



Hong Kong

August 2015

SFC FINES LICENSED ENTITY HK\$4.5 MILLION FOR DELAY IN REPORTING TRADER'S MISCONDUCT

The Hong Kong Securities and Futures Commission (the **SFC**) has reprimanded and fined Nomura International (Hong Kong) Limited (**Nomura Hong Kong**) HK\$4.5 million for failing to immediately report misconduct by a former trader, Mr. X, in breach of the obligation to report set out in paragraph 12.5 of the Code of Conduct for Persons Licensed by and Registered with the SFC (the **Code of Conduct**).

On 11 June 2013, Nomura Hong Kong reported to the SFC a US\$3.3 million trading loss incurred by its former trader, Mr. X, on 23 May 2013. However, it failed to inform the SFC of misconduct on the part of Mr. X, namely that he had made false entries in Nomura Hong Kong's risk management system to conceal the real risk exposure of his trades and had provided false information to Nomura Hong Kong, which Mr. X had admitted, until 17 July 2013, when the SFC requested further information. This was despite Nomura Hong Kong having been informed on 10 June 2013 of Mr. X's admission of misconduct and a draft preliminary report identifying the misconduct having been available since 19 June 2013.

In its disciplinary action, the SFC found that Nomura Hong Kong should have reported Mr. X's misconduct in its 11 June report to the SFC and that its failure to do so constituted a breach of paragraph 12.5 of the Code of Conduct.¹ The SFC rejected Nomura Hong Kong's argument that it delayed reporting the misconduct until it had concluded its investigation into the matter. The SFC noted that paragraph 12.5 of the Code of Conduct requires licensed entities to report misconduct

and suspected misconduct to the SFC immediately upon discovery, not when they have completed their own internal investigations into the matter. The SFC fined Nomura Hong Kong HK\$4.5 million under section 194 of the Securities and Futures Ordinance, which entitles the SFC to impose a number of sanctions where the SFC considers that an entity which is licensed or registered by the SFC is not fit and proper to remain licensed or registered.

Chronology

Below is a chronology of the key events.

23 May 2013	Mr. X incurred a US\$3.3 million trading loss and reported the loss to his supervisors. Nomura HK's Operational Risk department initiates an inquiry as Mr. X had reported an earlier trading loss in April 2013.
30 May 2013	Nomura HK discovers inconsistencies between Mr. X's trading activities on 23 May 2013 and his explanation of the trading loss on that day.
4 June 2013	Mr. X (on secondment from Nomura Japan) returns to Japan before the completion of Nomura HK's inquiry. Nomura HK notifies Nomura Japan of the inconsistencies discovered.

¹ The SFC's Statement of Disciplinary Action in relation to Nomura Hong Kong is available on the SFC website at <http://www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/openAppendix?refNo=15PR80&appendix=0>

5 June 2013	Mr. X admits in an interview with Nomura Japan that he made manual adjustments in Nomura HK's risk management system in order to avoid showing the real level of risk exposure resulting from his trading activities.
10 June 2013	The contents of the interview are relayed to Nomura HK informing it of Mr. X's admission. Senior member of Nomura HK's Compliance staff states his view that the admission of misconduct should be reported to the SFC but this advice is not followed.
11 June 2013	Nomura HK reports to the SFC the 23 May trading loss and Mr. X's 5 June repatriation to Japan. The report does not mention the misconduct by Mr. X, but states that a review of relevant trades is being performed and that any issues identified will be reported to the SFC.
19 June 2013	Draft preliminary report of Nomura HK's investigation includes findings that Mr. X misrepresented his trading activities to management and made adjustments to Nomura HK's risk management system. These findings are not reported to the SFC.
10 July 2013	SFC makes further enquiries about results of Nomura HK's review of Mr. X's trades.
17 July 2013	Nomura HK informs SFC for the first time that Mr X had engaged in inappropriate conduct.
19 July 2013	Nomura HK provides preliminary report to the SFC.

Breaches by Nomura Hong Kong

Paragraph 12.5 of the Code of Conduct sets out matters that entities licensed or registered by the SFC are required to immediately report to the SFC. They include:

“(a) any material breach, infringement of or non-compliance with any law, rules, regulations, and codes administered or issued by the Commission [the SFC] or where it suspects any such breach, infringement or non-compliance ... by persons it employs or appoints to conduct business with clients or other licensed or registered persons, giving particulars of the breach, infringement or non-compliance, or suspected breach, infringement or non-compliance, and relevant information and documents;”

The SFC found that Nomura Hong Kong was aware by 10 June 2013 that Mr. X had acted dishonestly in adjusting Nomura's risk management system to cover up the real level of risk exposure caused by his trading activities. However, it failed to include this important information in its 11 June report to the SFC, notwithstanding that it had discovered inconsistencies on 30 May between Mr. X's trading activities on 23 May and his explanation of the trading loss to management and his admission of misconduct had been relayed to Nomura Hong on 10 June.

Nomura Hong Kong only notified the SFC of the misconduct which occurred on 23 May on 17 July, and then only as part of its response to further enquiries made by the SFC following the 11 June report. This was despite the findings of Mr. X's misconduct identified in Nomura Hong Kong's draft preliminary report which was ready on 19 June, but was only delivered to the SFC on 19 July after the SFC chased Nomura for its review of Mr. X's trades on 17 July.

SFC Disciplinary Action

Section 194 of the SFO allows the SFC to impose a number of penalties where (among others) it is of the opinion that a regulated person (i.e. an entity which is licensed or registered by the SFC) is not a fit and proper person to remain a regulated person. Section 129(1)(c) of the SFO provides that, in considering whether a person is fit and proper, the SFC may consider the person's ability to carry on the regulated activity competently, honestly and fairly.

The SFC found that Nomura Hong Kong omitted highly relevant information from its 11 June report to the SFC and had to be chased to report properly. Nomura Hong Kong's failure to immediately report Mr. X's misconduct constituted a breach of paragraph 12.5 of the Code of Conduct and called into question its fitness and properness to be an SFC-licensed entity.

The SFC reprimanded Nomura Hong Kong for its conduct and fined it HK\$4.5 million under Section 194(2)(b)(i) SFO which allows the SFC to impose a maximum fine of the greater of HK\$10 million or 3 times the amount of profit gained or loss avoided by the conduct the subject of the disciplinary action.

Implications

Entities which are licensed or registered by the SFC are reminded of the need to comply with paragraph 12.5 of the Code of Conduct and its requirement that any breach or failure

to comply, or any suspected breach or failure to comply, with any laws, rules, regulations or SFC codes, by any of their employees, must be reported to the SFC immediately upon discovery.

The SFC's press release² of 30 July 2015 quotes Mr. Mark Steward, the SFC's Executive Director of Enforcement, who goes even further saying "Intermediaries must report problems to us immediately - not after internal investigation, not after legal advice has been obtained but straightaway".

² SFC. "SFC reprimands and fines Nomura International (Hong Kong) Limited HK\$4.5 million for regulatory breach". 30 July 2015. Available on the SFC website at <http://www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/doc?refNo=15PR80>

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