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MESSAGE

To: consult/SFC@SFC
cc:

CEOO Ext :

From:

Date: 30/12/2009 03:22 PM

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

Dear Sir/Madam:

I am pleased to attach my views on the above proposal.

I would like to have my name withheld from publication.

Thank you very much for all the hard work that the Securities and Futures Commission has committed and the leadership taken to develop a world-class infrastructure for the asset management industry in Hong Kong; and to ensure that the best interests of all parties, especially those of the investors, are well served.

I look forward to working closely with the Securities and Futures Commission to further Hong Kong's success as world-class international financial centre.

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

Dear Sir/Madam:

Re: Consultation Paper on Proposals to Enhance Protection for the Investing Public

I am pleased to submit herewith my views on the above proposal.

I would like to have my name withheld from publication.

Thank you very much for all the hard work that the Securities and Futures Commission has committed and the leadership taken to develop a world class infrastructure for the asset management industry in Hong Kong; and to ensure that the best interests of all parties, especially those of the investors, are well served.

I look forward to working closely with the Securities and Futures Commission to further Hong Kong's success as world-class international financial centre.

Yours faithfully,

Comments

We support the Securities and Futures Commission (SFC)'s continuing policy of a "disclosure based approach" coupled with conduct regulation on intermediaries who sell products, and believe that the Proposals to Enhance Protection for the Investing Public will further enhance Hong Kong's position as a leading centre for asset management and investments. The key is to ensure a level playing field for the various investment product providers in order to facilitate investors in accessing quality products and information on a comparable basis.

In particular, we endorse SFC's principles on:

- 1) **Standardization** - aligning fair practices across Funds, Unlisted Structured Products, Investment Linked Assurance Schemes to ensure a level playing field.
- 2) **Simplification** - streamlining the product to market process and standardizing documentation to make it easy for investors to buy an investment product with full knowledge on suitability.
- 3) **Disclosure** - ensuring investors are aware of any conflicts of interest at the product and sales level and of any material changes and risks related to the products during the pre and post sales process.
- 4) **Investor Characterisation** - taking further steps to ensure better matching of products vis-à-vis client suitability by characterizing clients, aligning the sales process and types of products that can be sold.
- 5) **Professional Investors** - defining clients based on both the asset and "experience, knowledge, and suitability" test.
- 6) **Education** - empowering investors to make an informed choice and equipping intermediaries to make a professional sale.

In particular, we would like to highlight our views in these areas:

1. Standardization

The introduction of the three products codes - Unit Trusts and Mutual Funds (UT,) Unlisted Structured Products (SP,) Investment Linked Assurance Schemes (ILA) - to align disclosure and advertising standards, product approval and quality assurance, and sales process is a significant step forward. This should facilitate a level playing field across sectors and, most importantly, enable investors to compare products in an objective and relevant manner.

Comments:

We would urge for more alignment and consistency in the following:

Key Fact Statement

Performance Representation

Under the Investment Linked Assurance Schemes Code 6.4, the presentation of “With profits features” or “bonus” that are not guaranteed and are paid at the absolute discretion of the insurer, even with disclosures, can be misleading. Likewise, for structured products, under Clause 20 of the Advertising Guidelines Applicable to Unlisted Structured Products, the presentation of annualized rate of expected return can be misleading.

We would propose that:

- i) Consistent with Advertising Guidelines Applicable to Collective Investment Schemes (Performance Information Clause 10) and Structured Products (Appendix C & D Clause 15) that no forecast of an investment product’s performance may be presented and that only guaranteed performance and or payouts be allowed for all products.
- ii) In the case of “Prospective Yields,” the same standards as per the Unit Trust and Mutual Funds Code should be applied requiring substantiation by the relevant investments and standards.
- iii) For structured products with a guaranteed formula payout, backtest linked to the formula with a long enough duration, should be allowed as it provides investors a more realistic view (vis-a-vis expected returns) on the risk and return profile of the product.

Fees

For Investment Linked Assurance Schemes with different layers of fees at the policy and fund level, it is difficult for investors to understand the total cost to them and make a fair comparison of the costs and benefits with similar products, for instance, a unit trust sold as a standalone product vs. one with an insurance wrapper.

