



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

Survey on the Sale of Non-exchange Traded Investment Products

December 2018

A. Background

Introduction

1. The Securities and Futures Commission (SFC) conducted a fact-finding survey on the sale of non-exchange traded investment products to individual investors by licensed corporations. The survey covered the sale of investment products from 1 April 2017 to 31 March 2018 (the reporting period). This survey was last conducted in 2016.

Objectives

2. The survey was designed to collect information relating to the types and value of investment products sold. Whilst the information gathered may assist the SFC in supervising licensed corporations, it is also useful to market participants.

Scope

3. The survey focused on the sale and distribution of investment products to individual investors (including investment vehicles of such individuals), who had opened accounts with licensed corporations or their overseas affiliates; and to whom investment products had been sold or distributed by licensed representatives in Hong Kong. Sales to corporate professionals such as banks or under omnibus/nominee arrangements were not included in the survey.
4. The investment products covered in the survey included structured investment products, government and corporate bonds, swaps and repos, collective investment schemes and hedge funds. Among those excluded from the survey were leveraged foreign exchange products, insurance products, mandatory provident funds, pooled retirement funds, paper gold schemes, listed securities, exchange-traded funds and exchange-traded derivatives.

Questionnaire and responses

5. The survey questionnaire was sent to 1,844 corporations licensed to deal in or advise on securities. All of them responded to the survey. A total of 252 licensed corporations reported that they sold investment products to individual investors during the reporting period. These firms mainly comprised investment advisors, asset management firms, securities brokers and international financial conglomerates.

B. Key findings

Total transaction amount increased 34% driven by Mainland-based firms

6. The number of firms which engaged in the sale of investment products increased only 3% to 252 in this survey from 244 in the last survey in 2016, and the aggregate transaction amount¹ increased by 34% to \$508 billion, from \$380 billion.
7. The increase in the aggregate transaction amount was mainly driven by Mainland-based firms, some of which expanded their wealth management business in the reporting period. A number of larger firms also reported that they provided more product training and information to staff, which might have contributed to the increase.

Equity-linked products and non-investment grade corporate bonds gained popularity

8. A wide range of investment products were offered to clients in the reporting period. Structured investment products remained the most predominant product type, accounting for 42% of the aggregate transaction amount, followed by fixed income products (29%), collective investment schemes (20%) and swaps and repos (6%).
9. In general, firms responded that due to the favourable market sentiment in 2017, more clients had bigger risk appetites and sought higher investment returns. They traded in investment products which generally offered higher returns or yields. For example, compared to the previous survey the transaction amounts for equity-linked products increased by 102% and for non-investment grade corporate bonds by 65%.

Top 10 firms dominate the market with Mainland-based firms increasing their presence

10. The top 10 firms continued to dominate the market, representing 71% (2016: 69%) of the aggregate transaction amount. These firms comprised a mix of international financial conglomerates, brokerage groups and investment advisory firms.
11. Of the top 10, four international financial conglomerates accounted for 38% of the aggregate transaction amount and four Mainland-based brokerage groups accounted for 24%. An international financial conglomerate and a Mainland-based brokerage group, together with their related companies, were also major issuers of structured investment products.

¹ Transaction amount refers to the amount paid or payable by investors for investment products. For leveraged products, the transaction amount means the maximum exposure of the contracts. Licensed corporations were requested to report only one side of transactions. For example, only the buy order should be included as the transaction amount in switching transactions.

C. Analysis of aggregate transaction amount

Overview

12. For the year ended 31 March 2018, the aggregate transaction amount for investment products sold to individual investors by the 252 licensed corporations surveyed was \$508 billion (2016: \$380 billion). This represented an increase of 34%, or \$128 billion, compared to the aggregate transaction amount reported in the last survey. The increase was mainly driven by Mainland-based firms in which some of them had expanded their wealth management business in the reporting period. Structured investment products continued to be the most predominant product type sold to individual investors.

Chart 1: Transaction amount and number of firms engaged in sale of investment products

