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SFC reprimands and fines State Street Global Advisors Asia Limited \$4 million over management of Tracker Fund

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The Securities and Futures Commission (SFC) has reprimanded and fined State Street Global Advisors Asia Limited (SSGA) \$4 million for its failure to comply with regulatory requirements in the management of Tracker Fund of Hong Kong (Fund) (Notes 1 & 2).

An SFC investigation found that from 1 December 2008 to 30 June 2013 (Relevant Period), the cash balances of the Fund that were deposited with State Street Bank and Trust Company's (SSBT) demand deposit account did not earn any interest because SSBT's deposit rates on Hong Kong dollars were zero. SSBT was the Fund's trustee and an affiliate of SSGA. SSGA did not check the rate of interest offered by other banks.

According to the SFC's investigation findings, the prevailing commercial interest rates on Hong Kong dollars (HKD) for a deposit of the same size and term as the Fund's cash balances were above zero during the Relevant Period (Note 3).

The SFC considers that SSGA had failed to ensure that interest received on the Fund's Hong Kong dollar cash balances from its connected person was at a rate not lower than the prevailing commercial rate for a deposit of that size and term as required by the Code on Unit Trusts and Mutual Funds (UT Code).

The SFC also found that SSGA's internal procedures on the management of the Fund's cash balances were inadequate. By not following the requirements of the UT Code and the Trust Deed when depositing the Fund's cash balances with SSBT, SSGA had failed to manage and minimise the conflict between the interests of the Fund's investors and the interests of SSGA/SSBT.

The SFC further found that SSGA had wrongly represented in six interim and annual reports of the Fund that the Fund's cash balances were placed in a non-interest bearing current account when in fact the cash was deposited with SSBT in an interest bearing account earning zero interest.

In deciding the sanctions, the SFC took into account that SSGA:

- co-operated with the SFC in resolving the SFC's concerns;
- agreed to **make a voluntary payment of \$318,315 into the Fund** (Note 4);
- agreed to engage an independent reviewer to conduct an internal controls review of the cash management policy and procedures of SFC-authorized funds managed by SSGA; and
- has a clean disciplinary record in relation to its regulated activities.

End

Notes:

1. SSGA is licensed under the Securities and Futures Ordinance (SFO) to carry on Type 1 (dealing in securities), Type 2 (dealing in futures contracts), Type 4 (advising on securities), Type 5 (advising on futures contracts), and Type 9 (asset management) regulated activities.
2. SSGA acted as the investment manager of the Fund. The Fund is an exchange-traded fund and its units have been listed on The Stock Exchange of Hong Kong Limited since 1999. Its investment objective is to provide investment results that closely correspond to the performance of the Hang Seng Index.
3. The SFC collected evidence on HKD overnight rates and HKD savings rates on deposits that were of the same size and term as the Fund's cash balances during the Relevant Period from six banks in Hong Kong, including three major retail banks and three overseas banks that have branches in Hong Kong. The interest rates that these banks offered are set out at Appendix A.
4. SSGA determined the amount of the voluntary payment **by applying an interest rate of 0.01% to the Fund's cash balance for the Relevant Period and from the end of the Relevant Period to the date when the majority of the Fund's cash balance was transferred out of SSBT's demand deposit account.**

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

Appendix A

	HKD overnight rates	HKD savings rates
Major retail bank 1	0.01% - 0.001%	0.01% - 0.001%
Major retail bank 2	0.01%	0.01%
Major retail bank 3	0.01%	0.01%
Overseas bank 1	0.001%	0%
Overseas bank 2	0.00001% – 0.4%*	0.001%
Overseas bank 3	0.06% - 0.6%*	0.01% - 0.04%*

*On the days when a quote was available.

