

15 January 2010

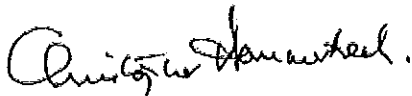
Securities & Futures Commission
8/F Chater House
8 Connaught Road Central
Hong Kong.

Dear Sirs

Consultation on Proposals to Enhance the Protection for the Investing Public

It will be recalled that we applied for and were given an extension of the date by which our response should be lodged with you. I have pleasure in enclosing the formal response of the British Chamber of Commerce in Hong Kong to the captioned consultation. We stand ready through our Financial Services Group to offer further assistance should your committee deem it necessary.

Yours sincerely



Brigadier Christopher Hammerbeck CB.CBE.
Executive Director

Cc: James Riley – Chairman
Deborah Annells – Chair Financial Services Interest Group

Where business gets done

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

We welcome this consultation, both in the light of the financial crisis, and in the light of the minibonds and accumulator mis-selling incidents in Hong Kong and the negative impact these had on the reputation of the Hong Kong financial markets.

The proposals are based on Hong Kong relying on proper disclosures about financial products coupled with proper conduct regulation for intermediaries who sell such products. This is in line with the practices in other major financial centres. We agree with this approach, overall.

Banks in Hong Kong have already made changes to their modus operandi in handling sales of investment and structured products, in terms of segregating staff who are involved in such sales from other bank personnel, ensuring that they are suitably qualified, and telephone recording their activities.

The main SFC proposals relate to:-

A) standardisation of offer documents for all investment products which are not listed (with few exceptions) , and advertisements relating to them. The new requirements are to be summarised in one SFC Handbook, including a new Code for creating and selling Unlisted Structured Products .

B) the handling of authorisation of all public offer documents for structured products by the SFC (and away from the Companies Ordinance).

C) All offer documents should include concise and understandable summaries - to be called product Key Facts Statements.

D) Disclosure at the pre-sale stage of all commissions fee and benefits from the sale of the products.

E) Requirements for on -going disclosures of material information to investors of unlisted structured products by issuers.

F) A sales disclosure document to be provided setting out minimum information about the seller

G) Whether gifts on sales should be controlled.

H) Whether all sales should be recorded (as is required by the HKMA).

I) Recharacterisation of investors. If the client does not "have derivative knowledge" the intermediary should not promote sales of unlisted derivative products to them.

J) Redefining "professional investors"

K) To reviewing Cooling off periods.

L) To establishing an Investor Education Council and thus to try to significantly increase investor education.

M) To improve the Dispute Resolution process, by establishing a Financial Services Ombudsman (there will be a further consultation on this year).

Our responses to the 32 specific questions raised in the consultation document are set out below,

Question (1)

Do you have any comments on the Overarching Principles Section of the Handbook generally or any particular provisions in the Section? Please explain your views.

We agree with the proposals to provide a general handbook setting out and to be based on the seven overarching principles to apply to the products covered, which will be all financial products except listed shares, and certain specialist areas already covered. This will include the ILAS Code (Insurance Linked Products); which is a welcome development since in the past it was often unclear whether the SFC had responsibility for this area of investment products.

Question (2)

What are your views on the proposed disclosure requirements in Appendix C (*Information to be Disclosed in Offering Documents for Unlisted Structured Products*) and Appendix D (*Advertising Guidelines Applicable to Unlisted Structured Products*) to the SP Code?

We agree there should be disclosures of at least the minimum information to be set out on structured products - as summarised in Para 69. And advertising standards accordingly for unlisted products.

Question (3)

What are your views on the requirement for Issuers to provide ongoing disclosure of the types of information set out in 7.6 of the SP Code throughout the term of a structured product? Please explain the reasons for your views. Are there any other matters which you think an Issuer should be obliged to disclose to investors on an ongoing basis?

Whilst we appreciate that issuers should provide information on material matters during the life of the product, the intermediary will typically provide that to the investor. The timing of disclosures is of critical importance.

Question (4)

What are your views on the eligibility requirements for Issuers and Guarantors of unlisted structured products proposed by the Commission?

We broadly agree with the eligibility criteria set out for Issuers and Guarantors.

Question (5)

(a) What are your views on the proposed requirements applicable to SPV Issuers?

Also agreed.

(b) What are your views on the current proposal to mandate the appointment of a Hong Kong-licensed Product Arranger for structured products issued by an SPV and make such Product Arranger responsible for ensuring an SPV Issuer's compliance with the SP Code throughout the term of the structured product?

Agreed although this may make HK less attractive for such issues. The investor may then go to another market.

(c) Do you think a Product Arranger should also be appointed for structured products issued by Issuers (whether SPVs or not) or guaranteed by Guarantors where these entities are not local Regulated Entities (i.e. where the Issuers/Guarantors are not licensed banks regulated by the HKMA or corporations licensed by the Commission pursuant to section 116 of the SFO)?

Agreed; comment as for (b) above.

(d) Other than what has been proposed, what other obligations or requirements (if any, both before and after an offering), do you think a Product Arranger should be made subject to? Please give a list of any such additional obligations with reasons. Please explain your views.

The proposals are already onerous and will make issues in HK less attractive

Question (6)

(a) What are your views on the proposed eligibility criteria for collateral in respect of structured products?

These proposals are sufficiently onerous

(b) Do you think that collateral should be subject to any additional eligibility criteria? If so, what criteria?

No

(c) What are your views on the requirement that investors' claims to collateral proceeds should be accorded priority and should not be subordinated to claims by counterparties to transactions with the Issuer that are related to the structured product?

Investors claims should come first.

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.

No. We are concerned the approval process through the SFC will become too detailed and too slow. How does the SFC plan to handle this large increase in approvals required please?

