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The Streamlined Approach to Complying with the Suitability Obligations When Dealing with Sophisticated Professional Investors

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On July 28, 2023, the Securities and Futures Commission ("**SFC**") and the Hong Kong Monetary Authority issued a joint circular that sets out their expectations regarding allowing a proportionate and risk-based streamlined approach (the "**Streamlined Approach**") for complying with the suitability obligations when dealing with sophisticated professional investors ("**SPIs**") (the "**Joint Circular**").[1] The Joint Circular included two Annexes, an explanatory document outlining the Streamlined Approach and an FAQ to facilitate intermediaries' application of the Streamlined Approach.

As explained below, the Streamlined Approach, when applicable, simplifies the point-of-sale procedures in eligible investment transactions executed by SPIs who exhibit a higher level of sophistication and loss absorption ability. The Streamlined Approach should be beneficial for intermediaries accustomed to dealing with clients who are likely to qualify as SPIs, such as private banks and multi-family offices.

I. Who qualifies as a Sophisticated Professional Investor (SPI)?

An SPI is an individual professional investor[2] who satisfies all of the following requirements:

- ***Financial situation***: the SPI has (i) a portfolio of at least HK$40 million (or its foreign currency equivalent), or (ii) net assets, excluding primary residence, of at least HK$80 million (or its foreign currency equivalent);[3]

- ***Knowledge or experience***: the investor is sufficiently sophisticated such that he/she understands the risks of being treated as an SPI and the application of the Streamlined Approach. The requisite level of sophistication should be ascertained based on the client's academic[4] or professional qualifications,[5] or work experience,[6] or accumulated trading experience in the relevant categories of investment products (by having executed at least five transactions within the past three years in the same category of investment products based on their terms, features, characteristics, nature, and risks).[7]

- ***Investment objectives***: the client is not a conservative client, i.e. the client's investment objective is not capital preservation and/or seeking regular income.[8]

A corporation can also qualify as an SPI if its principal business is the holding of investments and it is wholly owned by one or more SPIs. This will be relevant to wholly owned investment holding company that are often set up by very high net worth investors.

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Intermediaries can rely on information obtained during the onboarding or know-you-client reviews to determine whether an investor qualifies as an SPI.

II. What are Eligible Investment Transactions?

The Streamlined Approach allows for a simplified point-of-sales procedure only when executing investment transactions for an SPI within the Product Category and Streamlining Threshold specified by the SPI (the "**Eligible Investment Transactions**"):

- ***Project Category***: intermediaries are required to devise product categories to categorise investment products based on their terms and features, characteristics, nature, and risks (each a "**Product Category**"). The SPI specifies the Product Categories within which investment transactions can be executed under the Streamlined Approach. Intermediaries are required to document the SPI's choices and provide the SPI with a Product Category Information Statement which explains the terms, features, characteristics, nature and risks of investment products within the Product Category. Intermediaries must ensure that an SPI possesses the requisite knowledge or experience criteria (please refer to Section I above) before applying the Streamlined Approach to investment transactions within a Product Category for the SPI.[9]

- ***Streamlining Threshold***: the SPI should specify a maximum threshold of investment, either being (i) an absolute amount, or (ii) a percentage of the SPI's assets under management ("**AUM**") with the intermediary, that can be executed under the Streamlined Approach (the "**Streamlining Threshold**"). The SPI should specify a Streamlining Threshold appropriate to his/her circumstances, and intermediaries are required to maintain records of the setting of such thresholds, including the SPI's rationale for supporting the threshold set. For example, a higher amount may still be suitable if the AUM maintained with the intermediary represents an insignificant portion of the SPI's portfolio and/or net assets. Intermediaries are required to establish and maintain effective systems and controls to ensure continuous compliance with the Streamlining Threshold (please refer to Section VI below).[10]

III. What steps need to be completed before applying the Streamlined Approach?

Before an intermediary applies the Streamlined Approach, it must have completed all of the following procedures:

1. The intermediary has assessed that the SPI satisfies all of the qualifying criteria with respect to its financial situation, knowledge or experience, and investment objectives (please refer to Section I above). This assessment must be in writing, and records of the assessment and all relevant information and documents obtained for the assessment must be kept by the intermediary.[11]
2. The SPI has specified the Product Categories and the Streamlining Threshold, and the intermediary has maintained records to support the choices made by the SPI.[12]
3. The intermediary is required to enter into a written agreement with the SPI, for the SPI to acknowledge and give consent to being treated as an SPI.[13] The intermediary is also required to (i) specify in writing the assessment criteria under which the client qualified as an SPI, and (ii) the Product Categories and the Streamlining Threshold under which Eligible Investment Transactions can be executed under the Streamlined Approach.[14]
4. The intermediary is required to fully explain to the SPI the consequences of being treated as an SPI, and the SPI's right to withdraw from being treated as an SPI at any time. When explaining the consequences of being treated as an SPI, the intermediary shall at a minimum cover the points set out in paragraph 13.2 of

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Annex 1 of the Joint Circular.[15]

IV. How does the Streamlined Approach simplify the regulatory obligations when dealing with SPIs in Eligible Investment Transactions?

