Submission to the SFC Consultation Paper on the Proposed Amendments to the Professional Investor Regime and the Client Agreement Requirements

Josephine Chung
Director, CompliancePlus Consulting Limited

Tom Ng, Research Assistant
3 July 2013

For enquiries on this submission, please contact Josephine Chung at jchung@complianceplus.hk. CompliancePlus Consulting Limited understands and agrees that our name and/or submission may be published by the SFC.

Introduction

We are writing in response to the Consultation Paper on the Proposed Amendments to the Professional Investor Regime and the Client Agreement Requirements ("the Consultation Paper").

Question 1: Should Corporate and Individual Professional Investors continue to be allowed to participate in private placement activities?

Under the current Securities and Futures Ordinance (Cap. 571) ("SFO"), private placement targeting professional investors can be done without the authorization by the SFC.

This is based on section 103(3)(k) of the SFO, which provides that:

> Subsection (1) does not apply to the issue, or the possession for the purposes of issue-
>
> …
>
> (k) of any advertisement, invitation or document made in respect of securities or structured products, or interests in any collective investment scheme, that are or are intended to be disposed of only to professional investors.

We are of the view that no change should be made in this regard. This is in line with the SFC policy, consistently applied in the past decade. In the 2009 Consultation Paper on Possible Reforms to the Prospectus Regime in the Companies Ordinance and the Offers of Investments Regime in the Securities and Futures Ordinance, the SFC proposed to reform the offer of investment regime. In relation to structured products, the SFC agreed that the offering regime would be subject to the relevant exemptions under Part IV of the SFO, including the offers to professional investors exemption.[1] This approach was adopted in the 2010 Consultation Conclusions.[2] This

---

[1]SFC's Consultation Paper on Possible Reforms to the Prospectus Regime in the Companies Ordinance and the Offers of Investments Regime in the Securities and Futures Ordinance (Oct 2009), [9].

[2]SFC's Consultation Conclusions on Possible Reforms to the Prospectus Regime in the

demonstrates that the private placement regime has the support of the market and the general public.

Therefore, it will be strange if all of the sudden we abolish or modify the private placement regime. In particular, funds targeting professional investors (such as hedge funds) have been operating without authorization for many years. Any change to the regime will lead to drastic repercussion.

We would also like to stress that funds targeting professional investors cannot offer their products to the public. To do so the funds must generally obtain authorization from the SFC. Thus, there is already a trade-off mechanism in the SFO regime.

In particular, hedge funds are the major market players relying on private placement. Under the SFC Handbook for Unit Trusts and Mutual Funds, Investment-Linked Assurance Schemes and Unlisted Structured Investment Products ("the SFC Handbook") (Section II: Code on Unit Trusts and Mutual Funds), a hedge fund can obtain SFC's authorization provided that certain conditions are met: see paragraph 8.7 of the Code on Unit Trusts and Mutual Funds. An authorized hedge fund may target public investors and is sometimes called a "retail" hedge fund. The SFC's policy is to give hedge funds a choice. A hedge fund can either obtain SFC's authorization so as to tap into the retail market or it can just rely on private placement. If the private placement regime is modified or abolished, a hedge fund may have no choice but to seek SFC's authorization. This clearly contradicts the SFC's policy in the first place.

Question 2: Do you think that the minimum monetary thresholds for Corporate and Individual Professional Investors should be increased?

We are of the view that no change is required.

This is the conclusion reached by the SFC a few years ago. In the 2009

Companies Ordinance and the Offers of Investments Regime in the Securities and Futures Ordinance (April 2010), [71].

Consultation Paper on Proposals to Enhance Protection for the Investing Public, the SFC wisely noted that:[3]

> In considering the questions posed regarding the appropriate definition of professional investor it will be tempting to focus on the simple asset test and to suggest that the current hurdle is too low. However, consideration should also be given to legitimate concerns that if the asset hurdle is set too high this may adversely affect private placement activities in Hong Kong.

The 2010 Consultation Conclusions confirmed that the market was in favor of the status quo. The SFC therefore concluded:[4]

> All in all, the Commission considers that it is in the best interests of the investing public to maintain the existing minimum portfolio requirement at HK$8 million.

