

## Hong Kong: Ramp and dump schemes - what are the implications for Hong Kong financial intermediaries?

### In brief

"Ramp and dump" or "pump and dump" schemes continue to attract significant press coverage and are an enforcement priority for the Securities and Futures Commission (SFC) in Hong Kong. These schemes do not only have penalties for the fraudsters, but could also have significant implications for SFC-licensed corporations (LCs) who are the gatekeepers for the financial system. Recent statements by the SFC and The Stock Exchange of Hong Kong Limited (SEHK) suggest that the impact of these schemes is not limited to secondary trading and may extend to initial public offerings (IPOs). We discuss the key stages of these schemes, the primary regulatory obligations of LCs and the enforcement trends of the SFC.

### In this issue

#### Key takeaways

[Background: What is a ramp and dump scheme?](#)

[Regulatory obligations of LCs](#)

### Key takeaways

The SFC has reinforced in its latest Annual Report and Notification Circular that ramp and dump schemes remain an enforcement priority and that it does not tolerate any form of market misconduct. To reduce the risk from these types of schemes, LCs should do the following:

- Ensure that all employees are aware of, and comply with, the applicable regulatory requirements and internal processes and procedures.
- Review client onboarding and ongoing monitoring processes to ensure any high-risk client and unusual transaction patterns are identified in a timely manner with follow-up actions being taken promptly.
- Provide regular and ongoing reminders and trainings to staff on the red flag indicators and build in the red flag identification, escalation and blocking mechanisms into the trading and account monitoring programs.
- Implement processes to identify any potential market misconduct by clients or employees at an early stage to enable timely escalation and reporting to the regulators.
- Ensure that requests for information from the regulators are addressed in a timely and thorough manner.

In the IPO context, LCs should monitor the ongoing SFC and SEHK commentary regarding the development of the Proposed Code and "Sponsor Coupling" proposal for further developments and apply professional skepticism to ensure the following:

- The pricing of the IPO shares is fair and reasonable.
- Consideration is given to whether existing processes and procedures are sufficiently robust to prevent any of the potential misconduct that has been highlighted by the SFC and SEHK.



## Background: What is a ramp and dump scheme?

In the September 2020 Special Edition Enforcement Reporter ("**Enforcement Reporter**"),<sup>1</sup> the SFC issued a warning regarding stock investment schemes conducted through social media. The Enforcement Reporter discussed the key aspects of "ramp and dump" schemes and relevant legal and regulatory provisions.

The SFC's efforts to combat these schemes and educate investors have continued and increased in frequency since it released the Enforcement Reporter. In May 2021, the SFC issued a further warning to "netizens".<sup>2</sup> In the latest Annual Report issued by the SFC, the SFC again emphasises that cracking down on ramp and dump schemes is one of its enforcement priorities for the year.<sup>3</sup>

The three key stages of a "ramp and dump" scheme highlighted in the Enforcement Reporter are as follows:

- **Cornering and ramping** - Fraudsters often use multiple nominee accounts to corner the shares (i.e., gain control of the majority of the shares) of the target company and drive the share price up.
- **Offloading** - Fraudsters use messaging applications and other social media platforms to induce unrelated investors to purchase the shares at the inflated price.
- **Dumping** - Fraudsters dump all remaining shares in the market and cause the share price to collapse.

LCs, which are engaged in buying and selling stocks in the market on behalf of their clients, are the gatekeepers and market monitors in all the above stages.

## Regulatory obligations of LCs

### General Code of Conduct obligations

The Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission ("**Code of Conduct**")<sup>4</sup> imposes obligations on LCs that are relevant to combatting ramp and dump schemes including:

- General Principles 1 and 2, which, among others, impose a general obligation on LCs to act in the best interests of clients and the integrity of the market.
- Paragraph 5.1, which requires LCs to take all reasonable steps to establish the true and full identity of, each of their clients and determine each client's financial situation, investment experience, and investment objectives.
- Paragraph 5.4, which requires LCs to be satisfied as to:
  - (i) the identity, address and contact details of:
    - (a) the person or entity ultimately responsible for originating the instruction in relation to a transaction;
    - (b) the person or entity that stands to gain the commercial or economic benefit from the transaction and/or bear its commercial or economic risk; and
  - (ii) the instruction given by the person or entity referred to in (i).
- Paragraph 12.5(f), which requires LCs to report to the SFC any material breach, infringement or non-compliance with market misconduct provisions set out in Part XIII or Part XIV of the SFO by an LC's clients.

LCs should ensure they put in place proper measures and controls in client onboarding procedures and client/transaction monitoring processes to capture the above.

<sup>1</sup> [SFC Enforcement Reporter Sep 2020](#)

<sup>2</sup> [SFC warns netizens of online investment scams](#)

<sup>3</sup> [Securities and Futures Commission Annual Report 2020-21](#)

<sup>4</sup> [Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission](#)



In its recent June 2021 circular regarding notification to the SFC of suspected ramp and dump schemes ("**Notification Circular**"),<sup>5</sup> the SFC has specifically reminded LCs of the importance of paragraph 12.5 reporting to be made in a timely manner. The SFC clarified that the reporting threshold is low and is triggered without:

- Identifying which particular provisions of the SFO clients are suspected to have been breached;
- Working out exactly how the breaches were committed; or
- Ascertaining if profits were made or losses were avoided as a result of the suspected breach, or the amount of such profits or losses.

