STATEMENT OF DISCIPLINARY ACTION

The disciplinary action

1. The Securities and Futures Commission (**SFC**) has publicly reprimanded and fined Saxo Capital Markets HK Limited (**SCMHK**)[1] HK$4,000,000 pursuant to section 194 of the Securities and Futures Ordinance (**SFO**).

2. Between 1 November 2018 and 25 November 2022 (**Relevant Period**), SCMHK distributed virtual asset (**VA**) funds not authorised by the SFC and VA-related products (collectively, **VA Products**) to clients on its online trading platform (**Online Platform**), without complying with applicable requirements under the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (**Code of Conduct**) and the Guidelines on Online Distribution and Advisory Platforms (**Guidelines**). SCMHK also failed to observe the guidance set out in:

   (a) a circular to intermediaries entitled "*Distribution of virtual asset funds*" issued by the SFC on 1 November 2018 (**2018 Circular**); and

   (b) the "*Joint circular on intermediaries' virtual asset-related activities*" jointly issued by the Hong Kong Monetary Authority (**HKMA**) and the SFC on 28 January 2022 (**2022 Circular**).

3. Specifically, SCMHK allowed retail clients (i.e. individuals who did not qualify as professional investors (**PIs**)) to trade certain VA Products which should only be offered to PIs on the Online Platform without assessing whether clients had knowledge of investing in VA Products, providing clients with sufficient information and warning statements specific to VAs, and conducting adequate product due diligence.

4. The SFC found that SCMHK failed to implement adequate and effective policies and controls to:

   (a) effectively manage and adequately supervise the operation of the Online Platform to ensure that it meets the relevant regulatory requirements and expected standards and practices in distributing VA Products;

   (b) with respect to VA Products which were complex products, ensure that:

      (i) transactions in such VA Products effected via the Online Platform were suitable for the clients in all the circumstances; and

[1] SCMHK is licensed to carry on Type 1 (dealing in securities), Type 2 (dealing in futures contracts), Type 3 (leveraged foreign exchange trading), Type 4 (advising on securities) and Type 9 (asset management) regulated activities under the SFO. SCMHK has ceased carrying on regulated activities since 28 February 2025.

(ii) sufficient information on such VA Products and appropriate warning statements were provided on the Online Platform to enable clients to understand the nature and risks of such VA Products; and

(c) with respect to VA Products which were derivative products, properly assess clients' knowledge of derivatives and characterize them based on such knowledge.

5. The relevant regulatory standards are set out in the Appendix.

Summary of facts

A. Background

6. On 25 November 2022, SCMHK submitted a self-report pursuant to paragraph 12.5 of the Code of Conduct, notifying the SFC of its discovery of a potential breach of the 2022 Circular by unintentionally making it possible for clients to invest in VA Products on the Online Platform without conducting any VA-knowledge test due to a coding error.

7. Following the self-report, the SFC conducted an investigation into the conduct of SCMHK in relation to its distribution of VA Products on the Online Platform during the Relevant Period.

B. The 2018 Circular and the 2022 Circular

8. The 2018 Circular provides guidance on the expected standards and practices in relation to the distribution of VA funds. It states that intermediaries which distribute unauthorised VA funds[2] should, among other things:

(a) only target clients who are PIs;

(b) assess whether clients (except for institutional PIs) have knowledge of investing in VAs or related products prior to effecting transactions on their behalf;

(c) conduct proper due diligence on the VA Funds as well as their fund managers and the parties which provide trading and custodian services to the VA Funds; and

(d) provide clear and easily comprehensible information in relation to the fund and the underlying VA investments, as well as prominent warning statements covering various VA-specific risk factors.

9. The 2022 Circular, which superseded the 2018 Circular and took effect on 28 July 2022[3], provides guidance on investor protection measures applicable to the

[2] This refers to VA funds which: (a) are not authorised by the SFC under section 104 of the SFO; and (b) have a stated investment objective to invest in VAs or intend to invest or have invested more than 10% of their gross asset value in VAs directly or indirectly (**VA Funds**).

