

## **Hong Kong Forum—Executive Summary**

Wednesday, 27 February, 2012

### **Host**

**Lee Kha Loon**, CFA Head, Standards and Financial Market Integrity Division - Asia Pacific

### **Keynote Speakers:**

**Paul Smith**, CFA, Managing Director, Asia Pacific, CFA Institute

**Anthony Neoh**, Former Chief Adviser to the China Securities Regulatory Commission, Beijing

**Sou Chiam**, LI.M., CEO, Financial Dispute Resolution Centre Ltd, Hong Kong

### **Panel Moderator:**

**Stuart Leckie**, Chairman, Stirling Finance, Hong Kong, and Founding Chairman,  
Hong Kong Retirement Schemes Association

### **Panelists:**

**Reuben Guttman**, Director, Grant & Eisenhofer P.A., Washington

**Alexander Reus**, J.D., LL.M., Founding Partner, DRRT, Frankfurt

**Tan Kin Lian**, Founder and Director, Tan Kin Lian & Associates and former CEO, NTUC Income, Singapore

## **Lee Kha Loon Introduction**

**Mr. Lee Kha Loon** set the stage for discussion with some sobering statistics. In Singapore, ten thousand investors lost \$400 million investing in mini-bonds during the recent financial crisis. In Hong Kong, 40,000 investors lost \$3.7 billion while an estimated 29,600 investors lost \$3.1 billion in those bonds. These losses have led to a flurry of reforms, with India banning front end fees, Singapore requiring testing of financial advisors to sell sophisticated products, and Hong Kong passing new disclosure requirements and cooling off periods. He noted that the CFA/IIEF Forum will explore the impact of these reforms on investors and their advisors, available mechanisms for dispute resolution and redress, and perhaps the most critical question of all: how to rebuild investor trust.

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## **Paul Smith Keynote**

**Mr. Paul Smith** presented an overview of the [\*Global Markets Sentiments Survey\*](#), an annual survey of the CFA membership worldwide. The 2012 survey revealed what members believe went gone wrong in the financial services world – and what can be done to put things right. The sovereign debt crisis is seen as the biggest risk, with ethical culture among financial firms among the biggest concerns. Mis-selling by financial advisors is the leading issue among CFA members in Australia, Singapore and Hong Kong, while in China and India, market fraud is the leading issue of concern. With some geographical variation, CFA members want to see better enforcement of regulations, improvements in corporate governance and regulatory change. He noted that enforcement in Hong Kong has increased 17%, year over year, with Australia and Japan also enjoying rigorous enforcement.

## **Hong Kong Forum—Executive Summary Continued**

### **Anthony Neoh Keynote**

*In his keynote address, “Emerging trends in Investor Protection after the Global Financial Crisis,” Mr. Anthony Neoh touched on an extensive range of issues, and he strongly encouraged participants to reference the source materials posted on the [IIEF website](#). This summary gives a brief, high-level overview of his presentation.*

Mr. Neoh noted that three key developments are driving change: 1) the ascent of financial regulation to the top of the political agenda; 2) a growing convergence of financial regulatory concepts and 3) a convergence of accounting/financial reporting concepts with regulatory concepts.

The United States has aggressively pursued regulatory change on multiple fronts since the crisis, with the Dodd-Frank Act, the expansion of the Presidential Financial Services Oversight Council, increasing regulation by the Fed, the Volcker Rule, the creation of the Federal Insurance Office, the creation of the Liquidation Authority and Liquidation Fund, bringing OTC derivatives into central clearing.

One of the most notable U.S. developments is the creation of the Consumer Financial Services Protection Bureau. The Bureau is designed to act on many fronts to regulate credit rating agencies, strengthen corporate governance, increase transparency and strengthen international cooperation.

In the U.K., the Financial Services Act 2012 established the Financial Policy Committee under the Bank of England, the Prudential Regulation Authority and the Financial Conduct Authority.

Internationally, Mr. Neoh sees a universal template for reform emerging, a template that involves systematic coordination, deeper prudential regulation and stricter business and market conduct regulation. He expects that financial institutions will be required to put in a lot more real capital, as well as strong internal controls, corporate governance and disclosures. Every nation is concerned with identifying systemically important financial institutions that could bring everybody down.

Noting Basel III, Solvency II and the MidFid Review, Mr. Neoh sees the international agenda focusing on creating stable financial systems and institutions, efficient and transparent markets and effective consumer protection. He described a three-pillar approach that addresses capital adequacy, good internal controls and good disclosures.

### *More regulatory requirements for asset managers and advisors*

Mr. Neoh predicted that the impact of increased regulation on asset management and investment advice is likely to include more reporting requirements, product regulation, tighter asset allocation, greater transparency requirements, clearer definition of duties and more stringent requirements for risk assessment and disclosure.

