

## The latest regulatory initiatives on selling of investment products Speech to Financial Planning Standards Board

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Good morning.

I would like to thank the Financial Planning Standards Board (FPSB) for inviting me here today. It's a pleasure to be addressing all of you.

As financial planners, I believe you would agree that one of the growth areas in the financial sector is financial planning and wealth management.

Regulators and standard setters for the securities industry are mostly concerned about whether retail investors have been provided with appropriate recommendations when selecting investment products. This, of course, links very closely to the standard of conduct of intermediaries and the manner in which they serve their clients.

I will start my presentation with an overview of the key issues and concerns in the financial planning and advisory arena. I will be talking briefly about what regulators in some major jurisdictions are doing to enhance intermediary selling practices. I will then move on to speak about the latest international regulatory developments. This is an increasingly important area as the direction of international standard setting will ultimately affect how business is done in all jurisdictions.

Last but not least, I will share my thoughts on how professional bodies may contribute towards developing a healthy and vibrant financial planning industry.

### **Key issues concerning the financial planning industry**

There is little doubt that financial planners play an increasingly important role in assisting investors to make appropriate investment decisions. The basic fact is that people in many jurisdictions are not only getting older but also richer and are very keen to invest to have a secure future. For instance, according to UN data<sup>1</sup> (let me quote some Korean statistics as we are now in Korea), in the year 2000 the number of people in Korea aged over 65 years was estimated to be 7.3% of the population but this may increase to 19.5% in the year 2025. This ageing population trend is certainly not confined to Korea but is a global trend. On the

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<sup>1</sup> UN Department of Economics and Social Affairs, World Population Prospects, 2008 Revision



personal wealth side, there were 3 million millionaires in Asia Pacific in 2009<sup>2</sup> compared to 2.4 million in 2008. These 3 million millionaires in Asia control a total wealth of US\$9.7 trillion.

So while we have more people who are keen to invest, products have also become more complex. Investors are finding it difficult to make investment decisions themselves. Therefore, the key question becomes “Have financial planners played their part in helping their customers make informed investment decisions?”

The following are some key areas that financial planners should pay close attention to:

- **Fiduciary Duty**

- Putting customer needs first*

- Professional financial planners owe their client a fiduciary duty in that he or she needs to put the needs of their clients first. In other words, they need to act in the best interests of their client. In many jurisdictions this is imposed on the intermediary by law or by regulators. I understand that FPSB, to their great credit, has already set out this important duty in their Code of Ethics.

- Dealing with conflicts of interest*

- The other important aspect of a fiduciary duty is in the area of avoiding conflicts of interest. Intermediaries are expected to deal with possible conflicts of interest by either avoiding or minimising potential conflicts. If the conflicts cannot be avoided then the intermediary should consider not to advise or deal in relation to the transaction unless it has disclosed that material interest or conflict to their customer and made sure that the customer is fairly treated.

- Equally, intermediaries should ensure that any recommendation or service they provide to their customers is not determined by the amount of financial incentives received.

- **Disclosure of information**

- As I mentioned earlier, investors need enough relevant information in order to make informed investment decisions. It is the financial planner’s responsibility to provide investors with sufficient relevant information. What do I mean by “relevant information”? Examples of this would be to provide investors with key information such as investment strategies being used and associated risks.

- For instance, the growing complexity of financial products and financial innovation make investment risks less apparent to investors. Financial planners should identify these risks and highlight them to their customers and not just pass the offering documents to their customers and ask them to read it for themselves.

- It is equally important for this information to be presented in a way that can be easily understood and acted upon by the investor.

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<sup>2</sup> Merrill Lynch/ Capgemini World Wealth Report 2010



Financial planners should also ensure that any representations made to investors are accurate and not misleading. Misrepresenting that investment products are low risk alternatives to deposits and failing to explain the risks and complexity of these products to the investor usually results in investor complaints and allegations of mis-selling.

- **Suitability Obligation**

Last but not least, financial planners have to carry out adequate customer and product due diligence in order to ensure that the products recommended are suitable to the investment profile of their customers.

