

BDO NEWS

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To maintain the financial stability and facilitate the economic growth of Hong Kong, regulators have been reviewing different regulations and guidelines regularly. Regulators and financial institutions around the globe may have new developments. For the past months, the following incidents have happened:

UK SOX – Reform on audit and corporate governance in the United Kingdom

In March 2021, the UK Government has ambitious plans to strengthen the UK's audit and corporate governance framework, which will help companies build back stronger and better equipped to face tomorrow's challenges. It published proposal to hold of the largest companies to establish clearer responsibilities on detection and prevention of fraud, to empower shareholders and to increase choice and quality in the audit market. Crucially, these proposals also recognise the economic importance of the largest privately-owned companies by expecting them to meet the highest standards of reporting, alongside listed companies.

The reform covers the following areas among others:

1. Directors' accountability for internal controls, dividends and capital maintenance
2. New corporate reporting on resilience, assurance and payment practices
3. Strengthening the supervision of corporate reporting
4. Company directors: regulator's investigation and enforcement powers on directors' wrongdoing
5. Audit purpose and scope

In relation to internal controls, views are sought on different options, including the SOX like directors' statement on review of the effectiveness of their company's internal controls each year and auditor's opinion on the directors' annual attestation about the effectiveness of the company's internal controls, potentially limited to key internal controls over financial reporting. Further, there is also proposal on a new corporate auditing profession to operate independently of the professional accountancy bodies. For details, you may refer directly to the link to UK government's website below.

Similar to Hong Kong, UK already has rules within the Companies Act and UK Corporate Governance Code. However, facing the current corporate failures and long waited reform on the audit and corporate governance, increasing transparency and providing detailed guidance on the internal control practices are proposed measures to deal with the existing challenges. There are clear trends of increasing measures in enhancing the internal control and corporate governance in various countries. While SOX like requirements are not yet mandatory requirements in Hong Kong, strengthening our own internal control and corporate governance measures will certainly increase the attractiveness of our own companies for investors, financiers and other stakeholders in the capital market.

Read more from the source:

<https://www.gov.uk/government/publications/restoring-trust-in-audit-and-corporate-governance/restoring-trust-in-audit-and-corporate-governance>

Reprimanded and fined over short position reporting failures

In February 2021, the Securities and Futures Commission (SFC) reprimanded Brilliance Asset Management Limited (Brilliance) and fined it \$3.15 million over failures to ensure short position reports (SPRs) for four collective investment schemes (CISs) under its management were accurate and compliant with the requirements under the Securities and Futures (Short Position Reporting) Rules (SPR Rules).

Following two self-reports by Brilliance, the SFC conducted an investigation which found that Brilliance had prepared and submitted SPRs to the SFC for these four CISs between 8 July 2016 and 30 August 2019, but a total of 7,814 short positions held respectively by these CISs were either misstated or omitted in these reports.

The errors found in the SPRs prepared by Brilliance were the result of the following:

- Short position held through a broker were omitted due to failure in incorporating a new prime broker's code in its automated programme in its calculations of the short positions in the SPRs;

- Brilliance mistakenly calculated the short positions held by all CISs under its management on an aggregated basis, and reported all such short positions under the name of one of the four CISs; and
- Brilliance erroneously used data sources that included the market capitalisation of A-shares and non-listed shares of the issuers in calculating whether the net short positions held by the CISs exceed the 0.02 per cent reportable threshold instead of only using the market capitalisation of Hong Kong-listed shares as required by the SPR Rules in making the calculation.

The SFC considers that Brilliance had failed to act competently to ensure the SPRs it prepared would be accurate and compliant with the applicable requirements under the SPR Rules. Learning from this incident, it is important to review system setting and system parameters from time to time and diligently review the reasonableness of regulatory reports, short position reporting, in this case, to avoid any unnecessary regulatory investigation and fines.

Read more from the source:

<https://apps.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/doc?refNo=21PR20>

Reprimanded and fined for breaches due to third party fund transfers

On 17 March 2021, the Securities and Futures Commission (SFC) reprimanded and fined Yardley Securities Limited (YSL) \$5 million for failures in complying with anti-money laundering and counter-financing of terrorism (AML/CFT) regulatory requirements when handling third party fund transfers.

The SFC investigation found that, between February and October 2016, YSL failed to take all reasonable measures to ensure that proper safeguards exist to mitigate the risks of money laundering and terrorist financing.

Despite red flags suggesting that some of the third party fund transfers in two client accounts between February and May 2016 were unusual or suspicious, YSL processed and approved these transfers without conducting proper enquiries and sufficient scrutiny. In addition, YSL did not properly record enquiries it claimed to have made in relation to these transfers. Specifically, the SFC's investigation found that:

- YSL approved the third party transfers without documenting the reasons at the relevant time.
- The written evaluation forms for the transfers, which YSL prepared retrospectively to document the evaluation it claimed to have made, showed that YSL has failed to make adequate enquiries.
- There are no records of enquiries which YSL claimed to have made.

YSL also failed to have adequate policies, procedures, controls and provide adequate training to its staff to ensure compliance with the AML/CFT regulatory requirements. Specifically, the SFC's investigation found that:

- YSL had no written policies and procedures on AML/CFT until October 2016.
- YSL's staff were not aware of its AML/CFT policies and procedures, including those on suspicious transaction identification and the reporting of such transactions to the money laundering reporting officer (MLRO). The staff responsible for processing money deposits and withdrawals was not aware that YSL had an MLRO.
- YSL did not provide adequate AML/CFT training to its staff to ensure that they followed its policies.

The SFC has reprimanded and fined several times for licensed corporation's failure in compliance with the AML/CFT regulatory requirements in relation to third party transfers. This will certainly not be the last case.

Licensed corporations should not adopt a lax attitude in compliance with the AML/CFT requirements, especially when

handling a substantial amount of third party transfers in its clients' accounts. They should continuously identify and assess money laundering and terrorist financing risks and have in place effective internal controls and rules over their trading and settlement systems to minimise those risks.

Read more from the source:

<https://apps.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/enforcement-news/doc?refNo=21PR31>

How can BDO help?

It is important for financial institution and regulated entities to keep up with regulatory changes, review and update their internal monitoring system to keep up with those changes, and inform and continuously refresh their responsible staff through training or otherwise on those changes.

BDO has a dedicated team of experienced compliance consultants who have up-to-date knowledge on regulatory requirements and can provide services to institutions on reviewing their internal controls and compliance processes. Get in touch with us, if you need any help.

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