



SFC/ HKMA New Suitability Obligations for Sophisticated Professional Investors

Hong Kong's Securities and Futures Commission (the **SFC**) and Hong Kong Monetary Authority (the **HKMA**) have published a Joint Circular setting out a new streamlined approach that licensed intermediaries can adopt in complying with the suitability obligations when dealing with sophisticated professional investors with high levels of net worth and knowledge or experience. The streamlined approach is set out in the SFC and HKMA [Joint circular to intermediaries: Streamlined Approach for compliance with suitability obligations when dealing with sophisticated professional investors](#)¹ (**Joint Circular on Suitability Obligations for Sophisticated Professional Investors**) and [Frequently Asked Questions \(FAQs\) on Streamlined Approach for compliance with suitability obligations when dealing with sophisticated investors](#), published on 28 July 2023.²

Suitability Obligations of SFC-Licensed and Registered Intermediaries

Entities licensed or registered with the SFC to conduct activities regulated under the Securities and Futures (Ordinance) (the **SFO**) (**Licensed Intermediaries**) are required to comply with suitability obligations set out in paragraphs 5.2 and 5.5(a) of the SFC's Code of Conduct for Persons Licensed or Registered with the Securities and Futures Commission (the **SFC Code of Conduct**). Licensed Intermediaries' obligations under those paragraphs are to:

- ensure that any recommendation or solicitation made by the Licensed Intermediary is reasonably suitable for the particular client having regard to the information about the client of which the Licensed Intermediary is, or should be, aware through the exercise of due diligence (paragraph 5.2); and
- when providing services to clients in complex products, ensure that:
 - the transaction in a complex product is suitable for the client in all the circumstances (whether or not the Licensed Intermediary has recommended or solicited the transaction);
 - sufficient information on the complex product's nature, features and risks is provided to allow the client to understand the product before making an investment decision; and
 - clear warning statements about the complex product are provided to the client.

A "complex product" is an investment product "whose terms, features and risks are not reasonably likely to be understood by a retail investor because of its complex structure".³ In determining whether a product meets the

“complex product” definition, Licensed Intermediaries need to consider whether:

- the investment product is a derivative product;
- a secondary market is available for the investment product at publicly available prices;
- retail investors have access to adequate and transparent information about the investment product;
- investors risk losing more than the amount they invest;
- any of the investment product’s features or terms could fundamentally alter the nature or risk of the investment or pay-out profile, or include multiple variables or complicated formulas to determine the return (such as investments that contain a right for the issuer to convert the instrument into a different instrument); and
- any of the investment product’s terms or features could make it illiquid or difficult to value.⁴

New Streamlined Approach for Licensed Intermediaries to Comply with Suitability Obligations when Dealing with Sophisticated Professional Investors

[Annex 1](#) to the SFC/HKMA Joint Circular on Suitability Obligations for Sophisticated Professional Investors sets out a new Streamlined Approach (**Streamlined Approach**) to complying with the Suitability Obligations that Licensed Intermediaries can adopt when dealing with Sophisticated Professional Investors. This will allow Licensed Intermediaries to tailor their point-of-sale suitability obligations to Sophisticated Professional Investors’ personal circumstances.

Who are Sophisticated Professional Investors?

Sophisticated Professional Investors are Individual Professional Investors (as defined in section 5 of the Securities and Futures (Professional Investor) Rules (Cap. 571D)) who, at the relevant date, meet:

- the financial criteria set out in paragraph 3 of Annex 1 to the SFC/HKMA Joint Circular on Suitability Obligations for Sophisticated Professional Investors (**Annex 1**);
- at least one of the knowledge and experience criteria set out in paragraph 4.1 of Annex 1; and
- the investment objectives criterion set out in paragraph 5 of Annex 1.

Sophisticated Professional Investors: Qualifying Financial Criteria

To qualify as a Sophisticated Professional Investor at the relevant date, an individual must have:

- a portfolio of at least HK\$40 million (or its foreign currency equivalent); or
- net assets (i.e. total assets less total liabilities), excluding a primary residence, of at least HK\$80 million (or its foreign currency equivalent).

