



Republic of the Philippines  
Department of Finance  
**Securities and Exchange Commission**  
SEC Bldg. EDSA, Greenhills, Mandaluyong City

COMMISSION *EN BANC*

**HK SECURITIES, INC.,**

*Appellant,*

**-versus-**

SEC En Banc Case No. 01-09-152

**THE MARKET INTEGRITY BOARD OF  
THE PHILIPPINE STOCK EXCHANGE,**

*Appellee.*

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**DECISION**

This refers to HK SECURITIES, INC.'s ('HKS') appeal from the Philippine Stock Exchange ('PSE') - Market Integrity Board's ('MIB') *Resolution No. 22 (October) - Series of 2008*.

PSE is a registered exchange and self-regulating organization under the Securities Regulation Code<sup>1</sup> ('SRC'). HKS is a trading participant at the PSE.

Sometime in October 2007, November 2007, and January 2008, the Market Regulation Division of the PSE ('PSE-MRD') conducted spot audits on HKS. The spot audits revealed that HKS was not compliant with the reserve requirement – having a deficiency amounting to Php 2,061,365.39. It was also discovered that there seems to be misstatements in HKS' declared marketable securities account and short term placements.<sup>2</sup>

Consequently, PSE-MRD conducted a regular audit as of 31 March 2008. The findings in the regular audit were:<sup>3</sup>

<sup>1</sup> Republic Act 8299 (08 August 2000.)

<sup>2</sup> Spot Audit Report submitted as Annexes A to A-2 of PSE's Reply-Memorandum.

<sup>3</sup> Statement of Findings dated 31 March 2008 submitted as Annex D of the Reply-Memorandum.

1. HKS indicated that its short-term placements amounted to Php 11,051,939.50 representing five (5) U.S. dollar time deposit accounts with Citibank-Greenhills Branch. Upon review, PSE-MRD discovered that four (4) out of the five (5) accounts were actually the personal accounts of HKS's nominees, that is, under the name "Rodolfo Cruz &/or Cecilia Cruz" or "Rodolfo Cruz &/ or Cecilia Cruz &/or Primalee Christine." These four (4) accounts amounted to US\$ 227,751.40 equivalent to Php 9,337,807.40. HKS superimposed the words "HK Securities, Inc." over the actual account names to make it appear that the accounts belong to HKS.<sup>4</sup> Thus, PSE-MRD determined that Php 9.3 million should be excluded from the short-term placements since it is not under the name of HKS.

Further, Citibank N.A. certified that HKS's accounts with it, as of 31 March 2008, consist only of:<sup>5</sup>

Dollar CitiChecking Plus	808.74
MultiMoney Term Deposit	41,870.44
Total	\$42,678.00

Removing Php 9.3 million, representing the value of the accounts not in the name of HKS, from HKS's reported cash balance of Php 11 million reduces HKS's Risk-based Capital Adequacy (RBCA) Ratio from three hundred thirteen percent (313%) to negative thirty four percent (-34%). This low RBCA ratio means that, contrary to its representations, HKS was actually in violation of the required RBCA ratio level under SEC Memorandum Circular No. 16, Series of 2004 (RBCA Rules).

2. HKS also failed to present certain books and records required by the PSE-MRD in violation of SRC Rule 52.1(1)(B).
3. HKS' Cash Receipts and Disbursements Books for the period covering January to March, 2008 disclosed frequent and periodic payments made to various credit card companies, CHALECO and officers/employees. These disbursements were explained by HK as advances by the principal stockholder which were automatically adjusted to "Advances to/from Stockholders."
4. A review of "Advances from/to Stockholders" disclosed unusual entries mostly pertaining to accounts "Due to/from Customer". These entries were explained by HK as mere adjusting entries to record interval agreements of Mr. Rodolfo V. Cruz with clients.

<sup>4</sup> Citibank NA Client Confirmation showing the dollar-denominated placements was submitted as Annexes B to B-4 of the Reply-Memorandum.

