



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

## **Consultation Conclusions on Offline Requirements Applicable to Complex Products**

October 2018



## **Table of contents**

<b>Executive summary</b>	<b>1</b>
<b>Comments received and the SFC's responses</b>	<b>2</b>
<b>Conclusion and way forward</b>	<b>8</b>
<b>Appendix A - Final form of the amendments to the Code of Conduct</b>	<b>9</b>
<b>Appendix B - List of respondents</b>	<b>11</b>

---



## Executive summary

1. On 28 March 2018, the Securities and Futures Commission (**SFC**) issued consultation conclusions on proposed Guidelines on Online Distribution and Advisory Platforms (**Guidelines**), which included additional protective measures applicable to the distribution of complex products on online platforms, and further consulted the industry on our proposal that these measures also apply to the offline sale of complex products (**Consultation Conclusions and Further Consultation Paper**). The additional measures are designed to ensure the suitability of complex products and the provision of product information and warning statements to clients. Comments were invited from the public by 28 May 2018.
2. During the consultation period, the SFC received eight written submissions, including submissions from various industry associations. A list of respondents is set out in **Appendix B**.
3. Four respondents supported the proposal to apply the additional measures to the offline sale of complex products. Two respondents sought clarification without offering any comments on the proposal. Two other respondents were of the view that the additional measures should not be applied to the offline sale of complex products because online platforms were different from the offline world and investor protection could be achieved via other means.
4. Some respondents also sought clarification of the definitions of “complex products” and “non-complex products” as well as various technical issues such as the manner and frequency of disclosing product information and providing warning statements.
5. Having regard to the responses to the public consultation, the SFC has decided to proceed with the proposed amendments to the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (**Code of Conduct**) to apply the additional measures to the offline sale of complex products, whilst clarifying some aspects of their implementation.
6. The SFC’s responses to the public comments are set out in greater detail below.

### Implementation

7. The marked-up text of the amendments to the Code of Conduct is set out in **Appendix A**. The amendments will become effective six months from the date of gazettal.
8. We would like to thank the respondents for their time and effort in reviewing our proposals and for their detailed and thoughtful comments.
9. The Consultation Conclusions and Further Consultation Paper, the responses and this paper are available on the SFC website at [www.sfc.hk](http://www.sfc.hk).



## Comments received and the SFC's responses

### I. Proposed offline requirements applicable to complex products

Question 1: Do you have any comments on the proposed amendments to the Code of Conduct? Please explain your view.

10. In the Consultation Conclusions and Further Consultation Paper, it was concluded that additional protective measures (ie, observing the suitability requirement and providing sufficient information to the client on the key nature, features and risks of a complex product and warning statements) should apply to the distribution of complex products on online platforms<sup>1</sup>. We also proposed making amendments to the Code of Conduct to apply the same additional protective measures to the offline sale of complex products to align the regulatory requirements for both online and offline sales.

#### ***Rationale for aligning online and offline requirements***

##### *Public comments*

11. Four out of the eight respondents supported the proposal that the additional measures applicable to the online sale of complex products would also apply to the offline sale of such 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. They considered that these additional measures would help ensure the suitability of complex products and the provision of product information and warning statements to clients. They commented that aligning online and offline requirements would ensure a level playing field and avoid potential regulatory arbitrage. One respondent considered the proposal reasonable and opined that to protect investors' interests, the distribution of complex products should be subject to stricter requirements.
12. Two respondents had no comment on the proposed offline requirements and mainly provided their comments on the Guidelines.
13. Two respondents opposed the proposal and commented that online platforms are different from the offline world. They considered that it would be easier for clients to understand complex products in an offline environment as they could raise questions. They expressed concerns that the additional measures may hinder execution-only transactions, particularly for some sophisticated and experienced clients. They suggested excluding private banking customers altogether as the requirements target retail investors.
14. One respondent also commented that it would be impossible to perform product due diligence for all the products on the market before clients request them. It may need to reject execution-only transactions for products which are not on its products list and this would limit investor choice.
15. Further, this respondent was of the view that the existing obligations under the Code of Conduct (eg, paragraphs 5.1A and 5.3) have provided sufficient protection to investors. This respondent was also concerned that the additional measures may result in misalignment with the requirements in other jurisdictions and put Hong Kong at a

---

<sup>1</sup> The additional protective measures, together with other requirements in the Guidelines, will become effective on 6 April 2019.



competitive disadvantage. It suggested that, in relation to products requested by clients that are not on an intermediary's products list, instead of ensuring suitability, the intermediary be (i) permitted to execute the transaction after making necessary enquiries to ensure that the client understands the product; and (ii) required to confirm with the client in writing that the transaction is execution-only and warn the client that the suitability assessment has not been conducted.

