

立法會
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Panel on Financial Affairs

**Minutes of special meeting on
Tuesday, 16 July 2013, at 3:00 pm
in Conference Room 1 of Legislative Council Complex**

Members present : Hon Starry LEE Wai-king, JP (Chairman)
Hon CHAN Kin-por, BBS, JP (Deputy Chairman)
Hon James TO Kun-sun
Hon CHAN Kam-lam, SBS, JP
Hon WONG Ting-kwong, SBS, JP
Hon Ronny TONG Ka-wah, SC
Hon Mrs Regina IP LAU Suk-ye, GBS, JP
Hon James TIEN Pei-chun, GBS, JP
Hon NG Leung-sing, SBS, JP
Hon Kenneth LEUNG
Hon Dennis KWOK
Hon Christopher CHEUNG Wah-fung, JP
Hon SIN Chung-kai, SBS, JP

Member attending : Hon KWOK Wai-keung

Members absent : Hon Albert HO Chun-yan
Hon Abraham SHEK Lai-him, GBS, JP
Hon Jeffrey LAM Kin-fung, GBS, JP
Hon Andrew LEUNG Kwan-yuen, GBS, JP

Public officers : Agenda Item I

attending

Mr Paul WONG
Principal Assistant Secretary for Financial Services
and the Treasury (Financial Services) Special
Duties

Miss Ann CHAN
Assistant Commissioner for Tourism 1
Commerce and Economic Development Bureau

Mr Ros LAM, JP
Assistant Commissioner of Insurance (General Business)
Office of the Commissioner of Insurance

Agenda Item II

Miss Sara TSE
Principal Assistant Secretary for Financial Services
and the Treasury (Financial Services) 1

**Attendance by
invitation** : Agenda Item I

Hong Kong Federation of Insurers

Mr Harry WONG
Councillor of General Insurance Council

Ms Connie YUEN
Convenor of Task Force on Travel Insurance

Travel Industry Council of Hong Kong

Mr Michael WU
Chairman

Mr Joseph TUNG
Executive Director

Agenda Item II

Securities and Futures Commission

Mr James SHIPTON
Executive Director
Licensing and Intermediaries Supervision

Mr Stephen PO
Senior Director
Intermediaries Supervision

Organizations

Ms Shirley CHEUNG

Miss Jessica LAM

Mr Reason SEE
Chairman
Corporate Governance Directorship (HKU) Society

Mr Edward LI
Chinese Securities Association of Hong Kong

Ms Jeanne LEE
Chairman
Hong Kong Securities Professionals Association

Mr LUI Chi-wah
Chairman
The Investors Protection Association

Dr Pollyanna CHU
Chairman
The Institute of Securities Dealers Ltd.

Mr Gary CHEUNG
Vice-Chairman
Hong Kong Securities Association Limited

Mr Francis LUN
Permanent Honorary Chairman
The Hong Kong Institute of Financial Analysts and
Professional Commentators Limited

Mr Gilbert LEE
Hong Kong Securities and Futures Employees Union

Mr Gary CHEUNG
Head of Legal and Compliance
SinoPac Securities (Asia) Limited

Mr David WONG
Hon President
Hong Kong Securities & Futures Professionals Association

Mr Andrew SHUEN
The Lion Rock Institute

Clerk in attendance : Ms Connie SZETO
Chief Council Secretary (1)4

Staff in attendance : Ms Angel SHEK
Senior Council Secretary (1)4

Ms Sharon CHAN
Legislative Assistant (1)4

Action

I Regulatory issues relating to the sale of travel insurance

(LC Paper No. CB(1)1518/12-13(01) — Administration's paper on
"Sale of Travel Insurance"

LC Paper No. CB(1)1175/12-13(02) — Letter dated 24 May 2013
from Hon KWOK
Wai-keung proposing
discussion on regulatory
issues relating to travel
insurance arising from the
incident of hot air balloon

crash in Egypt (Chinese version only)

LC Paper No. CB(1)962/12-13(01) — Administration's written response dated 29 April 2013 to issues raised by Hon KWOK Wai-keung on regulatory issues relating to travel insurance arising from the incident of hot air balloon crash in Egypt)

Briefing by the Administration and the Travel Industry Council of Hong Kong

At the invitation of the Chairman, the Principal Assistant Secretary for Financial Services and the Treasury (Financial Services) Special Duties ("PAS(FS)SD") briefed members on matters relating to the sale of travel insurance, including regulation of intermediaries, future development of the regulatory regime for the insurance industry as well as public education and reminders and directives issued by the Travel Industry Council of Hong Kong ("TIC") on the operation of outbound tours by travel agents following the balloon explosion incident in Luxor, Egypt ("the Luxor incident"). The Councillor of General Insurance Council of the Hong Kong Federation of Insurers ("CGIC/HKFI") supplemented that after the Luxor incident, the Hong Kong Federation of Insurers ("HKFI") had encouraged its members to review matters relating to the terms of travel insurance policies and the concerned publicity materials in order to enhance the transparency of travel insurance products and protection for consumers. HKFI would continue to liaise with its members on the relevant work in this area.

Discussion

2. Mr CHAN Kin-por declared that he was returned by the Functional Constituency of Insurance.

Coverage of travel insurance

3. Mr KWOK Wai-keung noted from the latest issue of the Choice magazine issued on 15 July 2013 that only three out of 46 policies covered in the survey had explicitly mentioned the coverage of high risk activities. Mr KWOK remarked that the Luxor incident had revealed problems relating to the sale of travel insurance, including unclear coverage in the policies sold in

the market. For instance, there was no standard practice in the insurance industry on whether activities not mentioned in a travel insurance policy would be covered or otherwise, and definitions of terms like "aerial activities" were vague. As a result, it would be difficult for policyholders to grasp the actual coverage of the travel insurance they had purchased. Moreover, travel agents had not provided detailed information on the itineraries and activities (including self-paid activities) of the tours to facilitate participants in taking out appropriate travel insurance meeting their needs. Mr KWOK urged that travel agents should be required to provide tour participants with the detailed itineraries, and the Office of the Commissioner of Insurance ("OCI") should also require the insurance industry to enhance the transparency of travel insurance products, including requiring insurance intermediaries to explain the contents of the insurance policies clearly to their clients.

