SECURITIES AND FUTURES COMMISSION
證券及期貨事務監察委員會

Circular

24 October 2023

Circular on distributors providing additional returns and other services or arrangements when marketing SFC-authorised funds

1. This circular summarises the Securities and Futures Commission's (**SFC**) recent observations of licensed corporations' practices in offering and promoting SFC-authorised funds. Intermediaries who distribute these funds (**distributors**) have been offering additional returns or other incentives that may divert the client's focus from properly considering the risks and features of the underlying funds. This circular also highlights the legal and regulatory requirements to be met by distributors.

Background

2. In some cases, distributors promoted SFC-authorised funds (often via online platforms) and offered or imposed additional or distinct features or restrictions (eg, "guaranteed returns" or "lock-up periods") beyond the product features set out in the funds' offering documents.

3. In other cases, distributors asked clients to provide a mandate or standing instruction to invest in one or more SFC-authorised funds under specific circumstances, eg, using idle money in a client's securities trading account with an aim to generate additional returns, albeit without any guaranteed or specific rates.

4. These SFC-authorised funds and services were often promoted by the distributors to the public through aggressive and high-profile marketing campaigns.

Guaranteed returns

*Section 103 of the Securities and Futures Ordinance (Cap. 571) (**SFO**)*

5. Typically, the "guaranteed returns" in such cases comprise: (i) the actual return of the relevant fund(s) invested by the investor (ie, fund return); and (ii) a top-up return to make up the difference between the fund return and the guaranteed rate of return offered by the distributor.

6. The SFC wishes to remind intermediaries who engage in promotional activities that these guaranteed return arrangements may constitute a "structured product" under the SFO if the return to investors is determined by reference to the change in value of any securities (including funds).

7. It is an offence under section 103 of the SFO for a person to issue an advertisement, invitation or document which is or contains an invitation to the Hong Kong public to enter into or offer to enter into any structured products, unless the SFC has authorised the issue or an exemption applies.

8. SFC-authorised funds without guaranteed features are required to highlight in their offering documents that they do not have these features and that investors may not get back the principal of their investment[1]. As such, any guaranteed returns provided by distributors may create a misleading impression that these returns are provided by the underlying fund(s).

Paragraph 3.11 of the Code of Conduct[2]

9. Even where the guaranteed returns offered would not constitute a "structured product" under the SFO, distributors are reminded to have regard to paragraph 3.11 of the Code of Conduct in offering such returns or other incentives in promoting SFC-authorised funds, as they may be considered a gift that should not be offered to investors.

10. Paragraph 3.11 of the Code of Conduct provides that distributors should not offer any gifts (other than a discount of fees or charges) in promoting a specific investment product or a particular type of investment product to a client. The purpose of the requirement is to avoid the use of gifts to distract investors from the features and risks of a particular product. If gifts are offered in such a way that they are linked to a particular type of investment product, such as certain types of funds or funds offered by certain fund houses, then such gifts will be bound by this requirement as investors may be distracted from the unique features and risks of such particular funds[3].

11. In light of the concerns set out from paragraphs 5 to 10 above, when offering or promoting funds, distributors should not offer additional returns (which are not part of the product features set out in the relevant offering documents) or other incentives to investors in breach of section 103 of the SFO or paragraph 3.11 of the Code of Conduct.

Lock-up period and dealing frequency

12. When distributing SFC-authorised funds, some distributors imposed a lock-up period on their clients' investments or lowered the funds' dealing frequency. For instance, clients' redemption was only allowed on a weekly or monthly basis even though the fund provided daily dealing arrangements.

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1 Pursuant to 6.4 of the Overarching Principles Section as set out in the *SFC Handbook for Unit Trusts and Mutual Funds, Investment-Linked Assurance Schemes and Unlisted Structured Investment Products*, offering documents of an SFC-authorised fund shall contain the information necessary for investors to be able to make an informed judgement of the investment whilst all key features and risks of the fund shall be highlighted prominently in a succinct manner for investors.

2 The Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (**Code of Conduct**).

3 The answer to question 1 of the frequently asked questions on the Code of Conduct issued by the SFC on 30 September 2010.

13. Distributors should act fairly and in the best interests of their clients in providing services in accordance with General Principle 1 (Honesty and fairness) of the Code of Conduct. They should not restrict a client's right to redeem his or her investment in a fund pursuant to the dealing frequency specified in the fund's offering documents. Such restrictions would limit the client's ability to make effective and timely investment decisions in response to changing market conditions or individual circumstances.

14. While distributors of SFC-authorised funds may have different fund dealing procedures or cut-off times for administrative efficiency, the SFC expects them to use their best endeavours to adhere to a fund's dealing frequency as stipulated in its offering documents when dealing in the fund for clients, and not to reduce the fund's dealing frequency.

Other marketing issues

15. In some cases, distributors offered or marketed the services described in paragraph 3 above without any guaranteed rates of return, but highlighted the regular interest payments or distribution features of the services prominently (eg, interest generated daily, or clients' potential financial return from using such services), which would in fact be derived from the actual return(s) of the underlying fund(s). In preparing invitations and advertisements to promote their services, intermediaries should ensure that they do not contain any misleading or deceptive information, and they must comply with paragraph 2.3 of the Code of Conduct.

16. Where a distributor highlights in an advertisement the financial return of its services, which is in fact derived from the actual return(s) of the underlying SFC-authorised fund(s), the advertisement, particularly the presentation of financial return relating to the services, should be prepared in a manner that is consistent with the principles under the SFC's Advertising Guidelines Applicable to Collective Investment Schemes Authorized under the Product Codes[4].

17. Specifically, the advertisements of these services should avoid giving a misleading impression that the relevant services or underlying fund(s) would generate positive or guaranteed returns without any risk of loss. In addition, the advertisements should not draw a parallel between the services and the placement of cash on deposits, imply they are deposit-like arrangements (including any comparisons between the financial returns of the services and bank deposit rates), or suggest that the services are, or are equivalent to, bank deposits or savings (eg, by emphasising the services can address investors' "savings needs").

18. The SFC will closely monitor market practices concerning the promotion of SFC-authorised funds and may take regulatory action and issue further guidance where appropriate.

Intermediaries Supervision Department
Intermediaries Division
Securities and Futures Commission

Investment Products Division
Securities and Futures Commission

[4] As supplemented by the frequently asked questions and other guidance issued by the SFC from time to time.