Annex

Key observations from review of selling processes of investment products

A. Risk disclosure for subsequent transactions of comparable products

Observations
As far as investment funds are concerned, a retail bank allowed its sales staff to streamline risk disclosure to customers only for subsequent transactions of funds with the same fund name. A private bank streamlined risk disclosure only if a transaction was a subsequent one of a comparable product (which is the approach for retail banking customers) disregarding the customer's financial sophistication.

Regulatory standards

As mentioned in the circular of 25 September 2019 on "Investor Protection Measures in respect of Investment, Insurance and Mandatory Provident Fund Products"[1] ("2019 Circular"), when dealing with retail banking customers, RIs may streamline risk disclosure for subsequent transactions of an investment product comparable to the investment product for which risk disclosure has already been conducted by the RI, provided that the RI assures itself and maintains a record to evidence that the customer understands the product. In determining whether an investment product is comparable to another, the focus is the products' key nature, feature, structure and payout structure. For a transaction of a comparable product, after the RI has assessed and maintained a record that the customer understands the product, if the customer agrees, the RI may not need to explain again the generic terms but could focus on disclosing and explaining to the customer the differences and the specific risks, if any. Disclosure of common risks under the same fund type could be streamlined, and RIs may focus on explaining the different terms (i.e. fund-specific risks).

[1] Section (A)(II.2) of Annex 1

As provided in the HKMA's circular of 23 December 2020 on "Frequently Asked Questions on Investor Protection Measures"[2], for private banking customers, an RI can streamline product disclosure (regardless of whether it is a first transaction or subsequent transactions of comparable products) having regard to the customer's financial sophistication as long as it has ascertained and maintained a record that the customer understands the product and does not need a full product disclosure in the circumstances (i.e. not subject to the comparable product requirement as for retail banking customers).

B. Assessment of customer's investment horizon

Observation
A private bank considered investment funds, except for money market funds, liquidity funds and closed-ended funds, are only suitable for customers with investment horizon of more than 5 years, disregarding the fund's liquidity, lock in period or termination condition etc. A customer whose investment horizon of less than or equal to 5 years would be subject to the mismatch handling procedures.

Regulatory standards

As provided in HKMA's circular of 21 October 2022 on "Frequently Asked Questions on Investor Protection Measures in respect of Sale of Investment Products", for an investment product with long or no tenor, it may have sufficient liquidity which allows customers to exit the position without materially affecting the value before maturity, and thus RIs can consider that product even for customers with a shorter investment horizon.

In the product due diligence process of an investment product, RIs may take into account relevant factors and circumstances in assessing the product liquidity, e.g. transaction costs; any lock-in period or termination conditions, and determine to which category of a customer's investment horizon the product is suitable.

[2] Answer to Question 8

C. Assessment of customer's concentration risk

Observations
When assessing a customer's concentration risk in a single instrument, two banks set the same concentration risk threshold regardless of the risk levels of the investment products and the circumstances of the customers. As a result, for clients generally displaying a greater appetite for high risk products, false concentration alerts requiring client's acknowledgement or consent to proceed may often be triggered for transactions which do not have any concentration concern in the circumstances.

Regulatory standards

RIs should put in place reasonable methodology and thresholds for assessing customer's concentration risk, taking into account the risk-level of the products and the clients' circumstances (e.g. setting lower concentration thresholds for higher risk products for customer with lower risk tolerance level).

D. Handling of execution-only transactions

Observations
A private bank applied suitability requirements to all investment transactions i.e. including execution-only transactions of non-complex products.

Regulatory standards

RIs are required to comply with the suitability requirement when making a recommendation or solicitation, or in a transaction in complex product. Whether an interactive communication between a licensed or registered person and a client about an investment product triggers the suitability obligations would depend on whether there is solicitation or

recommendation having regard to the facts and circumstances of each case.[3]

In implementing regulatory requirements, RIs should put in place proper and reasonable processes and controls and provide adequate training and support to staff, to achieve desirable outcomes.

E. Audio-recording for retail banking customers

Observation
A retail bank required its staff to also audio-record the face-to-face sale process of non-complex investment products even without involving risk mismatch, for certain types of vulnerable customers.

Regulatory standards

As mentioned in the 2019 Circular[4], audio-recording of the face-to-face sale process is required only for retail banking customers in the course of:

(i) distribution of / advice on complex investment products; or

(ii) solicitation or recommendation of non-complex investment products, exchange-traded derivatives, or standardised structured deposits not regulated by the Securities and Futures Ordinance, involving risk mismatch.

[3] The circular issued by the Securities and Futures Commission ("SFC") on 23 December 2016 in relation to Frequently Asked Questions on Triggering of Suitability Obligations has clarified the scope of application of the suitability obligations under the Code of Conduct for Persons Licensed by or Registered with the SFC, and provided guidance and illustrations on whether and when the suitability obligations would be triggered under certain scenarios.

[4] Section (A)(II.1) of Annex 1