



HONG KONG MONETARY AUTHORITY
香港金融管理局

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Deputy Chief Executive

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20 May 2010

The Chief Executive
All Authorized Institutions

Dear Sir / Madam,

Implementation of Pre-Investment Cooling-off Period for Retail Customers

I am writing in relation to a new investor protection measure that authorized institutions (AIs) are required to implement in the sales of non-listed derivative products to retail customers.

Over the years, derivative products marketed by AIs have become more popular. According to our understanding of AIs' selling practice of derivative products, AIs in general have adopted a practice of allowing retail customers with less sophistication in such products, including elderly customers and first-time buyers, more time to consider the appropriateness of their investment before placement of an order¹. The Hong Kong Monetary Authority (HKMA) supports such practice. After detailed discussions with the Hong Kong Association of Banks², consensus has been reached that the practice is to be enhanced and consistently adopted by all AIs through the introduction of a Pre-Investment Cooling-off Period (PICOP) to offer additional protection to certain groups of customers, such as elderly customers and first-time buyers with high concentration. The HKMA is of the view that PICOP will help reinforce AIs' procedures for giving sufficient time to customers to enable them to consider the appropriateness of the investment and consult third parties without the need to commit themselves during the PICOP.

Key features of PICOP

Under the PICOP arrangements, after an AI has ensured that a relevant product is suitable for an eligible customer and adequately disclosed material information

¹ For example, following the suitability assessment and detailed explanation of the nature and risks of the products to the customers, some AIs may advise the elderly customers or first-time buyers to take a couple of days to consider the appropriateness of the investment and to consult with their family members or friends before making the investment decision.

² Through the Retail Banking Taskforce on Sale of Investment Products and the Securities Working Group

(including the nature, risks, indicative price(s) and other terms) of the product to the customer, the AI should allow the customer at least 2 calendar days (of which the last day should be a business day)³ to understand the product, consider the appropriateness of the investment and, if necessary, consult with family members and friends. The price(s) and terms of the transaction will be fixed on the day when the customer gives instruction to the AI to confirm placement of a purchase / subscription order, i.e. upon the end of the PICOP. The AI must put in place an arrangement for the customer to give specific confirmation of order placement on the execution day, supported by proper audit trail. Under no circumstances should the AI allow the customer to confirm the order instruction before the execution day.

Application of PICOP

The scope and operational arrangements of the PICOP as well as the expected controls to be adopted by AIs are set out below. For details, please refer to the illustration diagram in Annex 1 and practical guidance on the application of PICOP in Annex 2.

Scope of products covered

All derivative products that are not listed on an exchange in Hong Kong will fall within the scope of PICOP.

Types of customers covered

PICOP should be applied to retail customers.

Applicability of PICOP to particular dealings with customers

In determining whether PICOP should be applied to a particular dealing with a retail customer, the AI should consider the customer's age, asset concentration and whether he/she is a first-time buyer of the same type of product⁴ as follows:

- For an elderly customer aged 65 or above, PICOP should be **mandatory except** that the customer will be allowed to opt out from the PICOP arrangement if (i) the customer's asset concentration is below 20% **and** (ii) he/she is not a first-time buyer of the type of product in question.

³ Taking T as the sales day, execution day should be a business day on T+2 at the earliest. For example, if an AI performs suitability assessment and product explanation (based on indicative terms) for a customer on a Wednesday (i.e. the sales day), the earliest execution day for this product would be that Friday (assuming it is a business day). However, if the sales day is a Friday, the earliest execution day would be the following Monday (assuming it is a business day) since Sunday is not a business day.

⁴ Product types include currency-linked, interest-rate linked, equity-linked, credit-linked, fund-linked and any other product types specified by the HKMA from time to time.

- For a non-elderly customer, PICOP is **not necessary except** that **mandatory** PICOP should be applied if (i) the customer's asset concentration is 20% or above **and** (ii) he/she is a first-time buyer of the type of product in question.

Controls to be adopted by AIs

AIs should put in place adequate control procedures and measures to ensure that the PICOP requirements in this circular are properly implemented and explained to relevant customers when PICOP becomes applicable. AIs should provide sufficient training to all relevant staff before the implementation of the PICOP arrangements and thereafter on an ongoing basis. Adequate records and supporting documents on the actual operations of PICOP should be maintained. In addition, regular reviews by an independent unit (e.g. the compliance function) on the compliance with the PICOP requirements should be performed.

Implementation date

Taking into account the preparatory work to be carried out by AIs, the HKMA expects that the PICOP arrangements should be implemented by all AIs no later than 1 January 2011.

If you have any questions on this letter, please feel free to contact Mr. Shu-Pui Li at 2878-1826 or Ms Alice Lee at 2878-1603.

Yours faithfully,

Encl.

c.c. SFC (Attn: Mr Stephen Po, Senior Director of Intermediaries Supervision)
Chairman, Hong Kong Association of Banks
Chairman, The Deposit-taking Companies Association