

Consultation Paper on Proposals to Enhance Protection for the Investing Public

Part II

Consultation questions in relation to Overarching Principles Section	
1	<p>Q: 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.</p> <p>A: Some of the proposals set out in the consultation paper do not effectively address the current problem. The existing practice and guidelines of SFC are already well-developed and sufficient in monitoring the industry. Rather, a major consideration in tackling the problem is that the securities industry of Hong Kong should be ruled by one single regulatory body. We suggest that the HKMA should focus on the monitoring and control of banking-related operations of Banks (i.e. operations in the avenue of a depositor and borrower); whereas the SFC should extend its regulatory powers proactively in governing banks which provide services on the sale of investment products in addition to licensed intermediaries in the goal of protecting the public investors. Hence, the standards and control mechanisms between Banks and licensed intermediaries should always be on a level playing field.</p>
Consultation questions in relation to the SP Code	
2	<p>Q: What are your views on the proposed disclosure requirements in Appendix C (<i>Information to be Disclosed in Offering Documents for Unlisted Structured Products</i>) and Appendix D (<i>Advertising Guidelines Applicable to Unlisted Structured Products</i>) to the SP Code?</p> <p>A: In addition to the proposed disclosure requirements as stated in the consultation paper, we are of the view that the following product information is required to disclose to the investors:</p> <ul style="list-style-type: none"> ✚ Liquidity of the product ✚ Operation mechanism of the product ✚ Risk level of the product ✚ Leverage level of the product ✚ Exit mechanism of the product ✚ Explicitly state that the product is a SP in the product name
3	<p>Q: What are your views on the requirement for Issuers to provide ongoing disclosure of the types of information set out in 7.6 of the SP Code throughout the term of a structured product? Please explain the reasons for your views. Are there any other matters which you think an Issuer should be obliged to disclose to investors on an ongoing basis?</p> <p>A: Instead of relying on the distributing intermediary to disseminate such information to investors, issuers should develop platforms such as websites to ensure that existing or potential investors of unlisted SP can obtain product information from time to time disclosed by the Issuers on a timely basis.</p>

4	<p>Q: What are your views on the eligibility requirements for Issuers and Guarantors of unlisted structured products proposed by the Commission?</p> <p>A: Eligibility requirements for Issuers and Guarantors of unlisted SP should be subjected to the HKMA's acceptability.</p>
5	<p>Q: (a) What are your views on the proposed requirements applicable to SPV Issuers?</p> <p>A: In general, product classification and its risk level rating should not be conducted by brokers. Instead, the SFC should provide clear guideline on client classification (i.e. professional/sophisticated/general investors) and product risk level classification (i.e. high/medium/low risk). Practitioners can then, based on the result of a client's KYC and suitability test, introduce/advise suitable investment products to the client.</p> <p>Q: (b) What are your views on the current proposal to mandate the appointment of a Hong Kong-licensed Product Arranger for structured products issued by an SPV and make such Product Arranger responsible for ensuring an SPV Issuer's compliance with the SP Code throughout the term of the structured product?</p> <p>A: Agree. Product Arrangers should also be in good credit rating by international recognized credit rating agencies or can prove that they have adequate repayment ability.</p> <p>Q: (c) Do you think a Product Arranger should also be appointed for structured products issued by Issuers (whether SPVs or not) or guaranteed by Guarantors where these entities are not local Regulated Entities (i.e. where the Issuers/Guarantors are not licensed banks regulated by the HKMA or corporations licensed by the Commission pursuant to section 116 of the SFO)?</p> <p>A: No comment.</p> <p>Q: (d) Other than what has been proposed, what other obligations or requirements (if any, both before and after an offering), do you think a Product Arranger should be made subject to? Please give a list of any such additional obligations with reasons.</p> <p>A: Material issues on the product shall be communicated directly to the investors by the Product Arranger, instead of relying on the dealer/broker. Product Arranger should also ensure that the information are being provided to the investors on a regular and timely basis, and should provide exit mechanism (liquidity) for each product.</p>
6	<p>Q: (a) What are your views on the proposed eligibility criteria for collateral in respect of structured products?</p> <p>A: The proposed eligibility criteria are acceptable.</p> <p>Q: (b) Do you think that collateral should be subject to any additional eligibility criteria? If so, what criteria?</p> <p>A: No</p> <p>Q: (c) What are your views on the requirement that investors' claims to collateral proceeds</p>

	<p>should be accorded priority and should not be subordinated to claims by counterparties to transactions with the Issuer that are related to the structured product?</p> <p>A: Agreed with the proposal that investors' claims to collateral proceeds should be accorded priority and should not be subordinated to claims by counterparties to transactions with the Issuer that are related to the structured product.</p>
7	<p>Q: Do you believe that the Commission should take into account any additional eligibility criteria for reference assets, or any other factors, when considering whether or not to accept a proposed reference asset or asset class for a structured product? If so, please list such additional criteria / factors and give an explanation for each.</p> <p>A: The proposed criteria are sufficient.</p>
8	<p>Q: (a) Should indicative valuations of structured products be required to be provided daily? Do you think there are additional or other measures which could help investors to assess the performance of their investments? If so, please provide details.</p> <p>A: Indicative valuations of SP should be transparent objective and realistic to facilitate investors to make logical assumption based on the data.</p> <p>Q: (b) With regard to the proposal to provide liquidity by way of making firm price quotations, do you think an exemption is justifiable for structured products with a short scheduled tenor, e.g. of one month or less? How often do you think Issuers or their market agents should provide liquidity by way of making firm price quotations? Do you think that there are other circumstances or periods during the term of certain structured products in which liquidity provision should not be required or could not reasonably be provided? If so, why?</p> <p>A: Daily/weekly</p>
9	<p>Q: Please give your views on the use of annualised returns in offering documents and advertisements for structured products.</p> <p>A: When assessing the annualize returns in offering documents, the SFC should ensure the following:</p> <ul style="list-style-type: none"> ✚ Forecasts or assumptions should be realistic and is supported by sufficient factual data ✚ Terminology used should be understandable by the general public ✚ Information should be relevant and not misleading
10	<p>Q: Please provide your views on the length of the transition period for compliance with SP Code requirements for unlisted structured products where the issue of documents has been authorized prior to the date of the SP Code's effectiveness.</p> <p>A: Suggested timetable:</p> <ul style="list-style-type: none"> ✚ Market value (price quote) – ASAP ✚ Risk disclosure summary – 3 months ✚ Other criteria (including re-purchasing) – within 1 year

