SECURITIES AND FUTURES COMMISSION

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

From: e-workflow/IR/SFC@SFC
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Subject: Consultation Paper Comment - Consultation Paper on Proposals to Enhance Protection for the Investing Public (Ref: 20091231.1132.16538)

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Attachment : Feedback on the SFC Consultation Paper on Proposals to Enhance Protection for the Investing Public.doc

SFC Consultation Paper on Proposals to Enhance Protection for the Investing Public (Sep 2009)

Feedback from

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Question (7) 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.	**Criteria for Reference Assets** • The consultation paper mentions that the information regarding the performance value of the reference assets must be transparent and regularly available free of charge to investors. For some information that might not be easily accessible by the public but can be retrieved from major information agency, e.g. Bloomberg, Reuters, we should consider this kind of information is still transparent.
Question (8) (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. (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?	**Indicative Valuations & Liquidity Provision** • While, normally and currently mark-to-market price are available for some structured products especially those products with long tenor, we are of a view that it is not necessary to make the quotations available for certain kind of products, e.g. products with short tenor*. • For products with longer tenor, some of them by nature are meant to be held till maturity (especially products in the form of deposit like Equity-linked Deposit), investors should be well aware of this investment horizon commitment before they make the investment decision, and unwinding the position before maturity would incur substantial loss. We are of the view that the sell-back quotation should be made available upon investors' request. • Besides, it is quite common that the sell-back price for structured deposits would be very low even though there is no drastic change in the market environment after the order is made. Therefore, it might not be appropriate to reflect the quotations of these products in the regular customer communications like monthly statement considering that the original purpose of the investment is to commit a certain investment horizon. Instead, as mentioned above, the sell-back quotation should be made available upon investors' request. • Further, we might consider segregating structured products into 2 categories (1) principal-guaranteed at maturity, and (2) non-principal-guaranteed at maturity. For type (1), it is highly likely that investors intend to hold it until maturity. For type (2), indicative valuations will be available upon request to provide investor a way out if significant event happens. * Referencing the US treasury convention, product with tenor over 5 years is regarded as long tenor

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Question (10) 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.	**Transition Period** • A transition period of not less than 9 months is reasonable.
Question (16) 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 Chapter 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?	**Product Key Facts Statements (KFS)** • For some products especially of simple structure, e.g. Equity Linked Deposit, the information disclosed in the current principal brochure are very similar to the KFS requirements. We suggest the Commission to allow deviation for waiving the use of KFS on a case by case basis.
Question (18) 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.	**Proposals Applicable to Unlisted Investment Products only** • No objection on this proposal, as listed investment products have readily available secondary market for investor to adjust his/her strategy where necessary and the governance of these products is already in place.
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.	**Investor Characterization** • Agree in principle. • The Commission explicitly sets out that if a client is not characterized as a "client with derivative knowledge", the licensed or registered person should not promote any unlisted derivative products to such a client in all circumstances. • To facilitate a smooth execution of this principle: 1. We need a clear definition and scope of "unlisted derivative products". Nowadays it is very common for the product suppliers to embed a swap to a product in order to hedge their position against the underlying assets. Simple structured product with 100% principle protection (setting aside credit risk of the issuer) is also embedded with derivatives. 2. In our client suitability assessment process, we require client to indicate if they have knowledge or experience in derivatives. There is no need for customers to show proof to us how they acquired such knowledge. But in case of inquiries, frontline staff should be prepared to explain to investors regulator's interpretation of the way clients

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	acquiring derivative knowledge.
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) he has undergone training or studied courses which are related to the relevant product? Do you have any other suggestions?	**Professional Investors (PI):** • The relevant considerations for person's specific knowledge and expertise in the relevant product should also include other factors such as: 1. The person's general academic background, e.g. a university degree holder should be deemed to have the ability to exercise his judgment and make an informed decision based on his assessment of the product feature and risks, although they are not working in the relevant financial sector or have studied courses which are related to the relevant product. 2. Clients who have relevant trading experience in the relevant product should be deemed to have acquired relevant knowledge of the relevant product and be eligible to invest in the relevant product, although they are not working in the relevant financial sector or have studied courses which are related to the relevant product. • Assessment on P.I. should be in writing. It is our current practice to request clients to declare their knowledge and experience on the P.I. declaration form. But we doubt if it is practical to request clients to provide written proof of their academic background or courses studied.
Question (21) What amount should the minimum portfolio requirement be set at? Please give your reasons.	**Minimum Portfolio Requirement** • We suggest keeping the minimum portfolio requirement unchanged.
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	**Disclosure of monetary and non-monetary benefits** Explicit monetary benefit (Business model 1): • Agree that customers have the right to know the out-of-pocket charges. • Option 1.3 – Generic disclosure is preferred • There might be some practical difficulties if option 1.1 or 1.2 is applied. A typical example is offering of in-house structured products, i.e. both product issuer and distributor are under the same bank group. - The disclosure amount or percentage for an in-house product compared with a third party product might be very different. For in-house products, sometimes it is difficult to segregate the monetary benefit between different functional units playing different roles, i.e. product issuer and distributor. This may impose confusion to the general investors that in-house products are charging higher. Besides, sometimes different divisions of the same bank group have Chinese