After an intermediary has completed the procedures referred to in Section III above, the intermediary can then apply the Streamlined Approach when dealing with the SPI in Eligible Investment Transactions. Under the Streamlined Approach, an SPI sets aside an amount (i.e. the Streamlining Threshold) to invest in a portfolio of investment products within the specified Product Categories. For these Eligible Investment Transactions, the intermediary is no longer required to match the SPI's risk tolerance level, investment objectives and investment horizon, or to assess the SPI's knowledge, experience and concentration risk. The explanation of product characteristics, nature and extent of risks can also be provided to the SPI upfront.

Therefore, when applicable, the Streamlined Approach simplifies the point-of-sale processes that are normally required when dealing with retail clients or individual professional investor clients.

The table below summarises the key differences between the normal, non-streamlined approach, and the Streamlined Approach when dealing with an SPI in Eligible Investment Transactions. Please be aware that the table below is **not** a summary of all the regulatory obligations applicable to intermediaries when executing transactions with clients, it is only intended to highlight the key differences under the Streamlined Approach.

Note that there are some differences in the application of the Streamlined Approach: (a) when executing transactions in an investment product with a recommendation or solicitation, and (b) when executing transactions in a complex product[16] *without* recommendation or solicitation. These differences are also shown in the table below.

Regulatory requirement	**Normal approach**	**Streamlined Approach**
Applicable to transactions *both* (a) in an investment product with a recommendation or solicitation, and (b) in a complex product *without* recommendation or solicitation		
Suitability assessment	Intermediaries are required to assess that each recommended investment product is suitable for, and in the best interests of, the client, taking into account the client's investment objectives, investment horizon, investment knowledge and experience, risk tolerance, and financial situation, etc. Intermediaries are also required to assess concentration risk when assessing the suitability of a recommended investment product for the client, taking into account the risk profile and nature of a product, the client's risk tolerance level and financial situation, etc.[17]	Intermediaries are not required to match an SPI's risk tolerance level, investment objectives and investment horizon with Eligible Investment Transactions.[18] Intermediaries are not required to assess an SPI's knowledge and experience, and concentration risk in Eligible Investment Transactions.[19]
Product disclosure and product explanation	Intermediaries are required to provide each client with up-to-date prospectuses or offering circulars of the recommended investment products, and other up-to-date documents relevant to the investments. Intermediaries are also required to help each client make informed decisions by giving the client proper explanations of why recommended investment products are suitable for the client and the nature and extent of risks the investment products bear.[20]	Intermediaries are required to provide an SPI with up-to-date product offering documents for Eligible Investment Transactions, which could be done by sending a hyperlink to the offering documents or as attachments via electronic means (e.g., email). Intermediaries are not required to provide product explanation for Eligible Investment Transactions, except upon request and/or any material queries being raised by an SPI.[21]

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Applicable to transactions in an investment product with a recommendation or solicitation		
Record keeping	Intermediaries are required to maintain records documenting the rationale underlying investment recommendations made to the client and provide a copy of the rationale for the recommendations to the client upon his/her request.[22]	Intermediaries are not required to maintain records documenting the rationale underlying investment recommendations made to an SPI in Eligible Investment Transactions.[23]
Applicable to transactions in a complex product *without* recommendation or solicitation		
Product due diligence on complex products[24]	Intermediaries are required to perform product due diligence on a complex product even where the sale of the complex product was without solicitation or recommendation (i.e. on an unsolicited basis).[25]	Subject to the provision of offering documents to the SPI, intermediaries are not required to perform product due diligence for investment products (that are complex products) which fall within the Product Categories specified by the SPI. For bonds (that are complex products), where offering documents are not provided to the SPI, intermediaries should prepare and provide their own summaries of the key terms and features of the investment product; or provide to the SPI sufficient information on the key terms and features of the investment product based on information available from reliable public domain or data providers.[26]
Warning statements for complex products	Intermediaries are required to provide the complex products warning statements on a transaction-by-transaction basis prior to and reasonably proximate to the point of sale.[27]	Intermediaries can provide warning statements in relation to the distribution of a complex product on an annual basis instead of a transaction-by-transaction basis.[28]

