

SFC revokes licence of John David Lawrence and fines him \$900,000

9 Oct 2014

The Securities and Futures Commission (SFC) has revoked the licence of Mr John David Lawrence, a representative of PFC International Company Limited (PFC), and fined him \$900,000 for failings relating to his sale of the EEA Life Settlements Fund (Fund) to clients (Notes 1, 2 & 3).

An SFC investigation revealed that from March 2009 to October 2011, Lawrence, who was the chairman and a responsible officer of PFC at the material time, sold the Fund to 31 client accounts involving transaction amount of approximately \$28 million, although PFC had classified the Fund as “execution only” and should not be promoted to clients (Note 4).

A significant number of clients who bought the Fund through Lawrence were elderly clients despite the liquidity risk of the Fund and the risk of deferral of redemption requests associated with the Fund (Note 5).

The SFC found that Lawrence had failed:

- to ensure the suitability of the Fund to his clients;
- to ensure that the risks associated with the Fund were fully disclosed to his clients;
- to document the investment advice given to his clients in respect of the Fund, and the rationale underlying the advice and to provide clients with a copy of the written advice; and
- as a member of PFC’s senior management, to set appropriate standards for his staff to follow to ensure the suitability of products recommended to clients.

Lawrence’s misconduct calls into question his fitness and properness to remain a licensed person. He blatantly disregarded the firm’s due diligence result and ignored his fundamental duty to ensure suitability of his investment recommendation and to present balanced views regarding the Fund.

Moreover, as the then Chairman of PFC and a member of senior management, Lawrence failed to set appropriate standards for his staff to follow and failed to ensure that PFC’s investment advisory functions were properly directed and managed to serve the best interests of his clients.

In deciding on the penalty, the SFC took into account his financial position, his cooperation and his otherwise clean disciplinary record.

End

Notes:

1. Lawrence is licensed under the Securities and Futures Ordinance to carry on Type 1 (dealing in securities), Type 4 (advising on securities) and Type 9 (asset management) regulated activities and is accredited to PFC International Company Limited.
2. The Fund is a traded life policy investment, or a viatical settlement, which acquired and traded in outstanding life insurance policies issued in the United States. It is not a product authorized by the SFC.
3. On 28 November 2011, the UK Financial Services Authority issued a guidance consultation on traded life policy investments, indicating its intention to consult on a ban of all marketing of such products to retail investors as they were complex and high risk, and generally unlikely to be suitable for retail investors. On 30 November 2011, the Board of Directors of the Fund decided to suspend dealings in the Fund. The suspension was lifted on 1 January 2014 after a restructuring of the Fund came into effect.
4. Under PFC’s compliance manual, “execution only” funds can only be purchased according to clients’ requests. Account managers are not allowed to promote or give advice to clients on these funds. Lawrence was the only account manager of PFC who had sold the Fund to clients.
5. Lawrence sold the Fund to 12 client accounts which involved elderly clients who were 65 years old or above. A few of them were over 85.

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

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STATEMENT OF DISCIPLINARY ACTION

The Disciplinary Action

1. The Securities and Futures Commission (**SFC**) has revoked the licence of John David Lawrence¹ (**Lawrence**) and fined him \$900,000 pursuant to section 194 of the Securities and Futures Ordinance (**SFO**).
2. Lawrence was previously the Chairman and a responsible officer of PFC International Company Limited (**PFC**).
3. The disciplinary action relates to failings concerning Lawrence's sale of the EEA Life Settlements Fund (**Fund**) to clients from March 2009 to October 2011. The SFC found that Lawrence has failed:
 - (a) to ensure the suitability of the Fund to his clients, in breach of General Principle 2, paragraph 3.4 and paragraph 5.2 of the Code of Conduct²;
 - (b) to ensure that the risks associated with the Fund were fully disclosed to his clients, in breach of General Principle 5 of the Code of Conduct;
 - (c) to document, and provide a copy of, the investment recommendations and advice given to his clients; and
 - (d) as a member of PFC's senior management, to set appropriate standards for his staff to follow to ensure the suitability of products recommended to clients, in breach of General Principles 7 and 9, and paragraph 12.1 of the Code of Conduct.

Summary of facts

4. Lawrence sold the Fund to 31 client accounts from March 2009 to October 2011, involving transaction amount of approximately \$28 million. The Fund is a traded life policy investment, or a viatical settlement, which acquired and traded in outstanding life insurance policies issued in the United States. It is not a financial product authorised by the SFC.³

¹ Lawrence is licensed under the Securities and Futures Ordinance (SFO) to carry on Type 1 (dealing in securities), Type 4 (advising on securities) and Type 9 (asset management) regulated activities and is accredited to PFC International Company Limited.

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

³ On 28 November 2011, the UK Financial Services Authority issued a guidance consultation on traded life policy investments, indicating its intention to consult on a ban of all marketing of such products to the mass market retail investors as they were complex and high risk, and generally unlikely to be suitable for retail investors. On 30 November 2011, the Board of

5. An SFC investigation revealed a number of deficiencies in the selling of the Fund by Lawrence to his clients.

Fund was classified as “execution only” with a number of risk factors which should be disclosed to clients

6. In February 2009, the Investment Committee (IC) of PFC conducted due diligence on the Fund, and decided to categorise the Fund as “execution only” with a risk rating of “4” (balanced). Under PFC’s compliance manual, “execution only” funds can only be purchased according to clients’ requests. Account managers are not allowed to promote or give advice to clients on these funds.
7. Internal records show that the IC considered that the following risks should be highlighted to clients if the Fund was approved:
 - (a) insurance companies may go bankrupt; no one can ensure the payout of the Fund in the eventual death of the insured;
 - (b) if the insured do not pass away within the time frame estimated, this will affect the cash flow of the Fund; and
 - (c) if there is a run on the Fund, the Fund will have difficulty paying out because the underlying policies are not liquid.
8. The IC also decided that PFC should provide a specific written risk disclosure to clients when selling the Fund, highlighting that the Fund’s directors are entitled at their discretion to defer redemptions for not more than 23 months if the outstanding requests for redemption exceed 10 percent of the shares in issue on any redemption day.

