

**IFPHK's Response to the Securities and Futures
Commission Consultation Paper on the Proposed
Amendments to the Professional Investor Regime and
Client Agreement Requirements**

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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 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^{CM} certification and AFPTM 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.

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IFPHK's interest in this consultation

Since its inception, 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, 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, IFPHK launched the Guidance Note entitled *Suitability of Advice Obligations: Documenting your Financial Advice* for its members.

Since Professional Investors form an important part of our members' clientele the IFPHK, as the leading professional body representing the interests of the financial planning industry, shall respond to any consultation paper that may impact our members and their clients. In December 2009, IFPHK provided its views and recommendations on the proposed reforms for the Professional Investor regime as part of the response to Consultation Paper by Securities and Futures Commission ("SFC") entitled *Proposals to Enhance Protection for the Investing Public*. In October 2010, the SFC issued a "Consultation Paper on the Evidential Requirements under the Securities and Futures (Professional Investor) Rules" and the IFPHK provided its views. On 30 May 2011, IFPHK also provided a response to the Questionnaire on Suitability as initiated by IOSCO Standing Committee 3.

To continue serving the financial planning community, IFPHK has taken a strong interest in expressing its views on the proposed changes as stipulated in the Consultation Paper on the Proposed Amendments to the Professional Investor Regime and Client Agreement Requirements.

IFPHK's representation

IFPHK was founded by 30 members ('Founding Members') in order to raise the standards of financial planners and highlight the importance of sound financial planning.

IFPHK currently has 47 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, 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 proposals concerning the professional investor regime and the client agreement requirements in the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (the “Consultation Paper”) in May 2013. It then invited comments from market participants and the public on the relevant proposals set out in the Consultation Paper.

The Consultation Paper explains the SFC’s proposals to amend the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (the “Code of Conduct”) to enhance investor protection by:

- Requiring intermediaries to comply with all Code of Conduct requirements (including the Suitability Requirement) when dealing with all investors who are individuals, including their wholly owned investment vehicles and family trusts;
- Streamlining the criteria under the Code of Conduct in assessing the knowledge and experience of corporate professional investors by removing specific test
- Requiring (i) that the Suitability Requirement be incorporated in all client agreements as a contractual term, (ii) that client agreements should not contain provisions which are inconsistent with the Code of Conduct, and (iii) that client agreements should accurately set out in clear terms the actual services to be provided to client.

In considering various proposals as set out in the Consultation Paper, IFPHK’s views are based on the following principles and beliefs. Namely that:

- The Professional Investor Regime is important in providing a quicker and lower cost channel to investors who possess the knowledge, financial resources and skills to make their investment decision.
- Suitability is the cornerstone of financial planning. The six-step financial planning process that IFPHK promulgated helps clients take a holistic approach to assessing their financial situation.
- The professional standards of intermediaries should be enhanced to keep up with the demands of the market.
- A responsible investing attitude by consumers should be promoted through widespread investor education.

In principle, IFPHK has no major concerns over the proposals in the Consultation Paper. IFPHK agrees with the SFC that Corporate and Individual Investors shall continue to be allowed to participate in private placement activities, and that the current minimum monetary thresholds of the Professional Investor regime shall be maintained.

IFPHK also agrees with the extension of the Code of Conduct requirements to all investors who are individuals, including their wholly owned investment vehicles and family trusts. IFPHK considers that the new requirement would not have significant impact on the industry as it merely codifies the existing practice of the intermediaries. Nevertheless, IFPHK wishes the SFC to

consider providing some flexibility to the intermediaries to allow certain group of Investor to opt out of protection or streamline the requirements.

IFPHK also regards the proposal of replacing bright line tests to a principles-based knowledge and experience assessment when classifying Corporate Professional Investor as sensible. However, IFPHK thinks that it is not necessary to require intermediaries to undertake a separate assessment on Corporate Professional Investor for different product types or markets as a comprehensive suitability assessment is already serving the purpose of identifying products or markets that are suitable to clients. Hence, a general consent to be Corporate Professional Investor is sufficient.

