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Best Practice for Financial Planners

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I am honoured to be invited to address the conference today.

There is no doubt that members of the Institute of Financial Planners and the investment advisory professionals in Hong Kong are playing a crucial role to help investors manage their financial affairs and provide for the future.

Financial planning landscape

Wealth accumulation in Asia

Your role is becoming increasingly important with the rapid accumulation of wealth in the Asian Pacific region, which enjoys phenomenal growth and savings. Last month, the Merrill Lynch / Capgemini Asia Pacific Wealth Report announced that in 2006, millionaires in the Asian Pacific region as a whole had wealth amounting to US\$8.4 trillion, up 10.5% over 2005. Among the region's ultra high net worth individuals (that is those with more than US\$30 million in assets), more than 28% are in the mainland. Hong Kong is among the growth stories too, with 87,000 people (or 14 in every 1,000 people) being a US dollar millionaire.

Demographics and aspirations

Financial planning is no longer the preserve of the wealthy or the ultra wealthy. It is now an issue also for the average investors in Hong Kong. The government predicts that 25% of Hong Kong's population will be over 65 years old by the year 2031. The baby boomers who were born after the Second World War are now approaching or in retirement. With higher life expectancy, rising healthcare costs and an ageing population, there is a need to ensure that there is sufficient accumulation and growth of assets to support a life style they are accustomed to. Other people will also need to manage their finance wisely to meet their aspirations and needs, for example, recreation and travel, a larger home, overseas education for their children, etc.

Investor demand and expectations

Investors are becoming more demanding. They may not be satisfied with wealth management solutions, which invest in traditional asset classes and markets. They may be looking for alternative investments around the globe to diversify their holdings and/or increase the yield of their investments.

China Opportunities

I would like to take this opportunity to mention the strong economic performance of China which has given tremendous business opportunities to Hong Kong, especially through CEPA (i.e. the Mainland and Hong Kong Closer Economic Partnership) and QDII (i.e. the Mainland's scheme on Qualified Domestic Institutional Investors).

According to the National Bureau of Statistics, China is now the world's fourth largest economy, and is forecast to surpass Germany and Japan to become the second largest economy in the world. China has enjoyed economic growth of at around 10% a year for four consecutive years (from 2003 to 2006). China also has the world's biggest saving pool (at US\$2 trillion) and the world's largest foreign currency reserve (over US\$1 trillion).

Since the beginning of this year, the Mainland's domestic Shanghai and Shenzhen A-share markets have surged by over 100% and 150% respectively. As of July 2007, there were 340 funds under management in the Mainland and the total fund size was RMB 2.9 Trillion.

CEPA IV, for the first time, permits asset managers from the Mainland to set up subsidiaries in Hong Kong. With the arrival of these Mainland professionals, this will make Hong Kong even stronger as an international asset management hub with experienced managers from all major markets. The increased participation of Mainland fund managers will not only bring in Mainland expertise including their knowledge about the Mainland market and investor demands, it will also bring in connections and capital. A broadened base of market professionals and talents will likely attract more overseas investors and capital into Hong Kong.

Furthermore, the Chinese regulatory authorities have announced a series of measures to allow approved banks, asset management/securities firms and insurance companies to invest in overseas capital markets. These are done via the following regulators:

- (I) China Banking Regulatory Commission (CBRC) expanded the scope of investment of commercial banks (including Chinese banks and approved foreign banks in China) in May 2007. Equities and equity funds are permissible investments under the amended notice. Bank QDII can only invest in equities listed in Hong Kong and SFC-authorized investment funds. A wide variety of Bank QDII products have been created with a number of them invested in SFC-authorized funds.
- (II) China Securities and Regulatory Commission (CSRC) announced the Provisional Rules for QDII fund management companies and securities firms to invest overseas in June 2007. These firms are permitted to invest in and appoint intermediaries in 33 overseas jurisdictions. Hong Kong is to be the key investment market for Mainland firms.
- (III) China Insurance Regulatory Commission (CIRC) made QDII rules for insurance companies issued in August 2007. Domestic insurance companies have total insurance assets of approximately RMB 1.97 trillion. The rules allow insurance companies to invest up to 15% of the total asset as at the previous year-end in overseas equities and investment funds.

So far, the Mainland has granted US\$41.7 billion quota to QDII, of which US\$16.1 billion was granted to 21 banks, US\$19.5 billion was granted to five fund management companies and US\$6.1 billion was granted to ten insurance companies. The current utilisation rate of the whole QDII quota remains low at around 45%. The investment potential in this area is therefore tremendous.

