Annex 1

Streamlined approach for compliance with suitability obligations when dealing with sophisticated professional investors

The following guidance aims to facilitate intermediaries' application of a proportionate and risk-based streamlining approach (the "Streamlined Approach") for compliance with their suitability obligations[1] when dealing with sophisticated professional investors ("SPIs") who possess higher levels of net worth and knowledge or experience.

Intermediaries should bear primary responsibilities for ensuring the maintenance of appropriate standards of conduct and properly managing the risks associated with their business operations. These include having effective systems and controls in place to guard against misuse and detect red-flags arising from applying the Streamlined Approach.

Unless otherwise specified or the context otherwise requires, words and phrases in this guidance shall be interpreted by reference to any definition of such word or phrase in the Securities and Futures (Professional Investor) Rules, and/or the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission.

(A) Qualifying criteria

1. When dealing with Individual Professional Investors, intermediaries are required to comply with the suitability obligations. Under the Streamlined Approach and for the purpose of this guidance, an SPI refers to an Individual Professional Investor who has at the relevant date satisfied the criteria on the financial situation specified in paragraph 3, knowledge or experience specified in paragraph 4 and investment objectives set out in paragraph 5 below.

2. A corporation which has as its principal business the holding of investments and is wholly owned by one or more SPIs may be treated the same as the SPIs for the purpose of this guidance.

3. Financial situation

3.1 An SPI should have at the relevant date –

(a) a portfolio of at least HK$40 million or its equivalent in any other currency; or

(b) net assets, excluding primary residence, of at least HK$80 million or its equivalent in any other currency.

3.2 When ascertaining the value of the portfolio of an SPI, intermediaries may take into account one or more of the following –

(a) a portfolio on the SPI's own account;

[1] This refers to the requirements (as set out under paragraph 5.2 and 5.5(a) of the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission) that a licensed or registered person should ensure any recommendation or solicitation for the client, or a transaction in complex product is suitable for the client in all the circumstances.

(b) a portfolio on a joint account with the SPI's associate;

(c) the SPI's share of a portfolio on a joint account with one or more persons other than the SPI's associate, to the value equivalent to the SPI's share of the portfolio as specified in a written agreement among the account holders or, an equal share of the portfolio in the absence of such agreement;

(d) a portfolio of a corporation which, at the relevant date, has as its principal business the holding of investments and is wholly owned by the SPI.

3.3 "Net assets" refers to the value that is calculated by deducting total liabilities from total assets. "Net assets, excluding primary residence" refers to the value that is calculated by deducting the value of primary residence from net assets.

3.4 When ascertaining the value of net assets of an SPI, intermediaries may take into account one or more of the following –

(a) the value of assets and liabilities held on –

(i) an SPI's own account;

(ii) joint account with the SPI's associate;

(iii) joint account owned by the SPI with one or more persons other than the SPI's associate, to the value equivalent to the SPI's share on the joint account as specified in a written agreement among the account holders or, an equal share of the joint account in the absence of such agreement;

(b) the net assets of a corporation which has as its principal business the holding of investments and is wholly owned by the SPI.

4. <u>Knowledge or experience</u>

4.1 Intermediaries should be reasonably satisfied that an SPI has the degree of sophistication required to understand the risks arising from being treated as an SPI (including the Streamlined Approach) by ascertaining whether the SPI meets at least one of the following criteria –

(a) holding a degree or post-graduate diploma in accounting, economics or finance, or a related discipline;

(b) having attained a professional qualification in finance (such as Chartered Financial Analyst ("CFA"), Certified International Investment Analyst ("CIIA"), Certified Private Wealth Professional ("CPWP"), Chartered Financial Planner ("CFP") or other comparable qualifications);

(c) having at least one-year relevant work experience in a professional position in the financial sector in Hong Kong or elsewhere (eg, licensed for conducting relevant regulated activities); or

(d) having executed at least five transactions within the past three years in the same category of investment products as categorised based on their terms and features, characteristics, nature and extent of risks ("Product Category").

5. Investment objectives

5.1 Intermediaries should not apply the Streamlined Approach when dealing with conservative clients (eg, whose investment objective is capital preservation and/or seeking regular income). Accordingly, intermediaries should not treat conservative clients as SPIs.

(B) Eligible investment transactions

6. Intermediaries should only execute investment transactions for an SPI under the Streamlined Approach where the transactions fall within the Product Categories and the Streamlining Threshold specified by the SPI in accordance with paragraph 7 and paragraph 8 below respectively ("Eligible Investment Transactions").

