

**A new landscape for retail investment products  
Speech at the Fourth Annual Conference of  
the Hong Kong Investment Funds Association**

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**Introduction**

It's a pleasure to be here today. I would like to thank the Hong Kong Investment Funds Association (HKIFA) for inviting me to speak again at this prestigious event.

This is the fourth time that I speak at the HKIFA annual conference. I have just revisited my previous speeches. The topic of my first speech, in 2007, was "The Outlook for the Fund Management Industry in Hong Kong". It was given at a time when the global fund industry as well as that in Hong Kong were going from strength to strength. The theme of the day was to make the most out of the opportunities that were springing up left right and centre.

Then came September 2008, when I spoke two weeks after the collapse of Lehman Brothers and at a time when we got hundreds of people marching on the street complaining that they were sold investment products that they did not understand. That was not a good time.

What followed was a rather busy year, during which we completed a review of our regulatory framework on public offers of the structured products market, reached an agreement with the distributors of Lehman Brothers Minibonds, and released a consultation paper on reforming Hong Kong's retail investment products market. By the time I did my third speech in September 2009, the momentum for change had been gathering for a while, and reforms had already taken shape. The worst seemed to be over, though the end of the tunnel was not in sight.

The consultation on our proposals to reform the retail investment products market ended in May this year and new or revised regulatory codes and requirements have started coming into force by phases over the past few months. At the same time, the market seems to be picking up again. Our annual survey of the industry shows that it has been moving in the right direction steadily: all the performance indicators, from assets under management, to income from private banking and fund advisory businesses, have been going up.

My four speeches have been fortunate enough to bear witness to one of the most dramatic cycles of boom, bust and, fingers crossed, recovery, that have taken place in the past decades. With most of us finally shaking off the gloom and starting to look into the future with hope, it is perhaps an opportune time to think about where we are now, and how we are going to move forward.



## Global regulatory environment

I want to start off by talking about what is happening on the global level.

At the International Organization of Securities Commissions (IOSCO) level where securities industry regulators from all over the world get together to co-ordinate our works and to exchange information, what is mainly taking place are reforms – changes and more changes in possibly every aspect of the market that we think might have led to what we had in 2008. We have introduced changes and new rules for credit rating agencies, hedge funds, short selling (the Task Force which I chair), and now over-the-counter (OTC) derivatives.

Given the growing inter-connectedness of financial markets worldwide and the spill-over effect of local regulations, it is crucial that we as regulators take co-ordinated action. And such a development would be of particular relevance for the many of you that are also operating a global platform.

As an international financial centre, Hong Kong's financial regulation adopts principles which are in line with international standards. In bringing these principles to a local implementation level, we bear in mind that these principles need to be adapted to the local market needs as well as the regulatory regimes and practices that we have already built over the years. In this process we often actively engage the relevant sectors of the industry including yourselves. This process is dynamic. It does not stop at the point where we publish new rules or codes. We continuously keep an eye on the developments in other financial centres, and again engage the industry to continuously enhance our regulation, bearing in mind the specificities of Hong Kong.

What is going on overseas is more than just a backdrop to how we do business in Hong Kong. We are such a small but compact city, yet we are a free and open economy, which makes us the hub of China, and even Asia. By its very open market architecture, our industry inevitably faces cross-border issues all the time, and dealing with a whole range of both international and local regulation has become an integral part of the business of Hong Kong fund managers. Hence discussions of where our fund management industry is heading will not be complete without also setting our eyes or ears on what is happening around us in other major financial markets.

In the funds space, we also pay particular attention to some of the development of the more significant jurisdictions. Lately, we see regulation that is being proposed to regulate alternative fund managers, such as hedge fund and private equity fund managers. In the US, the Dodd-Frank Act sets out the framework for such regulations. In the EU, this is done by the Alternative Investment Fund Managers Directive (AIFMD), which continues to be debated by both the European Parliament and the European Council. Both regulations require alternative fund managers to be registered so that they are subject to some form of regulation. There are also reporting requirements and rules on custodian arrangements. You will probably have heard that the AIFMD approach to non-EU fund managers is not without dispute as it makes life not as easy for this group of fund managers to do business in the EU. And as the debate goes on, rules on short-selling and remuneration have also been added to the draft directive. All these regulatory proposals coming from the US and the EU will no doubt have an impact on the way your counterparts are doing business in these jurisdictions. And here in Asia, we have been keeping a close watch of these developments and will assess if any regulatory responses are needed.



In addition to the alternative investment funds space, the UCITS regime in Europe is also being updated. This is the second overseas regulatory reform that I wish to mention. The UCITS regime is well established and has been in place since 1985. The latest round of changes, which are known as UCITS IV, were passed into law in July 2009, and are expected to come into force in July 2011. One area in UCITS IV that is of particular relevance to us is the introduction of the Key Investor Information Document (KIID). The rules on KIID were just finalised this July and its contents are comparable to the product key facts statements (KFS) under our Products Handbook. The KIID requirement also reflects a broader phenomenon, which is the drive by regulators worldwide to ensure that investors are provided with information that they can easily understand. Similar requirements to those of KIID have been introduced or are being considered not just by the EU, but also by regulators in the US, Canada, Australia and Singapore. And what is more, such requirements will be applied not only to funds, but also to structured products and in the case of Europe, other packaged retail investment products.