STATEMENT OF DISCIPLINARY ACTION

The Disciplinary Action

1. The Securities and Futures Commission (**SFC**) has reprimanded State Street Global Advisors Asia Limited (**SSGA**) and fined it \$4,000,000 pursuant to section 194 of the Securities and Futures Ordinance (**SFO**).
2. The SFC found that, in managing the cash balances of a unit trust during the Relevant Period, SSGA has:
 - (a) failed to ensure that interest received on the fund's deposit from its connected person was at a rate not lower than the prevailing commercial rate for a deposit of that size and term;
 - (b) failed to manage the fund's deposits in accordance with the terms of the fund's constitutive documents;
 - (c) failed to have adequate policies and procedures in place to comply with the regulatory requirements and the fund's constitutive documents regarding the fund's deposits;
 - (d) failed to provide accurate information regarding the deposit accounts in the annual and interim reports of the fund; and
 - (e) failed to avoid situations where conflicts of interest may arise, and/or failed to manage and minimize the conflict by putting appropriate safeguards and measures in place where the conflict could not be avoided, in order to protect investors' interests.
3. The SFC is of the view that SSGA is guilty of misconduct and its fitness and properness has been called into question.

Summary of Facts

4. SSGA is the manager of an SFC-authorized fund, namely Tracker Fund of Hong Kong (**Fund**). The Fund is structured as a unit trust established under Hong Kong law. It is an exchange-traded fund and its units have been listed on The Stock Exchange of Hong Kong Limited since 1999. Its investment objective is to provide investment results that closely correspond to the performance of the Hang Seng Index.
5. SSGA and State Street Bank and Trust Company (**SSBT**) are wholly-owned subsidiaries of State Street Corporation and are considered connected persons for the purposes of the UT Code¹.
6. SSGA, as the manager of the Fund, has the responsibility to make the decision as to which bank the Fund's cash is placed and what type of deposit is applied.
7. During the period from 1 December 2008 to 30 June 2013 (**Relevant Period**), the cash balances of the Fund were deposited with SSBT. The deposits did

¹ Code on Unit Trusts and Mutual Funds.

not earn any interest because SSBT's Hong Kong dollar deposit rates were zero.

8. SSGA's internal procedures for cash management in relation to the Fund's cash balances at the material time and their application are summarized as follows:
 - (a) SSGA would only consider making an overnight time deposit if SSBT's overnight time deposit was greater than zero and exceeded SSBT's call rate.
 - (b) If a decision was made to place deposits in an overnight time deposit account, SSGA would then compare SSBT's overnight time deposit rate with indicative rates which SSGA viewed using Bloomberg.
 - (c) During the Relevant Period, the overnight time deposit rates for HK dollar quoted by SSBT to SSGA were zero, and SSBT's call rates for HK dollar balances in the demand deposit account of the Fund were also zero. Accordingly, SSGA did not make any overnight deposits.
 - (d) If the overnight time deposit rate was the same or lower than the call rate, SSGA would not refer to the reference rates in Bloomberg.
 - (e) The process of comparing SSBT's overnight time deposit rate with SSBT's call rate did not take place on a daily basis throughout the Relevant Period. As the interest rate continued to be zero, the frequency of the checking reduced, and varied from days to weeks to several months.
9. While SSGA's procedures included the checking of interest rates offered by other banks, that checking was predicated on SSBT's overnight rate being higher than SSBT's call rate. In managing the Fund's cash balances during the Relevant Period, SSGA did not check the interest rates offered by other banks. It only checked the overnight deposit rate offered by SSBT, and compared it with SSBT's call rate. When both rates quoted by SSBT were zero, SSGA deposited the cash balances with SSBT's demand deposit account and took no steps to check the prevailing commercial rate or market rate of interest offered by other banks.
10. According to the SFC's investigation findings, the prevailing commercial interest rates on Hong Kong dollars for a deposit of the same size and term as the Fund's cash balances were above zero during the Relevant Period.

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

11. The regulatory standards expected of a fund manager of an SFC-authorized fund when depositing funds with a connected person are set out below:
 - (a) Paragraph 10.10 of the UT Code 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.