In fact, the latest SFC's proposal is to expand the definition of professional investors. The Consultation Conclusions on the Evidential Requirements under the Securities and Futures (Professional Investor) Rules (Feb 2011) resulted in the extension of section 3(d) of the Securities and Futures (Professional Investor) Rules (Cap. 571D): under the amendment, any corporation which is wholly owned by one or more individuals or corporations/partnerships where each of those individuals or corporations/partnerships would qualify as a professional investor under section 3(b) or section 3(c) (as the case may be) of the Professional Investor Rules will qualify as a professional investor. Therefore, the trend in fact is to extend the definition of professional investors. Any proposal to narrow down the definition will be contrary to the expectation of the market.

Thus, no change is required.

---

[3]SFC's Consultation Paper on Proposals to Enhance Protection for the Investing Public (Sept 2009), [49].

[4]SFC's Consultation Conclusions on Proposals to Enhance Protection for the Investing Public (May 2010), p.75.

Question 3: Do you agree that intermediaries should observe the Code without exception when they deal with individuals?

An Overview

As the SFC has observed in the consultation paper, an investor in Hong Kong enjoys two "layers" of protection: the disclosure requirement and the conduct regulation.

As regards the disclosure requirements contained in the SFC Handbook, they apply if the funds require SFC's authorization. Therefore, funds targeting the general public (including but not limited to professional investors) such as mutual funds are subject to these requirements. Retail hedge funds (i.e. SFC-authorized hedge funds) belong to this class. Funds targeting professional investors *only* do not require SFC's authorization and hence are not subject to the SFC Handbook disclosure requirements.

In relation to the conduct regulation, the Code of Conduct applies to all intermediaries. Nevertheless, if the investors are professional investors, then certain rules may not apply *provided that the individual or corporate investors have the requisite knowledge*.

Therefore, individual or corporate professional investors investing in authorized funds (1) enjoys full SFC Handbook disclosure protection and (2) limited conduct protection (if the knowledge threshold is satisfied), while those investing in funds not authorized (1) do not enjoy the SFC Handbook disclosure protection, but (2) enjoy the full/limited conduct protection (depending on whether the investors have the requisite knowledge).

The SFC proposes that intermediaries dealing with individual professional investors should comply with all of the requirements in the Code of Conduct for Persons Licensed by or Registered with the SFC ("the Code of Conduct"). We disagree with this suggestion.

It is submitted that:

1. Individual professional investors investing in authorized-funds enjoy substantial protection (in terms of disclosure, etc.);
2. While the disclosure regime may not apply in full force to funds without authorization, the current Code of Conduct has already afforded adequate protection to individual professional investors; and

The Protection under the SFC Handbook

Funds targeting the general public (including but not limited to professional investors) require SFC's authorization.

In this regard, the SFC Handbook is directly relevant. It sets out the disclosure requirement expected of an authorized fund. It must be noted that the SFC Handbook draws no distinction between professional investors or other investors. Thus, as long as the funds require authorization, the SFC Handbook requirements will apply even though the investors happen to be professional investors.

In particular, the SFC Handbook contains a very detailed guideline on disclosure and advertisement. Moreover, when it comes to unlisted structured products, the Code on Unlisted Structured Investment Products (Section IV of the SFC Handbook) applies. Therefore, investors of authorized unlisted structured products enjoy extra protection. This includes the offering documents and advertisements regulation in Chapter 6 and the post-sales obligations in Chapter 7. A cooling-off period is also provided in Chapter 7.

All in all, professional investors investing in authorized funds enjoy adequate protection under the SFC Handbook.

The Current Code of Conduct

As regards unauthorized funds, it must once again be emphasized that not obtaining authorization involves a trade-off: the funds cannot target the general public. In any event, the funds (authorized or otherwise) have to comply with the Code of Conduct. Thus, professional investors investing in unauthorized funds are not unprotected, even though the SFC Handbook disclosure requirement may not apply. It is further submitted that the current Code of Conduct affords sufficient protection to the professional investors.