4. Mr CHAN Kin-por was of the view that the public should enquire about the details of coverage of insurance policies they had purchased, in particular the excluded items, in order to protect their interests given that the terms of an insurance policy would usually mention the arrangement for some common activities like diving and skiing but the details for each scenario could not be specified. Mr CHAN also remarked that travel agents should remind their clients to examine whether the insurance policies they had purchased suited their needs and whether the scope was sufficient to cover high-risk activities included in the itineraries.

5. PAS(FS)SD agreed that enhancing the transparency of travel insurance policies and strengthening consumer education were important for protection of policyholders of travel insurance. CGIC/HKFI added that under the common law, should an insurer decide not to provide compensation for losses arising from a policy it had underwritten, the burden of proof rested with the insurer to show that the item/activity concerned was excluded from the coverage of the policy. Thus, insurers would be prudent in formulating the terms and publicity materials of travel insurance policies. While HKFI encouraged its members to enhance the transparency of travel insurance products, it might not be in the best interests of consumers to standardize the policy terms of travel insurance as this might reduce market competition and restrict consumer choices. To benefit consumers, insurers should be allowed to design tailor-made travel insurance products for policyholders catering their individual needs, and hence policyholders would purchase insurance with the right coverage at a lower premium. The Executive Director of the Travel Industry Council of Hong Kong ("ED/TIC") stressed the importance for policyholders to inquire about details of the

insurance policies to protect their interests.

6. Mr CHAN Kam-lam pointed out that common issues relating to travel insurance included insufficient consumers' attention to the terms of policies and the lack of clear explanation on the details by the insurance intermediaries. Mr CHAN considered that both public education and quality of insurance intermediaries should be strengthened to address these issues, and believed that the establishment of the independent Insurance Authority ("IA") would help strengthen regulation and sale of travel insurance by insurance intermediaries, especially those sold to consumers at the travel agents when the former signed up for tours. Mr CHAN remarked that IA should also tackle the issue of increasing number of complaints against the insurance industry. The Chairman echoed that the public might not pay close attention to the details of the travel insurance as the amount of premium involved was relatively small.

7. PAS(FS)SD responded that while IA would continue to deal with issues relating to the sale of insurance policies, including travel insurance, consumers should also pay more attention to the coverage and exclusions of their travel insurance policies. He re-iterated that the Administration had rolled out publicity measures through various channels to remind consumers to purchase travel insurance according to their needs before travelling abroad. As for insurance intermediaries, the proposed IA would administer a licensing regime and set conduct requirements for the regulation of insurance intermediaries to replace the existing self-regulatory regime. PAS(FS)SD stressed that insurance agents were already required to explain clearly the details of the insurance policies to policyholders. IA would continue to enforce this requirement, and impose disciplinary sanctions on intermediaries in respect of their misconduct.

8. In response to the Chairman's enquiry about details of the professional indemnity insurance taken out by a travel agent for tour participants, the Chairman of the Travel Industry Council of Hong Kong remarked that the industry had been exploring the proposal of procurement of professional indemnity insurance by travel agents and liaising with the insurance sector on this matter.

Regulation of distribution channels for travel insurance

9. Noting the increasing popularity of consumers to purchase travel insurance through direct sales (e.g. via the Internet or automatic teller machines) which did not involve any insurance intermediaries and hence no explanation on the details of the policies by the intermediaries,

Mr Kenneth LEUNG enquired whether the future IIA would consider regulating the distribution channels for travel insurance and the sale of travel insurance at travel agents in order to enhance consumer protection. Mr KWOK Wai-keung shared Mr LEUNG's concern and enquired whether the Code of Practice for the Administration of Insurance Agents had provided guidance on travel insurance distributed through direct sales. In this connection, Mr CHAN Kin-por opposed the suggestion to restrict the distribution channels for travel insurance as this would reduce flexibility for consumers and the industry. He remarked that the proportion of travel insurance distributed through direct sales might account for more than 10% of travel insurance policies sold.

10. PAS(FS)SD responded that the availability of different distribution channels for travel insurance was a testament of the competitiveness of the insurance market in Hong Kong. Such diversity would facilitate consumers to choose a product that suited their needs, and restriction of direct sale might not be beneficial to potential policyholders. He re-iterated that public education, such as reminding the public of the important points-to-note when taking out travel insurance (e.g. the coverage and exclusions for protecting their own interest) and regulation of insurance intermediaries should be strengthened in order to enhance protection for policyholders. He added that insurers were encouraged to use plain language in the publicity materials of travel insurance products so that the public could understand such products more easily. All insurance intermediaries were also required to meet certain training hours requirement under the Continuing Professional Development ("CPD") programme to ensure that they were kept updated of the latest industry knowledge and maintain their professional competence. These requirements would be maintained after the establishment of IIA.

11. The Chairman remarked that she had made suggestion to OCI to explore the feasibility of providing some "basic plans" on travel insurance which would cover basic and essential insured items. On top of such "basic plans", insurers might provide other insurance plans with enhanced coverage for selection by consumers according to their own needs. She said that consumers purchasing the "basic plans" could easily understand the coverage of the policy and this could avoid disputes between consumers and insurance companies on coverage and compensation matters.

12. PAS(FS)SD responded that there could be difficulties in implementing this suggestion as the coverage of travel insurance policies should correspond with the itineraries of the tour participants and the activities they would participate during the trips. Even a "basic plan" for a travel insurance policy might cover items or activities which a policyholder would not need or take part. CGIC/HKFI supplemented that the insurance industry had been collaborating with the tourism industry in standardizing the coverage of the travel insurance policy. Items such as compensation for baggage loss and delays in trips, medical expenses in respect of personal accident and emergency medical incident etc., were among the most common items covered in a travel insurance policy. The Assistant Commissioner of Insurance (General Business), Office of the Commissioner of Insurance ("ACI/OCI") added that both OCI and the proposed IIA would require the insurance industry to enhance the transparency of insurance products like using plain language for the publicity materials and strengthen the training of insurance intermediaries. CPD programme could ensure the maintenance of professional competence of insurance intermediaries.

Regulation of self-paid activities

13. Mr KWOK Wai-keung expressed concern that the Luxor incident had also revealed the lack of regulation over travel agents in determining self-paid activities during a tour, and hence a travel agent might change high-risk activities to self-paid activities to avoid bearing responsibility for such activities. Furthermore, as the service providers or local agents of self-paid activities were usually recommended or selected by concerned travel agents, Mr KWOK considered that the travel agents should take responsibility in ensuring the safety of such activities and the quality of service providers or local agents concerned.