[3] The 2022 Circular was superseded and updated by the "*Joint circular on intermediaries' virtual asset-related activities*" jointly issued by the HKMA and the SFC on 20 October 2023, which was in turn superseded and updated by another joint circular of the same title issued by the HKMA and the SFC on 22 December 2023.

distribution of VA-related products[4]. It states that intermediaries should, among other things:

(a) offer VA-related products which are considered complex products to PIs only[5];

(b) assess whether clients (except for institutional PIs and qualified corporate PIs) have knowledge of investing in VAs or VA-related products prior to effecting a transaction in VA-related products on their behalf;

(c) conduct proper due diligence on the VA-related products, which would include understanding their risks and features, the targeted investors and the products' regulatory status;

(d) provide information to clients in relation to VA-related products and the underlying VA investments in a clear and easily comprehensible manner; and

(e) provide to clients warning statements specific to VAs.

C. SCMHK's non-compliance with the 2018 Circular and the 2022 Circular

C1. Distribution of VA Products to retail clients

10. The SFC's investigation revealed that, during the Relevant Period, SCMHK executed 1,446 transactions involving 32 VA Products (**32 VA Products**) for 136 clients, comprising 6 individual PIs and 130 retail clients. In particular:

(a) between 1 November 2018 and 27 July 2022 (when the 2018 Circular was effective), SCMHK effected 417 transactions in 9 VA Funds on behalf of 63 retail clients; and

(b) between 28 July 2022 and 25 November 2022 (when the 2022 Circular was effective), SCMHK effected 37 transactions in 3 complex VA Products (which are not exempted from the restrictions under the 2022 Circular) on behalf of 4 retail clients.

11. SCMHK relied on certain protocols established on a group-wise basis by its parent company, Saxo Bank A/S (**Saxo Bank**), on the Online Platform to identify instruments with VA exposure (**Protocols**). Due to deficiencies in the Protocols (see section D1 below), the 32 VA Products were unintentionally made available to SCMHK's clients, regardless of whether they were PIs, on the Online Platform during the Relevant Period.

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[4] This refers to investment products which: (a) have a principal investment objective or strategy to invest in virtual assets; (b) derive their value principally from the value and characteristics of virtual assets; or (c) track or replicate the investment results or returns which closely match or correspond to virtual assets.

[5] A limited suite of VA-related products is exempted from the selling restrictions, including VA-related derivative products traded on regulated exchanges specified by the SFC. Intermediaries can distribute these products without ensuring suitability if there is no solicitation or recommendation; however, paragraphs 5.1A and 5.3 of the Code of Conduct which relate to derivative products must still be complied with. See the Appendix for details.

12. Upon discovery of the matter, SCMHK implemented remedial measures, including blocking all clients from trading VA Products on the Online Platform as well as enhancing the Protocols. SCMHK also voluntarily reimbursed the impacted clients for the commissions, fees, interest and losses incurred from trading VA Products.

C2. Lack of VA-knowledge test and VA-specific warning statements

13. During the Relevant Period, SCMHK did not put in place any VA-knowledge test to assess whether clients had knowledge of investing in VAs or VA-related products prior to effecting transactions in the 32 VA Products on behalf of the clients. SCMHK explained that this was because:

    (a) the 32 VA Products were made available to retail clients on the Online Platform unintentionally; and

    (b) it inadvertently misunderstood that all PIs were exempted from the VA-knowledge test.

14. SCMHK also did not provide to clients warning statements specific to VAs during the Relevant Period. Although SCMHK did issue warning statements for complex products and derivative products, such warning statements neither made reference to the VA exposure of the investment products, nor adequately addressed the risks factors associated with VA Products.

C3. Inadequate product due diligence and information on VA Products

15. During the Relevant Period, SCMHK did not have in place any specific procedures for conducting product due diligence on VA Products.

16. SCMHK represented that product due diligence was conducted by Saxo Bank and its affiliates (**Saxo Group**) from a group perspective, which included verifying supporting materials such as the products' key information documents or key fact sheets. However, the SFC found that:

    (a) despite the due diligence allegedly performed by Saxo Group, SCMHK failed to identify the VA exposure associated with the 32 VA Products;

    (b) out of the 32 VA Products, the key information documents or key fact sheets of 11 VA Products[6] were not made available on the Online Platform. SCMHK explained that this was because the relevant key information documents or key fact sheets were not provided to Saxo Group by the vendors; and

    (c) with respect to VA Funds, Saxo Group's due diligence did not cover the fund managers of and the parties which provide trading and custodian services to the VA Funds.

