Circular to Licensed Corporations and Registered Institutions

Compliance with Suitability Obligations

On 12 June 2012, the Hong Kong Monetary Authority (HKMA) in consultation with the Commission issued a circular to Authorized Institutions that provides, among others, the definition of Private Banking Customer (PB customer) and guidance of using a portfolio-based approach in assessing suitability when providing services to PB customers.

In light of the above, the Commission wishes to provide guidance to intermediaries on compliance with suitability obligations, including question 6 of the Circular on Questions and Answers on Suitability Obligations (Suitability FAQ). This circular applies when intermediaries provide services to clients who fall under the definition of PB customer set out in the HKMA’s circular.

A principal feature of a private banking arrangement that adopts a portfolio-based approach is that there is an investment mandate agreed at the outset between an intermediary and its PB customer. The mandate sets out key elements such as the types, risks and allocation of investments and is arrived at after taking into account factors such as the customer’s investment objectives and horizon, risk tolerance level, etc.

An intermediary, when conducting suitability assessment for PB customers, should take into account all the circumstances of a customer. The application of a portfolio-based approach of suitability assessment under the private banking arrangement is calibrated according to the information disclosed by the customer.

Hence, if a customer maintains US$1 million or above in investable assets with an intermediary and refuses to disclose his/her amount of investable assets, investment objectives or mandates outside the intermediary concerned, the intermediary can only take into account the customer’s investable assets under its management when conducting suitability assessment using a portfolio-based approach. If the customer discloses that he/she has US$3 million or above in investable assets but refuses to disclose the investment objectives or mandates of the investable assets outside the intermediary concerned and maintains less than US$1 million in investable assets with the intermediary, then the customer cannot be treated as a PB customer for the purpose of providing rationale of an investment mandate instead of each transaction to the customer. Further, for such customer, the intermediary can only take into account his/her investable assets under its management when conducting suitability assessment.

---

1 Per HKMA’s circular dated 12 June 2012, an Authorized Institution (AI) may classify an individual as a private banking customer if he/she maintains a personalized relationship with the AI and receives personalized banking services or portfolio management service from the AI and has:
   (i) at least US$3 million or its equivalent in any other currency in investable assets; or
   (ii) at least US$1 million or its equivalent in any other currency in investable assets under the AI’s management.

Investable assets comprise securities, deposits and certificates of deposits. The account may be calculated on a relationship basis covering (i) individual accounts; (ii) joint accounts with associates; and (iii) personal investment companies jointly owned by the individual and associates. Associate means the spouse or any child of the individual.

2 Question 6 of the Circular on Questions and Answers on Suitability Obligations issued by the Commission on 8 May 2007 provides that an intermediary should document and provide a copy to each client of the rationale underlying investment recommendations made to the client.
The intermediary should follow the section under the heading of **“Portfolio-based” assessment of suitability when providing private banking services to PB customers** of the HKMA’s circular.

For the purpose of compliance with question 6 of the Suitability FAQ, the Commission considers that for a private banking arrangement that adopts a portfolio-based approach, an intermediary should provide a copy of the rationale of its recommendations for the mandate to the PB customer. For any transaction subsequently effected in accordance with this mandate, it is not necessary for the intermediary to provide the rationale of recommendation of that transaction.

The intermediary should review the PB customer’s mandate on a regular basis having regard to his/her current circumstances. Where the investment mandate is amended subsequent to such review, the intermediary should agree the revised mandate with the PB customer and provide a copy of the rationale of its recommendation on the revised mandate to the customer.

Intermediaries should continue to observe the suitability obligations when providing any recommendation or solicitation to their PB customers and should also put in place adequate systems and controls to enable proper implementation of the above-mentioned arrangements.

Should you have any queries regarding the contents of this circular, please contact Ms Lorraine Chan on 2842-7751.

Intermediaries Supervision Department
Securities and Futures Commission

End

SFO/IS/017/2012