<sup>5</sup> Letter dated 17 July 2008 to PSE; Submitted as Annex C of the Reply-Memorandum.

On 28 August 2008, the PSE-MRD conducted a follow-up audit revealing more severe violations committed by HKS, including a short position of customers' securities then amounting to Php 99.9 Million or approximately 42% of the total detailed collateral valuation of securities per books:<sup>6</sup>

Total Due to Customers (Php):	
Securities - per books (Detailed Collateral Valuation)	253,329,258.81
Securities - per count	
PCD	142,509,762.16
Vault	3,942,068.75
	146,451,830.91
Difference (Short)	106,877,427.90
	(as of 23 September 2008)

It was further discovered that HKS prepared two separate books on its stock position in order to conceal its short position of customers' securities.

In sum, the audits found that HKS committed at least two grave violations: (a) misstatement of cash balance of Php 1.7 Million as Php 11 Million, and (b) the short position of approximately Php 99.9 Million, which ballooned to Php 106,877,427.60 as of 23 September 2008. Consequently, on 03 September 2008, PSE-MRD issued trade limitations against HKS pursuant to SRC Rule 39.1 (1)(E).

On 4 September 2008, PSE-MRD met with HKS, to discuss the implementation of the trade limitations. HKS did not challenge the audit findings and agreed to comply with the limitations and grant full access to its books and records.

On 8 September 2008, HKS submitted its Stock Position Report by Client, Reconciliation of Stock Position Report v. PCD, Customer Ledgers, EQ Portfolio Report, and Detailed Collateral Valuation in accordance with the PSE-MRD's directive. The said documents confirmed the audit findings, particularly, HK's short security position of Php 106,877,427.90.<sup>7</sup>

On 12 September 2008, HKS again admitted its full and unconditional responsibility for the violations. It undertook to infuse the amount of US\$ 1.15 Million by 19 September 2008 in order to cover up its short security position. **HKS agreed that should such infusion fail to materialize by the given deadline, the PSE shall immediately suspend HKS and the latter shall not contest the suspension and any takeover order issued by the Commission.**<sup>8</sup>

<sup>6</sup> Stock Position Report by Security-Summary as of 05 September 2008 submitted as Annex E of the Reply-Memorandum.

<sup>7</sup> Copies of the said documents were submitted as part of Annexes I and J of the Reply Memorandum.

<sup>8</sup> Copies of letters dated 12 and 17 September 2008 of HK and its nominee are attached hereto and made integral parts hereof as Reply Memorandum, Annexes "F" and "F-1," respectively.

HKS and its nominee, Rodolfo Cruz, failed to infuse the funds in accordance with their undertaking. HKS also failed to submit to the PSE-MRD any evidence refuting the audit findings.

Consequently, on 23 September 2008, the PSE-MRD petitioned the Commission to issue an order authorizing the PSE to take over the operations of HKS pursuant to SRC Rule 33.2 (d) in order to protect the interests of HKS's clients and creditors, the investing public and the capital market.

On 25 September 2008, the Commission issued an Order authorizing the PSE to: (1) Take-over the operations of HKS; (2) Suspend HKS's membership with the PSE; and (3) Settle HKS's liabilities to its clients through the sale of its trading right and other trade-related assets.<sup>9</sup> HKS moved to quash this order, but after due notice and hearing, the Commission denied the motion for lack of merit on 19 February 2009.

Meanwhile, on 25 September 2008, the PSE-MRD issued a Resolution,<sup>10</sup> containing the results of the Annual Regulatory Examination of HKS for 2008, and imposing on monetary penalties on HKS for violation of the following:

- a. Section 26 of the SRC for Fraudulent Transactions;
- b. SEC Memorandum Circular No. 16, Series of 2004 on the Adoption of RBCA for Broker Dealers and SRC Rule 49.1-1 on Net Capital Rule;
- c. SRC Rule 52.1-1 on Books and Records Rule;
- d. SRC Rule 49.2-4 on the Special Reserve Bank Account for the Exclusive Benefit of Customers;
- e. SRC Rule 30.2-1 on the Ethical Standards Rule;
- f. SRC Rule 49.2-1 on Customer Protection Rule;
- g. SRC Rule 49.2-10 on the Delivery of Customers' Securities; and
- h. SRC Rule 52.1-8 on Customer Account Statement Rule.

