

3 June 2011

## **Circular to Licensed Corporations and Registered Institutions**

### **Frequently Asked Questions on Investor Characterization Requirement**

Further to its circulars dated 28 May 2010 and 30 September 2010, the Commission today updated and posted on its website a set of Frequently Asked Questions (FAQs) on new conduct requirements. The additional FAQs aim to help intermediaries implement the investor characterization requirement under paragraph 5.1A of the Code of Conduct<sup>1</sup>.

A copy of the additional FAQs is enclosed at Appendix for your information. The e-version of the FAQs is available for download on the SFC website at <http://www.sfc.hk> under the section "Intermediaries, Licensing & Investment Products – Intermediaries Supervision Related Matters – FAQs – Revised Code of Conduct". The FAQs will be updated from time to time and you are advised to check our website for new information.

Should you have any queries regarding the contents of this circular, please contact Ms Lorraine Chan on 2842-7751.

Intermediaries Supervision Department  
Securities and Futures Commission

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SFO/IS/013/2011

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<sup>1</sup> Code of Conduct for Persons Licensed by or Registered by with the SFC

**FREQUENTLY ASKED QUESTIONS**

	<b>Section reference</b>	<b>Question</b>	<b>Answer</b>	<b>Date of Posting</b>
<b>Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission</b>				
1.	5.1A	Is self declaration by a client that he/she has knowledge of derivatives acceptable?	In assessing whether a client has knowledge of derivatives, intermediaries should make appropriate enquiries of or gather relevant information about the client during the know your client (“KYC”) process so as to enable them to make the assessment instead of relying merely on the client’s declaration that he/she has knowledge of derivatives. A proper audit trail should also be maintained to demonstrate that they have made the assessment.	3.6.2011
2.	5.1A	What is the expected depth of the training programme on derivatives for an intermediary to consider whether a client has knowledge of derivatives?	The training programme should seek to provide clients with general knowledge of derivatives so as to assist them in understanding the nature and risks of derivative products.	3.6.2011
3.	5.1A	How to apply the investor characterization requirement to joint accounts?	When dealing with joint accounts, intermediaries should assess whether the individual(s) who places the order or operates the relevant joint account has knowledge of derivatives.	3.6.2011

	<b>Section reference</b>	<b>Question</b>	<b>Answer</b>	<b>Date of Posting</b>
4.	5.1A	How to apply investor characterization requirement to corporate accounts?	<p>When dealing with corporate customers, intermediaries may determine how to assess the level of knowledge of derivatives of the corporate customer by considering, among other things, the following factors:</p> <ul style="list-style-type: none"> <li>▪ Firm type, e.g. whether the firm is a substantial company with a dedicated investment function or is a small private company where the investment decision rests with the owner; and</li> <li>▪ Investment process and management structure of the firm, e.g. how an investment decision is made within the firm and whether it is properly organised to have a specialised function responsible for making investment decisions, and past investment experience of the firm.</li> </ul> <p>Hence, for example, where the corporate customer is a listed company, instead of assessing the individual staff responsible for the investment function, an intermediary may consider the firm's investment process and management structure, in particular, whether it has a specialised function responsible for making investment decisions on behalf of the company.</p>	3.6.2011

	<b>Section reference</b>	<b>Question</b>	<b>Answer</b>	<b>Date of Posting</b>
5.	5.1A	Prior trading experience in derivative products is one of the criteria for assessing if a client can be regarded as having knowledge of derivatives. Are intermediaries required to conduct an assessment on the prior trading experience (i.e. whether the client has executed five or more transactions in any derivative product within the past three years) on a continuous basis?	<p>Intermediaries are expected to assess a client's knowledge of derivatives and characterize the client based on such knowledge during the KYC process. Once a client is assessed to have knowledge of derivatives during the KYC process, the intermediary does not need to conduct the assessment continuously.</p> <p>Generally speaking, in assessing the prior trading experience of a client, the three year period is counted from the time when an assessment is conducted during the KYC process.</p>	3.6.2011