



## Suitability obligations/investment product selling practices – For intermediaries regulated by SFC and/or HKMA

### **Mazars financial services newsletter – Aug 2020**

**Investor protection has always been a priority for regulators all over the world and the cornerstone for investor protection is how suitability obligations of financial institutions selling investment products are being discharged. This document sets out the key regulatory focus areas of the Securities and Futures Commission ("SFC") and the Hong Kong Monetary Authority ("HKMA") for licensed intermediaries in relation to the suitability requirements as well as other aspects of the selling practices for investment products.**

## Background

The consideration of suitability requirements is key for investor protection and is integral to selling practices, which encompass the distribution and provision of advice on investment products to clients of financial institutions. Given its importance, the SFC and the HKMA (collectively the “Regulators”) have issued a number of codes, guidelines, circulars and FAQs to provide guidance to the financial services sector on their expected standards in relation to suitability requirements as well as other aspects of selling practices for investment products.

### Suitability obligations – key areas of focus

The chart below sets out the 7 main suitability obligations that are expected of licensed or registered persons in Hong Kong by the Regulators with respect to their investment product selling practices:



The key focus areas under each of the 7 main suitability obligations are set out below:

## Know your clients

- Information from clients about their financial situation, investment experience, investment objectives, investment knowledge and investment horizon
- Information from clients about risk tolerance (including risk of loss of capital) and risk capacity, often by making use of a properly designed risk-scoring mechanism
- Investor characterisation for clients based on their knowledge / experience of derivatives and the pertinent evidential requirements
- Identification, classification and evidential requirements for professional investors as defined under the Securities and Futures Ordinance and/or the SFC Code of Conduct

## Product due diligence

- New product and issuer / counterparty screening and selection process
- Understanding of the nature and extent of risks to investment products
- Consideration of the market and industry risks, economic and political environments, regulatory restrictions and any other factors which may directly or indirectly impact on risk return profiles and growth prospects of investments depending on the nature of the investment products
- Product due diligence process to be conducted on a continuous basis at appropriate intervals
- Product risk rating mechanism and the generation and validation mechanisms

of product risk rating for products to be offered

- Procedures and controls in determining whether an investment product is a complex or non-complex product

## Selling process and suitability

- Client and product suitability assessment mechanism
- Controls on point of sale requirements (e.g. suitability checklists)
- Approval procedures and handling of sales of mismatched / unsuitable investment products
- Assessment of concentration risk based on available information about the client
- Investment product selling procedures for professional investors as defined under the Securities and Futures Ordinance and/or the SFC Code of Conduct

## Disclosurers to clients

- Provision of all relevant and appropriate product information (e.g. brochure, term sheet, information fact sheet, etc.)
- Disclosure in relation to treating a client as a professional investor
- Mechanisms for providing extra care and disclosures when making recommendations to vulnerable clients on complex investment products
- Disclosure of contingency fees, actual/potential conflicts of interest, receipts/provision of benefits to clients

- Pre-trade disclosure requirements of benefits received and other sale-related information
- Processes and controls for helping clients make informed decisions by giving the client proper explanations of why the recommended investment product is suitable for the client and the nature and extent of risks the investment product bear

### Training

- Licensed staff providing investment product selling services should have an adequate level of knowledge and skills to provide recommendations to clients
- Licensed or registered persons should also provide regular and appropriate training to their staff and ensure that they keep abreast of developments in the industry

### Documentation and record retention

- Each client's information should be properly documented, and where appropriate, updated on a continuous basis
- Retention of documentation in relation to:
  - the verification work and enquiries for products offered,
  - the criteria for selecting the products and in what aspects they are considered suitable for different risk categories of investors, and
  - the approvals from senior management for recommending the products

- Records documenting the rationale underlying investment recommendations made to the client should be maintained and a copy of the rationale for the recommendations should be provided to the client upon request

### Senior management supervision

- An intermediary should maintain a good corporate governance structure, with clear lines of responsibility and authority, by which its activities are properly directed, managed and controlled
- Senior management should review, assess and be satisfied that an intermediary has adequate systems and controls to promptly identify issues and matters that may be detrimental to a client's interest
- Senior management should also ensure that transactions and related documents are reviewed by qualified and competent personnel
- Senior management should ensure client complaints are promptly investigated and appropriate remedial measures taken without undue delay
- Senior management should be kept informed on a timely basis of all issues and matters that may call into question of an intermediary's compliance with applicable laws, rules and codes and protection of client interests

## How can Mazars help?

At Mazars, we have extensive experience working with the diversity of financial services players. We assist major financial institutions including brokerage houses, asset managers, investment and corporate banks, retail and private banks, central banks, and national regulators in dealing with business and regulatory issues with multiple impacts, domestic and international.

Mazars is here to assist you in every step of your investment product selling process and beyond. Depending on the scope, coverage and specifics of your needs, our services would typically involve one or more of the following:

### Regulatory reviews and advice

- Review and provide advice on your firm's:
  - policies and procedures,
  - suitability assessment methodologies,
  - selling processes and controls, and
  - governance and supervision
- Provide observations and recommendations to assist you in complying with the Regulators' requirements and expectations, as well as industry best practices
- Provide pre-inspection advice or workshops or perform pre-inspection reviews

### Implementation of enhancements

- Provide advice / assistance in designing and implementing enhancements to the

governance and supervisory framework, as well as policies, procedures and controls of your investment selling process

- Provide advice / assistance in designing the mechanisms for client risk profiling / product risk rating

### Training

- Provide targeted training specific to your firm's unique product offerings, sales activities, and suitability framework
- Provide ongoing insights into how peer firms are dealing with the regulatory requirements and any common challenges encountered along the way

### Project management

- Set-up of project governance framework, structure and reporting arrangements
- Design of project plan including milestones and committee involvement
- Ensure timely delivery of pre-determined targets

We are flexible in our approach and offerings. Please feel free to contact us with any enquiries.

# Contacts

Mazars – financial services

## Hong Kong

42nd Floor, Central Plaza  
18 Harbour Road  
Wanchai  
Hong Kong  
(+852) 2909 5555

### Ernest Yiu

Managing Director – financial services  
ernest.yiu@mazars.hk  
(+852) 2909 5585

### Pierre Latrobe

Director – financial services  
pierre.latrobe@mazars.hk  
(+852) 5917 8812

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