

Customer Supplied Systems Surveillance

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Background

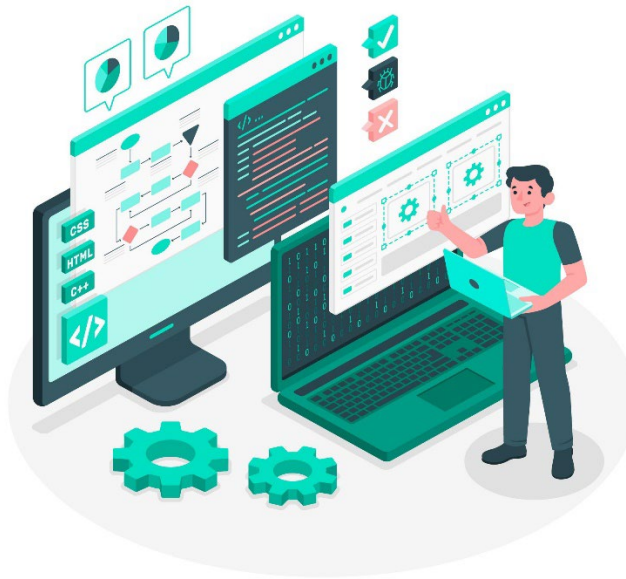
The SFC has recently taken disciplinary action against a broker carrying on Type 2 regulated activity (i.e. dealing in futures contracts) for deficiencies in due diligence check on clients' designated customer supplied system ("**CSS**") and in other issues. The broker had allowed some clients to place orders by CSS designed and set by the clients during the relevant period, but had omitted to carry out effective due diligence check on CSS. The omission had resulted in failure to comply with the anti-money laundering and other regulatory regulations.



Neglect to monitor and verification

1. **CSS:** The broker had required clients to complete an “application form and risk disclosure statement” and a “due diligence form stating, among others, the reasons for the application” before permitting the clients to connect CSS to broker’s own systems (i.e. Broker Supplied Systems). It is however found that CSS was still approved, albeit the features thereof were not identified. In addition, broker’s test of CSS was limited to check whether CSS was compatible with broker’s own systems, instead of ensuring that all features and functions of CSS were identified and verified. The above deficiencies may have triggered the broker’s failure to properly prevent money laundering and other risks from arising.

2. **Customer Statement:** The SFC revealed that the amounts deposited into the accounts of two clients were not commensurate with their financial profiles declared in their account opening documents. It is unfortunate that the broker had only required written confirmation from the clients without further verification.



3. **Ongoing monitoring system:** The above two clients conducted frequent and massive number of trades in their accounts, and there were many instances where buy and sell orders for the same futures contracts were placed by the same client, in the same second, and at the same price. The SFC opined that the broker had not established an effective ongoing monitoring system to effectively monitor frequent trade instructions.

Grounds of disciplinary action

In the disciplinary action, the broker was fined and reprimanded pursuant to (i) General Principles 2 and 3 of the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission; (ii) Schedule 2 to the Anti-Money Laundering and Counter-Terrorist Financing Ordinance; and (iii) the Guideline on Anti-Money Laundering and Counter-Terrorist Financing.

Conclusion

The above disciplinary action is not an isolated example. The SFC has recently taken disciplinary actions against a number of brokers for deficiencies in due diligence and ongoing monitoring of CSS. It is therefore recommended that brokers should conduct meticulous due diligence check on CSS to understand and verify CSS's features (e.g. whether sub-accounts are permitted to be created; third-party is delegated with authority to operate CSS; and algorithmic trade functions are embedded).

