



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

Consultation Conclusions on the Proposed Guidelines on Online Distribution and Advisory Platforms and Further Consultation on Offline Requirements Applicable to Complex Products

March 2018



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Foreword

On 5 May 2017, the Securities and Futures Commission (**SFC**) issued a Consultation Paper on the Proposed Guidelines on Online Distribution and Advisory Platforms (**Consultation Paper**). This paper summarises the comments received on the Consultation Paper, provides the SFC's responses to the feedback and also further consults the public on proposed offline requirements applicable to complex products.

Market participants and interested parties are invited to submit written comments on the further consultation or to comment on related matters that might have a significant impact upon the proposals by no later than 28 May 2018. Any person wishing to comment on the proposals on behalf of an organisation should provide details of the organisation whose views they represent.

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

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

Written comments may be sent as follows:

By mail to: Securities and Futures Commission
35/F Cheung Kong Center
2 Queen's Road Central
Hong Kong
Re: Further Consultation on Offline Requirements
Applicable to Complex Products

By fax to: (852) 2284-4660

By online submission at: www.sfc.hk/edistributionWeb/gateway/EN/consultation/

By e-mail to: ComplexProducts_Offline@sfc.hk

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

Securities and Futures Commission
Hong Kong

28 March 2018



Personal information collection statement

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

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² The term "relevant provisions" is defined in section 1 of Part 1 of Schedule 1 to the Securities and Futures Ordinance (Cap. 571) and refers to the provisions of that Ordinance together with certain provisions in the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32), the Companies Ordinance (Cap. 622) and the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance (Cap. 615).



Enquiries

6. Any enquiries regarding the Personal Data provided in your submission on this 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. On 5 May 2017, the Securities and Futures Commission (**SFC**) issued a Consultation Paper (**Consultation Paper**) on the Proposed Guidelines on Online Distribution and Advisory Platforms (**Guidelines**). The Guidelines aim to provide tailored guidance to the industry on the design and operation of online platforms and to clarify how the Suitability Requirement³ would operate in an online environment.
2. The consultation ended on 4 August 2017. The SFC received 34 written submissions, including from asset management firms, industry associations, robo-advisory and Fintech companies, law firms and individuals. A list of respondents (other than those who requested anonymity) is set out in **Appendix 6**.
3. Respondents were generally supportive of our proposal to provide tailored guidance and clarity on the design and operation of online platforms. The key comments focused on the types of investment products that would be considered to be non-complex or complex and on the requirement to ensure suitability in the sale of complex products online. Other comments mainly sought clarification of various technical and operational issues.
4. For the reasons set out in this paper, the SFC will adopt the Guidelines with certain modifications. Details of the modifications and further clarifications are discussed in this paper.
5. The SFC is conducting a further consultation on adopting the additional measures applicable to online sales of complex products (eg, ensuring suitability of the products) to offline sales of such products. The indicative draft of the corresponding proposed amendments to the Code of Conduct is set out in **Appendix 5**.

Key comments

Non-complex and -complex products

6. Respondents generally agreed with the concept of non-complex and complex products. However, many comments and suggestions were received on the types of investment products that would be considered to be non-complex or complex. In particular, some respondents were of the view that funds not authorized by the SFC are not necessarily complex.
7. We agree that overseas public funds⁴ which have not sought the SFC's authorization as well as other products traded on overseas exchanges may not necessarily be complex. However, many of them could well be complex. These overseas products are not subject to the SFC's remit and are very large in number and variety.

³ This refers to the requirement (as set out in paragraph 5.2 of the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (**Code of Conduct**)) that licensed or registered persons should, when making a recommendation or solicitation, ensure the suitability of the recommendation or solicitation for the client is reasonable in all the circumstances, 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.

⁴ Please refer to paragraph 159 for a discussion of "public funds".



8. It is therefore the Platform Operator's⁵ responsibility to determine whether an overseas product to be sold on its platform is complex having regard to the factors set out in paragraph 6.1 of the Guidelines and the non-exhaustive list of examples of non-complex and complex products to be provided as guidance. A Platform Operator may treat an overseas product as non-complex or complex after carrying out the above assessment with due skill, care and diligence. In this connection, a Platform Operator should consider whether the overseas product is of the same type as an investment product in the list and whether the overseas product is being regulated in or traded on an exchange in a specified jurisdiction⁶. For example, a Platform Operator may generally treat shares or physical exchange-traded funds (**ETFs**) traded on an exchange in the US as non-complex.
9. Platform Operators should exercise extra caution where the product is regulated in or traded on an exchange in a jurisdiction which is not a specified jurisdiction.
10. We will also seek to align the types of funds which will be regarded as "non-derivative" and "derivative" for the purposes of paragraph 5.1A⁷ and 5.3⁸ of the Code of Conduct, the Guidelines and the categorisation under the to-be revised Code on Unit Trusts and Mutual Funds (**UT Code**)⁹ to give better clarity to the industry in response to their consultation feedback.
11. The list of examples of non-complex products has also been revised to include callable bonds (without other special features). The revised list of non-complex and complex products is set out in **Appendix 3**.

Ensuring suitability in the sale of complex products online

12. A considerable number of respondents supported the proposal that the sale of complex products on online platforms (including those sold on an unsolicited basis) should be subject to the Suitability Requirement. There were also quite a number who objected to the proposal and were of the view that Platform Operators should not be responsible for a client's own self-directed decision to invest in a complex product.
13. Instead of ensuring suitability, some respondents suggested that online platforms be required to conduct an assessment of a client's knowledge of a complex product.
14. A key reason for putting forward our proposal is that we considered that only conducting an assessment of a client's knowledge of a complex product may not be adequate in the online context as it would be difficult to assess and ensure that a client truly understands the terms, features and risks of a particular complex product. We are also of the view that a suitability assessment would provide better investor protection.

⁵ This refers to licensed or registered persons conducting regulated activities in providing order execution, distribution and/or advisory services in respect of investment products via online distribution and advisory platforms.

⁶ Please refer to the discussion in paragraphs 160 and 164 of this paper.

⁷ This refers to the requirement for intermediaries to conduct an assessment of a client's knowledge of derivatives.

⁸ This refers to the know-your-client requirement for intermediaries to assure themselves that a client understands the nature and risks of derivative products and has sufficient net worth to be able to assume the risks and bear the potential losses of trading in the products.

⁹ A "non-derivative" fund or ETF will mean one whose derivatives investments do not exceed the overall limit set out in the UT Code for Chapter 7 funds (plain vanilla funds). Such overall limit is currently under consultation and proposed to be 50% of NAV in derivatives investments based on the commitment approach. Please refer to the Consultation Paper on Proposed Amendments to the Code on Unit Trusts and Mutual Funds issued by the SFC on 18 December 2017.



15. Some respondents appeared to have the perception that the Suitability Requirement could not be properly discharged on online platforms. As discussed in this paper, we are of the view that the Suitability Requirement can be properly discharged via an online platform through its proper design and operation.
16. For the reasons set out in the Consultation Paper, we will adopt the proposal to require Platform Operators to ensure suitability in the sale of complex products online (including those sold on an unsolicited basis). For complex products which are also derivative products traded on an exchange in Hong Kong or in a specified jurisdiction¹⁰, where there has been no solicitation or recommendation, a Platform Operator is not required to comply with the requirement to ensure suitability for transactions in such products executed on an exchange although it must still comply with the requirements under paragraphs 5.1A and 5.3 of the Code of Conduct.

Robo-advice

17. A number of respondents commented that technology tools which are not client-facing should not be caught under the definition of “robo-adviser” in the Guidelines. We have clarified that the scope of robo-advice under the Guidelines only applies to the provision of investment advice using client-facing technology tools. Intermediaries should, however, comply with other requirements applicable to their use of non-client-facing technology tools (eg, the Code of Conduct, various frequently asked questions (**FAQs**), and the Management, Supervision and Internal Control Guidelines for Persons Licensed by or Registered with the SFC (**Internal Control Guidelines**)).

Triggering of the Suitability Requirement

18. Respondents generally welcomed more clarity on what triggers the Suitability Requirement in the online context. Some respondents sought clarification of the specific examples, included in the Consultation Paper, of when the Suitability Requirement is and is not triggered in the online context. Some suggested other examples for the SFC’s consideration. To provide additional guidance, we have added more examples and these are included in **Appendix 2** along with the examples listed in the Consultation Paper.
19. To facilitate easy reference and access to SFC guidance materials in respect of the Suitability Requirement, we have consolidated and set out all the relevant materials in one page on the SFC’s website.

Alignment of online and offline requirements

20. One common comment on various aspects of our proposals was that the same conduct requirements should apply to all distribution platforms and channels (offline or online) to ensure a level playing field and avoid potential regulatory arbitrage.
21. In particular, many of the respondents who supported the requirement to ensure suitability in the sale of complex products online also supported aligning the requirements for online and offline sales.

¹⁰ Please refer to the discussion in paragraph 198 of this paper.



22. We are conducting a further consultation in this regard as set out in Section III of this paper.

Implementation

23. The final version of the Guidelines is set out in **Appendix 1**.
24. To allow reasonable time to implement the necessary operational and system changes to comply with the requirements and given that the proposals are mainly for investor protection purposes, the Guidelines will become effective 12 months from the gazettal of the Guidelines.
25. We would like to thank all who responded for their time and effort in reviewing the Guidelines and for their detailed and thoughtful comments.
26. The Consultation Paper, the responses (other than those from respondents who requested they be withheld from publication) and this paper are available on the SFC website at www.sfc.hk.



Section I – Online and offline sales processes

Question 1: Do you agree with the factors relevant to online platforms identified above? Please explain your view.

Question 2: Are there any factors that the SFC has not identified? Are these covered by existing conduct requirements? If not, do you have any suggestions about how they can be addressed through specific requirements? Please explain your view.

Factors relevant to the differences between the online and offline sales processes

Public comments

27. Respondents to these questions generally agreed with the factors identified and the differences between online and offline sales processes set out in the Consultation Paper. For example, they agreed that online platforms tend to offer more products than face-to-face sales channels and give clients access to a wider range of products.
28. Respondents agreed that clients may not have sufficient knowledge and experience to understand the broad range of investment products available on online platforms, most of which involve little human interaction. However, they considered that human interaction, where offered (eg, through hotlines or live chats), would assist clients with their enquiries and provide a better customer experience.

The SFC's response

29. As stated in the Consultation Paper, the Guidelines provide more tailored guidance to the industry on the design and operation of online platforms in compliance with existing regulatory requirements, taking into account the differences between the online and offline sales processes. We have considered the factors mentioned in the Consultation Paper (including the above) in formulating our proposals. The SFC will work with the Investor Education Centre (**IEC**) to enhance public awareness of the advantages and disadvantages of using online platforms.

“Simplified” suitability assessment

Public comments

30. A respondent suggested that the SFC should consider allowing online platforms to conduct a simplified suitability assessment for recommendations of non-complex products. Two respondents called for flexibility around the scope and application of the Suitability Requirement in a “simplified advice” context.
31. Some respondents were of the view that it was not realistic or practical to expect an online platform, with little human interaction, to be able to conduct the same level of comprehensive risk profiling and analysis for discharging the Suitability Requirement that is expected of an intermediary offline. There were requests that the same standard for discharging the Suitability Requirement online should be less onerous than offline.



The SFC's response

32. The Suitability Requirement is triggered by a solicitation or a recommendation. The act of solicitation or recommendation can take place both online and offline. Only the form of solicitation or recommendation may be different. For example, in the offline sales process a solicitation or recommendation may occur during an investor's conversation with the intermediary, while in an online environment, it would depend on the materials posted on the platform. However, once triggered, the standard for discharging the Suitability Requirement is the same.
33. With regard to the perception that the Suitability Requirement cannot be properly discharged on online platforms, we are of the view that the Suitability Requirement can be properly discharged via an online platform through its proper design and operation. As discussed above, the Guidelines aim to provide more tailored guidance on the design and operation of online platforms to assist Platform Operators in complying with existing requirements, including the Suitability Requirement.

Section II – Proposed Guidelines

Application of the Guidelines and other regulatory requirements

Licensing requirements

Public comments

34. A number of respondents sought clarification of the licensing requirements applicable to online platforms, for example, whether offshore operators of online platforms which do not have any operations in Hong Kong need to be licensed by the SFC in order to sell investment products to investors in Hong Kong.
35. Clarification of whether the provision of advice on asset allocation among general asset classes (eg, equity, fixed income, deposits) by online platforms would require a licence was also sought.

The SFC's response

36. Generally speaking, companies carrying on a business in regulated activities in Hong Kong would have to be licensed by or registered with the SFC¹¹. The type of licence required to operate an online platform would depend on the regulated activity to be performed (eg, a Type 1 licence would likely be required for a fund distribution platform). The fact that an offshore operator does not have operations in Hong Kong would suggest that it does not carry on a business in regulated activities in Hong Kong. However, licensing requirements may still be triggered¹² if: (i) the operator holds itself out as carrying on such a business in Hong Kong; or (ii) its services that amount to carrying on such a business are actively marketed to the public in Hong Kong, whether by itself or by other entities on its behalf in Hong Kong or from elsewhere.

¹¹ Please refer to Section 114 of the Securities and Futures Ordinance (SFO).

¹² Please refer to sections 114 and 115 of the SFO.



37. Regarding the provision of advice on asset allocation, whether a licence would be required depends on whether the online platform would provide any advice concerning specific investment products.

Scope of application of the Guidelines

Public comments

38. A few respondents sought clarification of the types of platforms to which the Guidelines apply, as the services offered by different online platforms may vary widely. For instance, there are websites which only showcase products; platforms used only by clients classified as institutional or corporate professional investors; self-service information platforms operated by product issuers, and platforms which only distribute research reports.
39. A respondent suggested that the SFC also pay attention to the offering of financial services other than those involving investment products on online platforms, for example, financing, securities lending or borrowing and other facilities. The respondent was of the view that platform operators offering such services should be required to implement additional protective measures.

The SFC's response

40. The Guidelines apply to all SFC-licensed and registered persons when conducting regulated activities in Hong Kong in providing order execution, distribution and advisory¹³ services in respect of investment products via online platforms (whether or not the platforms target Hong Kong investors). The Guidelines also remind Platform Operators to take note of, and comply with, all applicable laws and regulations including other conduct requirements.
41. Other SFC regulations, codes and guidelines would be applicable to other regulated activities conducted in Hong Kong on online platforms (eg, margin financing). Where a service provided on an online platform does not constitute a regulated activity (eg, provision of advice and execution of transactions in mandatory provident funds or banking products issued by an authorized financial institution¹⁴), the Guidelines would not be applicable.
42. In considering compliance with the Guidelines, we will take into account an intermediary's activities targeting Hong Kong investors via all channels in their totality (for example, an intermediary may operate a website which only provides information or is linked to a social network where users can discuss investment ideas with an investment adviser and a separate website which provides trade execution services).
43. We are also mindful that investors may be induced to enter into transactions through platforms linked to a social network or otherwise through forums and other forms of social media, which may or may not be operated by or involve licensed or registered persons. In this regard, the SFC will work with the IEC to alert investors to potential issues arising from the use of online platforms and to increase public awareness of the possible interaction between activities conducted on social media and online platforms.

¹³ Including advisory services provided on a discretionary basis and automated/robo-advice.

¹⁴ Section 103(3)(ea) and sub-paragraph (g) of the definition of "securities" in Schedule 1 to the SFO.



Compliance with other rules and regulations

Public comments

44. A number of respondents sought clarification of operational matters, such as the kind of activities which should be included in the audit trail; the relevance of paragraph 18 of the Code of Conduct and the Guidelines for Reducing and Mitigating Hacking Risks Associated with Internet Trading; timely disclosure of trade confirmations and the provision of investment statements and contact details for handling investor's enquiries and complaints.

The SFC's response

45. In addition to the Guidelines, Platform Operators are equally required to comply with all applicable legal and regulatory requirements in carrying out their regulated activities. These include all applicable requirements under the Code of Conduct and the SFO (eg, the Securities and Futures (Contract Notes, Statements of Account and Receipt) Rules). Additional references to some of these requirements have been included in the Guidelines.

A. Core Principles for the operation of online platforms

Question 3: Do you have any comments on the Core Principles in the Proposed Guidelines as outlined above? Are there any other areas which you think the Proposed Guidelines should cover? Please explain your view.

46. Overall, respondents to this question agreed with the Core Principles in the Guidelines. Some respondents sought clarification concerning the interpretation and scope of certain Core Principles whilst others suggested additional areas the Core Principles should cover.

