



# Statement of Guidance

## Client Understanding, Suitability, Dealing and Disclosure – Securities Investment Business

### 1. Statement of Objectives

To guide the licensee on its obligation to act with a high standard of market conduct, integrity and fair dealing in the conduct of securities investment business.

### 2. Pre-Transaction

A basic protection afforded to a private client is that a licensee takes responsibility for ensuring that the clients understand the risks they are exposing themselves to.

#### 2.1. Suitability

2.1.1 The licence-holder should ensure that the transaction is suitable for the client in the following instances:

- a) Where making recommendations to a client; or
- b) Where acting with discretion over a private client's assets.

2.1.2 The assessment of suitability requires an understanding of the private clients' personal and financial circumstances and also an assessment (based on reasonable and appropriate steps) that market information suggests suitability.

#### 2.2. Understanding of risk

2.2.1 A licence-holder must not recommend a transaction to a private client, or act as a discretionary manager for him, unless it has taken reasonable and appropriate steps to enable the client to understand the nature of the risks involved.

2.2.2 In particular, where the client is a private client, a licence-holder should not-



- a) advise him to deal with or for him in futures or options or contracts for differences, unless it has arranged for the client to receive (and the client has confirmed his understanding by signing and returning) a risk disclosure statement. The risk disclosure statement should include, but is not limited to the elements set out in Appendix 1.
- b) advise him to deal with or for him in warrants, unless it has arranged for the client to receive (and the client has confirmed his understanding by signing and returning) a risk disclosure statement. The risk disclosure statement should include, but is not limited to the elements set out in Appendix 2.
- c) advise him to buy or effect in the exercise of discretion any purchase of an illiquid investment or one which is not readily realisable, unless it has informed the client of the nature and extent of the risks involved in such investments, including any difficulties in determining their value, and has obtained his written consent.

2.3. Note that suitability and understanding of risk do not apply to execution only clients.

2.4. Introductions to unlicensed business or overseas branches

A licence-holder who introduces a private client to an investment business that is outside the Cayman Islands, should disclose to the client the nature and extent of the system of regulation pertaining to securities investment business in that jurisdiction.

### 3. Dealing

The following standards apply to licensees when acting for private and professional clients<sup>1</sup>.

#### 3.1. Churning

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<sup>1</sup> Private and Professional Clients are defined in the *Statement of Guidance – Classification of Clients – Securities Investment Business*



A licence-holder should not effect transactions with unnecessary frequency or in excessive size with or for a client for whom the licence-holder exercises discretion as to how the client's funds are invested.

### 3.2. Overcharging

A licence-holder's charges should not be unfair in their incidence or unreasonable in their amount. Charges should be adequately disclosed to the client before the relationship commences.

### 3.3. Front Running

A licence-holder, or any party related to it, should not enter into an investment transaction ahead of a client, if that client ought to have priority.

### 3.4. Fair Allocation

Where a bulk transaction cannot be fulfilled by the market, the licence-holder should allocate the partially filled order fairly and uniformly. It should put itself last in the allocation, unless its participation enabled each client to get a better deal.

### 3.5. Timely Allocation

An obvious area for abuse would be the ability to retrospectively allocate trades to different accounts. In order not to disadvantage clients for the advantage of a trader's own book or a personal account, a licensee must ensure that a transaction it executes is promptly allocated.

#### 3.5.1 The allocation must be:

- a) To the account of the client on whose instructions the transaction was executed:
- b) In respect of a discretionary transaction, to the account of the client or clients with or for whom the licensee had made and recorded, prior to the transaction, a decision in principle to execute that transaction; or
- c) In all other cases, to the account of the licensee.



### 3.6. Timely Execution

3.6.1 The general expectation from clients must be that once an order is passed to a broker the deal will be struck promptly. A certain degree of discretion must however be given to the broker to allow for a delay in the execution if, for example, the market is temporarily disorderly.

3.6.2 Once a licensee has agreed or decided in its discretion to effect or arrange a current client order, it must effect or arrange the execution of the order *as soon as reasonably practicable in the circumstances*. This does not preclude a licensee from postponing execution of an order where it believes on reasonable grounds that it is in the best interest of the client.

### 3.7. Best Execution

3.7.1 Where a licensee deals with or for a client, it must provide best execution, i.e. the guidelines require that the licensee deals at the best possible price for its clients.

