

Statement of Disciplinary Action

The Disciplinary Action

1. The Securities and Futures Commission (**SFC**) has publicly reprimanded and fined UBS AG¹ and UBS Securities Asia Limited (**UBSSAL**)² (collectively, **UBS**) HK\$9.8 million and HK\$1.75 million respectively pursuant to sections 194 and 196 of the Securities and Futures Ordinance (**SFO**).
2. The disciplinary action is taken in respect of:
 - (a) UBS AG's and UBSSAL's failures to comply with the disclosure requirement under paragraph 16.5 of the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (**Code of Conduct**) in relation to research reports issued and/or distributed by them; and
 - (b) UBS AG's failure to comply with:
 - (i) the requirements of the Securities and Futures (Client Securities) Rules (**CSR**) and the Securities and Futures (Contract Notes, Statements of Account and Receipts) Rules (**CNR**) in relation to its securities pooled lending (**SPL**) service provided to clients;
 - (ii) the telephone recording requirement under paragraph 3.9(b) of the Code of Conduct;
 - (iii) the know your client (**KYC**) requirement under paragraph 5.1A of Code of Conduct in assessing clients' derivatives knowledge; and
 - (iv) the product risk disclosure and KYC requirements under General Principle (**GP**) 5 and paragraph 5.3 of the Code of Conduct in the sale of a structured note to clients.

Summary of Facts

- A. *Disclosure of financial interests in research reports*
3. Paragraph 16.5(a) of the Code of Conduct requires a licensed or registered person to disclose in its research report its financial interests in relation to an issuer or a new listing applicant the securities in respect of which are reviewed in a research report if such interests aggregate to an amount equal to or more than 1% of the issuer's market capitalization (or 1% of the new listing applicant's issued share capital).
4. The SFC's investigation following self-reports by UBS found that, between May 2004 and May 2018, UBS failed to make proper disclosure of its financial interests in some Hong Kong listed issuers covered in its research reports in breach of paragraph 16.5(a) of the Code of Conduct.

¹ UBS AG is registered to carry on Type 1 (dealing in securities), Type 4 (advising on securities), Type 6 (advising on corporate finance), Type 7 (providing automated trading services) and Type 9 (asset management) regulated activities under the SFO.

² UBSSAL is licensed to carry on Type 1 (dealing in securities), Type 2 (dealing in futures contracts) and Type 4 (advising on securities) regulated activities under the SFO.

5. The failure was caused by (i) multiple data feed logic errors in relation to a legacy data source used by UBS for tracking its shareholding positions, and (ii) UBS's lack of proper systems and controls to test the accuracy of, and detect the logic errors in, the data feeds.
6. Based on UBS's review, the failure affected 80 (6.43%) research reports issued by UBSSAL and 125 (14.59%) research reports issued by UBS AG during sample periods between September 2017 and May 2018.
7. UBS's failure constituted a breach of:
 - (a) GP 2 of the Code of Conduct, which requires a licensed or registered person to act with due skill, care and diligence, in the best interests of its clients and the integrity of the market;
 - (b) paragraph 4.3 of the Code of Conduct, which requires a licensed or registered person to have internal control procedures which can be reasonably expected to protect its operations and its clients from financial loss arising from professional misconduct or omissions;
 - (c) GP 7 and paragraph 12.1 of the Code of Conduct, which require a licensed or registered person to comply with, and implement and maintain measures appropriate to ensure compliance with relevant regulatory requirements.

B. Compliance with the CSR and CNR

8. Section 4 of the CSR provides that a standing authority given by a client to the intermediary should be renewed every 12 months unless the client is a professional investor (**PI**). With the standing authority, the intermediary may apply any of the client securities or securities collateral pursuant to a securities borrowing and lending agreement under section 7 of the CSR.
9. Section 5 of the CNR requires an intermediary to prepare a contract note in respect of a relevant contract³ it enters with or on behalf of the client.
10. The SFC's investigation following a self-report by UBS AG found that, between November 2012 and February 2019, UBS AG failed to diligently supervise its client advisors and implement sufficient controls to ensure that only PI clients were subscribed to the SPL service. As a result, 2,263 non-PI clients were subscribed to the SPL service, out of which 91 clients entered into 913 SPL transactions with UBS AG.
11. As UBS AG had wrongly assumed that these clients were PIs, it failed to obtain valid standing authorities from and issue contract notes to them in respect of the SPL transactions, in breach of sections 4 and 7 of the CSR and section 5 of the CNR.
12. UBS AG's conduct fell below the standard expected of it under GP 2, GP 7, and paragraphs 4.3 and 12.1 of the Code of Conduct as well as paragraph 4.2 of the Code

³ A "relevant contract" means a contract entered into in Hong Kong by an intermediary with or on behalf of a client of the intermediary in the conduct by the intermediary of any of the businesses which constitute (a) any regulated activity for which the intermediary is licensed or registered, that is a contract for a dealing in securities or futures contracts (except a market contract); or (b) the regulated activity of leveraged foreign exchange trading for which the intermediary is licensed, that is a leveraged foreign exchange contract.

of Conduct, which requires a licensed or registered person to supervise diligently persons employed or appointed by it to conduct business on its behalf.

