



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

## **Consultation Paper on the Proposed Guidelines on Online Distribution and Advisory Platforms**

May 2017



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## **Personal information collection statement**

1. This Personal Information Collection Statement (PICS) is made in accordance with the guidelines issued by the Privacy Commissioner for Personal Data. The PICS sets out the purposes for which your Personal Data<sup>1</sup> will be used following collection, what you are agreeing to with respect to the SFC's use of your Personal Data and your rights under the Personal Data (Privacy) Ordinance (Cap. 486) (PDPO).

### **Purpose of collection**

2. The Personal Data provided in your submission to the SFC in response to this consultation paper may be used by the SFC for one or more of the following purposes:
  - (a) to administer the relevant provisions<sup>2</sup> and codes and guidelines published pursuant to the powers vested in the SFC;
  - (b) in performing the SFC's statutory functions under the relevant provisions;
  - (c) for research and statistical purposes; or
  - (d) for other purposes permitted by law.

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4. You have the right to request access to and correction of your Personal Data in accordance with the provisions of the PDPO. Your right of access includes the right to obtain a copy of your Personal Data provided in your submission on this consultation paper. The SFC has the right to charge a reasonable fee for processing any data access request.

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<sup>2</sup> The term "relevant provisions" is defined in section 1 of Part 1 of Schedule 1 to the Securities and Futures Ordinance (Cap. 571) and refers to the provisions of that Ordinance together with certain provisions in the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32), the Companies Ordinance (Cap. 622) and the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance (Cap. 615).

## **Enquiries**

6. Any enquiries regarding the Personal Data provided in your submission on this consultation paper, or requests for access to Personal Data or correction of Personal Data, should be addressed in writing to:

The Data Privacy Officer  
The Securities and Futures Commission  
35/F Cheung Kong Center  
2 Queen's Road Central  
Hong Kong

7. A copy of the Privacy Policy Statement adopted by the SFC is available upon request.

# Proposed Guidelines on Online Distribution and Advisory Platforms

## Executive summary

1. In recent years there has been an expansion of different forms of online platforms offering a wide range of investment services and functions, ranging from order execution, product distribution to portfolio construction and investment advice (commonly known as “robo-advice”<sup>3</sup>).
2. Online platforms are easily accessible. They allow all types of investors to access and transact a broad range of investment products easily and quickly. They also enable transactions to take place without any interaction with a sales representative. Investors can simply select and purchase a product based on the information and materials posted on the platform.
3. This new business model brings new opportunities as well as risks. In light of these developments, the SFC has reviewed the current conduct requirements applicable to the distribution of investment products and the provision of financial advice via online platforms.
4. The SFC proposes to introduce a set of specific guidelines (Proposed Guidelines) applicable to all SFC-licensed or registered persons when conducting their regulated activities in providing order execution, distribution and advisory services in respect of investment products via online platforms (Platform Operators). The Proposed Guidelines aim to provide tailored guidance and clarity on the design and operation of online platforms in compliance with existing regulatory requirements (including the Suitability Requirement), with additional protective measures proposed for the sale of complex products on online platforms.

## Proposed Guidelines

5. The Proposed Guidelines focus on the following three main areas:

### Governance and controls

6. First, the Proposed Guidelines set out various core principles with which all Platform Operators should comply in operating their online platforms. These mainly concern the governance and controls expected to be put in place by a Platform Operator. There is also specific guidance on the provision of automated or robo-advice on an online platform.

### Suitability Requirement

7. Secondly, the Proposed Guidelines aim to clarify how the suitability requirement<sup>4</sup> (Suitability Requirement) would operate in the context of an online platform, in terms of when it will be triggered and how it may be discharged.
8. The Suitability Requirement is a key conduct requirement and investor protection measure in the sale of investment products. It is triggered by a “solicitation” or a “recommendation”.

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<sup>3</sup> Sometimes also referred to as digital advice or automated advice.

<sup>4</sup> This refers to the requirement in paragraph 5.2 of the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission on a licensed or registered person to, when making a recommendation or solicitation, ensure the suitability of the recommendation or solicitation for the client is reasonable in all the circumstances, having regard to information about the client of which the licensed or registered person is or should be aware through the exercise of due diligence.

9. In the online environment, given the degree of reliance investors place on product information and materials posted on the platform, the context and content of such materials coupled with the design and overall impression created by the platform content will determine whether the Suitability Requirement is triggered.
10. The Proposed Guidelines will clarify that the posting of factual, fair and balanced materials on online platforms would not in itself amount to a solicitation or recommendation and will not trigger the Suitability Requirement. This is consistent with the offline position whereby, in the absence of direct communications with a client, the Suitability Requirement is unlikely to be triggered by the mere posting of an advertisement for an investment product in newspapers, magazines or television programmes, or by the wide dissemination of research reports<sup>5</sup>.
11. Examples of materials posted on online platforms which would or would not trigger the Suitability Requirement are discussed in more detail in this paper.
12. Only where product-specific materials are not factual, fair and balanced, or where there are other circumstances that may reasonably be expected to influence investors to purchase a specific investment product, will the Suitability Requirement be triggered.
13. The Proposed Guidelines should enable more distribution channels to flourish, lead to greater investor choice, and generally facilitate the development of online platforms for the benefit of both the industry and investors.
14. For the avoidance of doubt, robo-advice would normally include a solicitation or recommendation and thereby of itself trigger the Suitability Requirement.

*Additional protective measures for the sale of complex products on online platforms on an unsolicited basis*

15. The third part of the Proposed Guidelines sets out certain additional requirements applicable to the sale of complex products on an online platform in circumstances where no solicitation, recommendation or advice has been provided (referred to as “on an unsolicited basis” in this paper). In these circumstances, investors would not be protected by the Suitability Requirement under the current regulatory framework.
16. Complex products refer to products whose terms, features and risks are not reasonably likely to be understood by retail investors because of their structure (as opposed to more traditional or “plain vanilla” investment instruments), and which are difficult to value (ie, valuations require specific skills and/or systems, particularly when there is a very limited or no secondary market)<sup>6</sup>.
17. Given the broad range of investment products available and the ease with which transactions may be concluded on online platforms, the SFC considers it appropriate to extend the Suitability Requirement to provide an appropriate degree of protection to investors in the sale of these complex products. The requirement to ensure suitability would apply even where the materials posted on an online platform would not otherwise

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<sup>5</sup> Please refer to the Circular to Intermediaries – Frequently Asked Questions on Triggering of Suitability Obligations, SFC, December 2016.

<sup>6</sup> Suitability Requirements With Respect To the Distribution of Complex Financial Products Final Report, IOSCO, January 2013

trigger the Suitability Requirement and no recommendation or advice is being given or offered. This is generally in line with recommendations made by IOSCO<sup>7</sup>.

18. Therefore, the Proposed Guidelines would require that Platform Operators must ensure any transaction in a complex product (other than derivative products traded on an exchange) is suitable for the client in all the circumstances. In addition, Platform Operators would be required to provide, as a minimum, certain basic and key information on such complex products offered on their platforms as well as prominent and clear warning statement(s).
19. In formulating these measures, we are mindful that complex products generally tend to be sold, and not bought, in the offline environment. Further, it is likely that the sale of complex products in an offline environment would involve solicitations and recommendations, which would in any event trigger the Suitability Requirement. Moreover, it is likely to be difficult for an average investor to fully understand the nature and risks associated with a complex product based only on the information posted on an online platform.
20. Complex products vary in complexity and risk. The fact that a product is complex does not necessarily mean that it is also high risk (eg, principal protected derivative products). On the other hand, simple products may be risky, such as high yield bonds and emerging market equity securities. However, complexity may make it difficult for investors to understand a product, whether or not it is high risk. Hence, the proposed measures focus on addressing the complexity of products as opposed to their riskiness.
21. Investors should be able to make their own investment decisions in relation to a simple investment product where an average investor can reasonably be expected to understand the product features and associated risks based on the available product information. In other words, an investor should be able to choose to invest in a simple (ie, easy to understand) investment product on an unsolicited basis and should take responsibility for his or her own investment decision regardless of the riskiness of the product.
22. The above proposals are discussed in detail in this consultation paper in the following parts:
  - (a) Section I is an introduction to the consultation, examining more closely the benefits and risks that online platforms may bring to both the industry and investors;
  - (b) Section II elaborates on the specific characteristics of online platforms and the differences between the online and offline sales processes; and
  - (c) Section III sets out the detailed proposals in the Proposed Guidelines:
    - (i) Part A discusses the governance and controls expected to be put in place by a Platform Operator in the form of six core principles;
    - (ii) Part B sets out the guidance and requirements concerning the provision of automated or robo-advice on an online platform;
    - (iii) Part C discusses in more detail how the Suitability Requirement would apply in an online context and how it may be discharged; and

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<sup>7</sup> See footnote above.

(iv) Part D focuses on the additional measures to be imposed on the sale of complex products on online platforms.

23. Finally, this paper seeks views on an implementation timetable.

24. The SFC invites market participants and interested parties to submit written comments on the proposals discussed in this consultation paper by no later than 4 August 2017.

## Section I – Introduction

25. With the advent of new technology, investors are increasingly managing their finances and investments online. We have seen significant growth in online platforms providing a wide range of investment services and functions, spanning order execution, product distribution to portfolio construction and investment advice (commonly known as “robo-advice”).
26. Online platforms offer various services. For instance, some online brokerage platforms only provide clients with an order execution service for shares listed on The Stock Exchange of Hong Kong Limited (SEHK). Some online asset management platforms may offer a range of unlisted funds to clients who are expected to make their own decisions without advice, while other platforms may provide investment advice such as recommending a model portfolio with a product mix calibrated to the client’s personal circumstances. Some platforms combine different websites, for example, a platform for the execution of orders may be linked to a website providing information about the investment products available with additional links to social networking platforms which allow users to share and discuss investments. Some platforms may also involve web-based applications, mobile-based applications and/or a hybrid of both.
27. Online platforms are easily accessible. They allow high-net-worth professional investors and retail investors of average wealth, persons entering the workforce and persons near retirement, as well as both speculative and risk-averse investors, to trade with little difficulty. Many online platforms also offer real time trading, and the speed with which transactions can be concluded further encourages the use of such platforms.
28. In the online context, investors may be incentivised to buy investment products by means of specific promotions (such as product-specific fee waivers) or simply from the type of advertising or interface used by the platform.

### Benefits of online platforms

29. For product issuers, online platforms serve to broaden distribution channels (which in the Hong Kong market tend to be concentrated<sup>8</sup>) and cater for a wider variety of investment products. This should also lower distribution costs.
30. For intermediaries, the use of online platforms may reduce overheads. Increased automation may also reduce operational risk, for example, by helping intermediaries deliver a more standardised user experience and a more consistent quality of service and advice. It may also assist intermediaries to create an end-to-end digital process that integrates client on-boarding, suitability assessments, reporting and surveillance, while combining record keeping, auditing features and the monitoring of different types of conduct and product risk into one process flow.
31. For investors, apart from better access to products, reduced fees may render services, including robo-advice, more affordable.

### Risks arising from online platforms

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<sup>8</sup> Retail funds distribution in Hong Kong is concentrated in the bank channel with 78% of retail funds being distributed by banks, Risk-focused Industry Meeting Series: Asset Management: Looking Forward, SFC, January 2015.