Consultation questions in relation to the revised UT Code	
11	<p>Q: In relation to proposals regarding investment activities set out in Proposal 1 (structured funds), Proposal 2 (funds that invest in FDIs) 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.</p> <p>A: No comment on all 3 proposals</p>
12	<p>Q: 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.</p> <p>A: Proposal 4 – Interim reports should be published in both English and Chinese Proposal 5 – Layout of the Product KFS should remain the same for all products for investors' easy reference and comparison among different products</p>
13	<p>Q: Do you have any comments on the revisions to the UT Code generally? Please explain your views.</p> <p>A: SFC should assess and rate the risk level when reviewing the documents/material relating to authorization of the funds and make it available to public for investors and intermediaries' reference.</p>
14	<p>Q: 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.</p> <p>A: We take the view that KIDs is acceptable in substitution of Product KFS.</p>
15	<p>Q: 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)?</p> <p>A: 6-12 months is acceptable</p>
Consultation questions in relation to the revised ILAS Code	
16	<p>Q: 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</p>

	<p>Chapters 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?</p> <p>A: Agree with the proposal</p>
17	<p>Q: 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))?</p> <p>A: Agree with the proposal</p>

Part III

18	<p>Q: Do you agree that some of the proposals in this part of the consultation paper should only apply to unlisted investment products? Please explain your views.</p> <p>A: Yes, as the existing regulatory regime on listed products is well-established.</p>
19	<p>Q: 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 ?</p> <p>Please give your views on the contents of the proposed measures for intermediaries to assess whether investors have knowledge of derivatives.</p> <p>A: Refer to answer #18</p>
20	<p>Q: Should a high net worth investor be considered to have specific knowledge and expertise if:</p> <p>(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</p> <p>(b) he has undergone training or studied courses which are related to the relevant product?</p> <p>Do you have any other suggestions?</p> <p>A: No, because a person processing either/both (a) and (b) is not necessarily a high net worth investor. Rather, classification of high net worth investors should be flexible/variable depending on the individual but at the same time, must embrace the following criteria:</p> <ul style="list-style-type: none"> ✚ relevant product training or studied courses as stated in point (b) ✚ academic background, e.g. tertiary education ✚ investment experience i.e. number of years and investment frequency ✚ investment amount to total net worth ratio ✚ age

	<p>✚ risk tolerance level</p>
21	<p>Q: What amount should the minimum portfolio requirement be set at? Please give your reasons.</p> <p>A: We believe that it is more important to look at the investor's overall portfolio composition and the suggestions which westated in question 20 above.</p>
22	<p>Q: 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.</p> <p>Option 1.1 – Disclosure of dollar amount of percentage</p> <p>Option 1.2 – Disclosure of percentage bands or ceiling (i.e. “x% to y%” or “up to y%”)</p> <p>Option 1.3 – Generic disclosure</p> <p>A: We feel that the disclosure of such information is not necessary and is inappropriate, and do not have significant impact on investor's investment decision. Rather, it is more important that investors are being provided with sufficient product information including but not limited to the risk associated to a product and its operating mechanism, as these are the factors investors should make reference to when making investment decisions. Investor education also plays a key role in helping investors to make appropriate investment judgment.</p>
23	<p>Q: Do you have any suggestions as to how the percentage bands referred to in Question 22 should be set (e.g. up to 1%, over 1% to 2%, etc)?</p> <p>A: Ditto</p>
24	<p>Q: 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.</p> <p>Option 2.1 – Specific disclosure of distribution reward</p> <p>Option 2.2 – Generic disclosure</p> <p>A: Ditto</p>
25	<p>Q: 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.</p> <p>A: Ditto</p>
26	<p>Q: 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?</p> <p>A: Agree</p>
27	<p>Q: 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</p>

	<p>investors? A: Agree</p>
28	<p>Q: 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.</p> <p>A: We do not feel the need for enforcement on the above suggestion.</p>

Part IV

29	<p>Q: 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?</p> <p>A: We believe that the introduction of cooling-off period would be beneficial for investors for long term investment prior to execution (Long term refers to products with an investment life cycle of over 1 year).</p>
30	<p>Q: 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.</p> <p>A: Refer to #29 5 working days would be an appropriate cooling-off time frame.</p>
31	<p>Q: Please provide your views on whether, and in what circumstances, you think a window could or should be provided to investors after the date the trade in the relevant product is executed during which an issuer should be required to buy back the product at an investor's request.</p> <p>A: Agree. We also suggest the enforcement of 're-po' on secondary market.</p>
32	<p>Q: On the basis that a cooling-off period is incorporated in an investment product and a client has exercised his right under the mechanism, do you consider that a distributor should promptly pass on to the client the full amount of refund (including the sales commission) received from the product issuer less a reasonable administrative charge? Please explain your views.</p> <p>A: A certain fixed pre-disclosed and mutually agreed percentage of administrative cost should be imposed to the investor. The actual amount should be business decision of intermediaries.</p>