Application No. 6 of 2018

IN THE SECURITIES AND FUTURES APPEALS TRIBUNAL

IN THE MATTER OF a Decision made by the Securities and Futures Commission under section 194 of the Securities and Futures Ordinance, Cap. 571

AND IN THE MATTER OF section 217 of the Securities and Futures Ordinance, Cap. 571

BETWEEN

FT SECURITIES LIMITED Applicant

and

SECURITIES AND FUTURES COMMISSION Respondent

Tribunal: Mr. Michael Lunn, Chairman

Date of Hearing: 20 June 2019

Date of Determination: 24 June 2019

DETERMINATION

The application

1. By a notice, dated 7 December 2018, the applicant, FT Securities Limited ("FTSL"), applied to the Securities and Futures Appeals Tribunal ("the Tribunal"), pursuant to section 217 of the Securities and Futures Ordinance, Cap. 571 ("the Ordinance") for a review of the decision of the Securities and Futures Commission ("SFC") in a Decision Notice, dated 16 November 2018, to fine the applicant HK$3,500,000 and to administer a public reprimand, pursuant to section 194 of the Ordinance, on the ground that "…the pecuniary penalty was manifestly excessive and disproportionate in the circumstances of the case." At the hearing Mr. Matthew Pau, a director of FTSL, appeared for the applicant. The SFC made those orders having determined that FTSL was guilty of misconduct and that its fitness and properness had been called in to question arising out of its preparation and publication of three investment research reports ("Research Reports"). Two of the three Research Reports were in respect of Neptune Group Limited ("Neptune"), dated 25 July and 9 November 2012, and the third one, in respect of Chinese Food and Beverage Group Limited ("Chinese F&B"), dated 25 April 2013.

FTSL

2. FTSL held a licence to carry on business in Type 1 (dealing in securities) and Type 4 (advising on securities), which are regulated activities under the Ordinance.

Chronology

(i) 7 August 2014

3. Having conducted a "limited-scope review" into various

business activities of FTSL, including the circumstances in which FTSL had published the three Research Reports in 2012 and 2013, by letter dated 7 August 2014 the SFC informed FTSL of various matters "requiring your attention". In the first page of each of the reports Ms. Elisa Chan Ho Wai ("Elisa Chan") was described as the research analyst. She had been employed as a Responsible Officer of FTSL from 25 June 2012.

(ii) December 2014 - February 2017: SFC Notices requiring production of information and attendance at interviews

4. Beginning on 29 December 2014, and continuing until February 2017, the SFC served FTSL with a series of notices, pursuant to section 183 of the Ordinance, requiring FTSL to provide information, documents and records. Similarly, such notices were served on not only Elisa Chan, beginning in February 2015, but also on Mr. James Lam Wai Kit ("James Lam") in February 2016. He had been employed as a Responsible Officer of FTSL from 21 May 2012. Pursuant to section 183 of the Ordinance, records of interview were conducted by the SFC of Elisa Chan and James Lam in February 2016 and of Elisa Chan in February 2017. Similar interviews were conducted of Mr. William Yeung Kwok Leung ("William Yeung") in September and October 2016. He had been employed as a Compliance Officer of FTSL from 15 June 2011 and at all material times was a director of FTSL.

(iii) 23 May 2017: SFC's Notice of Proposed Disciplinary Action

5. By a Notice of Proposed Disciplinary Action, dated 23 May 2017, the SFC informed the directors of FTSL that the SFC was: [paragraph 2]

> "…inquiring into whether FTSL and/or persons connected with it have been guilty of misconduct and/or whether they are fit and proper persons to remain or to be licensed, for the purpose of considering whether to exercise any power under section 194 of the SFO."

6. The letter went on to state that the inquiry concerned the circumstances in which the three Research Reports had been published by FTSL "in the name of Elisa Chan in her capacity as a research analyst of FTSL."

The SFC's preliminary view of FTSL's conduct

7. Having regard to the evidence, the SFC stated that it took: [paragraphs 3 and 86]

> "…the preliminary view that FTSL had been guilty of misconduct and is not fit and proper to remain licensed for the purpose of section 194 of the SFO."

The proposed disciplinary action

8. The SFC stated that, in consequence of that preliminary conclusion, the SFC proposed to: [paragraph 88]

> "(a) publicly reprimand FTSL in terms of the enclosed press release and statement of disciplinary action under section 194 (1)(iii) of the SFO…, and
>
> (b) order FTSL to pay a pecuniary penalty in the sum of HK$5 million."

Right to be heard

9. The SFC informed FTSL that the "decision to take disciplinary action is not a final decision" and advised it that "if FTSL objects to the proposed disciplinary action, it must write to us with submissions to explain

the matters contained in this notice and why we should not impose the proposed penalty set out above." [paragraph 90]

(iv) 14 August 2017: objection to the proposed disciplinary action

10. By a letter to the SFC, dated 14 August 2017, Stevenson, Wong & Co on behalf of FTSL informed the SFC that FTSL "objects to the proposed disciplinary action" and said that FTSL submitted that "the penalty proposed to be imposed… is excessive".

(v) 16 November 2018: SFC's Decision Notice

11. By letter, dated 16 November 2018, to FTSL the SFC attached a Decision Notice "…setting out our decision, and the reasons for it, to publicly reprimand FT Securities Limited and fine it HK$3,500,000 under section 194 of the SFO."

12. Of the letter of 14 August 2017, the SFC said "in the Representations, FTSL does not dispute the SFC's findings" in the Notice of Proposed Disciplinary Action, dated 23 May 2017, "but submits that the SFC's proposed penalty is excessive."[paragraph 6] Then, the SFC set out in detail its responses to the submissions made on behalf of FTSL. Attached to the Notice was a press release and a Statement of Disciplinary Action.[paragraph 30 - Appendix 2] Finally, the SFC advised FTSL that it "…may apply to the Securities and Futures Appeals Tribunal for a review of this decision under section 217 of the SFO." [paragraph 34]

(vi) 7 December 2018: Notice of Application for Review

13. As noted at the outset, by a Notice of Application for Review

dated 7 December 2018, FTSL applied to the Tribunal for a review of the order that FTSL "pay a pecuniary penalty of HK$3,500,000" on the grounds that it was manifestly excessive and disproportionate.

SFC's Notice of Proposed Disciplinary Action

Preliminary View

14. In support of its preliminary view that FTSL was guilty of misconduct in the preparation and publication of the three investment research reports, in the Notice of Proposed Disciplinary Action the SFC said that FTSL had: [paragraph 3]

> "(a) made a false and misleading disclosure regarding its investment banking relationship with the issuer in one of the research reports;
>
> (b) failed to identify and eliminate, avoid, manage or disclose actual or potential analyst conflicts of interest;
>
> (c) failed to ensure that its analysts had a reasonable basis for the analyses and recommendations stated in the reports;
>
> (d) failed to define the terms used in making recommendations and utilize such definitions consistently; and
>
> (e) failed to provide adequate supervision and put in place effective systems and controls over the preparation and publication of the researchrReports."