V. Is there an annual review requirement?

Intermediaries are required to carry out annual reviews to ensure that each SPI continues to satisfy the requirements to qualify as an SPI, and continues to agree for the intermediary to deal with the SPI in Eligible Investment Transactions under a Streamlined Approach. As part of the annual review, intermediaries are required to remind the client in writing of the following:

- the consequences of being treated as an SPI;[29]
- the Product Categories specified by the SPI, including information on the Product Categories as per the Product Category Information Statement;
- the Streamlining Threshold specified by the SPI and an alert to the SPI where there was any incidents of breach; and
- the client's right to withdraw from being treated as an SPI, right to add or remove a Product Category, and/or right to revise the Streamlining Threshold at any time.[30]

VI. How to prepare for the implementation of the Streamlined Approach?

For intermediaries interested in applying the Streamlined Approach, they should consider taking the following steps:

Devise product categories	Intermediaries will need to devise Product Categories (see Section II above) to categorise their offered investment products based on their terms and features, characteristics, nature and risks. As a non-exhaustive example, the SFC notes that the following types of products should fall into separate Product Categories in order to differentiate them from other products with different characteristics, nature, risks and/or product-specific regulatory requirements:[31] • accumulators and decumulators;

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	• collective investment schemes whose investment objective or principal investment strategy is investing in insurance-linked schemes; • debt instruments with loss-absorption features and related products; and • virtual assets and virtual asset-related products.[32]
Prepare the Product Category Information Statements	Intermediaries will need to prepare the Product Category Information Statements to provide to SPIs to explain the terms and features, characteristics, nature, and risks of investment products within each Product Category that the SPI may choose from (see Section II above). The Product Category Information Statements can be distributed in the form of an information booklet or hyperlinks.[33] Where the Product Category concerns complex products, intermediaries should also include the required warning statements for complex products in the Product Category Information Statement.[34]
Update existing client agreements and acknowledgments	Intermediaries will need to update its written agreements and client documents to specify the following: • the SPI's acknowledgment and consent to being treated as an SPI; • the assessment criteria under which the client is assessed to qualify as an SPI; • the SPI's specified Product Categories and the Streamlining Threshold under which an Eligible Investment Transactions can be executed using the Streamlined Approach; • an explanation of the consequences of being treated as an SPI;[35] and • the SPI's right to withdraw from being treated as an SPI at any time.[36]
Update internal policies and controls	Intermediaries are responsible for ensuring the proper application of the Streamlined Approach, including ensuring compliance with the regulatory requirements described above. In this regard, one of the requirements that intermediaries must comply with is to establish and maintain effective systems and controls to ensure continuous compliance with the Streamlining Threshold for each SPI. To achieve this, intermediaries can either: • ensure the gross exposure arising from investment transactions executed under the Streamlined Approach remains at or below the Streamlining Threshold upon execution; or • devise designated accounts (or sub-accounts) to consolidate Eligible Investment Transactions of the SPI executed under the Streamlined Approach, and ensure that the gross exposure arising from all positions maintained in the designated account remains at or below the Streamlining Threshold after receiving top-up or deposit of new funds into such designated account. The amount or percentage of the SPI's AUM held with the intermediary to be allocated to the designated account should be discussed with the SPI at least annually, or whenever new funds are deposited into the designated account. Intermediaries are also required to implement measures to detect outsize or material transactions and issue warning statements to SPIs for these transactions. Intermediaries will need to review compliance with the Streamlining Threshold at least annually. If the gross exposure in the designated account exceeds the Streamlining Threshold, intermediaries are not expected to reduce/unwind the gross exposure to comply with the Streamlining Threshold. Rather, intermediaries may continue to operate and execute transactions in such designated account while restricting any top-up or deposit, or alternatively, intermediaries can execute investment transactions without applying the Streamlined Approach (e.g., outside of the designated account).[37] Intermediaries should update its internal policies, and systems and controls, to ensure ongoing compliance with the regulatory requirements when applying the Streamlined Approach, including keeping necessary records of all relevant information and documents from the application of the Streamlined Approach.

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[1] "*Joint circular to intermediaries – Streamlined approach for compliance with suitability obligations when dealing with sophisticated professional investors*" (July 28, 2023), published by the SFC, available at https://apps.sfc.hk/edistributionWeb/gateway/EN/circular/suitability/doc?refNo=23EC35

[2] An "individual professional investor" is an individual having a portfolio of not less than HK$8 million as ascertained according to the Securities and Futures (Professional Investor) Rules (Cap. 571D).

