



**IFPHK's Response to the Securities and Futures
Commission Consultation Paper on Proposals to
Enhance Asset Management Regulation and Point-of-
sale Transparency**

February 2017

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Institute of Financial Planners of Hong Kong (IFPHK) Profile

Background

The IFPHK was established in June 2000 as a non-profit organization for the fast-growing financial industry. It aims to be recognized in the region as the premier professional body representing those financial planners that uphold the highest standards for the benefit of the public.

The IFPHK is the sole licensing body in Hong Kong authorized by Financial Planning Standards Board Limited to grant the much-coveted and internationally-recognized CFP^{CM} certification and AFPTM certification to qualified financial planning professionals in Hong Kong and Macau.

It represents more than 6,800 financial planning practitioners in Hong Kong from such diverse professional backgrounds as banking, insurance, independent financial advisory, stockbroking, accounting, and legal services.

Currently there are more than 147,000 CFP certificants in 24 countries/regions; the majority of these professionals are in the U.S., Canada, China, Australia and Japan, with more than 4,700 CFP certificants in Hong Kong.

CFP^{CM}, CERTIFIED FINANCIAL PLANNER^{CM},  CFP^{CM},  CERTIFIED FINANCIAL PLANNERTM, AFPTM, ASSOCIATE FINANCIAL PLANNERTM,  **AFP** and  **ASSOCIATE FINANCIAL PLANNER**® are certification marks and/or trademarks owned outside the U.S. by Financial Planning Standards Board Ltd. The Institute of Financial Planners of Hong Kong is the marks licensing authority for the CFP marks and AFP marks in Hong Kong and Macau, through agreement with FPSB.

IFPHK's interest in this consultation

The mission and vision of the IFPHK is to promote the importance of financial planning. Financial planning refers to the process of setting, planning, achieving and reviewing life goals through proper management of finances¹.

Since its inception, the IFPHK has been striving to raise public awareness of the financial planning industry in Hong Kong and highlight the high standards that CFP professionals adhere to. In 2006, with contributions from our patrons, leading industry practitioners and experts, the IFPHK published the *IFPHK Practice Guide for Financial Planners*. The Guide is the first set of guidance materials for financial planners practicing in Hong Kong. To supplement this effort, the IFPHK launched the Guidance Note entitled *Suitability of Advice Obligations: Documenting your Financial Advice* for its members.

It is also the IFPHK's mission to protect public interest. In 2009, we provided our comments to the proposal to enhance the protection of the investing public. The proposal was put forward by the SFC as a result of the aftermath of the Lehman Brothers Minibond Saga. In 2010, the IFPHK submitted a response to the consultation paper on the proposed establishment of an Investor Education Council and a Financial Dispute Resolution Centre. In 2014, we responded to the Consultation Document on having an effective resolution regime in Hong Kong. Last year, we

¹ www.fpsb.org

provided comments on Hong Kong's Financial Competency Framework and Hong Kong's Strategy for Financial Literacy. The list of the IFPHK's responses to the various consultation papers can be found on our website (<http://www.ifphk.org/ee/importance-of-advocacy>). The list of the previous Consultation Paper submissions on consumer protection are as follows:

| Consultation Issue | Recipient | Submission Period |
|---|--|--------------------------|
| Consultation Paper on the Proposals to Enhance the Financial Dispute Resolution Scheme by the Financial Dispute Resolution Centre | Financial Dispute Resolution Centre | December 2016 |
| Joint Consultation Paper on Proposed Enhancements to The Stock Exchange of Hong Kong Limited's Decision-making and Governance Structure for Listing Regulations Issued by the Securities and Futures Commission and the Stock Exchange of Hong Kong Limited | Securities and Futures Commission | September 2016 |
| Consultation Document on Retirement Protection | Commission on Poverty | June 2016 |
| Consultation Document on Hong Kong Strategy for Financial Literacy | Investor Education Centre | October 2015 |
| Consultation Document on Hong Kong's Financial Competency Framework | Investor Education Centre | September 2015 |
| Further Consultation on the Client Agreement Requirements | Securities and Futures Commission | December 2014 |
| Consultation Document on Enhancements to the Deposit Protection Scheme | Financial Services and the Treasury Bureau & Hong Kong Monetary Authority | December 2014 |
| Consultation Document on Providing Better Investment Solutions for MPF Members | Financial Services and the Treasury Bureau & Mandatory Provident Fund Scheme Authority | September 2014 |
| Consultation Document on an Effective Resolution Regime for Financial Institutions in Hong Kong | Financial Services and the Treasury Bureau | April 2014 |
| Consultation Paper on the Proposed Amendments to the Professional Investor Regime and the Client Agreement Requirements | Securities and Futures Commission | August 2013 |
| Financial Services and the Treasury Bureau Consultation Paper on Key | Financial Services and the Treasury Bureau | January 2013 |

