



**SECURITIES AND FUTURES COMMISSION**  
證券及期貨事務監察委員會

## **Consultation Paper on the Proposed Amendments to the Professional Investor Regime and the Client Agreement Requirements**

May 2013



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## Foreword

The Securities and Futures Commission (SFC) invites the public to submit written comments on the proposals discussed in this Consultation Paper, or to comment on related matters that might have a significant impact upon the proposals, **no later than 14 August 2013**.

Any person wishing to submit comments on behalf of any organisation should provide details of the organisation whose views they represent. In addition, respondents who wish to suggest alternative approaches are encouraged to submit the proposed text of possible amendments that would be necessary to incorporate their suggestions.

**Please note that the names of commentators and the contents of their submissions may be published by the SFC on its website and in other SFC documents to be published. In this connection, please read the Personal Information Collection Statement attached to this Consultation Paper.**

**You may not wish your name and / or submission to be published by the SFC. If this is the case, please state that you wish your name and/or submission to be withheld from publication when you make your submission.**

Written comments may be sent

By mail to: Intermediaries Supervision Department  
Securities and Futures Commission  
35/F, Cheung Kong Center  
2 Queen's Road Central  
Hong Kong

By fax to: (852) 2284 4660

By on-line submission: <http://www.sfc.hk>

By e-mail to: [pi\\_client\\_agreement@sfc.hk](mailto:pi_client_agreement@sfc.hk)

All submissions received before expiry of the consultation period will be taken into account before the proposals are finalised and a consultation conclusions paper will be published in due course.



## Personal information collection statement

1. This Personal Information Collection Statement (PICS) is made in accordance with the guidelines issued by the Privacy Commissioner for Personal Data. The PICS sets out the purposes for which your Personal Data<sup>1</sup> will be used following collection, what you are agreeing to with respect to the SFC's use of your Personal Data and your rights under the Personal Data (Privacy) Ordinance (Cap. 486) (PDPO).

### Purpose of collection

2. The Personal Data provided in your submission to the SFC in response to this consultation paper may be used by the SFC for one or more of the following purposes:
  - (a) to administer the relevant provisions<sup>2</sup> and codes and guidelines published pursuant to the powers vested in the SFC;
  - (b) in performing the SFC's statutory functions under the relevant provisions;
  - (c) for research and statistical purposes;
  - (d) for other purposes permitted by law.

### Transfer of personal data

3. Personal Data may be disclosed by the SFC to members of the public in Hong Kong and elsewhere, as part of the public consultation on this consultation paper. The names of persons who submit comments on this consultation paper together with the whole or part of their submission may be disclosed to members of the public. This will be done by publishing this information on the SFC's website and in documents to be published by the SFC during the consultation period or at its conclusion.

### Access to data

4. You have the right to request access to and correction of your Personal Data in accordance with the provisions of the PDPO. Your right of access includes the right to obtain a copy of your Personal Data provided in your submission on this consultation paper. The SFC has the right to charge a reasonable fee for processing any data access request.

### Retention

5. Personal Data provided to the SFC in response to this consultation paper will be retained for such period as may be necessary for the proper discharge of the SFC's functions.

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<sup>1</sup> Personal Data means personal data as defined in the Personal Data (Privacy) Ordinance (Cap. 486).

<sup>2</sup> Defined in Section 1 of the Securities and Futures Ordinance (Cap. 571) (**SFO**) to mean provisions of the SFO and subsidiary legislation made under it; an provisions of Parts II and XII of the Companies Ordinance (Cap. 32) so far as those Parts relate directly or indirectly, to the performance of functions relating to: prospectuses; the purchase by a corporation of its own shares; a corporation giving financial assistance for the acquisition of its own shares etc.



## Enquiries

6. Any enquiries regarding the Personal Data provided in your submission on this consultation paper, or requests for access to Personal Data or correction of Personal Data, should be addressed in writing to:

The Data Privacy Officer  
Securities and Futures Commission  
35/F, Cheung Kong Center  
2 Queen's Road Central  
Hong Kong

7. A copy of the Privacy Policy Statement adopted by the SFC is available upon request.



## Executive Summary

1. In late 2011, at a Legislative Council (**LegCo**) session to deliberate the revised Professional Investor Rules<sup>3</sup>, the SFC undertook to conduct a comprehensive review of the current professional investor regime to determine whether it should be further refined, streamlined or improved.
2. For the purpose of this review, the SFC has scrutinised the existing professional investor regime by asking the following fundamental questions: For what purposes was this regime originally designed? Are these purposes still valid now? How to differentiate those investors who may not require full protection under our regulatory regime? Under what circumstances and to what extent should the legal and regulatory requirements be relaxed when an intermediary (i.e., licensed corporations and registered institutions being banks which conduct securities business) deals with this particular class of investors?
3. Based on this review, the SFC has endeavoured to make proposals which take into account industry views about the existing regulatory requirements but without compromising investor protection.
4. Separately, in light of recent findings in a thematic inspection report<sup>4</sup> published by the SFC last year, this review examines how other investor protection measures (specifically the minimum contents of client agreements under the Code<sup>5</sup>) may be enhanced.

## The professional investor regime

### Private placement activities

5. “Private placement” refers to offerings where the marketing documentation does not require authorization by the SFC.
6. These relaxations may give rise to concerns that some investors eligible to take part in private placements as “professional investors” are nevertheless vulnerable because the extent and quality of information disclosure is not subject to the regulatory standards which are equivalent to a public offering.
7. “Professional investors” is a defined term under the Securities and Futures Ordinance. It includes institutional professional investors<sup>6</sup> as well as those investors who have wealth above the monetary thresholds (i.e., the \$8 million minimum portfolio threshold for individuals and corporations or the \$40 million minimum total assets threshold for corporations) set out in the Professional Investor Rules<sup>7</sup>.

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<sup>3</sup> Securities and Futures (Professional Investor) Rules, (Cap. 571D)

<sup>4</sup> Please refer to the Report on the Thematic Inspection of Selling Practices of Licensed Corporations issued by the SFC in October 2012.

<sup>5</sup> Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission

<sup>6</sup> Paragraphs (a)-(i) of the definition of “professional investor” under Schedule 1 to the Securities and Futures Ordinance. These include the likes of licensed corporations, banks and insurance companies.

<sup>7</sup> These investors are: - (a) any individual who (either alone or with his/her spouse and child on a joint account) has a portfolio of not less than \$8 million; (b) any trust corporation having been entrusted with total assets of not less than \$40 million; (c) any corporation or partnership having (i) a portfolio of not less than \$8 million; or (ii) total assets of not less than \$40 million; (d) any corporation the sole business of which is to hold investments and is wholly owned by any one or more of (a), (b) or (c) above.



8. Institutional professional investors are mainly financial institutions which are highly sophisticated in the financial markets. The SFC believes they should continue to have access to the private placement market. The question is whether others who qualify as professional investors solely based on having wealth above a monetary threshold can be taken to have the knowledge and investment experience to evaluate an investment where marketing materials and related documentation are not regulated as in a public offering.
9. The SFC notes that other overseas jurisdictions, including the United States, Australia and Singapore, allow access by investors to the private placement market solely by reference to wealth criteria. Furthermore, it is well recognised that the industry greatly values having continuous access to this sector of the market for fund raising purposes.
10. The SFC wishes to seek views as to whether, and what, further measures should be introduced so as to better protect the interest of persons qualifying as professional investors in the private placement market based solely on wealth above a monetary threshold.

#### Intermediaries' conduct regulation

11. The regulatory framework in Hong Kong governing the conduct of intermediaries, which applies to both licensed corporations and banks that conduct securities business, is set out in the Code; the Management, Supervision and Internal Control Guidelines<sup>8</sup> and other circulars and FAQs that are issued from time to time. All these requirements must be observed by intermediaries when providing services to clients, subject to some limited exemptions.
12. For instance, under the current regime, intermediaries are automatically entitled to certain Code exemptions including the exemption from the important Suitability Requirement<sup>9</sup> when dealing with institutional professional investors. Institutional professional investors are considered to be sufficiently financially sophisticated to warrant these exemptions.
13. Intermediaries currently can also be exempt from the same Code requirements when dealing with other professional investors who have wealth above the monetary thresholds set out under the Professional Investor Rules and who also have been assessed to have sufficient knowledge and investment experience. These investors must also have given their consent to the exemptions.
14. Most selling misconduct cases involve individual investors. There is a concern as to whether it is still valid to attempt to segregate individuals into a professional and a non-professional class for the purpose of exempting intermediaries from their Code requirements.
15. The SFC therefore proposes to amend the current Code so that exemptions would not be available to intermediaries serving individual professional investors. Intermediaries would then have to comply with all Code requirements, including the Suitability Requirement, when dealing with all individual professional investors. The SFC also

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<sup>8</sup> The Management, Supervision and Internal Control Guidelines for Persons Licensed by or Registered with the Securities and Futures Commission

<sup>9</sup> The Suitability Requirement refers to the requirement to ensure that the suitability of a recommendation of an investment product for a client or a solicitation is reasonable in all circumstances. Please see Appendix B for details.



proposes to offer the same protection to corporations that operate as investment vehicles wholly owned by individuals and by family trusts.

16. Corporations, which have dedicated experienced investment personnel who make investment decisions – often as part of corporate treasury functions, have similarities with institutional professional investors even though they may operate different businesses. The SFC considers that intermediaries should continue to enjoy the same Code exemptions when dealing with such corporations, provided that they are assessed as being sufficiently knowledgeable and experienced.
17. It is proposed that an intermediary should exercise its own judgement in assessing a corporation's knowledge and investment experience by considering the corporate structure and investment process of the corporation and the background of relevant personnel, including their investment experience and risk awareness. Bright-line tests, for example, the number of transactions per annum and years of activeness in the relevant market, may not be good indicators of knowledge and investment experience if taken in isolation. The SFC wishes to seek views on this principles-based approach.

