies and failures across its internal controls should serve as a stark reminder to licensed corporations the importance of having adequate and effective safeguards in place to mitigate the real risk of becoming a conduit to facilitate illicit activities, such as money laundering, when exposed to potentially suspicious transactions," said Mr Thomas Atkinson, the SFC's Executive Director of Enforcement.

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Notes:

1. Guotai Junan is licensed under the Securities and Futures Ordinance to carry on Type 1 (dealing in securities) and Type 4 (advising on securities) regulated activities.
2. Red flags revealed in a review of some of the fund transfers include: (i) frequent fund transfers to and from third parties that were unrelated to the client, or whose relationship with the client was unverified or difficult to verify; (ii) transactions which have no apparent legitimate purpose and/or appear not to have a commercial rationale, and/or out of the ordinary range of services normally requested of a licensed corporation; (iii) instances where the source of funds was unclear or not consistent with the client's profile; (iv) unnecessary routing of funds from/to third parties or using the account as a conduit for transfers; and (v) large or unusual cash settlements.
3. Pursuant to paragraph 7 of Appendix 6 (Placing Guidelines for Equity Securities) to the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited, not more than 10% of the total placing may be offered to employees or past employees of the applicant.
4. Management, Supervision and Internal Control Guidelines for Persons Licensed by or Registered with the Securities and Futures Commission.
5. Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission.

[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 Guotai Junan Securities (Hong Kong) Limited (**Guotai Junan**) HK\$25.2 million pursuant to section 194 of the Securities and Futures Ordinance.
2. The disciplinary action is taken because Guotai Junan:
  - (a) failed to take all reasonable measures to ensure that proper safeguards existed to mitigate the risks of money laundering and terrorist financing with respect to third party fund transfers, as it failed to:
    - (i) adequately monitor the activities of its clients, conduct appropriate scrutiny of the third party deposits/withdrawals which it processed for its clients, and identify transactions that were suspicious and report them to the Joint Financial Intelligence Unit (**JFIU**) in a timely manner;
    - (ii) ensure that its policies and procedures regarding anti-money laundering and counter-financing of terrorism (**AML/CFT**) were properly and effectively implemented; and
    - (iii) put in place written procedures to identify third party deposits;
  - (b) while acting as the placing agent for the global offering of the shares of a listed company (**Listed Company**), failed to:
    - (i) conduct proper enquiries and sufficient scrutiny on third party deposits into client accounts which were unusual and/or suspicious and inconsistent with the clients' declared net worth and annual income; and
    - (ii) take reasonable steps, and implement effective systems and procedures, to ascertain whether the placees' subscription applications were consistent with its knowledge of their background and source of funds, and make appropriate enquiries when there were grounds for suspicion; and
  - (c) failed to put in place effective system and control procedures to detect wash trades and report the material errors or defects of its trade monitoring system to the SFC in a timely manner.

### Summary of facts and breaches

- A. *Lack of proper safeguards to mitigate the risks of money laundering and terrorist financing in relation to third party fund transfers***
3. The SFC investigation found that Guotai Junan processed 15,584 third party deposits/withdrawals totalling approximately HK\$37.5 billion for its clients between March 2014 and March 2015 (**Relevant Period A**), and it processed a further 5,406 third party deposits from July 2015 to June 2016 (**Relevant Period B**).

*Failure to adequately monitor client activities and scrutinise third party deposits/withdrawals during Relevant Period A*

4. The third party deposits/withdrawals and the activities in some of the clients' accounts fell within the situations which might give rise to suspicion as set out in the Guideline on Anti-Money Laundering and Counter-Terrorist Financing (**AML Guideline**) and Guotai Junan's internal policies.

(a) *Frequent fund transfers to or from third parties that are unrelated, unverified or difficult to verify*

(i) Among the 15,584 third party deposits/withdrawals executed for its clients, 11,501 were allegedly made between "friends" whose relationship was difficult to verify.

