MESSAGE

To: consult/SFC@SFC CEOO Ext :
cc:

From: "Josephine Chung" <jchung@complianceplus.hk>
Date: 14/12/2009 09:59 PM

Subject: Comments on SFC Consultation Paper on Proposals to Enhance Protection for Investing Public

Attached please find our comments on SFC Consultation Paper on Proposals to Enhance Protection for Investing Public. If any queries, please contact sender below. Thank you for your attention.

Regards,

Josephine Chung
Director
CompliancePlus Consulting Limited

801, Two Exchange Square,
8 Connaught Place, Central, Hong Kong
Direct : (852) 3180 9667
Tel : (852) 3667 9099
Mobile : (852) 9521 1166
Email : jchung@complianceplus.hk
www.complianceplus.hk

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Submission to the SFC consultation on Proposals to Enhance Protection for the Investing Public

Josephine Chung, Director, CompliancePlus Consulting Limited

Joanna Lee, Consultant

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CompliancePlus Consulting Limited provides comprehensive compliance support and solutions to hedge fund managers and mutual fund management companies. For enquiries on this submission, please contact **Josephine Chung** at jchung@complianceplus.hk.

CompliancePlus Consulting Limited understands and agrees that our name and/or submission may be published by the SFC.

Introduction

This submission is in response to the Consultation Paper named "Consultation on Proposals to Enhance Protection for the Investing Public" ("the Consultation Paper") issued by the Securities and Futures Commission on 25 September 2009.

The proposals were formulated in the aftermath of heavy investor losses from failed investments in certain retail structured products (generically referred to in the media as "Minibonds") triggered by the collapse of Lehman Brothers in September 2008 and the subsequent global financial crisis.

CompliancePlus generally believes that in light of the Lehman Brothers mini-bonds saga, investors need to be given sufficient protection and be provided with adequate and unambiguous guidelines and explanations in order to understand the wide ranging yet often confusing types of investment products available in the market.

We have deliberately focused our attention in Part III of the Consultation Paper as we believe this is most relevant to the industry of Hedge Funds as non retail hedge funds may be offered to professional investors through private banks and other non public distribution channel.

Part III concentrates on the conduct by intermediaries during the sales process and disclosure. It revises the Code of Conduct for Persons licensed by, and Registered with the SFC. Hedge fund managers and their placement agents may be impacted by proposals under Part III so we have gone into details in our responses in this area.

Our replies to the List of Questions in the Consultation Paper are attached to this submission for SFC consideration.

List of consultation questions in Part III

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)

This is in reference to the new para 5.1A inserted in the Code of Conduct for Licensed or Registered persons in the SFC. The intermediaries will be required, as part of the "Know Your Client" (KYC) process, to seek from clients, information in relation to each client's knowledge of derivatives.

The paper only aims at focusing on clients with derivative knowledge and rightly so in light of the mini-bond fiasco. However, the problem with utilizing a standard such as "clients' knowledge of derivatives" as part of the KYC procedure, is that it offers a narrow scope. There is an assumption that clients wish only to invest in unlisted derivatives products. On the contrary, investment strategies vary greatly with markets. New products with different risk elements are constantly cropping up and the Code of Conduct needs to be drafted wide enough to encompass clients' needs in investing in other products.

Perhaps the Consultation Paper should adapt a more long term approach and draft a KYC procedure that expands and encompasses new products that may appear in the markets 5 years down the line.

Question (20)

Should a high net worth investor be considered to have specific knowledge and expertise if:

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) b) he has undergone training or studied courses which are related to the relevant product?

Do you have any other suggestions?

Answer (20)

This is in reference to para 15 of the proposed amendment to Code of Conduct and Professional Investor Rules (Appendix C). We find this definition slightly risky and again limited.

Just because a High Net Worth investor has been working in the relevant financial sector for 1 year in a position that involves working with the relevant product or has undergone related training/courses, it does not necessarily mean that guarantee he has specific knowledge and expertise.

For example an investment banker that has been working with various financial models may still not have any understanding of a particular type of product on offer if it is packaged in a different way.

Furthermore, even if a High Net Worth investor possesses specific knowledge it does not necessarily protect a High Net Worth investor from receiving unsuitable investment advice.

Question (21)

What amount should the minimum portfolio requirement be set at? Please give your reasons.

Answer (21)

We are of the view that the HK$8 million portfolio requirement needs not be changed for the time being.

Question (22)

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.

Option 1.1 – Disclosure of dollar amount or percentage
Option 1.2 – Disclosure of percentage bands or ceiling (i.e. "x% to y%" or "up to y%)
Option 1.3 – Generic disclosure

Answer (22)

We believe that the disclosure approach should be plain and easy to be understood by the investors. We recommend disclosure of dollar amount and there should be a prominent disclosure or warning statement that investors should be reminded that the distributor does receive or will receive monetary benefits from selling the investment products and they need to understand the risks of the products they are going to invest.

Question (23)

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)?

Answer (23)

We prefer dollar amount disclosure to percentage bands disclosure.

Question (24)

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.

Option 2.1 – Specific disclosure of distribution reward
Option 2.2 – Generic disclosure

Answer (24)

Generic disclosure would be sufficient where a distributor does not explicitly receive any monetary benefits for distributing an investment product. However, if the distributor is connected with the investment products in offer, such connection should also be disclosed for investors' information.

Question (25)

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.

Option 3.1 – Disclosure of specific trading profit
Option 3.2 – Generic disclosure

Answer (25)

We believe generic disclosure is sufficient in this context.

Question (26)

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?

Answer (26)

We do not object to the offering of gifts, coupons or any benefits to investors in the selling process. The key is proper disclosure to investors of whether in accepting such gifts, coupons or any benefits, investors will pay more charges in subscribing the relevant products. As such, disclosure is recommended on whether such gifts, audio visual equipment and other gifts having monetary value will have direct impact on fees and charges and disclosure of whether there is an option to investors for better discount of fees if they do not receive the gifts and such benefits.

Question (27)

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?

Answer (27)

We agree that monetary and non-monetary benefits should definitely be disclosed as the investor has a right to know about a commission based relationship. The licensed/registered person should also disclose the capacity in which he is acting in, ie a Sales placement principal/agent.

Where the monetary benefits are quantifiable, the exact number should be disclosed. Hidden costs should always be revealed to investors and this includes discounts of fees and charges.

Question (28)

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.

Answer (28)

We view the use of audio visual equipment as appropriate but would like to raise the point that there are limitation issues for utilizing audio recording in case of future litigious disputes.

On period of record keeping, under the Limitation Ordinance, Cap 347, a civil action for breach of a commercial contract or in tort must be instituted within 6 years from the date on which the breach of contract happened (section 4(1)(a) of the Limitation Ordinance).

With this to consider, we recommend that the audio visual equipment should be kept at least for 6 years.

END