HKSFA 香港財經分析師學會
THE HONG KONG SOCIETY OF FINANCIAL ANALYSTS

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29th November 2010

Sent by Email

Hon. Starry Lee Wai-king, JP
Chairman of the Bills Committee
Legislative Council

Dear Chairman,

Bills Committee on Securities and Futures and Companies Legislation (Structured Products Amendment) Bill 2010

The Hong Kong of Society of Financial Analysts (HKSFA) supports the transfer of regulation of public offers of structured products from the prospective regime of the Companies Ordinance (CO) to the offers of investments regime of the Securities and Futures Ordinance (SFO).

The proposed change in regulatory framework can remove the potential use of the safe harbours in the CO by the financial intermediaries to offer unauthorized structured products to the public without proper regulatory review of the risk disclosure and product explanation of the subject structured products.

At the same time, the HKSFA strongly advocates that Hong Kong should adhere to her long-established disclosure-based regulatory regime of the financial markets. Every investor should be responsible for their own investment decisions provided they have full and fair access to the relevant information required for evaluating whether the subject investments are suitable for themselves in terms of risk preferences and expected returns.

Strengthening the investor education, investment sales and complaint handling process together with a comprehensive disclosure-based regulatory regime builds the much more effective investor protection mechanism than the merit-based approach.

Financial institutions in Hong Kong have been evolving over the years with the sort of embedded compliance and risk structures that have been mandatory in other established markets like the United States and United Kingdom. Particularly, we have evolved into more of a principle based regime away from a merit-based regulation with the objective to know clearly what the rules are so that they may be observed, the box ticked and the financial institutions to get on with its business.

In this case, compliance is sometimes seen as a brake rather than an enabler, and the risk function as necessary to meet a regulatory requirement rather than something that helps the financial institutions to run their business better for customers. This is a mindset that we will want to get away from.

Financial innovation is one of the cornerstones supporting Hong Kong as a global financial center. We support providing more precise definitions of structured products while maintaining a neutral ground on their investment merits. Structured products have been developed to meet the investors' desired risk and return requirements should the expected capital market scenario materialize. They can be used for yield enhancement, portfolio diversification, and hedging besides speculating on the market trend. Over-regulation of the structured product offerings to individual investors may hurt the competitiveness of the financial industry and hinder the development of Hong Kong as the wealth management hub.

Stringent disclosure requirements and a vigorous selling process with the financial intermediaries can help retail investors, who may have limited risk taking capacities, investment experience, and product knowledge, making the proper investment decisions on structured products that they may not fully understand.

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On the other hand, high net-worth individual investors (HNWI) in Hong Kong have demonstrated good demand for structured products that can be tailored for their investment needs. Under the new regulatory regime on structured product offering, HNWI will have limited access to the offerings of structured products from financial intermediaries unless they are classified and agree to be treated as "Professional Investors" (PI) under the Professional Investor Rules and the SFC Code of Conduct.

The current PI regime follows a "digital approach" that categorize investors as either retail investors who requires strong protection from mis-selling or professional investors who hardly need any protection. HNWI do have higher capacities to take risk than retail investors given their higher investment quotas with more ability to diversify and absorb potential losses. However, they are not necessary as sophisticated and experienced as institutional investors in the area of investment analysis and risk management.

Many HNWI are hesitant to be treated as PI as they are concerned that they will lose the protection against any inappropriate investment advices from their wealth managers. However, their choice of investment vehicles will be much more limited if they are not PI. This may have undesirable effect to the growth of the wealth management industry in Hong Kong.

We suggest the regulators reviewing the PI regime to allow the offering of unauthorized investment products including structured products to HNWI, who have the relevant investment knowledge and experience but not comfortable to be treated as PI, on the basis that the financial intermediaries have fulfilled their fiduciary responsibilities in product education, information disclosure, as well as the assessment of the product suitabilities.

The HKSFA would be pleased to engage in further discussions with the Bills Committee regarding the proposed changes.

Yours truly,
For and on behalf of
The Board of The Hong Kong Society of Financial Analysts

Jimmy Jim

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President

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