



Hong Kong

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SFC UPDATES FAQs ON COMPLIANCE WITH SUITABILITY OBLIGATIONS AND REQUIREMENTS FOR COMPLEX PRODUCTS

On 23 December 2020, the Securities and Futures Commission (the **SFC**) published a circular to intermediaries¹ announcing updates to its frequently asked questions (**FAQs**) on Compliance with Suitability Obligations² and Requirements for Complex Products.³

A summary of the key updates can be found below:

Updated Area	Purpose of the Update	Updated FAQs
Suitability Assessment	To clarify how to conduct suitability assessments.	New Question 5B (FAQs on Compliance with Suitability Obligations)
Product Explanation	To clarify the obligations of licensed or registered persons to explain product risks to clients with different degrees of financial sophistication.	New Question 6B (FAQs on Compliance with Suitability Obligations)
Distribution of Complex Products on an Unsolicited Basis	To provide guidance on complying with paragraph 5.5 of the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (the SFC Code of Conduct), particularly on how to perform product due diligence, disclose product information and provide warning statements for the sale of complex products on an unsolicited basis.	New Question 39 (FAQs on Complex Products)

1 <https://apps.sfc.hk/edistributionWeb/api/circular/openFile?lang=EN&refNo=20EC82>

2 <https://www.sfc.hk/en/faqs/intermediaries/supervision/Compliance-with-Suitability-Obligations/Compliance-with-Suitability-Obligations#2987785A439E4C32A71E5C54B0EEEE21>

3 <https://www.sfc.hk/en/faqs/intermediaries/supervision/Guidelines-on-Online-Distribution-and-Advisory-Platforms/Guidelines-on-Online-Distribution-and-Advisory-Platforms#356084BB19514296A0433942AA5184B8>

1. Updates to FAQs on Compliance with Suitability Obligations by Licensed or Registered Persons (the FAQs on Compliance with Suitability Obligations)

a. New Question 5B: How should licensed or registered persons devise their processes for performing suitability assessments for different clients?

The SFC clarifies that licensed or registered persons can develop their own processes for performing suitability assessments for their clients and that the process may be varied depending on:

- the client's circumstances;
- the type, complexity and risks of the investment product; and
- the services provided by the licensed or registered person.

While the duty to ensure suitability (paragraph 5.2 of the SFC Code of Conduct) remains the same, licensed and registered intermediaries can vary their processes and perform suitability assessments in a proportionate and risk-based manner. For example, in the case of high net worth clients who also exhibit financial expertise in relevant products and have higher levels of risk tolerance, the licensed or registered person could vary the suitability assessment process. However, they must still demonstrate that the recommendations provided to clients are reasonably suitable taking into account all the circumstances.

The SFC further clarifies that the same principle can be adopted when assessing the overall effect or impact of recommended investment products on their clients' investment portfolios. The SFC suggest that licensed or registered persons could focus on the risk-level of the products and the clients' circumstances in assessing concentration risk. Exceeding a particular concentration level may be acceptable provided that the outcome is commensurate with the overall risk profile of the investment portfolio and the client's other circumstances.

b. New Question 6B: How should licensed or registered persons discharge their obligations to explain the features and risks of investment products to clients who have different degrees of sophistication in terms of knowledge or experience?

The SFC clarifies that the purpose of this obligation is to help

the client understand the product properly, which may not be accomplished where a licensed or registered person merely reads product literature to the client without explanation.

The SFC states that the process and product explanations should be varied depending on the circumstances, including the client's financial markets sophistication and prior trading experience, as well as product-specific complexity and risks. Explanations may be given verbally or in writing, or a combination of both.

Where a client has little or no prior knowledge or experience of a particular type of investment product, the SFC states that the licensed or registered person must provide more assistance to ensure that the client understands the product. Explanations may be less "intensive" for clients who are financially sophisticated and have demonstrable and relevant expertise in the type of investment.

In the case of repeat transactions, the SFC clarifies that licensed or registered persons may vary their disclosure processes having regard to the circumstances and the adequacy and timing of their previous disclosures.

2. Update to FAQs on Guidelines on Online Distribution and Advisory Platforms and Paragraph 5.5 of the Code of Conduct (the Complex Products FAQs)

a. New Question 39: How may licensed or registered persons devise their processes for (i) performing product due diligence (PDD) and (ii) disclosing product information and providing warning statements to different clients, for complying with paragraph 5.5 of the Code of Conduct?

Product Due Diligence

The SFC states that if a licensed or registered person is asked by a client to purchase a product which is not on their approved product list, the licensed or registered person should perform due diligence based on all the information it obtains on a best effort basis, including product offering documents, documentation provided by the issuer and other information available in the public domain or from data providers.

Licensed or registered persons should identify the key features and risks of the product and:

- review the product offering information to determine whether it is a complex product;⁴
- if the product is a complex product, review the product information to identify its generic risks and specific risks arising from its special features; and
- identify any warning flags with reference to the information obtained.

The SFC further clarifies that licensed or registered persons are not expected to form a “house” view of these complex products or perform on-going product due diligence (**PDD**) for complex products only made available to clients on an unsolicited basis, but they should develop their policies on when the PDD needs to

⁴ Please refer to Question 33 and 34 of the Complex Products FAQs in determining whether a fund is complex or non-complex product. Available at <https://www.sfc.hk/en/faqs/intermediaries/supervision/Guidelines-on-Online-Distribution-and-Advisory-Platforms/Guidelines-on-Online-Distribution-and-Advisory-Platforms#7645FE9785D24D038DA9B2E3161E5A0D>

be re-performed or updated if the clients subsequently request to purchase the same complex products.

Disclosure of Product Information

When distributing a complex product, a licensed or registered person is required to disclose product information and provide warning statements to sufficiently draw clients’ attention to key features and risks. The SFC clarifies that licensed and registered intermediaries can vary their processes and explain products or make disclosures to clients in a proportionate and risk-based manner depending on the particular circumstances. For example, when executing an unsolicited order for a complex product for a client who has the requisite level of knowledge or experience, the explanations / disclosures could be reduced. In any event, proper records of the assessment of sophistication should be maintained. Further, where licensed or registered persons prepare and provide their own summaries of products’ key features and risks, they must ensure that all summaries are accurate and not misleading.

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