

STATEMENT OF DISCIPLINARY ACTION

The disciplinary action

1. The Securities and Futures Commission (**SFC**) has publicly reprimanded and fined UBS AG (**UBS**)¹ HK\$8 million pursuant to section 196 of the Securities and Futures Ordinance (**SFO**).
2. The disciplinary action is taken in relation to deficiencies in UBS's internal systems and controls, which failed to ensure the accurate classification of professional investors (**PIs**) in accordance with the SFO and the Securities and Futures (Professional Investor) Rules (**PI Rules**) during the period between 2009 and July 2022 (**Relevant Period**). As a result, UBS:
 - (a) provided securities pooled lending (**SPL**) service to certain clients who did not qualify as PIs (**Non-PI Clients**) without:
 - (i) obtaining valid standing authorities for the use of client securities or securities collateral from these clients, in breach of section 4 of the Securities and Futures (Client Securities) Rules (**CSR**); and
 - (ii) disclosing the relevant information prescribed by section 11(3A) of the Securities and Futures (Contract Notes, Statements of Account and Receipts) Rules (**CNR**) in the monthly statements issued to these clients; and
 - (b) offered and sold investment products intended for PIs only to certain Non-PI Clients.

Summary of facts

A. The PI Rules

3. The PI Rules, enacted on 1 April 2003 and last amended on 13 July 2018, stipulate the minimum portfolio requirement for an individual to qualify as a PI.
4. Before 13 July 2018, section 3 the PI Rules provides that any individual, either alone or with any of his associates on a joint account, having a portfolio of not less than HK\$8 million can be qualified as a PI.
5. "Associate" is defined in section 2 of the PI Rules as the spouse or any child of the individual.
6. Following the July 2018 amendments, section 5(1) of the PI Rules specifies that an individual qualifies as a PI if he/she has a portfolio of not less than HK\$8 million, when any one or more of the following are taken into account:

¹ UBS is registered under the SFO 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.

- “(a) a portfolio on the individual’s own account;
- (b) a portfolio on a joint account with the individual’s associate;
- (c) the individual’s share of a portfolio on a joint account with one or more persons other than the individual’s associate;²
- (d) a portfolio of a corporation which, at the relevant date, has as its principal business the holding of investments and is wholly owned by the individual.”

7. As stated in the “*Consultation Conclusions on the Draft Securities and Futures (Professional Investor) Rules*” published by the SFC in June 2002 (**Consultation Conclusions**), any joint account might be treated as a PI account, provided that each account holder satisfies the minimum portfolio requirement (without double counting) set out in the PI Rules (**Individual Portfolio Requirement**).³ The position has remained unchanged following the July 2018 amendments.

B. Misinterpretation of the PI Rules

8. In 2009, UBS implemented certain system changes to automate the process of verifying its clients’ PI status. However, during the implementation of the system changes, UBS misinterpreted the minimum portfolio requirement for the following types of account:

- (a) joint accounts held by one or more account holder(s) who was not an associate of any other account holder(s) (**Non-Associate Joint Accounts**); and
- (b) joint accounts held by parent(s) and child(ren) (**Parent-Child Joint Accounts**).

9. For Non-Associate Joint Accounts, due to UBS’s misinterpretation of the PI Rules, UBS incorrectly treated all Non-Associate Joint Accounts with a portfolio value of HK\$8 million or above as PI accounts without verifying that each account holder individually met the HK\$8 million Individual Portfolio Requirement.

10. For Parent-Child Joint Accounts:

- (a) While a child qualifies as an “associate” of the parent, the parent does not qualify as an associate of the child. Therefore, even if the joint account holds a HK\$8 million portfolio with UBS, the child must independently meet the Individual Portfolio Requirement for the account to qualify as a PI.

² Section 5(2) of the PI Rules further provides that, for section 5(1)(c), an individual’s share of a portfolio on a joint account with one or more persons other than the individual’s associate is (a) the individual’s share of the portfolio as specified in a written agreement among the account holders; or (b) in the absence of an agreement, an equal share of the portfolio.

³ See point 4 in Annex 1 of the Consultation Conclusions.

- (b) UBS misinterpreted this rule and classified all Parent-Child Joint Accounts with a portfolio of at least HK\$8 million as PI accounts without verifying the child's eligibility.
11. As a result, UBS misclassified certain joint accounts as PI accounts during the Relevant Period.
 12. These errors persisted for more than 12 years until around June 2022, when UBS identified the issue during a review.

C. Consequences and impact

13. Under UBS's internal policies during the Relevant Period, clients had to qualify as PI to:
 - (a) subscribe to the SPL service, so that UBS might borrow securities from the client accounts for onward lending; and/or
 - (b) purchase certain products such as bonds listed under Chapter 37 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (**Chapter 37 Bonds**), accumulators, decumulators, and products with loss absorption features (collectively, **PI-Restricted Products**).
14. A look-back review (**Look-Back Review**) conducted by UBS covering the period from July 2018 to July 2022 (**Look-Back Period**) revealed that a total of 560 joint accounts booked and/or managed in Hong Kong were misclassified as PI accounts during the Look-Back Period, comprising 135 Non-Associate Joint Accounts and 425 Parent-Child Joint Accounts.
15. Among the 560 misclassified accounts:
 - (a) 23 subscribed to the SPL service, involving 9,190 SPL transactions where securities listed or traded on the Stock Exchange of Hong Kong were lent to UBS (**23 Affected Accounts**).
 - (b) 94 conducted investment transactions in PI-Restricted Products, involving a total of 500 transactions (**94 Affected Accounts**).