15. The SFC said [paragraph 4] that those failures suggested that FTSL was in breach of General principles[1] 2, 3, 6 and 7 and paragraphs 4.2, 4.3, 10.1, 12.1 and multiple sub-paragraphs of paragraph 16 of the Code of Conduct for Persons Licenced by or Registered with the SFC ("Code of Conduct")[2], paragraph 4 of Part VII and paragraph 2 of Part II of the Internal

[1] Annexure I
[2] Annexure II

Control Guidelines for Persons Licensed by or Registered with the SFC ("Internal Control Guidelines").

SFC's Findings

16. The SFC set out its findings under five discrete headings.

I. False and misleading statement in the Chinese F&B Report

The SFC noted that under the rubric "Company Disclosures" in the Disclaimer section of the Chinese F&B Research Report it was asserted that: [paragraph 29]

> "[FTSL] has not been party to any agreement in the past 12 months for the provision of investment banking services to the company covered in this research report."

17. Of that statement, the SFC found, "This statement was false and misleading."

18. The statement in the Disclaimer was made in the context of the requirement of paragraph 16.5(d) of the Code of Conduct for Persons Licenced by or Registered with the SFC ("Code of Conduct"), namely that: [paragraph 27]

> "A firm that has an investment banking relationship with the issuer or the new listing applicant should disclose that fact in the research report. Any compensation or mandate for investment banking services received within the preceding 12 months would constitute an investment banking relationship."

19. Earlier, in its review of the evidence that it had received and considered, the SFC had noted: [paragraph 22]

> "FTSL was appointed as the placing agent for the placing activities of Chinese F&B on a best effort basis on 1 February 2013 and 26 March 2013 respectively, i.e. within three months before FTSL issued the Chinese F&B report."

20. Further, the SFC observed that the placement arising from the 1 February 2013 appointment in respect of a HK$15.5 million convertible bonds had been completed on 18 March 2013 and that FTSL had received "a placing commission of 3% of the principal amount of the convertible bonds successfully placed out." The appointment dated 26 March 2013 was in respect of the conditional placing of convertible bonds to raise up to HK$240 million. Finally, the SFC noted that FTSL had published the Chinese F&B Research Report on 25 April 2013.

21. Of the position taken by FTSL, the SFC noted that FTSL admitted that it should have disclosed that it was a party to a placing agreement for the provision of placing agent services to Chinese F&B, but claimed that it was an oversight by James Lam and Elisa Chan that the usual disclaimer had been adopted. [paragraph 30]

22. Of FTSL's failure to make the requisite disclosure and in making a false and misleading disclosure, the SFC found that: [paragraph 31]

> "FTSL breached paragraph 16.5 (d) of the Code of Conduct. The conduct of FTSL fell below the standard expected of it under General Principle 2 (diligence) of the Code of Conduct, which requires licensed persons to act with due skill, care and diligence, in the best interests of its client and the integrity of the market in conducting their business activities."

II. Failure to identify and eliminate, avoid, manage or disclose analyst conflicts of interest

23. The SFC went on to state that it was apparent that in preparing

and publishing the Research Reports FTSL had "failed to comply with the regulatory requirements and guidelines" set out in the Code of Conduct and Internal Control Guidelines.[paragraph 36] In particular, it was stated: [paragraphs 44 and 45]

> "…we are of the view that FTSL has failed:
>
> (a) to establish written internal procedures or controls to identify and eliminate, avoid, manage or disclose actual and potential analyst conflicts of interest, in breach of paragraph 16.3 (d) and 16.7 (a) of the Code of Conduct and paragraph 4 under Part VII (operational controls) of the Internal Control Guidelines[3];
>
> (b) to put in place mechanisms to ensure that the Researchers' trading activities or financial interests do not prejudice their investment research and recommendations as contained in the Research Reports, in breach of paragraph 16.3 (a) of the Code of Conduct;
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> (c) to develop mechanisms to ensure its investment research and recommendations are not prejudiced by its trading activities, financial interests or business relationships, in breach of paragraph 16.3 (b) of the Code of Conduct; and
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> (d) to prohibit its analysts from reporting to its investment banking function and to ensure that its research and corporate finance functions are properly segregated to ensure the objectivity of the research function, in breach of paragraph 16.6 (a) of the Code of Conduct and paragraph 2 under Part II of the Internal Control Guidelines.
>
> The conduct of FTSL also fell below the standards expected of it under General Principle 6 (conflicts of interest) and paragraph 10.1 (disclosure and fair treatment) of the Code of Conduct."

24. Earlier, in its review of the evidence relevant to paragraph 16.3(d) and 16.7(a) [4] of the Code of Conduct, the SFC said: [paragraph 37]

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[3] "**VII. Operational Control**

4. Specific policies and procedures are established to minimise the potential for the existence of conflicts of interest between the firm or its staff and clients, and further, in circumstances where actual or apparent conflicts of interest cannot reasonably be avoided, that clients are fully informed of the nature and possible ramifications of such conflicts and are in all cases treated fairly."

[4] "**16.7 Firm compliance systems**

(a) A firm should establish, maintain and enforce a set of written policies and control procedures to eliminate, avoid or manage actual and potential analyst conflicts of interest. These policies and procedures should be appropriately formulated having regard to the firm's particular structure and business model and the experience and investment profile of its clients."

> "...both James Lam and Elisa Chan confirmed that FTSL did not implement any written policies or procedures that identify and eliminate, avoid, manage or disclose actual and potential analyst conflicts of interest during the Relevant Period."

25. Of the evidence relevant to paragraph 16.3(a) of the Code of Conduct, the SFC said: [paragraphs 38 and 39]

> "…the Research Reports were prepared by two unidentified individuals, i.e. the Researchers. The information and data contained in the Research Reports were largely compiled and collected by the Researchers.
>
> As FTSL had adopted the draft Research Reports prepared by the Researchers wholly or substantially, it should have… (ensured) that the trading activities or financial interest of the Researchers did not prejudice their investment research and recommendations in the Research Reports notwithstanding that they were not employed by FTSL."

26. Of FTSL's failure to do so, the SFC noted: [paragraph 40]

> "However, neither Elisa Chan nor any other staff members at FTSL (except Tony Chang) knew the identities or background of the Researchers. There is no record to demonstrate that Elisa Chan and/or FTSL had taken any steps to ascertain whether the Researchers had any relationship with the companies covered in the Research Reports or obtained any financial interests that might prejudice their independence or objectivity. Elisa Chan did not know why Neptune was chosen to be covered in the First Neptune Report - she did not even ask the Researchers."