## **What are other major jurisdictions doing?**

### *United Kingdom*

Treating Your Customers Fairly or TCF is a core principle of the UK Financial Services Authority (FSA) that intends to promote fair treatment of customers by regulated firms. The TCF initiative aims to deliver six improved outcomes for retail consumers.

The improved outcomes will mean that:

1. fair treatment of customers will be a key part of the corporate culture;
2. customers are sold retail products that have been designed to meet their needs and are targeted accordingly;
3. customers receive clear information and are kept suitably informed before, during and after the point of sale;
4. customers receive suitable advice which takes account of their circumstances;
5. customers receive the product performance they have been led to expect by firms they deal with;
6. customers do not face unreasonable post-sale barriers imposed by firms when they want to change product, switch provider, submit a claim or make a complaint.

UK regulated firms are expected to demonstrate, among others, that they are integrating TCF into their business culture, and they have appropriate measures in place to test whether they are treating their customers fairly.

The UK has also launched the Retail Distribution Review to address issues regarding the regulation of the retail investment market. One of the most significant consequences of the initiative once it becomes effective on 1 January 2013 is that *product providers will be banned from offering commission to investment advisers*. UK investors will be assured that no conflicts of interest will arise from their advisers being incentivised by commissions paid by the product providers.

Investment advisers will also be required to meet higher and consistent standards in the areas of qualifications, continuing professional development and ethics.



### *Australia*

In April, the Australian government announced plans to introduce a ban on “conflicted remuneration structures”. This means that financial advisers would be prohibited from receiving commission from product providers. They also plan to impose a statutory duty requiring financial advisers to act in the best interests of their clients.

### *Singapore*

The Monetary Authority of Singapore (MAS) has proposed measures on product disclosure, enhanced due diligence for new products and improved documentation of the advisory process.

The MAS has also proposed a customer knowledge assessment framework for unlisted investment products and a customer account review framework for listed products. This would require financial advisers to formally assess the retail customer’s investment knowledge or experience before selling them any products.

### *Hong Kong*

#### *Major new intermediary conduct measures*

In relation to intermediary selling practices, we amended the intermediary Code of Conduct to give effect to the following proposals:

1. Investor characterization  
An intermediary will need to assess a client’s knowledge of derivatives before promoting derivative products to the client. When a client without derivative knowledge wishes to purchase a derivative product, the intermediary should, among others, warn the client about the transaction and advise on the suitability of the derivative product.
2. Restrict offering of gifts  
Intermediaries are restricted from offering gifts to promote a specific investment product so that investors would not be distracted from the features and risks of the particular product. For example, supermarket cash vouchers and flat screen TV sets can no longer be offered to investors in Hong Kong when promoting a specific product.
3. Pre-sale disclosure of monetary and non-monetary benefits  
Intermediaries will also be required to disclose benefits they receive from product issuers for distributing investment products, which is in line with the practices in other markets.

### **Application of international regulatory standards**

In addition to individual countries’ initiatives on regulating the financial planning industry, international bodies are also developing international standards in this area.

At the top of the global regulatory framework is the G20 and under that is the Financial Stability Board (FSB) which co-ordinates at the international level the work of national financial authorities and international standard setting bodies to develop and promote the implementation of effective regulatory, supervisory and other financial sector policies.



The FSB works with the three recognised global standard-setting bodies to set the regulatory agenda for the financial sector. These three bodies are the Basel Committee for Banking Supervision, the International Organization of Securities Commissions (IOSCO) and the International Association of Insurance Supervisors (IAIS). These three global bodies set the relevant sector standards that national regulators will implement to ensure a coherent regulatory framework that is in sync with the international financial community.

## **IOSCO**

Before I go any further, let me briefly explain what IOSCO is. IOSCO is the global standard setter for securities regulation. IOSCO's objective is to improve the regulation of securities markets and a key part of IOSCO's work is to set standards for securities regulation through a set of evolving Principles for Securities Regulation. IOSCO's work covers areas such as securitization, hedge funds, credit rating agencies and over-the-counter derivatives.

At last count, IOSCO has 110 member countries and the relevant regulator in each member country is expected to apply the IOSCO Principles and see that they are implemented and adhered to by industry players.