32. On the other hand, these new business models have regulatory implications. For example, platforms providing investment ideas or websites which direct investors to place transactions in investment products will require a licence where the business conducted in Hong Kong amounts to a regulated activity.
33. New business models also give rise to new risks<sup>9</sup> including in the areas of cybersecurity and data protection. From an investor perspective, the lack of any interaction with a sales or advisory representative means that they may not be able to fully understand the nature and risks of an investment product prior to making an investment decision.
34. We are not proposing additional protective measures for the sale of simple investment products, whether or not they are high risk. Investors should be able to make their own investment decisions in relation to a simple investment product where an average investor can reasonably be expected to understand the product features and associated risks based on the product information made available to the investor. In other words, an investor should be able to choose to invest in a simple (ie, easy to understand) investment product on an unsolicited basis and should take responsibility for his or her own investment decision regardless of the riskiness of the product.
35. Our proposals therefore focus on an investor's understanding of investment products through appropriate disclosure. In the case of investment products which are too complex for an average retail investor to understand we have proposed additional protective measures. This is consistent with the SFC's function to secure an appropriate degree of protection for investors, having regard to their degree of understanding and expertise in respect of such products<sup>10</sup>.

### Proposed Guidelines

36. The SFC's conduct requirements are in general principles-based, applicable equally to offline and online contexts. The SFC, however, is consulting on specific guidelines for the operation of online platforms to provide more tailored guidance to the industry.
37. In formulating the Proposed Guidelines the SFC has conducted an extensive informal consultation with industry stakeholders.
38. The key proposals are discussed in greater detail in Section III, and a draft of the Proposed Guidelines is set out in Appendix 2. The SFC invites comments on the proposals and Proposed Guidelines. A consultation conclusions paper will be published as soon as practicable after the end of the consultation period.

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<sup>9</sup> Fintech applications are developing at an increasingly fast pace, creating opportunities to achieve better investor outcomes, such as greater accessibility by previously underserved segments of modern portfolio theory-based investment at lower cost; easier comparability of investment options, costs, fees and investment returns; greater investor choice and diversification; and greater financial inclusion. The latter is especially true in emerging markets where due to the lack of legacy infrastructure, Fintech is often able to leapfrog current technology. At the same time, as with any change, come new risks and vulnerabilities. Though these risks differ depending on the technology, certain risks are recurring across the Fintech sector, such as those arising from unlicensed cross-border activity, programming errors in the algorithms that underlie automation, breaches in cyber security, and the failure of investors to understand financial products and services. See IOSCO's Research Report on Financial Technologies (Fintech), February 2017.

<sup>10</sup> Please refer to section 5(1)(l) of the Securities and Futures Ordinance (Cap. 571).

## Section II – Differences between the online and offline sales processes

39. The main difference between the online and offline sales processes lies in the absence of the interactive face-to-face communication with clients which usually takes place in the offline environment.
40. In an offline environment, an intermediary is generally expected to explain product features and risks to a client at the point of sale or advice. The intermediary's representative is expected to provide all material information necessary and answer questions from the client.
41. In the online context, an investor's understanding of an investment product would normally centre on the materials made available on the online platform about the product.
42. This may mean that great reliance is placed by investors on the materials posted on an online platform, whether in the form of offering documents, market news, research reports on specific investment products, analytics that compare products, views from other investors, or even directed marketing and flash advertisements based on previous searches. Further, the ease with which investors may be able to place orders after viewing these materials is a relevant consideration when considering regulation specific to online platforms.
43. The context (such as the manner of presentation) and content of product-specific materials posted on an online platform, coupled with the design and overall impression created by the platform content, could influence an investor to purchase the product.
44. On an online platform, investors can often view and have access to a very wide range of investment products, far more than in the traditional offline environment where investors are in general made aware of only a few particular products which a representative specifically mentions or recommends.
45. This means that in an online environment it is not practicable to ensure that every investment product listed on a platform is appropriate or suitable for all clients who may be able to access the platform.
46. The Proposed Guidelines seek to address these issues.
47. The SFC will also work with the Investor Education Centre on additional educational materials for investors who use online platforms.

### Questions:

1. Do you agree with the factors relevant to online platforms identified above? Please explain your view.
2. Are there any factors that the SFC has not identified? Are these covered by existing conduct requirements? If not, do you have any suggestions about how they can be addressed through specific requirements? Please explain your view.

## Section III – Proposed Guidelines

48. The Proposed Guidelines will be issued under section 399 of the Securities and Futures Ordinance (SFO) and will set out the principles and requirements applicable to online platforms. The Proposed Guidelines aim to provide tailored guidance and clarity on the design and operation of online platforms in compliance with existing regulatory requirements, including the Suitability Requirement.
49. Intermediaries may operate different websites, platforms and other channels such as social media accounts for posting information about investment products and transacting in them. Activities targeting Hong Kong investors conducted by an intermediary via all channels will be relevant to its compliance with the Proposed Guidelines.
50. Where the online platform also provides automated trading services (ATS) as defined under the SFO, the principles and standards set out in the Guidelines for the Regulation of Automated Trading Services<sup>11</sup> will apply. Platform Operators who conduct electronic trading should also ensure that paragraph 18 (Electronic Trading) of and Schedule 7 to the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (Code of Conduct) and any relevant guidelines are complied with.
51. The Suitability Requirement may be triggered having regard to the totality of the content and context of all communications involved (including any multiple-step solicitation or recommendation process), notwithstanding that some of the communications taken in isolation may not trigger the Suitability Requirement. For example, where there are one-to-one interactions between a client and representatives of a Platform Operator via an online platform (eg, through live web-chat) or there have been other communications between representatives of the Platform Operator and a client (eg, where a client calls a hotline listed on the online platform and speaks with a representative), this must be taken into account in determining whether the Suitability Requirement has been triggered. In these circumstances, Platform Operators should also refer to the guidance issued by the SFC concerning transactions conducted in an interactive or offline environment<sup>12</sup>.

### A. Core Principles for the operation of online platforms

#### General requirements

52. Platform Operators should note other requirements applicable to the offering of investment products including the prospectus requirements for offering of shares and debentures under the Companies (Winding Up and Miscellaneous Provisions) Ordinance (C(WUMP)O)<sup>13</sup>; the restrictions on offers of investments under Part IV of the SFO; and any restrictions applicable to overseas exchange-traded products or other products under ATS authorization conditions. Platform Operators should ensure compliance with such requirements when selecting investment products to be made available on its platform and when posting any information and materials.

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<sup>11</sup> These guidelines are applicable to providers of ATS authorised under Part III of the SFO or licensed or registered for Type 7 regulated activity under Part V of the SFO.

<sup>12</sup> For example, the SFC's Circular to Intermediaries – Frequently Asked Questions on Triggering of Suitability Obligations, December 2016.

<sup>13</sup> Parts II and XII of the C(WUMP)O

53. The regulatory framework governing the conduct of intermediaries, including Platform Operators, is set out in the Code of Conduct, the Management, Supervision and Internal Control Guidelines for Persons Licensed by or Registered with the Securities and Futures Commission, and other codes, guidelines, circulars and frequently-asked questions (FAQs) issued by the SFC from time to time.
54. Conduct requirements include the General Principles in the Code of Conduct. For example, under General Principle 1, a licensed or registered person is required, in conducting its business activities, to act honestly, fairly, and in the best interests of its clients and the integrity of the market. The General Principles are augmented by requirements more specific to the activities carried out by intermediaries. For example, when providing services in derivative products, the investor characterization requirements under paragraph 5.1A of the Code of Conduct and know-your-client requirements under paragraph 5.3 of the Code of Conduct would apply.

### Core Principles

55. In addition to these existing conduct requirements, the SFC proposes to introduce Core Principles for the operation of online platforms. These Core Principles address essential differences between online and offline sales processes and the specific nature and risks of online transactions.
56. Core Principle 1 – Proper design: A Platform Operator should ensure that its online platform is properly designed.
- (a) This would include, for example, that an online platform should have appropriate access rights and controls such that retail clients would not be able to invest in or view materials relating to investment products in circumstances that would constitute a breach of the C(WUMP)O or Part IV of the SFO. For example, materials concerning exchange-traded funds (ETFs) not authorized by the SFC (such as overseas ETFs) should not be accessible by retail clients.
  - (b) A Platform Operator should operate its online platform with due skill, care and diligence, including when selecting investment products to be made available on its platform and when posting any information and materials.
57. Core Principle 2 – Information for clients: A Platform Operator should make clear and adequate disclosure of relevant material information on its online platform.
- (a) This would include, for example, providing clients with up-to-date product offering documents or information<sup>14</sup> and providing them with information concerning their investments as soon as reasonably practicable. In this connection, there should be adequate arrangements which enable the Platform Operator to access and be informed of material up-to-date information concerning all non-exchange-traded investment products available on the platform.
  - (b) Online platforms should inform clients about the scope and limitations of services and products provided (eg, products are limited to those issued by related

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<sup>14</sup> In respect of offering documents for non-exchange-traded investment products, Platform Operators are expected to provide up-to-date product offering documents on their online platforms. For exchange-traded investment products, a good practice is to provide a hyperlink to where up-to-date information can be accessed or a reminder to clients to refer to any such information before making an investment decision.

companies), any remuneration to be paid by the client or other persons (eg, product issuers) to the Platform Operator, such as commission, brokerage and any other fees and charges, and other monetary benefits received or receivable by the Platform Operator.

- (c) Platform Operators should ensure that all information is communicated in an easily comprehensible manner. Platform Operators should use plain language in any disclosures made and presentation of information to make them easy to read and understand.

58. Core Principle 3 - Risk management: A Platform Operator should ensure the reliability and security (including data protection and cybersecurity) of the online platform.

- (a) This would include, for example, testing its online platform and any modifications before deployment and putting in place appropriate contingency plans.
- (b) Contingency plans should at least include a suitable backup facility or alternative arrangements for order execution in the event of an emergency as well as arrangements to ensure business records, client and transaction databases, servers and supporting documentation are backed-up in an offline medium.
- (c) The contingency plan should also be periodically tested.

59. Core Principle 4 - Governance, capabilities and resources: A Platform Operator should ensure there are robust governance arrangements for overseeing the operation of its online platform as well as adequate human, technology and financial resources to ensure that all operations are carried out properly.

- (a) For example, a Platform Operator should ensure that it has sufficient resources to safeguard data integrity, including confidential client information, and meet current and projected operational needs (eg, in respect of system capacity).

60. Core Principle 5 - Review and monitoring: Reviews of all activities conducted on its online platform should be performed by a Platform Operator as part of its ongoing supervision and monitoring obligation.

- (a) This would include regular reviews as well as ad hoc reviews where, for example, a major market event occurs. It is expected that regular reviews are conducted at least annually.
- (b) Where any function is outsourced to external service provider(s), the Platform Operator should exercise due skill, care and diligence in the selection, appointment and monitoring of the service provider(s).

61. Core Principle 6 - Record keeping: The Platform Operator should maintain proper records in respect of its online platform.

- (a) For example, comprehensive documentation on platform design, operational processes and risk management controls and records of applicable software versions (including programmes and any algorithms) should be maintained. All such documentation should be retained for a period of not less than two years after the online platform ceases to operate.

- (b) Proper audit trails of activities and transactions conducted on the online platform (including audit trails demonstrating the product information that has been provided on the platform and that the Platform Operator has disclosed any applicable warning statements) should also be kept and retained for a period of not less than two years or such longer period as may be required under the Code of Conduct or related guidance issued by the SFC from time to time.
- (c) Further, audit trails and records relating to all suitability assessments (including audit trails demonstrating that transactions are suitable) should be retained for at least two years for exchange-traded products and at least seven years for other investment products.

**Question:**

- 3. Do you have any comments on the Core Principles in the Proposed Guidelines as outlined above? Are there any other areas which you think the Proposed Guidelines should cover? Please explain your view.

