



Appendix C

Proposed amendments to Code of Conduct and Professional Investor Rules

Draft changes to the Code of Conduct

Use of gifts by distributors in promoting a specific investment product

A new paragraph 3.11 is to be inserted into the Code of Conduct as follows:

Diligence

3.11 Use of gifts by distributors in promoting a specific investment product

1. In promoting a specific investment product to a client, a licensed or registered person should not act in a way that would distract the client's attention from the features of the investment product by offering gifts that have a monetary value other than discount of fees and charges.

Investor characterisation

A new paragraph 5.1A is to be inserted into the Code of Conduct as follows:

Information about clients

5.1A Know your client : investor characterisation

- (a) Except where a client is a professional investor, a licensed or registered person should, as part of the know your client procedures, seek each client's knowledge of derivatives and characterise those with such knowledge as "clients with derivative knowledge".
- (b) Clients may be regarded as having knowledge of derivatives through:
 - (i) Undergoing training or attending courses on derivative products;
 - (ii) Prior trading experience in derivative products; or
 - (iii) Current or previous work experience related to derivative products.

Notes

If a client is not characterised as a "client with derivative knowledge", the licensed or registered person should not promote any unlisted derivative products to such a client in all circumstances. A licensed or registered person can promote unlisted derivative products to a "client with derivative knowledge" provided that it complies with paragraphs 5.2 and 5.3 of the Code and that the recommendation is suitable for the client.

Where a client who does not have derivative knowledge wishes to purchase an unlisted derivative product on his own initiative, the licensed or registered person should warn the client about the proposed transaction and provide appropriate advice to him, including assessment of suitability of the transaction. The suitability assessment should take into account, inter alia, the client's personal circumstances such as his total portfolio, asset concentration and exposure to a particular market or asset class. The warning and communications with the client should be recorded. If the product is assessed to be not suitable for the client, the licensed or registered person should exercise caution in serving the client and should act in the best interest of the client pursuant to GP1 of the Code.

Licensed or registered persons are not required to seek information about a client's knowledge of derivatives if no services in unlisted derivative products are envisaged to be provided to that client. If a client who has not been characterised as a "client with derivative knowledge" subsequently wishes to purchase unlisted derivative products, the licensed or registered person should seek such information from the client.

Pre-sale disclosure of monetary and non-monetary benefits

A new paragraph 8.3 is to be inserted into the Code of Conduct as follows:

Information for clients

8.3 Pre-sale disclosure of monetary and non-monetary benefits

Part A

Disclosure of monetary benefits

Where the monetary benefits received are **quantifiable**

(i) Specific disclosure

Explicit remuneration arrangement

1. Where a licensed or registered person and/or any of its associates explicitly receives monetary benefits from a product issuer (directly or indirectly) for distributing an investment product, the licensed or registered person should disclose the monetary benefits that are receivable by it and/or any of its associates [in dollar amount or a precise percentage of the investment amount – Option 1.1, OR in percentage band or percentage ceiling of the investment amount – Option 1.2]

Non-explicit remuneration arrangement

2. Where a licensed or registered person does not explicitly receive monetary benefits for distributing an investment product which is issued by itself or any of its associates, the licensed or registered person should disclose its distribution reward as follows:
 - (a) Where the same product or similar products so issued are also distributed by external distributing firms in Hong Kong, the distribution reward should be determined by reference to what an external distributing firm receives for distributing the same or similar products, with any reasonable adjustment necessary to reflect the licensed or registered person's particular circumstances – Option 2.1 (Scenario A).
 - (b) Where 2(a) is not possible, the distribution reward should be determined by estimating how much the licensed or registered person should charge for the service with a view to recovering its costs and making a profit – Option 2.1 (Scenario B).

In either of the above situations, the distribution reward should be disclosed [in dollar amount or precise percentage of the investment amount, together with a description of the methodology used OR in percentage band or percentage ceiling of the investment amount, together with a description of the methodology used].

Trading profit made from a back-to-back transaction

3. Where a licensed or registered person enters into a back-to-back transaction

concerning an investment product, the licensed or registered person should disclose to the client the trading profit to be made – Option 3.1.

4. The trading profit should be disclosed [in dollar amount or precise percentage of the client's investment amount OR in percentage band or percentage ceiling of the client's investment amount, together with a description of the methodology used.]

Notes

One example of a back-to-back transaction would be where a distributor sources the product externally and re-sells the product to the investor with a profit.

OR

(ii) Generic disclosure

Explicit remuneration arrangement

1. Where a licensed or registered person and/or any of its associates explicitly receives monetary benefits from a product issuer (directly or indirectly) for distributing an investment product, the licensed or registered person should disclose the existence and nature of each of the benefits and where possible, the method of calculating each benefit – Option 1.3.

Non-explicit remuneration arrangement

2. Where a licensed or registered person does not explicitly receive monetary benefits for distributing an investment product which is issued by itself or any of its associates, the licensed or registered person should disclose that it or any of its associates will benefit from the origination and distribution of this product – Option 2.2.

Trading profit made from a back-to-back transaction

3. Where a licensed or registered person enters into a back-to-back transaction concerning an investment product, the licensed or registered person should disclose to the client that it is making a trading profit from the transaction – Option 3.2.

Where the monetary benefits received are **not quantifiable**:

1. Where the monetary benefits received by a licensed or registered person and/or any of its associates are not quantifiable prior to or at the point of sale, the licensed or registered person should disclose the existence and nature of each of the monetary benefits.

Part B

Disclosure of non-monetary benefits

1. Where a licensed or registered person and/or any of its associates receives from a product issuer non-monetary benefits for distributing an investment product, the licensed or registered person should disclose the existence and nature of each of the non-monetary benefits.

Sales Disclosure Document

A new paragraph 8.3A is to be inserted into the Code of Conduct as follows:

Information for clients

8.3A Sales disclosure document

1. Where a licensed or registered person distributes an investment product to a client, the licensed or registered person should deliver a Sales Disclosure Document to the client prior to or at the point of sale.
2. In the circumstances where delivering a Sales Disclosure Document is not possible before a transaction is concluded, the licensed or registered person should make a verbal disclosure and deliver the Sales Disclosure Document to the client as soon as practicable after the conclusion of the transaction.
3. A Sales Disclosure Document should include the following information at a minimum:
 - (a) The capacity (principal or agent) in which a licensed or registered person is acting;
 - (b) Affiliation of the licensed or registered person with the product issuer;
 - (c) Disclosure of monetary and non-monetary benefits
Please refer to the proposed paragraph 8.3 of the Code); and
 - (d) Terms and conditions in generic terms under which an client may receive a discount of fees and charges from a licensed or registered person.
4. A Sales Disclosure Document should be in Chinese or English according to the language preference of a client.

Professional Investors

Selected parts under the Section on Professional Investors in the Code of Conduct are to be amended as marked up below:

15.1 Professional Investors : in general

Where a client of a licensed or registered person is a Professional Investor referred to in paragraph 15.2A or paragraph 15.2B (who has sufficient knowledge and expertise in relevant products and markets, the licensed or registered person will not be required to fulfil the requirements set out in paragraph 15.5 while serving such clients in respect of relevant products and/or markets of which they are treated as Professional Investors.

15.2 Professional Investors

There are 2 categories of Professional Investors:

- A. A person falling under paragraphs (a) to (i) of the definition of “professional investor” in Part 1 of Schedule 1 to the SFO.
- B. A person falling under paragraph (j) of the definition of “professional investor” in Part 1 of Schedule 1 to the SFO.

15.3 Before waiving the requirements set out in paragraph 15.5 for persons referred to in paragraph 15.2B above, the licensed or registered person should assess and be reasonably satisfied that the person is knowledgeable and has sufficient expertise in relevant products and markets. In assessing the knowledge, expertise and investment experience of any of the persons referred to in paragraph 15.2B above, the licensed or registered person should have regard to the following:

- (a) the type of products in which the person has traded;
- (b) the frequency and size of trades (a Professional Investor would be expected to have traded not less than 40 transactions per annum);
- (c) the person’s dealing experience (a Professional Investor would be expected to have been active in the relevant market for at least 2 years);
- (d) the person’s specific knowledge and expertise in the relevant products; and

Notes: The relevant considerations for specific knowledge and expertise are whether:

- (i) the person is currently working or has previously worked in the relevant financial sector for at least one year in a professional position that involves the relevant product; or
- (ii) the person has undergone training or studied courses which are related to the relevant product.

~~(d)~~(e)his awareness of the risks involved in trading in the relevant products and/or markets.

The above assessment should be in writing. All relevant information and documents obtained in the assessment should also be recorded and kept by the licensed or registered person so as to demonstrate the basis of the assessment.

15.3A A licensed or registered person should undertake an independent and separate assessment prior to treating an existing professional investor under paragraph 15.2B as a professional investor in a different product type or market.

15.3B A licensed or registered person should undertake a new assessment where a professional investor under paragraph 15.2B has ceased to trade in the relevant product or market for more than 2 years.

Draft changes to the Professional Investors Rules

Proposed amendments to the Professional Investor Rules are marked up as follows:

3. Persons prescribed as professional investors

For the purposes of paragraph (j) of the definition of "professional investor" in section 1 of Part 1 of Schedule 1 to the Ordinance, the following persons are prescribed as within the meaning of that definition for the purposes of any provision of the Ordinance other than Schedule 5-

- (b) any individual, either alone or with any of his associates on a joint account, having a portfolio of not less than [**million**] or its equivalent in any foreign currency-
 - (i) "..."

- (c) any corporation or partnership having-
 - (i) a portfolio of not less than [**million**] or its equivalent in any foreign currency; or