27. Having noted that FTSL had published the Chinese F&B Research Report without disclosing that it had a business relationship with Chinese F&B, the SFC concluded that "FTSL had no mechanisms in place to ensure that its investment research and recommendations (i.e. the Research Reports in this case) are not prejudiced by the trading activities, financial interests or business relationships of FTSL." [paragraph 42]

28. Next, the SFC found that, in contravention of paragraph 16.6(a)(i) of the Code of Conduct[5] and paragraph 2 of section II of the Internal Control Guidelines[6], FTSL failed to "segregate the research and corporate finance functions to avoid any actual or apparent conflicts of interest". [paragraph 43]

29. Noting that Mr. Tony Chang Chi Ping ("Tony Chang"), who was employed by FTSL as a Responsible Officer in the period of around October 2012 to October 2013, when he passed away, not only suggested that Neptune and Chinese F&B be the subject of research reports but also recommended the Researchers to Elisa Chan and was responsible for contacting and instructing the Researchers to prepare the Research Reports, the SFC said: [paragraph 43(b)(i)]

> "Elisa Chan did not know: a) whether Tony Chang was involved in the writing of the Research Reports; b) what kind of relationship existed between Tony Chang and the Researchers; and c) whether the Researchers had obtained any benefits from Tony Chang for preparing the Research Reports".

30. Further, the SFC noted that Elisa Chan and James Lam were responsible for preparing and approving respectively the Research Reports, whilst the former was involved in checking the placing application forms for the placements and the latter assisted Tony Chang in signing the placing agreements. [paragraph 43(c) and (d)]

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[5] "**16.6 Analyst reporting lines, compensation and participation in other functions**
(a) Analyst reporting lines and compensation
A firm that has an investment banking function should not:
(i) arrange for its analysts to report to such function"

[6] "**II. SEGREGATION OF DUTIES AND FUNCTIONS**
Control Guidelines
2. Operational functions including, but not limited to, sales, dealing, accounting and settlement are, where practicable, effectively segregated to minimise the potential for conflicts, errors or abuses which may expose the firm or its clients to inappropriate risks. Special care should be taken to ensure that the sales and dealing function should be segregated from the research function where possibility of potential conflict of interest exists. Where practicable, the research and the corporate finance functions should be segregated to ensure the objectivity of the research function."

III. No reasonable basis for the analyses and recommendations in the Research Reports

31. The SFC found that, in breach of paragraph 16.11(a) of the Code of Conduct[7], FTSL had failed to demonstrate that there was a reasonable basis for the analyses and recommendations in the Research Reports. [paragraph 49]

Reliance on documents dated after the publication of the Research Reports

32. Of the contents of the 'information packs' provided by FTSL to the SFC, said to have been provided by the Researchers to Elisa Chan together with the draft Research Reports, the SFC noted that many of the documents were dated after the date of publication of the respective Research Reports and could not have been relied upon in verifying the information in the Research Reports. [paragraphs 50 - 54]

33. In particular, it was noted that, other than a few pages of a printout from the website of Neptune providing a general overview of the company, all of the documents in the Neptune bundle were dated after the publication of the first Neptune Research Report, namely 25 July 2012.[paragraph 50] Similarly, it was noted that the document entitled "Neptune Group Limited Macau Junket Investment Opportunity" was dated 9 January 2013, whereas the second Neptune Research Report had been published on 9 November 2012. Further, some of the documents in the Chinese F&B bundle bore the date 29 April 2013, which the SFC said appeared to be the date the document was printed.

[7] "**16.11 Integrity and ethical behavior**
(a) An analyst should have a reasonable basis for his analyses and recommendations."

34. Of Elisa Chan's explanation that she was not aware of those respective dates on those documents and her assertion that she had not inserted any documents in the original information pack, the SFC said: [paragraph 54]

> "We find Elisa Chan's explanations difficult to accept. In any event, the fact that the documents were dated after the publication of the Research Reports means that they could not have been relied on by Elisa Chan in verifying the information in the Research Reports."

Lack of supporting documents to demonstrate the reasonableness of statements in the Research Reports

(i) Financial estimates

35. Having noted that all three Research Reports contained financial estimates under the heading "Forecast Summary", stating that the source was "FT Securities estimates", the SFC noted that none of the material contained in the information packs in the respective Neptune and Chinese F&B bundles "contains information showing the source of the calculation and basis for these financial estimates." [paragraph 57]

(ii) Management sales targets

36. Similarly, the SFC said that Elisa Chan acknowledged that statements in the Chinese F&B Research Report, in respect of what was asserted to be management targets of sales of mooncakes, "were not supported by any information contained in the information pack." [paragraph 59]

(iii) Key performance indicators

37. Of the key performance indicators ("KPI") in the Chinese F&B

Research Report of a comparison set out in tabular form between revenue said to be derived, *inter alia*, per table by Fook Lam Moon restaurants and what was claimed to be the Market Average, the SFC said that the source was stated to be "Company data, FT Securities". Nevertheless, the SFC went on to note "…such data was not available in the Chinese F&B Bundle." [paragraph 61]

38. Of Elisa Chan's assertion that she had cross-checked the stipulations in the table in respect of "Market Average" from annual reports of listed companies, the SFC observed that she had been unable to substantiate that claim. Similarly, she had been unable to recall the source of her belief that the figures attributed to Fook Lam Moon had been obtained by the Researchers from Fook Lam Moon. Finally, the SFC said that there was no record to demonstrate any such check. [paragraphs 62 - 64]

(iv) Stock rating

39. Having noted that FTSL assigned a "Buy" rating for Neptune shares in both the Neptune Research Reports, which recommendation was defined in the Research Report as being as "(>15% total return over the next 12 months)", in which the Absolute Total Return was described as being "the sum of the expected price appreciation and dividend yield", the SFC said that the information pack in the Neptune bundle did not provide any detail of any such calculation of Absolute Total Return. [paragraph 67]

IV. No policy on rating definition

40. Having noted that paragraph 16.11 of the Code of Conduct required an analyst to "…define the terms used in making recommendations, and utilise such definitions consistently", the SFC noted that Elisa Chan

admitted that, in breach of that requirement, FTSL did not have any such policy or guideline and that the phrase "Not Rated", used in the 'Rating' section of the Chinese F&B Research Report, was not defined by FTSL. [paragraphs 68 - 70]

V. Inadequate supervision, systems and controls

41. In its review of the evidence, the SFC noted that William Yeung, a director and then compliance manager of FTSL, confirmed that there was no specific provision in FTSL's compliance manual in respect of the process of issuing a research report and that no training had been provided to research analysts in that respect.[paragraphs 76 - 7.] Also, Elisa Chan knew no personal details of the two Researchers who were said to have compiled the three Research Reports. Moreover, there were no records to evidence any steps taken by her to verify the information contained in those Research Reports. Further, although James Lam said that he had approved the Research Reports, that process was not documented and he accepted that he had not reviewed any documents relied on by Elisa Chan in supporting the analyses and recommendations in the Research Reports. Finally, the SFC said that FTSL admitted that it had not established "any information barrier policy for the purpose of avoiding any apparent and actual conflicts of interest."

42. In the result, the SFC stated that it was of the view that FTSL had: [paragraph 83]

> "(a) failed to put in place adequate internal systems and controls which can be reasonably expected to protect its operations, its clients and other licensed or registered persons from financial loss arising from theft, fraud, and other dishonest acts, professional misconduct or omissions, in breach of General Principle 3

(capabilities) and paragraph 4.3 (internal control, financial and operational resources) of the Code of Conduct[8]; and

(b) failed to supervise diligently its staff members in connection to the preparation and publication of the Research Reports, in breach of paragraph 4.2 (staff supervision) of the Code of Conduct.[9]

The failures set out above also constitute a breach of General Principle 7 (compliance) of the Code of Conduct… and paragraph 12.1 (compliance: in general) of the Code of Conduct."

