STATEMENT OF DISCIPLINARY ACTION

The Disciplinary Action

1. The Securities and Futures Commission (**SFC**) has publicly reprimanded Yuanta Securities (Hong Kong) Company Limited[1] (**Yuanta Securities**) and fined it $4 million pursuant to section 194 of the Securities and Futures Ordinance (**SFO**).

2. The disciplinary action relates to failings of Yuanta Securities concerning its trading of debt securities for clients during the period from 1 July to 31 December 2012 (**Relevant Period**). The SFC found that:

   (a) Yuanta Securities failed to disclose the actual execution price, and provide accurate information to the clients regarding the full extent of the fees or charges it made in respect of the bond transactions executed during the Relevant Period;

   (b) the daily statements Yuanta Securities sent to the clients (which served as contract notes) in respect of these bond transactions did not set out the actual execution price of the bonds and its commission and charges as required under sections 5(3) and (4) of the Securities and Futures (Contract Notes, Statements of Account and Receipts) Rules (Cap. 571Q) (**CNR**);

   (c) Yuanta Securities failed to properly avoid and disclose conflicts of interest and treat its clients fairly or act in their best interests, in that it:

      (i) made undisclosed financial gains in some of the bond transactions entered into on behalf of clients at the expense of the clients; and

      (ii) failed to disclose its interest in the bond transactions to clients before dealing in those transactions.

3. The failures set out above suggest that Yuanta Securities has breached:

   (a) General Principles 2 (diligence), 5 (information for clients) and 6 (conflicts of interest) and paragraphs 2.1 (accurate representations) and 10.1 (disclosure and fair treatment) of the Code of Conduct for Persons Licensed by or Registered with the SFC (**Code of Conduct**); and

   (b) sections 5(3) and (4) of the CNR.

[1] Yuanta Securities is licensed under the Securities and Futures Ordinance (SFO) to carry on Type 1 (dealing in securities), Type 2 (dealing in futures contract), Type 3 (leveraged foreign exchange trading), Type 4 (advising on securities), Type 5 (advising on futures contracts), Type 6 (advising on corporate finance) and Type 9 (asset management) regulated activities.

Summary of facts

4. In February 2013, the SFC carried out an inspection of Yuanta Securities and identified a number of deficiencies in Yuanta Securities' practices in the trading of debt securities for its clients.

5. The SFC's investigation revealed that during the Relevant Period:

   (a) The terms and conditions which Yuanta Securities sent to its clients and the trading instruction form signed by the clients for trading bonds stated that Yuanta was acting as agent in the transactions. The Hong Kong clients who we had interviewed also understood that Yuanta Securities was acting as their agent in the transactions.

   (b) After receiving a buy/sell order for a bond from a client, Yuanta Securities would buy/sell the product through a counterparty. It would then mark-up (for buy orders) or mark-down (for sell orders) the price executed with the counterparty, and sell (or buy) the product to (or from) the client at the marked-up or marked-down price, as the case may be.

   (c) The mark-ups or mark-downs were done by two separate teams – the Financial Product Team (**Product Team**) and the sales team. When there was room for a profit, the Product Team would charge a fee in accordance with the criteria set out in its internal guidelines. The Product Team's mark-up or mark-down was not communicated to the sales team.

   (d) The sales team, being unaware of the Product Team's adjustment to the price, took the adjusted price quoted by the Product Team as the execution price, and would then further charge the clients a commission / fee by marking up or down the price.

   (e) The Product Team's commission was not disclosed to the clients at all, and was not reflected in the trading instruction form which was signed on the trade date, nor in the daily statement sent to the clients which served as a contract note for the transaction.

   (f) Some of the clients who we interviewed stated that they were aware of the amount of the sales team's commission or service charges for the trades. However, such commission or charges were not always separately and properly disclosed in the trading instruction form or in the daily statement.

   (g) On some occasions, in addition to the mark-ups by both the Product Team and the sales team, an additional commission for a fixed amount would be charged to the client, and only that fixed amount was disclosed as commission in the trading instruction form and in the daily statement.

   (h) Apart from the failure to disclose Yuanta Securities' commission, the daily statement only showed the marked-up or marked-down price as the execution price and did not mention the actual execution price at which the bond was bought from, or sold to, the counterparty.

