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SFC reprimands and fines UBS HK\$400 million for overcharging clients and related internal control failures

11 Nov 2019

The Securities and Futures Commission (SFC) has reprimanded and fined UBS AG (UBS) HK\$400 million for **overcharging its clients over a ten-year period** and for related serious systemic internal control failures (Note 1).

UBS has also undertaken to compensate the affected clients by repaying them the full value of the overcharged amount together with interest. The total repayment amount is approximately HK\$200 million and covers overcharges made through post-trade spread increases and charges in excess of standard disclosures or rates between 2008 and 2017. The overcharge practices affected about 5,000 Hong Kong-managed client accounts in about 28,700 transactions (Note 2).

The SFC considers that UBS not only failed to observe the fundamental and overarching duty to act in its clients' best interests but also abused the trust of unsuspecting clients by failing to disclose conflicts of interest and overcharging them in opaque trades.

Mr Ashley Alder, the SFC's Chief Executive Officer, said: "The SFC expects all intermediaries to uphold high standards of integrity when managing trades for clients. UBS fell far short of these expectations by systematically overcharging a very large number of clients over many years. Although each overcharge represented a fraction of each trade, UBS's misconduct involved deception and a pervasive abuse of trust resulting in significant additional revenue for UBS to which it was not entitled."

The SFC's investigations revealed that:

- **between 2008 and 2015**, the client advisors (CAs) and client advisors' assistants (CAAs) in UBS's Wealth Management division had **overcharged clients when conducting bond and structured note trades by increasing the spread charged after the execution of trades without clients' knowledge**; and
- **between 2008 and 2017**, UBS had also charged its clients fees in excess of its standard disclosures or rates.

Specifically, following their clients' requests to buy or sell products, the CAs and CAAs would enter the limit order price of the clients' trades into UBS's client order processing system. **In circumstances where the actual execution price achieved in the market was better than the limit order price, the CAs and CAAs would increase the spread after executing the trades in order to retain the price improvement for UBS without agreement with, or disclosure to, the clients**, and sometimes misrepresented the execution price or spread to the clients. **On some occasions, they would also falsify the account statements issued to financial intermediaries, who were authorized to trade for clients, by misreporting the spread amount to conceal the overcharges.**

The SFC considers that these malpractices involved a combination of serious systemic failures for a prolonged period of time including inadequate policies, procedures and system controls, lack of staff training and supervision, and failures of the first and second lines of defence functions of UBS.

The SFC's investigation further found that:

- UBS failed to understand and properly disclose the capacity in which it acted for its clients when conducting secondary market bond and structured note trades. UBS acknowledged that its historical approach to capacity was confused, its past communications with regulators regarding its capacity were incomplete, and its communications with clients on whether it was acting as their agent or principal were unclear and, in some cases, erroneous;
- **UBS failed to report its spread overcharge practices to the SFC until two years after the identification of the misconduct. This was not an isolated incident, but was one of a number of late reporting incidents whereby UBS failed to report the relevant misconduct to the SFC in a timely manner, or at all**; and
- as system enhancements following the discovery of the spread overcharge practices, **UBS implemented a new order taking platform, One Wealth Management Platform (1WMP), in October 2017. However, instead of putting in place a system that ensures its compliance with relevant regulatory requirements, UBS reported 15 incidents to the SFC or the Hong Kong Monetary Authority relating to the failures of 1WMP** covering a variety

of issues, including further spread overcharges. These issues call into question UBS's capability to put in place effective remediation to address the spread overcharge practices and proper internal controls to avoid the recurrence of historical deficiencies.

Under the circumstances, the SFC considers UBS failed to:

- act honestly, fairly and in the best interests of its clients;
- act with due skill, care and diligence, in the best interests of its clients;
- avoid conflicts of interest and ensure that its clients are treated fairly;
- provide adequate disclosure of relevant material information to clients; and
- comply with all relevant regulatory requirements applicable to the conduct of its business activities so as to promote the best interests of clients.

