
STATEMENT OF DISCIPLINARY ACTION

The disciplinary action

1. The Securities and Futures Commission (**SFC**) has publicly reprimanded HSBC Broking Securities (Asia) Limited (**HSBCBS**) and fined it \$9.6 million pursuant to section 194 of the Securities and Futures Ordinance (**SFO**).
2. The SFC found that between April 2015 and March 2016 (**Relevant Period**), in selling bonds listed under Chapter 37 of the Main Board Listing Rules¹ (**Chapter 37 Bonds**) to clients, HSBC Broking failed to:
 - (a) conduct proper and adequate product due diligence on individual bonds before making recommendations or solicitations to its clients;
 - (b) have an effective system in place to assess its clients' risk profile and to ensure that the recommendations or solicitations made to its clients in relation to bonds were suitable for and reasonable in all the circumstances of each of its clients;
 - (c) provide adequate product information to its sales staff to ensure that they fully understood not only the basic features of each bond, but also special features and the risks involved, and to enable them to provide adequate disclosure and explanation of such product features and risks to clients during the sale process; and
 - (d) maintain proper documentary records of the investment advice or recommendations given to its clients.
3. HSBCBS is licensed to carry on Type 1 (dealing in securities) and Type 4 (advising on securities) regulated activities under the SFO.

Summary of facts

Background

4. During the Relevant Period, HSBCBS executed 378 Chapter 37 Bonds transactions for its clients, 153 of which involved recommendations or solicitations made to clients.

Regulatory requirements

5. General Principle 2 (diligence), paragraphs 3.4 (advice to clients: due skill, care and diligence) and 5.2 (know your client: reasonable advice) of the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (**Code of Conduct**) require a licensed corporation to ensure that, through the exercise of due diligence, its investment recommendations to clients are based on thorough analysis and are reasonable in all the circumstances.

¹ Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited.

6. General Principle 5 (information for clients) of the Code of Conduct requires a licensed corporation to make adequate disclosure of relevant material information to its clients.
7. To ensure compliance with paragraphs 3.4 (advice to clients: due skill, care and diligence) and 5.2 (know your client: reasonable advice) of the Code of Conduct, a licensed corporation in making investment recommendations or solicitations to clients should take steps to document and retain the reasons for its recommendations or advice given to the client, and to implement special procedures to document the rationale underlying investment advice rendered or recommendations made.

Inadequate product due diligence

8. HSBCBS did not have written policies and procedures on product due diligence on individual bonds during the Relevant Period. Its procedures merely required new products to be approved, and bonds as an asset class was regarded as one product.
9. During the Relevant Period, HSBCBS had a Master Product Program (**MPP**) which determined the types of bonds that could be offered to professional investors (**PIs**) or non-PIs, on solicited or unsolicited basis, with reference only to the tenor, the credit rating (or the credit spread for unrated bonds) and seniority of the bonds, and the prohibition against sale of contingent convertible bonds. Such a general framework is not conducive to developing a thorough understanding of individual bonds, as other factors which are highly relevant to the risk return profiles of the bonds may be overlooked and/or not adequately taken into account. Such factors include, for instance, the liquidity of the bonds, past performance of the bonds, reputation and financial situation of product issuers, and special features such as callable, extendable, variable and/or deferral of interest payment, etc.
10. Further, HSBCBC did not systematically assess and assign a risk level to each bond which its account executives (**AEs**) recommended to clients during the Relevant Period. Individual AEs would have to assess the risks of the bonds.
11. AEs were provided with bond lists which contained basic information regarding the bonds available for secondary market transactions. The information includes the issuer, currency, guarantor (if any), coupon, maturity, indicative bid/offer prices, indicative yield, credit rating (Moody's and S&P, if any) and issue size.
12. Apart from the information in the bond lists, AEs were not provided with any particular information about the bonds to assist them to thoroughly understand the risk features of the bonds, and to enable them to properly assess whether the bonds were suitable for their clients, and/or disclose such risk features to the clients. Although the offering circulars of the bonds could be found on the firm's e-notice board, a majority of the AEs interviewed stated that they were not required under HSBCBS's policies to read the offering circulars of the bonds.
13. The extent to which AEs understood the bonds would depend on how diligent and proactive they were in getting themselves acquainted with the bond features by reading the offering circulars and/or making enquiries with the Product Management team. Different AEs might therefore have different understanding and different evaluation of the risks of the bonds.

14. The evidence in relation to product due diligence of HSBCBS as a whole suggests that during the Relevant Period, HSBCBS did not:
- (a) have adequate policies and procedures on product due diligence on individual bonds (including Chapter 37 Bonds); and
 - (b) conduct proper and adequate product due diligence on, and properly assess the risk levels of, individual bonds before recommending them to clients.

