



29 December 2009

Securities and Futures Commission
8th Floor
Chater House
8 Connaught Road Central
Hong Kong



Attn: Consultation on proposals to enhance the protection for the investing public

Dear Sirs

**Consultation Paper on Proposals to Enhance Protection for the Investing Public
("Consultation Paper")**

We set out below comments from SG Securities (HK) Limited in relation to a number of selected proposals set forth in the Consultation Paper. We confirm that we have no comments on the specific questions unless specifically addressed below. All defined terms used herein shall have the same meanings as defined in the "Consultation Paper".

Question (1)

With respect to the 7 overarching principles, we have the following specific comments:

- (a) Paragraph 1.6(d) – we are of the view that the drastic measure of the Commission of not authorizing future products of an institution should only occur in a case where there have been persistent and material breaches of the provisions of the Handbook.
- (b) Paragraph 6.7 – we are concerned that with a 4-page Product Key Facts Statement, the reality will be that investors will just read those 4 pages regardless of the warning that they need to be read in conjunction with the offering documents. The Product Key Facts Statement is likely to backfire and further disincentivise investors from truly understanding the product by reviewing the offering documents.

Question (2)

We have particular concern with respect to Paragraph 2(f) of Appendix C of (Information to be Disclosed in Offering Documents for Unlisted Structured Products) where details of the use of the financial derivative instrument embedded in the structured product need to be discussed.

We do not think that this disclosure is practical. It will complicate the offering document with no real benefit to the investor when the details would be in fact already be in the Final Terms should an investor require such detail.

We are also of the view that Paragraphs 2(l), (m) and (n) may not be relevant for the duration of the product. While we can disclose this at the launch of the product, the relevance may be short-lived due to changes in law which affect investor's rights. Accordingly, it may be complicating the Offering Document without any real significance to investors.

We also have concern over Paragraph 3(d) on fees, charges and commissions payable by investors. A structured product's payoff is well-defined in the final pay-off formula which is subject to the performance of the underlying assets. The pay-off formula is impacted by the level of fees, charges and commissions payable by the investors making the structured product less attractive for instance in terms of participation rate or any other financial characteristics of the product. The level of fees is only relevant if an investor can compare the fees charged by different distributors on exactly the same structured product. Even then, this could only affect the attractiveness of the product's payoff formula where the investors could compare the same products (and not similar products) provided by different Issuers / distributors. The fees, charges and commission imposed may not be comparable between different Issuers due to different parameters such as funding level and/or assumptions on volatilities.

Question (3)

In principle, we do not have any objection to provide ongoing disclosure of the types of information set out in 7.6 of the SP Code. However, there is no clarity as to the scope of the power of the SFC to suspend further issuance or offering.

We think it would be preferable for the SFC to confirm, on a case by case basis, as to whether the suspension of further issuance or offering is required. There is no reason for suspension unless the new financial information is materially adverse to the Issuer / relevant counterparty's financial status.

Question (4)

We are concerned about the requirement of "being in good standing" set forth in Paragraph 3.3(a) of the SP code. The Issuers/guarantors are financial institutions of enormous scale with operations in multiple jurisdictions involving hundreds of thousands of employees. It is unrealistic to expect that these financial institutions should have no disciplinary actions or proceedings of any nature whatsoever or have never been subject to any action by an exchange, regulated market or self-regulatory organization or have not been convicted of any offences of any kind in its history in all the various jurisdictions. It should be sufficient if there is no material breach within the recent period and the relevant essential licences of the Issuers/guarantors are not revoked or suspended at the time of issue of the structured product.

Question (5)(c)

Our view is that investor protection is better afforded through guarantees especially where the Issuer or SPV is not locally regulated. We see less reason to have a Product Arranger. Even where one is required, we fail to see why a Type 4 licence is required as there is not necessarily any advisory services which is undertaken by the Issuers. The Issuers are product providers only and the intermediaries are the advisers to the final clients.

Question (6)

- (a) Certain of the eligibility criteria need to be clarified or amended. For example, tradeable should include option to redeem. Liquidity can be a relative concept depending on the market at any point of time. Credit rating do not provide any real investor protection as demonstrated during the crises when a number of rated papers tanked. Related party issuer should not be prohibited but made into a disclosure issue. The requirement set out in Paragraph 98(h) of the Consultation Paper is far too vague and uncertain.
- (b) We are of the view that funds should be included as eligible collateral. Accordingly, the criteria should include i) option to redeem; ii) delete credit rating; iii) related party product becomes a disclosure point; iv) Paragraph 98(f) diversification should be assessed using the look-through method should such criteria be included and v) Paragraph 98(h) should be deleted due to vagueness.
- (c) We do not believe that this can be mandated as it depends on the laws of the situs of the collateral. We do, however, believe that issues of priority should be made a disclosure point.

