



SECURITIES AND FUTURES COMMISSION
證券及期貨事務監察委員會

Survey on the Sale of Non-exchange Traded Investment Products

For the year ended 31 March 2014

Introduction

1. The Securities and Futures Commission (SFC) conducted a fact-finding survey on the sale of non-exchange traded investment products (“investment products”) to individual investors by corporations licensed by the SFC. The survey covered the sale of investment products from 1 April 2013 to 31 March 2014 (“the reporting period”). A previous survey conducted in 2012 covered the period from 1 April 2011 to 31 March 2012.

Objectives

2. The survey was designed to collect information such as that relating to the types and value of investment products sold by SFC-licensed corporations. Whilst the information gathered may assist the SFC in supervising licensed corporations, it is also useful to market participants.

Scope

3. The survey focused on the sale and distribution of investment products to individual investors (including investment vehicles of such individuals), who had opened accounts with licensed corporations or their overseas affiliates and to whom investment products had been sold or distributed by licensed representatives in Hong Kong. Sales to market professionals such as banks or under omnibus/nominee arrangements were not included in the survey.
4. The investment products covered in the survey included structured investment products, government and corporate bonds, swaps and repos, collective investment schemes and hedge funds. Among those excluded from the survey were leveraged foreign exchange products, insurance products, mandatory provident funds, pooled retirement funds, paper gold schemes, listed securities, exchange-traded funds and exchange-traded derivatives.

Questionnaire and responses

5. The survey was sent to 1,465 corporations licensed to deal in or advise on securities or futures. We received 1,439 replies, representing a response rate of 98%. A total of 213 licensed corporations reported that they had sold investment products to individual investors during the reporting period.

Key findings

The market remains active and is composed of a wide variety of players and products

6. The aggregate transaction amount reported for the financial year ended 31 March 2014 dropped by 8% from \$510 billion¹ in the previous survey to \$468 billion in this survey. The main reason for the decrease was that two international financial conglomerates no longer carried out the sale of investment products to individual investors via their SFC-licensed corporations as a consequence either of folding this part of its business into the banking arm of the group or of the sale of this part of its business to another banking group. These were also among the principal factors for the significant drop in the sale of structured investment products reported in this survey compared to the previous one.
7. The number of firms which reported that they engaged in the sale of investment products nevertheless increased by 14%, from 187 to 213. About one-third of these firms reported in this survey for the first time that they engaged in the sale of investment products to individual investors. This included newly-licensed corporations or firms commenced to sell investment products since the previous survey. Those firms responding to the survey for the first time were securities brokers, asset management firms and investment advisors. They were principally involved in sales of collective investment schemes and fixed income products.
8. The majority of the 213 firms reported selling third-party-issued products to their clients. We noted that clients in general were offered a wide range of investment products.

An upward trend in sales of collective investment schemes and fixed income products by licensed corporations

9. Reported transaction amounts for collective investment schemes and fixed income products both increased by \$18 billion when compared to the previous survey. For fixed income products, a \$35 billion increase in sales of non-investment grade corporate bonds was offset by a \$17 billion decrease in sales of investment grade corporate bonds and sovereign bonds. This showed individual investors were increasingly looking for higher returns in a low-interest environment.

The top 10 firms² continued to dominate the market but the composition of these firms has changed

10. The top 10 firms contributed a total reported transaction amount of \$371 billion or 79% (2012: \$427 billion or 84%). They or their related companies were also major issuers of structured investment products, collective investment schemes, swaps and repos.

¹ The aggregate transaction amount reported in the survey conducted in 2012 has been revised from \$584 billion to \$510 billion. Several major asset management firms revised their figures for the period covered by the previous survey to exclude the sale of collective investment schemes through other intermediaries in omnibus or nominee arrangements. Please note that the revised figures (including those for product issuers and outstanding positions) are used throughout this report.

² Throughout this report, “the top 10 firms” refers to the ten licensed corporations with the highest transaction amount reported in this survey.

11. Half of these top 10 firms were part of major international financial conglomerates and accounted for 62% (2012: 74%) of the reported aggregate transaction amount. One major international financial conglomerate, which only served non-retail clients, accounted for about half of the aggregate transaction amount.

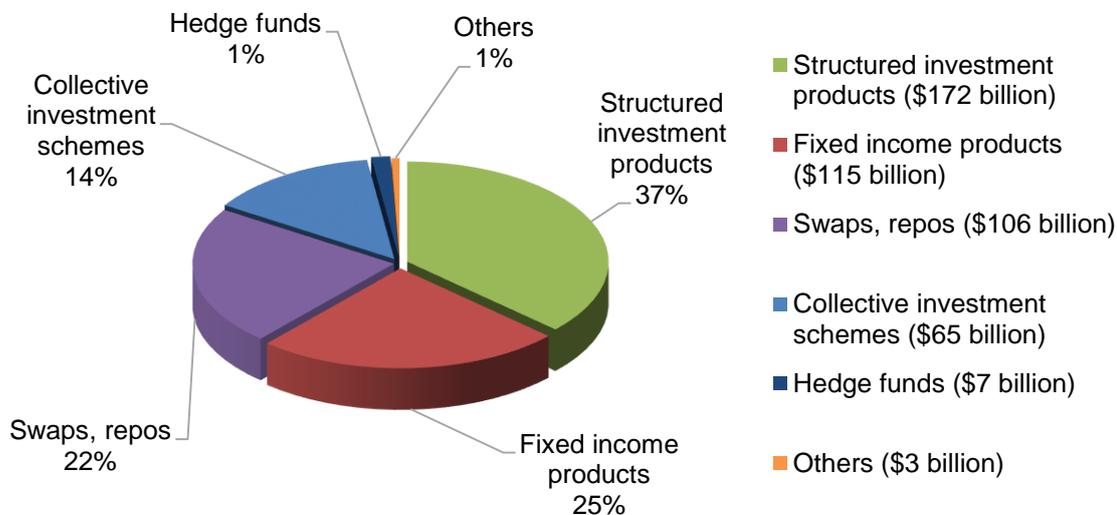
Detailed findings

Aggregate transaction amount: \$468 billion (2012: \$510 billion)

