

## MESSAGE

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cc: Christina FY CHOI/SFC@SFC

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From: "Lau Ka Shi" <lau.kashi@bcthk.com>  
Date: 31/12/2009 11:24 PM

Subject: HKTA submission to SFC's Consultation on Proposals to Enhance Protection for the Investing Public

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<<HKTA submission to SFC Consultation Paper (31-12-09).doc>>

To: The SFC

cc: Ms. Christina Choi (thank you for sending me the consultation paper for HKTA to comment)

On behalf of the MPF trustees of the Hong Kong Trustees' Association, I would like to express our support to the SFC consultation on proposals to enhance protection for the investing public ("Consultative Document"). We note that the Consultative Document covers retail products only and MPF products are not included. However, we consider this consultation to be wide in scope covering investment products. MPF products are essentially investment in nature though they are currently governed under stricter guidelines and investment restrictions, but we as an industry look beyond these restrictions and consider it appropriate to provide our comment with a longer term view on the potential development of the MPF regime. We also believe that the new or revised measures to be applied to investment products (after this consultation exercise by the SFC) might very well be applied to a certain extent, if not all, to MPF products when the government decides to review this regime at a later date.

Therefore it is important for MPF trustees of the HKTA to provide our views to the SFC at this juncture so that our views could also be considered by the SFC together with those of other parties. It is in this spirit that we make this submission. Please refer to the enclosure.

We are committed to working with the SFC on this initiative and please let me know if we can be of further assistance. I look forward to hearing from you.

Happy New Year to you and your colleagues at the Commission!

Sincerely,

Ka Shi Lau

Chairman, Retirement Schemes Subcommitte

Hong Kong Trustee's Association

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HKTA submission to SFC Consultation Paper (31-12-09).doc

# HKTA

Hong Kong Trustees' Association Ltd  
香港信託人公會

To: Securities and Futures Commission  
(By email: [consult@sfc.hk](mailto:consult@sfc.hk) and by fax: 2293 5722)

From: Retirement Schemes Subcommittee (RSS) - on behalf of MPF Trustees  
Hong Kong Trustees' Association  
(Ka Shi Lau, Chairman of RSS)

Date: 31 December 2009

Subject: **SFC's Consultation on Proposals to Enhance Protection for the Investing Public**

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On behalf of the MPF trustees of the Hong Kong Trustees' Association, I would like to express our support to the SFC's consultation on proposals to enhance protection for the investing public ("Consultative Document"). We note that the Consultative Document covers retail products only and MPF products are not included. However, we consider this consultation to be wide in scope covering investment products. MPF products are essentially investment in nature though they are currently governed under stricter guidelines and investment restrictions, but we as an industry look beyond these restrictions and consider it appropriate to provide our comment with a longer term view on the potential development of the MPF regime. We also believe that the new or revised measures to be applied to investment products (after this consultation exercise by the SFC) might very well be applied to a certain extent, if not all, to MPF products when the government decides to review this regime at a later date.

Therefore it is important for MPF trustees of the HKTA to provide our views to the SFC at this juncture so that our views could also be considered by the SFC together with those of other parties. It is in this spirit that we make the following submission.

#### **Proposed Handbook (Part II of the Consultative Document)**

Our comments on the Proposed Handbook are given (i) in connection with aspects of trustees' businesses which are not related to MPF products or (ii) in the event that the new or revised measures would someday be referred to or applied to MPF products when the government decides to apply similar enhancements to this regime later.

#### **Intermediaries Conduct and Post-Sale Arrangement (Parts III and IV of the Consultative Document)**

Given the fact that the selling and marketing of MPF products do not constitute any regulated

activities, these products should perhaps be exempted from parts III and IV of the Consultative Document in relation to intermediaries conduct and post-sale arrangements. For the avoidance of doubt on the part of the MPF trustees, we would appreciate if the SFC could confirm the above understanding.

Currently, there are many types of “distributors” or financial service intermediaries (such as banks, insurance agents, brokers and independent financial advisers, etc.) for investment products including MPF, and SFC intermediaries are only one of the channels for investors to purchase these products. It is necessary to ensure that the supervision and monitoring of distributors/intermediaries are subject to the same standards and requirements applicable to all types of products and also across different regulatory regimes (not just the SFC). We therefore urge all relevant regulators to work together for a consistent regulatory approach, especially the MPF regime which cut across all regulators in HK.