In deciding the disciplinary sanctions, the SFC took into account all relevant circumstances, including:

- the elements of dishonesty in UBS's spread overcharge practices;
- the duration of UBS's spread overcharge practices, i.e. around ten years;
- the fact that UBS's spread overcharge practices were undetected for at least seven years;
- the serious and systemic nature of UBS's internal control failures;
- UBS's disciplinary actions against over 20 staff who had engaged in the malpractice;
- UBS's appointments of independent reviewers to (i) identify the root causes of the spread overcharge practices and assess the magnitude of its spread overcharge practices, (ii) validate the relevant overcharge and compensation arising from 1WMP, and (iii) review the adequacy and effectiveness of UBS's remediation measures; (Note 3) and
- UBS's agreement to fully compensate the affected clients.

End

Notes:

1. UBS is a registered institution under the SFO to carry on business in 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.
2. UBS has engaged an independent reviewer to assess and validate the compensation amount to be paid to the affected clients. They will receive letters from UBS within 1 month notifying them the details of the repayment arrangement.
3. The reports of the relevant reviews have been or will be provided to the SFC and the Hong Kong Monetary Authority.

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

Page last updated : 11 Nov 2019

STATEMENT OF DISCIPLINARY ACTION

The disciplinary action

1. The Securities and Futures Commission (**SFC**) has publicly reprimanded and fined UBS AG (**UBS**)¹ HK\$400 million pursuant to section 196 of the Securities and Futures Ordinance (**SFO**).
2. The disciplinary action is taken in relation to UBS's spread overcharge practices and related internal control failures.
3. The relevant regulatory requirements are set out in the **Appendix**.

Summary of facts

(A) Spread overcharge practices

4. Between 2008 and 2017, UBS overcharged its clients by increasing the spread after execution of trades without their knowledge and charging them fees in excess of standard disclosures or rates. The overcharge amounted to approximately HK\$180 million, affecting about Hong Kong-managed 5,000 client accounts in about 28,700 transactions.

(I) Overcharge by making post-trade spread increase

5. Between 2008 and 2015, it was a widespread practice for the client advisors (**CAs**) and client advisors' assistants (**CAAs**) in UBS's Wealth Management division to increase the spread charged to clients following the execution of a trade (post-trade spread increase or **PTSI**) in bonds and structured notes (**Relevant Conduct**). It was found that:
 - (a) UBS failed to make adequate and accurate disclosure of the execution price and charges it made in bond and structured note trades to its clients during the relevant period;
 - (b) in circumstances where the execution price achieved in the market was better than the limit order price placed by the client in buy or sell trades (**Price Improvement**), the CAs and CAAs would increase the spread within UBS's Client Order Processing System (**COPS**) after the execution of trades for clients in order to retain the Price Improvement for UBS without agreement with, or disclosure to, the clients;
 - (c) on some occasions, the CAs and CAAs misreported the execution price or spread to the clients; and
 - (d) in some other cases, the CAs and CAAs falsified quarterly statements issued to financial intermediaries (**FIM**) who were authorized to trade for clients by misreporting the spread amount to conceal the overcharges.

¹ UBS is a registered institution under the SFO to carry on business in 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.

6. The use of PTSI to retain Price Improvement for UBS was found in trades for clients contracted under various types of accounts².
7. The SFC is of the view that the Relevant Conduct involving the act of increasing spread post trade to capture the benefit of Price Improvement unbeknown to clients demonstrates UBS's failures to:
 - (a) act honestly, fairly, with due skill, care and diligence, and in the best interests of their clients under General Principles 1 and/or 2 and paragraph 3.10 of the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (**Code of Conduct**);
 - (b) make adequate disclosure of the monetary benefits received and relevant material information to clients under General Principle 5 and paragraphs 8.3 and 8.3A of the Code of Conduct;
 - (c) avoid conflicts of interest and ensure fair treatment of clients under General Principle 6 and paragraph 10.1 of the Code of Conduct;
 - (d) ensure that any representations made and information provided to clients are accurate and not misleading under paragraph 2.1 of the Code of Conduct;
 - (e) ensure that the charges, mark-ups or fees affecting clients are fair and reasonable and characterized by good faith under paragraph 2.2 of the Code of Conduct;
 - (f) execute client orders on the best available terms when acting for or with clients under paragraph 3.2 of the Code of Conduct; and
 - (g) ensure that client is provided with adequate information about the services provided to the client including the nature and scope of fees, penalties and other charges UBS may levy under paragraph (1)(c) of the Appendix to the Management, Supervision and Internal Control Guidelines for Persons Licensed by or Registered with the Securities and Futures Commission (**Internal Control Guidelines**).
8. The Relevant Conduct was serious, systemic and fell below the SFC's regulatory requirements. It also fell short of the high standards UBS expects of itself to put its clients' best interests before its own and never let its own interests influence its dealings with its clients³.
9. The Relevant Conduct was a dishonest means through which UBS took profits from its clients without agreement with or disclosure to them. Dishonesty is further evidenced in the misreporting of the execution price and/or spread charged to certain non-FIM clients and FIMs, as well as the falsification of quarterly statements issued to the FIMs.

