IFPHK's Response to the Securities and Futures Commission Consultation Paper on the Proposed Guidelines on Online Distribution and Advisory Platforms

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IFPHK Institute of Financial Planners of Hong Kong 香港財務策劃師學會

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Institute of Financial Planners of Hong Kong (IFPHK) - Profile

Background

IFPHK was established in June 2000 as a non-profit organization for the fast–growing financial services industry. It aims to be recognized in the region as the premier professional body representing financial planners dedicated to upholding the highest professional standards.

The Institute is the sole licensing body in Hong Kong authorized by Financial Planning Standards Board Limited to grant the much-coveted and internationally-recognized CFP^{CM} Certification and AFP^{TM} Certification to qualified financial planning professionals in Hong Kong and Macau.

It represents more than 7,000 financial planning practitioners in Hong Kong from such diverse professional backgrounds as banking, insurance, independent financial advisory, stock broking, accounting, and legal services.

Currently there are more than 153,000 CFP certificants in 26 countries/regions; the majority of these professionals are in the U.S., Canada, China, Australia and Japan, with more than 4,700 CFP certificants in Hong Kong.

CFP^{CM}, CERTIFIED FINANCIAL PLANNER^{CM}, CFP^{CM}, CERTIFIED FINANCIAL PLANNER ™, AFP^{TM}, ASSOCIATE FINANCIAL PLANNER^{TM}, AFP® and ASSOCIATE FINANCIAL PLANNER® are certification marks and/or trademarks owned outside the U.S. by Financial Planning Standards Board Ltd. The Institute of Financial Planners of Hong Kong is the marks licensing authority for the CFP marks and AFP marks in Hong Kong and Macau, through agreement with FPSB.

IFPHK's interest in this consultation

The mission and vision of the IFPHK is to promote the importance of financial planning. Financial planning refers to the process of setting, planning, achieving and reviewing life goals through the proper management of finances.[1]

According to the Whitepaper published by the Financial Services Development Council (FSDC) in May 2017, FinTech is important to Hong Kong because over the coming decade or so it may

[1] www.fpsb.org

dramatically alter today's financial services delivery model. Since financial services contribute 18% of Hong Kong's GDP and 6% of its employment, the impact will be considerable.[2] FPSB believes that FinTech and robo-advising are an unavoidable global trend. To avoid being left behind the curve, the IFPHK has already urged the SFC to study the feasibility and challenges of robo-advising in our previous submission on asset management reform.

Indeed, the IFPHK perceives that robo-advice can be a low-cost alternative in a fee-for-service model. We have seen a lot of mergers and acquisitions in both the United States and United Kingdom. A lot of active asset managers (considered as high-fee fund providers) have acquired the stakes of robo-advisory firms that have played an important role in their distribution model under the new regime of no commissions. The FSDC paper also stated that the improvement of service quality and immediacy, the lowering of cost, and having greater transparency would transform the financial services experience for users, as well as enabling new services, with knock-on effects across the economy. New jobs would be created; new channels for business creativity would open for young people as well as for established entrepreneurs.[3]

The trend of robo advice poses new regulatory challenges that are more specific to automated advice. These include developing the capacities to assess: the algorithms and data incorporated in the automated advisors; the choice architecture through which the advice is presented and acted upon the underlying information technology infrastructure; and the downside risk from the scale that automation makes possible[4].

Since its inception, the IFPHK has been striving to raise public awareness of the financial planning industry in Hong Kong and highlight the high standards that CFP professionals adhere to. In 2006, with contributions from our patrons, leading industry practitioners and experts, the IFPHK published the *IFPHK Practice Guide for Financial Planners*. The Guide is the first set of guidance materials for financial planners practicing in Hong Kong. To supplement this effort, the IFPHK launched the Guidance Note entitled *Suitability of Advice Obligations: Documenting your Financial Advice* for its members.

[2] The Future of FinTech in Hong Kong, FSDC Paper No. 29, Financial Services Development Council, May 2017.
[3] The Future of FinTech in Hong Kong, FSDC Paper No. 29, Financial Services Development Council, May 2017.
[4] Tom Baker & Benedict Dellaert, Regulating Robo Advice Across the Financial Services Industry, University of Pennsylvania Law School.

It is also the IFPHK's mission to protect public interest. In 2009, we provided our comments to the proposal to enhance the protection of the investing public. The proposal was put forward by the SFC as a result of the aftermath of the Lehman Brothers Minibond Saga. In 2010, the IFPHK submitted a response to the consultation paper on the proposed establishment of an Investor Education Council and a Financial Dispute Resolution Centre. In 2014, we responded to the Consultation Document on having an effective resolution regime in Hong Kong. In 2015, we provided comments on Hong Kong's Financial Competency Framework and Hong Kong's Strategy for Financial Literacy. The list of the IFPHK's responses to the various consultation papers can be found on our website (http://www.ifphk.org/ee/importance-of-advocacy).

To continue serving the financial planning community, the IFPHK is interested in expressing its views on the proposed changes as stipulated in the Consultation Paper.

IFPHK's representation

The IFPHK was founded by 36 members (the 'Founding Members') in order to raise the standards of financial planners and highlight the importance of sound financial planning.

The IFPHK currently has 32 Corporate Members, including banks, independent financial advisors, and insurance companies and securities brokerages. With our Corporate Members providing a full spectrum of the client services and products, the IFPHK is well positioned to understand the needs, concerns and aspirations of the financial planning community.

Executive Summary

The Securities and Futures Commission (the "SFC") issued the Consultation Paper on the Proposed Guidelines on Online Distribution and Advisory Platforms (the "Consultation Paper") on 5 May 2017. It then invited comments from market participants and the public on the relevant proposals set out in the Consultation Paper. The submission deadline is 4 August 2017.

"Investors are increasingly managing their finances and investments online, and we hope the clarification will enable more distribution channels to flourish and give investors greater choice and flexibility without compromising their protection," said Mr. Ashley Alder, the SFC's Chief Executive Officer.

FinTech and how to regulate it are at the top of the agenda for most regulators. The Whitepaper published by the Financial Services Development Council (FSDC) in May 2017 also said FinTech is important to Hong Kong because over the coming decade or so it may dramatically alter today's financial services delivery model. In responding to the proposed guidelines, our comments are based upon several principles that we consider essential, which include:

1. Advocating the six-step financial planning process
For the IFPHK and other affiliates of the Financial Planning Standard Board ("FPSB"), the financial planning process consists of six steps that help clients take a holistic approach to assessing their financial situation. The process involves gathering relevant financial information, setting life goals, examining a client's current financial status and coming up with a strategy or plan for how clients can meet their goals given their current situation and future plans. Acknowledging that not all consumers are ready to work with a financial planner, financial planners hope that FinTech and automated advice tools will get more people to access some type of financial advice, which will provide a stepping stone to working with a human adviser as personal situations gain complexity.

2. Aligning with international best practice
On the one hand many governments are trying to attract FinTech businesses to their countries, and on the other many regulatory agencies have raised the concern that some individuals might not be appropriate clients for automated advice services. Many regulators have started to clarify

or refine regulatory frameworks to meet the development of FinTech and Robo-advising. On 30 August 2016, the ASIC released guidance on providing digital financial product advice for retail investors. In 2017, the SEC published robo adviser guidance along with an investor bulletin. Echoing the Consultation Paper by the SFC, the Monetary Authority of Singapore launched a public consultation paper on proposals to facilitate the provision of robo-advisory services in June 2017. The SFC must keep abreast of global regulatory development on FinTech.

3. Aligning with the positioning of the global financial planning community

As an affiliate of the FPSB, the IFPHK will align with the advocacy principles and positions of the FPSB. As part of the advocacy efforts, the FPSB is active in providing comments on robo-advice development. In October 2016, the FPSB published a white paper "FinTech and the Future of Financial Planning". Financial planners see FinTech as a tool to support the delivery of financial planning in the areas of data collection, speeding up client onboarding, data aggregation, checking calculations and allocating investments, delivery of documents, updates on real-time market changes, portfolio construction and asset allocation. Nevertheless, we believe that the practice of financial planning relies on human interaction and that the "personal touch", the listening, feeling, exploring and interpreting of qualitative information that is central to the financial planning process, cannot readily be replaced by automated advice tools.

The global CFP professional community posited that the future of financial advice and financial planning was bionic rather than automated, with technology tackling the aggregation, quantitative analysis and tracking of the financial recommendations, and thereby freeing up the human adviser to be "more human" and focus on the qualitative aspects of helping clients identify and achieve their financial and life goals.

4. Enhancement of professional standards of intermediaries

The IFPHK has always believed that qualified intermediaries and well-informed and educated consumers, together with a robust framework for regulating sales processes, should form the core pillars for protecting the investing public. The professional standards of intermediaries should keep up with the market demand. With the development of technology, financial planners must keep abreast of the development and enhance professional standards (include digital literacy). As such, the FPSB is considering adding or expanding content in the CFP certification education program to deepen CFP professionals' familiarity with FinTech. The IFPHK and the Department of Computing of Poly University signed a Memorandum of Understanding earlier this year to join forces to nurture FinTech talents in Hong Kong.

5. Protecting consumers by enhancing financial literacy

As financial products get more complex and sophisticated, it is of utmost importance that investors or consumers are provided with proper and adequate protection under a sound and effective regulatory system. The effectiveness of consumer protection and a healthy balance of robust regulations and market development are the IFPHK's area of focus. It is the IFPHK's view that improved financial literacy levels will not only allow consumers to make more informed investment decisions, but also result in a greater consumer appreciation of planning for a long-term financial future – a concept the IFPHK continuously promulgates. The greatest potential for harm of automated advice tools to consumers is the likelihood that they will provide short-term standardized solutions that are not entirely based on comprehensive customer profiles,[5] which the regulators should be mindful of. On the other hand, automated tools can help to grow a group of more empowered and financially literate clients. FinTech enables financial planning engagement to be client-driven rather than adviser-driven, and helps to enhance financial literacy.

6. Ensuring a level playing field across distribution channels and different sectors of the financial service industry

It should be noted that the key assumption throughout this submission is that the proposed changes in legislation should be adopted consistently by all financial intermediaries servicing consumers operating in the IFA, banking and insurance sectors in order to establish a 'level playing field' among all financial planners/advisors in the different distribution segments.

At this stage, **the IFPHK welcomes the proposed guidelines from the SFC**, rather than new rules or regulations, as we all navigate this growing field and its potential to dramatically improve the experience of consumers within the global financial services community.[6]

Whilst we think that the factors relevant to online platforms identified by the SFC are likely to be true, the IFPHK considers the levels of automation and/or human interaction are more important factors when assessing FinTech. In general, it is agreed that a fully automated advice process

[5] FinTech and the Future of Financial Planning, Financial Planning Standards Board, Oct 2016.
[6] The Future of FinTech in Hong Kong, FSDC Paper No. 29, Financial Services Development Council, May 2017.

may not be suitable for those with more complex needs, or that are heavily indebted, as many of these processes often do not take into account all of the clients' financial needs or holdings.