The proposed disciplinary action

43. In proposing to issue FTSL with a disciplinary penalty, namely a public reprimand and an order that it pay a pecuniary penalty of HK$5 million, the SFC said that it took into account all relevant considerations, including: [paragraph 89]

"(a) the systems and controls of FTSL regarding issuance of research reports were seriously deficient;

(b) the failure to ensure independence and objectivity of research reports might damage investor confidence in the research sector and in the financial services industry more broadly; and

(c) FTSL had not been previously disciplined by the SFC."

44. A copy of the proposed press release and a Statement of Disciplinary Action was attached to the Notice of Proposed Disciplinary Action ("NPDA").

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[8] "**Capabilities**

4.3 Internal control, financial and operational resources

A licensed or registered person should have internal control procedures and financial and operational capabilities which can be reasonably expected to protect its operations, its clients and other licensed or registered person from financial loss arising from theft, fraud, and other dishonest acts, professional misconduct or omissions."

[9] "**4.2 Staff supervision**

A licensed or registered person should ensure that it has adequate resources to supervise diligently and does supervise diligently persons employed or appointed by it to conduct business on its behalf."

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FTSL's objection to the proposed disciplinary action

45. As noted earlier in the objections to the SFC's proposed disciplinary action against FTSL, issue was taken only with the proposed pecuniary penalty of HK$5 million. In FTSL's submissions, reference was made to the disciplinary action taken by the SFC in respect of:

i. Merrill Lynch Far East Ltd and Merrill Lynch (Asia Pacific) Limited ("Merrill Lynch"), in which a pecuniary penalty of HK$15 million had been imposed in March 2017;

ii. JP Morgan Securities (Asia Pacific) Limited ("JP Morgan"), in which a pecuniary penalty of HK$3 million had been imposed in October 2016; and

iii. Moody's Investors Service Hong Kong Limited ("Moody's"), in which a pecuniary penalty of HK$11 million had been imposed in April 2016.

46. It was submitted that the conduct the subject of the disciplinary action in those cases was "…of a more serious nature than the present case".[paragraph 2] Attention was drawn to the ambit of the misconduct that was the subject of those disciplinary actions and the size and experience of the three offending companies, whereas it was emphasised that FTSL had only ever issued the three Research Reports, which were in respect of only two companies of relatively low market capitalisation. Further, it was asserted that FTSL had only around 200 active clients who might have read the Research Reports, so that it was submitted there was minimal impact on the market and, in fact, no evidence of loss. In that context, issue was taken [paragraph 8] with the statement of the SFC in the Notice of Proposed

Disciplinary Action that the failure to ensure independence and objectivity of research reports "might damage investor confidence in the research sector and in the financial services industry more broadly." [paragraph 89(b)]

47. More broadly, it was submitted that all of the disciplinary actions taken by the SFC which had been announced hitherto in respect of breaches concerning the issuance of research reports could be distinguished, in particular in respect of three factors in respect of those corporations, namely:

i. their greater size, which resulted in their greater experience and available resources to prepare research reports;

ii. their much larger client base, which resulted in a much greater likelihood of an impact being caused by the publication of research reports; and

iii. their much greater experience in publishing research reports.

48. It was submitted that the failure of FTSL to comply with the Code of Conduct and the Internal Control Guidelines was the result of inadvertence and lack of experience, not bad faith or dishonest intention.[paragraphs 5 - 7] Also, it was asserted that FTSL had deleted the three Research Reports from their website and had determined not to publish any further research reports in the foreseeable future and, in any event, not without first engaging an independent reviewer approved by the SFC to conduct a review to ensure that there were in place in FTSL policies and procedures that were compliant with the Code of Conduct in relation to the selection of companies to be the subject of research reports, the

preparation of such reports and the verification of the data and recommendations contained.[paragraph 13] Finally, reliance was placed on the fact that FTSL had never been the subject of any disciplinary action by the SFC.

Decision Notice

49. In the Decision Notice, having adverted to the preliminary view taken by the SFC expressed in the Notice of Proposed Disciplinary Action and its proposed Disciplinary Action, consideration was given to the submissions made on behalf of FTSL. First, it was noted that, [paragraph 6] "FTSL does not dispute the SFC's findings in the NPDA but submits that the SFC's proposed penalty is excessive."

The SFC's response to the submissions of FTSL in respect of the proposed pecuniary penalty

50. Of the reliance of FTSL on the pecuniary penalties imposed on Merrill Lynch, JP Morgan and Moody's respectively, the SFC said simply, "…the three cases cited by FTSL are not comparable to the present case." [paragraph 14]

Merrill Lynch

51. Of the differences between the conduct of FTSL and that of Merrill Lynch, the SFC said that the breaches committed by Merrill Lynch "involved internal control failures relating to the reporting of Large Open Positions, electronic trading systems, compliance with the licensing requirement, and disclosure of market-making activities in research reports." [paragraph 15(a)]

52. Of the imposition of a public reprimand and a total pecuniary penalty of HK$15 million, the SFC noted that the case had been resolved by agreement, pursuant to section 201 of the Ordinance, and identified various matters that had been taken into account, namely: [paragraph 15(c)]

- Merrill Lynch's self-report of the unlicensed activity and non-disclosure of market-making activities in its research reports to the SFC;
- their senior management's involvement in liaising the regulatory concerns with the SFC at an early stage;
- their undertaking to conduct a credible review to address the regulatory concerns; and
- their cooperation in resolving the SFC's concerns.

Moody's

53. Of the Moody's case, the SFC noted that it did not involve any breach of the provisions under paragraph 16 of the Code of Conduct and that this Tribunal [10] had rejected the SFC's allegation that Moody's had insufficient internal control procedures. Rather, Moody's had been found to have breached General Principles 1 and 2 of the Code of Conduct for "failing to provide sufficient explanations and justification for the red flags assigned by it to the rated companies in the Red Flag Report", which purportedly identified risk factors of Mainland rated issuers. [paragraph 16(a)]

[10] Application No. 4 of 2014. Reasons for Determination: 31 March 2016, paragraph 210.

JP Morgan

54. The SFC acknowledged that the imposition of a public reprimand and a fine of HK$3 million on JP Morgan arose, amongst other things, from its failure to make proper and/or adequate disclosure of the firm's financial interests in respect of certain listed issuers covered in its research reports, in breach of paragraph 16.5(a) and (b) of the Code of Conduct, and related internal control deficiencies. However, the SFC noted that the case had been resolved by agreement, pursuant to section 201 of the Ordinance, and said that in reaching that resolution the SFC had taken into account JP Morgan's "cooperation in resolving the SFC's concerns and the remedial measures taken by [JP Morgan] to rectify the deficiencies in its securities position reporting system".

