



Our Ref: B1/15C  
G16/1C

12 June 2012

The Chief Executive  
All Authorized Institutions

Dear Sir/ Madam,

**Selling of Investment Products to Private Banking Customers**

In view of the nature of the clientele and the mode of operations of private banking business, and taking into account relevant overseas practices, the Hong Kong Monetary Authority (“HKMA”) following consultation with the Securities and Futures Commission (“SFC”) and The Hong Kong Association of Banks, hereby provides further guidance and clarification to facilitate the private banking industry’s compliance with regulatory requirements governing the sales of investment products whilst ensuring an appropriate degree of investor protection.

**Definition of “Private Banking Customer”**

The arrangements in this circular will apply to “Private Banking Customer” (“PB customer”) as defined below:

*"An authorized institution (“AI”) may classify an individual as a PB customer if he/ she maintains a personalized relationship with the AI and receives personalized banking services or portfolio management service from the AI and has:*

- (a) at least US\$3 million or its equivalent in any other currency in investable assets; or*
- (b) at least US\$1 million or its equivalent in any other currency in investable assets under the AI's management.*

*Investable assets comprise securities<sup>1</sup>, deposits and certificates of deposits. The amount may be calculated on a relationship basis covering (i) individual accounts; (ii) joint accounts with associates; and (iii) personal investment companies jointly owned by the individual and associates. Associate means the spouse or any child of the individual."*

This definition of “PB customer” will be reviewed and may be subject to revision from time to time in the light of industry developments and supervisory experience.

For the avoidance of doubt, where a private bank relies on alternative (a) of assets threshold for classifying an individual as a “PB customer”, the bank should use methods that are appropriate in the circumstances to satisfy itself that the customer meets the assets threshold, and to ascertain the customer’s investment objectives/mandates outside the bank for the purpose of using a portfolio-based approach in conducting suitability assessment. The private bank should keep proper records to demonstrate that it has exercised professional judgement and has reached a reasonable conclusion. Whilst the HKMA will not rule out the possibility of accepting customers’ declaration as one of the methods, it should be restricted only to occasions that are appropriate in the circumstances.

### **“Portfolio-based” assessment of suitability when providing private banking services to PB customers**

Private banking services can be provided on either advisory or discretionary account basis. When providing such private banking services, private banks should ensure that they know their customers and conduct suitability assessment on a holistic basis, taking into account all the circumstances of the customer. When private banks adopt a “portfolio-based” approach in conducting suitability assessment (including assessment of any risk mis-match, tenor mis-match and concentration risk), they should conduct it properly to ensure compliance with Paragraph 5.2 of the SFC Code of Conduct<sup>2</sup>. As a PB customer may have different investment objectives for different accounts with the same private bank, “portfolio-based” assessment of suitability should be carried out in accordance with any specific investment mandate of an account.

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<sup>1</sup> Securities as defined in Part 1 of Schedule 1 to the Securities and Futures Ordinance (“SFO”).

<sup>2</sup> “SFC Code of Conduct” refers to the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission.

Adequate systems and controls should be put in place to enable proper implementation of the “portfolio-based” assessment.

Before providing any private banking services to a customer, a private bank should take reasonable steps to seek information from the customer about his/ her personal circumstances (including investment objectives and horizon, risk tolerance, investment experiences and knowledge, financial situation, investment objectives/ mandates outside the bank, etc.), and should clearly explain to and agree with the customer his/ her investment mandate (including such as the types, risks and allocation of investments). The private bank should provide a copy of the investment mandate to the customer and obtain customer’s acknowledgement of receipt. The investment mandate and the basis of portfolio allocation should be sound and reasonable taking into account all circumstances of the customer including his/ her investment objectives and horizon, risk tolerance level, investment experience/ knowledge, financial situation and, investment objectives/ mandates outside the bank, and other relevant factors such as product type and nature, product risk rating, etc. The rationale of such investment mandate should be properly recorded, and a copy of the record should be provided to the customer.

If a customer refuses to disclose his/ her amount of investable assets, investment objectives/ mandates outside the bank, the private bank can only take into account the customer’s investable assets under its management when conducting suitability assessment using a “portfolio-based” approach. If the customer disagrees with this alternative, then the “portfolio-based” assessment cannot be adopted.

In the case where a transaction would result in any deviation from the agreed investment mandate of the account (e.g. in terms of product risk, investment tenor, concentration risk, etc.), the private bank should alert the customer of such deviation and ascertain whether the customer wishes to proceed with the transaction and document the rationale for the same. A copy of the document recording the rationale for such deviation should be provided to the customer for record purposes.

The appropriateness of a customer’s investment mandate (including his/ her portfolio allocation) should be reviewed when conducting a review of the customer risk profile (at least once every two years as required under the HKMA’s circular entitled “Applicability of Enhanced Measures to Sales of Investment Products to Private Banking Customers” issued on 20 January 2012). Customers should also be reminded to advise the private bank of any material changes in their circumstances that warrant updates to their risk profile,

and/ or investment mandate (e.g. portfolio allocation) at the bank, as well as be provided with a copy of the rationale for the change in the investment mandate.

Private banks should clearly communicate and explain to a customer that he/ she is a “PB customer” and that the investment service will be provided to him/ her on a “portfolio-based” approach. Appropriate records should be maintained for this purpose.

### **Selling of accumulators<sup>3</sup>**

As accumulators involve client’s writing of a series of options, a private bank is obliged, inter alia, under Paragraphs 5.1, 5.1A and 5.3 of the SFC Code of Conduct to take reasonable steps to establish a customer’s investment experience and assess the customer’s knowledge of derivatives, as well as to assure itself that the customer understands the nature and risks of derivative products when selling accumulators to customers.

Following the spirit of the HKMA’s circular entitled “Selling of Accumulators” issued on 22 December 2010, private banks in general should not sell accumulators to customers without experience and knowledge in writing options or investing in structured investment products. Exceptions should be strongly justified. For example, an exception may be made for a customer who has high risk tolerance and his/ her maximum exposure to accumulators represents only an insignificant portion of his/ her portfolio with the private bank, and the private bank has assured itself that the customer (i) understands the nature and risks of accumulators; (ii) has sufficient net worth to be able to assume the risks and bear the potential losses of trading in the product; and (iii) the suitability of recommending or soliciting accumulators to a customer is reasonable in all the circumstances. Private banks should also ensure that such exceptional cases are subject to prudent policies and control procedures, clear guidance to staff, adequate management supervision and compliance review, as well as supported by proper records to demonstrate how the internal requirements and the regulatory standards have been followed.

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<sup>3</sup> The principles set out in this section also apply to sales of accumulators by AIs to non-PB customers who are professional investors as defined in Part 1 of Schedule 1 to the SFO.

If you have any questions regarding this letter, please feel free to contact Ms Florence To at 2878-1582 or Ms Angela Wong at 2878-1604.

Yours faithfully,

Meena Datwani  
Executive Director (Banking Conduct)

c.c. SFC (Attn: Mr Stephen Po, Senior Director of Intermediaries Supervision)