While products play a key role in the implementation of a financial plan, financial planners recommend products only after a financial plan is in place, and may refer their clients to other financial practitioners to purchase products. A financial planner's recommended strategies may not always include the need to purchase or sell financial products. Furthermore, while being a key part of the financial planning process, investment planning is only one of several financial components a financial planner reviews with a client – other areas addressed by financial planners include: financial management, risk management, tax planning, retirement planning and estate planning. As such, to better address consumer protection, the proposed guideline should be more clearly differentiated advice related to a product, versus advice related to an individual's entire financial picture.

In addition, we would like to highlight new regulatory challenges that are more specific to automated advice. These include developing the capacities to assess: the algorithms and data incorporated in the automated advisors; the choice architecture through which the advice is presented and acted upon the underlying information technology infrastructure; and the downside risk from the scale that automation makes possible.[7] In view of the above, we suggest that the regulators ensure adequate human capital to assess technology. As automated advisors grow in scale, protecting the integrity of financial markets will require the kind of cross disciplinary cooperation that regularly occurs in the domains of health and environmental regulation. As enunciated in our responses to previous consultation papers, the IFPHK would like to remind the Government that the drawback of the existing decentralized regulatory approach (i.e. regulation by products) creates the potential for inconsistencies in the application of rules and regulations by disparate regulators, as well as any challenges associated with interagency coordination.[8] Given the cross-disciplinary nature of FinTech, it is desirable to consult a higher authority to coordinate a cross-financial services industry guideline. The Government will have an important role in addressing these barriers.

[7] Tom Baker & Benedict Dellaert, Regulating Robo Advice Across the Financial Services Industry, University of Pennsylvania Law School.
[8] Group of Thirty, The Structure of financial supervision, approaches and challenges in a global marketplace, October 6, 2008.

In relation to the suitability requirement, we would like to stress that the concept of suitability is the cornerstone of the financial planning industry and the core principle of the six-step financial planning process. Financial planning is a dynamic process that may require updating due to changes in the client's personal, economic or other circumstances. Thus we perceive that **intermediaries should take customer suitability into account, regardless of the complexity of the product, because each customer's level of sophistication could vary depending on the type of product being recommended or sold.**

Despite our general agreement with regard to the suitability requirement, we would like to highlight some of the issues with the existing suitability requirement. The problem lies in the fact that service providers in Hong Kong tend not to offer client-centric advisory services and independent financial plans to customers. The advisory services clients receive nowadays are often focused on products. Consumers simply cannot easily obtain comprehensive financial planning advice, and the problem stems from the industry's product-based and sales-oriented culture, rather than emphasizing the fulfillment of clients' dream and life goals.[9] The current sales process of many financial services providers is aimed at fulfilling the business objectives set by the firms' management and compliance with requirements imposed by regulators. We do not anticipate the proposed guideline would lead to any changes to the current practice. Service providers will continue to focus on product selling and product matching, and merely aim to fulfill the SFC's suitability requirement.

It is good practice for intermediaries to have the following procedures in place within their organizations:

- ***Comprehensive "know your client" ("KYC") procedures***: The financial planning professional should work with the client to identify all relevant parameters. The parameters might include (but not be limited to) the client's background, financial condition, investment experience, attitude towards risk and capacity of loss. The assessment should be agreed upon with the client and updated at regular intervals (i.e. at least annually).

- ***Proper procedures of conducting client profiling***: Having obtained all the relevant KYC information, the intermediary must evaluate it properly in order to determine a client profile. The profile needs to be discussed and agreed upon with the client. As a result, profiling a

[9] "Key to Boosting Hong Kong's Financial Planning Industry", Advisors Today, Volume II 2016.

client is part of the suitability process of ensuring that his/her needs, financial conditions, objectives and priorities are well understood.

- ***Ensuring competence of staff***: Part of the skill of advisers or financial planning professionals is considering and evaluating different pieces of information to form an adequate client profile and recommend what is most suitable for the client. Intermediaries are obliged to employ competent staff and provide appropriate training. Training shall include, but not be limited to, product-specific training, compliance training, and general training on market issues such as the latest market trends.

Regarding the new requirements pertaining to complex products, the IFPHK thinks that the complexity of a product is not correlated to its suitability. Also, “complex” products may not be of high risk, while simple products may not be of low risk or fit for one financial situation. As long as the investors understand the products and are properly informed of the risks of the products, complex products can be appropriate investments for their portfolios. Whilst the complexity of a product might have an impact on an investor’s ability to understand the risks, it is dangerous to label products based solely on complexity.

The IFPHK is aligned with the opinion of our global counterpart that fully automated tools should limit neither clients with simple financial situations nor clients with complex needs. For us, the focus is not on whether the products are complex or non-complex but on client needs. As such, we believe retail clients should always get advice with a fiduciary-like level of care.

Whilst the proposals shall not significantly impact financial planners, the IFPHK is uncertain whether the proposals would lead to a paradigm shift of market practices (from product-centric to needs-based advisory) and the development of more alternative distribution channels.

In summary, the global CFP professional community posited that the future of financial advice and financial planning was bionic, rather than automated, with technology tackling the aggregation, quantitative analysis and tracking of the financial recommendations, and thereby freeing up the human adviser to be “more human” and focus on the qualitative aspects of helping clients identify and achieve their financial and life goals.

We think that financial planners need to spell out clearly the value of financial planning, and accurately inform clients that FinTech is like a ship that still needs a seasoned captain to navigate through the ups and downs of life's choppy seas.[10]

[10] FinTech and the Future of Financial Planning, Financial Planning Standards Board, Oct 2016.

The SFC Consultation

The Securities and Futures Commission (the “SFC”) issued the Consultation Paper on the Proposed Guidelines on Online Distribution and Advisory Platforms (the “Consultation Paper”) on 5 May 2017. It then invited comments from market participants and the public on the relevant proposals set out in the Consultation Paper. The submission deadline is 4 August 2017.

The proposed guidelines aim to provide tailored guidance to the industry on the design and operation of online platforms, as well as to clarify how the suitability requirement would operate in the online environment. The proposed guidelines also clarify that the posting of factual, fair and balanced materials on online platforms should not in itself trigger the suitability requirement. The suitability requirement will apply where investors can be subject to greater influence and need more protection, such as where robo-advice is provided.

In the proposed guidelines, the suitability requirement will be extended to the sale of complex products on online platforms because retail investors may have difficulty in fully understanding the nature and risks associated with a complex product based only on the information posted on an online platform.

The Consultation Paper contains 20 questions in three sections.

Section I – Introduction

Section II – Differences between the online and offline sales processes

1. **Do you agree with the factors relevant to online platforms identified above? Please explain your view.**

2. **Are there any factors that the SFC has not identified? Are these covered by existing conduct requirements? If not, do you have any suggestions about how they can be addressed through specific requirements? Please explain your view.**

Section III – Proposed Guidelines

3. **Do you have any comments on the Core Principles in the Proposed Guidelines as outlined above? Are there any other areas which you think the Proposed Guidelines should cover? Please explain your view.**

4. **Are there any other areas relating to robo-advice which you think the Proposed Guidelines should cover? Please explain your view.**

5. **What are your views on the shortcomings of robo-advice? How can the Proposed Guidelines be further enhanced to address these issues?**

6. **Do you have any comments on the guidance on the Suitability Requirement to be provided in the Proposed Guidelines?**

7. **Do you have any comments on how the design and overall impression created by an online platform's content could trigger the Suitability Requirement?**

8. **Do you have any comments on the above examples of when the posting of materials on online platforms would or would not amount to a solicitation or recommendation?**

9. **Are there any examples not mentioned above that may suggest that the content or presentation of materials would amount to a solicitation or recommendation? Please explain your view.**

10. **Do you have any view on how risk analysis assessments and client profiling should be conducted and the quantitative and qualitative factors that any risk methodology should taken into account?**

11. **Do you have any comments on the definition of a complex product, and the considerations that should be taken into account in determining whether a product is complex?**

12. **Do you have any comments on the list of investment products that are considered to be "non-complex"?**

13. **Do you have any comments on the list of examples of investment products that are considered to be "complex"? Please explain your view.**

14. **In the online environment, do you think that risks arising from the sale of complex products should be addressed by requiring Platform Operators to ensure transactions in complex products are suitable for clients? Please explain your view.**

15. **As the SFC's concern arises from the sale of complex products, do you agree that the same requirement to ensure suitability should also apply to offline sales of complex products? Please explain your view.**

16. **Are there any other additional or alternative protective measures that should be introduced for the sale of complex products online?**

17. **Are there any types of investment products (eg, accumulators) that should not be made available on online platforms even where the Platform Operator is required to ensure suitability?**

18. **Do you think the items of minimum information set out in Appendix 4 are sufficient and appropriate? Please explain your view.**

19. **Do you have any comments on the proposed warning statements set out in Appendix 4 that should be made on an online platform?**

20. **Do you think a 12-month transition period is appropriate? If not, what do you think would be an appropriate transition period? Please set out your reasons.**

IFPHK's Submission

The views expressed in this submission paper are not necessarily summaries of the views taken from the industry, but may have undergone more independent and critical analysis and consideration by the IFPHK as a professional body. As a result, not all the views collected by the IFPHK are recorded in this submission paper and neither have all the views expressed in this submission paper been directly endorsed by those industry representatives or members consulted.

In considering the various proposals of the Consultation Paper, the IFPHK's comments are based upon the following principles and beliefs:

1. Advocating the six-step financial planning process

It is the IFPHK's mission to promote the importance of financial planning. The definition of financial planning to the IFPHK and other FPSB-affiliate members is as follows:

"*a process of developing strategies to help people manage their financial affairs to meet life goals. In creating their recommendations and plans, financial planners may review all relevant aspects of a client's situation across a breadth of financial planning activities, including inter-relationships among often conflicting activities.*"[11]

For the IFPHK and other affiliates of the Financial Planning Standards Board ("FPSB"), the financial planning process consists of six steps that help clients take a holistic approach to assessing their financial situation. The process involves gathering relevant financial information, setting life goals, examining a client's current financial status and coming up with a strategy or plan for how clients can meet their goals given their current situation and future plans. Please refer to Appendix A for details of the six-step financial planning process. In light of the above definition, when the FPSB and IFPHK reviewed the implications of automated-advice tools or robo-advice tools, we did so through the rubric of financial planning, and from the comprehensive financial needs of a client, rather than focusing only on the investment needs of the client.