3.7.2 A licensee may rely on another person who executes the transaction to provide best execution, but only if it believes on reasonable grounds that he will do so.

3.7.3 For the purpose of this statement of guidance a licensee provides best execution if:

- a) It takes reasonable care, to ascertain the price which is the best available price for the client in the relevant market at the time for transactions of the kind and size concerned; and
- b) Unless the circumstances require it to do otherwise in the interests of the client, it deals at a price which is not less advantageous to him/her.

3.7.4 In applying best execution, a licensee should disclose to the client the

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price net of any charges, commission, associated fees or other form of remuneration that it or its agent would make.

- 3.7.5 Where a licensee acts on behalf of a professional client that wishes to deal in a market that allows for price discovery, the client has the ability to waive the Best Execution obligation of the licensee.

### 3.8. Client order priority

The basic intent of this guidance is to ensure that a licensee does not place its own interests above those of a client and, in particular, where an order is received, the licensee does not place its own interests above those of its clients. A licensee must deal with client and own account orders fairly and in due turn.

### 3.9. Research and analysis

A licence-holder should not:

- 3.9.1 Deal for itself or a connected client ahead of the distribution of its own or its associate's research or analysis and with the advance knowledge of any price sensitive information.
- 3.9.2 Distribute research or analysis for which a licence-holder expects to benefit unless this fact is disclosed.
- 3.9.3 Otherwise behave unfairly in the way in which it acts upon its research or analysis.

## 4. Post-Transaction – Client Statements

- 4.1. When a licensee manages or administers any account or portfolio which includes securities, for a client; or operates a client's account containing uncovered open positions in a contingent liability transaction, a licensee must, promptly and at suitable intervals, provide the client with a written statement containing adequate information on the value and composition of the client's account or portfolio with the licensee, as at the end of the period covered by the statement. The statement supplied should be regular, timely and provide



information on the client's investment portfolio.

4.1.1 In certain instances it may not be necessary to provide a client statement if it would duplicate a statement to be provided by another party to the transaction.

4.1.2 Record keeping requirements

A licensee must make a copy of any client statement, and retain it for five years from the date on which it was provided.

4.2. Promptness

4.2.1 A contract note should be sent to the client with due dispatch (i.e. as soon as practically possible). The contract note can be emailed, faxed or sent by mail to the client and this needs to be disclosed to the client in the client agreement.

4.2.2 A statement should be provided to a private client within 25 business days after the end of the period to which the statement relates.

4.2.3 A statement should be provided to a private client within 10 business days after the end of the period to which the statement relates if, at the end of that period, the portfolio includes any uncovered open positions in contingent liability transactions.

4.2.4 Any statement provided to a private client should be provided within such period as the private client has on his own initiative agreed with the licensee as adequate.

4.3. Suitable intervals

4.3.1 A statement should be provided at such intervals as a private client has on his own initiative agreed with the licensee as adequate, and in the absence of such agreement at six-monthly intervals.

4.3.2 A statement should be provided once in any other period not exceeding 12 months if the private client has advised the licensee in writing that he wishes to receive less frequent statements than required by (a);



4.3.3 A statement should be provided monthly if the client's portfolio includes an uncovered open position in a contingent liability transactions;

#### 4.4. Adequate Information

4.4.1 A statement should contain the general information set out in table 1 and the additional information set out in table 2-4 as applicable.

4.4.2 Where an agreement was reached upon the own initiative of a private client, the statement need only contain information therein agreed as between the client and the licensee, as being adequate.

#### General Information – Table 1

**Contents and value**

As at the end of the period covered: the number, description and value of each security held; the amount of cash held; and the total value of the portfolio.

**Basis of valuation**

A statement of the basis on which the value of each security has been calculated and, if applicable, a statement that the basis for valuing a particular security has changed since the previous client statement. If any *securities* are shown in a currency other than the usual one used for valuation of the portfolio, the relevant currency exchange rates must be shown.

#### Additional information required for a discretionary managed portfolio – Table 2

**Details of any assets loaned or charged**

A statement of which securities (if any) were at the closing date loaned to any third party and which securities (if any) were at that date charged to secure borrowings made on behalf of the portfolio.

Also the aggregate of any interest payments made and income received during the account period in respect of loans or borrowings made during that period.

