SECURITIES AND
FUTURES COMMISSION
證券及期貨事務監察委員會

SFC
證監會

HKMA – SFC – OECD Asian Seminar
Evolution of Financial Consumer Protection and Education in Asia

- Session II: Disclosure and transparency in banking and securities: meeting the needs of retail consumers

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Introduction

Lessons learned from financial crisis

- **Pre-sale**
  - ***Financial innovation has made some products become increasingly complex for the average investors to understand***
    - Introduction of Product Key Facts Statements (KFS)
    - More investor education
    - New code on unlisted structured products
    - New advertising guidelines for unlisted structured products
- **Sale**
  - ***Investors were not aware of the commercial interest of intermediaries selling the investment product to them i.e. the commission or benefits earned on the sale***
    - Level of commission (or benefits) should be disclosed at pre-sale stage to mitigate against conflicts of interest and to enhance transparency
  - ***Promotion of investment products using gifts***
    - Intermediaries should not use gifts to distract the client's attention from the features of the products
  - ***Difficulty experienced by average investors in understanding the complex nature and features of some unlisted structured products, which generally have embedded derivative elements***
    - Investor characterisation – "clients with derivative knowledge"
    - Review of requirements for professional investor

Introduction

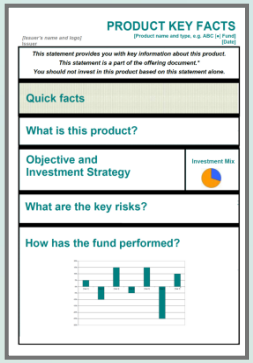
Lessons learned from financial crisis

- **Post-sale**
  - ***Our examination of Minibonds highlighted that a number of investment products have the effect of locking investors in for a considerable period of time because of the absence of a liquid secondary market to sell their investment***
    - Cooling-off period for unlisted structured products
  - ***There may have been occasions when little information was readily available to investors in the period between the completion of the sale and the maturity of the investment product***
    - Ongoing disclosure of material information

- SFC conducted a three-month public consultation on regulatory reforms in September 2009 and announced in May 2010 regulatory measures directed at enhancing investor protection which became effective in 2011.
- The new measures include a new consolidated products handbook, enhanced sales conduct measures and the requirement of cooling-off rights for structured products.

Product Key Facts Statement (KFS)

- We encourage the use of diagrams, charts, graphs or other illustrations in KFS
- Narrative approach rather than a risk-rating system
- KFS complements but does not supplant the offering document for a product
- Generally about 4 pages long
- Standardised templates are provided by the SFC, and product issuers are required to refer to the template that is applicable to their products



What is common to KFS of different products?

- Name and type of product
- Name of issuer
- Quick facts
- What is this product (and how does it work)?
- What are the key risks?
- What are the fees and charges?
- Additional information

How do KFS vary from one product to another?

Products	
Funds	• Objectives and investment strategy • Investment mix (optional, except for certain fund types with complex investment strategies) • Past performance (optional) • Guarantee, if any <u>Templates for specialized schemes:</u> - **Guaranteed funds/ funds with structured payouts** → key terms of the guarantee → scenarios analysis - **ETFs** → underlying index, investment strategy the fund adopts to replicate the performance of the index, top 10 index constituents → charges incurred when trading the ETF on SEHK → for synthetic ETF – details of counterparties issuing the financial derivatives, counterparty exposure and collateral arrangement - **Index funds** → underlying index, investment strategy the fund adopts to replicate the performance of the index, top 10 index constituents

How do KFS vary from one product to another?

Products	
Investment-linked assurance schemes (ILAS)	• Key features of ILAS •*the nature of an ILAS* •*how the return on investment is determined* •*what will happen to the premiums paid* •*how the investments under the insurance policy are held* •*the implications of insurance coverage and the cost of insurance (if any)* •*other salient features as applicable to the ILAS* • Credit and insolvency risks associated with the insurance company • Fees and charges at scheme level and underlying funds level • Guarantee, if any • Cooling-off period • Insurance company's information
Unlisted structured investment products (SIP)	• Key features • Guarantee or collateral, if any • Scenario analysis • How to buy the product • Mode of settlement • Adjustments to the terms and conditions upon the occurrence of extraordinary events • Cooling-off period • Whether you are sell the products before expiry • Continuing disclosure obligations