Both CEPA and QDII will attract tremendous capital flows to Hong Kong, which will also bring promising opportunities to the financial planners in Hong Kong.

Opportunities and challenges

All these factors point to a higher potential demand for professional investment advisory services. But at the same time, the higher client expectations and the wide variety and complexity of products brings a whole new host of complication and sophistication to the advisory business. Looking ahead, there are lots of opportunities and challenges in the financial planning industry and financial planners have to be well positioned to meet those challenges. In the longer term, only the fittest will survive. So, in practical terms, what is expected of the financial planners? My advice is to follow the “Best Practice” and this is the principal reason why I wish to talk about “Best Practice for Financial Planners” today.

A business of trust

Before I proceed, let us be clear on one point. Financial planning services are based on trust between the advisers and the clients. A client who has not been valued will walk away, move to a competitor or even sue for damages. A financial planner will not survive without the trust of its clients and nothing jeopardises the business of a financial planner more quickly than the loss of confidence of its clients.

Best Practice

What is “Best Practice”? Best practice goes beyond the law, which only prescribes the minimum acceptable standard. No set of laws, rules and regulations can contemplate all possible scenarios and circumstances, which financial planners have to face. All I can say is, in all these scenarios and circumstances, the financial planners should put the interests of their clients before those of their own. It is only by so doing that they can sharpen their competitive edge, preserve the industry reputation and sustain long-term profitability, growth and survival.

Best practice provides the foundation and framework for a financial planner to follow a disciplined process in running its investment advisory business with a view to achieving the desired outcome. In following the best practice, the financial planner is motivated and guided by doing what is right and in the best interests of its clients. By doing so, a firm will protect its clients by deterring misconduct and ensuring that its staff acts with integrity and professionalism.

Best practice is a framework which sets parameters within which the industry can operate and develop in good health and with the goal of providing good value and adequate protection to investors.

3 key components:

- Have good corporate governance;
- Provide high quality services; and
- Maintain sound business practice.

I will deal with each of them in turn.

(I) Good corporate governance

- Senior management oversight

A financial planning firm should have a good corporate governance system that sets the tone and culture of its business. In view of the importance of the ethical culture, the firm should have support at the highest level of the management. The firm should have strong systems and controls, which will prevent, detect and control problems.

- Competency and training

In addition to closely supervising the firm's business, senior management should ensure that the sales representatives are adequately trained and remain competent to provide the services they provide to the clients.

- Management of conflicts of interest

A financial planner is normally remunerated by commission rebates, which it receives from a product issuer for recommending a particular investment to a client. It therefore faces the conflicts of recommending a product, which promises higher commission rebates to itself, rather than a suitable product which is consistent with the client's objectives and risk tolerance.

To address the issue of conflicts of interest, a financial planning firm should have systems and controls which look at every aspect of its business, its relationship with clients and carefully consider and ensure that clients' best interests will not be compromised in all situations.

(II) High quality services

- Know your clients

Needless to say, a financial planner should understand its clients' unique financial situation, needs and concerns in order to give suitable advice.

- Know your products

A financial planner should have a thorough understanding of the products they recommend and then match the products to the needs of the clients.

- Provide suitable advice

A financial planner should recommend investments, which suit the clients' needs and their specific circumstances. It should help clients make informed decisions by giving them information on the possible risks of the investments as well as possible rewards. The information should be clear and in a language which is easily understandable by the clients.

- Put clients' interest first

The overarching principle is that a financial planner should always put its clients' interest first.

(III) Sound business practice

Financial planners should have good internal practice in order to avoid or quickly resolve disputes with their clients.

- Agree nature and scope of services

A financial planner should first agree with their clients on the exact nature and scope of services to be provided and then sign off on written engagement letters.

- Document the rationale of investment advice

A financial planner should maintain records that properly document the clients' specific personal circumstances, the investment advice provided and the rationale behind that advice.

- Balanced disclosure of investment product features

A financial planner should make full and fair disclosure of all material features of the investment products, which they recommend so that their clients understand the nature of the investments and the risks involved.

- Other measures

If a claim from a client does arise, a financial planner should act upon it immediately by following up on the complaint and promptly responding to the client.

Guidance from regulator

I hope that with the recent issue of the Questions and Answers on the suitability obligations of investment advisers and the inspection report on investment advisers, members of the industry have a better understanding of the expectations we have on them.

I will call on you to compare the best practice with that of your organization and target problem areas and develop solutions to put clients' interest first in order to achieve the best level of performance.

The SFC and the industry have a common interest in the healthy growth of the financial planning industry. I look forward to continue dialogue with the industry and wish you a fruitful conference today.

Thank you.