² The account types involving PTSI practices include General Advisory, Active Portfolio Advisory (**APA**) Flat Fee, APA Advisory Fee, UBS Advice, Discretionary Mandate (**DM**) and FIM Desk.

³ UBS's publication "The way we do business – Our Code of Business Conduct and Ethics".

10. The SFC considers that the overcharge malpractices involved a combination of serious systemic failures for a prolonged period of time, including inadequate policies, procedures and system controls, lack of staff training and supervision, and failures of the first and second lines of defence functions of UBS.
11. UBS failed to prevent or detect the Relevant Conduct during the relevant period due to a number of systemic internal control deficiencies:
 - (a) **Inadequate policies and procedures** – UBS lacked clearly defined and documented policies and procedures to govern the way in which client orders were handled and to ensure that conflicts of interest between CAs and clients were managed in accordance with regulatory expectations. Adequate policies and procedures governing pricing and disclosure, spread charged and best execution were absent.
 - (b) **Inadequate system controls** – For the purpose of taking the benefit of Price Improvement in the form of additional spread, UBS allowed CAs or CAAs to effect PTSI manually before 2012. In 2012, it created a new system functionality within COPS (**COPS System Change**) which would permit the CAs or CAAs sole discretionary control over post execution spread amendments thereby allowing them to unilaterally determine the final spread charges to clients. The COPS System Change facilitated the improper use of PTSI by the CAs or CAAs to retain Price Improvement. It further demonstrated UBS's failure to establish and maintain proper system controls to prevent and detect errors, omissions, and other improper activities in respect of trades effected on behalf of clients.
 - (c) **Lack of supervision** – Management did not establish, maintain and/or enforce an effective supervisory framework or programme for Desk Heads (**DHs**) to supervise CAs. DHs failed to identify conduct issues and poor ethical decision making by CAs which led to the Relevant Conduct being neither prevented nor detected.
 - (d) **Lack of staff training** – UBS failed to provide adequate training and guidance to its client-facing staff in the areas of (a) order taking and pricing disclosure, (b) obligations to execute client orders on the best available terms, and (c) fair treatment of clients. CAs or CAAs who engaged in the Relevant Conduct believed that it was acceptable for UBS to take the benefit of Price Improvement. Client-facing staff and their supervisors did not appear to understand the importance of their primary obligations to treat clients fairly and achieve best execution on behalf of their clients.
 - (e) **Failures of the first and second lines of defence function** – During the relevant period, both the Location Risk Unit (first line of defence) and Compliance (second line of defence) did not sufficiently address conflicts of interest between CAs or CAAs and their clients, and failed to identify risks with order taking, pricing and disclosure practices, thereby failing to prevent or detect the Relevant Conduct.
12. The SFC is of the view that UBS's lack of proper policies and procedures, inadequate system controls, lack of staff training and supervision, and failures of the first and second lines of defence functions demonstrate its failures to:

- (a) ensure that any person it employs or appoints to conduct business is fit and proper and otherwise qualified to act in the capacity so employed or appointed (including having relevant professional training or experience) under paragraph 4.1 of the Code of Conduct;
- (b) ensure that it has adequate resources to supervise diligently and does supervise diligently persons employed or appointed by it to conduct business on its behalf under paragraph 4.2 of the Code of Conduct;
- (c) ensure that it has internal control procedures and financial and operational capabilities which can be reasonably expected to protect its operations, and its clients and other licensed or registered persons from financial loss arising from theft, fraud, and other dishonest acts, professional misconduct or omissions under paragraph 4.3 of the Code of Conduct;
- (d) implement and maintain measures appropriate to ensuring compliance with all regulatory requirements applicable to the conduct of its business activities so as to promote the best interests of clients and the integrity of the market under General Principle 7 and paragraph 12.1 of the Code of Conduct;
- (e) (i) establish and maintain an appropriate and effective compliance function within UBS which is independent of all operational and business functions, (ii) ensure staff performing the compliance function possess the necessary skills, qualifications and experience to enable them to effectively execute their duties, (iii) enforce clear policies to ensure that the compliance function covers all relevant aspects of UBS's operations, including the unfettered access to necessary records and documentation, and (iv) ensure staff performing the compliance function, in conjunction with management, establish, maintain and enforce effective compliance procedures, under paragraph V of the Internal Control Guidelines; and
- (f) establish and maintain effective policies and operational procedures and controls in relation to UBS's day-to-day business operations, which should ensure (i) the compliance by UBS and its staff with relevant legal and regulatory requirements, and (ii) that client orders are handled in a fair and equitable manner, under paragraph VII of the Internal Control Guidelines.

(II) Charges in excess of standard disclosures or rates

13. Between 2008 and 2017, UBS had charged spreads or fees which exceeded the maximum level as set out in the written monetary benefit disclosure documents it provided to its clients, or as agreed with or understood by clients, or under its standard rates. The overcharges were made in circumstances including the following:
- (a) spreads in excess of the caps set out in its Sales Related Information Disclosure (**SRID**);
 - (b) overcharge of allotment fees in primary market bond trades;
 - (c) charges on APA accounts under a flat fee model;

- (d) charges on zero fee product types;
- (e) charges on UBS Advice accounts; and
- (f) charges on DM accounts.

Spreads in excess of caps under SRID

14. According to the monetary benefit disclosure included in the SRID provided to UBS's non-FIM clients with Hong Kong booked or managed accounts, spreads on bond trades were capped at 1% of the value of the trade, and spreads on structured note trades were capped at either 1%, 2%, 3% or 5% of the value of the trade, depending upon the type of product and, in certain cases, the maturity of the product. UBS charged spread in excess of those caps.

Overcharge of allotment fees

15. When clients purchase bonds through primary market trades, the CAs may charge the client an allotment fee. UBS disclosed to its clients through its Fees and Commissions Booklet that it would charge a fee of 0.25% of the notional amount of the primary market bonds allotted to the purchaser. However, UBS overcharged allotment fees in excess of the prescribed rate of 0.25%.

Charges on APA accounts under a flat fee model

16. Clients who subscribed to APA service are required to enter into a formal onboarding agreement entitled "UBS Active Portfolio Advisory Agreement" (from 2004 to 2010) or "Programme Specifications for the Active Portfolio Advisory Service" (from 2011 to 2017). Clients who subscribed to APA service could opt for either an advisory fee model or flat fee model when entering into an APA agreement. The fee inclusion and exclusion with respect to both models were set out in the APA agreement.
17. For APA flat fee clients, any additional transaction based charges being applied to their trades without their knowledge or consent would amount to spread overcharge. UBS had imposed such charges on the relevant clients.

Charges on zero fee product types

18. UBS's internal guidelines indicated exclusion of spread, commission and transaction fees on certain products. However, there is evidence to suggest that UBS had charged a spread on such zero fee products.

Charges on UBS Advice accounts

19. On 11 March 2014, UBS launched a new client service entitled UBS Advice. All clients contracted under UBS Advice services are charged on a flat fee basis. Any additional transaction based charges being applied to the trades of UBS Advice clients without the clients' knowledge or consent would amount to an overcharge. UBS had imposed such charges on the relevant clients.