**B. Robo-advice**

- 62. As mentioned above, online platforms offer a wide range of investment services. Apart from order execution and product distribution, some provide investment advice such as automated portfolio construction or model portfolios based on a client's personal circumstances. This is commonly known as "robo-advice".
- 63. Robo-advice involves the provision of financial advice in an online environment using algorithms and other technology (Platform Operators providing robo-advice are hereinafter referred to as "robo-advisers"). Different types of robo-advice can be offered, including (i) full automation (ie, fully-automated investment advice via an online platform with no human intervention); (ii) adviser-assisted (ie, the online platform provides an option for clients to contact an adviser depending on their needs); and (iii) guided advice (ie, investment advice is provided by an adviser who is assisted and supported by technology tools).
- 64. The conduct requirements applicable to the distribution of investment products and the provision of financial advice are principles-based, applicable equally to offline and online contexts. Accordingly, robo-advisers must comply with all applicable conduct requirements, including the Suitability Requirement.
- 65. The Suitability Requirement must be discharged in accordance with the existing requirements under the Code of Conduct when advice is given. For example, the algorithms used should not be programmed to direct clients towards particular investment products for which the robo-adviser or its affiliates receive higher commissions or other forms of compensation. Where advice is provided on a discretionary basis, robo-advisers

should also refer to guidance issued by the SFC concerning compliance with the Suitability Requirement<sup>15</sup>.

#### Information for clients

66. A wide range of approaches to the provision of robo-advice is seen in the market. Some robo-advisers provide goals-based advice whereby predefined model portfolios are offered with different underlying strategies to achieve individual goals such as planning for education of children, saving for a down-payment for a property or retirement. Others may provide predefined model portfolios calibrated to clients' different risk categories.
67. In describing the investment advisory services they offer, robo-advisers should ensure that the description is accurate. For example, where a robo-adviser provides goals-based advice such as planning for education of children, it should not describe its services as providing comprehensive financial planning.
68. Robo-advisers should also ensure that sufficient information is provided to investors prior to client on-boarding to enable investors to make an informed decision regarding whether to employ the services of the robo-adviser. This would include information on the limitations, risks and how key components of its services are generated (such as a description of how underlying algorithms operate, any limitations of the algorithm, how a portfolio rebalancing mechanism works and associated risks). Robo-advisers should also inform and explain to investors the degree of human involvement (eg, advice via web-chat) provided.
69. Disclosures made by robo-advisers should be easily comprehensible. This can be achieved by presenting information through design features such as pop-up boxes or tooltips, or other means or media.

#### Client profiling

70. Information about a client is central to the provision of suitable advice by a robo-adviser. Many robo-advisers obtain client information through tools and processes such as risk-scoring/profiling and other questionnaires. Where risk-scoring questionnaires are used, robo-advisers should pay particular attention to the design of the questions and the underlying scoring mechanism, which should be designed to accurately reflect the personal circumstances of a client<sup>16</sup>.
71. Any client profiling tool or questionnaire should be designed such that sufficient information is obtained (including, where appropriate, providing clients with the opportunity to provide additional explanatory and contextual information) to enable the robo-adviser to provide advice that is suitable based on clients' personal circumstances. Where a client provides inconsistent information, the robo-adviser should have mechanisms to identify and seek to reconcile the inconsistencies (eg, by alerting a client to such inconsistencies through pop-up boxes and providing an opportunity to change the information provided or internally flagging such inconsistent information for review and follow-up).

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<sup>15</sup> For example, the SFC's Circular to Intermediaries – Frequently Asked Questions on Triggering of Suitability Obligations, December 2016 and the SFC's Circular to Intermediaries – Frequently Asked Questions on Compliance with Suitability Obligations, December 2016, and as amended from time to time (the Suitability FAQs).

<sup>16</sup> Please refer to the Suitability FAQs.

72. Advisory services provided by a robo-adviser may be calibrated to clients' different risk categories. A discussion of relevant requirements for a risk analysis assessment is set out in Part C of Section III of this paper.

#### System design and development

73. Algorithms are core components of digital financial advice tools. It is therefore essential that robo-advisers effectively manage and adequately supervise their design, development, deployment and operations. The design and operations of algorithms should be in compliance with relevant conduct requirements including, where applicable, requirements in paragraph 18 (Electronic Trading) of and Schedule 7 to the Code of Conduct and any relevant guidelines.
74. Robo-advisers should maintain appropriate documentation concerning the design and development (including modifications) of all algorithms, including their rationale.
75. Robo-advisers should also ensure that the algorithms take into account the information obtained about each client and use objective criteria to generate reasonably suitable investment recommendations and/or advice.

#### Supervision and testing of algorithms

76. Robo-advisers should supervise the operation and testing of the algorithms used. Algorithms should be tested before deployment and before any subsequent developments and modifications to ensure that the output conforms to the robo-adviser's expectations. Robo-advisers should also regularly monitor and test algorithms and the reasonableness of the advice generated. Such reviews should be conducted by a qualified person who understands the technology, operations and algorithms used to generate the advice.
77. Robo-advisers should maintain documented manuals concerning the scope and strategy for the testing of algorithms. Records of testing conducted and test results should be maintained.
78. When errors are detected in algorithms, robo-advisers should also have adequate resources and measures in place to rectify any problem as well as controls to suspend the provision of advice or services where necessary.
79. Robo-advisers must also exercise due skill, care and diligence when selecting and monitoring any outsourced service providers. This would also include the selection and monitoring of any third party in the development, management, or ownership of the algorithms used.

#### Rebalancing

80. It is common for robo-advisers to generate predefined model portfolios and to use algorithms to automatically rebalance the portfolio in order to maintain a target asset allocation over time. Robo-advisers should make clear to clients how the rebalancing process operates including the frequency of such rebalancing, any additional costs that may be incurred due to the rebalancing, and risks associated with automatic rebalancing (such as automatic rebalancing occurring regardless of market conditions).
81. Robo-advisers are also expected to put in place policies and procedures which define how the algorithm would handle a major market event.

82. Where there are changes to the existing algorithm that may materially affect clients' portfolios, relevant clients should be clearly and promptly informed of such changes.

**Questions:**

4. Are there any other areas relating to robo-advice which you think the Proposed Guidelines should cover? Please explain your view.
5. What are your views on the shortcomings of robo-advice? How can the Proposed Guidelines be further enhanced to address these issues?

**C. Application and discharge of the Suitability Requirement in the online context**

83. Paragraph 5.2 of the Code of Conduct sets out the Suitability Requirement for intermediaries, which is a key investor protection measure. Under paragraph 5.2, a licensed or registered person should, when making a recommendation or solicitation, ensure the suitability of the recommendation or solicitation for the client is reasonable in all the circumstances having regard to information about the client of which the licensed or registered person is or should be aware through the exercise of due diligence.

**I. Triggering of the Suitability Requirement**

84. The question of whether an intermediary has "solicited" or "recommended" is a question of fact which should be assessed in the light of all the circumstances leading up to the point of sale or advice.
85. The context (such as the manner of presentation) and content of product-specific materials posted on an online platform coupled with the design and overall impression created by the platform content would determine whether the Suitability Requirement is triggered. This is the case irrespective of the type of product being sold.
86. The posting of factual, fair and balanced product-specific materials would not in itself amount to a solicitation or recommendation and will thus not trigger the Suitability Requirement. This is so in the absence of other facts and circumstances that may reasonably be expected to influence investors to purchase a particular investment product. For example, the Suitability Requirement would apply where the platform emphasises some investment products over others or there are interactive one-to-one communications involving solicitations or recommendations through the platform.
87. This is consistent with the offline environment where, in the absence of direct communications with a client, the Suitability Requirement is unlikely to be triggered by the mere posting of an advertisement for an investment product in newspapers, magazines or television programmes, or by the wide dissemination of research reports<sup>17</sup>.

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<sup>17</sup> Please refer to the SFC's Circular to Intermediaries – Frequently Asked Questions on Triggering of Suitability Obligations, December 2016.

88. Where materials about investment products that amount to solicitations or recommendations are posted on an online platform, the Suitability Requirement is triggered and must then be discharged at the point of sale or advice.

Materials posted on an online platform

89. Online platforms often provide factual product information such as corporate information (eg, announcements, circulars or annual reports) issued by listed issuers or the provision of a link to such information in relation to exchange-traded investment products, and offering documents, notices to investors, annual reports and fact sheets in relation to non-exchange-traded products. This is in line with existing Code of Conduct requirements which require intermediaries to make adequate disclosure of relevant material information.
90. Brokers, especially international firms, also provide information and analysis about different exchange-traded products as part of their services to clients. These range from research reports, to materials which may be promotional in nature (eg, advertisements). These materials often contain indications to buy, hold, or sell a specific listed stock with a target price.
91. To provide guidance to Platform Operators, set out below are examples of when the posting of materials would or would not trigger the Suitability Requirement:

Examples of when the Suitability Requirement is **NOT** triggered:

- (1) Provision of a direct facility to input stock codes to place orders for exchange-traded products for secondary market trading on the relevant exchange.
- (2) Posting of lists of, and provision of access to, investment products and posting of factual information such as corporate information (eg, announcements, circulars or annual reports) issued by listed issuers or the provision of a link to such information on the SEHK's website<sup>18</sup> or other factual information (eg, offering documents, notices to investors, annual reports, fact sheets, etc).
- (3) Posting of lists of investment products that are selected using objective criteria (eg, performance data, sales figures, research data).
- (4) Posting of advertisements of fee discounts not tied to any specific investment product (eg, lower subscription fees during a client's birthday month, time-limited reduced rates or loyalty discounts to reduce transaction fees in general).
- (5) Provision of objective filters for self-directed research on funds (eg, geographical location, underlying assets, one-year, three-year, five-year performance data or performance data since launch, risk categories and third party or in-house risk ratings).
- (6) Posting of non-product specific information such as market news or updates, industry and sector trends, and education materials.
- (7) The simple flashing of a "new" icon next to newly published research reports (which may contain views on buy, hold or sell with target prices) or newly issued investment products.

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<sup>18</sup> For shares listed on the SEHK. For shares listed on overseas exchanges, this would cover the provision of a link to the relevant overseas exchange's website or other official website to such information.

Examples of when the Suitability Requirement **IS** triggered:

- (1) Posting of advertisements with product-specific incentives (eg, cash rebates, fee discounts) for any transactions in a specific investment product<sup>19</sup>.
- (2) Posting of product-specific research reports on any investment product with words such as “Don’t Miss Out!” or “Act Now!”.
- (3) Presenting a specific list of investment products with an accompanying statement such as “product of risk rating X or below may suit you or match your risk tolerance level” or “these products may suit you or match your risk tolerance level” to clients immediately after the online platform conducts a risk profiling of clients.
- (4) Upon a client’s completion of the know-your-client process or provision of information through a client profiling tool or upon a client providing updates to his or her information, generating a specific model portfolio with a list of investment products or generating a list of selected investment products which may be perceived to be based on a consideration of the information provided by the client.

92. Subject to consultation feedback, the SFC proposes to include the above examples as further guidance in FAQs, which will be updated to take into account market developments.

Sale of complex products on online platforms on an unsolicited basis

93. As mentioned above, concerns nevertheless arise about the sale of complex products on online platforms even in circumstances where the Suitability Requirement is not triggered. The SFC is of the view that online platforms should incorporate additional safeguards when offering complex products. A discussion of what amounts to a complex product and the additional protective measures proposed are set out in Part D of Section III.

Provision of investment advice

94. The provision of investment advice (including robo-advice) via an online platform will trigger the Suitability Requirement.

II. Discharging the Suitability Requirement

95. Where the Suitability Requirement is triggered, Platform Operators must discharge the suitability obligations at the point of sale or advice in accordance with the existing requirements under the Code of Conduct<sup>20</sup>. Existing requirements include ensuring that advice and recommendations are based on thorough analysis and take into account available alternatives<sup>21</sup> (eg, the availability of similar products which may be less costly) and, when providing investment advice, not taking commission rebates or other benefits as

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<sup>19</sup> Advertisements of non-complex HK government and PRC sovereign bonds with product-specific incentives would not amount to a solicitation or a recommendation.