In addition to the proposed changes as stipulated in the Consultation Paper, IFPHK highlights that having a regular monitoring process as well as competent staff is vital in a sound suitability framework. Equally important is to engage and empower investors in the suitability assessment. While investors should be adequately informed in order to make sound investment decisions, they shall be held responsible for their own investment decisions. Intermediaries shall remind investors of the risk and limitation in cases where the investors refuse to provide sufficient information for assessment, or insist in investing in products that do not match with their profiles.

Notwithstanding our support for the above, IFPHK is concerned about and disagrees on the proposed changes on client agreement. IFPHK considers that these requirements when executed might be problematic and onerous to the industry. The requirements on client agreement pose high legal risk and uncertainty to the intermediaries. If implemented, IFPHK anticipates that there will be more court cases between clients and intermediaries, which will be contrary to the purposes of setting up the Financial Dispute Resolution Centre and the Investor Education Council. Rather than imposing prescriptive and rigid requirements on intermediaries to protect investors, IFPHK considers it more effective and appropriate to empower and improve investors through other means such as investor education or raising professional standard of intermediaries.

The statements given in IFPHK's response to the Consultation Paper are based on an objective and independent analysis of market and consumer needs. To ensure that IFPHK understands the concerns and practicality of the issue, it sought comments from active industry practitioners who deal with this issue on a regular basis.

The SFC Consultation

On 15 May 2013, the Securities and Futures Commission (the “SFC”) issued a “Consultation Paper on Proposed Amendments to the Professional Investor Regime and the Client Agreement Requirements” (“Consultation Paper”). The Consultation Paper was intended to enhance the existing professional investor regime and client agreement requirements as stated in the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (the “Code of Conduct”). The Consultation Paper is a regulatory response to the Report on the Thematic Inspection of Selling Practices of Licensed Corporations issued by the SFC in October 2012 and the two recent court cases; *Kwok Wai Hing Salina v HSBC Private Bank (Suisse) SA HCCL 7/2010*, and *DBS Bank (Hong Kong) Limited v San-Hot HK Industrial Company Limited Hao Ting HCA 2279/2008*. Key proposals set out in the Consultation Paper are as follows:

- Requiring intermediaries to comply with all Code of Conduct requirements (including the Suitability Requirement) when dealing with all investors who are individuals, including their wholly owned investment vehicles and family trusts;
- Streamlining the criteria under the Code of Conduct in assessing the knowledge and experience of Corporate Professional Investors by removing specific tests;
- Requiring that the Suitability Requirement be incorporated in all client agreements as a contractual terms;
- Requiring that client agreements should not contain provisions which are inconsistent with the Code of Conduct;
- Requiring that client agreements should accurately set out in clear terms the actual services to be provided to the client

The SFC is not proposing any change to laws concerning access to private placements of investments by those who fulfill existing wealth criteria.

The Consultation Paper contains three parts with 7 questions relating to the aforementioned proposals concerning the Professional Investor Regime and client agreement requirements on which market participants and the public can comment.

Part B - Issues relevant to the Professional Investor regime and proposed enhancement to the Professional Investor regime

II. Who within the Professional Investors categorization needs protection?

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

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

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

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

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

III. The Suitability Requirement

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

Part C – Proposed amendments to client agreement requirements

Question 7: Do you agree with the proposals in relation to the client agreement?

IFPHK Response Methodology

IFPHK is a professional body that seeks to promote higher professional standards in the financial planning industry. It feels that it is important to respond to consultation and policy papers that significantly impact on the financial planning sector. When formulating its response to such papers it takes a systematic approach that includes:

1. An independent and objective study of the proposals and their overall impact, both positive and negative on the industry and consumers, based on theoretical and practical analysis.
2. Study of international practices of markets that are either more developed or similar to Hong Kong's in order to understand how similar proposals may have succeeded or failed and the reasons why that happened.
3. Collection of comments and opinions from industry participants including legal and compliance professionals whose business practices may be impacted by the proposals in the Consultation Paper.

After collecting and consolidating industry views, IFPHK analyzed the information obtained in conjunction with its own research from markets deemed relevant to the situation in Hong Kong. IFPHK formulated its responses to the various questions raised in the Consultation Paper as well as the recommendations on the practical application and effectiveness of the relevant proposals after taking into account the likely impact on the industry.

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 IFPHK as a professional body. As a result, not all the views collected by 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.

IFPHK's Submission

The submission below is the result of IFPHK seeking views from its Members in addition to its own independent internal analysis. IFPHK considers the practical implication of the proposed changes on the business of those financial planners who consider advising and providing professional services to investors as its top most priority.

