



HONG KONG MONETARY AUTHORITY

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**Presentation to Legislative Council
Panel on Financial Affairs**

**HKMA's Report on Issues Concerning the
Distribution of Structured Products
Connected to Lehman Group Companies**

2 February 2009



Background (I)

- **Following the collapse of Lehman, HKMA received large numbers of complaints about the sale of Lehman investment products by authorized institutions (AIs)**
- **The Financial Secretary requested HKMA and SFC to submit reports on their observations on lessons learned and issues identified during their investigations of the complaints relating to Lehman investment products**
- **The report will be used by Government to undertake a comprehensive review of the present regulatory framework for protection of retail investors**



Background (II)

- **In preparing the report, HKMA:**
 - reviewed the present regulatory regime for offers of securities and conduct of securities business by AIs;
 - studied the practices of overseas jurisdictions;
 - provided some preliminary observations on issues identified from investigations to date; and
 - developed a set of recommendations to strengthen the present regulatory regime
- **On 31 December 2008, HKMA submitted its report to the Financial Secretary**



Present regulatory regime (I)

Offer of securities

- **Disclosure-based regime**
- **Suitability obligations imposed on intermediaries**
- **Similar to the practices of other jurisdictions (e.g. UK, other European Union countries, US, Australia and Singapore)**



Present regulatory regime (II)

Securities business of AIs

- **SFC as lead regulator and HKMA as frontline supervisor**
- **HKMA follows SFC standards in supervising AIs' securities business to maintain a level playing field between AIs and licensed corporations**
- **Disciplinary powers divided between HKMA and SFC**
- **MoU with SFC to ensure consistency in supervisory and enforcement practices**



Recommendations (I)

Policy (R1 - 4)

- **Retention of the disclosure-based regime**
- **Reaffirmation of the investor protection policy objectives underlying the disclosure-based regime**
- **Periodic public education to reinforce understanding of policy objectives**
- **Strengthening the regulatory framework to reflect growth in volume and complexity of products and change in public expectations and risk tolerance by investors**



Recommendations (II)

Disclosure (R5 – 8)

- **“Health-warnings” to be attached to retail structured products**
- **Introducing short-form uniform disclosure formats such as simple “product key facts statements” and “sales key facts statements”**
- **Consideration of restrictions on the use of gifts in the promotion of financial products**
- **Reviewing the private placement regime**



Recommendations (III)

Supervisory architecture (R9)

- **Placing all aspects of Als' securities business (including registration, standard-setting, supervision, investigation and sanction) under HKMA; and strengthening coordination between HKMA and SFC with the aim of setting broadly consistent standards of conduct**
 - **To provide HKMA with direct supervisory oversight of this important aspect of Als' business which may have implications for their safety and soundness and thereby enable HKMA to properly discharge its functions**



Recommendations (IV)

Regulation at point of sale (R10 – 11)

- **Clear differentiation between deposit-taking activities and retail securities business through:**
 - physical segregation
 - separate staff for the two activities
 - the use of warning signs to provide clear distinction between deposits and investments
 - information separation
- **Extending the above requirements to insurance activities**



Recommendations (V)

Regulation at point of sale (R12 – 14)

- **Assessment of customers' risk profiles to be carried out by non-sales staff and the process audio-recorded. Customers to be provided with copies of their risk profiles**
- **Mandatory audio-recording of the sales process**
- **Requiring institutions to notify customers where there are changes in the risk ratings of their products**



Recommendations (VI)

Regulation at point of sale (R15 – 16)

- **Requiring enhanced audit trail where there is mismatch between the product risk rating and the customer's risk profile**
 - complete documentation of the reasons for the investment
 - audio-recording of the sales process
 - endorsement by supervisory staff
- **Cooling-off period with waivers by customers subject to safeguards**



Recommendations (VII)

Regulation at point of sale (R 17 – 18)

- **The use of mystery shoppers by regulators and registered institutions, together with a pilot programme of customer surveys**
- **Greater scrutiny of remuneration structures for staff engaged in regulated activities**

Dispute resolution (R 19)

- **Establishment of a financial services ombudsman**



Recommendations (VIII)

- Letter issued to AIs on 9 January 2009 urging them to study the report carefully
- AIs are required to implement the more readily achievable point of sale recommendations either immediately or within the first quarter
- AIs to formulate plans on implementation of separation between deposit and investment services by end of March for discussion with HKMA