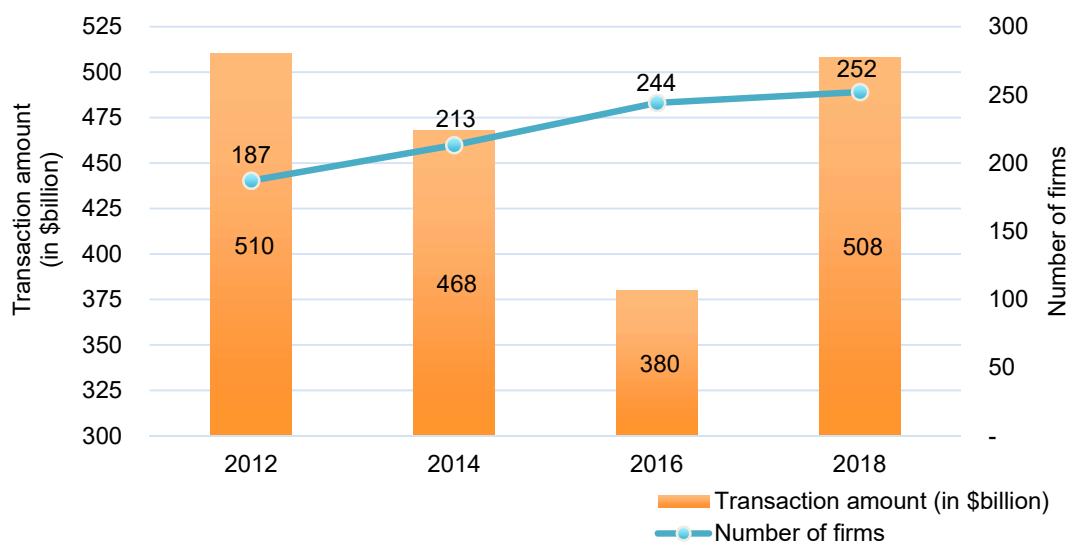
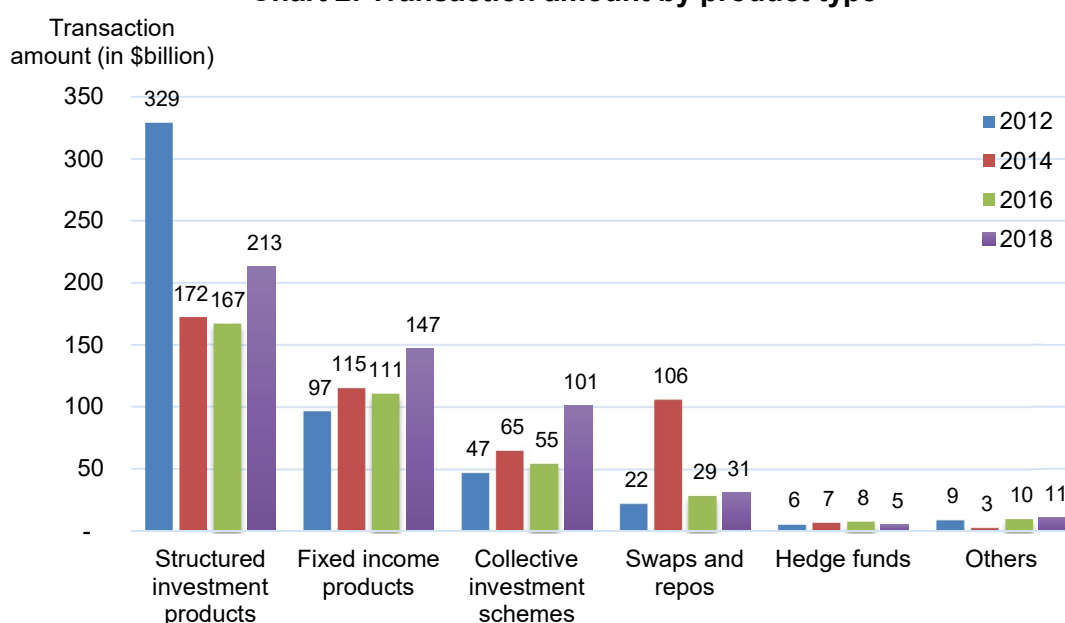
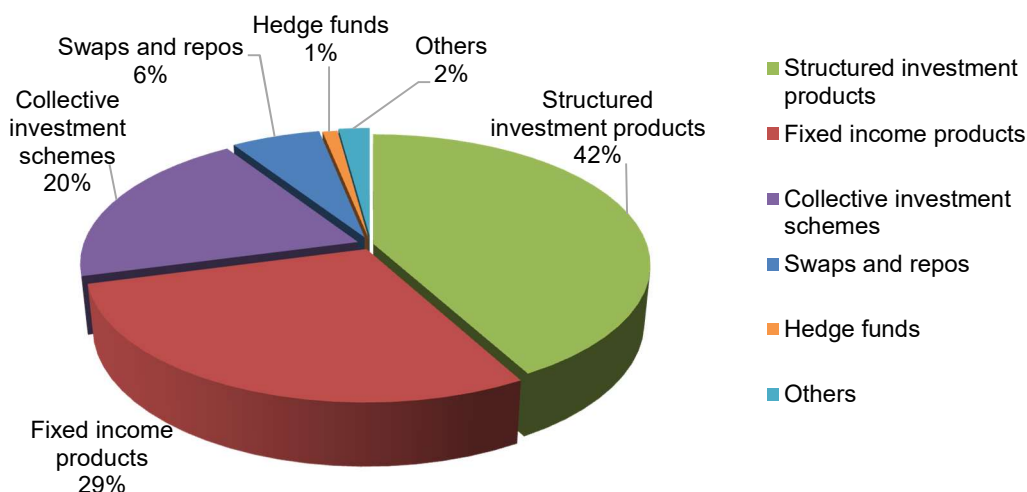


Chart 2: Transaction amount by product type



13. Structured investment products constituted 42% of the total transaction amount in the reporting period, followed by fixed income products (29%) and collective investment schemes (20%).

Chart 3: Total transaction amount by product type (2018)



14. Non-authorized investment products² continued to account for more than 90% of the aggregate transaction amount. Nearly all of the authorized investment products³ sold to individual investors were collective investment schemes. In terms of the number of transactions, collective investment schemes were the most frequently traded products.

Product types	Transaction amount (in \$million)				No. of transactions	No. of firms engaged in the sale ⁴
	Authorised products	Non-authorized products	Total			
Structured investment products	816	212,451	213,267	42%	23,887	45
Fixed income products	-	146,471	146,471	29%	28,000	148
Collective investment schemes	45,660	55,637	101,297	20%	454,122	164
Swaps and repos	-	30,852	30,852	6%	10,726	15
Hedge funds	-	5,203	5,203	1%	1,455	46
Others	-	10,793	10,793	2%	644	19
Total	46,476	461,407	507,883	100%	518,834	

² Non-authorized investment products are not subject to the regulation of the SFC and their structures and operations and their offering documents may not be governed by any rules or regulations in Hong Kong. They cannot be marketed to the public but they can be placed privately, offered to professional investors or offered in circumstances where an exemption applies.

³ Authorized investment products are products for which offering documents have been authorized by the SFC. They can be marketed to the public in Hong Kong.

⁴ A firm may have engaged in selling more than one type of investment product.

