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## SFC reprimands and fines Manulife Asset Management for internal control failings

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The Securities and Futures Commission (SFC) has issued a reprimand to Manulife Asset Management (Hong Kong) Limited (Manulife Asset Management) and fined it HK\$24 million for inadequate internal controls in relation to the distribution of Manulife Global Fund from 2007 to 2012 (Note 1 and 2).

The decision follows an SFC investigation into the distribution of the Manulife Global Fund by Manulife Asset Management in which the SFC found a number of serious deficiencies in the way the Manulife Global Fund was distributed between 2007 and 2012.

The SFC's findings focus on Manulife Asset Management's systems and processes for understanding its customer's financial situation, investment experience, and investment objectives in soliciting or recommending the sale of the Manulife Global Fund to them.

The SFC found that between 2007 and 2009, Manulife Asset Management obtained this information by performing an investor profile for each customer. However, 73% of the customers in 2009 were not profiled or their information was either incomplete or outdated for at least 12 months.

After 2010, Manulife Asset Management introduced a questionnaire to assess each customer's risk profile. By February 2012, the new process had not been fully implemented to all customers and Manulife Asset Management still had not secured a completed risk profile questionnaire from 70% of its Manulife Global Fund customers.

Together with concerns about the quality and extent of Manulife Asset Management's record-keeping, these failures have jeopardised Manulife Asset Management's capacity to ensure that recommended securities are suitable for each customer.

Despite these failures, there has been no default in any of the sub-funds of the Manulife Global Fund nor has any customer complained about the performance or suitability of the fund. Moreover, Manulife Asset Management has a clean record and has co-operated with the SFC in resolving this matter, including agreeing to conduct an independent review of its distribution system for funds and to enhance its complaint handling procedures to resolve, in a fair and reasonable manner, all client complaints arisen from this matter.

The SFC's Executive Director of Enforcement, Mr Mark Steward, said: "Intermediaries are obliged to ensure a product which they recommend is suitable for the customer. This cannot be done in a vacuum and is only effective if it is based on accurate, up-to-date information about the customer's financial situation, needs and objectives. Manulife Asset Management failed to implement proper processes to comply with this most basic obligation for intermediaries."

End

Notes:

1. Manulife Asset Management is licensed under the Securities and Futures Ordinance (SFO) to carry on business in Type 1 (dealing in securities), Type 4 (advising on securities), Type 5 (advising on futures contracts), and Type 9 (asset management) regulated activities.
2. Manulife Global Fund is a collective investment scheme authorized under section 104 of the SFO. Manulife Global Fund is an umbrella fund comprising a number of authorized funds investing in different equity and bond markets. The funds and the dates on which they received the SFC's authorization are available on the SFC's website.
3. A copy of the [Statement of Disciplinary Action](#) in relation to the matter is available on the SFC's website.



## STATEMENT OF DISCIPLINARY ACTION

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### The Disciplinary Action

1. The Securities and Futures Commission (**SFC**) has publicly reprimanded and ordered Manulife Asset Management (Hong Kong) Limited (**MAMHK**) to pay a pecuniary penalty of HK\$24 million pursuant to section 194 of the Securities and Futures Ordinance (**SFO**).
2. The disciplinary action is taken for MAMHK's failure to exercise due skill, care and diligence in carrying on its business in regulated activities (General Principle 2 of the Code of the Conduct<sup>1</sup>). In particular, MAMHK failed to comply with:
  - (a) paragraph 6 of the Code of Conduct in not having entered into a written agreement with client before providing services;
  - (b) paragraph 5.1 of the Code of Conduct by not having gathered sufficiently updated Know-Your-Client (**KYC**) information for the distribution of Manulife Global Fund;
  - (c) paragraph 5.2 of the Code of Conduct by not having ensured that the recommendations or solicitations made to its clients at the time of subscription for Manulife Global Fund were reasonably suitable in all the circumstances; and
  - (d) paragraph VII (3) of and paragraph 3 of the Appendix to the Management Guidelines<sup>2</sup> in not having documented investment advice given to clients and provided them a copy of the investment advice.
3. The failure to comply with the relevant regulatory provisions is also a breach of MAMHK's compliance duty under General Principle 7 and paragraph 12.1 of the Code of Conduct.
4. In relation to the recommendation and solicitation of investment products, the SFC has in February 2005, May 2007, and February 2009 issued circulars to repeatedly explain the regulatory duties for:
  - (a) entering into written agreements with clients setting out the scope of the services;
  - (b) conducting product due diligence on a continuous basis;
  - (c) knowing its clients continuously; and
  - (d) ensuring that a copy of investment recommendation is kept on file and given to client.
5. MAMHK is a licensed corporation<sup>3</sup> and a distributor of Manulife Global Fund in Hong Kong. The Manulife Global Fund is a collective investment scheme