Question (7)

Our comments are as follows:

- (a) Listing should not be a consideration as it unnecessarily restricts the underlying available to investors.
- (b) Lack of Chinese should not be a prohibiting factor but a fact subject to disclosure.
- (c) Paragraphs 110(c) - (e) are acceptable provided such information is assessed at the time of the issue date only.
- (d) Paragraph 110(e) should be further clarified to allow for the issuer's group company to be the calculation agent, which should then become a matter subject to disclosure.
- (e) Paragraph 111(a) – Information on the reference assets should be clarified to and be consistent with whatever is provided generally for that type of reference asset in a secondary market.

Question (8): (a) Daily indicative valuations

There are many factors apart from the performance of the reference assets which would affect the structured product's secondary prices. The daily indicative valuations may not be the most ideal way to inform the customers' about the performance of their investments, especially in the case where such price is not a tradeable price. We believe that weekly indicative valuation is a sufficient way to keep investors informed where the effects of other parameters such as interest rate and volatility of the reference assets would be evened out and create less

unnecessary enquiry from investors. Besides, the investors' objective should be investing for the "whole" period to capture the performance linked to the reference assets where the payoff is well-defined at inception rather than "trading" the product to capture short-term gains. For investors who would like to realise their investments, adhoc valuation could also be provided upon request.

Question (8): (b) Liquidity & firm price quotation

We can offer regular liquidity upon request, say on a weekly basis (liquidity provided nonetheless shall be better than the liquidity of the underlyings). However, the firm price proposed may not be in the interest of investors as the Issuers may provide a conservative price especially for those products with a very high sensitivity to market parameters.

Question (9)

The use of annualised returns is a common practice for providers of structured products to show the potential return to be received during the investment period and/or upon maturity. We do not have any significant concern in showing the actual return alongside the annualised return. However, we suspect that it may be even more confusing for the investors.

Question (10)

The SFC's authorization of the offering document of a structured product is for a period of one year, and therefore, the transition period should correspondingly be one year instead of six to nine months. Sudden changes in authorization could cause unnecessary anxiety and uncertainty to investors. In any event, upon the expiry of the original one-year authorization period of an offering document, the SFC will apply the new standards specified in the SP Code in the renewal of its authorization.

Question (11)

For Proposal 1 (structured funds), we suggest that backtesting illustration as in the case in Europe be allowed. This is an important and relevant information for investors to make an informed decision.

Question (12)

We agree with the proposals in principle. For annual reports, Paragraph 162, option 1 should be adopted given the demographics of Hong Kong and that the annual report is a material document.

To be more environmentally friendly, management companies should have the option of directing investors to a website where the bilingual annual reports will be made available as suggested in Paragraph 183.

The Product KFS is not a document which will replace the scheme's marketing materials (e.g., scheme fact sheets) on the offering document. Accordingly, we would suggest that the

Product KFS should simply serve as a brief summary of the scheme prospectus, and the information covered should be confined to the general features of the product (e.g., the investment objective / strategy / key risks / fees & charges / channels for investment or further enquiries, etc.) which are not time-sensitive and do not require any frequent update. For example, the asset allocation and performance updates are simply snapshot data and the updates of such data should be at the management company's discretion where circumstances justify the updates (and the management company should also have flexibility on the frequency of the updates, e.g., monthly or quarterly as the management company may consider appropriate).

Furthermore, the advertising guidelines have already stated in clear terms the principles for displaying such data, and investors should be able to make their own judgment by referring to different scheme fact sheets, instead of relying too heavily upon the Product KFS which will never give them a complete picture of the schemes.

Question (14)

As mentioned previously, we think too much emphasis is being placed on the Product KFS. This will have the unintended, but almost certain, consequences of investors only focusing on the Product KFS and not reading the rest. Total and complete comparisons of each scheme is not practical and realistic. Whilst we believe that to force investors to focus on the offering document is the key incentive of the Product KFS proposal, we also believe that the standardization of the KFS across all products sold to the Hong Kong public will not achieve this objective. Accordingly, allowing Product KFS and KIDs to co-exist will prevent a distorted reliance on the Product KFS.

Question (15)

For Existing Schemes, we suggest that a period of 9-12 months should only start to run from the last submission date of the revised offering document (including the Product KFS) to the Commission. This is because the final version of the document will be subject to the Commission's approval, and the date on which the Commission will grant such approval will not be within the management company's control.

Question (18)

We are of the view that the proposals should only come into force when the definition of "structured products" in Companies Ordinance is finalized to avoid any further changes and confusion in the market. Only unlisted structured products should be within the scope of the Consultation Paper as listed structured products are liquid with an established secondary market where the need of extensive regulation as in the case of unlisted structured products is not directly relevant.