Charges on DM accounts

20. By subscribing to the DM services, the authority of a client to make investment decisions with respect to his or her DM investment portfolio was delegated to UBS. UBS was contractually bound to manage and invest a client's assets on a discretionary basis in return for a fee. All clients contracted under DM services with UBS are charged on a flat fee basis. Any additional transaction based charges being applied to their trades without their knowledge or consent would amount to an overcharge. UBS had imposed such charges on the relevant clients.
21. The SFC is of the view that UBS's charging of clients spread in excess of disclosed, agreed or standard level demonstrates its failures to:
 - (a) act with due skill, care and diligence, and in the best interests of its clients under General Principle 2 and paragraph 3.10 of the Code of Conduct;
 - (b) make adequate disclosure of relevant material information in its dealings with its clients under General Principle 5 of the Code of Conduct;
 - (c) avoid conflicts of interest with clients and ensure that its clients are fairly treated under General Principle 6 and paragraph 10.1 of the Code of Conduct;
 - (d) ensure that any representations made and information provided to the client are accurate and not misleading under paragraph 2.1 of the Code of Conduct;
 - (e) ensure that the provision of the charges, mark-ups, or fees affecting a client should be fair and reasonable in the circumstances of dealing or advising the client, and be characterized by good faith under paragraph 2.2 of the Code of Conduct;
 - (f) execute client orders on the best available terms when acting for or with clients under paragraph 3.2 of the Code of Conduct; and
 - (g) ensure that the client is provided with adequate information about the services provided to the client including the nature and scope of fees, penalties and other charges UBS may levy under paragraph (1)(c) of the Appendix to the Internal Control Guidelines.

(B) Failure to properly disclose trading capacity to clients

22. UBS failed to properly understand the capacity in which it was acting when conducting secondary market bond and structured note trades for its clients, and consequently failed to make proper and accurate disclosure of its capacity to clients.
23. Despite internal records showing that UBS perceived itself to be an agent in over-the-counter securities transactions, and its communication to clients stating that it acted in an agency capacity, UBS repeatedly asserted in the SFC's investigation that it was acting as a riskless principal for its clients in these transactions.

24. It was only when the SFC challenged its position that UBS accepted that:
- (a) Its approach to capacity historically was confused. Its prior understanding of its trading capacity for secondary market bonds and structured notes was inadequate.
 - (b) Its past communications with regulators were incomplete.
 - (c) Its communications with clients regarding its capacity were unclear and, in some cases, must have been erroneous.
25. UBS's failure to have a proper understanding of its capacity vis-à-vis its clients raises serious concerns on how it could have ensured compliance with relevant legal and regulatory requirements when conducting trades for clients.
26. The SFC is concerned that UBS failed to put in place an effective system to properly track the capacity in which it acted in trades. Such failure affects UBS's ability to make proper disclosure of its capacity to clients, resulting in ambiguous and possibly incorrect information being disclosed to clients.
27. The SFC is of the view that by failing to identify and clearly disclose its trading capacity to clients, UBS failed to:
- (a) act with due skill, care and diligence, and in the best interests of its clients under General Principle 2 of the Code of Conduct;
 - (b) make adequate disclosure of relevant material information in its dealings with its clients under General Principle 5 of the Code of Conduct;
 - (c) avoid conflicts of interest and ensure fair treatment of clients under General Principle 6 and paragraph 10.1 of the Code of Conduct;
 - (d) comply with all regulatory requirements applicable to the conduct of its business activities under General Principle 7 of the Code of Conduct;
 - (e) ensure that any representations made and information provided to clients are accurate and not misleading under paragraph 2.1 of the Code of Conduct;
 - (f) disclose transaction related information to clients under paragraph 8.3A(a)(i) of the Code of Conduct; and
 - (g) establish effective procedures to ensure disclosure of its interest in a transaction with a client to the client prior to the execution of the relevant transaction under paragraph 6 of the Appendix to the Internal Control Guidelines.

