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3 March 2006

The Chief Executive
All Authorized Institutions

Dear Sir / Madam,

Retail Wealth Management (RWM) Business

The Hong Kong Monetary Authority (HKMA) has completed a round of on-site examinations on Authorized Institutions (AIs) which are active in selling wealth management products to retail customers. The objective is to assess the effectiveness of AIs' risk management controls in this line of business, particularly in respect of customer suitability management, know-your-customer documentation, new product development process and complaint handling procedures.

We would like to share with the industry some of the best practices on customer suitability management observed during our on-site examinations:-

- **Compliance with relevant codes of conduct** – All AIs engaging in RWM business should regularly review and assess their operations to ensure compliance with relevant codes and guidelines including "Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission", "Management, Supervision and Internal Control Guidelines for Persons Licensed by or Registered with the Securities and Futures Commission" and the "Code of Banking Practice"(particularly section 18.7).
- **Customer profiling** – AIs should ensure that the customer profiling process is conducted for all RWM customers and that assessment of customer's risk tolerance level should, as far as possible, be based on objective and pre-determined benchmarks such as customer's disposable assets, age profile, investment and liquidity needs, investment experience, etc. Customer's consent to the results of risk profiling including the assigned risk tolerance level should be documented. There should also be adequate controls to ensure proper establishment and periodic update of customer's risk profile.
- **Product suitability assessment** – AIs should establish specific policies and procedures to ensure that their front line sales staff would, before recommending certain RWM product to a customer, give due consideration to relevant factors including product tenor, product risk as well as the customer's risk appetite, age, investment horizon, investment experience and financial needs. AIs should also note that under normal circumstances, products with potentially very long lock-in period are not suitable for customers whose need for liquidity may generally be higher (e.g. the elderly).
- **Risk disclosure** – AIs should ensure that proper risk disclosure policies and procedures are vigorously applied. When selling RWM products to vulnerable customers such as the elderly, illiterate or visually impaired, additional precautionary measures (e.g. advise the customers to avoid

hasty decisions, invite their relatives or friends to attend, and/or assign more than one staff to conduct, the suitability assessment interview and product presentation) should be implemented to safeguard the interests of these customers and to mitigate any legal and reputational risks the AIs might be exposed to. AIs should not sell complex RWM products to customers who may have difficulty in fully understanding the nature and risks of these products. AIs should also ensure that the wording and terms used in their risk disclosure statements can be easily understood and have explicitly highlighted the underlying risks.

- **Management oversight** – To ensure effective management oversight of the selling practices adopted by front line sales staff, AIs should establish appropriate management information system (e.g. to regularly report to senior management RWM transactions which might be unsuitable for the customers concerned) and implement the requirement for regular review of RWM operations by independent units.

The HKMA intends to conduct in the second quarter of 2006 another round of on-site examinations on AIs engaging in RWM business, focusing on their selling of insurance and structured products to retail customers. AIs' implementation of the above practices will also be reviewed.

Should you have any question on the above, please feel free to approach your usual supervisory contacts at the HKMA.

Yours faithfully,

Arthur Yuen
Executive Director
(Banking Supervision)

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