Questions and comments raised by HKIFA members with respect to the SFC consultation paper on the proposed amendments to the Professional Investor Regime and the Client Agreement Requirements

Question 1: Should Corporate and Individual Professional Investors ("PI") continue to be allowed to participate in private placement activities?

- Yes, it is vital that Corporate and Individual PIs should continue to be allowed to participate in private placement activities.

Question 2: Do you think that the minimum monetary thresholds for Corporate and Individual Professional Investors should be increased?

- We think that the existing minimum thresholds for Corporate and Individual PIs are appropriate and changes are not necessary. The SFC has in fact stated in the consultation paper that the HK$8 million minimum portfolio threshold for Individual PIs is already higher than certain key jurisdictions, such as the United Kingdom.

- In addition, since the SFC has now proposed to remove various exemptions to Individual PIs, there will be additional protection for these investors in line with those accorded to the general retail investors.

- We concur with the SFC's view that individual PIs based solely on monetary assessment under the PI Rules may not be in a position to make sound investment decisions on sophisticated or complex investment products. Therefore, it is very important that licensed intermediaries always perform KYC and ensure suitability of an investment product recommended for the client as well as appropriate risk disclosure of the products.

- One needs to be aware that the original monetary threshold as set by the MAS in Singapore in 2002/03 was similar to the dollar amount as we had in Hong Kong. The reason why the Singaporean threshold now is higher than the one we have in Hong Kong is due to the Singaporean dollar appreciation in the past 10 years and the dollar amounts in both jurisdictions have not been changed.

Question 3: Do you agree that intermediaries should observe the Code without exception when they deal with individuals?

- We agree with this. In fact most investment managers do not apply exceptions on the conduct requirements that are currently allowed in the Code. And we generally believe this is the correct approach.

Question 4: Do you agree that investment vehicles wholly owned by individuals and by family trusts should be treated on the same basis as individuals under the Code?

- We generally agree that investment vehicles wholly-owned by individuals and by

family trusts that do not employ professional staff to manage the assets should be treated on the same basis as individuals under the Code. But this should only be the case if the person(s) making investment decision(s) for the investment vehicle(s) has/have no relevant investment experience.

- Moreover, we believe that a corporation engaging in the business of securities investment (subject to profits tax), but wholly owned by individual(s)/family trusts and where the investment decisions of the corporation are made by person(s) with relevant investment experience in the markets and/or products (similar to the process of a Corporate PI), should be classified as a Corporate PI. The key test is whether the investment decision maker(s) has/have the relevant experience in the markets and/or products; and if he/they have, then the corporation/trust should be classified as a Corporate PI.

Question 5: Do you agree that a principles-based Knowledge and Experience Assessment should dispense with bright line tests concerning dealing experience?

- Paragraph 15.3(e) of the Code requires a licensed or registered person to undertake a new assessment where a Corporate PI has ceased to trade in the relevant product or market for more than 2 years.

  We believe this should only apply to Corporate PIs that wish to make further investments in the relevant product or market after 2 years, but not for those who remain inactive and do not make further investments. Only when a Corporate PI makes further investment in the same product or market 2 years or more after its last investment then an assessment would be needed.

- Paragraph 15.3(f)(i) of the Code requires a licensed or registered person serving Corporate PIs to obtain a written and signed declaration from the client that the client has given consent.

  We would like to suggest to clarify the scope of consent, i.e. blanket consent to be treated as a Corporate PI would suffice – rather than having to seek consent on a product-by-product basis.

- Paragraph 15.3(g) of the Code requires a licensed or registered person to carry out a confirmation exercise annually to ensure that the client continues to fulfill the requisite requirements under the Professional Investor Rules ("PI rules"). It also requires the licensed or registered person, in carrying out the annual confirmation exercise, should remind the client in writing of the risks and consequences of being treated as a Corporate PI and its right to withdraw from being treated as such.

