

# SFC reprimands and fines Deutsche Bank AKTIENGESELLSCHAFT and Deutsche Securities Asia Limited \$8.3 million for regulatory breaches

13 Mar 2018

The Securities and Futures Commission (SFC) has resolved its concerns with Deutsche Bank AKTIENGESELLSCHAFT (DBAG) and its wholly-owned subsidiary Deutsche Securities Asia Limited (DSAL) over regulatory breaches related to short position reporting, unlicensed regulated activities and segregation of client monies (Notes 1 & 2).

Under the resolution, the SFC publicly reprimanded and fined them a total of \$8.3 million for the following regulatory breaches:

- DBAG failed to comply with the short position reporting requirements, which resulted in a failure to report 792 reportable short positions between June 2012 and January 2015, and published 49 research reports between January 2015 and March 2017 on futures contracts without a Type 5 regulated activity registration (Notes 3 & 4); and
- DSAL failed to segregate client monies within the timeline prescribed by the Securities and Futures (Client Money) Rules in 117 incidents between January 2010 and December 2014 and such failures were rectified after the prescribed timeline (Note 5).

In reaching this resolution, the SFC took into account:

- their self-reports to the SFC of the regulatory breaches and failures;
- their cooperation with the SFC in resolving the SFC's concerns;
- remedial measures they adopted to strengthen their internal controls and systems to avoid the recurrence of similar issues; and
- their undertaking to provide the SFC with a report prepared by their internal audit team after 12 months confirming that (i) DBAG has controls in place to ensure the accurate reporting of short positions and (ii) DSAL's controls are effective in ensuring that client monies are properly segregated.

The SFC considers that the cooperation of DBAG and DSAL has expedited the disciplinary proceedings; otherwise, similar failures would have resulted in a substantially higher level of fine.

End

Notes:

1. DBAG has been registered under the Securities and Futures Ordinance (SFO) to carry on Type 1 (dealing in securities), Type 4 (advising on securities), Type 6 (advising on corporate finance) and Type 9 (asset management) regulated activities since 29 April 2008. It is also an authorized institution under the supervision of the Hong Kong Monetary Authority.
2. DSAL is licensed under the SFO to carry on Type 1 (dealing in securities), Type 2 (dealing in futures contracts), Type 4 (advising on securities), Type 5 (advising on futures contracts), Type 6 (advising on corporate finance) and Type 7 (providing automated trading services) regulated activities.
3. Under rule 4(2) of the Securities and Futures (Short Position Reporting) Rules, a person who has a reportable short position in any specified shares at the close of trading on the Hong Kong Stock Exchange must notify the SFC about the position within a specific timeframe.
4. A corporation that distributes research reports on futures contracts is required to be registered or licensed with the SFC to carry on Type 5 (advising on futures contracts) regulated activity.
5. Under section 4(4) of the Securities and Futures (Client Money) Rules, a licensed corporation shall, within one business day after its receipt of client money, pay the client money into a segregated account, to the relevant client, or in accordance with a written direction or a standing authority given by the client.

[A copy of the Statement of Disciplinary Action is available on the SFC website.](#)

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## STATEMENT OF DISCIPLINARY ACTION

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### The Disciplinary Action

1. The Securities and Futures Commission (**SFC**) has publicly reprimanded Deutsche Bank AKTIENGESELLSCHAFT (**DBAG**) and Deutsche Securities Asia Limited (**DSAL**), and fined them \$5.3 million and \$3 million respectively pursuant to sections 194 and 196 of the Securities and Futures Ordinance (**SFO**).
2. The disciplinary action is taken according to an agreement pursuant to section 201 of the SFO dated 12 March 2018 in respect of:
  - (a) DBAG's failure to accurately report its reportable short positions pursuant to the Securities and Futures (Short Position Reporting) Rules (**Short Position Reporting Rules**);
  - (b) DBAG's carrying on of a regulated activity without the required registration; and
  - (c) DSAL's failure to segregate client money pursuant to the Securities and Futures (Client Money) Rules (**Client Money Rules**).
3. DBAG has been registered under the SFO to carry on Type 1 (dealing in securities), Type 4 (advising on securities), Type 6 (advising on corporate finance) and Type 9 (asset management) regulated activities since 29 April 2008. DBAG is also an authorized institution under the supervision of the Hong Kong Monetary Authority.
4. DSAL is licensed under the SFO to carry on Type 1 (dealing in securities), Type 2 (dealing in futures contracts), Type 4 (advising on securities), Type 5 (advising on futures contracts), Type 6 (advising on corporate finance) and Type 7 (providing automated trading services) regulated activities. It is wholly owned by DBAG.

### Summary of facts

#### *Short position reporting failure*

5. In February 2015, DSAL reported to the SFC that it identified certain short positions in reportable securities were under-reported in DBAG's weekly short position reports submitted pursuant to the Short Position Reporting Rules.<sup>1</sup>
6. In June 2015, DSAL provided an updated report to the SFC following further internal enquiries. In essence, the updated report suggests that:
  - (a) in order to calculate DBAG's short position, its Hong Kong Short Position Reporting system (**HKSPRS**) obtained the relevant reference data from DBAG's internal reference data system (**Internal System**), which in turn

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<sup>1</sup> Under rule 4(2) of the Short Position Reporting Rules, a person who has a reportable short position in any specified shares at the close of trading on the HKSE must notify the SFC about the position within a specific timeframe. Rule 3 of the Short Position Reporting Rules specifies the short position reporting threshold.

obtained the relevant market capitalisation data from an external service provider;