D. The SFC's findings

[6] Including 9 Non-derivative VA Products (as defined in paragraph 22) and 2 Exchange-traded derivative VA Products (as defined in paragraph 27).

D1. Inadequate management and supervision of the Online Platform

17. The Protocols which SCMHK relied on to identify VA Products were maintained by Saxo Bank and embedded into the Online Platform's internal back-end system. The SFC's investigation revealed that:

    (a) before the end of 2020, the group-level due diligence conducted by Saxo Group did not include assessing whether the instrument was a VA Product;

    (b) around early 2021, Saxo Bank's analysts began manually identifying instruments with VA exposure and flagging them as such; and

    (c) in early 2022, an automatic screening tool designed at the Saxo Group level was implemented to enhance the Protocols.

18. The 32 VA Products were not identified as VA-related due to a number of deficiencies in the Protocols, including:

    (a) the lack of a clearly defined set of criteria which allowed Saxo Bank's analysts to identify in a consistent way if an instrument was VA-related;

    (b) issues with the logic of the automatic screening tool; and

    (c) under-scoping of testing before the screening tool was implemented.

19. SCMHK did not request local customisation of the Protocols and was unaware of how the Protocols screened the underlying assets for VA elements. It failed to consider whether there were any gaps between the Protocols and the guidance set out in the 2018 Circular and the 2022 Circular. Further, SCMHK was not involved in the configuration, testing and maintenance of the screening tool. Nor did it review the list of available instruments on the Online Platform as part of its local product governance exercise.

20. As a result, the 32 VA Products were made available and distributed to clients, regardless of whether they were PIs, on the Online Platform during the Relevant Period. SCMHK did not realise this until it was notified in November 2022 via Saxo Bank following an enquiry from its London office.

21. The SFC found that, during the Relevant Period, SCMHK failed to:

    (a) exercise due skill, care and diligence in identifying instruments on the Online Platform with VA exposure;

    (b) employ effectively the resources and procedures needed for the proper performance of its business activities;

    (c) comply with all regulatory requirements applicable to the distribution of VA Products;

    (d) effectively manage and adequately supervise the design, development, deployment and operation of the Online Platform;

(e) conduct regular reviews to ensure that its internal policies and procedures on the operation of the Online Platform were in line with regulatory developments, and promptly remedy any deficiencies identified; and

(f) assign adequately qualified staff, expertise, technology and financial resources to the design, development, deployment and operation of the Online Platform,

in breach of General Principle (**GP**) 2, GP 3, GP 7 and paragraph 18.4 of, as well as paragraphs 1.1.3 and 1.1.4 of Schedule 7 to, the Code of Conduct.

D2. Failure to ensure suitability of and provide sufficient information on complex products

22. The 32 VA Products distributed by SCMHK on the Online Platform during the Relevant Period were all complex products, including 11 products that were not derivative products (**Non-derivative VA Products**). 62 retail clients and 2 PIs conducted a total of 467 transactions in the Non-derivative VA Products during the period from 6 July 2019 to 25 November 2022.

23. Since paragraph 5.5 of the Code of Conduct came into effect on 6 July 2019[7], SCMHK's clients were required to complete an online suitability test (**Suitability Test**) before they were allowed to trade in complex products on the Online Platform. Based on his/her answers, a client would be categorised into one of four risk profiles, namely "Conservative", "Balanced", "Aggressive" or "Speculative".

24. SCMHK placed limits on the complex products that could be traded by a client based on the risk profile assigned to the client. Clients with the "Conservative" risk profile were blocked from trading any complex products, whereas clients with the "Balanced", "Aggressive", or "Speculative" risk profiles could trade complex products at different concentrations on the Online Platform. Clients would also receive different warning statements based on their risk profiles when they attempted to trade complex products.

25. However, as mentioned in section C above:

(a) SCMHK did not realize that complex products with VA exposure were made available on the Online Platform;

(b) the Suitability Test did not include any questions to assess whether clients had knowledge of investing in VAs or VA-related products;

(c) the warning statements provided to clients neither made reference to the VA exposure of the complex products, nor adequately addressed the risks factors associated with VA Products; and

[7] Paragraph 5.5(a) of the Code of Conduct provides that, subject to paragraph 5.5(b), licensed persons should ensure complex product transactions are suitable for clients, provide sufficient information and clear warnings. Paragraph 5.5(b) exempts licensed persons from complying with paragraph 5.5(a) with respect to certain exchange-traded derivatives if there is no solicitation or recommendation; however, paragraphs 5.1A and 5.3 of the Code of Conduct which relate to derivative products must still be complied with. See the Appendix for details.