14. ED/TIC responded that TIC worked closely with OCI in monitoring the sale of travel insurance by travel agents. Travel agents and their staff could only sell travel insurance upon meeting the relevant requirements on insurance agents. Travel agents were required to register details of their tours, including self-paid activities, with TIC. In view of the increasing awareness of travellers on self-paid activities, TIC had reviewed and revised its relevant directive on self-paid activities arranged by travel agents. Travel agents were now required to provide two types of information for consumers before the latter signed up for tours: (a) the brochure or the list of self-paid activities should contain detailed information on each self-paid activity recommended by the travel agents; and (b) the arrangements for those tour participants who did not join the self-paid activities. ED/TIC also remarked

that travel agents were required to explain clearly details of the tours and travel insurance policies to their clients and were only allowed to sell travel insurance tied to a tour, travel package, or other travel service which they arranged for their clients. In arranging accommodation and activities (including self-paid ones) for a tour, a travel agent must choose licensed operators, such as licensed guesthouses and licensed local agents respectively. Otherwise, it would be subject to penalties by TIC. TIC had imposed relevant penalties on travel agents in the past.

Assistance to tour participants involved in overseas accidents

15. Mr KWOK Wai-keung hoped that the Administration could provide assistance, including judicial proceedings to tour participants and their families in need involved in accidents happened during their trips overseas. As regards the following up for the Luxor incident, Mr KWOK urged the Administration to assist the families in need in seeking the release of Egypt's investigation report on the incident and update these families on the relevant progress. Pointing out that Hong Kong people injured or died in the Luxor incident had purchased insurance for the activity through arrangement made by the local agent in Egypt, Mr CHAN Kin-por enquired about the progress of processing insurance claim against the relevant insurer in Egypt. The Chairman also enquired whether the Administration had provided any assistance to the Hong Kong people concerned in this respect.

16. ED/TIC responded that TIC had requested the travel agent concerned to step up efforts in assisting its clients in making insurance claim against the relevant insurer in Egypt. TIC had also written to and been liaising with the Egypt Tourism Board to seek their assistance in getting information on the latest progress of Egypt's investigation report on the Luxor incident. On the provision of assistance by a travel agent to its clients in the event of an accident occurred during the trip, ED/TIC said that the travel agent would be required to provide the necessary assistance to its clients. The concerned tourism board would also maintain close liaison with TIC in following up the matter with a view to minimizing possible adverse impact on the reputation of the place as a tourist destination. As tour participants might have purchased travel insurance from different insurers, a large number of insurers could be involved in some accidents. TIC would work with OCI to ensure that the insurers concerned would handle insurance claims in a consistent manner. The Assistant Commissioner for Tourism 1, Commerce and Economic Development Bureau added that after the Luxor incident, the Administration had sent relevant officers to Luxor to assist the Hong Kong people and their families in need. The TIC and other relevant parties had

also worked together to provide support for the Hong Kong people and their families in need. The Administration would keep in view the progress of the case with a view to informing families concerned of any information on the latest progress of the investigation as soon as possible when such information was available.

Complaints concerning travel insurance

17. Mr KWOK Wai-keung enquired about the number of complaints concerning travel insurance policies received in recent years. PAS(FS)SD advised that the number of complaints received concerning travel insurance policies in 2010, 2011 and 2012 were 84, 88 and 75 respectively. In response to Mr KWOK's further enquiry, ACI/OCI remarked that the complaints concerned were mainly about insurance claims and interpretation of the terms in the policies. There were only a few complaints received by OCI each year, and there was no breakdown on complaint statistics in respect of individual distribution channels (e.g. through direct sales).

II Meeting with deputations to receive views on Securities and Futures Commission's Consultation Paper on the Proposed Amendments to the Professional Investor Regime and the Client Agreement Requirements

Submissions from deputations attending the meeting

(LC Paper No. CB(1)1532/12-13(01) — Submission from The Hong Kong Institute of Financial Analysts and Professional Commentators Limited (Chinese version only)

LC Paper No. CB(1)1532/12-13(02) — Submission from SinoPac Securities (Asia) Limited (English version only)

Submissions from organizations not attending the meeting

(LC Paper No. CB(1)1532/12-13(03) — Submission from The Hong Kong Association of Banks (English version only)

LC Paper No. CB(1)1532/12-13(04) — Submission from Kingston

Securities Limited (Chinese version only)

LC Paper No. CB(1)1532/12-13(05) — Submission from Emperor Securities Limited (Chinese version only))

Other relevant papers

(LC Paper No. CB(1)1518/12-13(02) — Paper on "Securities and Futures Commission's Consultation on the Proposed Amendments to the Professional Investor Regime and the Client Agreement Requirements" provided by the Securities and Futures Commission

LC Paper No. CB(1)1532/12-13(06) — Securities and Futures Commission's Consultation Paper on the Proposed Amendments to the Professional Investor Regime and the Client Agreement Agreements

LC Paper No. CB(1)1175/12-13(01) — Letter dated 29 May 2013 from Hon Christopher CHEUNG proposing discussion on the Securities and Futures Commission's proposed amendments to the professional investor regime and the client agreement requirements (Chinese version only))

Oral presentation of views by deputations

18. The Chairman welcomed the representatives of the Administration and the Securities and Futures Commission ("SFC") as well as deputations to the meeting. She reminded the deputations that their views presented at the meeting and their submissions provided to the Panel would not be covered

by the protection and immunity provided under the Legislative Council (Powers and Privileges) Ordinance (Cap. 382). She then invited the deputations to express their views on SFC's consultation paper on the proposed amendments to the professional investor regime and client agreement requirements. The summary of deputations' views is in the **Appendix**.

Initial responses from the Administration and SFC to the views raised by deputations

19. The Principal Assistant Secretary for Financial Services and the Treasury (Financial Services) 1 ("PAS(FS)1") said that, as the public consultation was still in progress, SFC would take into account the views of the deputations raised at the meeting and in the submissions in considering the proposed amendments.