Materials concerning non-SFC-authorized ETFs

Public comments

47. Several comments were received on the requirement that materials concerning ETFs not authorized by the SFC (such as overseas ETFs) should not be accessible by retail clients. A respondent sought clarification of the meaning of a "retail client". A few respondents commented that the SFC should provide more guidance as to what critical safeguards could be implemented to ensure activities conducted on an online platform would not constitute, or be perceived as, an offering of unauthorized products to the public.
48. A number of respondents also questioned whether a client's self-declared confirmation that he or she is not a Hong Kong retail investor would fulfil the requirement to restrict offers of investments under Part IV of the SFO.



The SFC's response

49. Part IV of the SFO restricts offers of investments to the Hong Kong public. Accordingly, by “retail client”, we generally refer to a member of the public of Hong Kong who is not a professional investor (as defined under the SFO).
50. Regarding a client's self-declared non-retail investor status, it should be noted that intermediaries are already required under the Securities and Futures (Professional Investor) Rules to use methods which are appropriate to satisfy themselves that an investor meets the relevant assets or portfolio threshold to qualify as a professional investor, or to obtain certain prescribed evidential documents showing that the investor qualifies as a professional investor.
51. Platform Operators should ensure that their online platforms are properly designed and have appropriate access rights and controls to ensure compliance with Part IV of the SFO. Whether the provision of information to a client about ETFs traded on an overseas exchange would amount to a breach of Part IV of the SFO would depend on the facts and circumstances of each case. The key issue would be whether such information would amount to an advertisement, invitation or document that is or contains an invitation to the public to invest in those ETFs.
52. For example, in the case of a Platform Operator which provides investment advisory or discretionary portfolio management services to its clients, it should have already conducted proper know-your-client (**KYC**) procedures to obtain sufficient information on its clients at the time of onboarding. If, after taking into account a client's personal circumstances, the platform then makes a recommendation to that client with whom it has a one-to-one advisory relationship to invest in particular ETFs traded on an overseas exchange or effects transactions in such ETFs for that client, this is unlikely to amount to an invitation to the public, which, if not authorized, is prohibited under Part IV of the SFO.
53. In the case of a Platform Operator which provides execution services for overseas ETFs, if the platform does not set out any information about these ETFs (save for information on the exchanges for which it provides execution services) and clients are only able to access factual information about such ETFs after keying in the relevant stock code themselves, this is also unlikely to be prohibited under Part IV of the SFO.

Use of third-party data

Public comments

54. Clarification was sought of whether a Platform Operator is expected to ensure the reliability and accuracy of third-party data posted on its platform, for example, automatic news feed from the press or third-party data used in generating investment advice.

The SFC's response

55. Under the Guidelines, Platform Operators are expected to act with due skill, care and diligence when posting information and materials on their platforms. This would include acting with due skill, care and diligence in the selection, appointment and ongoing monitoring of third-party service providers to enable the Platform Operator to be reasonably satisfied that the information provided by the service provider is accurate and reliable. For example, while we do not generally expect Platform Operators to



monitor the accuracy of each and every news feed item or stock price update, if Platform Operators become aware of incidents which may suggest that the third party may no longer be competent in providing its services, they should consider whether to continue to engage its services.

Disclosure requirements

Public comments

56. A respondent commented that the disclosure requirements applicable to online platforms appear to be more detailed than those applicable to offline channels. An example was the requirement to disclose information about an online platform's risk assessment methodology.
57. Another respondent sought clarification of whether a Platform Operator is required to disclose remuneration received for selling advertisement space on its online platform which is not related to the financial services it provides or a particular investment product.

The SFC's response

58. In an offline environment, an intermediary is generally expected to explain product features and risks to clients at the point of sale or advice. For example, where a client queries the risk rating which an intermediary has assigned to an investment product, the intermediary should respond by explaining the reasons for assigning the rating.
59. In the online context, an investor's understanding of an investment product would normally derive from the materials available on the online platform about the product. Hence, where an online platform provides risk ratings for investment products, it would also be necessary to provide information on how the risk ratings were determined.
60. We have revised the Guidelines to make it clear that the requirement to disclose remuneration information is based on existing disclosure requirements such as those under the Code of Conduct. The example cited of advertisement fees which are not received or linked to the distribution of an investment product would not fall within the scope of the disclosure requirements.

Methodology for risk assessment of product and categorising client

Public comments

61. Respondents sought clarification of the SFC's expectation of the extent to which disclosure should be made of the methodologies adopted for assessing and assigning risk ratings to investment products and categorising clients, including whether a general description would be adequate.

The SFC's response

62. The intention behind this disclosure requirement is to enable clients to form a general understanding of the methodology adopted for risk ratings provided by online platforms. We do not expect platforms to go into the technical details of the methodologies (for example, we do not require detailed disclosure of the weightings for the factors they take into account). The focus is to enable clients to understand and assess how they



should incorporate risk ratings into their investment decisions. Information should be communicated in an easily comprehensible manner by using plain language to make the disclosure easy for investors to read and understand.

Ongoing disclosure

Public comments

63. A respondent was of the view that Platform Operators should provide clients with information concerning their investments promptly and on an ongoing basis to ensure that investors are well informed of any changes in market conditions, such as the occurrence of a major event which may increase the risk of their investments.

The SFC's response

64. The obligation to disclose information to clients is set out under Core Principle 2 of the Guidelines and General Principle 5 of the Code of Conduct. The obligation is to make clear and adequate disclosure of relevant material information. This would include, for example, suspension of dealings in a fund or a proposed merger or termination of funds which are made available by a Platform Operator on its online platform.

Scope and limitation of services provided by a Platform Operator

Public comments

65. A respondent suggested that information should be provided about investors' rights and restrictions (such as how the online platform deals with the cancellation of services and orders), any risks relating to the use of facility, safeguards, personal data (privacy) protection and IT security measures (including an explanation of what would happen in the event of the failure of the platform).

The SFC's response

66. Under the Guidelines, Platform Operators should inform clients of the scope and limitation of services provided through their online platform. We will provide further guidance in FAQs on the information which could be provided, and a Platform Operator may provide more information as it deems appropriate, in particular, if such information is considered relevant material information in its dealings with clients.

Posting of the licensing status of a Platform Operator

Public comments

67. One respondent suggested that the SFC should require that Platform Operators post their licensing status on their online platforms so that users would be aware that they are operated by SFC-licensed or registered persons.

The SFC's response

68. We do not propose to mandate that Platform Operators indicate their licensing status on their platforms. However, we would encourage Platform Operators to do so. The SFC will also work with the IEC to enhance public awareness of the need to check the



licensing status of Platform Operators when using online platforms and the possibility of unlicensed activities conducted through social media and other online channels.

Review and monitoring

Public comments

69. A respondent commented that a review of all activities on the Online Platform would not be feasible or practicable and suggested that Platform Operators be allowed to adopt a risk-based approach to comply with this requirement. Clarification of the scope and depth of the reviews (including the frequency of contingency plan testing), and the activities to be included was also sought.

The SFC's response

70. We wish to clarify that the activities expected to be reviewed by Platform Operators under Core Principle 5 (Review and monitoring) of the Guidelines relate to the design and operation of their online platforms. These include the processes for and the outcomes of any client risk profiling, investment product selection and risk profiling, suitability assessments as well as the reasonableness of any recommendation or advice generated by the algorithm used and any rebalancing conducted. We have revised the Guidelines accordingly.
71. It should be noted that paragraph 2.6 of the Guidelines requires that appropriate reviews be conducted. Platform Operators should exercise their professional judgment about the scope and frequency of reviews. However, where a regular review is required, it is expected that it should be conducted at least annually.

B. Robo-advice

Question 4: Are there any other areas relating to robo-advice which you think the Proposed Guidelines should cover? Please explain your view.

Question 5: What are your views on the shortcomings of robo-advice? How can the Proposed Guidelines be further enhanced to address these issues?

Definition of “robo-adviser”

Public comments

72. Respondents to the above questions generally agreed with the requirements in the Guidelines on robo-advice.
73. Some respondents sought clarification of what constitutes “robo-advice”. A number commented that technology tools which are not client-facing should not be caught under the definition of “robo-adviser” in the Guidelines. Another respondent also sought clarification of the licensing requirements for robo-advisers operating different business models.



The SFC's response

74. We are aware that robo-advisers operate different business models and provide a wide range of advisory services. The scope of robo-advice under the Guidelines only applies to the provision of investment advice using client-facing technology tools. Hence, intermediaries using technology tools to assist and support them in providing investment advice to clients are outside the scope of the Guidelines. However, these intermediaries should comply with other applicable requirements (eg, Code of Conduct, FAQs, and the Internal Control Guidelines). For example, they have to exercise due skill, care and diligence in the selection, appointment and ongoing monitoring of the technology service provider. This has been clarified in the Guidelines.
75. Online platforms which provide investment advice or allow investors to transact investments would require a licence or registration where the business conducted in Hong Kong amounts to a regulated activity. The Guidelines apply to these licensed or registered persons.
76. The SFC will work with IEC in preparing educational materials for the different types of online platforms, including robo-advisory platforms.

Information on algorithms

Public comments

77. In respect of the requirement for robo-advisers to provide information to clients including a description on how underlying algorithms operate and any limitations of the algorithm, one respondent commented that this will require Platform Operators to give away their trade secrets. Another respondent commented that such information should be limited to a broad, high level disclosure. Other respondents suggested that additional information should be provided, including the trade execution strategies employed by the robo-adviser and the options available if the investor wants to override these trading decisions, and how the robo-adviser charges for its services.

The SFC's response

78. It is important for clients to understand how investment advice is generated and how algorithms are used to manage their accounts. Information provided to clients should include the limitations of the robo-adviser's services and how and when the algorithm might rebalance a client's portfolio. We do not expect platforms to go into the technical details of the algorithms. The focus of the requirement is that clients are provided with information which enables them to assess whether to use the services of the robo-adviser. Disclosures must be clear and easy to read. Overly technical terms should be avoided.

Supervision and testing of algorithms

Public comments

79. A respondent commented that putting in place controls to suspend the provision of advice or services in the event of an algorithmic error may not be necessary. A more practical approach would be to disclose situations under which the Platform Operator may override the algorithm (instead of suspending the provision of advice).



80. There was also a question about the SFC's expectation regarding the "suitably-qualified person" who is expected to test, review, and ensure the reasonableness of the advice provided on a robo-advice platform.

The SFC's response

81. When an algorithm fails to work properly or as intended, service may be disrupted and investors may incur losses on their investments. The SFC expects robo-advisers to have in place internal controls to detect these failures, and halt trading if necessary. Robo-advisers should decide whether it would be in the best interest of clients to override the algorithm or even suspend trading activities.
82. The SFC expects a "suitably-qualified person" to test and review the algorithm used to generate the investment advice as well as the reasonableness of the advice. The robo-adviser should exercise its professional judgment about who would be an appropriate person with the experience and competency to carry out these duties. For example, the third-party service provider which designed the algorithm may work with the investment manager or adviser and the compliance officer to ensure that the algorithm is generating appropriate advice for platform users.

Rebalancing

Public comments

83. A respondent commented that Platform Operators should explain the purpose of rebalancing. Another respondent suggested that in addition to informing clients clearly at the outset that automatic portfolio rebalancing (where applicable) would occur, clients should be asked when first entering a relationship with the firm whether they wish to opt-in to the automatic rebalancing mechanism. A respondent commented that platform-executed trades resulting from the automatic rebalancing of portfolios should not be deemed as solicitations and should not trigger the Suitability Requirement.

The SFC's response

84. The SFC agrees that clients of robo-advisers should understand the purpose of rebalancing. If a robo-adviser offers clients the flexibility to opt-out of auto-rebalancing, it should inform clients of the potential risks and consequences of opting out of the rebalancing service (for example, their portfolio may no longer maintain the target asset allocation over time). It should also warn clients that the original portfolio that they may invest into or have invested into according to the robo-adviser's recommendation could, as a result of the opt-out, become unsuitable for them and that they require a different service to be provided. If a client insists on opting out, the client should be directed to acknowledge and confirm a change in the scope and terms of services to be provided by the Online Platform going forward. Although the robo-adviser may no longer have an advisory relationship with the client as a result, it should still comply with all other applicable requirements in the Guidelines. These include the requirement to ensure suitability in the sale of any complex product online (as discussed below in this paper).
85. The SFC will work with IEC to enhance investors' understanding of the services offered by online platforms including robo-advisers and their operation.
86. Auto-rebalancing (for example, for the purpose of controlling the risk weighting of existing products within a portfolio, or making changes to the portfolio by adding or



removing products) would generally be regarded as a recommendation and trigger the Suitability Requirement, as the client would be buying or selling products in the portfolio on the advice or recommendation of the robo-adviser. If the purpose of rebalancing would be to maintain the target asset allocation of a predefined model portfolio previously agreed with a client, robo-advisers can discharge their suitability obligations by ensuring that the rebalancing is conducted in accordance with the predefined portfolio.

Other comments

Public comments

87. Most respondents agreed with the SFC that online platforms (including robo-advisory platforms) are beneficial to investors. They commented that online platforms are well placed to offer consistent, unbiased advice and continuous services to the mass retail market at potentially lower cost compared to financial advisors. As such, it was suggested that the SFC should consider waiving or relaxing the KYC requirements and the Suitability Requirement for online sales in order to encourage the development of online distribution in Hong Kong.
88. It was noted that ETFs are among the most common products recommended by automated advice platforms. Many robo-advisers include ETFs in their model portfolios when generating advice for their clients. Respondents sought clarification of whether including overseas ETFs in model portfolios would be in breach of Part IV of the SFO.
89. A few respondents commented that robo-advice also has its shortcomings, as it lacks the human touch. They commented that many automated advice tools are currently product-driven and not client-centric. They are not able to provide holistic advice which incorporates client's life goals, needs, and preferred approaches to financial matters.

The SFC's response

90. Robo-advice would normally involve a solicitation or recommendation and thereby trigger the Suitability Requirement. Regulatory arbitrage would result if a waiver or relaxation of the Suitability Requirement or KYC requirements were granted only for transactions conducted online. With respect to KYC, requirements for, and guidance on, non-face-to-face client on-boarding are set out in paragraph 5.1 of the Code of Conduct and circulars issued by the SFC from time to time¹⁵.
91. Whether the inclusion of overseas ETFs in model portfolios would be in breach of Part IV of the SFO depends on the facts and circumstances of each case, and in particular whether there was an invitation to the public to acquire an interest in the ETFs. For example, some robo-advisers may choose to describe their scope of services to include the distribution of investment products which are overseas ETFs (without specifying or disclosing the particulars of the investment products in the model portfolio which is generated). Others may generate a tailor-made recommended portfolio which includes overseas ETFs for a particular client with whom they have a one-to-one advisory relationship only after taking into account that client's personal circumstances. Robo-advisers should ensure their online platforms are properly designed in compliance with

¹⁵ For example, the Advisory circular to intermediaries - Client identity verification in account opening process issued by the SFC in October 2016.



the applicable laws and regulations. Reference should also be made to paragraphs 49 to 53 of this paper.

92. Regarding the possible shortcomings of robo-advice, the Guidelines require robo-advisers to provide information on the limitations of their services and ensure they accurately describe the services they provide. For example, where a robo-adviser provides goals-based advice such as planning for children's education, it should not describe its services as providing comprehensive financial planning.

C. Application and discharge of the Suitability Requirement in the online context

Question 6: Do you have any comments on the guidance on the Suitability Requirement to be provided in the Proposed Guidelines?

Question 7: Do you have any comments on how the design and overall impression created by an online platform's content could trigger the Suitability Requirement?

Question 8: Do you have any comments on the above examples of when the posting of materials on online platforms would or would not amount to a solicitation or recommendation?

Question 9: Are there any examples not mentioned above that may suggest that the content or presentation of materials would amount to a solicitation or recommendation? Please explain your view.

Question 10: Do you have any view on how risk analysis assessments and client profiling should be conducted and the quantitative and qualitative factors that any risk methodology should take into account?

I. Triggering of the Suitability Requirement

Existing requirement

Public comments

93. Many respondents were of the view that only "personal" recommendations should trigger the Suitability Requirement.
94. One respondent suggested that recommendations of "plain vanilla" products (eg, ETFs) should not trigger the Suitability Requirement as they are generally suitable for the mass market.
95. A few respondents also commented that human interaction on online platforms should not automatically trigger the Suitability Requirement.

The SFC's response

96. The Guidelines are formulated to provide tailored guidance on the design and operation of online platforms in compliance with existing regulatory requirements, including the Suitability Requirement. Under paragraph 5.2 of the Code of Conduct, the Suitability



Requirement is triggered by a solicitation or a recommendation (ie, not a personal recommendation). For many years, this has served as a key investor protection measure calibrated to Hong Kong's market and local selling practices.

