



18 November 2022

**PUBLIC CENSURE OF UBS NEW ZEALAND LIMITED BY THE NZ MARKETS DISCIPLINARY TRIBUNAL FOR BREACHES OF NZX PARTICIPANT RULE 19.1.1 AND NEW ZEALAND CLEARING LIMITED CLEARING AND SETTLEMENT RULE 9.1.1**

1. The NZ Markets Disciplinary Tribunal (*Tribunal*) has approved a settlement agreement between NZX Limited (*NZX*) and UBS New Zealand Limited (*UBS*) dated 10 November 2022 (*Settlement Agreement*).
2. As this matter was referred to the Tribunal before 17 October 2022, it has been considered under the Tribunal Rules dated 10 December 2020 and the Tribunal Procedures dated 29 February 2016.

**Background**

3. UBS is an NZX Trading and Advising Participant and an Individual Clearing Participant, and is therefore bound by the NZX Participant Rules (*Participant Rules*) and the New Zealand Clearing Limited Clearing and Settlement Rules (*C&S Rules*).
4. UBS' obligations under both the Participant Rules and the C&S Rules include a requirement to ensure that its Net Tangible Current Assets (*NTCA*) are maintained at all times at a level equal to, or greater than, its Prescribed Minimum Capital Adequacy (*PMCA*). This requirement is expressed as a Capital Adequacy Ratio (*CAR*), with an NZX Participant's *CAR* being determined by dividing its *NTCA* by its *PMCA* – a *CAR* below 100% breaches the Participant Rules and C&S Rules.
5. The Participant Rules and C&S Rules permit an NZX Participant to exclude Subordinated Debt from the calculation of *NTCA* when approved by NZX and New Zealand Clearing Limited (*CHO*).
6. At 4:25pm on the relevant day (Day 0),<sup>1</sup> a member of UBS' dealing team sought approval of a large sell order for an offshore client (*the Block Trade*). At that time UBS held sufficient capital to cover the Block Trade, based on its *NTCA* calculation completed earlier that afternoon.
7. At approximately 4:35pm, the Dealer advised UBS Compliance that the potential size of the Block Trade had increased substantially. Initial calculations indicated that UBS' participation in the Block Trade at the increased size would not be permitted, with the capital implications of the resulting exposure modelled to cause UBS' *CAR* to fall below 100%. Revised calculations were undertaken at 5:11pm, following further information being provided by the Dealer. The revised calculations indicated that UBS could transact the Block Trade with *CAR* remaining above 100%, but that, nonetheless, UBS would make a drawdown of Subordinated Debt to be confident of remaining above required capital levels for the following day's (Day 1) trading activities.

---

<sup>1</sup> The parties have agreed to redact the date of the breach to prevent an identification of UBS' client.

8. At 6:32pm, after the Block Trade had been agreed and reported to the market, UBS completed its internal procedures to enable it to apply for the exclusion of the Subordinated Debt from its liabilities as permitted under the Participant Rules and C&S Rules. UBS did not submit that application on that day, but deferred the application until Day 1 in the belief that it continued to remain at all times in excess of its capital requirements.
9. At approximately 8:23am on Day 1, UBS lodged its application for approval to exclude the Subordinated Debt from its liabilities.
10. On the morning of Day 1, UBS completed its Capital Adequacy calculations for Day 0 and determined that its participation in the Block Trade had resulted in a breach of its capital requirements, with UBS' CAR having fallen to 86% at the close of business on Day 0. The breach was escalated internally to UBS management at 12:10pm on Day 1 and reported to NZ RegCo at 12:24pm. The breach was remedied as soon as the Subordinated Debt request made earlier that morning was approved by NZ RegCo at 1:46pm.
11. NZ RegCo determined that UBS had breached Participant Rule 19.1.1 and C&S Rule 9.1.1, when UBS' NTCA as a percentage of UBS' PMCA for Day 0 was 86% (while it was required to be 100% or higher), with the breach of C&S Rule 9.1.1 also constituting a Credit Event under C&S Rule 7.1.1 (noting that CHO determined not to treat the Credit Event as a Declared Default because the breaches were rectified promptly, and CHO remained comfortable with UBS' ability to continue its financial and operational duties as a Clearing Participant).

#### **Determination**

12. UBS accepts that it breached Participant Rule 19.1.1 and C&S Rule 9.1.1 in relation to the failure to maintain its NTCA at or above its PMCA on Day 0. UBS accepts that a penalty should be imposed by the Tribunal for these breaches. Compliance with the capital adequacy requirements at all times, including maintaining an acceptable level of liquidity, is a key protection mechanism for the integrity of the market and the maintenance of investor confidence.
13. The Tribunal has considered the appropriate penalties, in light of the Tribunal Procedures. The Tribunal considers that this matter falls within Penalty Band 2 of Procedure 9 because:
  - (a) the breaches were of a moderate operational nature, with inaccurate modelling resulting in UBS believing it was operating within its Capital Adequacy limits; and
  - (b) NZ RegCo has not advised of any impact on investors, clients or the market arising from the breaches.
14. In determining the appropriate level of penalty in this case, the Tribunal considered the following aggravating factors:
  - (a) while UBS considered it prudent to apply for approval to exclude Subordinated Debt, it did not seek that approval until the morning of Day 1, after the Block Trade had been reported; and
  - (b) UBS did not have a sufficient peer review process, which contributed to the breaches because although UBS reviewed the outputs of its CAR modelling, it did not revalidate the assumptions and inputs made in relation to the risk exposures.

15. The Tribunal also considered that there were mitigating factors:
- (a) the breaches were of short duration;
  - (b) the breaches were not intentional or reckless;
  - (c) the breaches were promptly self-reported;
  - (d) UBS cooperated with NZ RegCo during the course of the investigation;
  - (e) the breaches were an isolated event and do not form a pattern of non-compliance with Participant Rule 19.1.1 or C&S Rule 9.1.1;
  - (f) since the breach occurred, UBS has:
    - (i) clarified the process for large transaction notifications to ensure timely escalation of expected transactions and that accurate information is obtained and communicated between the relevant parties involved in the large transaction assessment;
    - (ii) undertaken education and training for all relevant parties to ensure that the approval process for large trades is clear;
    - (iii) clarified its communication timelines and approvals required for large transactions; and
    - (iv) re-assessed the structure and level of capital that is appropriate for UBS based on historical and current market conditions.
16. Taking these aggravating and mitigating factors into account, the Tribunal considers that a penalty at the lower end of Penalty Band 2, together with a public censure, is appropriate.

### **Penalties**

17. NZX and UBS have agreed that:
- (a) a public censure will be made by the Tribunal;
  - (b) UBS will pay to the NZX Discipline Fund a financial penalty of \$20,000 for the breaches of Participant Rule 19.1.1 and C&S Rule 9.1.1;
  - (c) UBS will pay the costs incurred by the Tribunal (plus GST, if any); and
  - (d) UBS will pay the costs incurred by NZX (plus GST, if any) in bringing this proceeding.

### **Approval**

18. The Settlement Agreement is approved by the Tribunal pursuant to Tribunal Rule 8, and as such, the Settlement Agreement is the determination of the Tribunal.

### **Censure**

19. The Tribunal hereby censures UBS for breaches of Participant Rule 19.1.1 and C&S Rule 9.1.1.

### **The Tribunal**

20. The Tribunal is a disciplinary body which is independent of NZX and its subsidiaries. The Financial Markets Authority approves its members. Under the Tribunal Rules, the Tribunal determines and imposes penalties for referrals made to it by NZX in relation to the conduct of parties regulated by the NZX market rules.

### **ENDS**