(d) SCMHK did not conduct adequate product due diligence and provide sufficient information in relation to 9 VA Products which were not derivative products.

26. The SFC also found that, with respect to the Non-derivative VA Products, SCMHK has failed to exercise due skill, care and diligence to ensure that:

(a) the transactions in such products, which were complex products, were suitable for the clients;

(b) sufficient information on the key nature, features and risks of such complex products was provided so as to enable clients to understand them before making investment decisions; and

(c) appropriate warning statements in relation to such complex products were provided to clients,

in breach of GP 2 and paragraph 5.5(a) of the Code of Conduct and paragraphs 6.3, 6.7 and 6.8 of the Guidelines[8].

D3. Failure to assess clients' knowledge of derivatives

27. Among the 32 VA Products, 21 were complex exchange-traded derivative products (**Exchange-traded derivative VA Products**)[9]. 82 retail clients and 5 PIs conducted a total of 979 transactions in the Exchange-traded derivative VA Products on the Online Platform during the Relevant Period.

28. SCMHK claimed that it relied on its risk profile questionnaire (**RPQ**) to assess clients' knowledge of derivatives.

29. During the onboarding process, SCMHK required each client to complete the RPQ, which gathered information about the client's education background, financial position, risk appetite and investment objective, knowledge and experience. Clients were categorised into one of five risk tolerance levels[10] based on the aggregate scores of their answers. The risk tolerance level from the RPQ was used by SCMHK to set the margin ceiling limit[11] for each client account.

30. In filling out the RPQ, a client was required to (among other things) select one of the following options in relation to a number of financial instruments which included a few types of derivative products:

(a) "*no knowledge and no trading experience*";

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[8] Similar to paragraph 5.5 of the Code of Conduct, the Guidelines came into effect on 6 July 2019.

[9] The Exchange-traded derivative VA Products fell within the exemption in paragraph 5.5(b) of the Code of Conduct. See footnote 7 above.

[10] Namely, "*Secured*", "*Conservative*", "*Balanced*", "*Aggressive*" or "*Speculative*".

[11] This refers to a predetermined limit on the margin collateral that could be used for margin trading by each client. A client's risk tolerance level determined by the RPQ was not factored into SCMHK's assessment of whether complex products would be suitable for the client.

(b) "*some knowledge but no trading experience*";

(c) "*knowledge and less than 3 years trading experience*"; or

(d) "*knowledge and more than 3 years trading experience*".

31. Apart from that, the RPQ did not contain any other questions about the client's knowledge and experience in trading derivative products, such as the number of transactions that the client conducted in the past three years.

32. The SFC found that SCMHK did not make adequate enquiries or gather sufficient information which would enable it to properly assess whether a client had knowledge of derivatives instead of relying merely on the client's self-declaration. Furthermore, while SCMHK categorized clients into five different risk tolerant levels based on their answers to the RPQ, it did not characterize clients based on their knowledge of derivatives.

33. SCMHK's failure to properly assess clients' knowledge of derivatives and characterize clients based on such knowledge, coupled with its failures to conduct VA-knowledge test, provide VA-specific warning statements, conduct adequate product due diligence and provide sufficient information on VA Products, suggests that SCMHK also failed to exercise due skill, care and diligence in assuring itself that clients understood the nature and risks of the Exchange-traded derivative VA Products, before executing transactions in such derivative products on behalf of the clients.

34. The SFC found that, with respect to Exchange-traded derivative VA Products, SCMHK has breached GP 2 and paragraphs 5.1A(a), 5.3 and 5.5(b) of the Code of Conduct.