#### Summary of key proposals

18. The key proposals can be summarised as follows:
  - (a) No proposed change to the access to private placements by professional investors, but the SFC nevertheless seeks views on whether corporate and individual professional investors should continue to be allowed to participate in private placement activities and whether the monetary thresholds set out in the Professional Investors Rules should be increased;
  - (b) A requirement that intermediaries must comply with all Code requirements (including the Suitability Requirement) when dealing with all investors who are individuals, their wholly owned investment vehicles and investment vehicles that are wholly owned by family trusts;
  - (c) For institutional professional investors, the SFC proposes to maintain the current position so that intermediaries dealing with them are automatically entitled to all current Code exemptions<sup>10</sup>; and
  - (d) For professional investors that are corporations, the SFC proposes that intermediaries can continue to be exempt from the Suitability Requirement and other current Code exemptions after conducting a principles-based assessment of knowledge and investment experience and obtaining their consent etc.

#### **The Suitability Requirement**

19. The Suitability Requirement is a cornerstone of investor protection. Given that the Suitability Requirement is so core and important in the whole regulatory regime, the SFC wishes to seek views on the Suitability Requirement.

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<sup>10</sup> Please refer to paragraph 48 below.





## **Client agreement requirements**

20. Separately, the SFC proposes that amendments be made to the client agreement requirements in the Code.
21. Whilst the Suitability Requirement is a key investor protection measure, the requirement is regulatory and the SFC cannot require the intermediary to pay compensation to aggrieved clients. Nor do such breaches, of themselves, enable clients of an intermediary to claim compensation or bring any other claims. Further, some intermediaries include clauses in client agreements which are designed to restrict the ability of clients to successfully seek compensation by mis-describing the actual services to be provided.
22. In order to address the concerns mentioned above, the SFC proposes, in summary, that (1) the Suitability Requirement should be incorporated into client agreements as a contractual term; and (2) client agreements should not contain terms which are inconsistent with the Code and should accurately set out in clear terms the actual services to be provided to the client.



## Part A – Current regulatory framework for the sale of investments

23. The professional investor regime is part of a much broader regulatory framework governing the sale of investments in Hong Kong including the private placement market, the Suitability Requirement and other conduct requirements. The SFC sets out in this Part background information on how the existing law and regulations offer protection to investors and how the professional investor regime operates. As professional investors, as with other investors, may be offered different types of services in their dealings with intermediaries, this Part also explains the different application of the regulatory requirements to different types of services.
24. Details of the current regulatory framework are set out in this Part, arranged in the following sections:-
- (a) Overview of the regulatory structure
    - (i) The first pillar - product disclosure
    - (ii) The second pillar - conduct regulation and the Suitability Requirement
  - (b) Application of legal and regulatory requirements to different classes of investors in Hong Kong
    - (i) How the Professional Investor regime operates
  - (c) Application of regulatory requirements (in particular, the Suitability Requirement) to different types of services provided by intermediaries
    - (i) Advisory services – transaction-by-transaction advisory services
    - (ii) Advisory services – discretionary portfolio management services
    - (iii) Non-advisory services

### I. Overview of the regulatory structure

25. The regulatory structure in Hong Kong for the sale of investments rests on two pillars – disclosure of information and conduct regulation of intermediaries that are required to ensure the suitability of each recommendation or solicitation made to the investor. The first pillar requires offering documents of all retail investments (i.e., public offerings) to contain adequate and accurate disclosures for investors to make informed decisions. The second pillar requires intermediaries to ensure the suitability of any solicitation or recommendation made regarding an investment.
26. In respect of reviewing the product disclosure aspect of the regulatory framework, certain types of offers were specified to be exempt from the prospectus regime<sup>11</sup> in the Companies Ordinance (Cap. 32) (CO) in 2004 so as to facilitate offers of shares and debentures<sup>12</sup>. The regulation of structured products was further transferred from the

<sup>11</sup> Please refer to paragraph 27 for the meaning of the “prospectus regime”.

<sup>12</sup> Please refer to the Consultation Paper on Proposed Amendments to the Companies Ordinance to Facilitate Offers of Shares and Debentures issued by the Financial Services and the Treasury Bureau and the SFC in March 2003 and the relevant consultation conclusions issued in November 2003.



prospectus regime to the offers of investments regime<sup>13</sup> in the Securities and Futures Ordinance (Cap. 571) (SFO) in 2011<sup>14</sup>. Regarding conduct regulation, the last review was conducted in 2009<sup>15</sup> and concluded in 2010<sup>16</sup>. This focused on improving investor protection measures including key facts statements in offering documents, the introduction of a cooling-off period for sales of investment products, requiring intermediaries to disclose the benefits they receive from issuers for distributing investment products and restricting intermediaries from offering gifts to promote an investment product. In 2010<sup>17</sup>, the SFC consulted on amendments to evidential requirements under the Professional Investor Rules, which was concluded in 2011<sup>18</sup>.

## **Ia. The first pillar - product disclosure**

27. In public offerings, offering documents must contain prescribed information and be authorized by the SFC unless an exemption applies. Under the existing legislation, the requirements for authorization of offering documentation governing the public offerings of shares and debentures, etc., are set out in the CO (i.e., the prospectus regime) and the authorization requirements governing offering documentation of structured products and collective investment schemes are set out in the SFO (i.e., the offers of investments regime).
28. The disclosure standards are set out in the CO and the SFC Handbook for Unit Trusts and Mutual Funds, Investment-Linked Assurance Schemes and Unlisted Structured Investment Products respectively. The relevant disclosure documents should contain sufficient particulars and information necessary for investors to make an informed investment decision. For structured products and collective investment schemes offered to the public, product summaries in the form of Product Key Fact Statements are also required.
29. Where an exemption applies to an offering, the offering documents need not be authorized by the SFC. Under both the prospectus regime and the offers of investments regime, an exemption is available to offers made to professional investors (please see paragraph 41 below for details of “professional investors”). Other exemptions under the prospectus regime but not under the offers of investments regime<sup>19</sup> include offers made to not more than 50 persons and offers where the minimum consideration payable by any person for shares or debentures is not less than \$500,000. All these are examples of private placement activities. The extent and quality of information disclosed in marketing documentation in private placement activities is not subject to the regulatory standards which are equivalent to a public offering.

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<sup>13</sup> Please refer to paragraph 27 for the meaning of the “offers of investments regime”.

<sup>14</sup> Please see footnote 19 for details.

<sup>15</sup> Please refer to the Consultation Paper on Proposals to Enhance Protection for the Investing Public issued by the SFC in September 2009.

<sup>16</sup> Please refer to the Consultation Conclusions on Proposals to Enhance Protection for the Investing Public issued by the SFC in May 2010.

<sup>17</sup> Please refer to the Consultation Paper on the Evidential Requirements under the Securities and Futures (Professional Investor) Rules issued by the SFC in October 2010.

<sup>18</sup> Please refer to the Consultation Conclusions on the Evidential Requirements under the Securities and Futures (Professional Investor) Rules issued by the SFC in February 2011.

<sup>19</sup> As a result of the transfer of the regulation of public offers of structured products from the prospectus regime to the offers of investments regime in 2011, certain exemptions under the prospectus regime (e.g., offers made to not more than 50 persons and offers where the minimum consideration payable by any person for the shares or debentures is not less than \$500,000) are no longer applicable to offers of structured products. The SFC consulted on such transfer in October 2009 and published its consultation conclusions in April 2010. Please refer to the Consultation Paper on Possible Reforms to the Prospectus Regime in the Companies Ordinance and the Offers of Investments Regime in the Securities and Futures Ordinance issued by the SFC in October 2009 and the relevant consultation conclusions issued by the SFC in April 2010.



## **Ib. The second pillar - conduct regulation and the Suitability Requirement**

30. The regulatory framework governing the conduct of intermediaries (i.e., licensed corporations and registered institutions being banks which conduct securities business) is set out in the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (the **Code**), the Management, Supervision and Internal Control Guidelines for Persons Licensed by or Registered with the Securities and Futures Commission and other circulars or FAQs that are issued from time to time. They are relevant to all intermediaries and to all services they provide to clients regardless of whether offering or marketing documents are exempt from authorization by the SFC.
31. Under the Code, intermediaries are required to comply with a series of general principles (**General Principles**), which are augmented by specific requirements. General Principles are fundamental. For example, under General Principle 1, an intermediary is required, in conducting its business activities, to act honestly, fairly and in the best interests of its clients and the integrity of the market. Under General Principle 2, an intermediary is also required, in conducting its business activities, to act with due skill, care and diligence.
32. These General Principles set the standards which intermediaries should meet in carrying out the business for which they are licensed or registered and must be observed by them.
33. More detailed requirements are also set out under the Code. For instance the “know your client” process is designed to ensure intermediaries understand the circumstances and needs of their clients and provide services best suited to their clients. Intermediaries are therefore required to take all reasonable steps to establish the financial situation, investment experience and investment objectives of their clients.

### The requirement to ensure suitability

34. Paragraph 5.2 of the Code further sets out the key investor protection requirement on intermediaries to, when making a recommendation or solicitation, ensure that the suitability of the recommendation or solicitation for the client is reasonable in all the circumstances (i.e., the **Suitability Requirement**). The Suitability Requirement is a cornerstone of investor protection; similar requirements exist in all other major jurisdictions. Details of the Suitability Requirement are set out in Appendix B to this Consultation Paper.

### Intermediaries’ conduct – disclosure prior to or at the point of sale<sup>20</sup>

35. Under General Principle 5, an intermediary should make adequate disclosure of relevant material information in its dealings with its clients.
36. In particular, to address any potential or perceived conflicts of interest, where intermediaries are remunerated by the issuers of investment products for distributing their investment products, intermediaries are required to disclose to clients the benefits they receive from the sale of products that they recommend. Also, intermediaries are required to disclose to their clients the capacity in which they act (principal or agent) and their affiliations with the issuer.