- (b) at the relevant time, there were two sets of market capitalisation data available from the external service provider, i.e. one set containing data of all issued share capital of a stock regardless of where the stock was traded, and another set containing data of a stock as traded on a specific ticker/single exchange;
  - (c) while the calculation of DBAG's short positions as required under the Short Position Reporting Rules should make reference to issued shares admitted to trading on the Hong Kong Stock Exchange (HKSE), the Internal System only received and stored the set of market capitalisation data that included all issued share capital of a stock. Consequently, HKSPRS used this latter set of data to calculate DBAG's net short positions, which resulted in the miscalculation of DBAG's net short position values and inaccurate short position reporting; and
  - (d) DBAG omitted to report 792 short positions affecting 35 stocks between 22 June 2012 and 16 January 2015.
7. DBAG's failure to ensure compliance with the requirements for reporting reportable short positions has breached the Short Position Reporting Rules, as well as:
- (a) General Principle 2 (Diligence) of the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (**Code of Conduct**) which requires licensed corporations and registered institutions, in conducting business activities, to act with due skill, care and diligence, and in the best interests of its clients and the integrity of the market; and
  - (b) General Principle 7 (Compliance) and paragraph 12.1 (Compliance: in general) of the Code of Conduct which require licensed corporations and registered institutions to comply with, and implement and maintain measures appropriate to ensure compliance with, relevant regulatory requirements.

#### *Unlicensed regulated activity*

- 8. On 5 April 2017, DBAG reported to the SFC that it had published research reports which might constitute a Type 5 regulated activity of "advising on futures contracts" without the required registration.
- 9. An internal review conducted by DBAG found that, while not registered to carry on Type 5 regulated activity, it had published 49 research reports that include an investment opinion and/or advice on futures or certain index options (which fell within the definition of "futures contracts" under the SFO) during the period from 1 January 2015 to 27 March 2017. These research reports could be accessed either through DBAG's in-house research web portal or by email.
- 10. The publication of research reports on futures contracts without a Type 5 (advising on futures contracts) registration shows that DBAG has failed to put in place adequate controls to ensure compliance with a registration requirement<sup>2</sup>, in breach of General

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<sup>2</sup> Under section 114 of the SFO, no person shall carry on a business in a regulated activity or hold himself out as carrying on a business in a regulated activity without a licence or registration for the regulated activity.

Principle 2 (Diligence), General Principle 7 (Compliance) and paragraph 12.1 (Compliance: in general) of the Code of Conduct (see paragraph 7 above).

#### *Breach of the Client Money Rules*

11. On 11 April 2014, DSAL made a self-report to the SFC regarding its **failure to pay cash dividends of HK\$11,818,900 of a client into a segregated account within one business day after receipt of the dividends**. The dividend payment was incorrectly booked to a nominal income account rather than a segregated account of DSAL. DSAL subsequently notified the SFC on 11 September 2014 and 14 November 2014 that it had identified other instances of failure to segregate client money.
12. Upon discovery of its failure to segregate client money in accordance with the Client Money Rules, DSAL instructed its legal advisor to investigate the instances of failure and advise on appropriate remedial actions. It also engaged an independent reviewer to review amounts received in DSAL's non-segregated house accounts from 1 January 2010 to 31 December 2014 relating to equities activities and determine whether client money was handled in accordance with the Client Money Rules.
13. The available information shows, from 1 January 2010 to 31 December 2014, there were 117 incidents where client monies (for example, dividends payable to clients) were not segregated by DSAL within the timeline prescribed by the Client Money Rules. The failures were rectified within 1 to 1321 days after the timeline prescribed by the Client Money Rules.
14. It was found that there were control weaknesses which contributed to DSAL's failure to segregate some of the clients' dividends to segregated accounts. These included the lack of explicit guidance in DSAL's operating procedures on the importance of paying client dividends to segregated accounts, the lack of appreciation among the relevant staff of the importance of client money segregation, and the lack of policies and procedures in monitoring client money segregation.
15. The conduct of DSAL constitutes a breach of:
  - (a) Section 4(4) of the Client Money Rules, which requires a licensed corporation to, within one business day after its receipt of client money, pay the client money into a segregated account, to the relevant client, or in accordance with a written direction or a standing authority given by the client;
  - (b) General Principle 8 (Client assets) and paragraph 11.1 (Handling of client assets) of the Code of Conduct which require licensed corporations and registered institutions to ensure that client assets are promptly and properly accounted for and adequately safeguarded; and
  - (c) General Principle 2 (Diligence), General Principle 7 (Compliance) and paragraph 12.1 (Compliance: in general) of the Code of Conduct (see paragraph 7 above).

#### **Conclusion**

16. Having considered all the circumstances, the SFC is of the opinion that it is in the interest of the investing public and in the public interest to resolve the above concerns with DBAG and DSAL and take the disciplinary action as set out in paragraph 1.

17. In deciding the disciplinary sanctions, the SFC has taken into account:
- (a) DBAG's and DSAL's self-reports to the SFC on the regulatory breaches and failures;
  - (b) their co-operation with the SFC in resolving the SFC's concerns;
  - (c) remedial measures they adopted to strengthen their internal controls and systems to avoid the recurrence of similar issues; and
  - (d) their undertaking to provide the SFC with a report prepared by their internal audit team after 12 months confirming that (i) DBAG has controls in place to ensure the accurate reporting of short positions and (ii) DSAL's controls are effective in ensuring that client monies are properly segregated.
18. The SFC considers that the co-operation of DBAG and DSAL has expedited the disciplinary proceedings; otherwise, similar failures would have resulted in a substantially higher level of fine.