- (b) Paragraph 3.9 of the Fund Manager Code of Conduct requires that a fund manager should not deposit funds on behalf of a client with a connected person unless, in the case of a deposit, interest is received at a rate not lower than the prevailing commercial rate for a deposit of that size and term.
12. Under paragraph 5.10(a) of the UT Code, a management company must manage the scheme in accordance with the scheme's constitutive documents in the best interests of the holders. The Trust Deed of the Fund stated that cash may be placed by the manager in deposit accounts with its connected persons provided that the cash is deposited in an interest bearing account providing for a market rate of interest.
 13. The SFC considers that in depositing the Fund's cash balances with SSBT's demand deposit account during the Relevant Period, SSGA failed to ensure that:
 - (a) interest received on the deposits from its connected person was at a rate not lower than the prevailing commercial rate for a deposit of the same size and term as the deposits with SSBT, in breach of paragraph 10.10 of the UT Code and paragraph 3.9 of the Fund Manager Code of Conduct; and
 - (b) a market rate of interest was received, contrary to the requirements set out in the Trust Deed, and therefore in breach of paragraph 5.10(a) of the UT Code.

Inadequate internal controls

14. Paragraph 1.2(c) of the Fund Manager Code of Conduct requires a fund manager to maintain satisfactory internal controls and written compliance procedures which address all applicable regulatory requirements.
15. SSGA's internal procedures only provided for an initial comparison of SSBT's two internal rates, and required a comparison with external rates only if SSBT's overnight rate was higher than the call rate.
16. While SSGA's procedures included the checking of interest rates offered by other banks, that checking was predicated on SSBT's overnight rate being higher than SSBT's call rate. SSGA's procedures failed to cover how SSGA would comply with paragraph 10.10 of the UT Code if the Fund's cash balances were put on deposit other than the overnight deposit with SSBT at a rate other than the overnight rate. SSGA's procedures also failed to provide for comparison with banks other than SSBT, with reference to the size and term of the deposit as required by the UT Code.
17. The SFC considers that SSGA's procedures in relation to the management of the Fund's cash balances were inadequate and failed to ensure SSGA's compliance with paragraph 10.10 of the UT Code.

Conflict of interest

18. The regulatory standards expected of a fund manager of an SFC-authorized fund to avoid conflict of interest are set out below:

- (a) Under General Principle 4 of the Overarching Principles Section of the SFC Products Handbook², Product Providers, counterparties and service providers shall avoid being placed in a conflict of interest position that may undermine the interests of the investors of the relevant product.
 - (b) Under paragraph 4.2 of the Overarching Principles Section of the SFC Products Handbook, Product Provider 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. 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.
19. While the placing of the Fund's cash balances by SSGA with SSBT was not prohibited under the UT Code and the Trust Deed, both documents set out how the conflict of interest between the Fund's investors and SSBT in such circumstances should be addressed and managed. Paragraph 10.10 of the UT Code and paragraph 3.9 of the Fund Manager Code of Conduct specifically require that 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.
20. By not following the requirements of the UT Code and the Fund Manager Code of Conduct when depositing the Fund's cash balances with SSBT, SSGA failed to manage and minimize the conflict between the interests of the Fund's investors and the interests of SSGA/SSBT.

Misstatements in annual and interim reports of the Fund

21. General Principle 6 (Diligence) of the Overarching Principles Section of the SFC Products Handbook requires Product Providers to discharge their functions with due skill, care and diligence.
22. The following Interim and Annual Reports of the Fund described that the Fund's cash balances were placed in a "non-interest bearing current account" (**Misstatement**):
- (a) Annual Report 2009;
 - (b) Interim and Annual Reports 2010;
 - (c) Interim and Annual Reports 2011; and
 - (d) Interim Report 2012.
23. Despite the description, the Fund's cash was deposited with SSBT in an interest bearing account since the Fund's inception.
24. In view of the above, the SFC considers that SSGA has failed to discharge its functions as the manager of the Fund with due skill, care and diligence, falling short of the standard set out in General Principle 6 (Diligence) of the Overarching Principles Section of the SFC Products Handbook.

² SFC Handbook for Unit Trusts and Mutual Funds, Investment-Linked Assurance Schemes and Unlisted Structured Investment Products.

Conclusion

25. In reaching the decision to take disciplinary action set out in paragraph 1 against SSGA, the SFC has taken into account that SSGA:
- (a) co-operated with the SFC in resolving the SFC's concerns;
 - (b) agreed to make a voluntary payment of \$318,315 into the Fund;
 - (c) agreed to engage an independent reviewer to conduct an internal control review of the cash management policy and procedures of SFC-authorized funds managed by SSGA; and
 - (d) has a clean disciplinary record in relation to its regulated activities.