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SFC reprimands and fines Solid King Securities Limited \$700,000

3 May 2016

The Securities and Futures Commission (SFC) has reprimanded Solid King Securities Limited (Solid King) and fined it \$700,000 for failing to comply with the telephone recording requirements under the Code of Conduct and put in place effective internal control procedures to safeguard its telephone recording system and monitor its clients' telephone orders (Notes 1 & 2).

The SFC's investigation found that Solid King had failed to record client order instructions received through one of its telephone extension lines between May 2013 and January 2014 (relevant period) as the telephone machine concerned was disconnected from Solid King's telephone recording system due to a loose electric cable.

During the relevant period, Solid King did not conduct any routine checks on its telephone recording system, nor did it review the recordings of client telephone orders on a regular basis. The loose electric cable was detected and re-attached to the telephone recording system by Solid King on 2 January 2014 and it discovered that its telephone recording system had failed to record client order instructions during the relevant period when it was required by the SFC on 8 January 2014 to produce the telephone recordings of certain client orders. As a result of the undetected defect in its telephone recording system, Solid King was unable to produce the telephone recordings required by the SFC.

Telephone recording of client orders is an integral part of an intermediary's audit trails. It protects the interests of both the intermediary and its clients and serves as an effective compliance monitoring tool for preventing or detecting irregularities or fraudulent activities. Solid King's failures have called into question its fitness and properness as an SFC licensee (Note 3).

End

Notes:

1. Solid King is licensed to carry on Type 1 (dealing in securities) and Type 4 (advising on securities) regulated activities under the Securities and Futures Ordinance.
2. Paragraph 3.9(b) of the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission requires a licensed or registered person to: (i) use a telephone recording system to record the order instructions that are received from clients through the telephone; and (ii) maintain the telephone recordings as part of its records for at least six months.
3. Please see the [Circular](#) to the SFC's Licensed Intermediaries on Telephone Recording Requirements dated 25 November 2004 for details.

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

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STATEMENT OF DISCIPLINARY ACTION

The Disciplinary Action

1. The Securities and Futures Commission (**SFC**) has publicly reprimanded Solid King Securities Limited (**Solid King**) and fined it \$700,000 pursuant to section 194 of the Securities and Futures Ordinance (**SFO**).
2. The disciplinary action is taken because Solid King had:
 - (a) failed to record and maintain the telephone recording of all client order instructions received through one of its telephone extension lines during the period from 28 May 2013 to 2 January 2014 (**Relevant Period**); and
 - (b) failed to put in place effective internal control procedures to safeguard its telephone recording system and monitor its clients' telephone orders.

Summary of facts

3. Solid King is licensed to carry on Type 1 (Dealing in Securities) and Type 4 (Advising on Securities) regulated activities under the SFO.
4. The SFC's inquiry into Solid King's conduct stemmed from an insider dealing investigation, in which Solid King was required in January 2014 to produce records (including telephone tapes, dealing tickets, blotters) showing the times at and means through which certain clients placed their orders for shares in the company in question. In response, Solid King submitted the relevant dealing tickets and extracts from its internal register of client instruction and trade confirmation to the SFC. However, it informed the SFC that the recorder in respect of the telephone line through which the relevant clients placed their orders had ceased to function from 28 May 2013 to 2 January 2014 and hence no telephone recording was provided.
5. When the SFC inquired into Solid King's failure to record and maintain the telephone recording of the relevant clients' order instructions, the SFC found that:
 - a. after market close on 2 January 2014, Li Leung Wa (**Li**), a Responsible Officer of Solid King, discovered that the telephone machine with the extension number 230 (**Ext 230**) was disconnected from Solid King's telephone recording system due to a loose electric cable (**Cable**). He immediately re-attached the Cable to the recording system and checked that the Cable was in place. However, he did not check whether the recording of any previous client order instructions was missing;
 - b. on 8 January 2014, after Solid King received a notice from the SFC requiring it to produce the telephone recording of one of its clients' order instructions received during the Relevant Period, Li checked Solid King's

telephone recording system and found that it did not contain any recording of telephone conversations on Ext 230 during the Relevant Period;