Conclusion

35. In the circumstances, the SFC is of the opinion that SCMHK is guilty of misconduct.

36. In arriving at the disciplinary sanctions set out at paragraph 1, the SFC has had regard to its Disciplinary Fining Guidelines and taken into account all relevant considerations, including the following:

(a) SCMHK's failures persisted for over four years;

(b) SCMHK self-reported its misconduct to the SFC;

(c) SCMHK has taken remedial actions including voluntarily compensating clients for losses incurred from trading VA Products during the Relevant Period;

(d) SCMHK has ceased carrying on regulated activities;

(e) SCMHK's cooperation with the SFC and acceptance of the SFC's findings and disciplinary action facilitated an early resolution of the matter; and

(f) SCMHK has no previous disciplinary record.

Appendix

Relevant Regulatory Standards

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

1. GP 2 (Diligence) of the Code of Conduct requires a licensed person to act with due skill, care and diligence, in the best interests of its clients and the integrity of the market in conducting its business activities.

2. GP 3 (Capabilities) of the Code of Conduct requires a licensed person to employ effectively the resources and procedures which are needed for the proper performance of its business activities.

3. GP 7 (Compliance) of the Code of Conduct requires a licensed person to comply with all regulatory requirements applicable to the conduct of its business activities so as to promote the best interests of clients and the integrity of the market.

4. Paragraph 5.1A(a) (Know your client: investor characterization) of the Code of Conduct provides that a licensed person should, as part of the know-your-client procedures, assess the client's knowledge of derivatives and characterize the client based on his knowledge of derivatives.

5. Paragraph 5.3 (Know your client: derivative products) of the Code of Conduct requires a licensed person providing services to a client in derivative products to assure itself that the client understands the nature and risks of the products and has sufficient net worth to be able to assume the risks and bear the potential losses of trading in the products.

6. Paragraph 5.5 (Know your client: complex products)[12] of the Code of Conduct provides that:

   (a) Subject to paragraph 5.5(b), a licensed person providing services to a client in complex products should ensure that:

      (i) a transaction in a complex product is suitable for the client in all the circumstances;

      (ii) sufficient information on the key nature, features and risks of a complex product is provided so as to enable the client to understand the complex product before making an investment decision; and

      (iii) warning statements in relation to the distribution of a complex product are provided to the client in a clear and prominent manner.

   (b) For complex products that are derivative products traded on an exchange in Hong Kong or in a specified jurisdiction, where there has been no solicitation or recommendation, a licensed person is not required to comply with paragraph 5.5(a) but must still comply with paragraphs 5.1A

[12] This paragraph came into effect on 6 July 2019.

and 5.3. For derivative products traded on an exchange which is not in a specified jurisdiction, a licensed person should comply with paragraph 5.5(a) unless such product could reasonably be treated on the same basis as derivative products traded on an exchange in Hong Kong or in a specified jurisdiction.

7. Paragraph 18.4 (Management and supervision) of the Code of Conduct requires a licensed person to effectively manage and adequately supervise the design, development, deployment and operation of the electronic trading system it uses or provides to clients for use.

8. Paragraph 1.1.3 of Schedule 7 to the Code of Conduct requires a licensed person to conduct regular reviews to ensure that its internal policies and procedures on the operation of its electronic trading system are in line with changing market conditions and regulatory developments and promptly remedy any deficiencies identified.

9. Paragraph 1.1.4 of Schedule 7 to the Code of Conduct requires a licensed person to assign adequately qualified staff, expertise, technology and financial resources to the design, development, deployment and operation of its electronic trading system.

Guidelines on Online Distribution and Advisory Platforms (Guidelines)

10. Subject to paragraphs 6.5[13], 6.6[14] and 6.9 to 6.11[15]:

    (a) Paragraph 6.3 of the Guidelines specifies that an online distribution platform for investment products operated by licensed persons should ensure that a transaction in a complex product is suitable for the client in all the circumstances.

    (b) Paragraph 6.7 of the Guidelines requires licensed persons to ensure that their online distribution platforms provide sufficient information on the key nature, features and risks of a complex products to enable clients to understand the complex product before making an investment decision.

    (c) Paragraph 6.8 of the Guidelines provides that licensed persons should ensure that there are prominent and clear warning statement(s) on their online distribution platforms, where appropriate, to warn clients about a complex product prior to and reasonably proximate to the point of sale or advice.

Circular entitled "*Distribution of virtual asset funds*" issued by the SFC on 1 November 2018 (2018 Circular)

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[13] Paragraph 6.5 of the Guidelines provides exemptions applicable to complex products which are also derivative products traded on an exchange in Hong Kong or in a specified jurisdiction.

