



## Regulatory Update – SFC Updates FAQ’s on Compliance with Suitability Obligations and Requirements for Complex Products (December 2020)

Following numerous questions raised by the industry, on 23<sup>rd</sup> December 2020, the Securities and Futures Commission (“SFC”) released new FAQ’s in relation to suitability obligations when providing services to high-net-worth investors with a high level of financial knowledge and experience.

The SFC has added three additional FAQs which address the suitability assessment process, how licensed persons should explain investment products to high-net-worth investors with different experience levels and the processes expected when distributing complex products on an unsolicited basis. In this regulatory update we will outline these additional FAQs and how they may impact your operations when dealing with high-net-worth investors moving forward.

### Suitability Assessment Process for Different Clients

The SFC has included question 5B to address how a licensed corporation (“LC”) should design their process for performing suitability assessments for different clients. To be clear, a suitability assessment is not just a risk matching process but is a dynamic process which varies considerably depending on your client’s circumstances, the type of investment product (complex / non-complex) and the service provided to the client (discretionary / advisory services).

LCs may take a proportionate risk-based approach when performing a suitability assessment for high-net-worth clients by taking into consideration all relevant factors that may impact such clients. For example, it may be suitable to offer a wider range of investment products to HNWI’s that show that they have a high level of financial knowledge and experience and can demonstrate that they can handle investment products with a higher-level risk tolerance.

The proportionate risk-based approach should also be utilised when assessing the overall effect or impact of any investment products recommended for a client’s investment portfolio including concentration risk assessments. When assessing concentration levels LCs should consider both the risk-level of the products and the clients’ circumstances.

As with the suitability assessment, the concentration risk assessment should not be a mechanical process. In certain scenarios, exceeding the concentration level may be acceptable as long as the outcome is commensurate with the overall risk profile of the investment portfolio and the client’s specific circumstances.

### Explaining the Features and Risks of Investment Products

Question 6B provides further clarity to LCs on how to explain the features and risks of investment products to clients who have varying levels of financial knowledge and experience. It is crucial that the features and risks of an investment product are clearly explained to a client as this process will help the client understand the specific details of the product.

A one-size-fits all approach does not work when explaining products to clients. LCs must ensure that their licensed representatives customise their product explanation processes to fit the level of knowledge and experience of the client.

Licensed representatives seek to explain the product features in an interactive approach that includes written or verbal explanations or a combination of both.



Simply providing a client with standard product literature to review is not sufficient to discharge this obligation.

In the case of a client with no or little prior knowledge or experience in the investment product in questions, LCs must ensure that their representatives provide additional assistance to that client to understand the product. For example, LC's may require that licensed representatives clearly explain to their clients in simple language the specific features of the product and allow the client the opportunity to ask questions to ensure that their understanding of the product is accurate.

Experienced or high-net-worth investors may not require as intensive explanations if they can clearly demonstrate that they have the relevant knowledge and experience in investing in such product.

LCs may vary the disclosure process for clients who repeat specific transactions as they can take into account the previous disclosures made as well as the adequacy and timing of the client's previous transactions.

## **Distribution of Complex Products on an Unsolicited Basis**

Question 39 has been added to provide LCs guidance on the design of their process for performing product due diligence ("PDD"), how they should disclose product information and how they should provide warning statements to different clients to ensure that they comply with paragraph 5.5 of the Code of Conduct ("CoC").

### ***Product Due Diligence for Unsolicited Products***

If an LC is asked by a client to purchase a product that is not on its approved product list, the LC must undertake PDD on that product. The PDD should be based on the product offering documentation, documentation provided by the issuer and other relevant information that is available in the public domain or from a data provider.

When undertaking PDD an LC must have in place procedures to identify the following key features and risks of the product in question:

- A review of the product offering document or information to determine if the product is a complex product;
- If it is a complex product the LC must review the product information to identify generic risks and specific risks arising from its special features; and
- Identify any warning flags with reference to the information obtained.

LCs need not develop a house view of complex products nor is there a requirement to perform ongoing PDD for complex product only made available to clients on an unsolicited basis.

However, LCs must clearly reference in their policies when PDD needs to be re-performed or updated especially when a client requests to purchase the same complex product.

