

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. In this month, the following has happened:

Sound risk management practices for algorithmic trading

The Hong Kong Monetary Authority (HKMA) conducted in 2018 a survey to understand the extent and nature of authorised institutions' (AIs) algo-trading activities. The results indicated that around 40% of the surveyed AIs already undertook algo-trading, most commonly in executing trade orders and marketmaking for foreign exchange-related transactions. A majority of these AIs indicated that they would expand the scale of algo-trading. Some of the surveyed AIs which did not engage in algo-trading reported that they had plans to do so.

In light of the survey results on 6 March 2020, the HKMA conducted in 2019 a round of thematic on-site examinations focused on algo-trading. Seven AIs, mainly international banks using algorithms for making investment decisions, were covered in the thematic examinations. The objective of the examinations was to assess the adequacy and effectiveness of AIs' risk management practices relating to algo-trading activities, including governance and oversight, development and testing of algorithms, and risk monitoring and controls.

In the course of the examinations, the HKMA observed a number of sound practices adopted by the more advanced AIs. As the survey suggests that algo-trading may become more prevalent in the banking industry, the HKMA considers it useful to

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set out its supervisory expectations around algo-trading and share the sound practices observed during the thematic examinations with all AIs. AIs engaged in algo-trading activities are expected to give due consideration to these supervisory expectations and sound practices when developing their risk management framework, having regard to the nature, scale and complexity of their algo-trading activities.

An effective risk management practices ensures efficient risk mitigation system in place. It creates the environment whereby authorised institutions well-aware of the majority of the risks involved in a particular algorithmic trading strategy and sustains their leading position in the financial markets.

Read more from the source:

<https://www.hkma.gov.hk/media/eng/doc/key-information/guidelines-and-circular/2020/20200306e1.pdf>

Market Misconduct Tribunal finds Magic Holdings International Limited and its directors culpable of late disclosure of inside information

On 25 March 2020, the Market Misconduct Tribunal (MMT) found that Magic Holdings International Limited (Magic) and five of its directors culpable of the company's failure to disclose in a timely manner inside information on L'Oréal S.A.'s (L'Oréal) proposed acquisition of Magic in 2013, as required under the corporate disclosure requirements of the Securities and Futures Ordinance (SFO).

The MMT was told that Magic and L'Oréal, a French cosmetics group, had discussions relating to the latter's acquisition proposal since early March 2013. In a meeting held on 27 April 2013, L'Oréal and Magic's founders agreed that an offer price of not less than \$5.5 per share would be put before Magic's board of directors for their consideration. Magic's founders indicated to L'Oréal that they would contact Magic's institutional investors to gauge their interest in the acquisition proposal and they would also support L'Oréal's request to Magic's board of directors to carry out due diligence. However, Magic did not disclose the information relating to L'Oréal's acquisition proposal to the public until August 2013.

The MMT considered that there was a commercial reality to the negotiations between Magic and L'Oréal and such negotiations had gone beyond testing the waters and that Magic had failed to disclose inside information to the public as soon as reasonably practicable. In the MMT's view, Magic's breach of the disclosure requirements was due to the fact that its directors were not informed in a timely manner of all information relevant to the determination of whether it was necessary to make disclosure about the potential acquisition by L'Oréal to the public.

The MMT hence found them had failed to carry out their

functions as the company's chairman and company secretary which resulted in Magic's breach of the corporate disclosure requirements. It also found that the five directors had failed to take all reasonable measures to ensure that proper safeguards existed within Magic to prevent it from breaching its disclosure obligation. The MMT will hold a hearing on the making of the consequential orders on 25 April 2020.

Read more from the source:

<https://www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/doc?refNo=20PR24>

Ex-HKEX senior executive and consultant charged with bribery and misconduct in public office over IPO applications

On 25 March 2020, the ICAC charged a former joint-head of the IPO Vetting Team of the Hong Kong Exchanges & Clearing Limited (HKEX) and an Initial Public Offering (IPO) consultant have been charged for alleged bribery and misconduct in public office (MIPO) involving a total of \$9.15 million in connection with the IPO applications of various listed companies.