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<sup>1</sup> Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission

<sup>2</sup> Management, Supervision and Internal Control Guidelines for Persons Licensed by or Registered with the Securities and Futures Commission

authorized under section 104 of the SFO. It is an umbrella fund comprising a number of funds investing in different equity and bond markets (**Sub-funds**).

## Summary of facts

### *Compliance with paragraph 6 of the Code of Conduct*

6. Paragraph 6 of the Code of Conduct provides that a licensed corporation has to enter into a written agreement with each client before provision of services. Among other things, the client agreement should include a description of the nature of the services to be provided to client, such as investment advice.
7. The account opening form MAMHK used for the distribution of Manulife Global Fund is essentially a fund subscription form. The account opening form has fallen short of the Code of Conduct requirements in that the services provided by MAMHK to its clients are not set out in the form. As a result, it is unclear as to whether or not MAMHK will give investment advice in the distribution of Manulife Global Fund.

### *Compliance with paragraphs 5.1 and 5.2 of the Code of Conduct from 2007 to 2009*

8. Paragraphs 5.1 and 5.2 of the Code of Conduct provide that a licensed corporation should take all reasonable steps to establish the financial situation, investment experience, the investment objectives of each client and to have regard to the client information for ensuring suitability of recommendation and solicitation.
9. During the relevant period, MAMHK mainly based on its investor profile form (**IPF**) to gather KYC information for the purpose of ensuring product suitability and relied on the IPF to classify clients into four risk profiles.
10. However, the SFC's review of the client subscriptions of Manulife Global Fund in 2009 show that 73% of the clients had no IPF or their IPF were incomplete or outdated for 12 months.
11. MAMHK purported to ensure suitability by matching the risk levels of Sub-funds to client risk profiles. The risks of Sub-funds were classified into three levels, i.e. high, medium, and low risk.
12. The SFC found that the assessments of the risk levels were carried out only at the launch of Sub-funds, some of which were as early as 1992. In addition, MAMHK ceased to publish the risk levels of Sub-funds in January 2007 and, as a result, the risk levels of some Sub-funds had never been published.
13. However, MAMHK's records show that the matching process had not been followed before the clients subscribed for the funds. The only record produced to evidence the matching of client profiles and product risk levels was the monthly sample review reports of mismatched subscriptions. However, the review reports as well as other business records do not show any written assessments of the mismatched subscriptions.
14. When reviewing the mismatched subscriptions, MAMHK merely asked the relevant representatives to give explanation for the mismatch and did nothing

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<sup>3</sup> MAMHK is a corporation licensed to carry on business in Type 1 (dealing in securities), Type 4 (advising on securities) and Type 9 (asset management) regulated activities.

to verify whether or not the explanation given in circumstance satisfactorily explain the mismatch. Among the explanations given, no representatives confirmed that they had explained to their clients that the risk levels of the Sub-funds they subscribed did not match their risk profiles.