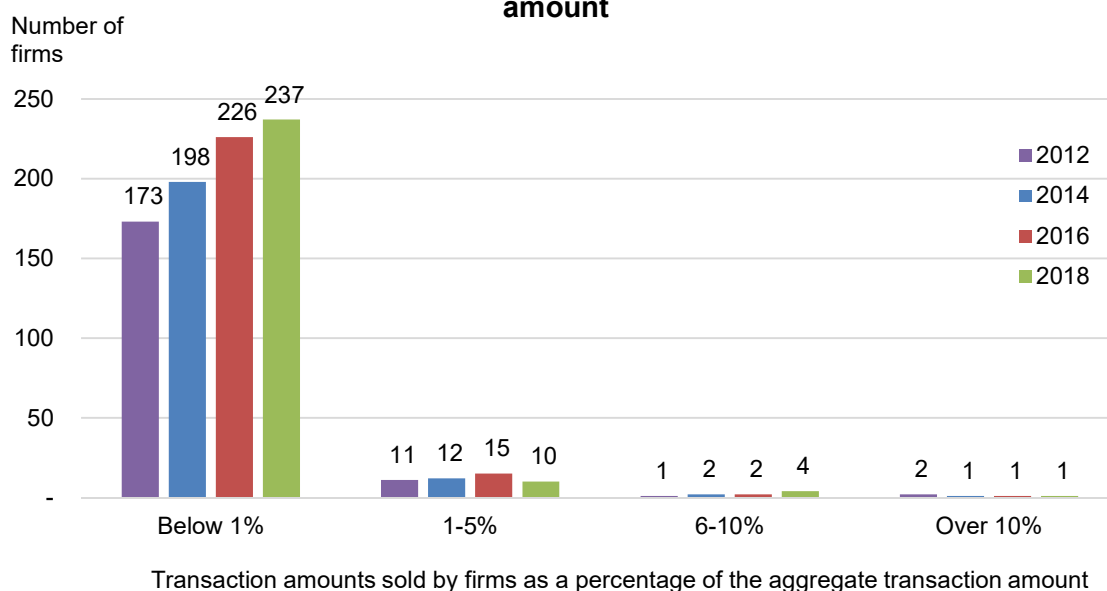
Sale of investment products by nature of firm

15. As in previous surveys, a few international financial conglomerates remained the major sellers of structured investment products. Securities brokers mainly focused on the sale of fixed income products, whereas collective investment schemes were sold by a wide range of firms, including international financial conglomerates, asset management firms, securities brokers and investment advisors.

The top 10 firms

16. The top 10 firms accounted for \$359 billion or 71% of the aggregate transaction amount in 2018, which was similar to the share of the top 10 firms in 2016 (69%). However, the top firm was less dominant, accounting for 25% of the aggregate transaction amount in the current survey compared to 33% in the last survey.

Chart 4: Distribution of firms in terms of the aggregate transaction amount



17. The top 10 firms comprised a mix of international financial conglomerates, brokerage groups and investment advisory firms. In terms of transaction amount, structured investment products were the principal products sold by the top 10 firms. Fixed income products and collective investment schemes continued to account for the majority of investment products sold to individual investors by the remaining 242 firms.

Chart 5: Transaction amount by product type - top 10 firms (2018)

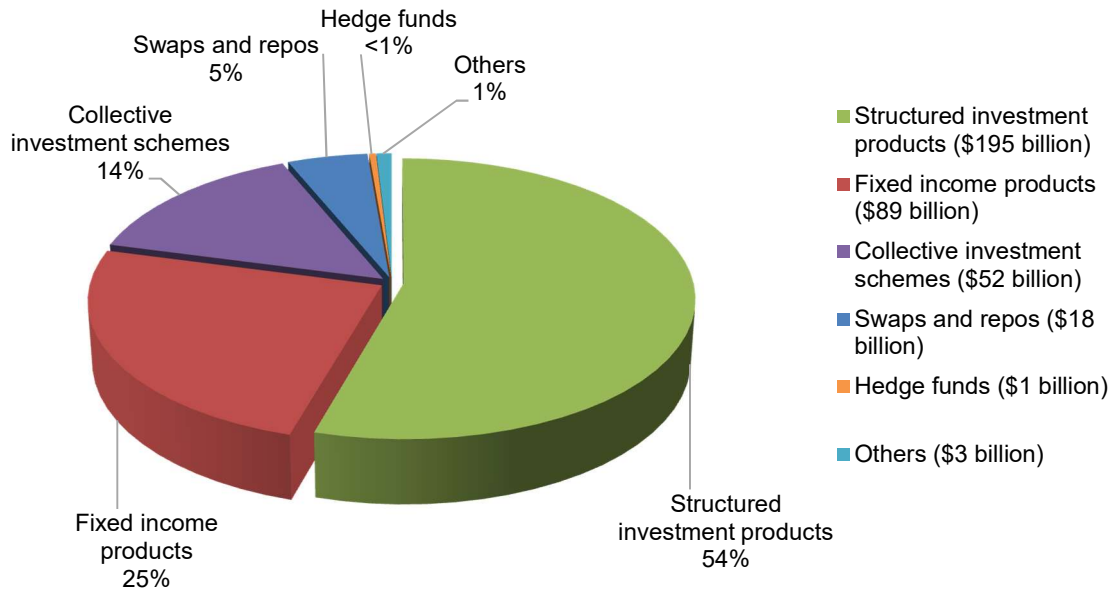
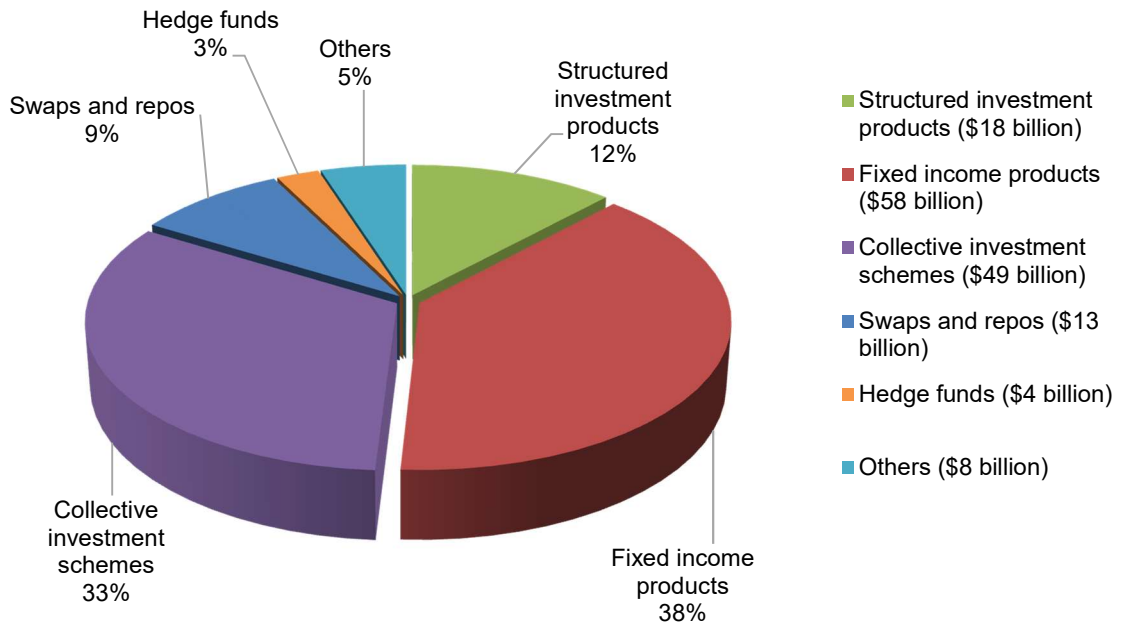