20. The Executive Director, Licensing and Intermediaries Supervision of SFC (ED(L&IS)/SFC) thanked the deputations for their views and suggestions on the proposed amendments to the professional investor regime and client agreement requirements. He said that SFC would consider the views and comments before finalizing the consultation conclusions. ED(L&IS)/SFC explained that it was an existing and long-standing practice under the Code of Conduct for Persons Licensed by or Registered with SFC ("the Code") that SFC could prescribe the minimum contents of client agreements. SFC observed that some intermediaries had included clauses in client agreements or requested clients to sign declaration or acknowledgement which was designed to restrict the ability of clients to seek compensation by mis-describing the actual services to be provided. Some intermediaries even designed client agreements to expressly exclude obligations that mirrored the Code. SFC considered this to be contrary to the general principles that intermediaries should act honestly, fairly, in the best interests of clients and the integrity of the market. Moreover, the existing Suitability Requirement, whereby intermediaries had to ensure the suitability of their recommendation/solicitation made to the clients was reasonable in all circumstances, was a key investor protection measure. In order to enhance investor protection, and bring Hong Kong's investor protection regime in line with other major jurisdictions, SFC proposed that the Suitability Requirement be incorporated into client agreements as a contractual term; and client agreements should not contain terms which were inconsistent with the Code and should accurately set out in clear terms the actual services to be provided to the client. SFC considered that the proposed amendments to the client agreements were essentially to

harmonize client agreement obligations with existing regulatory obligations.

Declaration of interests

21. Mr CHAN Kam-lam declared that he was a non-executive director of SFC. Mr Christopher CHEUNG declared that he conducted securities business. Mr NG Leung-sing declared that the banking corporation he was working for conducted both banking and securities businesses.

Discussion

Scope of persons and products subject to the proposed amendments

22. Mrs Regina IP enquired about the product coverage of the proposed amendments, whether the proposed amendments regarding the professional investor regime and clients agreement requirements were applicable to both banks and securities firms undertaking the relevant regulated activities ("RAs") and be subject to the same regulatory standards.

23. The Senior Director, Intermediaries Supervision of SFC ("SD(IS)/SFC") advised that the proposed amendments covered all securities products such as equities, callable bull/bear contracts, bonds, but not insurance products; and were applicable to all persons licensed by or registered with SFC, including securities firms and banks, who undertook securities and futures business. ED(L&IS)/SFC said that it was SFC's intention to provide a level-playing field in the securities market. For instance, the Suitability Requirement was deliberately designed to be principles-based, flexible and scalable so that it could be applied to cater for a huge array of circumstances in the securities industry. Paragraph 5.2 of the Code concerning "Know your clients – reasonable advice" also stated that the suitability of recommendation or solicitation should be reasonable in all circumstances in order to address changes in a fast-evolving securities industry.

24. Mr Christopher CHEUNG said that, while the securities industry had no objection against enhancing conduct regulation on over-the-counter ("OTC") derivative transactions, it did not see the need to extend the proposed amendments to transactions of listed products which had not given rise to problems so far. He observed that cases of mis-selling associated with Lehman Brothers-related Minibonds and other structured products were largely OTC transactions. As such, SFC should not indiscriminately impose the proposed requirements on all transactions. Referring to the recent

closure of a securities firm with a long establishment history exceeding 40 years, Mr CHEUNG remarked that securities firms had been facing an increasingly difficult operating environment due to harsh regulatory requirements. He considered that SFC should take into account the operation environment in the market and viability of securities firms when considering new regulatory measures with a view to sustaining the development of the securities market.

25. Mr NG Leung-sing and Mr CHAN Kin-por shared the view about the difficult business environment in the financial services industry amid increasing financial regulation to enhance investor protection in the wake of the Lehman Brothers incident. The compliance cost for the industry had generally increased due to the need to undertake additional steps and safeguards in conducting transactions to protect investors' interests. Intermediaries were worried that they might breach the Code or other regulations inadvertently on one hand, and would face increased legal liabilities towards their clients on the other hand. They urged SFC and other financial regulators to listen to the views of the industry and customers, and strike a balance between investor protection and development of the financial services industry. They cautioned that over-regulation would affect the livelihood of intermediaries, jeopardize the operation of banks and securities firms, and discourage investment activities.

26. Referring to the segregation of areas at banks for undertaking traditional deposit-taking activities and retail securities business and other investor protection measures implemented after the Lehman Brothers incident, Mr NG Leung-sing said that the financial regulators should review the effectiveness of these measures for the development of financial services in Hong Kong, which would be useful for considering the appropriateness of the proposed amendments to the professional investor regime and client agreement requirements. The Chairman enquired whether SFC had considered limiting the application of the proposed amendments to OTC transactions only as suggested by some members and deputations.

27. ED(L&IS)SFC said that the proposed amendments put forth in the consultation paper were meant to enhance the investor protection regime and bring it into line with those of other key jurisdictions. As the consultation period ended on 14 August 2013, SFC would be open to consider the views and suggestions from the relevant stakeholders. PAS(FS)1 stressed that SFC adopted an open attitude towards the views and suggestions received on the proposed amendments, and that SFC was committed to strike a balance between investor protection and financial industry development. For

instance, as stated in paragraphs 97 and 98 of the consultation paper, SFC saw the importance to provide adequate protection to investors while not being oppressive to intermediaries or increasing their compliance costs.

Suitability Requirement and exemptions

28. Mr James TO said that, unlike securities products sold over the counter, trading of stocks was essentially a matter of decisions based on the stock prices at the time of buying/selling and the perception of potential rise/fall in the prices. There did not seem to be any solid basis for assessing whether a particular stock was suitable for an investor. He enquired how intermediaries had exercised the Suitability Requirement when dealing in equities.

29. ED(L&IS)/SFC stressed that it was an existing obligation upon intermediaries under the Code to fulfil the Suitability Requirement irrespective of the types of securities products. As the Suitability Requirement was principles-based, flexible and scalable, it should be reasonable and practicable for intermediaries of different operational scales and capabilities to comply with. The proposed amendment to put the Suitability Requirement as a term in the client agreements did not change the substance of the Suitability Requirement which was currently imposed on all intermediaries.

30. Mrs Regina IP noted that one of the main concerns raised by the depositions was the need for intermediaries to conduct suitability assessment for each product traded with individual professional investors because there would be no Code exemptions (including Suitability Requirement) if the proposed amendments were effected. As an individual professional investor might conduct transactions of several products of the same risk level or of the same product type at one time or within a day, it would appear cumbersome to conduct suitability assessment on a product basis. In this connection, she sought clarification whether the suitability assessment was based on individual product or product type.

