
STATEMENT OF DISCIPLINARY ACTION

The Disciplinary Action

1. The Securities and Futures Commission (**SFC**) has publicly reprimanded and fined Deutsche Bank Aktiengesellschaft (**DB**)¹ \$23.8 million pursuant to section 196 of the Securities and Futures Ordinance (**SFO**).
2. The disciplinary action is taken because DB:
 - (a) failed to apply the discounted management fee rates agreed with clients to 39 Discretionary Portfolio Management (**DPM**) accounts between June 2016 and September 2022, resulting in management fees totalling around US\$5 million being overcharged to these accounts;
 - (b) incorrectly valued 392 floating rate debt instruments between November 2015 and December 2020, resulting in 92 clients being overcharged total custodian and management fees of EUR10,988;
 - (c) overstated or understated the valuations of 16 private equity funds (**PE Funds**) and 3 real estate funds (**RE Funds**) in monthly statements sent to 233 clients between May 2022 and November 2023, resulting in 32 clients being overcharged total custodian fees of US\$493;
 - (d) failed to disclose its investment banking relationships in 261 single stock company reports and 1,590 industry reports issued between September 2014 and September 2021; and
 - (e) incorrectly assigned a lower product risk rating (**PRR**) to 40 exchange-traded funds (**ETFs**) between August 2012 and December 2020 which impacted 265 transactions involving 93 clients.

Relevant Regulatory Requirements

3. General Principle 2 (Diligence) of the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (**Code of Conduct**) requires a

¹ DB is registered under the Securities and Futures Ordinance (**SFO**) to carry on Type 1 (dealing in securities), Type 4 (advising on securities), Type 6 (advising on corporate finance) and Type 9 (asset management) regulated activities since 29 April 2008.

registered person to act with due skill, care and diligence, in the best interests of its clients and the integrity of the market.

4. General Principle 7 (Compliance) of the Code of Conduct requires a registered person to 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.
5. Paragraph 2.1 (Accurate representations) of the Code of Conduct provides that where a registered person advises or acts on behalf of a client, it should ensure that any representations made and information provided to the clients are accurate and not misleading.
6. Paragraph 12.1 (Compliance: in general) of the Code of Conduct requires a registered person to, among other things, comply with, and implement and maintain measures appropriate to ensuring compliance with the law, rules, regulations and codes administered or issued by the SFC.
7. Paragraph 16.5(d) (Disclosure by firms of relevant business relationships) of the Code of Conduct requires a registered person that has an investment banking relationship with the issuer or the new listing applicant to disclose that fact in the research report. Any compensation or mandate for investment banking services received within the preceding 12 months would constitute an investment banking relationship.

Summary of Facts

A. Overcharging management fees in DPM accounts

8. In November 2022, DB reported to the SFC that it had overcharged management fees to DPM accounts between April 2019 and May 2022.
9. The standard management fee rate for DPM accounts was between 1.5% and 2% per annum at the material time. Subject to the approval of designated senior management members (**Designated Approvers**), relationship managers (**RMs**) could offer discounted management fee rates (**Discounted Rates**) to clients.
10. The SFC's investigation found that, as a result of a combination of shortcomings in DB's processes and failures in their implementation, Discounted Rates that had been agreed with clients were not properly applied to DPM accounts in the following situations:
 - (a) for new account set-ups, the default standard management rate was applied instead of the Discounted Rate due to:
 - i. failure to input the Discounted Rate request into DB's system;
 - ii. failure or delay by the Designated Approvers to formally approve the Discounted Rate request; or
 - iii. delays by the Operations team in completing verification checks for the Discounted Rates; and

- (b) after each portfolio switch, DB's system automatically reverted the management fee rate for DPM accounts to the standard rate, requiring the Discounted Rates to be reinputted into the system. However, the RMs and their service assistants were not aware of the requirement and failed to reinput the Discounted Rates following portfolio switches.
11. Between June 2016 and September 2022, 39 DPM accounts were overcharged management fees totalling approximately US\$5 million.
 12. DB's failure to apply the agreed Discounted Rates to the relevant DPM accounts resulting in the overcharging of management fees was in breach of General Principle 2 and paragraph 2.1 of the Code of Conduct.

B. Incorrect valuations of floating rate debt instruments

13. In January 2021, DB reported to the SFC that it had applied the wrong interest rates to floating rate debt instruments which resulted in their incorrect valuations.
14. The SFC's investigation found that 392 floating rate debt instruments were created and maintained in DB's system in the same manner as fixed interest rate debt instruments (**Affected Debt Instruments**).
15. The incorrect application of "fixed" interest rates to the Affected Debt Instruments led to their market values being overstated or understated. Consequently, this affected the overall portfolio valuation of the client account and the fees (such as custodian and management fees) charged to the account, as these fees were calculated on a portfolio valuation basis.
16. Between November 2015 and December 2020, 519 accounts traded and/or held existing positions in the Affected Debt Instruments, of which 92 accounts were overcharged fees totalling EUR10,988.
17. The incident was caused by DB's failure to set up an automated function to apply periodic interest rates to floating rate debt instruments in its system.
18. DB's failure to correctly value the Affected Debt Instruments and the consequent overcharging of fees to client accounts was in breach of General Principle 2 of the Code of Conduct.