(ii) On a sample review of the activities of 7 clients of Guotai Junan (the **7 Clients**), the SFC found that there were frequent and significant sums of monies transferred between 6<sup>1</sup> of the 7 Clients' accounts and third parties who were unrelated to these clients and/or whose identities were unknown to Guotai Junan or not verified by Guotai Junan.

(iii) In the account of 1 of the 7 Clients, there were frequent transfers to 6 different clients of Guotai Junan which were all of the same amount and just below the HK\$2 million threshold which would trigger the obligation of Guotai Junan's staff to report the transfer to Guotai Junan's Compliance Officer and/or Money Laundering Reporting Officer (**MLRO**) under Guotai Junan's policies.

(b) *Transactions which have no apparent legitimate purpose and/or appear not to have a commercial rationale, and/or is out of the ordinary range of services normally requested of a licensed corporation*

(i) Although Guotai Junan's clients were asked to provide a reason for the third party deposits/withdrawals and their relationship with the third party, the reason or the relationship given often lacked particulars to enable Guotai Junan's staff to reasonably understand the purpose of the fund transfers.

(ii) For example, "往來 (incoming and outgoing)" was stated to be the reason for the transfers on 4,956 occasions. Although the reason given by the clients was vague and did not properly explain the purpose of the transfers, Guotai Junan accepted these transfers without question.

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<sup>1</sup> Among the 7 Clients' accounts reviewed by the SFC, 6 of them were accounts with frequent and/or substantial third party deposits/withdrawals, and 1 appeared to have unusual cash deposits from third parties.

- (iii) “朋友 (friend)”, “業務 (business)”, or “生意伙伴 (business partner)” was usually given as the client’s relationship with the third party, and “還款 (repayment)”, “往來 (incoming and outgoing)”, “借款 (loan)”, “合作投資 (co-operative investment)”, or “朋友代轉 (transfer on behalf of friend)” was often given as the reason for the transfers without any further elaboration. None of the reasons given could properly explain why the clients had to use their securities accounts at Guotai Junan, which should have been used primarily for trading in securities, to receive or route funds from/to third parties.
  - (iv) There were also occasions when the client gave no details of the third party depositor and did not explain the reason for using his/her securities account to receive the deposit. These were also accepted by Guotai Junan without question.
- (c) *Source of funds is unclear or not consistent with the client’s profile*
- (i) The initial deposits made into the accounts of 2 of the 7 Clients (a total of over HK\$77 million and HK\$39 million respectively) were all from third parties who were not clients of Guotai Junan and whose identities were not verified by Guotai Junan. The source of the funds deposited into these Clients’ accounts was also unclear.
  - (ii) The activities in the accounts of 3 of the 7 Clients were inconsistent with their net worth and/or annual income as recorded in their account opening documentation. For example, 1 of the 7 Clients claimed to be a “自由投資者 (investor)” with an annual income under HK\$500,000 and a net worth under HK\$2,500,000. However, Guotai Junan’s records show that he withdrew and transferred a total of over HK\$185 million to 4 third parties and a total of over HK\$167 million to 6 third parties in February 2015 and March 2015 respectively.
  - (iii) In a Withdrawal Instruction Form regarding a transfer of over HK\$43 million from the account of 1 of the 7 Clients to a third party, it was stated that the third party was his “僱主 (employer)”. This was, however, inconsistent with the information recorded in his account opening documentation which stated that he was a “自由投資者 (investor)” with no indication that he was employed.
- (d) *Unnecessary routing of funds from/to third parties or using the account as a conduit for transfers*

The account of 1 of the 7 Clients received a total sum of over HK\$39 million through 11 separate deposits from unverified third parties from 7 May 2014 to 15 May 2014, and the entire sum was transferred to a third party on 16 May 2014. The amount substantially exceeded that Client’s declared net worth, and there was no securities trading in the account between 7 and 16 May 2014. The account might have been used as a depository account or a conduit for transfers.

(e) *Large or unusual cash settlements*

On 2 consecutive trading days, 22 separate cash deposits (involving a total of over HK\$2 million) were made into the account of 1 of the 7 Clients.