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

Importance of having a Professional Investor Regime

The principle of the Professional Investor regime is to allow investors, who presumably possess the knowledge, have the financial resources, and skills to make their decision, to participate in the markets without facing unnecessary barriers or incurring unnecessary transaction costs. Therefore by proper information disclosure the professional investors are able to make their own investment decisions. As long as the Professional Investor is properly categorised and properly informed of their status and have the option to opt for greater protection they should be held responsible for the consequences of their investment decisions. IFPHK noted that there are mis-selling claims and court cases associated with Professional Investors that lead to considerable debates on whether protection for Professional Investors should be enhanced. However, IFPHK would like to highlight that mis-selling claims are mostly related to investors investing in products that are inconsistent with their objectives and needs, regardless of whether they are Professional Investors or retail investors. Therefore, if clients are properly identified and classified based on all relevant parameters¹ which enable the financial planners and advisers to make recommendations that are suitable to the client, IFPHK think that the current regime should be sufficient and there is no urgent need to amend the professional investor regime.

Advocating the six-steps financial planning process

It is IFPHK's mission to promote the importance of financial planning. For 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. As a result, suitability requirements are already embedded in the six-steps of IFPHK's financial planning process which financial planning professionals are required to be familiar with.

Enhancement of professional standards of intermediaries

IFPHK has always believed that qualified intermediaries and well informed and educated consumers, together with a robust framework for regulating sales process, 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.

¹ These parameters include but not limited to knowledge, experience, worth, means, etc

Regulators in overseas jurisdictions realize the importance of having qualified and competent financial planners and advisers. As such, they have introduced policy change to raise minimum standard of the industry and many of them achieve it by partnering with professional organizations. The Retail Distribution Review (“RDR”) in United Kingdom put forward several changes that have had significant impact on the industry². One of the changes is to require higher minimum entry requirements for front line staff empowered with the important task of providing financial advice to consumers. By the end of last year all financial advisers must demonstrate new minimum entry educational requirements equivalent to a first year university qualification³. The Financial Services Authority (“FSA”) has approved eight accredited bodies to help with and verify the gap-fill and qualification⁴. On 20 June 2012 the Australian Senate passed the Future of Financial Advice (FoFA) bill in which the regulator requires financial advisers to undertake a “knowledge update review” every three years and new financial advisers have to be supervised for a year by a planner with at least five years’ experience. Under the reforms planners will effectively be forced to join a professional association⁵. The wave of reform also spread to Asia. Last year, Ravi Menon, Managing Director of Monetary Authority of Singapore (MAS) surprised the advisory industry by announcing at an industry dinner that they would form a review panel to spearhead a new initiative called FAIR, to strengthen investor protection. In January MAS finally announced the FAIR Panel Report, which made 28 recommendations under five thrusts. One of the recommendations is to raise the competence of financial advisory representatives by raising the minimum entry requirement for new entrants and requiring financial advisors to undergo at least 30 hours of formal training annually. Also in January the Securities and Exchange Board of India (“SEBI”) issued the final investor adviser regulations. The SEBI requires all advisers to have a post-graduate diploma in a finance-related subject or five years industry experience. Because of the global contagion witnessed during the current financial crisis, there have been greater calls for better coordination between regulators from different jurisdictions and for an increase in the convergence of financial regulation. IFPHK expects regulators in Hong Kong to propose similar requirements on minimum qualification and attachment to professional organizations.

Certainly, it is recommended in the report of the Legislative Council Subcommittee to study issues arising from the Lehman Brothers-related Minibond and Structured Financial Products (“Minibond report) published in June 2012. In particular, there should be more focus on strengthening supervision of intermediaries to ensure that sales staff are fit and proper, adequately trained, and have sufficient understanding of the investment products being sold by them. The Subcommittee recommended the regulator consider the feasibility of setting benchmarks on certain key requirements to achieve consistency in standards and better protection for investors. These key requirements include training for sales staff. The Subcommittee also recommended the regulator consider raising the minimum academic qualification of intermediaries to university degree level and/or professional training in specified fields such as finance or accounting.⁶

² Changes under RDR include but not limited to prohibiting commission payment to intermediaries on advised sales to retail clients, facilitating adviser charging and raising minimum qualification

³ It is important that advisers now press on and achieve an appropriate level 4 RDR qualification and then obtain a Statement of Professional Standing (“SPS”)

⁴ The Institute of Financial Planning (IFA), the affiliate member of FPSB in UK is one of the eight accredited bodies.