<sup>20</sup> Platform Operators should also refer to the Suitability FAQs.

<sup>21</sup> Paragraph 3.4 of the Code of Conduct

the primary basis for soliciting or recommending particular investment products to clients<sup>22</sup>. Platform Operators should refer to relevant guidance issued by the SFC from time to time<sup>23</sup>.

#### Risk / return profile matching with client's personal circumstances

96. As part of its existing obligation to discharge the Suitability Requirement, Platform Operators should match the risk / return profile of each investment product with each client's personal circumstances<sup>24</sup>. Online platforms would likely need, as a minimum, to make an assessment of a client's risk tolerance and risk profile, and conduct product due diligence to ascertain the risk return profile of an investment product. Merely mechanically matching a product's risk rating with a client's risk tolerance level, however, may not be sufficient to discharge the Suitability Requirement<sup>25</sup>.

#### Risk analysis assessment

97. Platform Operators should ensure the proper design of a comprehensive risk profiling methodology which takes into account both quantitative and qualitative factors. This includes credit risk, liquidity risk, counterparty risk and use of leverage.
98. A Platform Operator should have appropriate processes to periodically review the mechanism and methodology for risk profiling clients and investment products. Platform Operators should update clients' information and risk categorisations on a regular basis, where appropriate<sup>26</sup>, and review the risk profiles of investment products at regular intervals.
99. The online platform should inform clients how risk profiles or ratings (if any) are determined by disclosing on the platform the methodology adopted for assigning ratings to investment products and categorising clients. Such disclosure should be accompanied by an explanation of the risk profiles of investment products and clients.

### III. Single SFC reference point for the Suitability Requirement

100. Separately, to ensure that the SFC guidance materials in respect of the Suitability Requirement can be easily referenced and accessed, we will consolidate and set out all relevant materials in one page on the SFC's website.

#### **Questions:**

6. Do you have any comments on the guidance on the Suitability Requirement to be provided in the Proposed Guidelines?
7. Do you have any comments on how the design and overall impression created by an online platform's content could trigger the Suitability Requirement?
8. Do you have any comments on the above examples of when the posting of materials on online platforms would or would not amount to a solicitation or recommendation?

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<sup>22</sup> The Suitability FAQs

<sup>23</sup> For example, the Suitability FAQs.

<sup>24</sup> Please refer to the Suitability FAQs.

<sup>25</sup> Please refer to the Suitability FAQs.

<sup>26</sup> For example, this may not be relevant for dormant client accounts.

9. Are there any examples not mentioned above that may suggest that the content or presentation of materials would amount to a solicitation or recommendation? Please explain your view.
10. Do you have any view on how risk analysis assessments and client profiling should be conducted and the quantitative and qualitative factors that any risk methodology should take into account?

#### **D. Sale of complex products on online platforms on an unsolicited basis**

101. The International Organization of Securities Commissions (IOSCO) has observed that “regulatory strategies that rely heavily on disclosure, without consideration of the sophistication of the customer, and/or suitability of the product, may not achieve satisfactory outcomes in terms of customer protection, especially where complex financial products are sold”<sup>27</sup>. IOSCO has emphasised that robust customer protection is particularly required in connection with the distribution of complex products.
102. In addition, IOSCO has set out principles for suitability with respect to the distribution of complex products. One of these requires that when an intermediary sells a complex product on an unsolicited basis (ie, without portfolio or discretionary management, advice or recommendations), the regulatory system should provide for adequate means to protect clients from associated risks. Possible protections include conducting a knowledge assessment, warnings to clients, disclosure of risks, and restrictions on access or distribution.

##### What is a complex product?

103. IOSCO’s definition of complex products refers to those whose terms, features and risks are not reasonably likely to be understood by a retail investor because of their complex structure (as opposed to more traditional or plain vanilla investment instruments), and which are difficult to value (ie, their valuations require specific skills and/or systems, particularly when there is a very limited or no secondary market).
104. The Proposed Guidelines set out the following factors which, in our view, should be considered in determining whether or not an investment product is complex:
  - (a) whether the product is a derivative product;
  - (b) whether a secondary market is available for the product at publicly available prices;
  - (c) whether there is adequate and transparent information on the product available to retail investors;
  - (d) whether there is a risk of losing more than the amount invested;

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<sup>27</sup> Suitability Requirements With Respect To the Distribution of Complex Financial Products Final Report, IOSCO, January 2013

- (e) whether any features or terms of the product could fundamentally alter the nature or risk of the investment or the pay-out profile or which include multiple variables or complicated formulas to determine the return; and
- (f) whether any features or terms of the product might render the investment illiquid.

105. Based on the above, the SFC is of the view that the following investment products are non-complex products:

- (a) shares traded on the SEHK or overseas exchanges that are subject to the oversight of regulators which are signatories to the IOSCO Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information (IOSCO MMoU)<sup>28</sup>;
- (b) non-complex bonds<sup>29</sup>;
- (c) SFC-authorized funds (including ETFs) that do not use financial derivative instruments (FDIs) extensively for investment or non-hedging purposes; and
- (d) SFC-authorized real estate investment trusts (REITs).

106. While derivative products are, by definition, complex products, additional requirements already apply to the sale of derivative products (including futures contracts, options, any leveraged transaction, SFC-authorized synthetic or futures-based ETFs, SFC-authorized leveraged and inverse products (L&I products), derivative warrants (DWs) and callable bull/bear contracts (CBBCs)) on an unsolicited basis under paragraphs 5.1A and 5.3 of the Code of Conduct. The SFC is proposing that additional protective measures should apply to the sale of all complex products via online platforms on an unsolicited basis. Examples of complex products include:

- (a) bonds with special features (including, but not limited to, perpetual, subordinated or callable bonds, or those with variable or deferred interest payment terms, extendable maturity dates, or those which are convertible or exchangeable or have contingent write down or loss absorption features<sup>30</sup>, or those with multiple credit support providers and structures) and/or bonds comprising one or more special features (complex bonds);
- (b) funds authorized by the SFC under 8.7 of the Code on Unit Trusts and Mutual Funds (UT Code) (ie, SFC-authorized hedge funds); and
- (c) funds not authorized by the SFC.

107. We have set out, in Appendix 3, examples of investment products we consider to be “non-complex” and examples of investment products that we consider are “complex products”. Subject to consultation feedback, we will publish the list on our website and will update it as needed.

<sup>28</sup> A list of these signatories can be found on the SFC’s website: <http://www.sfc.hk/web/EN/about-the-sfc/collaboration/overseas/iosco-mmou.html>.

<sup>29</sup> Please refer to paragraph 106(a) for the definition of “complex bonds”.

<sup>30</sup> Please refer to the SFC’s “Circular to Licensed Corporations – Selling of complex bonds and high-yield bonds”, 25 March 2014 and “Circular to Licensed Corporations and Registered Institutions – Selling of Fixed Income Products”, 19 November 2012.

### Proposed additional protective measures

108. Complex products exhibit varying degrees of complexity and risk levels. The fact that a product is complex does not necessarily mean that it is also high risk (eg, principal protected derivative products). On the other hand, simple products may be risky, such as high yield bonds and emerging market equity securities. However, complexity may make it difficult for investors to understand a product, whether or not it is high risk.
109. In an offline environment, it may be easier for clients to understand complex products by raising enquiries or answering questions posed by intermediaries. Intermediaries can ask follow-up questions if they have doubts about a client's understanding of a complex product.
110. In an online environment, where no advice is given and the Suitability Requirement is not triggered, an investor's understanding of a product would depend mainly on his or her ability to assimilate information posted on an online platform. It is likely to be difficult for an average investor to fully understand the nature and risks associated with a complex product based only on this information.
111. As mentioned above, on an online platform investors can often view and have easy access to a wide range of investment products, which may include complex products. This, coupled with our proposal that the posting of factual, fair and balanced product-specific materials would not in itself amount to a solicitation or recommendation, means that, without more, there would be scope for complex products to be sold on an unsolicited basis on online platforms without the protection of the Suitability Requirement.
112. Core Principle 1 of the Proposed Guidelines requires Platform Operators to act with due skill, care and diligence in selecting the products, including complex products, to be made available on their platforms. However, it would clearly not be practicable for a Platform Operator to ensure that every complex product made available on its platform is appropriate or suitable for all clients who may be able to access the platform.
113. In the traditional offline environment, investors are usually only made aware of a limited number of products which a representative specifically mentions or recommends. Further, complex products generally tend to be sold, not bought, with representatives providing advice. As a result, in the offline environment it is likely that sales of complex products would involve solicitations and recommendations triggering the Suitability Requirement. This is an important factor distinguishing the offline from the online environments.

### Ensuring suitability in the sale of complex products

114. In view of the above, the Proposed Guidelines would require that Platform Operators must ensure any transaction in a complex product (other than derivative products traded on an exchange) is suitable for the client in all the circumstances as if it were under the obligation to discharge the Suitability Requirement under paragraph 5.2 of the Code of Conduct. The requirement to ensure suitability would apply even where the materials posted on an online platform would not otherwise trigger the Suitability Requirement and no recommendation or advice is being given or offered.
115. Given that exchange-traded derivative products will generally have more standardised features, the existing additional requirements that already apply to the sale of exchange-traded derivative products under paragraphs 5.1A and 5.3 of the Code of Conduct are considered adequate. As such, Platform Operators should continue to comply with

paragraphs 5.1A and 5.3 of the Code of Conduct in relation to the sale of exchange-traded derivative products.

116. In line with the existing position under the Code of Conduct, Platform Operators will not be exempt from this new requirement to ensure suitability in the sale of complex products<sup>31</sup> through online platforms with respect to clients who are Individual Professional Investors, but may be exempt with respect to Corporate Professional Investor clients.
117. The SFC is mindful that it is proposing a new basis for triggering the Suitability Requirement which hinges on whether a product available on an online platform is in fact complex, rather than whether there has been any solicitation or recommendation of the product. Depending on consultation feedback, if this proposal is implemented, we will consider extending the same requirement to the offline environment by way of an amendment to the Code of Conduct, subject to further consultation if appropriate.

Minimum information and warning statements

118. Another additional proposed safeguard is to require Platform Operators to provide, as a minimum, certain basic and key information on all complex products<sup>32</sup>. This is in addition to providing clients with up-to-date product offering documents or information under Core Principle 2 (which requires Platform Operators to make clear and adequate disclosure of relevant material information). The proposed minimum information that should be provided is set out in Appendix 4. Subject to consultation feedback, the SFC will issue FAQs on this. The posting of offering documents containing such minimum information on the online platform would generally satisfy this requirement.
119. The SFC also proposes that there should be prominent and clear statements on online platforms to warn investors about a complex product<sup>33</sup> prior to and reasonably proximate to the point of sale or advice. In Appendix 4, we have set out some examples of warning statements which should be included on an online platform. Subject to consultation feedback, these will also be set out in the form of FAQs.
120. A flowchart (Flowchart) setting out the proposals in relation to the sale of investment products on online platforms as per the Proposed Guidelines is contained in Appendix 1 to this paper.

**Questions:**

11. Do you have any comments on the definition of a complex product, and the considerations that should be taken into account in determining whether a product is complex?
12. Do you have any comments on the list of investment products that are considered to be “non-complex”?
13. Do you have any comments on the list of examples of investment products that are

<sup>31</sup> Other than derivative products traded on an exchange.

<sup>32</sup> Other than derivative products traded on an exchange as these are already subject to the requirements in paragraph 5.1A and 5.3 of the Code of Conduct.