5. Notwithstanding the numerous red flags which suggest that some of the third party deposits/withdrawals might be unusual and/or appeared suspicious, Guotai Junan and its staff failed to make proper enquiries in relation to those transactions and/or identify them as suspicious transactions and bring them to the attention of its Legal & Compliance Department (**LCD**):

(a) Operations staff was responsible for reviewing and approving third party deposits/withdrawals, conducting enquiries with the clients and identifying suspicious transactions to be reported to LCD. However, they did not properly scrutinise these fund transfers and make appropriate enquiries with the clients to ensure that they understood the purpose of the fund transfers or maintain proper records of enquiries made (if any):

- (i) Guotai Junan did not obtain any information from the clients in relation to a number of third party deposits/withdrawals. It has no records of the reasons for such transfers and the clients' relationship with the third parties.
- (ii) On occasions where Guotai Junan had obtained information from the clients about the third party deposits/withdrawals, its Operations staff would accept the clients' explanation without making further enquiries. For example, if a client stated that his/her relationship with the third party was "business partner", Operations staff would not ask the client to provide supporting documents to support the claim.
- (iii) Guotai Junan told its staff in AML/CFT training that it did not accept "朋友 (friend)" as a proper explanation for third party transfers. However, it continued to process third party deposits/withdrawals for clients allegedly made from/to their friends. Guotai Junan did not conduct further enquiries or reject the transfers when the client simply stated that the third party was a friend.
- (iv) Guotai Junan would routinely accept third party deposits/withdrawals even if the reason provided by the clients (e.g. "往來 (incoming and outgoing)") was vague and not supported by any particulars to enable Guotai Junan to properly understand the purpose of the transaction.
- (v) Guotai Junan did not make appropriate enquiries on the source of clients' funds and evaluate whether they were consistent with the clients' profile.
- (vi) Guotai Junan's policy states that any fund-in cash over HK\$1,000 would generally not be accepted for settlement of transactions. Although there was a large number of cash deposits over HK\$1,000 in one of the Clients' account, Guotai Junan approved these cash deposits and there is no record to show that it made any enquiries about these cash deposits.

- (b) Guotai Junan only reported certain suspicious transactions in the account of 1 of the 7 Clients to the JFIU. It was only when the SFC made enquiries during its inspection that Guotai Junan identified and gradually reported other suspicious transactions in the 7 Clients' accounts to the JFIU. These suspicious transactions were reported to the JFIU around half a year to a year after the relevant transactions took place.
6. Guotai Junan's failures summarised in paragraphs 4 to 5 above constitute a breach of section 5(1) of Schedule 2 to the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance (**AMLO**) and paragraphs 5.1, 5.10 and 5.11 of the AML Guideline which requires a licensed corporation to continuously monitor its business relationship with its clients including:
- (a) monitoring the activities (including cash and non-cash transactions) of the clients to ensure that they are consistent with the nature of business, risk profile and source of funds;
  - (b) identifying transactions that are complex, large or unusual or patterns of transactions that have no apparent economic or lawful purpose and which may indicate money laundering and/or terrorist financing;
  - (c) making relevant enquiries, examining the background and purpose, including where appropriate the circumstances, of the transactions;
  - (d) reporting suspicious transactions to the JFIU in a timely manner; and
  - (e) documenting the findings and outcomes of its examinations in writing to assist the relevant authorities.

*Failure to ensure that Guotai Junan's AML/CFT policies and procedures were properly and effectively implemented during Relevant Period A and Relevant Period B*

7. Although Guotai Junan had AML/CFT policies which covered the handling of third party deposits/withdrawals at the material time, the SFC found that Guotai Junan did not have appropriate measures in place to ensure that such policies and procedures would be properly and effectively implemented:
- (a) Guotai Junan's staff was required under its policy to report suspicious transactions to the Compliance Officer or the MLRO. However, the activities in most of the 7 Clients' accounts were not brought to the Compliance Officer/MLRO's attention. There did not appear to be any monitoring by senior management on how Operations staff assessed whether a particular transaction was suspicious. The Head of Operations would only randomly review the clients' third party deposit/withdrawal instructions and check if the forms were completed properly.
  - (b) Operations staff was required under Guotai Junan's policy to enquire with the clients the reasons for the third party transfers and the relationship between the client and the third party, and document the reasons in the Third Party Fund Deposit Instruction or the Withdrawal Instruction Form. However:

- (i) the SFC's investigation into the third party transfers during Relevant Period A shows that:
  - a. Guotai Junan did not provide adequate guidance to its staff on the extent of enquiries they had to make with clients about the reasons for the transfers and their relationship with the third parties.
  - b. There were a number of occasions where the reasons for the third party deposits/withdrawals, the relationship between the client and the third party and/or the identity of the third parties were not documented and such omissions were not identified by the Head of Operations during his random review.
  - c. In relation to third party withdrawals, it was specifically stated in the Withdrawal Instruction Form that if the beneficiary was a third party, the withdrawal instruction would not be processed unless the client's relationship with the third party and the reason for the third party to receive the funds were set out in the form. It was found that this requirement was not implemented by Guotai Junan in practice, as there were occasions when third party withdrawals were approved even when the requisite information was not provided by the clients.
  - d. In relation to third party deposits, although Guotai Junan's policy requires its Operations staff to use a "Third Party Fund Deposit Instruction" to document the reason for the deposits and the relationship between the client and the third party, such a form was not used by Operations staff in practice to record their enquiries with the clients about the deposits. The reasons for the deposits were usually just briefly written on the deposit slips.
- (ii) Guotai Junan's records for the third party deposits during Relevant Period B show that:
  - a. of the 4,034 third party deposits between July and December 2015:
    - i. the identity of the depositor for 527 third party deposits was missing; and
    - ii. the depositor's identity, the customer's relationship with the depositor and the reason for the deposits were all missing in at least 13 third party deposits; and
  - b. of the 1,372 third party deposits between January and June 2016, 97 of them were made through bank transfers or cheques, contrary to Guotai Junan's policies and procedures effective at the material time, that all third party deposits made through transfers, remittances, or cheques were not accepted.
- (c) The guidance provided by Guotai Junan in its AML/CFT training to its staff that the firm did not accept "朋友 (friend)" as a proper explanation for third party transfers was not reflected in Guotai Junan's policies. There were no measures in place to ensure that this was implemented in practice.



- (d) Operations staff gave conflicting evidence on who would approve the third party deposits/withdrawals. The Operations manager said that whilst he would review and approve the transfers, the Head of Operations would have a final review before the fund transfers were processed. The Head of Operations, however, said that he would only randomly review these transfers.<sup>2</sup>
8. The SFC found that Guotai Junan's failure to ensure that its Operations staff was fully equipped with the knowledge to scrutinise third party deposits/withdrawals and identify suspicious transactions to be serious, as Guotai Junan relied heavily on Operations staff to identify and report suspicious transactions to LCD who would then assess if the transactions should be further reported to the JFIU:
- (a) Evidence of the Operations staff and LCD staff shows that Operations was responsible for identifying suspicious transactions and referring them to LCD. LCD would not know that a transaction was suspicious unless it was first identified by Operations.
- (b) There were no procedures requiring the MLRO or the Compliance Officer to conduct regular review of clients' deposits/withdrawals. LCD would not be provided with reports in relation to clients' daily fund transfers. Guotai Junan did not have an automated transaction monitoring system and relied heavily on Operations staff to assess clients' activities and identify suspicious transactions.
9. Guotai Junan's procedures did not require its MLRO to play an active role in identifying suspicious transactions. This was contrary to the guidance set out in paragraph 7.21 of the AML Guideline. The Director of LCD asserted that he was not aware that he was the MLRO of Guotai Junan until around September 2015. His evidence gives rise to further concerns as to his understanding of his role in identifying and reporting suspicious transactions.
10. Evidence further shows that there was inadequate communication between LCD and Operations to ensure that there was effective monitoring of clients' activities. LCD was not required to inform Operations after it had reported suspicious clients' activities to the JFIU, nor would it request Operations to scrutinise the relevant clients' activities more closely to mitigate the risks of money laundering and/or terrorist financing.

