



Hong Kong

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SFC REPRIMANDS AND FINES HSBC HK\$2.5 MILLION OVER REGULATORY BREACHES

Introduction

The Securities and Futures Commission (**SFC**) has taken disciplinary action against The Hongkong and Shanghai Banking Corporation Limited (**HSBC**) pursuant to section 196 of the Securities and Futures Ordinance (Cap. 571)(**SFO**).

HSBC has been publicly reprimanded and a pecuniary penalty of HK\$2.5 million was imposed on the bank.

The disciplinary action is a result of HSBC's failure to: (i) comply with the Securities and Futures (Contracts Limits and Reportable Positions) Rules (Cap. 571Y) (the **Rules**); 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.

Section 4(1) of the Rules provides: no person, except persons authorized by the SFC or the Hong Kong Exchanges and Clearing Limited (the **Exchange**), may hold or control futures contracts or stock options contracts in excess of the prescribed limit.¹ The prescribed limit for HSCEI futures contracts and options contracts is 12,000 long or short position delta for all contract months combined.²

Summary of Facts

According to the Statement of Disciplinary Action³ published by the SFC, HSBC first notified the SFC that it was in breach of the prescribed position limits on 31 July 2014. On 21 November 2014, HSBC informed the SFC that between 26 May to 1 August 2014 (the **Inquiry Period**), 17 breaches of the prescribed limit had been identified.

HSBC then identified and notified the SFC of one more instance of a breach during the Inquiry Period on or around 8 May 2015, more than 9 months after it became aware of its first breach.

According to the Statement of Disciplinary Action, HSBC admits it had failed to identify breaches of the position limit due to the 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, HSBC notes: (i) HSBC staff were not aware that the Large Open Position (the **LOP**) report submitted to the Hong Kong Futures Exchange (the **HKFE**) only reported positions above the reportable threshold; and (ii) HSBC staff were not aware of proper aggregation requirements.

The LOP report is required under section 6(1) of the Rules, which 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

¹ Section 4, Securities and Futures (Contracts Limits and Reportable Positions) Rules (Cap. 571Y)

² Schedule 1, Securities and Futures (Contracts Limits and Reportable Positions) Rules (Cap. 571Y)

³ <http://www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/openAppendix?refNo=16PR92&appendix=0>

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.

Further, under paragraph 2.6 of the Guidance Note on Position Limits and Large Open Position Reporting Requirements,⁴ 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). The word “control” is not defined in the SFO or the Rules. However, the SFC has in the past, under certain circumstances, taken the view that a person is regarded as having control of positions 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.

It was noted that during the Inquiry Period, HSBC only had policies setting out the position limit requirements and LOP monitoring requirements as prescribed by the Rules. There were no policies or procedures in place for position limit monitoring and controls in relation to HKFE listed products. Consequently, there were no position limit monitoring systems and controls introduced in the daily operational processes of HSBC in that period.

HSBC also acknowledged that during the Inquiry Period, no staff were 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 centralised intra-day monitoring of HSBC’s positions in HKFE listed products.

Conclusion: SFC’s Findings

The SFC concludes that HSBC has, on multiple occasions, breached the prescribed position limit for HSCEI futures and options contracts. It concludes that between 26 May 2014 and 1 August 2014, HSBC had held open positions in HSCEI futures and options contracts in breach of the prescribed limit

on 18 occasions. Further, the SFC found that HSBC had failed to put in place adequate measures to ensure compliance with the prescribed position limit.

However, in deciding the penalty of HK\$2.5 million, the SFC took into account that HSBC has since taken steps to improve its internal controls on monitoring of its position limit, strengthening its ability to ensure compliance with the prescribed position limit, and HSBC has co-operated with the SFC in resolving the SFC’s concerns.

⁴ <http://www.sfc.hk/web/EN/assets/components/codes/files-current/web/guidance-note-on-position-limits-and-large-open-position-reporting-requirements/guidance-note-on-position-limits-and-large-open-position-reporting-requirements.pdf>

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