<sup>33</sup> Other than derivative products traded on an exchange as these are already subject to the requirements in paragraph 5.1A and 5.3 of the Code of Conduct.

considered to be “complex”? Please explain your view.

14. In the online environment, do you think that risks arising from the sale of complex products should be addressed by requiring Platform Operators to ensure transactions in complex products are suitable for clients? Please explain your view.
15. As the SFC’s concern arises from the sale of complex products, do you agree that the same requirement to ensure suitability should also apply to offline sales of complex products? Please explain your view.
16. Are there any other additional or alternative protective measures that should be introduced for the sale of complex products online?
17. Are there any types of investment products (eg, accumulators) that should not be made available on online platforms even where the Platform Operator is required to ensure suitability?
18. Do you think the items of minimum information set out in Appendix 4 are sufficient and appropriate? Please explain your view.
19. Do you have any comments on the proposed warning statements set out in Appendix 4 that should be made on an online platform?

## Implementation timeline

121. The proposals set out in this paper will be subject to a three-month public consultation. Taking into account the respondents’ comments, a consultation conclusions paper will be issued together with the final form of the Proposed Guidelines, which will become effective upon gazettal.
122. The SFC appreciates that the industry may wish to revise systems and controls to align with any final proposals. Accordingly, it is proposed that there will be a 12-month transition period before the full implementation of the Proposed Guidelines.

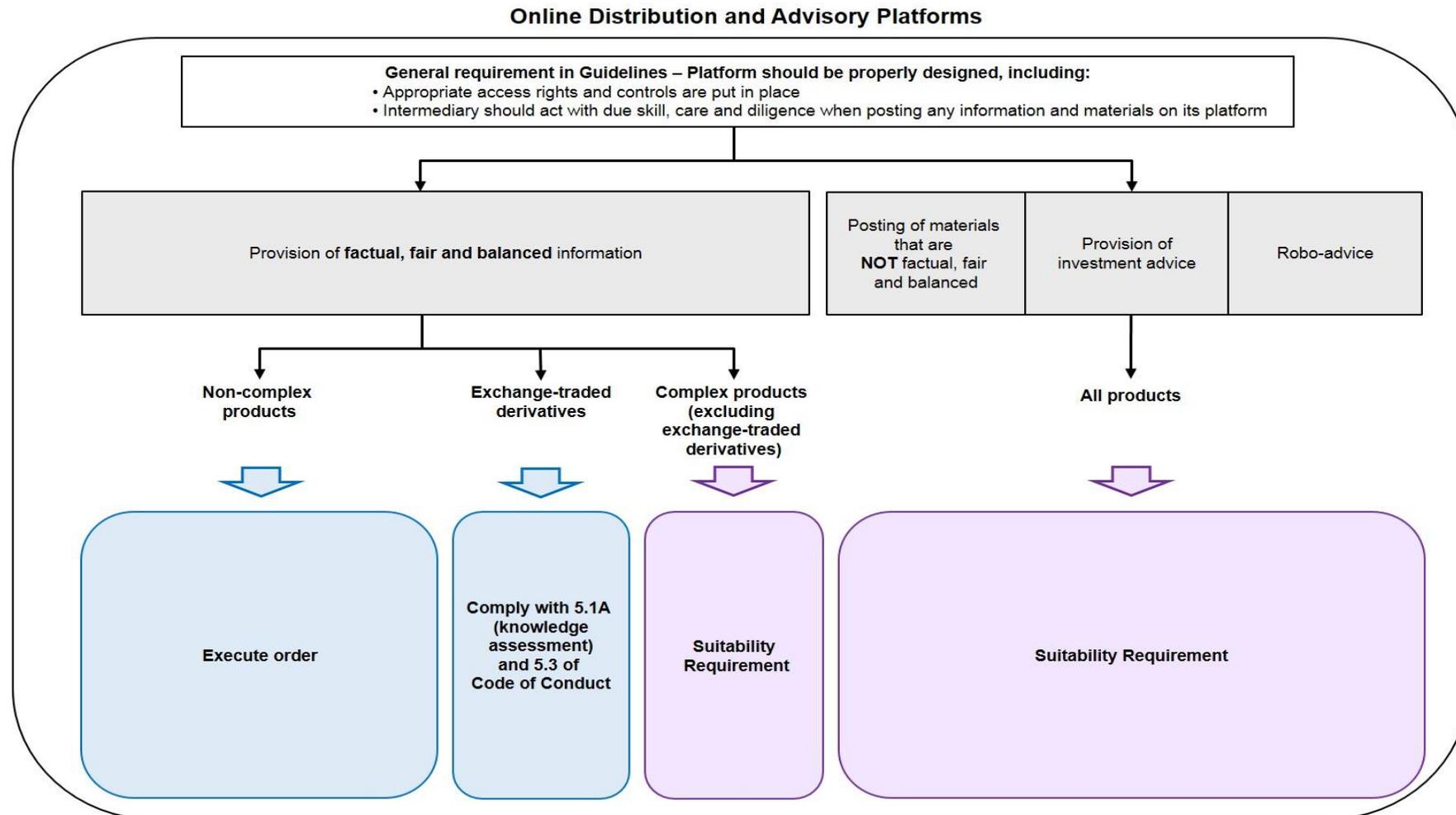
### Question:

20. Do you think a 12-month transition period is appropriate? If not, what do you think would be an appropriate transition period? Please set out your reasons.

## Seeking comments

123. The SFC welcomes any comments from the public and the industry on the proposals made in this paper and the indicative draft of the Proposed Guidelines on Online Distribution and Advisory Platforms set out in Appendix 2. Please submit comments to the SFC in writing by no later than 4 August 2017.

**Overview of the sale of investment products on online platforms as per the Proposed Guidelines**





**Proposed draft of the Guidelines on Online Distribution and Advisory Platforms**

**Guidelines on Online Distribution and Advisory Platforms**

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# Guidelines on Online Distribution and Advisory Platforms

## Chapter 1: Introduction

- 1.1 These Guidelines are issued under section 399 of the Securities and Futures Ordinance (SFO) and set out principles and requirements applicable to online distribution and advisory platforms for investment products operated by licensed or registered persons (Online Platforms). These Guidelines are not intended to be exhaustive and may be updated and revised from time to time.

*Note: A licensed or registered person may operate different websites, platforms and other channels such as social media accounts for posting information about investment products and transacting in them. The Securities and Futures Commission (SFC) will take into account activities targeting Hong Kong investors conducted by a licensed or registered person via all channels in their totality in considering the licensed or registered person's compliance with the requirements in these Guidelines.*

- 1.2 These Guidelines apply to all licensed or registered persons when conducting their regulated activities in providing order execution, distribution and advisory<sup>1</sup> services in respect of investment products via Online Platforms (Platform Operators).
- 1.3 Where an Online Platform also provides automated trading services (ATS) as defined in the SFO, the principles and standards set out in the Guidelines for the Regulation of Automated Trading Services<sup>2</sup> will apply.
- 1.4 Platform Operators who conduct electronic trading should also ensure that the requirements in paragraph 18 (Electronic Trading) of and Schedule 7 to the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (Code of Conduct) and any relevant guidelines are complied with.
- 1.5 Unless specified otherwise, terms used in these Guidelines bear the same meaning as defined in the SFO.
- 1.6 These Guidelines do not have the force of law and shall not be interpreted in a way which would override the provision of any law.
- 1.7 Failure by any person to comply with any applicable provision of these Guidelines:
- (a) shall not by itself render it liable to any judicial or other proceedings, but in any proceedings under the SFO before any court, these Guidelines may be admissible in evidence, and if any provision set out in these Guidelines appears to the court to be relevant to any question arising in the proceedings, it may be taken into account in determining the question; and

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<sup>1</sup> Including advisory services provided on a discretionary basis and automated/robo-advice.

<sup>2</sup> The SFC's Guidelines for the Regulation of Automated Trading Services, September 2016, as amended from time to time. These guidelines are applicable to providers of ATS authorized under Part III of the SFO or licensed or registered for Type 7 regulated activity under Part V of the SFO.

- (b) may cause the SFC to consider whether such failure adversely reflects on the person's fitness and propriety.

## Chapter 2: Core Principles

- 2.1 The SFC has identified six core principles which Platform Operators should comply with in the operation of their Online Platforms.

### **CP1. Proper design**

- 2.2 A Platform Operator should ensure that the Online Platform is properly designed and operated in compliance with all applicable laws and regulations.

*Note: This includes, but is not limited to, ensuring that:*

- (i) appropriate access rights and controls are put in place such that retail clients would not be able to invest in or view materials relating to investment products in circumstances that would constitute a breach of the Companies (Winding Up and Miscellaneous Provisions) Ordinance (C(WUMP)O) or Part IV of the SFO. For example, materials concerning exchange-traded funds (ETFs) not authorized by the SFC (such as overseas ETFs) should not be accessible by retail clients;*
- (ii) the Online Platform is operated with due skill, care and diligence, for example:
  - (a) a Platform Operator should act with due skill, care and diligence when selecting investment products to be made available on its Online Platform and when posting any information and materials on its Online Platform; and*
  - (b) when providing investment advice or recommendations to clients on its Online Platform, a Platform Operator should design its Online Platform to ensure that the investment advice or recommendations provided are based on thorough analysis and take into account available alternatives;**
- (iii) any conflicts of interest should be properly managed and minimised to ensure that clients are fairly treated, for example, when providing investment advice to clients on its Online Platform, a Platform Operator should not design its Online Platform in such a way that commission rebates or other benefits are taken as the primary basis for soliciting or recommending particular investment products to clients;*
- (iv) where available, exercise due skill, care and diligence to ensure the methodology for risk profiling investment products and/or clients is properly designed. In this connection, Platform Operators should make reference to the requirements in Chapter 5 of these Guidelines; and*
- (v) all systems and processes underpinning the operation of the Online Platform are robust and properly maintained such that the risk of fraud, errors and omissions, interruptions or other operational or control failures is minimised and appropriately managed.*

## **CP2. Information for clients**

2.3 A Platform Operator should make clear and adequate disclosure of relevant material information on its Online Platform.

*Note: This includes, but is not limited to:*

- (i) providing clients with access to up-to-date product offering documents or information<sup>3</sup>;*
- (ii) providing clients with material information as soon as reasonably practicable to enable clients to appraise the position of their investments (eg, in the event of any suspensions in the redemption of funds, any proposed merger or termination of funds or any other material information provided by issuers). In this connection, a Platform Operator should put in place proper arrangements and take adequate measures to enable it to access and be informed of up-to-date information concerning all non-exchange-traded investment products available on its Online Platform;*
- (iii) communicating any information in an easily comprehensible manner. A Platform Operator should use plain language in any disclosures made and presentation of information to make them easy to read and understand;*
- (iv) making available information on the methodology adopted for assessing and assigning ratings to investment products and categorising clients on the Online Platform, if any. Such information should also be accompanied by an explanation of the risk profiles of investment products and clients;*
- (v) informing clients of the scope and limitations of services and investment products that are provided through and on the Online Platform (eg, the availability of investment products is limited to those issued by related companies); and*
- (vi) disclosing to clients any remuneration to be paid by the client or other persons (eg, product issuers) to the Platform Operator, such as commission, brokerage and any other fees and charges, and any other monetary benefits received or receivable by the Platform Operator.*

## **CP3. Risk management**

2.4 A Platform Operator should ensure the reliability and security (including data protection and cybersecurity) of its Online Platform.

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<sup>3</sup> In respect of non-exchange-traded investment products, Platform Operators are expected to provide up-to-date product offering documents on their Online Platforms. For exchange-traded investment products, a good practice would be to provide a hyperlink to where up-to-date information could be accessed or a reminder to clients to refer to any such information before making an investment decision.