A “portfolio” is defined as a portfolio of:

- securities;
- certificate(s) of deposit issued by a Hong Kong authorised financial institution or a bank regulated in any offshore jurisdiction; and
- money held for the individual by a Hong Kong authorised financial institution or a bank regulated in any offshore jurisdiction, an SFC-licensed corporation or an investment intermediary regulated in any offshore jurisdiction.⁵

In determining the value of a Sophisticated Professional Investor's portfolio or net assets, Licensed Intermediaries can include any of:

- the Sophisticated Professional Investor's own portfolio or net assets;
- a joint portfolio of, or net assets held jointly by, the Sophisticated Professional Investor and their associate (i.e. their spouse or child⁶);
- the Sophisticated Professional Investor's share of a joint account with one or more other persons who is/are not their associate(s), where their share is: the share specified in a written agreement between the account holders; or if none, an equal share of the portfolio or net assets on joint account; and
- the portfolio or net assets of an investment holding company that is wholly-owned by the Sophisticated Professional Investor at the relevant date.

Sophisticated Professional Investors: Knowledge or Experience Qualifying Criteria

Licensed Intermediaries need to be reasonably satisfied that a Sophisticated Professional Investor has *"the degree of sophistication required to understand the risks arising from being treated as a Sophisticated Professional Investor"* by ascertaining whether they meet at least one of the following:

- they hold a degree or post-graduate diploma in accounting, economics or finance, or a related discipline;
- they have a professional qualification in finance (such as Chartered Financial Analyst, Certified International Investment Analyst, Certified Private Wealth Professional, Chartered Financial Planner or other comparable qualifications);
- they have at least one-year's relevant work experience in a professional position in the financial sector in Hong Kong or elsewhere (e.g. licensed for conducting relevant regulated activities); or
- they have executed at least five transactions in the past three years in the same category of investment products based on their terms and features, characteristics, nature and extent of risks (**Product Category**).

Licensed Intermediaries must not execute a transaction in a product within its Product Categories under the Streamlined Approach for a Sophisticated Professional Investor who does not meet any of the above knowledge and experience qualifying criteria.

Sophisticated Professional Investors: Investment Objectives Qualifying Criterion

Licensed Intermediaries must not treat conservative clients (for example clients whose investment objective is capital preservation and/or obtaining a regular income) as Sophisticated Professional Investors.

Sophisticated Professional Investors: Eligible Investment Transactions

Licensed Intermediaries are only allowed to execute investment transactions for Sophisticated Professional Investors under the Streamlined Approach (as described in section C of Annex 1) where the investment product is within:

- the Product Categories specified for execution under the Streamlined Approach (in accordance with paragraph 7 of Annex 1); and
- the streamlining threshold set by the Sophisticated Professional Investor (in accordance with paragraph 8 of Annex 1) (**Eligible Investment Transactions**).⁷

Product Categories and Product Category Information Statement

Licensed Intermediaries are required to devise (or adjust) Product Categories which categorise investment products according to their terms and features, characteristics, nature and extent of risks. Sophisticated Professional

Investors can then choose the Product Categories for which investment transactions can be executed under the Streamlined Approach.

Licensed Intermediaries must:

- document Sophisticated Professional Investors' choice as to which Product Categories can be executed under the Streamlined Approach;
- provide Sophisticated Professional Investors with a 'Product Category Information Statement' explaining the terms and features, characteristics, nature and extent of risks of investment products within that Product Category (the **Product Category Information Statement**). This can be in the form of an information booklet or hyperlinks). Where appropriate, the Product Category Information Statement should contain warning statements about complex product distribution; and
- explain the terms and features, characteristics, nature and extent of risks of investment products within a Product Category upon request from a Sophisticated Professional Investor.

Sophisticated Professional Investors: Threshold for Adopting Streamlined Approach

The Streamlining Threshold

Sophisticated Professional Investors must specify the maximum threshold of investment, as an absolute amount or a percentage of their assets under management with the Licensed Intermediary, that can be executed under the Streamlined Approach (the **Streamlining Threshold**).

It is the Sophisticated Professional Investor who sets the Streamlining Threshold which is appropriate to their particular circumstances. Licensed Intermediaries are required to maintain records of Sophisticated Professional Investors' Streamlining Thresholds and their rationale for setting thresholds at the specified level.