15. In short, its systems and controls for product suitability from 2007 to 2009 show that MAMHK not only failed to gather sufficiently up-to-date KYC information but also failed to ensure that:
  - (a) its risk assessments of the Sub-funds were updated; and
  - (b) the Sub-funds were suitable for the clients.

*Compliance with paragraphs 5.1 and 5.2 of the Code of Conduct from 2010 onwards*

16. MAMHK introduced changes to its suitability procedures in or around 2010. Among other things, the changes included:
  - (a) reviewing the risk levels of Sub-funds regularly according to a 5-risk level system;
  - (b) replacing the IPF with the risk profile questionnaire (**RPQ**), which classified clients into 5 risk profiles;
  - (c) introducing the suitability check table (**SCT**) to match the 5 risk levels of Sub-funds with the 5 client risk profiles derived from the RPQ; and
  - (d) requiring clients to telephone confirm their understanding of the investment risk and that it was their own decision to subscribe for the sub-funds.
17. Despite these changes, MAMHK's records show that, in October 2010, the product suitability of 91% of the client accounts could not be ensured by way of SCT because only less than 9% of the clients (who had opened their accounts more than one year in May 2010) had completed and returned their RPQs.
18. Not until October 2011 did MAMHK require fund subscriptions to be supported by the RPQ and SCT dated within 24 months. However, in February 2012, MAMHK still had not secured adequate KYC information for ensuring suitability because only 30% of its clients had the RPQ in place, 42% only had the IPF, and 28% had neither the RPQ nor the IPF.

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

19. The Management Guidelines require a licensed corporation to document and retain the reasons for its recommendations or advice given to clients, and provide clients with a copy of the same together with the underlying rationale of the investment advice.
20. Appendix 3 to the Report on Selling Practices of Licensed Investment Advisers of February 2005 (**Selling Practice Report**) also provides that a financial plan or recommendation should include:
  - (a) a summary of the key features of the recommended product;

- (b) a clear explanation of the consequences of early encashment;
  - (c) a clear explanation of the product risks and how they are consistent with the client's risk profile and objectives;
  - (d) why the product has been recommended and what the investment adviser knows about it; and
  - (e) alternative investments that the investment adviser had considered and the reasons why alternative investments are not suitable.
21. MAMHK claimed the IPF, RPQ and SCT were records of such investment advice and the underlying rationale. However, the IPF and RPQ are clearly no more than KYC tools and the SCT only identifies the mismatch between client risk profiles and risk levels of Sub-funds. In addition, the RPQ and SCT expressly provided that they should not be treated as investment advice. In any event, the IPF, the RPQ, or the SCT do not satisfy the record requirements under the Selling Practice Report.

### **Conclusion**

22. Having considered all the circumstances, the SFC is of the view that MAMHK is guilty of misconduct and its fitness and properness as a licensed person has been called into question.
23. The SFC has decided that the sanction of public reprimand and fine of \$24 million is most appropriate and commensurate with the view of the SFC on the gravity of the failures. In coming to the decision to take disciplinary action against MAMHK for its failures, the SFC has taken into account that:
- (a) the duration of MAMHK's failures lasted for substantial period of time and affected all its clients subscribing the Manulife Global Fund;
  - (b) despite the performance of individual sub-funds of Manulife Global Fund varied, no default is reported and no complaints from investors are received by the SFC;
  - (c) MAMHK has not been previously disciplined by the SFC and cooperated in resolving the present disciplinary action, including agreeing to conduct an independent review of its distribution system for funds and to enhance its complaint handling procedures to resolve in a fair and reasonable manner, all client complaints arisen from this matter; and
  - (d) a clear message needs to be sent to the market that the SFC would not tolerate any failure to comply with regulatory requirements of the Code of Conduct.
24. The SFC considers sanction and measures that have been imposed and agreed to constitute a satisfactory resolution of the SFC's concerns over MAMHK's failures and the SFC's view about MAMHK's fitness and properness.