The former joint-head of the IPO Vetting Team of the Listing Department of the HKEX is facing two charges – one of public servant accepting an advantage, contrary to Section 4(2)(a) of the Prevention of Bribery Ordinance (POBO); and one of MIPO, contrary to Common Law. The IPO consultant is facing one count of offering an advantage to a public servant, contrary to Section 4(1)(a) of the POBO.

At the material time, the former joint-heads overseeing the IPO Vetting Team of the Listing Department of the HKEX. He was responsible for vetting IPO applications for compliance with the Listing Rules and the Companies Ordinance, and endorsing recommendations of approval or rejection before those IPO applications were tabled to the Listing Committee or GEM Listing Approval Group. The IPO consultant providing advice and assistance to companies who intended to make IPO applications.

The misconduct in public office charge alleges that between 20 June 2017 and 30 April 2019, the joint-head of the IPO Vetting Team of the Listing Department of the HKEX, willfully misconducted himself in the course of or in relation to his public office, without reasonable excuse or justification as follows:

- allegedly concealed from or failed to declare or disclose to the HKEX the transfer of a total sum of \$9.15 million;
- allegedly failed to declare a conflict of interest in connection with his handling and processing of various IPO applications;
- allegedly failed to abstain from the deliberation and decision making in respect of those IPO applications;

- bribery charges alleges that on or about 21 December 2017, accepted a sum of \$2 million, without lawful authority or reasonable excuse, as an inducement to or reward for being or remaining favourably disposed to the IPO application; and
- bribery charge alleges that on or about 21 December 2017, offered the abovementioned \$2 million to for the same purpose without lawful authority or reasonable excuse.

The case arose from a corruption complaint referred by the Securities and Futures Commission (SFC). The SFC and the HKEX have rendered assistance to the ICAC during its investigation into the case.

Read more from the source:

https://www.icac.org.hk/en/press/index_id_903.html

Introducing the latest e-KYC models

On 1 April 2020, the FATF (Financial Action Task Force) issued an official statement encouraging 'the use of technology regarding to the current Covid-19 pandemic, including Fintech, Regtech and Suptech to the fullest extent possible' in light of social distancing measures, including for digital customer onboarding. To reflect this shift, over the past few years regulators have been slowly introducing new e-KYC guidelines to allow financial institutions to perform KYC checks and approve customer applications electronically, such as revised guidance on remote customer verification to help financial institutions ensure business continuity and compliant client onboarding during lockdowns. Overall, the latest e-KYC models could be summarised as the following four groups.

• Identity authentication & matching

Hong Kong's Anti-Money Laundering Ordinance and Counter-Terrorist Financing Ordinance (AMLO) – first published in 2011 – is the city's principle piece of legislation covering customer due diligence and record keeping requirements. It includes special requirements for when customers are not physically present for identification purposes but maintains a somehow high-level approach.

In February 2019 the HKMA (Hong Kong Monetary Authority) released an updated circular on 'remote on-boarding of individual customers'. The new guidance does not provide a specific checklist of actions to follow, but states that technology adopted for remote onboarding purposes should cover both identity authentication/verification and identity matching (eg facial recognition, liveness detection). The upside of this flexible model – which relies on identity documents plus liveness detection – is that it results in a broad ecosystem of solutions that is not prone to any one attack that could work across the whole financial system. A downside would be the uncertainties that relatively vague requirements

cause for responsible compliance teams that want to adopt innovative new technologies.

• Video verification

The video verification approach enabled customer identification and verification via a live two-way video link with a compliance professional. One examples include the RBI (Reserve Bank of India), which in January 2020 announced it would allow video-based KYC as an option to establish a customer's identity. In India, the financial industry has long sought permission to perform video KYC to address the high costs of physically reaching out to customers in remote locations. Similarly, in 2018, the MAS (Monetary Authority of Singapore) explicitly suggested that real-time video conferencing for identity verification must be 'omparable to face-to-face communication'.

