

BDO NEWS

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To maintain the financial stability and facilitate the economic growth of Hong Kong, regulators have been reviewing different regulations and guidelines regularly. Regulators and financial institutions around the globe may have new developments. In this month, the following has happened:

New SFC guidance addresses market misconduct

On 21 November 2019, the Securities and Futures Commission (SFC) issued a statement to remind listed companies about their disclosure obligations together with a circular on the conduct expected of asset managers. These measures were part of the SFC's ongoing efforts to tackle market and corporate misconduct.

The SFC's statement reminded listed companies to ensure that their announcements and other documents do not include false, incomplete or misleading information about their counterparties in pending corporate transactions. In some cases, the SFC observed that insufficient information was provided about counterparties' controllers or beneficial owners.

The circular set out guidance for asset managers considering transactions or arrangements for private funds and discretionary accounts. During recent inspections, the SFC found a number of these to be dubious. Some were used to conceal the identities of the actual parties to a transaction and in some cases 'nominees' and 'warehousing' arrangements were suspected to be involved. If a transaction or arrangement appears dubious, asset managers should make proper enquiries and not unquestioningly carry out investors' instructions.

CONTENTS

- ▶ **New SFC guidance addresses market misconduct**
- ▶ **UBS fined HK\$400 million for internal control failures**
- ▶ **New approach to virtual asset trading platforms**

Where listed companies do not disclose information which is necessary for shareholders to make an informed assessment of its activities or financial position, the SFC can use its powers under the Securities and Futures (Stock Market Listing) Rules to intervene in order to protect the investing public. In addition, the SFC will not hesitate to take regulatory action against asset managers which fail to detect dubious arrangements or transactions or which facilitate illegal or improper conduct due to material inadequacies in their procedures and controls.

Maintaining clear guidance, policy and procedures for compliance with such requirements and establishing monitoring controls for such procedures by the internal audit function would certainly mitigate risks of non-compliance (international or non-intentional) of such disclosure obligation.

(Source: Securities and Futures Commission, <https://www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/doc?refNo=19PR113>)

UBS fined HK\$400 million for internal control failures

On 11 November 2019, the SFC 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.

UBS undertook to compensate the affected clients by repaying them the full value of the overcharged amount together with interest. The total repayment amount was approximately HK\$200 million and covered overcharges made through post-trade spread increased and charged 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.

The SFC considered 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.

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 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 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 authorised to trade for clients, by misreporting the spread amount to conceal the overcharges.

The SFC considered 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 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; and
- after the discovery of the spread overcharge practices, UBS implemented a new order taking platform, One Wealth Management Platform (1WMP), in October 2017. However, UBS still 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 called into question UBS's capability to put in place effective remediation to address the problem and proper internal controls to avoid the recurrence of these deficiencies.

Failing the first, second or third line of defence in detecting and preventing malpractices in selling can have serious consequences. It may call in questions by regulators and others its ability in fixing its own problem, damaging its reputation and customers' trust. Immediate action in reviewing the corporate culture, board oversight and policy and procedures would certainly help improve the control environment.

(Source: Securities and Futures Commission, <https://www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/doc?refNo=19PR111>)

New approach to virtual asset trading platforms

On 6 November 2019, the SFC issued a position paper setting out a new regulatory framework for virtual asset trading platforms. Platforms which operate in Hong Kong and offer trading of at least one security token may now apply to be licensed by the SFC.

The position paper emphasises that the SFC will only grant licences to platform operators which are capable of meeting robust regulatory standards. These standards are comparable to those which apply to licensed securities brokers and automated trading venues but also incorporate additional requirements to address specific risks associated with virtual assets.

For example, the SFC will impose licensing conditions requiring that platform operators offer their services exclusively to professional investors, only service clients who have sufficient knowledge of virtual assets and maintain stringent criteria for the inclusion of virtual assets on their

platforms. In addition, licensed platforms will be placed in the SFC Regulatory Sandbox for a period of close and intensive supervision.

The SFC's new regulatory framework is aligned with the recommendations of international standard setting bodies. It will help investors identify trading platforms which agree to be regulated or supervised. However, the SFC would like to make clear that virtual assets traded on licensed platforms will not be subject to the same kind of regulation which applies to traditional offerings of securities or collective investment schemes. Moreover, the SFC has no power to grant a licence to or supervise platforms which only trade virtual assets or tokens which do not qualify as securities under Hong Kong law.

(Source: Securities and Futures Commission, <https://www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/doc?refNo=19PR105>)

HOW CAN BDO HELP?

BDO Risk Advisory in Hong Kong has a robust team of former banking practitioner, compliance, IT and risk professionals, which has helped our clients in reviewing it policies and systems, risk management processes and regulatory compliance. If you have any question in the above matters, please contact Ricky Cheng or Peter Pang as shown below.

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