On 9 October 2008, HKS appealed the PSE-MRD Resolution to the MIB. On 03 December 2008, HKS was notified that the MIB issued *Resolution No. 22 (October) - Series of 2008* that affirmed the findings of the PSE-MRD, and denied HKS's appeal.<sup>11</sup>

Hence, HKS initiated this present appeal raising the sole issue of "whether the monetary and non-monetary sanctions should be imposed on HK."<sup>12</sup>

<sup>9</sup> Case No. 09-08-236 filed with the Commission *En Banc*.

<sup>10</sup> Submitted as Annex G to G-1 of the Reply-Memorandum.

<sup>11</sup> MIB Resolution No. 22 (October) - Series of 2008.

<sup>12</sup> Memorandum on Appeal, page 5.

HKS claims that the PSE-MRD failed to support its findings that HKS committed violations with any credible and competent evidence on record.<sup>13</sup> In particular, HKS addresses each of the alleged violations:<sup>14</sup>

- a. Fraudulent Transactions - It did not commit any falsification of its records and books of accounts.
- b. RBCA - In computing the RBCA of HKS, PSE-MRD erroneously disregarded the fact that HKS' nominee Rodolfo Cruz assigned his personal accounts in Citibank in the amount of Php9,300,000.00 in favor of HKS.
- c. Books and Records Rule - It never denied PSE-MRD access to its books and records.
- d. Special Reserve Bank Account - It always replenished any deficiencies in its reserve bank account for the exclusive benefit of clients.
- e. Ethical Standards Rule - It did not misappropriate any securities belonging to its clients, and after every transaction, it always directed full payment or settlement of proceeds to its clients. HKS appeals the penalties for violation of the Ethical Standards Rule considering that "a delay in delivery of check payment to a client occurred only once due to an avoidable circumstance."<sup>15</sup>
- f. Customer Protection Rule - It could not have regularly secured the written consent of each of its clients for every transaction made as it is in a quandary in indentifying the shares used with the corresponding stock position since all the shares of its clients were co-mingled. Further, the HKS also cites the accumulation of numerous daily buying and selling transactions as an excuse.
- g. Delivery of Customers' Securities - It has always promptly complied with clients' request for transfer of securities to another broker except for one instance, which was nevertheless rectified.
- h. Customer Account Statement Rule - It admits that it is remiss in the delivery of monthly statements of account to clients. However, it alleges that clients are nevertheless updated of their securities position and money balance from time to time through telephone.

We rule that the appeal has no merit.

In administrative proceedings, substantial evidence is all that is needed to support findings of fact.<sup>16</sup> Substantial evidence is "such relevant evidence as a reasonable mind might accept as adequate to support a conclusion."<sup>17</sup>

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<sup>13</sup> Ibid., pages 6-7.

<sup>14</sup> Ibid., pages 7-10.

<sup>15</sup> Ibid., pages 8-9.

<sup>16</sup> *Securities and Exchange Commission vs. Interport Resources Corporation, et al.*, G.R. No. 135808 October 6, 2008 citing *Atlas Consolidated Mining and Development Corporation v. Factoran, Jr.*, G.R. No. L-75501, 15 September 1987.

<sup>17</sup> Ibid; *Edison Co. v. Labor Board* (1938) 305 U.S. 197, 229.

Contrary to HKS' allegation, the audit findings<sup>18</sup> adequately support the conclusion that HKS violated the subject provisions of the SRC and its implementing rules. In fact, it is HKS that has failed to submit any evidence that would support its denials and excuses, or would discredit the audit findings.

