

# NEW SFC GUIDANCE ON CLIENT AGREEMENT REQUIREMENTS

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Legal Briefings

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In the light of the queries raised by Herbert Smith Freehills following industry consultation, the Securities and Futures Commission (**SFC**) has issued guidance (**FAQs**) on the application of new paragraph 6.2(i) of the client agreement requirements under the Code of Conduct for Persons Licensed by or Registered with the SFC (**Code**), i.e. the mandatory suitability clause (**Suitability Clause**), to corporate finance mandates.

The FAQs also deal with the application of the Suitability Clause to client agreements in respect of asset management activities, discretionary investment management services and where certain types of funds are the client, in addition to addressing some procedural matters relating to compliance with the new client agreement requirements more generally.

## **CORPORATE FINANCE MANDATES**

Paragraph 35 of the Consultation Conclusions on the Client Agreement Requirements (**Consultation Conclusions**) issued by the SFC on 8 December 2015 provided that the Suitability Clause is unlikely to be applicable in a standard corporate finance mandate. However, no guidance was provided as to what constituted a "standard corporate finance mandate".

The FAQs clarify that an intermediary conducting corporate finance activities (e.g. advising on new share placements or rights offerings, merger and acquisition advisory, corporate restructuring, financing activities, underwriting and sponsor activities) that fall within the definition of advising on corporate finance in Part 2 of Schedule 5 to the Securities and Futures Ordinance (**SFO**), should generally be able to rely on paragraph 6.4 of the Code as justification for using its discretion and not including the Suitability Clause in the client agreement with such clients.

## **ASSET MANAGEMENT ACTIVITIES AND DISCRETIONARY INVESTMENT MANAGEMENT SERVICES**

The FAQs clarify that all intermediaries licensed or registered for Type 9 regulated activity (asset management) and all intermediaries that provide discretionary management services to their clients should include the Suitability Clause in the agreements they enter into with their clients unless the intermediary is entitled to an exemption.

In such circumstances, an intermediary will only be entitled to an exemption where the client is:

(a)	an “institutional professional investor” (as defined by paragraph 15.2 of the Code); or	
(b)	a “corporate professional investor” ( <b>CPI</b> ) (as defined by paragraph 15.2 of the Code) in relation to whom:	
	(i)	the intermediary is reasonably satisfied (as a result of having conducted an assessment) meets the three criteria set out in paragraph 15.3A of the Code (appropriate corporate structure, qualified investment decision makers etc); and
	(ii)	the intermediary has complied with procedural steps under paragraph 15.3B of the Code (e.g. written consent of the CPI obtained etc).

## **UNREGULATED FUNDS, HEDGE FUNDS AND SOVEREIGN WEALTH FUNDS**

The FAQs provide that where these types of funds are clients, they will need to fall under paragraphs (a) to (i) of the definition of “professional investor” in section 1 of Part 1 of Schedule 1 to the SFO for an intermediary to be able to justify using its discretion and not including the Suitability Clause in the client agreement with these clients.

## **PROCEDURAL MATTERS**

The FAQs clarify that while the Suitability Clause must be incorporated in client agreements verbatim with no modification to its original wording, the SFC will not object to minor and inconsequential drafting amendments which modify the references of, for example, “you” to “the Customer” or “agreement” to “Terms” etc, to make them compatible with corresponding descriptors in the firm's underlying documents.

The SFC also reiterated in the FAQs that it expects intermediaries to make available revised client agreements expeditiously to enable existing clients to enter into them (by way of amending or replacing their existing agreements) as soon as possible.

## **LEGAL ADVICE**

The SFC acknowledged in the FAQs that the manner in which existing client agreements might be re-executed to comply with the new client agreements depends on the circumstances and can be done in different ways (e.g. by negative consent or by re-executing the agreement). Intermediaries are encouraged by the SFC to seek legal advice on this if in doubt.

Herbert Smith Freehills can assist in this regard as we have advised a number of regional and global financial institutions in relation to this point. We are also well experienced in:

- advising on the application of the new client agreement requirements more broadly, the principles of the long-standing suitability requirement in paragraph 5.2 of the Code and the application of the revised professional investor regime to particular financial products/markets and business lines;
- drafting, reviewing and amending client agreements to ensure compliance with the Code; and
- providing training on the client agreement requirements, suitability and the revised professional investor regime



## KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.



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