

[Home](#) ▶ [News & announcements](#) ▶ [News](#) ▶ [All news](#)

SFC reprimands and fines Okasan International (Asia) Limited \$4 million

2 Nov 2015

The Securities and Futures Commission (SFC) has reprimanded and fined Okasan International (Asia) Limited (Okasan) \$4 million for failures in selling unlisted investment products and making proper disclosure of trading profits (Note 1).

An SFC investigation into Okasan's practices and procedures in distributing unlisted investment products to its clients between January and September 2013 found that Okasan:

- did not ensure adequate product due diligence had been conducted on the products before recommending them to clients;
- did not ensure that recommendations and/or solicitations made to its clients in relation to the products were suitable for and reasonable in all the circumstances of the clients;
- did not maintain adequate documentary records of the investment advice or recommendations given to its clients nor provide clients with a copy of the written advice; and
- failed to make adequate disclosure to clients of the trading profits it made from back-to-back transactions (Notes 2 & 3).

In determining the penalty, the SFC took into account that Okasan:

- co-operated in resolving the disciplinary proceedings;
- has agreed to conduct an independent review of its systems and controls in respect of its distribution of unlisted investment products and to enhance its complaint handling procedures; and
- has an otherwise clean disciplinary record in relation to its regulated activities.

End

Notes:

1. Okasan is licensed under the Securities and Futures Ordinance (SFO) to carry on Type 1 (dealing in securities) and Type 4 (advising on securities) regulated activities.
2. Upon receiving a buy/sell order for unlisted investment product from a client, Okasan would buy/sell the same through its counterparty and take profit by marking up (for buy orders) or marking down (for sell orders) the price charged/paid to the client, as the case may be.
3. Paragraph 8.3 of the Code of Conduct requires that where a licensed person enters into a back-to-back transaction concerning an investment product, the licensed person should disclose to the client the trading profit to be made as a percentage ceiling of the investment amount or the dollar equivalent.

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

Page last updated : 2 Nov 2015

STATEMENT OF DISCIPLINARY ACTION

The Disciplinary Action

1. The Securities and Futures Commission (**SFC**) has publicly reprimanded Okasan International (Asia) Limited (**Okasan**)¹ and fined it \$4 million pursuant to section 194 of the SFO.
2. The disciplinary action is taken because Okasan has failed to:
 - (a) ensure adequate product due diligence had been conducted on unlisted investment products before making recommendations or solicitations to its clients;
 - (b) ensure that the recommendations or solicitations made to its clients in relation to unlisted investment products were suitable for and reasonable in all the circumstances of each of its clients;
 - (c) maintain adequate documentary records of the investment advice given to its clients and provide clients with a copy of the written advice; and
 - (d) make adequate disclosure to clients of the trading profits it made from back-to-back transactions in relation to unlisted investment products.

Summary of facts

3. In October 2013, the SFC's Intermediaries Supervision Division conducted a limited review of Okasan's business activities and identified a number of deficiencies in Okasan's selling practices in relation to unlisted investment products.
4. The SFC therefore conducted an investigation into the policies and procedures adopted by Okasan in connection with its business of distributing unlisted investment products and providing investment advice in connection therewith.
5. According to information provided by Okasan, between January and September 2013 (**Relevant Period**), Okasan executed 51 transactions in relation to unlisted investment products² for its retail clients, of which 29 transactions involving 21 clients were buy transactions solicited by Okasan, and 12 transactions involving 11 clients were sell transactions solicited by Okasan.

¹ Okasan is licensed under the Securities and Futures Ordinance (SFO) to carry on Type 1 (dealing in securities) and Type 4 (advising on securities) regulated activities.

² The unlisted investment products distributed by Okasan included bonds of different features, such as bonds that are callable, bonds that are perpetual in nature, bonds that have subordinated ranking or have variable interest payment terms, etc.

Due diligence

6. Okasan did not have adequate written policy and/or procedures on conducting product due diligence during the Relevant Period. Okasan also did not have any standard mechanism for evaluating investment products. Okasan's due diligence process allegedly primarily involved making enquiries from product issuers on a number of matters such as the structure of the investment products, how they work, the nature of underlying investments, the inherent risk, reputation / credit risk of product issuers etc.
7. Okasan has no record of its due diligence work other than the "product offer sheets", which only record information about the products obtained from the prospectuses, Bloomberg and the bookrunners. They do not record any verification work that Okasan has done and/or enquiries it has made about the products; nor do they document Okasan's criteria for selecting the products for distribution to its clients.
8. Okasan's managing director and responsible officer, who was responsible for product due diligence, said that in deciding whether an investment product should be marketed to Okasan's clients, the credit rating of the product provided by the credit rating agencies was the most important factor. Such an approach risks overlooking other factors that are highly relevant to the risk return profiles and/or growth prospects of the products, such as the liquidity of the products, the past performance of the products, the experience and reputation of the product issuers, the fees and charges, etc.
9. All in all, the circumstances suggest that Okasan did not ensure adequate product due diligence had been conducted on the unlisted investment products before recommending them to its clients.