C. *Compliance with the telephone recording requirement*

13. Paragraph 3.9(b) of the Code of Conduct provides that where order instructions are received from clients through the telephone, a licensed or registered person should use a telephone recording system to record the instructions and maintain telephone recordings as part of its records for at least six months.
14. The HKMA's investigation into three self-reports made by UBS AG found that, between August 2017 and June 2019, UBS AG had failed to record client order instructions received through the telephone in breach of paragraph 3.9 of the Code of Conduct:
 - (a) Between August 2017 and December 2017, the order instructions placed through eight overflow lines⁴ for 2,006 transactions executed for 364 clients were not recorded. This was caused by an omission in the voice recording setting during the migration of UBS AG's telephone system to a new system. Due to the wrong assumption held by the project team responsible for the migration that overflow lines of UBS AG's wealth management department would be automatically recorded after migrating to the new telephone system, it failed to enable the recording function of such phone lines during and after the migration.
 - (b) Between November 2018 and January 2019, the order instructions placed through a telephone line for 20 transactions executed for five clients were not recorded. This was caused by an omission to re-activate the voice recording function when the telephone line was transferred from a former client adviser to a newly joined client adviser.
 - (c) Between 13 and 17 June 2019, the order instructions placed through 26 telephone lines for 96 transactions executed for 51 clients were not recorded. This was caused by human error in the course of transitioning UBS AG's telephony system from Skype for Business soft phones to Cisco desk phone which led to a break in the voice recording system.
15. The repeated instances of telephone recordings failures suggested that UBS AG failed to put in place effective internal controls to ensure proper functioning of its voice recording system for compliance with the telephone recording requirement, in breach of GP 2, GP 7, and paragraphs 4.3 and 12.1 of the Code of Conduct.

D. *Assessment of clients' derivatives knowledge*

16. Paragraph 5.1A of the Code of Conduct provides that a licensed or registered person should, as part of the KYC procedures, assess the client's knowledge of derivatives and characterize the client based on his knowledge of derivatives.
17. On 3 June 2011, the SFC issued a set of frequently asked questions (**FAQ**) regarding the requirement under paragraph 5.1A of the Code of the Conduct (**2011 FAQ**) which states (*inter alia*) that:

⁴ Overflow lines are telephone lines which would ring only when a call made to an individual client advisor was not answered within 20 seconds.

“In assessing whether a client has knowledge of derivatives, intermediaries should make appropriate enquiries of or gather relevant information about the client during the know your client (“KYC”) process so as to enable them to make the assessment instead of relying merely on the client’s declaration that he/she has knowledge of derivatives. A proper audit trail should also be maintained to demonstrate that they have made the assessment.”

18. In July 2020, UBS AG reported to the SFC and the HKMA that it might have breached paragraph 5.1A of the Code of Conduct by failing to gather relevant information about its clients’ knowledge of derivatives.
19. Prior to 2018, UBS AG required its staff to obtain trading evidence (such as bank statements) from clients who declared that they had conducted five or more derivative trades in the past three years. UBS AG discontinued this practice in 2018 due to its misinterpretation of another FAQ issued by the SFC⁵.
20. As a result, between 2 January 2018 and 17 June 2020, UBS AG failed to follow applicable regulatory guidelines relating to the assessment of clients’ derivatives knowledge by failing to obtain trading evidence from 858 clients who declared that they had conducted five or more derivative trades in the past three years, in breach of paragraph 5.1A of the Code of Conduct. Out of these 858 clients, 380 of them have subsequently traded derivative products with UBS AG.
21. UBS AG’s failure to maintain proper procedures to ensure compliance with paragraph 5.1A of the Code of Conduct and the 2011 FAQ fell below the standard expected of it under GP 2, GP 7, and paragraphs 4.3 and 12.1 of Code of Conduct.

E. Disclosure of product risk

22. GP 5 of the Code of Conduct provides that a licensed or registered person should make adequate disclosure of relevant material information in its dealings with its clients.
23. Paragraph 5.3 of the Code of Conduct further provides that a licensed or registered person providing services to a client in derivative products should assure itself that the client understands the nature and risks of the product.
24. In May 2020, UBS AG reported to the SFC and the HKMA that it had failed to disclose to its clients the “stop loss event” feature of a structured note issued by an issuer (**Notes**) before trade execution. The failure affected 15 client accounts involving the sale of 12 Notes between October 2017 and February 2020 for a total notional amount of about US\$12 million.
25. UBS AG’s disclosure failure was caused by an omission of the stop loss event feature in the additional product sheet prepared by UBS AG’s Structured Product Sales Team in Singapore (**SP Team**). The SP Team member who prepared the additional product sheet was not aware of the stop loss event feature. When another SP Team member reviewed the draft additional product sheet, he noted that the stop loss event feature was not included but he did not raise any issues as he considered the stop loss event feature to be insignificant as compared to the issuer default risk. UBS AG discovered the failure when handling a client complaint in April 2020.

⁵ FAQ issued by the SFC on 23 December 2016.

26. UBS AG breached GP 5 and paragraph 5.3 of the Code of Conduct by failing to disclose to its clients the risks associated with the stop loss event feature in the Notes and assure itself that the clients understood such risk before trade execution.
27. UBS AG also breached GP 2, GP 7, and paragraphs 4.3 and 12.1 of the Code of Conduct by failing to put in place proper systems and procedures to ensure all material product information in relation to the Notes was disclosed in the pre-trade product documentation provided to the clients.

Conclusions

28. In the circumstances, the SFC considers that UBS has failed to act with due skill and care and put in place adequate systems and controls to ensure compliance with the applicable regulatory requirements.
29. In reaching the decision to take the disciplinary action set out in paragraph 1 above, the SFC has taken into account all relevant circumstances, including:
 - (a) UBS's remedial actions to strengthen their internal controls and systems upon identifying the breaches;
 - (b) UBS's offer to compensate the clients affected by its failure to disclose the "stop loss event" feature of the Notes;
 - (c) UBS AG's agreement to engage an independent reviewer to review the effectiveness and adequacy of its remedial measures taken in relation to its telephone recording failures; and
 - (d) UBS's cooperation with the SFC in resolving the SFC's concerns.