Chart 6: Transaction amount by product type - firms other than top 10 firms (2018)

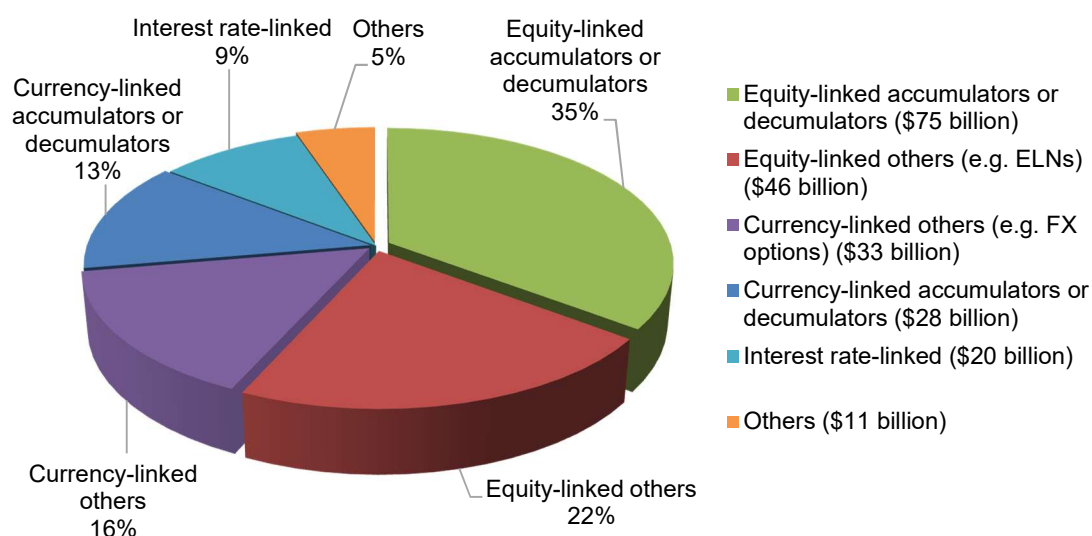


D. Analysis by product type

a) Structured investment products

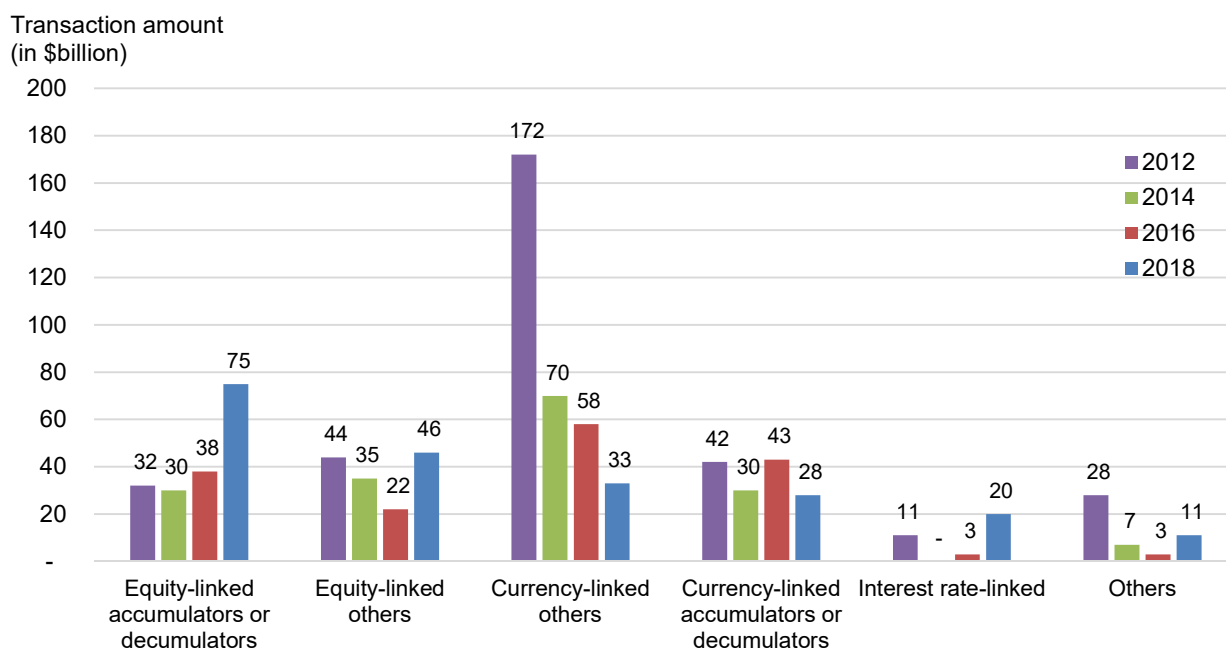
18. The aggregate transaction amount for structured investment products sold by licensed corporations to individual investors increased by 28%, from \$167 billion in the last survey to \$213 billion in the current survey. The sale of structured investment products continued to be dominated by the top 10 firms, representing 92% of the total transaction amount, with top firm contributing 31%.

