

STATEMENT OF DISCIPLINARY ACTION

1. The Disciplinary Action

- 1.1. The Securities and Futures Commission (**SFC**) has taken the following disciplinary action against The Royal Bank of Scotland Public Limited Company (**RBS**) pursuant to section 196 of the Securities and Futures Ordinance (**SFO**):
 - 1.1.1. Publicly reprimand RBS pursuant to section 196(1)(b)(ii) of the SFO.
 - 1.1.2. Impose a pecuniary penalty of HK\$6,000,000 on RBS pursuant to section 196(2) of the SFO.
- 1.2. The disciplinary action is taken for RBS's failure to implement adequate and effective systems and controls to detect and prevent unauthorised trading activities and the conduct of its Emerging Markets Rates business in Hong Kong from May 2008 to October 2011(the "Relevant Period").

2. Summary of Facts

- 2.1. On 15 October 2011, RBS self reported to the SFC serious irregularities in the trading books of one of its traders, Tsang Pui Yu Shirlina ("Tsang"). Tsang was a trader on the Emerging Market Rates desk in RBS's Hong Kong branch. After taking action to close out all RBS's positions relating to Tsang's unauthorised trading, the losses incurred by RBS were calculated at GBP 24.4 million (the "Loss").
- 2.2. RBS also reported the incident to the Hong Kong Monetary Authority ("HKMA") and the Hong Kong Police Department (the "Police"). On 17 October 2011, the Police arrested Tsang. On 30 August 2013, Tsang was convicted of one charge of fraud and subsequently sentenced to four years and two months imprisonment.
- 2.3. The Loss was caused by unauthorised activities conducted by Tsang during the Relevant Period. This includes mismarking of positions in Hong Kong Government debt instruments i.e. Hong Kong Government bonds, exchange funded notes and exchange funded bills, breaching futures trading limits and the mismarking of the HKD 1 month interest rate swap curve.
- 2.4. Tsang concealed her unauthorised activities from RBS's risk management systems and controls using the following methods.
 - 2.4.1. Manipulated the independent price verification ("IPV") process and influenced third party brokers to publish off market prices for the IPV process.
 - 2.4.2. Booked and cancelled fictitious bonds trades around IPV dates to circumvent RBS's valuation controls and conceal the variances in her positions.
 - 2.4.3. Cancelled and amended trades to conceal her unauthorised futures positions.

2.4.4. Mismarked the HKD swap curves.

- 2.5. The Emerging Markets Rates trading desk in the Hong Kong Branch was primarily managed and supervised from Singapore.
- 2.6. During the Relevant Period, RBS's internal systems and controls in relation to its Emerging Markets Rates business were seriously inadequate.

Front office supervision and oversight

- 2.7. In respect of supervision and oversight over individual traders by the Front Office, this was poorly executed and ineffective. The policy governing the supervisory framework and supervisory responsibilities was neither comprehensive nor clear. This led to supervisory gaps over Tsang as her supervisors did not sufficiently understand the extent of their supervisory responsibilities.
- 2.8. There were also no procedures or processes to encourage or reward its Front Office to self-identify issues and weaknesses. As such, there was little incentive for Front Office staff members to set and meet risk control objectives. This together with the absence of an unequivocal tone from RBS's senior regional management on strong controls contributed to the Front Office's primary focus on meeting revenue or other metric based targets.

IPV control weaknesses

- 2.9. Even though RBS had implemented an IPV control to mitigate the risk of inaccurate markings by traders of their positions, this was not effective despite being performed regularly twice a month.
- 2.10. The staff members in RBS responsible for carrying out the IPV process for Tsang's bonds positions did not have adequate knowledge and understanding of their roles. This led to them being unduly influenced by Tsang where they accepted her explanations of her bond prices without sufficiently challenging her or identifying issues for escalation.
- 2.11. RBS also did not have in place written policies or internal guidelines to determine the pricing hierarchies for the IPV process such as the selection of, and changes to, pricing sources and the minimum number of independent pricing sources that need to be obtained for a price to be verified. There were also no guidelines to monitor the independence of brokers and to ensure that they were truly independent from the traders. Had such guidelines been in place, this would have significantly undermined Tsang's ability to influence the third party brokers to provide quotes favourable to her for the IPV process.

Block leave control weaknesses

- 2.12. RBS's block leave controls¹ were inadequate in that there were no written guidelines or procedures on arrangement of cover during an employee's block leave nor on the adequacy and appropriateness of the cover. As a

¹ Block leave was a control designed by RBS to ensure that a trader's positions were managed and valued by another trader daily over for a two week period at least once a year. During their block leave, traders were not permitted to effect transactions, alter official bank records, conduct or influence business activities via telephone or emails or remote access.

result, Tsang's bonds trading books were neither covered nor updated by another trader during her block leave in 2008, 2009 and 2010.

