

STATEMENT OF DISCIPLINARY ACTION

The Disciplinary Action

1. The Securities and Futures Commission (**SFC**) has publicly reprimanded GEO Securities Limited (**GEO**)¹ and fined it \$6.3 million pursuant to section 194 of the Securities and Futures Ordinance (**SFO**).
2. The disciplinary action is taken because GEO has:
 - (a) provided discretionary account management services to its clients and introduced clients directly to listed companies to subscribe for their unlisted bonds, in breach of the conditions imposed on its licence;
 - (b) failed to ensure adequate product due diligence has been conducted on unlisted bonds before making recommendations or solicitations to its clients;
 - (c) failed to ensure that recommendations or solicitations made to its clients in relation to unlisted bonds were suitable for and reasonable in all the circumstances of each of its clients;
 - (d) failed to maintain proper documentary records of the investment advice or recommendations given to its clients and provide clients with a copy of the written advice; and
 - (e) failed to make disclosure to clients of the commission it received or would receive from the issuers of the unlisted bonds for the successful placement of each bond.

Summary of facts

3. Between 3 May 2013 and 22 March 2016, GEO's licence was subject to the following conditions:
 - (a) GEO shall not hold client assets; and
 - (b) for Type 1 regulated activity, GEO shall not conduct business other than:
 - (i) communicating offers to effect dealings in securities to a corporation that is licensed by or registered with the SFC for Type 1 regulated activity, in the names of the persons from whom those offers are received; and
 - (ii) introducing persons to a corporation that is licensed by or registered with the SFC for Type 1 regulated activity in order that they may effect dealings in securities or make offers to deal in securities.

¹ GEO is licensed under the SFO to carry on Type 1 (dealing in securities), Type 4 (advising on securities) and Type 9 (asset management) regulated activities.

Regulatory requirements

4. General Principle 2 (diligence), paragraphs 3.4 (advice to clients: due skill, care and diligence), 4.2 (staff supervision) and 5.2 (know your client: reasonable advice) of the Code of Conduct for Persons Licensed by or Registered with the SFC (**Code of Conduct**) 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.
5. Paragraph VII(3) and paragraph 3 of the Appendix to the Management, Supervision and Internal Control Guidelines for Persons Licensed by or Registered with the SFC (**Internal Control Guidelines**) 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.
6. With respect to information to be provided to clients, General Principle 5 of the Code of Conduct requires a licensed person to make adequate disclosure of relevant material information in its dealings with its clients. Paragraph 8.3(a)(i), 8.3A(a) and 8.3A(b) of the Code of Conduct require that where a licensed corporation receives monetary benefits from a product issuer, either directly or indirectly, for distributing an investment product, the licensed corporation should disclose to the client the monetary benefits that are receivable by it as a percentage ceiling of the investment amount or the dollar equivalent in writing or electronically.
7. General Principle 7 (Compliance) and paragraph 12.1 (Compliance: in general) of the Code of Conduct require a licensed person to comply with, and implement and maintain measures to ensure compliance with relevant regulatory requirements.

Breach of licensing conditions

8. The SFC found that between 1 July 2014 and 15 June 2015, GEO provided discretionary management services to eight clients in seven client accounts for payment of an annual management fee from the clients in breach of the conditions on its licence.
9. In providing the discretionary management services to its clients, GEO directly accessed the discretionary clients' securities accounts via remote terminals located at its office.
10. The SFC also found that between 28 October 2014 and 16 November 2015, GEO procured 36 clients to subscribe for six unlisted bonds directly from four companies that were listed either on the Main Board or the Growth Enterprise Market of The Stock Exchange of Hong Kong Limited (collectively, **Issuers**), involving 43 transactions in the total amount of approximately HK\$108 million, in breach of the conditions on its licence.
11. GEO sent the subscription agreements completed by the clients and fees for the unlisted bonds directly to the Issuers on behalf of its clients, or sent its account executives (**AEs**) to accompany the clients to the Issuers' offices to directly subscribe for the respective bonds. GEO received commission payments directly from the Issuers for the successful placement of each bond.