97. Human interaction on online platforms would not automatically trigger the Suitability Requirement. Whether the Suitability Requirement is triggered would depend on whether the human interaction involves a solicitation or recommendation which requires an analysis of the content and context of each interactive communication. Platform Operators should refer to guidance issued by the SFC in this connection¹⁶.

Biased "execution-only" platforms

Public comment

98. A respondent expressed concern about "execution-only" platforms which have statistical tools or analytical services biased in some particular direction which may blur the line between providing "execution-only" services and providing "advice and recommendations". It urged the SFC to reconsider whether such tools and services trigger the Suitability Requirement.

The SFC's response

99. Where an online platform's statistical tools or analytical services are inherently biased, they would not be "factual, fair and balanced" and would trigger the Suitability Requirement.

Examples on when the Suitability Requirement would be triggered

Public comments

100. Respondents generally welcomed more clarity on what triggers the Suitability Requirement in the online context. Some respondents sought clarification of the specific examples of triggers and some suggested other examples for the SFC's consideration.
101. Most respondents agreed that the posting of factual, fair and balanced product-specific materials would not in itself amount to a solicitation or recommendation and should not trigger the Suitability Requirement. However, they sought clarification of what the SFC meant by "*facts and circumstances that may reasonably be expected to influence investors to purchase a particular investment product*", and "*the Suitability Requirement would apply where the platform emphasises some investment products over others*".
102. Respondents sought clarification of whether the posting on an online platform of an advertisement for a specific product without any product-specific incentive or a list of products would be deemed as placing emphasis on some investment products over others, thus triggering the Suitability Requirement.
103. Some respondents expressed the need for the SFC to provide examples or guidance for when the design and overall impression created by the content of an online platform would trigger the Suitability Requirement as this could be highly subjective.

¹⁶ For example, the SFC's Circular to Intermediaries – Frequently Asked Questions on Triggering of Suitability Obligations, December 2016.



104. Another respondent commented on the differences between the requirements for online and offline sales and sought clarification of the rationale behind such differences. For example, the Suitability Requirement is triggered when an advertisement which includes product-specific incentives is posted on an online platform, whereas the posting of the same advertisement in newspapers, magazines or on television would not trigger the Suitability Requirement.

The SFC's response

105. As set out in the Consultation Paper, the posting of factual, fair and balanced product-specific materials would not in itself amount to a solicitation or recommendation and will not trigger the Suitability Requirement in the absence of other facts and circumstances which may reasonably be expected to influence investors.
106. In determining whether the posting of materials would trigger the Suitability Requirement, the assessment should take into account the content and context of these materials coupled with the design and overall impression created by the platform content.
107. In the Consultation Paper, we provided the example that the posting of research reports (which may contain views on buy, hold or sell with target prices) would not trigger the Suitability Requirement provided that the research reports are factual, fair and balanced.
108. In other words, to trigger the Suitability Requirement, we would expect additional factors to be present which would induce a client to enter into a transaction or that would put pressure on a client to proceed with a transaction, whether through the content of the materials or the context (such as the manner of presentation). For example, we clarified that the Suitability Requirement would be triggered by posting advertisements which include product-specific incentives (eg, cash rebates, fee discounts) as well as product-specific research reports with words such as "Don't Miss Out!" or "Act Now!" As noted by one of the respondents, it may also be easier for pop-up messages and flashing icons to give the impression of making recommendations or solicitations which would trigger the Suitability Requirement.
109. On factual, fair and balanced materials, we provided the example that the posting of lists of investment products (ie, such lists are not the full list of investment products available on the online platform but are lists within the full list) selected using objective criteria would not trigger the Suitability Requirement. In this connection, Platform Operators should have a reasonable basis for coming up with the selected lists of products and the objective criteria used should also be set out or made available.
110. In the offline context where there is face-to-face communication, the display of advertisements or other materials may or may not trigger suitability obligations depending on whether they are relevant to the selling or advisory process in the direct communications with the client¹⁷. The assessment should be made at the point of sale or advice. This is different from the online context, where without any human interaction the "selling or advisory process" centres on the materials posted on the platform.

¹⁷ Please refer to the SFC's Circular to Intermediaries – Frequently Asked Questions on Triggering of Suitability Obligations, December 2016



111. To provide more guidance on when the Suitability Requirement is and is not triggered in the online context, we have added more examples to the list set out in **Appendix 2**. These examples will be included in FAQs and will be updated from time to time as appropriate.

II. Discharging the Suitability Requirement

Portfolio-based approach to ensuring suitability

Public comments

112. Several respondents commented that Platform Operators should be allowed to adopt a portfolio-based approach to ensuring suitability. Some respondents were of the view that ensuring suitability on a portfolio basis (instead of on a product or transaction basis) was desirable.

The SFC's response

113. As set out in the Frequently Asked Questions on Compliance with Suitability Obligations by Licensed or Registered Persons, we expect, as part of the suitability assessment, that licensed or registered persons should consider the overall effect of their recommended product on their clients' portfolios.

Concentration risk

Public comments

114. A respondent sought guidance on how concentration risk can be assessed in an online environment. Another respondent wished to clarify that a high-risk investment may be suitable for a person with a medium risk profile (ie, where there is a risk mismatch).

The SFC's response

115. Platform Operators should refer to the guidance issued by the SFC on assessing concentration risk¹⁸. In the context of online platforms, it is expected that an online platform should have in place appropriate tools for assessing a client's concentration risk based on the information about the client obtained through the platform's KYC process and any investment portfolio held with the platform.
116. As discussed above, as part of the suitability assessment, Platform Operators should consider the overall effect of their recommended product on their clients' portfolios. For example, for a client with low or medium risk profile, a proportion of high risk products in the portfolio may not be unsuitable so long as this is commensurate with the risk return profile of the portfolio and the Platform Operator is able to satisfy itself that any investment products recommended are likely to meet the investment objectives and other personal circumstances of the client.

¹⁸ Please refer to the SFC's Circular to Intermediaries – Frequently Asked Questions on Compliance with Suitability Obligations, December 2016.



Unsuitable transactions

Public comments

117. Respondents sought clarification of whether, or suggested that, online platforms could proceed with a transaction which has been assessed to be unsuitable for a client.

The SFC's response

118. Where the Platform Operator, being under the obligation to ensure suitability, has assessed the transaction to be unsuitable for the client but the client still wishes to proceed, the Platform Operator should not proceed to effect the transaction.

Inconsistent or incomplete information

Public comments

119. A respondent commented that where inconsistent answers from clients cannot be reconciled, there should be a mechanism to determine whether the client should be allowed to place an order rather than requiring online platforms to completely “filter the client out”. Another respondent noted that it is not uncommon for clients to omit providing all the information requested by the intermediary, especially about their financial situations. Clarification was sought on whether a Platform Operator can still proceed to provide a recommendation based on incomplete information.

The SFC's response

120. As set out in the Frequently Asked Questions on Compliance with Suitability Obligations, Platform Operators should collect from each client information that includes the client's investment knowledge, investment horizon, risk tolerance and capacity to make regular contributions and meet extra collateral requirements, where appropriate. Where a Platform Operator has used reasonable efforts to obtain information from clients, the Platform Operator may rely on the information provided by clients unless the information obtained is inconsistent with the client's information held with the Platform Operator.
121. If a client's answers are inconsistent, the Platform Operator should alert the client and seek to reconcile the inconsistencies before performing the suitability assessment. Platform Operators could implement control procedures to direct clients to the inconsistent information and provide the opportunity for them to change their previous answers and provide the most up-to-date and accurate information.
122. If incomplete information is provided by a client, the Platform Operator should alert the client and seek clarification from the client before performing the suitability assessment. If disclosure by the client is limited and as a result, the Platform Operator is unable to make that assessment properly, the Platform Operator should, as a minimum, explain to the client the inherent limitations of the recommendations made as a result of the lack of information. Furthermore, the Platform Operator should explain to the client the assumptions, if any, made in relation to such recommendations.
123. We will also work with the IEC to enhance investors' knowledge regarding the use of online platforms (eg, the importance of providing accurate and sufficient information so that appropriate advice can be provided by online platforms).



Risk analysis assessment and profiling

Public comments

124. Two respondents asked whether the SFC would publish a template for, or minimum factors that should be taken into account in, conducting risk assessments for client profiling and product risk rating. Another respondent commented that no detailed guidance should be provided for risk analysis assessments, client profiling and the factors to be considered because it should be left to intermediaries to come up with the appropriate methodology or metrics. A different respondent commented that it is both important and appropriate not to make the design and scoring mechanism requirements overly prescriptive. Instead, two respondents were of the view that a principles-based approach should be used.
125. One respondent suggested that when assessing product risk, intermediaries should consider the standard deviation of product prices, liquidity, the asset class of the investment product (eg, whether it is a derivative or non-derivative product), credit ratings and whether margin financing arrangements apply.
126. A respondent commented that traditional factors including credit scores, gender, employment, location, revenues and wealth should be considered in client profiling along with non-traditional factors such as behavioural economics and gamification.

The SFC's response

127. Our regulations are principles-based and Platform Operators should formulate their own risk analysis and assessment methodologies taking into account both qualitative and quantitative factors. In order to give firms the flexibility to develop methodologies suitable for their business models, it would not be appropriate for the SFC to prescribe a standard risk assessment methodology or provide a standard template for risk assessment and client profiling.
128. Platform Operators should have a good understanding of the nature and extent of risks of the investment products and may need to consider market and industry risks, economic and political environments, regulatory restrictions and any other factors which may directly or indirectly impact the risk return profiles and growth prospects of investments depending on the nature of the investment products. Platform Operators should conduct their own assessment which takes into account all relevant information that is appropriate and reasonably available for a fair and balanced assessment.
129. For the purpose of conducting suitability assessments, in addition to KYC information about a client's financial situation, investment experience and investment objectives, Platform Operators should 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. The SFC does not limit the factors to be considered or the data (including big data from customer behaviour) to be used in client profiling for the purpose of the suitability assessment. However, a Platform Operator should be reasonably satisfied that a proper assessment is made of both clients and products in order to provide recommendations which are reasonably suitable for its clients.



Timing of ensuring suitability

Public comments

130. A respondent commented that private bank staff may have prior conversations with a client about trade ideas involving a specific product before the client decides to execute the trade online. A more practical approach should be taken to allow timely post-trade suitability checks if pre-trade checks are not possible.

The SFC's response

131. The Code of Conduct requires that the intermediary should, when making a recommendation or solicitation, ensure the suitability of the recommendation or solicitation for that client is reasonable in all the circumstances. Discussing trade ideas with a client may trigger the Suitability Requirement depending on the content of the conversations. Intermediaries should ensure the investment product is suitable for the client before making the solicitation or recommendation, or at the latest, before executing the order.

D. Sale of complex products on online platforms on an unsolicited basis

I. What is a complex product

Question 11: Do you have any comments on the definition of a complex product, and the considerations that should be taken into account in determining whether a product is complex?

Question 12: Do you have any comments on the list of investment products that are considered to be “non-complex”?

Question 13: Do you have any comments on the list of examples of investment products that are considered to be “complex”? Please explain your view.

IOSCO¹⁹ definition

Public comments

132. The majority of respondents agreed with our reference to IOSCO's definition of a complex product. However, one respondent disagreed with classifying investment products as non-complex or complex and was of the view that rules governing the selling of authorized and unauthorized products were sufficient.
133. A respondent suggested amendments to the definition such that to be classified as complex, an investment product need not be both “difficult to value” and have terms, features and risks that are not reasonably likely to be understood by retail investors whilst retaining the “difficult to value” factor as one which may render a product complex. Comments to reflect that overall complexity and individual features may render an investment product complex were also received.

¹⁹ The International Organization of Securities Commissions



134. Another respondent was of the view that whether or not an investment product is complex should be a client-focused concept (ie, the determination should be made with reference to a client's personal circumstances).

The SFC's response

135. We agree that the key to determining what is a complex product is whether, objectively, it is likely that a retail investor is able to understand its terms, features and risks. If an investment product is difficult for a retail investor to understand, it should be considered complex irrespective of whether it is difficult to value. We also note that IOSCO is of the view that the complexity of a product may make it difficult for it to be valued with a high degree of confidence. Hence, we have revised the Guidelines to the effect that "difficult to value" will be a factor indicating that a product is complex.
136. We also clarify that the definition of a complex product covers products which are complex by their natures or as a result of the inclusion of a particular feature.
137. Regarding whether the determination of complexity should be dependent on a client's personal circumstances (eg, the client's knowledge), the intention behind the proposal is to identify investment products the terms, features and risks of which retail investors (ie, general members of the public) are objectively unlikely to be able to understand. In other words, the assessment is not dependent on any particular client.

Factors indicating complexity

Public comments

138. Some respondents were of the view that the proposed factors indicating complexity went beyond IOSCO's definition.
139. A few respondents suggested that the factors should not be fixed and overly prescriptive or should be assessed on the basis of the totality of the facts instead of adopting a checkbox approach. Guidance was also sought on how each factor should be assessed and how much weight each factor should be given.
140. A number of comments were received about the proposed factors. For example, respondents considered that whether there is a risk of losing more than the amount invested, or whether any features or terms of the investment product might render the investment illiquid, were measures of risk rather than complexity and were thus not relevant. However, one respondent supported including these as determining factors.
141. Some respondents disagreed that derivative products are necessarily complex as some have standardised features and are easy to understand.
142. Respondents raised questions about some of the proposed factors. For example, it was pointed out that the over-the-counter market for bonds provides available pricing and hence clarification was sought on whether this would satisfy the factor regarding the availability of a secondary market for the investment product at publicly available prices.
143. In relation to whether there is adequate and transparent information about the investment product available to retail investors, a respondent asked whether the SFC expected information over and above the information required to be provided by



Platform Operators pursuant to the Core Principle to provide material information to investors.

The SFC's response

144. In proposing the definition of a complex product and the factors to determine whether or not an investment product is complex, we have taken into account the definitions and factors adopted in other major overseas jurisdictions. In our view, the presence of any one of the factors likely suggests that the product should be considered a complex product. However, we do not intend to be overly prescriptive (eg, assigning weighting to the factors) as each product should be holistically assessed on the basis of the totality of the facts depending on its particular terms and features.
145. In a recent investor study conducted by the IEC²⁰, investment products with high liquidity and trading volume (eg, stocks) were perceived to be simple. Well over half (63%) of fund investors surveyed regarded funds investing in derivatives as complex financial products. Leveraged products were also perceived to be more complex. Further, the survey indicated that investment products with more first-hand market news and with prices set by the market were perceived to be less complex.
146. With respect to exchange-traded derivative products which typically are more standardised and transparent, the Guidelines have clarified that, where there has been no solicitation or recommendation, a Platform Operator is not required to ensure suitability for transactions in such products executed on an exchange although it must still comply with paragraphs 5.1A and 5.3 of the Code of Conduct. Please refer to paragraph 198 for a further discussion.
147. We also clarify that for the factor relating to the availability to retail investors of adequate and transparent information about the investment product, the focus should be on whether the investment product is subject to public disclosure requirements rather than whether the Platform Operator has provided adequate information on its online platform.

Other comments

Public comments

148. Comments were received on the use of "retail investor" in the definition of a complex product and clarification of its meaning was sought.
149. Respondents were concerned that the same investment product may be classified by some Platform Operators as complex and by others as non-complex. It would therefore be difficult to achieve consistent application throughout the industry. In this connection, one respondent asked whether the SFC would require product issuers to stipulate a complexity classification of an investment product in offering documentation.

²⁰ IEC Retail Investor Study Research Report, Investor Education Centre, December 2017.



The SFC's response

150. The intention of the reference to a “retail investor” in the definition of a complex product is to objectively cover investment products the terms, features and risks of which a general member of the public is unlikely to be able to understand. Whilst the term “retail investor” may not be specifically defined under our regulatory framework, we believe the term is generally understood.
151. The SFC is aware that different Platform Operators may classify complex products differently. As such, we will provide further guidance to the industry by way of FAQs as well as a non-exhaustive list of investment products which are considered either non-complex or complex to facilitate the industry’s understanding. The FAQs and the example list will be updated from time to time.

Examples of non-complex and complex products

Non-SFC-authorized funds and overseas exchange-traded products

Public comments

152. Many respondents disagreed that funds which have not obtained the SFC’s authorization should be automatically classified as complex products. They stated that funds investing in the same underlying securities and having the same features and natures should be no different in complexity, irrespective of authorization status.
153. Some suggested that concerns regarding the classification of unauthorized funds could be addressed by classifying as non-complex those which are recognized jurisdiction schemes, the investment managers of which are subject to acceptable inspection regimes, or which are issued and operated under internationally accepted regulatory frameworks.
154. Many respondents were of the view that overseas-listed REITs and ETFs not authorized by the SFC should also be considered as non-complex.
155. One respondent was of the view that all shares which are traded on an exchange should be considered as non-complex.