- 2.13. At the time of Tsang's block leave:
 - 2.13.1. In 2008, her bonds trading books were mismarked by about GBP 6.4 million.
 - 2.13.2. In 2009, her bonds trading books were mismarked by about GBP 5.34million.
 - 2.13.3. In 2010, her bonds trading books were mismarked by about GBP 11 million.
- 2.14. RBS's computer systems also failed to lock out Tsang from its applications during her block leave in 2009 and 2010. Tsang therefore accessed both her email account at RBS via remote access and engaged in Bloomberg chats during this period.
- 2.15. Furthermore, staff members in BUC did not know Tsang was on block leave or were not fully conversant with the rules associated with block leave as her interactions with them were neither challenged nor escalated to senior management.
- 2.16. There was also no management information or reports to show that Tsang's bonds positions had not been marked on a daily basis or the extent of her remote access activity during her block leave.

Control failures with respect to futures reconciliation controls

- 2.17. RBS's key futures reconciliation controls were not effective with discrepancies in the trading data not being adequately investigated. Between 1 August 2011 and 14 October 2011, there were 79 trade breaks revealed in Tsang's futures positions. A "trade" break was a discrepancy in trade positions between RBS's different systems in terms of either price or quantity or both. RBS did not adequately investigate these trade breaks and accepted Tsang's explanations without conducting further investigation or following up on how they were resolved. Furthermore, Tsang's line supervisor did not challenge the number or the nature of Tsang's trade breaks despite receiving a list of all trade breaks and accompanying explanations on a daily basis.

Control failures with respect to the cancellation and amendment reporting for bonds and futures trades

- 2.18. In respect of futures and bonds trades, RBS did not have any management information or reports on the level of cancellation and amendment activity for such trades prior to May 2011. Tsang's supervisors therefore had no effective means to identify and monitor such activities.
- 2.19. Subsequent to May 2011, RBS captured all post-trade cancellations including bonds and futures trade made by the Front Office in a cancellation and amendment report. However, the cancellation and amendment report was inadequate in that it did not capture pertinent information such as changes in counterparties and did not identify trends in cancellation and amendment

activities. The reports were also poorly designed and did not facilitate effective review and analysis.

Inadequate monitoring of use of remote access

- 2.20. RBS allowed traders to conduct trades away from the office and/or out of normal business hours via remote connection to its systems. From 15 April 2011 to 14 October 2011, Tsang logged onto RBS's systems 386 times via remote access, frequently between 6pm to midnight (Hong Kong time) and occasionally past midnight from 1am to 2am (Hong Kong time). However, there were no monitoring or reporting controls to capture Tsang's remote access use and therefore her trade cancellations and amendments in the early hours of the morning or late at night went undetected.

Trading book controls

- 2.21. RBS's controls for opening, closing, review and user access for its trading systems and trading books were inadequate in that it allowed, among other things, traders to access multiple trading books due to a "cloning" process whereby identical access is granted to a user by copying the profile assigned to another user. As a consequence, Tsang had access to and could book trades into over 1,600 trading books at RBS. The ability to clone books increased the risk of unauthorized trading being undetected.

Training

- 2.22. In respect of training, there was no clear framework and training curriculum for specific roles and supervisory responsibilities such as for the Front Office, new employees and employees promoted to supervisory roles. Instead, line managers adopted supervision methods which they had employed in previous jobs which led to inconsistencies in the standards of supervision. In addition, there was heavy reliance on line managers to determine relevant topics and to deliver on-the-job training.

3. Conclusion

- 3.1. Having regard to the extensiveness and prolonged nature of RBS's internal controls failings in its Emerging Markets Rates business and the risks that such failings posed to the SFC's regulatory objectives to protect the investing public, the SFC has decided to take the disciplinary action against RBS as described in paragraph 1.1. above.
- 3.2. In coming to the decision to take disciplinary action against RBS for its failures, the SFC has taken into account:
- 3.2.1. The serious deficiencies in RBS's internal controls and systems in its Emerging Markets Rates business.
- 3.2.2. No losses were apparently suffered by RBS's clients or other third parties.
- 3.2.3. RBS's prompt reporting of Tsang's conduct to the SFC and the Police which prevented Tsang from fleeing the jurisdiction.
- 3.2.4. RBS's full co-operation with the SFC's investigation.

- 3.2.5. RBS has a clean disciplinary record.
- 3.2.6. The considerable resources (approximately HK\$96 million) expended by RBS to date in dealing with Tsang's unauthorised trading and mismarking activities.
- 3.2.7. The significant measures taken by RBS to remediate its internal control deficiencies.