| Consultation Issue | Recipient | Submission Period |
|---|---|--------------------------|
| Legislative Proposals on Establishment of an Independent Insurance Authority ("IIA") | | |
| Mandatory Provident Fund Authority's Consultation on Guidelines on Conduct Requirements for Registered Intermediaries | Mandatory Provident Fund Authority | July 2012 |
| Mandatory Provident Fund Authority's Consultation Document on Withdrawal of MPF Benefits | Mandatory Provident Fund Authority | March 2012 |
| Securities and Futures (Amendment) Bill 2011 - Establishment of an Investor Education Council | Bills Committee on Securities and Futures | October 2011 |
| Proposed Establishment of a Policyholder's Protection Fund | Financial Services and Treasury Bureau | June 2011 |
| Evidential Requirements under the Securities and Futures (Professional Investor) Rule | Securities and Futures Commission | November 2010 |
| Proposed Establishment of an Independent Insurance Authority | Financial Services and Treasury Bureau | September 2010 |
| Proposed Establishment of an Investor Education Council and a Financial Dispute Resolution Centre | Financial Services and Treasury Bureau | May 2010 |
| Proposal to Enhance Protection of the Investing Public | Securities and Futures Commission | December 2009 |

To continue serving the financial planning community, the IFPHK is interested in expressing its views on the proposed changes as stipulated in the Consultation Paper on the Proposed Amendments to point-of-sales transparency.

IFPHK's representation

The IFPHK was founded by 30 members (the 'Founding Members') in order to raise the standards of financial planners and highlight the importance of sound financial planning.

The IFPHK currently has 47 Corporate Members including banks, independent financial advisors, insurance companies, and securities brokerages. With our Corporate Members providing a full spectrum of the client services and products, the IFPHK is well positioned to understand the needs, concerns and aspirations of the financial planning community.

Executive Summary

On 23 November 2016, the Securities and Futures Commission (SFC) launched a three-month consultation on proposals to enhance the regulation of the asset management industry in Hong Kong to better protect investors' interests and ensure market integrity. The SFC formulated the proposals following a review of the major international regulatory developments, and taking into account observations and views of industry stakeholders. The proposed changes will be made to the SFC's Fund Manager Code of Conduct (FMCC) and the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (Code of Conduct). The proposed changes to the Code of Conduct aim to address the potential conflicts of interest in the sale of investment products and enhance disclosure at the point-of-sale by:

- (i) restricting an intermediary from representing itself as "independent" or using any term(s) with a similar inference if the intermediary receives commission or other monetary or non-monetary benefits or it has links or other legal or economic relationships with product issuers which are likely to impair its independence; and
- (ii) requiring an intermediary to disclose the range and maximum dollar amount of any monetary benefits received or receivable that are not quantifiable prior to or at the point of sale.

This submission will only respond to the proposals of enhancing point-of-sales transparency. Also, our submission is based on the following principles:

Advocating the six-steps financial planning process

It is the IFPHK's mission to promote the importance of financial planning. The financial planning process consists of six steps that help clients take a holistic approach to assessing their financial situation.

Aligning with international best practice

As an international financial centre, Hong Kong is not immune from international financial market and regulatory development. After the collapse of Lehman Brothers, regulators in major jurisdictions have imposed various consumer protection measures aimed at minimizing conflicts of interest and improving the quality of advice. The compensation structure to advisers is also under global scrutiny. Some regulators are trying to bring down the commission or even ban it to ensure that advisers do not have a vested interest in pushing products. To enhance Hong Kong's position as a major international asset management centre, it is important to ensure that regulations are properly benchmarked to evolving international standards.

Enhancing consumer protection

The IFPHK has always believed that qualified intermediaries and well-informed and educated consumers, together with a robust framework for regulating sales processes, should form the core pillars for protecting the investing public. The IFPHK supports a regulatory system which would facilitate delivering better financial products and services to the benefit of members of the public, as well as protecting them.

Promoting responsible investing attitudes of consumers through financial education

As aforementioned, well-informed and educated consumers are the core elements in a healthy regulatory system. For a market to perform effectively and consumers to be protected properly, a

fundamental understanding of how financial products work is essential. It is the IFPHK's view that improved financial literacy levels will not only allow consumers to make more informed investment decisions, but also result in a greater consumer appreciation of planning for a long-term financial future – a concept the IFPHK continuously promulgates.

Based on the above principles, the IFPHK supports the proposals stipulated in the Consultation Paper which include restricting the use of terms suggesting “independence” and enhancing the disclosure requirements on monetary benefits.

Whilst there are potential ethical problems resulting from commission-related conflicts of interest, a fee-based model is not totally immune from similar conflicts of interest. Banning commission is not the only way to improve consumer trust. It is our opinion that compensation should not influence products chosen, and should not influence advice given. We consider that a financial planner should manage his or her personal biases and avoid or manage and mitigate unavoidable conflicts, so that they do not adversely affect his or her services or recommendations to clients.