  We would like to suggest for clarity purposes, it would be helpful to make it clear that the client has to sign and return to the licensed or registered person annually to confirm that it continues to fulfill the requisite requirements under the PI Rules (or a negative confirmation - i.e., no response is deemed as fulfilling the requisite requirements under the PI rules - will be sufficient); and the licensed or registered person can rely on the confirmation and does not need to

obtain supporting documents that substantiate the clients' fulfillment of the PI Rules.

If "negative confirmation" is not deemed acceptable to the SFC, it would be helpful if the SFC can let the industry understand what it would expect the licensed or registered person to do if the clients do not return the annual confirmation; or if the clients reply and confirm that they do not fulfill the requisite requirements under the PI Rules.

- As for the application of "principles-based Knowledge and Experience Assessment" to the category of Corporate PIs based on the criteria in the proposed paragraph 15.3 of the Code, we would like to suggest the SFC to consider adopting a "bright line test" to ensure consistency amongst industry participants. E.g. specify the number of years of investment experience of the person(s) responsible for making investment decisions (as in 15.3(b)(ii)) and also how to determine if the Corporate PI is aware of the risks involved (as in 15.3(b)(iii)).

Question 6: Do you have any views on the Suitability Requirement?

- The current Suitability Requirement ("SR") is sufficient.

- There is no doubt that SR is a key investor protection measure. However there is no objective formula to conclude that the investment product is suitable to the investor or not. Given its broad application and it is a principle-based standard and thus can be subjective, the implication of including the SR without qualification in the client agreements will easily lead to contractual disputes.

- In order to strike a balance between investor protection and unwarranted contractual disputes (onerous compliance costs for intermediaries), we urge the SFC to reconsider the proposal for allowing intermediaries to add assumptions/conditions and limitations in the client agreement. The intermediaries' responsibility on the SR should have conditions attached, e.g. Suitability check ("SC") may not be able to cover all the personal circumstances of the investor; SC is dependent on the accuracy of information provided by the investor; SC is carried out at the time of subscription or switch in transactions and the investor still has the responsibility to review his portfolio and personal circumstances from time to time to ensure suitability.

- Intermediaries may offer regular investment plans to investors. SC is normally carried out when an investor starts the regular investment plan. Investor personal circumstances and product risk level may change subsequently. Can the intermediaries perform SC at the time of the investment plan is set up? It is difficult to carry out SC after the account has been set up. More importantly, it is the responsibility of the client to review his portfolio regularly.

- As the SR is only triggered when an intermediary makes a recommendation or solicitation, if the intermediary advertises the investment product on internet or

other media channels publicly without targeting a specific client, would this amount to solicitation?

- It seems that the SR is the same when the intermediary makes recommendation or solicitation. Can SFC share its view as to whether there is any difference in the SR when an intermediary makes "recommendation" or "solicitation" such as in the documentation of the rationale underlying an investment under each of this scenario?

- If the investor is not willing/refuses to provide his investor profile, what actions/steps does the SFC expect the intermediary to carry out before accepting the order to fulfill the SR?

- If the investor insists on investing in a risk mis-matched product and the intermediary has warned the client about the mismatch and the investor provides his reason of investing it. What extra actions/steps does the SFC expect the intermediary to carry out to demonstrate accepting the order is in the best interests of the investor?

Question 7a: Do you agree with the SFC's proposals that the Suitability Requirement should be incorporated into client agreements as a contractual term?

- Are the client agreement requirements for all type of investors? We believe that Institutional Professional Investors are exempted, is this correct?

- We do not agree with the SFC's proposal that the SR should be incorporated into the client agreement as a contractual term. The application of SR is set out in the Code and is principle-based. The SFC pointed out in the Consultation Paper that when there is a breach of the Code, the SFC can only impose disciplinary action on the intermediary. However, the SFC cannot require the intermediary to pay compensation to aggrieved clients.

- We do not think it is appropriate to incorporate the SR into the contract between the client and intermediary. Contracts need to have clarity and certainty, yet the SR is principle-based. And these principles are to be applied appropriately by the intermediary.

- It is quite often that the licensed or registered persons may not be able to obtain a thorough SC from clients and if there is the case, will the licensed or registered persons be deemed not fulfilling the duties as included in a client agreement if SR is incorporated into client agreements?