Firstly, the exemption in paragraph 15.5 does not apply unless the professional investors have the requisite knowledge and experience: paragraph 15.3. As the SFC repeatedly emphasizes, it is a misconception to assume that all professional investors enjoy less protection. The truth is that they enjoy full protection under the Code of Conduct unless they have the requisite knowledge. In the 2009 Consultation Paper on Proposals to Enhance Protection for the Investing Public, the SFC pertinently noted that:[5]

> We believe that this test, as set out in paragraph 15.3 of the Code of Conduct, is the key test of whether or not an investor can be considered to be a "professional investor" and that this is where we need to take the most care to ensure that our criteria remain appropriate.

In addition, in the 2010 Consultation Conclusions, the SFC defended the existing regime:[6]

> Finally, in response to the suggestions that there should be no separate category of professional investors and/or no waiver of the requirement to ensure suitability, the Commission considers that similar arguments have been considered and discussed in the Consultation Conclusions on the Code of Conduct for Regulated Persons Serving the Professional or Sophisticated Markets issued in February 2001. The current professional investor regime in Hong Kong is in line with other major international financial markets and should not be changed significantly.

It is therefore surprising that the SFC has a sudden change of heart. It is submitted that the existing knowledge requirement offers sufficient protection to professional investors. The knowledge assessment has been thoroughly reviewed in recent years to ensure that the investors indeed possess the requisite knowledge and experience. The assessment in product-specific (paragraph 15.3A) and is only valid

---

[5]SFC's Consultation Paper on Proposals to Enhance Protection for the Investing Public (Sept 2009), [48].

[6]SFC's Consultation Conclusions on Proposals to Enhance Protection for the Investing Public (May 2010), p.74-75.

for 2 years (paragraph 13.5B). The factors listed in paragraph 15.3 are also useful threshold screens.

The knowledge and experience requirement is designed to ensure that those eligible investors possess enough knowledge to know what they are doing. It seems somehow illogical to say that on the one hand the investors have sufficient knowledge and on the other hand require the intermediaries to perform the suitability assessment for these experienced investors.

We also wish to highlight that even when the professional investors possess the requisite knowledge, the intermediaries are still required to observe the Code of Conduct (except the provisions listed in the current paragraph 15.5). Therefore it is a mistake to assume that those experienced individual professional investors enjoy no protection.

In particular, paragraph 5.3 dealing with derivatives and "know your client" is still applicable to professional investors. This must be strongly emphasized. It is true that the investor characterization requirement in paragraph 5.1A does not apply to professional investors. Nevertheless, paragraph 5.3 must be complied with. This has always been the position before and after paragraph 5.1A is introduced. In the Consultation Conclusions on Proposals to Enhance Protection for the Investing Public,[7] the SFC states categorically:

> As professional investors are subject to a separate regime governed by paragraph 15 of the Code of Conduct, the new requirement for characterization will not apply to such professional investors. Nevertheless, an intermediary providing services to such professional investors in derivative products still has to comply with paragraph 5.3 of the Code of Conduct.

This has been reiterated in the Legislative Council document prepared by the SFC:[8]

---

[7] SFC's Consultation Conclusions on Proposals to Enhance Protection for the Investing Public (May 2010), p.72.

[8] Bills Committee on Securities and Futures and Companies Legislation (Structured Products Amendment) Bill 2010, *Definition of Professional Investors and Update on the Progress on*

In a nutshell, pursuant to section 103(3)(k) of the SFO, offering documents of investment products regulated under the SFO which are only targeted to Professional Investors (as defined in the SFO and the PI Rules) need not obtain authorization of the Securities and Futures Commission ("SFC"). However, before offering such products to individual Professional Investors, an intermediary will have to ascertain, as required under the Code of Conduct, that the individual has a portfolio of not less than HK$8 million, the individual is knowledgeable and has sufficient expertise in the relevant products and markets, and that the individual formally agrees, in writing, that he wishes to be classified as a Professional Investor. In addition, similar to selling any other securities to the rest of the public, intermediaries have to comply with all relevant requirements under the Code of Conduct, for example, in relation to derivative products, the intermediary should still comply with the "know your client" requirement in paragraph 5.3 of the Code of Conduct – i.e., it should assure itself that the individual 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.