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<sup>20</sup> In complying with the Suitability Requirement, intermediaries must meet the documentation standards of the Suitability Requirement, which, amongst others, involve providing certain documentation to clients prior to or at the point of sale. Please refer to Appendix B for details.



## Intermediaries' conduct – disclosure after the selling process

37. Upon effecting transactions for clients, intermediaries are required to confirm promptly with clients the essential features of the transactions. Intermediaries are also required to provide to clients, subject to the exemption set out in paragraph 47 below, contract notes and statements of account pursuant to the Securities and Futures (Contract Notes, Statements of Account and Receipts) Rules (**Contract Notes Rules**).
38. Where an intermediary is a distributor of an investment product and it, or its nominee holds the investment product on behalf of its clients, it should disseminate or procure the dissemination of notices and other communications concerning the investment product to its clients on a timely basis upon receipt of the notices<sup>21</sup>.

## **II. Application of legal and regulatory requirements to different classes of investors in Hong Kong**

39. Intermediaries must comply with all relevant legal and regulatory requirements in dealing with all types of investors except where an exemption applies for professional investors.
40. The concept of professional investors was first introduced to the Code in 2001 to enable intermediaries dealing with wealthy and sophisticated investors to operate without the need to comply with requirements designed to protect retail investors, but without compromising investor protection. The concept is also used in the SFO to, inter alia, enable issuers to raise funds in the private placement market.
41. The term “professional investor” is defined under the SFO and the Professional Investor Rules. The entities specifically identified under the SFO as Professional Investors<sup>22</sup> include the likes of banks, licensed corporations and insurance companies (referred to as **Institutional Professional Investors** in this Consultation Paper). They can be taken to be financially sophisticated. Those defined as Professional Investors under the Professional Investor Rules are entities or individuals, who may or may not be financially sophisticated but which meet minimum monetary portfolio or asset thresholds specified under the Professional Investor Rules. These include:-
  - (a) any individual who (either alone or with his/her spouse or child on a joint account) has a portfolio of not less than \$8 million; (referred to as **Individual Professional Investors** in this Consultation Paper);
  - (b) any trust corporation having been entrusted with total assets of not less than \$40 million;
  - (c) any corporation or partnership having (i) a portfolio of not less than \$8 million; or (ii) total assets of not less than \$40 million; and
  - (d) any corporation the sole business of which is to hold investments and is wholly owned by any one or more of (a), (b) or (c) above.

The entities in (b) to (d) above are collectively referred to as “**Corporate Professional Investors**” in this Consultation Paper.

<sup>21</sup> Please refer to the circular issued by the SFC “Circular to Licensed Corporations and Registered Institutions - Obligations Relating to Selling / Distribution of Investment Products” on 28 May 2010.

<sup>22</sup> Paragraphs (a)-(i) of the definition of “professional investor” under Schedule 1 to the SFO.



42. Accordingly, those classified as Professional Investors can either be institutional (and financially sophisticated) or can qualify based on monetary thresholds only.
43. There may be some concern about the terminology used in this area. For example, there is no assurance that investors who meet the monetary thresholds under the Professional Investor Rules are in reality financially sophisticated to be regarded as truly “professional” investors. However, any proposal to alter this terminology will involve amending the Professional Investor Rules, the SFO and the CO. The SFC would therefore prefer to concentrate on the substance of this classification rather than its form or labelling.
44. Investors other than those eligible to be classified as Professional Investors represent the vast majority of the investing public and are conventionally referred to as “retail”. Under the current regime, intermediaries dealing with Professional Investors can operate under lighter legal and regulatory requirements when compared with retail investors on the assumption that Professional Investors are in a better position to protect their own interests or have sufficient resources to absorb greater risk and therefore require less regulatory protection than retail investors.

## **Ila. How the Professional Investor regime operates**

45. Professional Investors can be offered investments in private placements where the offering or marketing documents need not comply with the SFC authorization requirements, as discussed in paragraphs 27 – 29 above. The legal restrictions on the making of unsolicited calls and the communication of an offer in relation to securities also do not apply to intermediaries when such calls or communications are made to Professional Investors<sup>23</sup>.
46. If private placements are made through intermediaries who are subject to the Code, all Code requirements governing the conduct of intermediaries would still apply, subject to the exemptions listed in paragraph 48 below if applicable.
47. In relation to disclosure requirements following the selling process, an intermediary can be exempt from the requirements of the Contract Notes Rules when serving a client who is a Professional Investor and where the client has agreed in writing<sup>24</sup>.
48. The Code requirements that may be dis-applied when intermediaries serve Professional Investors are:-
  - (a) the Suitability Requirement;
  - (b) the need to establish a client's financial situation, investment experience and investment objectives;
  - (c) the need to characterize a client based on his knowledge of derivatives;
  - (d) the need to disclose certain sales related information;

<sup>23</sup> Sections 174 and 175 of the SFO respectively.

<sup>24</sup> There are differences in the application of the exemption from the Contract Notes Rules for clients who are Corporate and Individual Professional Investors and clients who are Institutional Professional Investors. For clients who are Corporate or Individual Professional Investors, the intermediary must agree with its clients in writing that the clients agree not to receive from the intermediary contract notes, statements of account or receipts (as the case may be) in accordance with the Contract Notes Rules (section 3(2)(b) of the Contract Notes Rules). For clients who are Institutional Professional Investors, intermediaries only need to notify such clients in writing and no explicit consent is required (section 3(2)(a) of the Contract Notes Rules).



- (e) the need to enter into a written agreement and the provision of relevant risk disclosure statements;
- (f) for discretionary accounts, the need to obtain from the client an authority in written form prior to effecting transactions for the client without his specific authority, the need to explain the authority and the need to confirm it on an annual basis;
- (g) the need to inform the client about the identity and status of its employees and others acting on its behalf;
- (h) the need to confirm promptly with the client the essential features of a transaction after effecting a transaction for a client; and
- (i) the need to provide the client with documentation on the Nasdaq-Amex Pilot Program. (This requirement only applies to a very limited number of investors.)

49. The Code requirements set out above provide important information to clients and also operate as effective investor protection measures. Some or all may, however, be considered unnecessary or inappropriate where the client is a non-Individual Professional Investor. For example, while it is necessary for an intermediary to enter into written agreements in compliance with paragraph 6 of the Code with its retail investor clients, Institutional Professional Investors invariably negotiate individual client agreements with intermediaries and the contents of which may not meet the minimum content requirements under paragraph 6 of the Code.
50. Further, to cater for the differences between Institutional, Corporate and Individual Professional Investors, the circumstances under which these exemptions are available vary as follows.

#### Institutional Professional Investors

51. Institutional Professional Investors include financial institutions (such as licensed corporations, banks and insurance companies) whose day-to-day business involves substantial dealings in the financial markets.
52. Intermediaries serving Institutional Professional Investors are automatically exempt from complying with all the Code requirements set out in paragraph 48 above.

#### Corporate and Individual Professional Investors

53. Corporate and Individual Professional Investors may also be financially sophisticated, but the mere fact that they qualify under specified monetary thresholds is no guarantee or assurance of sophistication. Accordingly, the availability of Code exemptions<sup>25</sup> is not automatic for intermediaries serving Corporate and Individual Professional Investors.
54. Under the current regime, intermediaries are required to conduct an assessment for each Corporate and Individual Professional Investor to determine whether he is sufficiently knowledgeable and experienced in relevant products and markets if the exemptions are to apply (the **Knowledge and Experience Assessment**). The SFC has set out the

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<sup>25</sup> Please refer to paragraph 48 above.



following factors as relevant considerations (**Relevant Factors**), however, intermediaries are not expected to apply these criteria rigidly:-

- (a) the type of products in which the person has traded;
- (b) the frequency and size of trades (not less than 40 transactions per annum);
- (c) the person's dealing experience (active in the relevant market for at least 2 years);
- (d) the person's knowledge and expertise in the relevant products; and
- (e) his awareness of the risks involved in trading in the relevant products and/or markets.

- 55. Further, an intermediary is required to comply with other procedural steps which include obtaining consent from the client to be treated as a Professional Investor, and explaining the implications of this. The intermediary must also inform the client of the right to revoke this consent at any time.
- 56. The SFC understands from the industry that the Knowledge and Experience Assessment is not used frequently; intermediaries doubt that many clients are in practice able to meet the Relevant Factors.

### **III. Application of regulatory requirements (in particular, the Suitability Requirement) to different types of services provided by intermediaries**

- 57. Typically, intermediaries provide either advisory services or non-advisory services to retail investors as well as Professional Investors.
- 58. Advisory services can generally be split into two types: transaction-by-transaction advisory services and discretionary portfolio management services. Although discretionary portfolio management services can be provided to all clients, they are, in practice, usually offered to wealthier clients. The majority of clients are provided with transaction-by-transaction advisory services.
- 59. Whenever intermediaries provide advisory services, the Suitability Requirement must be observed. It is, however, applied differently.

#### **IIIa. Advisory services - transaction-by-transaction advisory services**

- 60. Before recommending an investment to a client, an intermediary would need to make an assessment to ensure that it is suitable for the client taking into account the client's personal circumstances. The intermediary would gather information about the background, knowledge, investment experience and investment objectives of the client through a "know your client" process and would also need to conduct product due diligence to ensure that the intermediary has a thorough understanding of the investment being recommended.
- 61. Recommendations would then be made on a transaction-by-transaction basis, and the intermediary would seek the client's approval before buying or selling each product.
- 62. Intermediaries must also provide clients with copies of the rationale underlying each investment.