### *The SFC's response*

16. The main purpose of introducing the additional protective measures for complex products is to better protect clients' interests by ensuring that clients are well informed about the nature, risks and features of the complex products and that the complex products are suitable for them.
17. It is important for intermediaries to conduct due diligence on a product before offering it to clients. Without performing any product due diligence, it is doubtful whether intermediaries could have sufficient product knowledge to be in a position to respond to clients' questions properly and in a timely manner in an offline environment. As the products involved may be traded over-the-counter with limited publicly available information, the clients may have little knowledge of the products and may not be aware that they are complex and thus extra caution should be exercised. Hence, we consider that the additional measures, including ensuring suitability of transactions in complex products, shall be applicable even if the complex products are not on an intermediary's products list. The additional measures will provide better protection to investors. Intermediaries should conduct more frequent reviews and updates of their products lists and ensure staff have an adequate level of knowledge to respond to clients' requests and properly discharge their duties.
18. Further, we do not agree that an intermediary should request that its clients sign a document or make any statement to exempt the intermediary from conducting a suitability assessment for a specific transaction. This will not serve the purpose of investor protection.
19. The SFC is of the view that better investor protection would be achieved by requiring intermediaries to perform a suitability assessment<sup>2</sup> which takes into account all the client's personal circumstances and provide product information and warning statements to the client. We also maintain the view that aligning the online and offline requirements for the distribution of complex products would ensure a level playing field and avoid potential regulatory arbitrage. Hence, the SFC will proceed to amend the Code of Conduct to give effect to the proposed additional measures set out in **Appendix A**.
20. We will also work with the Investor Education Centre (IEC) on educational materials to raise investors' awareness and understanding of these new requirements.

### ***Definition of "complex products" and "non-complex products"***

#### Funds

---

<sup>2</sup> Intermediaries should refer to guidance published by the SFC (which may be updated from time to time) on how to comply with the suitability obligations. For example, the Circular to Intermediaries – Frequently Asked Questions on Compliance with Suitability Obligations.



### *Public comments*

21. A respondent commented that it is difficult for intermediaries to obtain information about the use of derivatives by funds and determine whether or not funds are derivative funds as this depends on whether a Commitment or Value at Risk approach is used to calculate derivatives exposure. It suggested that the SFC require issuers of SFC-authorized funds to state clearly in the offering documents whether or not the fund is a derivative fund.
22. A respondent expressed the need for more clarity and guidance for intermediaries to classify products as non-complex or complex. The respondent also suggested that the classification should be stated in the Key Fact Statements of funds authorized by the SFC.
23. A respondent suggested that currency-hedged funds should be treated as non-complex. Another respondent commented that whether or not a jurisdiction has a mutual recognition of funds arrangement with the SFC should not affect whether that jurisdiction is generally regarded as an “acceptable” or “safe” jurisdiction.

### *The SFC’s response*

24. As discussed in the Consultation Conclusions and Further Consultation Paper<sup>3</sup>, the SFC will seek to align the product categorisation requirements, in respect of a derivative fund, for the purposes of the Code of Conduct<sup>4</sup>, the Guidelines and the to-be revised Code of Unit Trusts and Mutual Funds (**UT Code**). The SFC will also provide more practical guidance where appropriate by way of frequently asked questions (**FAQs**). With respect to currency-hedged funds, we have stated in the Consultation Paper on Proposed Amendments to the UT Code that SFC-authorized funds can use derivatives for hedging purposes and as a result are not subject to the proposed derivatives investments limits.
25. The responsibility to classify products as non-complex or complex lies with intermediaries, 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 set out on the SFC’s website. Intermediaries should determine whether a product may be treated as non-complex or complex with due skill, care and diligence. Where the product is not regulated in a specified jurisdiction, intermediaries should exercise extra caution in making this determination.

## Bonds and other products

### *Public comments*

26. A respondent commented that all cash equity products should be classified as non-complex regardless of jurisdiction. It also suggested that bonds with “multiple credit support providers” not be categorised as complex products because they are not derivative products. The respondent also suggested that all high-yield bonds should be categorised as non-complex as the high yield element simply reflects the riskiness of

---

<sup>3</sup> Please refer to paragraph 173 of the Consultation Conclusions and Further Consultation Paper.

<sup>4</sup> Paragraph 5.1A and 5.3 of the Code of Conduct



the product and it is not difficult for retail investors to understand the terms, features or risks of high-yield bonds.