### ***Disclosure of Product Information***

When an LC distributes a complex product, it must ensure that it discloses all product information and provide warning statements to clearly highlight to the client the key features and risks of the product.



# CA | ComplianceAsia

A proportionate risk-based approach can also be taken when disclosing complex product information depending on the circumstances of the particular client. For example, if a client is very familiar with a product, the required level of disclosure may be less.

When executing an unsolicited order for a complex product for a client that has relevant knowledge and experience about the product (e.g. if the client is a SFC licensed person himself or is an investment professional) the need to provide detailed product explanations, disclosures or warning statements can be reduced.

If you do opt to reduce the explanation or disclosures, you must ensure that you maintain proper records of the assessment in these circumstances.

Further where LCs provide clients with their own summary of a product’s key features and risks, they must ensure that all summaries are accurate and not misleading.

## How we can help

Our dedicated projects team can assist with reviewing and updating your suitability policies and procedures to ensure that they clearly address the additional changes made to the SFC’s suitability FAQs. In addition, we can undertake a full suitability assessment or conduct sample testing of your current suitability assessments to ensure that they comply with the necessary requirements expected of a SFC Licensed Corporation.

---

## About ComplianceAsia

ComplianceAsia is the longest established compliance consulting firm in Asia Pacific established in 2003 with key offices in Hong Kong, Shanghai, Singapore, Tokyo and London. We have an unmatched track record of completing complex compliance consulting projects for financial firms in the APAC region.

With over 70 staff, including compliance experts with experience in dealing with the SFC, HKMA, MAS, CSRC, JFSA and Asian exchanges, we provide independent, unbiased advice on Asian financial industry legislation and regulations. Our international client base consists of asset managers, hedge funds, private equity funds, family offices, broker-dealers, insurers, wealth managers and investment banks.

## Contact Us Today

### HONG KONG

Suite 1102  
ChinaChem Tower  
34 – 37 Connaught Road  
Central

T: +852 2868 9070

### SINGAPORE

137 Telok Ayer Street  
#03-06  
Singapore 068602

T: +65 6533 8834

### MAINLAND CHINA

Room 4205-4207 42/F, Shanghai  
Tower  
No.479 Lujiazui Ring Road  
Pudong New Area Shanghai

T: +86 147 1431 1859



ComplianceAsia



## JAPAN

Level 2  
Marunouchijubashi Building  
3-2-2 Marunouchi Chiyoda-ku  
Tokyo 100-0005

T: +81 3 6837 5483

W: [www.complianceasia.com](http://www.complianceasia.com)

### Philippa Allen

CEO  
E: [philippa.allen@complianceasia.com](mailto:philippa.allen@complianceasia.com)

### Gerallt Owen

Regional Head of Client Relations  
E: [gerallt.owen@complianceasia.com](mailto:gerallt.owen@complianceasia.com)

### Hanae Kuroda

Compliance Consultant  
E: [hanae.kuroda@complianceasia.com](mailto:hanae.kuroda@complianceasia.com)

### Lucia Liao

Head of Shanghai Office  
E: [lucia.liao@complianceasia.com](mailto:lucia.liao@complianceasia.com)

### Hardy Hussain

Head of AML Services, South East Asia  
E: [hardy.hussain@complianceasia.com](mailto:hardy.hussain@complianceasia.com)

## LONDON

1 St. Andrew's Hill  
London  
EC4V 5BY

T: +44 (0) 20 7213 0300

### Alex Duperouzel

Managing Director  
E: [alex.duperouzel@complianceasia.com](mailto:alex.duperouzel@complianceasia.com)

### Lachlan Chubb

Regional Head of Regulatory Advisory and Projects  
E: [lachlan.chubb@complianceasia.com](mailto:lachlan.chubb@complianceasia.com)

### Rachel Wu

Head of Mainland China Client Engagements  
E: [rachel.wu@complianceasia.com](mailto:rachel.wu@complianceasia.com)

### Rob Lind

Senior Representative – UK and Europe  
E: [robert.lind@complianceasia.com](mailto:robert.lind@complianceasia.com)

### Justin Fletcher

Head of AML Services, North Asia  
E: [justin.fletcher@complianceasia.com](mailto:justin.fletcher@complianceasia.com)