Effective Systems and Controls

Licensed Intermediaries must establish and maintain effective systems and controls to ensure compliance with Sophisticated Professional Investors' Streamlining Thresholds. In particular, they should:

- ensure that the gross exposure resulting from transactions executed under the Streamlined Approach never exceeds the Streamlining Threshold; or
- devise designated accounts (or sub-accounts) to consolidate Sophisticated Professional Investors' eligible investment transactions executed under the Streamlined Approach. If they do, Licensed Intermediaries must ensure that the gross exposure resulting from positions maintained in the designated account does not exceed the investor's Streamlining Threshold after a deposit or top-up of funds is made into the designated account. Licensed Intermediaries are required to discuss with the Sophisticated Professional Investor the amount or percentage of their assets under management allocated to the designated account at least annually, or whenever new funds are added to the account.

Licensed Intermediaries also have obligations to:

- implement measures to detect outsize or material transactions and issue warning statements to Sophisticated Professional Investors in relation to these transactions;
- review compliance with the Streamlining Thresholds at least annually; and
- notify Sophisticated Professional Investors if their gross exposure resulting from their investments executed under the Streamlined Approach and/or the positions maintained in their designated accounts has exceeded the Streamlining Threshold.

Sophisticated Professional Investors: the Streamlined Approach

The suitability obligation procedures that can be streamlined for transactions that a Licensed Intermediary recommends or solicits are set out in paragraph 10 of Annex 1, while the streamlined procedures for transactions in complex products that are not recommended or solicited by the Licensed Intermediary are set out in paragraph 11 of Annex 1.

Streamlined Approach for Transactions Recommended or Solicited by Licensed Intermediaries

Where Licensed Intermediaries recommend or solicit an investment transaction to or from a Sophisticated Professional Investor, they do not have to:

- match Eligible Investment Transactions with Sophisticated Professional Investors' risk tolerance level, investment objectives and investment horizon;
- assess Sophisticated Professional Investors' knowledge and experience, and concentration risk in Eligible Investment Transactions;
- provide product explanations, except upon request and/or any material queries being raised by Sophisticated Professional Investors. Licensed Intermediaries are required to provide Sophisticated Professional Investors with up-to-date product offering documents, which can be done by sending a hyperlink to the offering documents or sending offering documents as attachments via electronic means (e.g. by email); and
- maintain records documenting the rationale for investment recommendations made to Sophisticated Professional Investors.

Streamlined Approach for Transactions in Complex Products not Recommended or Solicited

The Streamlined Approach that Licensed Intermediaries can adopt for transactions in Complex Products that they do not recommend or solicit is the same as the Streamlined Approach described above for solicited and recommended transactions. However, other than their obligation to provide offering documents to Sophisticated Professional Investors, Licensed Intermediaries performing transactions in Complex Products are relieved from the obligation to perform product due diligence on complex products within the Product Categories specified by Sophisticated Professional Investors. Where bond offering documents are not provided to Sophisticated Professional Investors, Licensed Intermediaries must:

- prepare and provide their own summaries of the bond's key terms and features with reference to the SFC's FAQs on performing product due diligence and disclosing product information for the sale of complex products on an unsolicited basis published on 20 December 2020; or
- provide Sophisticated Professional Investors with sufficient information on the bond's key terms and features based on information available from reliable public domain or data providers. Licensed intermediaries can provide this information in writing or verbally or using a combination of written and verbal communication, provided that a record of the information communicated is kept.

Licensed Intermediaries are also allowed to provide warning statements regarding complex products annually instead of for each individual transaction.

How to Apply the Streamlined Approach

Sophisticated Professional Investor Assessment

Licensed Intermediaries should only apply the Streamlined Approach if they are reasonably satisfied that the relevant Sophisticated Professional Investor meets the financial and knowledge or investment qualifying criteria and is not a conservative investor. The assessment must be in writing and Licensed Intermediaries must keep information and documents obtained during the assessment to demonstrate the basis of the assessment.

Licensed Intermediaries should also keep records of all correspondence with Sophisticated Professional Investors to justify their choice of Product Categories and the Sophisticated Professional Investors' setting of the Streamlining Threshold.

The SFC's FAQs note that provided a Licensed Intermediary makes reasonable efforts to obtain client information during the know-your-client process, it can rely on the information disclosed by the client in determining whether they qualify as a Sophisticated Professional Investor. However, Licensed Intermediaries need to be alert to any inconsistencies between the information provided and that held with the intermediary.⁸

Client Acknowledgement

Before applying the Streamlined Approach to a Sophisticated Professional Investor conducting an Eligible Investment Transaction, Licensed Intermediaries are required to:

- enter into a written agreement with the Sophisticated Professional Investor in which the client acknowledges and consents to being treated as a Sophisticated Professional Investor including in relation to the Streamlined Approach, the Product Categories and the Streamlining Threshold;
- specify in writing the assessment criteria under which the client qualifies as a Sophisticated Professional Investor; and
- specify in writing the Product Categories and the Streamlining Threshold within which investment transactions can be executed under a Streamlined Approach; and
- explain in full the consequences of being treated as a Sophisticated Professional Investor and the client's right to withdraw from being treated as such at any time.

