



Our Ref: B1/15C

16 September 2010

The Chief Executive
All Authorized Institutions

Dear Sir / Madam,

Selling of Renminbi Deposit, Investment and Insurance Products

In the light of increasing popularity of Renminbi (RMB) deposit, investment and insurance products, I am writing to remind authorized institutions (AIs) to ensure that the material features and risks of such products are adequately taken into account in the product due diligence process (including the product risk rating assessment) and the suitability assessment of customers. AIs should also ensure that the features and risks of such products are properly disclosed and explained to customers during the marketing and selling process. In addition to explaining the benefits of the products, AIs should always present balanced views, drawing their customers' attention to the disadvantages and downside risks as well.

As RMB products have different features and varying degrees of risks, AIs should ensure that their product due diligence, suitability assessment and disclosure to customers in respect of each RMB product take into account the specific nature and risks of that product properly. In particular, while a low risk rating may be assigned to sovereign RMB bonds given the specific product nature and lower risks involved, a higher risk rating may be required for RMB products involving more complex structure and higher risks.

While the remaining sections of this circular focus on the disclosure of the nature and risks of RMB products to customers, it is important to note that in making any solicitation, recommendation or advice, AIs should take all reasonable steps to ensure that the proposed transaction is suitable for the customer having regard to the customer's own personal circumstances together with the nature and risks of the product.

Proper disclosure of the nature of RMB products

AIs should ensure that customers understand the nature of the RMB product including any underlying investments (e.g. the product involves non-RMB denominated investments¹, if applicable) and whether any deposit protection is available.

Proper disclosure of the risks of RMB products

The following paragraphs highlight some of the key risks relevant to RMB products. This is however not a comprehensive list and some of the risks may not be applicable to every RMB product.

RMB currency risk

When a customer opens a RMB deposit account, the AI should disclose to the customer the RMB exchange rate risk and the fact that RMB is currently not freely convertible and conversion of RMB through banks in Hong Kong is subject to certain restrictions. Such risks should also be disclosed by the AI to its customers during the marketing and selling process of RMB investment and insurance products. In particular, for personal customers for instance, the AI should explain that as the conversion of RMB is subject to a daily limit, the customer may have to allow time for conversion of RMB from/to another currency of an amount exceeding the daily limit.²

For RMB products which are not denominated in RMB or with underlying investments which are not RMB-denominated, AIs should disclose to their customers that such products will be subject to multiple currency conversion costs involved in making investments and liquidating investments, as well as the RMB exchange rate fluctuations and bid/offer spreads when assets are sold to meet redemption requests and other capital requirements (e.g. settling operating expenses).

Other risks associated with RMB products

Apart from the RMB currency risk, AIs are required to adequately disclose to their customers other risks associated with specific RMB products during the marketing and selling process, including but not limited to the following risks (where applicable):

- **Limited availability of underlying investments denominated in RMB** – For RMB products that do not have access to invest directly in Mainland China, their available choice of underlying investments denominated in RMB outside Mainland China may be limited. AIs should explain to the customers that such limitation may adversely affect the return and performance of the RMB products.
- **Projected returns which are not guaranteed** – If the RMB investment product (e.g. RMB investment-linked assurance scheme) is attached with a statement of illustrative return which is (partly) not guaranteed, AIs should clearly disclose to their customers that the return (or the part of the return, as the case may be) which

¹ For example, a RMB fund may invest in non-RMB assets.

² For personal customers, conversions conducted through RMB deposit accounts are subject to the limit of up to RMB20,000 per person per day.

is not guaranteed and the assumptions on which the illustrations are based, including, e.g., any future bonus or dividend declaration.

- **Long term commitment to investment products** – For RMB products which involve a long period of investment (e.g. RMB investment-linked assurance scheme), AIs should remind customers that if they redeem their investment before the maturity date or during the lock-up period (if applicable), they may incur a significant loss of principal where the proceeds may be substantially lower than their invested amount. Customers should be reminded of the early surrender/withdrawal fees and charges as well as the loss of bonuses (where applicable) as a result of redemption before the maturity date or during the lock-up period.
- **Credit risk of counterparties** – AIs should disclose to their customers the credit risk of counterparties involved in the RMB products. To the extent that the RMB products may invest in RMB debt instruments not supported by any collateral, AIs should ensure customers’ understanding that such products are fully exposed to the credit risk of the relevant counterparties. Where a RMB product may invest in derivative instruments, counterparty risk may also arise as the default by the derivative issuers may adversely affect the performance of the RMB product and result in substantial loss.
- **Interest rate risk** – For RMB products which are, or may invest in, RMB debt instruments, AIs should disclose to their customers that such instruments are susceptible to interest rate fluctuations, which may adversely affect the return and performance of the RMB products.
- **Liquidity risk** – AIs should remind customers of the liquidity risk associated with the RMB products, and where applicable, the possibility that the RMB products may suffer significant losses in liquidating the underlying investments, especially if such investments do not have an active secondary market and their prices have large bid/offer spreads.
- **Possibility of not receiving RMB upon redemption** – For RMB products with a significant portion of non-RMB denominated underlying investments, AIs should disclose to their customers that there is a possibility of not receiving the full amount in RMB upon redemption. This may be the case if the issuer is not able to obtain sufficient amount of RMB in a timely manner due to the exchange controls and restrictions applicable to the currency.
- **Additional risks associated with leveraged trading** – AIs should note that leveraged trading facilities should not be offered to personal customers and Designated Business Customers (DBC³) in respect of RMB products³. While AIs may extend RMB loans to corporate customers, prior to conducting leveraged trading of RMB products for corporate customers, AIs should ensure that the customers understand and are willing

³ RMB lending to personal customers and DBCs is not permissible for the time being, as noted in item 13 of the Frequently Asked Questions attached to the HKMA circular “Renminbi Business in Hong Kong” dated 19 July 2010. For the meaning of DBCs, refer to the HKMA circular “Personal Renminbi Business in Hong Kong” dated 13 December 2005.

to accept the risks and the terms and conditions of the borrowing arrangement. AIs should explain to customers that leveraging heightens the investment risk by magnifying prospective losses. Customers should be properly informed of the circumstances under which they will be required to place additional margin deposits at short notice and that their collateral may be liquidated without their consent. AIs should also ensure their customers' understanding of the risk that market conditions may make it impossible to execute contingent orders, such as "stop-loss" orders. In addition, customers should be reminded of their exposure to interest rate risk, and in particular, their cost of borrowing may increase due to interest rate movements.

If you have any questions on this circular, please contact Ms Alice Lee at 2878-1603 or Ms Florence Lee at 2878-1292.

Yours faithfully,

Meena Datwani
Executive Director (Banking Conduct)

c.c. SFC (Attn: Mr Stephen Po, Senior Director of Intermediaries Supervision)
Insurance Authority (Attn: Ms Carol Hui, acting Assistant Commissioner of
Insurance (Policy & Development))