**Transactions and changes in composition**

Particulars of each transaction entered into for the portfolio during the period; and the aggregate of client money and particulars of all securities transferred into and out of the portfolio during the period; and the aggregate of any interest payments, together with the dates of their application and dividends or other benefits received by the licensee for the portfolio during that period.

The particulars required may be disclosed in separate statements (excluding confirmations of transactions) issued to the client during the period.

**Charges and remuneration**

If not previously advised in writing:



- (a) a statement of the aggregate charges of the licensee and its associates; and
- (b) a statement of any remuneration received by the licensee or its associates or both from a third party in respect of the transactions entered into, or any other services provided, for the portfolio.

### Additional information required for a contingent liability transaction – Table 3

**Changes in value**

The aggregate of client money transferred into and out of the portfolio during the valuation period.

**Open positions**

In relation to each open position in the account at the end of the account period, the unrealised profit or loss to the client (before deducting or adding any commission which would be payable on closing out).

**Closed positions**

In relation to each transaction executed during the account period to close out a client's position, the resulting profit or loss to the client after deducting or adding any commission.

Note: Instead of this specific detail, the statement may show the net profit or loss in respect of the client's overall position in each contract.

**Aggregate of contents**

The aggregate of each of the following in, or relating to, the client's portfolio at the close of business on the valuation date:

- (a) cash;
- (b) collateral value;
- (c) management fees; and
- (d) commissions attributable to transactions during the period or a statement that this information has been separately disclosed in writing in earlier statements or confirmations to the client.

**Option account valuations** in respect of each open option contained in the account on the valuation date stating:

- (a) the share, future, index or other investment involved;
- (b) the trade price and date for the opening transaction, unless the valuation statement follows the statement for the period in which the option was opened;
- (c) the market price of the contract; and
- (d) the exercise price of the contract.

Option account valuations may show an average trade price and market price in respect of an option series if the client buys a number of contracts within the same series.

### Additional information required for a broker fund – Table 4

**Significant holdings**

If any asset is worth more than 5% of the value of the fund, it must be described and its percentage in





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value stated.

**Price comparison**

Unless the licensee is managing a broker fund on behalf of a single client, a comparison of the price of units in the fund or scheme with the published index or sector average stated in the product particulars.

**Investment objectives and strategies**

The current investment objectives and strategies including an indication as to whether or not either of these have changed since the previous report.

**Benefits and rewards**

The cash value of the benefits and rewards which the broker fund adviser and any associate have received directly or indirectly during the reporting period by way of remuneration which may be shown in aggregate or as applicable to each client or both.



## Appendix 1

### Derivatives Risk Warning Notice – Two-way communication

This notice is provided to you as a private client in compliance with the Cayman Islands Monetary Authority Securities Investment Business Law (2003 Revision) and its accompanying Regulations. Private clients are afforded greater protections under this Law and its accompanying Regulations than other clients, and you should ensure that your broker tells you what these are.

This notice does not disclose all of the risks and other significant aspects of derivatives products such as futures, options, and contracts for differences. You should not deal in derivatives unless you understand the nature of the contract you are entering into and the extent of your exposure to risk. You should also be satisfied that the contract is suitable for you in the light of your circumstances and financial position. Certain strategies, such as a "spread" position or a "straddle", may be as risky as a simple "long" or "short" position.

Whilst derivative instruments can be utilised for the management of investment risk, some investments are unsuitable for many investors. Different instruments involve different levels of exposure to risk, and in deciding whether to trade in such instruments you should be aware of the following points.

#### 1. **Futures**

Transactions in futures involve the obligation to **make, or to take, delivery** of the underlying asset of the contract at a future date, or in some cases to settle your position with cash. They carry a high degree of risk. The "gearing" or "leverage" often obtainable in futures trading means that a small deposit or down payment can lead to large losses as well as gains. It also means that a relatively small market movement can lead to a proportionately much larger movement in the value of your investment, and this can work against you as well as for you. **Futures transactions have a contingent liability**, and you should be aware of the implications of this, in particular the margining requirements, which are set out in paragraph (6) below.

#### 2. **Options**

There are many different types of options with different characteristics subject to different conditions:

- (1) **Buying options:**



Buying options involves less risk than selling options because, if the price of the underlying asset moves against you, you can simply allow the option to lapse. The maximum loss is limited to the premium, plus any commission or other transaction charges. However, if you buy a call option on a futures contract and you later exercise the option, you will acquire the future. This will expose you to the risks described under "futures" and "contingent liability transactions".