- c. Ext 230 was used by one of the dealers at Solid King to receive calls from clients in respect of their order instructions. It was one out of 11 recorded telephone lines that were used by account executives and dealers at Solid King to receive client order instructions during the Relevant Period; and
 - d. for around 7 months, no one at Solid King noticed that the Cable was disconnected from the telephone recording system and that no clients' order instructions communicated via Ext 230 could be recorded.
6. The SFC also found that Solid King did not carry out any routine checks on the telephone recording system to make sure that it functioned properly. In addition, no one at Solid King reviewed the recordings of the clients' telephone order instructions unless: (i) a client complained about an order; (ii) a dealer or account executive could not hear a particular client order instruction over the phone clearly; or (iii) an external party such as the auditors made a request to review the recording of particular client orders. The nature of any such reviews were ad hoc, infrequent and specific to the particular order instructions which either could not be heard clearly, or were the subject of the client's dispute, or selected by the auditors, as the case may be.
 7. Remedial measures have been implemented by Solid King to enhance its telephone recording system and to monitor its clients' telephone orders. Since February 2014, Solid King has been conducting routine checks on its telephone recording system and regular reviews of its clients' orders against telephone recordings.

Reasons for action

8. Paragraph 3.9(b) of the Code of Conduct¹ requires licensed persons to record and maintain telephone recordings of client orders as part of its records for at least six months.
9. Paragraph 4.3 of the Code of Conduct states that: "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 persons from financial loss arising from theft, fraud, and other dishonest acts, professional misconduct or omissions."
10. General Principles 2, 3 and 7 of the Code of Conduct provide that:

GP2. Diligence

In conducting its business activities, a licensed or registered person should act with due skill, care and diligence, in the best interests of its clients and the integrity of the market.

¹ The Code of Conduct for Persons Licensed by or Registered with the SFC

GP3. Capabilities

A licensed or registered person should have and employ effectively the resources and procedures which are needed for the proper performance of its business activities.

GP7. Compliance

A licensed or registered person should comply with all regulatory requirements applicable to the conduct of its business activities so as to promote the best interests of clients and the integrity of the market.

11. Solid King's failure to record and maintain the telephone recordings of all client instructions received through Ext 230 during the Relevant Period constitutes breaches of paragraph 3.9(b) and General Principle 7 of the Code of Conduct. By failing to carry out routine checks on the telephone recording system and to conduct regular reviews on the recordings of its clients' telephone orders, Solid King had also breached paragraph 4.3 and General Principles 2 and 3 of the Code of Conduct.
12. As a result of its breach of the order recording requirements, Solid King failed to produce the telephone recording of the relevant clients' order instructions as required by the SFC, thereby depriving the SFC of the opportunity to review the telephone recording in its insider dealing investigation.

Conclusion

13. Telephone recordings of client orders is an integral part of the audit trails which intermediaries should maintain in order to facilitate the resolution of any trade disputes. It is also an effective compliance monitoring tool for preventing or detecting any irregularities or fraudulent activities.² As a licensed intermediary, Solid King should have put in place effective procedures to ensure the integrity, reliability and security of the telephone recording system.
14. Having considered all the circumstances, the SFC is of the opinion that Solid King's fitness and properness as a licensed person has been called into question.
15. In deciding the disciplinary sanction, the SFC has had regard to the SFC Disciplinary Fining Guidelines and taken into account all relevant circumstances, including Solid King's clean disciplinary record, the remedial measures adopted by Solid King to monitor and enhance its telephone recording system and its cooperation with the SFC in the investigation.

² See the SFC's Circular to SFC's Licensed Intermediaries on "*Telephone Recording Requirements*" dated 25 November 2004 and the Circular to Licensed Corporations on "*Guarding against Risk of Client Asset Misappropriation*" dated 1 February 2013.