27. Another respondent commented that insurance-linked and wrapped products should be considered complex.

#### *The SFC's response*

28. As mentioned in the Consultation Conclusions and Further Consultation Paper, overseas products are not subject to the SFC's remit and are very large in number and variety. In determining whether a product is complex or not, intermediaries should consider the factors set out in paragraph 6.1 of the Guidelines and our non-exhaustive list of examples which is posted on the SFC's website.
29. Similarly, in determining whether a high-yield bond should be treated as complex, intermediaries should make reference to the Guidelines and the non-exhaustive list of examples. Intermediaries should not focus on the yield generated by the bonds. Intermediaries should, however, consider other features such as whether multiple variables or complicated formulas determine the return, whether it is a perpetual or subordinated bond or whether it has variable or deferred interest payment terms or contingent write down or loss absorption features.
30. We wish to clarify that complex products are not restricted to derivative products only. Non-derivative investment products whose terms, features and risks are not reasonably likely to be understood by retail investors would also be treated as complex products. We proposed that bonds with "multiple credit support providers" be treated as complex as we noted that some bonds have multiple credit support providers with no material operations, or involve complex structures which subordinate the bondholders' rights to those of the multiple credit support providers<sup>5</sup>. Hence, investment products with such features should be treated as complex products and subject to a suitability assessment regardless of the risk.
31. We also want to point out that insurance products are excluded from the definition of "securities" under the Securities and Futures Ordinance and any sale of contracts of insurance<sup>6</sup> does not fall within the remit of the Guidelines or the new paragraph 5.5 to the Code of Conduct.

#### ***Other comments or clarifications sought***

##### *Public comments*

32. Two respondents sought clarification of the manner and frequency of disclosing product information and providing warning statements. They were of the view that the minimum product information and warning statements could be provided on a one-off basis, rather than a transaction-by-transaction basis, particularly for repeat transactions. A respondent also asked if the minimum product information and warning statements should be provided to clients in execution-only transactions.

---

<sup>5</sup> Some bonds have both.

<sup>6</sup> The sale of contracts of insurance is subject to a separate regulatory regime governing the insurance industry.



33. A respondent suggested revising the proposed amendment to paragraph 15.4 of the Code of Conduct for the purpose of clarifying that an intermediary could also be exempted from providing warning statements when it is serving Institutional Professional Investors and Corporate Professional Investors<sup>7</sup> as defined in the Code of Conduct.
34. A respondent sought clarification if the Guidelines would equally apply to the overseas websites of a global firm which operates in Hong Kong and a firm which does not operate in Hong Kong.
35. A respondent sought clarification of whether the mere posting of an advertisement for an investment product in print media or on public transportation (eg, MTR, buses or trams) would be viewed as “solicitation” under paragraph 5.2 of the Code of Conduct. The respondent also enquired what would amount to showcasing products and what kind of information can be posted on the web without triggering the applicability of the Guidelines.
36. A respondent suggested that the SFC require product manufacturers that are regulated by the SFC to state product information and warning statements clearly and prominently in their product documentation.
37. A respondent enquired if an intermediary could execute an unsolicited trade, despite the fact that it has been assessed to be unsuitable for a client, if the intermediary considered it would be acting in the best interests of the client to do so.

#### *The SFC’s response*

38. The purpose of disclosing minimum product information and warning statements is to draw a client’s attention to the key nature, features and risks of a complex product before the client makes a decision<sup>8</sup>, irrespective of whether a solicitation or recommendation is made. Hence, the SFC is of the view that such disclosure should be made on a transaction-by-transaction basis.
39. We wish to clarify that the “required information” in the proposed amendment to paragraph 15.4 of the Code of Conduct includes the minimum product information and warning statements. Paragraph 15.4(e) has been amended to make this clear (see **Appendix A**).
40. An intermediary could be exempted from ensuring the suitability of a transaction in a complex product and providing the minimum product information and warning statements when it is serving Institutional Professional Investors and Corporate Professional Investors. Notwithstanding this exemption, intermediaries are reminded of their obligation to comply with General Principle 5 of the Code of Conduct (ie, intermediaries should make adequate disclosure of relevant material information in their dealings with their clients).
41. In determining whether the display of advertisements, or other materials, for an investment product triggers the suitability obligations, the assessment should be made

---

<sup>7</sup> For the purpose of this paper, “Corporate Professional Investors” refer to those professional investors where licensed or registered persons have complied with paragraphs 15.3A and 15.3B of the Code of Conduct.

<sup>8</sup> We wish to remind intermediaries that it is not enough for intermediaries to hand over these documents, ask the client to read them or merely read the documents to the clients. Intermediaries should also give the client proper explanations.





at the point of sale or advice. It would depend on whether there is communication with clients and whether such communication is relevant to the selling or advisory process. In the absence of direct communication with the client, suitability obligations are unlikely to be triggered by the mere posting of an advertisement for an investment product<sup>9</sup>. Guidance has also been provided by way of FAQs for intermediaries to determine when the posting of materials on an online platform would or would not trigger the suitability obligations<sup>10</sup>.

