

SFC reprimands and fines BOCI Securities Limited HK\$10 million for regulatory breaches in selling investment products

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The Securities and Futures Commission (SFC) has reprimanded and fined BOCI Securities Limited (BSL) HK\$10 million over BSL's internal system and control failures in its **investment product selling practices** (Note 1).

The SFC's disciplinary action followed an investigation which found that BSL had failed to comply with various regulatory requirements concerning client profiling, product due diligence and suitability assessment in its sale and distribution of investment products, **including bonds listed under Chapter 37 of the Rules Governing the Listing of Securities** on The Stock Exchange of Hong Kong Limited (Chapter 37 Bonds) (Note 2).

In particular, BSL failed to:

- properly assess and determine its clients' risk tolerance level and investment strategy in certain cases;
- ensure the investment recommendations and/or solicitations made to its clients were reasonably suitable in all the circumstances;
- ensure the clients had sufficient net worth to be able to assume the risks and bear the potential losses of trading in derivative products and/or leveraged transactions;
- conduct proper and adequate product due diligence on certain investment products; and
- implement and maintain adequate and effective internal controls and systems to diligently supervise its sale and distribution of investment products to clients and to ensure its compliance with the regulatory requirements.

In deciding the penalty, the SFC took into account all relevant circumstances, including that:

- the multiple concerns identified by the SFC revealed systemic deficiencies in BSL's systems and controls in relation to its overall investment selling and advisory business;
- BSL has taken remedial measures to enhance its suitability framework;
- BSL cooperated with the SFC in resolving its concerns; and
- BSL will implement Enhanced Complaint Handling Procedures (ECHP) to review client complaints in relation to its sale and distribution of investment products (Note 3).

End

Notes:

1. BOCI Securities Limited is licensed under the Securities and Futures Ordinance (SFO) to carry on Type 1 (dealing in securities), Type 2 (dealing in futures contracts), Type 4 (advising on securities) and Type 5 (advising on futures contracts) regulated activities.
2. The SFC's investigation looked into BSL's sale and distribution of: **(i) Chapter 37 Bonds to clients during the period from 1 April 2015 to 31 March 2016 (Relevant Period 1); and (ii) equity-linked notes, mutual funds, bonds and accumulators/decumulators (collectively, Other Products) to clients during the period from 1 October 2016 to 31 December 2016 (Relevant Period 2).**
3. ECHP was designed to ensure that an intensive review is conducted by BSL into relevant transactions to ensure complaints are resolved in a fair and reasonable manner. BSL shall apply the ECHP to all client complaints in relation to its sale and distribution of Chapter 37 Bonds during Relevant Period 1 and Other Products during Relevant Period 2.

[A copy of the Statement of Disciplinary Action is available on the SFC website](#)

Page last updated : 18 Mar 2019

STATEMENT OF DISCIPLINARY ACTION

The Disciplinary Action

1. The Securities and Futures Commission (**SFC**) has publicly reprimanded BOCI Securities Limited (**BSL**)¹, and fined it HK\$10 million pursuant to section 194 of the Securities and Futures Ordinance (**SFO**).
2. The SFC's disciplinary action was taken in relation to BSL's sale and distribution of:
 - (a) bonds listed under Chapter 37 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (**Chapter 37 Bonds**) during the period from 1 April 2015 to 31 March 2016 (**Relevant Period 1**); and
 - (b) equity-linked notes (ELNs), mutual funds, bonds and accumulators/decumulators (AD/DQ) (collectively, **Other Products**) during the period from 1 October 2016 to 31 December 2016 (**Relevant Period 2**).
3. The SFC found that, in selling Chapter 37 Bonds during Relevant Period 1 and Other Products during Relevant Period 2 to clients², BSL failed to:
 - (a) properly assess and determine its clients' risk tolerance level and investment strategy in certain cases;
 - (b) ensure the investment recommendations and/or solicitations made to its clients were reasonably suitable in all the circumstances of each of its clients;
 - (c) ensure the clients had sufficient net worth to be able to assume the risks and bear the potential losses of trading in derivative products and/or leveraged transactions;
 - (d) conduct proper and adequate product due diligence on certain investment products; and
 - (e) implement and maintain adequate and effective internal controls and systems to diligently supervise its sale and distribution of investment products to clients and to ensure its compliance with the regulatory requirements.

¹ BSL is licensed under the SFO to carry on Type 1 (dealing in securities), Type 2 (dealing in futures contracts), Type 4 (advising on securities) and Type 5 (advising on futures contracts) regulated activities.

² BSL, through its Equity Sales and Derivatives Division, executed for its clients (excluding institutional clients): (a) 1,251 transactions of 186 different Chapter 37 Bonds during Relevant Period 1; and (b) 339 transactions of Other Products during Relevant Period 2.

Summary of facts

Client profiling

4. During Relevant Period 1 and Relevant Period 2 (collectively, **Relevant Periods**), BSL required its clients to complete a “Customer Risk Profiling Analysis Questionnaire” (**CRPA**) which was designed to establish the clients’ risk tolerance level.
5. Based on the assessment result in the CRPA, BSL would categorise its clients into one of four risk tolerance levels and recommend a corresponding investment strategy to them, as set out in the table below:

Risk tolerance level	Recommended investment strategy
Low	Conservative
Moderate	Balanced
Moderately-High	Balanced Growth
High	Aggressive

6. Under BSL’s policy, clients were allowed to upgrade or downgrade their investment strategy recommended to them if they disagreed with the assessment result. If they opted for an upgrade, they were allowed to upgrade by one level above the strategy recommended to them (**Upgrade**). For example, a client who was assessed to have a "Low" risk tolerance level and recommended a “Conservative” investment strategy could select a "Balanced" investment strategy instead.
7. According to BSL’s records, a considerable number of clients who purchased Chapter 37 Bonds and Other Products have upgraded their investment strategy during the Relevant Periods. As a result of the Upgrades, over one-third of the transactions which would otherwise have resulted in a mismatch between the clients’ investment strategy and the product risk rating were treated by BSL as “no mismatch” cases.
8. The Upgrade policy was defective in that BSL:
 - (a) allowed its clients to select an Upgrade without providing any justification;
 - (b) did not have a policy requiring its relationship managers (**RMs**) to evaluate the appropriateness of the Upgrade, document the evaluation, and obtain approvals from their supervisors;
 - (c) failed to demonstrate that proper assessment was performed by the RMs in each Upgrade case to ensure the Upgrade was reasonable and appropriate in light of the clients’ overall circumstances; and
 - (d) had little or no supervision of, and control over, the Upgrade process.

Suitability assessment process

9. During the Relevant Periods, BSL required the RMs to perform a suitability assessment before recommending or providing advice on investment products to a client. The suitability assessment process included matching the client

profile³ against the product profile⁴ and checking whether the proposed product or transaction might lead to a high concentration of assets (**High Asset Concentration**)⁵ and/or a tenor mismatch⁶. The assessment process and the rationale underlying the investment recommendation were documented in the Suitability Analysis Report (**SAR**).

10. In the event that the product profile did not match with the client profile (**Product Mismatch**) and/or the transaction resulted in High Asset Concentration (collectively, **Mismatch Transactions**), additional control measures, such as giving verbal warning to the client and obtaining approval from BSL's Team Head (or above), were required to be carried out before the product could be sold to the client.
11. The SFC identified the following deficiencies in BSL's suitability assessment process:
 - (a) There was a prevalence of Mismatch Transactions during the Relevant Periods: (i) Product Mismatch was found in around 28% of the solicited Chapter 37 Bonds transactions executed in Relevant Period 1; and (ii) High Asset Concentration was found in around 74% and around 55% of the solicited transactions in Chapter 37 Bonds during Relevant Period 1 and Other Products (except mutual funds) during Relevant Period 2⁷, respectively.
 - (b) BSL did not implement adequate and effective systems and controls for handling Product Mismatch and High Asset Concentration cases to ensure investment suitability.
 - (c) While BSL required the RMs to give verbal warning to clients and obtain their written acknowledgement of Product Mismatch and/or High Asset Concentration, such procedures were not sufficient to discharge BSL's suitability obligation.
 - (d) BSL should conduct suitability assessment to ensure the product was actually suitable on reasonable grounds for the client having considered all relevant circumstances of the client and fully document the rationale justifying the recommendation of Mismatch Transactions to clients. However, under BSL's policy, the RMs were only required to select one or more of the pre-set investment rationales provided in the SAR, and it was not mandatory for the RMs to provide further explanations to justify the Mismatch Transactions. The descriptions of the pre-set investment rationales were overly broad and general and failed to sufficiently explain why a product was considered to be suitable for a client despite a Product Mismatch and/or High Asset Concentration.

³ There were four aspects of client profile, including "Investment strategy", "Investment knowledge and experience", "Market experience" and "Eligibility".

⁴ The product profile consisted of "Product risk", "Product complexity", "Risk country" and "Selling restrictions".

⁵ High Asset Concentration refers to the situations where (i) the nominal amount of a single product exceeded 20% of the client's declared total net worth; and/or (ii) the total proportion of the client's portfolio invested in a single product type exceeded 20% of the client's total net worth.

⁶ Tenor mismatch refers to a mismatch between product tenor and the client's intended investment horizon.

⁷ Prior to BSL revised its concentration policy on 28 November 2016.

- (e) BSL did not establish any objective criteria to guide the approvers in approving the Mismatch Transactions. The approval was based on the approvers' professional judgement and there was no mandatory requirement for the approvers to record the factors considered and the reasons for approving the transactions in the approval process.
- (f) BSL also failed to implement adequate systems and controls to (i) protect clients from exposure to an excessive level of concentration risk; and (ii) assure itself that the clients have sufficient net worth to be able to assume the risks and bear the potential losses of trading in derivative products and/or leveraged transactions. No limit was imposed on the permissible level of concentration prior to 28 November 2016. In around 25% of cases concerning Chapter 37 Bonds and around 10% of cases concerning Other Products, the client's investment in a single product and/or a single product type exceeded 100% of his/her declared net worth.
- (g) While BSL had a policy requiring the RMs to perform matching of the product tenor against the client's intended investment horizon, such policy was not applied to bonds which were tradable in the secondary market (including Chapter 37 Bonds) prior to 28 November 2016.

Product due diligence

12. BSL's Product Marketing Department (**PMD**) was responsible for carrying out product due diligence and profiling exercise in relation to all financial products sold by BSL to clients. The exercise involved classifying products into different profiles under four aspects, namely product risk, product complexity, risk country and selling restrictions, based on BSL's guidelines.
13. The SFC found the following deficiencies in BSL's product due diligence and profiling process in relation to Chapter 37 Bonds sold during Relevant Period 1:
 - (a) BSL heavily relied on the credit rating of the bond or the bond's issuer/guarantor in deriving the product risk rating.
 - (b) BSL did not require PMD to conduct independent assessment on the financial soundness of the bonds' issuers/guarantors.
 - (c) BSL prescribed a limited set of factors to be considered in its product risk rating exercise and did not require PMD to consider other factors which might directly or indirectly impact on the risk return profiles of the products.
 - (d) The product due diligence performed by PMD and the rationale underlying its assessment results were not properly documented. As a result, there is no record to show that PMD has considered and given due weight to all relevant factors during the product due diligence and profiling exercise.
 - (e) While the product due diligence documents provided to the RMs listed out the key terms and features of the bonds, they were insufficient to assist the RMs to thoroughly understand all distinctive features and risks of Chapter 37 Bonds, and to enable them to properly assess whether the bonds were suitable for their clients, and/or to disclose and explain such features to the clients.
 - (f) BSL required the RMs to conduct their own product due diligence, however, there was no system in place to ensure that the RMs would read the

offering documents in detail and make their own enquiries about the inherent risks and features of Chapter 37 Bonds.

14. The SFC also identified the following deficiencies in BSL's product due diligence and risk rating process in relation to ELNs and AQ/DQ sold during Relevant Period 2:
 - (a) The risk ratings for ELNs and AQ/DQ were determined based on the asset class and tenor of the product. BSL failed to have systems and controls in place to ensure all relevant factors and features of each individual product were appropriately taken into account in the risk rating process.
 - (b) BSL failed to maintain sufficient documentation to demonstrate that proper due diligence was conducted on the products, such as PMD's analysis and assessment of the terms and features of ELNs and AQ/DQ.
 - (c) BSL had underrated the complexity level⁸ of AQ/DQ by classifying them as "simple" products, leading to the sale of AQ/DQ to clients with limited investment knowledge and experience in structured products without triggering the mismatch control mechanisms.
 - (d) Prior to the fourth quarter of 2016, PMD did not conduct any on-going due diligence on ELNs and AQ/DQ.

Conclusion

15. The conduct of BSL set out above constitutes a breach of the following provisions of the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission:
 - (a) General Principle 2 (diligence), which requires a licensed person to act with due skill, care and diligence, in the best interest of its clients and the integrity of the market;
 - (b) General Principle 3 (capabilities) and paragraph 4.3 (internal control, financial and operational resources), which require a licensed person to employ effectively the resources and procedures which are needed for the proper performance of its business activities and have internal control procedures which can be reasonably expected to protect its operations and its clients from financial loss arising from professional misconduct or omissions;
 - (c) paragraph 4.2 (staff supervision), which requires a licensed person 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;
 - (d) paragraph 3.4 (advice to clients: due skill, care and diligence), which requires a licensed person to act diligently and carefully in providing advice to a client and ensure its advice and recommendations are based on thorough analysis and take into account available alternatives;

⁸ There were three levels of product complexity, namely "simple", "medium" and "complex".

- (e) paragraph 5.2 (know your client: reasonable advice), which requires a licensed person to ensure that, through the exercise of due diligence, the suitability of its recommendation or solicitation for the client is reasonable in all the circumstances; and
 - (f) paragraph 5.3 (know your client: derivative products), which requires a licensed person, when providing services to a client in derivative products or any leveraged transaction, assure itself that the client understands the nature and risks of the products and has sufficient net worth to be able to assume the risks and bear the potential losses of trading in the products.
16. In deciding the disciplinary sanctions, the SFC has taken into account that:
- (a) the multiple concerns identified by the SFC revealed systemic deficiencies in BSL's systems and controls in relation to its overall investment selling and advisory business;
 - (b) BSL has taken remedial measures to enhance its suitability framework;
 - (c) BSL cooperated with the SFC in resolving its concerns; and
 - (d) BSL will implement Enhanced Complaint Handling Procedures to review client complaints in relation to its sale and distribution of Chapter 37 Bonds during Relevant Period 1 and Other Products during Relevant Period 2.