

SFC seeks to abolish non-reliance clauses with new suitability requirement

Following an extensive consultation, the SFC has published a new clause which must be included in all client agreements. The new clause, published as part of a change to the Professional Investor Regime (PIR), requires financial intermediaries to ensure that any financial product solicited for sale or recommended to a client is reasonably suitable for the client, regardless what is stated in the client agreement. The clause will enable investors to claim for damages under the client agreement where an intermediary sells or recommends products that are not reasonably suitable. The SFC has said that institutions should review their client agreements immediately to ensure that they include the new clause and that no terms of their existing client agreements are inconsistent with it.

Consultation Findings

The SFC notified the changes as part of the final Consultation Conclusions on the Client Agreement Requirements published on 8 December 2015.

The initial consultation paper proposing changes to the PIR was issued in May 2013.¹ In that paper, the SFC proposed that, amongst other things, the Suitability Requirement under the Code of Conduct for Persons Licensed by or Registered with the Securities and

Futures Commission (Code) should be incorporated into client agreements as a contractual term. Having considered the comments received, the SFC modified its proposals and published a further consultation paper in September 2014.² This paper included a new clause which it was proposed should be incorporated into client agreements pursuant to a new Code requirement.

² See our briefing: *SFC Consultation Conclusions on the Proposed Amendment to the Professional Investor Regime and Further Consultation on the Client Agreement Requirements*

¹ See our briefing: *SFC proposes to amend Professional Investor Regime and Client Agreement Requirements*

Key issues

- Banks and other financial intermediaries will no longer be able to rely on non-reliance clauses as a defence to a mis-selling claim.
- A new paragraph 6.5 in the Code will disallow contractual terms which are inconsistent with obligations under the Code or misdescribe the actual services provided to a client.
- The new clause will enable investors to claim for damages under the client agreement where an intermediary sells or recommends products that are not reasonably suitable.
- Financial intermediaries should review their client agreements immediately to ensure they include the new clause and that no terms are inconsistent with it.

The SFC's latest publication³ confirms that the new clause applies to all intermediaries including in the corporate finance context. If an intermediary acts under a restricted mandate that does not involve soliciting the sale of, or recommending financial products, that intermediary will have the discretion to consider whether it is necessary to include the clause in light of the existing paragraph 6.4 of the Code. The SFC envisages there will be limited situations in which intermediaries can rely on this paragraph.

New Clause – Wording

The new clause reads:

"If we [the intermediary] solicit the sale of or recommend any financial product to you [the client], the financial product must be reasonably suitable for you having regard to your financial situation, investment experience and investment objectives. No other provision of this agreement or any other document we may ask you to sign and no statement we may ask you to make derogates from this clause."

"Financial product" is defined as "any securities, futures contracts or leveraged foreign exchange contracts as defined under the SFO." As for *"leveraged foreign exchange contracts"*, the new clause is only applicable to those traded by persons licensed for Type 3 regulated activity (i.e. excluding banks).

The new clause is to be incorporated into client agreements pursuant to a new paragraph 6.2(i) under the Code.

A new paragraph 6.5 will also be inserted into the Code to disallow contractual terms in the client agreement which are inconsistent with obligations under the Code or which misdescribe the actual services provided to a client. Financial institutions will therefore have to review their client agreements carefully to ensure there are no terms that are inconsistent with the new clause.

Timescale

All intermediaries must comply with the new Code requirements on or before 9 June 2017 (ie 18 months from the date of the SFC's announcement on 8 December 2015). The SFC has emphasised however that this period is very much a long-stop date, designed mainly to cater for circumstances where intermediaries, despite their best efforts, encounter practical difficulties when re-executing agreements with existing clients. The SFC's Chief Executive Officer Ashley Alder said he expected *"all intermediaries to commence reviewing and revising their client agreements immediately. Intermediaries are expected to make revised client agreements available as soon as possible so that new clients can execute them and existing clients can amend or replace their existing agreements."*

He said that the changes would *"result in fairer terms of business for investors, and also prevent intermediaries from misdescribing the actual services provided to the client."*

Effectiveness of Non-Reliance Clauses

The SFC's instructions follow a series of cases in which claims by customers against banks have been thrown out by the courts.

In April this year, the Hong Kong High Court dismissed a customer's mis-selling claim against DBS in respect of the sale of financial products, confirming the applicability of contractual estoppel and non-reliance clauses in Hong Kong.⁴

The bank relied on its standard non-reliance clauses in the underlying contracts, the effect of which was that DBS had no duty to give investment advice to the customer. Even if DBS did give investment advice, it was provided on an *"execution only"* basis. The customer was not entitled to rely on the advice and should exercise his own independent judgement in making investment decisions.

The Court rejected the customer's allegations in respect of the alleged oral contract and the customer's misrepresentation claim. The non-reliance clauses defined the relationship between DBS and the customer such that, even if DBS had provided advice, the customer could not assert that he had relied upon, or had been induced by, such advice in making his investments.

³ Consultation Conclusions on the Client Agreement Requirements

⁴ *DBS Bank (Hong Kong) Ltd v Sit Pan Jit* (unreported, HCA 382/2009, [2015] HKEC 548)

As noted in our briefing at the time⁵, even if the case had been determined under the SFC's proposed changes to the PIR, it is possible the Court may not have found differently for DBS as, amongst other things, DBS was found (as a matter of fact) not to have made the misrepresentations to the customer and the Court found (as an aside) that the financial products were suitable for the customer.

A New Dawn for Investors?

Following the introduction of the new clause, banks and financial will no longer be able to point to a non-reliance clause to create a contractual estoppel and limit the duties to the customer. The new clause seeks explicitly to rule out the possibility of a bank raising contractual estoppel as a defence by the inclusion of the wording, *"No other document we may ask you to sign and no statement we may ask you to make derogates from this clause."*

Instead, the dispute will centre on the suitability of the financial product for that particular individual. As part of the effort to demonstrate suitability, banks and other financial institutions will need to ensure that sufficient records are kept in respect of any transactions, including records of any statements made to the client both orally and in writing.

Banks should also consider who their client is in any particular context, particularly where families may operate a group of accounts with different objectives and different account signatories.

⁵ *Hong Kong High Court confirms the effectiveness of non-reliance clauses in bank-customer contracts*

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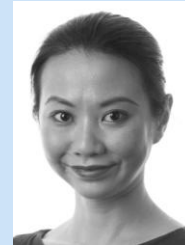
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