### Response to Consultation Questions

<b>Part II Products – Revised Unit Trust (UT) Code</b>	
<b>Q.1</b>	<p><b>Do you have any comments on the Overarching Principles Section of the Handbook generally or any particular provisions in the Section? Please explain your views</b></p> <p>The overarching principles emphasize product disclosure, general standards expected of product issuers and advertisement issuers, and ongoing monitoring of product information to investors.</p> <p><u>HKTA</u></p> <p>We believe the focus should be on consistent advice across comparable investment products rather than investors’ understanding of all product details.</p> <p>We prefer seeing regulatory pre-approval of marketing materials replaced by the imposition of higher accountability on product providers and advertisement issuers across all investment products.</p> <p>Regarding the scope and extent of due care and diligence for the purpose of selection and appointment of distributors, clear guidance would be useful as this will enable product providers to adopt a consistent approach and distributors to understand the due diligence process.</p> <p>The SFC Code on MPF Products should be included in the New Handbook because such products expose the scheme members to investment risks similar to mutual funds.</p> <p>The Code on Investment-linked Assurance Schemes in the New Handbook requires the authorized insurer to inform scheme participants of any material adverse change in the financial conditions or businesses of the key counterparties. Some MPF trustees find this requirement potentially very onerous as many situations that do not impact policyholders could be deemed to be “adverse”, e.g. remitting capital to parent company. Clarification is required as to what events will trigger the requirement.</p>
<b>Q.11</b>	<p><b>In relation to proposals regarding investment activities set out in Proposal 1 (structured funds), Proposal 2 (funds that invest in FDI) and Proposal 3 (investments in other schemes), other than the proposed general requirements, what other requirements do you think should be included? Please explain your views.</b></p>

	<p><b>HKTA</b></p> <p>We agree to the initiative to provide clarity on structured funds and the use of FDI. However, there are areas that required further clarification on applying paras 8.8 and 8.9. For example:</p> <p>Treatment of a fund where the investment objective is to track the performance of an index comprising stocks from an emerging market and if the fund cannot invest directly in the constituent stocks and needs to achieve the investment objective through participation instruments issued by a third party issuer, should the fund fall within para 8.9?</p> <p>A guaranteed fund where 90% of the capital is guaranteed by a guarantor – the investment objective is to give an investment exposure to an index through a swap with a counterparty pursuant to which an investor may participate in a leveraged exposure to the index growth of up to a capped return. If substantially all the assets of the fund are invested in the swap, we expect that such a fund would fall within paras 8.5, 8.8, and Chapter 7 would not apply.</p>
Q12	<p><b>In relation to the disclosure and reporting requirements set out in Proposal 4 (bilingual annual reports) and Proposal 5 (Product KFS), do you agree with the proposals? Please explain your views.</b></p> <p><b>HKTA</b></p> <p>We agree that the publication of a Chinese language annual report is voluntary for SFC-authorized schemes that are recognized jurisdiction schemes (RJS), provided that distributors that market such schemes to the public in Hong Kong would take steps to let investors be aware that annual reports would be available in English only.</p> <p>Rather than having KFS as part of the offering document as proposed, we suggest to keep this as a separate document to offering documents; especially for offshore funds, as any offering document would generally require regulatory approval from the respective home regulator as well as the authorization regulator.</p> <p>To avoid double regulation, we would like to further clarify that Chapter 11.6 requirements do not apply to collective investment schemes that fall under the MPF regime as there are separate accounting, auditing and reporting requirements for these products.</p>
Q.13	<p><b>Do you have any comments on the revisions to the UT Code generally? Please explain your views.</b></p> <p><b>HKTA</b></p> <p>As regards the proposed amendment to 9.4 of the UT Code that management companies of non-Hong Kong schemes are encouraged to appoint a representative within the management group, we do not concur with this amendment as it would have adverse implication to the business of local entities providing trustee and administrative services to third parties.</p>
Q14	<p><b>What are your views about the idea of UCITS schemes which have issued KIDs under their own E.U. regulator's regime using those KIDs in place of the Product KFS? The issue here is how we should balance the importance of developing broadly standardized Product KFS across all products sold to the Hong Kong public so that it is easy for Hong Kong investors to understand and compare different products, and the commercial needs of individual fund houses to reduce costs and lessen administrative burdens. Also, if a large number of SFC-authorized funds adopt KIDs instead of Product KFS, it may defeat the purpose of comparability under the Product KFS proposal. The SFC would like to hear your views</b></p> <p><b>HKTA</b></p> <p>We are of the view that the content of KID is similar to KFS and can fulfill the purpose of KFS. Therefore, KID should be deemed as acceptable for KFS purpose. Should there be any</p>

