



Hong Kong

April 2018

SFC GUIDELINES ON ONLINE PLATFORMS AND ADVISORY SERVICES

On 28 March 2018, the Securities and Futures Commission (**SFC**) released its Consultation Conclusions¹ on the Proposed Guidelines on Online Distribution and Advisory Platforms² (the **Guidelines**) on online order execution and distribution of investment products and related advisory services. The Guidelines will clarify in particular how SFC-licensed and registered entities should comply in an online environment with the obligation to ensure the suitability of client recommendations and solicitations (the **Suitability Requirement**) under section 5.2 of the SFC's Code of Conduct for Persons Licensed by or Registered with the SFC (the **Code**). Specific protective measures will also apply to online sales of complex products.

The Guidelines will become effective 12 months from the date of their gazettal.

Application

The Guidelines will apply to all SFC-licensed or registered persons which conduct regulated activities via online platforms (**Platform Operators** or **POs**). They will apply to all online channels used for presenting information on investment products and transacting in them which are targeted at Hong Kong investors, including social media accounts posting such information.

Where a Platform Operator also provides automated trading services (**ATS**), the Guidelines for the Regulation of Automated Trading Services will also apply. Platform Operators conducting electronic trading must also comply with paragraph 18 (Electronic Trading) and Schedule 7 to the Code of Conduct.

Proposed Guidelines

The Guidelines cover four principal areas:

1. The governance and controls Platform Operators are expected to put in place in the form of six core principles;
2. Guidance and requirements for robo-advisers;
3. Discharging the suitability requirement in an online context; and
4. Additional measures applicable to online sales of complex products.

1. Governance and controls – Guidelines Chapter 2

In offering investment products, Platform Operators need to comply with the following general provisions:

- Parts II and XII of the Companies (Winding Up and Miscellaneous Provisions) Ordinance (**C(WUMP)O**³);

¹ <http://www.sfc.hk/edistributionWeb/gateway/EN/consultation/conclusion?refNo=17CP3>

² <http://www.sfc.hk/edistributionWeb/gateway/EN/consultation/openFile?refNo=17CP3>

³ <https://www.elegislation.gov.hk/hk/cap32>

- Part IV of the Securities and Futures Ordinance (**SFO**⁴);
- Restrictions applicable to overseas exchange-traded products or other products under ATS authorisation conditions;
- **Code of Conduct**⁵; and
- Management, Supervision and Internal Control Guidelines⁶ for Persons Licensed by or Registered with the SFC.

The Guidelines introduce the following six Core Principles regarding governance and controls.

1) **Core Principle 1 - Proper design**

A PO must ensure that its online platform is properly designed, operate it with due skill, care and diligence and restrict retail clients' access to information relating to exchange-traded funds not authorised by the SFC.

2) **Core Principle 2 - Information for clients**

A PO should make clear and adequate disclosure of relevant material information on its online platform, such as providing up-to-date product offering documents, informing of the scope and limitations of services and disclosing commission, brokerage and any other fees and charges.

3) **Core Principle 3 - Risk management**

A PO should ensure the reliability and security (including data protection and cybersecurity) of the online platform. This includes testing and monitoring the systems regularly, having a contingency plan to deal with emergencies.

4) **Core Principle 4 - Governance, capabilities and resources**

A PO should ensure 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. This includes conducting regular reviews on internal policies and ensuring sufficient technology resources to safeguard confidential client information.

5) **Core Principle 5 - Review and monitoring**

Reviews of all activities conducted on an online platform should be performed by a PO as part of its ongoing supervision and monitoring obligation. This requires a regular review at least once per year and ad hoc reviews, for example after a major market event.

6) **Core Principle 6 - Record keeping**

POs should maintain proper records in respect of their online platforms. This includes documentation on the platform design, operations, tests and reviews, which should be retained for at least 2 years after the online platform ceases to operate. The audit trails of transactions should be retained for at least 2 years for exchange traded products and at least 7 years for non-exchange traded products.

2. **Suitability Requirement – Guidelines Chapter 5**

When making a recommendation or solicitation, POs need to ensure the suitability of the recommendation or solicitation for the client is reasonable having regard to the information about the client of which the licensed entity is or should be aware through due diligence (Guidelines paragraph 5.1).