The SFC's response

156. Platform Operators should note that the offering of unauthorized funds is subject to the offers of investments restrictions under Part IV of the SFO. Platform Operators should thus ensure that the offering of such funds on their online platforms is in compliance with the relevant restrictions (eg, by restricting access to professional investors only).
157. We agree that overseas public funds²¹ which have not sought the SFC’s authorization may not necessarily be complex. However, many of them could well be complex. These overseas funds are not subject to the SFC’s authorization process.
158. It is therefore the Platform Operator’s responsibility to determine whether an unauthorized fund to be sold on its platform is complex having regard to the factors set

²¹ Please refer to paragraph 159 for a discussion of “public funds”.



out in paragraph 6.1 of the Guidelines and the non-exhaustive list of examples of non-complex and complex products to be provided as guidance, which specifies that SFC-authorized non-derivative²² funds are non-complex.

159. An unauthorized fund may only be considered to be non-complex if the fund is a non-derivative fund and is authorized or approved for offering to retail investors by an overseas regulator (**public fund**).
160. In general, a Platform Operator may treat a non-derivative unauthorized public fund as non-complex if it is authorized or approved in a specified jurisdiction²³ for public offering. The list of specified jurisdictions for non-exchange-traded unauthorized funds will be posted on the SFC's website. The initial list will consist of the jurisdictions in which recognized jurisdiction schemes²⁴ are regulated and jurisdictions with which a mutual recognition of funds arrangement with the SFC is in place.
161. The SFC may review the list of specified jurisdictions from time to time and Platform Operators may make submissions for adding jurisdictions to this list.
162. Platform Operators should exercise extra caution where the fund is authorized or approved in a jurisdiction which is not a specified jurisdiction.
163. Similarly, for overseas exchange-traded products such as shares, ETFs and REITs, it is also the Platform Operator's responsibility to determine whether such products to be sold on its platform are complex having regard to the factors set out in paragraph 6.1 of the Guidelines and the non-exhaustive list of examples of non-complex and complex products to be provided as guidance.
164. In general, a Platform Operator may treat an exchange-traded product as non-complex if it is of the same type as a non-complex product listed as an example and is traded on an exchange in a specified jurisdiction²⁵. The list of specified jurisdictions for exchange-traded products will be posted on the SFC's website and includes jurisdictions in which the specified exchanges set out in the SFO²⁶ and the Securities and Futures (Financial Resources) Rules are located. Accordingly, a Platform Operator may, for example, generally treat shares or physical ETFs traded on an exchange in the US as non-complex.
165. Platform Operators should exercise extra caution where the product is traded on an overseas exchange which is not in a specified jurisdiction.
166. Platform Operators should determine whether a product may be treated as non-complex or complex with due skill, care and diligence, especially in the case of overseas products as they are not subject to the SFC's regulations and the lists of

²² Please refer to paragraphs 170 – 175 of this paper for a discussion on “derivative funds”.

²³ “Specified jurisdictions” for non-exchange-traded unauthorized funds are currently Australia, France, Germany, Guernsey, Ireland, Isle of Man, Jersey, Luxembourg, Mainland China, Malaysia, Switzerland, Taiwan, the UK and the US.

²⁴ With reference to 1.2 of the UT Code, the SFC may accept that some schemes already comply in substance with certain provisions of the UT Code by virtue of prior authorization in a regulated jurisdiction. The list of “recognized jurisdiction schemes” so accepted are set out on the SFC's website.

²⁵ “Specified jurisdictions” for exchange-traded products are currently Australia, Austria, Belgium, Brazil, Canada, Denmark, Finland, France, Germany, India, Ireland, Italy, Japan, Korea, Luxembourg, Mainland China, Malaysia, Netherlands, New Zealand, Norway, the Philippines, Singapore, Spain, Sweden, Switzerland, Taiwan, Thailand, the UK and the US.

²⁶ Schedule 1 to the SFO.



specified jurisdictions should not be regarded as a form of assessment by the SFC or an endorsement of equivalence. Platform Operators should also refer to the guidance issued by the SFC from time to time in this connection.

Derivative funds

167. Some respondents also disagreed that funds which use financial derivative instruments (**FDIs**) extensively for investment or non-hedging purposes should be classified as complex products. They pointed out that it is not uncommon for SFC-authorized Undertakings for Collective Investment in Transferable Securities (**UCITS**) funds to use FDIs for efficient portfolio management in addition to hedging.
168. A respondent was also of the view that, provided a client understands the risks of using derivatives, it would not be necessary for the client to understand how the relevant fund manager would deliver the investment strategy through the use of derivatives.
169. Industry participants noted that some distributors tend to be hesitant to distribute a fund which is classified as a “derivative fund”. In this connection, some respondents (in their submissions and during further discussions with the industry) were concerned that there are different assessments²⁷ and product categories²⁸ for complex and derivative products across the SFC’s regulatory framework. Going forward, Platform Operators would also be required to conduct suitability assessments in the sale of complex funds on online platforms. Respondents therefore requested that the definitions in the Guidelines, the UT Code and the circular be aligned.

The SFC’s response

170. As noted above, according to a recent investor study conducted by the IEC²⁹, well over half (63%) of fund investors surveyed regarded funds investing in derivatives as complex financial products. In the same survey, over 90% of Hong Kong investors surveyed did not expect plain vanilla equity or bond funds to invest more than 50% of the fund’s NAV in derivatives. In view of this general perception and expectation among Hong Kong investors, plain vanilla public funds are subject to an overall limit on derivatives investments to ensure they do not invest in derivatives to a material extent³⁰.
171. Accordingly, we are of the view that SFC-authorized funds (domiciled in Hong Kong or overseas, including UCITS funds) with derivatives investments exceeding such overall limit should be regarded as “derivative products” for the purposes of the Code of Conduct³¹ and thus “complex products” for the purposes of the Guidelines³². We have revised the non-exhaustive list of non-complex and complex products to reflect this.

²⁷ For derivative funds, intermediaries are currently required to conduct a knowledge assessment of a client under paragraph 5.1A and an additional know your client assessment under paragraph 5.3 of the Code of Conduct.

²⁸ For example, in assessing whether a fund is a derivative fund or otherwise uses FDIs extensively, intermediaries need to refer to the UT Code and the circular “Guidance to Licensed Corporations and Registered Institutions in relation to Derivative Products under the Code of Conduct” issued by the SFC in April 2012 (**Derivative Products Circular**).

²⁹ IEC Retail Investor Study Research Report, Investor Education Centre, December 2017.

³⁰ Such overall limit is currently under consultation and proposed to be 50% of NAV in derivatives investments based on the commitment approach. Please refer to Consultation paper on Proposed Amendments to the Code on Unit Trusts and Mutual Funds issued by the SFC on 18 December 2017.

³¹ Paragraphs 5.1A and 5.3 of the Code of Conduct

³² Prior to the revised UT Code taking effect, intermediaries should refer to existing requirements including the Derivatives Product Circular in determining whether a fund is a derivative fund.



172. To ensure a level-playing field, all non-SFC-authorized funds with derivatives investments exceeding the same overall limit should be categorized in the same manner.
173. In calculating the extent of derivatives investments for SFC-authorized funds, derivatives positions for hedging arrangements may be disregarded. Derivatives used for cash flow management purposes or to enter into a restricted market may or may not be calculated towards the proposed overall limit, depending on the genuine purpose and nature of the derivatives used as well as the exposure of the fund arising from such use. We will seek to align the product categorisation requirements for the purposes of the Code of Conduct³³, the Guidelines and the UT Code and provide more practical guidance where appropriate by way of FAQs.
174. In the course of our discussions with the industry, participants pointed out that the use of derivatives would not necessarily render a fund riskier. For example, it is common for a bond fund to use derivatives to gain exposure, which may be necessary for some market sectors. The use of derivatives in such case may enhance liquidity, reduce costs and facilitate duration management.
175. We agree that the use of derivatives may not necessarily mean that a fund is of high risk. However, the concern is complexity and the difficulty that retail investors may have in understanding a complex product. In the case of a complex but low risk product, it should not be difficult for a Platform Operator to match the risk profile of the product and a client's risk tolerance level which is one of the major factors to be considered when performing a suitability assessment.

Bonds

Public comments

176. Comments were received on the special features which render a bond complex. In particular, many respondents were of the view that bonds with only a callable feature (ie, bonds with an early redemption feature) should not be considered complex products. They considered that such bonds are common and investors are reasonably likely to understand the callable feature and associated risks.
177. Some respondents also suggested that perpetual bonds, convertible bonds (convertible into stock) and subordinated bonds should not be considered complex as these features can be easily understood by retail investors.
178. A respondent asked for clarification of the meaning of the special feature "multiple credit support providers and structures" and whether a sukuk would be considered as having this special feature. A question about whether bonds with "change of control" features would be considered complex was also raised.

The SFC's response

179. We agree it is fairly common for bonds to have a callable feature and this feature as well as the risks it entails should not be too difficult for retail investors to understand. A

³³ Paragraphs 5.1A and 5.3 of the Code of Conduct



bond with a “change of control” feature should be considered non-complex if it only involves a simple callable feature.

180. We consider that the other bond types suggested, which are currently regarded as complex/bonds with special features³⁴, should remain in the list of complex products. This list may be updated from time to time where appropriate.
181. The special feature “multiple credit support providers and structures” covers structures such as a bond having multiple guarantors. Whether a sukuk would be regarded as having such a special feature would depend on the particular structure of the sukuk.

Other products

Public comments

182. Comments were also received that all SFC-authorized investment products and all products listed on the SEHK³⁵ should be considered non-complex.
183. Structured products, equity-linked, credit-linked and interest rate-linked instruments, hybrid instruments, asset-backed or mortgage-backed securities, collateralised debt securities, credit default swaps and forwards should be considered complex.

The SFC’s response

184. We do not agree that all SFC-authorized investment products are non-complex. For example, SFC-authorized hedge funds are considered complex. Structured products, irrespective of authorization status, are also considered complex. We agree with the comments that structured products such as asset-backed or mortgage-backed securities are complex.
185. Investment products listed on an exchange are not necessarily non-complex. For example, there are bonds with special features, and thus complex, which are listed on the SEHK.

II. Additional protective measures

Question 14: In the online environment, do you think that risks arising from the sale of complex products should be addressed by requiring Platform Operators to ensure transactions in complex products are suitable for clients? Please explain your view.

Question 15: As the SFC’s concern arises from the sale of complex products, do you agree that the same requirement to ensure suitability should also apply to offline sales of complex products? Please explain your view.

Question 16: Are there any other additional or alternative protective measures that should be introduced for the sale of complex products online?

³⁴ Circular to Licensed Corporation – Selling of complex bonds and high-yield bonds, SFC, 25 March 2014, and Circular to Licensed Corporations and Registered Institutions – Selling of Fixed Income Products, SFC, 19 November 2012.

³⁵ The Stock Exchange of Hong Kong Limited



Question 17: Are there any types of investment products (eg, accumulators) that should not be made available on online platforms even where the Platform Operator is required to ensure suitability?

Question 18: Do you think the items of minimum information set out in Appendix 4 are sufficient and appropriate? Please explain your view.

Question 19: Do you have any comments on the proposed warning statements set out in Appendix 4 that should be made on an online platform?

Ensuring suitability in the sale of complex products online

Public comments

186. Views from respondents were mixed. A considerable number of respondents supported the proposal that the sale of complex products on online platforms should be subject to the Suitability Requirement. One respondent was of the view that Platform Operators should also be required to ensure the suitability of all transactions conducted on online platforms, irrespective of the complexity of the investment product.
187. There were also quite a number of respondents who objected to the proposal. They stated that the Suitability Requirement should only be triggered where there has been a solicitation or recommendation. Where a Platform Operator has not solicited or recommended a complex product, it should not be responsible for a client's own decision to invest in one.
188. Further, requiring online platforms to ensure suitability would hinder a client's ability to execute transactions in a timely manner.
189. Instead of ensuring suitability, some respondents suggested that online platforms be required to conduct an assessment of a client's knowledge of a complex product. It was also suggested that a concentration assessment may be conducted in addition to the knowledge assessment, and where the concentration of a particular complex product in the client's portfolio exceeded a certain threshold, a suitability assessment would be required. Another respondent suggested that online platforms should only be required to ensure suitability for clients without knowledge. Other respondents suggested that clients without knowledge should be barred from purchasing complex products.
190. Some respondents pointed out that in any event, ensuring suitability would not necessarily result in clients understanding a complex product. However, if it were concluded that Platform Operators should be required to ensure suitability in the sale of complex products, it was suggested that repeat purchases of similar complex products should be exempt from the Suitability Requirement.
191. It was also suggested that where clients had questions or comments about complex products being sold, they should be redirected to human sales through traditional communication channels as opposed to relying purely on an online sales model.
192. One respondent also enquired how Platform Operators could comply with paragraph 3.4 of the Code of Conduct and take into account available alternatives when distributing complex products to clients on an unsolicited basis.



193. Questions about whether the suitability clause in client agreements would apply to unsolicited sales in complex products were also raised.

The SFC's response

194. It appeared that some of the comments which did not support the extension of the Suitability Requirement to the sale of complex products online were based on the perception that it is difficult, if not impossible, to ensure suitability via online platforms.
195. We wish to emphasise once again that the Suitability Requirement can be properly discharged on online platforms. Through proper system design, ensuring suitability should not be a time-consuming exercise which hinders a client's ability to execute transactions in a timely manner.
196. One of the key reasons for putting forward our proposal to require Platform Operators to ensure suitability when selling complex products is that we considered that only conducting an assessment of a client's knowledge of a complex product may not be adequate in the online context as it would be difficult to assess and ensure that a client truly understands the terms, features and risks of a particular complex product. We are also of the view that a suitability assessment would provide better investor protection.
197. We will thus adopt the proposal to require Platform Operators to ensure suitability in the sale of complex products online (including those sold on an unsolicited basis) for the reasons set out in the Consultation Paper.
198. In respect of derivative products traded on an exchange in Hong Kong or in a specified jurisdiction for exchange-traded products³⁶, where there has been no solicitation or recommendation, a Platform Operator is not required to comply with the requirement to ensure suitability for transactions in such products executed on an exchange although it must still comply with the requirements under paragraphs 5.1A and 5.3 of the Code of Conduct. For derivative products traded on an exchange which is not in a specified jurisdiction, a Platform Operator should ensure suitability unless such products could reasonably be treated on the same basis as derivative products traded on an exchange in Hong Kong or in a specified jurisdiction.
199. With respect to the suggestion that suitability need not be ensured for repeat purchases of similar complex products, it should be noted that while an investment product may have been suitable previously it may no longer be suitable due to changes in the client's personal circumstances or market conditions. Further, depending on the risks of the complex product, repeat purchases may increase the concentration of risk in a client's investment portfolio. It is thus necessary for Platform Operators to ensure suitability even in the case of repeat purchases. However, a Platform Operator is free to design the steps it could take to discharge the suitability obligations for repeat purchases (for example, the steps could be different from those for a first-time purchase) provided that it can still be reasonably satisfied that a repeat purchase is suitable for a client having regard to the personal circumstances of the client.
200. We also wish to clarify that paragraph 3.4 of the Code of Conduct (ie, the requirement to ensure that advice and recommendations are based on thorough analysis and take

³⁶ "Specified jurisdictions" for exchange-traded products are currently Australia, Austria, Belgium, Brazil, Canada, Denmark, Finland, France, Germany, India, Ireland, Italy, Japan, Korea, Luxembourg, Mainland China, Malaysia, Netherlands, New Zealand, Norway, the Philippines, Singapore, Spain, Sweden, Switzerland, Taiwan, Thailand, the UK and the US.



into account available alternatives) applies only when an intermediary provides advice to a client. Hence, this provision would not apply to unsolicited sales of complex products.

201. In relation to the applicability of the suitability clause in client agreements under paragraph 6.2(i) of the Code of Conduct, it should be noted that the clause is applicable where an intermediary “*solicits* the sale of or *recommends* any financial product to” a client. The clause would therefore not apply to unsolicited sales of complex products.
202. We will work with the IEC to educate investors about the legal and regulatory implications of the new suitability requirements in respect of complex products as well as matters they should pay attention to when transacting on online platforms.

Minimum information

Public comments

203. The majority of respondents were of the view that the minimum information set out in **Appendix 4** of the Consultation Paper was sufficient and appropriate.
204. A respondent requested that Platform Operators be allowed flexibility in the presentation of the minimum information and compliance with the requirement in general. Another respondent requested that the SFC prescribe templates for disclosure of the minimum information.
205. It was suggested that the minimum information also include information on the product issuer and any risks associated with it, information on the potential maximum drawdown and maximum bid-ask spread if unwinding of the transaction were sought, scenario analyses or working examples for investors to understand the features of a complex product as well as gain/loss or risk impact analyses.
206. A respondent was of the view that the requirement to provide the minimum information should not be applicable to Platform Operators when serving Institutional Professional Investors and Corporate Professional Investors (as defined in the Code of Conduct).
207. Two respondents noted that the minimum information would likely be covered in the complex products’ offering documentation or would have already been provided to the client. A respondent was also of the view that the responsibility to provide minimum information should lie with product issuers.