Video verification has the advantage of preventing some versions of identity theft and is easily understood as simply a digital version of traditional face-to-face onboarding by regulators and financial institutions alike. But it places a huge burden on the team managing the flood of incoming video calls and doesn't have any advantage in scalability compared to traditional in-person onboarding.

• Digital ID schemes

The creation of either federated digital IDs or centralised KYC utilities mandates the creation of a trustworthy official source of information – often, but not always provided by the government – that financial institutions can refer to when checking the identity of a prospective customer.

India, with its Aadhaar e-KYC system, was one of the pioneers of the centralised variety of this model. Launched in 2009 and seen as the global eID archetype, Aadhaar now counts more than 1.21 billion users. Put simply, Aadhaar is an individual identification number issued by the Unique Identification Authority of India (UIDAI) for the purpose of establishing the unique identity of every subscribed individual. Unfortunately, a centralised scheme is prone to huge risks from hacking attacks or implementation faults. Aadhaar has seen exactly this happen in January 2019, when the Indian government announced that millions of complete biometric records of Aadhaar users were leaked, prompting a temporary halt in any non-governmental use of the system.

In Singapore, the government introduced a digital personal data platform known as MyInfo in May 2016 to streamline identity verification during online transactions. Since its introduction, the MAS does not require financial institutions that have been given access to a customer's MyInfo data to obtain additional documents to verify the

customer's identity. Singapore has been more successful in protecting the MyInfo user data by designing a highly secure system that works without distributing said data in multiple places.

Sweden presents another interesting example of the other variety of digital ID schemes: a federated digital ID scheme first introduced by banks, but the eIDs thus created are now accepted as a form of identification also by government authorities. A group of large Swedish banks – including Danske Bank, Länsförsäkringar Bank and Swedbank — introduced the BankID system in 2003. It is estimated that 80% of Sweden's population are now consistently using it. The identity data in this scheme resides with the bank of the user, not in a centralised place and is therefore less prone to hacking attacks or insecure implementations.

- **Enhanced vs simplified due diligence**

The Joint Money Laundering Steering Group (JMLSG) is the body tasked with producing guidance to assist financial services providers with their obligations in terms of UK AML/CTF legislation. Under the current JMLSG guidance, low-risk customers are eligible for simplified due diligence (SDD). Under SDD, financial institutions can verify customers' identities by simply collecting name, date of birth and residential address information and verifying the provided pieces of information against official sources (eg electoral register, court judgements, credit institutions).

Under JMLSG rules, the criteria for verification is called 2+2 as it requires financial institutions to match two data points given by the customer to two data points from a trustworthy source. For example, the name of the person

plus their date of birth, or the name plus their address. With its simplified vs enhanced due diligence, the UK model might have been a key source of inspiration for the Bangladeshi regulator when preparing their newly introduced e-KYC requirements.

As more countries introduce new guidelines of the use of technology to facilitate KYC and AML compliance, it not unthinkable to expect a further harmonisation and consolidation of e-KYC schemes around a smaller number of models. At the same time, we expect even greater effort from regulators to promote e-KYC adoption and strengthen AML risk prevention.

Read more from the source:

[https://www.regulationasia.com/the-four-e-kyc-models-around-the-world/?ct=t\(6Apr2020-RA\)&goal=0_d30b640721-66ca7cd7ae-116605569\)](https://www.regulationasia.com/the-four-e-kyc-models-around-the-world/?ct=t(6Apr2020-RA)&goal=0_d30b640721-66ca7cd7ae-116605569))

How can BDO help?

At BDO, we have seen threats coming from inadequate risk management practices relating to algo-trading activities, obsolete KYC approach, poor corporate governance and so on. The longer your organisation undertakes with improper practices, the bigger the risk becomes of a potentially costly loss. As Risk Advisory Services (RAS), our experts have a wealth of experience and expertise in achieving sound risk management practices, proper compliance approach and good corporate governance. We are dedicated to assisting your organisation with assessing and meeting the effectiveness of your requirement. Don't wait, contact us today for details of sound practices as well as risk assessment to extend your adequacy and effectiveness to achieve new business needs.

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