7. Product Category

7.1 Intermediaries should devise (or adjust as appropriate) Product Categories to categorise investment products based on the terms and features, characteristics, nature and extent of risks of investment product.

7.2 The SPI should specify the Product Categories within which investment transactions could be executed under a Streamlined Approach. Intermediaries are required to document the choice of the SPI and provide a Product Category Information Statement to the SPI to explain the terms and features, characteristics, nature and extent of risks of investment products within such Product Category (the "Product Category Information Statement" eg, in the form of an information booklet/ hyperlinks). Where applicable, the Product Category Information Statement should include warning statements in relation to the distribution of complex products. Intermediaries are also required to explain to the SPI upon request, to facilitate the SPI's understanding of the Product Category Information Statement, terms and features, characteristics, nature and extent of risks of investment products within such Product Category.

7.3 Intermediaries should not apply the Streamlined Approach to investment transactions within a Product Category for an SPI unless –

(a) the SPI has met the criteria specified under paragraph 4.1(a) or (b) or (c) above; or

(b) the SPI has executed within such Product Category at least five transactions within the past three years (ie, the criteria specified under paragraph 4.1(d) above).

8. Streamlining Threshold

8.1 The SPI should specify a maximum threshold of investment, as an absolute amount or a percentage relative to the SPI's assets under management ("AUM") with the intermediary, that is acceptable to be executed under a Streamlined Approach ("Streamlining Threshold").

8.2 SPI could specify a Streamlining Threshold appropriate to their circumstances and the intermediary is required to maintain proper records of setting any such threshold, including the SPI's rationale that provides support for setting such threshold.

8.3 Intermediaries are required to establish and maintain effective systems and controls to ensure compliance with the Streamlining Threshold.

(a) Intermediaries should ensure the gross exposure arising from investment transactions executed under the Streamlined Approach remains at or below the Streamlining Threshold upon execution; or

(b) Intermediaries could devise designated accounts (or sub-accounts) to consolidate Eligible Investment Transactions of the SPI executed under the Streamlined Approach. In such circumstances, they should ensure the gross exposure arising from all positions maintained in the designated account remains at or below the Streamlining Threshold after receiving top-up or deposit of new fund into such designated account. The amount or percentage of AUM with the intermediary being allocated to the designated account should be discussed with the SPI at least annually, or when new fund is added to the designated account.

8.4 Intermediaries should implement measures to detect outsize or material transactions and issue warning statements to the SPI for these transactions.

8.5 Intermediaries should review compliance with the Streamlining Threshold at least on an annual basis and alert the SPI where the gross exposure arising from investment transactions executed under a Streamlined Approach and/or positions maintained in the designated accounts have exceeded the Streamlining Threshold.

(C) Streamlined Approach

9. Paragraph 10 (for transactions with recommendation or solicitation) and paragraph 11 (for transactions in a complex product without recommendation or solicitation) set out the procedures that could be streamlined by intermediaries for compliance with suitability obligations when dealing with SPIs in Eligible Investment Transactions.

10. <u>For transactions with recommendation or solicitation executed under a Streamlined Approach</u>

10.1 Intermediaries are not required to match SPI's risk tolerance level, investment objectives and investment horizon with Eligible Investment Transactions.

10.2 Intermediaries are not required to assess SPI's knowledge and experience, and concentration risk in Eligible Investment Transactions.

10.3 Intermediaries are not required to provide product explanation, except upon request and/or any material queries being raised by the SPI. Intermediaries should provide SPI with up-to-date product offering documents, which could be done by sending a hyperlink to the offering documents or as attachments via electronic means (eg, email).

10.4 Intermediaries are not required to maintain records documenting the rationale underlying investment recommendations made to SPI.

11. For transactions in a complex product without recommendation or solicitation executed under a Streamlined Approach

11.1 Subject to the provision of offering documents to the SPI, intermediaries are not required to perform product due diligence for investment products falling within the Product Categories specified by the SPI. For bonds, where offering documents are not provided to the SPI, intermediaries should prepare and provide their own summaries of the key terms and features of the investment product[2]; or provide to the SPI sufficient information on the key terms and features of the investment product based on information available from reliable public domain or data providers.[3]

11.2 Intermediaries are not required to match SPI's risk tolerance level, investment objectives and investment horizon with Eligible Investment Transactions.

