

## [ CIRCULAR NO. 891, November 25, 2015 ]

### **SALES AND MARKETING GUIDELINES FOR FINANCIAL**

*Adopted: 09 November 2015*  
*Date Filed: 25 November 2015*

The Monetary Board, in its Resolution No. 1811 dated 29 October 2015, approved the following guidelines governing the sales and marketing of financial products, which replaces the sales and marketing guidelines for derivatives under Appendix 26 of the Manual of Regulations for Banks (MORB) and Appendix Q-16 of the Manual of Regulations for Non-Bank Financial Institutions (MORNBFI).

**Section 1.** The contents of Appendix 26 of the MORB and Appendix Q-16 of the MORNBFI are hereby transferred to Section X661 of the MORB and Section 4661Q of the MORNBFI, respectively, and amended to read as follows:

#### **"Section X661/4661Q Sales and Marketing Guidelines for Financial Products.**

**General Principles.** A BSP-Supervised Financial Institution (BSFI) shall always act with honesty, fairness, and professionalism, and pursue the best interests of its clients. Due to the increasingly sophisticated products being introduced in the market, a BSFI acting as a dealer or broker shall have a clearly articulated strategy for the sale and marketing of financial products. The BSFI is expected to manage the risks arising from such activities and protect the interest of its clients. In this regard, a BSFI shall have appropriate policies, procedures and controls in place to ensure the suitability of the products being offered to its clients. It shall ensure that (1) the client understands the nature of the transaction and the risks involved and (2) the transaction meets the client's financial objectives and is aligned with the client's risk tolerance. It shall also provide sufficient, accurate and comprehensible information about the products, including inherent risks, in a clear and balanced manner to enable its clients to make informed financial decisions.

The BSFI shall be guided by the principle of proportionality in setting policies and procedures for its sales and marketing activities. It shall differentiate between less and more sophisticated clients, and tailor the manner by which they are engaged in accordance with such sophistication. Controls shall be in place to ensure that the BSFI complies with its internal policies and procedures, as well as relevant rules and regulations. At the minimum, BSFIs must satisfy the expectations set out in these guidelines.

The BSFI's sales and marketing policies, procedures and controls shall form part of its consumer protection risk management system, consistent with the regulations on financial consumer protection set forth under Circular No. 857 dated 21 November

2014.

**§ X661.1/4661Q.1 Scope of Application.** These guidelines prescribe the minimum standards for sales and marketing activities of BSFIs acting as dealers or brokers of financial products.

These shall apply to all banks and non-bank financial institutions performing quasi-banking functions. Trust departments shall not be covered by these regulations; they shall continue to be governed by the provisions of Part IV of the MORB and MORNBFi as applicable. Likewise, cross-selling activities shall not be covered by these guidelines; they shall be governed by the provisions of Section X172 of the MORB, as amended.

**§ X661.2/4661Q.2 Definition of Terms.** For purposes of this section, the following terms shall have the meanings set forth below:

- a. Financial products – refer to debt and equity securities, hybrid securities, derivatives as defined under sections X611 of the MORB and 4611Q of the MORNBFi, securitization structures, and similar products with substantial investment characteristics.
- b. Broker – a person engaged in the business of buying and selling securities for the account of others.
- c. Dealer – a person who buys and sells securities for own account in the ordinary course of business.
- d. complex products – refer to financial products whose terms, features and risks are not reasonably likely to be understood by a non-sophisticated client because of their complex structure, and which are also difficult to value, particularly when there is a very limited or no secondary market.

**§ X661.3/4661Q.3 Client Suitability Guidelines.** A BSFI shall ensure that the financial products it recommends to a client are appropriate for that client through a client suitability process, which involves obtaining client information, classifying a client according to financial sophistication and risk tolerance, and conducting a suitability review.

**a. Client Information**

The BSFI shall obtain necessary and sufficient information about the client that will serve as bases for its suitability assessment. At a minimum, the following information shall be obtained in addition to the basic account information:

- *Investment amount/investible funds or amount of exposure to be hedged;*
- Financial situation – the client's financial standing, which includes information on assets, net worth, financial commitments, regular income, and capacity to withstand losses arising from financial transactions;
- *Knowledge of financial products* – the client's knowledge and

understanding of the financial markets and products and the risks involved therein;

- *Investment/hedging experience* – the nature of investments and/or derivatives transactions undertaken by the client, including the length of time, frequency of dealings, and the extent to which he/it has relied on the advice of a bank or a financial advisor, if any;
- *Financial objectives* – the client's goal or purpose for entering into a transaction, whether it be for regular income, capital appreciation, capital preservation, maintenance of purchasing power, hedging as against investment, and/or long-term buy and hold as opposed to short-term active trading;
- *Risk appetite* – the level of risk a client is willing to take;
- *Holding period or investment horizon* – the length of time over which the position or exposure to be hedged will be held by the client;
- *Regulatory and legal constraints* – prohibitions or limitations imposed on the activity of the client by existing laws, rules, and regulations, and;
- *Liquidity needs* – the client's need to convert positions into cash and the timing of such requirement.

To foster cooperation from the client, the BSFI shall explain the reason for assessing suitability. If the BSFI is unable to obtain sufficient information, it shall refrain from offering or recommending any financial product.

