

## Appendix

### Frequently Asked Questions on Compliance with Suitability Obligations by Licensed or Registered Persons (FAQs on Compliance with Suitability Obligations)

#### Suitability assessment

##### To add a new Q5B

##### ***Q5B: How should licensed or registered persons devise their processes for performing suitability assessments for different clients?***

Licensed or registered persons could develop their own processes for performing suitability assessments for their clients. A suitability assessment is not a mechanical risk matching process. Rather, it is a dynamic process which may vary depending on the client's circumstances, the type of investment product (including its complexity and risks) and the services provided by the licensed or registered person. While the duty to ensure suitability remains the same (ie the licensed or registered person should ensure that the product is suitable for the client taking into account all the circumstances), licensed or registered persons may vary their processes and perform suitability assessments in a proportionate and risk-based manner. For example, as a wider range of investment products is more likely to be suitable for high net worth clients who also exhibit financial expertise (ie high levels of knowledge or experience) in relevant products and higher levels of risk tolerance, licensed or registered persons could vary the suitability assessment process for these clients so long as they can demonstrate the overall outcome is that recommendations provided to them are reasonably suitable.

The same principle can be adopted when licensed or registered persons assess the overall effect or impact of recommended investment products on their clients' investment portfolios, including concentration risk assessments. Licensed or registered persons could focus on the risk-level of the products and the clients' circumstances in assessing concentration risk. A concentration risk assessment should not be a mechanical calculation. Exceeding a particular concentration level may be acceptable so long as the outcome is commensurate with the overall risk profile of the investment portfolio and the client's other circumstances (eg, financial expertise, risk tolerance and financial situation).

#### Product explanation

##### To add a new Q6B

##### ***Q6B: How should licensed or registered persons discharge their obligations to explain the features and risks of investment products to clients who have different degrees of sophistication in terms of knowledge or experience?***

The purpose of explaining the features and risks of an investment product to a client is to help the client understand them properly. A client may not be able to understand a product if a licensed or registered person merely reads product literature to the client without any explanation. Licensed or registered persons may vary their processes and provide product explanations in a proportionate and risk-based manner having regard to the circumstances,



such as the client's financial markets sophistication and prior trading experience as well as product-specific complexity and risks.

If a client has no or little prior knowledge or experience of a particular type of investment product, the licensed or registered person must provide more assistance to ensure that the client understands the product. However, where appropriate, products explanations may be less intensive for clients who are financially sophisticated with demonstrable and relevant expertise in investing in the same products or products of the same category.

Instead of adopting a one-size-fits-all approach, licensed or registered persons could tailor their product explanation processes according to the client's degree of sophistication. It is acceptable for licensed or registered persons to explain the features and risks of investment products to clients in an interactive manner; this may be done using written, verbal or a combination of both types of communications.

#### *Repeat transactions*

Licensed or registered persons may vary their disclosure processes for repeat transactions having regard to the aforementioned circumstances and the adequacy and timing of their previous disclosures<sup>1</sup>.

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<sup>1</sup> Please refer to Question 38 of the Frequently Asked Questions on Guidelines on Online Distribution and Advisory Platforms and Paragraph 5.5 of the Code of Conduct.

## Frequently Asked Questions on Guidelines on Online Distribution and Advisory Platforms and Paragraph 5.5 of the Code of Conduct (Complex Products FAQs)

### Distribution of complex products on an unsolicited basis

#### To add a new Q39

**Q39: How may licensed or registered persons devise their processes for (a) performing product due diligence (PDD) and (b) disclosing product information and providing warning statements to different clients, for complying with paragraph 5.5 of the Code of Conduct?**

#### *Product due diligence*

If asked by a client to purchase a product which is not on the firm's approved product list, the licensed or registered person should perform due diligence based on all the information it obtains on a best effort basis, including product offering documents, documentation provided by the issuer and other information available in the public domain or from data providers.

Licensed or registered persons should identify the key features and risks of the product and they should:

- review the product offering document or information to determine whether it is a complex product<sup>2</sup>;
- if the product is a complex product, review the product information to identify its generic risks and specific risks arising from its special features; and
- identify any warning flags with reference to the information obtained.

While licensed or registered persons are not expected to form a “house” view of these complex products or perform on-going PDD for complex products only made available to clients on an unsolicited basis, they should develop their policies on when the PDD needs to be re-performed or updated if the clients subsequently request to purchase the same complex products.

#### *Disclosure of product information*

When distributing a complex product, a licensed or registered person is required to disclose product information and provide warning statements to sufficiently draw clients' attention to key features and risks. In this regard, a licensed or registered person can vary its processes and explain the product or make disclosures to the client in a proportionate and risk-based manner depending on the circumstances of each case (eg, the level of disclosure may be different if a client is very familiar with the product). Please refer to Q6B of the FAQs on Compliance with Suitability Obligations and Q38 of this set of FAQs for further guidance.

For example, when executing an unsolicited order for a complex product for a client who has the requisite level of knowledge or experience (eg, a client who is a licensed or registered person or an investment professional employed by a fund manager), the need to provide

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<sup>2</sup> In determining whether a fund is complex or non-complex product, please make reference to Q33 and Q34 of the Complex Products FAQs.



detailed product explanations or disclosures (including warning statements) could be reduced, in some cases, substantially when warranted by the circumstances. The licensed or registered person should maintain proper records of its assessment of sophistication in these circumstances.

Where licensed or registered persons prepare and provide their own summaries of products' key features and risks (eg, for bonds, in lieu of a product prospectus) they must ensure that all summaries are accurate and not misleading.