	<p>additional information required to be disclosed under our HK regime, we prefer to place a standardized addendum on the KID. It is more cost effective to maintain one set of KFS of the fund and avoid additional administrative workload thereby increasing related costs.</p>
Q.15	<p><b>Do you agree that the proposed approach to implementation of the revised UT Code is acceptable and practicable, taking into account the needs and circumstances of various stakeholders? Do you have any particular views as to exactly how long the transition period should be for Existing Schemes to fully comply with the Product KFS and Other Disclosure Requirements (paragraph 191)?</b></p> <p><u>HKTA</u> We agree with the proposed approach. A transition period of 12 months is suggested.</p>
Q.16	<p><b>Do you have any comments on (1) the Product KFS requirements, (2) the enhanced disclosure requirements on "with-profit" features and internal funds, (3) the deletion of Chapter 5, 8 and 9 of the current ILAS Code, and (4) the codification of the existing practices regarding the computation of surrender values and the notification requirements on scheme changes?</b></p> <p><u>HKTA</u></p> <p>(a) In addition to the statement that "customer is investing in the underlying funds and does not have the right of ownership of these funds", it should be highlighted that "customer does have ownership of the life insurance policy to reflect the overall arrangement".</p> <p>(b) We recommend that the guideline will cover "Class C" insurance policies and exclude "Class A" insurance policies explicitly to avoid any possible misunderstanding.</p> <p>(c) No comment.</p> <p>(d) Majority of the investments are non-guaranteed and are subject to the investment performance of the underlying funds. It is not clear the value to be gained under the proposed arrangement indicated as "codification of existing practices".</p> <p>In view of the extensive use of initial contribution period products that carry substantial charges on the first 2 - 3 years' premium even if the customer takes a premium holiday, we recommend that an illustration be required to show what happens if a customer takes a premium holiday say for the first 3 years.</p>
Q.17	<p><b>Do you agree that the proposed approach to implementation of the revised ILAS Code as acceptable and practicable, taking into account the needs and circumstances of various stakeholders? Do you have any particular views as to exactly how long the transition period should be for Existing Schemes to fully comply with the Product KFS and Other Disclosure Requirements (paragraph 214(c))?</b></p> <p><u>HKTA</u> We agree with the proposed approach. A transition period of 12 months is suggested.</p>
Q.19	<p><b>Do you think that intermediaries should, as part of their "know your client" procedures, seek clients' information about their knowledge of derivatives and characterize those clients (other those professional investors) with such knowledge as "clients with derivative knowledge" to assist intermediaries in ensuring that the investment advice and products offered in relation to unlisted derivative products are suitable ? Please give your views on the contents of the proposed measures for intermediaries to assess whether investors have knowledge of derivatives.</b></p>