### Hong Kong Forum—Executive Summary Continued

#### Anthony Neoh Keynote—Continued

##### *Many countries are moving toward a “Twin Peaks” model*

The Twin Peaks model relies on two types of regulators: a prudential regulator and a conduct of business (consumer protection) regulator. “The reason for this shift is very simple,” Mr. Neoh declared. A lot of financial instruments being sold to the public are falling through the cracks. Trust companies, insurance companies, wealth management firms and banks, are selling instruments that are not regulated; there are no across the board set of rules.”

Mr. Neoh declared that the regulation of credit rating agencies has come in with a vengeance, with the question of what constitutes financial “advice” being questioned in the Hong Kong courts.

He noted that common law, with its basic concept of “caveat emptor,” isn’t working well today. Particularly in the U.S., U.K. and India, statutory law is being used to fashion some kind of relief. With regard to product regulation, Mr. Neoh believes that there should at least be some consumer testing to see if people understand the products being sold.

*The question of whether fiduciary standards should be imposed on broker dealers is an issue being addressed in the U.S.*

FINRA rules in the U.S. and ESMA in Europe are dealing with the issues of suitability and “know your client” requirements, which are now being treated as separate issues, largely in response to the serious problem of money laundering. Mr. Neoh believes that most of the issues in mis-selling have been dealt with effectively by the regulators. In the aftermath of the mini-bond crisis, they’ve forced the institutions to make reparations or lose their licenses. And with Hong Kong’s recently published class action report (now under review) the hope is that class actions dealing with mini-bond mis-selling will become an option for investors.

#### Sou Chiam Keynote

In her short keynote address, **Ms. Sou Chiam** explained the purpose and activities of the nonprofit FDRC (Financial Dispute Resolution Center) which opened in Hong Kong in June 2012. Independent and impartial, the FDRC offers a free hotline, free info sessions, free face-to-face appointments with investors, and low cost mediation and arbitration services. With over 1000 calls in its first nine months, the need and market demand is obvious.

FDRC’s activities have been greatly limited by a \$500K loss cap and a one year, after-loss limitation. Only 16 of the 1000 calls met those requirements, and she hopes that the eligibility rules will soon be broadened. She noted that in Taiwan, where there is no limitation period and they accept insurance cases, they have provided dispute resolution in thousands of cases.

## Hong Kong Forum—Panel Discussion

### Panel Moderator:

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### Panelists:

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Alexander Reus, J.D., LL.M., Founding Partner, DRRT, Frankfurt

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**Mr. Stuart Leckie** launched the panel discussion by stating that many people in Hong Kong want it both ways: “Heads I win; tails I don’t lose.” He believes that investors should have the right to information about the products they’re buying, but no right to not lose money. He worries about the moral hazard of providing too much government compensation for investor losses.

### *“Caveat Emptor” - let the buyer beware*

A lot of discussion revolved around the concept of “caveat emptor:” let the buyer beware. In his keynote address, Mr. Neoh talked about the investor’s obligation to “look in the horse’s mouth,” but investors are relying on a piece of paper that says the horse’s teeth are OK, **Mr. Guttman** noted. “I represent the dentists (whistleblowers) who have looked in the horse’s mouth and found that the paper is false.” In the U.S., the whistleblower system is driving compliance, and the U.S. False Claims Act has been used effectively against a ratings agency. The IRS also has a bounty system. However, the most powerful tool for aggrieved investors in the U.S. is the class action system, which has allowed smaller investors to aggregate and bring suits. This system can be utilized by foreign investors who purchase securities on US exchanges.

**Mr. Alexander Reus**, who practices law in Germany, the U.K. and the U.S., represents big institutional investors who wonder what they can do in the U.S. if their investments have gone bad. He also handles non-U.S. alternatives to class actions when the U.S. is closed to enforcement.

**Mr. Tan Kin Lian** gave a brief history of the investor protests he organized after the 2008 financial crisis. Most investors were “found to be negligent because they were found to be investing with their eyes open,” and many lost all of their money. Unlike in Singapore, regulators in Hong Kong were able get more compensation for Hong Kong investors, in part due to extensive media coverage. He noted that many blame the sellers because they failed to explain the nature of the risk, and in some cases misrepresented the risk. In fact, many of the relationship managers were themselves not aware of the risks. But because all misrepresentations were made verbally, there was no documentary evidence or investors signed forms in English saying they knew what they were doing, investors were not compensated. Mr. Tan believes that financial products should be pre-approved by the regulators, and noted that in this period of low interest rates, unsophisticated investors don’t have suitable, fairly priced products.