The SFC’s response

208. Platform Operators operate differently and sell different products with different target investors and clients. It would not be appropriate for the SFC to prescribe a template or a fixed format for the information to be disclosed. The responsibility to provide such information lies with Platform Operators and they should exercise their professional judgment to decide how best to present it to clients. We have also provided guidance in the Guidelines that the posting on an online platform of offering documents containing the minimum information on an online platform would generally satisfy this requirement.
209. In relation to the request that Platform Operators should not be required to provide the minimum information set out in **Appendix 4** of the Consultation Paper when serving Institutional and Corporate Professional Investors, we agree that this requirement may



not be necessary for Institutional and Corporate Professional Investors³⁷ who should be in a position to look after their own interests. We have revised the Guidelines accordingly. Notwithstanding this exemption, Platform Operators are reminded of their obligation to comply with General Principle 5 (Information for clients) of the Code of Conduct.

210. We agree that some of the suggested information would be useful for investors and have revised the non-exhaustive list of examples accordingly. As the list sets out the minimum information which should be provided, Platform Operators are free to provide additional information.
211. We will work with the IEC to raise investors' awareness of the availability of information on online platforms (eg, offering documents, minimum information and warning statements for complex products) and the importance of reading and understanding such information prior to making any investments.

Warning statements

Public comments

212. It was requested that Platform Operators be allowed flexibility in deciding the format for providing the warning statements as well as complying with the requirement in general.
213. Various additional warning statements were suggested. For example, warning statements reminding clients to read offering documentation and other materials, a warning that investors may lose more than the invested amount, as well as a concentration risk warning to warn clients that their investment exceeds a certain percentage of the client's asset concentration were proposed.
214. One respondent was of the view that the warning statement that a product is only available to professional investors was unnecessary as the online platform's internal processes would ensure that investment products are only available to eligible clients.
215. Similar to the comments received on the minimum information to be provided, some respondents noted that the warning statements would likely be covered in the complex products' offering documentation (for example, the fact that the product is only available to professional investors) or would be better suited for inclusion in offering documentation.
216. There was also a comment that the requirement to provide warning statements should not be applicable to Platform Operators when serving Institutional and Corporate Professional Investors (as defined in the Code of Conduct).

The SFC's response

217. As with the disclosure of minimum information, we will not prescribe a template or a fixed format for warning statements. Platform Operators are free to exercise their professional judgment to decide how best to present such warning statements to clients.

³⁷ For the purpose of this paper, "Corporate Professional Investors" refer to those professional investors where licensed or registered persons have complies with paragraphs 15.3A and 15.3B of the Code of Conduct.



218. We are aware that some warning statements may be covered in the complex products' offering documentation. However, these warning statements may not be consolidated in one place in the offering documentation for investors' easy reference. Hence, to further facilitate investors, we are of the view that the warning statements should be presented on an online platform in a prominent and clear manner.
219. Further, while online platforms may have internal processes to ensure that investment products are only available to eligible clients, it is important to warn clients that a product is only available to professional investors given that clients who are professional investors would have access to a wider range of investment products which could include both authorized and unauthorized products.
220. Taking into account respondents' comments, we have revised the list of warning statements which focus on warning a client about the relevant complex product. As the list only sets out the minimum warning statements to be provided, Platform Operators are free to provide additional warnings to investors.
221. We agree that this requirement may not be necessary for Institutional and Corporate Professional Investors who should be in a position to look after their own interests. We have revised the Guidelines accordingly.

Other additional or alternative protective measures

Public comments

222. Respondents suggested other additional or alternative protective measures, including a pre-investment cooling-off period, a minimum investment threshold and barriers to entry (eg, only clients with appropriate risk profiles who have passed tests or gone through training could view and purchase particular complex products).
223. Some respondents suggested requiring online platforms to alert clients that they have chosen a complex product and offer an option for clients to choose whether to proceed, or requiring clients to acknowledge the risks of the complex product or the fact that they are purchasing a complex product.
224. Other suggestions generally focused on ensuring that adequate information is provided to investors and that they have sufficient knowledge.

The SFC's response

225. In formulating the additional protective measures which should apply in the sale of complex products on online platforms, we took into account various factors such as the need to align the requirements applicable to the offline and online sales processes and considered various measures which provide more adequate investor protection. We note that many of the suggestions put forward are in the form of additional disclosures and warnings and are already covered in our proposal to require Platform Operators to provide minimum information and warning statements.



Investment products that should not be made available on online platforms

Public comments

226. The majority of respondents did not support limiting the types of investment products that could be made available on online platforms. Many were of the view that as long as there are appropriate safeguards such as adequate disclosure of information and risks, or proper assessment of suitability, any complex product could be sold through online platforms. They also stated that it should be up to Platform Operators to decide the types of investment products that could be accessible via their online platforms.
227. One respondent was of the view that investment products with complex techniques and structures (such as structured investment vehicles and conduits, collateralised debt obligations, collateralised loan obligations and synthetic securitisations, credit default swaps) should not be provided to clients without advice and should not be provided on an online platform. The respondent also commented that complete automation without a financial planner's face-to-face advice should not be available for complex products.
228. One respondent cited accumulators as a type of product which should not be permitted to be sold via online platforms. The respondent was also of the view that certain investment products could be offered or introduced online as long as an offline confirmation or intervention was required.

The SFC's response

229. We agree that it is the responsibility of Platform Operators to decide on the types of investment products that could be accessible via their online platforms. Core Principle 1 (Proper design) of the Guidelines requires Platform Operators to act with due skill, care and diligence when selecting investment products to be made available on their online platforms. This would include conducting proper KYC assessments and product due diligence.
230. We also note the comments that supported requiring complex products to be sold under advice, which is essentially our proposal to require Platform Operators to ensure suitability in the sale of complex products online. As noted above, it remains our view that the Suitability Requirement can be properly discharged on online platforms.

Alignment of online and offline requirements

Public comments

231. Respondents generally supported aligning the requirements applicable to the online and offline sales processes to ensure a level playing field.

The SFC's response

232. The SFC is conducting a further consultation on this topic. Please refer to Section III of this paper for more details about the comments received and the SFC's proposals.



Transition period

Question 20: Do you think a 12-month transition period is appropriate? If not, what do you think would be an appropriate transition period? Please set out your reasons.

Public comments

233. A number of respondents suggested a longer transition period of 18 or 24 months. Most of these respondents stated that a longer period is needed as the proposals concerning complex products are new, and intermediaries need to enhance their systems and arrange operational support.

The SFC's response

234. The SFC had further discussions with various industry players to better understand their views on the proposed transition period.
235. Intermediaries with existing online platforms expressed difficulty in implementing system changes within the proposed timeframe of 12 months as more time is needed to update and test their systems. Different systems and logic may apply to different types of investment products and any changes would need to be made to all systems and logic. Global intermediaries would also need to ensure that any changes made pursuant to Hong Kong requirements also complied with overseas requirements.
236. For online platforms which are already ensuring suitability (such as robo-advisers), it appeared that a 12-month period would suffice. Generally, smaller scale online platforms would need less time to implement changes.
237. We have considered the above comments and remain of the view that a 12-month transition period should allow a reasonable time for the industry to implement changes in compliance with the Guidelines given that the proposals are mainly for investor protection purposes. Hence, we will allow a 12-month transition period before the Guidelines take effect following the gazettal of the final form of the Guidelines.

Conclusion and way forward

238. The SFC will proceed to implement the Guidelines with the modifications and clarifications set out in this paper. The final form of the Guidelines is set out at **Appendix 1**.
239. The SFC would like to take this opportunity to thank all respondents for their submissions.



Section III – Further consultation on offline requirements applicable to complex products

240. In the Consultation Paper, the SFC sought public views on whether the requirement to ensure the suitability of complex products should apply to offline sales of complex products, for example, when the sale is concluded with a client via face to face communication, over the telephone or via other forms of interactive communication. Some respondents supported applying the Suitability Requirement to offline sales as they considered that regulatory requirements should be technology neutral. Some respondents also commented that aligning the regulatory requirements for both online and offline sales would avoid any loopholes and ensure a level playing field.
241. However, some respondents considered that the Suitability Requirement should only be triggered in circumstances where there was a solicitation or recommendation and should not be applied to unsolicited sales of complex products whether online or offline. One respondent stated that in the offline environment, clients would generally seek intermediaries' advice if they were aware that a product was complex. Hence, the Suitability Requirement under paragraph 5.2 of the Code of Conduct would be triggered and no additional requirement was needed.

The SFC's response and further consultation

242. While the SFC recognises that offline sales of complex products would likely involve solicitations and recommendations which trigger the Suitability Requirement, taking respondents' comments into account, we propose making amendments to the Code of Conduct to align the regulatory requirements for both online and offline sales and ensure a level playing field.
243. We propose that when an intermediary provides a client with offline services for complex products (other than derivative products traded on an exchange in Hong Kong or in a specified jurisdiction), the intermediary should observe the Suitability Requirement. The intermediary should also provide sufficient information to the client on the key nature, features and risks of a complex product and warning statements where appropriate. This is consistent with the requirements applicable to online sales of complex products³⁸ and would ensure a level playing field. It is also in line with the existing requirement that intermediaries should provide all relevant material information to clients and help them make informed decisions³⁹.
244. Under paragraph 5.1A of the Code of Conduct, intermediaries are required to assess a client's knowledge of derivatives and characterize the client based on his or her knowledge of derivatives. If a client has no knowledge of derivatives but wishes to invest in a non-exchange traded derivative product on an unsolicited basis, the intermediary is required under paragraph 5.1A(b)(ii) of the Code of Conduct to warn the client about the transaction, provide advice to the client as to whether or not the transaction is suitable for the client and maintain records of the warning and all communications. Intermediaries should comply with their obligations under paragraph 5.1A(b)(ii) of the Code of Conduct notwithstanding the introduction of the new

³⁸ Chapter 6 of the Guidelines and Appendices 3 and 4 to this paper. The requirement to ensure suitability for online sales of complex products will become effective 12 months following the gazettal of the Guidelines on Online Distribution and Advisory Platforms

³⁹ General Principle 5 of the Code of Conduct and Answer to Questions 1 and 6 of the FAQs on Compliance with Suitability Obligations SFC, 23 December 2016



paragraph 5.5 of the Code of Conduct. However, their obligation to ensure the suitability of a derivative product under paragraph 5.1A(b)(ii) of the Code of Conduct will be considered as discharged when they comply with paragraph 5.5 of the Code of Conduct.

245. A licensed or registered person is required to comply with paragraph 5.1A of the Code of Conduct under the KYC process and paragraph 5.3 when providing services to a client in derivative products. For complex products which are also derivative products traded on an exchange in Hong Kong or in a specified jurisdiction for exchange-traded products⁴⁰, a licensed or registered person is not required to comply with the proposed paragraph 5.5. For derivative products traded on an exchange which is not in a specified jurisdiction, a licensed or registered person should comply with the proposed paragraph 5.5 unless such products could reasonably be treated on the same basis as derivative products traded on an exchange in Hong Kong or in a specified jurisdiction. Intermediaries should comply with paragraph 5.2 of the Code of Conduct when any solicitation or recommendation is involved.
246. In line with the Guidelines, intermediaries will not be exempt from these proposed suitability and disclosure requirements with respect to clients who are Individual Professional Investors, but may be exempt with respect to Institutional and Corporate Professional Investors. Notwithstanding this exemption, intermediaries are reminded of their obligation to comply with General Principle 5 of the Code of Conduct and disclose relevant material information in their dealings with their clients.
247. The draft amendments to give effect to the above-mentioned proposals are set out in **Appendix 5** to this paper.

Questions:

1. Do you have any comments on the proposed amendments to the Code of Conduct? Please explain your view.
2. Do you think a six-month transition period is appropriate? If not, what do you think would be an appropriate transition period and please set out your reasons.

248. The SFC welcomes any comments from the public on the proposed requirements applicable to the offline sale of complex products and on the indicative draft of the proposed amendments to the Code of Conduct in **Appendix 5** to this paper. Please submit comments to the SFC in writing no later than 28 May 2018.

⁴⁰ "Specified jurisdictions" for exchange-traded products are currently Australia, Austria, Belgium, Brazil, Canada, Denmark, Finland, France, Germany, India, Ireland, Italy, Japan, Korea, Luxembourg, Mainland China, Malaysia, Netherlands, New Zealand, Norway, the Philippines, Singapore, Spain, Sweden, Switzerland, Taiwan, Thailand, the UK and the US.

Final form of the Guidelines on Online Distribution and Advisory Platforms

The highlighted parts indicate revisions to the Guidelines which differ from the proposed Guidelines set out in the Consultation Paper

Guidelines on Online Distribution and Advisory Platforms

April 2019

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Guidelines on Online Distribution and Advisory Platforms

Chapter 1: Introduction

- 1.1 These Guidelines are issued under section 399 of the Securities and Futures Ordinance (SFO) and set out principles and requirements applicable to online distribution and advisory platforms for investment products operated by licensed or registered persons (Online Platforms). These Guidelines are not intended to be exhaustive and may be updated and revised from time to time.
- Note: A licensed or registered person may operate different websites, platforms and other channels such as social media accounts for posting information about investment products and transacting in them. The Securities and Futures Commission (SFC) will take into account activities targeting Hong Kong investors conducted by a licensed or registered person via all channels in their totality in considering the licensed or registered person's compliance with the requirements in these Guidelines.*
- 1.2 These Guidelines apply to all licensed or registered persons when conducting their regulated activities in providing order execution, distribution and/or advisory¹ services in respect of investment products via Online Platforms (Platform Operators).
- 1.3 Where an Online Platform also provides automated trading services (ATS) as defined in the SFO, the principles and standards set out in the Guidelines for the Regulation of Automated Trading Services² will apply.
- 1.4 Platform Operators who conduct electronic trading should also ensure that the requirements in paragraph 18 (Electronic Trading) of and Schedule 7 to the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (Code of Conduct) and any relevant guidelines are complied with.
- 1.5 Unless specified otherwise, terms used in these Guidelines bear the same meaning as defined in the SFO.
- 1.6 These Guidelines do not have the force of law and shall not be interpreted in a way which would override the provision of any law.
- 1.7 Failure by any person to comply with any applicable provision of these Guidelines:
- (a) shall not by itself render it liable to any judicial or other proceedings, but in any proceedings under the SFO before any court, these Guidelines may be admissible in evidence, and if any provision set out in these Guidelines appears to the court to be relevant to any question arising in the proceedings, it may be taken into account in determining the question; and

¹ Including advisory services provided on a discretionary basis and automated/robo-advice.

² The SFC's Guidelines for the Regulation of Automated Trading Services, September 2016, as amended from time to time. These guidelines are applicable to providers of ATS authorized under Part III of the SFO or licensed or registered for Type 7 regulated activity under Part V of the SFO.

- (b) may cause the SFC to consider whether such failure adversely reflects on the person's fitness and propriety.

Chapter 2: Core Principles

- 2.1 The SFC has identified six core principles which Platform Operators should comply with in the operation of their Online Platforms.

CP1. Proper design

- 2.2 A Platform Operator should ensure that the Online Platform is properly designed and operated in compliance with all applicable laws and regulations.

Note: This includes, but is not limited to, ensuring that:

- (i) *appropriate access rights and controls are put in place such that the public (including retail clients) would not be able to invest in or view materials relating to investment products in circumstances that would constitute a breach of the Companies (Winding Up and Miscellaneous Provisions) Ordinance (C(WUMP)O) or Part IV of the SFO. ~~For example, materials concerning exchange-traded funds (ETFs) not authorized by the SFC (such as overseas ETFs) should not be accessible by retail clients;~~*
- (ii) *the Online Platform is operated with due skill, care and diligence, for example:*
 - (a) *a Platform Operator should act with due skill, care and diligence when selecting investment products to be made available on its Online Platform and when posting any information and materials on its Online Platform; and*
 - (b) *when providing investment advice or recommendations to clients on its Online Platform, a Platform Operator should design its Online Platform to ensure that the investment advice or recommendations provided are based on thorough analysis and take into account available alternatives;*
- (iii) *any conflicts of interest should be properly managed and minimised to ensure that clients are fairly treated, for example, when providing investment advice to clients on its Online Platform, a Platform Operator should not design its Online Platform in such a way that commission rebates or other benefits are taken as the primary basis for soliciting or recommending particular investment products to clients;*
- (iv) *where available, exercise due skill, care and diligence to ensure the methodology for risk profiling investment products and/or clients is properly designed. In this connection, Platform Operators should make reference to the requirements in Chapter 5 of these Guidelines; and*
- (v) *all systems and processes underpinning the operation of the Online Platform are robust and properly maintained such that the risk of fraud, errors and omissions, interruptions or other operational or control failures is minimised and appropriately managed.*

CP2. Information for clients

2.3 A Platform Operator should make clear and adequate disclosure of relevant material information on its Online Platform.

