

4th August 2017

The Securities and Futures Commission
35/F Cheung Kong Center
2 Queen's Road Central
Hong Kong

Submitted via email to: spaconsultation@sfc.hk

RE: SFC Consultation Paper on Proposed Guidelines on Online Distribution and Advisory Platforms

Dear Sirs,

BlackRock, Inc. (BlackRock)^[1] is pleased to have the opportunity to respond to the Securities and Futures Commission ("SFC") Consultation Paper on Proposed Guidelines on Online Distribution and Advisory Platforms ("Consultation").

BlackRock supports a regulatory regime that increases transparency, protects investors, and facilitates responsible growth of capital markets while preserving consumer choice and assessing benefits versus implementation costs.

We welcome the opportunity to comment on the issues raised by this Consultation and will continue to contribute to the discussion on the set of guidelines ("Proposed Guidelines") applicable to SFC-licensed or registered persons when conducting their regulated activities in providing order execution, distribution and advisory services in respect of investment products via online platforms ("Platform Operators"), or on any issues that may assist in the final outcome.

Yours faithfully,

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^[1] BlackRock is one of the world's leading asset management firms. We manage assets on behalf of institutional and individual clients worldwide, across equity, fixed income, liquidity, real estate, alternatives, and multi-asset strategies. Our client base includes pension plans, endowments, foundations, charities, official institutions, insurers and other financial institutions, as well as individuals around the world.

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Responses to questions

- 1. Do you agree with the factors relevant to online platforms identified above? Please explain your view.**

We agree with most of the factors relevant to online platforms identified in SFC's Consultation. However as the Consultation has pointed out, there is a wide range of services provided by online platforms and it would be helpful if the Guidelines could differentiate between the various service models and clarify the regulatory requirements for each. In particular, if the platform offers pure execution of investors' orders; if it posts only factual, fair and balanced information; if it makes available general asset allocation model portfolios on the internet without any solicitation or input from the website user about their own circumstances (and the website user self-selects which model portfolios he/she wants to access); or if it executes trades as a result of automatic rebalancing of portfolios back to the model portfolio weights, this should not be deemed as solicitation and Suitability Requirement should not be triggered.

- 2. Are there any factors that the SFC has not identified? Are these covered by existing conduct requirements? If not, do you have any suggestions about how they can be addressed through specific requirements? Please explain your view.**

In the BlackRock Investor Pulse 2017¹ where we surveyed 1,000 people in Hong Kong (amongst the 6,000 in Asia and 28,000 in the world), only 37% use financial advice and of those only 1/3 are satisfied with their (human) advisors. Many have stopped using advisors due to lack of trust and failure to provide relevant advice. The main factors for their dissatisfaction are the fees they pay, the frequency of contact, the responsiveness of the advisors and the quality of advice. 74% of Hong Kong respondents go online regularly to monitor savings and investments and 91% of investors had a positive experience online, saying it offers greater clarity and control.

We believe the development of online platforms and robo-advice will be able to address the unserved needs of investors. It is therefore important that the regulatory framework is crafted to promote the development of this industry and not stifle it with over-burdensome requirements. In view of the main differences between online and offline channels being the lack of / limited human interaction with the user and the reliance on user-provided information, regulations should be calibrated to the different context.

In particular we note that the Consultation Paper issued by the Monetary Authority of Singapore (MAS) dated 7 June 2017 titled "Provision of Digital Advisory Services" recognizes that digital advisors typically provide advice on exchange traded funds with limited use of derivatives and the risk of a client purchasing an ETF that is beyond their financial means is relatively contained as ETFs are low-cost and diversified instrument products and therefore the MAS is prepared to grant digital advisors case-by-case exemptions from the need to collect full information on the financial circumstances of a client. We believe there is merit in adopting a similar policy in Hong Kong to encourage the provision of such services to close the advice gap faced by investors currently.

- 3. Do you have any comments on the Core Principles in the Proposed Guidelines as outlined above? Are there any other areas which you think the Proposed Guidelines should cover? Please explain your view.**

¹ <https://www.blackrock.com/hk/en/insights/investor-pulse>

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We agree in general with the Core Principles with the following comments:

- a) In relation to Core Principle 1, we would ask that the example provided in paragraph 56(a) be modified to exclude:
 - (i) Fund-of-funds structures which include a non-SFC-authorized ETF provided the feeder fund being offered in Hong Kong is itself SFC-authorized; and
 - (ii) Reverse enquiries from retail clients in the absence of any solicitation or recommendation from the Platform Operator.
- b) In relation to the requirement in paragraph 56(a) for “access rights and controls”, a “self-declaration” by users that they are not retail clients should be an appropriate means of access control. If not, we would request that the SFC clarifies its expectations in this respect.
- c) In relation to Core Principle 2, additional information should be provided with regards to a robo-advice platform, such as the platform’s investment strategies and methods, the methodology or algorithms behind the platform’s client-facing tool (e.g. to make recommendations to clients or to execute trade for clients), how the underlying algorithms work as applied to products and services on the platform, any limitations of the algorithm, how investments of a portfolio is rebalanced, whether any adjustments to the algorithm can be made and whether investors will be given prior notice thereof, the circumstances under which the algorithm may be overridden or the platform services suspended, the range of types of investment products that will be included, actual or potential conflicts of interest that may arise, etc. Information should also be provided on the degree and type of human interaction available to clients (if any) and the means through which clients can gain such access in cases where this is possible.