In 2015, global research firm GfK conducted a consumer survey jointly with the FPSB. Of the 1,005 consumers surveyed in Hong Kong who were all broadly interested in financial planning,

11 The six-step process includes: 1. Establish and define the relationship with the client. 2. Collect the client's information.3. Analyze **and assess the client's financial status.** 4. Develop **the financial planning recommendations and present them to the client.** 5. Implement **the financial planning recommendations and 6.**Review **the client's situation.**

only a fifth were confident that they will reach their financial life goals. Also, once again, only 20% felt that they are knowledgeable about financial matters. Consumers working with a financial professional generally feel better prepared, and this pattern is even more pronounced among those working with a CFP professional.[12] The provision of client-centric financial planning advisory services and independent financial plans is becoming a matter of course for a lot of financial industry operators. Global financial corporations also realize that the demand for financial planning and needs-based selling is acute. Earlier this year, HSBC and the Financial Planning Standards Board announce a Global Partnership to Promote Financial Planning CFP Certification. The local practice is in contrast to what is becoming substantial in European and North American countries. At present, service providers in Hong Kong tend not to offer client-centric advisory services and independent financial plans to customers. It is the mission of the IFPHK to promote public awareness of the financial planning industry. The IFPHK envisages that customers will pay for financial planning services at a fee and financial service providers will need to keep pace with what consumers really need and want. As such, we hope that policy changes will lead to a paradigm shift of market practices and the development of more alternative distribution channels.

Acknowledging that not all consumers are ready to work with a financial planner, financial planners hope that FinTech and automated advice tools will get more people to access some type of financial advice, which will provide a stepping stone to working with a human adviser as personal situations gain complexity. The FPSB and the global financial planning community have identified eight benefits in developing robo-advice tools. These benefits include increased efficiency, increased accuracy of analysis of data, a compliance and disclosure tool, reduced bias, conflicts and emotions, the engagement of the client, the availability of real-time big data, scenario planning, and more empowered and financially literate clients. (Please refer to Appendix B for details). We hope that FinTech will help further develop the financial planning industry.

Notwithstanding the above, we still believe that the practice of financial planning relies on human interaction and that the “personal touch”, the listening, feeling, exploring and interpreting of qualitative information that is central to the financial planning process, cannot readily be replaced by automated advice tools.

[12] The Value of Financial Planning and Awareness of CFP Certification: A Global Financial Planning Survey, Hong Kong Results, FPSB & GfK.

2. Aligning with international best practice

Globalization and financial market integration have increased rapidly in the past decade. As an international financial centre, Hong Kong is not immune from international financial market and regulatory development. Investors poured $19 billion worldwide into FinTech – including P2P lenders, distributed ledger technology and crowdfunding platforms – in 2016 alone and thousands of FinTech start-ups continue to proliferate, according to a report by IOSCO.[13] The Whitepaper published by the Financial Services Development Council (FSDC) in May 2017 also said FinTech is important to Hong Kong because over the coming decade or so it may dramatically alter today's financial services delivery model. Since financial services contribute 18% of Hong Kong's GDP and 6% of its employment, the impact will be considerable.[14] As a result, FinTech is definitely a top regulatory agenda for many regulators in the world.

In pursuit of a bigger share of the growing pie, Asian countries have raced to introduce measures to develop FinTech. Hong Kong was reported to be lagging behind Singapore, which has deployed a combination of state-funding and light touch regulations to become Asia's leading FinTech hotspot. Singapore's ambition to develop the FinTech sector became evident in 2015. The Monetary Authority of Singapore (MAS) committed S$225 million over five years in growing FinTech start-ups in Singapore, and promised to support the creation of innovation centers and technology projects within and across banks. In May 2017, Singapore set up a dedicated FinTech office as a one-stop entity to promote Singapore as a FinTech hub. It offers advice to FinTech businesses intending to set up in Singapore on technology-related government grants and schemes. In 2016, the MAS announced a "regulatory sandbox" approach, allowing banks to experiment without seeking regulatory approval in advance, an approach which was quickly followed by the HKMA in Hong Kong.

On the one hand many governments are trying to attract FinTech businesses to their countries, and on the other many regulatory agencies have raised the concern that some individuals might not be appropriate clients for automated advice services. For example, a fully automated advice process may not be suitable for those with more complex needs, or that are heavily indebted, as many of these processes often do not take into account all of the clients' financial needs or

[13] Hong Kong, Singapore rivalry hobbling Asia in $100 billion fintech race: lobby group, Reuters, 9 June 2017.
[14] The Future of FinTech in Hong Kong, FSDC Paper No. 29, Financial Services Development Council, May 2017.

holdings. This in turn raises the concern that a client may not provide sufficient details to determine whether he or she is suitable for online advice.

Many regulators have started to clarify or refine regulatory frameworks to meet the development of FinTech and Robo-advising. On 30 August 2016, the ASIC released its guidance on providing digital financial product advice for retail investors: Providing digital financial product advice to retail clients (RG255). In 2017, the SEC published robo adviser guidance to the industry along with an investor bulletin. In its new guidance released in April 2017, the FCA said any funds offered to investors by robo-advisers offering “streamlined advice” to be suitable for customers’ risk tolerance and investment objectives. Echoing the Consultation Paper by the SFC, the Monetary Authority of Singapore launched a public consultation paper on proposals to facilitate the provision of robo-advisory services in June 2017. The actions of selected jurisdictions are extracted in Appendix C.

The SFC is on the right track in putting forward a proposal to clarify the regulatory requirements of robo-advisers. It is worth noting that most jurisdictions are focusing on clarifying the frameworks for robo-advice, while the SFC’s proposed guidelines also cover additional requirements pertaining to online distribution platforms and the distribution of financial products.

3. Aligning with the positioning of the global financial planning community

As an affiliate of the FPSB, the IFPHK will align with the advocacy principles of the FPSB which includes:

- Financial technology innovation
- Increased access to financial services
- Competition
- Consumer protection
- Increased professionalism and accountability by financial advisers and financial planners

In essence, the FPSB wants to ensure that, around the world, consumers will have access to financial advice that is in their best interests from humans (or technology) competent enough to provide that advice in an ethical manner.[15]

[15] FinTech and the Future of Financial Planning, Financial Planning Standards Board, Oct 2016.

As part of its advocacy efforts, the FPSB has been active in providing comments on robo-adviser development. The IFPHK itself is one of the contributors of constructive comments. The FPSB's responses to global regulators with regard to robo-advisers and/or FinTech are listed as follows:

- In March 2015, the FPSB responded to the IOSCO C3 on Automated-Advice Tools.
- In June 2015, the FPSB responded to the ESA Joint Discussion Paper on Automation in Financial Advice.
- On 27 June 2017, FPSB Europe responded to the European Commission's Consultation on FinTech in the European Financial Sector.

Regarding the trend of technology in financial planning, the FPSB published a white paper "FinTech and the Future of Financial Planning" in October 2016. As stated in the white paper, financial planners see FinTech as a tool to support the delivery of financial planning in the areas of data collection, speeding up client onboarding, data aggregation, checking calculations and allocating investments, delivery of documents, updates on real-time market changes, portfolio construction and asset allocation. Acknowledging that not all consumers are ready to work with a financial planner, many financial planners believe automated advice can be a good fit for those with less complex situations.

As aforementioned, the FPSB defines financial planning as the process of developing strategies to assist clients in managing their financial affairs to meet life goals. Financial planning can involve reviewing all relevant aspects of a client's situation across a large breadth of financial planning activities (including inter-relationships among often conflicting objectives). As mentioned above, we still strongly believe that the practice of financial planning relies on human interaction and that the "personal touch", the listening, feeling, exploring and interpreting of qualitative information that is central to the financial planning process, cannot readily be replaced by automated advice tools.

The global CFP professional community posited that the future of financial advice and financial planning was bionic, rather than automated, with technology tackling the aggregation, quantitative analysis and tracking of the financial recommendations, and thereby freeing up the human adviser to be "more human" and focus on the qualitative aspects of helping clients identify and achieve their financial and life goals. As such, most affiliates of the FPSB agree that oversight of the use of robo-advice should be required, and that automated advice tools should be held to the same regulatory standard as human advisers.

Despite the challenges posed by FinTech, financial planners also see opportunities to use FinTech to increase the public's levels of financial literacy and financial capability; it could lower costs, thereby improving consumer access to financial advice and financial markets. The tools may provide "good enough" advice and recommendations to younger people to encourage them to save and invest; and to increase the options for consumers to access advice and work with financial planning professionals.

Things like mobile apps and online platforms are worthy developments (in terms of lower cost and convenience), but they are not imposing any significant changes with regard to the way the financial system currently works. The global financial planning community considers three innovations are likely to have the greatest impact on the future of financial advice and financial planning. They are online end-to-end, omni-channel solutions, Integration of big data or bio data from all aspects of a consumer's life, and the elimination of physical borders.[16]

In evaluating the policy changes, we hope that they will bring a paradigm shift and positive change in the financial services industry.

4. Enhancement of professional standards of intermediaries

The IFPHK has always believed that qualified intermediaries and well-informed and educated consumers, together with a robust framework for regulating sales processes, should form the core pillars for protecting the investing public. If the professional standards of financial intermediaries do not keep up with the demands of the market, even if all the protection measures proposed are implemented, Hong Kong would not be able to maintain its reputation as an international financial centre and therefore grow its financial services industry. We perceive that FinTech is an inevitable trend that if properly developed can lead to a drastic change in the industry and create opportunities that could contribute to economic growth. As such, financial planning professionals must keep abreast of the development and enhance professional standards (including digital literacy) in order to be the best choice for consumers in a FinTech-enabled environment.

[16] FinTech and the Future of Financial Planning, Financial Planning Standards Board, Oct 2016.

The FPSB is considering adding or expanding content in the CFP certification education program to deepen CFP professionals' familiarity with: FinTech or automated advice; as well as behavioral financial, client engagement and soft skills to support deeper levels of client engagement and empowerment; and understanding financial planners' own biases, emotions and conflicts. As such, the IFPHK and Department of Computing of Poly University signed a Memorandum of Understanding earlier this year to collaborate in an effort to nurture FinTech talents in Hong Kong.

5. Protecting consumers by enhancing financial literacy

As aforementioned, the IFPHK has always believed that qualified intermediaries and well-informed and educated consumers, together with a robust framework for regulating sales processes, should form the core pillars for protecting the investing public. As financial products get more complex and sophisticated, it is of utmost importance that investors/consumers are provided with proper and adequate protection under a sound and effective regulatory system. The IFPHK supports a regulatory system which would facilitate delivering better financial products and services to the benefit of members of the public, as well as protecting them. Hence, the effectiveness of consumer protection and a healthy balance of robust regulations and market development are the IFPHK's areas of focus.

It is the IFPHK's view that improved financial literacy levels will not only allow consumers to make more informed investment decisions, but also result in a greater consumer appreciation of planning for a long-term financial future – a concept the IFPHK continuously promulgates. Financial education is also an important channel to promote responsible investing attitudes.