Ineffective systems to ensure product suitability for clients

15. During the Relevant Period, although HSBCBS had written policies and procedures requiring its AEs to ensure that the products they recommended to clients were suitable in light of the clients' personal circumstances, there were deficiencies in the suitability framework it adopted for the sale of bonds which raised serious doubts as to its ability to effectively discharge its suitability obligations:
- (a) HSBCBS did not conduct adequate product due diligence on, and did not assign a risk rating to, individual bonds. The information it provided to its AEs in the bond lists was also insufficient to enable them to fully understand the risks and special features of the bonds.
 - (b) Whilst HSBCBS's policy was that it could only sell bonds to clients whose risk appetite was "ambitious" and "speculative", the risk appetite recorded in the Customer Information Statement (**CIS**) was self-declared by the client. HSBCBS did not have a system in place to independently assess the risk profile of each client based on the client's overall circumstances.
 - (c) In the absence of (i) an assigned risk rating to each bond following a proper product due diligence process, and (ii) an assessed level of risk tolerance for each client following a systemic analysis of the client's profile, AEs were left to their own devices in determining whether a recommendation for, or solicitation to, a particular client about a particular bond is reasonably suitable based on the information collected in the CIS and their conversations with the clients. There was no framework to indicate how the different information ought to be taken into account to enable the AEs to accurately assess whether the investment return characteristics and risk features of a particular bond matched with a client's circumstances. The rationale of the AEs' recommendations was often not recorded.
 - (d) Whilst the MPP provided general guidance to AEs on the types of bonds that could be sold to PIs or non-PIs, in a solicited, customer directed or execution only trades, the MPP focussed only on the tenor, credit rating (or the credit spread for unrated bonds) and seniority of the bonds.
 - (e) Further, in cases where there was a mismatch in terms of risk, tenor or investment objective between the product and the client's profile, the guidance given by HSBCBS to its AEs was merely to bring this to the clients' attention and let the clients decide whether to proceed. If the clients decided to proceed, they simply needed to update their CIS. This might give rise to an opportunity for clients to amend their CISs to

enable them to buy particular bonds despite the mismatch. There were no internal policies requiring its AEs or senior management to justify why they considered the investment to be suitable to the client despite the mismatch, and to record the advice given to the client, the client's desire to purchase the product despite the mismatch, and the decision to allow the client to proceed with the trade.

- (f) Likewise, for cases where there was a concentration risk, AEs would only inform the client about the risk and allowed the client to decide whether to go ahead with the transaction.
16. The approach adopted by HSBCBS in conducting suitability assessments for the sale of bonds in the Relevant Period raised serious concerns in that:
- (a) it lacked a systematic approach to assess suitability; and
 - (b) it shifted the burden of assessing suitability back to the clients.
17. The SFC found that in the Relevant Period HSBCBS did not have an effective system for ensuring suitability of bonds for clients, and its suitability framework fell below the standards required of it in the Code of Conduct.

Inadequate disclosure of risks and features of bonds to clients

18. During the Relevant Period, when explaining bonds to clients, AEs mainly relied on the bond lists. If they needed more information about the bonds, they might request the Product Management team to provide further information, or read the offering circular or other online sources. The bond lists merely contained basic features of the bonds and did not contain all material information that should be brought to the clients' attention.
19. A review of some sample Chapter 37 Bonds trades show that there were a number of trades (a) where the AEs did not disclose all material bond features to the clients when discussing these bonds with the clients, and/or (b) the standard risk disclosure that AEs were required to read out were either not read out or not recorded.
20. The lack of proper and adequate product due diligence on individual bonds, and AEs' reliance on the basic information in the bond lists when explaining product features to clients have resulted in (a) inadequate information about the bonds being disclosed to clients, and (b) different AEs disclosing different level of details of the same bonds to clients.
21. The SFC found that HSBCBS did not put in place appropriate measures, systems and controls during the Relevant Period to ensure that its AEs:
- (a) were able to explain key features and risks of individual bonds to their clients to enable them to make informed decisions; and
 - (b) did disclose the general risks involved in trading in bonds as set out in its sales checklist.

Failure to maintain documentary records of investment advice and recommendations

22. Although HSBCBS had policies in place during the Relevant Period requiring its AEs to document the investment advice given, a review of some sample

Chapter 37 Bonds trades shows that the records maintained by its AEs were often incomplete:

- (a) Although AEs' telephone calls with clients were recorded, the telephone records might not reflect the full chain of communications which the AEs had with the clients as the AEs might also meet the clients in person.
 - (b) No call logs were filled in by the AEs in respect of some of the trades.
 - (c) Call logs that were filled in by AEs did not record the rationale of their recommendation of particular bonds to clients, and/or the factors they took into account when assessing whether the bonds they recommended to clients were suitable for the particular clients.
 - (d) The call logs might only record the fact that calls or meetings took place on certain dates, and did not contain any details which could assist HSBCBS management in monitoring the trades.
23. In the absence of proper records of the investment advice or recommendations given and the rationale of such advice or recommendations, it would be difficult for HSBCBS (a) to effectively supervise and monitor its AEs to ensure that the recommendations or solicitations they made to the clients were suitable and reasonable in all the circumstances; and (b) to assess its position if it receives client complaints about possible mis-selling of products by its AEs.

Conclusion

24. HSBCBS's failures constitute a breach of General Principles 2 and 5, and paragraphs 3.4 and 5.2 of the Code of Conduct.
25. In deciding the disciplinary sanctions, the SFC has taken into account:
- (a) There is currently no evidence suggesting that any client who bought Chapter 37 Bonds during the Relevant Period has complained about HSBCBS's selling practices or suffered loss.
 - (b) Despite the repeated reminders given by the SFC to licensed corporations on the importance of compliance with their suitability obligations, and specific guidance given by the SFC in its circulars dated 19 November 2012 and 25 March 2014 regarding the selling of fixed income products, complex and high-yield bonds, HSBCBS had not tightened up its controls and procedures in order that it had an effective system in place to ensure the suitability of bonds it recommended to clients during the Relevant Period.
 - (c) A strong message has to be sent to the market to deter other market participants from committing similar misconduct.
 - (d) HSBCBC has taken steps to enhance its suitability framework during our investigation into the matter.
 - (e) HSBCBS cooperated with the SFC in resolving its concerns.