4. Are there any other areas relating to robo-advice which you think the Proposed Guidelines should cover? Please explain your view.

We would request that the SFC explicitly confirm that the Suitability Requirement can be fulfilled on-line using the client profiling tools referred to in paragraphs 70 and 71 and without any “face-to-face” human interaction). Human interaction should not be required if an investor wants to do everything online. By the same token, the Suitability Requirement should not be triggered simply by the ability to interact with a human; for instance when the user contacts technical support staff for assistance on certain functions of the platform. It would be helpful if the SFC could clarify the Suitability Requirement in each of those scenarios.

As mentioned in our response to Question 1, we believe a platform which makes available general asset allocation model portfolios on the internet without any solicitation or input from the website user about their own circumstances (and the website user self-selects which model portfolios he/she wants to access) should not be considered as a robo-advisor.

A key component of digital advisors’ service models is the use of optimization algorithms, which are designed to solve investment challenges ranging from portfolio allocation to tax efficient asset placement, while factoring in various trade-offs such as transaction costs, liquidity, etc. The outcomes derived from algorithms used by any given digital advisor will vary based on the methodologies, assumptions, tools, and data inputs used by the algorithms. It is important that digital advisors reasonably design their algorithms based on their stated investment strategies and methods and make appropriate disclosures to clients concerning

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such investment strategies and methods. Asset allocation models should be based on generally accepted investment theories that take into account the historic returns of different asset classes, and key assumptions of the algorithms should be made available to investors. In addition, algorithms should be designed to consider a range of factors including performance, transaction costs, and management fees associated with various products. Where an investment within a predefined model portfolio is not available (e.g. because trading in that asset has been suspended or closed to further investment), the robo-advisor may rebalance the client's portfolio using similar investments or re-weight it across the remaining investments within the model portfolio.

Digital advisors should provide clear disclosure of the above to investors in order to allow them to evaluate the assumptions of the models².

5. What are your views on the shortcomings of robo-advice? How can the Proposed Guidelines be further enhanced to address these issues?

In our opinion, the lack of or limited human interaction with the user and the reliance on user-provided information are the major limitations of robo-advice. We believe transparency of product and algorithm information, enhanced disclosure, heightened warnings and careful design of the user questionnaires to avoid behavioural biases and inconsistencies in responses should be the means to address these issues. Outside of the Proposed Guidelines, investor education should be strengthened to make investors aware of the limitations of robo-advice vs traditional human-led advice and to remind users of their own responsibility when providing information to the robo-advisor platforms and adopting the resultant recommendations.

6. Do you have any comments on the guidance on the Suitability Requirement to be provided in the Proposed Guidelines?

Where a model portfolio is made available on an on-line platform, no suitability assessment should be required in the absence of (i) any statement indicating it may suit or match the investor's risk tolerance level, and (ii) any risk profiling of potential clients. We would request that this be included in paragraph 91 of an example of circumstances which would **not** trigger the Suitability Requirement.

We would also ask the SFC state explicitly in paragraph 95 that the Suitability Requirement can be discharged on-line (i.e. without the need for any human "face-to-face" interaction) should the user opt to provide all the relevant information on-line.

Paragraph 96 requires the Platform Operators to match the risk-return profile of each investment product with each client's personal circumstances. However the output of a robo-advisor is often a recommended portfolio of investment products and there are inherent diversification benefits in the portfolio approach that reduce the overall risk. We believe it would be more appropriate to match the risk-return profile of the recommended portfolio, instead of the underlying individual products, to the client's personal circumstances in the discharge of the Suitability Requirement.

7. Do you have any comments on how the design and overall impression created by an online platform's content could trigger the Suitability Requirement?

² <https://www.blackrock.com/corporate/en-us/literature/whitepaper/viewpoint-digital-investment-advice-september-2016.pdf>

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How the design and overall impression created by an online platform's content could trigger the Suitability Requirement is highly subjective and open to interpretation. In terms of practical implementation, platform operators will inevitably resort to requesting prior approval from the SFC on all their platform designs to ensure compliance with this provision. We are concerned about the administrative burden that will be placed on both the SFC and the industry. As long as the content posted on the online platform is factual, fair and balanced, we believe the design should be left to the discretion of the Platform Operators and it should not be construed as a solicitation that would trigger the Suitability Requirement.

8. Do you have any comments on the above examples of when the posting of materials on online platforms would or would not amount to a solicitation or recommendation?

