SFC reprimands and fines HSBC Securities Brokers (Asia) Limited $5 million for providing inaccurate information in licence application

19 Dec 2013

The Securities and Futures Commission (SFC) has reprimanded HSBC Securities Brokers (Asia) Limited (HSBC Securities), a wholly owned subsidiary of The Hongkong and Shanghai Banking Corporation Limited (HSBC), and fined it $5 million for providing inaccurate information to the SFC during a licence application process (Note 1).

HSBC Securities submitted a licence application to carry on business in Type 7 (providing automated trading services) regulated activity for its provision of matching and crossing services in Hong Kong (Crossing Service) in May 2010. During the licence application process, HSBC Securities represented to the SFC that existing clients would be given the option of “opting in”, by signing “opt in letters”, if they wished to participate in the Crossing Service (the “opt in” approach). The SFC granted HSBC Securities a Type 7 licence in March 2011.

In July 2011, the media reported that HSBC proposed to launch the Crossing Service to its retail clients, and that an “opt out” approach would be adopted, whereby clients would effectively be assumed to consent to their trades being matched and crossed on the Crossing Service unless they took the initiative to notify HSBC otherwise. This is contrary to the representations that HSBC Securities had made to the SFC during the licence application process (Notes 2 & 3).

An SFC investigation found that:

- A preliminary decision by HSBC to change the enrolment approach for retail clients from “opt in” to “opt out” was made in mid-October 2010 but as a result of internal miscommunication, when the SFC specifically queried HSBC Securities in November 2010 whether the “opt in” approach would apply to retail clients, HSBC Securities misrepresented to the SFC that this would be the case.
- When the decision to change from “opt in” to “opt out” approach for retail clients was confirmed in around December 2010, HSBC Securities failed to notify the SFC about the change as required by the Securities and Futures (Licensing and Registration) (Information) Rules (Note 4).

The SFC considers that HSBC Securities’ failure to ensure the accuracy of information submitted to the SFC in support of its licence application and its failure to notify the SFC about the change from “opt in” to “opt out” approach for retail clients called into question its fitness and properness as a licensed person.

In deciding the sanction, the SFC took into account that HSBC Securities has cooperated with the SFC in resolving the disciplinary action and agreed to engage an independent reviewer to review its access controls concerning trading information in the Crossing Service (Note 5).

End

Notes:

1. HSBC Securities is licensed under the Securities and Futures Ordinance (SFO) to carry on business in Type 1 (dealing in securities) and Type 7 (providing automated trading services) regulated activities.
2. According to HSBC Securities, in connection with the provision of the Crossing Service, HSBC would be the client facing entity and HSBC Securities’ only client.
3. On 8 August 2011, the SFC imposed a condition on HSBC Securities’ licence to the effect that HSBC Securities shall only provide the Crossing Service to “professional investors”, as defined in the SFO and its subsidiary legislation.
4. The Securities and Futures (Licensing and Registration) (Information) Rules require that certain changes in information that has previously been provided to the SFC in support of a licence application must be communicated to the SFC within seven days after the change takes place. The change from “opt in” approach to “opt out” approach for retail clients was a notifiable change.
5. In August 2012, HSBC Securities informed the SFC that it had discovered that certain functions in its trading system might indirectly have provided unintended internal visibility to orders in the Crossing Service. HSBC Securities suspended the Crossing Service immediately pending resolution of the matter,

and has since taken steps to remedy this visibility issue and restarted the Crossing Service in September 2013.

6. A copy of the Statement of Disciplinary Action in relation to the matter is available on the SFC 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 HSBC Securities Brokers (Asia) Limited[1] (“**HSBC Securities**”), pursuant to section 194 of the Securities and Futures Ordinance (**SFO**):

   (a) publicly reprimanded HSBC Securities; and

   (b) imposed a financial penalty of $5,000,000 on HSBC Securities.

2. The disciplinary action relates to HSBC Securities’ provision of inaccurate information to the SFC during a licence application.

Summary of facts

<u>Application for the Type 7 licence</u>

3. On 14 May 2010, HSBC Securities, a wholly owned subsidiary of Hongkong and Shanghai Banking Corporation (“**HSBC**”), submitted to the SFC an application by which it sought to be licensed to carry on business in Type 7 regulated activity (providing automated trading services) (the “**Application**”) for its provision of matching and crossing services in Hong Kong (“**Crossing Service**”).

4. In the Application, HSBC Securities represented, among other things, that:

   (a) HSBC would be the client facing entity and HSBC Securities’ only client. In other words, HSBC Securities would provide the Crossing Service, on which the securities trades of HSBC’s clients would be matched and crossed.

   (b) The Crossing Service would initially be introduced for the existing agency flows from institutional clients, proprietary trades from HSBC and HSBC group companies and would be extended to retail clients from the business line of Personal Financial Services of HSBC in subsequent phases.

   (c) An “opt in” approach would be adopted for existing clients, i.e. clients interested in the Crossing Service would be required to sign “opt in letters” to acknowledge their agreement to participate in the Crossing Service.

5. The SFC granted HSBC Securities a Type 7 licence on 4 March 2011.

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[1] HSBC Securities is a corporation licensed under the SFO to carry on Type 1 (dealing in securities) and Type 7 (providing automated trading services) regulated activities.