Failure to ensure suitability of the Fund to clients

19. 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 require licensed persons to ensure that, through the exercise of due diligence, their investment recommendations to clients are based on thorough analysis and are reasonable in all the circumstances.
20. In assessing the suitability of the Fund to clients, Lawrence must consider diligently whether the investment return characteristics and risk exposures of the Fund are suitable for the specific clients and are in the best interests of the clients, taking into account the clients’ investment objectives, investment horizon, risk tolerance and financial circumstances. The onus is on Lawrence to show that the Fund was an appropriate one for the clients. The obligation is not on the clients.
21. Lawrence breached General Principle 2, paragraphs 3.4 and 5.2 of the Code of Conduct by failing to ensure the suitability of the Fund to his clients, in that:
 - (a) Although the Fund was classified as “execution only”, he recommended the Fund to his clients and/or included the Fund in the

Directors of the Fund decided to suspend dealings in the Fund. The suspension was lifted on 1 January 2014 after a restructuring of the Fund came into effect.

portfolio of clients whose accounts were under PFC's discretionary management.

- (b) Given the risk that requests for redemption might be deferred at the discretion of the Fund's directors, and the liquidity risks as highlighted by the IC, the Fund might not be suitable for elderly clients. However, 12 of the accounts to whom the Fund was sold involved elderly clients who were 65 years old or above. A few of them were over 85.
- (c) There was apparent risk mismatch in respect of three accounts to whom the Fund was sold, in that the risk level of the Fund ("4", balanced) exceeded the risk tolerance level of the clients concerned.
- (d) He obtained and/or documented limited information about the clients who invested in the Fund (including their financial circumstances and investment objectives and horizon) in their Financial Questionnaires, and the risk tolerance level as set out in the questionnaires was often decided by the clients themselves.
- (e) Apart from a few emails which show that he had highlighted the benefits of the Fund to certain clients, the reasons for his recommendation of the Fund and how it was suitable to the clients' specific circumstances were not documented.

Failure to disclose risks associated with the Fund to clients

- 22. General Principle 5 (information for clients) of the Code of Conduct requires licensed persons to make adequate disclosure of relevant material information to their clients.
- 23. When providing investment advice, licensed persons must help each client make informed decisions by giving the client proper explanation of why the recommended product is suitable for him/her, and the nature and extent of risks the product carries. They must present balanced views, drawing the client's attention to not only the benefits of investing in the product, but the disadvantages and downside risks as well.
- 24. Lawrence breached General Principle 5 of the Code of Conduct by failing to present a balanced view about the Fund to his clients to enable them to make informed decisions:
 - (a) Apart from informing clients of the benefits of investing in the Fund, Lawrence should also have explained to them the nature and extent of the risks involved. Evidence shows that he failed to provide adequate disclosure of the risks associated with the Fund to his clients during the selling process.
 - (b) Although the IC decided that specific risk disclosure regarding the possibility of delayed redemptions should be made to both broking and discretionary account clients, Lawrence had not provided such a risk disclosure statement to any of the discretionary account clients who bought the Fund.

Failure to document investment advice and rationale underlying the advice

25. 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 SFC provide that a licensed corporation in the business of offering investment advice should take steps to, among others:
 - (a) document and retain the reasons for its recommendations and advice given to the client; and
 - (b) implement special procedures to document (and provide a copy to the client) the rationale underlying investment advice rendered or recommendations made.
26. In accordance with these regulatory requirements, PFC's Compliance Manual requires its employees to record in writing the advice given and the rationale underlying that advice, and keep a copy of any research or other materials supporting the basis for the advice.
27. Lawrence failed to comply with this record keeping requirement in that, apart from a few emails recording his recommendation of the Fund to certain clients, there were:
 - (a) no documentary records of what information had been given to each client in respect of the Fund, including records of whether the Prospectus or any of the fund fact sheets were provided to the client;
 - (b) no documentation which contained the rationale underlying his recommendation of the Fund to each client in respect to the Fund; and
 - (c) no evidence of the clients being provided with a copy of the documented investment advice or recommendations together with the underlying rationale.

Senior management responsibility

28. 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 licensed corporations 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.
29. General Principle 9 (responsibility of senior management) of the Code of Conduct specifically provides that the senior management of a licensed person should bear primary responsibility for ensuring the maintenance of appropriate standards of conduct and adherence to proper procedures by the firm.
30. As a responsible officer and the Chairman of PFC, Lawrence failed to set appropriate standards for his staff to follow to ensure the suitability of products recommended to clients, in that he himself did not adhere to the internal control measures that existed at the time, as demonstrated by his recommendation of an "execution-only" product to clients, his failure to obtain and document client information in the Financial Questionnaire, and his failure

to document the rationale underlying his recommendation of the Fund to his clients.

Conclusion

31. Lawrence blatantly disregarded the firm's due diligence result and ignored his fundamental duty to ensure suitability of his investment recommendation and to present balanced views regarding the Fund. Moreover, as the then Chairman of PFC and a member of senior management, he failed to set appropriate standards for his staff to follow and failed to ensure that PFC's investment advisory functions were properly directed and managed to serve the best interests of his clients.
32. In deciding the penalty, the SFC has taken into account Lawrence's financial position, his cooperation and his otherwise clean disciplinary record.