



HONG KONG MONETARY AUTHORITY  
香港金融管理局

Our Ref.: B1/15C  
B9/81C

31 August 2016

The Chief Executive  
All Authorized Institutions

Dear Sir/Madam,

**Operational Incidents Watch**

The Hong Kong Monetary Authority published today the enclosed sixth issue of Operational Incidents Watch.

The Operational Incidents Watch is a periodic newsletter to share with the industry the major lessons learnt from selected significant operational incidents that have happened in the banking sector. It aims at facilitating authorized institutions (AIs) and members of the public in Hong Kong to stay alert and to take appropriate measures to prevent similar incidents from happening to them. In this connection, we expect AIs' senior management to ensure that their relevant business lines and operational risk management functions will take into account the Operational Incidents Watch to review and enhance where appropriate the relevant risk management controls, including any applicable customer education efforts.

If there are any questions on the Operational Incidents Watch, please contact Mr Parry Tang at 2878-1524 or Ms Debora Chan at 2878-1593.

Yours faithfully,

Raymond Chan  
Executive Director (Banking Supervision)

Encl



*Operational Incidents Watch is a periodic newsletter published by the Banking Supervision Department of the Hong Kong Monetary Authority (HKMA). It summarises the major lessons learnt from selected operational incidents<sup>1</sup> that have happened in the banking industry and led to impact on relevant customers or material financial losses of the authorized institutions (AIs) concerned. It aims at facilitating AIs and members of the public in Hong Kong to stay alert and to take appropriate measures to prevent similar incidents from happening to them.*

In this newsletter, the modus operandi or the factors and key control loopholes leading to two operational incidents are outlined: (i) insufficient controls over storage of title deeds of customers; and (ii) underpayment of stamp duty for certain OTC transactions.

## **Insufficient controls over storage of title deeds of customers**

An AI was unable to locate the title deeds of some customers due to deficiencies inherent in its controls over safekeeping of these documents.

### **Modus operandi / factors leading to the incident**

The AI received a request from a customer's solicitor for returning the title deed for amending his title to the mortgaged property. However, the AI's Credit Administration Unit was unable to locate the document even after conducting a full search of the vault as well as the AI's premises. The AI also did not maintain proper records about the persons involved and the timing when the title deed was received from the customer or taken out from the vault. In the light of the incident, the AI then conducted a further check of all physical title deeds stored in the vault

---

<sup>1</sup> Because of sensitivity, the incidents mentioned in this newsletter may be prepared on the basis of synthesis of multiple incidents and certain details of the incidents may deliberately be omitted.

against the inventory register and it uncovered that several title deeds of other customers were also missing.

The AI subsequently informed the affected customers and reached agreements with them about compensation measures, including reimbursing the legal expenses incurred by the customers for legal advice and remedial measures, and compensating the customers for any financial losses as a result of the incident.

### **Control loopholes and lessons learnt**

- i. While two staff members of the Credit Administration Unit were assigned to manage the storage of the title deeds, the supervisor did not exercise adequate supervision of these members. The following control deficiencies existed without being identified by the supervisor:
  - Particulars related to movements of title deeds handled by the Credit Administration Unit were not properly recorded;
  - Records of annual reconciliations of title deeds held in the vault against the inventory register were not maintained; and
  - During a recent annual reconciliation of title deeds, the responsible staff did not check the physical documents held in the vault. Instead, the staff member just relied on an ad-hoc physical stocktake of title deeds carried out by the Credit Administration Unit for office relocation purpose.
- ii. There was a lack of guideline on how the AI's relationship managers should handle physical credit documents received from customers. In particular, there were cases where the relationship managers received title deeds from customers but they did not record the receipt of these documents. They also failed to promptly pass the documents to the Credit Administration Unit for safekeeping.

## Underpayment of stamp duty for certain OTC transactions

The incident involved underpayment of stamp duty for certain over-the-counter (OTC) transactions due to incorrect stamp duty calculation processes for several years, which could result in material penalty payment.

### **Modus operandi / factors leading to the incident**

The AI provided OTC derivatives to its clients where the underlying of the OTC derivatives were shares listed on a stock market. Some of these OTC derivatives transactions could result in physical settlement of the underlying listed shares, which involved two separate ownership transfers of underlying stocks: (i) the transfer between the AI and a third-party financial institution (i.e. the market leg); and (ii) the transfer between the AI and its client (i.e. the client leg). Stamp duty would be payable on these transactions on both the market leg and the client leg. However, the AI's long-established operational processes for stamp duty calculation had been set up to cater for the stamp duty payment of the market leg only but not the client leg. Shortly after realising the issue, the AI disclosed the matter on a voluntary basis to the relevant tax authority and made good of any non-payment.

### **Control loopholes and lessons learnt**

- i. The relevant OTC products had not been signed-off formally via the new product approval process. The stamp duty calculation processes had not been properly reviewed by the AI's tax department or subject to any independent review.
- ii. Subsequent to the incident, the AI engaged a tax advisor to review the relevant processes and the review also covered the stamp duty calculation processes in other stock markets.