We would therefore suggest that either:

- i) The underlying Fund’s Key Fact Statement be attached with the ILA’s; or
- ii) The Fund’s “fees and charges” be inserted directly on the ILA’s Key Fact Statement.

Risk Factors - “When Will You Lose Your Money”

We notice that the section on “When will you lose your money? ” is only required for guaranteed funds which does not seem to be in line with the concept of “level playing field.” As we have seen in the case of money funds breaking the buck in the last financial crisis, this “when will you lose your money” section can be relevant even in the case of money funds which investors may deem as the safest and most liquid of managed funds, let alone funds that invest in securities.

We would suggest that:

- i) This “When will you lose your money?” section be taken out.
- ii) Providers of all funds address all relevant risk factors including counterparty, liquidity, market, and valuation risks etc. in the “What are the key risks?” section.
- iii) Backtests be allowed for guaranteed funds to present investors with a realistic view on when this fund can “lose money” and “make money” in different market cycles.

Scenario Analysis, Hypothetical Examples vs. Backtesting

The use of Scenario Analysis for guaranteed funds or hypothetical examples for unlisted structured products to demonstrate how the formula or structured product works may be construed by investors as a “performance track record,” especially in the case of products without any performance track record.

Consistent with SFC’s principles to highlight key risks and realistic features to investors, we would propose that SFC adopt the MiFID principles on allowing backtesting to be presented and use backtest, subject to guidelines to ensure fair and objective analysis, as a basis for showing how the formula works in worst case, best case, and base case scenarios.

By so doing, we believe that this will allow investors to:

- Compare products in a holistic and objective manner
- Assess the risks of the fund in various realistic market situations
- Decide on the product’s suitability based on their risk return preference

Product

Guarantor – Unlisted Structured Products vs. Guaranteed Funds

Under the Unlisted Structured Products Code, the guarantor can be “a corporation incorporated in Hong Kong or any jurisdiction acceptable to the Commission.”

We propose that this be allowed and standardised for guaranteed funds in view of the similarity of the guarantee, the obligations of the guarantor, and the nature of these products.

2. Simplification

The “Key Facts Statement” which forms part of the Offering Document AND the sales process should facilitate investors in understanding what they are buying and making an

informed choice at the point of sale. However, the simplification of one single document whilst adding the number of documents and in turn the volume of content that an investor must read before buying a product may complicate the process and deter investors.

Comments:

To further streamline the process and ensure we “simplify” vs. “complicate” the process with too much information, we would suggest that:

- i) The “Key Fact Statement” can be treated as a stand-alone “MUST READ” document; to be supplemented by the Fund Prospectus made available either online and/or in hard copies with full client acknowledgement. This simplified process would facilitate our goal in “getting investors’ attention on the key features and risks” via the Key Fact Statement at point of sale.

To present the “Key Fact Statement” together with the Sales Disclosure Documents plus the Fund Prospectus would detract vs. attract the right behavior from investors (i.e. not read any) and distributors (not sell any.)

- ii) We exercise caution in the implementation of this and other required procedures in the sales process to ensure that clients are not “deterred” and “inconvenienced” when investing in mutual funds vs. other investment products such as stocks and bonds which are not subject to the same process. This includes:
 - a. Pre-sales documentation, i.e., Fund Prospectus + Key Fact Statement + Sales Disclosure Documents
 - b. Cooling Off Period
 - c. Audio recording

3. Cooling Off Period

We support SFC’s stance that a cooling off period be applied to products which have a long lock up period with high early redemption penalties and or where there is not a readily available secondary market such as ILAs.

However, we do not propose that cooling off period be applied to Hong Kong SFC authorized funds which generally offer daily liquidity. We are concerned that the cooling off feature may signal another “complication” for investors and distributors in their buying and selling process respectively and may be counter-productive in encouraging other behaviors such as:

- a) Investors viewing the whole funds sales process as too complicated and decide to buy stocks or bonds directly which may be perceived as easier vs. managed funds.
- b) Market timing to benefit from market performance or reduce market losses.

4. Professional Investors

The combination of an asset test (minimum portfolio requirement) and the “Know Your Client” (relevant investment experience) assessment is essential especially in safeguarding investors’ interests in the private placement process where unauthorized and often-times more complex products are sold to the investors.