55. Further, the SFC said that, in its view, FTSL's misconduct was more serious than that of JP Morgan in that FTSL: [paragraph 17(b)]

- demonstrated a serious lack of internal systems and controls to ensure compliance with the requirements for addressing analyst conflicts of interest;
- falsely disclosed in the Research Reports on Chinese F&B that it did not provide any investment banking services to Chinese F&B;
- knew nothing about the Researchers who prepared the Research Reports and did not take any steps to ascertain their independence from the companies covered in the Research Reports;
- was unable to explain the source of some of the information in the Research Reports and failed to demonstrate that there was a reasonable basis for the analyses and recommendations.

Impact on the market and client loss

56. Noting that FTSL had published the Research Reports on its website, the SFC said that they could be accessed by the "general investing public" and that the readership of the Research Reports could have been more than the 200 clients FTSL asserted was the extent of the publication. Further, the SFC said that the absence of evidence of client loss did not mitigate FTSL's culpability for its failure to ensure compliance with paragraph 16 of the Code of Conduct, which requirements it said were "of fundamental importance to the business undertaken by all analysts." [Paragraph 20.] In stating that "FTSL's failure to ensure independence and objectivity of research reports might damage investor confidence in the research sector and in the financial services industry more broadly", the SFC reaffirmed its earlier statement[11], namely: [paragraph 21]

> "Analysts play an important role in the relationship between companies and investors by providing valuable insights to investors in trying to make sense of a wide range of information. The flow of timely and accurate information about companies and securities is fundamental to achieving fairness, efficiency and transparency in a capital market."

Remedial action and risk of further breach

57. The SFC said that, contrary to the assertions made in the submissions on behalf of FTSL that, as a remedial step, FTSL had deleted the Research Reports from its websites, the Research Reports were still accessible on the Internet which the SFC had accessed on 15 November 2018 by a search of the name of companies covered in the Research Reports.

[11] Consultation Paper on the Regulatory Framework for Addressing Analyst Conflicts of Interest-SFC March 2004, at paragraph 9.

Lack of bad faith/dishonesty and FTSL's clean disciplinary record and cooperation

58. The SFC said that it had never alleged that FTSL had acted dishonestly or in bad faith. [Paragraph 18.] Conversely, it had taken into account the fact that the FTSL had a clean disciplinary record. Of the assertion that FTSL had "actively and fully cooperated" with the SFC, the SFC said that it did not appear that "…FTSL had done anything beyond what it was legally required to do to facilitate the investigation." That was not a mitigating factor. [Paragraphs 25 - 26]

Undertaking

59. Similarly, the SFC said that FTSL's undertaking to put in place formal policies and procedures governing the preparation publication of research reports before any future such publication was not a mitigating factor. To do so, was merely to comply with the regulatory requirements. [Paragraph 27.]

Conclusion

60. In the result, the SFC concluded: [paragraph 28]

> "Having carefully considered all the circumstances of this case and the representations, we conclude that FTSL was guilty of misconduct and its fitness and properness has been called into question."

Penalty

61. Of the pecuniary penalty to be imposed on FTSL, the SFC said: [paragraph 29]

> "Taking into account that FTSL does not dispute the SFC's findings in the NPDA, we consider it appropriate to reduce the amount of fine from HK$5,000,000 to HK$3,500,000."

62. Finally, the SFC said: [paragraph 30]

> "We have decided to publicly reprimand FTSL in the terms of the press release and statement of disciplinary action enclosed at Appendix 2 and fine it HK$3,500,000 under section 194 of the SFO."

The submissions of the parties

FTSL

63. The Tribunal received no written submissions from FTSL, whose solicitors informed the Tribunal on 29 May 2019, the day before the deadline for the service of written skeleton arguments stipulated in Agreed Directions made by the Tribunal on 23 January 2019, that they were discharging themselves from acting for FTSL having been unable "to get conclusive and confirmatory instructions." On 11 June 2019, the Tribunal refused an application made by Mr. Matthew Pau, a director of FTSL, by email on 7 June 2019 that the hearing dates, fixed for 20 and 21 June 2019, be vacated and re-fixed in September 2019. Having acknowledged the failure of FTSL to file and serve skeleton arguments in compliance with the Agreed Directions, in an apparent explanation for that failure and in support of the application, Mr. Pau said simply "our board of directors have taken more time than expected in reviewing and considering several options, some of which came late". On the other hand, the Tribunal granted an extension of time to file skeleton arguments and ordered that FTSL be permitted to file skeleton arguments up and until the close of business on 12 June 2019, the day before the SFC was required to file its skeleton arguments.

64. At the hearing Mr. Pau submitted that no quantitative basis had been advanced by the SFC for stipulating a proposed pecuniary penalty of HK$5 million, or the reduction of the actual pecuniary penalty to HK$3,500,000. He reiterated the point, made in the submissions to the SFC by Stevenson, Wong & Co. in objection to the proposed penalty, that there was no evidence of loss by clients or investors having occurred as a result of the impugned conduct. In the Decision Notice, the SFC appears to have accepted that contention, but determined that it did not diminish the culpability arising from failure to comply with the Code of Conduct. [paragraph 20.] In addition, Mr. Pau contended that there was no evidence of any profit made by FTSL. That allegation had never been made by the SFC.

65. The parties having been provided by the Tribunal during the hearing with a copy of the SFC Disciplinary Fining Guidelines, issued pursuant to section 199(1) of the Ordinance, Mr. Pau adverted to the statement at page 4 of those Guidelines that "a fine should not have the likely effect of putting a firm or individual in financial jeopardy" and asserted that the imposition of the pecuniary penalty might put FTSL out of business. He acknowledged that this was the first time that the contention had ever been raised. He advanced nothing to substantiate the bare assertion.

The SFC

66. In written submissions, on behalf of the SFC, Mr. Jenkin Suen invited the Tribunal to dismiss with costs the application for review of the pecuniary penalty of HK$3,500,000, noting that it was unparticularised and not supported by any grounds. In those circumstances, and on the assumption that FTSL would rely on the arguments advanced to the SFC in the letter from Stevenson, Wong & Co., dated 14 August 2017, Mr. Suen

relied on the reasoning of the SFC rejecting those submissions in its Decision Notice, dated 16 November 2018. He reiterated the position taken by the SFC that the circumstances obtaining in the cases of Merrill Lynch, Moody's and JP Morgan were quite different from the circumstances of the multiple breaches committed by FTSL.

67. In addition, Mr. Suen submitted that the fact that the three Research Reports published in the name of Elisa Chan and approved by James Lam were actually written by two unidentified individuals who had never been employed by FTSL, in the complete absence of the required procedures and controls was a blatant and systemic failure to provide adequate supervision and put in place effective systems and controls over the preparation and publication of the Research Reports. That, called for "the imposition of a substantial fine." Further, the gravity of those breaches lay in the publication of the Research Reports to the investing public at large on the FTSL website, in addition to their circulation to around 200 of its active clients.