(2) Writing options:

If you write an option, **the risk involved is considerably greater** than buying options. You may be liable for margin to maintain your position and a loss may be sustained well in excess of any premium received. By writing an option, you accept a legal obligation to purchase or sell the underlying asset if the option is exercised against you, however far the market price has moved away from the exercise price. If you already own the underlying asset which you have contracted to sell (known as "covered call options") the risk is reduced. If you do not own the underlying asset (known as "uncovered call options") the risk can be unlimited. Only experienced persons should contemplate writing uncovered options, and then only after securing full details of the applicable conditions and potential risk exposure.

Certain options markets operate on a margined basis, under which buyers do not pay the full premium on their option at the time they purchase it. In this situation you may subsequently be called upon to pay margin on the option up to the level of your premium. If you fail to do so as required, your position may be closed or liquidated in the same way as a futures position.

**3. Contracts for differences**

Futures and options contracts can also be referred to as a Contract for Differences. These can be options and futures on any index, as well as currency and interest rate swaps. However, unlike other futures and options, these contracts can only be settled in cash. Investing in a contract for differences carries the same risks as investing in a future or an option and you should be aware of these as set out in paragraphs 1 and 2 respectively. Transactions in contracts for differences may also have a contingent liability and you should be aware of the implications of this as set out in the paragraph (6) below.

**4. Off exchange transactions**



It may not always be apparent whether or not a particular derivative is on or off-exchange. Your broker must make it clear to you if you are entering into an off exchange derivative transaction. While some off-exchange markets are highly liquid, transactions in off-exchange or "non transferable" derivatives may involve greater risk than investing in on-exchange derivatives because there is no exchange market on which to close out an open position, i.e. these might be securities that are not readily realisable instruments. It may be impossible to liquidate an existing position, to assess the value of the position arising from an off-exchange transaction or to assess the exposure to risk. Bid and offer prices need not be quoted, and, even where they are, they will be established by dealers in these instruments and consequently it may be difficult to establish what is a fair price.

## **5. Foreign markets**

Foreign markets will involve specific market risks. In some cases the risks will be greater. On request, your broker must provide an explanation of the relevant risks and protections (if any) which will operate in any relevant foreign markets, including the extent to which he will accept liability for any default of a foreign broker through whom he deals. The potential for profit or loss from transactions on foreign markets or in foreign denominated contracts will be affected by fluctuations in foreign exchange rates.

## **6. Contingent liability transactions**

Contingent liability transactions that are margined require you to make a series of payments against the purchase price, instead of paying the whole purchase price immediately.

If you trade in futures, contracts for differences or sell options you may sustain a total loss of the margin you deposit with your broker to establish or maintain a position. If the market moves against you, you may be called upon to pay substantial additional margin at short notice to maintain the position. If you fail to do so within the time required, your position may be liquidated at a loss and you will be liable for any resulting deficit.

Even if a transaction is not margined, it may still carry an obligation to make further payments in certain circumstances over and above any amount paid when you entered the contract.

Contingent liability transactions which are not traded on or under the rules of a recognised may expose you to substantially greater risks.



**7. Collateral**

If you deposit collateral as security with your broker, the way in which it will be treated will vary according to the type of transaction and where it is traded. There could be significant differences in the treatment of your collateral depending on whether you are trading on a recognised investment exchange, with the rules of that exchange (and associated clearing house) applying, or trading off exchange. Deposited collateral may lose its identity as your property once dealings on your behalf are undertaken. Even if your dealings should ultimately prove profitable, you may not get back the same assets that you deposited and may have to accept payment in cash. You should ascertain from your broker how your collateral will be dealt with.

**8. Commissions and charges**

Before you begin to trade, you should obtain all the relevant facts relating to the firm's remuneration attributable to any transaction and details of any other charges for which you will be liable. If any charges are not expressed in money terms (but, for example, as a percentage of contract value), you should obtain a clear written explanation, including appropriate examples, to establish what such charges are likely to mean in specific money terms. In the case of futures, when commission is charged as a percentage, it will normally be as a percentage of the total contract value, and not simply as a percentage of your initial payment.