We would propose that:

- i) Hong Kong adopts the higher of international standards in terms of minimum portfolio requirement (e.g. HKD16M in Australia.)
- ii) Additional qualification process be in place for intermediaries engaged in the selling of products on a private placement basis. Given that many of these products are higher risk by nature as they are not regulated from an investment and disclosure perspective, we need to ensure that the sales person advising on these products are qualified to explain these products to investors and advise them based on suitability.

5. Client Segmentation – “Client with Derivatives Knowledge”

We support SFC’s views that clients without the relevant derivatives knowledge should not be sold unlisted structured products unless proven “suitable.”

This is especially the case with SPVs.

6. SPVs, Structured Products with a Non-Hong Kong Licensed Issuer/Guarantor, and Product Arranger

Following #5 above, we would further suggest that:

- i) Given the nature of SPVs and their potentially higher inherent risks in terms of beneficial interests, right of recourse, counterparty risks, underlying assets and collaterals (unless aligned with UT Code) etc., it is essential to mandate a Hong Kong licensed Product Arranger which is accountable for the product’s ongoing compliance and servicing to investors and regulators.
- ii) The same applies for structured products issued or guaranteed by a non-Hong Kong licensed entity.

7. Disclosure of Monetary and Non Monetary Benefits and

As intermediaries remain the key conduit between the product and the investor, it is essential that proper disclosure on transaction related fees and any potential conflicts of interest such as internal group dealings and profit sharing be highlighted.

We would suggest Option 1.3 of general disclosure to be the most pragmatic solution. The intermediary should also highlight any revenue sharing policies within group on such

products to ensure investors are aware of all potential conflicts of interest and hidden costs to them.

This information would also facilitate investors in answering the "value for money" question in relation to the investment services that the intermediaries are providing. Most importantly, it should drive the industry towards a more differentiated sales and service model on "execution" vs. "advice."

8. Products Advisory Committee

The SFC is contemplating replacing the existing Committee on Unit Trusts by Products Advisory Committee. The Committee on Unit Trusts is currently charged with certain administrative powers such as authorizing funds, granting waivers from regulatory guidelines and considering policy issues relating to mutual funds. On the other hand, the proposed Products Advisory Committee will be purely advisory in nature. Replacing a decision-making body (which has industry representatives as members) with a consultative body may appear to be taking away industry/public representation from the regulatory process regarding mutual funds and unit trusts.

Comments:

We would suggest that there be:

- i) More regular interactions between the SFC and the Product Advisory Committee to ensure that the fund management industry's voice is heard.
- ii) Due process be in place for the SFC to grant the necessary waivers for "genuine" cases which so warrant.

9. Qualifications of Key Personnel of Management Companies (Chapter 5.5 of the UT Code.)

The SFC proposes that for multi-manager schemes, it is acceptable that as long as the key personnel of sub-managers possesses demonstrable investment experience, it is not a must for them to have managed public funds before.

Comments:

We would suggest that the SFC extend this flexibility to key personnel of management companies of funds other than multi-manager schemes. We believe that these management companies, with demonstrable investment experience of key personnel, ring fenced by the proper guidelines and rules imposed by the SFC, should be able to meet the "fit and proper" test required for both institutional and retail funds.

10. Investor Education

We look forward to the Commission's views on the subject in the consultation paper due to come out next year.

We would like to highlight the following in the interim:

i) Academic curriculum

- To facilitate the next generation in attaining financial literacy and in understanding the importance of sound wealth management as a life skill, we may wish to consider introducing "Money Management" courses in the school curriculum, starting at least at the high school level.

Whilst this is a longer-term solution, we must recognize that, as evidenced by the sometimes challenging task of "teaching old dogs new tricks" and "trying to save the situation when it is too late," for instance, with retirement planning, it may be more effective to start early and educate the ones with an open mind.

Striking a balance between short term and long-term education is important. Commercial dollars, or business-initiated education initiatives, will always have a preference for short-term results. As such, it may be prudent for the government to allocate certain resources to educate the next generation in this very important life skill.

ii) Messages

- One of the key messages that we need to drive through should be that "Investors too have the responsibility when it comes to investment decisions and sound money management." Investors need to understand that as responsible consumers, they have a choice when it comes to purchase decisions, of any goods let alone financial services; and that they are also responsible for the consequences of their own actions and decisions.