[14] Paragraph 6.6 of the Guidelines provides that licensed persons operating online distribution platforms for investment products should comply with paragraph 5.1A of the Code of Conduct.

[15] Paragraphs 6.9 to 6.10 of the Guidelines contain exemptions applicable to institutional professional investors (**PIs**) and corporate PIs, whereas paragraph 6.11 states that no exemption is available when dealing with individual PIs.

11. The 2018 Circular reminds intermediaries engaged in distributing VA funds regarding existing regulatory requirements and provides guidance on expected standards and practices in relation to the distribution of VA funds.

12. The 2018 Circular states that intermediaries should observe the following requirements if they distribute VA funds which are not authorised by the SFC and which have a stated investment objective to invest in VAs or intend to invest or have invested more than 10% of their gross asset value in VAs directly or indirectly:

(A) Selling restrictions and concentration assessments

(a) Intermediaries should only target clients who are PIs as defined under the SFO.

(b) Except for institutional PIs, intermediaries should assess whether clients have knowledge of investing in VAs or related products prior to effecting the transaction on their behalf. If the clients do not possess such knowledge, intermediaries may only proceed to effect the transaction if, by so doing, they would be acting in the best interests of the clients.

(B) Due diligence on virtual asset funds not authorised by the SFC

(c) Intermediaries distributing VA Funds should conduct proper due diligence on VA Funds as well as their fund managers and the parties which provide trading and custodian services to the funds. This should include scrutinising the fund's constitutive documents and due diligence questionnaire, as well as making enquiries with the fund manager, in order to develop an in-depth understanding of the fund manager, the fund, and counterparties of the fund.

(C) Information for clients

(d) Intermediaries should help clients make informed investment decisions by providing information in relation to the fund as well as the underlying VA investments in a clear and easily comprehensible manner.

(e) Intermediaries should also provide prominent warning statements covering, among others:

(i) continuing evolution of VAs and how this may be affected by global regulatory developments;

(ii) price volatility;

(iii) potential price manipulation on exchanges or trading platforms;

(iv) lack of secondary markets for certain VA;

(v) most exchanges, trading platforms and custodians of VA are presently unregulated;

(vi) counterparty risk when effecting transactions with issuers, private buyers/sellers or through exchanges or trading platforms;

(vii) risk of loss of VA, especially if held in hot wallets; and

(viii) cybersecurity and technology-related risks.

Circular entitled "*Joint circular on intermediaries' virtual asset-related activities*" jointly issued by the HKMA and SFC on 28 January 2022 (2022 Circular)

13. The 2022 Circular provides further guidance and additional investor protection measures regarding the distribution of VA-related products[16].

14. For VA-related products that are complex products, and that do not meet the criteria for complex exchange-traded derivatives (see paragraph 15 below), paragraphs 5 and 7 of the 2022 Circular provides that:

    (a) intermediaries distributing such products should comply with suitability requirements in paragraph 5.5 of the Code of Conduct and Chapter 6 of the Guidelines, irrespective of whether or not there has been a solicitation or recommendation;

    (b) such products should only be offered to PIs; and

    (c) except for institutional PIs and qualified corporate PIs, intermediaries should assess whether clients have knowledge of investing in VAs or VA-related products prior to effecting a transaction in VA-related products on their behalf. If a client does not possess such knowledge, the intermediary may only proceed if, by doing so, it would be acting in the client's best interests and it has provided training to the client on the nature and risks of VA.

15. Paragraph 8 of the 2022 Circular states that the "*PIs only*" restriction is not imposed for the distribution of a limited suite of VA-related derivative products that are traded on regulated exchanges specified by the SFC, and in the case of exchange-traded VA derivative funds, are authorised or approved for offering to retail investors by the respective regulator in a designated jurisdiction. For these products, where there has been no solicitation or recommendation, intermediaries can distribute them without the need to comply with the suitability requirement, but must comply with the existing requirements for derivative products in paragraphs 5.1A and 5.3 of the Code of Conduct. Intermediaries must also conduct a VA-knowledge test as an additional safeguard.

16. Appendix 3 to the 2022 Circular provides a flowchart illustrating the factors for determining whether or not a VA-related product is a complex product, which is also extracted at the end of this Appendix.