*Failure to put in place written procedures to identify third party deposits*

11. Guotai Junan failed to identify that 2 deposits totalling HK\$38.2 million for a share subscription in December 2015 did not come from the relevant client but a third party. The SFC discovered that Guotai Junan did not have written procedures for the identification of third party deposits until around September 2016.
12. The written policies and procedures of Guotai Junan before September 2016 only provided for steps to be taken if third party deposits were identified. There were no procedures to identify third party deposits and the identity of the depositor was not checked.

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<sup>2</sup> The lack of clear procedures on approval of the third party deposits/withdrawals is contrary to the expectation set out in the "Circular to Licensed Corporations and Associated Entities – Anti-Money Laundering / Counter Financing of Terrorism – Suspicious Transactions Monitoring and Reporting" issued by the SFC on 3 December 2013 that such fund transfers should be discouraged and should only be accepted after approvals have been obtained from the designated senior staff member.

13. Guotai Junan claimed that after 1 January 2016, the cheque copy would be obtained for a cheque deposit from a high risk customer or if it was over a certain amount to determine if the deposit was from a third party. However, it was not until around September 2016 that Guotai Junan had procedures to a similar effect set out in its written policies, but which only stated that Operations staff should ensure that the cheque issuer is the same as the account holder for cheque deposits, and that the remitter is the same as the account holder for bank transfers.
14. Guotai Junan's failures summarised in paragraphs 7 to 13 above constitute a breach of section 23 of Schedule 2 to the AMLO and paragraph 2.1 of the AML Guideline which require a licensed corporation to take all reasonable measures to ensure that proper safeguards exist to mitigate the risks of money laundering and terrorist financing, and to prevent a contravention of any customer due diligence and record-keeping requirements under the AMLO. To ensure compliance with this requirement, a licensed corporation should implement appropriate internal AML/CFT policies, procedures and controls.
15. Guotai Junan's failure to identify third party deposits, which may potentially be suspicious transactions, also breached paragraph 5.1 of the AML Guideline (see paragraph 6 above).
16. In view of Guotai Junan's failure to comply with relevant provisions of the AMLO and the AML Guideline as set out in paragraphs 6, 14 and 15 above, Guotai Junan also failed to comply with General Principle 7 and paragraph 12.1 of the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (**Code of Conduct**), which require licensed corporations to comply with, and implement and maintain measures appropriate to ensuring compliance with, all regulatory requirements applicable to the conduct of their business activities.

**B. Failures in relation to the Listed Company's placing activities**

17. Guotai Junan was the sole global coordinator, sole bookrunner and sole lead manager of the listing application of the Listed Company on the Main Board of The Stock Exchange of Hong Kong Limited.
18. In January 2016, an aggregate of 21,338,000 shares of the Listed Company were placed by or through Guotai Junan to 5 placees (**5 Placees**) for the total consideration of HK\$28.8 million. The 5 Placees settled their allocations with funds deposited to their Guotai Junan accounts from a third party company.

*Failure to conduct proper enquiries and sufficient scrutiny on third party deposits*

19. On 29 December 2015, Guotai Junan received 5 fund transfer instructions (collectively, **Transfer Instructions**). The Transfer Instructions showed that 5 deposits, in the total sum of HK\$29,103,610, were made by a company to Guotai Junan's bank account. Each of the Transfer Instructions contained similar handwritten notes instructing Guotai Junan to deposit certain amount of funds into the respective accounts of the 5 Placees. According to the Transfer Instructions, the 5 Placees had entrusted their friend's company to deposit the money on their behalf because they were not able to come to Hong Kong on time.