Financial planners also cited low levels of financial literacy and financial capability among the general public, which could cause some consumers to make poor choices or to receive incomplete or poorly conceived recommendations based on the data they input into the tool or platform. Financial planners have repeatedly responded that the greatest potential for harm to consumers is the likelihood that automated advice tools would churn out standardized, "cookie cutter" solutions for consumers who are "forced to fit" into broad financial consumer profiles. Technology, misused, can often lead to 'one-size-fits-all' solutions that ignore the human element and individual differences.[17] To us, the best planners will be the ones who can let computers do what computers do best, and humans do what humans do best.

[17] FinTech and the Future of Financial Planning, Financial Planning Standards Board, Oct 2016.

As aforementioned, one of the benefits of automation is to grow a group of more empowered and financially literate clients. Financial planners use FinTech to provide clients access to their own information, allowing clients to track the progress of their financial plans real-time, through user friendly applications. Financial planners see FinTech promoting a more collaborative type of engagement with clients, with a FinTech-enabled financial planning engagement being client-driven rather than adviser-driven. Financial planners are also open to clients taking a “do-it yourself” approach to manage some aspects of their finances. Thus, we view FinTech positively on the aspect of enhancing overall consumer literacy.

6. Ensuring a level playing field across distribution channels and different sectors of the financial service industry

It should be noted that the key assumption throughout this submission is that the proposed changes in legislation should be adopted consistently by all financial intermediaries servicing consumers operating in the IFA, banking and insurance sectors. The IFPHK believes that the failure to implement a consistent approach across the industry could result in significant negative consumer and industry consequences. The IFPHK is frequently urged by industry professionals to highlight the need for implementing a consistent approach across the industry to establish a ‘level playing field’ among all financial planners/advisors in the different distribution segments. We have already expressed our views in our responses to various consultation documents. The IFPHK strongly believes that a consistent approach will significantly reduce any regulatory arbitrage that could potentially undermine the good intentions of protecting investors.

Questions raised in the Consultation Paper

Section I – Introduction

Section I is an introduction to the Consultation Paper. It sets out the benefits and risks that online platforms may bring to both the industry and investors.

Section II – Differences between the online and offline sales processes

Section II elaborates on the specific characteristics of online platforms and the differences between the online and offline sales processes.

The main difference between the online and offline sales processes lies in the absence of the interactive face-to-face communication with clients which usually takes place in the offline environment.

The differences between the offline and online platforms as set out in the Consultation Paper are presented in the following table:

Online Environment	**Offline Environment**
An investor's understanding of an investment product would normally centre on the materials made available on the online platform about the product.	An intermediary is generally expected to explain product features and risks to a client at the point of sale or advice. The intermediary's representative is expected to provide all material information necessary and answer questions from the client.
Great reliance is placed by investors on the materials posted on an online platform. Thus, the ease with which investors may be able to place orders after viewing these materials is a relevant consideration when considering regulation specific to online platforms.	
The context and content of product-specific materials posted on an online platform, coupled with the design and overall impression created by the platform content, could influence an investor to purchase the product.	
On an online platform, investors can often view and have access to a very wide range of	

Online Environment	Offline Environment
investment products, far more than in the traditional offline environment.	
It is not practicable to ensure that every investment product listed on a platform is appropriate or suitable for all clients who may be able to access the platform.	

Question 1:

Do you agree with the factors relevant to online platforms identified above? Please explain your view.

Question 2:

Are there any factors that the SFC has not identified? Are these covered by existing conduct requirements? If not, do you have any suggestions about how they can be addressed through specific requirements? Please explain your view.

<u>IFPHK's Response to Question 1 and Question 2</u>

Whilst the factors identified by the SFC are likely to be true, the IFPHK does not see the need to highlight these factors in formulating a guideline or as a basis of the design of the proposed guidelines. The factors identified are generic and based on existing technology development which may not be relevant with technology advancement. The IFPHK suggests that the key difference lies not simply on whether the process is online or offline but also on the process involves the degree of automation and/or human interaction.

We think that same conduct requirements should apply equally to all platforms and channels. Regulators shall ensure that regulation is proportionate to the risk posed by new technology but at the same time technology neutral. Such an approach is most likely not only to facilitate innovation, but also to maintain a level playing field, guard against regulatory arbitrage and reduce system stability risks associated with an explosion of unregulated participants.[18] In general, most national regulators (as we believe to be the same in Hong Kong) believe their existing rules are adequate.

[18] Navigating the year ahead, Financial Services Regulator Outlook 2017, Centre for Regulatory Strategy Asia Pacific, Deloitte.

A number, though, are seeking to clarify the difference between general information, generic advice and personal recommendations, and are requiring regulated firms to disclose the type of service they are offering and its limitations.[19] There may also be biases in the tool, for example, the favoring of proprietary products, about which a potential client may not be aware. The SFC put forward a proposal earlier this year to restrict the use of words that suggest and lead to an impression of “independent”. This somehow helps address the issue of conflicts of interest.

When formulating a framework for technology, the IFPHK urges the SFC to adopt a more open and flexible approach. As mentioned in the FSDC paper, financial regulation in Hong Kong is one of the barriers in developing FinTech. Hong Kong financial regulation is very much based on traditional business models with dedicated regulators for banking, securities, insurance, and pensions.[20] With such a decentralized regulatory approach, there is the potential for inconsistency in the application of rules and regulations by disparate regulators, as well as any challenges associated with interagency coordination. FPSB member organizations, including the IFPHK, believe that FinTech will require regulators to balance: reducing existing regulatory hurdles (to allow for innovation); guarding against rapid FinTech innovation that could destabilize the financial services industry and create more risks for consumers and unfair competition; and avoiding diminishing the value of professional advice in an effort to increase access to automated advice (which could damage both the profession and the public).[21] In view of the uncertainty of the fast-growing technology advancement, we advise the SFC to take a pragmatic approach, offering flexibility to different business models. Taking reference to the Singaporean approach, acknowledging the availability of digital advisory services will widen investor choices to low-cost investment advice. To make it easier for entities offering digital advisory services to operate in Singapore, the MAS intends to refine the licensing and business conduct requirements.

Section III – Proposed Guidelines

The Proposed Guidelines will be issued under section 399 of the Securities and Futures Ordinance (SFO) and will set out the principles and requirements applicable to online platforms. The Proposed Guidelines aim to provide tailored guidance and clarity on the design and operation of online platforms in compliance.

[19] Evolving Investment Management Regulation, Succeeding in an uncertain landscape, KPMG International, June 2017.
[20] The Future of FinTech in Hong Kong, FSDC Paper No. 29, Financial Services Development Council, May 2017.
[21] FinTech and the Future of Financial Planning, Financial Planning Standards Board, Oct 2016.

A. Core Principles for the operation of online platforms

The regulatory framework governing the conduct of intermediaries, including Platform Operations, is set out in the Code of Conduct, the Management, Supervision and Internal Control Guidelines for Persons Licensed by or Registered with the Securities and Futures Commissions, and other codes, guidelines, circulars and FAQs issued by the SFC from time to time.

In addition to these existing conduct requirements, the SFC proposes to introduce Core Principles for the operation of online platforms. These Core Principles address essential differences between online and offline sales processes and the specific nature and risks of online transactions. These principles are detailed as follows:

Core Principle	High level description
Principe 1 – Proper design	A Platform Operator should ensure that its online platform is properly designed and that the online platform should have appropriate access rights and controls to guard retail clients from products that are not authorized by the SFC. A Platform Operator should operate its online platform with due skill, care and diligence.
Principle 2 – Information for clients	A Platform Operator should make clear and adequate disclosure of relevant material information on its online platform. This would include providing clients with up-to-date product offering documents or information. Platform Operators should ensure that all information is communicated in an easily comprehensible manner.
Principle 3 – Risk management	A Platform Operator should ensure the reliability and security (including data protection and cybersecurity) of the online platform. These include testing any modifications before deployment and contingency plans.
Principle 4 – Governance, capabilities and resources	A Platform Operator should ensure that there are robust governance arrangements for overseeing the operation of its online platform as well as adequate human, technology and financial resources to ensure that all operations are carried out properly.
Principle 5 – Review and monitoring	Reviews of all activities conducted on its online platform should be performed by the Platform Operator as part of its

Core Principle	**High level description**
	ongoing supervision and monitoring obligation.
Platform 6 – Record keeping	The Platform Operator should maintain proper records in respect of its online platform.

Question 3:

Do you have any comments on the Core Principles in the Proposed Guidelines as outlined above? Are there any other areas which you think the Proposed Guidelines should cover? Please explain your view.

IFPHK's Response to Question 3

The IFPHK regards the principles to be sensible. The principles are consistent with IOSCO reports and the proposals of other jurisdictions. For example, the ASIC guide "providing digital financial product advice to retail clients" said that the regulatory guide generally builds on existing ASIC guidance and does not introduce new regulatory concepts. The obligations applying to the provision of traditional (i.e. non-digital) financial product advice and digital advice are the same. The guide also includes those that are specific to digital advice such as how the operator should monitor and test their algorithms.

The IFPHK welcomes guidance from regulators, rather than new rules or regulations, as we navigate this growing field and its potential to dramatically improve the experience of consumers with the global financial services community.[22] In the future, the IFPHK believes that regulators should focus on ensuring that regulations and legislation stay relevant in a rapidly changing technological environment.

[22] The Future of FinTech in Hong Kong, FSDC Paper No. 29, Financial Services Development Council, May 2017.

B. Robo-advice

Some online platforms provide investment advice such as automated portfolio construction or model portfolios based on a client's personal circumstances. This is commonly known as "robo-advice". Robo-advice involves the provision of financial advice in an online environment using algorithms and other technology. Different types of robo-advice can be offered, including (i) full automation; (ii) adviser-assisted; and (iii) guided advice.

The conduct requirements applicable to the distribution of investment products and the provision of financial advice are principles-based, applicable equally to offline and online contexts. Accordingly, robo-advisers must comply with all applicable conduct requirements, including the Suitability Requirement. The Suitability Requirement must be discharged in accordance with the existing requirements under the Code of Conduct when advice is given. The high level of the requirements includes:

- Information for clients
  In describing the investment advisory services they offer, robo-advisers should ensure that the description is accurate. Robo-advisers should also ensure that sufficient information is provided to investors prior to client on-boarding to enable investors to make an informed decision regarding whether to employ the services of the robo-adviser. This would include information on the limitations and risks, and how key components of its services are generated. Robo-advisers should also inform and explain to investors the degree of human involvement provided. Disclosures made by robo-advisers should be easily comprehensible.

- Client profiling
  Many robo-advisers obtain client information through tools and processes such as risk-scoring/profiling and other questionnaires. Where risk-scoring questionnaires are used, robo-advisers should pay particular attention to the design of the questions and the scoring mechanism. Any client profiling tool or questionnaire should be designed such that sufficient information is obtained.

- System design and development

Algorithms are core components of digital financial advice tools. It is therefore essential that robo-advisers effectively manage and adequately supervise their design, development, deployment and operations.