Whether or not the Suitability Requirement is triggered requires an analysis of the facts and circumstances and POs should refer to the SFC's guidance - Frequently Asked Questions on Triggering of Suitability Obligations. The context and content of product-specific materials which are posted online together with the overall impression formed by the online platform will determine whether the Suitability Requirement is triggered. The Guidelines state however that the posting of factual, fair and balanced product-specific materials would not in itself amount to a solicitation or recommendation and will not trigger the Suitability Requirement, provided there are no

⁴ <https://www.elegislation.gov.hk/hk/cap571>

⁵ <http://www.sfc.hk/web/EN/assets/components/codes/files-previous/web/code-of-conduct-for-persons-licensed-by-or-registered-with-the-securities-and-futures-commission/2017-06-08-2016-03-23-Code-of-Conduct-for-Persons-Licensed-by-or-Registered-with-the-Securities-and-Futures-Commission.pdf>

⁶ [http://www.sfc.hk/web/EN/assets/components/codes/files-current/web/guidelines/management,-supervision-and-internal-control-guidelines-for-persons-licensed/Management, Supervision and Internal Control Guidelines for Persons Licensed by or Registered with the Securities and Futures Commission.pdf](http://www.sfc.hk/web/EN/assets/components/codes/files-current/web/guidelines/management,-supervision-and-internal-control-guidelines-for-persons-licensed/Management,SupervisionandInternalControlGuidelinesforPersonsLicensedbyorRegisteredwiththeSecuritiesandFuturesCommission.pdf)

other facts or circumstances that amount to a solicitation or recommendation in respect of a particular investment product. The Suitability Requirement would be triggered, for example, where some investment products are emphasized over others or solicitations or recommendations are made through the platform via interactive one-to-one communications.

Online platforms often give factual information in relation to (i) exchange-traded investment products (such as listed issuers' corporate information (e.g. announcements, circulars or annual reports) or links to this information) and (ii) non-exchange traded products (such as offering documents, notices to investors and fact sheets). This is in line with existing Code of Conduct requirements which require intermediaries to make adequate disclosure of relevant information.

Brokers also provide information and analysis about exchange-traded products ranging from research reports to materials that are promotional (e.g. advertisements). These materials often contain indications to buy, hold, or sell a specific listed stock with a target price.

Situations when the Suitability Requirement is triggered

The Suitability Requirement will be triggered when online platforms post materials that are solicitations or recommendations. Examples of situations triggering the Suitability Requirement include:

- a) Posting of advertisements with product-specific incentives (such as cash rebates or fee discounts) for transactions in any specific product;
- b) Posting of product-specific research reports on any investment product with words such as "Don't Miss Out!" or "Act Now!";
- c) Persistent pop-ups or flashing in connection with a specific investment product;
- d) Presenting a specific list of investment products with an accompanying statement such as "product of risk rating X or below may suit you or match your risk tolerance level" or "these products may suit you or match your risk tolerance level" to clients immediately after the online platform conducts a risk profiling of clients; and
- e) Upon a client completing the KYC process or provision of information through a client profiling tool, or providing updates to his or her information, the generation of a specific model portfolio with a list of investment products or generating a list of selected investment products which could be perceived to be based on a consideration of the client's information;
- f) Presenting a model portfolio that allocates a percentage of the portfolio to a class of products (e.g., bonds) but there is only one product in that class of product offered by the platform; and
- g) Showing the performance of a model portfolio offered by the platform against the performance of the client's current portfolio held with the platform without the client requesting such a comparison.

Situations when the Suitability Requirement is not triggered

The Suitability Requirement will not be triggered when online platforms post factual, fair and balanced materials. Examples of situations not triggering the Suitability Requirement are:

- a) Providing a direct facility to input stock codes to place orders for exchange-traded products for secondary market trading on the relevant exchange.
- b) Posting lists of, and providing access to, investment products and posting factual information such as listed issuers' corporate information (e.g., announcements, circulars or annual reports) or providing links to such information on the SEHK website or other factual information (e.g., offering documents, notices to investors, annual reports, fact sheets, etc.).
- c) Posting lists of investment products that are selected using objective criteria (e.g., performance data, sales figures, research data).
- d) Posting advertisements of fee discounts not tied to any specific investment product (e.g., lower subscription fees during a client's birthday month, time-limited reduced rates or loyalty discounts to reduce transaction fees in general).

- e) Provision of objective filters for self-directed research on funds (e.g., geographical location, underlying assets, performance data, risk categories and third party or in-house risk ratings).
- f) Posting of non-product specific information such as market news or updates, industry and sector trends, and educational materials.
- g) The simple flashing of a “new” icon next to newly published research reports (which may contain views on buy, hold or sell with target prices) or newly issued investment products.
- h) Posting model portfolios constructed using objective criteria (e.g., research data, performance data, asset allocation strategies/models) which are not linked to or generated based on information provided by the client.
- i) Posting statistics or trends in customer activities involving a particular product that are factual and based on objective criteria and do not put pressure on a client to proceed with a transaction (for example, setting out a list of investment products with a description that “Other clients who bought product A also looked at these products”).
- j) Posting educational materials that are product-specific as long as such materials do not include (standing alone or in combination with other communications) a recommendation of the specific investment product.