Thus, it must be born in mind that paragraph 5.3 applies to intermediaries dealing with professional investors.

In summary, even if the funds operate without authorization, the professional investors still enjoy the Code of Conduct protection. They either enjoy (1) full Code of Conduct protection or (2) limited protection provided that they have the requisite experience. In particularly, the knowledge assessment is a useful screen to differentiate the experienced investors from the others. Moreover, even the "limited protection" encompasses the "know your client" requirement when it comes to derivatives: paragraph 5.3 of the Code of Conduct. Therefore, the existing regime requires no modification.

Overseas Approaches

As the SFC pointed out in the Consultation Paper, in the United Kingdom,

---

Reviewing/Amending the Definition, LC Paper No. CB(1)788/10-11(02), [7], available online at: http://www.legco.gov.hk/yr09-10/english/bc/bc11/papers/bc111216cb1-788-2-e.pdf.

Singapore and Australia, intermediaries are exempted to a certain extent if they are dealing with professional investors. We therefore find SFC's current proposal puzzling.

In particular, in the United Kingdom, section 9.2.8R(1) of the Conduct of Business Sourcebook ("COBS") provides:

> If a firm makes a personal recommendation or manages investments for a professional client in the course of MiFID or equivalent third country business, it is entitled to assume that, in relation to the products, transactions and services for which the professional client is so classified, the client has the necessary level of experience and knowledge for the purposes of COBS 9.2.2 R (1)(c).

Professional client includes per se professional client and elective professional client: COBS 3.5.1R.

Elective professional client is defined in COBS 3.5.3R:

> A firm may treat a client as an elective professional client if it complies with (1) and (3) and, where applicable, (2):
>
> (1) the firm undertakes an adequate assessment of the expertise, experience and knowledge of the client that gives reasonable assurance, in light of the nature of the transactions or services envisaged, that the client is capable of making his own investment decisions and understanding the risks involved (the "qualitative test");
>
> (2) in relation to MiFID or equivalent third country business in the course of that assessment, at least two of the following criteria are satisfied:
>
> (a) the client has carried out transactions, in significant size, on the relevant market at an average frequency of 10 per quarter over the previous four quarters;
>
> (b) the size of the client's financial instrument portfolio, defined as including cash deposits and financial instruments, exceeds EUR 500,000;
>
> (c) the client works or has worked in the financial sector for at least one year in a professional position, which requires knowledge of the transactions or services envisaged;

(the "quantitative test"); and

(3) the following procedure is followed:

(a) the client must state in writing to the firm that it wishes to be treated as a professional client either generally or in respect of a particular service or transaction or type of transaction or product;

(b) the firm must give the client a clear written warning of the protections and investor compensation rights the client may lose; and

(c) the client must state in writing, in a separate document from the contract, that it is aware of the consequences of losing such protections.

It can be seen that the "elective professional client" provision is quite similar to our individual professional investor provision in the Code of Conduct. For the purpose of the Code of Conduct, the investors must satisfy the knowledge threshold. The same is applicable to elective professional client.

The United Kingdom approach mirrors the MiFID implementing Directive 2006/73/EC.[9] Article 36 (Assessment of appropriateness) of the Directive provides that:

> Member States shall require investment firms, when assessing whether an investment service as referred to in Article 19(5) of Directive 2004/39/EC is appropriate for a client, to determine whether that client has the necessary experience and knowledge in order to understand the risks involved in relation to the product or investment service offered or demanded.
>
> For those purposes, an investment firm shall be entitled to assume that a professional client has the necessary experience and knowledge in order to understand the risks involved in relation to those particular investment services or transactions, or types of transaction or product, for which the client is classified as a professional client.

---

[9] The Commission Directive 2006/73/EC of 10 August 2006 implementing Directive 2004/39/EC of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive.

Therefore, the SFC's current proposal sits uncomfortably with the overseas approaches. The existing regime is more in line with market expectation and should be maintained.