Note: This includes, but is not limited to:

- (i) providing clients with access to up-to-date product offering documents or information³;*
- (ii) providing clients with material information as soon as reasonably practicable to enable clients to appraise the position of their investments (eg, in the event of any suspensions in the redemption of funds, any proposed merger or termination of funds or any other material information provided by issuers). In this connection, a Platform Operator should put in place proper arrangements and take adequate measures to enable it to access and be informed of up-to-date information concerning all non-exchange-traded investment products available on its Online Platform;*
- (iii) communicating any information in an easily comprehensible manner. A Platform Operator should use plain language in any disclosures made and presentation of information to make them easy to read and understand;*
- (iv) making available information on the methodology adopted for assessing and assigning ratings to investment products and categorising clients on the Online Platform, if any. Such information should also be accompanied by an explanation of the risk profiles of investment products and clients;*
- (v) where selected list(s) of investment products are posted on its Online Platform, setting out or making available the objective criteria by reference to which such investment products are selected;*
- (vi) informing clients of the scope and limitations of services and investment products that are provided through and on the Online Platform (eg, the availability of investment products is limited to those issued by related companies); and*
- (vii) disclosing to clients any remuneration to be paid by the client or other persons (eg, product issuers) to the Platform Operator, such as commission, brokerage and any other fees and charges, and any other monetary benefits received or receivable by the Platform Operator, pursuant to applicable codes, guidelines, circulars and frequently-asked questions (FAQs); and*

³ In respect of non-exchange-traded investment products, Platform Operators are expected to provide up-to-date product offering documents on their Online Platforms. For exchange-traded investment products, a good practice would be to provide a hyperlink to where up-to-date information could be accessed or a reminder to clients to refer to any such information before making an investment decision.

- (viii) providing clients with the Platform Operator's contact details for handling client enquiries and complaints.

CP3. Risk management

- 2.4 A Platform Operator should ensure the reliability and security (including data protection and cybersecurity) of its Online Platform.

Note: This includes, but is not limited to:

System reliability

- (i) *a Platform Operator should ensure that its Online Platform, and all modifications to the Online Platform, are tested before deployment and are regularly reviewed to ensure that the Online Platform and its modifications are reliable;*
- (ii) *a Platform Operator should promptly report to the SFC any material service interruption or other significant issues related to its Online Platform;*

Contingencies

- (iii) *a Platform Operator should identify and manage the associated risks (including any unintended consequences) prudently with appropriate contingency arrangements in place. Such arrangements should include a written contingency plan to cope with emergencies and disruptions related to the Online Platform. The contingency plan should at least include:*
- (a) *a suitable backup facility or alternative arrangements for order execution in the event of an emergency;*
- (b) *arrangements to ensure business records, client and transaction databases, servers and supporting documentation are backed up in an off-line medium. Off-site storage is generally expected to be subject to proper security measures; and*
- (c) *a plan for dealing with client and regulatory enquiries by trained staff;*
- (iv) *a Platform Operator should ensure that the contingency plan to deal with potential emergencies and disruptions is periodically tested and the plan is viable and adequate;*
- (v) *in the event of a material delay or failure of the Online Platform, a Platform Operator should, in a timely manner:*
- (a) *ensure the material delay or failure is rectified; and*
- (b) *inform clients about the causes or possible causes of the material delay or failure and how client orders will be handled.*

System security

- (vi) a Platform Operator should also refer to guidance issued by the SFC from time to time on cybersecurity⁴.

CP4. Governance, capabilities and resources

- 2.5 A Platform Operator should ensure that there are robust governance arrangements in place for overseeing the operation of its Online Platform as well as adequate human, technology and financial resources available to ensure that the operations of its Online Platform are carried out properly.

Note: A Platform Operator should establish and implement written internal policies and procedures on the operation of its Online Platform to ensure that:

- (i) there is at least one responsible officer or executive officer responsible for the overall management and supervision of the Online Platform;*
- (ii) there is a formalised governance process with input from the dealing, information technology, risk and compliance functions;*
- (iii) there are clearly identified reporting lines with supervisory and reporting responsibilities assigned to appropriate staff members; and*
- (iv) there are managerial and supervisory controls that are designed to manage the risks associated with the use of the Online Platform.*

A Platform Operator should conduct regular reviews to ensure that these internal policies and procedures are in line with regulatory developments and promptly remedy any deficiencies identified.

In operating its Online Platform, a Platform Operator should ensure that it has sufficient technology resources to, for example, safeguard data integrity, including confidential client information, and meet current and projected operational needs (eg, in respect of system capacity).

CP5. Review and monitoring

- 2.6 Appropriate reviews of all activities conducted on the Online Platform should be performed by a Platform Operator as part of its ongoing supervision and monitoring obligation.

Note: This includes, but is not limited to, regular reviews as well as ad hoc reviews where appropriate, for example, if a major market event occurs. It is expected that a regular review should be conducted at least annually.

Such regular review should cover all activities conducted on the Online Platform in relation to the design and operation of the Online Platform,

⁴ For example, the Guidelines for Reducing and Mitigating Hacking Risks Associated with Internet Trading, as amended from time to time Circular to All Licensed Corporations on Cybersecurity, SFC, March 2016.

including the processes and outcomes of any client ~~risk~~ profiling, investment product selection and risk profiling, ~~risk analysis assessment~~, suitability assessment, as well as the reasonableness of any recommendation or advice generated by the algorithm used (including any recommended model portfolio) and any rebalancing conducted. It should include sample checking and testing by a suitably-qualified person. There should also be policies and procedures to follow up on any review results and to implement any enhancements required.

Where any function is outsourced to external service provider(s), the Platform Operator should exercise due skill, care and diligence in the selection, appointment and ongoing monitoring of the outsourced service provider(s) to ensure proper performance of the outsourced function.

CP6. Record keeping

2.7 A Platform Operator should maintain proper records in respect of its Online Platform.

Note: This includes, but is not limited to, comprehensive documentation on platform design, operational processes and risk management controls, including any testings, reviews, modifications, upgrades or rectifications of its Online Platform and records of the applicable software versions (including programmes and any algorithms). The documentation should be retained for a period of not less than 2 years after the Online Platform ceases to operate.

A Platform Operator should also keep proper audit trails of activities and transactions conducted on its Online Platform, including the processes and outcomes of any client profiling, investment product selection, and risk analysis assessment ~~profiling, suitability assessment~~, provision of product information, disclosure of warning statement, ~~suitability assessment~~, advice provided and any rebalancing conducted, and incident reports for all material delays or failures of the Online Platform. The audit trails and records should be retained for a period of not less than 2 years or such longer period as may be required under the Code of Conduct or related guidance issued by the SFC from time to time. Further, audit trails and records relating to all suitability assessments (including audit trails and records demonstrating that transactions are suitable) should be retained for at least 2 years for exchange-traded investment products and at least 7 years for non-exchange-traded investment products.

Chapter 3: General Requirements

- 3.1 Platform Operators when conducting their regulated activities in providing order execution, distribution and/or advisory services in respect of investment products via Online Platforms must comply with all applicable laws and regulations including the SFC's conduct requirements, restrictions on the offer of investments, and those applicable to materials that may be posted on their Online Platforms.

Conduct requirements

- 3.2 The regulatory framework governing the conduct of licensed or registered persons (including Platform Operators) is set out in the Code of Conduct, the Management, Supervision and Internal Control Guidelines for Persons Licensed by or Registered with the Securities and Futures Commission (Internal Control Guidelines), and other codes, guidelines, circulars⁵ and ~~frequently asked questions (FAQs)~~ issued by the SFC from time to time.
- 3.3 These conduct requirements are in general principles-based such that they apply irrespective of the medium through which a licensed or registered person provides its services in carrying on the regulated activities for which the person is licensed or registered.
- 3.4 Conduct requirements include the General Principles in the Code of Conduct which set out the standards and requirements licensed or registered persons should meet in carrying out regulated activities. The Code of Conduct further sets out requirements augmenting the General Principles.
- 3.5 In particular, paragraph 5.2 of the Code of Conduct sets out the suitability requirement pursuant to which a licensed or registered person should, when making a recommendation or solicitation to a client, ensure the suitability of the recommendation or solicitation for that client is reasonable in all the circumstances 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 Suitability Requirement).
- 3.6 This requirement forms part of a suite of duties set out in the Code of Conduct to which licensed or registered persons who distribute investment products or provide financial advice are subject. Such duties include a duty to "know your client" (General Principle 4 and paragraphs 5.1 and 5.1A), a duty to exercise due skill, care and diligence, in the best interests of clients and the integrity of the market (General Principle 2 and paragraph 3.4), a duty to disclose relevant material information (General Principle 5), a duty to ensure that clients understand the nature and risks of derivative products and have sufficient net worth to bear the risks and potential losses of trading in derivative products (paragraph 5.3), and a duty to implement internal controls and supervise staff to ensure compliance with regulatory requirements (General Principles 3 and 7 and paragraphs 4.2, 4.3 and 12.1). Guidance in respect

⁵ Including the Circular to Intermediaries – Frequently Asked Questions on Triggering of Suitability Obligations, SFC, December 2016 and the Circular to Intermediaries – Frequently Asked Questions on Compliance with Suitability Obligations, SFC, December 2016, and as amended from time to time (Suitability FAQs)

of these duties is found in guidelines, circulars and reports issued by the SFC from time to time.

- 3.7 Further guidance on the Suitability Requirement in the context of Online Platforms is also set out in Chapter 5 of these Guidelines.
- 3.8 Platform Operators should note in particular, but without limitation, the following conduct requirements:
- (a) for derivative products (including futures contracts, and options) and any leveraged transaction, the investor characterization requirements in paragraph 5.1A of the Code of Conduct and the know-your-client requirement in paragraph 5.3 of the Code of Conduct;
 - (b) the requirement to disclose monetary and non-monetary benefits in paragraph 8.3 of the Code of Conduct;
 - (c) the requirement to disclose transaction related information in paragraph 8.3A of the Code of Conduct;
 - (d) the requirement to ensure best execution in paragraph 3.2 of the Code of Conduct;
 - (e) the requirement to handle client orders fairly and in the order in which they are received in paragraph 9.1 of the Code of Conduct;
 - (f) the requirement governing the priority for client orders in paragraph 9.2 of the Code of Conduct;
 - (g) where a Platform Operator only makes available on its Online Platform investment products issued by it and/or its related companies, the requirement to disclose this limited availability of investment products to clients⁶;
 - (h) the requirement not to take commission rebates or other benefits receivable by them or their related companies as the primary basis for soliciting or recommending particular investment products to clients⁷;
 - (i) the prohibition on the use of gifts in promoting a specific investment product in paragraph 3.11 of the Code of Conduct; and
 - (j) compliance requirements in paragraph 12 of the Code of Conduct, including the requirements in relation to complaints-handling in paragraph 12.3 and the obligation in paragraph 12.5 to report any material breach or suspected material breach of any law, rules, regulations, and codes administered or issued by the SFC, etc to the SFC immediately.

⁶ Suitability FAQs

⁷ Suitability FAQs

Offer of investments

- 3.9 Platform Operators should note in particular, but without limitation, the following offer of investments requirements:
- (a) prospectus requirements for offering of shares and debentures under the C(WUMP)O⁸ ;
 - (b) restrictions on offers of investments under Part IV of the SFO - in particular the restrictions on offering of unauthorized collective investment schemes (CIS) and structured products (eg, overseas exchange-traded ETFs, unauthorized CIS and structured products) notwithstanding the offer is made by or on behalf of an intermediary licensed or registered for Type 1, Type 4 or Type 6 regulated activity⁹;
 - (c) restrictions applicable to certain overseas exchange-traded products or ATS products under the relevant ATS authorization conditions; and
 - (d) relevant requirements relating to the offering of CIS on the internet as set out in the Guidance Note for Persons Advertising or Offering Collective Investment Schemes on the Internet.

Materials posted on an Online Platform

- 3.10 In respect of the posting of any advertisement, research report and other investment product-specific materials on their Online Platforms, Platform Operators should note in particular, but without limitation, the following requirements relevant to the issue of such materials:
- (a) the issue of advertisements in respect of investment products is regulated under Part IV of the SFO. In particular, certain misrepresentations made by a person may attract civil¹⁰ and/or criminal¹¹ liability under Part IV of the SFO and the disclosure of false or misleading information inducing transactions may constitute market misconduct which is subject to civil or criminal liability under the SFO¹²;
 - (b) the contents of advertisements must also comply with relevant advertising guidelines¹³, offer awareness guidelines¹⁴, marketing materials guidelines¹⁵ and/or the SEHK Listing Rules¹⁶ where applicable;

⁸ Parts II and XII of the C(WUMP)O

⁹ Sections 103(2)(a) and 103(11) of the SFO

¹⁰ Section 108 of the SFO

¹¹ Section 107 of the SFO

¹² Sections 277 and 298 of the SFO

¹³ Advertising Guidelines Applicable to Collective Investment Schemes Authorized under the Product Codes issued by the SFC

¹⁴ Guidelines on use of offer awareness and summary disclosure materials in offerings of shares and debentures under the Companies Ordinance issued by the SFC

¹⁵ Guidelines on Marketing Materials for Listed Structured Products issued by the SFC

¹⁶ Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited

- (c) the requirement to ensure that advertisements do not contain information that is false, biased, misleading or deceptive¹⁷;
- (d) for research reports, the conflicts of interest requirements¹⁸ and the applicable requirements under paragraph 16 (Analysts) as well as the General Principles¹⁹ of the Code of Conduct; and
- (e) the requirement to act with due skill, care and diligence in expressing any opinion²⁰.

¹⁷ GP1 (Honesty and fairness) and paragraphs 2.1 and 2.3 of the Code of Conduct, Advertising Guidelines Applicable to Collective Investment Schemes Authorized under the Product Codes issued by the SFC, Guidelines on Marketing Materials for Listed Structured Products issued by the SFC

¹⁸ GP6 (Conflicts of interest) and paragraph 10.1 of the Code of Conduct

¹⁹ Including GPs 1 (Honesty and fairness), 2 (Diligence), 5 (Information for clients) and 6 (Conflicts of interest) of the Code of Conduct

²⁰ GP2 (Diligence) of the Code of Conduct, which requires a licensed or registered person to act with due skill, care and diligence, in the best interests of its clients and the integrity of the market in conducting its business activities.

Chapter 4: Robo-Advice

- 4.1 Robo-advice (sometimes referred to as digital advice or automated advice) involves the provision of financial advice in an online environment using algorithms and other technology ~~(a licensed or registered person providing robo-advice is hereinafter referred to as a “robo-adviser”)-tools.~~

Note: There are many different types of robo-advice services, for example, (i) full automation (ie, fully-automated investment advice via an Online Platform with no human intervention); (ii) adviser-assisted (ie, the Online Platform also provides an option for clients to contact an adviser depending on their needs); and (iii) guided advice (ie, investment advice is provided by an adviser who is assisted and supported by technology tools).

These Guidelines generally intend to apply to robo-advice services which are provided directly to clients in an online environment by way of direct use of technology tools by clients (“client-facing tools”). Licensed or registered persons providing such robo-advice through client-facing tools are hereinafter referred to as “robo-advisers”.

In the case where client-facing tools are not involved, licensed and registered persons should refer to other relevant applicable requirements governing the conduct of their regulated activities in providing guided advice, including the Code of Conduct, Internal Control Guidelines and other codes, guidelines, circulars²¹ and FAQs issued by the SFC from time to time.

Robo-advisers, whether providing advice on a discretionary basis or otherwise, should also refer to guidance issued by the SFC from time to time in respect of compliance with the Suitability Requirement²².

Where such the robo-advice services provided involve web-chats or similar interactive facilities, the licensed or registered person should also comply with the guidance²³ in the context of transactions conducted in an interactive environment issued by the SFC from time to time.

~~*Where advice is provided on a discretionary basis, robo-advisers should also refer to guidance issued by the SFC from time to time in respect of compliance with the Suitability Requirement²⁴.*~~

Information for clients

- 4.2 A robo-adviser should provide sufficient information on its Online Platform to enable investors to make an informed decision regarding whether to employ its services. A robo-adviser should also make clear and adequate disclosure of relevant material information to clients on its Online Platform on an ongoing basis.