Of course, we are implementing similar requirements in Hong Kong. In fact, Hong Kong is one of the first major international financial centres to introduce a requirement to provide product summary statements, and this requirement has been in force in Hong Kong since June 2010.

In Hong Kong, and particularly in the fund space, we often see products that are issued by financial institutions from overseas jurisdictions, such as UCITS funds. It is important that the disclosure of the key risks and product features in the KFS of different investment products that are offered to the public in Hong Kong are consistent in principles, to ensure a high standard of disclosure and to facilitate comparison across different products. To improve transparency and to assist the process of aligning requirements across jurisdictions, we have posted the templates of our KFS on our website and we have been sharing our experience in designing these templates with other regulators in leading financial centres like the US and the UK. We will keep in view the developments in respect of the product summary worldwide. With regard to our local requirements for the KFS, we always maintain an open dialogue with you.

While we are at it I would also like to quickly go through the new rules governing OTC derivatives. In the US, such rules are included in the all-encompassing Dodd-Frank Act while in the EU, new rules were published by the European Commission last month. The reforms introduce new rules on clearing and reporting on a broad range of OTC derivatives. Some of our funds use derivatives for hedging purposes or for achieving a particular return pattern, and there has been an ongoing discussion on how the rules should be interpreted and whether these funds would be subject to these regulations. There is no consensus yet. In fact, the US regulators are still busy fleshing out the rules. This is going to take some time but is worth watching out for.

## **Products Handbook**

Enough is said about the international regulatory environment. Let me now move back to Hong Kong.

In my speech last year I walked you through how we planned to reform the regimes governing the regulation of unit trusts, investment-linked assurance schemes (ILAS) and



unlisted structured products. I would like to thank you again for coming up with constructive proposals on the issues that we consulted, and for sharing your views on, among other things, the contents and structure of the KFS.

Most of our proposals were well-received, and after months of consultation and active engagement with different sectors of the industry, most of these proposals have been accepted into the final version of the Products Handbook. The handbook is a consolidated document that contains a set of non-statutory codes covering the three categories of products that I have just mentioned. On various occasions I have already spoken about some of these new measures, and my colleagues have also held workshops to assist you in meeting the new requirements. I do, however, want to highlight a number of key points that we had in mind when we put together the Products Handbook. I hope that by sharing our regulatory thinking behind some of these key regulatory requirements, you will be able to gain better insight as to why we have come up with the Products Handbook in its current form.

The first is to achieve a level playing field. We have sought to ensure that regardless of the products' legal form, as long as they have similar underlying economics and risk profiles, they should be subject to a set of broadly similar regulatory standards. For example, regardless of whether it is a fund or a structured investment product that plans to use a collateralised structure, the collateral would have to meet a similar set of principles, such as those over the liquidity and the credit rating of the assets that serve as collateral. We have also made the KFS applicable to unit trusts, ILAS and structured investment products in order to encourage comparability and transparency.

To make sure that our different products teams are able to align their regulatory approach, we have inserted a set of overarching principles at the beginning of the Products Handbook, so as to make sure that when applying a specific code requirement, we don't lose sight of the need to ensure consistency and transparency.

The next thinking that pervades throughout the Products Handbook is to enhance the quality and readiness of disclosure of product information. We believe that investors should have access to clear and succinct information about a product. We believe that such information should be available before investors make investment decisions, and throughout the life of the investment. To this end, we have introduced two requirements.

The first, as briefly mentioned before, is the requirement to include a KFS that summarises a product's key features and risks. The second is the ongoing disclosure obligations. We were happy to see that even before the requirements became mandatory in June, some issuers have already started producing KFS voluntarily. Issuers have also been keeping investors updated of material information on an ongoing basis. I would like to commend product issuers on their efforts to make the launch of these initiatives possible.

The third point is "fairness to investors". In the Products Handbook we are not just dealing with disclosure, we are also concerned about how you design products and how you deal with investors. It is critical that as you design and promote products, you do not lose sight of the investors' needs. To have a sustainable market, there must be a business case for both sides of the bargain. In that sense, a product must be "fair". A product's design and payout that is skewed in favour of one side will not stand the test of time. While we, as regulator, have set out requirements to improve disclosure and transparency, we cannot take your



place and design the product for you. This is a matter for you, as market participants, to consider what is the genuine business case, what is the value that you are bringing to the transaction, and how best to serve investors' interests by delivering products that are fairly designed.

Good regulation needs to balance investor protection and market development, and implementing these regulations requires efforts from both market participants and regulators. This is why we have taken an "engaging and direct communication approach" when we were preparing the Products Handbook: we have had numerous meetings with you before and after the publication of the consultation paper, and we have reviewed and considered more than 100 formal consultation responses from you and from the public.

