Recommended Practices on the presentation of the "Risk Disclosure Box" for authorized retail unit trusts and mutual funds – Issued by HKIFA on April 6, 2009

(1) Objectives

This set of Recommended Practices ("RDB RP") aims to provide practical guidance to Fund Managers and other Issuers (hereinafter collectively referred to as "Issuers") of marketing materials of SFC authorized retail unit trusts and mutual funds (hereinafter referred to as "products") in the application of the Letter (dated December 5, 2008) issued by SFC.

It aims to ensure that the industry adopts a consistent approach when communicating the risk factors to potential and existing investors.

Issuers should bear in mind that the ultimate objective of any risk disclosure initiative is to enable investors to understand the principal risks involved in an authorized product before making any investment decisions.

(2) Application

2.1. Scope

The RDB RP apply to all Issuers of marketing materials of products.

2.2. Effective date

The RDB RP take immediate effect. It is expected that the RDB RP will be reviewed regularly, at least annually, to reflect the changes in the market circumstances. The review will be undertaken by the HKIFA Work Group, in consultation with its members and the relevant authorities.

(3) Key principles

In preparing the Risk Disclosure Box ("RDB") and any other disclosures about risks surrounding a product, Issuers should observe the following principles. The disclosures should:

- always adhere to the general principles applicable to all marketing materials for authorized products ("MM") (for details, please refer to the Advertising Guidelines Applicable to CIS Authorized under the Product Codes issued by SFC in July 2008) (hereinafter referred to "AG") and be prepared on the basis of fair dealing and good faith;
- not be biased or misleading;
- contain information that is timely, updated and consistent with its offering document;
- be fair, appropriate, balanced and proportionate. This entails adopting a holistic approach – Issuers should, based on the attributes and complexity of the products and the degree of specificity regarding the statement of returns/upside, develop the disclosures that effectively take into account the profile and mix of the target recipients, the unique characteristics of the marketing channels, as well as the messages that are to be conveyed;

- be clear, upfront and prominent, reader-friendly and this should be considered in the context of :
    - the font size, typeface and style used;
    - format and layout of the MM;
    - the use of graphics; and
    - where the MM is displayed or published, e.g. the order and location of the RDB.

  The key test for "prominence" is whether the disclosure, in terms of overall impression, is "eye-catching" or not. There are different means to achieve this outcome – a common approach is to put the RDB at the top of a piece of the material. However, as the MMs may be used or put in different contexts or places, Issuers should, based on the specific circumstances of each case, determine an approach that can best ensure that this outcome is achieved;
- the message should be short and clearly-worded. Complex sentence structure and legal language/technical jargons should be avoided.
- the message should be in plain English and/or Chinese and be idiomatic. If it is a translation, the rendition should also be idiomatic, too;
- If Issuers are aware of any changes in the market circumstances that warrant a change in the wordings, it should, at the earliest instance, update the RDB so as to provide investors with the appropriate context to reflect the latest market situations, and
- supported by a sound internal controls infrastructure, including but not limited to a robust supervisory system, well-qualified personnel, as well as a well-defined set of procedures and processes and a documentation system.

The RDB RP should only be construed as the minimum standards and Issuers are encouraged to raise the bar and develop complementary measures to achieve the outcome of enhanced disclosures. Also, it must be noted that the examples cited below are for illustration purpose only and Issuers are expected to take a balanced and proportionate approach in the application, bearing in mind that the ultimate objective is to enable investors to make informed decisions.

(4) <u>Specific applications of the Risk Disclosure Box ("RDB"</u>)

Based on the SFCAG, most of the MMs are expected to carry the standard risk warning statements. The following are materials that may generally not be regarded as MMs:

- Corporate adverts or any marketing materials that only carry the company name of the fund manager without referring to any particular scheme;
- Marketing materials that provide market commentaries, without mentioning any product names and features; and
- Corporate souvenirs and premiums which contain only the scheme name without any additional information of the scheme.

