

**MEMO# 31209**

May 15, 2018

# **HKSFC Consultation Conclusions on the Proposed Guidelines on Online Distribution and Advisory Platforms and Further Consultation on Application of Offline Requirements to Complex Products**

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TO: ICI Global Pacific Chapter ICI Global Regulated Funds Committee RE: HKSFC Consultation Conclusions on the Proposed Guidelines on Online Distribution and Advisory Platforms and Further Consultation on Application of Offline Requirements to Complex Products

On 28 March, the Hong Kong Securities and Futures Commission (SFC) issued its Consultation Conclusions (Conclusions) to the May 2017 Consultation Paper on the Proposed Guidelines on Online Distribution and Advisory Platforms (Guidelines).<sup>[1]</sup> The SFC adopted the Guidelines to regulate provision of investment services on online platforms and to introduce additional protective measures for the sale of complex products on online platforms. The Guidelines will become effective on 6 April 2019, and the SFC has published a list of frequently asked questions with further guidance.<sup>[2]</sup>

Contemporaneously, in response to comments that offline and online rules should be aligned, the SFC announced a further consultation to amend the Code of Conduct to cover sales of complex products *offline* (i.e., investment advice through all intermediary channels). Comments are due on 28 May 2018. We are not anticipating filing a response to the new consultation. If you have particular concerns, please contact Irene Leung at [irene.leung@iciglobal.org](mailto:irene.leung@iciglobal.org) or Anna Driggs at [adriggs@ici.org](mailto:adriggs@ici.org).

The memo summarizes the key points from the Conclusions and the Guidelines.

## **KEY ELEMENTS OF THE GUIDELINES**

The Guidelines focus on the governance and controls of platform operators and the application of the suitability requirement in this new context.<sup>[3]</sup> Additionally, the Guidelines impose more stringent requirements for the sale of complex products on online

platforms, including the suitability requirement for all sales (solicited or unsolicited) and additional disclosure and warning requirements.

## **Scope of the Guidelines**

The Guidelines apply to all SFC-licensed or registered persons when conducting regulated activities in providing order execution, distribution, and advisory services in respect of investment products via online platforms.

## **Suitability Requirement - Trigger and Discharge**

The Guidelines clarify what triggers the suitability requirement in the context of online platforms and how to satisfy the requirement. Generally, the trigger for the suitability requirement is a solicitation or a recommendation. Under the final Guidelines, the posting of factual, fair and balanced materials will not in itself amount to a solicitation or recommendation in the absence of other facts and circumstances, which may reasonably be expected to influence investors. Appendix 2 to the Conclusions includes examples of when the posting of materials would or would not trigger the suitability requirement. Platform operators must discharge the suitability obligations in accordance with the existing Code of Conduct requirements.[\[4\]](#)

## **Additional Requirements for “Complex” Products**

The Guidelines introduce additional protective measures for the sale of “complex” products on online platforms, including the suitability requirement for *all* sales (solicited or unsolicited) and disclosure and warning requirements.

The final Guidelines provide new details on the platform operator’s responsibility to determine whether a product to be sold on its platform is complex or non-complex. As different platform operators may classify products differently, the SFC has provided further guidance in the form of FAQs and also a non-exhaustive list of investment products that are considered to be complex or non-complex.[\[5\]](#) This information can also be found on the Suitability Requirement webpage in the SFC’s website.[\[6\]](#)

## **What is a Complex Product?**

Under the Guidelines, 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. The SFC has set out a list of factors in the Guidelines to assist platform operators to determine whether an investment product is complex:

- 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 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 listed above 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.<sup>[7]</sup>

Regarding derivative products, a fund that falls within the definition of a "derivative product" in the Code on Unit Trusts and Mutual Funds (**UT Code**) will be deemed a complex product for purposes of the Guidelines. The UT Code is currently under review, and the SFC has proposed that funds with derivative investments exceeding 50% of net asset value (NAV), calculated based on the commitment approach, would be classified as derivative products.<sup>[8]</sup> By using the definition of "derivatives products" in the UT Code, the SFC is seeking to align the product categorization requirements for the purposes of the Code of Conduct<sup>[9]</sup>, the Guidelines, and the UT Code, and providing more practical guidance where appropriate by way of FAQs.

Where there has been no solicitation or recommendation, the Guidelines do not impose the suitability requirements for transactions in complex products that are also derivative products traded on an exchange in Hong Kong or in a specified jurisdiction.

### ***Other Rules for Complex Products***

The final Guidelines impose additional rules for certain disclosure and warning statements for complex products. For derivatives products, platform operators should also comply with the requirement for a process to assess a client's knowledge of derivatives and the corresponding warnings.

## **CONCLUSION**

With the release of the final Guidelines, platform operators will need to review their processes to ensure they come into compliance by the deadline. They will particularly need to determine which platform products are complex to ensure compliance with the heightened standards for complex products. They will also need to review the online sales flow and systems to ensure that the suitability checking process is built into all transactions involving complex products.

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### **endnotes**

<sup>[1]</sup> The Conclusions are available at  
<http://www.sfc.hk/edistributionWeb/gateway/EN/consultation/conclusion?refNo=17CP3>

The final Guidelines, effective April 2019, can be accessed here:  
<http://www.sfc.hk/web/EN/assets/components/codes/files-current/web/guidelines/guidelines-on-online-distribution-and-advisory-platforms/guidelines-on-online-distribution-and-advisory-platforms.pdf>

<sup>[2]</sup> FAQs are available at

<http://www.sfc.hk/web/EN/faqs/intermediaries/supervision/guidelines-on-online-distribution-and-advisory-platforms/guidelines-on-online-distribution-and-advisory-platforms.html>

[3] The Guidelines also explicitly address “robo-advice” – the provision of financial advice in an online environment using algorithms and other technology tools.

[4] Under the FAQs (Ques. 17A), a platform operator may discharge its suitability obligations on online platforms by (a) performing product due diligence; (b) conducting KYC processes; and (c) matching the risk return profile of investment products with the personal circumstances of a client to ensure suitability.

[5] See Appendix 3 to the Conclusions.

[6] Suitability Requirement webpage

<http://www.sfc.hk/web/EN/rules-and-standards/suitability-requirement/>

[7] See Appendix 1, Chapter 6, pg. 23, to the Conclusions.

[8] See the Consultation Paper on Proposed Amendments to the Code on Unit Trusts and Mutual Funds issued by the SFC on 18 December 2017.

[9] Paragraphs 5.1A and 5.3 of the Code of Conduct. The Code of Conduct can be assessed here: <http://www.sfc.hk/web/EN/assets/components/codes/files-current/web/codes/code-of-conduct-for-persons-licensed-by-or-registered-with-the-securities-and-futures-commission/Code%20of%20Conduct%20for%20Persons%20Licensed%20by%20or%20Registered%20with%20the%20Securities%20and%20Futures%20Commission.pdf>