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Client Alert – SFC reprimands and fines Convoy Asset Management Limited HK$6.4 million for internal control failures (June 2020)

On 19 May 2020, the SFC announced that Convoy Asset Management Limited (Convoy) were reprimanded and fined HK$6.4 million over internal control failures when soliciting and recommending bonds to clients.

The SFC found that when recommending bonds listed under Chapter 37 of the Main Listing Rules to clients or referring clients to a third-party platform to execute the transactions Convoy failed to:

- Conduct proper and adequate product due diligence on the bonds before making recommendations or solicitations to clients;
- Have an effective system in place to ensure recommendations / solicitations made to clients in relation to bonds were suitable and reasonable in all circumstances for each client;
- Maintain proper documentary records of the investment advice / recommendations given to clients and provide clients with a copy of the written advice; and
- 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.

Product Due Diligence

The SFC found that during the period in question, Convoy failed to have in place product approval and due diligence procedures for chapter 37 Bonds sold to clients through the third-party platform.

Convoy engaged a third-party bond dealing service platform and that did provide limited guidance to Convoy's consultants on how they should conduct product due diligence on the bonds before recommending such products to their clients. The platform offered Convoy the services of its designated bond expert, provided briefings, presentations and articles to Convoy's consultants on bond products, as well as responded to questions from Convoy's consultants. However, the third-party platform failed to assign a risk rating to the bonds and did not identify which bonds on its platform were Chapter 37 Bonds and as a result individual consultants were relied upon to conduct product due diligence and assess the risks of the bonds.

Convoy only provided its consultants with limited guidance on how to conduct product due diligence on the bonds. Convoy's consultants should have been provided guidance including:

- Policies and procedures outlining what features they should review and the criteria to be adopted;
- What other factors they should take into account; and
- The weight they should attribute to these factors when conducting product due diligence.

The fact that Convoy relied too heavily on its consultants to conduct the product due diligence raised serious concerns with the SFC. This showed that Convoy clearly lacked a proper understanding of its obligations to conduct product due diligence. Without proper guidance Convoy's consultants may have individual interpretations of the different aspects of the bonds offered and evaluate the risks of the bonds differently.

ComplianceAsia Consulting Ltd. Suite 1102, ChinaChem Tower, 34-37 Connaught Road, Central, Hong Kong
Tel: (852) 2868 9070 www.complianceasia.com

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Product Suitability

Convoy had in place written policies and procedures requiring its consultants to ensure products recommended to clients were suitable when taking into account the clients' personal circumstances. However, the SFC identified deficiencies in Convoy's suitability framework adopted in respect of bonds sold via the third-party platform which raised serious doubts as to Convoy's ability to effectively discharge its suitability obligations. The SFC found that:

- Convoy did not conduct adequate product due diligence on and did not assign a risk rating to the bonds sold through the third-party platform.
- Without an assigned risk rating to each bond following a proper due diligence process, consultants were left to their own devices in determining the risks of individual bond and whether a recommendation to a client about the bond was reasonably suitable.
- There was no framework to demonstrate how the different information available on the third-party platform, the offering circular and other sources should be taken into account to allow the consultants to accurately assess if the investment return and risk features of a bond matched with a client's circumstances.
- Convoy lacked an effective system for ensuring product suitability for clients, and its suitability framework for bonds sold via third-party platforms was far below the standards expected of it as per the Code of Conduct.

Maintaining Documentary Records

Convoy had in place internal policies requiring it to document and record information provided to clients and the rationale for recommendations given to clients, including any material queries raised by clients and responses provided. In relation to the Chapter 37 Bonds sold to clients, Convoy stated that the majority of product recommendation or advice was done via face-to-face meetings with clients with no formal written records kept.

Without proper records of the investment advice or recommendations given and the overall rationale, it was difficult for Convoy to effectively supervise and monitor its consultants to ensure recommendations or solicitations made where suitable and reasonable in all circumstances. If a client complaint had been received, Convoy would find it difficult to assess its position about possible mis-selling without such records.

Effective Supervision

Apart from having senior consultants or responsible officers attend some client meetings with the consultants, Convoy did not have policies and procedures to ensure that:

- Senior management were kept appraised of solicitations, recommendations and or advice given to clients in relation to bonds sold through the third-party platform;
- Consultants conducted proper and adequate product due diligence on bonds recommended to clients;
- Consultants disclosed all material information relating to the bonds recommended to clients; and
- The suitability of advice or recommendations had regard to the clients' personal circumstances.

Due to a lack of diligent and effective supervision and monitoring of the sales process the SFC were concerned that Convoy did not appear to be aware that recommendations or solicitations of Chapter 37 Bonds might have been made to clients as its consultants often shortlisted a number of bonds for clients to consider. In addition, the SFC raised concerns that Convoy were unable to

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monitor whether its consultants provided clients with product relevant offering documentation or other information as required in Convoy's internal guidelines.

Conclusion

Convoy's failures constituted various breaches of the General Principles and the Internal Control Guidelines. Despite numerous reminders 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 selling of fixed income products, complex and high-yield bonds, Convoy failed to tighten up its controls and procedures in order to have an effective system in place to ensure the suitability of bonds it recommended to clients during the relevant period.

Contact Us Today

HONG KONG

Suite 1102, ChinaChem Tower
34 - 37 Connaught Road
Central

T: +852 2868 9070

SINGAPORE

137 Telok Ayer Street #03-06
Singapore
068602

T: +65 6533 8834

MAINLAND CHINA

Room 4205 - 4207
42/F, Shanghai Tower
No.479 Lujiazui Ring Road
Pudong New Area, Shanghai
T: +86 147 1431 1859

W: www.complianceasia.com

Philippa Allen
CEO
E: philippa.allen@complianceasia.com

Alex Duperouzel
Managing Director
E: alex.duperouzel@complianceasia.com

Gerallt Owen
Regional Head of Client Relations
E: gerallt.owen@complianceasia.com

Lachlan Chubb
Regional Head of Advisory and Projects
E: lachlan.chubb@complianceasia.com

ComplianceAsia