The SFC has provided guidance on the red flags that may indicate a potential ramp and dump scam and should be taken into consideration in assessing whether reporting to the SFC is required, such as:

- Clients effecting transactions with amounts of funds that are not consistent/commensurate with the client's financial/risk profile;
- Clients who regularly acquire shares through bought and sold notes, or on a free-of-payment basis, or who receive large third-party deposits into their accounts;
- Clients who bought shares on a delayed settlement basis, following which the share price rose substantially during the delayed settlement period, and then gave instructions before the payment date to sell the shares;
- Clients only transacting in one or two stocks over an extended period;
- Clients who bought shares in a particular stock toward the end of the trading day in a way that had the effect of substantially raising the closing price on a number of days, particularly when the company is a thinly traded, small-cap stock with a highly concentrated shareholding and it has experienced a sustained price increase that cannot be explained by any corporate or sector-specific news;
- Clients who sold a large volume of shares in a particular company shortly before a collapse of the share price, which cannot be explained by any corporate or sector-specific news;
- A large number of seemingly unrelated clients having authorised the same third party (which is not a licensed representative or registered individual of a licensed intermediary) to operate their accounts; or
- A large number of seemingly unrelated clients that share the same trading and settlement patterns (e.g., investing in the same stocks) or have the same correspondence address such as telephone numbers or email addresses.

## Anti-Money Laundering and Counter-Terrorist Financing obligations

The Anti-Money Laundering and Counter-Terrorist Financing Ordinance (AMLO),<sup>6</sup> together with the Guideline on Anti-Money Laundering and Counter-Terrorist Financing,<sup>7</sup> impose key obligations on LCs to combat the establishment, or ongoing use, of securities trading accounts by fraudsters, which include transfers of the funds facilitating the illegal sales/purchase of securities and layering of the profits and proceeds derived from the scam. LCs should also be aware of the suspicious transaction reporting obligations under the Drug Trafficking (Recovery of Proceeds) Ordinance, the Organized and Serious Crimes Ordinance and the United Nations (Anti-Terrorism Measures) Ordinance.

LCs should put in place proper measures and controls such as the following to cover the different stages of their dealings with, or for, their clients in securities transactions:

- Conduct customer due diligence (CDD) at the client on-boarding stage and also when there is any suspicion of accounts being involved in money laundering/terrorist financing or when there are doubts on the veracity/adequacy of CDD information previously obtained.
- Identify the source of wealth and source of funds.
- Apply enhanced due diligence measures in high-risk situations.

<sup>5</sup> [Circular to intermediaries – Notification to the SFC of suspected ramp and dump scams involving market manipulation in the shares of companies listed on the Stock Exchange of Hong Kong](#)

<sup>6</sup> [The Anti-Money Laundering and Counter-Terrorist Financing Ordinance \(AMLO\)](#)

<sup>7</sup> [Guideline on Anti-Money Laundering and Counter-Financing of Terrorism \(For Licensed Corporations\)](#)



- Prohibit the use of anonymous accounts or accounts in fictitious names for any new or existing client.
- Conduct appropriate scrutiny of transactions carried out for the client to ensure that they are consistent with the LC's knowledge of the client, the client's business, risk profile and source of funds.
- Identify transactions that are complex, unusually large in amount or of an unusual pattern and have no apparent economic or lawful purpose, and examine the background and purposes of those transactions.
- Identify suspicious transactions and report to the regulators in a timely manner.

## Nominee accounts and third-party deposits and payments

Fraudsters commonly use nominee accounts to conceal their identities and activities when gaining control of a target company's shares. In the SFC's October 2018 circular regarding the use of "nominees" and "warehousing" arrangements in market and corporate misconduct, the SFC reminded LCs of their obligations when dealing with these kinds of accounts, including to: (i) know your clients; (ii) detect potentially illegal or manipulative activities; and (iii) make prompt follow-up enquiries and report suspicious transactions where necessary.

Payments to, or from, client accounts to third parties are also common tools used to facilitate money laundering or other misconduct. In a May 2019 circular<sup>8</sup> ("**Third Party Payment Circular**"), the SFC highlighted that these arrangements may be used to disguise the true beneficial owner, source, or even recipient of funds. Ramp and dump fraudsters frequently exploit this area to conceal their activities and prevent tracing of the gains from the scheme. The SFC recommended in its Third Party Payment Circular that serious consideration be given to refusing third-party deposits and payments. Such payments should only be accepted by LCs where they are consistent with a client's profile and normal commercial practices and subject to adequate control measures to mitigate against the associated risks.

