ALLEN & OVERY

SFC and HKMA's joint circular on streamlined approach for dealing with sophisticated professional investors (SPIs)

Wealth managers and advisers, and distributors in relation to non-retail investment products, for example interests in private equity funds or hedge funds, sustainability linked bonds and other private capital related securities products, will be pleased to see the SFC and HKMA's latest joint guidance. The guidance sets out a streamlined approach to suitability obligations when dealing with individual professional investors (and their wholly owned investment companies) who meet financial, knowledge and experience and investment objective tests (**SPIs**). This is intended to overcome challenges faced by private wealth intermediaries in Hong Kong and satisfy SPIs who are looking to access a wider private capital product universe. As the joint circular explains, where relevant criteria are met, and with supporting documentation, intermediaries are no longer required to match the SPI's risk tolerance level, investment objectives and investment horizon, or to assess the SPI's knowledge, experience and concentration risk at the transaction level in certain circumstances and as otherwise set out in Chapter 15 (Professional investors) of the Code of Conduct for Persons Licensed by or Registered with the SFC (**Code of Conduct**). Explanation of product characteristics, nature and extent of risks can also be provided to the SPI upfront. In order to take advantage of this streamlined approach intermediaries will need to consider the implications of the guidance to their business and appropriately adapt their internal on-boarding and suitability processes to address the guidance expectations. Such internal processes should incorporate the following:

SPI Assessment

– If the intermediary is reasonably satisfied that the SPI has the degree of sophistication to understand and take on the risks arising from the Streamlined Approach by meeting the **Qualifying Criteria:**
  – **Financial Situation**
    – An SPI should have [1]:
      – (a) a **portfolio** of at least **HK$40 million** [2]; or
      – (b) **net assets**, excluding primary residence, of at least **HK$80 million**[2].
  – **Knowledge or Experience**
    – An SPA should meet at least one of the following [3]:
      – (a) holding a **degree or post-graduate diploma in accounting, economics or finance**, or a related discipline;
      – (b) having attained a **professional qualification in finance** (such as Chartered Financial Analyst (**CFA**), Certified International Investment Analyst (**CIIA**), Certified Private Wealth Professional (**CPWP**), Chartered Financial Planner (**CFP**) or other comparable qualifications);
      – (c) having at least **one-year relevant work experience** in a professional position in the financial sector in Hong Kong or elsewhere (eg, licensed for conducting relevant regulated activities); or
      – (d) having executed at least **five transactions** within the **past three years** in the same category of investment products as categorised based on their terms and features, characteristics, nature and extent of risks (**Product Category**).
  – **Investment Objectives**
    – Intermediaries should not apply the Streamlined Approach when dealing with conservative clients (eg, where the relevant investment objective is capital preservation and/or seeking regular income).

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Client Acknowledgment

– Intermediaries should:
  – (a) enter into a **written agreement** with each SPI for acknowledging and giving consent to be treated as an SPI (including the Streamlined Approach, the Product Categories and the Streamlining Threshold);
  – (b) **specify in writing** the **assessment criteria** under which the client qualified as an SPI;
  – (c) **specify in writing** the **Product Categories** and the **Streamlining Threshold** within which investment transactions could be executed under a Streamlined Approach; and
  – (d) fully **explain to the SPI the consequences** of being treated as an SPI and the SPI's **right to withdraw** from being treated as such at any time.

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Eligible Investment Transactions

– There are transactions that fall within the **Product Categories** and the **Streamlining Threshold** specified by the SPI:
  – **Product Category**
    – Intermediaries should devise (or adjust as appropriate) Product Categories to **categorise** investment products.[4]
    – The **SPI should specify the Product Categories** within which investment transactions could be executed under a Streamlined Approach.[5]
  – **Streamlining Threshold**
    – The **SPI should specify a maximum threshold**[6] of investment that is acceptable to be executed under a Streamlined Approach.

Miscellaneous

– The application of the Streamlined Approach should be **reviewed annually** to ensure that the **SPI continues to fulfil** the **Qualifying Criteria** and continues to agree to its specified **Product Categories** and the **Streamlining Threshold** under a Streamlined Approach.

– The client should be reminded in writing of the terms of their Client Acknowledgment.[7]

– The SPI should be made aware of any breach of the Streamlining Threshold.

– The Code of Conduct still applies to the extent it is not varied by the joint circular, or the joint circular is not relied upon.

– The joint circular does not amend the statutory definition of "professional investors".

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01_At the relevant date.

02_Or equivalent in any other currency.

03_Intermediaries should be reasonably satisfied that an SPI has the degree of sophistication required to understand the risks arising from being treated as an SPI (including the Streamlined Approach) by ascertaining whether the SPI meets at least one of the following criteria.

04_Based on the **terms and features, characteristics, nature** and extent of **risks** of investment product.

05_Intermediaries are required to **document the choice** of the SPI and **provide a Product Category Information Statement** to the SPI to explain the terms and features, characteristics, nature and extent of risks of investment products within such Product Category (the "Product Category Information Statement" eg, in the form of an information booklet/ hyperlinks). Where applicable, the Product Category Information Statement should include warning statements in relation to the distribution of complex products. Intermediaries are also required to explain to the SPI upon request, to facilitate the SPI's understanding of the Product Category Information Statement, terms and features, characteristics, nature and extent of risks of investment products within such Product Category.

06_As an **absolute amount** or a **percentage** relative to the SPI's assets under management (**AUM**) with the intermediary. SPI could specify a Streamlining Threshold **appropriate to their circumstances** and the **intermediary is required to maintain proper records** of setting any such threshold, including the SPI's **rationale** that provides support for setting such threshold. Intermediaries are required to **establish and maintain effective systems and controls** to ensure compliance with the Streamlining Threshold. Intermediaries should implement **measures to detect outsize or material transactions** and **issue warning statements** to the SPI for these transactions.

07_In carrying out the annual review, intermediaries should remind the client in writing of: (a) the consequences of being treated as an SPI; (b) the Product Categories specified by the SPI and information about the Product Categories as contained in the Product Category Information Statements; (c) the Streamlining Threshold specified by the SPI and an alert to the SPI where there was any instance of breach; and (d) the right for the SPI to withdraw from being treated as an SPI, to add or remove a Product Category and/or to amend the Streamlining Threshold at any time.