²¹ Including the Suitability FAQs

²² For example, the Suitability FAQs.

²³ For example, the Suitability FAQs Circular to Intermediaries – Frequently Asked Questions on Triggering of Suitability Obligations.

²⁴ For example, the Suitability FAQs.

Note: This would include information on the limitations, risks and how key components of its services are generated (such as a description of how underlying algorithms operate, any limitations of the algorithm, how the portfolio rebalancing mechanism operates and associated risks).

Robo-advisers should also inform and explain to investors and clients the degree of human involvement that it provides.

4.3 A robo-adviser should ensure that it accurately describes the services it provides.

4.4 Information disclosed by a robo-adviser should be easily comprehensible.

Note: This could be achieved by presenting information through design features such as pop-up boxes or tooltips, or other means or media.

Client profiling

4.5 Where a robo-adviser uses client profiling tools and/or questionnaires to obtain information about clients as part of its know your client process, it should ensure that the client profiling tools and/or questionnaires are properly designed such that sufficient information is obtained to enable it to provide advice that is suitable based on clients' personal circumstances.

Note: This would include designing the client profiling tools and/or questionnaires such that clients are provided with the opportunity to provide additional explanatory and contextual information, where appropriate.

4.6 A robo-adviser should have in place proper mechanisms to identify and seek to reconcile any inconsistencies in the information provided by a client.

Note: For example, robo-advisers could alert a client to such inconsistencies through pop-up boxes and could provide the client with an opportunity to change the information provided. Robo-advisers could also internally flag any inconsistent information for review and follow-up.

4.7 Where a robo-adviser uses risk-scoring questionnaires to risk profile clients and/or to determine the advisory services to be provided to clients, it should pay particular attention to the design of the questions and the underlying scoring mechanism, which should be properly designed to accurately reflect the personal circumstances of a client.

Note: In this connection, robo-advisers should also make reference to the requirements in Chapter 5 of these Guidelines.

System design and development

4.8 Algorithms are the core components of digital financial advice tools adopted by robo-advisers. It is essential that a robo-adviser effectively manages and adequately supervises the design, development, deployment and operations of algorithms used in digital-advice tools. In particular, a robo-adviser should:

- (a) ensure the design and operations of algorithms used are in compliance with relevant conduct requirements including, where applicable, requirements in

paragraph 18 (Electronic Trading) of and Schedule 7 to the Code of Conduct and any relevant guidelines;

- (b) ensure that the algorithms take into account all relevant information about each client obtained through the know-your-client process and use objective criteria to generate investment recommendations and/or advice which match the client's personal circumstances against suitable investment products and operate in a manner that is not biased; and

Note: This would include ensuring that algorithms used should not be programmed to direct clients towards particular investment products for which the robo-adviser or its affiliates receive higher commissions or other forms of compensation.

- (c) maintain appropriate documentation on the design and development (including any modifications) of the algorithms. The documentation should set out the rationale for the design, development and modification, as well as the intended outcome, objectives, and scope of the algorithms.

Supervision and testing of algorithms

4.9 A robo-adviser should supervise the operation and testing of the algorithms that form the basis of any investment advice it provides. A robo-adviser should:

- (a) have a documented plan with details on the scope and strategy for the testing of algorithms (including the design and implementation of test plans, selection of test cases, treatment of test results and defect rectification procedures);
- (b) have security measures in place to prevent and detect unauthorized access to the algorithms;
- (c) test algorithms before deployment and any subsequent developments and/or modifications to assess whether the methodology (including any assumptions made) is well-suited, the data input used is appropriate to cover the expected scenarios and the output conforms with the robo-adviser's expectations;
- (d) have robust policies and procedures in place to monitor and test the algorithms and the reasonableness of the advice provided to clients (eg, regular and random samples of robo-advice provided should be tested/reviewed by a suitably-qualified person to ensure all applicable requirements are complied with);
- (e) have proper policies and procedures for a suitably-qualified person to manage, supervise, review and modify algorithms where appropriate (eg, when there are market or regulatory changes);
- (f) exercise due skill, care and diligence when selecting and monitoring any outsourced service provider, including in the selection and monitoring of any third party in the development, management, or ownership of the algorithms used;
- (g) conduct regular reviews of advice. When modifications to the algorithms are made, the robo-adviser should arrange for a suitably-qualified person to

perform validation and other appropriate tests to ensure the reasonableness of the advice provided; and

- (h) take immediate measures to rectify any problem when errors are detected in the algorithms and have controls in place to suspend provision of advice or service where necessary.

Adequate resources

- 4.10 A robo-adviser should ensure that it has adequate staff who have sufficient expertise and understanding of the technology, operations and algorithms (including the rationale, risks and rules behind the algorithms), and who are closely involved in the design, development, deployment and ongoing supervision of the operation of the algorithms.
- 4.11 Adequate training or testing should be provided by the robo-adviser to all staff who make use of the robo-advisory tools of the robo-adviser.
- 4.12 A robo-adviser should ensure that it has sufficient technology resources and up-to-date infrastructure to support the proper operation of the Online Platform (including any system requirements arising from modifications to the algorithms used).

Rebalancing

- 4.13 When algorithms are used to rebalance a predefined model portfolio automatically in order to maintain a target asset allocation over time, the robo-adviser should ensure effective practices for automatic rebalancing are in place. Such practices should include, without limitation, the following:
 - (a) informing clients clearly at the outset that automatic portfolio rebalancing (where applicable) would occur on a periodic basis to maintain the target asset allocation and, where applicable, additional costs may be incurred due to such rebalancing;
 - (b) disclosing to clients how the portfolio rebalancing mechanism operates, including:
 - (i) if the robo-adviser uses deviation thresholds on an asset class or a particular type of securities, disclosing what the thresholds are and whether (and, if so, how) they vary by asset class or particular type of securities; and
 - Note: The composition of an investment portfolio may deviate from time to time from its intended target asset allocation for different reasons (eg, market volatility). In such cases, portfolio rebalancing may become necessary.*
 - (ii) if portfolio rebalancing is scheduled, disclosing the frequency; and
 - (iii) any risks associated with automatic rebalancing (such as rebalancing may occur irrespective of market conditions);

- (c) establishing and maintaining policies and procedures to define how the algorithms would handle any major market event; and
- (d) where there are changes to the existing algorithm that may materially affect clients' portfolios, clearly and promptly informing the relevant clients of such changes.

4.14 Where a robo-adviser offers its clients the flexibility to opt-out of automatic portfolio rebalancing, it should inform clients of the potential risks and consequences of opting-out of automatic rebalancing.

Note: The robo-adviser should provide appropriate warnings to clients such as the warning that the original portfolio that a client may invest into or has invested into according to the robo-adviser's recommendation could become unsuitable for the client as a result of the opt-out and that by choosing to opt-out, the client would require a different service to be provided.

4.15 Before a client confirms to opt-out of automatic rebalancing, the robo-adviser should ensure the client has acknowledged and confirmed agreement to the change in the scope and terms of services to be provided by the Online Platform going forward.

Note: Although the Platform Operator may no longer have an advisory relationship with the client as a result, it should still comply with all other applicable requirements in these Guidelines, including the requirement to ensure that a transaction in a complex product is suitable for the client in all the circumstances pursuant to paragraph 6.3 of these Guidelines.

Chapter 5: Suitability Requirement and other conduct requirements applicable to the Sale of Investment Products

- 5.1 Platform Operators should comply with all existing conduct requirements under the Code of Conduct applicable to the regulated activities they conduct via their Online Platforms.

Suitability Requirement

- 5.2 The sale of investment products on Online Platforms is also subject to the Suitability Requirement set out in paragraph 5.2 of the Code of Conduct. Under paragraph 5.2, a licensed or registered person should, when making a recommendation or solicitation, ensure the suitability of the recommendation or solicitation for the client is reasonable in all the circumstances 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.

Triggering of the Suitability Requirement

- 5.3 The question of whether there has been a “solicitation” or “recommendation” triggering the Suitability Requirement is a question of fact which should be assessed in light of all the circumstances leading up to the point of sale or advice.

Note: To facilitate a better understanding of the circumstances under which the Suitability Requirement would be likely or unlikely to be regarded as being triggered under paragraph 5.2 of the Code of Conduct, Platform Operators should refer to guidance²⁵ published by the SFC (which may be updated from time to time).

The context (such as the manner of presentation) and content of product-specific materials posted on an Online Platform coupled with the design and overall impression created by the content of the Online Platform would determine whether the Suitability Requirement is triggered.

The posting of factual, fair and balanced product-specific materials would not in itself amount to a solicitation or recommendation and will not trigger the Suitability Requirement. This is so in the absence of other circumstances that amount to a solicitation or recommendation in a particular investment product. This would occur, for example, where the Online Platform emphasises some investment products over others or there have been interactive one-to-one communications involving solicitations or recommendations through the Online Platform.

Platform Operators should also note the additional requirements applicable to transactions in complex products set out in Chapter 6 of these Guidelines.

- 5.4 Platform Operators should also refer to guidance published by the SFC (which may be updated from time to time) on how the posting of materials on Online Platforms would or would not trigger the Suitability Requirement.

²⁵ For example, the Circular to Intermediaries – Frequently Asked Questions on Triggering of Suitability Obligations, SFC, December 2016.

- 5.5 For the avoidance of doubt, the provision of investment advice (including robo-advice²⁶) on investment products on an Online Platform will trigger the Suitability Requirement.

Discharging the Suitability Requirement

- 5.6 Once the Suitability Requirement is triggered, Platform Operators must discharge the suitability obligations at the point of sale or advice in accordance with the existing requirements under the Code of Conduct²⁷.
- 5.7 As part of its existing obligation to discharge the Suitability Requirement, Platform Operators should match the risk return profile of the investment product selected by a client with the personal circumstances of that client²⁸.

Note: This may involve an Online Platform making an assessment of a client's risk tolerance level and risk profile and accordingly risk profiling the client, and the Platform Operator conducting product due diligence to ascertain the risk return profile of an investment product and accordingly risk profiling the investment product. It should be noted, however, that merely mechanically matching an investment product's risk rating with a client's risk tolerance level may not be sufficient to discharge the Suitability Requirement²⁹.

A Platform Operator should ensure that in assigning risk profiles to investment products, its risk profiling methodology is properly designed to take into account both quantitative and qualitative factors and consider all risks involved, including credit risk, liquidity risk, counterparty risk, use of leverage, etc. Platform Operators should have appropriate processes in place to periodically review the risk profiling methodology and mechanism for investment products. The risk profiles of investment products should also be reviewed at regular intervals.

In determining a client's risk profile, an Online a Platform Operator should base its assessment on information about the client obtained through its know-your-client process³⁰. The individual risk profile of a client should also be reviewed and updated regularly, where appropriate³¹. Where risk-scoring questionnaires are used to risk profile clients, Platform Operators should pay particular attention to the design of the questions and the underlying scoring mechanism, which should be properly designed to accurately reflect the personal circumstances of a client³². Platform Operators should also have appropriate processes in place to periodically review the risk profiling methodology and mechanism for clients.

²⁶ This would include automatic rebalancing conducted by robo-advisers.

²⁷ Intermediaries should also refer to the Suitability FAQs.

²⁸ Please refer to the Suitability FAQs.

²⁹ Please refer to the Suitability FAQs.

³⁰ Paragraphs 5.1 and 5.1A of the Code of Conduct and the Suitability FAQs

³¹ For example, this may not apply to a dormant client account.

³² Please refer to the Suitability FAQs.

- 5.8 In discharging the Suitability Requirement, Platform Operators should also note in particular (but not exclusively) the following where applicable:
- (a) Platform Operators should act diligently and carefully in providing any advice and ensuring that advice and recommendations are based on thorough analysis and take into account available alternatives³³ (eg, availability of any similar investment products which may be less costly);
 - (b) when providing investment advice to clients, Platform Operators should not take commission rebates or other benefits as the primary basis for soliciting or recommending particular investment products to clients³⁴;
 - (c) Platform Operators should establish a proper mechanism to assess the suitability of investment products ~~when clients place orders~~ via their Online Platforms. Such mechanism should be holistic (ie, all relevant factors concerning the personal circumstances of a client, including concentration risk, should be taken into account); and
 - (d) an Online Platform should have in place appropriate tools for assessing a client's concentration risk and such an assessment should be based on the information about the client obtained by the Platform Operator through its know-your-client process and/or any investment portfolio held with the Platform Operator.

Other conduct requirements applicable to the sale of investment products

- 5.9 In addition to the Suitability Requirement, a Platform Operator should also comply with other applicable conduct requirements under the Code of Conduct.

Note: This would include (but is not limited to) the following where applicable:

- (i) *A Platform Operator should establish appropriate governance and supervisory mechanisms for the client profiling tool provided on its Online Platform, if any, and identify the key elements of information necessary to profile a client accurately³⁵.*
- (ii) *An Online Platform should enable a client to update the client's information in any client profiling tool provided at any time should there be any updates or changes to the client's personal information (eg, investment objectives, risk appetite etc.)³⁶*
- (iii) *Where insufficient information is obtained from a client by a Platform Operator through any client profiling tool provided on the Online Platform or otherwise through its know-your-client process, there should be a proper mechanism in place to determine whether the client*

³³ GP2 (Diligence) and paragraph 3.4 of the Code of Conduct

³⁴ Suitability FAQs

³⁵ Suitability FAQs

³⁶ Suitability FAQs

should be allowed to proceed to place an order for an investment product³⁷.

- (iv) Where a client provides inconsistent answers in any online client profiling tool provided, the Platform Operator should have in place a proper mechanism to identify and seek to reconcile the inconsistencies (eg, by providing the client with an opportunity to change its input)³⁸. Where inconsistencies cannot be reconciled, it may be appropriate to filter the client out of the Online Platform.*
- (v) An Online Platform should have in place proper systems to ensure that client orders are executed promptly in accordance with clients' instructions and are executed on the best available terms, where applicable. The Online Platform should also have in place proper mechanisms to promptly and fairly allocate any transactions executed on behalf of clients to the respective client accounts³⁹.*

Further points to note

5.10 Platform Operators should note that where there are one-to-one interactions between a client and representatives of the Platform Operator via the Online Platform or there have been other communications between representatives of the Platform Operator and a client, this must be taken into account in determining whether the Suitability Requirement has been triggered. The Suitability Requirement may be triggered notwithstanding that some communications taken in isolation may not trigger the Suitability Requirement. Platform Operators should also refer to guidance concerning transactions conducted in an interactive environment issued by the SFC from time to time⁴⁰.

Note: Interaction between a client and representatives of the Platform Operator via the Online Platform or other communications between representatives of the Platform Operator and a client would include, for example, communications through live web-chat or where a client calls a hotline listed on the Online Platform and speaks with a representative of the Platform Operator.

³⁷ Suitability FAQs

³⁸ Suitability FAQs

³⁹ Paragraphs 3.1, 3.2, 3.3, 9.1 and 9.2 of the Code of Conduct

⁴⁰ For example, the Circular to Intermediaries – Frequently Asked Questions on Triggering of Suitability Obligations, SFC, December 2016.

Chapter 6: Complex Products

Definition of a complex product

- 6.1 A complex product is an investment product whose, terms, features and risks are not reasonably likely to be understood by a retail investor because of its complex structure and which is difficult to value.

Note: Set out below are factors to determine whether an investment product is complex or not:

- (i) whether the investment product is a derivative product;
- (ii) whether a secondary market is available for the investment product at publicly available prices;
- (iii) whether there is adequate and transparent information on/about the investment product available to retail investors;
- (iv) whether there is a risk of losing more than the amount invested;
- (v) whether any features or terms of the investment product could fundamentally alter the nature or risk of the investment or pay-out profile or include multiple variables or complicated formulas to determine the return; and

Note: This would include, for example, investments that incorporate a right for the investment product issuer to convert the instrument into a different investment.

- (vi) whether any features or terms of the investment product might render the investment illiquid and/or difficult to value.

- 6.2 A Platform Operator should determine whether a product may be treated as non-complex or complex with due skill, care and diligence. In making such determination, the Platform Operator should have regard to the factors set out in paragraph 6.1 and the non-exhaustive list of examples of non-complex and complex products (which may be updated from time to time) set out on the SFC's website.

Note: Platform Operators should refer to the examples of investment products that the SFC considers are not complex, ~~and~~ examples of complex products, and other guidance issued by the SFC, which are published on the SFC's website.

A Platform Operator should consider whether an investment product is of the same type as an investment product in the list of examples of non-complex and complex products and whether the product is being regulated in or traded on an exchange in a specified jurisdiction. Platform Operators should refer to the list of specified jurisdictions which is published on the SFC's website. Platform Operators should exercise extra caution where the product is regulated in or traded on an exchange in a jurisdiction which is not a specified jurisdiction.