31. Referring to the answers to some frequently answered questions ("FAQs") issued by SFC on "Suitability Obligations of licensed and registered persons who were engaged in financial planning and wealth management business" in May 2007, SD(IS)/SFC said that intermediaries who were engaged in those activities and made recommendations and/or solicitation were expected to conduct due diligence of the products they recommended, to know their clients, and to conduct suitability assessment for "each investment product" by matching the risk return profile of the

product with the personal circumstances of each client. While the FAQs did not state any specific arrangements for equities, SD(IS)/SFC said that Paragraph 5.2 of the Code concerning "Know your clients – reasonable advice" did not make any distinction in the types of investment products required for intermediaries to ensure the suitability of recommendation or solicitation. If the intermediaries simply executed orders at the request of their clients without making any recommendation or solicitation in the process, they did not have to conduct the suitability assessment. Sharing similar views, Mr CHAN Kam-lam pointed out that there was no need for intermediaries to conduct suitability assessment for the clients if the intermediaries had not made any recommendation or solicitation in the transaction.

32. Mr CHAN Kam-lam noted that some of the depositions had expressed concerns about the unclear guidelines for conducting suitability assessment. He invited views from the depositions on the aspects of the guidelines which were considered vague to facilitate SFC in making necessary improvement. Mr Christopher CHEUNG said that the securities industry in general found it unclear how to put the Suitability Requirement into practice. Mr NG Leung-sing said that SFC should address the securities firms' request for making more objective and concrete guidelines on the Suitability Requirement for industry's reference.

33. Mr Andrew SHUEN of The Lion Rock Institute pointed out that new investment products were introduced to the market from time to time and the nature of novel products was getting more complex and diversified involving changing credit ratings of products/issuers, underlying assets and links to equities or share market indexes, etc. Securities firms might face uncertainties as to whether certain product belonged to a new product type that warranted conducting a fresh suitability assessment with the client. Besides, as stock prices were time-sensitive and subject to great volatility, it would be in the interests of clients to undertake the transaction in a timely and efficient manner to secure gains or avoid losses. The need to conduct suitability assessment with every individual professional investor before transaction of each stock involving recommendation/solicitation would deter investors from making the investment or investors might shift their investment to other markets. Mr SHUEN envisaged that, if more amendments to the Code and other regulations were put in place to tighten the regulation of intermediaries, the securities market would become "over-sanitized" and stagnant.

Incorporating Suitability Requirement as a term in client agreements

34. Mr NG Leung-sing enquired whether the proposed amendments to the client agreements were comparable to overseas practices. ED(L&IS)/SFC said that a comparison of international practices in relation to, amongst others, suitability obligations and exemptions was set out in Annex C of SFC's consultation paper. The comparison showed that enabling clients directly to enforce and pursue suitability claims was in line with the practices of key jurisdictions. Referring to paragraphs 112 and 113 of the consultation paper, ED(L&IS)/SFC drew members' attention to a number of court cases which highlighted the difficulties of investors in making claims outside the precise wording of their client agreements.

35. Mr Christopher CHEUNG pointed out that securities brokers possessed the professional expertise and knowledge to make recommendations to their clients. In fact, it was an obligation upon the brokers to provide market information to clients in facilitating the latter to make an informed investment decision. It would be up to the clients to acquire the investment products or not. Mr CHEUNG considered that a client agreement was a contract mutually agreed between the intermediary and the client and should afford legal protection to both sides (and not just the client/investor). It would be a policy blunder to incorporate Suitability Requirement as a contractual term in the client agreements as this would remove legal protection for securities firms or intermediaries which could no longer limit their liabilities by putting disclaimers in the agreements as in the past. In particular, it could induce more disputes from non-local clients who might not easily understand or accept the local legislation and rules due to different legal and cultural backgrounds. Clients might make use of the loopholes in the contract to make claims indiscriminately when they suffered losses.

36. Mr James TO said that, as the Suitability Requirement was an existing requirement under the Code for individual investors and applicable to all intermediaries including securities brokers, and given the securities industry's view that the existing arrangements had operated smoothly; he failed to see why the incorporation of the Suitability Requirement in the clients agreements would give rise to a concern. On the other hand, he observed that, while a breach of the Suitability Requirement might result in SFC taking disciplinary action against an intermediary since the Suitability Requirement was regulatory in nature, SFC could not mandate the intermediary to pay compensation to an aggrieved client nor did such breaches enable the concerned client to claim compensation. It appeared to him that it would be in the better interest of investors to include the

Suitability Requirement in the client agreements. He invited views from the deputations in this regard.

37. Mrs Regina IP remarked that, while SFC did not have the right to order payment of compensation to clients; in the Lehman Brothers incident, some banks had taken initiative to settle claims with aggrieved investors or reach an agreement with the Hong Kong Monetary Authority or SFC to repurchase Lehman Brothers-related structured products from the investors. Mr Christopher CHEUNG said that, according to his recollection, there were very few past cases involving misconduct of securities brokers in which the concerned clients could not seek reasonable claims. In his view, intermediaries, being professionals, were far more concerned about their reputational risks and the heavy penalty to be imposed by SFC.

38. Mr Gary CHEUNG, Vice-Chairman of the Hong Kong Securities Association Limited said that it was an existing practice under the Code for the industry to conduct suitability assessment for ordinary investors, whereas Code exemptions could apply to individual professional investors upon their agreement and subject to their meeting the relevant requirements of financial knowledge and investment experience. If no Code exemptions would be available as proposed, intermediaries would need to conduct suitability assessment for these clients in respect of every investment product before conducting the relevant transactions. This would greatly impair the efficiency of transactions, and result in adverse impact in particular for transactions that should be conducted within a short time in response to rapid market changes or during the after-hours futures trading hours where investors had to hedge their positions timely.

39. Mr Edward LI of the Chinese Securities Association of Hong Kong said that intermediaries and clients might hold different opinions as to whether the Suitability Requirement had been duly complied with for a transaction. When clients suffered investment losses, they might be inclined to contend that the intermediaries had not fulfilled the relevant obligations in order to seek compensation from the intermediaries. The situation could be aggravated by requiring intermediaries to fulfill the Suitability Requirement not just for individual investors, but individual professional investors as well; and by requiring incorporation of the Suitability Requirement in all client agreements. In his view, the proposed amendments could serve little purpose because even if the Suitability Requirement was not made a contractual term of the client agreements, SFC could still exercise regulation and take disciplinary actions towards non-compliance in accordance with the Code, and investors could still pursue their claims if their cases involved

non-compliance or misconduct of the intermediaries. It appeared to him that by rendering the Suitability Requirement a contractual term between the clients and the intermediaries, SFC only wished to shirk the responsibility of exercising due oversight and turning any disputes into a matter for the clients to seek legal redress from the intermediary in accordance with the agreement terms. Mr Andrew SHUEN expressed concern that the principles-based and seemingly lax nature of the Suitability Requirement might become a loophole for clients to pursue claims if it was incorporated as a term in the client agreements. Intermediaries would then be liable to not just frivolous claims but also the burden of potential legal costs.