## Hong Kong Forum—Panel Discussion

**Mr. Reuben Guttman** pointed out that in the U.S., investors don't depend solely on the regulators for compliance enforcement, and that without the threat of jail time offenders can simply calculate the cost of breaking the law. He noted that transparency is necessary at all levels and questioned why the FDRC does not publish the names of defendants.

**Ms. Sou Chiam** reminded the audience that the FDRC was never meant to be a financial ombudsman. "Our role is not to name and shame, and we have no power to investigate a case or say who is right or wrong." The FDRC's role is to provide a quicker, cheaper dispute resolution system outside the court system. If the mediation is unsuccessful, the claimant can choose to go to arbitration or to the courts.

### *"It pays to commit securities fraud"*

In the absence of a class action system in Asia, **Mr. Reus** believes that the FDRC is a great temporary system. But without criminal enforcement, he said, "It pays to commit securities fraud." **Ms. Chiam** countered, insisting that security fraud does NOT pay. She believes that the culture is shifting, and insider dealing and fraud are no longer viewed as victimless crimes.

**Mr. Tan** agrees that the dispute system is not working well from the consumer point of view, and that for a class action system to work there needs to be a contingency fee system.

He strongly endorses the Twin Peaks system of regulation, because regulators with responsibility to both regulate financial institutions and protect consumers don't know which role to perform. He endorses the idea of a separate consumer protection agency representing retail investors.

The problem is not just the lack of class actions, **Mr. Reus** believes. It's the fee system. Without contingency fees, the high filing costs, legal fees and adverse party costs make it nearly impossible for investors to sue a big party. **Mr. Guttman** noted that that's why the U.S. is an attractive forum for international investors. Losers don't pay and the costs of labor-intensive cases are born by the lawyers.

**Audience Question:** A recent news report revealed that investment advisors were making conflicting private and public comments about the health of the Asia and China markets. Is this unethical or actionable?

**Mr. Reus** believes that an investor would have good evidence if they bought based on such public opinion and then something goes wrong. "Proper disclosure means sharing what you believe; otherwise the advisor has misled the client."

**Mr. Guttman** noted that in, the U.S., the SEC would be looking at the evidence to see if such a comment reflects systemic, pervasive behavior. He noted that one of the challenges in cross-border prosecution is the collection of core information that can be used in court.

### Hong Kong Forum—Panel Discussion

**Audience question:** “How do you ensure that a financial institution that goes through mediation doesn’t misbehave again?”

**Ms. Sou Chiam** admitted that the FDRC has no control but that it does cost the financial institution if they keep repeating the problems. “We’re not regulators, and it’s not our job to report on anyone.”

**Audience question:** What is the potential liability for banking and other executives who inherit issues from previous management?

**Mr. Alexander Reus** answered that local laws govern statutes of limitation, and that institutions are responsible for the actions of their management, even after they’re gone.

#### *“Sunshine is the greatest disinfectant”*

**Mr. Reuben Guttman** discussed the concept of *Ultra Vires* in the U.S., which can be used to as the basis for a Breach of Fiduciary Duty claim against a director. He emphasized that “sunshine is the greatest disinfectant; transparency drives regulators to do something, pushes the press to provide oversight, and puts investors on notice that they should “check the horse’s teeth.”

**Audience question:** Today’s news reported that a large family conglomerate in Korea has been selling large blocks of shares at major discounts off the public price. Is this illegal or unethical behavior, and do smaller shareholders have any recourse?

**Mr. Alexander Reus** responded that such an action implies that the company may be acting on insider information that caused them to lose confidence in the share price, and there may be some recourse for that.

**Audience question:** There’s been little mention of investors’ responsibility.

**Mr. Alexander Reus** believes that we need to get away from entitlement thinking. “It’s not always someone else’s fault if you make a bad investment.” **Mr. Reuben Guttman** countered, “Buyer beware doesn’t work if investors don’t have the ability to look inside the horse’s mouth.”

**Audience question:** Why are financial advisors not required to be professionally trained and licensed?

**Mr. Tan Kin Lian** agreed that training and licensing is needed, and **Mr. Alexander Reus** pointed out that there also needs to be an ongoing certification requirement. **Mr. Reuben Guttman** noted that lawyers in the U.S. live in fear of being disbarred and losing their license, so they’re extra careful to stay within the law. **Ms. Sou Chiam** pointed out that there was huge resistance when New Zealand (after the financial crash) required training, licensing and payment for financial advice.

**Mr. Stuart Leckie** wrapped up the discussion on a humorous note, saying, “I’m tempted to go to my lawyer for financial advice, because he’ll lose his license if he does the wrong thing.”