Note: This includes, but is not limited to:

### System reliability

- (i) a Platform Operator should ensure that its Online Platform, and all modifications to the Online Platform, are tested before deployment and are regularly reviewed to ensure that the Online Platform and its modifications are reliable;
- (ii) a Platform Operator should promptly report to the SFC any material service interruption or other significant issues related to its Online Platform;

### Contingencies

- (iii) a Platform Operator should identify and manage the associated risks (including any unintended consequences) prudently with appropriate contingency arrangements in place. Such arrangements should include a written contingency plan to cope with emergencies and disruptions related to the Online Platform. The contingency plan should at least include:
  - (a) a suitable backup facility or alternative arrangements for order execution in the event of an emergency;
  - (b) arrangements to ensure business records, client and transaction databases, servers and supporting documentation are backed up in an off-line medium. Off-site storage is generally expected to be subject to proper security measures; and
  - (c) a plan for dealing with client and regulatory enquiries by trained staff;
- (iv) a Platform Operator should ensure that the contingency plan to deal with potential emergencies and disruptions is periodically tested and the plan is viable and adequate;
- (v) in the event of a material delay or failure of the Online Platform, a Platform Operator should, in a timely manner:
  - (a) ensure the material delay or failure is rectified; and
  - (b) inform clients about the causes or possible causes of the material delay or failure and how client orders will be handled.

### System security

- (vi) a Platform Operator should also refer to guidance issued by the SFC from time to time on cybersecurity<sup>4</sup>.

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<sup>4</sup> For example, the Circular to All Licensed Corporations on Cybersecurity, SFC, March 2016.

#### **CP4. Governance, capabilities and resources**

- 2.5 A Platform Operator should ensure that there are robust governance arrangements in place for overseeing the operation of its Online Platform as well as adequate human, technology and financial resources available to ensure that the operations of its Online Platform are carried out properly.

*Note: A Platform Operator should establish and implement written internal policies and procedures on the operation of its Online Platform to ensure that:*

- (i) there is at least one responsible officer or executive officer responsible for the overall management and supervision of the Online Platform;*
- (ii) there is a formalised governance process with input from the dealing, information technology, risk and compliance functions;*
- (iii) there are clearly identified reporting lines with supervisory and reporting responsibilities assigned to appropriate staff members; and*
- (iv) there are managerial and supervisory controls that are designed to manage the risks associated with the use of the Online Platform.*

*A Platform Operator should conduct regular reviews to ensure that these internal policies and procedures are in line with regulatory developments and promptly remedy any deficiencies identified.*

*In operating its Online Platform, a Platform Operator should ensure that it has sufficient technology resources to, for example, safeguard data integrity, including confidential client information, and meet current and projected operational needs (eg, in respect of system capacity).*

#### **CP5. Review and monitoring**

- 2.6 Appropriate reviews of all activities conducted on the Online Platform should be performed by a Platform Operator as part of its ongoing supervision and monitoring obligation.

*Note: This includes, but is not limited to, regular reviews as well as ad hoc reviews where appropriate, for example, if a major market event occurs. It is expected that a regular review should be conducted at least annually.*

*Such regular review should cover all activities conducted on the Online Platform including the processes and outcomes of any client risk profiling, investment product selection and risk profiling, risk analysis assessment, suitability assessment, as well as the reasonableness of any recommendation or advice generated by the algorithm used (including any recommended model portfolio) and any rebalancing conducted. It should include sample checking and testing by a suitably-qualified person. There should also be policies and procedures to follow up on any review results and to implement any enhancements required.*

*Where any function is outsourced to external service provider(s), the Platform Operator should exercise due skill, care and diligence in the selection, appointment and ongoing monitoring of the outsourced service provider(s) to ensure proper performance of the outsourced function.*

## **CP6. Record keeping**

2.7 A Platform Operator should maintain proper records in respect of its Online Platform.

*Note: This includes, but is not limited to, comprehensive documentation on platform design, operational processes and risk management controls, including any testings, reviews, modifications, upgrades or rectifications of its Online Platform and records of the applicable software versions (including programmes and any algorithms). The documentation should be retained for a period of not less than 2 years after the Online Platform ceases to operate.*

*A Platform Operator should also keep proper audit trails of activities and transactions conducted on its Online Platform, including the processes and outcomes of any client profiling, investment product selection, risk analysis assessment, provision of product information, disclosure of warning statement, suitability assessment, advice provided and any rebalancing conducted, and incident reports for all material delays or failures of the Online Platform. The audit trails and records should be retained for a period of not less than 2 years or such longer period as may be required under the Code of Conduct or related guidance issued by the SFC from time to time. Further, audit trails and records relating to all suitability assessments (including audit trails and records demonstrating that transactions are suitable) should be retained for at least 2 years for exchange-traded investment products and at least 7 years for non-exchange-traded investment products.*

## Chapter 3: General Requirements

- 3.1 Platform Operators when conducting their regulated activities in providing order execution, distribution and advisory services in respect of investment products via Online Platforms must comply with all applicable laws and regulations including the SFC's conduct requirements, restrictions on the offer of investments, and those applicable to materials that may be posted on their Online Platforms.

### *Conduct requirements*

- 3.2 The regulatory framework governing the conduct of licensed or registered persons (including Platform Operators) is set out in the Code of Conduct, the Management, Supervision and Internal Control Guidelines for Persons Licensed by or Registered with the Securities and Futures Commission, and other codes, guidelines, circulars<sup>5</sup> and frequently-asked questions (FAQs) issued by the SFC from time to time.
- 3.3 These conduct requirements are in general principles-based such that they apply irrespective of the medium through which a licensed or registered person provides its services in carrying on the regulated activities for which the person is licensed or registered.
- 3.4 Conduct requirements include the General Principles in the Code of Conduct which set out the standards and requirements licensed or registered persons should meet in carrying out regulated activities. The Code of Conduct further sets out requirements augmenting the General Principles.
- 3.5 In particular, paragraph 5.2 of the Code of Conduct sets out the suitability requirement pursuant to which a licensed or registered person should, when making a recommendation or solicitation to a client, ensure the suitability of the recommendation or solicitation for that client is reasonable in all the circumstances having regard to information about the client of which the licensed or registered person is or should be aware through the exercise of due diligence (the Suitability Requirement).
- 3.6 This requirement forms part of a suite of duties set out in the Code of Conduct to which licensed or registered persons who distribute investment products or provide financial advice are subject. Such duties include a duty to "know your client" (General Principle 4 and paragraphs 5.1 and 5.1A), a duty to exercise due skill, care and diligence, in the best interests of clients and the integrity of the market (General Principle 2 and paragraph 3.4), a duty to disclose relevant material information (General Principle 5), a duty to ensure that clients understand the nature and risks of derivative products and have sufficient net worth to bear the risks and potential losses of trading in derivative products (paragraph 5.3), and a duty to implement internal controls and supervise staff to ensure compliance with regulatory requirements (General Principles 3 and 7 and paragraphs 4.2, 4.3 and 12.1). Guidance in respect of these duties is found in guidelines, circulars and reports issued by the SFC from time to time.

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<sup>5</sup> Including the Circular to Intermediaries – Frequently Asked Questions on Triggering of Suitability Obligations, SFC, December 2016 and the Circular to Intermediaries – Frequently Asked Questions on Compliance with Suitability Obligations, SFC, December 2016, and as amended from time to time (Suitability FAQs)

- 3.7 Further guidance on the Suitability Requirement in the context of Online Platforms is also set out in Chapter 5 of these Guidelines.
- 3.8 Platform Operators should note in particular, but without limitation, the following conduct requirements:
- (a) for derivative products (including futures contracts, options and any leveraged transaction), the investor characterization requirements in paragraph 5.1A of the Code of Conduct and the know-your-client requirement in paragraph 5.3 of the Code of Conduct;
  - (b) the requirement to disclose monetary and non-monetary benefits in paragraph 8.3 of the Code of Conduct;
  - (c) the requirement to disclose transaction related information in paragraph 8.3A of the Code of Conduct;
  - (d) the requirement to ensure best execution in paragraph 3.2 of the Code of Conduct;
  - (e) the requirement to handle client orders fairly and in the order in which they are received in paragraph 9.1 of the Code of Conduct;
  - (f) the requirement governing the priority for client orders in paragraph 9.2 of the Code of Conduct;
  - (g) where a Platform Operator only makes available on its Online Platform investment products issued by it and/or its related companies, the requirement to disclose this limited availability of investment products to clients<sup>6</sup>;
  - (h) the requirement not to take commission rebates or other benefits receivable by them or their related companies as the primary basis for soliciting or recommending particular investment products to clients<sup>7</sup>;
  - (i) the prohibition on the use of gifts in promoting a specific investment product in paragraph 3.11 of the Code of Conduct; and
  - (j) compliance requirements in paragraph 12 of the Code of Conduct, including the obligation in paragraph 12.5 to report any material breach or suspected material breach of any law, rules, regulations, and codes administered or issued by the SFC, etc to the SFC immediately.

#### *Offer of investments*

- 3.9 Platform Operators should note in particular, but without limitation, the following offer of investments requirements:

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<sup>6</sup> Suitability FAQs

<sup>7</sup> Suitability FAQs

- (a) prospectus requirements for offering of shares and debentures under the C(WUMP)O<sup>8</sup> ;
- (b) restrictions on offers of investments under Part IV of the SFO - in particular the restrictions on offering of unauthorized collective investment schemes (CIS) and structured products (eg, overseas exchange-traded ETFs, unauthorized CIS and structured products) notwithstanding the offer is made by or on behalf of an intermediary licensed or registered for Type 1, Type 4 or Type 6 regulated activity<sup>9</sup>;
- (c) restrictions applicable to certain overseas exchange-traded products or ATS products under the relevant ATS authorization conditions; and
- (d) relevant requirements relating to the offering of CIS on the internet as set out in the Guidance Note for Persons Advertising or Offering Collective Investment Schemes on the Internet.

*Materials posted on an Online Platform*

3.10 In respect of the posting of any advertisement, research report and other investment product-specific materials on their Online Platforms, Platform Operators should note in particular, but without limitation, the following requirements relevant to the issue of such materials:

- (a) the issue of advertisements in respect of investment products is regulated under Part IV of the SFO. In particular, certain misrepresentations made by a person may attract civil<sup>10</sup> and/or criminal<sup>11</sup> liability under Part IV of the SFO and the disclosure of false or misleading information inducing transactions may constitute market misconduct which is subject to civil or criminal liability under the SFO<sup>12</sup>;
- (b) the contents of advertisements must also comply with relevant advertising guidelines<sup>13</sup>, offer awareness guidelines<sup>14</sup>, marketing materials guidelines<sup>15</sup> and/or the SEHK Listing Rules<sup>16</sup> where applicable;
- (c) the requirement to ensure that advertisements do not contain information that is false, biased, misleading or deceptive<sup>17</sup>;

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<sup>8</sup> Parts II and XII of the C(WUMP)O

<sup>9</sup> Sections 103(2)(a) and 103(11) of the SFO

<sup>10</sup> Section 108 of the SFO

<sup>11</sup> Section 107 of the SFO

<sup>12</sup> Sections 277 and 298 of the SFO

<sup>13</sup> Advertising Guidelines Applicable to Collective Investment Schemes Authorized under the Product Codes issued by the SFC

<sup>14</sup> Guidelines on use of offer awareness and summary disclosure materials in offerings of shares and debentures under the Companies Ordinance issued by the SFC

<sup>15</sup> Guidelines on Marketing Materials for Listed Structured Products issued by the SFC

<sup>16</sup> Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited

<sup>17</sup> GP1 (Honesty and fairness) and paragraphs 2.1 and 2.3 of the Code of Conduct, Advertising Guidelines Applicable to Collective Investment Schemes Authorized under the Product Codes issued by the SFC, Guidelines on Marketing Materials for Listed Structured Products issued by the SFC

- (d) for research reports, the conflicts of interest requirements<sup>18</sup> and the applicable requirements under paragraph 16 (Analysts) as well as the General Principles<sup>19</sup> of the Code of Conduct; and
- (e) the requirement to act with due skill, care and diligence in expressing any opinion<sup>20</sup>.