⁵ As long as the associations have their codes of conduct approved by the Australia Securities and Investment Commission (“ASIC”), their members will be exempt from opt-in rules, which require advisers to obtain consent every two years from those clients who pay asset-based percentage fees and wish to remain with their adviser.

⁶ Legislative Council Subcommittee to Study Issues Arising from Lehman Brothers-related Minibonds and Structured Financial Products, June 2012.

Promoting responsible investing attitudes of consumers through financial education

As aforementioned, 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.

In May 2010, IFPHK submitted a response to the Government's public consultation on the proposed establishment of an Investor Education Council ("IEC"). It is 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 IFPHK continuously promulgates. Financial education is also an important channel to promote responsible investing attitudes which corresponds with the recommendation contained in the Minibond report. As told by Miles Larbey, General Manager of the Investor Education Council, "Given the high degree of participation of Hong Kong people in financial markets, it is important for people to adopt and apply responsible attitudes towards investing and money management when it comes to making financial decisions."⁷

Questions raised in the Consultation Paper

Part B (II) – Who within the Professional Investors categorization needs protection?

The SFC seeks views on proposed amendment to the Code of Conduct for Persons Licensed by or Registered with the SFC (the "Code of Conduct") to ensure that different classes of investors are adequately protected under the Code of Conduct. Professional Investors discussed throughout this paper as defined under Schedule 1 of the Securities and Futures Ordinance (the "SFO"). It includes institutional professional investors as well as those investors who have wealth to fulfill the monetary threshold⁸ set out in the Securities and Futures (Professional Investor) Rules ("Professional Investor Rule").

Question 1:

Should Corporate and Individual Professional Investors continue to be allowed to participate in private placement activities?

Under the existing regime in private placement activities where offers are made to professional investors only, market participants are able to rely on exemptions from both the prospectus content and registration requirement under the Companies Ordinance and the authorization requirements on product offering under the SFO⁹. These relaxations may give rise to concerns that some professional investors taking part in private placement could be vulnerable because the extent and quality of information disclosure is not subject to the regulatory standards which are equivalent to a public offering. Notwithstanding of the above concerns, the private placement market is well established and other overseas jurisdictions allow investors to access private placements solely by reference to wealth criteria. Moreover, those participating in private placements may opt to do so via intermediaries, and therefore will be covered by the investor

⁷ Investor Education Council, Press release on 23 July 2013

⁸ 8 million portfolio threshold for individuals and corporation or 40 million minimum total assets threshold for corporations

⁹ Baker & McKenzie, Client Alert May 2013

protection requirements of the Code of Conduct. Hence, the SFC believes that Professional Investors should continue to be allowed to participate in private placement activities if they meet prescribed monetary thresholds.

IFPHK's Response

Private placement remains an alternative avenue for companies to raise capital from a limited number of investors in a quicker and less expensive way¹⁰. Given that other overseas jurisdictions have no barrier to the private placement market, prohibiting Professional Investors in accessing the private placement market would harm Hong Kong's competitiveness. As a result, IFPHK concurs with the SFC's view that Professional Investors should be allowed to participate in private placements market based solely on wealth criteria.

Question 2:

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

The current minimum monetary thresholds for qualifying Professional Investors have remained unchanged since 2003. A suggestion is to enhance protection to Professional Investors by increasing the minimum monetary threshold of \$8 million. The SFC pointed out that the \$8 million minimum portfolio threshold for Individual Professional Investors is already higher than that in the United Kingdom (though lower than that in Australia and Singapore) and the consultation on proposals to enhance protection for the investing public in May 2012 had concluded that this should be maintained

IFPHK's Response

As discussed above, mis-selling claims are mostly related to investors investing in products that are inconsistent with their objectives and needs. As long as the investors are properly classified according to all relevant parameters, IFPHK considers the current regime is sufficient and there is no urgent need to review the monetary threshold. Also, as SFC accurately pointed out, the current monetary threshold is comparable to other overseas jurisdictions thus IFPHK agrees with the SFC that the threshold should be maintained.

