HONG KONG MONETARY AUTHORITY
香港金融管理局

Circulars

13 Jul 2009

Selling of Investment Products

Our Ref.: B1/15C

13 July 2009

The Chief Executive
All authorized institutions

Dear Sir/Madam,

Selling of Investment Products

In the current low interest rate environment, depositors are likely to have an increased interest in looking for enhanced return from investment products. This circular reminds authorized institutions (AIs) that they should exercise due care in marketing and selling investment products to customers.

Investment products regulated under the Securities and Futures Ordinance (SFO)

For sale of investment products that fall within the scope of regulated activities under the SFO, AIs are reminded again that they must have effective controls and procedures to ensure compliance with the requirements of the SFO, the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission and the questions and answers on suitability obligations dated 8 May 2007 issued by the Securities and Futures Commission (SFC), and all other relevant requirements of the SFC and the Hong Kong Monetary Authority (HKMA). These include the requirements set out in the HKMA circular of 25 March 2009 on the "Implementation of Recommendations in the HKMA Report on Issues Concerning the Distribution of Structured Products Connected to Lehman Brothers" (the HKMA circular).

Investment products not regulated by the SFO

Many AIs also distribute investment products which are not regulated by the SFO, such as currency and interest rate linked deposits and derivatives. Similar to SFO-regulated investment products, these products involve investment risks to the customers and are often not principal-protected. AIs selling these products must ensure the suitability of their recommendations and/or solicitation for the customers.

Apart from ensuring suitability, AIs should also clearly disclose, among other things, the following key facts and risks to the customers when marketing and selling investment products that are not regulated by the SFO:

- these products are NOT equivalent to time deposits and are NOT protected deposits under the Deposit Protection Scheme in Hong Kong
- where applicable, the fact that these products are not principal-protected

- explanation of the nature of these products and whether they include any embedded derivatives and/or leverage, and the key risks of the investment including any risk of substantial losses to their investments
- any disclosure of the maximum expected return of the investment must be accompanied by **equally** prominent and clear warning that the investor is subject to the risk of loss to his investment
- the "health warning" as set out in the HKMA circular, if they are structured products

AIs should conduct the above procedures inside the investment corner, and for audit trail purposes, must maintain adequate records to demonstrate that they have conducted appropriate suitability assessment and evidence that they have made the above disclosures, including audio recording as required in the HKMA circular.

For products that are relatively simple, such as non-leveraged foreign currency linked deposits of major currencies[1], non-leveraged interest rate linked deposits and non-leveraged gold linked deposits, the HKMA is prepared to allow some operational flexibility in complying with the risk disclosure requirements for roll-over and repeated transactions. For these products, AIs should conduct the suitability assessment and make a full disclosure of the key facts and risks as set out above inside the investment corner at the time of the first transaction of each type of products. For roll-over transactions and repeated transactions (within six months of the previous transaction) of the same product, AIs may provide the customer with leaflets or other written materials disclosing the key product facts and risks in lieu of orally repeating the full risk disclosure provided that the customer confirms that he/she continues to be fully aware of the risks of the product and the AI maintains proper records (such as audio recording) to evidence that this is the case. In cases where the roll-over transactions or repeated transactions are made by telephone instructions, RIs must ensure and maintain audio records to prove that the customers continue to understand the key risks of these transactions. For roll-over and repeated transactions occurring more than six months after the previous transaction, if the customer has represented to the AI that he/she understands the risks of these products and insisted to waive the full risk disclosure, the AI may upon the customer's request, waive the full disclosure of the risks but the AI should ensure that the customer's representation and request are properly audio recorded as evidence. AIs are reminded that this operational flexibility does not discharge them from the obligation of ensuring the suitability of the product to the customer in every transaction.

For marketing materials of all investment products that are not regulated by the SFO, the HKMA expects AIs to follow standards similar to those issued by the SFC on marketing materials, including the enhanced disclosure requirements as set out in the SFC's circular of 3 October 2008 to issuers of retail investment products and the SFC's letter of 5 December 2008 to issuers of SFC-authorised Collective Investment Schemes. In particular, marketing materials must be clear, fair and

present a balanced picture with adequate and prominent risk disclosure in compliance with all applicable regulations. Financial or other incentives (e.g. gifts) to invest in a product should not be used or presented in a way that is likely to divert or mislead investors' focus from the proper consideration of the product.

Investment products sold through private placement

Currently, product issuers may distribute investment products through the "private placement" channel only if the distribution meets the prescribed exemptions under the Companies Ordinance (CO)[2]. A prospectus is not required in respect of products sold through a private placement and the associated marketing materials are not required to be authorized by the SFC. These requirements are designed to ensure the provision of adequate information to investors and thereby offer them a measure of protection. Accordingly, AIs must be satisfied that the use of the private placement channel for distributing investment products is appropriate and justified. In particular, AIs must be careful when dealing with schemes involving recurrent series of substantially similar products with minimal changes in product features and ensure that these schemes fully meet the prescribed exemptions for private placement. Further, as the offering documents of investment products distributed through the private placement channel are not required to be authorized by the SFC, the HKMA will look to AIs that distribute these products to ensure that the offering documents contain full and clear disclosure of product nature and risks. To enhance investor protection, the HKMA and Hong Kong Association of Banks' Retail Banking Task Force have agreed that investment products sold through private placement should be distributed only to professional investors, or to retail investors with a minimum investment in the product of not less than HK$500,000.

If you have any questions on the above, please get in touch with your usual supervisory contact at the HKMA.

Yours faithfully,

Nelson Man
Executive Director
(Banking Supervision)

c.c. Chairman, Hong Kong Association of Banks
Chairman, The Deposit-taking Companies Association

[1] For the purpose of this circular letter, major currencies refer to US dollar, Euro, UK Pound Sterling, Australian dollar, New Zealand dollar, Canadian dollar, Swiss Franc, and Japanese Yen.

[2] The distribution must, amongst others, meet one of the following criteria in order to be qualified as private placements exempt from the issue of a prospectus under the Companies Ordinance
- to not more than 50 persons;
- with a minimum denomination of HK$500,000;
- with a maximum size of HK$5 million; or
- to professional investors

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