Non-compliance with the CSR and CNR

16. Section 4 of the CSR provides that a standing authority given by a client to the intermediary authorising the intermediary to deal with the securities or securities collateral it received or held on behalf of the clients should be renewed every 12 months unless the client is a 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.
17. Section 11(3A) of the CNR requires an intermediary which has held securities collateral for a client account at any time during a monthly accounting period and has at any time during that period repledged its securities collateral to disclose in the monthly client statements (a) whether the client has provided the intermediary with valid standing authority authorising the intermediary to repledge securities collateral provided by the client; and (b) the fact that the

intermediary has repledged its securities collateral during the monthly accounting period. This does not apply if the client is a PI and the intermediary has notified the client in writing that no statement of account would be provided to him/her under section 3(2) of the CNR.

18. Due to the misclassification, UBS erroneously relied on the exemptions applicable to PIs under the CSR and the CNR while providing the SPL service to the 23 Affected Accounts. Consequently, UBS failed to:
 - (a) obtain annual standing authorities for the use of client securities or securities collateral from the relevant clients, in breach of section 4 of the CSR; and
 - (b) disclose the relevant information in the monthly statements issued to the clients, in breach of section 11(3A) of the CNR.

Sale of PI-Restricted Products to Non-PI Clients

19. The SFC and the Hong Kong Monetary Authority (**HKMA**) have issued various circulars and FAQs highlighting that certain products, such as Chapter 37 Bonds⁴, accumulators⁵, and debt instruments with loss-absorption features⁶, are generally unsuitable for retail investors and should only be offered to PIs.
20. UBS's sale of the PI-Restricted Products to the 94 Affected Accounts was incompatible with the expected standards set out in the relevant SFC and HKMA circulars and FAQs and constituted a breach of UBS's internal policies.

The SFC's findings

21. The SFC considers that UBS, as well as contravening the CSR and CNR provisions mentioned above, failed to act with due skill and care and establish adequate and effective systems and controls to ensure accurate classification of PI and compliance with the CSR, the CNR and UBS's internal policies, in breach of:
 - (a) General Principle (**GP**) 2 of the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (**Code of Conduct**), which requires a registered person to act with due skill, care and diligence, in the best interests of its clients and the integrity of the market;

⁴ The circular on "Distribution of Bonds Listed under Chapter 37 of the Main Board Listing Rules and Local Unlisted Private Placement Bonds" issued by the SFC on 31 March 2016 highlights that Chapter 37 Bonds, which contain complex features and/or inherent risks, are unsuitable for sale to retail investors and are meant to be targeted only at PIs (including high net worth investors).

⁵ The circular on "Selling of Accumulators" issued by the HKMA on 22 December 2010 states that accumulators are derivative products associated with significant investment risks, and the HKMA expects that intermediaries should only sell such products to PIs.

⁶ The circular and FAQs on "Sale and Distribution of Debt Instruments with Loss-absorption Features and Related Products" issued by the HKMA on 30 October 2018 and 8 July 2019, respectively, provide that debt instruments with loss-absorption features are inherently complex and are of high risk and are generally not suitable for retail investors. Intermediaries should stay vigilant and sell and distribute the products only to PIs, in both primary and secondary markets.

- (b) GP 3 and paragraph 4.3 of the Code of Conduct, which require a registered person to (i) have and employ effectively the resources and procedures which are needed for the proper performance of its business activities; and (ii) have internal control procedures and operational capabilities which can be reasonably expected to protect its operations and its clients from financial loss arising from theft, fraud, and other dishonest acts, professional misconduct or omissions; and
- (c) GP 7 and paragraph 12.1 of the Code of Conduct, which require a registered person to implement and maintain measures appropriate to ensure compliance with all regulatory requirements applicable to the conduct of its business activities.

Conclusion

- 22. The SFC is of the opinion that UBS is guilty of misconduct.
- 23. In deciding the disciplinary sanction set out at paragraph 1 above, the SFC has taken into account all relevant circumstances, including:
 - (a) the long duration of UBS's failures for over 12 years;
 - (b) the previous disciplinary action against UBS for failures of a similar nature;⁷
 - (c) the Look-Back Review and remedial actions by UBS to strengthen its internal controls and systems upon identifying and self-reporting the breaches;
 - (d) UBS's cooperation with the SFC in resolving the SFC's concerns; and
 - (e) UBS will implement Enhanced Complaint Handling Procedures to review any complaints which may be made by clients potentially misclassified as a PI during the Relevant Period.

⁷ In August 2021, the SFC reprimanded and fined UBS HK\$9.8 million for various regulatory breaches, including its failure to diligently supervise its client advisors and implement sufficient controls to ensure that its SPL service was subscribed by PIs only, which further resulted in its failure to comply with the CSR and the CNR in relation to its SPL service provided to clients who were misclassified as PIs. For details, please see the SFC's press release dated [3 August 2021](#).