Product due diligence

12. Prior to August 2015, GEO's due diligence process allegedly focused primarily on evaluating the default risk of the Issuers and it did not assess other factors such as the individual features of the bonds. An examination of these features was vital for understanding and assessing the risks of the bonds and their suitability for each client.
13. GEO also did not have in place a methodology to assign a risk rating to each of the unlisted bonds, and allowed the bonds issued by two issuers to be recommended to clients before the completion of their due diligence.
14. Further, while GEO's product due diligence was summarised in internal reports, it did not record information such as the steps taken and enquiries made to verify the information in these internal reports. The rationale for restricting the distribution of the bonds to professional investor clients only was also not documented.
15. GEO also did not have any written policy and / or procedures on conducting due diligence during the material period.
16. GEO's failure to ensure adequate product due diligence had been conducted on the unlisted bonds before recommending them to clients made it impossible for it to adequately discharge its suitability obligations as prescribed by paragraphs 3.4 and 5.2 of the Code of Conduct. Such failures show that GEO did not act with due care, skill and diligence, and in the best interests of clients as required under General Principle 2 of the Code of Conduct.

Suitability of recommendations

17. While GEO collected information from the clients relating to their risk tolerance during the account opening process, it relied on the clients' self-declared risk tolerance and did not have in place procedures to independently review their self-declared risk tolerance prior to October 2015.
18. GEO also did not have written policies or procedures in relation to determining the suitability of investment products for clients, and appears to have largely relied on the judgement of its AEs to determine the suitability of an investment product for its clients. Without guidance on the suitability of investment products, it would be difficult for GEO's AEs to accurately match the characteristics and risk profile of the investment products to the clients' financial situation, investment experience, investment objectives and risk tolerance level.
19. Further, although GEO claimed the distribution of the unlisted bonds were restricted to professional investors clients only and it communicated this sales restriction to its AEs during internal training seminars, GEO did not require the mandatory attendance of its AEs on internal training seminars nor did it have in place a system to ensure its AEs complied with this requirement.
20. The lack of guidance on suitability assessment combined with a lack of proper assessment of clients' risk tolerance means that GEO's AEs would unlikely 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.

21. The deficiencies in GEO's system and controls to ensure the suitability of the unlisted bonds for its clients when recommending or soliciting their sale shows it failed to comply with General Principle 2 and paragraphs 3.4, 4.2 and 5.2 of the Code of Conduct.

Documentation of investment advice

22. GEO confirmed during the SFC's investigation that its AEs were not required to document the rationale underpinning their recommendations / advice to clients for subscribing to the unlisted bonds.
23. Regarding records showing recommendations or advice given to clients, GEO was not able to provide any documentation on the reasons why the AEs recommended or advised the clients to subscribe for the unlisted bonds.
24. Without proper documentation of the investment advice or recommendations given to clients and the rationale for such advice or recommendations, it would be difficult for GEO to effectively supervise and monitor its AEs to ensure that the recommendations or solicitations they made to the clients were suitable and reasonable in all the circumstances. It would also be difficult for GEO to properly assess any client complaint regarding possible mis-selling of investment products by its AEs.
25. GEO's failure to maintain documentary records of the investment advice or recommendations given to its clients and provide clients with a copy of the written advice breached paragraph VII(3) of, and paragraph 3 of the Appendix to, the Internal Control Guidelines.

Disclosure of monetary benefits

26. The records provided by GEO did not show that it had disclosed to clients the commission it received or would receive from the Issuers for each successful placement of the unlisted bonds.
27. The commission that GEO received from the Issuers 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 on whether or not to subscribe to the unlisted bonds through GEO.
28. By failing to disclose to clients the commission it would receive / has received from the Issuers for the successful placement of the unlisted bonds, GEO breached General Principle 5 and paragraph 8.3 of the Code of Conduct.

Conclusion

29. Having considered all the circumstances, the SFC is of the view that GEO is guilty of misconduct, and its fitness and properness to carry on regulated activities have been called into question.
30. In deciding the disciplinary sanction set out in paragraph 1 above, the SFC has had regard to its Disciplinary Fining Guidelines and has taken into account all relevant circumstances, including:

- (a) no client appeared to have suffered losses from GEO's distribution of the unlisted bonds;
- (b) GEO cooperated with the SFC to resolve the SFC's regulatory concerns;
- (c) in resolving the SFC's regulatory concerns, GEO agreed to engage an independent reviewer to review its internal controls; and
- (d) GEO's otherwise clean disciplinary record with the SFC.