C. Incorrect valuation of funds

19. In December 2023, DB reported to the SFC that it had overstated or understated the valuations of 16 PE Funds and 3 RE Funds (collectively, **PE/RE Funds**).
20. According to DB:
 - (a) The prices of the PE/RE Funds were manually updated by its outsourced vendor (**Vendor**), and it was the Vendor's practice to update the prices of all the PE/RE Funds together once the Vendor had obtained all the fund statements.
 - (b) Due to an IT issue, the Vendor could not obtain the fund statements for 10 out of 19 PE/RE Funds. Therefore, the Vendor stopped updating the prices of all 19 PE/RE Funds.

- (c) While the Vendor should have escalated issues which could impact its service delivery to two committees jointly established by DB and the Vendor, the Vendor only contacted various IT/operations teams of DB regarding the IT issue, but did not report it to the two committees or inform DB of its impact.
 - (d) Although DB had controls in place to alert it to the existence of “stale” prices of financial instruments, no follow-up actions were required for “stale” prices of PE/RE Funds according to DB’s internal procedures.
 - (e) As a result of overstated or understated valuations of the 16 PE Funds and 3 RE Funds in the monthly statements sent to 233 clients, DB overcharged 32 clients an aggregated total custodian fees of US\$493 between May 2022 and November 2023.
21. The incident was caused by a combination of the Vendor’s oversight and lack of due diligence, and DB’s lack of appropriate and adequate controls to ensure that prices of PE/RE Funds were duly updated.
 22. By overstating or understating the valuations of PE/RE Funds in the monthly statements sent to clients and overcharging clients custodian fees, DB was in breach of General Principle 2 and paragraph 2.1 of the Code of Conduct.

D. Failure to disclose investment banking relationships

23. In September 2021, DB reported to the SFC that it had failed to disclose its investment banking relationships in certain research reports covering Hong Kong listed securities.
24. According to DB, it used a global research disclosure system to identify the required disclosures to be included in each research report based on information received from various data sources such as its investment banking deal logging system and client information system.
25. However, the system failed to cause disclosure of DB’s investment banking relationships in Hong Kong equities research reports in situations where:
 - (a) it had been mandated by an issuer or new listing applicant but not yet received any fees; or
 - (b) the mandate had not been marked as “closed” in its client information system in the 12 months preceding the publication of the relevant reports.
26. The SFC’s investigation found that DB failed to disclose its investment banking relationships with issuers in 261 single stock company reports and 1,590 industry reports published between September 2014 and September 2021.
27. DB’s failure to disclose its investment banking relationships in research reports was in breach of General Principles 2 and 7, and paragraphs 12.1 and 16.5(d) of the Code of Conduct.

E. Incorrect assignment of PRRs

28. In December 2020, DB reported to the SFC that it had assigned incorrect PRRs to certain ETFs between January and July 2020.
29. According to DB, the process for the assignment of PRR is set out in an internal document (**Guidelines**). Updates to PRR were either made by an automated process, or manually by DB's Operations Securities Master Team (**SMT**)².
30. The SFC's investigation found that, between August 2012 and December 2020, DB incorrectly assigned a lower PRR of "3" instead of "4" to 40 ETFs which impacted 265 transactions involving 93 clients. After applying the correct PRR to the 40 ETFs, risk mismatches were identified in 10 transactions involving 8 client accounts (**Risk Mismatch Transactions**).
31. The incorrect PRR assignment was attributable to:
 - (a) DB's failure to provide the SMT with an updated version of the Guidelines. This resulted in the input of PRR "3" for certain ETFs instead of "4" as set out in the updated Guidelines; and
 - (b) gaps in the product knowledge of the SMT, leading to failures to identify certain ETFs that should have been assigned a PRR of "4", due to staff turnover.
32. The Risk Mismatch Transactions involved 2 advisory accounts and 6 DPM accounts. DB's clients did not suffer any losses from the Risk Mismatch Transactions.
33. DB's incorrect assignment of PRRs to ETFs was in breach of General Principle 2 of the Code of Conduct.

Conclusion

34. Based on the matters set out above, the SFC is of the view that DB is guilty of misconduct for the purpose of section 196 of the SFO.
35. In deciding the sanctions set out in paragraph 1 above, the SFC has taken into account all relevant circumstances, including:
 - (a) DB has conducted reviews to identify the root causes and extent of the breaches;
 - (b) DB has remediated the issues and strengthened its internal controls and systems upon identifying the breaches;
 - (c) DB has refunded the overcharged fees to the relevant client accounts;
 - (d) DB's breaches were inadvertent and did not involve any deliberate or intentional misconduct; and
 - (e) DB's cooperation with the SFC in resolving the SFC's concerns and its acceptance of the SFC's findings and disciplinary action.

² The SMT was outsourced to an external service provider since November 2015.