Question 3:

Do you agree that intermediaries should observe the Code of Conduct without exception when they deal with individuals?

For the purpose of this Consultation Paper, the SFC proposes to further delineate Professional Investors into three different classes:

1. Institutional Professional Investor – banks, insurers and other financial institutions falling within paragraph (a) to (i) of the definition of “professional investor” in the SFO

¹⁰ Tanner DeWitt, Private Placement in Hong Kong

2. Corporate Professional Investor – trust corporations, corporations or partnerships that qualify as professional investors under the Professional Investor Rules, other than investment vehicles that fall within the definition of Individual Professional Investor.
3. Individual Professional Investor – Individuals that qualify as professional investors under the Professional Investor Rules and wholly owned investment vehicles that are owned by such persons or by family trust.¹¹

As stipulated in the Consultation Paper, treatment of Institutional Professional Investors remains unchanged. Intermediaries dealing with Institutional Professional Investors are automatically exempt from complying with all the Code of Conduct requirements.

Since the vast majority of mis-selling cases involve individual investors, the SFC is of the view that individual investors yield greater protection than Corporate Professional Investors. The SFC proposes that all Code of Conduct requirements, including the Suitability Requirement, should be observed, and that the waivers to not applying certain Code of Conduct requirements on Professional Investors are no longer valid in the future.

IFPHK's Response

The proposed changes mean that waivers from certain Code of Conduct provisions that intermediaries currently rely on will no longer be available when providing services to Individual Professional Investors¹². It is stated in PART II (11) of IFPHK's Code of Ethics and Professional Responsibility that "a financial planning professional shall make and/or implement only recommendations that are suitable for the client"¹³. As mentioned previously, IFPHK promotes the concept of financial planning and suitability is performed as part of the financial planning process. To IFPHK, financial planning is the process of developing strategies to assist clients in managing their financial affairs to meet life goals or objectives. It is envisaged that both retail and Professional Investors will have their own investment objectives and goals. The financial planning process, as well as the suitability assessment process, shall therefore be no different for retail or Professional Investors.

IFPHK understands from industry participants that many intermediaries have not been applying the Professional Investor classification due to uncertainty over existing requirements. Others have already implemented a suitability framework within their organization. Some argue that the tougher suitability requirements may do no more than codify what is already practiced in the market¹⁴. Despite the fact proposals will incur compliance costs on system and operational adjustments, they will not significantly affect the intermediaries' businesses as opposed to the proposed change on client agreement that will be discussed in Question 7 below.

Notwithstanding IFPHK's support on the general principles of the proposals, the SFC should be aware that the proposals are narrowing the differences between retail and Professional Investors.

¹¹ Deacons, Financial Services Newsletter, Issue 5 of 2013: June

¹² Code of conduct provisions that currently Professional Investors are exempted include the Suitability Requirement; the need to establish a client's financial situation, investment experience and investment objectives; the need to characterize a client based on his knowledge of derivatives; the need to disclose sales related information; the need to enter into a written agreement and provide relevant risk disclosure statements; and

¹³ All CFP certificants, AFP certificants and candidates need to agree on an annual basis to be abided by IFPHK's Code of Ethics & Professional Responsibility.

¹⁴ Allen & Overy, Asia – International trends and local operational developments, 15 July 2013

The proposed change may increase difficulty in acting as an intermediary for large-scale product offerings to investors who have significant financial means and investment experience, as well as a loss in efficiency due to the protection and disclosure mechanisms that would need to be extended to investors who were formerly classified as Professional Investors¹⁵. Indeed, there is a group of Professional Investors who are ultra high net worth clients that are sophisticated in terms of wealth and investment experience. It may not be efficient and could be onerous to request them to go through a lengthy assessment and risk disclosure process.

As mentioned before, professional Investors are perceived to be more sophisticated in terms of experience, knowledge and financial resources. It is the responsibility of the client to ask for a higher level of protection if they are unable to properly assess or manage the risks involved, or where the client does not feel comfortable with particular products. On the other hand, if the client considers that he/she has sufficient knowledge or experience regarding a product, he/she can decide to invest in that product and refuse regulatory protection. In other words, the investor has the freedom to opt-out of the protection that is afforded to him/her. Intermediaries have an obligation to consider with great care any request by a client to opt-out of protection that is due to him/her, and to reject it should the corresponding requirements not be met. While IFPHK agrees suitability requirements should generally be performed on every individual client, IFPHK suggests the SFC to consider offering flexibility to the industry, such as allowing Individual Professional Investor to opt out certain protections that are due to them, or to streamline some of the Code of Conduct requirements.

