

Comments to the Consultation Paper on Proposals to Enhance Protection for the Investing Public, by Anthony K. T. Wong

I believe one of the reasons why the Lehman minibond incident attracted a great deal of attention by the media, and thus the general public, is due to the large number of average investors, who, unknowing of the underlying risks, bought into the structured products for the higher return or because of the improper sales method, or for other reasons. After reading the consultation paper, I see a lot of constructive proposals with good intention. Among them, I particularly agree that educating the general public, enforcing more transparency and disclosure of unlisted structured products, and ensuring the use of proper sales techniques and advertisement are the keys to a better investing environment. If the average investor knows and understands, to a good extent, the risks behind the investment products, and with all the relevant information fully disclosed, the burden lies squarely on the investor himself/herself to make that decision to purchase the product.

However, this is easier said than done. I'd like to express my thoughts in the form of answers to some of the questions posed.

Question (12):

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.

Answer (12):

I agree with Proposal 4 and 5. The concept of a Product KFS is good and necessary. How long should the KFS section be, 4 pages max? I think the shorter and more concise the better. And the emphasis should be on the underlying risks. Ideally, the KFS should be simple enough to be included in the information leaflet or advertisements that the sales channels use. If it is many pages long, some investors might not have the patience to read through. Take the example of an IPO prospectus. How many of the investors who apply for the new shares actually spend time to go through the whole thick booklet? I think very few. If the KFS is long and only for show, it defeats the real purpose.

Question (9):

Please give your views on the use of annualised returns in offering documents and advertisements for structured products.

Answer (9):

I agree that disclosure in advertisement must not be false, biased, misleading or deceptive. I would also add that the disclosure should be as complete as possible, putting all material facts on the same page (and not in small prints) with good balance on the risks and benefits. Often times, we see high annualized return figures (in large font) being used as bait in an advertisement to attract attention. This is not right. The advertisement should make clear to the investors that unless the capital is re-invested the same way many times throughout the year, the published high annualized rate will not be achieved.

Another crucial problem in the Lehman minibond case is the naming of the product --- "minibond". The name is misleading and simply inappropriate. I'd like to see measures or legislation in the future to address this issue. Because of this name "minibond", I'm sure a lot of the investors lowered their guard and did not even suspect that it's not as simple a product as its name suggests --- a bond, which great many people are familiar with. And I'm also sure it's the intention of the creators of the "minibonds" to call the products this way to facilitate the approval and sale of the structured notes.

Question (19) :

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.

Answer (19):

I agree that before selling unlisted derivative products to an investor, the intermediary should check that the client is indeed one with derivative

knowledge. For someone without any experience, he/she needs to start somewhere to be qualified. Of the various ways to gain derivative knowledge, “undergoing training or attending courses on derivative products” is one that is not easy to make an objective judgement. Does an hour-long investor seminar which touches upon derivatives products count as proper training? Or does it need to be a formal derivative course that lasts for a few days minimum? I think one way to address this uncertainty is to ask the issuers of the investment products and the intermediaries to offer free training or courses to the investors who lack the experience with derivative products but want to learn about them. The training should last half to one day and cover all the basics including options and the embedded derivative elements and risks. These investors are the intermediaries’ potential clients and it’s to the intermediaries’ advantage to offer training courses to increase the customer base. It’s a win-win situation.