17. Paragraph 11 of the 2022 Circular provides that intermediaries should observe the suitability obligations as supplemented by the Suitability FAQs, including:

[16] This refers to investment products which: (a) have a principal investment objective or strategy to invest in VA; (b) derive their value principally from the value and characteristics of VA; or (c) track or replicate the investment results or returns which closely match or correspond to VA.

(a) where the VA-related product is a derivative product, ensuring compliance with paragraphs 5.1A and 5.3 of the Code of Conduct; and

(b) conducting proper due diligence by understanding their risks and features (in particular the inherent high-risk nature of the underlying VAs), the targeted investors (including selling restrictions) and the products' regulatory status.

18. Paragraph 12 of the 2022 Circular states that, as part of its obligation under paragraph 5.3 of the Code of Conduct, an intermediary assessing whether to provide a client with services for VA-related derivative products should assure itself that the client understands the nature and risks of these products. Intermediaries should also provide clients with warning statements specific to VA futures contracts.

19. Paragraphs 14 and 15 of the 2022 Circular provides that intermediaries should provide to clients information in relation to VA-related products and the underlying VA investments in a clear and easily comprehensive manner, as well as warning statements specific to VAs.

Other guidance

20. The SFC issued a set of Frequently Asked Questions (**FAQs**) on Investor Characterization Requirement on 3 June 2011, which states that (among others):

"*Q1. Is self declaration by a client that he/she has knowledge of derivatives acceptable?*

A: 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."

21. The SFC issued a set of FAQs on Compliance with Suitability Obligations by Licensed or Registered Persons on 23 December 2016, which states that (among others):

"*Q4: How should licensed or registered persons conduct due diligence on investment products?*

A: … When conducting product due diligence, apart from understanding the nature and extent of risks of the investment products, licensed or registered persons may need to consider market and industry risks, economic and political environments, regulatory restrictions and any other factors which may directly or indirectly impact on risk return profiles and growth prospects of investments depending on the nature of the investment products.

Licensed or registered persons should conduct their own product due diligence and arrive at their own assessment of the products by taking into account all relevant information that is appropriate and reasonably available for a fair and balanced assessment…"

22. The SFC issued a circular entitled "*Guidance to Licensed Corporations and Registered Institutions in relation to Investor Characterization and Professional Investors Requirements*" on 28 May 2010, which states the following regarding compliance with paragraph 5.1A of the Code of Conduct: *"6. A client will be considered as having knowledge of derivatives if he has executed five or more transactions in any derivative product (whether traded on an exchange or not), within the past three years*."

23. The SFC published on its website[17] a non-exhaustive list of examples of the minimum information on a complex product that should be provided in an easily comprehensible manner for the purpose of complying with paragraph 6.7 of the Guidelines as well as paragraph 5.5 of the Code of Conduct:

    (a) product nature;

    (b) key terms and features of the complex product;

    (c) whether the complex product is available to professional investors only;

    (d) key risks of the complex product;

    (e) worst case scenario analysis for structured products;

    (f) whether potential gain may be capped or limited;