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<sup>18</sup> GP6 (Conflicts of interest) and paragraph 10.1 of the Code of Conduct

<sup>19</sup> Including GPs 1 (Honesty and fairness), 2 (Diligence), 5 (Information for clients) and 6 (Conflicts of interest) of the Code of Conduct

<sup>20</sup> GP2 (Diligence) of the Code of Conduct, which requires a licensed or registered 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.

## Chapter 4: Robo-Advice

- 4.1 Robo-advice (sometimes referred to as digital advice or automated advice) involves the provision of financial advice in an online environment using algorithms and other technology (a licensed or registered person providing robo-advice is hereinafter referred to as a “robo-adviser”).

*Note: There are many different types of robo-advice services, for example, (i) full automation (ie, fully-automated investment advice via an Online Platform with no human intervention); (ii) adviser-assisted (ie, the Online Platform provides an option for clients to contact an adviser depending on their needs); and (iii) guided advice (ie, investment advice is provided by an adviser who is assisted and supported by technology tools). Where such services involve web-chats or similar interactive facilities, the licensed or registered person should also comply with the guidance<sup>21</sup> in the context of transactions conducted in an interactive environment issued by the SFC from time to time.*

*Where advice is provided on a discretionary basis, robo-advisers should also refer to guidance issued by the SFC from time to time in respect of compliance with the Suitability Requirement<sup>22</sup>.*

### Information for clients

- 4.2 A robo-adviser should provide sufficient information on its Online Platform to enable investors to make an informed decision regarding whether to employ its services. A robo-adviser should also make clear and adequate disclosure of relevant material information to clients on its Online Platform on an ongoing basis.

*Note: This would include information on the limitations, risks and how key components of its services are generated (such as a description of how underlying algorithms operate, any limitations of the algorithm, how the portfolio rebalancing mechanism operates and associated risks).*

*Robo-advisers should also inform and explain to investors and clients the degree of human involvement that it provides.*

- 4.3 A robo-adviser should ensure that it accurately describes the services it provides.

- 4.4 Information disclosed by a robo-adviser should be easily comprehensible.

*Note: This could be achieved by presenting information through design features such as pop-up boxes or tooltips, or other means or media.*

### Client profiling

- 4.5 Where a robo-adviser uses client profiling tools and/or questionnaires to obtain information about clients as part of its know your client process, it should ensure that the client profiling tools and/or questionnaires are properly designed such that

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<sup>21</sup> For example, the Suitability FAQs.

<sup>22</sup> For example, the Suitability FAQs.

sufficient information is obtained to enable it to provide advice that is suitable based on clients' personal circumstances.

*Note: This would include designing the client profiling tools and/or questionnaires such that clients are provided with the opportunity to provide additional explanatory and contextual information, where appropriate.*

- 4.6 A robo-adviser should have in place proper mechanisms to identify and seek to reconcile any inconsistencies in the information provided by a client.

*Note: For example, robo-advisers could alert a client to such inconsistencies through pop-up boxes and could provide the client with an opportunity to change the information provided. Robo-advisers could also internally flag any inconsistent information for review and follow-up.*

- 4.7 Where a robo-adviser uses risk-scoring questionnaires to risk profile clients and/or to determine the advisory services to be provided to clients, it should pay particular attention to the design of the questions and the underlying scoring mechanism, which should be properly designed to accurately reflect the personal circumstances of a client.

*Note: In this connection, robo-advisers should also make reference to the requirements in Chapter 5 of these Guidelines.*

#### *System design and development*

- 4.8 Algorithms are the core components of digital financial advice tools adopted by robo-advisers. It is essential that a robo-adviser effectively manages and adequately supervises the design, development, deployment and operations of algorithms used in digital-advice tools. In particular, a robo-adviser should:

- (a) ensure the design and operations of algorithms used are in compliance with relevant conduct requirements including, where applicable, requirements in paragraph 18 (Electronic Trading) of and Schedule 7 to the Code of Conduct and any relevant guidelines;
- (b) ensure that the algorithms take into account all relevant information about each client obtained through the know-your-client process and use objective criteria to generate investment recommendations and/or advice which match the client's personal circumstances against suitable investment products and operate in a manner that is not biased; and

*Note: This would include ensuring that algorithms used should not be programmed to direct clients towards particular investment products for which the robo-adviser or its affiliates receive higher commissions or other forms of compensation.*

- (c) maintain appropriate documentation on the design and development (including any modifications) of the algorithms. The documentation should set out the rationale for the design, development and modification, as well as the intended outcome, objectives, and scope of the algorithms.

### *Supervision and testing of algorithms*

- 4.9 A robo-adviser should supervise the operation and testing of the algorithms that form the basis of any investment advice it provides. A robo-adviser should:
- (a) have a documented plan with details on the scope and strategy for the testing of algorithms (including the design and implementation of test plans, selection of test cases, treatment of test results and defect rectification procedures);
  - (b) have security measures in place to prevent and detect unauthorized access to the algorithms;
  - (c) test algorithms before deployment and any subsequent developments and/or modifications to assess whether the methodology (including any assumptions made) is well-suited, the data input used is appropriate to cover the expected scenarios and the output conforms with the robo-adviser's expectations;
  - (d) have robust policies and procedures in place to monitor and test the algorithms and the reasonableness of the advice provided to clients (eg, regular and random samples of robo-advice provided should be tested/reviewed by a suitably-qualified person to ensure all applicable requirements are complied with);
  - (e) have proper policies and procedures for a suitably-qualified person to manage, supervise, review and modify algorithms where appropriate (eg, when there are market or regulatory changes);
  - (f) exercise due skill, care and diligence when selecting and monitoring any outsourced service provider, including in the selection and monitoring of any third party in the development, management, or ownership of the algorithms used;
  - (g) conduct regular reviews of advice. When modifications to the algorithms are made, the robo-adviser should arrange for a suitably-qualified person to perform validation and other appropriate tests to ensure the reasonableness of the advice provided; and
  - (h) take immediate measures to rectify any problem when errors are detected in the algorithms and have controls in place to suspend provision of advice or service where necessary.

### *Adequate resources*

- 4.10 A robo-adviser should ensure that it has adequate staff who have sufficient expertise and understanding of the technology, operations and algorithms (including the rationale, risks and rules behind the algorithms), and who are closely involved in the design, development, deployment and ongoing supervision of the operation of the algorithms.
- 4.11 Adequate training or testing should be provided by the robo-adviser to all staff who make use of the robo-advisory tools of the robo-adviser.

- 4.12 A robo-adviser should ensure that it has sufficient technology resources and up-to-date infrastructure to support the proper operation of the Online Platform (including any system requirements arising from modifications to the algorithms used).

### *Rebalancing*

- 4.13 When algorithms are used to rebalance a predefined model portfolio automatically in order to maintain a target asset allocation over time, the robo-adviser should ensure effective practices for automatic rebalancing are in place. Such practices should include, without limitation, the following:
- (a) informing clients clearly at the outset that automatic portfolio rebalancing (where applicable) would occur on a periodic basis to maintain the target asset allocation and, where applicable, additional costs may be incurred due to such rebalancing;
  - (b) disclosing to clients how the portfolio rebalancing mechanism operates, including:
    - (i) if the robo-adviser uses deviation thresholds on an asset class or a particular type of securities, disclosing what the thresholds are and whether (and, if so, how) they vary by asset class or particular type of securities; and  

*Note: The composition of an investment portfolio may deviate from time to time from its intended target asset allocation for different reasons (eg, market volatility). In such cases, portfolio rebalancing may become necessary.*
    - (ii) if portfolio rebalancing is scheduled, disclosing the frequency; and
    - (iii) any risks associated with automatic rebalancing (such as rebalancing may occur irrespective of market conditions);
  - (c) establishing and maintaining policies and procedures to define how the algorithms would handle any major market event; and
  - (d) where there are changes to the existing algorithm that may materially affect clients' portfolios, clearly and promptly informing the relevant clients of such changes.

## Chapter 5: Suitability Requirement and other conduct requirements applicable to the Sale of Investment Products

- 5.1 Platform Operators should comply with all existing conduct requirements under the Code of Conduct applicable to the regulated activities they conduct via their Online Platforms.

### *Suitability Requirement*

- 5.2 The sale of investment products on Online Platforms is also subject to the Suitability Requirement set out in paragraph 5.2 of the Code of Conduct. Under paragraph 5.2, a licensed or registered person should, when making a recommendation or solicitation, ensure the suitability of the recommendation or solicitation for the client is reasonable in all the circumstances having regard to information about the client of which the licensed or registered person is or should be aware through the exercise of due diligence.

### *Triggering of the Suitability Requirement*

- 5.3 The question of whether there has been a “solicitation” or “recommendation” triggering the Suitability Requirement is a question of fact which should be assessed in light of all the circumstances leading up to the point of sale or advice.

*Note: To facilitate a better understanding of the circumstances under which the Suitability Requirement would be likely or unlikely to be regarded as being triggered under paragraph 5.2 of the Code of Conduct, Platform Operators should refer to guidance<sup>23</sup> published by the SFC (which may be updated from time to time).*

*The context (such as the manner of presentation) and content of product-specific materials posted on an Online Platform coupled with the design and overall impression created by the content of the Online Platform would determine whether the Suitability Requirement is triggered.*

*The posting of factual, fair and balanced product-specific materials would not in itself amount to a solicitation or recommendation and will not trigger the Suitability Requirement. This is so in the absence of other circumstances that amount to a solicitation or recommendation in a particular investment product. This would occur, for example, where the Online Platform emphasises some investment products over others or there have been interactive one-to-one communications involving solicitations or recommendations through the Online Platform.*

*Platform Operators should also note the additional requirements applicable to transactions in complex products set out in Chapter 6 of these Guidelines.*

- 5.4 Platform Operators should also refer to guidance published by the SFC (which may be updated from time to time) on how the posting of materials on Online Platforms would or would not trigger the Suitability Requirement.

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<sup>23</sup> For example, the Circular to Intermediaries – Frequently Asked Questions on Triggering of Suitability Obligations, SFC, December 2016.

- 5.5 For the avoidance of doubt, the provision of investment advice (including robo-advice) on investment products on an Online Platform will trigger the Suitability Requirement.

#### *Discharging the Suitability Requirement*

- 5.6 Once the Suitability Requirement is triggered, Platform Operators must discharge the suitability obligations at the point of sale or advice in accordance with the existing requirements under the Code of Conduct<sup>24</sup>.
- 5.7 As part of its existing obligation to discharge the Suitability Requirement, Platform Operators should match the risk return profile of the investment product selected by a client with the personal circumstances of that client<sup>25</sup>.