### **IIIb. Advisory services – discretionary portfolio management services**

63. When conducting discretionary portfolio management services, an intermediary is authorized by a client to manage his investments and make investment decisions on his behalf. The intermediary should have regard to the personal circumstances of the client and ensure that all investments as well as the overall portfolio are suitable for the client. Discretionary portfolio management services are many and varied. For example, some intermediaries would agree a bespoke investment strategy with a client in writing, some would allow their clients to place limits on the intermediary in managing the client's investment portfolio, and some may offer a choice of pre-set investment strategies to their clients to choose from.
64. In all cases an investment mandate must be agreed between an intermediary and the client at the outset. The intermediary must ensure that all discretionary trades are reasonable in all the circumstances, and should only act within the mandate.
65. Intermediaries do not need to obtain prior client approval for each transaction or to inform them of each transaction carried out under a discretionary mandate. It is therefore unnecessary to provide clients with copies of the rationale of each transaction.
66. It is common in Hong Kong for intermediaries to agree discretionary portfolio mandates with clients but still seek clients' approval before executing investment decisions. These accounts should in substance be dealt with as transaction-by-transaction advisory.
67. Separately, the Hong Kong Monetary Authority (**HKMA**) has introduced a Private Banking Customer (**PB Customer**) concept applicable to banks and has provided guidance to facilitate adoption of a "portfolio-based" approach as an alternative to a transaction-by-transaction basis in conducting suitability assessments adopted for private banks<sup>26</sup>, which is very similar to discretionary portfolio management services that other intermediaries provide. The SFC wishes to make clear that the Suitability Requirement applies to all intermediaries (i.e., licensed corporations and banks) irrespective of the type of advisory services provided, and its operation is independent of the PB Customer concept. Indeed, HKMA has explicitly set out in a circular<sup>27</sup> that banks should conduct suitability assessments when providing private banking services, whether or not they involve discretionary portfolio management services.
68. The SFC is also aware that there may be a misconception that once an investor is a PB Customer, he is also a Professional Investor and the bank serving the PB Customer needs not comply with the Suitability Requirement. The SFC wishes to emphasise that an intermediary can only be exempt from complying with the Suitability Requirement when serving an investor who is a Professional Investor and has been assessed to be sufficiently knowledgeable and experienced under paragraph 15 of the Code, and has given his consent to be treated as a Professional Investor under the Code.

### **IIIc. Non-advisory services**

69. Under this heading, intermediaries do not provide investment advice to clients but merely accept instructions from clients and carry out the instructions accordingly.

<sup>26</sup> For details, please refer to the circular issued by HKMA on 20 January 2012, "Applicability of Enhanced Measures to Sales of Investment Products to Private Banking Customers". Please also refer to HKMA's circular of 12 June 2012, "Selling of Investment Products to Private Banking Customers" for the latest definition of a "private banking customer".

<sup>27</sup> Please refer to the circular issued by HKMA on 12 June 2012, "Selling of Investment Products to Private Banking Customers".



70. As the Suitability Requirement is only triggered when an intermediary makes a “recommendation” or “solicitation”, it has no application. Intermediaries providing non-advisory services, nevertheless, must comply with all other applicable conduct requirements, including the General Principle to act honestly, fairly, with due skill, care and diligence and in the best interests of clients and the integrity of the market. Paragraph 5.3 of the Code also applies; the intermediary is required to assure itself, when providing services to clients in derivative products, that the clients understand the products and have sufficient net worth to assume the risks and bear the potential losses of trading in those products.
71. The Code prescribes further requirements for retail investors without derivatives knowledge and who wish to transact in derivative products in the circumstance where intermediaries have not solicited or provided recommendations to such investors. The intermediary is required to warn the investor and to provide appropriate advice and if the transaction is assessed to be unsuitable, it may only proceed to effect the transaction if to do so would be acting in the best interests of the client in accordance with the General Principles of the Code.
72. Whether services provided to clients are in substance non-advisory can only be determined based upon an evaluation of the actual services provided. Client agreements describing services as ‘non-advisory’ would have no effect on the operation of relevant Code obligations if, in fact, advisory services are provided.



## **Part B – Issues relevant to the Professional Investor regime and proposed enhancements to the Professional Investor regime**

### **I. Purpose of the Professional Investor regime**

73. The primary purposes of the Professional Investor regime are to (a) enable intermediaries to dis-apply certain Code requirements (in particular the Suitability Requirement) when dealing with wealthier and sophisticated investors; and (b) enable issuers to raise funds through private placements.
74. The SFC believes that Professional Investors should continue to be allowed to participate in private placement activities if they meet prescribed monetary thresholds; this is the stance taken in major overseas jurisdictions. Those participating in private placements may opt to do so via intermediaries (or decide not to participate in the absence of an intermediary), and in that case they will still be covered by the investor protection requirements of the Code.
75. It therefore appears that the principal question is how to delineate different classes of investors to assure that the appropriate classes are adequately protected under the Code.

### **II. Who within the Professional Investors categorisation needs protection**

#### Private placement

76. Given that information disclosure in private placements is not subject to mandatory contents requirements equivalent to a public offering or authorization by the SFC, there may be a concern that investors may not be in a position to make informed investment decisions. Professional Investors who qualify solely by meeting the prescribed monetary thresholds under the Professional Investor Rules (i.e., Corporate and Individual Professional Investors) might not in practice be financially sophisticated and could be vulnerable.
77. Nevertheless, the private placement route is well established and other overseas jurisdictions, including the United States, Australia and Singapore, allow investors to access private placements solely by reference to wealth criteria. Moreover, as mentioned above, the private placement route does not preclude the involvement of intermediaries as distributors or advisors subject to the Code. We also understand that it is normal for private placement memoranda, subscription agreements and related transaction documentation to create rights and obligations between issuers and investors in private placements, and these usually cover disclosure by the issuer.
78. The SFC seeks views on whether any changes should be made in this regard.

#### **Question 1: Should Corporate and Individual Professional Investors continue to be allowed to participate in private placement activities?**

79. If Corporate and Individual Professional Investors are to continue to have access to the private placement market, one possible investor protection enhancement is to add the Knowledge and Experience Assessment into the Professional Investors Rules so that the monetary thresholds are not the only qualification criteria. This suggestion was made by some LegCo members in 2011. The SFC has further studied this proposal and has decided against adopting it for the following reasons:



- (a) Australia is a major overseas jurisdiction where a principles-based assessment for classifying investors as a type of professional investor<sup>28</sup> is a legal obligation<sup>29</sup>. This involves assessing a client's previous experience in using financial services and investing in financial products. According to a paper issued by the Australian Treasury, feedback from the financial industry in Australia indicates that this has not been well-received due to the potential liability associated with administering a subjective test<sup>30</sup>. Given that intermediaries are vulnerable to legal liability if they have incorrectly classified a client as a professional investor, the assessment is rarely conducted<sup>31</sup> and therefore most clients are not treated as professional investors via this route.
- (b) There is no objective one-size-fits-all criterion that can cater for differences in the profiles of knowledgeable and experienced investors. There are many routes by which an investor can acquire knowledge and investment experience in products and markets and any attempt to specify these in legislation could be unduly restrictive.
- (c) The SFC is of the view that a principles-based assessment, when conducted correctly, is more effective than rigid statutory criteria to identify investors who possess sufficient knowledge, expertise and investment experience.

80. Another measure is to increase the current minimum monetary thresholds which have remained unchanged since 2003. This was also suggested by LegCo members in 2011. Industry deputations commented that the existing minimum portfolio requirement of \$8 million was comparable to other jurisdictions, should be maintained, and that any excessive increase in the minimum portfolio requirement would adversely affect private placement activities in Hong Kong. The SFC also pointed out that the \$8 million minimum portfolio threshold for Individual Professional Investors is already higher than that in the United Kingdom (though lower than that in Australia and Singapore<sup>32</sup>) and a recent consultation had concluded that this should be maintained<sup>33</sup>.

81. The SFC nevertheless welcomes views on whether the \$8 million minimum portfolio threshold for individuals and corporations and the \$40 million minimum total assets threshold for corporations should be increased.

**Question 2: Do you think that the minimum monetary thresholds for Corporate and Individual Professional Investors should be increased?**

82. Incidentally, one LegCo member suggested that the SFC should license Professional Investors. The overwhelming industry feedback in response to this suggestion was not in favour as it was thought that very few clients would wish to apply to be licensed. The SFC has decided not to proceed with this suggestion.

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<sup>28</sup> Investors may be classified as professional investors in Australia according to other criteria such as wealth only. Please refer to the international comparison table set out in Appendix C for more details.

<sup>29</sup> Corporations Act 2001 ss761GA and 708(10)

<sup>30</sup> Pages 21 and 23, Wholesale and Retail Clients – Future of Financial Advice Options Paper issued by the Treasury of the Australian Government in January 2011

<sup>31</sup> Same as above.

<sup>32</sup> Please refer to the international comparison table set out in Appendix C for more details.

<sup>33</sup> Please refer to the Consultation Conclusions on Proposals to Enhance Protection for the Investing Public issued by the SFC in May 2010 for details.



## Conduct regulation

83. The SFC has also reviewed the current Code requirements for intermediaries serving Professional Investors which, in this context covers Institutional, Corporate and Individual Professional Investors-- different regulatory requirements apply to each.
84. Intermediaries dealing with Institutional Professional Investors are automatically exempt from complying with all the Code requirements set out in paragraph 48 above.
85. The SFC does not propose any changes to the exemptions applicable to Institutional Professional Investors.
86. Corporate and Individual Professional Investors, on the other hand, can decide on the level of investor protection they require when dealing with intermediaries. They can opt for full protection under the Code including the obligation for the intermediary to comply with the Suitability Requirement by refusing consent to be treated as a Professional Investor under the Code<sup>34</sup> even if they have been assessed to have sufficient knowledge, expertise and investment experience – or by withdrawing their consent subsequently.
87. The SFC is of the view that this optionality, together with the obligation on intermediaries to conduct the Knowledge and Experience Assessment (as discussed in paragraphs 54) prior to dis-applying requirements under the Code<sup>35</sup>, remains an appropriate framework, subject to the observations in paragraphs 88 - 96 below.
88. Given that the vast majority of mis-selling cases dealt with by the SFC involve individual investors, the SFC is of the view that, in general Individual Professional Investors merit greater protection than Corporate Professional Investors.
89. The United Kingdom and the United States do not allow the dis-application of suitability requirements when intermediaries deal with individuals, no matter how wealthy they may be:-
  - (a) In the United States, the requirement to ensure the suitability of investments cannot be waived when dealing with non-institutional professional investors; and
  - (b) In the United Kingdom, while there are some specific relaxations when dealing with professional investors who are individuals, intermediaries must always ensure that the transaction to be recommended meets the client's investment objectives and that the client is able financially to bear any related investment risks consistent with his investment objectives<sup>36</sup>.
90. Investment vehicles wholly owned by Individual Professional Investors and investment vehicles that are wholly owned by family trusts should be afforded the same protection as the individual.

