

SFC reprimands and fines Hang Seng Investment Management Limited \$3 million for regulatory breaches over funds' cash management

31 May 2018

The Securities and Futures Commission (SFC) has reprimanded and fined Hang Seng Investment Management Limited (HSIM) \$3 million for its failure to comply with regulatory requirements on cash management involving SFC-authorized funds (Note 1).

The SFC's disciplinary action followed an independent review jointly agreed by the SFC and HSIM. The review found that, from 2010 to 2016, these HSIM-managed funds maintained substantial cash deposits with connected persons, but the interest received on some of these cash deposits was at a rate lower than the prevailing commercial rate (Notes 2 & 3).

The amount of interest involved was approximately \$875,648. HSIM has agreed to make a voluntary payment of the equivalent amount to the affected funds.

The review also found that although HSIM had procedures in place to check the interest rate offered by other banks, it did not apply the procedures to deposits placed in the funds' current accounts maintained with The Hongkong and Shanghai Banking Corporation Limited as it had inadvertently and mistakenly presumed that those accounts were non-interest bearing. The misconception lasted until July 2016 when HSIM communicated with the funds' trustees to confirm the nature of the current accounts, only then did the trustees indicate that those current accounts were in fact interest bearing, even though the interest rate at that time was 0%.

The SFC considers that HSIM's internal controls and procedures on cash management of the funds at the relevant period were inadequate and it failed to manage and minimize the conflicting interests between the funds' investors and its connected persons.

In deciding the sanctions, the SFC took into account all the circumstances, including that HSIM:

- engaged an independent reviewer to conduct the review;
- agreed to make a voluntary payment equivalent to the amount of interest involved to the affected funds to rectify the financial impact of its failures;
- took remedial actions to strengthen its internal systems and controls;
- undertook to provide the SFC with a report prepared by an independent reviewer within nine months confirming all the identified concerns are properly rectified;
- cooperated with the SFC in resolving its concerns; and
- had no previous disciplinary record with the SFC.

End

Notes:

1. HSIM is licensed under the SFO to carry on Type 1 (dealing in securities), Type 4 (advising on securities), Type 5 (advising on futures contracts), Type 6 (advising on corporate finance) and Type 9 (asset management) regulated activities.
2. In September 2017, the SFC and HSIM jointly engaged an independent reviewer to review HSIM's cash management process in relation to a total of 39 SFC-authorized funds managed by HSIM from 1 January 2010 to 31 December 2016.
3. Under paragraph 10.10 of the Code on Unit Trusts and Mutual Funds (UT Code) and paragraph 3.9 of the Fund Manager Code of Conduct, a fund manager should not deposit cash forming part of the fund's assets with a connected person unless interest is received on the deposit at a rate not lower than the prevailing commercial rate for a deposit of that size and term.

[A copy of the Statement of Disciplinary Action 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 reprimanded Hang Seng Investment Management Limited (**HSIM**) and fined it \$3,000,000 pursuant to section 194 of the Securities and Futures Ordinance (**SFO**).
2. The disciplinary action is taken according to an agreement pursuant to section 201 of the SFO dated 29 May 2018 in respect of HSIM's failure to comply with various provisions of the Code on Unit Trusts and Mutual Funds (**UT Code**), Fund Manager Code of Conduct, and the SFC Handbook for Unit Trusts and Mutual Funds, Investment-Linked Assurance Schemes and Unlisted Structured Investment Products (**Products Handbook**).
3. HSIM is licensed under the SFO to carry on Type 1 (dealing in securities), Type 4 (advising on securities), Type 5 (advising on futures contracts), Type 6 (advising on corporate finance) and Type 9 (asset management) regulated activities.

Summary of facts

Background

4. In September 2017, the SFC and HSIM jointly engaged an independent reviewer to review (**Review**) HSIM's cash management process in relation to a total of 39 SFC-authorized funds (**Funds**) managed by HSIM from 1 January 2010 to 31 December 2016 (**Relevant Period**). The independent reviewer reported its findings in March 2018.
5. HSIM is a wholly owned subsidiary of Hang Seng Bank Limited (**HSBL**) and an affiliated company of The Hongkong and Shanghai Banking Corporation Limited (**HSBC**). HSIM, HSBL and HSBC (individually and collectively, **HSBL Group**) are "connected persons" for the purpose of the UT Code.