Question 4:

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

As mentioned in Question 3, the SFC considers that Individual Professional Investors are vulnerable and shall be granted greater protection. Thus, the SFC thinks that investment vehicles wholly owned by Individual Professional Investors and Investment vehicles that are wholly owned by family trusts should be afforded the same protection as individuals. As a result, the SFC proposed that waivers should not apply to investment vehicles wholly owned by individuals and by family trusts.

IFPHK's Response

The rationale of the proposal is that the owners of these investment vehicles are expected to make investment decisions that are little different from individual investments¹⁶. As discussed in Question 3, investors vary in background and experience. The SFC shall recognize that there are ultra high net worth clients who are capable, and sophisticated in means and knowledge, and are therefore responsible for their own investment decisions. Investment vehicle and family trusts are useful common tools for these ultra high net worth individuals to use for tax planning purposes or other investment purposes. They may even hire experts to assist them on investment management. As such, these investment vehicles operate more like a Corporate Professional Investor. IFPHK has no significant concerns on the proposals. However, the SFC may consider

¹⁵ Australian Government, Wholesale and Retail Clients Future of Financial Advice, Options Paper, January 2011

¹⁶ Panel on Financial Affairs Special meeting on 16 July 2013, Securities and Futures Commission's Consultation on the Proposed Amendments to the Professional Investor Regime and the Client Agreement Requirements, CB(1)1518/12-13(02)

providing some flexibility to the industry such as allowing clients to opt out of certain protection that is due to them or allow intermediaries to classify certain investment vehicles or family trusts as Corporate Professional Investor.

Question 5:

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

Having regarded the fact that level of financial sophistication will vary within the class of Corporate Professional Investors, the SFC suggests revising the Code of Conduct criteria to determine whether a Corporate Professional Investor is knowledgeable and experienced in the relevant products and/or markets, intermediaries should consider

- The corporate structure and investment process and controls;
- The background of the person(s) responsible for making investment decisions on behalf of the corporate

Intermediaries should identify who the person or persons making investment decisions are and assess their relevant working experience, training and qualifications, and whether they have sufficient investment experience in relevant products and/or markets. The Intermediaries should be satisfied that such persons aware of the risks involved in relevant product and/or markets.

Under the current assessment criteria, more than 40 transactions per annum is not a reliable indicator of an investor's financial sophistication. The SFC proposed to dispense with this "bright line" test in favor of a principles-based Knowledge and Experience Assessment.

IFPHK's Response

IFPHK thinks that the objective of the suitability assessment on corporation is to ensure that Corporate Professional Investors are sufficiently sophisticated to 'dis-apply' the protection under the Code of Conduct. The "bright line" test has been problematic to the industry as it fails to properly identify clients who are truly knowledgeable. IFPHK regards a principle-based Knowledge and Experience assessment as more sensible and thus supports the proposal to streamline the requirements by replacing the "bright line" test with a principles-based Knowledge and Experience Assessment.

Nonetheless, IFPHK has specific comments on the proposed amendment to Code of Conduct Section 15.3(d) which require a licensed or registered person to undertake a separate assessment for different product types or markets. By properly performing the procedure of 'know your client', client profiling, and product due diligence, planners or advisers should be able to identify and recommend products/markets that are suitable to clients based on their analysis of all relevant parameters. 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 (e.g. changes to members of the Investment Committee of a Corporate Professional Investor) rather than on each purchase. Requiring intermediaries to do separate assessment for different product

types or markets is a duplication of efforts and IFPHK thinks that a general consent to confirm with clients their Corporate Professional Investor status is sufficient.

Part B (III) – The Suitability Requirement

Question 6:

Do you have any views on the Suitability Requirement?

The Suitability Requirement has a broad application and applies to all intermediaries. It is a comprehensive principles-based standard without further segregating different classes of investors in its application. In complying with the Suitability Requirement, intermediaries should 'know their clients', conduct product due diligence, and provide reasonably suitable recommendations to clients. The Suitability Requirements are so core and important that the SFC would like to seek views on existing Suitability Requirements.