(C) Delay in reporting breaches to the SFC

28. Paragraph 12.5 of the Code of Conduct requires licensed corporations or registered institutions to report to the SFC immediately upon the happening of any material breach, infringement of or non-compliance with any rules, laws, regulations and codes administered or issued by the SFC, or where it suspects

any such breach, infringement or non-compliance by itself or persons it employs or appoints to conduct business with clients.

29. UBS investigated an operational loss incident in Singapore in 2014 involving incorrect input of a limit order in an order management system. The relevant findings of UBS's legal team documented in June 2014 identified spread taking practices in relation to bonds that included elements of the Relevant Conduct. By the time UBS reported its spread overcharge practice to the SFC in June 2016, there was a lapse of 2 years after it became aware of the Relevant Conduct.
30. This late reporting incident was not an isolated one. UBS failed to report, or delayed in reporting, misconduct to the SFC in 4 other cases.

(D) System failures in relation to One Wealth Management Platform (1WMP)

31. UBS submitted that it made a number of systems enhancements following the discovery of the Relevant Conduct, including implementation of a new order taking platform, 1WMP, in October 2017. However, instead of putting in place a system that ensures compliance with relevant regulatory requirements, UBS has reported 15 incidents to the SFC or the Hong Kong Monetary Authority relating to the failures of 1WMP covering a variety of issues, including:
 - (a) 1 report concerning further spread overcharges;
 - (b) potential non-compliance with the Securities and Futures (Contract Notes, Statements of Account and Receipts) Rules;
 - (c) potential non-compliance with the Personal Data (Privacy) Ordinance;
 - (d) omission of principal capacity disclosure, and inaccurate capacity disclosure for agency trades; and
 - (e) potential breaches of suitability obligations.
32. The issues arising from the use of 1WMP cast doubt on the effectiveness of UBS's remediation and enhancements to address the Relevant Conduct and UBS's capability to ensure that it has proper internal controls to avoid recurrence of historical deficiencies. The SFC is of the view that UBS failed to:
 - (a) ensure that it has internal control procedures and financial and operational capabilities which can be reasonably expected to protect its operations, and its clients and other licensed or registered persons from financial loss arising from theft, fraud, and other dishonest acts, professional misconduct or omissions under paragraph 4.3 of the Code of Conduct; and
 - (b) establish and maintain effective policies and operational procedures and controls in relation to UBS's day-to-day business operations, which should ensure that client orders are handled in a fair and equitable manner, under paragraph VII(6) of the Internal Control Guidelines.

Conclusion

33. The SFC has decided to take the disciplinary action against UBS as described in paragraph 1 above, after taking into account all relevant circumstances, including:
- (a) the Disciplinary Fining Guidelines made under section 199(1)(a) of the SFO;
 - (b) the elements of dishonesty in the Relevant Conduct;
 - (c) the duration of UBS's spread overcharge practices, i.e. around ten years;
 - (d) the fact that the Relevant Conduct was undetected for at least seven years;
 - (e) the serious and systemic nature of UBS's internal control failures;
 - (f) UBS's disciplinary actions against over 20 staff who had engaged in the malpractice;
 - (g) UBS's appointments of independent reviewers to (i) identify the root causes of the Relevant Conduct and assess the magnitude of its spread overcharge practices, (ii) validate the relevant overcharge and compensation arising from 1WMP, and (iii) review the adequacy and effectiveness of UBS's remediation measures; and
 - (h) UBS's agreement to fully compensate the affected clients.

Appendix

Regulatory requirements

A. Code of Conduct

1. General Principle 1 (Honesty and fairness)

In conducting its business activities, a licensed or registered person should act honestly, fairly, and in the best interests of its clients and the integrity of the market.

2. General Principle 2 (Diligence)

In conducting its business activities, a licensed or registered person should act with due skill, care and diligence, in the best interests of its clients and the integrity of the market.

3. General Principle 5 (Information for clients)

A licensed or registered person should make adequate disclosure of relevant material information in its dealings with its clients.

4. General Principle 6 (Conflicts of interest)

A licensed or registered person should try to avoid conflicts of interest, and when they cannot be avoided, should ensure that its clients are fairly treated.