The RDB RP are prepared based on this premise and on top of this, Issuers are expected to include an appropriate RDB in the MMs.

In view of the diversity of the types of MMs and their usage and to achieve effective disclosure, a three-tiered approach is recommended, as follows:

A three-tiered approach

Depending on the types of MMs, Issuers can refer to the following guidelines when they make disclosures:

4.1 Regular publications of fund listing and ranking

- Regular publications or tables that provide historical fund performance data (e.g. fund ranking tables) – either issued by the Issuer or a distributor, a third party vendor or the press;
- Regular publications that include a listing of the name of the funds for comparison or information purposes only (e.g. fact sheets produced by distributors – typically in each of its fact sheet, the distributor will list out the funds it carries, plus certain factual information for each of the fund, such as performance, holdings and fees)
- Ad hoc publications of fund listing may fall within this category if they are not print adverts or materials which contain sales pitch; and only provide facts and figures for information;

For materials that fall within this category, a box should be placed in an upfront and prominent position and should include:

- the standard warning statements; and
- a note specifying that the fund may invest extensively in financial derivative instruments (hereinafter referred to as “fdis”) (accordingly an asterisk should be put against the name of the fund in the fund listing if it may invest extensively in fdis).

4.2. MMs that are for display purposes only (except for print advert)

If a piece of MM does not contain complex product information and is only used for display purposes (i.e. not for distribution), then the MM will fall within this category.

“Display purposes” is defined to mean any MMs which are for display only and are not intended for distribution or to be taken away by any investors. The MMs under this category will normally include the items listed below:

- Adverts on TV, radio/audio media;
- Posters, e.g. shown at exhibition booths or at bank branches/tentcards;
- Billboards/rooftop signs/buntings/tram shelters and any other point of sales visual;
- Outdoor TV;
- Building LCD; and
- Transport TV (e.g. tram, bus, ferry, MTR)

For materials that fall within this category, a box should be placed in an upfront and prominent position and should include:

- the standard warning statements; and

- a note specifying that the fund may invest extensively in fdis and mention the consequences of higher risk of capital loss or the worst case scenario resulting from this.

As to whether the MMs should carry the suitability statement (i.e. point 2(d) of the SFC Dec 5 circular), it would be at the discretion of the Issuers.

4.3. <u>Full RDB</u>

Generally speaking, if a piece of MM is intended to or can be taken away by the investors, then it will fall under this category. And this piece of MM would be required to carry the full RDB as specified in the SFC circular dated December 5, 2008. The MMs that are likely to fall within this category include:

● Handouts or direct mails or any other items, a copy of which will be taken by the client:
  * fund factsheet (e.g. individual fund manager’s fund fact sheet) and fund book;
  * flyer;
  * brochure;
  * ppt materials and presentation deck; and
  * adverts in magazine and newspaper (incl. advertorials)

● Website & hyperlinks & webcasts
  * Issuer's own website;
  * distributors' websites; and
  * other third parties' websites

  (For websites, the RDB should be shown on the landing page of the fund, which should be readily accessible or downloadable. Very often, an investor has to go through a number of steps before they can get access to the fund page, - e.g. go through a search function on the site. It is expected that the RDB should be placed at the page to which investors will, through the natural course of navigation, first gain access to details of a fund).

● Editorials
  * Article contributions;
  * Media interviews (print and non-print); and
  * Press releases

<u>Cases where there might be moderation in the application of full RDB</u>

● In general, it is expected that any MMs that fall within the three broad categories in paragraph 4.3 above should carry the standard warning statements plus the full RDB box, i.e. carry all the four bullet points, i.e. from 2(a) to 2(d) as specified in the Dec 5 SFC Circular plus the following point:

  “Investors should not only base on this marketing material alone to make investment decisions.”

