

HKMA-SFC Joint Circular to Intermediaries: Streamlined approach for compliance with suitability obligations when dealing with sophisticated professional investors

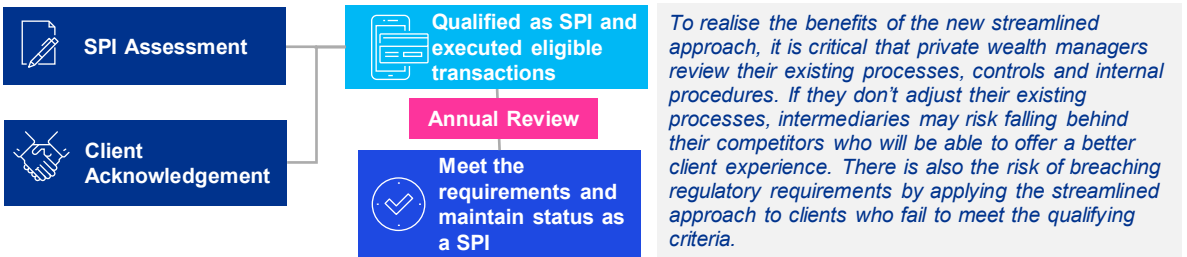
Risk Management
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On 28 July 2023, the HKMA and SFC jointly issued a circular introducing a proportionate and risk-based streamlined approach for intermediaries when dealing with sophisticated professional investors (SPI) who possess higher levels of net worth and investment knowledge or experience. **The new approach allows private wealth managers and other intermediaries dealing with high-net-worth individuals to simplify the point-of-sale process thereby improving client experience, enhancing competitiveness and potentially improving efficiency and reducing costs.**

Streamlined approach

Under the streamlined approach, intermediaries are no longer required to perform certain obligations on product due diligence, suitability assessment and risk disclosures. The simplified process is illustrated in the diagram below:



Key requirements from the guidance

Intermediaries are required to assess whether their clients meet the qualifying criteria of a SPI for the streamlined approach to be adopted. On an annual basis, intermediaries are expected to provide relevant disclosures to the SPIs and perform regular reviews to ensure that the SPI continues to meet the qualifying criteria.

01 Qualifying criteria

- Financial situation and investment objectives:** Individual PIs with a portfolio of at least HK\$40M, or net assets of at least HK\$80M and whose investment objective is not capital preservation or seeking regular income
- Knowledge or experience:** Intermediaries **must** ensure that the SPI meets **at least one** of the following criteria:
 - Holding a relevant academic or professional qualification; or
 - Having at least one year of work experience in a professional position in the financial sector; or
 - Having executed at least five transactions within the past three years in the same category of investment products
- Personal investment company (PIC) which is wholly owned by one or more SPIs

02 Streamlined approach

Intermediaries are **not required** to:

- Match SPI's risk tolerance level, investment objectives and investment horizon
- Assess SPI's knowledge and experience, and concentration risk
- Provide product explanation, unless requested by the SPI
- Maintain documentation on the rationale underlying investment recommendations
- Perform product due diligence and provide warning statements on a transaction-by-transaction basis for complex products sold on an unsolicited basis, subject to the provision of product offering documents

03 Eligible transactions

Transactions executed within the product categories and the streamlining threshold specified by the SPI

- For **product categories**, intermediaries **must**:
 - Categorise investment products based on the terms and features, characteristics, nature and extent of risks
 - Provide, and explain upon SPI request, the Product Category Information Statement (including warning statements in the case of complex products) for each product category
 - Document the SPI's choice of product category
- For **streamlining threshold**, intermediaries **must**:
 - Define the maximum investment threshold either as an absolute amount or a percentage of the AUM
 - Record the rationale of the maximum investment threshold specified by the SPI
 - Establish and maintain systems and controls to:
 - Ensure the streamlining threshold will not be breached upon execution or utilise a designated account that remains at or below the streamlining threshold
 - Detect outsize or material transactions and issue warning statements to the SPI

04 Client agreement



Intermediaries **should** enter into a written agreement with each SPI, which covers:

- SPI acknowledgement and consent
- Assessment criteria for the SPI qualification
- Product categories and streamlining threshold that can be executed under the streamlined approach
- Consequences of being treated as an SPI
- SPI's rights to withdraw from such arrangement and classification

05 Annual review



Intermediaries **should** annually:

- Perform a review to ensure the qualifying criteria continues to be met, and the SPI continues to agree to execute eligible transactions within the product categories and the streamlining threshold
- Remind the SPI in writing:
 - the consequences of being treated as a SPI
 - the product categories and streamlining threshold specified by the SPI
 - the rights to withdraw from such classification, and to add/remove a product category and/or amend the streamlining threshold at any time

06 Record keeping



Intermediaries **must** maintain all records of:

- SPI written assessment result, including all information and documents obtained
- All correspondences with the SPI, including written agreement, choice of product categories and setting of streamlining threshold



How KPMG can help

We have advised numerous clients on customer risk profiling, product due diligence and sales suitability to help them navigate the evolving regulatory requirements and guidelines. Below are some of KPMG's service offerings that we can tailor to your organisation's specific needs.

Health-Check/Readiness



- End-to-end review of customer risk profiling (CRP), product due diligence (PDD) and sales suitability framework, and governance and oversight, including alignment with HKMA-SFC guidelines on the streamlined approach for SPIs
- Assess the adequacy and effectiveness of the methodology and criteria used to set up the product categories and the streamlining thresholds under the streamlined approach for SPIs
- Review of controls over transaction monitoring, including appropriateness of thresholds to identify outside or material transactions

Framework Design/Remediation



- Develop tailored templates, policies and procedures, flowcharts and checklists for elements of the sales suitability framework for customisation and implementation (i.e. CRP process, PDD process and sales suitability process and management supervision)
- Design CRP questions and underlying scoring mechanism, and product risk rating model
- Where applicable, advise on updates to existing policies and procedures on PDD and sales suitability with regulatory requirements, which may include re-design of processes and workflows as appropriate

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