5. General Principle 7 (Compliance)

A licensed or registered person should comply with all regulatory requirements applicable to the conduct of its business activities so as to promote the best interests of clients and the integrity of the market.

6. Paragraph 2.1 (Accurate representations)

Where a licensed or registered person advises or acts on behalf of a client, it should ensure that any representations made and information provided to the client are accurate and not misleading.

7. Paragraph 2.2 (Fair and reasonable charges)

The general course of dealing or advising concerning a client, the provision of margin lending, and the charges, mark-ups, or fees affecting a client should be fair and reasonable in the circumstances, and be characterized by good faith.

8. Paragraph 3.2 (Best execution)

A licensed or registered person when acting for or with clients should execute client orders on the best available terms.

9. Paragraph 3.10 (Best interests of clients)

A licensed or registered person should act in the best interests of its clients in providing services or recommending the services of an affiliated person to its clients.

10. Paragraph 4.1 (Fit and proper staff)

A licensed or registered person should ensure that any person it employs or appoints to conduct business is fit and proper and otherwise qualified to act in the capacity so employed or appointed (including having relevant professional training or experience).

11. Paragraph 4.2 (Staff supervision)

A licensed or registered person should ensure that it has adequate resources to supervise diligently and does supervise diligently persons employed or appointed by it to conduct business on its behalf.

12. Paragraph 4.3 (Internal control, financial and operational resources)

A licensed or registered person should have internal control procedures and financial and operational capabilities which can be reasonably expected to protect its operations, and its clients and other licensed or registered persons from financial loss arising from theft, fraud, and other dishonest acts, professional misconduct or omissions.

13. Paragraph 8.3 (Pre-sale disclosure of monetary and non-monetary benefits) (with effect from 4 June 2011)

Part A

Disclosure of monetary benefits

Where the monetary benefits received are quantifiable

(a) Specific disclosure

(i) ...

Trading profit made from a back-to-back transaction

(ii) Where a licensed or registered person enters into a back-to-back transaction concerning an investment product, the licensed or registered person should disclose to the client the trading profit to be made. The trading profit should be disclosed as a percentage ceiling of the investment amount or the dollar equivalent.

Notes

...

Back-to-back transactions refer to those transactions where a licensed or registered person, after receiving a purchase order from an investor, purchases an investment product from a third party and then sells the same investment product to the investor and no market risk is taken by the licensed or registered person.

14. Paragraph 8.3A (Disclosure of sales related information) *(with effect from 4 June 2011)*

- (a) *Where a licensed or registered person distributes an investment product to a client other than a Professional Investor for the purpose of paragraph 15 of the Code, the licensed or registered person should deliver the following information to the client prior to or at the point of sale:*
- (i) *The capacity (principal or agent) in which a licensed or registered person is acting;*
 - (ii) *...*
 - (iii) *Disclosure of monetary and non-monetary benefits (Please refer to paragraph 8.3 of the Code of Conduct; and*
 - (iv) *...*

15. Paragraph 10.1 (Disclosure and fair treatment)

Where a licensed or registered person has a material interest in a transaction with or for a client or a relationship which gives rise to an actual or potential conflict of interest in relation to the transaction, it should neither advise, nor deal in relation to the transaction unless it has disclosed that material interest or conflict to the client and has taken all reasonable steps to ensure fair treatment of the client.

16. Paragraph 12.1 (Compliance: in general)

A licensed or registered person should comply with, and implement and maintain measures appropriate to ensuring compliance with the law, rules, regulations and codes administered or issued by the Commission, the rules of any exchange or clearing house of which it is a member or participant, and the requirements of any regulatory authority which apply to the licensed or registered person.