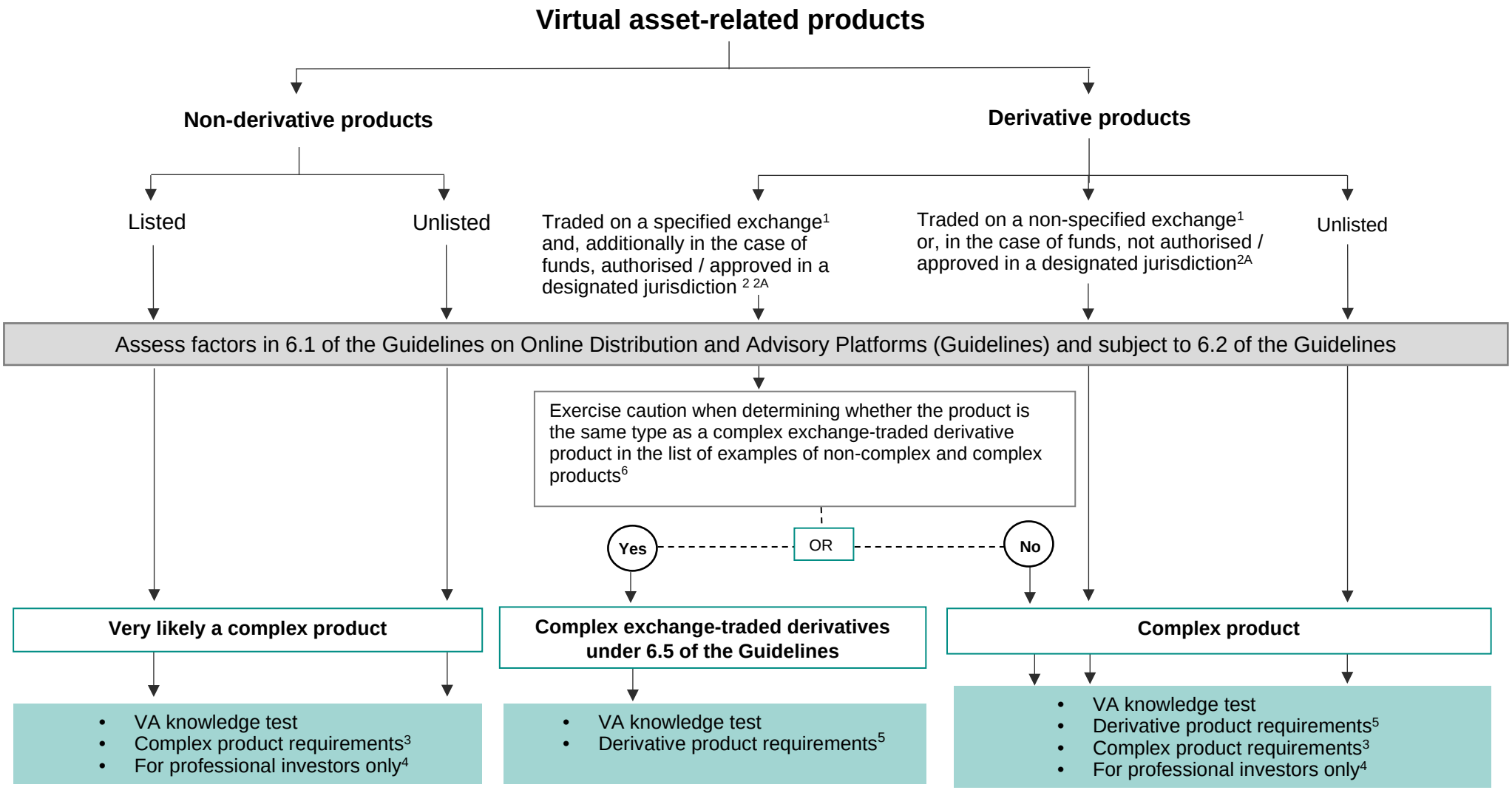
    (g) whether the complex product is principal protected or not;

    (h) whether there is an early termination feature;

    (i) any penalty for early exit; and

    (j) whether a secondary market is available for the complex product.

17 https://www.sfc.hk/en/Rules-and-standards/Suitability-requirement/Non-complex-and-complex-products/Minimum-information-to-be-provided-and-warning-statements



[1] "Specified exchange" refers to the list of specified exchanges in Schedule 3 to the Securities and Futures (Financial Resources) Rules.
[2] This refers to exchange-traded VA derivative funds traded on specified exchanges and authorised or approved in a designated jurisdiction for offering to retail investors by the respective regulator.
[2A] "Designated jurisdictions" are Australia; France; Germany; Ireland; Luxembourg; Malaysia; the Netherlands; Switzerland; Taiwan, China; Thailand; the UK and the US.
[3] This includes ensuring suitability, minimum information and warning statements.
[4] In addition to existing selling restrictions, only professional investors will be allowed to invest in the product if it is classified as complex.
[5] This refers to paragraphs 5.1A (knowledge assessment) and 5.3 (eg, ensure sufficient net worth) of the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission.
[6] The non-exhaustive list of examples of non-complex and complex products can be accessed at https://www.sfc.hk/en/Rules-and-standards/Suitability-requirement/Non-complex-and-complex-products.

* This flowchart is for illustration purposes only. Please refer to the Joint Circular on intermediaries' virtual asset-related activities issued by the SFC and the HKMA on 28 Jan 2022 regarding the specific requirements for determining whether or not a virtual asset-related product is a complex product.