IFPHK's Response

IFPHK agrees that suitability is the cornerstone of financial planning process. Appreciating its importance, IFPHK launched a Guidance Notes, *Suitability of Advice Obligations: Documenting your Financial Advice* ("Suitability Guidance Note") for members. Good practices discussed in the Suitability Guidance Note include know your client, product due diligence, proper basis of recommendation, client engagement and understanding and proper documentation. There are other important factors that IFPHK also considers important in a suitability assessment.

Constant monitoring process

The Suitability Guidance Note suggests intermediaries constantly monitor the quality of financial advice provided by their staff. Intermediaries shall put in place the following measures to improve and monitor the quality of the advice provided to clients and the suitability assessment process. These measures include but are not limited to;

- Having a recruitment process that is robust enough to ensure that intermediaries employ staff with the relevant skills and qualifications.
- Adopt a training strategy to identify gaps in skills and knowledge, and to oversee the performance of newly recruited staff.
- Having a review process that allows an intermediary to check for regulatory compliance, and assess the advisory or financial planning process and the quality of the advice given. An independent party such as the Compliance department shall conduct the review.
- Having a complaint process that is clearly communicated to the clients

Competent Financial planners and advisers

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 recommending 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. As discussed in the beginning of this paper, some overseas regulators have taken measures to raise minimum qualification of financial planners and advisers, many of them do so by partnering with professional organisations. Individuals are asked to join one of the approved organisations and be abided by the association's professional standards.

Role and responsibilities of Clients

Whilst an intermediary has an obligation to ensure that the recommendation or solicitation to a client is suitable to that client's circumstances, the client has a responsibility to provide adequate information to the intermediary. The role of a financial planner is to help a client make an informed investment decision. Ultimately it is the client himself/herself who makes the investment decision. In cases where the client does not provide the information needed to perform the test, or provides insufficient information, the financial planner shall discuss the matter with the client. The financial planner should warn the client about the limitations of the advice given. If the financial planner believes that the advice may be based on misleading or incomplete information, the financial planner may choose to withdraw his/her service and end the relationship with the client. The financial planner should agree with the client the frequency of the periodic review, and the client is obliged to inform the financial planning professional of any significant changes to these circumstances. Generally speaking, if the financial planner finds that none of the investment products available are suitable for the customer, no recommendation or transaction should be made. However, if a client needs or requests a plan or product that conflicts with the level of risk and the strategies of the financial plan that the intermediary has suggested, the financial planners should have a detailed discussion with the client. They should draw the customer's attention to any mis-matches in their investment objectives, financial circumstances, risk tolerance, and capacity for loss. The financial planners should explain the implications to the client, and ensure that the client understands the risk associated with their decision. Despite this warning that the intermediary is obliged to provide, clients still have the freedom of choice to invest in any product they wish provided they have fulfilled all the requisite customer categorisation requirements and undertake to accept the consequences of such decision.

Part C – Proposed amendments to client agreement requirements

Question 7:

Do you agree with the proposals in relation to the client agreement?

The SFC could only take disciplinary action for any breaches of the Code and cannot require the intermediary to pay compensation to an aggrieved client. It is noted that some intermediaries include clauses in client agreements which are designed to restrict the ability of clients to seek compensation by not accurately describing the actual services to be provided. These contractual restrictions do not affect the SFC's ability to pursue disciplinary action against an intermediary for breaches of its Code obligations. However, the clauses may prevent aggrieved clients from successfully bringing legal action for compensation, as has been seen in recent court cases.

To address these issues, the SFC proposes:

1. Inclusion of the Suitability Requirement in client agreements
The Code requires an intermediary to enter into a written agreement with each of its client and stipulates the minimum contents of client agreements. The SFC proposes that the

Suitability Requirement in paragraph 5.2 of the Code i.e. an intermediary, when making a recommendation or solicitation to a client, should ensure the suitability of the recommendation or solicitation for that client is reasonable in all the circumstances, should be expressly included in all client agreements without qualification.