Question 4: Do you agree that investment vehicles wholly owned by individuals and by family trusts should be treated on the same basis as individuals under the Code?

We re-iterate that the SFC's current proposal (i.e. to abolish the existing paragraph 15.5 exemption when it comes to individual investors) ought not to be adopted.

In case the SFC is minded to adopt the proposed amendment, it is submitted that the amendment ought not to be extended to investment vehicles wholly owned by family trusts (i.e. intermediaries dealing with family trust-owned investment vehicles should be allowed to enjoy the exemption provided that the knowledge threshold is satisfied).

The investment vehicles may be owned by the family trusts. The beneficiaries may belong to a particular family. However, the trustees are those who make the decisions. The trustees (or at least some of the trustees) are usually professionals and not a family member of the beneficiaries. In fact, the family trusts might have been set up by professional trust companies. This is especially so given that the trust involves considerable legal technicalities. Therefore, it is inappropriate to treat such family trusts as individual professional investors. They are more akin to institutional/corporate professional investors and the paragraph 15.5 exemption ought not to be abolished.

Question 5: Do you agree that a principles-based Knowledge and Experience Assessment should dispense with bright line tests concerning dealing experience?

The proposed paragraph 15.3 (applicable to corporate professional investors) is quite similar to the present paragraph 15.3 (applicable to both individual and corporate professional investors).

The factors listed in the proposed paragraph 15.3(b) are relevant, although they are inapplicable to individual professional investors. As discussed above, we disagree with the SFC proposal and the current 15.5 exemption should equally apply to individual professional investors provided that they have the relevant knowledge required by paragraph 15.3.

We are of the view that the "bright line tests" in the current paragraph 15.3 are still useful. This test provides a concrete guideline to intermediaries. This reduces uncertainty and avoids abuses. One should not set up a false dichotomy between a "principle-based assessment" and the "bright line tests". In our view, they complement each other.

We also wish to highlight that the quantitative test is also adopted in definition of "elective professional client" in COBS 3.5.3R.

Therefore, while the proposed paragraph 15.3(b) are relevant and appropriate as regards corporate investors, we are of the view that (1) the current paragraph 15.3 should be retained and (2) the proposed 15.3 should be extended to individual professional investors given our view that intermediaries dealing with individual professional investors should still enjoy the exemption provided that the knowledge requirement is satisfied.

Questions 3-5: Institutional Professional Investors

The SFC proposes that intermediaries serving institutional professional investors are automatically exempt from the provisions set out in the proposed paragraph 15.4 of the Code of Conduct (which mirrors the current paragraph 15.5).

We agree with the proposal.

Question 6: Do you have any views on the Suitability Requirement?

We believe that the existing regime is appropriate.

General Comments

We wish to highlight that the paragraph 5.1A and paragraph 5.3 of the Code of

Conduct are also relevant safeguards for investors. In particular, paragraph 5.3 cannot be waived even if the intermediaries are dealing with experienced professional investors (see the analysis above).

Returning to the SFC's proposal to abolish the paragraph 15.5 exemption when it comes to individual professional investors, we envisage that the paragraph 5.2 suitability requirement may duplicate the current knowledge assessment in paragraph 15.3 to a certain extent. Once again, we wish to emphasize that the current paragraph 15.3 knowledge assessment also ensures suitability. Therefore, individual professional investors are sufficiently protected and the proposed change may not be justified.

In case the SFC is minded to proceed with its proposal, we urge the SFC to provide concrete guidelines to funds and intermediaries targeting professional investors. For hedge funds targeting individual professional investors, we envisage that the guideline may be along the line of paragraph 8.7(r) and (s) in the SFC Handbook.

What if the client insists on an unsuitable transaction?

Difficult issues arise if the client insists on an unsuitable transaction. According to our understanding, the present suitability requirement is not violated if the intermediaries allow their clients to involve in unsuitable transaction on the clients' insistence.