A BSFI may design and use its own system for obtaining client information, which may include questionnaires and interviews. However, pre-formatted questions and responses shall be fit for the purpose and presented in a clear and understandable manner. Likewise, technical or unfamiliar terms shall be explained as needed, in order to prevent different interpretations and/or erroneous responses.

While the client is responsible for providing accurate and updated information, BSFI personnel shall exercise diligence in reviewing the consistency of the responses and reliability of the information provided based on available documents, such as publicly disclosed information and those obtained from the client's existing contractual relationships with the BSFI. It is highly recommended that the BSFI requests for documents to support the client's representations, particularly where the client wishes to transact in complex products. Subsequent changes to client information, if any, shall be adequately documented and concurred with by the client along with the discussions and/or clarifications made.

For a legal entity or a group of two or more natural persons, the BSFI shall obtain evidence that: (1) the client is specifically authorized to enter into all or specific kinds of financial transactions, and (2) the client's representative/s is/are authorized to carry out transactions on behalf of the entity/other parties, in accordance with the applicable legal framework.

When gathering information from a representative, the BSFI should be able to demonstrate that it has taken steps to ascertain that the information

obtained is reflective of the entity or group's situation. In addition, it shall determine if the client has competent/qualified personnel to handle the proposed activities.

If a corporate client seeks to participate in complex products, the BSFI shall require the client to incorporate in the document authorizing the latter's activities that it likewise has appropriate risk management systems sufficient to manage and monitor the risks it will take.

At a minimum, client information, including client classification, shall be reviewed and updated prior to transacting in a product that is new to the client, or earlier in case of material changes in the client's financial situation or goals. Adequate controls shall be implemented to ensure the confidentiality and security of client information.

#### **b. *Client Classification***

Based on the information obtained from a client, a BSFI should be able to classify a client into one of the following categories according to financial sophistication:

- *Market counterparty* – refers to any financial institution, only with respect to the instruments in which it is authorized to engage as a broker dealer;
- *Sophisticated institutional client* – refers to an institution that is not a market counterparty but has the level of net worth, knowledge, expertise, and experience to deal with financial products;
- *Sophisticated individual client* – refers to an individual who has demonstrated to the BSFI that he has the level of net worth, knowledge and experience to deal with financial products; or
- *Other clients* – refer to all other institutional or individual clients not categorized as market counterparty, sophisticated institutional client or sophisticated individual client.

BSFIs are encouraged to adopt a more granular categorization according to financial sophistication, provided that the categories can be mapped into the broad classifications above and the differences between categories are clearly set out.

In addition, a BSFI shall classify a client according to risk tolerance. This entails assessing the client's preferences, willingness to take on the risks associated with a product, and ability or capacity to absorb the losses that may arise from such product, as well as whether such losses will have a detrimental impact on the client's financial condition. At a minimum, a BSFI's classification of a client according to risk tolerance shall include, but need not be limited to, the following categories:

- *Conservative* – client prefers an investment and/or hedging strategy where the primary goal is to prevent the loss of principal;
- *Moderate* – client is willing and able to expose funds to a moderate level of risk in consideration for higher returns or to meet certain objectives; and

- *Aggressive* – client is willing and able to accept higher risks involving volatility of returns and even possible loss of investment in return for potentially higher long-term results.

Whenever a scoring system is used for client profiling, the BSFI shall ensure that the system is robust, fit for the purpose, and adequately tested. Any limitation in the system shall be mitigated through client discussions and the suitability review process. The system shall be calibrated as necessary to reflect appropriate results.

The BSFI shall make a record of the classification under which each client is categorized, including sufficient information to support the categorization. The classifications of the client according to sophistication and risk tolerance shall serve as bases for the BSFI's product offerings and the level of disclosures required.

### **c. *Suitability Review***

Before proposing or recommending a particular product to a client, a BSFI shall determine that the product is:

- Suitable to the client's needs, financial situation, and objectives;
- Consistent with the client's mandate, risk tolerance, and constraints; and
- Aligned with the client's knowledge and experience, such that he/it understands the nature of and risks associated with the product.

Likewise, the BSFI shall inform its client of alternative products that are suitable to his/its circumstances.

A BSFI shall maintain a record of the assessment as well as all information used as bases of its suitability review. This includes written documentation to the extent that such was created to evidence interviews and analyses made in the performance of its due diligence process. The BSFI is expected to conduct a more in-depth assessment before offering complex products. It is highly recommended that a BSFI requires a client to sign his/its conformity to the suitability assessment (including the information on which it is based) in order to avoid disputes with the client.

A client who is classified as conservative may only transact in plain vanilla financial products as follows: (i) peso-denominated Government securities representing direct obligations of the Government of the Republic of the Philippines; (ii) foreign currency-denominated Government Securities representing direct obligations of the Government of the Republic of the Philippines; (iii) highly liquid sovereign bonds, corporate bonds, and commercial papers issued off-shore rated at least "AA-" or its equivalent by a reputable international credit rating agency; (iv) highly liquid domestic corporate bonds and commercial papers rated at least "AAA" or its equivalent by a reputable credit rating agency; and/or (v) foreign exchange derivatives solely for hedging, subject to the results of the suitability review.<sup>1</sup>