2. No inclusion of clauses which are inconsistent with the Code or which mis-describe the actual service provided to clients

The Code requires intermediaries to provide a description of the “nature of service”. The SFC considers that such requirement is insufficient and other elements of the relationship between the client and the intermediary are important in defining the obligations of the intermediary to clients. The SFC therefore considers that client agreements should also set out in clear terms all of the services to be provided to clients. The SFC proposes a new paragraph 6.5 of the Code which provides that (1) a licensed or registered person should not incorporate any clause, provision or term in the client agreement or in any other document signed by the client at the request of the licensed or registered person which is inconsistent with its obligations under the Code; and (2) no clause, provision, term or statement should be included in any client agreement which mis-describes the actual services to be provided to the client.

IFPHK’s Response

IFPHK understands that the proposals follow the findings of the Thematic Inspection Report in which the SFC found that some intermediaries insert clauses, disclaimers, declarations and acknowledgements in the client agreements or account opening documentation that restrict the power of investor protection. Nonetheless, IFPHK has concerns about the proposals as the proposed changes will have a profound impact on the industry as they cover all types of intermediaries and all kinds of products and services. IFPHK’s views on the proposals are:

1. Inclusion of the Suitability Requirement in client agreements
Unlike quantitative requirement such as the “bright line test”, whether a recommendation is suitable to a client is judgmental which could lead to different interpretations. By incorporating suitability requirement in all client agreements as contractual terms, intermediaries could face an increasing number of disputes with clients. It will expose intermediaries to higher legal and litigation risk. Besides, the suitability is only relevant when there is advice. Although there is no defined execution-only regime like the one under the Markets in Financial Instruments Directive (“MiFID”), intermediaries such as traditional securities brokerage services are offering purely transaction-only service. Suitability assessment is irrelevant to intermediaries that are providing “execution-only” service.
2. No inclusion of clauses which are inconsistent with the Code or which mis-describe the actual service provide to clients
IFPHK agrees with the general principle that the Client agreement shall not include clauses which are inconsistent with the Code or which mis-describe the actual service provided to clients. IFPHK also agrees that intermediaries have the obligation to provide or discuss with the client the actual services that are going to be delivered, but it is simply onerous and impractical to provide an exhaustive and detailed list of services on the client agreement. The long list will ultimately confuse and irritate clients. To execute the changes, intermediaries need to re-issue agreements to all client whenever there is a new

service offering. The intermediaries are also obliged to reject client request on services that are not listed on the agreement. IFPHK regards the existing requirement of providing a description of the nature of services to be provided to or available to the client as adequate. The SFC can explain its expectation and interpretations on the description of the nature of services in a FAQ.

The collapse of Lehman Brothers and the high degree of political involvement in the event highlighted the risk of moral hazard. With the proposed changes on client agreements investors may be left with the perception that they can resolve to the court on any risky or irresponsible investment decision made by them which may be contrary to the purpose of establishing Financial Dispute Resolution Centre ("FDRC") and the Investor Education Council ("IEC"). The former is intended to enhance consumer protection by providing more accessible and affordable alternative dispute resolution channels. The latter is established to improve their financial literacy and capability of investors so as to help them make sound financial decisions through the provision of holistic financial education across the entire financial sector

In view of the above impact and disruption to the industry, the proposals in general are not well received by participants. To address the industry's concerns, it is considered necessary to reconsider and fine tune the proposal. Any revisions or new proposals can be discussed in another round of consultation.

Conclusion

The IFPHK believes that the regulatory regime should facilitate market efficiency and integrity, product innovation, market confidence, and investor education. Investors should be expected to undertake their own analysis, but at the same time be able to take action against issuers and sellers of financial products. Rather than imposing prescriptive and rigid requirements to protect certain classes of investors, it might be more effective to empower and improve investors by providing adequate customer redress through private courses of action and/or arbitration, and a broad-based consumer education program in order to enhance their knowledge.

Despite their differing approaches, regulators around the world have a common goal: to better protect investors by making them confident enough to take on advice. IFPHK, as Hong Kong's leading professional body representing the financial planning community, fully supports any move that can better protect investors that are practical and would restore consumer confidence in taking investment advice. One of the approaches adopted by overseas regulators that IFPHK strongly recommends is the requirement for practitioners to attach themselves to a professional body. Having this connection, the public can be assured that these practitioners have achieved an established level of professional and ethical standard.