3. Robo-advice - Guidelines Chapter 4

The Guidelines apply to robo-advice (i.e. automated portfolio construction or model portfolios based on a client’s personal circumstances) provided directly to clients in an online environment using technology tools (**client facing tools**). If client facing tools are not involved, licensed entities should refer to the requirements applicable to their conduct of regulated activities under the SFC’s codes etc.

Robo-advice can be: (i) fully-automated and involve no human intervention; (ii) adviser-assisted where the platform gives clients the option to contact an adviser; or (iii) guided – i.e. investment advice is given by an adviser who is assisted and supported by technology tools.

Robo-advisers need to comply with the Suitability Requirement at the point advice is given. Algorithms should not therefore be programmed to direct clients towards particular investment products for which the robo-adviser or its affiliates receive higher commissions or other types of compensation. Where advice is given on a discretionary basis, robo-advisers should refer to the SFC’s guidance in its Frequently Asked Questions on Triggering of Suitability Obligations⁷ and Frequently Asked Questions on Compliance with Suitability Obligations by Licensed or Registered Persons⁸.

Information for clients

Robo-advisers are required to ensure they accurately describe the investment advisory services they offer. They should also ensure that sufficient information is provided to investors prior to client on-boarding to allow investors to make an informed decision on whether to employ the robo-adviser’s services. This should include information on the limitations, risks and how key components of its services are generated (e.g. a description of how underlying algorithms operate, any limitations on the algorithm, how a portfolio rebalancing mechanism works and the associated risks). Investors should also be informed of the degree of human involvement provided (e.g. advice via web-chat).

Client profiling

Client profiling tools or questionnaires should be designed to obtain sufficient information (including, where appropriate, the opportunity for clients to provide additional explanatory and contextual information) to enable the robo-adviser to provide advice that is suitable based on clients’ personal circumstances. Robo-advisers need to have mechanisms to identify and reconcile inconsistent information provided by clients (e.g., by alerting clients to inconsistencies through popup boxes and allowing the information to be altered, or internally flagging inconsistent information for review and follow-up).

System design and development

Robo-advisers need to effectively manage and adequately

⁷ <http://www.sfc.hk/web/EN/faqs/intermediaries/supervision/triggering-of-suitability-obligations/triggering-of-suitability-obligations.html>

⁸ <http://www.sfc.hk/web/EN/faqs/intermediaries/supervision/suitability-obligations-of-investment-advisers/compliance-with-suitability-obligations.html>

supervise the design, development, deployment and operations of algorithms. The design and operations of algorithms must comply with relevant conduct requirements including, where applicable, requirements in paragraph 18 (Electronic Trading) of and Schedule 7 to the Code of Conduct and any relevant guidelines.

Robo-advisers should maintain appropriate documentation concerning the design and development (including modifications) of all algorithms, including their rationale. They must also ensure that algorithms take into account client information obtained and use objective criteria to generate reasonably suitable investment recommendations and/or advice.

Supervision and testing of algorithms

Algorithms should be tested before deployment and before any subsequent developments and modifications to ensure that the output conforms to the robo-adviser's expectations. Robo-advisers are required to regularly monitor and test algorithms and the reasonableness of the advice generated. These reviews should be conducted by a qualified person who understands the technology, operations and algorithms used to generate the advice.

Robo-advisers should maintain documented manuals concerning the scope and strategy for the testing of algorithms. Records of testing conducted and test results should be maintained.

When errors are detected in algorithms, robo-advisers need to have adequate resources and measures in place to rectify any problem and controls for suspending the provision of advice or services where necessary. Due skill, care and diligence should be exercised by robo-advisers in the selection and monitoring of outsourced service providers, including of a third party involved in development, management, or ownership of the algorithms used.

Rebalancing

Robo-advisers should make clear to clients how the rebalancing process operates including the frequency of rebalancing, any additional costs that may result from rebalancing, and risks associated with automatic rebalancing (such as automatic rebalancing occurring regardless of market conditions). Policies and procedures should be put in place to define how

the algorithm will handle a major market event. Clients should be promptly informed of changes to the algorithm that may materially affect their portfolios.

