

SFC disciplines and fines CIC Investor Services \$4 million over handling of professional investors and documentation of advice

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The Securities and Futures Commission (SFC) has reprimanded CIC Investor Services Limited (CIC) and fined it \$4 million for its failures to comply with regulatory requirements in treating clients as professional investors and to keep adequate records of its investment advice to clients (Note 1).

An SFC investigation revealed that CIC failed:

- to evidence that the clients had met the requisite requirements under the Securities and Futures (Professional Investor) Rules (Note 2);
- to adequately assess the investment experience of its clients as required under the Code of Conduct (Notes 3 and 4); and
- to obtain signed declarations from clients who agreed to be treated as professional investors as required under the Code of Conduct (Note 5).

In addition, CIC failed to maintain adequate documentary records of its investment advice given to clients (Note 6).

In agreeing to resolve the case, CIC has agreed to engage an independent reviewer, to be agreed by the SFC, to review its internal controls in relation to identification and treatment of professional investors and the provision of investment advice. CIC has also agreed to implement all recommendations to be made by the reviewer.

In deciding the disciplinary sanction, the SFC took into account:

- the duration of CIC's failures, i.e. between 2004 and 2010;
- CIC has a clean disciplinary record; and
- CIC co-operated in resolving these disciplinary proceedings.

End

Notes:

1. CIC is licensed under the Securities and Futures Ordinance (SFO) to carry on business in Type 1 (dealing in securities) and Type 4 (advising on securities) regulated activities.
2. The SFO and in particular section 3 of the Securities and Futures (Professional Investor) Rules in force at the material time provide that, among various categories of professional investors, a professional investor who is an individual should, either alone or with any of his associates on a joint account, has a portfolio of not less than \$8 million or its equivalent in any foreign currency, as evidenced by a certificate issued by an auditor or certified public accountant within the last 12 months or one or more custodian statements issued in the last 12 months.
3. Paragraph 5.1 of the Code of Conduct for Persons Licensed by or Registered with the SFC (Code of Conduct) provides that a licensed corporation should take all reasonable steps to establish the investment experience of each of its clients.
4. Paragraph 15.3 of the Code of Conduct provides that intermediaries have to know and assess the investment experience of the professional investors in terms of the investment products they have traded, the frequency and size of their trades, the years of experience in the relevant market, and their awareness of risks involved in the relevant market. One of the consequences of being treated as a professional investor is that certain provisions of the Code of Conduct designed to protect investors can be waived. One of the key provisions that intermediaries can waive when dealing with professional investors is the requirement under the Code of Conduct (paragraph 5.2) to ensure that, when recommending, giving advice or soliciting the sale of a financial product, the product is suitable for the customer.
5. Paragraph 15.4 (b) of the Code of Conduct provides that, before treating a client as professional investor, intermediaries should obtain from the client a written and signed

declaration acknowledging that a written explanation of the risks and consequences of being treated as a professional investor and the right to withdraw from being treated as such had been given and that the client agrees to be treated as professional investor.

6. The Management, Supervision and Internal Control Guidelines for Persons Licensed by or Registered with the SFC provide that a licensed corporation in its provision of investment advice should document the rationale of the advice or recommendations and provide the clients a copy of the advice.
7. A copy of the [Statement of Disciplinary Action](#) in relation to the matter is available on the SFC website.

STATEMENT OF DISCIPLINARY ACTION

The Disciplinary Action

1. The Securities and Futures Commission (SFC) has taken the following disciplinary action against CIC Investor Services Limited (CIC), pursuant to section 194 of the Securities and Futures Ordinance (SFO):
 - (a) publicly reprimanded CIC pursuant to section 194(1)(iii) of the SFO; and
 - (b) ordered CIC to pay a pecuniary penalty of HK\$4 million pursuant to section 194(2) of the SFO.
2. The disciplinary action is taken due to CIC's failure to comply with:
 - (a) section 3 of the Professional Investor Rules¹ relating to proof of the professional investor's portfolio value and General Principle 7 and paragraph 12.1 of the Code of the Conduct²
 - (b) General Principle 2 and paragraph 5.1 of the Code of Conduct by not adequately assessing the trading experience of clients before taking them to be professional investors;
 - (c) General Principle 7 of the Code of the Conduct by not having adequately satisfied the requirements under paragraph 15.3 and paragraph 15.4 (b) of the Code of Conduct relating to the treatment of clients as professional investors; and
 - (d) General Principle 2 of the Code of Conduct by not having adequately documented investment advice and provided a copy of the investment advice to clients in accordance with paragraph VII (3) of and paragraph 3 of the Appendix to the Management Guidelines³.
3. CIC is a licensed corporation⁴ which gives advice to its clients on their investments with Crédit Industriel et Commercial, Singapore Branch.

Summary of facts

Proof of professional investor status

4. Among other things, section 3 of the Professional Investor Rules requires a professional investor to have a portfolio of not less than HK\$8 million as evidenced by an accountant certificate or custodian statements.

¹ Securities and Futures (Professional Investor) Rules (Cap 571D) of the Law of HKSAR

² Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission

³ Management, Supervision and Internal Control Guidelines for Persons Licensed by or Registered with the Securities and Futures Commission

⁴ CIC is a corporation licensed to carry on business in Type 1 (dealing in securities) and Type 4 (advising on securities) regulated activities

5. When asked to produce records evidencing that its clients from 2004 to February 2010 had fulfilled the requirements under section 3 of the Professional Investor Rules, CIC did not produce any accountant certificates or custodian statements but relied on its Know-Your-Client records.
6. The SFC examined the Know-Your-Client records and found that on average, more than half of the clients said to be professional investors did not meet the portfolio value requirement under section 3 of the Professional Investor Rules.
7. In the circumstances, the SFC considers that not only did CIC fail to provide the required proof of the clients' portfolio value, but it had also inappropriately taken a majority of its clients as professional investors.