20. The third party deposits appear unusual and suspicious in light of the following circumstances:
- (a) the 5 Placees applied to open securities accounts with Guotai Junan on the same day;
  - (b) the 5 Placees all lived in Zhejiang Province and their employment, annual income and net worth as declared in their account opening forms were identical;
  - (c) the 5 deposits amounting to HK\$29,103,610 were transferred from the same third party company to the bank account of Guotai Junan on the day after the accounts of the 5 Placees were opened with Guotai Junan;
  - (d) the Transfer Instructions were sent to Guotai Junan from unknown sender(s) via 2 facsimiles within a short period of time;
  - (e) the Transfer Instructions contained similar handwritten notes and were not signed by the 5 Placees; and
  - (f) the amount of the third party deposit received by each of the 5 Placees substantially exceeded the annual income and net worth as declared in their respective account opening forms.
21. Notwithstanding the above red flags, Guotai Junan accepted the third party deposits and effected the fund transfers in accordance with the Transfer Instructions without making any enquiries.

*Failure to conduct proper enquiries and sufficient scrutiny on the 5 Placees' subscriptions*

22. The Equity Capital Market Department (**ECM Department**) of Guotai Junan was responsible for handling the 5 Placees' subscription applications.
23. The relevant staff members of the ECM Department were not aware that the funds used by the 5 Placees for subscribing the placing shares were transferred from the same third party company. They did not review the account opening documents of the 5 Placees, nor did they check the source of funds used by the 5 Placees to settle their subscriptions.
24. Notwithstanding the red flags described at paragraph 20 above, which raised suspicions as to whether the 5 Placees were the beneficial owners of their accounts and were independent of the Listed Company, Guotai Junan did not:
- (a) take reasonable steps to verify the ultimate beneficial owners of the 5 Placees' accounts and their source of funds; and
  - (b) apart from relying on the 5 Placees' declarations of independence in their subscription forms and placing letters, make appropriate enquiries to ascertain whether they were independent of the Listed Company.
25. 3 of the 5 Placees were subsequently revealed to be the Listed Company's employees. A total of 12,758,000 shares of the Listed Company were allotted

to these 3 employees, representing 11% of the total placing under the international offering.<sup>3</sup>

26. Based on the above circumstances, Guotai Junan has failed to:
- (a) diligently monitor the 5 Placees' activities to ensure that they were consistent with its knowledge of the 5 Placees;
  - (b) take steps to ensure that the information of the 5 Placees obtained during account openings was up-to-date and relevant given the mismatch between the 5 Placees' declared net worth and their subscription amounts; and
  - (c) make appropriate enquiries to address the risks associated with the 5 Placees' subscription applications and take all reasonable steps to establish the true and full identity of the 5 Placees and their financial situation in light of the red flags mentioned above.
27. Guotai Junan's failures summarised in paragraphs 19 to 26 above constitute a breach of:
- (a) General Principle 2 of the Code of Conduct, which requires a licensed corporation to act with due skill, care and diligence, in the best interests of its clients and the integrity of the market in conducting its business activities;
  - (b) paragraph 5.1 of the Code of Conduct, which requires a licensed corporation to take all reasonable steps to establish the true and full identity of each of its clients, and of each client's financial situation, investment experience, and investment objectives;
  - (c) paragraph 4.7.12 of the AML Guideline, which requires a licensed corporation to take steps from time to time to ensure that the client information that has been obtained for the purposes of complying with the client due diligence and record-keeping requirements are up-to-date and relevant; and
  - (d) section 5(1) of Schedule 2 to the AMLO and paragraphs 5.1, 5.10 and 5.11 of the AML Guideline (see paragraph 6 above).
28. Guotai Junan's conduct also demonstrated its failure to put in place adequate and effective systems and procedures in breach of General Principle 3 of the Code of Conduct, which requires a licensed corporation to have and employ effectively the resources and procedures which are needed for the proper performance of its business activities.

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<sup>3</sup> Pursuant to paragraph 7 of Appendix 6 (Placing Guidelines for Equity Securities) to the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited, not more than 10% of the total placing may be offered to employees or past employees of the applicant.