- Supervision and testing of algorithms
  Robo-advisers should supervise the operation and testing of the algorithms used. Algorithms should be tested before deployment and before any subsequent developments and modification to ensure that the output conforms to the robo-advisers's expectations. Robo-advisers should also regularly monitor and test algorithms and the reasonableness of the advice generated. Such reviews should be conducted by a qualified person.

- Rebalancing
  It is common for robo-advisers to generate predefined model portfolios and to use algorithms to automatically rebalance the portfolio in order to maintain a target asset allocation over time. Robo-advisers should make clear to clients how the rebalancing process operates, including the frequency of such rebalancing, any additional costs that may be incurred due to the rebalancing, and the risk associated with automatic rebalancing. Robo-advisers are also expected to put in place policies and procedures which define how the algorithm would handle a major market event.

Question 4:

Are there any other areas relating to robo-advice which you think the Proposed Guidelines should cover? Please explain your view.

IFPHK's Response to Question 4

The principles stipulated in the Proposed Guidelines generally cover areas that are essential for Robo-advice, and are consistent with the IOSCO report and the practice of other jurisdictions.

As set out in the FPSB whitepaper, regulators and legislators will need to develop guidance and standards for automated advice tools or digital advice tools and clarify how "automated advice" will be defined and regulated. This could include:

- Distinguishing between what constitutes "advice" and "information" delivered by automated advice tools;
- Regulating "advice" provided by an automated tool in the same manner as human advice, following the same consumer protection rules, including suitability and/or fiduciary requirements; and
- Requiring that any output from an automated advice tool be reviewed prior to implementation by a human financial adviser who is appropriately licensed to conduct such reviews.
- Demonstrations that the algorithms do not take into account – directly or indirectly – factors that would bias the outcomes in a way that is harmful for consumers.[23]

Basically, the principles set out in the Consultation Paper cover most of the above elements. However the SFC may wish to provide more distinction between "advice" and "information" and to some extent provide a definition of "regulated advice". For instance, a financial plan offering a portfolio mix without product recommendations is a form of regulated advice.

The Consultation Paper says that "robo-advice" would normally include a solicitation or recommendation and would thereby itself trigger the suitability requirement.[24] We agree that a robo-advice or automated advice or digital advice tool must involve advice, but it may not necessarily trigger the solicitation or recommendation of financial products (which the current regulatory framework assumes will occur). We have seen in overseas digital advice tools, cases where clients are helped to formulate a financial plan. The client has the option to execute the recommendations himself or through other financial institutions.

While products play a key role in the implementation of a financial plan, financial planners recommend products only after a financial plan is in place, and may refer their clients to other financial practitioners to purchase products. A financial planner's recommended strategies may not always include the need to purchase or sell financial products. Furthermore, while being a key part of the financial planning process, investment planning is only one of several financial components a financial planner reviews with a client – other areas addressed by financial planners include: financial management, risk management, tax planning, retirement planning and estate planning.

[23] Tom Baker & Benedict Dellaert, Regulating Robo Advice Across the Financial Services Industry, University of Pennsylvania Law School.
[24] "Brave new world – SFC consults on proposed guidelines on online distribution and advisory platforms", Clifford Chance Client Briefing, May 2017.

As mentioned earlier, when the FPSB and IFPHK reviewed the implications of automated-advice tools or robo-advice tools, we did so through the rubric of financial planning, and from the comprehensive financial needs of a client, rather than focusing only on the investment needs of the client. As such, to better address consumer protection, the proposed guidelines should more clearly differentiate advice related to a product versus advice related to an individual's entire financial picture.

In addition, we would like to highlight new regulatory challenges that are more specific to automated advice. These include developing the capacities to assess: the algorithms and data incorporated in the automated advisors; the choice architecture through which the advice is presented and acted upon the underlying information technology infrastructure; and the downside risk from the scale that automation makes possible.[25] Here are some points for the SFC to consider apart from the proposals set out in the Consultation Paper:

<u>Human capital of regulators</u>

Academia have identified four core components of robo-advisors that require distinct capacities of the regulators to assess: (1) the ranking or matching algorithms and related processes, (2) the customer and financial product data to which the algorithms or other matching processes are applied, (3) the choice architecture through which the advice is delivered, and (4) the information technology infrastructure.[26]

To assess the competence of these algorithms, some of the information that regulators could require from the intermediaries include explanations of the models and the data upon which the models are based; explanations of the outcomes that the algorithms are seeking; evidence that the algorithms in fact perform in the way that they are designed (for example, by requiring the robo-advisor to respond to difficult test cases).[27]

In view of the above, the SFC should ensure that they have the required human capital to assess the abovementioned areas before setting the regulatory agenda.

[25] Tom Baker & Benedict Dellaert, Regulating Robo Advice Across the Financial Services Industry, University of Pennsylvania Law School.
[26] Tom Baker & Benedict Dellaert, Regulating Robo Advice Across the Financial Services Industry, University of Pennsylvania Law School.
[27] Tom Baker & Benedict Dellaert, Regulating Robo Advice Across the Financial Services Industry, University of Pennsylvania Law School.

Cross-disciplinary and cross-regulatory agency (both local and overseas) coordination

As automated advisors grow in scale, protecting the integrity of financial markets will require the kind of cross-disciplinary cooperation that regularly occurs in the domains of health and environmental regulation. The lawyers, economists and behavioral scientists already involved in financial services regulation will need to understand enough about computer and data science to craft and apply new regulatory strategies; and the computer and data scientists at the forefront of the innovation will need to understand enough about legal structures and ways of thinking to help make the new regulatory strategies sensible.[28]

As enunciated in our responses to previous consultation papers, the IFPHK would like to remind the Government that the drawback of the existing decentralized regulatory approach (i.e. regulation by products) creates the potential for inconsistencies in the application of rules and regulations by disparate regulators, as well as any challenges associated with interagency coordination.[29] Given the cross disciplinary nature of FinTech, it is desirable to consult a higher authority to coordinate a cross-financial services industry guideline. Initiatives are more government-led than regulatory-led, and specifically aimed at engagement with and support of FinTech.

As mentioned in the FSDC whitepaper, the Government will have an important role in addressing these barriers. Numerous agencies and institutions within the public sector have a role in FinTech, including: the Financial Services and Treasury Bureau, the Innovation and Technology Bureau, financial regulators, InvestHK , Cyberport, ASTRI, the Science Parks (including eventually the Lok Ma Chau loop), universities, and the FinTech offices of the HKMA and other regulators. There appears scope for communication and coordination to be improved, so that opportunities are not missed and resources are better utilized.[30] Therefore, the IFPHK urges the SFC to align with the recommendations in the FSDC paper and the territory-wide FinTech strategy (if any).

[28] Tom Baker & Benedict Dellaert, Regulating Robo Advice Across the Financial Services Industry, University of Pennsylvania Law School.
[29] Group of Thirty, The Structure of financial supervision, approaches and challenges in a global marketplace, October 6, 2008.
[30] The Future of FinTech in Hong Kong, FSDC Paper No. 29, Financial Services Development Council, May 2017.

Question 5:

What are your views on the shortcomings of robo-advice? How can the proposed Guidelines be further enhanced to address these issues?

<u>IFPHK's Response to Question 5</u>

As mentioned earlier, technology, misused, can often lead to 'one-size-fits-all' solutions that ignore the human element and individual differences. While robo-advisors have the potential to outperform humans in matching consumers to mass market financial products, they are not inherently immune from the misalignment of incentives that has historically affected financial product intermediaries.[31]

Automated advice tools could drive consumers to focus more on short-term, tactical decisions (predominantly in the area of investing), at the expense of long-term, integrated financial strategies focused on achieving financial and life goals.[32] Financial planners have responded that the greatest potential for harm to consumers is the likelihood that automated advice tools will churn out standardized, "cookie cutter" solutions for consumers who are "forced to fit" into broad financial consumer profiles.[33]

At present, many automated advice tools are investment-driven, which could lead consumers to receive product-driven versus client-centric advice. Financial planners have also questioned whether FinTech tools or platforms could realistically provide holistic advice, adequately assessing a person's life goals, approach to financial matters, and employee benefits, tax, investing, retirement, estate planning and insurance needs, and integrating all of those into a product or goal-specific recommendation.[34]

In view of the above limitations, we think that a fully automated advice process may not be suitable for those with more complex needs, or that are heavily indebted, as many of these processes often do not take into account all of the clients' financial needs or holdings. Moreover,

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[31] Tom Baker & Benedict Dellaert, Regulating Robo Advice Across the Financial Services Industry, University of Pennsylvania Law School.
[32] FPSB Response to Consultation Document on FinTech: A More Competitive and Innovative European Financial Sector.
[33] FinTech and the Future of Financial Planning, Financial Planning Standards Board, Oct 2016.
[34] FinTech and the Future of Financial Planning, Financial Planning Standards Board, Oct 2016.

clients may not provide sufficient details for a proper determination whether they are suitable for online advice. In particular, we would like to emphasize that the value proposition of financial planning is that financial planning is not totally "logic-based"; we believe the human touch is essential for elements like the identification of goals, family dynamics, and dealing with destructive financial behavior. Some members recommend that disclosures be made to clients to address the limitations of FinTech-based financial advice (i.e. that the advice provided is not based on a holistic approach).[35]

FPSB-affiliate members meet regularly to discuss trends in the financial planning industry. There have been discussions in one meeting on which aspects of the six-step financial planning process can be automated. In short, the group considers that "establishing the relationship with the client" and "developing the financial planning recommendations" are two of the elements in the financial planning process that should be presented as being better executed by humans (with the support of technology). Steps such as "collecting the quantitative data" and "analyzing the data", meanwhile, were seen as elements more competently performed by technology. The Group thinks that at this stage qualitative data collection would still be best performed by humans.

In summary, the global CFP professional community posited that the future of financial advice and financial planning was bionic, rather than automated, with technology tackling the aggregation, quantitative analysis and tracking of the financial recommendations, and thereby freeing up the human adviser to be "more human" and focus on the qualitative aspects of helping clients identify and achieve their financial and life goals.

[35] FinTech and the Future of Financial Planning, Financial Planning Standards Board, Oct 2016.

C. Application and discharge of the Suitability Requirement in the online context

Paragraph 5.2 of the Code of Conduct sets out the Suitability Requirement for intermediaries, which is a key investor protection measure. Under paragraph 5.2, a licensed or registered person should, when making a recommendation or solicitation, ensure the suitability of the recommendation or solicitation for the client is reasonable in all the circumstances having regard to information about the client of which the licensed or registered person is or should be aware through the exercise of due diligence.

