

MESSAGE

To: consult/SFC@SFC
cc:

CEOO Ext :

From:
Date: 12/11/2009 11:15 AM

Subject: Comments on Consultation Paper on Proposals to Enhance Protection for the
investing Public

Thank you for the opportunity to make a submission in relation to the above. Please see the attached submission and let me know if there are any queries.

Kind regards

Andrew Godwin
Senior Lecturer
Melbourne Law School
The University of Melbourne, Victoria 3010

⋮
⋮
⋮

12 November 2009

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

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

By email: consult@sfc.hk

Dear Sir/Madam

Comments on Consultation Paper on Proposals to Enhance Protection for the Investing Public

Thank you for the opportunity to make a submission in relation to the above. My specific comments are set out below.

Question (2): Disclosure Requirements

My comments below relate to the Disclosure Requirements in Chapter 6 of the Overarching Principles Section, which is Section I of the proposed SFC Handbook (Appendix A of the Consultation Paper).

- Paragraph 6.1 provides that 'Disclosure shall be clear and effective and readily understandable by the investing public'.
 - I query whether the underlined phrase is a realistic criterion for disclosure, since the technical nature of structured products often makes it difficult for lay persons to understand such products. By their very nature, such products are often not 'readily understandable by the investing public.'
 - In my view, the focus should be on clear and effective expression, rather than on the less realistic goal of clear and effective meaning.
 - Accordingly, I would suggest that this be amended as follows:

'Disclosure shall be expressed [or 'presented'] in a clear and effective manner.'
 - This is consistent with paragraph 6.2, which provides that 'Where comparative information in [*note the typo: 'in' should be 'is'*] presented, the comparison shall be meaningful and presented in a fair and balanced way.'

- A similar issue arises in relation to paragraph 6.5 (note also the inconsistency between the language used in paragraphs 6.1 and 6.5).
- Paragraph 6.7, note (1): 'A Product Key Facts Statement should contain information that enable [*note the typo: 'enable' should be 'enables'*] investors to comprehend the key features and risks of the product.'
 - Once again, I query whether it is realistic to express this requirement in terms that investors will be able to 'comprehend' the key features and risks of the product. Instead, I would suggest that this be amended as follows:

'A Product Key Facts Statement should contain information that enables a reasonable person to identify the key features and risks of the product.'
- Paragraph 6.7, note (3): 'Product Key Facts Statements shall be prepared in plain, concise and easily-understood language. Legal or financial jargon should be avoided.'
 - The use of the word 'plain' can be misleading insofar as it suggests that technical language should be avoided or that the language should be 'dumbed down'. Instead, I would suggest that this be amended as follows:

'Product Key Facts Statements shall be prepared in clear, concise and effective language. Legal or financial jargon should be avoided.'
 - Note that in this context, 'effective' means 'effective in relation to the purpose for which the product key fact statement was prepared.'
- Paragraph 6.7, note (5): 'Information in a Product Key Facts Statement shall be presented in a font that is easy to read and highly legible. The font size adopted shall also be reasonably legible taken [*note the typo: 'taken' should be 'taking'*] into account the language used.'

Question (12): Product Key Facts Statements

I note the proposal of the SFC that any structured product that has embedded derivative elements should only be sold to 'clients with derivative knowledge.' In the event that this proposal is not accepted and such products continue to be sold to retail investors generally, I query whether the key facts statement would be effective in highlighting risk and filtering out those investors for whom such products would not be suitable.

I have argued¹ that when structured products are sold to investors generally, it is important to highlight risk on the basis of the following criteria:

- risk in isolation
- risk in context
- risk in lay language
- risk in stark language

The proposed key facts statement deals with all of the above criteria except risk in isolation. In other words, instead of isolating risk in a separate document, it includes risk with all of the other product-specific information in the key fact statement.

In the event that such products continue to be sold to retail investors generally, I would suggest that consideration be given to producing a separate risk awareness statement along the lines of the example in the schedule to this letter. In my view, this would help to filter out those investors for whom such products would not be suitable. It would also provide investment advisers with a basis on which they could better align their product advice with the disclosure documents and more effectively personalise the advice for individual clients.

This would require consideration as to (1) whether a separate risk awareness statement would be one document too many; and (2) whether the statement should be incorporated by reference in the key facts statement. In relation to (2), I note that Australia has allowed information to be incorporated by reference in product disclosure statements and statements of advice.

Please let me know if there are any queries in relation to the above suggestions.

Yours faithfully



Andrew Godwin
Senior Lecturer
Melbourne Law School
The University of Melbourne, Victoria 3010

¹ See Andrew Godwin, 'The Lehman Minibonds Crisis in Hong Kong: Lessons for Plain Language Risk Disclosure' (2009) 32(2) *University of New South Wales Law Journal* 547.

Schedule

[Issuer's name and logo]

Dear Customer

[Product] - Risk Awareness Statement

We have prepared this risk awareness statement to help you understand the risks associated with the purchase of [product].

Investment involves risk. Before buying [product], you must be aware of all of the relevant risks. Please refer to the [offering document] for details including the risk factors.

If you are in doubt, you should seek professional advice.

What is this product and how does it work?

[Include the information on risk as set out in the key facts statement]

[Briefly describe the nature of the product and how it works, in particular the situations under which investors will make gains / incur losses]

[Include appropriate risk warnings]

Can you sell the product before expiry?

[Include appropriate risk warnings]

[Include the information as set out in the key facts statement]

What are the key risks?

[Include appropriate risk warnings]

Yours faithfully

[Issuer]