	<p><b>HKTA</b></p> <p>Since the risk level of derivative products is generally higher than that of traditional funds, we agree with the SFC proposal. This agreement is subject to an understanding that collective investment schemes that only use derivatives for hedging and/or efficient portfolio management purposes are not treated as derivative products.</p> <p>It should be noted, however, that the use of derivatives has become an integral part of fund management and requiring investors to have such knowledge would bar quite a number of investors from accessing many of the investment funds with derivative imbedded in managing these funds. It would also be rather difficult for front-end staff to assess the adequacy of derivative knowledge of clients. May be the focus should be on ensuring the quality of intermediaries and the adequacy of their knowledge in marketing investment products (in particular the more complex ones) and in conveying to investors the risks associated with derivatives.</p> <p>In addition, instead of only allowing clients with derivative knowledge to access certain funds using derivatives, it might be better to rely on strengthening and tightening of the existing framework that focuses on risk management/internal control and investment compliance of fund managers as well as the oversight function of the respective funds' trustees. So far this has worked well under the MPF regime with MPF trustees discharging their duties under the supervision of the MPFA.</p>
<p>Q.20</p>	<p><b>Should a high net worth investor be considered to have specific knowledge and expertise if:</b></p> <p><b>(a) he is currently working, or has previously worked in the relevant financial sector for at least one year in a professional position that involves the relevant product; or</b></p> <p><b>(b) he has undergone training or studied courses which are related to the relevant product?</b></p> <p><b>Do you have any other suggestions?</b></p> <p><b>HKTA</b></p> <p>We would like to clarify further whether certain requirements mentioned on the Code of Conduct are waived from the investor protection perspective for the high net worth investors.</p> <p>We are of the view that high net worth investor should be treated as a normal investor while professional investors should be treated as a separate category.</p> <p>As to raising the minimum portfolio threshold (HK\$8 million currently) for PI, we think it would have limited value in terms of enhancing investor protection.</p>
<p><b>Part III Intermediaries conduct</b></p>	
<p>Q22.</p>	<p><b>Where a distributor and/or any of its associates explicitly receives or will receive monetary benefits from a product issuer (directly or indirectly), which of the following three disclosure options would be more appropriate? Please explain your views.</b></p> <p><b>Option 1.1 - Disclosure of dollar amount or percentage</b></p> <p><b>Option 1.2 - Disclosure of percentage bands or ceiling (i.e "x% to y%" or "up to y%")</b></p> <p><b>Option 1.3 - Generic disclosure?</b></p> <p><b>HKTA</b></p> <p>Although the disclosure of dollar amount or percentage would be the most useful from investors' perspective, option given the confidential nature of information, most MPF trustees suggest 1.3 i.e. <u>generic disclosure</u> taking into account the following:</p> <ul style="list-style-type: none"> <li>- In general, the scope of the services, clear description of the role and the total costs are the key information in the customer decision-making process. The</li> </ul>

	<p>general disclosure of the remuneration for intermediary is sufficient to alert the customers about conflict of interest;</p> <ul style="list-style-type: none"> <li>- Some benefit arrangements may well be too complicated for the general public to understand;</li> <li>- If options 1.1 or 1.2 are used, distributors/product issuers may devise more use of soft dollar arrangements as another form of remunerations.</li> </ul> <p>In fact, as we are aware, the key information for customer decision-making process should be the understanding of the product/fund, the risks/return spectrum, scope of services provided and the fee &amp; charges (for MPF products, the Fund Expense Ratio, FER, is a useful indicator of total costs).</p>
Q24	<p><b>Where a distributor does not explicitly receive any monetary benefits for distributing an investment product, which of the following disclosure options would be more appropriate? Please explain your views.</b></p> <p><b>Option 2.1 – Specific disclosure of distribution reward</b>  <b>Option 2.2 – Generic disclosure</b></p> <p><u>HKTA</u>  Most MPF trustees recommend a general disclosure of non-monetary benefits is sufficient.</p>
Q25	<p><b>Where a distributor makes a trading profit from a back-to-back transaction, which of the following disclosure options would be more appropriate? Please explain your views.</b></p> <p><b>Option 3.1 – Disclosure of specific trading profit</b>  <b>Option 3.2 – Generic disclosure</b></p> <p><u>HKTA</u>  Most MPF trustees are of the view that a general disclosure of trading profits arising from back-to-back transaction is sufficient.</p>
Q26	<p><b>Do you consider it appropriate to restrict distributors from offering investors supermarket gift coupons, audio visual equipment and other kinds of gifts having monetary value (except discount of fees and charges) in promoting a specific investment product to investors?</b></p> <p><u>HKTA</u>  Whilst offering investors with gifts that are unrelated to the products offered by the distributor may not be appropriate, it is only a gesture of appreciation and is unlikely to constitute as a distraction to investors in making decision as normally the value of the gift or coupon is not of a substantial value. Therefore, most MPF trustees are of the view that these activities should not be restricted in a jurisdiction which upholds the principles of free trade and freedom of contract such as Hong Kong. To restrict what are essentially commercial decisions would be over-regulating.</p> <p>Instead of restricting such gifts offerings, most MPF trustees believe that that it is more important to strengthen the controls in the selling process for investment recommendations, stipulating appropriate disclosure requirements and educating the public in the understanding of investment objectives and risks.</p> <p>Also, the terms “gift” is difficult to define exhaustively. There are many different kinds of gifts in addition to gift coupons or audio visual requirement, how about</p> <ul style="list-style-type: none"> <li>i) waiver of front or back-end load;</li> <li>ii) provision of medical check-up;</li> <li>iii) provision of travel packages;</li> <li>iv) advantages offered through other products such reduction in insurance premium</li> </ul>