The Consequences of Being Treated as a Sophisticated Professional Investor

The consequences for the client of being treated as a Sophisticated Professional Investor include that:

- the Licensed Intermediary will apply the procedures set out in section (C) of Annex 1 in complying with their suitability obligations when dealing with the Sophisticated Professional Investor in Eligible Investment Transactions;
- the Licensed Intermediary's point-of-sale procedures will be streamlined considering the degree of sophistication and loss absorption ability demonstrated by the Sophisticated Professional Investor, and subject to the Product Categories and Streamlining Threshold specified, a Sophisticated Professional Investor could invest in a portfolio of high risk investment products under a Streamlined Approach on both a solicited and unsolicited basis where the Sophisticated Professional Investor may not be provided with the rationale for recommendations or be given warnings in relation to transactions in complex products;
- by specifying a Product Category within which investment transactions can be executed under a Streamlined Approach, the Sophisticated Professional Investor acknowledges having the degree of sophistication to understand and accept:
 - the characteristics, nature and extent of risks of investment products within a Product Category (as contained in a Product Category Information Statement);
 - their right to raise queries about or request product explanations before each execution; and
 - their right to add or remove a Product Category at any time;
- by specifying a Streamlining Threshold within which investment transactions can be executed under a Streamlined Approach, the Sophisticated Professional Investor acknowledges having the degree of sophistication to understand and accept:
 - the extent of risks (including concentration risks) arising from such executions;
 - that the Streamlining Threshold specified is commensurate with the Sophisticated Professional Investor's personal circumstances (e.g. degree of sophistication and loss absorption ability); and
 - their right to amend the Streamlining Threshold at any time.

Licensed Intermediaries' Annual Review Obligation

Licensed Intermediaries are required to conduct an annual review to ensure that Sophisticated Professional Investors continue to meet the qualifying criteria for treatment as Sophisticated Professional Investors and still agree to the Licensed Intermediary executing investment transactions within the Product Categories and the Streamlining Threshold specified by the Sophisticated Professional Investor under a Streamlined Approach. In conducting their annual review, Licensed Intermediaries are required to remind the client in writing of:

- the consequences of being treated as a Sophisticated Professional Investor;
- the Product Categories specified by the Sophisticated Professional Investor and information about the Product Categories as contained in the Product Category Information Statements;
- the Streamlining Threshold specified by the Sophisticated Professional Investor and any breach of it; and
- the Sophisticated Professional Investor's right to withdraw from being treated as such, to add or remove a Product Category and/or to amend the Streamlining Threshold at any time.

[1] SFC/HKMA. (July 2023). 'Joint circular to intermediaries: Streamlined Approach for compliance with suitability obligations when dealing with sophisticated professional investors' at: <https://apps.sfc.hk/edistributionWeb/gateway/EN/circular/suitability/doc?refNo=23EC35>

[2] SFC. (July 2023) 'Frequently Asked Questions on Streamlined Approach for compliance with suitability obligations when dealing with sophisticated professional investors' at: <https://www.sfc.hk/en/faqs/intermediaries/supervision/Sophisticated-Professional-Investors/Sophisticated-Professional-Investors>

[3] Note to paragraph 5.5 of the SFC Code of Conduct

[4] Ibid. Further guidance on investment products that are considered to be complex and non-complex products is set out on the SFC website at: <https://www.sfc.hk/en/Rules-and-standards/Suitability-requirement/Non-complex-and-complex-products>

[5] S.2 Securities and Futures (Professional Investor) Rules

[6] Ibid.

[7] Paragraph 6 of the SFC/HKMA Joint Circular

[8] FAQ 1

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CHARLTONS
易周律師行

Hong Kong Office

Dominion Centre 12th Floor
43-59 Queen's Road East Hong Kong

enquiries@charltonslaw.com

www.charltonslaw.com
Tel: + (852) 2905 7888
Fax: + (852) 2854 9596