*Note: This may involve an Online Platform making an assessment of a client's risk tolerance level and risk profile and accordingly risk profiling the client, and the Platform Operator conducting product due diligence to ascertain the risk return profile of an investment product and accordingly risk profiling the investment product. It should be noted, however, that merely mechanically matching an investment product's risk rating with a client's risk tolerance level may not be sufficient to discharge the Suitability Requirement<sup>26</sup>.*

*A Platform Operator should ensure that in assigning risk profiles to investment products, its risk profiling methodology is properly designed to take into account both quantitative and qualitative factors and consider all risks involved, including credit risk, liquidity risk, counterparty risk, use of leverage, etc. Platform Operators should have appropriate processes in place to periodically review the risk profiling methodology and mechanism for investment products. The risk profiles of investment products should also be reviewed at regular intervals.*

*In determining a client's risk profile, an Online Platform should base its assessment on information about the client obtained through its know-your-client process<sup>27</sup>. The individual risk profile of a client should also be reviewed and updated regularly, where appropriate<sup>28</sup>. Where risk-scoring questionnaires are used to risk profile clients, Platform Operators should pay particular attention to the design of the questions and the underlying scoring mechanism, which should be properly designed to accurately reflect the personal circumstances of a client<sup>29</sup>. Platform Operators should also have appropriate processes in place to periodically review the risk profiling methodology and mechanism for clients.*

- 5.8 In discharging the Suitability Requirement, Platform Operators should also note in particular (but not exclusively) the following where applicable:

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<sup>24</sup> Intermediaries should also refer to the Suitability FAQs.

<sup>25</sup> Please refer to the Suitability FAQs.

<sup>26</sup> Please refer to the Suitability FAQs.

<sup>27</sup> Paragraphs 5.1 and 5.1A of the Code of Conduct and the Suitability FAQs

<sup>28</sup> For example, this may not apply to a dormant client account.

<sup>29</sup> Please refer to the Suitability FAQs.

- (a) Platform Operators should act diligently and carefully in providing any advice and ensuring that advice and recommendations are based on thorough analysis and take into account available alternatives<sup>30</sup> (eg, availability of any similar investment products which may be less costly);
- (b) when providing investment advice to clients, Platform Operators should not take commission rebates or other benefits as the primary basis for soliciting or recommending particular investment products to clients<sup>31</sup>;
- (c) Platform Operators should establish a proper mechanism to assess the suitability of investment products when clients place orders via their Online Platforms. Such mechanism should be holistic (ie, all relevant factors concerning the personal circumstances of a client, including concentration risk, should be taken into account); and
- (d) an Online Platform should have in place appropriate tools for assessing a client's concentration risk and such an assessment should be based on the information about the client obtained by the Platform Operator through its know-your-client process and/or any investment portfolio held with the Platform Operator.

*Other conduct requirements applicable to the sale of investment products*

5.9 In addition to the Suitability Requirement, a Platform Operator should also comply with other applicable conduct requirements under the Code of Conduct.

*Note: This would include (but is not limited to) the following where applicable:*

- (i) *A Platform Operator should establish appropriate governance and supervisory mechanisms for the client profiling tool provided on its Online Platform, if any, and identify the key elements of information necessary to profile a client accurately<sup>32</sup>.*
- (ii) *An Online Platform should enable a client to update the client's information in any client profiling tool provided at any time should there be any updates or changes to the client's personal information (eg, investment objectives, risk appetite etc.)<sup>33</sup>*
- (iii) *Where insufficient information is obtained from a client by a Platform Operator through any client profiling tool provided on the Online Platform or otherwise through its know-your-client process, there should be a proper mechanism in place to determine whether the client should be allowed to proceed to place an order for an investment product<sup>34</sup>.*

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<sup>30</sup> GP2 (Diligence) and paragraph 3.4 of the Code of Conduct

<sup>31</sup> Suitability FAQs

<sup>32</sup> Suitability FAQs

<sup>33</sup> Suitability FAQs

<sup>34</sup> Suitability FAQs

- (iv) *Where a client provides inconsistent answers in any online client profiling tool provided, the Platform Operator should have in place a proper mechanism to identify and seek to reconcile the inconsistencies (eg, by providing the client with an opportunity to change its input)<sup>35</sup>. Where inconsistencies cannot be reconciled, it may be appropriate to filter the client out of the Online Platform.*
- (v) *An Online Platform should have in place proper systems to ensure that client orders are executed promptly in accordance with clients' instructions and are executed on the best available terms, where applicable. The Online Platform should also have in place proper mechanisms to promptly and fairly allocate any transactions executed on behalf of clients to the respective client accounts<sup>36</sup>.*

*Further points to note*

5.10 Platform Operators should note that where there are one-to-one interactions between a client and representatives of the Platform Operator via the Online Platform or there have been other communications between representatives of the Platform Operator and a client, this must be taken into account in determining whether the Suitability Requirement has been triggered. The Suitability Requirement may be triggered notwithstanding that some communications taken in isolation may not trigger the Suitability Requirement. Platform Operators should also refer to guidance concerning transactions conducted in an interactive environment issued by the SFC from time to time<sup>37</sup>.

*Note: Interaction between a client and representatives of the Platform Operator via the Online Platform or other communications between representatives of the Platform Operator and a client would include, for example, communications through live web-chat or where a client calls a hotline listed on the Online Platform and speaks with a representative of the Platform Operator.*

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<sup>35</sup> Suitability FAQs

<sup>36</sup> Paragraphs 3.1, 3.2, 3.3, 9.1 and 9.2 of the Code of Conduct

<sup>37</sup> For example, the Circular to Intermediaries – Frequently Asked Questions on Triggering of Suitability Obligations, SFC, December 2016.

## Chapter 6: Complex Products

### *Definition of a complex product*

- 6.1 A complex product is an investment product whose, terms, features and risks are not reasonably likely to be understood by a retail investor because of its complex structure and which is difficult to value.

*Note: Set out below are factors to determine whether an investment product is complex or not:*

- (i) whether the investment product is a derivative product;*
- (ii) whether a secondary market is available for the investment product at publicly available prices;*
- (iii) whether there is adequate and transparent information on the investment product available to retail investors;*
- (iv) whether there is a risk of losing more than the amount invested;*
- (v) whether any features or terms of the investment product could fundamentally alter the nature or risk of the investment or pay-out profile or include multiple variables or complicated formulas to determine the return; and*

*Note: This would include, for example, investments that incorporate a right for the investment product issuer to convert the instrument into a different investment.*

- (vi) whether any features or terms of the investment product might render the investment illiquid.*

- 6.2 A Platform Operator should refer to the examples of investment products that the SFC considers are not complex, and examples of complex products, which are published on the SFC's website.

### *Ensuring suitability of transactions in complex products*

- 6.3 Subject to paragraphs 6.5 to 6.7, an Online Platform should ensure that a transaction in a complex product is suitable for the client in all the circumstances.
- 6.4 Online Platforms should discharge the requirement in paragraph 6.3 to the standard of, and in accordance with, the existing requirements under the Code of Conduct applicable to the Suitability Requirement under paragraph 5.2 of the Code of Conduct.

*Note: Platform Operators should refer to the guidance on the Suitability Requirement in the context of Online Platforms in Chapter 5 of these Guidelines.*

- 6.5 For complex products which are also derivative products traded on an exchange, an Online Platform should comply with paragraphs 5.1A and 5.3 of the Code of Conduct instead of paragraph 6.3.

- 6.6 Platform Operators dealing with Institutional Professional Investors (as defined in the Code of Conduct) are automatically exempt from the requirement in paragraph 6.3.
- 6.7 To be exempt from the requirement in paragraph 6.3 when dealing with Corporate Professional Investors (as defined in the Code of Conduct), Platform Operators should observe and comply with the same requirements and procedures as set out in paragraphs 15.3A and 15.3B of the Code of Conduct in order to be exempt from the Suitability Requirement.
- 6.8 For the avoidance of doubt, no exemption is available to Platform Operators from the requirement in paragraph 6.3 when dealing with Individual Professional Investors (as defined in the Code of Conduct).

*Minimum information and warning statements*

- 6.9 Platform Operators should ensure that their Online Platforms provide sufficient information on the key nature, features and risks of a complex product (other than complex products which are also derivative products traded on an exchange) to enable clients to understand the complex product before making an investment decision.

*Note: Platform Operators should refer to guidance issued by the SFC from time to time in relation to the minimum information that should be provided. Where this information is contained in the offering documents of a complex product, the posting of such offering documents on the Online Platform would generally satisfy this requirement.*

- 6.10 Platform Operators should ensure that there are prominent and clear warning statement(s) on their Online Platform, where appropriate, to warn clients about a complex product (other than complex products which are also derivative products traded on an exchange) prior to and reasonably proximate to the point of sale or advice.

*Note: Platform Operators should refer to guidance issued by the SFC from time to time for examples of the warning statement(s) that should be made on their Online Platforms.*

### Non-complex and complex products

Set out below is a non-exhaustive list of examples of investment products that are considered to be “non-complex”. The SFC may revise the list of non-complex products from time to time where appropriate:

#### Non-complex products

1. Shares traded on the SEHK or overseas exchanges that are subject to the oversight of regulators which are signatories to the IOSCO MMoU;
2. Non-complex bonds (please refer to the definition for “complex” bonds below);
3. Funds authorized by the SFC under the UT Code (including ETFs) that do not use FDIs extensively for investment or non-hedging purposes;
4. REITs authorized by the SFC; and
5. Any other investment products the SFC may specify from time to time.

Set out below is a non-exhaustive list of examples of investment products that are considered to be complex products:

#### Complex products (that are exchange-traded derivatives)

1. Futures contracts;
2. Equity derivatives listed on the SEHK (eg, DWs, CBBCs and listed share options);
3. Synthetic ETFs and futures-based ETFs authorized by the SFC and listed on the SEHK; and
4. L&I products authorized by the SFC and listed on the SEHK.

#### Complex products (other than exchange-traded derivatives)

5. Complex bonds. Complex bonds are bonds with special features (including, but not limited to, perpetual, subordinated or callable bonds, or those with variable or deferred interest payment terms, extendable maturity dates, or those which are convertible or exchangeable or have contingent write down or loss absorption features, or those with multiple credit support providers and structures) and/or bonds comprising one or more special features;
6. Funds authorized by the SFC under the UT Code that use FDIs extensively for investment or non-hedging purposes;
7. Funds authorized by the SFC under 8.7 of the UT Code (ie, SFC-authorized hedge funds);
8. SFC-authorized unlisted structured investment products (including SFC-authorized equity-linked deposits, equity-linked notes, etc.);
9. Collective investment schemes not authorized by the SFC; and
10. Other structured investment products not authorized by the SFC.

### Minimum information to be provided and warning statements

Set out below is a non-exhaustive list of examples of the minimum information on a complex product that should be provided in an easily comprehensible manner on an online platform:

1. Product nature eg, convertible stock, options, bonds, funds, structured products;
2. Key terms and features of the complex product, eg, for bonds: (i) bond category; (ii) credit information; (iii) coupon and coupon frequency; (iv) maturity date; (v) special features; and for structured products: (i) product category, eg, equity-linked investment, equity-linked note, credit-linked note; (ii) maturity date; (iii) any possible adjustments to the terms and conditions of the product; (iv) investor's rights over collateral, if any;
3. Whether the complex product is available to professional investors only;
4. Key risks of the complex product eg, whether there is a risk of losing more than the amount invested;
5. Whether the complex product is principal protected or not;
6. Any penalty for early exit; and
7. Whether a secondary market is available for the complex product.

Set out below is a list of the types of warning statements which should be made on an online platform, where applicable:

1. A warning statement to the effect that the product is a complex product and investors should exercise caution in relation to the product.
2. For complex products for which the offering documents or information provided by the issuer have not been reviewed by the SFC, a warning statement to the effect that the relevant offering documents have not been reviewed by the SFC and investors are advised to exercise caution in relation to the offer.
3. For complex products described as having been authorized by the SFC, a warning statement to the effect that authorization does not imply official recommendation / SFC authorization is not a recommendation or endorsement of a product nor does it guarantee the commercial merits of a product or its performance.
4. Where past performance information is provided, a warning statement to the effect that past performance information is not indicative of future performance.
5. For complex products only available to professional investors, a warning statement to the effect that the product is only available to professional investors.