68. In his oral submissions, Mr. Suen submitted that the imposition of a pecuniary penalty was punitive in nature and was intended to act as a deterrent. The pecuniary penalty took into account multiple different factors, which were not capable of individual quantification. Of the conduct of FTSL, Mr. Suen said that it revealed serious and systematic weaknesses in the management systems and internal controls and impacted on the integrity of the securities and futures market, factors identified as relevant to the nature and seriousness of the conduct in the SFC Disciplinary Fining Guidelines.

69. Having noted in his written submissions that, although it had been asserted on behalf of FTSL by Stevenson, Wong & Co. that proposed

pecuniary penalty would have the "effect of stifling small businesses" such as FTSL, it had not been contended that the latter was not in a position to meet the proposed pecuniary penalty, in his oral submissions Mr. Suen invited the Tribunal to note that the bare assertion now made that the imposition of the pecuniary penalty would place FTSL in financial jeopardy was wholly unparticularised.

The role of the Tribunal

70. This Tribunal is required to make a full merits review, conducting the review as if it were the original decision maker.[12]

71. The Tribunal does so mindful of the fact that the applicant has not challenged any of the findings made against it by the SFC. Accordingly, this review is limited to determining the appropriate sanction to be imposed on the applicant. Relevant to that consideration is the weight to be afforded to the findings in determining the culpability of FTSL.

FTSL's culpability

(i) Systems and controls to address analyst conflicts of interest

72. It is clear from the unchallenged findings of the SFC that FTSL was culpable of egregious failures to comply with the regulatory requirements addressing analyst conflicts of interest. The SFC's categorisation of those failures as "serious" was entirely warranted.[13] That finding resonates with some of the circumstances identified as relevant to the determination of the nature and seriousness of the conduct in the SFC

[12] *Tsien Pak Cheong David v Securities and Futures Commission* [2011] 3 HKLRD
[13] Decision Notice, paragraph 17(b)(ii)

Disciplinary Fining Guidelines.[14] First, no written policies and control procedures had been established to address potential analyst conflicts of interest, as required by paragraph 16.3(d) and 16.7(a) of Code of Conduct. Secondly, no related training had been provided to members of staff of FTSL. Responsibility for failure in respect of those two matters was that of William Yeung, the Compliance Officer and a director of the company. Thirdly, given that the Research Reports have been prepared wholly or substantially by two Researchers, whose identity was unknown to both Elisa Chan and James Lam and there were no records that anyone had taken any appropriate steps, clearly FTSL had failed to establish mechanisms to ensure that their trading activities and financial interest did not prejudice their Research Reports, contrary to paragraph 16.3(a) of the Code of Conduct. Fourthly, FTSL had failed to prohibit reporting by its analyst to its investment banking function, given the two roles played by Tony Chang, first as the person responsible for the related placing activities and, secondly in the directing and supervising role that he played over Elisa Chan with regard to the Research Reports. In context, the failures were those of the firm overall, which then employed about a dozen people, not merely of an individual or individuals.[15]

73. The Tribunal is satisfied that FTSL conducted itself with a contemptuous lack of regard to these important regulatory requirements. Its failures were not born of inadvertent disregard of written policies and controls stipulated by FTSL. Rather, there were no stipulated policies and controls. That state of affairs lasted throughout the period of more than nine

[14] "**Specific Considerations**
The nature and seriousness of the conduct
- in the case of a firm, whether the conduct reveals serious or systematic weaknesses, or both, in respect of the management systems or internal controls in relation to all or part of that firm's business
- whether the SFC has issued any guidance in relation to the conduct in question."

[15] SFC Disciplinary Fining Guidelines

months, from before 25 July 2012 to 25 April 2013 during which the three Research Reports were prepared and published and subsisted until well after the intervention of the SFC. The "duration and frequency of the conduct" is also a matter to which the SFC is required to have regard in respect of the nature and seriousness of the conduct in the SFC Disciplinary Fining Guidelines.

(ii) False and misleading statement in the Chinese F&B Research Report

74. The statement in the Research Report in respect of Chinese F&B, dated 25 April 2013, that FTSL had not been a party to any agreement in the previous 12 months for the provision of investment banking services to Chinese F&B was false and misleading. In fact, at that date FTSL was the placing agent pursuant to a placement agreement with Chinese F&B, dated 26 March 2013, and had conducted an earlier placement for Chinese F&B, pursuant to an earlier agreement which had been completed on 18 March 2013 and for which FTSL received a placing commission.

75. Elisa Chan was not only identified as the research analyst of that Research Report but also had a role in the processing of the placement application forms. Similarly, James Lam, who reviewed the Research Report, assisted Tony Chang in the signing of the placement agreements. For her part, Elisa Chan acknowledged that at the time the Research Report was published not only did she know that FTSL was carrying out placement activities for Chinese F&B but also she said there had been discussions at a meeting she attended with Tony Chang, William Yeung and James Lam at which it was agreed that it was necessary for FTSL to disclose their role in the placement in the Research Report. In that context, it is to be noted that in the very first paragraph of the Research Report reference was made to the

announcement by Chinese F&B on 27 March 2013 of entering into a conditional placement of convertible bonds for a principal amount of up to HK$240 million. However, no reference was made to the fact that the announcement also identified FTSL as the placing agent. Nevertheless, FTSL said that the statement in the disclaimer was published as an oversight. James Lam confirmed that at the time of the publication of that Research Report he was aware that FTSL had acted as a placing agent for Chinese F&B and acknowledged that in approving that Research Report he wrongly overlooked the disclaimer to the contrary.

76. In the Decision Notice the SFC addressed the assertion advanced in mitigation by FTSL, that it had not acted in bad faith or with dishonest intention in preparing or publishing the Research Reports, by denying that it had ever alleged that FTSL was dishonest or had acted in bad faith in doing so. The SFC said that, if that had been the finding, "a higher level of sanction would have been proposed." Notwithstanding those specific findings, it is clear that, in all the circumstances described earlier, in particular in publishing the false disclaimer in the Chinese F&B Research Report, FTSL exhibited a high degree of incompetence and was culpable of considerable negligence.

(iii) No reasonable basis for the analyses and recommendations in the Research Reports

77. The unchallenged finding that FTSL was unable to demonstrate that there was a reasonable basis for the analyses and recommendations in the Research Reports, in breach of paragraph 16.11(a) of the Code of Conduct, not only resonated with its failures to establish systems and controls in respect of analyst conflicts of interest but also further evidenced a complete disregard for the regulatory requirements. The

inability to substantiate the KPI comparisons in the Chinese F&B Research Report, the source of which was stated to be "Company data, FT Securities" beggars belief.

78. The Tribunal accepts the validity of the SFC's statement that FTSL: [Decision Notice, paragraph 22]

> "…failure to ensure independence and objectivity of research reports might damage investor confidence in the research sector and in the financial services industry more broadly."