<u>I. Triggering of the Suitability Requirement</u>

- The question of whether an intermediary has solicited or recommended is a question of fact which should be assessed in the light of all the circumstances leading up to the point of sale or advice.
- The context and content of product-specific materials posted on the platform would determine whether the Suitability Requirement is triggered.
- The posting of factual, fair and balanced product-specific materials would not in itself amount to a solicitation or recommendation and will thus not trigger the Suitability Requirement.
- The Suitability Requirement would apply where the platform emphasizes some investment products over others or there are interactive one-to-one communications involving solicitations or recommendations through the platform. This is consistent with the offline environment.
- Where materials about investment products that amount to solicitations or recommendations are posted on an online platform, the Suitability Requirement is triggered and must then be discharged at the point of sale or advice.

<u>Materials posted on an online platform</u>

- Online platforms often provide factual product information which is in line with existing Code of Conduct requirements which require intermediaries to make adequate disclosure of relevant material information.

<u>Sale of complex products on online platforms on an unsolicited basis</u>

- Concerns nevertheless have arisen about the sale of complex products on online platforms, even in circumstances where the Suitability Requirement is not triggered.

- The SFC is of the view that online platforms should incorporate additional safeguards when offering complex products.

Provision of investment advice

- The provision of investment advice (including robo-advice) via an online platform will trigger the Suitability Requirement.

II. Discharging the Suitability Requirement

- Where the Suitability Requirement is triggered, Platform Operators must discharge the suitability obligations at the point of sale or advice in accordance with the existing requirements under the Code of Conduct.
- Existing requirements include ensuring that advice and recommendations are based on thorough analysis and take into account available alternatives.

Risk / return profile matching with client's personal circumstances

- Platform Operators should match the risk / return profile of each investment product with each client's personal circumstances.
- Online platforms would likely need, as a minimum, to make an assessment of a client's risk tolerance and risk profile, and conduct product due diligence to ascertain the risk return profile of an investment product.

Risk analysis assessment

- Platform Operators should ensure the proper design of a comprehensive risk profiling methodology which takes into account both quantitative and qualitative factors.
- Platform Operators should have appropriate processes to periodically review the mechanism and methodology for risk profiling clients and investment products.
- Platform Operators should update clients' information and risk categorizations on a regular basis, where appropriate, and review the risk profiles of investment products at regular intervals.
- The online platform should inform clients how risk profiles or ratings are determined by disclosing on the platform the methodology adopted for assigning ratings to investment products and categorizing clients.

III. Single SFC reference point for the Suitability Requirement

- To ensure that the SFC guidance materials in respect of the Suitability Requirement can be easily referenced and accessed.

Question 6:

Do you have any comments on the guidance on the Suitability Requirement to provide in the Proposed Guidelines?

IFPHK's Response to Question 6

In Hong Kong, the suitability requirement is triggered by a "solicitation" or "recommendation". The SFC contends that the context and content of the materials posted online will determine whether the suitability requirement is triggered.[36] Where execution-only services of non-complex financial products are provided, Platform Operators should assess whether product information is presented in a factual, fair and balanced manner so as not to trigger suitability requirements. To the IFPHK, suitability is the cornerstone of the financial planning process. On the other hand, we encourage the development of execution platforms of financial products, as the value proposition of financial planning is the provision of advice to clients on their financial situation at a fee. Clients are not obliged to execute financial plans with financial planners. We believe that the availability of different distribution channels will encourage consumers to seek holistic advice.

The concept of suitability is the cornerstone of the financial planning industry and the core principle of the six-step financial planning process. Financial planning is a dynamic process that may require updating due to changes in the client's personal, economic or other circumstances. As such, it is critical to assess whether the advice or recommendations are still valid in cases of parameter changes rather than on each purchase. Maintaining relationships with clients are so essential to financial planning that even the recommendations of non-complex products require a thorough understanding of clients' needs and financial situation. As discussed, the financial planning professional should agree with the client on the frequency of the periodic review, and the client is obliged to inform the financial planning professional of any significant changes to these circumstances. **Intermediaries should take customer suitability into account, regardless of**

[36] "Brave new world – SFC consults on proposed guidelines on online distribution and advisory platforms", Clifford Chance Client Briefing, May 2017.

the complexity of the product, because each customer's level of sophistication could vary depending on the type of product being recommended or sold.

Despite our general agreement to the suitability requirements, we would like to highlight some of the issues with the existing suitability requirements. As highlighted by Deacon, the suitability requirement to match products offered with investors' needs and circumstances, applies in Hong Kong both where there is a solicitation and where there is a recommendation. In many other developed jurisdictions where a Suitability Requirement is imposed, it applies only where there is a personal recommendation of a financial product. "Solicitation" is a very broad term – it has been argued that the mere display of offering documents or marketing materials amounts to a solicitation triggering the Suitability Requirement.[37]

As discussed before, service providers in Hong Kong tend not to offer client-centric advisory services and independent financial plans to customers. The current sales process of many financial services providers is aimed at fulfilling the business objectives set by the firms' management and compliance with requirements imposed by regulators. We do not anticipate the proposed guidelines would lead to any changes to the current practice, service providers will continue focus on product-selling and product-matching, and merely only aim to fulfill the SFC's suitability requirements.

Question 7:

Do you have any comments on how the design and overall impression created by an online platform's content could trigger the Suitability Requirement?

Question 8:

Do you have any comments on the above examples of when posting of materials on online platforms would or would not amount to a solicitation or recommendation?

[37] "SFC consults on proposed guidelines on online distribution and advisory platforms", Deacons Financial Services Client Alert, 11 May 2017.

Question 9:

Are there any examples not mentioned above that may suggest that the content or presentation of materials would amount to a solicitation or recommendation? Please explain your view.

IFPHK's Response to Questions 7 to 9

We regard the example provided by the SFC to be sensible. The guidelines did provide some clarifications to the industry, for instance, the posting of a factual and fair platform would not itself amount to a solicitation or recommendation and so not trigger the suitability requirement.[38]

For the IFPHK, any financial planner must perform suitability checks before providing services to a client. To date, most automated advice tools provide focused investment advice and portfolio management as opposed to overall financial planning. These tools may evolve to provide holistic financial planning, as they have begun to do so in several jurisdictions. The next step for regulators is to set bright lines on when the use of an automated tool constitutes advice, as opposed to providing an execution-only platform. If the tool provides advice, this will likely raise questions regarding the standard of care required for such advice.

Question 10:

Do you have any view on how risk analysis assessments and client profiling should be conducted and the quantitative and qualitative factors that any risk methodology should take into account?

IFPHK's Response to Question 10

As mentioned before, suitability is the cornerstone of the financial planning process. We expect financial planners to perform thorough suitability checks and "know your client" procedures before delivering any services. The IFPHK would like to emphasize that risk is only part of the assessment in the financial planning process, and a financial product that suits a client's risk profile may not be suitable for his or her financial situation.

[38] "Brave new world – SFC consults on proposed guidelines on online distribution and advisory platforms", Clifford Chance Client Briefing, May 2017.

As mentioned in the IFPHK's Suitability Guidance Note, the "Know Your Client" (KYC) procedure is fundamental to the provision of financial services or advice. It protects both the client and the financial planning professional by having the financial planning professional know which services or investment best suits the client, based on his/her needs and ensuring the financial planning professional knows his/her client's financial goals and objectives and other important information before giving any financial advice. The six-step financial planning process requires the financial planning professional to work with the client to identify all relevant parameters. The financial planning professional is required to collect and properly document quantitative and qualitative data regarding these parameters, which might include (but not be limited to) the client's background, financial condition, investment experience, attitude toward risk and capacity for loss, in order to enable the financial planning professional to provide a recommendation, advice, product or service that is suitable and appropriate for the client. The assessment should be agreed on with the client and updated at regular intervals (i.e. at least annually).

The IFPHK advocates the importance of having a proper suitability framework within an intermediary, and customer categorisation and product matching is regarded by the IFPHK as part of a larger suitability framework. The critical point is to ensure that clients are appropriately classified based on all relevant parameters (i.e. knowledge, experience, worth, means, etc) and benefit from the protection that is due to them. In order to form a reasonable basis on the advice, it is good practice for intermediaries to have the following procedures in place within their organizations:

Comprehensive "know your client" (KYC) procedures: As mentioned in the IFPHK's Suitability Guidance Note, KYC is fundamental to the provision of financial services or advice. It protects both the client and the financial planning professional by having the financial planning professional know which services or investment best suits the client, based on his/her needs and ensuring the financial planning professional knows his/her client's financial goals and objectives and other important information before giving any financial advice. The financial planning professional should work with the client to identify all relevant parameters. The financial planning professional is required to collect and properly document quantitative and qualitative data regarding these parameters, which might include (but not be limited to) the client's background, financial condition, investment experience, attitude toward risk and capacity for loss, in order to enable the financial planning professional to provide a recommendation, advice, product or service that is suitable and appropriate for the client. The assessment should be agreed on with the client and updated at regular intervals (i.e. at least annually).

Proper procedures for conducting client profiling: Having obtained all the relevant KYC information, the intermediary must evaluate it properly in order to determine a client profile. The profile needs to be discussed and agreed on with the client. As a result, profiling a client is part of the suitability process of ensuring that his/her needs, financial condition, objectives and priorities are well understood. Intermediaries should establish a procedure and methodology in conducting client profiling, and the procedures should be regularly checked and reviewed by independent parties. The IFPHK notes that more intermediaries are using tools such as risk-profiling questionnaires to assist them in the client-profiling exercise. These tools help to enhance the efficiency of the suitability checking process and to enhance consistency among frontline staff. However, a report published by the Financial Services Authority (FSA) found that some firms are over-reliant on risk-profiling and asset-allocation tools that produce flawed results. Therefore when relying on tools, intermediaries need to ensure that they consider and are aware of such limitations and actively mitigate against any shortcomings.[39] We also think that the current sales process and suitability assessment merely aim at compliance with the regulatory requirement instead of providing client-centric advice.

Ensuring competence of staff: Part of the skill of advisers or financial planning professionals is considering and evaluating different pieces of information to form an adequate client profile and recommend what is most suitable for the client. The advisers or financial planning professionals must have an adequate level of knowledge and skill and be able to effectively apply that knowledge and skill towards accurately classifying and profiling clients, identifying their needs and objectives, and providing quality advice and services to them. In this regard, intermediaries are obliged to employ competent staff and provide appropriate training. Training shall include, but not be limited to, product-specific training, compliance training, and general training on market issues such as the latest market trends.

[39] Financial Services Authority, Assessing suitability: Establishing the risk a customer is willing and able to take and making a suitable investment selection, January 2011.

The current sales process of many financial services providers is aimed at fulfilling the business objectives set by the firms' management and compliance with requirements imposed by regulators. We think that the problem lies in the fact that service providers in Hong Kong tend not to offer client-centric advisory services and independent financial plans to customers. The advisory services clients receive nowadays are often focused on products.

In light of the above, it is our opinion that the financial planning process cannot be fully automated. As aforementioned, certain steps in financial planning processes such as "establishing the relationship with the client" and "developing the financial planning recommendations" are perceived to be better executed by humans (with the support of technology). The steps such as "collecting the quantitative data" and "analyzing the data", meanwhile, are seen as elements more competently performed by technology. At this stage, qualitative data collection would still be best performed by humans.