Chart 7: Transaction amount for structured investment products (2018)



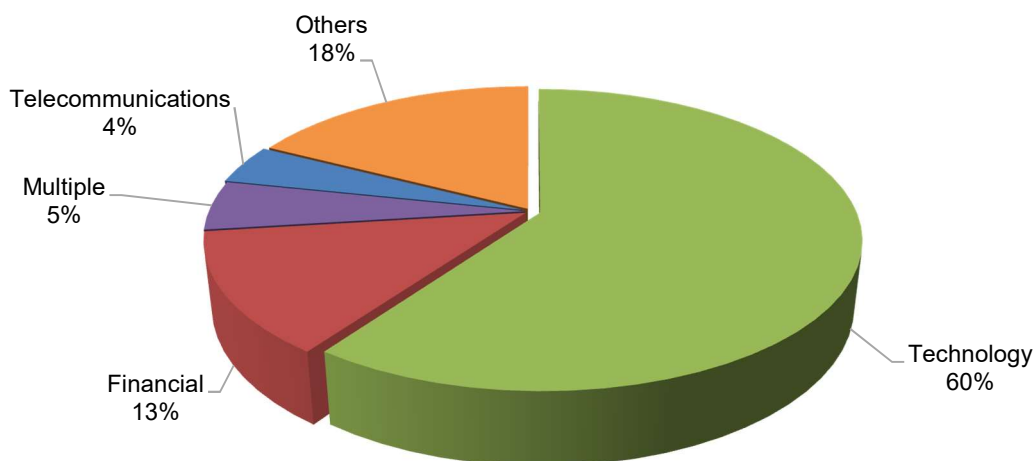
19. The transaction amount for equity-linked products doubled from \$60 billion in the last survey to \$121 billion in the current survey. They surpassed currency-linked products to become the top structured investment products sold. In general, firms commented that the strong performance of global equities in 2017 had driven clients' demand for equity-related products.

Chart 8: Transaction amount for structured investment products



20. One of the top 10 firms responded that clients' interest in the technology sector was a key driver of the overall transaction volume in equity-linked products. Of the top five equity-linked products reported by the respondent firms⁵, 60% were linked to the technology sector equities, 13% to financial sector equities and 5% to baskets of equities from two or more industry sectors.

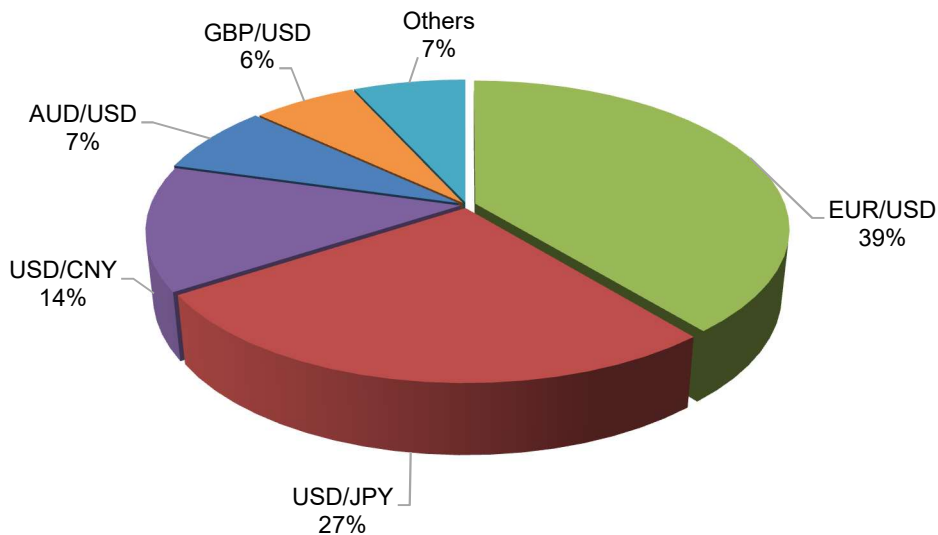
Chart 9: Transaction amount of equity-linked structured investment products by industry sector of underlying equities (2018)



⁵ In the survey, firms were requested to provide details such as the names and issuers of the top five products ranked by transaction amount for each type of investment product.