11.3 Intermediaries are not required to assess SPI's knowledge and experience, and concentration risk in Eligible Investment Transactions.

11.4 Intermediaries are not required to provide product explanation, except upon request and/or any material queries being raised by the SPI. Intermediaries should provide SPI with offering documents (where applicable), which could be done by sending a hyperlink to relevant documents, or as attachments via electronic means (eg, email).

11.5 Intermediaries could provide warning statements in relation to the distribution of a complex product on an annual basis instead of a transaction-by-transaction basis.

(D) Application of the Streamlined Approach

12. SPI assessment

12.1 An intermediary should apply the Streamlined Approach when dealing with an SPI only if the intermediary is reasonably satisfied that the SPI has the degree of sophistication to understand and take on the risks arising from a Streamlined Approach by meeting the qualifying criteria (ie, financial situation, knowledge or experience and investment objectives) set out in section (A) above.

12.2 The above assessment should be in writing. Records of all relevant information and documents obtained in the assessment should be kept by the intermediary so as to demonstrate the basis of the assessment.

12.3 Intermediaries should also maintain records of all correspondences with the SPI to support the choice of Product Categories and the setting of a Streamlining Threshold by the SPI.

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[2] Intermediaries should refer to the prevailing guidance issued by the SFC in the form of frequently asked questions on 23 December 2020 in relation to performing product due diligence and disclosing product information for the sale of complex products on an unsolicited basis.

[3] Intermediaries may provide the key terms and features of the investment product to SPI using written, verbal or a combination of both types of communications with records maintained.

13. Client acknowledgment

13.1 Prior to applying the Streamlined Approach when dealing with an SPI in Eligible Investment Transactions, the intermediaries should –

(a) enter into a written agreement with each SPI for acknowledging and giving consent to be treated as an SPI (including the Streamlined Approach, the Product Categories and the Streamlining Threshold);

(b) specify in writing the assessment criteria under which the client qualified as an SPI;

(c) specify in writing the Product Categories and the Streamlining Threshold within which investment transactions could be executed under a Streamlined Approach; and

(d) fully explain to the SPI the consequences of being treated as an SPI and the SPI's right to withdraw from being treated as such at any time.

13.2 The consequences of being treated as an SPI include –

(a) the intermediary would apply the procedures set out in section (C) above (as the case may be) for compliance with suitability obligations when dealing with the SPI in Eligible Investment Transactions;

(b) the point-of-sale procedures of the intermediary were streamlined considering the degree of sophistication and loss absorption ability exhibited by the SPI, and subject to the Product Categories and Streamlining Threshold specified, an SPI could end up investing in a portfolio of high risk investment products under a Streamlined Approach on both solicited and unsolicited basis where the SPI may not be provided with the rationale of recommendations or be warned of a transaction in complex products;

(c) by specifying a Product Category within which investment transactions could be executed under a Streamlined Approach, the SPI acknowledged having the degree of sophistication to understand and accept –

(i) the characteristics, nature and extent of risks of investment products within a Product Category (as contained in a Product Category Information Statement);

(ii) the right to raise queries on or request product explanations before each execution; and

(iii) the right to add or remove a Product Category at any time;

(d) by specifying a Streamlining Threshold within which investment transactions could be executed under a Streamlined Approach, the SPI acknowledged having the degree of sophistication to understand and accept –

(i) the extent of risks (including concentration risks) arising from such executions;

(ii) the Streamlining Threshold specified is commensurate with the personal circumstances (eg, degree of sophistication and loss absorption ability) of the SPI; and

(iii) the right to amend the Streamlining Threshold at any time.

14. Annual review

14.1 Intermediaries should carry out a review annually to ensure that the SPI continues to fulfil the requisite requirements set out in section (A) above and continues to agree for the intermediary to execute investment transactions falling within the Product Categories and the Streamlining Threshold specified by the SPI under a Streamlined Approach.

14.2 In carrying out the annual review, intermediaries should remind the client in writing of –

(a) the consequences of being treated as an SPI;

(b) the Product Categories specified by the SPI and information about the Product Categories as contained in the Product Category Information Statements;

(c) the Streamlining Threshold specified by the SPI and an alert to the SPI where there was any instance of breach; and

(d) the right for the SPI to withdraw from being treated as an SPI, to add or remove a Product Category and/or to amend the Streamlining Threshold at any time.