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	wall. Some sensitive information is not supposed to be shared among divisions or open to public as it might disrupt the normal business model. - Furthermore, the monetary benefits of the same product might vary significantly for different customer segments or different period of time. Setting a wide percentage range would be meaningless to investors. • We understand that the references from the overseas markets on commission disclosure are largely referring to distributors acting as agents. As in HK, some distributors are acting as principals as well, hence would the Commission please consider providing more guidelines on the roles and responsibilities in this disclosure requirement in respect of any differences if the bank is acting as an "agent" or a "principal".
Question (24) Where a distributor does not explicitly receive any 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	**Disclosure of monetary and non-monetary benefits** Non-explicit monetary benefit (Business model 2): • Indicating the commercial calculation and methodology might be too technical and complicated • Option 2.2 – Generic disclosure is preferred
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	**Disclosure of monetary and non-monetary benefits** Trading profit from back-to-back transaction (Business model 3): • Option 3.1 is not preferred as trading profit is sensitive commercial information. The trading profits of the same product might vary significantly for different customer segments or different period of time. Setting a wide percentage range would be meaningless to investors. • Option 3.2 – Generic disclosure is preferred
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?	**Use of Gifts:** • If distributors are only allowed to offer discount of fees and charges as a marketing tool to promote financial products to investors, on one hand, the approach might induce a price war in the industry. • On the other hand, this also leads to a question of fairness issues as large-size players would have more bargaining power and stronger position to offer a more enticing pricing than small and medium-sized players. The situation may be very unhealthy to the market if some distributors are playing a cut-throat pricing strategy. • Traditionally the offering of gift and cash coupons is a way to enhance marketing flexibility and distinguish product or service uniqueness. While

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	we agree that some investors of mass market may be distracted by the gifts, we should also take into consideration of the implications and consequences of restricting distributors' marketing flexibility. • We believe that the government is doing well in enhancing investors' education which is a more long-term and sustainable approach to arouse investors' awareness before making an investment decision.
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?	**Sales Disclosure Document:** • We suggest to have a generic disclosure at account opening stage rather than providing the Sales Disclosure Document at transactional basis for the following products/circumstances. o For non-monetary benefits (non-transactional basis) o For products which are time-critical, e.g. Equity Linked Deposit, Premium Deposit o For repeated purchase products • If, as suggested above, providing the Sales Disclosure Document at account opening stage is agreeable, the SFC should spell out the requirements clearly in the SFC Code of Conduct.
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.	**Audio Recording:** • The implementation of audio recording should be consistent across all market practitioners in the industry. • We agree that "the benefits of a mandatory audio recording requirement should be balanced against the additional costs to firms and inconvenience to investors." • Making reference with the recent launch of the RMB Sovereign Bond, we suggest under some circumstances, e.g. selling of simple and low risk products, the audio recording requirement should not be necessary. • The record keeping should not be longer than the product tenor or at most 7-years, whichever is shorter.
Question (29) 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?	**Cooling-off** • For investment products that meant to lock up customers' cash flow for a certain period, currently the bank is exercising its discretion to allow customers to early terminate the contract upon special request. • If the cooling-off period proposal is going to be implemented, the SFC needs to draw the attention of investing public that they won't be able to receive their full investment funds if they exercise their cooling-off rights. (different from the current cooling-off concept in the insurance industry.) To avoid confusion, we suggest using a different terminology such as "accept cancellation" so that investors should not mix this new concept up with the full refund cooling-off concept in the insurance industry. Investor

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	education from the regulator/government is needed to arouse public awareness to this new concept. • Besides, investor should not be entitled to any investment return (if any) generated from unwinding the position during the cooling-off period to avoid any abuse of exercising this right. • In short, the benefit to investors of exercising this cooling-off rights is quite minimal as they need to absorb the market loss and administrative costs etc. We foresee the usage of this application might be low.
Question (30) 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.	**Cooling-off before product execution date:** • Agree that cooling-off is not necessary for (i) products which have a liquid secondary market, e.g. UT; or (ii) short tenor products* (iii) time-critical products. • For products that the pricing is fixed after the closing of the subscription period, e.g. Equity-linked structured notes/deposit, with a specified selling window, we support this arrangement. • For example if a product is open for subscription for a selling window of 4 days (Monday to Thursday), investors, after placing an order, should be given the opportunity to cancel the order during the selling window. If the order is placed on the last day of the selling window, i.e. on Thur, he can still request to cancel the order on the next business day, i.e. Friday. • In short, we suggest the cooling-off period should start on the first day of the selling window and end on the following business of the last day of the selling window. * Referencing the US treasury convention, product with tenor over 5 years is regarded as long tenor
Question (31) 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.	**Cooling-off after product execution date:** • Normally when a product is executed, the issuer should be able to provide a buy back price for the product. • Following the above-proposed cooling-off period during the selling window + 1 business day, we do not recommend to provide cooling-off right after the product execution date.

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Question (32) 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.	**Cooling-off:** • It is reasonable that distributor should, less a certain administrative charge, refund to investor the investment amount at market value, including the sales commission, when investors exercise their cooling-off right. • We need to set investors' expectation that while distributors will refund the amount to customer as soon as possible, the administrative work for calculating and reconciling the refund amount by both the distributor and product issuer may take time which varies product by product. The distributors cannot commit a definite turnaround time upfront for the refund applicable for all eligible investment products.