

Dr Wise is a fictitious character. Through his column, he talks to investors about the key issues of investing and regulatory thoughts.

Are all SFC-authorized products suitable for everyone?

Yesterday I received an e-mail from an overseas research student, asking for my assistance with his thesis on global regulatory structures. He wanted to know what "authorisation" by the Securities and Futures Commission (SFC) meant in the context of Hong Kong. Since the topic may be of interest to members of the investing public, let me recap what I told him.

Authorisation is not a guarantee

The overseas student's question revealed some common misunderstandings about the regulator's role.

"In Hong Kong, I have been told that the SFC authorises products that are sold to the public. Does this mean that investment products cleared by the SFC are suitable for all retail investors?"

I explained that, generally speaking, before any investment product is offered to the Hong Kong public, it is the relevant offer *documentation* that must be "authorised" by the SFC. This involves a review by the regulator to ensure that the product documentation complies with relevant rules and regulations. However, with the exception of collective investment schemes, such as unit trusts and mutual funds, the regulator does not authorise the product itself nor indeed does it approve any products, a point misunderstood by many investors.

When looking at product documentation, it is also important to understand that authorisation is not a recommendation nor an endorsement of the product; nor does it provide any assurance that it is suitable for any particular investor. In Hong Kong, as in other developed economies, it is not part of the regulator's statutory role to provide assurance on the commercial merits, or likely performance and return, of any investment products.

Authorisation requires disclosure

Simply put, the basis of SFC authorisation is a check that issuers have provided adequate information so that investors can make informed decisions. The regulatory structure, in Hong Kong, as in all other developed financial centres, is based on the principle that sufficient disclosure about a product and the issuer, will place *investors* in a better position to assess whether it is suitable for their particular circumstances.



Key Messages

- When your intermediary makes a recommendation at the point of sale, do not take this at face value. Be smart and ask questions.
- SFC authorisation is not a recommendation or endorsement of a product; nor does it guarantee the commercial merits of a product or its performance.
- SFC authorisation involves the review of product documentation, and in some cases the structural features of an investment, to see if certain impartial benchmarks are met and the required information is disclosed.
- Marketing materials of an investment product only contain highlights of the product features.

Given the wide range of individual investor profiles, it is not possible to prejudge what is suitable or not suitable for different investors. However, sufficient disclosure also helps *intermediaries* properly consider whether or not a product matches a particular investor's needs and to discharge their responsibility to ensure that it is suitable for that specific individual investor, taking into account his personal circumstances. Intermediaries are also required to do their own product due diligence and not just rely on the product documentation.

This regulatory structure provides two layers of protection – information that can be used by investors, and a requirement that the selling intermediary ensures the suitability of the investment for the individual investor, having regard to his particular circumstances.

Different products have different requirements

Under Hong Kong's regulatory structure, SFC authorisation is conducted under one of two separate regulatory regimes: the Securities and Futures Ordinance (SFO) or the Companies Ordinance (CO), depending on the product type. While the existence of different codes and guidelines for different types of investment products can appear confusing, the offering documents of all products must contain certain essential information to allow investors to make informed decisions, including issuer information, key product features and significant product risks. For example, if a product requires the investment to be held to maturity to benefit from principal protection, that poses liquidity risk for the investor. The offering document must therefore include a reference to this.

For some products there are other specific requirements which must be met. For example, the offering documents for mutual funds must also meet the more detailed requirements of the SFC's Code on Unit Trusts and Mutual Funds, which covers disclosure of the investment restrictions, product features and risks. The SFC also looks at the structure of mutual funds to ensure that their manager and/or trustee/custodian meet relevant requirements to properly discharge their responsibilities, whereas there are no equivalent requirements for equity-linked instruments and structured notes.

However, whatever regulatory regime the product is issued under, it is very important to recognise that no assessment of suitability is made at the time of the authorisation of product documentation. This important protection takes place at the point of sale i.e. when the product is actually sold to the investor, and must be based on an understanding of both the product and the individual investor's personal circumstances.

As products vary in terms of features, investment objectives and risks factors, they may not suit everyone. Each investor has his own personal circumstances and what is considered conservative by one person may well be deemed aggressive by another. It is important for investors and their intermediaries, to weigh each investment against their specific circumstances.

Ask more

When your intermediary makes a recommendation at the point of sale, do NOT take this at face value. Ask questions. An intermediary has a duty, under the Code of Conduct and guidelines administered by the SFC, to explain to you the nature and the extent of a product's risks and why the recommended product is suitable for you.

Also, don't rely solely on an investment product's marketing materials when making a decision. While adverts and leaflets should not provide misleading or biased information, they will usually only provide highlights and cannot replace an offering document, or the help of an intermediary, in providing sufficient information.

To conclude let me repeat what I tell every investor: do your homework before investing your hard earned money – take some time to ensure that you have all of the relevant facts. Check the product's offering document, then evaluate the intermediary's recommendation and the product risks against your own investment objectives, time horizon and risk appetite.

Be a smart investor – Ask First!

The Dr Wise Column is posted under the "Dr Wise" section of the SFC's InvestEd website at <http://www.InvestEd.hk>.

Feedback and comments are welcome and can be sent to invested@sfc.hk

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