21. The transaction amount for currency-linked structured investment products amounted to \$61 billion, dropping 40% from \$101 billion in the last survey. One firm in the top 10 reported that the closure of a major client’s account led to a substantial decrease in its transaction amount for currency-linked products. Another top 10 firm observed that some clients diversified from currency-linked accumulators or decumulators to other currency-linked products with shorter tenors, such as dual currency notes, to better manage their risks.
22. Based on the top five currency-linked products reported by each respondent firm, US dollar against the Euro (39%) was the most common currency pair, followed by US dollar against the Japanese yen (27%), renminbi (14%) and Australian dollar (7%).

Chart 10: Transaction amount for currency-linked structured investment products by currency pairs (2018)

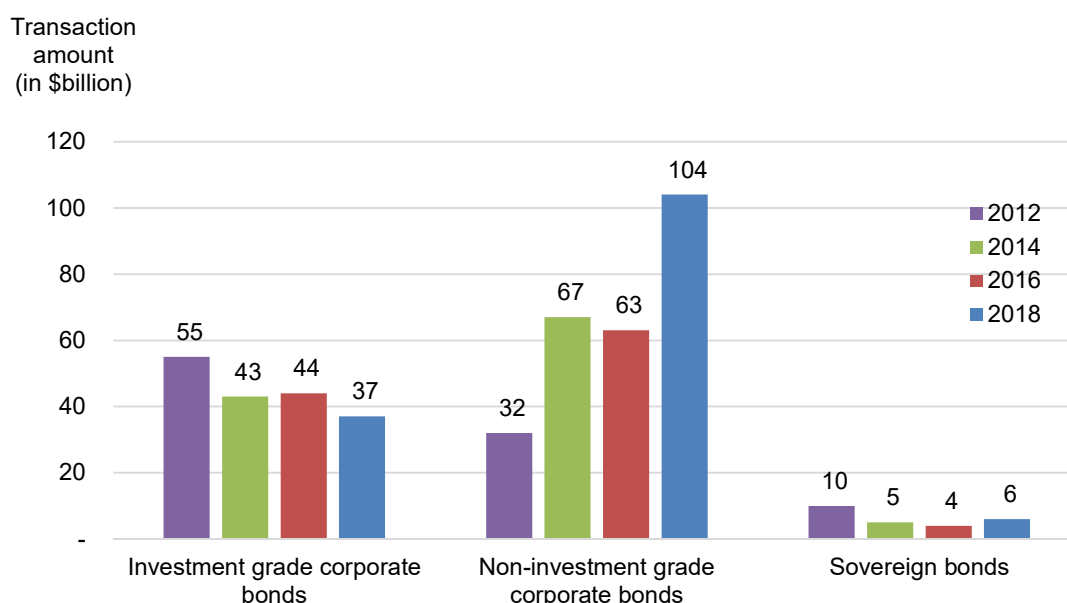


23. The transaction amount for interest rate-linked structured investment products increased from \$3 billion in the last survey to \$20 billion in the current survey. Respondent firms generally commented that interest rate-linked products gained popularity as interest rates have been increasing.

b) Fixed income products

24. The aggregate transaction amount for fixed income products increased by 32% from \$111 billion in the last survey to \$147 billion in the current survey. Six of the top 10 firms, including two international financial conglomerates and four Mainland-based brokerage groups, accounted for over half of this amount. Firms generally noted increased demand for fixed income products in the reporting period. One of the Mainland-based firms also reported that it had recruited a sales team which specialised in selling fixed income products to high-net-worth clients.

Chart 11: Transaction amount by type of fixed income products



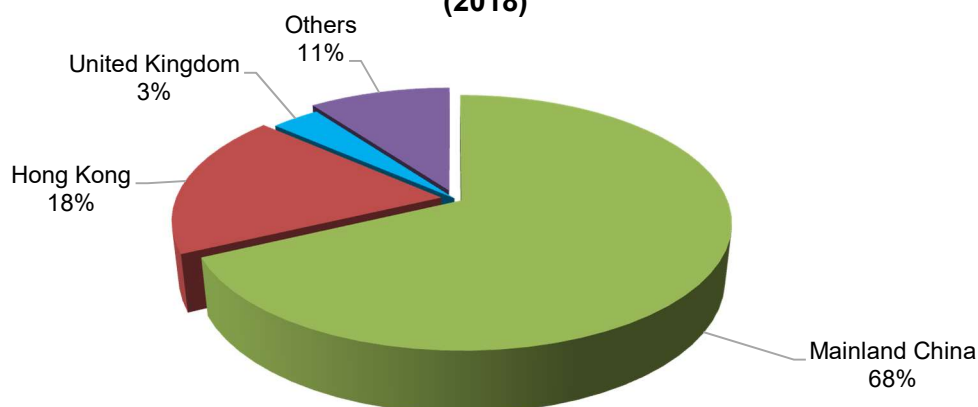
25. The share of non-investment grade⁶ corporate bonds as a percentage of the total transaction amount for fixed income products increased from 56% in the last survey to 71% in the current survey, while that of investment grade corporate bonds decreased from 40% to 25%. Some firms commented that there was an increase in high-yield bond issuance during the reporting period and investors looked for yield in the low interest rate environment and therefore shifted to investing in non-investment grade corporate bonds which generally offered higher yields.
26. Similar to the last survey, sovereign bonds only contributed 4% of the total transaction amount for fixed income products.

⁶ Firms were requested to classify unrated corporate bonds as non-investment grade in the survey.