Now that we are moving on to the implementation phase, we have not forgotten the importance of keeping our ongoing dialogue alive. After the release of the Products Handbook, we organised workshops and briefing luncheons to walk your colleagues through the key areas of the revised codes and to explain in practical terms how they should be applied. I would like to take this opportunity to encourage you to also actively engage us: let us know if you have any concerns, and come speak to us at an early stage if you have any new product ideas.

## **RMB products**

I have so far been talking about the new landscape on the regulation side. Let me now spend a few minutes going through a new product development that is of particular relevance to Hong Kong. And this is renminbi (RMB) products.

Developing RMB products is a market issue that has wider policy implications. Using Hong Kong as the testing ground in the internationalisation of RMB has been generally recognised as a key national policy objective of the Mainland government. It is also the Administration's goal to develop Hong Kong into an offshore RMB centre, to contribute to the RMB internationalisation process and to deepen Hong Kong's position as an international financial centre.

Hong Kong already has a financial ecosystem that is conducive to the development of RMB businesses. On the demand side, the pool of RMB deposits in Hong Kong reached RMB104 billion at the end of July, representing a 65% increase from the year-end 2009 level. And the figure is growing by the day, through a combination of conversion by local residents, the inflow of the Mainland's enormous wealth, and RMB cross-border trade settlement, 75% of which is conducted through Hong Kong. On the supply side, Hong Kong has a world class financial infrastructure and industry participants that are capable of handling RMB transactions. In August, a Mainland policy change that allows some Hong Kong banks to invest in the Mainland inter-bank bond market, worth RMB15 trillion, has substantially broadened the scope for designing RMB investment products in Hong Kong.

In fact, over the past few years, the development of RMB products has been evolving steadfastly, though quietly. The first RMB bond offered to the public was launched in 2007, and in little more than three years we have seen the total level of RMB bonds issued risen to RMB40 billion.



The policy to allow inter-account and inter-bank RMB transfers in July this year has further unlocked opportunities for developing RMB products in Hong Kong. The policy prompted a surge in the number of RMB investment products being introduced, and these products include a plethora of RMB structured deposits and RMB insurance products. The Securities and Futures Commission has also authorized the first RMB public fund in August. A recent RMB bond offering by a Mainland bank was well-received, with over four times over-subscription.

All the above are clear and unequivocal facts confirming once again that Hong Kong is the natural choice when financial institutions want to explore their RMB businesses. We have the infrastructure, legal system, policy support and track record. These are characteristics specific and exclusive to Hong Kong. Developing RMB investment products in Hong Kong is part and parcel of the internationalisation of the currency. This is an objective that we lend our support to.

That said, we have to approach the development of RMB products with a note of caution, given that it is still at the experimental phase and that RMB is still not fully convertible. In launching a new RMB product, an issuer should also ensure that the product is capable of providing genuinely RMB-related returns to investors. It ties back to the point that I made just now, which is that issuers must ensure there is a genuine business case for their products for both sides, ie, it is a fair deal.

### **The revised Code of Conduct**

Now I have talked about what products are to be made available and how they should be constructed, it is equally important to look at how these products are to be marketed and sold to investors.

Apart from the Products Handbook, we also introduced changes in our Code of Conduct to more comprehensively outline what should be done by sellers of the products to ensure that products are offered to investors in the most suitable manner.

We outline more elaborated suitability requirements, in particular, the investor characterization requirement which will come into effect in June 2011. We prohibit the offering of gifts for specific products. We require disclosure of monetary and non-monetary benefits, and more elaborated information about the products at the point of sale. We also require firms to promptly execute instructions under the cooling-off period.

### **Concluding remarks**

In conclusion, I'll come back to my theme, "A new landscape for retail investment products". A new landscape is certainly emerging. Regulators worldwide have reacted swiftly and positively to the crisis, and they have taken the chance to introduce a raft of new measures. Some of them are necessary, but some are yet to be tested and proven. Many of these reforms will have an impact on you, though for some, exactly how remains to be seen. We will keep a close eye on them and will respond accordingly.

The financial industry in Hong Kong has come out of the crisis relatively unscathed. Yet we have our share of reforms too. I highlighted just now the Products Handbook, which is one of





our key responses to the financial crisis. Through the Products Handbook, we want to establish an up-to-date regulatory regime that puts investor protection at the forefront and at the same time provides a fair and level playing field for compliant issuers to compete in terms of market innovation and product development. The launch is only the first step towards a better regulated market, and we foresee a more challenging time when it comes to implementation.

Turning to the market, product development in Hong Kong has been given a boost from some recent policy initiatives by Mainland authorities that may facilitate the introduction of more RMB products. Our existing regulations are capable of handling RMB products, but I would like to remind you that the same high standards would be applied in the design, disclosure and distribution of these products.

As the market regulator, we have always been committed to maintaining an efficient marketplace and protecting the investing public. To that end, and in light of some recent market developments, we have introduced a number of reforms in the past few years. You have offered us great help in bringing these reforms to life, and I am sure that your commitment to a higher professional standard and a better compliance culture will no doubt reap you immeasurable rewards in the years ahead.

Thank you inviting me here today, and I hope you all enjoy the rest of the conference.