

Annex 7: Comparison of recommendations made in the HKMA's Review Report and practices of overseas regulators

(A) Recommendations which are related to local policy objectives and associated public education campaigns

The following recommendations are related to local policy objectives and undertaking of public education campaigns regarding these objectives, and therefore are not relevant for comparison with measures adopted by overseas jurisdictions.

- *To retain the policy objectives on which the disclosure-based system for investor protection rests [Recommendation 1];*
- *The Government to reaffirm these policy objectives [Recommendation 2];*
- *To periodically undertake public education campaigns regarding these objectives, focusing particularly on the responsibilities of investors, intermediaries and regulators [Recommendation 3];*
- *To strengthen the regulatory framework to take into account the growth in investment products sold to the retail public by AIs and the change in public expectations and risk tolerance by investors particularly in the light of the LB episode [Recommendation 4]; and*
- *To place all aspects of AIs' securities business (including registration, standard-setting, supervision, investigation and sanction) under the HKMA's mandate [Recommendation 9].*

(B) Recommendations where the HKMA is not aware of any overseas regulators having similar regulatory requirements

- *To consider imposing restrictions on the use of gifts as a marketing tool to promote financial products to investors [Recommendation 7];*
- *To undertake a review of the private placement regime to ensure that the regime is appropriate in the light of market developments [Recommendation 8];*

- *To enhance controls over the assessment of a customer's risk profile through introducing the requirements that (a) the assessment should be conducted by qualified staff independent of staff making the sale; (b) the customer should be provided with a copy of the risk profile and asked to confirm that it is accurate; and (c) the assessment process should be audio-recorded [Recommendation 12];*
- *To introduce a requirement to audio-record the sales process and ancillary arrangements [Recommendation 13];*
- *To require institutions to disclose to customers where the institutions' continuous review of the risk ratings of investment products results in a higher risk rating being attributed to a product [Recommendation 14];*
- *To enhance controls over the situation of risk mismatch between the risk rating applied to the investment products and the customer's risk profile through introducing the requirements that full and complete documentation should be retained of the reasons, the sales process should be audio-recorded, and endorsement of supervisory staff should be sought [Recommendation 15].*

(C) Recommendations in which certain elements of the existing practices of other financial centres are found

- (i) For Recommendations 17 and 18 (see below), related regulatory requirements are already in place but the HKMA is strengthening the controls
- *The HKMA to institute periodically a mystery shopper programme (as well as by RIs themselves) to test sales processes, and commission a pilot programme of customer surveys to gauge whether such surveys can provide information useful for the examination of specific issues in the context of the longer-term*

customer relationship. [Recommendation 17]

- Before the LB Minibond incident, the HKMA had already issued a circular¹ in 2007 to recommend mystery shopper inspections be conducted by RIs. The HKMA's Review Report reinforces such a measure and indicates our plan to further strengthen regulatory efforts in this respect.

- Regulators in Australia, the UK and Singapore conduct mystery shopping exercises to test sales processes of intermediaries.

- *To place greater focus on remuneration structures for staff engaged in AIs' securities business in the HKMA's on-site examinations and off-site surveillance of AIs' securities business [Recommendation 18]*

- Before the LB Minibond incident, the HKMA's regular securities-related on-site examinations have already covered review of remuneration structures for staff engaged in AIs' securities business. The HKMA's Review Report reinforces the importance of such reviews and indicates our plan to further strengthen regulatory efforts in this respect.

- It is noted that the UK FSA indicated it would arrange a round of visits to authorized firms in the last quarter of 2008 to review their remuneration practices to assure that bad remuneration practices (e.g. those that encourage excessive risk taking) are not present.

(ii) For Recommendations (5, 6, 10, 11, 16 and 19), the related regulatory requirement concerned is a new arrangement under the HKMA's existing regulatory regime

¹ Circular on Thematic Examinations on Investment Advisory Activities issued on 1 March 2007

- *To require attaching “health warnings” to retail derivative products [Recommendation 5]*
 - Although the HKMA does not find any requirement of attaching a “health warning” to retail derivative products in the reviewed jurisdictions, it is noted that a simple graphic indicator indicating five categories of risk from “very low” to “very high” must be included in a Financial Information Leaflet to be issued in respect of sale of complex financial products in the Netherlands.

- *To require investment products to have concise and easily understood product and sales key facts statements [Recommendation 6]*
 - In the UK, firms selling certain investment products are generally required to provide retail clients with a “key features document” (with information about the nature and complexity of the product, material benefits and risks, etc). A “key features illustration” providing information describing projected performance and the effect of charges is also required for some of these products like life policies and collective investment schemes.
 - Other jurisdictions such as the Netherlands and Australia also have similar requirements.

- *To require RIs to take steps to ensure clearer differentiation between traditional deposit-taking activities and retail securities business, including: (1) AIs should physically segregate their retail securities business from their ordinary banking business; (2) staff involved in selling investment products to retail customers should not be involved in ordinary banking business; (3) AIs should make clear, through physical signs and warnings, the distinction between deposits and investments and particularly the risks attached to the latter; (4) AIs should implement complete*

information separation between a retail customer's deposit accounts and his investment accounts and be prohibited from making use of deposit-related information to target and channel retail customers into investment activities. [Recommendation 10]; and to apply the forms of separation above to AIs' insurance activities and other investment activities [Recommendation 11]

- Similar requirements are found to have been adopted in the US. In general, sales or recommendations of non-deposit investment products on the premises of a depository institution should be conducted in a physical location distinct from the area where retail deposits are taken. Bank staff involved in ordinary banking services are not allowed to make general or specific investment recommendations regarding non-deposit investment products, qualify a customer as eligible to purchase such products, or accept orders for such products, even if unsolicited.
- *To consider the feasibility of a “cooling-off” period to investors for certain investment products [Recommendation 16]*
- We are not aware of any reviewed jurisdictions adopting “cooling-off” periods to cover structured products taking the form of debentures. However, “cooling-off” periods are found in Singapore, Australia and the UK in relation to certain financial products such as collective investment schemes.
- *To consider the need for a financial services ombudsman with statutory powers to order compensation [Recommendation 19]*
- In the UK, Germany, the Netherlands, Singapore and Australia, some form of dispute resolution mechanism is available at low cost to both customers and market participants in the financial sector.