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<sup>34</sup> Please refer to paragraph 55 above.

<sup>35</sup> Please refer to paragraph 48 above.

<sup>36</sup> In ensuring that a specific transaction to be recommended meets the client's investment objectives, intermediaries are required to obtain information regarding, where relevant, the length of time the client wishes to hold the investment, the client's preferences regarding risk taking, the client's risk profile, and the purpose of the investment. In ensuring that the client is able financially to bear the related investment risks consistent with his investment objectives, intermediaries are required to obtain information regarding, where relevant, the source and extent of the client's regular income, client's assets, including liquid assets, investments and real property, and client's regular financial commitments. Please refer to the international comparison table set out in Appendix C for more details.



91. The SFC proposes that all Code requirements, including the Suitability Requirement, should be observed by intermediaries without exemption when they deal with Individual Professional Investors, their wholly owned investment vehicles and investment vehicles wholly owned by family trusts. In short, all individuals, regardless of their wealth, should be covered by the same principles-based protections in the Code when they deal with intermediaries.

**Question 3: Do you agree that intermediaries should observe the Code without exception when they deal with individuals?**

**Question 4: Do you agree that investment vehicles wholly owned by individuals and by family trusts should be treated on the same basis as individuals under the Code?**

92. Levels of financial sophistication will vary within the class of Corporate Professional Investors. The main thrust of this paper is that Code protections<sup>37</sup> should only be dis-applied when intermediaries deal with sufficiently sophisticated investors.
93. The SFC is considering revising the Code criteria so that in determining whether a Corporate Professional Investor is knowledgeable and experienced in the relevant products and/or markets, intermediaries should consider:
- (a) the corporate structure and investment process and controls, i.e., how investment decisions are made, including whether the corporation has a specialised treasury or other function responsible for making investment decisions; and
  - (b) the background of the person(s) responsible for making investment decisions on behalf of the corporation including the investment experience of such person(s).
94. The intermediary should generally seek to identify who the persons making investment decisions are and assess their relevant work experience, training and qualifications, and whether they have sufficient investment experience in relevant products and/or markets.
95. Further, the intermediary should be satisfied that such persons are aware of the risks involved in relevant products and/or markets.
96. The current assessment criteria include that investors should have traded not less than 40 transactions per annum and been active in the relevant market for at least 2 years. However, it seems clear that dealing experience alone is not a reliable indicator of financial sophistication. The SFC therefore is inclined to the view that this “bright line” test should be dispensed with in favour of a principles-based Knowledge and Experience Assessment.

**Question 5: Do you agree that a principles-based Knowledge and Experience Assessment should dispense with bright line tests concerning dealing experience?**

### **III. The Suitability Requirement**

97. The Suitability Requirement is a cornerstone of investor protection. Our proposal that intermediaries serving Individual Professional Investors must comply with the Suitability

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<sup>37</sup> Please refer to paragraph 48 above.



Requirement, as discussed under paragraphs 83 - 91 above, further highlights the importance of Suitability Requirement as there will be no derogation from it when intermediaries serve individuals. It is therefore utmost important that the Suitability Requirement should provide adequate protection to investors while not being oppressive to intermediaries.

98. Since the Suitability Requirement is so core and important in the whole regulatory regime, the overriding question should then be whether the Suitability Requirement effectively serves its purpose. Does it achieve the purpose of providing adequate protection to investors? Should any refinements be introduced or considered? Is the Suitability Requirement well-balanced between investor protection and compliance costs on intermediaries?
99. The Suitability Requirement has a broad application and applies to all intermediaries (unless an exemption applies). It is a comprehensive principles-based standard without further segregating different classes of investors in its application. The Suitability Requirement is also flexible and scalable which means it is reasonable and practical for intermediaries to comply with.
100. In complying with the Suitability Requirement, intermediaries should “know their clients”, conduct product due diligence, provide reasonably suitable recommendations by matching the risk return profile of each investment product with the personal circumstances of the client to whom it is recommended and document and retain the reasons for each product recommendation made to each client and provide a copy to each client. For further details of what the Suitability Requirement entails, the SFC provides a detailed description in Appendix B.
101. The Suitability Requirement is also found in other overseas jurisdictions and the SFC notes that other overseas jurisdictions have very similar requirements in relation to ensuring suitability.
102. In the United Kingdom, in ensuring suitability, a firm must obtain information as is necessary for the firm to have a reasonable basis for believing, giving due consideration to the nature and extent of the service provided, that the specific transaction to be recommended (1) meets the client’s investment objectives; (2) is such that the client is able to financially bear any related investment risks consistent with his investment objectives; and (3) is such that the client has the necessary experience and knowledge in order to understand the risks involved in the transaction.
103. In the United States, a firm’s suitability assessment of a recommended transaction should be based on the information it obtained through reasonable diligence to ascertain the customer’s investment profile, which includes, but is not limited to the customer’s other investments, financial situation and needs, investment objectives, investment experience, investment time horizon, liquidity needs, risk tolerance etc.
104. As can be seen, the substance of the suitability requirements in overseas jurisdictions is very similar to our Suitability Requirement.

**Question 6: Do you have any views on the Suitability Requirement?**



#### **IV. Likely effects of the Proposals**

105. The current proposals do not include any change to the law, including the Professional Investor Rules and the prescribed monetary thresholds. On that basis, there will not be any effect on the scope of private placements.
106. The SFC proposes that all intermediaries cannot dis-apply any Code requirements including the Suitability Requirement for (a) Individual Professional Investors and (b) investment vehicles wholly owned by Individual Professional Investors and investment vehicles that are wholly owned by family trusts. This eliminates the ability of intermediaries to classify any individual investors as “professional” for Code purposes.
107. The proposed changes to the Knowledge and Experience Assessment for Corporate Professional Investors may affect the class of corporations that can be treated as Corporate Professional Investors by intermediaries. The SFC does not have market data on how many intermediaries make use of the Code exemptions<sup>38</sup> and how many investors are classified as “professional” for Code purposes. However, it is understood that few intermediaries presently use the Code exemptions<sup>39</sup>. If so, the impact of the overall proposal (save from the perspective of investor protection) should not be substantial.
108. It should be stressed that Individual Professional Investors’ choice of or access to investments should not be affected by this proposal; intermediaries will need, however, to ensure suitability in all cases when serving Individual Professional Investors.

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<sup>38</sup> Please refer to paragraph 48 above.

<sup>39</sup> Please refer to paragraph 48 above.





## Part C – Proposed amendments to client agreement requirements

109. The Suitability Requirement is a key investor protection measure and while breaches of it can lead to disciplinary action being taken by the SFC against an intermediary, the SFC cannot require the intermediary to pay compensation to aggrieved clients. Nor do such breaches, of themselves, enable clients of an intermediary to claim compensation or bring any other claims.
110. Some intermediaries include clauses in client agreements which are designed to restrict the ability of clients to seek compensation by mis-describing the actual services to be provided. Restrictions may also appear in declarations or acknowledgements signed by clients at the request of intermediaries. Examples include:-
- (a) clients have been required to declare that the intermediary or its employees have not solicited or invited the client to deal in investment products or offered investment recommendations – although in fact the intermediary has made solicitations, invitations or recommendations;
  - (b) terms and conditions along the lines of “whilst we may make recommendations or provide advice from time to time, any recommendation or advice provided does not constitute investment advice of any nature”; and
  - (c) clients have been required to acknowledge, by way of signing the client agreement, that any investment decision is made of their own volition and independently of the intermediary and the intermediary is not responsible for the suitability of a transaction notwithstanding advice provided by the intermediary in relation to the transaction.
111. These contractual restrictions do not affect the SFC’s ability to pursue disciplinary action against an intermediary for breaches of its Code obligations. However, where they mis-describe services actually provided this may prevent aggrieved clients from successfully bringing legal action for compensation in respect of these services.
112. For example, in a recent court case<sup>40</sup>, an investor had opened an account with an intermediary which was described as an execution-only account. Based on the terms of the client agreement, the judge found that the intermediary was not to be regarded as offering investment advice of any nature in connection with the account. Despite the fact that the intermediary had made recommendations and had given views about investments the court found that the express terms of the client agreement prevailed. Further, the court made clear that the Code could not override a contract and could not impose a duty which the intermediary had not undertaken under the client agreement.
113. The above mentioned decision was followed in another recent case<sup>41</sup>. However, in that case the court considered a United Kingdom authority in which it was held that a code of conduct could be applicable where it was expressly incorporated by reference into a contract. Although this authority was distinguished, as there was no such incorporation of the Code by reference to it in the contract at issue, it indicates a means to address the problem identified above.

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<sup>40</sup> *Kwok Wai Hing Selina v HSBC Private Bank (Suisse) SA (formerly known as HSBC Republic Bank (Suisse) SA)* HCCL 7/2010

<sup>41</sup> *DBS Bank (Hong Kong) Limited v San-Hot HK Industrial Company Limited and Hao Ting* HCA 2279/2008



114. The SFC, in its Report on the Thematic Inspection of Selling Practices of Licensed Corporations issued in October 2012, stated that it would propose an appropriate regulatory response.
115. The SFC proposes, in summary, that (1) the Suitability Requirement should be incorporated into client agreements as a contractual term; and (2) client agreements should not contain terms which are inconsistent with the Code and should accurately set out in clear terms the actual services to be provided to the client.

