

# **IFPHK's Response to the Securities and Futures Commission's Further Consultation on Offline Requirements Applicable to Complex Products**

**May 2018**

## **Contents**

<b>1.</b>	<b>IFPHK Profile</b>	<b>2</b>
<b>2.</b>	<b>Executive Summary</b>	<b>3</b>
<b>3.</b>	<b>The SFC Consultation</b>	<b>5</b>
<b>4.</b>	<b>IFPHK's Submission</b>	<b>6</b>

## **Institute of Financial Planners of Hong Kong (IFPHK) Profile**





### **Background**

The IFPHK was established in June 2000 as a non-profit organization for the fast-growing financial industry. It aims to be recognized in the region as the premier professional body representing those financial planners that uphold the highest standards for the benefit of the public.

The IFPHK is the sole licensing body in Hong Kong authorized by Financial Planning Standards Board Limited to grant the much-coveted and internationally-recognized CFP<sup>CM</sup> certification and AFP<sup>TM</sup> certification to qualified financial planning professionals in Hong Kong and Macau.

It represents more than 6,800 financial planning practitioners in Hong Kong from such diverse professional backgrounds as banking, insurance, independent financial advisory, stockbroking, accounting, and legal services.

Currently there are more than 147,000 CFP certificants in 24 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<sup>CM</sup>, CERTIFIED FINANCIAL PLANNER<sup>CM</sup>,  CFP<sup>CM</sup>,  CERTIFIED FINANCIAL PLANNER<sup>TM</sup>, AFP<sup>TM</sup>, ASSOCIATE FINANCIAL PLANNER<sup>TM</sup>,  **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**

IFPHK submitted our opinion on the proposed Guidelines on Online Distribution and Advisory Platform in August last year. Part of our feedbacks has been published in the consultation paper conclusion. In view of the above, the IFPHK is interested in expressing its views on this further consultation paper.

### **IFPHK's representation**

The IFPHK was founded by 30 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 37 Corporate Members including banks, independent financial advisors, 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**

On 28 March 2018, The Securities and Futures Commission (SFC) released consultation conclusions on proposed Guidelines on Online Distribution and Advisory Platforms (the “Guidelines”). The Guidelines provide tailored guidance to the industry on the design and operation of online platforms, including specific guidance on the provision of automated or robo-advice. The guidelines also clarify that the posting of factual, fair and balanced materials on online platforms should not in itself trigger the suitability requirement.

The SFC will also implement the requirement for platform operators to ensure the suitability of complex products sold, recognising that retail investors should be in a position to take responsibility for their decisions to invest in simple products which they can reasonably be expected to understand. The guidelines will become effective 12 months after gazettal. The SFC will publish frequently asked questions to provide further guidance to the industry.

The SFC proposes to apply the same requirement to ensure suitability to the offline sale of complex products and has commenced a two-month consultation on this proposal. The Consultation period ended on 28 May 2018.

Consistent with our previous submission in last August, our submission is based on the following principles:

1. Advocating the six-steps financial planning process
2. Aligning with international best practice
3. Aligning with the positioning of the global financial planning community
4. Enhancement of professional standards of intermediaries
5. Protecting consumers by enhancing financial literacy
6. Ensuring a level playing field across distribution channels and different sectors of the financial service industry

Based on the above principles, the IFPHK agrees that same requirements should apply in all circumstances and all channels and the transition period shall be aligned with the effective date of the Guidelines.

Nevertheless, as we highlighted in previous submission that the complexity of a product is not correlated to its suitability, and we consider it is dangerous to label products based solely on complexity. The tightening of the requirements is based on Investor Education Center (“IEC”) report which found that 81% of respondents rated derivatives as high risk products and 63% of fund investors surveyed regarded funds investing in derivatives as complex financial products. Whilst the IEC report did provide certain insight to improve financial education, it is not a solid base of imposing more stringent requirements on financial products. We still think the SFC still needs to obtain consensus from the industry in respect of the classification of complex products especially classification of derivatives funds. Given that there are still uncertainties on the

requirements and some respondents already expressed their difficulties in implementing requirements within the proposed time frame in the previous consultation paper. The IFPHK urges the SFC to extend the deadline of implementing the Guidelines.

As told by the SFC's Chief Executive Ashley Alder, "it is hoped the clarifications offered within Guidelines on Online Distribution and Advisory Platforms will facilitate the growth of online platforms, giving investors greater choice of products and advice"<sup>1</sup>. While the Guidelines did setup certain framework, we are doubtful whether it could foster the growing of the FinTech industry. Rather we think the requirements may abate the development of technology in this area.

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<sup>1</sup> SFC press release on 28 March 2018.

## **The SFC Consultation**

On 28 March 2018, The Securities and Futures Commission (SFC) released consultation conclusions on proposed Guidelines on Online Distribution and Advisory Platforms. The Guidelines provide tailored guidance to the industry on the design and operation of online platforms, including specific guidance on the provision of automated or robo-advice. The Guidelines also clarify that the posting of factual, fair and balanced materials on online platforms should not in itself trigger the suitability requirement.

The SFC will implement the requirement for platform operators to ensure the suitability of complex products sold, recognising that retail investors should be in a position to take responsibility for their decisions to invest in simple products which they can reasonably be expected to understand. The Guidelines will become effective 12 months after gazettal. The SFC will publish frequently asked questions to provide further guidance to the industry.