40. Dr Pollyanna CHU, Chairman of The Institute of Securities Dealers Ltd. said that securities firms would normally try to settle disputes with clients before the cases were brought to SFC or the Financial Dispute Resolution Centre. However, if the Suitability Requirement was explicitly incorporated in the client agreements, there would be less flexibility for securities firms to handle complaints and disputes. She urged SFC to carefully re-consider the proposed amendments.

41. Mr Gilbert LEE of the Hong Kong Securities and Futures Employees Union said that, as it was at the discretion of investors to opt as individual professional investors subject to meeting the requisite requirements, they had an obligation to understand the associated risks and assume their share of responsibility in a transaction. He observed that some investors made investment in excess of their financial limits and risk appetite because of overwhelming desire for profits. He considered that these investors should be prevented from passing the responsibility for their investment loss onto the intermediaries concerned.

42. Mr LUI Chi-wah, Chairman of The Investors Protection Association said that some of the arguments against the proposal to incorporate the Suitability Requirement into the client agreements were based on the erroneous and unfair assumption that investors would act unreasonably and seek compensation whenever they sustained investment loss. In his observation, many of the aggrieved investors in the 2008 financial crisis were vulnerable customers, i.e. the elderly or retirees with low educational level and had no investment experience at all. They alleged that complex structured products (e.g. accumulators, Lehman Brothers-related equity-linked notes, etc) were explained and sold to them as low-risk products. Mr LUI considered that there was an urgent need to make improvement on the professional investor regime and client agreement requirements to afford better investor protection.

Prescribed monetary threshold for individual professional investors

43. Noting the view of a deputation that the prescribed monetary threshold of a portfolio of no less than \$8 million to qualify an investor as individual professional investor should be increased taking into account the inflation factor, Mrs Regina IP sought SFC's views on the suggestion. ED(L&IS)/SFC said that, as part of the consultation, SFC had included in the consultation paper to invite public views on the question as to whether the minimum monetary threshold for corporate and individual professional investors should be increased. SFC would take note of the views received from the consultation in considering the way forward on the matter.

Consultation with the industry on the proposed amendments

44. In reply to the enquiries of the Chairman and Mr SIN Chung-kai, ED(L&IS)/SFC confirmed that the proposed amendments to the Code were within the statutory authority of SFC and did not involve legislative amendments. Mr SIN observed that, while the proposed amendments involved certain changes to the Code only, they had nonetheless given rise to controversial issues and concerns from the industry. He expressed concern that SFC might not have consulted the industry adequately before putting forth the proposal, and enquired about the channels SFC had taken to communicate with the industry and engage their views. The Chairman enquired whether SFC had, before the meeting, engaged the industry for views on related matters.

45. PAS(FS)1 said that various channels were available for the industry to express their views to the Administration/SFC, including formal meetings and informal exchanges from time to time. For the proposed amendments to the professional investor regime and client agreement requirements, SFC had been maintaining communication with the industry before the release of the consultation paper. She said that the Administration and SFC welcomed views and suggestions from the industry and thanked the Panel for arranging the current meeting for receiving views from deputations. ED(L&IS)/SFC said that it had always been the practice of SFC to listen to and engage the views of the relevant segments of the industry and the community at large. SFC was aware of the views raised by the deputations, which were elaborated in greater details at the meeting. SFC would continue to adopt an open attitude in receiving further views from industry members, Legislative Council Members and other stakeholders before the deadline of public consultation on 14 August 2013. As a non-executive director of SFC,

Mr CHAN Kam-lam shared that it was the aim of SFC to conduct the public consultation in question to gauge the views of the industry and refine the proposed amendments to the professional investor regime and client agreement requirements.

Way forward

46. The Chairman enquired about the timeframe for SFC to publish its consultation conclusions, and whether the proposed amendments would be implemented in late September or early October 2013 before commencement of the next legislative session.

47. ED(L&IS)SFC said that the lead time for finalizing the consultation conclusions would depend very much on the number and length of submissions received, as well as the complexity of the views and suggestions raised therein. As such, it would be difficult at this stage to state accurately when the conclusions could be released. Nevertheless, he assured members that SFC would continue to maintain a dialogue with the Administration, the Panel and key industry participants during the consultation process.

48. As regards the timeframe for implementing the proposed amendments, SD(IS)SFC said that it would take time to collate and consolidate the views and suggestions received during the consultation, and to further discuss with the industry after finalizing the proposals. As with previous amendments to the Code and other regulations under SFC's purview, a grace period would be provided as a transitional arrangement before the full implementation of the proposed amendments. SFC would also be ready to provide more guidelines to the industry to facilitate compliance.

49. The Chairman thanked the deputations for attending the meeting to give views on the subject. She concluded that, while the deputations generally agreed on the importance to enhance investor protection, they had raised a number of concerns on the proposed amendments, in particular that amendments should not be indiscriminately applied to all transactions of securities products. The Chairman requested the Administration and SFC to consider the views raised by members and the deputations at the meeting, and maintain a dialogue with the industry. If necessary, the Panel would follow up on the matter in future.