Suitability of recommendations

10. Providing reasonably suitable recommendations to clients involves matching the risk return profile of each recommended investment product with the personal circumstances of each client after taking into consideration the product characteristics and risks and the client's investment objectives, investment horizon, risk tolerance and financial circumstances.
11. During the Relevant Period, Okasan did not collect from its clients sufficient information relating to their investment horizon and risk tolerance. It also did not always collect from its clients other information about their financial situation, investment experience and investment objectives.
12. Further, Okasan did not have any adequate policies or procedures in relation to determining the suitability of investment products for its clients. Okasan mainly relied on the judgment of its sales representatives, taking into account the clients' circumstances, such as their financial information, risk tolerance, investment objectives and experience, in determining the suitability of clients' investments in unlisted investment products.
13. However, the lack of guidance on product due diligence and suitability assessment, combined with the incomplete client profiles and lack of proper assessment of clients' risk tolerance level, means that it was improbable for Okasan's sales representative to have been able to ensure that the

recommendations and advice they gave to clients were suitable for and reasonable in all the circumstances of each of its clients.

Documentation of investment advice

14. During the Relevant Period, Okasan did not have any policies and procedures requiring (a) the documentation of its investment advice or recommendations to clients and the underlying rationale of such advice or recommendations and (b) the provision of a copy of the investment advice or recommendations together with the underlying rationale to the clients.
15. In terms of records showing recommendations or advice given to its clients, Okasan was only able to provide certain emails and call reports which do not record the reasons why the sales representatives recommended or advised the clients to buy the relevant products or the rationale underlying such recommendations or advice.
16. Without proper records of the investment recommendations or advice, it would have been difficult for Okasan to supervise its sales representatives to ensure that any recommendations or solicitations made to clients were suitable and reasonable in all the circumstances. Further, the lack of such records would make it difficult for Okasan to assess its position if it receives client complaints about possible mis-selling of products by its sales representatives.

Disclosure of monetary benefit

17. Upon receiving a buy/sell order for unlisted investment product from a client, Okasan would buy/sell the same through its counterparty and take profit by marking up (for buy orders) or marking down (for sell orders) the price charged/paid to the client, as the case may be.
18. Contrary to Okasan's assertion, the trading profit was not disclosed to its clients in the Product Offer Sheets provided to the clients. Indeed, the statement in the Product Offer Sheets that "*Only purchase cost is charged to customers when customers buy bond*" may give the impression that the clients are purchasing bonds at cost when, in fact, that is not the case.
19. The percentage or amount of trading profit that Okasan made from back-to-back transactions is relevant material information that should have been disclosed to its clients. Without such disclosure, clients are deprived of a fair opportunity to make an informed decision not to trade through Okasan.

Breaches and reasons for action

20. General Principle 2 (diligence), paragraph 3.4 (advice to clients: due skill, care and diligence) and 5.2 (know your client: reasonable advice) of the Code of Conduct³ require a licensed corporation to ensure that, through the exercise of due diligence, its investment recommendations to clients are based on thorough analysis and are reasonable in all the circumstances.

³ Code of Conduct for Persons Licensed by or Registered with the SFC

21. Paragraph VII(3) of and paragraph 3 of the Appendix to the Management Guidelines⁴ provide that a licensed corporation in the business of offering investment advice should take steps to document and retain the reasons for its recommendations or advice given to the client and to implement special procedures to document (and provide a copy to the client) the rationale underlying investment advice rendered or recommendations made.
22. With respect to information to be provided to clients, General Principle 5 requires a licensed person to make adequate disclosure of relevant material information in its dealings with its clients. Paragraph 8.3 of the Code of Conduct requires that where a licensed person enters into a back-to-back transaction concerning an investment product, the licensed person should disclose to the client the trading profit to be made as a percentage ceiling of the investment amount or the dollar equivalent.
23. In this case, Okasan breached:
 - (a) General Principle 2 of the Code of Conduct by failing to conduct adequate due diligence before making recommendations and/or solicitations to clients;
 - (b) General Principle 2, paragraphs 3.4 and 5.2 of the Code of Conduct by failing to ensure the suitability of its recommendations and/or solicitations to clients;
 - (c) Paragraph VII(3) and paragraph 3 of the Appendix to the Management Guidelines by failing to adequately document the investment recommendations and advice given to clients by its sales representatives; and
 - (d) General Principle 5 and paragraph 8.3 of the Code of Conduct by failing to make adequate disclosure to clients of the trading profits made by Okasan from back-to-back transactions.
24. The SFC has decided to take the disciplinary action against Okasan as described in paragraph 1 above, after taking into account the following:
 - (a) Okasan's co-operation in resolving the SFC's concerns;
 - (b) Okasan will immediately implement special enhanced complaints handling procedures to resolve, in a fair and reasonable manner, any complaints in relation to the purchase and sale of unlisted investment products or the provision of investment advisory services relating to such purchase and sale; and
 - (c) Okasan has agreed to engage an independent reviewer, to be approved by the SFC, to review its systems and processes in respect of its distribution of unlisted investment products.

⁴ Management, Supervision and Internal Control Guidelines for Persons Licensed by or Registered with the SFC.