- The proposal to include the SR in the client agreement can potentially give rise to an influx of invalid claims from investors with the intermediaries claiming contractual breach of this SR, the parameters of which cannot be clearly defined in the contract.

Also, intermediaries will be required to spend time and resources to handle such claims even though it is ultimately found that the principles of the SR have been applied appropriately by the intermediary. In any case licensed intermediaries are required to follow all applicable SFC requirements at all times regardless of whether it is stated in a client contract or not. Therefore, not putting them in as contractual terms would not limit the intermediary's responsibility.

- The Financial Dispute Resolution Centre ("FDRC") established in 2012 serves as an avenue for investors to claim compensation from intermediaries who are involved in misconduct during the selling activities. By making the SR a contractual term of the client agreement, clients may choose to use the court system to sue for a contractual breach rather than use the FDRC to settle any suitability dispute. This will increase the burden on the court system and reduce the effectiveness of the FDRC regime.

- If the SR is incorporated into the client agreement, the investor may question why the rest of the requirements applicable to an intermediary are not incorporated. The investor may interpret that he does not obtain full protection under the Hong Kong regulations and refuses to enter the contract with an intermediary.

- Regarding the proposal that a client agreement should contain provisions that the licensed or registered person must ensure the suitability of any recommendation or solicitation made to the client is reasonable in all the circumstances, we would like to propose to exempt "discretionary investment management services" from this requirement. Unlike a retail fund, the terms of Investment Management Agreements ("IMA"), including investment objectives and guidelines, in relation to the provision of discretionary investment management services are subject to negotiation and agreement with clients. Clients typically would counter-propose the terms during the negotiation process. Thus, the final IMA is a result of discussions between the client and the portfolio manager. As such, we believe that clients' interests and views are fully factored in the negotiation process and the final agreement.

Question 7b: Do you agree with the SFC's proposals that client agreements should not contain terms which are inconsistent with the Code and should accurately set out in clear terms the actual services to be provided to the client?

- We agree with the SFC that client agreements should not contain terms that may be contrary to the Code. However it is impractical for an intermediary to list out all the services to be provided to the clients or summarizes the services in a generic statement. In particular, it is common that the intermediary may, at the specific request of the client, provide ad-hoc support to the client. It would appear unreasonable for intermediaries to refrain from providing ad-hoc assistance of any nature to its clients for fear that the SFC will interpret this as a service beyond what is contractually agreed to provide.

- Regarding the proposal to add the "setting out in clear terms the actual services to be provided to client" in client agreements, there are numerous services (e.g.

seminar, different types of account services, web, mobile, IVR services, various dealing channels etc), the listing out of these, could be confusing and annoying for clients. Also, there is always room for adding new services and realistically speaking, an intermediary cannot envisage what services can be offered in the future. We believe that it would suffice if the intermediary sets out in the agreement the generic "core" service(s) (e.g. whether investment advice is being given) that will be provided to clients.

- Although the intermediary may be willing to provide advice or advice may be given at the time of account opening but the customer later decides to make investment decisions independently or based on outdated advice (e.g. if a portfolio review was conducted in January, and the investor does not make an investment decision until March and markets have changed), it would be difficult to clearly classify the services as provided by the intermediary.

- If SFC still maintains that it is a must to spell out the actual services, it is important that it provides examples/elaborate on its expectations of the extent of description or what types of services, if provided, must be included.

- Client agreements should reflect the commercial terms as agreed between the client and the intermediary. Thus, a prescription by the SFC for inclusion of (i) the Suitability Requirement and (ii) no inconsistency with the Code provisions are not consistent with the spirit of contract. Intermediaries are already governed by the Code in any events.

Others

- We welcome the SFC's proposal to maintain the current position with regard to the institutional professional investors so that intermediaries dealing with them are automatically entitled to all current Code exemptions.
- We hope to exhort the SFC to remind investors that notwithstanding all these amendments, investors have the ultimate responsibility for the investment decisions made regardless of whether advice or recommendations have been given.

(End)