Question (19)

The basic principle is that intermediaries should conduct "know your client" procedures on their clients according to product categories. Categorisation of clients into "clients with

derivative knowledge” does not replace thorough “know your client” procedures, and may be somewhat artificial. One possible solution would be that for each product category, e.g., ELNs, range accrual etc., a thorough explanation of the product must be given. Once this is done, they should be allowed to purchase those products which they have been trained on by that intermediary only.

Question (20)

People normally make decisions on risky activities by taking the advice of professional advisers. For instance, ordinary people seek the advice of relevant medical practitioners before deciding to undergo a surgical operation. They do not attend medical courses or work in a hospital to acquire the relevant knowledge and expertise required for their decisions. Realistically, very few, if any, high net worth investors will bother to attend courses or undergo training in structured products or will work or have worked in a professional position that involves the relevant product. We suggest that private banks need to perform “know your client” procedures on their clients to ensure that they understand the product and, if not, to provide the appropriate advice.

Question (21)

As mentioned in the Consultation Paper, the minimum portfolio requirement in United Kingdom is only EUR500,000 (around HK\$5.5 million). The current minimum portfolio requirement should remain at the existing level of HK\$8 million. Raising this minimum portfolio requirement will adversely affect the competitiveness of Hong Kong as an international wealth management centre with significant out flows to a nearby centre like Singapore.

Question (22): Disclosure of monetary benefits from a product issuer

Option 1.3 - Generic disclosure would be more appropriate. The most critical point for investors’ decision is the product feature itself and their risk tolerance level, suitability etc. Given two investment products with the same underlying / payoff / tenor etc, the fee itself would not affect the return to investors. A clear and transparent disclosure of the product and the pay-off is the crucial issue and not the fees. Amount of fees paid per se by an issuer can also not be compared on the same level as different parameters, such as funding levels may be different for each issuer. Overplaying the fee issue distracts from the more important issues of i) clear disclosure of product features and ii) suitability of the product to the particular investor.

If the Commission is convinced that specific disclosure is to be made, it should be standardized at Option 1.2 at a percentage level of “up to x% per annum” to ease investors comparisons. This is among the current practice in Europe since implementation of MiFI Directive.

Question (23)

We maintain a strong stance on generic disclosure based on the same reasoning as in Question (22).

Question (24)

We maintain our views on generic disclosure based on the same reasoning as in Question 22

Question (25)

Again, we maintain the principle of generic disclosure. The disclosure of specific trading profit is irrelevant to the product pay-off, return to investors and the suitability of the product.

Question (26)

We agree that gifts having monetary value should be prohibited as they may distract investors from focusing on the product and distract intermediaries from explaining the product features.

Question (27)

The four categories of information listed are already contained in the account opening documents, subscription forms, trade confirmations and other documents of the intermediaries. We are not aware of any investor dissatisfaction with the existing market practice of fee disclosure by the intermediaries. We do not see the necessity to introduce an additional sales disclosure document.

Question (28)

In the context of private banking clients, mandatory audio recording of the client risk profiling process, and the advisory or selling process is not practicable or desirable. If audio recording is made compulsory, Hong Kong will cease to be a major private banking centre. Audio recording may contain sensitive personal data and may not be allowed or be desirable to be retained for lengthy periods in view of the requirements under the Personal Data (Privacy) Ordinance.

Question (29)

Cooling off period is only relevant to investors if (a) there is a long lock-up period, (b) low liquidity, and (c) the product involves substantial surrender value / upfront costs which will be reflected if the investor may want to sell the product shortly after the investment is made. Structured products which are normally short term products with no lock-ups, are, therefore, not appropriate for applying cooling off periods to the subscription thereof. To impose this would only increase the cost of the product to investors, thereby making the pay-off less attractive without achieving any investor protection.

Question (30)

As long as the product is not executed, clients should be able to cancel their order. Regardless of the product, so long as the trade has not been executed, investors should have the full right to cancel their orders.

Question (31)

We are of the view that unless the structured product has an unusually long lockup during which redemption is not allowed (e.g., more than one month), otherwise windows for buy backs are not necessary. If market making is available and redemption is allowed for the structured product, the window is unnecessary and may be opened to abuse by investors.

Question (32)

Refund inclusive of sales commission less administrative charges is feasible provided the cooling off period is made applicable only to a restricted class of structured products mentioned in Question (31) i.e., those with an unusually long lock-up period. If the cooling off period applies to all structure products, the extent of administration inconvenience will be burdensome with no apparent advantage to investor protection.

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You will note that we have kept our comments extremely concise and focused. We are more than happy to discuss this at your convenience such that a balanced approach between availability of products with attractive returns and investor protection is achieved.

Yours faithfully



Ferheen Mahomed
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SG Securities (HK) Limited