## IPO related conduct

In February 2021, the SFC released a Consultation Paper ("**Consultation Paper**") on: (i) the Proposed Code of Conduct on Bookbuilding and Placing Activities in Equity Capital Market and Debt Capital Market Transactions ("**Proposed Code**") and (ii) the "Sponsor Coupling" Proposal.<sup>9</sup> The Proposed Code and "Sponsor Coupling" Proposal seek to address conduct issues identified during the SFC thematic review process including the following:

- The use of price-insensitive retail demand to drive up the price of an offering to a level desired by the issuer, but not sustainable in secondary market trading<sup>10</sup>;
- Intermediaries knowingly placing orders in the order book which had been inflated<sup>11</sup>;
- The use of X-orders to inflate what may be seen to be market driven demand in the order book<sup>12</sup>;
- Rebating brokerage fees to IPO investors so that those investors will pay a lower price for shares than other investors<sup>13</sup>; and
- Cases where the price discovery process was hampered by factors including brokers without a mandate "swarming" order books with orders of unknown quantity<sup>14</sup>.

The Consultation Paper was followed in May 2021 by a joint statement ("**Joint Statement**") released by the SFC and the SEHK<sup>15</sup> noting problematic issues in recent IPOs. The Joint Statement reinforced that the SFC and SEHK will investigate and take action against any parties involved in any of these circumstances:

- (i) There are any unusual movements in the share price or trading volume;
- (ii) There is a high concentration of shareholdings after listing;
- (iii) It appears that a listing document may have included false, incomplete or misleading information;
- (iv) There is evidence of other misconduct.

<sup>8</sup> [Circular to licensed corporations and associated entities Third-party deposits and payments](#)

<sup>9</sup> [Consultation Paper on \(i\) the Proposed Code of Conduct on Bookbuilding and Placing Activities in Equity Capital Market and Debt Capital Market Transactions and \(ii\) the "Sponsor Coupling" Proposal](#)

<sup>10</sup> See paragraph 26 of the Consultation Paper.

<sup>11</sup> See paragraph 27 of the Consultation Paper.

<sup>12</sup> See paragraph 28 of the Consultation Paper.

<sup>13</sup> See paragraph 33 of the Consultation Paper.

<sup>14</sup> See paragraph 4 of the Consultation Paper.

<sup>15</sup> [SFC HKEX Joint statement on IPO-related misconduct](#)



## Possible disciplinary sanctions, civil liabilities and criminal offences

The SFC has demonstrated no hesitation in investigating and cracking down on ramp and dump scams. On 7 July 2021, the SFC conducted a joint operation with the Independent Commission against Corruption (ICAC) which involved searches of the offices of a listed company and one of the underwriters in its IPO, and the arrest of a senior executive of the listed company.<sup>16</sup> The SFC and ICAC suspected that offences related to a ramp-and-dump scheme, other market misconduct and corruption offences might have been committed.

Earlier this year, the SFC and the police also conducted joint operations against several syndicates suspected of operating ramp and dump schemes.<sup>17</sup> Numerous offices and residences were raided in the operations. Besides, the SFC has issued restriction notices to various LCs freezing client accounts related to suspected ramp and dump scams.<sup>18</sup> The LCs are required to notify the SFC if they receive any instructions to dispose of or deal with any assets in those trading accounts.

In light of this current enforcement priority, the SFC's investigation into ramp and dump scams may possibly lead to regulatory inquiries/investigations into the prevailing practices of the LCs and the fitness and properness of licensed persons and/or managers-in-charge of core functions of the LCs. If the SFC is of the opinion that the LC (or any regulated person) is guilty of misconduct or not fit and proper, the SFC may impose disciplinary sanctions such as the following:

- Private or public reprimand;
- A fine up to a maximum of HK\$10 million or three times the profit gained or loss avoided, whichever is the higher;
- Suspension of licence;
- Revocation of licence.

Further, civil liabilities and criminal offences may arise if there is evidence suggesting that the LC and/or its staff facilitated and/or assisted in the fraudsters' operation of a ramp and dump scheme. Relevant criminal offences may include market misconduct offences under the SFO, money-laundering offences and the common law offence of conspiracy to defraud.

In respect of the market misconduct provisions under the SFO, the SFC may bring civil proceedings before the Market Misconduct Tribunal (MMT) or commence criminal prosecutions. The MMT is empowered to make various orders such as disqualification orders and costs orders. As for individuals who committed a market misconduct offence, they may be subject to imprisonment for up to 10 years and a fine of up to HK\$10 million on indictment, or imprisonment for up to three years and a fine of up to HK\$1 million on a summary conviction.

To discuss how our experience can assist you, or if you have any questions on any of the matters above, please do not hesitate to liaise with your usual contact at Baker McKenzie or the lawyers listed in this alert.

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<sup>16</sup> SFC and ICAC search a listed company and an underwriter

<sup>17</sup> SFC and Police joint operation against listed company and senior executives and SFC and Police joint operation against suspected ramp-and-dump syndicate

<sup>18</sup> SFC issues restriction notices to 15 brokers to freeze client accounts linked to suspected social media ramp-and-dump scam and SFC issues restriction notices to 13 brokers to freeze client accounts linked to suspected social media ramp-and-dump scam



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