

28 May 2010

Circular to Licensed Corporations and Registered Institutions Obligations Relating to Selling / Distribution of Investment Products

Post-sale cooling-off or unwind right

1. The Commission's Code on Unlisted Structured Investment Products imposes an obligation on issuers to confer on investors a right in respect of unlisted structured investment products offered to the public (except where the scheduled tenor is one year or less), whereby investors may cancel their orders, sell the product back or otherwise unwind the transaction, and receive a refund. The right is exercisable "post-sale", i.e. for a period of at least 5 business days in Hong Kong after the investor places an order.
2. Where an investment product confers a cooling-off or unwind right on the investor, and the investor exercises his right, the relevant intermediary who sells or distributes such a product shall promptly execute the instruction for the client and pass on to the client the full amount of refund (including the sales commission) received from the product issuer less a reasonable administrative charge. The sales commission should include the amount retained by the distributor in relation to that transaction and the administrative charge should be disclosed at or prior to the point of sale and should not contain any profit margin.
3. To comply with such requirement, distributors are reminded to put in place proper systems and procedures to facilitate their clients to exercise their rights under such mechanism. In particular, distributors are expected to pay attention to the following obligations under the Code of Conduct¹:
 - (a) Under General Principle 5 of the Code of Conduct, distributors are required to make adequate disclosure of relevant material information in their dealings with clients. In this regard, distributors are expected to disclose the cooling-off mechanism prior to or at the point of sale (including information on how clients can exercise their cooling-off right). Where a distributor or its nominee holds the products on behalf of the clients, the information expected to be disclosed in relation to cooling-off includes the possible market value adjustment attributable to unwinding a transaction, the possibility that the clients may not be able to receive a full refund of the principal invested, what the refund (if known) will be and when the clients will receive the refund.
 - (b) Under paragraph 2.2 of the Code of Conduct, in the general course of dealing or advising concerning a client, the provision of margin lending, and the charges, mark-ups, or fees affecting a client should be fair and reasonable in the circumstances, and be characterised by good faith. Hence, in relation to the administrative charges which are handling fees in processing the refund, they

¹ Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission.



should only cover the direct processing cost and not recoupment of the sales commission or contain any profit margin. Distributors are reminded that such charges to be imposed on clients should be fair and reasonable and characterised by good faith.

Other obligations relating to selling / distribution of investment products²

4. Following the publication of the Consultation Conclusions on Proposals to Enhance Protection for the Investing Public, intermediaries are reminded to observe the following in compliance with the principles stemmed from the Code of Conduct (as revised) in the selling and distribution of investment products, including products authorized by the SFC:

Investment characteristics and risks of investment products

- (a) to understand the investment products (including SFC-authorized funds) that they intend to sell to their clients, including the nature of the products, the investment strategy (where applicable), the types of underlying investments, the risks involved. In particular, where an investment product may acquire financial derivative instruments for investment purposes, intermediaries are expected to be aware of the extent of the use of such instruments, and the risks involved. Notwithstanding any risk indicator or assessment of the risks of an investment product made by an issuer or as disclosed in the offering document, intermediaries are reminded to make an independent assessment of the product;

Product Key Facts Statements (“Product KFS”)³

- (b) given that the Product KFS contains information about a product’s key features and risks, to distribute both the Product KFS and the offering documents to clients prior to or at the point of sale;
- (c) intermediaries must not solely rely on the Product KFS in carrying out an independent assessment of an investment product or in advising a client the suitability of such product for the client;

Language version of financial reports

- (d) to advise clients the language in which the financial reports of an SFC-authorized fund are prepared, for example, whether the reports are produced in English, Chinese or both languages, when marketing an SFC-authorized fund to clients;

Other disclosure

- (e) in the case of an unlisted structured investment product offered to the public, where an issuer provides market-making, to make available indicative bid prices to clients and to promptly execute clients’ orders;

² Intermediaries are reminded to also refer to the SFC circular “Guidance to Licensed Corporations and Registered Institutions in relation to Investor Characterization and Professional Investors Requirements” issued today.

³ Product KFS are required for products authorized under the consolidated SFC Handbook for Unit Trusts and Mutual Funds, Investment-Linked Assurance Schemes and Unlisted Structured Investment Products.



- (f) where distributors or their nominees hold an investment product on behalf of their clients, to disseminate or procure the dissemination of notices and other communications prepared/issued by the issuer, product arranger or management company (as the case may be) of the investment product to their clients on a timely basis upon receipt of the notices from the issuer, product arranger or the management company (as the case may be); and
- (g) while nominees of clients may not be the distributors themselves but affiliates of the distributors, to make arrangement with the affiliates to ensure that the information mentioned in paragraphs (e) and (f) above is disseminated to the clients.

Should you have any queries regarding the contents of this circular, please contact Ms Rachel Chung on 2283 6153.

Intermediaries Supervision Department
Securities and Futures Commission

End

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