Notwithstanding the above, we still have faith in a fee-based model. We believe that the advisory industry has two evolving trends: fee-based and tech-obsessed. The advisory services that clients in Hong Kong receive nowadays are often focused on products. It is the mission of the IFPHK to promote public awareness of the financial planning industry. We believe consumers are getting smarter, and the IFPHK envisages that customers will pay for financial planning services at a fee and financial service providers will need to keep pace with what consumers really need and want. As such, we hope policy changes will lead to a paradigm shift of market practices and the development of more alternative distribution channels.

The IFPHK recognizes that there are people who like the comfort of knowing that there is a big brand sitting behind their financial planners. However, we agree that any pertinent information should be fully disclosed to clients. Aligned with FPSB standards, we believe that the cost for financial planning advice should be separately and clearly identified from other services provided by the financial planner and disclosed as an amount rather than a percentage, unless the total costs are unknown at the time of disclosure.

Despite our general consent to the proposed changes, the IFPHK is uncertain the proposals would lead to a paradigm shift of market practices (from product-centric to needs-based advisory) and the development of more alternative distribution channels.

The SFC Consultation

On 23 November 2016, the Securities and Futures Commission (SFC) launched a three-month consultation on proposals to enhance the regulation of the asset management industry in Hong Kong to better protect investors' interests and ensure market integrity. The consultation period ended on 22 February 2017.

The SFC formulated the proposals following a review of the major international regulatory developments, and taking into account the observations and views of industry stakeholders. The proposed changes will be made to the SFC's Fund Manager Code of Conduct (FMCC) and the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (Code of Conduct).

The key areas of enhancement under the FMCC are in respect of securities lending and repurchase agreements, custody of fund assets, liquidity risk management, and disclosure of leverage by fund managers. The proposed changes to the Code of Conduct aim to address the potential conflicts of interest in the sale of investment products and enhance disclosure at the point-of-sale by:

- (i) restricting an intermediary from representing itself as "independent" or using any term(s) with a similar inference if the intermediary receives commission or other monetary or non-monetary benefits or it has links or other legal or economic relationships with product issuers which are likely to impair its independence; and
- (ii) requiring an intermediary to disclose the range and maximum dollar amount of any monetary benefits received or receivable that are not quantifiable prior to or at the point of sale.

The Consultation Paper contains three parts with 21 questions relating to the aforementioned proposals. Since the IFPHK is a professional body aimed at promoting the financial planning industry, this submission is mainly focused on the 5 questions in Part II of the Consultation Paper.

Part II Intermediaries' conduct

17. What is your view on a pay-for-advice model for Hong Kong? Do you have any comments on our suggested approach to addressing the inherent conflicts of interest arising from receipt of commissions by intermediaries from other parties including product issuers?

18. Do you have any comments on the proposed disclosure requirement in relation to independence set out above?

19. Do you have any comments on the enhanced disclosure proposed with regard to monetary benefits received or receivable by intermediaries that are not quantifiable prior to or at the point of entering into a transaction (and in particular, in relation to specific types of investment products)?

20. Do you have any comments on the suggested manner of disclosure of trailer fees (in the context of funds) set out in the sample disclosure above? Do you have any other

suggestions to ensure the disclosure of non-quantifiable monetary benefits relating to other types of investment products will be clear, fair, meaningful and easily understood by investors?

21. Do you think a 6-month transition period following gazettal of the final form of the amendments to the Code of Conduct is appropriate? If not, what do you think would be an appropriate transition period and please set out your reasons.

IFPHK's Submission

The submission below is the result of the IFPHK seeking views from its Members in addition to its own independent internal analysis. The IFPHK considers the practical implication of the proposed changes on the business of those financial planners who consider advising and providing professional services to investors as its top-most priority. As such, the IFPHK is only providing comments on Questions 17 to 21.

In considering the various proposals of the Consultation Paper, the IFPHK's comments are based upon the following principles and beliefs:

Advocating the six-steps financial planning process

It is the IFPHK's mission to promote the importance of financial planning. For the IFPHK and other affiliates of the Financial Planning Standard Board ("FPSB"), the financial planning process consists of six steps that help clients take a holistic approach to assessing their financial situation. The process involves gathering relevant financial information, setting life goals, examining a client's current financial status and coming up with a strategy or plan for how clients can meet their goals given their current situation and future plans. The definition of financial planning to the IFPHK and other FPSB-affiliate members is as follows:

"a process of developing strategies to help people manage their financial affairs to meet life goals. In creating their recommendations and plans, financial planners may review all relevant aspects of a client's situation across a breadth of financial planning activities, including inter-relationships among often conflicting activities."