42. The Guidelines are applicable to all SFC-licensed and registered persons when conducting regulated activities in providing order execution, distribution and advisory services in respect of investment products via online platforms. Generally speaking, companies carrying on a business in regulated activities in Hong Kong would have to be licensed by or registered with the SFC. The fact that an offshore intermediary 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 triggered if: (i) the intermediary holds itself out as carrying on regulated activities in Hong Kong; or (ii) its services, if provided in Hong Kong, would constitute regulated activities, 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<sup>11</sup>.
43. While the Guidelines in general will not apply to websites that only showcase products, we would like to reiterate that we will take into account activities targeting Hong Kong investors conducted by the intermediary via all channels in their totality in considering the intermediary's compliance with the Guidelines<sup>12</sup> and applicable requirements governing the conduct of intermediaries in relation to other non-online channels.
44. While offering documents authorised by the SFC should contain the key features and risks of the relevant product, it is the responsibility of intermediaries to provide product information and warning statements to their clients at the point of sale and provide proper explanations.
45. Further, in line with the position stated in the Further Consultation and Conclusions Paper<sup>13</sup>, if an intermediary, being under the obligation to ensure suitability, has assessed a transaction in a complex product to be unsuitable for a client, the intermediary should not effect the transaction for the client even if the client still wishes to proceed. This is because the SFC is of the view that it is very unlikely that effecting an unsuitable transaction for the client could still be acting in the best interests of the client.

## II. Transition period

Question 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.

<sup>9</sup> Please refer to the SFC's Circular to Intermediaries – Frequently Asked Questions on Triggering of Suitability Obligations issued on 23 December 2016.

<sup>10</sup> Please refer to the answer to question 15 of the Frequently Asked Questions on Guidelines on Online Distribution and Advisory Platform issued on 28 March 2018.

<sup>11</sup> Please refer to section 115 of the Securities and Futures Ordinance.

<sup>12</sup> Please refer to the answer to question 2 of the Frequently Asked Questions on Guidelines on Online Distribution and Advisory Platforms issued on 28 March 2018.

<sup>13</sup> Please refer to paragraph 118 of the Consultation Conclusions and Further Consultation Paper.



### *Public comments*

46. While a few respondents agreed with our proposed six-month transition period, others suggested a longer transition period of 12 to 24 months to allow time to review and amend products lists, enhance systems and controls, revise policies and procedures and provide staff training.
47. Some respondents also suggested aligning the effective dates for online and offline requirements so as to ensure a level playing field, or aligning the transition periods and extending the implementation date of the Guidelines.

### *The SFC's response*

48. We expect that intermediaries have already taken steps to review their systems and controls and arranged necessary operational support to ensure compliance with the Guidelines. Since the proposed additional requirements for the offline sale of complex products are the same as those applicable to online platforms under the Guidelines, intermediaries are able to conduct the review and enhance their policies and procedures simultaneously.
49. Given the importance of these investor protection measures, it is the SFC's view that the requirements should be implemented as soon as possible. Aligning the effective dates of the online and offline requirements will ensure a level playing field and avoid confusing sales staff. Hence, the SFC has decided that the proposed requirements applicable to the offline sale of complex products will come into effect six months following the gazettal of the final form of the amendments to the Code of Conduct, ie, on 6 April 2019, the same date as the online requirements.

### **Conclusion and way forward**

50. The SFC will adopt the proposal to apply the additional protective measures applicable to the distribution of complex products on online platforms to the offline sale of complex products. A marked-up version of the Code of Conduct with amendments for greater clarity is set out in **Appendix A** to this paper. In implementing the new paragraph 5.5 of Code of Conduct, intermediaries should refer to the guidance issued by the SFC from time to time, in particular the Guidelines, FAQs, list of examples and lists of specified jurisdictions issued by the SFC for online distribution and advisory platforms.
51. The amendments to the Code of Conduct will be adopted and become effective six months from the gazettal of the amendments.
52. The SFC would like to take this opportunity to thank all respondents for their submissions.



## Appendix A

### Final form of the 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~~ but 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, **to provide sufficient and disclose the required** information about **a the** complex product **and to provide warning statements** (paragraph 5.5(a) of the Code).



## Appendix B

### List of respondents

(in alphabetical order)

1. Asia Securities Industry & Financial Markets Association
2. CompliancePlus Consulting Limited
3. Mr Stewart Aldcroft
4. Private Wealth Management Association
5. The Hong Kong Association of Banks
6. The Hong Kong Society of Financial Analysts
7. The Institute of Financial Planners of Hong Kong
8. The Law Society of Hong Kong