BDO NEWS

June 2020

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FINANCIAL SERVICES SECTOR UPDATES
June 2020 Issue

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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:

Coronavirus disease and anti-money laundering and counter financing of terrorism measures

On 7 April 2020, the Hong Kong Monetary Authority (HKMA) issued a circular and shared observations gathered through recent engagement with authorised institutions (AIs) and set out the type of support, guidance and assistance in relation to money laundering and terrorist financing (ML/TF) risk management. The HKMA will provide support to swift and effective implementation of measures in response to COVID-19. The HKMA acknowledges that COVID-19 poses unprecedented challenges, which impact the normal operations of the AML/CFT systems and customer due diligence processes of AIs.

The content of the circular resonated with the statement published by the Financial Action Task Force (FATF) on 1 April 2020 encouraging governments to work with financial institutions and other businesses in support of COVID-19 aid and containment efforts whilst remaining alert to new and emerging risks. In particular, the statement encourages use of the flexibility built into the FATF's risk-based approach and the fullest use of reliable digital customer on-boarding; emphasises the role of the FATF standards in giving confidence in financial transactions; and draws attention to COVID-19 related financial crime risks. These includes:

Remote on-boarding and simplified due diligence

While noting the anti-infection measures which AIs have put in place in their branches to maintain essential banking services to the public in the light of COVID-19, the use of financial technology (FinTech) will provide significant opportunities to manage some of the challenges presented by the current situation, especially the community efforts on social distancing. In particular, following the guidance and ongoing dialogue of the HKMA with AIs and FinTech companies since 2018, so far more than ten retail banks have launched remote account opening services and other banks are considering or testing similar initiatives. AIs are encouraged to continue to work closely with the HKMA to provide greater convenience for account opening and continued access, physically and digitally, to essential banking services to the public amidst our fight against COVID-19.

Remaining vigilant to COVID-19 related financial crime risks

In line with FATF's observations, it has become apparent that criminals are taking advantage of COVID-19 to perpetrate a number of fraud and exploitation scams. Some of which have impacted Hong Kong (eg face mask scams). The changing financial behaviour, including the rising number of customers unfamiliar with online platforms, also increase vulnerabilities to the banking system globally and locally. While AIs continue to work closely with the HKMA and assist law enforcement agencies' investigations to deter such scams and recover assets concerned, it is important that AIs should remain vigilant to emerging ML/TF risks and ensure that they continue to focus on priority areas and effectively mitigate risks through information sharing and detecting and reporting suspicious transactions to the Joint Financial Intelligence Unit (JFIU).

Ongoing outreach and advice

The HKMA is also in touch with AIs to understand the challenges they are facing and recognises that maintaining normal operations of AML/CFT systems may not be achievable in all cases. Where there is a short-term impact on an AI's ability to meet a particular obligation, the AI concerned should maintain a record of the circumstances, the risk assessment that has been performed as well as any mitigation measures being taken. The HKMA is using its supervisory tools flexibly in this period and reiterates that its risk-based approach to AML/CFT supervision does not require or expect a 'zero failure' outcome.

The HKMA also supports public-private partnership in the sharing of information and typologies to help prioritise and address key ML/TF risks, particularly those related to fraud linked to COVID-19. Moreover, the HKMA also continues its active participation in the FATF discussion as well as ongoing dialogues with other supervisors and regulators to identify and share good practices in response to common issues faced in many affected jurisdictions.

Read more from the source:
https://www.hkma.gov.hk/media/eng/doc/key-information/guidelines-and-circular/2020/20200407e1.pdf

SFC cautions on crude oil futures and ETFs

In view of the recent unprecedented volatility of the oil future prices, on 24 April 2020, the Securities and Futures Commission (SFC) issued a circular that required commodity futures brokers to take precautionary measures to manage the risks of trading crude oil futures contracts. Brokers were reminded not to open new positions for clients who do not fully understand these contracts or do not have the financial capability to bear the potential losses. They were also urged to collect sufficient margin from clients in light of the upcoming public holidays in Hong Kong.

In a separate circular, the SFC reminded managers of SFC-authorised futures-based exchange-traded funds (ETFs) to remain vigilant so that in extreme market conditions the funds can be managed in the best interests of investors. In addition, firms were reminded to ensure compliance with the conduct requirements when providing trading services for futures-based ETFs.

Crude oil ETFs and other commodity futures ETFs are derivatives products targeted at investors who understand the risks. Commodity futures markets are extremely volatile. Investors could suffer substantial or complete losses in a short period of time and should exercise caution when trading these products.

The SFC also cautions investors to be aware that if they engage in leveraged or margin trading of financial products such as crude oil futures and options, they may face large margin calls on their positions on short notice. Their positions might be compulsorily closed out as the market moves against them and they could be liable for any realised losses in excess of their margin deposits.