#### Inclusion of the Suitability Requirement in client agreements

116. The Code requires an intermediary to enter into a written agreement with each of its clients. The Code also stipulates the minimum contents of client agreements. It should however be noted that this requirement does not apply if intermediaries are dealing with Institutional Professional Investors and Professional Investors who have been assessed under the Knowledge and Experience Assessment (and have complied with incidental procedures) as set out in paragraph 15 of the Code.
117. The SFC proposes that the Suitability Requirement in paragraph 5.2 of the Code (i.e., an intermediary, when making a recommendation or solicitation to a client, should ensure the suitability of the recommendation or solicitation for that client is reasonable in all the circumstances) should be expressly included in all client agreements without qualification.

#### No inclusion of clauses which are inconsistent with the Code or which mis-describe the actual services provided to clients

118. While it is expected that client agreements should properly describe the actual services to be provided, the existing Code requirement that intermediaries should provide a description of the “nature of services” such as securities cash account, securities margin account etc., does not appear to be sufficient. Other elements of the relationship between the client and the intermediary (e.g., whether investment advice is being given on a continuing basis), are important in defining the obligations of the intermediary to clients. The SFC therefore considers that client agreements should also set out in clear terms all of the services to be provided to clients.
119. In addition, some intermediaries design client agreements expressly to exclude contractual obligations which mirror their Code obligations.
120. The SFC considers this practice to be contrary to General Principle 1 of the Code under which intermediaries are required to act “honestly, fairly, and in the best interests of clients and the integrity of the market”.
121. The SFC also notes that some clients are requested by their intermediaries to declare or acknowledge that liability is limited or that their intermediaries have provided services which are different from the actual services provided.
122. The SFC therefore proposes a new paragraph 6.5 of the Code which provides that (1) a licensed or registered person should not incorporate any clause, provision or term in the client agreement or in any other document signed by the client at the request of the licensed or registered person which is inconsistent with its obligations under the Code; and (2) no clause, provision, term or statement should be included in any client agreement (or any other document signed by the client at the request of a licensed or registered person) which mis-describes the actual services to be provided to the client.



**Question 7: Do you agree with the above proposals in relation to the client agreement?**



## Seeking comments

123. The SFC welcomes comments from the public on the proposals made in this Consultation Paper and the indicative draft of the relevant revised paragraphs of the Code in **Appendix A** to this Consultation Paper. Comments should be submitted to the SFC in writing by no later than 14 August 2013.



## Appendix A

### Indicative draft of the relevant paragraphs of the Code

(The following draft Paragraph 15 will replace the current Paragraph 15 in full if adopted)

#### Paragraph 15

#### Professional investors

##### 15.1 Professional Investors: in general

- (a) “Professional Investor” is defined in section 1 of Part 1 of Schedule 1 to the SFO. It includes specified entities set out in paragraphs (a) to (i) of the definition (e.g., banks and insurance companies) and persons belonging to a class which is prescribed under the Securities and Futures (Professional Investor) Rules (“Professional Investor Rules”) (paragraph (j) of the definition).
- (b) Notwithstanding that some legal restrictions imposed by the SFO do not apply (e.g., the issuance of advertisements, the making of unsolicited calls and the communication of an offer in relation to securities) to licensed or registered persons in serving Professional Investors, all the requirements in the Code of Conduct (including the general principles such as acting honestly and fairly and in the best interests of clients and the requirement to ensure the suitability of a recommendation or solicitation for a client is reasonable in all the circumstances) must still be strictly observed subject to exemptions.
- (c) For the purposes of setting out exemptions and for ease of reference under the Code, Professional Investors are referred to in the Code in specific terms as set out in paragraph 15.2.

##### 15.2 Overview and terminology

Professional Investors are referred to in the Code in the following terms:-

**Institutional Professional Investors-** persons falling under paragraphs (a) to (i) of the definition of “professional investor” in section 1 of Part 1 of Schedule 1 to the SFO.

Licensed or registered persons serving Institutional Professional Investors are automatically exempt from the provisions as set out in paragraph 15.4 hereunder.

**Corporate Professional Investors-** trust corporations, corporations or partnerships falling under sections 3(a), (c) and (d) of the Professional Investor Rules, except for investment vehicles falling under the definition of “Individual Professional Investors”.



Should licensed or registered persons also choose to be exempt from the provisions set out in paragraph 15.4, they should observe the assessment requirements and procedures set out in paragraph 15.3.

For those Corporate Professional Investors that cannot meet paragraph 15.3 in any aspect, all regulatory obligations should be observed by the licensed or registered persons without any exemption unless stated otherwise.

**Individual Professional Investors-** individuals falling under section 3(b) of the Professional Investor Rules, investment vehicles wholly owned by them, and investment vehicles that meet the monetary thresholds under the Professional Investor Rules and are wholly owned by family trusts.

All regulatory obligations should be observed by the licensed or registered persons without any exemption unless stated otherwise.

### **15.3 Assessment requirements and procedures for Corporate Professional Investors**

- (a) A licensed or registered person is exempt from the provisions under paragraph 15.4 if it has complied with paragraph 15.3(f), and is reasonably satisfied that the Corporate Professional Investor has sufficient knowledge and investment experience in relevant products and markets.
- (b) In assessing the knowledge and investment experience in the relevant products and/or markets of the Corporate Professional Investor, the licensed or registered person should take into account:
  - (i) the corporate structure and investment process and controls, i.e., how investment decisions are made, including whether the corporation has a specialised treasury or other function responsible for making investment decisions;
  - (ii) the background of the person(s) responsible for making investment decisions on behalf of the Corporate Professional Investor including the investment experience of such person(s); and
  - (iii) that the Corporate Professional Investor is aware of the risks involved considered in terms of the person(s) responsible for making investment decisions.
- (c) The above assessment should be in writing. Records of all relevant information and documents obtained in the assessment should be kept by the licensed or registered person so as to demonstrate the basis of the assessment.
- (d) A licensed or registered person should undertake a separate assessment for different product types or markets.
- (e) A licensed or registered person should undertake a new assessment where a Corporate Professional Investor has ceased to trade in the relevant product or market for more than 2 years.



- (f) Prior to dis-applying the provisions set out under paragraph 15.4, a licensed or registered person serving Corporate Professional Investors should also:-
  - (i) obtain a written and signed declaration from the client that the client has given consent;
  - (ii) fully explain to the client the consequences of being treated as a Corporate Professional Investor and that the client has the right to withdraw from being treated as such at any time; and
  - (iii) specify that the client is treated as a Corporate Professional Investor in a particular product and market and inform the client that it has a right to withdraw from being treated as a Corporate Professional Investor whether in respect of all products or markets or any part thereof; and
- (g) A licensed or registered person should carry out a confirmation exercise annually to ensure that the client continues to fulfill the requisite requirements under the Professional Investor Rules. In carrying out the annual confirmation exercise, a licensed or registered person should remind the client in writing of:-
  - (i) the risks and consequences of being treated as a Corporate Professional Investor, in particular, the licensed or registered person is not required to comply with the regulatory requirements set out in paragraph 15.4 of the Code; and
  - (ii) the right for the client to withdraw from being treated as a Corporate Professional Investor whether in respect of all products or markets or any part thereof.

**15.4 Exempt provisions for Corporate Professional Investors meeting the assessment requirements in paragraph 15.3 and where intermediaries have complied with paragraph 15.3 and Institutional Professional Investors**

- (a) Information about clients
  - (i) the need to establish a client's financial situation, investment experience and investment objectives (paragraph 5.1 and paragraphs 2(d) and 2(e) of Schedule 6 to the Code), except where the licensed or registered person is providing advice on corporate finance work;
  - (ii) the need to ensure the suitability of a recommendation or solicitation (paragraph 5.2 and paragraph 49 of Schedule 6 to the Code); and
  - (iii) the need to assess the client's knowledge of derivatives and characterize the client based on his knowledge of derivatives (paragraph 5.1A of the Code);



(b) Client agreement

- (i) the need to enter into a written agreement and the provision of relevant risk disclosure statements (paragraph 6.1, paragraph 2 of Schedule 3, paragraph 2 of Schedule 4 and paragraph 1 of Schedule 6 to the Code);

(c) Discretionary accounts

- (i) the need for a licensed or registered person to obtain from the client an authority in a written form prior to effecting transactions for the client without its specific authority (paragraph 7.1(a)(ii) of the Code); and
- (ii) the need to explain the authority described under paragraph 7.1(a)(ii) of the Code and the need to confirm it on an annual basis (paragraph 7.1(b) of the Code);

(For the avoidance of doubt, a licensed or registered person should still obtain an authorization from a Corporate Professional Investor, in order to effect transactions on the client's behalf, however where Corporate Professional Investors are concerned the procedures for obtaining such authorizations as described in (i) and (ii) above are relaxed.)

(d) Information for clients

- (i) the need to disclose sales related information (paragraph 8.3A of the Code);
- (ii) the need to inform the client about the licensed or registered person and the identity and status of its employees and others acting on its behalf (paragraph 8.1 of the Code);
- (iii) the need to confirm promptly with the client the essential features of a transaction after effecting a transaction for a client (paragraph 8.2, paragraph 4 of Schedule 3 and paragraph 18 of Schedule 6 to the Code); and
- (iv) the need to provide the client with documentation on the Nasdaq-Amex Pilot Program (paragraph 1 of Schedule 3 to the Code).





## Paragraph 6

### Client agreement

#### 6.1 Client agreement in writing

Licensed or registered persons should enter into a written agreement (“Client Agreement”) with each client before services are provided to the client. The Client Agreement should be in Chinese or English according to the language preference of the client, as should any other agreement, authority, risk disclosure, or supporting document. Licensed or registered persons should provide a copy of these documents to the client and draw to the client’s attention the relevant risks. Where an account opening procedure other than a face-to-face approach is used, the covering correspondence should specifically direct the client’s attention to the appropriate risk disclosure statements. As explained below, the type of Client Agreement may vary depending on the services provided.