Firstly, paragraph 5.2 only obliges the intermediaries to ensure the suitability of their recommendation or solicitation. The intermediaries are not responsible for the suitability of the actual transaction. It is for the investors themselves to make an informed decision. Even if the intermediaries are of the view that the transaction is not suitable, the client is free to ignore the advice and go ahead with the unsuitable transaction. The client's freedom cannot be restricted and as long as the intermediaries provide reasonable advice, the requirement in paragraph 5.2 is satisfied.

Secondly, paragraph 5.2 merely applies to advisory services, i.e. recommendation and solicitation. As the SFC recognized in the Consultation Paper, it

does not apply to non-advisory services. Therefore, if the clients, after receiving the advice (that the transaction is unsuitable), insist on an unsuitable transaction, the intermediary executing the transaction is not providing any recommendation and solicitation. The intermediaries should provide reasonable advice as to suitability, but once the clients decide nevertheless to go ahead with the unsuitable transaction, the intermediary is no longer performing an advisory function: the firm is merely executing the trade (a non-advisory function) and therefore paragraph 5.2 does not apply to the execution.

Our understanding is confirmed by the Hong Kong Monetary Authority's (HKMA) Circular dated 20 January 2012 "Applicability of Enhanced Measures to Sales of Investment Products to Private Banking Customers". While the circular targets Authorized Institutions serving Private Banking Customer, the Code of Conduct nevertheless applies. In particular, paragraph 5.2 is also applicable even though the customers are Private Banking Customer (unless they are also professional investors having the requisite knowledge). Therefore, the advice outlined in the HKMA's circular should be of general application.

The HKMA recognizes that the Authorized Institutions are bound by paragraph 5.2: see Recommendations 12 and 13. The HKMA clearly recognizes that the clients may insist on unsuitable transactions. To this end, the flexible version of Recommendation 15 states:

> In the case of a risk mis-match, the reason why such product is still considered by the sales staff to be suitable for the private banking customer despite the mis-match, or in the case the product is advised to be not suitable, the reason why the customer insists on buying the product should be documented. The private bank should provide a copy of this document to the customer.

Therefore, on the HKMA's interpretation of the suitability requirement, an intermediary is allowed to execute an unsuitable transaction on the client's insistence. We support the HKMA's interpretation.

We believe that this interpretation is correct. For the avoidance of doubt, we propose that the SFC should make clear that the intermediary is not liable if it

executes an unsuitable transaction on the client's insistence.

International practices suggest that our interpretation is acceptable. The International Organization of Securities Commissions ("IOSCO") Consultation Report on Suitability Requirements with respect to the Distribution of Complex Financial Products (February 2012) summarized the international practices: the IOSCO notes that in the US, Singapore, Mexico, Switzerland, Canada and Brazil, intermediaries can execute the unsuitable transaction on the clients' insistence (the IOSCO also notes the different approaches adopted in Australia and a number of European countries).[10]

Our interpretation of paragraph 5.2 does not involve a violation of the General Principle to act in the clients' best interest. In the IOSCO's Consultation Report, it is noted that the obligation denotes, at the minimum, the duty not to encourage the clients to participate in an unsuitable transaction.[11] This seems to suggest that the General Principle is not breached if the intermediaries merely execute the trade. At a fundamental level, if the client insists on the transaction, executing it cannot be said to be detrimental to his interest.

We fully appreciate that the above is subject to paragraph 5.3 (and other General Principles) of the Code of Conduct. Thus, if the intermediaries provide services (which include non-advisory services) in relation to derivative, the intermediaries must satisfy themselves that the clients understand the products and have sufficient assets to assume the risks.

The fact that paragraph 5.3 (that the intermediaries should nevertheless ensure some degree of suitability even in non-advisory services) is confined to derivatives confirms the correctness of our interpretation of paragraph 5.2 (i.e. if the clients insist

---

[10] Technical Committee of the IOSCO, Consultation Report on Suitability Requirements with respect to the Distribution of Complex Financial Products (February 2012), p.44, available online at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD373.pdf.

[11] Technical Committee of the IOSCO, Consultation Report on Suitability Requirements with respect to the Distribution of Complex Financial Products (February 2012), p.22, available online at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD373.pdf.

on a non-derivative unsuitable transactions, the intermediaries can execute the trade without breaching this paragraph).