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.

Daily valuations are impractical. The frequency of valuations should be set according to the product features.

(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?

Liquidity is a function of the product and should be fully explained when offered.

Question (9)

Please give your views on the use of annualised returns in offering documents and advertisements for structured products.

Annualised returns can be included if they can be calculated, and the assumptions used set out, if any. They are helpful for comparison. Scenario analyses may also be helpful in some KFS rather than a bland statement such as "your capital may be at risk". Negative returns should also be shown

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.

The transition period should be 12 months although longer transition periods could be agreed on an exceptional basis by the SFC.

Question (11):

In relation to proposals regarding investment activities set out in Proposal 1 (structured funds), Proposal 2 (funds that invest in FDI) and Proposal 3 (investments in other schemes), other than the proposed general requirements, what other requirements do you think should be included? Please explain your views.

The proposals at 1-3 are sufficiently detailed.

Question (12):

In relation to the disclosure and reporting requirements set out in Proposal 4 (bilingual annual reports) and Proposal 5 (Product KFS), do you agree with the proposals? Please explain your views.

We agree with Proposals 4 and 5.

Question (13):

Do you have any comments on the revisions to the UT Code generally? Please explain your views.

We agree the UT code should be reviewed and revised as proposed.

Question (14):

What are your views about the idea of UCITS schemes which have issued KIDs under their own E.U. regulator's regime using those KIDs in place of the Product KFS? The issue here is how we should balance the importance of developing broadly standardized Product KFS across all products sold to the Hong Kong public so that it is easy for Hong Kong investors to understand and compare different products, and the commercial needs of individual fund houses to reduce costs and lessen administrative burdens. Also, if a large number of SFC-authorized funds adopt KIDs instead of Product KFS, it may defeat the purpose of comparability under the Product KFS proposal. The SFC would like to hear your views.

We think KIDS can substitute for KFS; there is no need to redo as a KFS in case ambiguities or differences arise, and to minimise work. We wish Hong Kong to remain attractive to issuers, not more onerous. However, where fact sheets are prepared for other less well recognized markets we believe a KFS could still be required instead. This will be agree as part of the approval process.

Question (15):

Do you agree that the proposed approach to implementation of the revised UT Code is acceptable and practicable, taking into account the needs and circumstances of various stakeholders? Do you have any particular views as to exactly how long the transition period should be for Existing Schemes to fully comply with the Product KFS and Other Disclosure Requirements (paragraph 191)?

Agreed: exceptionally a longer transition period for the implementation can be agreed by the SFC.

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?

This has been perceived as a weak area relating to products available in the Hong Kong market. It is surprising more complaints have not arisen relating to inadequate (and often misleading) information relating to these products. -It is time the SFC picked up and standardised the code on disclosures including surrender values, as we mentioned earlier.

Question (17)

Do you agree that the proposed approach to implementation of the revised ILAS Code as acceptable and practicable, taking into account the needs and circumstances of various stakeholders? Do you have any particular views as to exactly how long the transition period should be for Existing Schemes to fully comply with the Product KFS and Other Disclosure Requirements (paragraph 214(c))?

Many did not find the previous ILAS Code helpful, so the revisions are helpful. Again, a longer transition period to adopting the new Code may be granted by the SFC in exceptional cases.

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.

Agreed these proposals should relate only to unlisted investment products (including ILAS)

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.

Yes Intermediaries should assess, as part of their KYC on customers, whether the client has knowledge of derivatives.

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

Yes

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

Do you have any other suggestions?

Yes.

We have no other comments on this.

Question (21)

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

The minimum portfolio for a Professional Investor could be reset at Hk\$20M; however they should also pass the skill level tests as well. It is quite possible to inherit HK\$20m and have no knowledge of investments ; that person should not be categorised as a Professional Investor, without further assessment of their actual knowledge of investments; it is not just a function of the "number of trades" , which may be in a narrow sector of the market...

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

We prefer Option 1.1 - disclosure of \$ amount or percentage.

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)?

N/A

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

We prefer Option 2.1 specific disclosure.

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

We prefer Option 3,1

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?

Distributors should be allowed to offer gift coupons etc. This is different than when - as has happened - bank staff oblige the investor to purchase products in return for providing - for example banking facilities; this type of harassment should be precluded.

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?

We agree with the details to be disclosed in the proposed Sales Disclosure Document; in addition it should make commissions and potential override commissions to be received very clear.

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.

Written records of risk profiling and advice given are sufficient; it is often impractical to audio record all meetings. Where audio recording does occur records should be kept for 3 years minimum.

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?

Yes there should be a cooling off period., where practical

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

This is impractical as many items are bought based on a quoted market value and a delay in execution after cannot work.

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.

After a trade a buy back may occur within say 10 days.

Question (32)

In 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.

Yes - a full refund including commission, but less a modest handling fee.

Further comments

One of the problem with sales of minibonds and accumulators was that bank staff ganged up on investors so they felt they had no choice but to invest. Bank or other financial services sector staff, and investors, should be allowed to complain to an impartial third party such as a Financial Services Ombudsman to stop such practices being imposed on them , and the institution which allows or even

encourages it to be sanctioned. There should be a "responsible officer" in each bank which sells products approved by the SFC who could be sanctioned; this has not been included in the proposals but we think it is relevant. All SFC licensed have a named individual as a responsible officer.

In addition many of our members feel that the introduction of a Financial Services Sector Ombudsman, is a good thing if the Ombudsman will have broad remit. It could provide a necessary check and balance where there are complaints about the SFC itself, which is not currently available, in terms of how they handle issues or complaints from SFC licensed entities themselves (as contrasted with complaints from customers re investment products sold).