In particular, we emphasize the following:

1. Discrepancies in the stock position of HKS are evident from its PCD Stock Position Report, EQ Portfolio Report and the Stock Inventory Reconciliation Report.<sup>19</sup>
2. Despite having numerous opportunities to do so,<sup>20</sup> HKS did not submit any evidence to support its allegation that Rodolfo Cruz assigned Php9,300,000.00 in favor of HKS. In any case, the alleged assignment is inconsequential considering that HKS' short position of clients securities was at Php106,877,427.90, or more than ten (10) times the amount allegedly assigned.
3. The Reserve Formula Worksheet of HKS for 31 October 2007, 30 November 2007, 31 January 2008, and 31 August 2008,<sup>21</sup> showing the deficiency in HKS's special reserve bank account belies HKS' bare allegation that it always replenished any deficiencies.
4. There is no evidence proving that HKS regularly updated its clients through telephone. And in any case, conversation through telephone with the client cannot be deemed substantial compliance with the Customer Account Statement Rule considering the requirement for brokers to regularly deliver statement of accounts to clients is express and unambiguous<sup>22</sup>.

Crucially, when PSE confronted HKS with the audit findings, the latter did not contest the alleged violations it committed. Instead, HKS, through its nominee Rodolfo Cruz, undertook to infuse US\$1,150,000.00 in order to cover up its short security position, and to rectify its other violations. HKS made a commitment that if it fails to comply with its undertaking it would not challenge being suspended or

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<sup>18</sup> Consolidated Audit Findings of the PSE-MRD as of 23 September 2008 submitted as Annex H of the Reply-Memorandum.

<sup>19</sup> Submitted as Annexes I to I-2 of the Reply-Memorandum.

<sup>20</sup> PSE-MRD's Letter to HKS dated 05 September 2008 submitted as Annex K of the Reply-Memorandum.

<sup>21</sup> Submitted as Annexes L to L-3 of the Reply-Memorandum

<sup>22</sup> SRC Rule 52.1-8-A provides:

"A Broker Dealer shall, with a frequency of not less than monthly, send a statement of account containing a description of any securities positions, money balances, or account activity to each customer xxx"

taken over by the PSE.<sup>23</sup> Relying on this undertaking, PSE deferred further action on HKS's violations. However, HKS failed to comply with its undertaking, and thus, the PSE imposed the appropriate penalties, and petitioned the Commission for a take-over of HKS in accordance with SRC Rule 33.2 (d).

And, during the proceedings for PSE's petition for take-over, the Commission's Market Regulation Department verified the PSE-MRD's audit findings, and thus, the Commission authorized the PSE to take-over HKS.<sup>24</sup>

Contrary to its promise, HKS moved to quash the order for take-over. In resolving this motion, the Commission extended due notice and hearing to HKS, even though a motion to quash is a prohibited pleading under the Commission's procedural rules.<sup>25</sup> However despite such opportunity, HKS failed to submit any substantial evidence that would controvert PSE's audit findings. And now in the course of the present appeal proceedings, HKS again did not submit any such evidence, and it continued to rely on unsupported self-serving denials, and unjustified excuses.

**WHEREFORE**, premises considered, the instant appeal is hereby **DENIED** for lack of merit. The Philippine Stock Exchange - Market Integrity Board's Resolution No. 22 (October) - Series of 2008 is hereby **AFFIRMED**.

**SO ORDERED.**

Mandaluyong City, 04 August 2011.

  
**TERESITA J. HERBOSA**  
Chairperson

  
**MA. JUANITA E. CUETO**  
Commissioner

  
**RAUL J. PALABRICA**  
Commissioner

**MANUEL HUBERTO B. GAITE** \*  
Commissioner

  
**ELADIO M. JALA**  
Commissioner

\*on official business

<sup>23</sup> Supra. at note 8.

<sup>24</sup> Supra. at note 9; 25 September 2008 Order attached as Annex G of HKS's Memorandum of Appeal.

<sup>25</sup> The 2006 Rules of Procedure of the Securities and Exchange Commission, Section 3-6.