Surveillance on KFS or SFC-authorised funds and revised offering documents of SFC-authorised ILAS

KFS selection basis:

- Assets under management based/market impact priority ranking
- Complexity of the funds
- Observations regarding the quality of draft KFS submitted during the directional comments process
- At least 1 KFS from each issuer was selected for surveillance

ILAS selection basis:

- SFC previously vetted all KFS before 25 June 2011, the focus was on the revised offering documents

Observations and further guidance

- Circular to Management Companies of SFC-Authorized Funds and Issuers of SFC-authorized Investment-Linked Assurance Schemes – Surveillance exercise on product key fact statements and offering documents dated 4 November 2011

Observations

- Majority of the sample KFS reviewed were generally in compliance with disclosure standards in SFC Handbook and Code on Unit Trusts and Mutual Funds
- Disclosure in revised offering documents of ILAS was satisfactory

Observations and further guidance

Guidance

- **Disclosure of financial derivative instruments (FDI) of funds**
  - consistency between KFS and offering documents
  - FDI for investment purposes → extensive or not
- **Disclosure of objectives and investment strategies**
  - key features
  - consistency between KFS and offering documents
  - types of instruments to be invested by the funds
- **Risk disclosure**
  - Uses FDI extensively → risk of substantial or total loss arising from the extensive use of FDI and other key risks associated with investing in FDI (e.g. counterparty, liquidity, leverage, volatility and valuation risk)
  - Risks specific to the fund
- **Simple and plain language**

Enhancing Transparency of Synthetic ETFs

Identification by marker

- Effective from 22 November 2010, the marker "X" will be placed at the beginning of the English and Chinese stock short names of all synthetic ETFs listed on the SEHK.

X ABC ETF

Identification by notification

- Effective from 16 January 2011, managers of synthetic ETFs are required to append an asterisk (*) and an annotation-"(*This is a synthetic ETF)"- right after the name of a synthetic ETF whenever it appears in all offering documents and marketing materials of the synthetic ETF issued by or on its behalf to investors in Hong Kong, notices and communications with Hong Kong investors, including those on the corporate websites for Hong Kong investors.

ABC ETF*
(*This is a synthetic ETF)

Synthetic ETFs – Website disclosures

- Effective from the end of March 2011, synthetic ETF managers are also required to provide and update the following information on their websites.
  - On a daily basis, the overall collateralization level/ total invested assets (expressed as a percentage of the fund's NAV); and
  - On a monthly basis:
    - Pictorial presentation of collateral / invested assets information by way of pie charts to illustrate the following:
      - Breakdown by type of collateral / invested assets, such as equity, bond, cash or cash equivalent
      - For equities, there should be a further breakdown by primary listing (e.g. Hong Kong Stock Exchange), index constituents (e.g. Hang Seng Index) and sector (e.g. financials, energy)
      - For bonds, there should be a further breakdown by type (e.g. corporate, government), countries of issuers / guarantors (e.g. US, Japan) and credit rating (e.g. AAA or equivalent)
    - Top 10 holdings in the collateral / invested assets
- Effective from 12 September 2011, domestic synthetic ETF managers are also required to publish the latest collateral management policy on the ETFs' websites.

Sale of investment products

- **Enhanced commission and other point of sale disclosure**
  - Starting from 4 June 2011, intermediaries (e.g. banks, brokerages, investment advisers) will be required to disclose more information to enhance transparency with respect to the sale of investment products.
  - Intermediaries selling investment products must disclose any benefits it would receive from the product issuer – both monetary benefits such as commission rebates, as well as non-monetary benefits such as free access to research services
- **Investor Characterisation**
  - With effect from 4 September 2011, investor characterisation is one of the SFC's latest measures to strengthen investor protection by extending the existing requirement for intermediaries to know their clients by assessing their knowledge of derivatives
- **Gifts**
  - Intermediaries are restricted from offering gifts in selling products so that investors would not be distracted from the features and risks of the product being promoted.

- **Concluding remarks**

- **Q&A**