Aligning with international best practice

Globalization and financial market integration have increased rapidly in the past decade. As an international financial centre, Hong Kong is not immune from international financial market and regulatory development. This has been illustrated by the financial crisis, where problems originating in one country quickly spread across the globe. Because of the global contagion witnessed during that time, there have been greater calls for better coordination between regulators from different jurisdictions and for an increase in the convergence of financial regulation. As Ashley Alder, CEO of the Securities and Futures Commission ("SFC"), said in the 3rd Pan-Asian Regulatory Summit: "Because Hong Kong is a host city to international investors and companies, things that happen outside our borders really matter and that's why we have to be involved to shape the agenda."²

After the collapse of Lehman Brothers, regulators in major jurisdictions have imposed various consumer protection measures aimed at minimizing conflicts of interest and improving the quality of advice. These measures include but are not limited to imposing fiduciary duty on advisers, enhancing disclosure requirements and raising minimum qualifications. The compensation structure to advisers is also under global scrutiny. Certain types of compensation, especially commissions, are under attack because there is a growing belief that they misalign the interests of advisers and consumers³. Some regulators are trying to bring down the commission or even

² The 3rd Pan-Asian Regulatory Summit was hosted by Thomson Reuters Accelus on 27 & 28 November 2012.

³ Towers Watson, "Commissions – the beginning of the end? New approaches to compensation, 2011/3"

ban it to ensure that advisers do not have a vested interest in pushing products. Countries including the United Kingdom, Australia, India, Norway, Finland, Denmark and the Netherlands have banned commissions from being paid to advisers. We have done a summary of measures taken by different countries in one of our publications (please refer to Annex A). Notwithstanding the differences regarding the changes, all regulators, in their review of the remuneration structure, emphasized the importance of investment advisers to act in the best interest of the client and avoid possible conflicts of interest.

"A robust and responsive regulatory regime is fundamental to the development and growth of an international asset management centre. This Consultation Paper is part of the SFC's broader initiative to enhance Hong Kong's position as a major international asset management centre, it is important to ensure that our regulations are properly benchmarked to evolving international standards," said Mr Ashley Alder, the SFC's Chief Executive Officer.

Enhancing consumer protection

The IFPHK has always believed that qualified intermediaries and well-informed and educated consumers, together with a robust framework for regulating sales processes, should form the core pillars for protecting the investing public. As financial products get more complex and sophisticated, it is of utmost importance that investors/consumers are provided with proper and adequate protection under a sound and effective regulatory system. The IFPHK supports a regulatory system which would facilitate delivering better financial products and services to the benefit of members of the public, as well as protecting them. Hence, the effectiveness of consumer protection and a healthy balance of robust regulations and market development are the IFPHK's areas of focus.

The IFPHK also believes that financial practitioners have a duty to protect consumers. Financial institutions that embrace transparency, redress and financial education promote financial inclusion and expand the market. Financial institutions that understand the potential of financial inclusion recognize that in the long term it is in their best interest to foster fair and equitable business practices as part of good governance and brand building which in turn will promote good returns for the institutions and consumers⁴.

Promoting responsible investing attitudes of consumers through financial education

As aforementioned, well-informed and educated consumers are the core elements in a healthy regulatory system. For a market to perform effectively and consumers to be protected properly, a fundamental understanding of how financial products work is essential.

In May 2010, the IFPHK submitted a response to the Government's public consultation on the proposed establishment of an Investor Education Council ("IEC"). It is the IFPHK's view that improved financial literacy levels will not only allow consumers to make more informed investment decisions, but also result in a greater consumer appreciation of planning for a long-term financial future – a concept the IFPHK continuously promulgates. Financial education is also an important channel to promote responsible investing attitudes.

Last year, global research firm GfK conducted a consumer survey jointly with FPSB. Of the 1,005 consumers surveyed in Hong Kong who were all broadly interested in financial planning, only a

⁴ Alliance for Financial Inclusion, Policy Note Consumer Protection Leveling the playing field in financial inclusion, 2010

fifth were confident that they will reach their financial life goals. Also, once again, only 20% felt that they are knowledgeable about financial matters. Consumers working with a financial professional generally feel better prepared, and this pattern is even more pronounced among those working with a CFP professional.⁵

Questions raised in the Consultation Paper

Part II Intermediaries' conduct

Question 17:

What is your view on a pay-for-advice model for Hong Kong? Do you have any comments on our suggested approach to addressing the inherent conflicts of interest arising from receipt of commission by intermediaries from other parties including product issuers?

After the global financial crisis, there have been a number of regulatory developments aimed at addressing conflicts of interest and the enhancement of transparency. There are a number of examples which ban commissions and adopt a “pay-for-advice” model instead. Under the Retail Distribution Review (RDR) in the UK, financial advisers are no longer permitted to earn commissions from fund companies in return for selling or recommending their investment products. Australia has also banned commissions. The Canadian Securities Administrators are considering consulting on discontinuing embedded commissions and transitioning to direct-pay arrangements. The SFC is aware of the global regulatory developments. When considering its own regulatory approach, the SFC is mindful of the characteristics of Hong Kong’s investment and investor behavior. The Consultation Paper cited part of the FPSB survey that “the adoption of a pay-for-advice model with a complete ban on the receipt of commissions by intermediaries may not seem appropriate for Hong Kong”. Hence, the SFC has decided to take a more balanced approach and has no intention of banning commissions in this proposal.