However, depending on the types of fund and the context the box is used, bullet points 2(a) to 2(c) as specified in the Circular do not necessarily have to be presented as three distinct points insofar as the spirit of the circular is adhered to. For instance, in a fund fact sheet where there are already detailed discussions about product features and objectives, it may not be necessary to repeat such information, i.e. pt 2(a), in the RDB. Also, pt 2(b) and pt 2(c), namely the key risks and the worst case scenario may be combined into one bullet point instead of being shown as two separate ones. What is important is that the key risks and the potential consequences are highlighted to potential investors. For instance, if a product may use fdis extensively, the Issuer has to specify this in the box, and mention the consequences of higher risk of capital loss or the worst case scenario envisaged. With respect to 2(d), if it is for a one page regularly-published fund fact sheet, then the Issuers can use an abridged one as follows:

> "Before you decide to invest, you should make sure
> the intermediary has explained to you that
> the fund is suitable to you."

However, in other circumstances, it is expected that the full version, i.e. "You should not invest unless the intermediary who sells it to you has advised you that the product is suitable for you and explained how it is consistent with your investment objectives" will be used.

- In general, it is expected that any marketing materials or information provided to the press or any other third parties, such as for media interviews or other media related initiatives, etc. has to carry the RDB.

  However, it is noted that very often, the production of the outputs is neither owned nor controlled by the Issuer. Nor are they distributed or presented by the Issuer to the end investors. Instead, they are owned by the distributors, media or other third parties.

  In circumstances where the Issuer does not own or have the final control over the outputs, the Issuer should demonstrate that it has used its best endeavors to ensure that the third parties, which having taken into account the practical situations and contexts, use the MM (including the RDB) in its entirety. The Issuer should maintain an audit trail of all documentations to evidence it has used its best endeavor. For instance, for the purposes of a media interview which may mention a product, the Issuer should upfront provide a note to the journalist which carries the full RDB. Alternatively, if the discussions can be taped, a copy of the tape should be kept. The Issuer should also maintain records of the final outputs in a format that is readily accessible and should also comply with other applicable record keeping rules.

  Also, the Issuer should maintain a written internal policy on interviews, including but not limited to the appointment of designated spokespersons, the scope on which the spokespersons can comment, the basis for selecting the media or other third party organizations to be interviewed, as well as the process to monitor the outputs and to take possible remedial measures to ensure compliance with the relevant rules and regulations.

In any event, if the Issuer is aware of any errors, omissions or misrepresentations in third party-controlled outputs with respect to its product, it should immediately inform the relevant party and seek to clarify or rectify as soon as practicable.

(5) <u>Other complementary initiatives</u>

5.1 Process and documentation relating to the development of the RDB:

The Issuer should have in place a written policy regarding who should be involved in developing the RDB and the process for developing/updating the wordings. Also, it needs to document the rationale for the approach being adopted – including for example why certain products are categorized as plain vanilla ones and why certain risks are being identified as key risks.

5.2 Training and investor education

The RDB is only one of the many tools to protect investor interests. The Issuer should, as best as it can, consider adopting or participating in initiatives to complement the RDB. These include, but not limited to the following:

- Provide training to the staff, distributors and other relevant stakeholder groups regarding the requirements;
- Use the best endeavours to ensure that the distributors and other relevant stakeholders groups will help potential investors fully understand the risks before making any investments;
- Undertake educational initiatives on its own and/or with distributors, any other relevant stakeholder groups to remind investors about their rights and responsibilities, including:
  - investors should take responsibility for their decisions, and they have the responsibility to fully understand the product before they invest. Furthermore, they have to continue to monitor the investments to ensure that the product continues to suit them;
  - the limitation of the risk disclosure box, i.e. the risks cited are only some of the risks of the product – there are other risks that investors should consider. Also, the focus is only on the product risk. Investors should take a holistic approach in assessing risks, i.e. one should, based on his/her financial background and risk appetite/return expectations as well as other types of assets, determine whether the product is suitable for him/her. (End)