Top five corporate bonds⁷

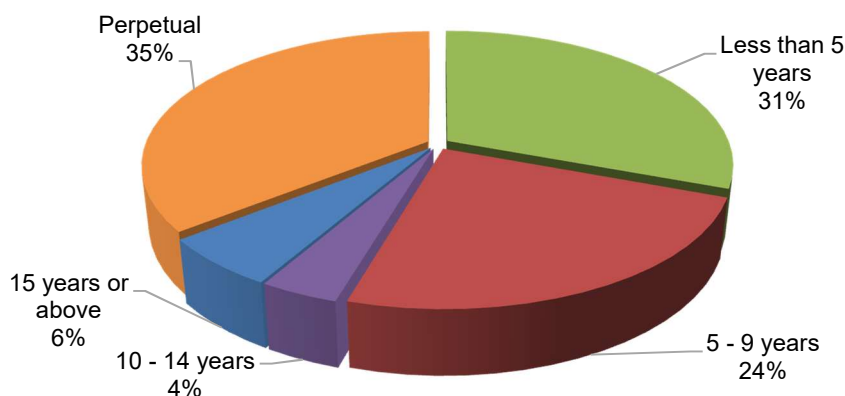
27. The majority of the issuers of the top five corporate bonds reported in the survey were from the financial sector (such as banks, financial services groups and insurance companies) and the real estate sector. In terms of the underlying “country of risk”⁸ of the issuers, Mainland China and Hong Kong remained the top two, representing 68% and 18% respectively of the transaction amount for the top five corporate bonds.

Chart 12: Underlying country of risk of corporate bond issuers (2018)



28. As at 31 March 2018, 31% of the top five corporate bonds had a remaining tenor⁹ of less than five years, while 24% had a remaining tenor of five to nine years. The proportion of perpetual bonds increased from 10% in the last survey to 35% in the current survey. More than 70% of these perpetual bonds were issued by banking groups.

Chart 13: Remaining tenor of corporate bonds (2018)



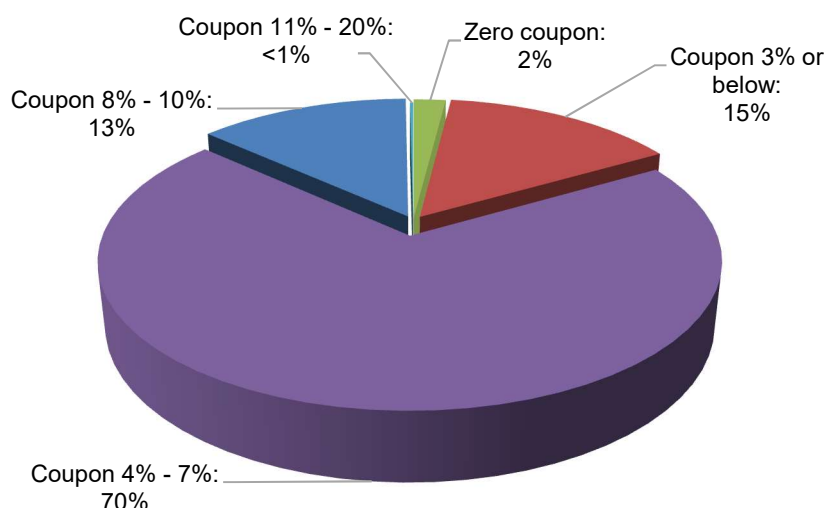
⁷ This refers to the top five investment and non-investment grade corporate bonds by transaction amount reported by each respondent firm.

⁸ The underlying country of risk and other information about fixed income products, eg, industry sector, coupon rate and maturity date, were sourced from an external market data provider.

⁹ Remaining tenor refers to the time to the maturity date calculated from 31 March 2018. Bonds with a maturity date between 1 April 2017 and 31 March 2018 were included under remaining tenor of less than 5 years.

29. Of the top five corporate bonds, 70% had a coupon rate of 4% to 7% per annum while 15% had a coupon rate of 3% or below and 2% were zero coupon bonds.

Chart 14: Coupon rate range of corporate bonds (2018)



Top five sovereign bonds¹⁰

30. Among the top five sovereign bonds reported by each respondent firm, US government bonds (44%) and Hong Kong government bonds (26%) were the most commonly sold. As of 31 March 2018, over 70% of the top five sovereign bonds had a remaining tenor of less than five years while about 10% had a remaining tenor of 10 years or above. 68% had a coupon rate of less than 4% per annum and 12% were zero coupon bonds.

Fixed income products with non-viability loss absorption features¹¹

31. The sale of non-viability loss absorption bonds increased from about \$8 billion in the last survey to \$17 billion in the current survey. 76% of these bonds were sold by five firms, including four Mainland-based brokerage groups.
32. Among the top five non-viability loss absorption bonds sold, 85% had an equity conversion feature. Other features included permanent and temporary write down¹². 97% were perpetual bonds, and over 80% had a coupon rate of 4% to 6% per annum.

¹⁰ This refers to the top five sovereign bonds by transaction amount reported by each respondent firm.

¹¹ These fixed income products are often attached with conversion options or loss absorption features which are triggered when the issuer's regulatory capital ratio drops to a certain level or upon the occurrence of specific government or regulatory action in the event the issuer faces financial difficulties (ie, non-viability events).