IFPHK’s Response

As mentioned earlier, after the collapse of Lehman Brothers, regulators in major jurisdictions have imposed various consumer protection measures aimed at minimizing conflicts of interest and improving the quality of advice. These measures include but are not limited to imposing fiduciary duty on advisers, enhancing disclosure requirements and raising minimum qualifications.

The compensation structure to advisers is also under global scrutiny. Certain types of compensation, especially commissions, are under attack because there is a growing belief that they misalign the interests of advisers and consumers⁶. Some regulators are trying to bring down the commission or even ban it to ensure that advisers do not have a vested interest in pushing products. Countries including the United Kingdom, Australia, India, Norway, Finland, Denmark and the Netherlands have banned commissions from being paid to advisers. The banning of commissions has been a great hit to the financial advisers and planners communities in these countries. Some are terrified of the possible loss of their main stream of income.⁷ (Please see Annex A for the regulatory changes of selected countries.)

⁵ The Value of Financial Planning and Awareness of CFP Certification: A Global Financial Planning Survey, Hong Kong Results, FPSB & GfK

⁶ Towers Watson, “Commissions – the beginning of the end? New approaches to compensation, 2011/3”

⁷ The Guardian, FSA ban on commission-based selling sparks “death of salesman” fears, 30 December 2012

Regulators have adopted different approaches towards remuneration structures. Some countries have adopted a more stringent approach while others have decided not to ban their advisors from receiving commissions. Sweden's Minister for Financial Markets and Consumer Affairs and Deputy Minister for Finance, Per Bolund, has confirmed that the Swedish government will be proposing legislation in response to EU directives, such as MiFid II and IDD (Insurance Distribution Directive), which will not ban the commission-led sales of financial advice and products. The proposal has been welcomed by the Swedish Investment Fund Association, which says that it means competitiveness on a level playing field will be maintained and that fund investors will continue to have access to a broad range of funds from different manufacturers as well as advice.⁸

The issues arising from banning commission and other remuneration models have been hotly debated in the FPSB Council meeting. Most of the members consider that whilst there are potential ethical problems resulting from commission-related conflicts of interest, a fee-based model is not totally immune from similar conflicts of interest. Banning commissions is not the only way to improve consumer trust. According to a poll by Financial Planet, 42% of financial professionals think increased transparency or disclosure would most improve consumer trust. Leaders of FPSB affiliates all agreed that compensation should influence neither the products chosen nor the advice given.

In light of the above, leaders in the FPSB Council meeting adopted the following positions with regard to remuneration:

- A CFP professional's responsibility is to put the interests of the client first.
- The cost to the client of the services that are delivered should be mutually agreed between the client and the CFP professional, and should be fully disclosed, transparent and compliant with local regulatory requirements.

The above positions are concluded in the FPSB's white paper "*Financial Planner Remuneration*". The white paper also sets out the advantages and disadvantages of different remuneration models, which includes commissions (upfront and ongoing), financial assets under management (or percentage of net worth) and flat or hourly rate models. Commissions are the predominant form of payment in many jurisdictions; consumers are already familiar with how they work.

Last year, global research firm GfK conducted a consumer survey jointly with the FPSB. From the results, we noted that some individuals do not see the value, in terms of cost, of working with a financial adviser or financial planner. The IFPHK also recognizes that there are people who like the comfort of knowing that there is a big brand sitting behind their financial planners. In this sense, our position regarding remuneration models is neutral.

Notwithstanding with our neutral position, the IFPHK has faith in a fee-based model. We believe that the advisory industry has two evolving trends: fee-based and tech-obsessed.⁹

⁸ Jonathan Boyd, Swedish government proposes not to ban commission-led sales, Investment Europe, 24 May 2016,

⁹ Mitchell H. Caplan, Voices the future of advisers is fee-based and tech obsessed, 11 May 2016, According to Cerulli, AUM managed by RIAs and fee-based advisers will increase more than 60% from \$4.1 trillion in 2015 to \$6.6 trillion in 2019, and RIA and fee-based

At present, service providers in Hong Kong tend not to offer client-centric advisory services and independent financial plans to customers. The advisory services clients receive nowadays are often focusing on products. Consumers simply cannot easily obtain comprehensive financial planning advice, and the problem stems from the industry's product-based and sales-oriented culture, rather than emphasizing the fulfillment of clients' dream and life goals¹⁰. It is the mission of the IFPHK to promote public awareness of the financial planning industry. We believe consumers are getting smarter. The IFPHK envisages that customers will pay for financial planning services at a fee and financial service providers will need to keep pace with what consumers really need and want. As such, we hope policy changes will lead to a paradigm shift of market practices and the development of more alternative distribution channels.

Regarding the trend of technology in financial planning, the FPSB has published a white paper "Fintech and the Future of Financial Planning". As stated in the white paper, financial planners see Fintech as a tool to support the delivery of financial planning in the areas of data collection, speeding up client onboarding, data aggregation, checking calculations and allocating investments, delivery of documents, updates on real-time market changes, portfolio construction and asset allocation. Acknowledging that not all consumers are ready to work with a financial planner, many financial planners believe automated advice can be a good fit for those with less complex situations.

Ultimately, financial planners hope that Fintech and automated advice tools will get more people to access some type of financial advice, which will provide a stepping stone to working with a human adviser as personal situations gain complexity. "Technology, misused, can often lead to 'one-size-fits-all' solutions that ignore the human element and individual differences. The best planners will be the ones who can let computers do what computers are best at, and humans do what humans are best at".

In short, robo-advising in financial planning is an unavoidable global trend. To avoid being left behind the curve, the IFPHK urges the SFC to study the feasibility and challenges of robo-advising. Robo-advice can also be a low-cost alternative in a fee-for-service model. We have seen a lot of mergers and acquisitions in both the US and UK. A lot of active asset managers (considered as high-fee fund providers) have acquired the stakes of robo-advisory firms that have played an important role in their distribution model under the new regime of no commissions. Three prominent outcomes have been observed by the IFPHK. Firstly, a boom of ETPs (considered as low-fee and to-be-bought products) in many countries; secondly, a migration from commission to fee-based advisory models; and thirdly, more smart beta fund products (with an active return performance but charges as low as ETFs) have been launched in the OTC market as a low-cost alternative (particularly important if intermediaries are adopting fee-based advisory models). The IFPHK hopes that the SFC is aware of these trends and conducts studies to assess the feasibility to provide broader opportunities for robo-advising in Hong Kong.

adviser headcount will expand 59,000 to 67,000. As more advisers shift to the fee-based and fee-only model, an increasing number of manufacturers and distributors are developing and adopting no-load and fee-based products to fit the way they work.

¹⁰ "Key to Boosting Hong Kong's Financial Planning Industry, Advisors Today, Volume II 2016.

Question 18:

Do you have any comments on the proposed disclosure requirement in relation to independence set out above?

An alternative approach has been adopted in the European Union under Markets in Financial Instruments Directive II (MiFID II). If investment advice is provided on an independent basis, the investment firm is prohibited from accepting and retaining fees, commissions or any monetary or non-monetary benefits paid or provided by any third party. In Singapore, the term “independent” can only be used if a financial adviser does not receive any commission for products provided which may create product bias.

To address the conflicts of interest arising from intermediaries receiving benefits from other parties including product providers in the sale of investment products to clients, it is proposed that a two-pronged approach be taken:

1. Governing the conduct of intermediaries when they represent themselves as “independent” or as providing “independent advice”; and
2. Enhancing the disclosure of monetary benefits received or receivable that are not quantifiable prior to or at the point of entering into a transaction.

It is proposed to restrict representation by an intermediary as being “independent” of using any other term(s) with similar inference (e.g. “independent financial advisers”, “IFA”, “impartial”, “neutral”, “objective”, or “unbiased”) if monetary or non-monetary benefits from other parties including product issuers are received.

In terms of what constitutes “independence”, it is proposed that when distributing an investment product, a licensed or registered person would generally not be regarded as independent if he or she receives fees, commissions, or any monetary or non-monetary benefits paid or provided (whether directly or indirectly) by any party in relation to such distribution of the investment product to clients or if he or she has any links or other legal or economic relationships with product issuers which are likely to impair his or her independence in respect of favouring a particular investment product, a class of investment products or a product issuer.

IFPHK’s Response

The current proposal follows the practice of Singapore that an intermediary who claims itself “independent” cannot receive fees, commissions, or any monetary or non-monetary benefits paid or provided (whether directly or indirectly) by any party in the distribution of an investment product to clients. In November, the Association of Banks in Singapore laid down rules for private banks, requiring them to “provide clients with a fee schedule at account opening, which sets out fees, charges and other quantifiable benefits (including commissions, rebates and retrocessions) for all investment products and services”.¹¹

¹¹ Fund Selector Asia, “HK and Singapore in push for fee transparency”

Other jurisdictions which already have restricted the use of independent advice have also undergone some changes in the requirements. In September 2016, the Financial Conduct Authority proposed to extend the independent advice criteria set out in MiFID II to products that fall outside the EU directive's scope. The extension will cover products such as personal pensions and insurance-based investments. The proposal is intended to ensure consistent regulatory standards and a competitive and level playing field, and to prevent potential consumer confusion. It has been said that many respondents prefer the MiFID II standard. Many respondents view the Retail Distribution Review requirements for independent advisers to cover all products on the market as "impracticable", while MiFID II rules are "more realistic or closer to the common meaning of independent than the RDR standard".¹² The Australian Securities and Investments Commission has also addressed the proliferation of the term "independently owned" and has consulted the industry on regulatory changes to further restrict the term.

Based on the principle of protecting the investing public, the IFPHK supports the proposals of restricting the use of terms suggesting "independence". We consider that a financial planner should manage his or her personal biases and avoid or manage and mitigate unavoidable conflicts, so that they do not adversely affect his or her services or recommendations to clients. The IFPHK also recognizes that there are people who like the comfort of knowing that there is a big brand sitting behind their financial planners. However, any pertinent information should still be fully disclosed to clients.

