STATEMENT OF DISCIPLINARY ACTION

The disciplinary action

1. The Securities and Futures Commission (**SFC**) has publicly reprimanded Convoy Asset Management Limited (**CAML**)[1] and fined it $6.4 million pursuant to section 194 of the Securities and Futures Ordinance (**SFO**).

2. The SFC found that between March 2015 and January 2017 (**Relevant Period**), in recommending bonds listed under Chapter 37 of the Main Board Listing Rules[2] (**Chapter 37 Bonds**) to clients to be executed via a third party platform, CAML failed to:

   (a) conduct proper and adequate product due diligence on the bonds before making recommendations or solicitations to the clients;

   (b) have an effective system in place to ensure that the recommendations or solicitations made to its clients in relation to bonds were suitable for and reasonable in all the circumstances of each of its clients;

   (c) maintain proper documentary records of the investment advice or recommendations given to its clients and provide clients with a copy of the written advice; and

   (d) have adequate and effective internal controls and system to diligently supervise and monitor the sale of bonds through the third party platform and to ensure its compliance with applicable regulatory requirements.

Summary of facts

Background

3. During the Relevant Period, CAML introduced its clients to a third party platform to execute 30 Chapter 37 Bonds transactions in the secondary market for 28 retail clients. Clients who purchased bonds via the third party platform had to open accounts at both CAML and the third party platform. They were clients of both firms.

Regulatory requirements

4. General Principle 2 (diligence), paragraphs 3.4 (advice to clients: due skill, care and diligence) and 5.2 (know your client: reasonable advice) of the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (**Code of Conduct**) require a licensed corporation to ensure that, through the exercise of due diligence, its investment recommendations to clients are based on thorough analysis and are reasonable in all the circumstances.

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[1] CAML is licensed to carry on Type 1 (dealing in securities), Type 4 (advising on securities) and Type 9 (asset management) regulated activities under the SFO.

[2] Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited.

5. General Principle 7 (compliance) and paragraphs 4.3 (internal control, financial and operational resources) and 12.1 (compliance: in general) of the Code of Conduct require a licensed corporation to implement and maintain measures appropriate to ensuring compliance with relevant regulatory requirements and internal control procedures to protect their clients from financial losses arising from professional misconduct or omissions.

6. Paragraph 4.2 (staff supervision) of the Code of Conduct requires a licensed corporation to ensure that it has adequate resources to supervise diligently and does supervise diligently persons employed or appointed by it to conduct business on its behalf.

7. Paragraph VII(3) of, and paragraph 3 of the Appendix to, the Management, Supervision and Internal Control Guidelines for Persons Licensed by or Registered with the Securities and Futures Commission (**Internal Control Guidelines**) provide that a licensed corporation in the business of offering investment advice should take steps to document and retain the reasons for its recommendations or advice given to the client, and to implement special procedures to document (and provide a copy to the client) the rationale underlying investment advice rendered or recommendations made.

Inadequate product due diligence

8. During the Relevant Period, CAML did not have product approval and due diligence procedures on Chapter 37 Bonds which were sold to clients through the third party platform. CAML relied solely on individual consultants to conduct product due diligence and to assess the risks of the bonds.

9. CAML engaged the bond dealing services of the third party platform to assist its consultants to understand each bond product before recommending such product to clients. The third party platform offered the services of a designated bond expert to CAML, and provided briefings, presentations and articles to CAML's consultants on bond products, as well as responded to enquiries from CAML's consultants. However, the third party platform did not assign a risk rating to the bonds, and did not identify which of the bonds on its platform were Chapter 37 Bonds.

10. CAML provided limited guidance to its consultants on how they should conduct product due diligence on the bonds, including for instance, what features they had to review and the criteria to be adopted, what other factors they should take into account, and the weight to be attributable to those factors. Its consultants were also not required to record in writing what documents they had reviewed, in what respects the bonds were considered suitable for different risk categories of investors, and justification for such findings.

11. Some of the consultants were not even aware of CAML's expectation that they should conduct product due diligence on the bonds.

12. CAML's reliance on individual consultants to conduct product due diligence raises serious regulatory concerns:

    (a) It shows CAML's lack of proper understanding of its obligation to conduct product due diligence and its suitability obligation.

(b) Individual consultants might have different understanding and different evaluation of the risks of the bonds. In the absence of guidance from CAML on what its consultants were expected to do when conducting product due diligence, each consultant simply proceeded to explain the bonds to the clients based on the information available on the third party platform and/or other information they reviewed in getting themselves acquainted with the bond features.

13. The evidence in relation to product due diligence of CAML as a whole suggests that during the Relevant Period, CAML did not:

(a) have product approval and due diligence procedures on Chapter 37 Bonds which were sold to clients through the third party platform; and

(b) conduct proper and adequate product due diligence on, and properly assess the risk levels of, bonds before recommending them to clients.

Ineffective systems to ensure product suitability for clients

14. During the Relevant Period, although CAML had written policies and/or procedures requiring its consultants to ensure that the products they recommended to clients were suitable in light of the clients' personal circumstances, there were deficiencies in the suitability framework it adopted in respect of bonds sold via the third party platform which raised serious doubts as to its ability to effectively discharge its suitability obligations:

(a) CAML did not conduct adequate product due diligence on, and did not assign a risk rating to, the bonds sold through the third party platform.

(b) In the absence of an assigned risk rating to each bond following a proper product due diligence process, consultants were left to their own devices in determining the risks that a particular bond entails and whether a recommendation for, or solicitation to, a client about the bond is reasonably suitable. There was no framework to indicate how the different information available on the third party platform, the offering circular and/or other sources ought to be taken into account to enable the consultants to accurately assess whether the investment return characteristics and risk features of a particular bond matched with a client's circumstances. The rationale of the consultants' recommendations was not required to be recorded.

15. The SFC found that CAML did not have an effective system for ensuring product suitability for clients, and its suitability framework for bonds sold via the third party platform fell below the standards required of it in the Code of Conduct.

Failure to maintain documentary records of investment advice and recommendations

16. CAML had internal policies which require it to document and record (via tape recording and/or other means) contemporaneously the information given to each client and the rationale for recommendations given to the client, including any material queries raised by the client and the responses given.

17. However, in relation to the Chapter 37 Bonds sold to clients during the Relevant Period, CAML stated that as most of the product explanation or

advice were done via face-to-face meetings with the clients, no formal written records were kept of the product explanation or advice given.

18. In the absence of proper records of the investment advice or recommendations given and the rationale of such advice or recommendations, it would be difficult for CAML (a) to effectively supervise and monitor its consultants to ensure that the recommendations or solicitations they made to the clients were suitable and reasonable in all the circumstances; and (b) to assess its position if it receives client complaints about possible mis-selling of products by its consultants.

Lack of diligent and effective supervision and monitoring of the sales process

19. Apart from having senior consultants or responsible officers to attend client meetings with the consultants from time to time, CAML did not have any procedures in place during the Relevant Period to:

(a) keep its senior management apprised of solicitation, recommendation and/or advice made or given to clients in relation to bonds sold through the third party platform;

(b) ensure that its consultants had conducted proper and adequate product due diligence on the bonds recommended to clients;

(c) ensure that its consultants had disclosed all material information relating to the bonds they recommended to clients; and

(d) ensure the suitability of advice or recommendation having regard to clients' personal circumstances.

20. The lack of diligent and effective supervision and monitoring of the sale process gave rise to concerns as:

(a) CAML did not appear to be aware that recommendation and/or solicitation of Chapter 37 Bonds might have been made to clients as its consultants often shortlisted a number of bonds for the clients to consider; and

(b) CAML would not be able to monitor whether its consultants had provided clients with the relevant product's offering documents or other information as required under CAML's internal guidelines.

21. The SFC found that CAML did not have any effective monitoring and control mechanism to ensure that its consultants and the firm as a whole satisfy the suitability obligation when making recommendation or giving advice to clients on bonds sold via the third party platform.

Conclusion

22. CAML's failures constitute a breach of:

(a) General Principles 2 and 7, and paragraphs 3.4, 4.2, 4.3, 5.2 and 12.1 of the Code of Conduct; and

(b) paragraph VII(3) of, and paragraph 3 of the Appendix to, the Internal Control Guidelines.

23. In deciding the disciplinary sanctions, the SFC has taken into account:

(a) There is no evidence suggesting that any client who bought Chapter 37 Bonds during the Relevant Period has complained or suffered loss.

(b) Despite the repeated reminders given by the SFC to licensed corporations on the importance of compliance with their suitability obligations, and specific guidance given by the SFC in its circulars dated 19 November 2012 and 25 March 2014 regarding the selling of fixed income products, complex and high-yield bonds, CAML had not tightened up its controls and procedures in order that it had an effective system in place to ensure the suitability of bonds it recommended to clients during the Relevant Period.

(c) A strong message has to be sent to the market to deter other market participants from committing similar misconduct.

(d) CAML has decided to cease selling Chapter 37 Bonds to clients.

(e) CAML is now under the management of a new team of directors and managers-in-charge.

(f) CAML cooperated with the SFC in resolving the SFC's concerns.

(g) CAML has an otherwise clean disciplinary record.