4. Additional protective measures for unsolicited sales of complex products on online platforms

The Guidelines set out additional requirements applicable to sales of complex products on an online platform in circumstances where no solicitation, recommendation or advice has been provided. In these circumstances, investors would not be protected by the Suitability Requirement under the current regulatory framework.

Complex Product Definition

Complex products are investment products whose terms, features and risks are not reasonably likely to be understood by retail investors because of their complex structure (Guidelines paragraph 6.1). Factors to be taken into account in determining whether a product is a complex product include whether:

- a) the investment product is a derivative product;
- b) a secondary market is available for the investment product at publicly available prices;
- c) adequate and transparent information about the investment product is available to retail investors;
- d) there is a risk of losing more than the amount invested;
- e) any features or terms of the investment product could fundamentally alter the nature or risk of the investment or pay-out profile or include multiple variables or complicated formulas to determine the return. This would include, for example, investments that incorporate a right for the investment product issuer to convert the instrument into a different investment; and
- f) whether any features or terms of the investment product might render it illiquid and/or difficult to value.

The SFC website will set out lists of investment products which the SFC regards as complex and non-complex products.

Complex products include:

- a) derivatives traded on an exchange (where paragraph 6.5 of the Guidelines is applicable);
- b) futures contracts traded on the HKFE;
- c) equity derivatives traded on the SEHK (e.g., DWs, CBBs and listed share options);
- d) synthetic ETFs and futures-based ETFs authorized by the SFC and traded on the SEHK;
- e) L&I products authorized by the SFC and traded on the SEHK; and
- f) Complex bonds – i.e. bonds with special features (including, but not limited to, perpetual or subordinated bonds, or those with variable or deferred interest payment terms, extendable maturity dates, or those which are convertible or exchangeable or have contingent write down or loss absorption features, or those with multiple credit support providers and structures) and/or bonds comprising one or more special features;
- g) Funds authorized by the SFC under the UT Code which are derivative funds;
- h) SFC authorized hedge funds (authorized by the SFC under 8.7 of the UT Code);
- i) SFC-authorized unlisted structured investment products (including SFC-authorized equity-linked deposits, equity-linked instruments/ investments, etc.);
- j) Other non-exchange-traded structured investment products; and any other investment product specified by the SFC from time to time.

Non-complex products are:

- a) shares traded on the SEHK;
- b) non-complex bonds (including callable bonds without other special features);
- c) non-derivative funds authorized by the SFC under the UT Code;

- d) SFC-authorized non-derivative ETFs traded on the SEHK;
- e) SFC-authorized REITs traded on the SEHK; and
- a) any other investment product the SFC may specify from time to time.

Suitability Requirement

The Guidelines require POs to ensure that any transaction in a complex product is suitable for the client in all the circumstances (paragraph 6.3 of the Guidelines). This obligation should be discharged to the standard applicable to paragraph 5.2 of the Code of Conduct and POs should refer to SFC guidance on the Suitability Requirement. The Suitability Requirement applies to complex products even where the materials posted online would not otherwise trigger the Suitability Requirement and no recommendation or advice is given or offered.

Minimum information and warning statements

Online platforms are required to provide sufficient information on the key nature, features and risks of complex products (paragraph 6.7 Guidelines).

Clear and prominent warning statements are also required (paragraph 6.8 of the Guidelines).

Exchange-traded derivatives

The requirements regarding suitability, provision of information and warning statements under paragraphs 6.3, 6.7 and 6.8 do not apply to derivative products traded on a Hong Kong or Specified Jurisdiction exchange for which there has been no solicitation or recommendation.

Exemptions for institutional and corporate professional investors

POs dealing with Institutional Professional Investors are automatically exempt from the requirements of paragraphs 6.3, 6.7 and 6.8 of the Guidelines.

POs dealing with Corporate Professional Investors will be exempt from the requirements of paragraphs 6.3, 6.7 and 6.8 of the Guidelines where they have followed the requirements and procedures set out in paragraphs 15.3A and 15.3B of the Code of Conduct.

Overseas products

It is a PO's responsibility to determine whether an overseas product to be sold on its platform is complex. A PO may treat an overseas product as non-complex or complex after carrying out the assessment proposed by the Guidelines with due skill, care and diligence. POs should consider whether the overseas product is of the same type as an investment product in the list and whether the overseas product is regulated in or traded on an exchange in a specified jurisdiction.

Further Consultation on offline complex products

The SFC is holding a further consultation, on whether the additional measures applicable to online sales of complex products (including ensuring suitability) should also be applied to offline sales of these products, e.g. where sales are concluded face-to-face or over the telephone.

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