Notwithstanding the above, the IFPHK is uncertain whether the proposals would lead to a paradigm shift of market practices (from product-centric to needs-based advisory) and the development of more alternative distribution channels.

Question 19:

Do you have any comments on the enhanced disclosure proposed with regard to monetary benefits received or receivable by intermediaries that are not quantifiable prior to or at the point of entering into a transaction (and in particular, in relation to specific types of investment products)?

There have also been and will be regulatory developments to enhance transparency. From January 2018, MiFID II will require improved disclosure of information relating to investment services, the cost of the financial instrument and how the client may pay for it, which also encompasses any third-party payments. In relation to third-party payments, they are also to be identified separately.

The US SEC Investor Advisory Committee has also reviewed various ways to improve mutual fund cost disclosures. One of its recommendations is to require standardized disclosure of actual dollar amount costs on customer account statements.

To enhance the disclosure requirement in relation to monetary benefits received or receivable that are not quantifiable prior to or at the point of entering into a transaction (for example, trailer fees) to enable investors to make a more informed decision, it is proposed that an intermediary be required to disclose:

¹² FT Adviser, FCA plans extension of MiFID II independent advice rules, 29 September 2016.

- (i) the range amount of such monetary benefits receivable on an annualized basis; and
- (ii) the maximum dollar amount of such monetary benefits receivable per year. (A sample disclosure about trailer fees is set out in the Consultation Paper.)

IFPHK's Response

The IFPHK generally agrees with the proposed changes as they are consistent with our principles. The IFPHK, as an affiliate member of the FPSB, aligns with the views of our Global leaders. As aforementioned, leaders in the FPSB Council meeting have adopted the following positions regarding the remuneration of financial planners:

- *A CFP professional's responsibility is to put the interests of the client first.*
- *The cost of the services should be mutually agreed between the client and the CFP professional, and should be fully disclosed, transparent and compliant with local regulatory requirements.*

As stated in the FPSB's white paper, non-salary compensation should be disclosed to the client in a manner that is clear, concise, understandable and comparable, and aligned to services that deliver value to the client. The cost for financial planning advice should be separately and clearly identified from the other services provided by the financial planner and disclosed as an amount rather than a percentage, unless the total costs are unknown at the time of disclosure. Regardless of the compensation model used, the financial planner should communicate to the client sufficient information about the likely consequences to the client as a result of using a particular charging model.

The US also tightened disclosure requirements in 2016. The Securities and Exchange Commission (SEC) has approved the recommendations of its Investor Advisory Committee in which it has asked asset management companies to disclose fees in dollar terms while issuing account statements to investors. All types of investment costs, including costs for advice and services as well as costs for investment products, affect the total monies accumulated by an investor in a long-term investment¹³.

While we understand that the disclosure of trailer fees is intended to enhance transparency and eventually lead to price competition and reduce costs, we consider it will be more beneficial to the consumer if the trailer fee is used to reward the service provided to consumers (e.g. financial consultancy) instead of rewarding the service provided to product providers (e.g. distribution). We understand that a total ban on trailer fees will cause resistance from the industry, especially from the distributors. However, we wish the regulators to consider measures that will lead to a paradigm shift in the market towards competition on the quality of advisory services.

¹³ Nishant Patnaik, After SEBI, US market regulator SEC asks AMCs to disclose fee in absolute terms, Cafemutual, 27 May 2016

Question 20:

Do you have any comments on the suggested manner of disclosure of trailer fees (in the context of funds) set out in the sample disclosure above? Do you have any other suggestions to ensure the disclosure of non-quantifiable monetary benefits relating to other types of investment products will be clear, fair, meaningful and easily understood by investors?

It is proposed in the Consultation Paper that an intermediary is required to disclose (i) the range amount of such monetary benefits receivable on an annualized basis; and (ii) the maximum dollar amount of such monetary benefits receivable per year. A sample disclosure about trailer fees is set out in the Consultation Paper:

“We will receive from the fund manager as ongoing commission 40% - 60% of Fund A’s annual management fees.

This means that if you invest HK\$10,000 in Fund A, we will receive up to HK\$x out of the annual management fees every year throughout the term of your investment.*

**HK\$x is based on the assumption that you remain invested in Fund A for a 12-month period, and that there is no change in the net asset value per unit of Fund A such that the value of your HK\$10,000 investment remains unchanged throughout the period.”*

IFPHK’s Response

The IFPHK has no major comments on the suggested disclosure of trailer fees as an enhancement of point-of-sale transparency. As aforementioned, FPSB standard states that the cost for financial planning advice should be separately and clearly identified from the other services provided by the financial planner and disclosed as an amount rather than a percentage, unless the total costs are unknown at the time of disclosure. In light of consumer protection, the IFPHK thinks it will be useful to disclose in the statement the actual trailer fees received in dollar amounts on annual as well as on accumulated basis.