Ensuring suitability of transactions in complex products

- 6.3 Subject to paragraphs 6.5 to 6.7 and 6.9 to 6.11, an Online Platform should ensure that a transaction in a complex product is suitable for the client in all the circumstances.
- 6.4 Online Platforms should discharge the requirement in paragraph 6.3 to the standard of, and in accordance with, the existing requirements under the Code of Conduct applicable to the Suitability Requirement under paragraph 5.2 of the Code of Conduct.

Note: Platform Operators should refer to the guidance on the Suitability Requirement in the context of Online Platforms in Chapter 5 of these Guidelines.

- 6.5 For complex products which are also derivative products traded on an exchange in Hong Kong or in a specified jurisdiction, where there has been no solicitation or recommendation, an Online Platform ~~should~~ is not required to comply with paragraphs 6.3, 6.7 and 6.8 for transactions in such products executed on an exchange although it must still comply with paragraphs 5.1A and 5.3 of the Code of Conduct instead of paragraph 6.3.
- ~~6.6 Platform Operators dealing with Institutional Professional Investors (as defined in the Code of Conduct) are automatically exempt from the requirement in paragraph 6.3.~~
- ~~6.7 To be exempt from the requirement in paragraph 6.3 when dealing with Corporate Professional Investors (as defined in the Code of Conduct), Platform Operators should observe and comply with the same requirements and procedures as set out in paragraphs 15.3A and 15.3B of the Code of Conduct in order to be exempt from the Suitability Requirement.~~
- ~~6.8 For the avoidance of doubt, no exemption is available to Platform Operators from the requirement in paragraph 6.3 when dealing with Individual Professional Investors (as defined in the Code of Conduct).~~

Note: Platform Operators should refer to the list of specified jurisdictions for exchange-traded products which is published on the SFC's website. For derivative products traded on an exchange which is not in a specified jurisdiction, Platform Operators should comply with paragraphs 6.3, 6.7 and 6.8 unless such products could reasonably be treated on the same basis as derivative products traded on an exchange in Hong Kong or in a specified jurisdiction.

- 6.6 For the avoidance of doubt, Platform Operators should also comply with the requirement to assess a client's knowledge of derivatives and characterize the client based on his knowledge of derivatives under paragraph 5.1A(a) of the Code of Conduct as part of their know your client procedures and, where a client without knowledge of derivative wishes to purchase a derivative product which is not traded on an exchange, warn the client about the transaction pursuant to paragraph 5.1A(b)(ii) of the Code of Conduct.

Minimum information and warning statements

6.97 Subject to paragraphs 6.5 to 6.6 and 6.9 to 6.11, Platform Operators should ensure that their Online Platforms provide sufficient information on the key nature, features and risks of a complex product (other than complex products which are also derivative products traded on an exchange) to enable clients to understand the complex product before making an investment decision.

Note: Platform Operators should refer to guidance issued by the SFC from time to time in relation to the minimum information that should be provided. Where this information is contained in the offering documents of a complex product, the posting of such offering documents on the Online Platform would generally satisfy this requirement.

6.108 Subject to paragraphs 6.5 to 6.6 and 6.9 to 6.11, Platform Operators should ensure that there are prominent and clear warning statement(s) on their Online Platforms, where appropriate, to warn clients about a complex product (other than complex products which are also derivative products traded on an exchange) prior to and reasonably proximate to the point of sale or advice.

Note: Platform Operators should refer to guidance issued by the SFC from time to time for examples of the warning statement(s) that should be made on their Online Platforms.

Exemptions for Institutional and Corporate Professional Investors

6.9 Platform Operators dealing with Institutional Professional Investors (as defined in the Code of Conduct) are automatically exempt from the requirements in paragraphs 6.3, 6.7 and 6.8.

6.10 To be exempt from the requirements in paragraphs 6.3, 6.7 and 6.8 when dealing with Corporate Professional Investors (as defined in the Code of Conduct), Platform Operators should observe and comply with the same requirements and procedures as set out in paragraphs 15.3A and 15.3B of the Code of Conduct⁴¹.

6.11 For the avoidance of doubt, no exemption is available to Platform Operators from the requirements in paragraphs 6.3, 6.7 and 6.8 when dealing with Individual Professional Investors (as defined in the Code of Conduct).

⁴¹ In order to be exempt from the provisions set out in paragraph 15.4 of the Code of Conduct (which includes an exemption from compliance with the Suitability Requirement) when dealing with Corporate Professional Investors, intermediaries are required to observe and comply with the requirements and procedures set out in paragraphs 15.3A and 15.3B of the Code of Conduct. On the same basis, Platform Operators should observe and comply with the same requirements and procedures in order to be exempt from paragraphs 6.3, 6.7 and 6.8 of these Guidelines when dealing with Corporate Professional Investors.



Appendix 2

Examples of when the posting of materials would or would not trigger the Suitability Requirement:

Examples of when the Suitability Requirement is **NOT** triggered:

- (1) Provision of a direct facility to input stock codes to place orders for exchange-traded products for secondary market trading on the relevant exchange.
- (2) Posting of lists of, and provision of access to, investment products and posting of factual information such as corporate information (eg, announcements, circulars or annual reports) issued by listed issuers or the provision of a link to such information on the SEHK's website⁴¹ or other factual information (eg, offering documents, notices to investors, annual reports and fact sheets).
- (3) Posting of lists of investment products that are selected using objective criteria (eg, performance data, sales figures, research data).
- (4) Posting of advertisements of fee discounts not tied to any specific investment product (eg, lower subscription fees during a client's birthday month, time-limited reduced rates or loyalty discounts to reduce transaction fees in general).
- (5) Provision of objective filters for self-directed research on investment products (eg, geographical location, underlying assets, one-year, three-year, five-year performance data or performance data since launch, risk categories and third party or in-house risk ratings).
- (6) Posting of non-product-specific information such as market news or updates, industry and sector trends, and education materials.
- (7) The simple flashing of a "new" icon next to newly published research reports (which may contain views on buy, hold or sell with target prices) or newly available investment products.
- (8) Posting of model portfolios that are constructed using objective criteria (eg, research data, performance data, asset allocation strategies/models) which are not linked to or generated based on information provided by the client.
- (9) Posting statistics or trends in customer activities involving a particular product that are factual and based on objective criteria and do not put pressure on a client to proceed with a transaction (for example, setting out a list of investment products with a description that "Other clients who bought product A also looked at these products").
- (10) Posting of educational materials that are product-specific as long as such materials do not include (standing alone or in combination with other communications) a recommendation of the specific investment product.

⁴¹ For shares listed on the SEHK. For shares listed on overseas exchanges, this would cover the provision of a link to the relevant overseas exchange's website or other official website.



Examples of when the Suitability Requirement **IS** triggered:

- (1) Posting of advertisements which include product-specific incentives (eg, cash rebates, fee discounts) for any transactions in a specific investment product⁴².
- (2) Posting of product-specific research reports on an investment product which include words such as “Don’t Miss Out!” or “Act Now!”.
- (3) Persistent pop-ups or flashing in connection with a specific investment product.
- (4) Presenting a specific list of investment products with an accompanying statement such as “product of risk rating X or below may suit you or match your risk tolerance level” or “these products may suit you or match your risk tolerance level” to clients immediately after the online platform conducts a risk profiling of clients.
- (5) Upon a client’s completion of the know-your-client process or provision of information through a client profiling tool or upon a client providing updates to his or her information, generating a specific model portfolio with a list of investment products or generating a list of selected investment products which may be perceived to be based on a consideration of the information provided by the client.
- (6) Presenting a model portfolio that allocates a percentage of the portfolio to a class of products (eg, bonds) but there is only one product in that class of product offered by the platform.
- (7) Showing the performance of a model portfolio offered by the platform against the performance of the client’s current portfolio held with the platform without the client requesting such a comparison.

⁴² Advertisements of non-complex HK government and PRC sovereign bonds with product-specific incentives would not amount to a solicitation or a recommendation.



Non-complex and complex products

Set out below is a non-exhaustive list of examples of investment products that are considered to be “non-complex”. The SFC is in a better position to provide examples of investment products that are subject to the SFC’s remit as non-complex in this list of examples. For overseas products, a Platform Operator should determine whether an overseas product to be sold on its platform is non-complex or complex having regard to the factors set out in paragraph 6.1 of the Guidelines and this list of examples. It may be possible for a Platform Operator to treat an overseas product as non-complex after carrying out the above assessment with due skill, care and diligence, for example, where the product is of the same type as a non-complex product in this list of examples and is regulated in or traded on an exchange in a specified jurisdiction⁴³. The SFC may revise the list of non-complex products from time to time where appropriate:

Non-complex products

- (1) Shares traded on the SEHK;
- (2) Non-complex bonds (including callable bonds without other special features) (please refer to the definition for “complex” bonds below);
- (3) Non-derivative⁴⁴ funds authorized by the SFC under the UT Code;
- (4) SFC-authorized non-derivative⁴⁵ ETFs traded on the SEHK;
- (5) SFC-authorized REITs traded on the SEHK; and
- (6) Any other investment product the SFC may specify from time to time.

Set out below is a non-exhaustive list of examples of investment products that are considered to be complex products:

Complex products - Derivatives traded on an exchange (where paragraph 6.5 of the Guidelines is applicable)

- (1) Futures contracts traded on the HKFE⁴⁵;
 - (2) Equity derivatives traded on the SEHK (eg, DWs, CBBCs and listed share options);
 - (3) Synthetic ETFs and futures-based ETFs authorized by the SFC and traded on the SEHK;
 - (4) L&I products authorized by the SFC and traded on the SEHK;
- and
- (5) Any other investment product the SFC may specify from time to time.

⁴³ Please refer to the lists of specified jurisdictions for exchange-traded products and non-exchange-traded funds respectively posted on the SFC’s website.

⁴⁴ A non-derivative fund or ETF is one whose derivatives investments do not exceed the overall limit set out in the UT Code for Chapter 7 funds (plain vanilla funds). Such overall limit is currently under consultation and proposed to be 50% of NAV in derivatives investments based on the commitment approach. Please refer to the Consultation Paper on Proposed Amendments to the Code on Unit Trusts and Mutual Funds issued by the SFC on 18 December 2017.

⁴⁵ Hong Kong Futures Exchange Limited



Other complex products

- (1) Complex bonds. Complex bonds are bonds with special features (including, but not limited to, perpetual or subordinated bonds, or those with variable or deferred interest payment terms, extendable maturity dates, or those which are convertible or exchangeable or have contingent write down or loss absorption features, or those with multiple credit support providers and structures) and/or bonds comprising one or more special features;
- (2) Funds authorized by the SFC under the UT Code which are derivative⁴⁶ funds;
- (3) Funds authorized by the SFC under 8.7 of the UT Code (ie, SFC-authorized hedge funds);
- (4) SFC-authorized unlisted structured investment products (including SFC-authorized equity-linked deposits, equity-linked instruments / investments, etc.);
- (5) Other non-exchange-traded structured investment products; and
- (6) Any other investment product the SFC may specify from time to time.

⁴⁶ A derivative fund is one whose derivatives investments exceed the overall limit set out in the UT Code for Chapter 7 funds (plain vanilla funds). Such overall limit is currently under consultation and proposed to be 50% of NAV in derivatives investments based on the commitment approach. Please refer to the Consultation Paper on Proposed Amendments to the Code on Unit Trusts and Mutual Funds issued by the SFC on 18 December 2017.



Appendix 4

Minimum information to be provided and warning statements

Set out below is a non-exhaustive list of examples of the minimum information on a complex product that should be provided in an easily comprehensible manner on an online platform:

- (1) Product nature eg, convertible stock, option, bond, fund, structured product;
- (2) Key terms and features of the complex product, eg, for bonds: (i) bond category; (ii) credit information; (iii) coupon and coupon frequency; (iv) maturity date; (v) special features; and for structured products: (i) product category, eg, equity-linked investment, equity-linked note, credit-linked note; (ii) maturity date; (iii) any possible adjustments to the terms and conditions of the product; (iv) investor's rights over collateral, if any;
- (3) Whether the complex product is available to professional investors only;
- (4) Key risks of the complex product eg, whether there is a risk of losing more than the amount invested;
- (5) Worst case scenario analysis for structured products;
- (6) Whether potential gain may be capped or limited;
- (7) Whether the complex product is principal protected or not;
- (8) Whether there is an early termination feature;
- (9) Any penalty for early exit; and
- (10) Whether a secondary market is available for the complex product.

Set out below is a list of the types of warning statements which should be made on an online platform, where applicable:

- (1) A warning statement to the effect that the product is a complex product and investors should exercise caution in relation to the product.
- (2) A warning statement to the effect that investors may lose more than the invested amount (if applicable).
- (3) For complex products for which the offering documents or information provided by the issuer have not been reviewed by the SFC, a warning statement to the effect that the relevant offering documents have not been reviewed by the SFC and investors are advised to exercise caution in relation to the offer.
- (4) For complex products described as having been authorized by the SFC, a warning statement to the effect that authorization does not imply official recommendation or that SFC authorization is not a recommendation or endorsement of a product nor does it guarantee the commercial merits of a product or its performance.
- (5) Where past performance information is provided, a warning statement to the effect that past performance is not indicative of future performance.
- (6) For complex products only available to professional investors, a warning statement to the effect that the product is only available to professional investors.



Proposed amendments to the Code of Conduct

5.5 Know your client: complex products

- (a) Subject to paragraph 5.5(b), a licensed or registered person providing services to a client in complex products should ensure that –
- (i) a transaction in a complex product is suitable for the client in all the circumstances;
 - (ii) sufficient information on the key nature, features and risks of a complex product is provided so as to enable the client to understand the complex product before making an investment decision; and
 - (iii) warning statements in relation to the distribution of a complex product are provided to the client in a clear and prominent manner.
- (b) For complex products which are also derivative products traded on an exchange in Hong Kong or in a specified jurisdiction, where there has been no solicitation or recommendation, a licensed or registered person is not required to comply with paragraph 5.5(a) although must still comply with paragraphs 5.1A and 5.3. For derivative products traded on an exchange which is not in a specified jurisdiction, a licensed or registered person should comply with paragraph 5.5(a) unless such product could reasonably be treated on the same basis as derivative products traded on an exchange in Hong Kong or in a specified jurisdiction.

Notes

“Complex product” refers to an investment product whose, terms, features and risks are not reasonably likely to be understood by a retail investor because of its complex structure.

Set out below are factors to determine whether an investment product is complex or not:

- (i) whether the investment product is a derivative product;*
- (ii) whether a secondary market is available for the investment product at publicly available prices;*
- (iii) whether there is adequate and transparent information about the investment product available to retail investors;*
- (iv) whether there is a risk of losing more than the amount invested;*
- (v) whether any features or terms of the investment product could fundamentally alter the nature or risk of the investment or pay-out profile or include multiple variables or complicated formulas to determine the return; and*

Note: This would include, for example, investments that incorporate a right for the investment product issuer to convert the instrument into a different investment.



- (vi) *whether any features or terms of the investment product might render the investment illiquid and/or difficult to value.*

A licensed or registered person should refer to the guidance (eg, guidelines and FAQs) issued by the Commission from time to time for examples of complex products, lists of specified jurisdictions, information on the key nature, features and risks of a complex product and warning statements in relation to the distribution of a complex product that should be provided to its clients.

Professional investors

- 15.4 Exempt provisions for Corporate Professional Investors where licensed or registered persons have complied with paragraphs 15.3A and 15.3B and Institutional Professional Investors
- (e) the need to ensure the suitability of a transaction in a complex product and disclose the required information about the complex product (paragraph 5.5 of the Code).



Appendix 6

List of respondents

(in alphabetical order)

1. AGDelta Limited
2. Asia Securities Industry & Financial Markets Association
3. Baker & McKenzie
4. BlackRock, Inc.
5. CompliancePlus Consulting Limited
6. Computershare
7. Consumer Council
8. Deacons
9. Hong Kong Investment Funds Association
10. iFAST Financial (HK) Limited
11. Morningstar Investment Management Asia, Ltd
12. Noble Apex Advisors Limited
13. Nutmeg Asia Limited
14. Private Wealth Management Association
15. TD Ameritrade Hong Kong Limited
16. The Hong Kong Association of Banks
17. The Hong Kong Association of Online Brokers Limited
18. The Hong Kong Society of Financial Analysts
19. The Institute of Financial Planners of Hong Kong
20. The Law Society of Hong Kong
21. Thomson Reuters
22. Vanguard Investments Hong Kong Limited
23. Yunfeng Securities Limited
24. Submissions of 8 respondents are published on a “no-name” basis upon request
25. Submissions of 3 respondents are withheld from publication upon request