III Any other business

50. There being no other business, the meeting ended at 5:52 pm.

Council Business Division 1
Legislative Council Secretariat
3 October 2013

Panel on Financial Affairs

Special meeting on Tuesday, 16 July 2013 at 3:00 pm

Agenda item II – "Securities and Futures Commission's Consultation Paper on the Proposed Amendments to the Professional Investor Regime and the Client Agreement Requirements"

Summary of views and concern expressed by deputations/individuals

No.	Name of deputation/individual	Major views and concern
1.	Ms Shirley CHEUNG	<ul style="list-style-type: none"> ● the proposed amendments to the professional investor regime should not be applied across-the-board for all securities products ● the incorporation of the Suitability Requirement into the client agreement requirements was unfair to securities firms
2.	Mr Reason SEE, Chairman of the Corporate Governance Directorship (HKBU) Society (LC Paper No. CB(1)1553/12-13(01))	<ul style="list-style-type: none"> ● the financial crisis in 2008 had revealed deficiencies in the regulation of over-the-counter ("OTC") derivative transactions but not in the trading of products listed in Hong Kong. The measures adopted by the financial regulators to enhance regulation should aim at plugging existing loopholes in the regulatory regime, and should not affect market operation indiscriminately where no problems existed ● the existing arrangements for client agreements, which had been in practice for a long time, should be maintained as they had not given rise to problems so far. The proposed amendment to incorporate the Suitability Requirement into client agreements as a contractual term would increase compliance cost on the part of securities firms as they had to re-issue client agreements for every existing client
3.	Mr Edward LI, Chinese Securities Association of Hong Kong ("CSAHK") (LC Paper No. CB(1)1553/12-13(02))	<ul style="list-style-type: none"> ● while supporting the direction to enhance investor protection, CSAHK had reservation about SFC's proposed amendments

No.	Name of deputation/individual	Major views and concern
		<ul style="list-style-type: none"> ● the proposed amendment requiring that client agreements should set out in clear terms the actual services to be provided to the client would not achieve the purpose of enhancing investor protection. In order to avoid omissions, securities firms would resort to include also products and services potentially to be made available to the client, and not just the actual services provided ● Suitability Requirement should be enforced by the financial regulator, and not the clients. Incorporating the Suitability Requirement as a contractual term into the client agreements appeared to pass the regulatory responsibility onto investors who had to seek legal redress when the securities firms did not fulfill contractual obligations. It would also lead to more litigations from clients and add burden on the liabilities of intermediaries. The proposal was also against the principle of freedom of contract ● past experiences of the Hong Kong Exchange and Clearing Limited ("HKEx") using standard forms for client agreements in relation to listed product transactions had not served to prevent occurrence of non-compliance or misconduct on the part of intermediaries ● strengthening investor education was more effective than the proposed amendments in enhancing investor protection
4.	Ms Jeanne LEE, Chairman of the Hong Kong Securities Professionals Association	<ul style="list-style-type: none"> ● in support of the principle of the proposed amendments to enhance investor protection for OTC derivative transactions, whereas the ongoing regulatory regime for products tradable on HKEx should remain unchanged ● corporate professional investors and individual professional investors should continue to be allowed to participate in private placement activities ● the minimum monetary thresholds under the Professional Investor Rules should not be increased but maintained at the current level (e.g. a portfolio of not less than \$8 million was currently adopted for individual professional investor) in order not to jeopardize the investment market and the status of Hong Kong as an international financial services centre ● the Code of Conduct of the Securities and Futures Commission ("SFC") required that

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		<p>intermediaries should conduct suitability assessment for clients and disclose the risks of the investment product to them. Intermediaries failing to comply with the requirements were subject to disciplinary sanction by SFC. As the existing mechanism had provided adequate deterrence to ensure compliance and protect investors' interests, it was not necessary to introduce the proposed amendments to incorporate the suitability requirement as a contractual term in the client agreements</p> <ul style="list-style-type: none"> ● the proposed requirement that client agreements should not contain terms which were inconsistent with the Code and should accurately set out in clear terms the actual services to be provided to the client, would in effect necessitate the deletion of any disclaimers made by intermediaries in the agreement, thus undermining the development of the securities market ● the proposed amendments to the client agreement requirements would increase the compliance cost on securities firms and the risks of legal challenges from clients
5.	Mr LUI Chi-wah, Chairman of The Investors Protection Association ("IPA")	<ul style="list-style-type: none"> ● as revealed by the Lehman Brothers incident, investors who were qualified as individual professional investors solely by meeting the prescribed monetary thresholds under the Professional Investor Rules might not in practice be financially sophisticated and could be vulnerable. Their knowledge of investment products was often based on the explanation and recommendation by intermediaries ● supported the proposed amendment that no Code exemptions should be available for intermediaries when serving any individual investors, including individual professional investors, so as to heighten the awareness of intermediaries in exercising due diligence towards their clients and not to compromise due compliance for the sake of maximizing profits and earnings ● the minimum monetary threshold for qualifying individual professional investor, which had been adopted since 2001, should be increased from \$8 million to \$16 million taking into account inflation of asset values and commodity prices in the past some ten years ● the bright-line tests on the minimum number of transactions per annum and years of

No.	Name of deputation/individual	Major views and concern
		<p>being active in the relevant financial market should not be replaced but should continue to be adopted in parallel with the proposed "principles-based" test for assessing the knowledge and investment experience of corporate professional investors</p> <ul style="list-style-type: none"> ● if the Code exemptions would cease application for individual professional investors as proposed, IPA advocated that a further regulatory step should be taken in future to abolish the distinction of individual professional investors from other individual investors for affording equal investor protection to them
6.	Dr Pollyanna CHU, Chairman of The Institute of Securities Dealers Ltd. (LC Paper No. CB(1)1553/12-13(03))	<ul style="list-style-type: none"> ● the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited had already provided for adequate investor protection over transactions of listed products since listing application required the conduct of due diligence on the company by its sponsor and approval from HKEx. Issuers of listed products, including exchange traded funds and callable bull/bear contracts, were required to fully disclose product risks in the offering documents. The relevant documents for opening investment accounts of investors also stated clearly the risks of equities and derivatives products. Any proposed amendments to the professional investor regime and client agreement requirements should not be applied across-the-board to all products, or to the effect that securities firms had to share the responsibility of sponsors and product issuers for the integrity of the investment products ● to facilitate compliance, SFC should provide more industry guidelines on suitability assessment as it appeared to be vague and not standardized amongst intermediaries, and the Suitability Requirement should not be applied to listed products ● corporate professional investors and individual professional investors should continue to be allowed to participate in private placement activities having regard to the relatively high thresholds to qualify these types of investors in terms of investment portfolio, assets, investment experience, etc. ● agreed on the proposal to adopt a "principles-based" test for assessing the knowledge and investment experience of corporate professional investors, and SFC should lay down clear guidelines and standards in this regard ● the minimum monetary thresholds under the Professional Investor Rules should not be

