



ComplianceAsia Regulatory Update – SFC suspends Lun Sheung Nim for 7.2 months (June 2021)

Introduction

On 10 June 2021, the Securities and Futures Commission (“SFC”) announced that it has suspended the license of Mr. Lun Sheung Nim, a Responsible Officer (“RO”) of Geo Securities Limited (“Geo”) for a period of 7.2 months for failing to discharge his duties as a RO.

The SFC commenced disciplinary action against Mr. Lun after earlier sanctioning Geo for breaches of its licensing conditions and failures related to its sales of unlisted bonds between 1 July 2014 and 16 November 2015 (“Relevant Period”). The Geo sanctions were detailed in our previous regulatory update issued in March 2021.

Geo are licensed by the SFC to conduct Type 1 (Dealing in Securities), Type 4 (Advising on Securities and Type 9 (Asset Management) regulated activities and is subject to the licensing condition that it shall not conduct business involving the discretionary management of any collective investment scheme (“CIS”).

Background

The SFC took the view that Geo’s breaches and failures were directly correlated to Mr. Lun’s failure to properly discharge his duties as an RO and as a member of Geo’s senior management team.

Mr. Lun’s failure to discharge his duties contributed to the breach of Geo’s licensing condition as during the Relevant Period he allowed Geo to provide discretionary account management services to eight Geo clients in return for an annual management fee. In addition, Mr. Lun introduced 36 clients directly to four listed companies so they could subscribe for their unlisted bonds, totalling HK\$108 million during the relevant period.

As Mr. Lun allowed these activities to take place, this clearly showed that he failed to properly understand and manage the risks associated with Geo’s business.

Product Due Diligence

Geo failed to ensure that adequate product due diligence (“PDD”) was conducted on the unlisted bonds before they were recommended to clients. Geo managed to evaluate the default risk of the issuer but failed to examine the individual features of the unlisted bonds which meant they could not fully understand and assess their risks and suitability for clients prior to August 2015.

An important element of PDD is the need to implement a methodology that helps the LC to assign a risk rating for each product. Geo failed to implement a methodology for the unlisted bonds and to make matters worse allowed the bonds of two issuers to be recommended to clients before they had completed their due diligence.

In its internal reports Geo managed to summarise the PDD but failed to record any details of the steps taken and enquires made to verify the information in the reports or the rationale for restricting the distribution of the bonds to professional investor clients only.



Investment Suitability

Geo relied on the self-declared risk tolerance of its clients and did not have procedures in place to provide guidance on how employees should review these self-declarations until October 2015. Geo failed to have policies and / or procedures to provide guidance to determine the suitability of investment products for clients which was left to the Accounts Executives (“AE”) to determine.

The sale of complex products like unlisted bonds is only allowed to certain types of experienced professional investors. Geo failed to implement a system that would ensure AEs only distributed the unlisted bonds to professional investor clients.

Compounding this matter, Geo did not require AEs to attend internal training seminars despite claims the PI sales restriction was communicated to the AEs during such training.

Record Keeping

The failure to keep appropriate documentary records of recommendations / investment advice given to clients has been a continual point of contention during SFC Inspections in recent times. The SFC expects all LCs to keep documentary records detailing conversations with clients and the recommendations / advice given. Claiming that there has been an informal process in place will not be accepted by the SFC.

Geo failed to maintain any documentary records of the recommendations / investment advice given to clients for subscribing to the unlisted bonds, nor did they provide clients with written copies of advice.

Client Disclosures

Another issue that continues to pop up during inspections is the lack of disclosures of fees and commissions made to clients. The SFC found that Geo failed to disclose to its clients the commission it received or would be receiving from the issuers for successful placement of the unlisted bonds.

Disciplinary Action

The SFC concluded that Mr. Lun’s actions showed that he did not properly understand or manage Geo’s business, understand his duties as an RO and senior manager, manage the risks associated with Geo’s business and implement policies and procedures and controls to ensure appropriate standards of conduct during the sale of the unlisted bonds.

The SFC found that Mr. Lun’s actions were a direct breach of the following provisions of the Code of Conduct for Persons Licensed by or Registered with the SFC:

- General Principle (“GP”) 2 which requires a licensed person to act with due skill, care and diligence, in the best interests of its clients and the integrity of the market.
- GP 9 which requires senior management of a licensed corporation to bear primary responsibility for ensuring the maintenance of appropriate standards of conduct and adherence to proper procedures by the firm.
- Paragraph 14.1 which requires senior management to properly manage the risks associated with the firm’s business.



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In deciding on suspending Mr. Lun for a period of 7.2 months, the SFC took into account the seriousness of Geo’s breaches and the fact that Mr. Lun cooperated and was very willing to resolve the SFC’s concerns throughout the course of the investigation.

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