#### 6.2 Minimum content of client agreement

Subject to paragraph 6.4 and Schedules 1, 3, 4 and 6 to the Code, a Client Agreement should contain at least provisions to the following effect:

- (a) the full name and address of the client as verified by a retained copy of the identity card, relevant sections of the passport, business registration certificate, corporation documents, or any other official document which uniquely identifies the client;
- (b) the full name and address of the licensed or registered person's business including the licensed or registered person's licensing or registration status with the Commission and the CE number (being the unique identifier assigned by the Commission);
- (c) undertakings by the licensed or registered person and the client to notify the other in the event of any material change to the information (as specified in paragraphs 6.2(a), (b), (d), (e) and (f)) provided in the Client Agreement;
- (d) a description setting out in clear terms the actual ~~of the nature of~~ services to be provided to ~~or available to~~ the client, ~~such as securities cash account, securities margin account, discretionary account, portfolio management, investment advice, unit trusts, futures/options account, or leveraged foreign exchange trading account;~~
- (e) a description of any remuneration (and the basis for payment) that is to be paid by the client to the licensed or registered person, such as commission, brokerage, and any other fees and charges;
- (f) if margin or short selling facilities are to be provided to the client, details of margin requirements, interest charges, margin calls, and the circumstances under which a client's positions may be closed without the client's consent;



- (g) if services are to be provided to the client in relation to derivative products, including futures contracts or options, (1) a statement that the licensed or registered person shall provide to the client upon request product specifications and any prospectus or other offering document covering such products and (2) a full explanation of margin procedures and the circumstances under which a client's positions may be closed without the client's consent; ~~and~~
- (h) the risk disclosure statements as specified in Schedule 1 to the Code; and
- (i) that the licensed or registered person must ensure the suitability of any recommendation or solicitation made to the client is reasonable in all the circumstances.

### **6.3 No circumvention of legal requirements**

A licensed or registered person should ensure that it complies with its obligations under a Client Agreement and that a Client Agreement does not operate to remove, exclude or restrict any rights of a client or obligations of the licensed or registered person under the law.

### **6.4 Limited provision of services**

Whilst a Client Agreement should properly reflect the services to be provided, ~~Where~~ the services to be provided are limited in nature, the Client Agreement may be limited accordingly. For example, where the services to be provided by a licensed or registered person to a client are limited to effecting one-off disposals of securities in connection with initial public offerings, the Client Agreement would only need to contain the provisions set out in paragraphs 6.2(a), (b), (d) and (e).

### **6.5 No inclusion of clauses which are inconsistent with the Code or which mis-describe the actual services provided to clients**

A licensed or registered person should not incorporate any clause, provision or term in the Client Agreement or in any other document signed by the client at the request of the licensed or registered person which is inconsistent with its obligations under the Code.

No clause, provision, term or statement should be included in any Client Agreement (or any other document signed by the client at the request of a licensed or registered person) which mis-describes the actual services to be provided to the client.



## Consequential amendments to the Code

### Paragraph 5

#### Information about clients

##### 5.1A Know your client: investor characterization

- (a) ~~Except where a client is a Professional Investor for the purpose of paragraph 15 of the Code,~~ a licensed or registered person should, as part of the know your client procedures, assess the client's knowledge of derivatives and characterize the client based on his knowledge of derivatives.

### Paragraph 8

#### Information for clients

##### 8.3A Disclosure of sales related information

- (a) Where a licensed or registered person distributes an investment product to a client ~~other than a Professional Investor for the purpose of paragraph 15 of the Code,~~ the licensed or registered person should deliver the following information to the client prior to or at the point of sale:
  - (i) The capacity (principal or agent) in which a licensed or registered person is acting;
  - (ii) Affiliation of the licensed or registered person with the product issuer;
  - (iii) Disclosure of monetary and non-monetary benefits (*Please refer to paragraph 8.3 of the Code*); and
  - (iv) Terms and conditions in generic terms under which client may receive a discount of fees and charges from a licensed or registered person.



## Appendix B

### Suitability Requirement

1. Paragraph 5.2 of the Code is also referred to as the “Suitability Requirement” or “Suitability Obligation”. It states as follows:-

*“Having regard to information about the client of which the licensed or registered person is or should be aware through the exercise of due diligence, the licensed or registered person should, when making a recommendation or solicitation, ensure the suitability of the recommendation or solicitation for that client is reasonable in all circumstances.”*

2. In complying with the Suitability Requirement, the Suitability FAQs<sup>42</sup> state that intermediaries should, including but not limited to, “know their clients”, conduct product due diligence, provide reasonably suitable recommendations by matching the risk return profile of each investment product with the personal circumstances of the client to whom it is recommended and document and retain the reasons for each product recommendation made to each client and provide a copy to each client.
3. In the “know your client” process, intermediaries should seek information from clients about their financial situation, investment experience and investment objectives. Intermediaries should also collect from each client information that includes the client’s investment knowledge, investment horizon, risk tolerance (including risk of loss of capital) and capacity to make regular contributions and meet extra collateral requirements, where appropriate.
4. In addition to conducting the “know your client” assessment (which includes assessing a client’s knowledge of derivatives<sup>43</sup>), the Suitability FAQs expressly set out that intermediaries should not recommend investment products which they do not understand and must conduct product due diligence in selecting appropriate investment products for each client. Such due diligence involves intermediaries developing a thorough understanding of the structure of investment products, how they work, the nature of underlying investments, the level of risks they bear, the experience and reputation of product issuers and service providers, fees and charges, the relative performance and liquidity of investment products, lock-in periods, termination conditions, valuation and unit pricing and safe custody arrangements. Intermediaries need also to consider other factors which may directly or indirectly impact on risk return profiles and growth prospects of investments.
5. In ensuring suitability, intermediaries should use their professional judgement to assess diligently whether the characteristics and risk exposures of each recommended investment product (including transaction costs, effect of gearing and foreign currency risks, where appropriate) are actually suitable for the client and are in the best interests of the client, taking into account the client’s investment objectives, investment horizon, risk tolerance and financial circumstances etc.

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<sup>42</sup> Circulars issued by the SFC on 8 May 2007 and/or 23 February 2009

<sup>43</sup> Under paragraph 5.1A of the Code, an intermediary should assess whether a client has knowledge of derivatives, characterize him accordingly and take additional steps to safeguard the client’s interest if the client without knowledge of derivatives wants to purchase a derivative product and the intermediary has not solicited the client or made a recommendation to the client in relation to the proposed transaction.



6. The Suitability FAQs also clarify that intermediaries must not only provide each client with recommended investments prospectuses or offering circulars and other relevant documents but also help each client make informed decisions by giving the client proper explanations of why recommended investment products are suitable for the client and the nature and extent of risks involved in the investment, present balanced views and draw the client's attention to disadvantages and downside risks.
7. Intermediaries are also required to document and provide a copy to each client of the rationale underlying investment recommendations made to the client. Intermediaries should record contemporaneously the information given to each client and the rationale for recommendations given to the client, including any material queries raised by the client and the responses given by the intermediary (these requirements are collectively referred to as the **documentation standards of the Suitability Requirement**).



## Appendix C

### International comparison table

	The United Kingdom	The United States	Singapore	Australia
Qualifying criteria for professional investors	<p>A relevant category of investors who can participate in private placements is <i>qualified investors</i>.</p> <p>A qualified investor includes:</p> <p>(1) a natural person meeting at least 2 out of the following 3 criteria:</p> <p>(a) the person has carried out transactions, in significant size, on securities markets at an average frequency of, at least, 10 per quarter over the previous 4 quarters;</p> <p>(b) the size of the person's securities portfolio exceeds EUR500,000;</p> <p>(c) the person works or has worked in the financial sector for at least 1 year in a professional position, which</p>	<p>A relevant category of investors who can participate in private placements is <i>accredited investors</i></p> <p>The term <i>accredited investor</i> includes:</p> <p>(i) a natural person whose individual net worth, or joint net worth with his/her spouse exceeds US\$1,000,000 at the time of the purchase; and</p> <p>(ii) a natural person who had an individual income in excess of US\$200,000 in each of the 2 most recent years or joint income with his/her spouse in excess of US\$300,000 in each of those years and has a reasonable expectation of reaching the same income level in the current year;</p> <p>(iii) a corporation or partnership not formed for the specific purpose</p>	<p>The relevant category of investors is <i>accredited investors</i>.</p> <p>An <i>accredited investor</i> includes:</p> <p>(a) an individual whose net personal assets exceed in value SG\$2,000,000 (or such other amount as the Monetary Authority of Singapore (MAS) may prescribe); or</p> <p>(b) an individual whose income in the preceding 12 months is not less than SG\$300,000 (or such other amount as the MAS may prescribe); (s.4A Securities and Futures Act)</p> <p>(c) a corporation with net assets exceeding SG\$10,000,000 (or such other amount as the MAS may prescribe).</p>	<p>A relevant category of investors is <i>wholesale clients</i>. The regulatory requirements differentiate between <i>retail</i> and <i>wholesale clients</i>.</p> <p>s.761G(4) Corporations Act 2001 (CA 2001): if the client is not a <i>retail client</i>, then the client is a <i>wholesale client</i>.</p> <p>A financial product (excluding general insurance products, superannuation products and retirement savings accounts) is provided to a <i>wholesale client</i> if:</p> <p>(1) before the provision of the product, the client gives to the provider a copy of a certificate issued within the preceding 6 months by a qualified accountant stating that the client has</p> <p>(a) net assets of at least AUD2,500,000; or</p>