[3] Paragraph 3.1, Annex 1 of the Joint Circular

[4] By holding a degree or post-graduate diploma in accounting, economics or finance, or a related discipline.

[5] By having attained a professional qualification in finance (such as Chartered Financial Analyst (CFA), Certified International Investment Analyst (CIIA), Certified Private Wealth Professional (CPWP), Chartered Financial Planner (CFP) or other comparable qualifications).

[6] By having at least one-year relevant work experience in a professional position in the financial sector in Hong Kong or elsewhere (e.g., licensed for conducting relevant regulated activities).

[7] Paragraph 4.1, Annex 1 of the Joint Circular.

[8] Paragraph 5.1, Annex 1 of the Joint Circular.

[9] Paragraphs 7.1 to 7.3, Annex 1 of the Joint Circular.

[10] Paragraphs 8.1 and 8.2, Annex 1 of the Joint Circular.

[11] Paragraphs 12.1 and 12.2, Annex 1 of the Joint Circular.

[12] Paragraph 12.3, Annex 1 of the Joint Circular.

[13] Paragraph 13.1(a), Annex 1 of the Joint Circular.

[14] Paragraph 13.1(b) and (c), Annex 1 of the Joint Circular.

[15] See paragraphs 13.1(d) and 13.2, Annex 1 of the Joint Circular.

[16] "Complex product" refers to an investment product whose, terms, features and risks are not reasonably likely to be understood by a retail investor because of its complex structure. See the definition of a "complex product" in the "*Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission*" (the "**Code of Conduct**"). See also the non-exhaustive list of examples of non-complex and complex products, published by the Securities and Futures Commission, available at https://www.sfc.hk/en/Rules-and-standards/Suitability-requirement/Non-complex-and-complex-products.

[17] Questions 5A and 5B of the "*Frequently Asked Questions on Compliance with Suitability Obligations by Licensed or Registered Persons*" (the "**Suitability FAQ**"), last updated by the SFC on December 23, 2020 and available at: https://www.sfc.hk/en/faqs/intermediaries/supervision/Compliance-with-Suitability-Obligations/Compliance-with-Suitability-Obligations#759450F3651D4BBF8AAA2F39C9F2BE88.

[18] Paragraphs 10.1 and 11.2, Annex 1 of the Joint Circular.

[19] Paragraphs 10.2 and 11.3, Annex 1 of the Joint Circular.

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[20] Questions 6A and 6B, the Suitability FAQ.

[21] Paragraphs 10.3 and 11.4, Annex 1 of the Joint Circular.

[22] Question 7, the Suitability FAQ.

[23] Paragraph 10.4, Annex 1 of the Joint Circular.

[24] For the avoidance of doubt, product due diligence is required when an intermediary recommends an investment product, irrespective of whether the investment product is a complex product or not, see Question 4, Suitability FAQ. This row in the table concerns transactions in complex products where there is no recommendation or solicitation.

[25] Paragraph 5.5(a) of the Code of Conduct, which provides that the suitability requirements (including product due diligence), applies to the sale of complex products without a solicitation or recommendation.

[26] Paragraph 11.1, Annex 1 of the Joint Circular.

[27] Paragraph 5.5(a)(iii) of the Code of Conduct. See also the "*Minimum information to be provided and warning statements*" (June 12, 2019), published by the SFC, available at: https://www.sfc.hk/en/Rules-and-standards/Suitability-requirement/Non-complex-and-complex-products/Minimum-information-to-be-provided-and-warning-statements.

[28] Paragraph 11.5, Annex 1 of the Joint Circular.

[29] The consequences of being treated as an SPI are listed under paragraph 13.2, Annex 1 of the Joint Circular.

[30] Paragraph 14, Annex 1 of the Joint Circular.

[31] Question 3, Annex 2 of the Joint Circular.

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

[33] Paragraph 7.2, Annex 1 of the Joint Circular.

[34] Question 4, Annex 2 of the Joint Circular.

[35] The consequences of being treated as an SPI are listed under paragraph 13.2, Annex 1 of the Joint Circular.

[36] Paragraph 13.1, Annex 1 of the Joint Circular.

[37] Question 6, Annex 2 of the Joint Circular.

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Gibson Dunn's lawyers are available to assist in addressing any questions you may have regarding these developments. If you wish to discuss any of the matters set out above, please contact any member of Gibson Dunn's Global Financial Regulatory team, including the following members in Hong Kong:

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