D. Sales of complex products on online platforms on an unsolicited basis

The SFC stipulated in the Consultation Paper that the International Organization of Securities Commissions (IOSCO) has set out principles for suitability with respect to the distribution of complex products. The IOSCO's definition of complex products refers to those whose terms, features and risks are not reasonably likely to be understood by a retail investor because of their complex structure (as opposed to more traditional or plain vanilla investment instruments), and which are difficult to value. The Proposed Guidelines set out the following factors which, in our view, should be considered in determining whether or not an investment product is complex:

(a) whether the product is a derivative product;
(b) whether a secondary market is available for the product at publicly available prices;
(c) whether there is adequate and transparent information on the product available to retail investors;
(d) whether there is a risk of losing more than the amount invested;
(e) whether any features or terms of the product could fundamentally alter the nature or risk of the investment or the pay-out profile or which include multiple variables or complicated formulas to determine the return; and
(f) whether any features or terms of the product might render the investment illiquid.

Based on the above, the SFC is of the view that the following investment products are non-complex products:

(a) shares traded on the SEHK or overseas exchanges that are subject to the oversight of regulators which are signatories to the IOSCO Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information (IOSCO MMoU);
(b) non-complex bonds;
(c) SFC-authorized funds (including ETFs) that do not use financial derivative instruments (FDIs) extensively for investment or non-hedging purposes; and
(d) SFC-authorized real estate investment trusts (REITs).

Proposed additional protective measures

1. Sales of complex products

- Complex products exhibit varying degrees of complexity and risk levels. Complex products are not also necessarily high risk. However, the SFC regards that complexity may make it difficult for investors to understand a product, whether or not it is high risk.
- The SFC thinks that on an online platform investors can often view and have easy access to a wide range of investment products, which may include complex products.
- Whilst it would be unpractical for a Platform Operator to ensure that every complex product made available on its platform is appropriate or suitable for all clients who may be able to access the platform, the Proposed Guidelines would require that Platform Operators must ensure any transaction in a complex product (other than derivative products traded on an exchange) is suitable for clients in all the circumstances as if they were under the obligation to discharge the Suitability Requirement under paragraph 5.2 of the Code of Conduct. The requirement to ensure suitability would apply even where the materials posted on an online platform would not otherwise trigger the Suitability Requirement and no recommendation or advice is being given or offered.
- Platform Operators will not be exempt from this new requirement to ensure suitability in the sale of complex products through online platforms with respect to clients who are Individual

Professional Investors, but may be exempt with respect to Corporate Professional Investor clients.

- The SFC is mindful that it is proposing a new basis for triggering the Suitability Requirement which hinges on whether a product available on an online platform is in fact complex, rather than whether there has been any solicitation or recommendation of the product. Depending on consultation feedback, if this proposal is implemented, we will consider extending the same requirement to the offline environment by way of an amendment to the Code of Conduct, subject to further consultation if appropriate.

2. Minimum information and warning statements

- Another additional proposed safeguard is to require Platform Operators to provide, as a minimum, certain basic and key information on all complex products. This is in addition to providing clients with up-to-date product offering documents or information under Core Principle 2 (which requires Platform Operators to make clear and adequate disclosure of relevant material information). The proposed minimum information that should be provided is set out in Appendix 4. Subject to consultation feedback, the SFC will issue FAQs on this. The posting of offering documents containing such minimum information on the online platform would generally satisfy this requirement.
- The SFC also proposes that there should be prominent and clear statements on online platforms to warn investors about a complex product prior to and reasonably proximate to the point of sale or advice.

Question 11:

Do you have any comments on the definition of a complex product, and the considerations that should be taken into account in determining whether a product is complex?

<u>IFPHK's Response to Question 11</u>

Given the broad range of investment products available and the ease with which transactions may be concluded on online platforms, the SFC considers it appropriate to extend the suitability requirement to provide additional protection to investors.[40] The sale of complex products on online platforms will be subject to the suitability requirement in circumstances even when no

[40] "Brave new world – SFC consults on proposed guidelines on online distribution and advisory platforms", Clifford Chance Client Briefing, May 2017.

solicitation, recommendation or advice has been provided.[41] The SFC notes that this is generally in line with recommendations made by the IOSCO.

The complexity of a product is not correlated to its suitability. Also, “complex” products may not be of high risk, while simple products may not be of low risk or fit for one financial situation. As long as the investors understand the products and are properly informed of the risks of the products, complex products can be appropriate investments for their portfolios. The IFPHK acknowledges that derivatives and structured products have become taboo after the Lehman Brothers Minibonds saga, and the derivatives industry has been heavily criticised. Nonetheless, derivatives, if used properly can play an important role as a management tool for those seeking to minimise their exposure to various risks. Whilst the complexity of a product might have an impact on an investor’s ability to understand the risks, it is dangerous to label products based solely on complexity.

The IFPHK is aligned with the opinion of our global counterpart that fully automated tools should limit neither clients with simple financial situations nor clients with complex needs. For us, the focus is not on whether the products are complex or non-complex but on client needs. As such, we believe retail clients should always get advice with a fiduciary-like level of care. Also, the financial planning process should not differ for complex and non-complex financial products. The most important point is to match varying investor characteristics to the characteristics of the product being sold so that both parties are fully aware of the risks, rewards and consequences of their actions. **Intermediaries should take customer suitability into account, regardless of the complexity of the product, because each customer’s level of sophistication could vary depending on the type of product being recommended or sold.**

Proposals put forward by most jurisdictions in relation to FinTech focus on digital advice or robo-advice while the Consultation Paper set forth by the SFC focuses on product-selling – the suitability of products sold on online platforms and the distribution of complex products. The problem here lies in the fact that service providers in Hong Kong tend to focus on product-selling instead of offering client-centric advisory services and independent financial plans to customers. As a result, the current sales process of many financial services providers is aimed at fulfilling the business objectives set by the firms’ management and compliance with the requirements imposed

[41] “Brave new world – SFC consults on proposed guidelines on online distribution and advisory platforms”, Clifford Chance Client Briefing, May 2017.

by regulators. The proposed changes stipulated in this Consultation Paper would do little to change such practices.

Question 12:

Do you have any comments on the list of investment products that are considered to be "non-complex"?

Question 13:

Do you have any comments on the list of investment products that are considered to be "complex"?

Question 14:

In the online environment, do you think that risks arising from the sale of complex products should be addressed by requiring Platform Operators to ensure transactions in complex products are suitable for clients? Please explain your view.

<u>IFPHK's Response to Questions 12 to 14</u>

The Consultation sets forward new suitability requirements applicable to "complex products" even if there is no "recommendation" or "solicitation" by intermediaries. Simple products refer to stocks, ETFs, mutual funds, REITs, etc., according to the SFC. Complex products include derivatives and derivatives-based investments such as futures, equity derivatives, synthetic ETFs, futures-based ETFs, leveraged and inverse ETFs, bonds with special features, hedge funds, or other unlisted structured products. Derivatives, if used properly, can play an important role as a management tool for those seeking to minimise their exposure to various risks. It might be a suitable investment in a client's financial plan even though he or she may not have derivatives exposure.

The IFPHK advocates the six-step financial planning process and thus to us, we assume financial planners will perform suitability checks regardless of there being any recommendation of financial products or whether the product is complex or non-complex. However, we also agree that a fully automated advice process may not be suitable for those with more complex needs, or those that are heavily indebted, as many of these processes often do not take into account all of the clients' financial needs or holdings. Moreover, there is the question of whether a client provides sufficient details to determine whether he or she is suitable for online advice. Thus, we strongly feel that advice around complex products (and, for that matter, any product) should be given with a fiduciary-like standard of care.

Consistent with our previous consultation paper submission, we agree that financial products have become more complicated. The technology of securitisation has expanded over the past decade to encompass a wide range of complex techniques and structures, including structured investment vehicles (SIVs) and conduits, collateralised debt obligations (CDOs), collateralised loan obligations (CLOs), and synthetic securitisations. Many of these took the technology of securitisation (pooling, off-balance sheet, and investor funding) and combined it with that of OTC derivatives, especially credit derivatives such as credit default swaps (CDSs).[42] Unlike collective investment schemes, which are subject to rigorous pre-approval requirements before they can be marketed to the Hong Kong public, we agree that the abovementioned products should not be provided to clients without advice and at this stage should not be provided on an online platform.

Question 15:

As the SFC's concern arises from the sale of complex products, do you agree that the same requirement to ensure suitability should also apply to offline sales of complex products? Please explain your view.

<u>IFPHK's Response to Question 15</u>

The SFC notes that it may consider extending the same requirement applicable to complex products to the offline world by way of an amendment to the Code of Conduct.

Whilst we think the SFC still needs to obtain consensus from the industry in respect of the classification of complex products, the IFPHK agrees that there should be a level playing field, i.e. the same requirements should apply in all circumstances and all channels.

42 Asian Institute of International Financial Law, The Global Financial Crisis and the Future of Financial Regulation in Hong Kong, February 2009.

Question 16:

Are there any other additional or alternative protective measures that should be introduced for the sale of complex products online?

<u>IFPHK's Response to Question 16</u>

No further comments.

We think that as technology matures, the SFC should consider relaxing some of the current requirements so as to align with the overall development.

Question 17:

Are there any types of investment products (eg, accumulators) that should not be made available on online platforms even where the Platform Operator is required to ensure suitability?

<u>IFPHK's Response to Question 17</u>

The IFPHK considers that complete automation without a financial planner's face-to-face advice should not be available for complex products. The IFPHK agrees that the complicated and high-risk products mentioned in our response to Questions 12-14 should not be provided to clients without advice at a fiduciary level.

Question 18:

Do you think the items of minimum information set out in Appendix 4 are sufficient and appropriate? Please explain your view.

<u>IFPHK's Response to Question 18</u>

No further comments.

As noted in the FPSB's comments to the IOSCO on the suitability of complex products, it has been suggested that any material information provided to the customer should also include context for the recommendation, including why the product is preferred over a comparable, simpler product (if applicable), how the product will meet the needs of the client, and how both the intermediary and product manufacturer will be remunerated. The SFC can also take into account these suggestions.

Question 19:

Do you have any comments on the proposed warning statements set out in Appendix 4 that should be made on an online platform?

<u>IFPHK's Response to Question 19</u>
No further comments.

To help strengthen consumer protection, there should be clearly visible and easily understood warnings to clients that in the absence of goods or sufficient information, the output from the automated advice tools may not be appropriate. (Note: Consumers of automated advice will need to acknowledge the correctness of the data supplied, creating some level of responsibility on the part of the user of the automated advice provided.)

Implementation timeline

It is proposed that there will be a 12-month transition period before the full implementation of the Proposed Guidelines.

Question 20:

Do you think a 12-month transition period is appropriate? If not, what do you think would be an appropriate transition period? Please set out your reasons.