	The United Kingdom	The United States	Singapore	Australia
	<p>requires knowledge of securities investment. (ss86 and 87R, Financial Services and Markets Act 2000 (FSMA 2000))</p> <p>The relevant categories of investors whereby exemptions from both legal and regulatory requirements are available to intermediaries are <i>per se professional clients</i> and <i>elective professional clients</i>.</p> <p>At the client's request, a firm may treat a client as an <i>elective professional client</i> if:</p> <p>(1) it undertakes an adequate assessment of the expertise, experience and knowledge of the client that gives reasonable assurance, in light of the nature of the transactions or services envisaged, that the client is capable of making his own investment decisions and understanding the</p>	<p>of acquiring the securities offered, with total assets in excess of US\$5,000,000;</p> <p>(iv) a trust, with total assets in excess of US\$5,000,000, not formed for the specific purpose of acquiring the securities offered, whose purchase is directed by a <i>sophisticated person</i>. (Rules and regulations promulgated under the Securities Act of 1933, 17 CFR 230.501(a)(5), (6), (3) &amp; (7))</p> <p>For the purposes of calculating net worth, the person's primary residence is excluded as an asset and any indebtedness secured by the person's primary residence, up to its estimated fair market value, is correspondingly excluded as a liability. (Please refer to 17 CFR 230.501(a)(5) for details)</p> <p><i>A sophisticated person</i></p>		<p>(b) gross income of at least AUD250,000 per annum for each of the last 2 financial years; or (s.761G(7)(c), CA 2001, Reg 7.1.28, Corporations Regulations 2001 &amp; s.761G(4), CA 2001).</p> <p>A financial product is also provided to a <i>wholesale client</i> if the financial services licensee is satisfied on reasonable grounds that the client has previous experience in using financial services and investing in financial products that allows the client to assess:</p> <p>(i) the merits and value of the product;</p> <p>(ii) the risks associated with holding the product;</p> <p>(iii) the client's own information needs; and</p> <p>(iv) the adequacy of the information given by the licensee and the product issuer. (s.761GA, CA 2001)</p>



	<b>The United Kingdom</b>	<b>The United States</b>	<b>Singapore</b>	<b>Australia</b>
	<p>risks involved; and</p> <p>(2) at least 2 of the following are satisfied:</p> <p>(a) the client has carried out transactions, in significant size, on the relevant market at an average frequency of 10 per quarter over the previous 4 quarters;</p> <p>(b) the size of the client's financial instrument portfolio, defined as including cash deposits and financial instruments, exceeds EUR500,000;</p> <p>(c) the client works or has worked in the financial sector for at least 1 year in a professional position, which requires knowledge of the transactions or services envisaged. (COBS 3.5.3R)</p>	<p>is a person with such knowledge and experience in financial and business matters that he is capable of evaluating the merits and risks of the prospective investment, or the issuer reasonably believes immediately prior to making any sale that such purchaser comes within this description. (17 CFR 230.506(b)(2)(ii))</p>		





	<b>The United Kingdom</b>	<b>The United States</b>	<b>Singapore</b>	<b>Australia</b>
Procedural requirement	<p>Prior to treating a client as an <i>elective professional client</i>:</p> <p>(a) the client must state in writing that it wishes to be treated as a professional client either generally or in respect of a particular service or transaction or type of transaction or product;</p> <p>(b) the firm must give the client a clear written warning of the protections and investor compensation rights the client may lose; and</p> <p>(c) the client must state in writing, in a separate document from the contract, that it is aware of the consequences of losing such protections. (COBS 3.5.3R(3))</p>	Nil	Nil	<p>Before, or at the time when, the product or advice is provided to a <i>wholesale client</i> (for the purpose of s.761GA, CA 2001):</p> <p>(a) the licensee must give to the client a written statement of its reasons for being satisfied that the client has the requisite previous experience in using financial services and investing in financial products; and</p> <p>(b) the client is required to sign a written acknowledgment that:</p> <p>(i) the licensee has not provided him with any document which would be required if he were a retail client and</p> <p>(ii) the licensee does not have any other obligations to him that relate to retail clients.</p>



	The United Kingdom	The United States	Singapore	Australia
Requirement to ensure suitability	<p>A firm is required to take reasonable steps to ensure that a <i>personal recommendation</i><sup>44</sup> (or a decision to trade in relation to <i>managing investments</i>) is suitable for its client. The firm must obtain information as is necessary for the firm to have a reasonable basis for believing, giving due consideration to the nature and extent of the service provided, that the specific transaction to be recommended</p> <p>(a) meets the client's investment objectives;</p> <p>(b) is such that the client is able financially to bear any related investment risks consistent with his investment objectives; and</p> <p>(c) is such that the client has the necessary experience and knowledge in order to understand the risks involved in the transaction. (COBS9.2.1R(1))</p>	<p>A member or an associated person must have a reasonable basis to believe that a recommended transaction or investment strategy involving a security or securities is suitable for the customers, based on the information obtained through the reasonable diligence of the member or associated person to ascertain the customer's investment profile. A customer's investment profile includes, but is not limited to, the customer's age, other investments, financial situation and needs, tax status, investment objectives, investment experience, investment time horizon, liquidity needs, risk tolerance, and any other information the customer may disclose to the member or associated person in connection with such recommendation. (FINRA Rule 2111(a))</p>	<p>A licensee must have a reasonable basis for any recommendation it makes with respect to an investment product to a person who may reasonably be expected to rely on the recommendation. (s27, Financial Advisers Act) (FAA)</p> <p>For the purposes of ascertaining that the recommendation is appropriate, the licensee must have regard to information possessed by it concerning the client's investment objectives, financial situation and particular needs. It should give such consideration to, and conduct such investigation of, the subject matter of the recommendation as is reasonable in all the circumstances, and make its recommendation based on such consideration and</p>	<p>A financial services licensee must only provide <i>personal advice</i> to a person as a <i>retail client</i> if it would be reasonable to conclude that the advice is appropriate to the client had the licensee satisfied the duty to act in the best interests of the client.</p> <p>The duty to act in the best interests of the client is satisfied if the licensee has done each of the following:</p> <p>(a) identified the objectives, financial situation and needs of the client that were disclosed to it by the client through instructions;</p> <p>(b) identified:</p> <p>(i) the subject matter of the advice that has been sought by the client (whether explicitly or implicitly); and</p> <p>(ii) the objectives, financial situation and needs of the</p>

<sup>44</sup> When providing investment services other than making a personal recommendation and managing investments, the requirement to ensure the appropriateness of the service or product to be provided applies. Please refer to COBS10 for details.



	The United Kingdom	The United States	Singapore	Australia
	<p>In relation to (a) above, the information must include, where relevant, information regarding:</p> <ul style="list-style-type: none"> <li>(1) the length of time the client wishes to hold the investment;</li> <li>(2) client's preferences re risk taking;</li> <li>(3) client's risk profile; and</li> <li>(4) the purpose of the investment (COBS 9.2.2R(2))</li> </ul> <p>In relation to (b) above, the information must include, where relevant, information regarding:</p> <ul style="list-style-type: none"> <li>(1) source and extent of client's regular income;</li> <li>(2) client's assets, including liquid assets, investments and real property; and</li> <li>(3) client's regular financial commitments (COBS 9.2.2R(3))</li> </ul>	<p>Rule 2111 is composed of three main obligations: reasonable-basis suitability, customer-specific suitability and quantitative suitability. (FINRA Rule 2111.05) The relevant obligation for comparison is the customer-specific suitability obligation.</p> <p>The customer-specific obligation requires that a member or associated person have a reasonable basis to believe that the recommendation is suitable for a particular customer based on that customer's investment profile, as delineated in Rule 2111(a).</p>	<p>investigation.</p>	<p>client that would reasonably be considered as relevant to advice sought on that subject matter (the <i>client's relevant circumstances</i>);</p> <ul style="list-style-type: none"> <li>(c) where it was <i>reasonably apparent</i> that information relating to the <i>client's relevant circumstances</i> was incomplete or inaccurate, made reasonable inquiries to obtain complete and accurate information;</li> <li>(d) assessed whether it has the expertise required to provide the client advice on the subject matter sought and, if not, declined to provide the advice;</li> <li>(e) if, in considering the subject matter of the advice sought, it would be reasonable to consider recommending a financial product: <ul style="list-style-type: none"> <li>(i) conducted a reasonable investigation into the financial products</li> </ul> </li> </ul>



	The United Kingdom	The United States	Singapore	Australia
				<p>that might achieve those of the objectives and meet those of the needs of the client that would reasonably be considered as relevant to advice on that subject matter; and</p> <p>(ii) assessed the information gathered in the investigation;</p> <p>(f) based all judgments in advising the client on the <i>client's relevant circumstances</i>;</p> <p>(g) taken any other step that, at the time the advice is provided, would reasonably be regarded as being in the best interests of the client, given the <i>client's relevant circumstances</i>. (s961B, CA 2001)</p> <p>Something is <i>reasonably apparent</i> if it would be apparent to a person with a reasonable level of expertise in the subject matter of the advice that has been sought by the client, were that</p>



	The United Kingdom	The United States	Singapore	Australia
				person exercising care and objectively assessing the information given to the licensee by the client. (s961C, CA 2001)
Exemptions to the requirement to ensure suitability available for dealings with Professional Investors	<p><u>Suitability</u><sup>45</sup></p> <p>For the purposes of COBS 9.2.2R(1)(c), the firm can assume that, in relation to the products, transactions and services for which the <i>professional client</i> is so classified, the client has the necessary level of experience and knowledge (COBS 9.2.8R(1)).</p> <p>The term <i>professional client</i> refers to either <i>per se professional clients</i> or <i>elective professional clients</i>. (COBS 3.5.1R)</p> <p>For the purposes of COBS9.2.2R(1)(b), the firm can assume that the <i>per se professional client</i> is able to financially bear any related investment risks consistent his investment objectives. (COBS 9.2.8R(2))</p>	No exemptions are available for <i>accredited investors</i> .	Financial advisers are exempt from section 27 of FAA when making a recommendation in respect of any investment product to an <i>accredited investor</i> . (Regulation 34, Financial Advisers Regulations)	No equivalent requirement to ensure suitability applies if the advice is provided to a <i>wholesale client</i> .

<sup>45</sup> Exemptions to the requirement to ensure appropriateness are available for dealings with professional investors. Please refer to COBS10 for details.