

Press release

LCQ19: Vetting and approval of investment products

Wednesday, January 19, 2011

Following is a question by the Hon Mrs Regina Ip and a written reply by the Secretary for Financial Services and the Treasury, Professor K C Chan, in the Legislative Council today (January 19):

Question:

I have learnt that since the Lehman Brothers went bankrupt in September 2008, the Securities and Futures Commission (SFC) has substantially tightened the vetting and approval of retail investment products. There have been criticisms that although SFC should enhance its protection for investors, it should not overdo things as to affect the normal market development of Hong Kong as an international financial centre. In this connection, will the Government inform this Council:

(a) whether it knows the average number of applications received annually by SFC before September 2008 for launching investment products, the number approved among such applications and the average time for vetting and approving an application, with a breakdown by product type (including but not limited to unit trust, mutual fund, investment-linked assurance schemes and unlisted structured investment products);

(b) whether it knows the total number of applications received by SFC to date since September 2008 for launching investment products, the number approved among such applications and the average time for vetting and approving an application, with a breakdown by product type (including but not limited to unit trust, mutual fund, investment-linked assurance schemes and unlisted structured investment products);

(c) whether it has studied, when a comparison between the figures in (a) and (b) reveals that after September 2008, there has been a significant reduction in the proportion of applications approved by SFC for launching investment products and/or a substantial increase in the average time for vetting and approval:

- (i) the reasons for this;
- (ii) how long this situation or trend will last; and
- (iii) whether prolonged continuation of such situation or trend will have any adverse impact on Hong Kong as an international financial centre; and
- (d) given that I have received complaints from front-line bank staff that:
 - (i) for various investment products, inadequate disclosure of information (e.g. management fees, trustee fees and custodian fees, etc. not being stated in prominent positions in offer documentation and marketing materials) may confuse investors, and SFC decided in May 2010 to introduce product key facts statements to address the problem, whether it knows if this measure has been fully implemented; if so, the market response and effectiveness of the measure; if not, when SFC plans to implement the measure fully; and
 - (ii) the Hong Kong Monetary Authority or SFC has imposed restriction on front-line bank staff or intermediaries providing some materials, from issuers/distributors of investment products, which are potentially useful reference for investors (e.g. previous dividend records and annual interest rates of bond funds), of the reasons for imposing the restriction, and whether there is plan to review the existing measure?

Reply:

President,

Replies to the sub-questions are as follows:

- (a) and (b) The Securities and Futures Commission (SFC) has provided the number of new applications for authorisation of investment products it received and approved respectively from 2007 to 2010, as set out at Annex.

As regards the actual time taken from application to authorisation of an investment product, it depends on the level of compliance, the quality of the submission, the response time of the applicant and often the response of overseas regulators, which is outside the control of even the issuers themselves. For example, for a new sub-fund that sought to be authorised under an SFC-authorized structure in 2010, the processing time was five weeks. However, a new fund application in the same year from a new management company which involved checking with the overseas regulator had taken as long as approximately ten months. The above has not taken into account situations where the whole process is lengthened due to applicants' initiatives in changing product features and documentation, which is very prevalent. It may therefore not be very meaningful to calculate the average time for vetting and approving an application.

(c) SFC continues to process authorisation applications for unit trusts and mutual funds (Funds), investment-linked assurance schemes (ILAS) and unlisted structured investment products (SIP) despite the onset of the financial crisis. Nonetheless, there was a downward trend in the number of applications submitted to SFC after the collapse of Lehman Brothers.

It is product issuers' commercial decision as to whether they would submit new applications or would prefer to shelf their applications. Their decisions would understandably be driven by a number of factors including the prevailing market sentiments and investor interest. For instance, there was a general lack of market demand after the collapse of Lehman Brothers. Also, some product issuers took time to review and bring up to date their product disclosure in light of the latest circumstances and concerns in the market.

In order to enhance investor protection, SFC, after having consulted the market, published on June 25, 2010, a new consolidated products handbook comprising revised codes on Funds and ILAS as well as a new code on SIP (Handbook). The Handbook has enhanced transparency and disclosure requirements, raised qualification requirements for collateral, as well as updated the regulatory framework for retail funds and ILAS. As of December 31, 2010, 14 applications had been authorised under the revised or new product codes in the Handbook.

While the industry has been working through these new requirements, SFC has since June 2010 organised 11 workshops and seminars (attended by a total of 650 persons) to explain the revised/new product codes and to give practical guidance on the implementation of the requirements therein, and has published up to date application forms, checklists, templates and Frequently Asked Questions for industry participants to facilitate their compliance with the relevant codes and guidelines.

We trust that SFC will continue to adopt appropriate initiatives and work closely with the industry with a view to assisting their compliance with the new requirements.

(d) (i) The Handbook, which requires issuers of publicly offered Funds, ILAS and SIP to prepare a product key facts statement (KFS), was gazetted and became effective on June 25, 2010. All new applications in respect of Funds, ILAS and SIP submitted after June 25, 2010, are required to have KFS, and this requirement will be extended to all existing Funds, ILAS and SIP that are being marketed to the public upon expiry of the transitional period on June 25, 2011. Since KFS is yet to be fully implemented, it is premature to comment on its effectiveness at this stage.

SFC has maintained a close dialogue with the industry regarding the implementation of KFS on the one hand, and conducted comprehensive investor education on KFS, on the other hand, to help investors know how to read a KFS. SFC has developed, with industry involvement, KFS templates as reference/guides for commonly available publicly offered investment products. Recently, SFC held briefing sessions for the industry to provide guidance about the preparation of KFS. These briefing sessions were well attended by industry participants, industry bodies' representatives and their legal advisers (total attendance of more than 240).

(ii) SFC and the Hong Kong Monetary Authority advised that neither of them had imposed any specific restrictions on the type of information that an intermediary can provide to its clients. Indeed, SFC's Frequently Asked Questions on "Suitability Obligations of Investment Advisers" have stipulated that investment advisors should help each client make informed decision by, among others, providing each client with recommended investment products' prospectuses or offering circulars and other documents relevant to the investments.

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