Also, any fee structure should be clearly explained to consumers. The global survey by the FPSB shows that more than four in ten consumers do not understand financial planning fee structures. While we believe marketing campaigns should be conducted in conjunction with the Investor Education Centre to ensure that consumers are fully aware of their right to obtain information, we consider that the financial planner should also ensure that the client fully understands the nature and scope of the financial planner’s services.

Question 21:

Do you think a 6-month transition period following gazettal of the final form of the amendments to the Code of Conduct is appropriate? If not, what do you think would be an appropriate transition period and please set out your reasons.

IFPHK's Response

We wish the SFC could provide more guidelines to the industry in the form of FAQs in order to ensure that practitioners fully understand the new requirements. The 6-month transition period is sufficient provided that the SFC answers specific questions of the industry via FAQs.

Annex A

The following information has been extracted from Advisors Today:

United Kingdom

The Retail Distribution Review (“RDR”) went into effect from January 2013 onwards. The RDR aims to identify long-running problems within the UK’s investment market that impact on the quality of advice given to consumers, as well as gauge the level of confidence and trust consumers have in financial planning professionals. The objectives of the RDR are to:

- Make consumers more confident about seeking advice from advisers and trusting that advice.
- Ensure that financial planning is properly recognized as a profession by setting a minimum set of standards.
- Encourage advisers to describe what they do in a way that customers can understand.
- Make sure commissions or other forms of remuneration do not influence an adviser’s decisions and the quality of the advice he or she may offer.¹⁴

From January 2013 onwards, the FSA has banned all financial advisers from receiving commissions from providers for selling their products. Under the new adviser-charging regime, all charges will have to be agreed in advance. Advisers and planners will only be permitted to charge fees. Also, advisers get to decide whether they are providing “independent” or “restricted” advice. These requirements will impact all financial advisers whether they are IFAs, wealth managers, private bankers or stockbrokers. Nevertheless, the requirements do not apply to protection-only life insurance, general insurance or mortgages, or to non-advised, direct or execution-only sales.

On 16 January 2014, the Financial Conduct Authority published “FG14/1 - Supervising retail investment advice: inducements and conflicts of interest”. The Guideline explains concerns of the Authority and why certain practices under service or distribution agreements are likely to create conflicts of interest and result in firms not acting in their customers’ best interests.

Australia

The Future of Financial Advice (“FoFA”) commenced on 1 July 2013. The FoFA is seen as the Australian answer to the RDR in the UK. The FoFA goes further by banning all conflicted remuneration and other payments. It applies to both personal and general advice given to retail clients about any financial product. The range of benefits that are banned include upfront and trailing product commissions, and volume-based benefits. The Australian Securities and Investment Commission (“ASIC”) has issued a guidance (Regulatory Guide 246) to help the industry understand the practical operation of the ban on conflicted remuneration and how the ASIC will administer it.

The Netherlands

The detailhandel beoordeling (retail assessment) came into force in the Netherlands in January 2014. It forbade commission payments to advisers.¹⁵ The ban goes further than the FoFA and RDR by banning commissions on all risk products.

¹⁴ Getting ready for the Retail Distribution Review (RDR), Speech by Linda Woodall, Head of Investments Department FSA at the FT Intermediary Forum, FSA

India

After having released two draft papers in 2011 and 2012, on 21 January 2013, the Securities and Exchange Board of India (“SEBI”) notified the final guidelines on investment adviser regulations which bring the requirements related to qualification, certification, capital adequacy, period of validity of certificate and other general obligations for investment advisors. The regulations went into effect from April 2013 onwards.

The SEBI requires investment advisors to act in a fiduciary capacity towards clients and avoid any conflicts of interest. Investment advisors will not receive any consideration by way of remuneration or any other form from any person other than the client being advised, in respect of the underlying products or securities for which advice is provided. The regulation also sets minimum net worth requirements for investment advisors and for firms. Financial service firms in India that provide services other than advice will be required to keep their financial advisory services segregated either through a separate division or a subsidiary.

Singapore

In 2012, Ravi Menon, Managing Director of the Monetary Authority of Singapore (MAS) surprised practitioners by announcing at an industry dinner that they would form a review panel to spearhead a new initiative called FAIR to strengthen investor protection. In January 2013, the authority finally announced the long-awaited FAIR Panel Report, which made 28 recommendations under 5 key thrusts. The recommendations include raising the competence of financial advisory representatives, raising the quality of financial advisory firms, making financial advising dedicated services, lowering distribution costs and promoting a culture of fair dealing.

The changes proposed by the FAIR panel are considered “pragmatic” by the industry. The MAS did not propose the controversial fee-based model because its survey showed that 80% of Singaporeans were not prepared to pay an upfront fee for advice. The panel was wary that a ban on commissions would lead to a reduction in the provision of financial advice when there is an acute need for consumers to obtain good professional advice. The regulator hopes that consumers will get better advice and thus have more adequate financial planning in place. Thus, a ban on commissions, like what the UK and Australia have done, has not been put in place in Singapore.

¹⁵ FTAdviser, “Dutch RDR has created adviser gap similar to UK”, 23 January 2014