



HONG KONG MONETARY AUTHORITY
香港金融管理局

Our Ref: B1/15C
G16/1C

8 February 2018

The Chief Executive
All Authorized Institutions

Dear Sir / Madam,

Distribution of Fixed Income and Structured Products

I am writing to share some key observations and good practices in relation to distribution of fixed income and structured products identified during the course of our supervision.

In view of the increase in the sale of investment products and increased market volatility recently, Authorized Institutions (“AIs”) are reminded to comply with the expected standards governing the selling of investment products, especially complex and high-risk bonds and structured products as set out below. Further guidance is elaborated in **Annex 1**.

- AIs should maintain effective management oversight and compliance monitoring to ensure product due diligence is properly conducted, and put in place appropriate systems and controls to ensure that the local circumstances and regulatory requirements, as well as other relevant information, are duly considered.
- AIs should ensure that sufficient disclosure is made to customers during the selling process, particularly when the product involves special features or complex structure (e.g. high-yield bonds, Chapter 37 Bonds¹). Staff should be provided with sufficient training and guidance to enable them to appropriately disclose and explain key product information and risks to customers.
- AIs should implement proper systems and controls to ensure compliance with suitability obligations, including know your clients, suitability assessment and selling process, and the relevant regulatory requirements and standards applicable to distribution of specific products (such as Chapter 37 Bonds).

¹ Referring to bonds listed under Chapter 37 of the Main Board Listing Rules.

- AIs should adopt a cautious approach in selling accumulators and ensure that accumulators are only sold to customers who can fully understand the structure and risks, have the risk appetite for acquiring the underlying assets with leverage (where applicable), and have the ability to withstand the potential financial loss. AIs should provide adequate disclosure and explanation of material information to customers, particularly the worst case scenario and margin requirements, and conduct proper suitability assessment, including assessment of concentration risk².

AIs are also reminded to be vigilant in selling debt instruments that may be converted to common equity or written down on the occurrence of a trigger event, in particular loss-absorbing capacity (“LAC”) debt instruments that would absorb loss when the issuer is likely to reach or has reached the point of non-viability. AIs should have an adequate understanding of the nature and risks of these products, assign appropriate risk rating, identify suitable target market, and provide adequate training to staff. AIs may wish to note that the HKMA issued a consultation paper on 17 January 2018 on “Rules on LAC requirements for AIs” which suggests that LAC debt instruments are not suitable for retail investors due to the complex nature and riskiness, and proposes that distribution of LAC debt instruments and related products should be restricted to Professional Investors³ that are not retail banking customers. Subject to the outcome of the consultation, the HKMA will introduce appropriate selling restrictions and enhanced investor protections on distribution of LAC debt instruments and related products.

Taking this opportunity, your attention is also drawn to the attached circular issued by the Securities and Futures Commission (“SFC”) to licensed corporations (“LCs”) on compliance failures identified in the SFC’s onsite inspections and investigations of LCs’ distribution of complex bonds and structured products (**Annex 2**).

AIs should review the areas of concern as discussed in this circular and the two annexes, and take prompt action to rectify any deficiencies to ensure compliance with the relevant regulatory requirements and standards. AIs are also encouraged to adopt the good practices where appropriate. The HKMA will continue to monitor AIs’ selling practices and follow up with individual AIs concerned.

² HKMA’s circular “Selling of accumulators” of 22 December 2010

³ as defined in section 1 of Part 1 of Schedule 1 to the Securities and Futures Ordinance

If you have any questions on this circular, please contact Ms Ada Au at 2878-8814 or Ms Florence To at 2878-1582.

Yours faithfully,

Alan Au
Executive Director (Banking Conduct)

Encl.

c.c. SFC (Attn: Ms Julia Leung, Executive Director (Intermediaries))