6. According to information provided by Yuanta Securities, it executed 256 transactions in debt securities for 96 clients during the Relevant Period with a total transaction value of approximately HK$400 million. The fees or charges earned by Yuanta Securities in these transactions amounted to approximately HK$3.1 million, about HK$336,000 of which was commission made by the Product Team.

Failure to disclose material information in transactions

7. General Principle 5 (information for clients) and paragraph 2.1 (accurate representations) of the Code of Conduct require licensed corporations to make adequate disclosure of relevant material information in their dealings with clients. Information provided to clients must be accurate and not misleading.

8. Further, licensed corporations which enter into securities transactions with or on behalf of clients are required under the CNR to prepare and provide contract notes to the clients. Such contract notes must include the information stipulated in sections 5(3) and (4) of the CNR, including the price of the securities, the rate or amount of commission and charges payable in respect of the transaction.

9. During the Relevant Period, the Product Team made a profit from some of the bond transactions, but that information was not disclosed to the sales team or to the clients. Inaccurate information about the trading price was therefore provided to the clients verbally, in the trading instruction form and the daily statement by stating the adjusted price to be the price at which the bonds were bought or sold, without explaining to the clients the nature of the price or the full extent of the profit made by Yuanta Securities.

10. Although some of the clients appear to be aware of the part of the commission charged by Yuanta Securities' sales team, such commission was not always properly disclosed in the trading instruction forms. The daily statement sent to them also contained no information about such commission, and the marked-up or marked-down price was shown as the trading price.

11. The SFC found that:

    (a) Yuanta Securities failed to disclose the actual price at which the bonds were executed to its clients, and failed to provide accurate information to the clients regarding the full extent of the fees or charges it made in respect of the bond transactions executed during the Relevant Period, in breach of General Principle 5 and paragraph 2.1 of the Code of Conduct; and

    (b) the daily statements Yuanta Securities sent to the clients (which served as contract notes) did not set out the actual execution price of the bonds and its commission and charges as required under sections 5(3) and (4) of the CNR.

Failure to disclose conflicts of interest

12. As a licensed corporation, Yuanta Securities is required under General Principles 2 and 6 and paragraph 10.1 of the Code of Conduct to act in the best interests of its clients, and avoid conflicts of interest. Where it has a material interest in a transaction with or for a client which gives rise to an actual or potential conflict of interest, it should not 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 that its clients are treated fairly.

13. There appeared to be conflicts of interest between Yuanta Securities and its clients by the way in which Yuanta Securities' Product Team made a mark-up or mark-down of the execution prices before quoting them to the sales team and ultimately to the clients.

14. Yuanta Securities had informed clients that it was acting as their agent in the bond transactions. In its capacity as agent, it should have informed the clients about the actual trading prices at which it had bought the bonds for them on the market, and the commission or service charges that it would charge for the transactions. Yuanta Securities failed to do so.

15. Whilst some of the clients appear to be aware of the amount of the sales team's commission for the trades, the mark-up / mark-down by the Product Team on the trading prices was not disclosed to the clients.

16. The profit which Yuanta Securities made through its Product Team whilst conducting transactions on behalf of its clients was made at the expense of its clients. Its failure to avoid or properly disclose conflicts of interest was unfair to its clients as Yuanta Securities' profit taking through the Product Team directly reduced the return on investment for the clients, which was unbeknown to them. As such, Yuanta Securities did not act in their best interests.

17. Further, in the absence of any disclosure of Yuanta Securities' interests in the transactions, clients were not aware of them and were deprived of the opportunity to make an informed decision as to whether to continue to use the services of Yuanta Securities in conducting bond transactions.

18. In the circumstances, the SFC found that Yuanta Securities has failed to properly avoid and disclose conflicts of interest and failed to treat its clients fairly or act in their best interests, in breach of General Principles 2 and 6 and paragraph 10.1 of the Code of Conduct.

Conclusion

19. It is a fundamental duty of a licensed person to act in the best interests of its clients and to treat clients fairly by providing them with relevant material information about their transactions. Yuanta Securities failed to provide accurate information to its clients regarding the trading price and its commission charges when trading debt securities for its clients. Its practices of making undisclosed financial gains from the bond transactions at the clients' expense were unfair to the clients.