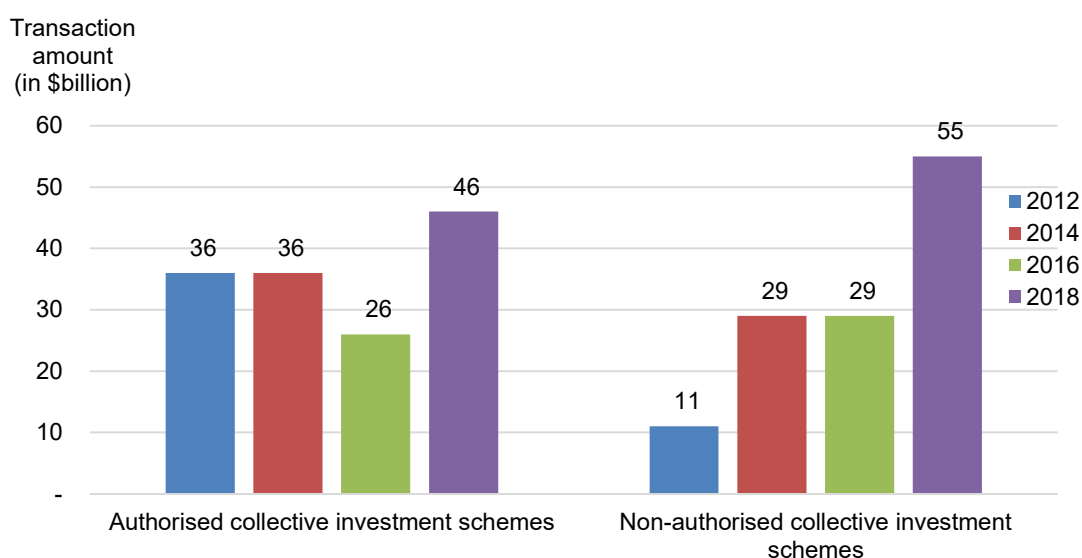
¹² Under a temporary write-down, the principal amount of the bond would be written down fully or partially upon the occurrence of a triggering event. However, if the issuer's financial position subsequently improved and met certain requirements, the principal amount of the bond could be fully or partially reinstated.

33. While European banks were the major issuers of the top five non-viability loss absorption bonds reported in the last survey, over 70% of these bonds reported in the current survey were issued by Mainland-based banking groups.

c) Collective investment schemes and hedge funds

34. As in the previous survey, more firms which engaged in the sale of investment products in the reporting period sold collective investment schemes (65%) than any other product. The transaction amount for collective investment schemes increased significantly by 84% from \$55 billion in the last survey to \$101 billion in the current survey; authorised and non-authorised collective investment schemes contributed 45% and 55% respectively in the reporting period.

Chart 15: Transaction amount by type of collective investment schemes



35. Among the 164 firms selling collective investment schemes in the reporting period, five firms contributed \$63 billion or 62% to the total transaction amount. They also contributed \$36 billion or 78% of the increase in the transaction amount for collective investment schemes. These five firms included an international financial conglomerate, an investment advisory firm, an asset management firm and two brokerage groups. One of the brokerage groups advised that it expanded its wealth management team which drove an increase in the turnover of collective investment schemes.
36. Bond funds were the most commonly sold fund type out of the top five collective investment schemes reported by each respondent firm. In particular, the transaction amount for high-yield bond funds increased from \$2 billion in the last survey to \$18 billion in the current survey. This was in line with the market view that more investors were looking for higher yields.
37. The transaction amount for hedge funds decreased from \$8 billion in 2016 to \$5 billion in 2018. Among the 46 firms which sold hedge funds to individual investors, five firms accounted for 67% of the total transaction amount. Of the top five hedge funds, equity long/ short continued to be the most common investment strategy.

d) Swaps and repos

38. The sale of swaps and repos slightly increased by 7% from \$29 billion in the last survey to \$31 billion in the current survey. Only 15 firms reported to have sold swaps and repos to individual investors. Five of them contributed over 90% of the total transaction amount, including three international financial conglomerates and two brokerage groups.

E. Outstanding contracts

39. Among the 252 firms selling investment products, 156 firms or their related companies held outstanding positions on behalf of their clients or as contracting parties. The market value of outstanding positions held by these firms amounted to \$468 billion, up 50% from \$313 billion in the last survey. The top 10 firms accounted for 40% of total outstanding positions (2016: 42%).
40. Fixed income products and collective investment schemes each accounted for 44% of the outstanding positions. They also accounted for 54% and 42% of the growth in total outstanding positions respectively.

Product types	Market value of outstanding positions on 31 March 2018			
	Authorised products (in \$ million)	Non-authorised products (in \$ million)	Total (in \$ million)	Total (%)
Fixed income products	-	205,941	205,941	44%
Collective investment schemes	114,485	90,156	204,641	44%
Structured investment products	252	25,868	26,120	5%
Hedge funds	88	15,035	15,123	3%
Swaps and repos	-	3,384	3,384	1%
Others	-	13,170	13,170	3%
Total	114,825	353,554	468,379	100%

F. Active clientele

41. The 252 firms reported a total of 55,172 clients who had completed at least one transaction in investment products during the reporting period (2016: 47,335 clients). Around 75% (2016: 73%) of these clients were Hong Kong residents.
42. 91% (2016: 82%) of firms reported that clients had opened accounts with them directly. The others reported that they had served clients who opened accounts with their overseas affiliates in the reporting period. The transaction amount related to these clients accounted for 15% of the aggregate transaction amount in the reporting period.

43. 19% or 10,549 clients (2016: 16% or 7,595 clients) had been treated as professional investors under the Code of Conduct¹³.

G. Investment product issuers

44. Each respondent firm was requested to report its top five issuers of investment products sold. For the year ended 31 March 2018, \$273 billion (54%) of the total transaction amount of \$508 billion was related to these issuers, which included financial institutions, governments or their agencies, and local or overseas corporations.
45. Three international financial conglomerates and three Mainland-based brokerage groups in the top 10 firms or their related companies were also among the major issuers of investment products sold. The transaction amount for the products issued by these six firms or their related companies was \$133 billion, of which \$125 billion (94%) was sold directly to their clients. These products were mainly structured investment products.

H. Manpower

46. As at 31 March 2018, 5,469 licensed representatives were reported to be engaged in the sale of investment products, which was similar to the number reported in the last survey (2016: 5,448).
47. Over half of the respondent firms reported to have five or fewer licensed representatives engaged in the sale of investment products whereas 11 firms reported to have over 100 licensed representatives.

¹³ Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission