Annex 2

Frequently Asked Questions on Portfolio-based Approach to Suitability Assessment ("PBA")

1. Under PBA, can products with a lower or higher risk profile than the customer's overall risk tolerance level be considered suitable for the customer?

Under PBA, products with a lower or higher risk profile than the customer's overall risk tolerance level can be considered suitable so long as the overall risk profile of the portfolio is commensurate with the customer's overall risk tolerance level.

2. How could registered institutions ("RIs") assess a product's suitability to the customer with respect to the customer's investment horizon under PBA?

An RI may adopt any methodology as appropriate for the circumstances of a customer. Among others, an RI may consider the overall liquidity of a customer's portfolio, taking into account the composition and liquidity[1] of the products in the customer's portfolio. By way of example, for a customer whose liquidity need is to be able to liquidate a certain portion of the investment portfolio within, say, one year, one possible approach could be ensuring that such portion of the portfolio is invested in assets with short tenor or liquid assets which can be readily monetised within one year without incurring significant loss. In such case, a proportion of products with relatively longer tenor in the customer's portfolio may not have suitability issue so long as the intermediary is able to satisfy itself that any investment products recommended are likely to meet the investment objectives and other personal circumstances of the customer. In respect of illiquid products, an RI should consider whether such products could be included in a customer's investment portfolio, and if so the extent that such products could be included, after taking into account the customer's investment horizon and financial situation such as liquidity needs.

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[1] In assessing the product liquidity, examples of relevant factors and circumstances to be taken into account include transaction costs, any lock-in period or termination conditions.

3. How could RIs assess concentration risk under PBA?

Some customers may have different investment objectives for different accounts with different intermediaries or the same RI. Under the PBA, an RI could establish with a customer an investment agreement for a specific account, taking a holistic view of all the accounts and overall circumstances of the customer.

RIs can formulate reasonable methodology for assessing a customer's concentration risk under the PBA. For example, a highly concentrated account which only represents a very small portion of a customer's overall portfolio or net worth, etc., may not have suitability issue as far as concentration risk is concerned.

4. Are RIs expected to monitor the intraday movements of the portfolio for ensuring investment products held remain consistent with the investment agreement?

Under the PBA, RIs are only required to ascertain the customer's exposures in investment products held at the point of the new transaction to understand if the customer's portfolio has additional appetite for the new transaction (i.e. the portfolio will still be suitable for the customer in light of the new transaction). In other words, the PBA does not require monitoring on a continuous basis of intraday movements of investment products held, as long as at the point of the new transaction, the RI is reasonably satisfied that the customer's portfolio has the additional appetite for the new transaction.