

Brave new world – SFC consults on proposed guidelines on online distribution and advisory platforms

The Securities and Futures Commission's (SFC) three-month consultation proposes a new basis for triggering the suitability requirement which hinges on whether an investment product available online is complex, rather than whether there has been any solicitation or recommendation of the product. The responses to the submission may also have implications for the sale of complex products in the offline world.

Introduction

The SFC's paper¹ notes that in recent years there has been an expansion of different forms of online platforms offering a wide range of investment services and functions. These range from order execution and product distribution to portfolio construction and investment advice.

Such transactions may 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. Clients and investors may not be able to fully understand

the nature and risks of an investment product prior to making an investment decision.

The SFC recognises that the pure provision of factual, fair and balanced information on an online platform relating to non-complex products does not constitute a solicitation or recommendation and will not trigger the suitability requirement.

The proposed guidelines focus on three main areas:

- suitability requirement
- additional protective measures for the sale of complex products on online platforms on an unsolicited basis; and
- governance and controls

Suitability requirement

The guidelines aim to clarify how the suitability requirement in paragraph 5.2 of the SFC's Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (Code of Conduct) would operate in the

Key issues

- "Complex products" will be subject to suitability requirements regardless of whether there is a solicitation of or a recommendation to a client.
- Online platform operators will be subject to the disclosure of minimum information and warning statements on all complex products.
- The consultation closes on 4 August 2017.

context of an online platform – when it may be triggered and how it may be discharged. The suitability requirement is triggered by a "solicitation" or "recommendation". The SFC says that in the online world, the context and content of the materials posted online will determine whether the suitability requirement is triggered.

The guidelines clarify that the posting of factual, fair and balanced materials on online platforms would not itself amount to a solicitation or recommendation and will not trigger the suitability requirement. The SFC says this is

¹ [Consultation paper on the proposed guidelines on online distribution and advisory platforms, SFC, May 2017](#)

consistent with the position in the offline world where the requirement is unlikely to be triggered by the mere posting of an advertisement for an investment product in newspapers or magazines. The paper says that "robo-advice" (advice generated without human intervention) would normally include a solicitation or recommendation and would thereby of itself trigger the suitability requirement.

Complex products

The sale of complex products on online platforms will be subject to the suitability requirement in circumstances even when no solicitation, recommendation or advice has been provided. Complex products refer to products whose terms, features and risks are not reasonably likely to be understood by retail investors because of their structure and which are difficult to value.

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 additional protection to investors. Platform operators would also be required to provide certain basic and key information on complex products offered on their platforms as well as prominent warning statements. Given that in practice some non-SFC authorised funds are money market funds that are not complicated in nature, it may not be appropriate to classify all non-SFC authorised funds as complex products.

Governance and controls

In addition to the existing conduct requirements for regulated intermediaries, the SFC proposes

to introduce six Core Principles for the operation of online platforms.

Core Principle 1 – Proper design: A platform operator should ensure that its online platform is properly designed and operated in compliance with all applicable laws and regulations. This includes ensuring appropriate access rights and controls are in place and that systems and processes underpinning the operation of the platform are robust and properly maintained;

Core Principle 2 – Information for clients: a platform operator should make clear and adequate disclosure of relevant material information on its online platform. This includes making available information on the methodology adopted for assessing and assigning ratings to investment products and categorising clients. It also includes disclosing to clients whether any remuneration is to be paid by the client to the platform operator such as commission or brokerage;

Core Principle 3 - Risk management: a platform operator should ensure the reliability and security of the online platform. This includes a thorough assessment of the reliability of the system and having appropriate contingency requirements in place;

Core Principle 4 – Governance, capabilities and resources: a platform operator should ensure there are robust governance arrangements in place for overseeing the operation of the platform as well as adequate human, technological and financial resources available to ensure that operations of the platform are carried out properly;

Core Principle 5 - Review and monitoring: Reviews of all

activities conducted on its online platform should be performed by the platform operator as part of its ongoing supervision and monitoring obligation; and

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

The principles are in addition to existing conduct requirements. For example, a platform operator who provides automated trading services as defined in the Securities and Futures Ordinance will also need to comply with the Guidelines for the Regulation of Automated Trading Services.

Where the Online Platform Operator conducts electronic trading, the requirements in paragraph 18 (Electronic Trading) and Schedule 7 of the Code of Conduct and any relevant guidelines are also applicable.

Guidance for Robo-Advisers

The SFC sets out specific requirements that apply to robo-advisers concerning information for clients, client profiling, system design and development, supervision and testing of algorithms and rebalancing. For example, a robo-adviser is required to effectively manage and adequately supervise the design, development, deployment and operations of algorithms used in digital-advice tools.

Implications

Whilst the SFC recognises there is a difference between the online and offline environment, it effectively requests the conduct requirements to be applicable equally to the offline and online contexts. For a robo-adviser that is fully automated, it may be difficult

to comply with the full suite of the SFC's requirements.

The responses to the submission will have implications on the offline environment; the SFC notes that it may consider extending the same requirement applicable to complex products to the offline world by way of an amendment to the Code of Conduct.

The SFC's suggestions as to the scope and depth of the information available online are helpful but may not go far enough. For example, from an investor's perspective it would be helpful to understand how an algorithm works as it applies to the services received.

It is interesting to note that the SFC only touches upon the use of third party service providers lightly. The questions that many may have around outsourcing and data privacy issues have yet to be addressed.

Separately, the Financial Services Development Council recently published a paper titled "The Future of Fintech in Hong Kong" providing related and useful discussions around how the Hong Kong financial technology sector looks to reshape in the coming years. A question remains as to how these proposed guidelines on online distribution and advisory platforms will impact on those Fintech initiatives.

For more publications and information on Fintech please visit Clifford Chance's [Insights on Fintech](#) and [Fintech Topic Guide](#) on our Financial Markets Toolkit.

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