Failure to ensure prevailing commercial rate of interest was received from a connected person

6. During the Relevant Period, the Funds maintained substantial cash balances deposited with the HSBL Group. However, the interest received on some of these cash deposits, in particular, the deposits placed in HSBC current accounts (**Current Accounts**), was at a rate lower than the prevailing commercial rate.
7. The Review found that, had the prevailing commercial rates been applied, the total interest income received on the Funds' cash deposits might have been higher by about \$875,648¹ (**Impact Amount**) over the Relevant Period.
8. HSIM's failure to ensure that the interest received on the Funds' cash balances deposited with its connected person is at a rate not lower than the prevailing commercial rate for a deposit of the same size and term constitutes a breach of:

¹ Without taking into account any transaction costs that might be involved in re-allocating cash between banks.

- (a) Paragraph 10.10 of the UT Code, which requires that if cash forming part of the scheme's assets is deposited with the trustee/custodian, the management company, the investment adviser or with any connected person of these companies (being an institution licensed to accept deposits), interest must be received on the deposit at a rate not lower than the prevailing commercial rate for a deposit of that size and term; and
- (b) Paragraph 3.9 of the Fund Manager Code of Conduct, which requires that a fund manager should not deposit funds on behalf of a client with a connected person unless interest is received at a rate not lower than the prevailing commercial rate for a deposit of that size and term.

Inadequate internal controls and conflicts of interest

- 9. During the Relevant Period, HSIM had procedures in place which required its fund managers to, when placing surplus cash in time deposit, quote the interest rate from at least two different banks², of which at least one should be a non-HSBL Group bank, and select the best rate among the quotations if possible. If time deposits were placed with the HSBL Group or its associated entities, fund managers would check that the interest received on the deposit was at a rate not lower than the prevailing commercial rate when placing the time deposit.
- 10. However, the Review found that HSIM did not apply the above procedures when placing surplus cash into the Current Accounts as it had inadvertently and mistakenly presumed that those accounts were non-interest bearing.
- 11. HSIM explained that, as the current accounts in HSBL were all non-interest bearing in nature, it presumed that HSBC, being a member of the same group, would have the same terms as HSBL and therefore deemed the Current Accounts as non-interest bearing.
- 12. The misconception lasted until July 2016 when HSIM communicated with the Funds' trustees to confirm the nature of the Current Accounts in order for HSIM to respond to the SFC's enquiries. The trustees indicated that those accounts were in fact interest bearing, even though the interest rate at that time was 0%.
- 13. HSIM's internal controls and procedures on cash management of the Funds were inadequate at the Relevant Period, as demonstrated by its failures to recognize the interest bearing nature of the Current Accounts and apply the interest rate quotation procedures to the Funds' deposits placed with those accounts for a period of more than 6 years.
- 14. Further, by depositing the Funds' cash balances with the HSBL Group without ensuring that the interest received on the deposits was at a rate not lower than the prevailing commercial rate for a deposit of that size and term, HSIM failed to manage and minimize the conflict between the interests of the Funds' investors and the interests of the HSBL Group.

² Since 27 March 2015, the policy has been revised to the effect that fund managers were required to quote the relevant interest rate from at least *three* different banks, of which at least *two* should be from non-HSBL Group banks.

15. HSIM's failures constitute a breach of:
- (a) paragraph 1.2(c) of the Fund Manager Code of Conduct, which requires a fund manager to maintain satisfactory internal controls and written compliance procedures which address all applicable regulatory requirements; and
 - (b) General Principle 4 and paragraph 4.2 of the Overarching Principles Section of the Products Handbook, which provide that Product Provider³ shall avoid situations where conflicts of interest may arise including any actual or potential conflicts that may arise between different parties in respect of a product, and where such a conflict cannot be avoided, and provided that investors' interests can be sufficiently protected, the conflict shall be managed and minimized by appropriate safeguards, measures and product structure and these measures and safeguards shall be properly disclosed to investors.

Conclusion

16. Having considered all the circumstances, the SFC is of the opinion that it is in the interest of the investing public and in the public interest to resolve the above concerns with HSIM, and take the disciplinary action set out in paragraph 1.
17. In deciding the disciplinary sanctions, the SFC has taken into account that HSIM:
- (a) engaged an independent reviewer to conduct the Review;
 - (b) agreed to make a voluntary payment of \$875,648 to the Funds to rectify the financial impact of its failures;
 - (c) took remedial actions to strengthen its internal systems and controls;
 - (d) undertook to provide the SFC with a report prepared by an independent reviewer within nine months confirming all the identified concerns are properly rectified;
 - (e) cooperated with the SFC in resolving its concerns; and
 - (f) had no previous disciplinary record with the SFC.

³ "Product Provider" means, among other things, the issuer of a structured investment product, the management company of a unit trust/mutual fund and the unit trust/mutual fund itself.