We therefore urge the SFC to expressly confirm our understanding. In the case the SFC disagrees with our interpretation (i.e. the SFC is of the view that an intermediary will be in breach when it execute an unsuitable transaction on the client's insistence), we urge the SFC to create a "safe harbor" or exception. As discussed above, a number of jurisdictions allow intermediaries to execute such trade at the client's insistence. Fundamentally, it is for the client to decide whether he wants to go ahead with the transaction provided that the intermediaries have provided reasonable advice. We also highlight that customers interested in derivatives enjoy the protection of paragraph 5.3 of the Code. Therefore, the exception to paragraph 5.2 is of limited effect only.

Question 7: Do you agree with the above proposals in relation to the client agreement?

The SFC proposes that (1) the suitability requirement has to be incorporated into the client agreement, and (2) there should be no exemption clause in the client agreement.

In relation to (2), we wish to highlight that exemption clauses are subject to the Control of Exemption Clauses Ordinance (Cap. 71) and the Supply of Services (Implied Terms) Ordinance (Cap. 457). Therefore, the effect of exemption clause ought not to be overstated.

As regards (1), we doubt the usefulness of the SFC's proposal. Under paragraph 6.1 of the Code of Conduct, a client agreement is required as long as the licensed persons provide services to the client. However, not all services require the suitability assessment. It all depends on the nature of the services. As recognized by the SFC, the suitability requirement has no application when the intermediaries merely provide non-advisory services.

On the other hand, if the intermediaries do provide advisory services, it is quite likely that the intermediaries are under a duty of care by operation of law. Therefore,

even without incorporating the suitability requirement into the client agreement, the intermediaries are still under a similar duty if the facts of the case warrant the imposition of such duty.

For example, in the landmark Hong Kong case of *Susan Field v Barber Asia Limited* (HCA 7119/2000), the investment adviser was found to have breached the duty of care.

In contrast, in the recent case of *Selina Kwok v HSBC Private Bank (Suisse) SA* (HCCL 7/2010), the plaintiffs argued that HSBC owed the following core duties:[12]

(1) To advise the Plaintiff;
(2) To manage the Plaintiff's account with due care and skill;
(3) To provide fair and accurate information in relation to her account;
(4) To inform and warn her of risks in relation to her account;
(5) To know the Plaintiff as a client; and,
(6) Not to sell financial products to the Plaintiff that were unsuitable for her known risk appetite, investment objective, or net worth.

This argument was rejected on the facts. Reyes J held that the bank was not under the said duty because:[13]

> The account being execution-only (that is, authorising HSBC to act in accordance with Ms. Kwok's instructions in relation to financial transactions), HSBC cannot be taken as having impliedly accepted a core duty to manage Ms. Kwok's account. To the contrary, HSBC was only undertaking to execute Ms. Kwok's instructions promptly with due care and skill.

Thus, the existence of the duty depends on the facts of the case. Adding the suitability requirement in the client agreement may make no difference. If the facts of the case do not warrant the imposition of such duty, it is very likely that the suitability requirement would also be inapplicable. Therefore, the utility of the SFC's proposal is in doubt.

---

[12] *Selina Kwok v HSBC Private Bank (Suisse) SA* (HCCL 7/2010), [98].

[13] *Selina Kwok v HSBC Private Bank (Suisse) SA* (HCCL 7/2010), [107].

We also wish to highlight that under paragraph 6.3 of the Code of Conduct, a licensed person should ensure that the client agreement does not restrict the rights of the clients or limit the obligation of the intermediaries. This presumably includes the duty of care arising by operation of law. Thus, under the existing regime the clients enjoy adequate protection.

Conclusion

The existing regime affords sufficient protection to investors. In particular, investors investing in authorized funds enjoy the disclosure protection under the SFC Handbook. Investors investing in authorized or unauthorized funds enjoy the Code of Conduct protection. Professional investors also enjoy full Code of Conduct protection unless they possess the requisite knowledge. The knowledge requirement is designed to ensure that the investors are able to make an informed decision. The existing regime is in line with market expectation as well as overseas practice and no substantial change is required.

END