

SFC reprimands and fines HSBC \$2.5 million for regulatory breaches

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The Securities and Futures Commission (SFC) has reprimanded and fined The Hongkong and Shanghai Banking Corporation Limited (HSBC) \$2.5 million for regulatory breaches and internal control failings related to position limit failures (Note 1).

The disciplinary action follows an SFC investigation into the holding by HSBC of open positions in Hang Seng China Enterprises Index futures and options contracts in breach of the prescribed limit on 18 occasions from 26 May to 1 August 2014 (Note 2).

The SFC also found HSBC in breach of the SFC's Code of Conduct for failing to implement adequate internal controls to monitor its positions in Hong Kong Futures Exchange's (HKFE) futures and options contracts to ensure compliance with the prescribed position limit (Note 3).

Specifically, the SFC found that:

- HSBC failed to identify its position limit breaches promptly;
- there was a lack of adequate knowledge within HSBC regarding HSBC's position limits and its state of compliance with the relevant regulatory requirements; and
- HSBC lacked policies or procedures in place for position limit monitoring of HKFE's futures and options contracts and failed to implement any position monitoring control over these contracts.

In deciding the penalty, the SFC has taken into account that HSBC has since taken steps to improve its internal controls on monitoring of position limit and co-operated with the SFC in resolving the SFC's concerns.

End

Notes:

1. HSBC is a registered institution under the Securities and Futures Ordinance to carry on Type 1 (dealing in securities), Type 2 (dealing in futures contracts), Type 4 (advising on securities), Type 5 (advising on futures contract), Type 6 (advising on corporate finance) and Type 9 (asset management) regulated activities.
2. Section 4(1) of the Securities and Futures (Contracts Limits and Reportable Positions) Rules provides that no person, except persons authorized by the SFC or the Hong Kong Exchanges and Clearing Limited, may hold or control futures contracts or stock options contracts in excess of the prescribed limit. The prescribed limit for Hang Seng China Enterprises Index futures contracts and options contracts is 12,000 long or short position delta for all contract months combined.
3. Under General Principles 3 and 7 of the Code of Conduct for Persons Licensed by and Registered with the SFC (Code of Conduct), a registered institution is required to have and employ effectively the resources and procedures which are needed for the proper performance of its business activities and to comply with all regulatory requirements applicable to the conduct of its business activities respectively. Under Paragraph 12.1 of the Code of Conduct, a registered institution is required to comply with and maintain appropriate measures to ensure compliance with all applicable regulatory law, rules, regulations and codes administered or issued by the SFC, exchanges, clearing houses and other regulatory authorities which apply to the registered institution.

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

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Statement of Disciplinary Action

The Disciplinary Action

1. The Securities and Futures Commission (**SFC**) has taken the following disciplinary action against The Hongkong and Shanghai Banking Corporation Limited (**HSBC**) pursuant to section 196 of the Securities and Futures Ordinance (**SFO**):
 - a. publicly reprimanded HSBC; and
 - b. imposed a pecuniary penalty of \$2,500,000.
2. The disciplinary action is taken as a result of HSBC's failure to: (i) comply with the Securities and Futures (Contracts Limits and Reportable Positions) Rules (CAP 571Y) (**Rules**)¹; and (ii) put in place systems and controls to ensure compliance with the prescribed limits for Hang Seng China Enterprises Index (**HSCEI**) futures and options contracts with all applicable regulatory requirements.

Summary of Facts

3. HSBC first notified the SFC on 31 July 2014 that its net position delta as of 30 July 2014 on HSCEI related products was in breach of the prescribed position limit².
4. On 21 November 2014, HSBC notified the SFC that it had identified breaches of the prescribed limit on 17 occasions from 26 May to 1 August 2014 (**Inquiry Period**).
5. On or around 8 May 2015, which was more than 9 months after it became aware of its first breach, HSBC notified the SFC of an additional breach during the Inquiry Period.
6. HSBC admitted that its failure in identifying breaches of position limit was due to a lack of adequate knowledge within HSBC regarding, amongst other things, its position limits and its state of compliance with the relevant regulatory requirements. In particular: (i) HSBC staff did not realise that the Large Open Position (**LOP**) report³ submitted to the Hong Kong Futures Exchange (**HKFE**)

¹ Section 4(1) of the Rules provides that no person, except persons authorized by the SFC or the Hong Kong Exchanges and Clearing Limited (**HKEx**), may hold or control futures contracts or stock options contracts in excess of the prescribed limit.

² Under the Rules, the prescribed limit for Hang Seng China Enterprises Index futures contracts and options contracts is 12,000 long or short position delta for all contract months combined.

³ Section 6(1) of the Rules provides that any person who holds or controls a reportable position shall lodge a notice in writing of that reportable position with the HKEx within one business day following (a) the day on which the person first holds or controls that reportable position; and (b) each succeeding day on which the person continues to hold or control that reportable position. Under section 2 of the Rules, "reportable position" is defined as an open position in futures contracts or stock options contracts the number of which is in excess of that specified in Schedules 1 and 2 of the Rules respectively.

only reported positions above the reportable threshold and (ii) HSBC staff were not aware of the proper aggregation requirements⁴.

7. During the Inquiry Period, although there were policies in place at HSBC setting out the position limit requirements and LOP monitoring requirements as prescribed by the Rules, there were no policies and procedures in place for position limit monitoring and controls in relation to HKFE listed products. Accordingly, no position limit monitoring systems and controls were introduced in the daily operational processes of HSBC.
8. HSBC also admitted that, during the Inquiry Period, there was no staff responsible for monitoring the net open positions of HSCEI related products entered into by its house account. Furthermore, at the time of the incident (with reference to the breaches of the position limits during the Inquiry Period), there was no centralized intra-day monitoring of HSBC's positions in HKFE listed products.
9. HSBC has since taken steps to strengthen its internal controls on monitoring positions in HSCEI futures and options contracts to ensure compliance with the prescribed position limit.

Conclusion

10. The SFC concludes that HSBC breached, on multiple occasions, the prescribed position limit for HSCEI futures and options contracts and failed to put in place adequate measures to ensure compliance with the prescribed position limit.

⁴ According to paragraph 2.6 of the Guidance Note on Position Limits and Large Open Position Reporting Requirements, the prescribed limits in the Rules apply to all positions held or controlled by any person including positions held by the person for his own account and positions belonging to other persons but under the control of such person (the aggregation requirements). While the word "control" is not defined in the SFO or the Rules, there are circumstances where the SFC takes the view that a person is regarded as having control of positions as for example where a person is allowed to exercise discretion to trade or dispose of positions independently without the day-to-day discretion of the owner of the positions.