IFPHK's Response to Question 20

We strongly advised the SFC to find consensus with the industry before putting forward the guidelines. If consensus is reached, a 12-month transition period should be adequate for institutions to amend their procedure.

Appendix A

The steps in the financial planning process are as follows:

1. **Establish and define the relationship with the client.**
The financial planning professional informs the client about the financial planning process, the services the financial planning professional offers, and the financial planning professional's competencies and experience. The financial planning professional and the client determine whether the services offered by the financial planning professional and his or her competencies meet the needs of the client. The financial planning professional considers his or her skills, knowledge and experience in providing the services requested or likely to be required by the client. The financial planning professional determines if he or she has, and discloses, any conflict(s) of interest. The financial planning professional and the client agree on the services to be provided. The financial planning professional describes, in writing, the scope of the engagement before any financial planning is provided, including details about: the responsibilities of each party (including third parties); the terms of the engagement; and compensation and conflict(s) of interest of the financial planning professional. The scope of the engagement is set out in writing in a formal document signed by both parties or formally accepted by the client and includes a process for terminating the engagement.

2. **Collect the client's information.**
The financial planning professional and the client identify the client's personal and financial objectives, needs and priorities that are relevant to the scope of the engagement before making and/or implementing any recommendations. The financial planning professional collects sufficient quantitative and qualitative information and documents about the client relevant to the scope of the engagement before making and/or implementing any recommendations.

3. **Analyze and assess the client's financial status.**
The financial planning professional analyzes the client's information, subject to the scope of the engagement, to gain an understanding of the client's financial situation. The financial planning professional assesses the strengths and weaknesses of the client's

current financial situation and compares them to the client’s objectives, needs and priorities.

4. **Develop the financial planning recommendations and present them to the client.** The financial planning professional considers one or more strategies relevant to the client’s current situation that could reasonably meet the client’s objectives, needs and priorities; develops the financial planning recommendations based on the selected strategies to reasonably meet the client’s confirmed objectives, needs and priorities; and presents the financial planning recommendations and the supporting rationale in a way that allows the client to make an informed decision.

5. **Implement the financial planning recommendations.** The financial planning professional and the client agree on the implementation of responsibilities that are consistent with the scope of the engagement, the client’s acceptance of the financial planning recommendations, and the financial planning professional’s ability to implement the financial planning recommendations. Based on the scope of the engagement, the financial planning professional identifies and presents appropriate product(s) and service(s) that are consistent with the financial planning recommendations accepted by the client.

6. **Review the client’s situation.** The financial planning professional and client mutually define and agree on terms for reviewing and reevaluating the client’s situation, including goals, risk profile, lifestyle and other relevant changes. If conducting a review, the financial planning professional and the client review the client’s situation to assess progress towards the achievement of the objectives of the financial planning recommendations, determine if the recommendations are still appropriate, and confirm any revisions mutually considered necessary.

Appendix B

Financial planners feel that their practices will benefit most from FinTech in the following areas:

1) Increased Efficiency – Financial planners view increased levels of efficiency as the greatest benefit that FinTech tools, and technology in general, can provide. Financial planners cite the greatest opportunities FinTech presents as the ability to: automate back-office and administrative tasks; speed up reporting to clients; and provide real-time, up-to-date information to respond to client questions more efficiently.

2) Accuracy – Planners use FinTech to improve the accuracy of analysis of large amounts of data, with regard to information input, calculations and recommendations.

3) Compliance and Disclosure – Planners see FinTech as a way to manage “know your client”, transparency and disclosure requirements through automation to ensure that all requirements have been met.

4) Bias, Conflicts and Emotions – Planners see FinTech as a way to reduce the potential for biases and conflicts of interest in the products or allocations chosen, or recommendations made, by financial planners. (Several research respondents cautioned that biases of the creators of the FinTech applications will need to be similarly managed to ensure systems generate appropriate client recommendations and products.) Financial planners suggest that FinTech can take the emotion out of the decision-making process for both the adviser and the client, and do a better job of providing an impartial recommendation that best suits the client’s needs.

5) Engaging Clients – Financial planners cite the opportunity to better engage clients as another positive aspect of FinTech. More specifically, financial planners said FinTech can make the client experience effective and engaging; it presents excellent opportunities to interact and engage with clients; it leverages the power of technology to more fully include the client in the planning; and it enables financial planners to spend more time with clients in a meaningful way.

6) Real-time Big Data – Planners see Big Data as a key support to clients and financial planners in terms of understanding real-time market and client changes, and adjusting strategies and tactics accordingly. Planners welcome the ability to automate portfolio rebalancing, and prompt clients to act in response to real-time risks and opportunities.

7) Scenario Planning – Planners see value in the ability to use FinTech to collaborate with clients, real-time, in discussing a wide range of strategies and cash flow scenarios.

8) More Empowered and Financially Literate Clients – Financial planners use FinTech to provide clients access to their own information, allowing clients to track the progress of their financial plans real-time, through user friendly applications. Financial planners see FinTech promoting a more collaborative type of engagement with clients, with a FinTech-enabled financial planning engagement being client-driven rather than adviser-driven. Financial planners are also open to clients taking a “do-it yourself” approach to manage some aspects of their finances.

Appendix C

Jurisdiction	Development in regulating FinTech and Robo-advising
Australia	On 30 August 2016, the ASIC released its guidance on providing digital financial product advice for retail investors: Providing digital financial product advice to retail clients (RG255). Overall the ASIC supports the development of a healthy and robust digital advice market in Australia. RG255 also includes guidance on some issues that are unique to digital advice, such as how the organizational competence obligation applies to digital advice licensees and the ways in which digital advice licensees should monitor and test their algorithms.
United States	In 2017, the SEC published robo-adviser guidance to the industry along with an investor bulletin. The SEC guidance focuses on three areas: disclosure requirements, provision of suitable advice and compliance programs. The SEC guidance reiterates that robo-advisors, like any investment advisor, have a fiduciary duty to make full and fair disclosure of all material facts and to employ reasonable care to avoid misleading clients. The Investor Bulletin describes a number of issues that investors should consider, including: • The level of human interaction important to the investor • The information the robo-adviser uses in formulating recommendations • The robo-adviser's approach to investing • The fees and charges involved - The SEC guidance stresses the importance of thorough disclosures about conflicts of interest with third parties.[43] - The guidance calls on robo-advisers to develop meaningful disclosures detailing their business models and risks, including an explanation of how algorithms factor into the investment recommendations that they produce.[44] - The SEC also expects firms to detail the extent of human involvement in their digital offerings.[45]
United Kingdom	The Financial Conduct Authority has established a new statutory

[43] Kenneth Corbin, New SEC robo adviser guidance spotlights disclosure, client communication, Financial Planning, 23 February 2017.
[44] Kenneth Corbin, New SEC robo adviser guidance spotlights disclosure, client communication, Financial Planning, 23 February 2017.
[45] Kenneth Corbin, New SEC robo adviser guidance spotlights disclosure, client communication, Financial Planning, 23 February 2017.

Jurisdiction	Development in regulating FinTech and Robo-advising
	objective: 'to promote effective competition in the interests of consumers and innovation is a key part of effective competition'. In its new guidance released in April 2017, the FCA said that any funds offered to investors by robo-advisers offering "streamlined advice" to be suitable for customers' risk tolerance and investment objectives. The guidelines are intended to free online providers from the heavier regulation associated with traditional financial advice, making it easier for them to offer low-cost help for less wealthy investors.[46] It also set out examples of information it expected companies to collect from investors, and warned of the importance of forming "clearly worded" risk questionnaires that did not assume "a high level of financial capability". Different from other jurisdictions, the FCA intends to offer low-cost advice to less wealthy clients. The regulations introduced in 2012 banned asset managers from paying commissions to anyone selling their funds. This led to a shift of focus to wealthier clients who could pay a higher sum for services. The regulator expects robo-advice tools to be able to serve the less affluent masses.
Canada	The response of the Canadian regulators refers to CSA Staff Notice 31-342—*Guidance for Portfolio Managers Regarding Online Advice* (the Guidance), which was issued by the CSA on September 24, 2015. The Guidance provides an overview of the operations of online advisors in Canada and focuses on the regulatory obligations of registered portfolio managers (PMs) and advising representatives (ARs) that seek to provide discretionary investment management services through an interactive website.
Singapore	Echoing the Consultation Paper by the SFC, the Monetary Authority of Singapore launched a public consultation paper on proposals to facilitate the provision of robo-advisory services in June 2017. Acknowledging the availability of digital advisory services will widen investor choice to low-cost investment advice. To make it easier for entities offering digital advisory services to operate in Singapore, the MAS intends to refine the licensing and business conduct requirements. First, digital advisers that operate as fund managers under the SFA will be allowed to offer their services to retail investors even if they do not meet the track record requirement, provided that they meet certain safeguards. These include: • offering diversified portfolios of non-complex assets; • having key management staff with relevant collective

[46] FCA prepares for the march of 'robo advisers', Financial Times, 11 April 2017.

Jurisdiction	Development in regulating FinTech and Robo-advising
	experience in fund management and technology; and • undertaking an independent audit of the digital advisory business within one year of operations. Second, digital advisers that operate as financial advisers under the FAA will be allowed to assist their clients to execute their investment transactions (e.g. passing their trade orders to brokerage firms) and re-balance their clients' investment portfolios in collective investment schemes without the need for an additional licence under the SFA. This licensing exemption will also be made available to non-digital advisers. Third, digital advisers can seek exemption from the FAA requirement to collect the full suite of information on the financial circumstances of a client, such as income level and financial commitments, if they can satisfactorily mitigate the risks of providing inadequate advice based on limited client information.

Appendix D

The global financial planning community considers that three innovations will be likely to have the greatest impact on the future of financial advice and financial planning:

1. Online end-to-end, omni-channel solutions will cause a shift in the model for client acquisition or engagement and advice delivery – FinTech will allow for a more integrated online, end-to-end solution that can onboard clients; aggregate information from every aspect of a client's financial situation (banking, investments, tax, insurance, retirement plans, estate plan, etc).

2. Integration of "Big Data" or "Bio Data" from non-financial aspects of a consumer's life (i.e. online social media, health, behavioral or job-related information) that will enable predictive modeling and the nimble execution of adjustments, in real-time, to a client's financial plan. The global financial planning community predicts that non-financial information will become increasingly relevant to financial services providers in qualifying customers for services based on their behavioral patterns and online habits; helping create more precise and relevant, real-time offerings based on the client's life stage, interests and needs, etc.

3. The shift to online/mobile/apps will erase physical borders, dramatically expand product and service options, re-invent advisory services, empower consumers, and increase risk. The trend is towards continuing and expanding beyond banking-type services, possibly enabling individuals to carry access to their entire financial lives in their pockets.[47]

[47] FinTech and the Future of Financial Planning, Financial Planning Standards Board, Oct 2016.