Read more from the source:
https://www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/doc?refNo=20PR37

SFC reprimands and fines BOCOM International Securities $19.6 million for internal control failures

On 20 April 2020, the SFC reprimanded and fined BOCOM International Securities Limited (BISL) a total of $19.6 million for a range of regulatory breaches, including failures concerning the handling of third party fund deposits and the maintenance and implementation of a margin lending and margin call policy. BISL also failed to put in place adequate and effective controls to identify deposits made into client accounts by third parties, hence failed to ensure compliance with the Guideline on Anti-Money Laundering and Counter-Terrorist Financing and various provisions in the Internal Control Guidelines and the Code of Conduct. Specifically, the SFC found that third party deposits made into client accounts in 2009, 2011 and 2015 by way of cheques and bank transfers were not identified until 2016. Extensive deficiencies were also identified during the SFC's review of BISL's margin lending and margin call policy from December 2012 to November 2016, including failures to:

- document and strictly enforce a clear margin lending and margin call policy, in particular, in relation to the making of margin calls, forced liquidation and stopping further advances;
- keep records of written explanations for deviation from the margin lending policy;
- ensure margin calls are communicated to clients;
- promptly collect from clients amounts due as margin;
- maintain appropriate detailed records of margin call history;
- objectively set and enforce the credit limits for margin clients; and
- segregate the key duties and functions related to the application and approval of liquidation suspension and the making of margin calls.

Moreover, BISL failed to ensure that:

- transactions conducted in client accounts were properly authorised;
- it could be satisfied on reasonable grounds about the identity of the person ultimately responsible for originating the instruction in relation to a transaction and that order instructions were properly recorded;
- client identities and transaction details were properly confirmed in trade confirmations;
- it reported its representatives' failures to record order instructions to SFC immediately; and
- a client complaint was adequately investigated and promptly responded to.

In deciding the disciplinary sanction, SFC took into account all relevant circumstances, including the following:

- BISL has an otherwise clean disciplinary record;
- BISL has taken steps to revise its policies and procedures in relation to the areas where deficiencies were identified;
- BISL has agreed to engage an independent reviewer to conduct a review of its internal controls;
- BISL's failures are serious, extensive and lasted for a substantial period of time; and
- a clear message needs to be sent to the industry that the SFC will not hesitate to take action against licensed corporations that fail to put in place appropriate internal controls to protect their operations and clients.

The consequences of internal control failures can be wide-ranging and severe. Without well-established proper safeguard against a number of possible deficiencies, it may affect the profitability or even the long-term survival of a company.

Read more from the source:
https://www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/doc?refNo=20PR36

Concurrent SFC & HKMA thematic review of spread charges and other practices

On 18 May 2020, the SFC and HKMA commenced a concurrent thematic review in the second half of this year to assess intermediaries' spread charges and other practices as well as their compliance with requirements governing the disclosure of trading capacity and monetary benefits under the Code of Conduct. The review covered the selected intermediaries' policies, procedures, systems and controls as well as management oversight of the distribution to clients of non-exchange traded investment products such as bonds and structured products.

Conflicts of interest may arise when intermediaries manage trades for clients. The concurrent thematic review aimed to ascertain whether charges may be in excess of the spreads or fees disclosed in the intermediaries' standard documents to clients, or as agreed with or understood by the clients, or spreads may be increased after a trade is executed and the price improvement is retained without agreement with or disclosure to clients. The review also ascertained whether intermediaries understand and properly disclose the capacity in which they are acting when conducting trades for clients.

The Code of Conduct provides that intermediaries should act honestly, fairly, and with due skill, care and diligence in the best interests of their clients; make adequate disclosure of relevant material information in their dealings with their clients; and avoid conflicts of interest, and when they cannot be avoided, ensure that their clients are treated fairly. To comply with these requirements, intermediaries are expected to:

- put in place appropriate policies, systems, controls and management supervision over order handling and spread charges;

- properly disclose price, fees, monetary benefits received and trading capacity to clients; and
- maintain adequate records (eg telephone recordings) to ensure compliance with internal policies and procedures as well as with regulatory requirements and to enable reviews or investigations by the intermediaries, their external auditors and the regulators.

The findings of the concurrent thematic review will form the basis for the SFC and the HKMA to assess intermediaries' compliance, and in the event of a breach, take regulatory action. The SFC and the HKMA will also share the findings of the thematic review with the industry and consider the need for further guidance, where appropriate.

Once again it is important to review a company's current system, policy and procedures to ensure that they are in line with the current regulatory requirements.

Read more from the source:
https://www.hkma.gov.hk/media/eng/doc/key-information/guidelines-and-circular/2020/20200518e1.pdf

How can BDO help?

With a view to enhance your internal control practices and minimise the risk of failure, you can seek assistance from the BDO Risk Advisory team in Hong Kong. Leveraging on our experience with international and local financial institutions and conglomerates, we provides various advisory services that suits your business and regulatory needs. If you want to find out more, please visit our website or write to your usual BDO contact today!

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