Rolling out of the Crossing Service

6. HSBC Securities rolled out the Crossing Service to HSBC's institutional clients on 23 May 2011 and then to HSBC's staff investment accounts on 14 July 2011.

7. On 15 July 2011, numerous local newspapers reported on HSBC's proposed launch of the Crossing Service to retail clients. Among other things, it was reported that HSBC would adopt an "opt out" client enrolment procedure by which the clients would effectively be assumed to consent to their trades being matched and crossed on the Crossing Service unless they took the initiative to notify HSBC to the contrary.

8. HSBC Securities did not inform the SFC of the change from "opt in" to "opt out" option for retail clients prior to 15 July 2011.

9. On 8 August 2011, the SFC imposed a condition on HSBC Securities' Type 7 licence to restrict its provision of the Crossing Service to professional investors only.

HSBC Securities*' provision of inaccurate information to the SFC*

10. In its Type 7 licence application, HSBC Securities had represented to the SFC that an "opt in" approach would be adopted for all clients in relation to the Crossing Service.

11. By an email dated 11 November 2010, the SFC explicitly asked HSBC Securities to confirm whether the "opt in" approach would apply to retail clients ("**SFC's November Email**").

12. In reply, HSBC Securities told the SFC that consent from clients who wished to participate in the Crossing Service was required ("**HSBC Securities' November Reply**"). In other words, the "opt in" approach would be applied to retail clients.

13. However, contrary to HSBC Securities' representations, the SFC's investigation revealed that HSBC had made a preliminary decision to change the enrolment approach for retail clients from "opt in" to "opt out" in mid-October 2010.

14. The representations made by HSBC Securities to the SFC in relation to the "opt in"/"opt out" approach for retail clients in HSBC Securities' November Reply were, therefore, inaccurate. HSBC Securities explained to the SFC that the misrepresentation was the result of an internal miscommunication.

Breaches and reasons for action

15. General Principle 2 (Diligence) of the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission ("**Code of Conduct**") requires licensed persons to act with due skill, care and diligence, in the best interests of its clients and the integrity of the market in conducting it business.

16. HSBC Securities breached General Principle 2 of the Code of Conduct by failing to ensure information regarding the “opt in”/“opt out” approach for retail clients provided to the SFC in support of its Application is accurate.

17. Furthermore, it is apparent from the evidence that the decision to change to “opt out” approach for retail clients was confirmed by December 2010, well before the SFC granted the licence to HSBC Securities in March 2011. Yet, no steps were taken by HSBC Securities to inform the SFC about the change.

18. Under section 3(1)(a)(iii) of the Securities and Futures (Licensing and Registration) (Information) Rules (Cap. 571S) (“**Information Rules**”), an application by a corporation seeking to be licensed under section 127 of the SFO is required to contain applicable information specified in Part 1 of Schedule 2 of the Information Rules, such as:

    (a) the nature of the business carried on or to be carried on and types of services provided or to be provided by the applicant; and

    (b) a business plan of the applicant covering internal controls, organizational structure, contingency plans and related matters.

19. Section 4(2) of the Information Rules requires that certain changes in information (as specified in Part 1 of Schedule 3) that have previously been provided to the SFC in support of a licence application must be communicated to the SFC within seven days after the changes take place. The changes include, among other things:

    (a) significant changes in nature of the business carried on or to be carried on and types of services provided or to be provided by the licensed corporation; and

    (b) significant changes in the business plan of the licensed corporation covering internal controls, organizational structure, contingency plans and related matters.

20. The SFC considers that the change from an “opt in” approach to an “opt out” approach for retail clients constituted a significant change in HSBC Securities’ business nature and HSBC Securities’ business plan. As such, HSBC Securities was obliged to give written notice about the change to the SFC in accordance with section 4(2) of the Information Rules.

21. By failing to notify the SFC about the change from an “opt in” approach to an “opt out” approach for retail clients within seven days after the changes took place, HSBC Securities breached:

    (a) the Information Rules;

    (b) General Principle 7 (Compliance) of the Code of Conduct which requires licensed persons to comply with all regulatory requirements applicable to the conduct of its business activities; and

(c) paragraph 12.1 (Compliance: in general) of the Code of Conduct which provides that licensed persons should comply with, and implement and maintain measures appropriate to ensuring compliance with the law, rules, regulations and codes administered or issued by the SFC.

Conclusion

22. Having considered all the circumstances, the SFC is of the opinion that HSBC Securities is guilty of misconduct and its fitness and properness as a licensed person has been called into question.

23. In deciding the disciplinary sanction, the SFC has taken into account that HSBC Securities has cooperated with the SFC in resolving the disciplinary action and agreed to engage an independent reviewer to review its access controls concerning trading information in the Crossing Service[2].

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[2] In August 2012, HSBC Securities informed the SFC that it had discovered that certain functions in its trading system might indirectly have provided unintended internal visibility to orders in the Crossing Service. HSBC Securities suspended the Crossing Service immediately pending resolution of the matter, and has since taken steps to remedy this visibility issue and restarted the Crossing Service in September 2013.