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		<p>increased as they were already very high</p> <ul style="list-style-type: none"> ● SFC might consider that certain types of professionals (e.g. accountants, lawyers and chartered financial analysts) could be qualified as professional investors without meeting the minimum monetary thresholds ● it was difficult for intermediaries to assess whether the client agreements contained terms which were inconsistent with the Code
7.	Mr Gary CHEUNG, Vice-Chairman of the Hong Kong Securities Association Limited ("HKSAL")	<ul style="list-style-type: none"> ● agreed on the importance to enhance investor protection in light of the lesson drawn from the Lehman Brothers incident but the enhancement should be directed towards transactions of derivatives and structured financial products which were relatively more complex and where mis-selling was more prevalent, instead of non-structured products traded on HKEx which had a much higher extent of transparency in pricing and information disclosure ● investors meeting the prescribed thresholds should be given the choice to opt as professional investors or not, including the option to seek exemption of the suitability requirement if they fulfilled the relevant criteria of investment knowledge and experience ● the proposed cessation of exemption from suitability requirements for individual professional investors not only would increase compliance burden as intermediaries thereafter had to conduct suitability assessment with these investors for each investment product before transaction, but also increase the market risks on investors arising from a delay in the transaction due to the need to complete suitability assessment ● instead of the proposed amendment to remove Code exemptions for individual professional investors, HKSAL suggested enhancing the disclosure regime and adopting a "principles-based" test to assess the knowledge and investment experience of individual professional investors as a more effective way to strengthen the requirements on individual professional investors and their understanding of product risks ● the proposed inclusion of the suitability requirement as a contractual term in the client

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		<p>agreements, and requiring client agreements not to contain terms which were inconsistent with the Code would violate the principles of free trade, and appeared to take advantage of the client agreements as a tool to enforce the Code through contractual obligations</p>
8.	<p>Mr Francis LUN, Permanent Honorary Chairman of The Hong Kong Institute of Financial Analysts and Professional Commentators Limited ("HKIFAPCL") (LC Paper No. CB(1)1532/12-13(01))</p>	<ul style="list-style-type: none"> ● the proposed amendments should target at OTC derivative products and not listed products ● suitability assessment should be conducted once and for all for each individual professional investor, instead of product-based, as it would be costly and not practicable to conduct assessment on the suitability of each product for individual professional investors. In particular, it would be cumbersome to conduct suitability assessment for all existing clients considering the large number of clients a securities firm might deal with ● securities firms could not possibly afford the unduly expanded liabilities arising from the proposed requirement that client agreements should not contain terms which were inconsistent with the Code as this would dismiss all disclaimers made by the intermediaries. The proposal might open the floodgate for litigations initiated by clients when disputes arose and undermine the protection of the interests of intermediaries
9.	<p>Mr Gilbert LEE, Hong Kong Securities and Futures Employees Union</p>	<ul style="list-style-type: none"> ● SFC should review the categorization of professional investors according to their asset amounts, value of investment portfolio and years of investment experience, etc. As a matter of fact, investors meeting the thresholds should be given the choice to become individual professional investors or not ● supported adopting a "principles-based" test to assess the knowledge and investment experience of corporate professional investors but the current bright-line tests concerning dealing experience should not be dispensed with. SFC should consult the industry to come up with a consensus on the assessment criteria in this regard ● corporations that operated as investment vehicles wholly owned by individual and by family trusts should not be treated as individual investors unless they did not have the requisite investment experience ● the proposed amendment to disallow exemption from suitability requirements when intermediaries dealt with individual professional investors would increase compliance

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		<p>cost on securities firms, reduce market efficiency and weaken competition with other financial markets</p> <ul style="list-style-type: none"> ● regarding the court cases cited in paragraphs 112 and 113 of SFC's consultation paper to illustrate the need for client agreements not to contain terms which were inconsistent with the Code and to set out in clear terms the actual services to be provided to clients, SFC should also take into account the investment experience and decision of investors, and his share of responsibility vis-à-vis the intermediaries in a transaction
10.	Mr Gary CHEUNG, Head of Legal and Compliance of SinoPac Securities (Asia) Limited (LC Paper No. CB(1)1532/12-13(02))	<ul style="list-style-type: none"> ● agreed on the need to enhance investor protection for retail investors, including the protection afforded by the terms of the client agreements to these investors ● corporate and individual professional investors should be distinguished from retail investors in that the former were more experienced and sophisticated than retail investors and were in a better position to negotiate the client agreement terms and make their own decisions such that it was unnecessary to impose the proposed requirements on the agreements ● supported that corporate and individual professional investors should continue to be allowed to participate in private placement activities
11.	Mr David WONG, Hon President of the Hong Kong Securities & Futures Professionals Association	<ul style="list-style-type: none"> ● objected to the imposition of the proposed amendments to the professional investor regime and client agreement requirements as the existing regime had operated smoothly so far and could provide adequate protection for investors ● even if the proposed amendments would be imposed, they should apply to transactions of OTC derivative transactions and not listed products ● it would be impracticable to re-issue contracts with existing clients having regard to the administrative costs concerned and potential disruption to securities firms' daily operation ● the proposed amendment requiring client agreements to include suitability requirement

No.	Name of deputation/individual	Major views and concern
		<p>as a contractual term, to set out in clear term the actual services to be provided to clients and not to contain terms inconsistent with the Code would give rise to legal issues, and increase liabilities on intermediaries</p> <ul style="list-style-type: none"> ● a balance should be struck between enhancing regulation on one hand and streamlining the investment transaction procedures to increase market efficiency and develop the securities market
12.	Mr Andrew SHUEN, The Lion Rock Institute	<ul style="list-style-type: none"> ● pointed out that the high risks associated with derivatives like Minibonds and accumulators would not diminish upon mere amendments to the definition of professional investor and its regulatory regime ● it was the policy of the Government to encourage banks to pursue non-interest income that had caused the banks to widely sell financial products, including high-risk and complex structured financial products, in order to maintain revenue and maximize profits ● the Lehman Brothers incident proved that the credit ratings of a product issuer or an investment product might not be reliable at all to ensure high investment return or prevent substantial investment loss as the issuer, regardless of its credit rating, might fall bankrupt and default its obligations to investors ● as no legislation could eradicate greed and stupidity, and the principles of free trade and freedom to enter into contract should be respected, SFC should carefully re-consider whether it was appropriate to impose the proposed amendments and whether they could indeed serve the purpose of enhancing investor protection