

## SFC reprimands and fines UBS Securities Hong Kong Limited HK\$1.6 million for regulatory breaches

21 May 2013

The Securities and Futures Commission (SFC) has reprimanded and fined UBS Securities Hong Kong Limited (UBS) HK\$1.6 million for regulatory breaches and internal control failings relating to position limit failures (Note 1).

The disciplinary action follows an SFC investigation into the holding of UBS on behalf of its client, UBS AG London, of 175,697 contracts in China Construction Bank stock options in breach of the prescribed position limit of 150,000 contracts on 18 October 2011 (Notes 2, 3, 4 & 5).

The SFC also found that UBS failed to implement adequate internal controls to ensure that all opened positions in stock options contracts it held or controlled were in compliance with the prescribed position limits (Notes 6 & 7).

In particular, the SFC found that UBS:

- only implemented a real time monitoring system for one trading desk, the Equities Volatility Trading Desk, and failed to extend the monitoring system to other trading desks, even though it knew these trading desks were actively trading single stock options listed on the Stock Exchange of Hong Kong Limited (SEHK) since December 2010; and
- in the absence of a real time monitoring system, failed to implement adequate procedures to guide trading staff of its other trading desks on how and who to approach for monitoring and checking position limits.

In deciding the penalty, the SFC has taken into account UBS's co-operation and that it has since strengthened its internal controls on the monitoring of position limits.

End

Notes:

1. UBS is a licensed corporation under the Securities and Futures Ordinance to carry on Type 1 (dealing in securities), Type 6 (advising on corporate finance) and Type 7 (providing Automated Trading Services) regulated activities.
2. Rule 4(1) of the Securities and Futures (Contracts Limits and Reportable Positions) Rules (Rules) provides that no person, except persons authorized by the SFC or the Hong Kong Exchanges and Clearing Limited, may hold or control futures contracts or stock options in excess of the prescribed limit.
3. Section 5(b) of the Rules provides that the limit on the number of contracts that may be held or controlled, in the case of stock options contracts, is specified in Schedule 2 of the Rules.
4. Schedule 2 of the Rules provides that the prescribed limit for stock options contracts on shares listed on the SEHK is 50,000 open contracts per option class in any one market direction for all expiry months combined.
5. In 11 June 2011, the SEHK granted UBS's application to increase the prescribed position limit for China Construction Bank stock options to 150,000 open contracts in any one direction for all expiry months combined until 31 December 2011.
6. General Principle 7 of the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (the Code of Conduct) requires a licensed person to comply with all regulatory requirements applicable to the conduct of its business activities.
7. Paragraph 12.1 of the Code of Conduct requires a licensed person to comply with and maintain appropriate measures to ensure compliance with all applicable regulatory law, rules, regulations and codes administered or issued by the SFC, exchanges, clearing houses and other regulatory authorities which apply to the licensed person.
8. A copy of the [Statement of Disciplinary Action](#) in relation to the matter is available on the SFC's website.

Page last updated : 21 May 2013

## STATEMENT OF DISCIPLINARY ACTION

### The Disciplinary Action

1. The Securities and Futures Commission (**SFC**) has taken the following disciplinary action against UBS Securities Hong Kong Limited (**UBS**) pursuant to section 194 of the Securities and Futures Ordinance (**SFO**):
  - (a) publicly reprimanded UBS pursuant to section 194(1)(b)(iii) of the SFO; and
  - (b) ordered UBS to pay a pecuniary penalty of HK\$1,600,000 pursuant to section 194(2) of the SFO.
2. The disciplinary action is taken due to UBS's failure:
  - (a) to comply with the prescribed limits for stock options contracts on shares listed on the Stock Exchange of Hong Kong Limited (**SEHK**)<sup>123</sup>; and
  - (b) to implement adequate internal controls to ensure compliance with the prescribed position limits.
3. UBS's failings constitute a breach of General Principle 7 and paragraph 12.1 of the Code of Conduct for Persons Licensed by and Registered with the SFC (Code of Conduct).

### Summary of Facts

#### *Breach of position limit and internal controls*

4. On 18 October 2011, UBS held for its client, UBS AG London, 175,697 contracts in the downside direction<sup>4</sup> in China Construction Bank ("CCB") stock options in breach of the prescribed position limit in one market direction of 150,000 contracts.<sup>5</sup>
5. On 19 October 2011, UBS had reduced UBS AG London's holdings in CCB stock options to a level below the prescribed limit.
6. Regarding the internal controls that UBS had in place for monitoring and checking position limits at the material time, UBS had implemented real time position limit monitoring controls for trading desks that used the Options Market Making ("OMM") trading system since March 2010. These controls included:

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<sup>1</sup> Section 4(1) of the Securities and Futures (Contracts Limits and Reportable Positions) Rules (Cap 571Y) (the "Rules") provides that no person, except persons authorized by the SFC or the Hong Kong Exchange (HKEx), may hold or control futures contracts or stock options contracts in excess of the prescribed limit.

<sup>2</sup> Section 5(b) of the Rules provides that the limit on the number of contracts that may be held or controlled, in the case of stock options contracts, is specified in Schedule 2 of the Rules.

<sup>3</sup> Schedule 2 of the Rules provides that the prescribed limit for stock options contracts on shares listed on the SEHK is 50,000 open contracts per option class in any one market direction for all expiry months combined.

<sup>4</sup> At day end on 17 October 2011, UBS had an open position of 81,542 contracts.

<sup>5</sup> In June 2011, the SEHK granted UBS's application to increase the prescribed position limit for CCB stock options to 150,000 open contracts in any one direction for all expiry months combined until 31 December 2011.

- (a) monitoring UBS's intra-day positions;
  - (b) alerting OMM traders when a position reaches 80% of the position limit;
  - (c) automatically ceasing quotations and alerting the OMM trader when the position reaches 90% of the position limit;
  - (d) preventing the OMM trading from resuming quotes until an approval has been granted by the trading desk head; and
  - (e) when the position reaches 90% of the position limit, sending an email to all other traders that they should cease to trade in the direction of the limit without the consent of the OMM trader responsible for monitoring all further trading in the stock option.
7. However, only UBS's Equities Volatility Trading Desk used the OMM system. UBS did not extend the real time monitoring controls to other trading desks that actively traded single stock options listed on the Hong Kong Stock Exchange notwithstanding it knew of their trades since December 2010.
8. Although UBS claimed it had implemented standard procedures on monitoring and checking position limits and which all its trading staff was aware of, UBS could not show that these procedures were in place and/or properly communicated to trading staff and other relevant staff members at the material time.
9. UBS has since taken steps to strengthen its internal controls on the monitoring of position limits.

## **Conclusion**

10. Having considered all the circumstances, the SFC is of a view that UBS is guilty of misconduct and its fitness and properness as a licensed person has been called into question.
11. The SFC has decided that the sanction of public reprimand and fine of HK\$1.6 million is most appropriate and commensurate with the view of the SFC on the gravity of the failure.
12. In coming to the decision to take disciplinary action against UBS for its failures, the SFC has taken into account:
- (a) the serious inadequacies of UBS's internal controls in monitoring the prescribed position limits;
  - (b) UBS's breach of the prescribed position limits was rectified the following day;
  - (c) the remedial measures implemented by UBS to improve its internal controls system;
  - (d) UBS's co-operation in resolving the present disciplinary action including agreeing to conduct an independent review of its current internal controls and procedures in relation to ensuring compliance with the prescribed position limits; and

- (e) a clear message should be sent to the market on the importance of compliance with regulatory requirements.