**9. Suspensions of trading**

Under certain trading conditions it may be difficult or impossible to liquidate a position. This may occur, for example, at times of rapid price movement if the price rises or falls in one trading session to such an extent that under the rules of the relevant exchange trading is suspended or restricted. Placing a stop-loss order will not necessarily limit your losses to the intended amounts, because market conditions may make it impossible to execute such an order at the stipulated price.

**10. Clearing house protections**

On many exchanges, the performance of a transaction by your broker (or the third party with whom he is dealing on your behalf) is "guaranteed" by the exchange or its clearing house. However, this guarantee is unlikely in most circumstances to cover you, the client, and may not protect you if your broker or another party defaults on its obligations to you. On request, your broker must explain any protection provided to you under the clearing guarantee applicable to any on-exchange derivatives in which you are dealing. There is no clearing house for off-exchange instruments which are not traded under the rules of a recognised investment exchange.



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**11. Insolvency**

Your broker's insolvency or default, or that of any other brokers involved with your transaction, may lead to positions being liquidated or closed out without your consent. In certain circumstances, you may not get back the actual assets that you lodged as collateral and you may have to accept any available payment in cash. On request, your broker must provide an explanation of the extent to which he will accept liability for any insolvency of, or default by, other brokers involved with your transactions.

[Name of Firm]

[On duplicate for Signature by private client]

I/We have read and understood the risk warning notice set out above.

Date \_\_\_\_\_

[Signature of Client] \_\_\_\_\_

[Signature of Joint Account Holder] \_\_\_\_\_

**Note to firms**

Paragraphs 1–7 may be deleted when they relate to particular kinds of business which will not be carried out with or for the client. Paragraphs 8–11 are mandatory and may not be deleted.

Firms may also include descriptions of the types of investments covered by this notice, provided such descriptions do not lessen the effect of the risk warnings provided.



## Appendix 2

### Warrants Risk Warning Notice – Two-way communication

This notice is provided to you as a private client in compliance with the Cayman Islands Monetary Authority Securities Investment Business Law (2003 Revision) and its accompanying Regulations. Private clients are afforded greater protections under this Law and its accompanying Regulations than other clients, and you should ensure that your broker tells you what these are.

This notice cannot disclose all of the risks and other significant aspects of warrants. You should not deal in them unless you understand the nature of the transaction you are entering into and the extent of your exposure to potential loss.

You should consider carefully whether warrants are suitable for you in the light of your circumstances and financial position. In deciding whether to trade, you should be aware of the following matters.

#### **1. Warrants**

A warrant is a time-limited right to subscribe for shares, debentures, loan stock or government securities, and is exercisable against the original issuer of the underlying securities. Warrants often involve a high degree of gearing, so that a relatively small movement in the price of the underlying security results in a disproportionately large movement in the price of the warrant. The prices of warrants can therefore be volatile.

You should not buy a warrant unless you are prepared to sustain a total loss of the money you have invested plus any commission or other transaction charges.

Some other instruments are also called warrants but are actually options (for example, a right to acquire securities which is exercisable against someone other than the original issuer of the securities, often called a "covered warrant").

#### **2. Off-Exchange Warrant Transactions**

Transactions in off-exchange warrants may involve greater risk than dealing in exchange traded warrants because there is no exchange market through which to liquidate your position, to assess

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the value of the warrant or the exposure to risk. Bid and offer prices need not be quoted, and even where they are, they will be established by dealers in these instruments and consequently it may be difficult to establish what is a fair price.

Your broker must make it clear to you if you are entering into an off-exchange transaction and advise you of any risks involved.

**3. Commissions and charges**

Before you begin to trade you should have all the relevant facts relating to the firm's remuneration attributable to any transaction and details of any other charges for which you will be liable.

**4. Foreign Markets**

Foreign markets will involve different risks to those that you are used to. In some cases the risks will be greater. On request, your broker must provide an explanation of the protections that will operate in any relevant foreign markets, including the extent to which he will accept liability for any default of a foreign broker through whom he deals. The potential for profit or loss from transactions on foreign markets will be affected by fluctuations in foreign exchange rates.

[Name of firm]

[On duplicate for signature by private client]

I/we have read and understood the risk warning notice set out above.

Date \_\_\_\_\_

[Signature of Client] \_\_\_\_\_

[Signature of Joint Account Holder] \_\_\_\_\_