17. Paragraph 12.5 (Notifications to the Commission)

A licensed or registered person, as a firm, should report to the Commission immediately upon the happening of any one or more of the following:

- (a) *any material breach, infringement of or non-compliance with any law, rules, regulations, and codes administered or issued by the Commission, the rules of any exchange or clearing house of which it is a member or participant, and the requirements of any regulatory authority which apply to the licensed or registered person, or where it suspects any such breach, infringement or non-compliance whether by:*
- (i) *itself; or*
 - (ii) *persons it employs or appoints to conduct business with clients or other licensed or registered persons,*

giving particulars of the breach, infringement or non-compliance, or suspected breach, infringement or non-compliance, and relevant information and documents;

B. Internal Control Guidelines

18. Paragraph V (Compliance)

Objective

Policies and procedures shall be established and maintained to ensure the firm's compliance with all applicable legal and regulatory requirements as well as with the firm's own internal policies and procedures.

Control Guidelines

1. Management establishes and maintains an appropriate and effective compliance function within the firm which, subject to constraint of size, is independent of all operational and business functions, and which reports directly to Management.

2. Management ensures that staff performing the compliance function possess the necessary skills, qualifications and experience to enable them to effectively execute their duties.

3. Management establishes and enforces clear policies to ensure that the compliance function covers all relevant aspects of the firm's operations, including the unfettered access to necessary records and documentation.

4. Staff performing the compliance function, in conjunction with Management, establish, maintain and enforce effective compliance procedures. These procedures should cover legal and regulatory requirements including where applicable registration / licensing and financial resources requirements; record keeping (for management and regulatory reporting, audit and investigations); business practices (e.g. codes of conduct; commission rebates and soft dollar practices; and preparation, approval and dissemination of research reports); prevention of money laundering; internal control matters; and compliance with the relevant client, proprietary and staff dealing requirements.

19. Paragraph VII (Operational Controls)

Objective

Effective policies and operational procedures and controls in relation to the firm's day-to-day business operations shall be established, maintained and compliance therewith ensured. The effectiveness of such operational procedures and controls will be evaluated in the light of whether they serve to ensure:

- a) an adequate exchange of information between the firm and its clients including information from and required disclosures of information to clients;*
- b) the integrity of the firm's dealing practices, including the treatment of all clients in a fair, honest and professional manner;*
- c) the safeguarding of both the firm's and its clients' assets;*

- d) *the maintenance of proper records and the reliability of the information contained therein and used within the firm or used for publication; and*
- e) *the compliance by the firm and persons acting on the firm's behalf, with relevant legal and regulatory requirements.*

Control Guidelines

- 4. *Specific policies and procedures are established to minimize the potential for the existence of conflicts of interest between the firm or its staff and clients, and further, in circumstances where actual or apparent conflicts of interest cannot reasonably be avoided, that clients are fully informed of the nature and possible ramifications of such conflicts and are in all cases treated fairly.*
- 5. *Management establishes and maintains policies and procedures which ensure that whenever the firm or its staff member(s) have a material interest in a transaction with a client, this fact is disclosed, where practicable, to the client prior to the execution of the relevant transaction.*
- 6. *Management establishes and maintains policies and procedures which ensure that client orders are handled in a fair and equitable manner and, in all cases comply with order handling requirements specified in the various codes or regulations. In particular, clear and comprehensive audit trails are created to precisely record all orders (both client and internally generated) from the time of origination, including the time the order was received or initiated, through order execution and settlement, e.g. through use of sequential numbering on order tickets and the use of time stamping facilities.*

20. Appendix – Paragraph (1)(c)

- 1. *Mandatory account opening procedures are clearly defined and followed. Such procedures may include:*
 - c) *ensuring that the client is provided with adequate information about the firm and the services to be provided to the client, together with other relevant documents such as relevant risk disclosure statements (particularly where the firm possesses discretionary authority over the account or where derivative financial products will be transacted on the client's behalf), and the nature and scope of fees, penalties and other charges the firm may levy;*

21. Appendix – Paragraph (6)

- 6. *Effective procedures are established to ensure that whenever the firm or its staff member(s) have an interest in a transaction with a client (i.e. a direct/cross transaction), this fact is disclosed to the client prior to the execution of the relevant transaction. For example, the firm may maintain a register of direct and cross trades which also records the name of the client and the firm account involved, the person contacted and the time when the consent was received. The register is reviewed regularly (at least monthly) by designated staff member(s) performing the compliance function or a senior staff member in the dealing department.*