79. The egregious breaches of multiple provisions in the Code of Conduct committed by FTSL in the preparation and publication of the three Research Reports on the one hand resonated with the concerns about the "independence and objectivity of analysts" which led to the SFC's Consultation Paper on the Regulatory Framework for Addressing Analyst Conflicts of Interest in 2004, and, on the other hand, served to undermine confidence in the effectiveness of the regulatory regime put in place as a result to address those concerns. As a result, it impacted on "the integrity of the securities and futures market".[16]

Pecuniary penalties imposed by the SFC for regulatory breaches by other companies

80. It is to state the obvious, to observe that the circumstances and ambit of the commission of regulatory breaches and the available mitigating factors vary enormously. Accordingly, having regard to the levels of the pecuniary penalties imposed by the SFC in other cases is often likely to be of not much assistance in determining the appropriate pecuniary penalty in another case, in this case for FTSL. That much is made abundantly clear by

[16] SFC Disciplinary Fining Guidelines.

a closer examination of the circumstances of the three cases to which the applicant referred in its submissions to the SFC. Further, it is to be noted that in only one of the three cases, Moody's, was the pecuniary penalty imposed by the SFC the subject of review to this Tribunal. Moreover, this Tribunal is under an obligation to make a 'full merits' review as if it is the original decision maker.

Moody's

81. On 11 July 2011, Moody's, a credit rating agency, published a report entitled 'Red flags for Emerging-Market Companies: A Focus on China'. The report explained that 20 red flags, grouped into five categories, were used as a framework to identify possible governance or accounting risks of "Chinese property" and "Chinese non-property" companies. Subject to qualifications, the greater number of red flags allocated to a company reflected a greater credit risk. The price of shares of many of the companies, particularly those allocated a large number of red flags, fell after publication of the report.

82. The SFC found that in breach of General Principle 1 of the Code of Conduct, namely to act "honestly, fairly, and in the best interest of its clients and the integrity of the market", Moody's: had made misleading statements to the effect that the red flag framework was part of Moody's established methodology and had been used in the past; had failed to explain and justify sufficiently the red flag framework; and had allocated red flags inappropriately to some companies, identifying companies allocated the most number of red flags as 'negative outliers' notwithstanding that the number of flags did not correlate with a higher credit risk. The SFC found that, in breach of General Principle 2, namely to act with "due skill, care and

diligence, in the best interests of its clients and the integrity of the market" the report contained 12 "glaring" factual errors.

83. On review, this Tribunal affirmed those findings, save in respect of the first alleged breach of General Principle 1, namely that Moody's gave the misleading impression that the red flag framework was an established methodology which had been used before. In addition, the Tribunal rejected the SFC's finding that Moody's was in breach of paragraph 4.3 of the Code of Conduct, namely that Moody's failed to put in place adequate control procedures concerning the preparation and publication of the report.

Pecuniary penalties

84. This Tribunal said that it was satisfied that the pecuniary penalty of HK$3 million, for each of the breaches of General Principle 1, imposed by the SFC was appropriate. Having determined that there were two, not three, such breaches, the overall penalty was reduced to HK$6 million. In respect of the breach of General Principle 2, the Tribunal determined the appropriate pecuniary penalty to be HK$5 million, not HK$6 million as imposed by the SFC.

85. As the SFC noted in the Decision Notice, the Moody's case did not involve findings of breaches contrary to paragraph 16 of the Code of Conduct or failures of internal control procedures. In those circumstances, the case is wholly irrelevant to considerations of the appropriate penalty to be imposed on FTSL.

Merrill Lynch

86. On 24 March 2017, the SFC published a reprimand, together with a Statement of Disciplinary Action, against Merrill Lynch for various breaches of regulatory requirements. First, for Merrill Lynch (Far East) Limited's ("MLFE") failure to report 'Large Open Positions' in respect of futures contracts. Secondly, for its failure, over a period of a decade from 2006, to put in place effective systems and controls to ensure compliance with that requirement. Thirdly, for failing to put in place internal controls to effectively manage and document the operation of the electronic and algorithmic trading systems and to ensure their integrity and reliability. Fourthly, for the publication by (Merrill Lynch (Asia Pacific) Limited's ("MLAP") of 34,832 research reviews, to which about 4,429 clients on average had access, in the period of about 11 years from May 2005, which might contain commentaries on future contracts, without being licensed in Type 5 regulated activity. Fifthly, for MLAP's failure to put in place effective controls to ensure compliance with the licensing requirement. Sixthly, for the publication by MLAP of research reports for the period of about five and half years from May 2011, in which there were 2,704 references to stocks in respect of which MLFE had acted as a market maker from 2011, but in respect of which MLAP failed to make such disclosure, as required by paragraph 16.5(b) of the Code of Conduct.[17]

A total pecuniary penalty of HK$15 million: mitigating factors

87. In determining to resolve its concerns about the failures of the two Merrill Lynch companies and in determining to impose a total pecuniary penalty of HK$15 million on Merrill Lynch, the SFC adverted to

[17] "**16.5 Firm financial interests and business relationships**
(b) Disclosure by firms of relevant market making activities
A firm that makes…a market in the securities in respect of the issuer… should disclose that fact in the research report."

a wide range of mitigating factors, including that the companies had self-reported to the SFC "their unlicensed activity and non-disclosure of market making activities in its research reports" and that they had "cooperated with the disciplinary action by resolving the SFC's regulatory concerns". Having described that cooperation as "prompt", the SFC said that in consequence the disciplinary proceedings had been "significantly expedited". Of that, the SFC said that otherwise, similar failures would have resulted in a "substantially higher level of fine."

88. The statement of the SFC in the Decision Notice that the breaches of the regulatory requirements were "different from that in the present case" was justified. The same observation, is appropriate in respect of the mitigating factors, given that the breaches were self-reported and that Merrill Lynch had cooperated with the disciplinary action resolving the SFC's regulatory concerns.

JP Morgan

89. On 20 October 2016, the SFC issued a public reprimand, together with a Statement of Disciplinary Action, against JP Morgan for breaches of the Code of Conduct by JP Morgan Securities (Asia Pacific) Limited ("JP Morgan (Asia Pacific)") and JP Morgan Chase Bank.

90. The pecuniary penalty of HK$3 million imposed on JP Morgan in respect of the numerous breaches by JP Morgan (Asia Pacific) was stated to be in respect of its failure:

(i) to disclose its financial interests in respect of certain listed securities covered in its research reports, contrary to paragraph 16.5(a) of the Code of Conduct;

(ii) to put in place adequate systems and controls to ensure compliance with the requirement of the disclosure of financial interests, contrary to General Principle 7 and paragraph 12.1 of the Code of Conduct;

(iii) to make clear, concise and specific disclosure in the research reports where JP Morgan is a market maker, contrary to paragraphs 16.5(b) and 16.10(a) of the Code of Conduct;

(iv) to report the breaches or suspected breaches to the SFC in a timely manner, JP Morgan doing so only around five months after discovery of the breaches, contrary to paragraph 12.5 of the Code of Conduct.