Assessment of the clients' trading experience

8. CIC had taken its clients as professional investors in all investment products, which included bonds, equities, structured products, and derivatives. CIC's policies provided that a professional investor would be expected to have traded the relevant investment product not less than 40 transactions per annum and been active in the relevant market for at least 2 years.
9. Nonetheless, CIC's Know-Your-Client records and the clients' trading activities from 2004 to 2009 show that:
 - (a) not all of the clients had a "High" level of knowledge about or dealing experience in the investment products they traded;
 - (b) most of the clients did not have 40 transactions per annum even when all transactions in bonds, equities, structured products, and derivatives are taken together; and
 - (c) about 90% of the clients did not have 2 years of active dealing experience in bonds, equities, or structured products and derivatives.
10. In the circumstances, the SFC considers that CIC had not taken adequate steps to reasonably satisfy that its clients had sufficient knowledge and expertise in all investment products for which they were being taken as professional investors.

Compliance with paragraph 15 of the Code of Conduct

11. In February 2010, CIC sent to its clients (about 420 clients) a letter asking them to acknowledge that they were professional investors in all investment products and informing them that CIC was waiving the requirements set out in paragraph 15.5 of the Code of Conduct.
12. Paragraph 15.3 of the Code of Conduct provides that, before waiving the requirements under paragraph 15.5 of the Code of Conduct⁵ for a professional investor, a licensed corporation should assess and be reasonably satisfied that the professional investor has traded not less than 40 transactions per annum and been active in the relevant market for at least 2 years.

⁵ The regulatory requirements that may be waived for Professional Investors under paragraph 15.5 of the Code of Conduct include information about clients, suitability of recommendation or solicitation, client agreement, discretionary accounts requirements, and information for clients.

13. The SFC's examination of CIC's Know-Your-Clients records and client trading activities shows that:
 - (a) only slightly more than half of the 420 clients were said to have a "High" level of knowledge in investment products; and
 - (b) only about one out of 10 of the 420 clients had not less than 40 transactions per annum and 2 years or more of active dealing experience in bonds, equities, and structured products and derivatives.
14. Given these findings, the SFC has considered that CIC failed to take adequate steps to assess and be reasonably satisfied that the clients had met the trading frequency and dealing experience requirements under paragraph 15.3 of the Code of Conduct before seeking to waive the requirements set out in paragraph 15.5 of the Code of Conduct.
15. Among other things, paragraph 15.4 (b) of the Code of Conduct provides that, before treating a client as professional investor, the licensed corporation should obtain from the client a signed declaration acknowledging that a written explanation of the risks and consequences of being treated as a professional investor had been given and that the client agrees to be treated as professional investor.
16. When asked to produce the acknowledgments from the 420 clients acknowledging the treatment of Professional Investor, CIC submitted that 184 clients acknowledged the treatment but produced only documentary acknowledgements relevant to 4 out of the 420 clients.

Compliance with paragraph VII (3) of and paragraph 3 of the Appendix to the Management Guidelines

17. The Management Guidelines require a licensed corporation to document and retain the reasons for its recommendations or advice given to the clients, and provide the clients with a copy of the same and its underlying rationale.
18. CIC's sales policy provided that it was the responsibilities of its representatives to:
 - (a) set out the basis for their recommendation in details; and
 - (b) ensure proper documentation of the marketing process by way of questionnaire, call report, and tape recording of telephone calls with clients.
19. Appendix 3 to the Report on Selling Practices of Licensed Investment Advisers of February 2005 (the "**Selling Practices Report**") provides that a financial plan or recommendation should include the following:
 - (a) a summary of the key features of the recommended product including a statement whether the recommended product is SFC authorized or not;
 - (b) a clear explanation of the consequences of early encashment of the recommended product;

- (c) a clear explanation of the risks of the recommended product and how these are consistent with the client's risk profile and objectives;
 - (d) why the product has been recommended and what the licensed investment adviser knows about it; and
 - (e) alternative investments that the licensed investment adviser had considered and the reasons why alternative investments are not suitable.
20. When asked to produce the records of investment advice given to clients, the documentary records produced, including emails, faxes, meeting notes, questionnaires, and telephone call log, do not demonstrate satisfaction of the above requirements under the Selling Practices Report.
21. In addition, it was not part of CIC's sales policy to provide clients with a copy of the documented investment advice.

Conclusion

22. Having considered all the circumstances, the SFC is of the opinion that CIC is guilty of misconduct and not a fit and proper person to remain licensed given its failure to take adequate steps to comply with the relevant provisions of the SFO, the Code of Conduct, and the Management Guidelines.
23. In coming to the decision to take disciplinary action against CIC for its failures in relation to the treatment of clients as professional investor and the documentation of investment advice or recommendation, the SFC has decided that the sanction of public reprimand and fine is most appropriate and commensurate with the view of the SFC on the gravity of the failures.
24. In addition, the SFC took into account that CIC:
- (a) cooperated in resolving the disciplinary action; and
 - (b) agreed to engage an independent reviewer to review CIC's internal controls regarding treatment of professional investor and the provision of investment advice, and to implement all recommendations to be made by the reviewer.