In the previous Consultation Paper, the SFC sought public views on whether the requirements to ensure the suitability of complex products should apply to offline sales of complex products. In the Conclusion, the SFC said some respondents supported applying the Suitability Requirement to offline sales as they considered that regulatory requirements should be technology neutral. Some respondents also commented that aligning the regulatory requirements for both online and offline sales would avoid any loopholes. Some respondents considered that the Suitability Requirement should only be triggered in circumstances where there was a solicitation or recommendation and should not be applied to unsolicited sales of complex products whether online or offline.

While the SFC recognizes that offline sales of complex products would likely involve solicitations and recommendations which trigger the Suitability Requirement, the SFC proposes making amendments to the Code of Conduct to align the regulatory requirements for both online and offline sales and ensure a level playing field. As such, the SFC has commenced a two-month consultation on this proposal. The Consultation period ended on 28 May 2018.

The Consultation Paper contains two questions relating to the aforementioned proposals.

1. Do you have any comments on the proposed amendments to the Code of Conduct? Please explain your view?
2. Do you think a six-month transition period is appropriate? If not, what do think would be an appropriate transition period and please set out your reasons.

## **IFPHK's Submission**

The Securities and Futures Commission (SFC) released consultation conclusions on proposed Guidelines on Online Distribution and Advisory Platforms on 28 March 2018 (the "Guidelines"). The IFPHK responded to the Consultation Paper in August last year. We are delighted that some of IFPHK's comments are highlighted in the Consultation Paper's conclusion. IFPHK's comments have been specifically spelt out in paragraph 89, 93, 183 and 228 of the Consultation Paper's conclusion.

The Guidelines provide tailored guidance to the industry on the design and operation of online platforms, including specific guidance on the provision of automated or robo-advice. The Guidelines also clarify that the posting of factual, fair and balanced materials on online platforms should not in itself trigger the suitability requirement. The SFC will implement the requirement for platform operators to ensure the suitability of complex products sold, recognising that retail investors should be in a position to take responsibility for their decisions to invest in simple products which they can reasonably be expected to understand. It will be the platform operator's responsibility to determine whether a product is complex having consider the factors set out in the Guidelines. The Guidelines will become effective on 6 April 2019.

The SFC conducts a further consultation on adopting the additional measures applicable to online sales of complex products to offline sales of such products. The submission deadline of the further consultation is on 28 May 2018.

In the previous Consultation Paper, the SFC sought public views on whether the requirements to ensure the suitability of complex products should apply to offline sales of complex products. In the Conclusion, the SFC said some respondents supported applying the Suitability Requirement to offline sales as they considered that regulatory requirements should be technology neutral.

As told by the SFC's Chief Executive Ashley Alder, "it is hoped the clarifications offered within Guidelines on Online Distribution and Advisory Platforms will facilitate the growth of online platforms, giving investors greater choice of products and advice". While the Guidelines did setup certain framework, we are doubtful whether it could foster the growing of the FinTech industry. Rather we think the requirements may abate the development of technology in this area.

Consistent with our previous submission, the IFPHK's comments are based upon the following principles and beliefs which are:

1. Advocating the six-steps financial planning process
2. Aligning with international best practice
3. Aligning with the positioning of the global financial planning community
4. Enhancement of professional standards of intermediaries
5. Protecting consumers by enhancing financial literacy

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

Please refer to IFPHK's previous submission for the details of the above principles.

### ***Questions raised in the Consultation Paper***

#### ***Question 1:***

***Do you have any comments on the proposed amendments to the Code of Conduct? Please explain your view.***

#### **IFPHK's Response**

One of our principles is to ensure a level playing field across distribution channels and different sectors of the financial service industry. The IFPHK strongly believes that a consistent approach will significantly reduce any regulatory arbitrage that could potentially undermine the good intentions of protecting investors. We agree that the same requirements should apply in all circumstances and all channels.

Nevertheless, as we highlighted in previous submission that the complexity of a product is not correlated to its suitability, and we consider it is dangerous to label products based solely on complexity. We still think the SFC still needs to obtain consensus from the industry in respect of the classification of complex products especially classification of derivatives funds.

Mr. Alder said that the Guidelines represent "a balanced regulatory approach. They allow more flexibility for investors to manage their investments online, whilst providing them with additional protection in relation to complex products whose features and risks retail investors may have difficulty in fully understanding". The tightening of the requirements is based on Investor Education Center ("IEC") report which found that 81% of respondents rated derivatives as high risk products and 63% of fund investors surveyed regarded funds investing in derivatives as complex financial products. Whilst the IEC report did provide certain insight to improve financial education, it is not a solid base of imposing more stringent requirements on financial products. Distributors of financial products do not invest enough in educating consumers of the products. IFPHK launched Financial Education Leadership Award earlier this year. Institutions are awarded based on their efforts and works in educating the public on financial education, no fund management company has been awarded in our Financial Education Leadership Award.

We consider that well-informed and educated consumers are the core elements in a healthy regulatory system. For a market to perform effectively and consumers to be protected properly, a fundamental understanding of how financial products work is essential. Without proactive works to educate the investors on proper use of derivatives and correct the misconception of risk and complexity, we do not think the proposed requirements enhance the effectiveness of consumer protection rather the SFC shall mandate financial institution to invest more on educating the public.



**Question 2:**

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

**IFPHK's Response**

Referring to our responses in Question 1, we consider that there should be a level playing field for all distribution channels. As such, we suggest the transition period of the proposed requirements (if the proposals are generally agreed by the industry) shall be aligned with the effective date of the Guideline. The Guidelines will become effective on 6 April 2019. Nonetheless, there are still uncertainties on the requirements and some respondents already expressed their difficulties in implementing requirements within the proposed time frame in the previous consultation paper. The IFPHK urges the SFC to extend the implementation date of the Guidelines so as the proposed requirements on offline sales.