	As long as their disclosures are fair and standardized across all types of products and distributors, and do not involve misleading information, these activities should be acceptable.
Q27	<p><b>Do you have any comments on the proposed information content of the Sales Disclosure Document which includes (a) capacity (principal or agent); (b) affiliation with product issuer; (c) monetary and non-monetary benefits; and (d) discount of fees and charges available to investors?</b></p> <p><u>HKTA</u> We generally do not have comment on the disclosures of items (a) to (c). However, as regards item (d), most MPF trustees consider that such disclosure may involve sensitive commercial information. They take the view that inclusion of such sensitive marketing information in the Sales Disclosure Statement would not be appropriate. Again we would suggest keeping the statement concise and easy to understand. Information overload would be an overkill.</p>
Q28	<p><b>Do you think audio recording of the client risk profiling process and the advisory or selling process for investment products should be made mandatory or the current record keeping requirements are sufficient? If audio recording is made mandatory, how long do you think these audio records should be kept for? Please explain your views.</b></p> <p><u>HKTA</u> We do not support making the audio recording a requirement. The requirement of the audio recording, while having cost implication for providers, may not be practicable for those distributors/intermediaries who conduct marketing and selling activities outside their office premises and where investors might object on privacy ground. It might be more useful and practical to strengthen the requirement for written documentation/ record of the selling process.</p> <p>In fact, as far as MPF is concerned, the current disclosure is transparent and adequate; and moreover, generally no investment advice is given to investors.</p>
<b>Part IV Post-sale arrangements – cooling period</b>	
Q29	<p><b>Do you believe that a cooling-off period would generally be beneficial for investors, or do you believe that costs associated with its implementation would outweigh the benefits for investors?</b></p> <p><u>HKTA</u> We support the SFC's proposal that cooling-off period should apply only to investment products where there is no secondary market readily available and are subject to a long "lock-in" period. It, however, should not be relevant to other unit trust including MPF funds which generally have daily liquidity and a ready mechanism for exit.</p> <p>In fact, given the mandatory nature of MPF, cooling-off period may lead to late and/or default contribution.</p>
Q30	<p><b>Please provide your views on whether investors should be given a period of time after placement of their orders during which execution of the trade is delayed and the investor is given an opportunity to cancel the order before the trade is executed. If your view is that this would generally be beneficial to investors, please provide your views on the types of investment products for which it should be considered and the appropriate cooling-off timeframe.</b></p> <p><u>HKTA</u> If a subscription order is being put on hold because of delay of the execution such as funds</p>

suspension, the offer in canceling the order should be available to all investors (including non-HK investors) to ensure fair trading and that interest payments should not be involved, additional administrative costs would be incurred which would increase the cost to the funds and is therefore ultimately detrimental to the interest of investors.
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### **Other General Comment and Suggestions**

- **Responsibility of the investing public:** the coverage of this consultation appears to focus on placing additional requirements and burden on service providers and distributors. While it is critical to further enhance the robustness of the regulatory framework (including the transparency and adequacy of the selling process, and the professionalism and conduct of intermediaries), it is also necessary that the investing public takes up a more appropriate level of responsibility/accountability in making investment decisions. Investors' expectation also needs to be managed. As we could see from the last 9 years of MPF, the limited or lack of engagement on the part of most scheme members in managing their MPF accounts has rendered the efforts made by providers/distributors on investor education (focusing on investing for retirement) and member communication largely ineffective and cost inefficient.
- **Importance of promoting investor education** (especially on the implication to the investing public on implementing recommendations arising from this consultation) and enhancing financial literacy among investors – the role of the government and regulators in this respect is of utmost importance, as it is viewed by investors to be more objective and carry more weight and credibility. The establishment of an investment education council would be a step in the right direction.
- **New or enhanced disclosure requirements** should not be onerous, but rather be simple, concise, easy to understand and consistently applied to all financial products and all distribution channels. Quality of disclosure standards is the name of the game .
- It might be useful for the SFC to set up a workgroup with relevant stakeholders to go through the comments received on this consultation and the issues faced by the financial services industry with a view of working together in coming up with appropriate final recommendations. The HKTA would very much like to participate in this process.

The HKTA is committed to working with the SFC and other relevant regulators in making this consultation exercise a success and of value to the investing public (who hopefully will become more informed/educated in investments) while fostering market development and providing for a level playing field for market participants across all investment products in the financial services industry and for alignment of regulatory regimes in Hong Kong.