As the Chair of IOSCO's Standing Committee 3 on the Regulation of Market Intermediaries (or SC3 for short) I am privileged to have the opportunity to be championing some key standard setting work. The SC3 comprises of members from 16 jurisdictions including the US, UK, EU countries, Brazil, Japan, Singapore, India, China and Hong Kong. Current projects and areas that we are looking into include suitability, insolvency, point-of-sale disclosure and liquidity and internal controls.

### **Current IOSCO projects**

For today, I will focus on two projects that are related to selling practices which SC3 has considered.

#### **Point-of-Sale Disclosure Project**

This project is already at an advanced stage and aims to introduce principles later this year regarding key information that customers ought to receive from intermediaries at the point of sale in order to support sound investment making.

Briefly, the principles state that intermediaries are expected to provide relevant information (e.g. benefits, risks, terms and costs) at or before the point of sale to investors. The information should be presented in a manner that is appropriate to the target investor and in a format that can be easily understood and enables comparisons to be made between competing products. The information should be accurate and updated regularly. Regulators themselves should know who has control over the information to be provided when developing disclosure rules for intermediaries.

The six principles being proposed require intermediaries to:

1. disclose to investors fundamental benefits, risks, terms and costs of the product and intermediary remuneration and conflicts;
2. provide such information to investors for free before the point of sale to help them make an informed decision about whether to invest;



3. deliver or make the information available in a manner that is appropriate for the target investor;
4. ensure that the disclosure is in plain language and in a simple, accessible and comparable format to facilitate a meaningful comparison with competing products;
5. ensure that the disclosure is clear, accurate and not misleading to the target investor and updated on a regular basis; and
6. the final principle is aimed at regulators who, when making rules on what key information disclosure to impose on intermediaries and product producers, should know who has control over the information to be provided.

### **Suitability Project**

Let's now talk a bit about the suitability project. Suitability has been at the forefront of the regulatory agenda because of the fallout from the mis-selling of structured products to retail investors. It is certainly a global concern and revolves around the fundamental question as to whether retail investors should be allowed to invest in complex products and how intermediaries can ensure suitability of investment products for their customers. In fact, this project falls under the request of the G20 to carry out a review of business conduct rules to protect markets and investors and promote financial market integrity.

The aim of this project is to focus on the suitability obligations applicable to intermediaries in the distribution of complex financial products to both retail and non-retail customers. We conducted a survey in 2009 to study how different jurisdictions regulate the assessment of suitability of complex products for retail and non-retail customers. We have completed the survey and the next step in this project would be to summarise the survey results, including the definitions of "non-retail customer" and how the application of customer protections including suitability requirements differ with respect to such non-retail customers as opposed to retail customers.

We would then try to identify particular areas where suitability standards need strengthening; and at the final stage we will consider developing principles on suitability and selling of complex products to retail and non-retail customers.

### **Regulatory partnership with professional industry bodies?**

While international standard setters like IOSCO are focused on developing principles, I believe professional industry bodies like FPSB can and do play an important role in raising standards in the financial planning sector. I find a striking similarity between the objectives of FPSB and IOSCO's activities. This conference is a very good example of your commitment to promoting worldwide professional standards.

In addition, I would say that professional bodies can also help by:

- establishing and enforcing industry standards of professional practice to ensure that the industry upholds the highest standards of conduct and integrity when providing services to investors. A key example is FPSB's Code of Ethics which mirror many of the most important standards set out by IOSCO and national regulatory frameworks;
- providing ongoing training and guidance to members to keep them abreast with the latest standards; and



- maintaining continuous dialogue with the regulator, and providing input during the consultation and formative process of international regulatory measures. Here, I would like to give special thanks to the Hong Kong member of FPSB - the Institute of Financial Planners of Hong Kong – for their time, assistance and constructive contributions during the recent consultation on enhancing protection for the investing public.

I also welcome FPSB's views on IOSCO projects such as the principles regarding suitability when we issue the IOSCO consultation in 2011. I wish you all a fruitful and enjoyable conference.

Thank you.