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Briefing note | September 2014

# SFC Consultation Conclusions on the Proposed Amendments to the Professional Investor Regime and Further Consultation on the Client Agreement Requirements

On 25 September 2014, the Securities and Futures Commission (the "**SFC**") published its Consultation Conclusions on the Proposed Amendments to the Professional Investor Regime and Further Consultation on the Client Agreement Requirements (the "**Consultation Conclusion**")[1].

## Changes to the Professional Investor Regime

The Consultation Conclusion will introduce the following changes:

- intermediary will no longer be able to waive certain Code of Conduct requirements - including the requirement to ensure suitability - when dealing with individual professional investors as well as investment vehicles, family trust and corporate professional investors in certain circumstances ("**Changes to the Professional Investor Regime**"). The Changes to the Professional Investor Regime are scheduled to take effect on 25 March 2016 (yes, 18 months after the date of the Consultation Conclusions!). Whilst these changes do not come as a "surprise", intermediaries will need to review and evaluate their existing processes, policies and procedures when distributing or advising on an investment product, amongst others.
- it will no longer be allowed to include non-reliance provisions (i.e. a clause by which the client purports to acknowledge that no reliance is placed on any recommendation made or advice given by the intermediary) in client agreements. This will only come into effect on a date stipulated in the subsequent consultation paper on the proposed New Clause (discussed below).

[1] For a copy of the SFC's Consultation Conclusions on the Proposed Amendments to the Professional Investor Regime and Further Consultation on the Client Agreement Requirements, please press here.

# Client Agreement Requirements

One of the most contentious proposals in the SFC's original Consultation Paper on the Proposed Amendments to the Professional Investor Regime and Client Agreement Requirements (the "**Consultation Paper**") was the proposal to incorporate the suitability requirement in paragraph 5.2 of the Code of Conduct[2] as a contractual term in client agreements.

Whilst the SFC recognises the majority of the respondents to the Consultation Paper did not agree with this, in the interests of enhancing investor protection the SFC is inviting the public to comment on a revised "new clause" to be inserted into a client agreement (the "**New Clause**") by 24 December 2014.

The New Clause proposed by the SFC to be included into client agreements reads:

"*If we [the intermediary] solicit the sale of or recommend any financial product to you [the client], the financial product must be reasonably suitable for you having regard to your financial situation, investment experience and investment objectives. No other provision of this agreement or any other document we may ask you to sign and no statement we may ask you to make derogates from this clause*."

We think it is inevitable that some form of New Clause will be required by the SFC, so we will be proposing a redraft of the New Clause.

# Changes to the Professional Investor Regime

The SFC will introduce the majority of the proposals in relation to the professional investor regime3 as set out in the Consultation Paper. The key changes include that intermediaries will no longer be exempted from certain requirements under the Code of Conduct4 in their dealings with:

- individual clients; and
- investment vehicles that are wholly owned by individual professional investors, family trusts and corporate professional investors which the intermediaries consider as not having the requisite knowledge and investment experience, after completing a "CPI Assessment" ("**CPI Assessment**") or if they elect not to be treated as a "professional investor" under the Code of Conduct.

In other words, an intermediary will need to treat all individual and certain corporate professional investors in the same manner as retail investors under the Code of Conduct in its dealings with them.

For corporate professional investors that are not institutional professional investors, the SFC introduced a CPI Assessment. The CPI Assessment is a principles-based assessment and has three criteria, namely: (i) the investor has the appropriate corporate structure and investment process and controls; (ii) the person(s) responsible for making investment decisions has(have) sufficient investment background; and (iii) the investor is aware of the risks involved. If an intermediary is satisfied that an investment vehicle, a family trust or a

[2] Paragraph 5.2 of the SFC Code of Conduct essentially provides that an intermediary, when making a recommendation or solicitation for a client, should ensure that the suitability of the recommendation or solicitation for the client is reasonable in all the circumstances.

[3] For a copy of our previous briefing on the SFC's Consultation Paper on the Proposed Amendments to the Professional Investor Regime and the Client Agreements Requirements, please press here.

[4] These include (i) the requirement to ensure suitability; (ii) the need to establish a client's financial situation, investment experience and investment objectives; (iii) the need to assess a client's knowledge of derivatives and characterise the client based on his knowledge of derivatives; (iv) the need to disclose certain transaction-related information; (v) the need to enter into a written agreement and the provision of relevant risk disclosure statements; and for discretionary accounts, the need to obtain from the client an authority in written form prior to effecting transactions for the client without his specific authority, the need to explain the authority and the need to confirm it on an annual basis, amongst others.

corporate professional investor meets the above assessment, the intermediary can treat that investor as a "professional investor" and be exempted from complying with the relevant requirements under the Code of Conduct, unless the investor objects to be treated as a "professional investor" under the Code of Conduct.

# No inclusion of Clauses which are inconsistent with the Code of Conduct or which mis-describe the actual services provided to Clients

The SFC proposes to introduce a new Clause 6.5 of the SFC Code of Conduct (see Appendix) on the basis that non-reliance provisions (e.g. as typically seen in a "big boy letter") in client agreements and disclaimers may neutralise or render redundant investor protection as intended under the Code of Conduct.

# Others

### Retention of Private Placement Safe harbours

The SFC has also confirmed individual and corporate professional investors can continue to participate in private placement activities pursuant to the safe harbour under the Securities and Futures Ordinance. This means that intermediaries can continue to offer investment products which are not authorised by the SFC to these investors.

### Suitability Requirements

With a view to giving further guidance on the requirement to ensure suitability, when it is triggered and what amounts to a "solicitation" or a "recommendation", the SFC will conduct a detailed internal study on this requirement, as well as soliciting views from the industry.

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# Appendix

Proposed new Clause 6.5 of the Code of Conduct

*A licensed or registered person should not incorporate any clause, provision or term in the Client Agreement or in any other document signed or statement made by the client at the request of the licensed or registered person which is inconsistent with its obligations under the Code.*

*Note: This paragraph precludes the incorporation in the client agreement (or in any other document signed or statement made by the client) of any clause, provision or term by which a client purports to acknowledge that no reliance is placed on any recommendation made or advice given by the licensed or registered person.*

*No clause, provision, term or statement should be included in any Client Agreement (or any other document signed or statement made by the client at the request of a licensed or registered person) which misdescribes the actual services to be provided to the client.*



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