We believe that the posting of factual information regarding overseas ETFs does not amount to solicitation or recommendation. Specifically in relation to paragraph 56(a), as long as the investor has certified that he/she is not a retail client they should have the ability to view factual materials on overseas non-complex ETFs posted on the online platforms. As discussed in our previous response, we are of the opinion that enhanced disclosure and full transparency of information are the best means to compensate for the limitation of online platforms. Hence platforms should be encouraged, not penalized, for making available more information as long as the content is factual, balanced and fair.

9. Are there any examples not mentioned above that may suggest that the content or presentation of materials would amount to a solicitation or recommendation? Please explain your view.

No comment.

10. Do you have any view on how risk analysis assessments and client profiling should be conducted and the quantitative and qualitative factors that any risk methodology should take into account?

No comment.

11. Do you have any comments on the definition of a complex product, and the considerations that should be taken into account in determining whether a product is complex?

We agree with IOSCO's definition of complex products, which are those whose terms, features and risks are not reasonably likely to be understood by a retail investor because of their complex structure and which are difficult to value. However we beg to differ from the SFC in the interpretation of this definition:

- a) Derivative product – we do not believe all derivative products are necessarily complex products as there is a wide range of derivatives in the market, some of which have standardized features and are easy to understand while others have more complicated terms. We understand that whether a fund that utilizes financial derivative instruments (FDIs) is a derivative product is one of the subjects currently under discussion in the Consultation on Review of Code on Unit Trusts and Mutual Funds. In particular the SFC adopts a different approach from the UCITS interpretation in that only FDIs used for hedging purposes are excluded from the calculation of derivative usage and there is no consideration for FDIs used in efficient portfolio management (EPM). This is not in line with the industry's practice and the SFC's proposal to treat funds which use FDIs for EPM

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purposes (i.e. investment or non-hedging purposes) as complex products would appear to be overly cautious. We would therefore ask the SFC to reconsider this definition and adopt a similar approach to UCITS until the IOSCO workstream concludes on its work on derivatives and leverage.

- b) Risk of losing more than the amount invested – in paragraphs 20 and 108 the SFC clearly separates the definition of complexity from the measure of risk and yet paragraph 104(d) indicates a direct linkage. We therefore propose that this criterion be removed. All investments carry such a risk, apart from capital guaranteed products but even those carry counterparty risks which may still trigger a loss of capital.
- c) Portfolio context – as mentioned in our response to Question 6, the output of robo-advisors is often a recommended portfolio of investment products. The resultant portfolio should not be automatically deemed as a complex product just because one or more of the underlying products are complex. The weighting of a complex product in the portfolio and the diversification effect of other products can be a mitigating effect. If a limit needs to be imposed, we would propose a 30% underlying complex product limit below which the portfolio itself will not be considered complex product and the additional Suitability Requirement will not be triggered.

12. Do you have any comments on the list of investment products that are considered to be “non-complex”?

No comment

13. Do you have any comments on the list of examples of investment products that are considered to be “complex”? Please explain your view.

We do not agree that all non-SFC-authorized funds should automatically be considered as complex products as the SFC authorization status is not equivalent to the determination of whether a product is complex or not. We would ask the SFC to use the IOSCO’s definition in evaluating funds and consider those non-SFC-authorized funds which are Recognized Jurisdiction Schemes or authorized in an Acceptable Inspection Regime as non-complex products. At the very least, collective investment schemes which are not SFC-authorized but which are Recognized Jurisdiction Schemes domiciled in Luxembourg, Ireland, the United Kingdom or United States should be classified as non-complex products.

14. In the online environment, do you think that risks arising from the sale of complex products should be addressed by requiring Platform Operators to ensure transactions in complex products are suitable for clients? Please explain your view.

Yes but only if the suitability assessment can be carried out online and automatically without the requirement for independent verification of the information provided by the potential investor. It is important to note that the key differences between online and offline channels lie in the lack of human interaction and reliance on user-provided information and regulations should tailor for such differences.

15. As the SFC’s concern arises from the sale of complex products, do you agree that the same requirement to ensure suitability should also apply to offline sales of complex products? Please explain your view.

See our response to Q14.

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16. Are there any other additional or alternative protective measures that should be introduced for the sale of complex products online?

Users' declaration that they are aware that they are purchasing a complex product may be incorporated into the online sales process before the conclusion of the transaction.

17. Are there any types of investment products (e.g., accumulators) that should not be made available on online platforms even where the Platform Operator is required to ensure suitability?

We do not believe there should be exclusions of any particular type of products from online platforms as long as there are sufficient safeguards in the form of disclosure, warnings and user acknowledgement of the risks involved. Product exclusions will not be inductive to product innovation nor development of the online distribution industry.

18. Do you think the items of minimum information set out in Appendix 4 are sufficient and appropriate? Please explain your view.

No comment.

19. Do you have any comments on the proposed warning statements set out in Appendix 4 that should be made on an online platform?

No comment.

20. Do you think a 12-month transition period is appropriate? If not, what do you think would be an appropriate transition period? Please set out your reasons.

No comment.