As to (i)

91. The failure was caused by deficiencies in JP Morgan's global securities position reporting system, which failed to include "stock borrow and options positions" in the calculation of positions in relevant securities. Given that the system had been in use since at least 2010 and, notwithstanding their enquiries, the SFC had been unable to establish when the reporting failures had begun, the SFC acknowledged that those failures might have occurred from 2010. In 2013, described as a "sample year", JP Morgan (Asia Pacific) was required to disclose its financial interests of more than 1% in "four listed issuers in 33 research reports, but it failed to do so in 30 of those reports, in breach of paragraph 16.5(a) of the Code of Conduct."[18]

[18] "**16.5 Firm financial interests and business relationships**
(a) Disclosure by firms of relevant financial interests
Where a firm has any financial interests in relation to an issuer….the securities in respect of which are reviewed in a research report, and such interests aggregate to an amount equal to or more than:
(i) in the case of an issuer, 1% of the issuer's market capitalisation;
…
the firm should disclose that fact in the research report."

As to (ii)

92. JP Morgan (Asia Pacific) relied on systems in the United States of America "…(which were designed for US disclosure requirements) for ensuring compliance with paragraph 16.5 of the Code of Conduct." The SFC found that JP Morgan (Asia Pacific) had "…failed to put in place adequate systems and controls to ensure compliance with the disclosure of financial interests requirements under the Code of Conduct, in breach of General Principle 7 and paragraph 12.1 of the Code of Conduct."

As to (iii)

93. The SFC noted that a standard disclosure clause was included at the end of all equity research reports published by JP Morgan (Asia Pacific), irrespective of whether or not the securities were traded in Hong Kong and were securities in which JP Morgan was a market maker, referring investors to the Stock Exchange of Hong Kong's website for them to check whether or not JP Morgan Broking (Hong Kong) Limited was a liquidity provider or market maker for the securities the subject of the research report. The SFC determine that in those circumstances JP Morgan (Asia Pacific) had failed to discharge its obligations to make "clear, concise and specific" disclosure, as required under paragraph 16.5(b) of the Code of Conduct.

As to (iv)

94. Having said that, in October 2013, JP Morgan in the United States of America had identified that "stock borrow and options positions" were not included in the position reporting system, which matter was drawn to the attention of JP Morgan (Asia Pacific) in January 2014, the SFC noted that the self-report to the SFC by JP Morgan (Asia Pacific) was not made

until 26 March 2014. It described that delay as "lengthy" and in breach of paragraph 12.5 of the Code of Conduct, which required a report "immediately" of the happening of a material breach.[19]

A pecuniary penalty of HK$3 million: mitigating factors

95. In determining to impose a pecuniary penalty of HK$3 million on JP Morgan (Asia Pacific), the SFC enumerated various matters that it said that it had taken into account, including its cooperation in resolving the SFC's concerns and in remedying the deficiencies in the reporting system.

96. As noted earlier, in the Decision Notice the SFC enumerated a number of factors, which it asserted rendered "more serious" the circumstances of the breaches of the regulatory requirements by FTSL than those of JP Morgan (Asia Pacific). First, that there was "a serious lack of internal systems and controls" to ensure compliance with regulatory requirements in respect of analyst conflict of interest. Secondly, FTSL asserted falsely in the Research Report that it had not provided any investment banking services to Chinese F&B in the previous 12 months. Thirdly, FTSL knew nothing about the Researchers who prepared the Research Reports. Fourthly, FTSL was unable to explain the provenance of the information stated in the report and to demonstrate that it was a reasonable basis for the analyses and recommendations.

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[19] "**12.5 Notifications to the Commission**

A licensed or registered person, as a firm, should report to the Commission immediately upon the happening of any one or more of the following:

(a) any material breach, infringement of or non-compliance with any law, rules regulations and codes administered or issued by the Commission…which apply to the licensed or registered person, or where it suspects any such breach, infringement or non-compliance whether by:

(i) itself; or

…"

97. The Tribunal is satisfied that, for the reasons set out above, the SFC was correct in identifying the circumstances of the regulatory breaches committed by FTSL as being more serious than those committed by JP Morgan (Asia Pacific).

Conclusion

98. Section 194 (2) of the Ordinance provides that, on a finding of guilt of misconduct against a person, the maximum penalty that may be imposed, other than in circumstances of profit gain or loss avoided, is HK$10 million. In context, it is to be noted that the misconduct was ongoing and involved multiple breaches of the Code of Conduct over a period of more than nine months. Clearly, the imposition of a pecuniary penalty is intended to be both punitive and to act as a deterrent both to FTSL and to other market participants. The Tribunal is satisfied that, in all the circumstances, the proposed pecuniary penalty of HK$5 million was entirely appropriate.

Discount

99. As noted earlier, the SFC stated that it reduced the proposed pecuniary penalty to HK$3,500,000 to take into account the fact that FTSL "did not dispute the SFC's findings" made in the Notice of Proposed Disciplinary Action. Clearly, the discount of 30% was an acknowledgement of a clear acceptance of culpability by FTSL. That approach resonates in principle with that taken by the courts in face of a plea of guilty in criminal proceedings. The Tribunal is satisfied that it was appropriate to discount the proposed pecuniary penalty to the extent and for the reasons stated by the SFC.

Financial jeopardy

100. The Tribunal rejects the belated and bare assertion made by Mr. Pau during the hearing that the imposition of the pecuniary penalty would put FTSL in "financial jeopardy". It was made only in reply and appeared to be made as an opportunistic afterthought, after Mr. Pau had been provided with a copy of the SFC Disciplinary Fining Guidelines during the course of the hearing. Further, not only was that the first time that the assertion had been made but also it was also wholly unsubstantiated. It found no place in the detailed submissions contained in the objections submitted by Stevenson, Wong & Co. in opposition to the proposed pecuniary penalty, nor was it articulated in the notice of review or in any of the subsequent communications by FTSL with the Tribunal prior to the hearing.

101. In the result, the Tribunal is satisfied that the imposition of a pecuniary penalty of HK$3,500,000 on FTSL is appropriate, which order it confirms.

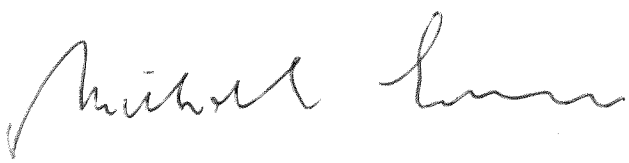
Costs

102. The Tribunal is satisfied that there is no reason why costs should not follow the event. The assertion made by Mr. Pau that such an order would inflict financial hardship on the applicant was wholly unsubstantiated. In any event, such a consideration is generally irrelevant to the award of costs in such circumstances. In the event, the Tribunal orders that the applicant pay the costs of the respondent, to be taxed if not agreed.

Delay

103. It is a matter of regret to the Tribunal that the issue of the appropriate penalty to be imposed for misconduct which occurred in the

period July 2012 to April 2013, and apparently to which the SFC was first alerted in 2014, has not been finally resolved until mid-2019.



(Mr. Michael Lunn)
Chairman, Securities and Futures Appeals Tribunal

Mr. Matthew Pau, Director of FT Securities Limited
for the Applicant

Mr. Jenkin Suen, instructed by SFC
for the Respondent