### ***Failure to detect wash trades and late reporting***

29. The SFC found that Guotai Junan failed to detect a total of 590 potential wash trades in a timely manner between January 2014 and July 2016.
30. Guotai Junan lacked adequate written trade monitoring procedures or guidelines before June 2016. Whilst various versions of Guotai Junan's Compliance Manual and other written policies in force prior to June 2016 did refer to wash trades, they did not set out in detail the procedures to detect wash trades.
31. With respect to post-trade surveillance, Guotai Junan implemented a transaction pattern monitoring system provided by a third party vendor in or around December 2014. However, the system experienced technical failures from December 2014 to July 2016 and was therefore unable to generate any alert of suspicious activity during that period.
32. The system failures were left undetected by Guotai Junan for around a year.
33. On 30 June 2016, Guotai Junan was notified about the failure in its transaction pattern monitoring system. In July 2016, Guotai Junan became aware of the 210 potential wash trades between October 2015 and July 2016 which could not be detected in a timely manner. However, Guotai Junan did not report these 210 trades to the SFC until 10 February 2017 (i.e. around 7 months later) when it responded to the SFC's enquiry on 25 January 2017 regarding other trades that might not be in compliance with regulatory requirements.
34. Guotai Junan's failures summarised in paragraphs 29 to 33 above constitute a breach of:
  - (a) General Principle 2 of the Code of Conduct (see paragraph 27(a) above);
  - (b) General Principle 3 of the Code of Conduct (see paragraph 28 above);
  - (c) General Principle 7 and paragraph 12.1 of the Code of Conduct (see paragraph 16 above);
  - (d) paragraph 12.5 of the Code of Conduct, which requires licensed persons to report to the SFC immediately when there is any material breach or non-compliance with relevant regulatory requirements, or when they suspect any such breach or non-compliance;
  - (e) paragraph 2.1.1(b) of Schedule 7 of the Code of Conduct, which requires licensed corporations to put in place post-trade monitoring to reasonably identify any order instructions and transactions which may be manipulative or abusive in nature; and
  - (f) paragraph VII.8 of the Management, Supervision and Internal Control Guidelines for Persons Licensed by or Registered with the Securities and Futures Commission, which requires management of a licensed corporation to establish and maintain appropriate and effective procedures in relation to dealing and related review processes to prevent or detect errors, omissions, fraud and other unauthorised or improper activities, and which ensure the fair and timely allocation of trades effected on behalf of clients.

## Conclusion

35. Having considered all the circumstances, the SFC is of the view that Guotai Junan is guilty of misconduct, and its internal control failures and regulatory breaches set out above have called into question its fitness and properness to remain a licensed corporation.
36. 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:
  - (a) there were multiple AML/CFT related failures and Guotai Junan was handling a substantial number or amount of third party deposits/withdrawals;
  - (b) Guotai Junan's failures in complying with AML/CFT requirements lasted for an extensive period of time – its failure to put in place written procedures to identify third party deposits lasted from September 2009 (when the Prevention of Money Laundering and Terrorist Financing Guidance Note came into effect)<sup>4</sup> to around September 2016;
  - (c) while the failures in the transaction pattern monitoring system were primarily attributable to the third party vendor, Guotai Junan failed to detect wash trades for more than 2 years and around 590 potential wash trades were not detected;
  - (d) the SFC has sent a clear message in previous disciplinary cases that licensed corporations are required to report misconduct to the SFC immediately upon discovery of such misconduct;
  - (e) a strong message is necessary to deter similar misconduct;
  - (f) Guotai Junan has taken prompt remedial measures to rectify the deficiencies in its trade monitoring system and procedures once identified, and has proactively enhanced its policies and procedures in relation to AML/CFT; and
  - (g) in resolving the SFC's concerns, Guotai Junan undertook to provide the SFC with a report prepared by an independent reviewer within 12 months confirming all the identified concerns are properly rectified.

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<sup>4</sup> Paragraph 6.1.2(d) of the Prevention of Money Laundering and Terrorist Financing Guidance Note dated September 2009 provides that licensed corporations were required to conduct ongoing due diligence and scrutiny on the transactions and account throughout the course of the business relationship to ensure that the transactions being conducted are consistent with its knowledge of the customer, its business and risk profile, taking into account, where necessary, the customer's source of funds.