Overview

12. For the year ended 31 March 2014, an aggregate transaction amount³ of \$468 billion in investment products was reported to have been sold to individual investors by 213 licensed corporations (2012: 187). This represented a drop of 8% or \$42 billion compared to the aggregate transaction amount reported in the previous survey. In both surveys, unauthorized investment products accounted for more than 90% of the aggregate transaction amount for investment products which licensed corporations sold to individual investors. Nearly all of the authorized investment products sold to individual investors were collective investment schemes.

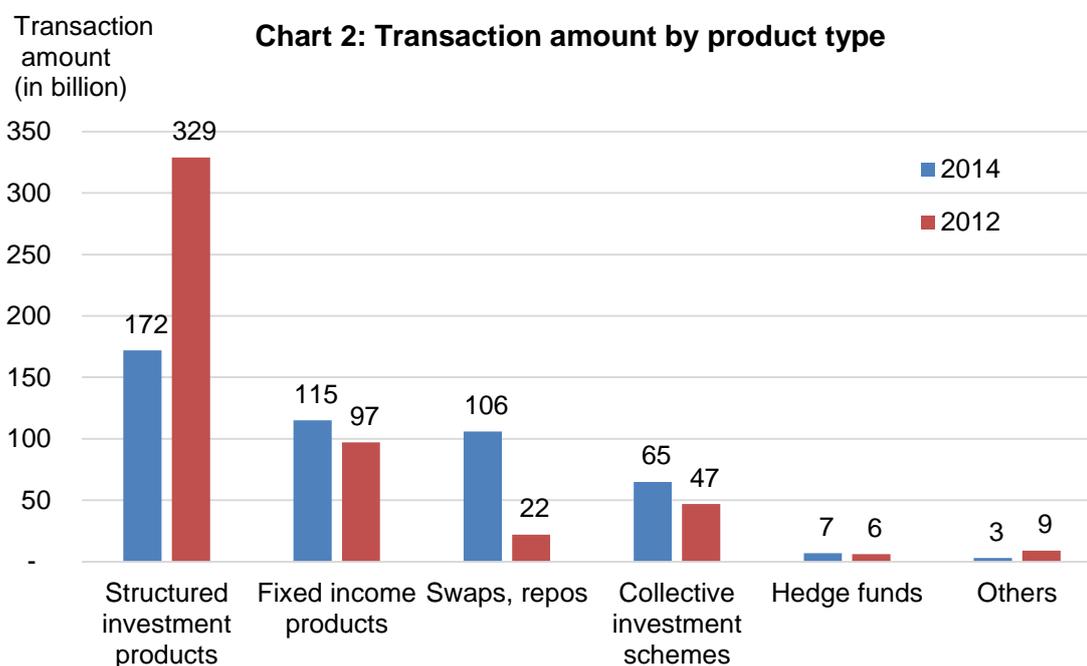
Chart 1: Total transaction amount by product type



³ In this survey, transaction amount refers to the amount paid or payable by investors for securities and futures products. For leveraged products, the transaction amount means the maximum exposure of the contracts. Licensed corporations were requested to report only one-sided transactions. For example, only the buy order of individual investors should be included as the transaction amount in switching transactions.

Product types	Transaction amount (April 2013 – March 2014) (in \$ million)				No. of firms engaged in sale
	Authorized products	Unauthorized products	Total		
Structured investment products	38	172,403	172,441	37%	40
Fixed income products	-	115,312	115,312	25%	104
Swaps and repos	-	105,496	105,496	22%	13
Collective investment schemes	36,082	28,399	64,481	14%	150
Hedge funds	35	7,067	7,102	1%	52
Others	-	3,086	3,086	1%	7
Total	36,155	431,763	467,918	100%	213

13. Structured investment products again recorded the highest transaction amount but their share of the total decreased substantially to 37% from 65% in the previous survey. The transaction amount for swaps and repos increased by \$84 billion, driven mainly by the demand of a few clients of an international financial conglomerate for interest rate swaps. The transaction amounts for collective investment schemes and fixed income products were both reported to have increased by \$18 billion compared to the previous survey, while the transaction amount for hedge funds was similar in both surveys. The decrease in the transaction amount for structured investment products in the reporting period was partially offset by an increase in the transaction amounts for swaps, repos, collective investment schemes and fixed income products.



Change in firms that engaged in the sale of investment products

14. 50 firms which indicated in the previous survey that they engaged in the sale of investment products reported in 2014 that they no longer did so. These 50 firms accounted for \$69 billion or 13% of the aggregate transaction amount in the previous survey. 10 of these firms had ceased carrying out regulated activities altogether. A few firms transferred the business of selling investment products to individual investors to the banking arm of the group and one sold this part of its business to another banking group.
15. 76 firms reported that they now engaged in the sale of investment products in this survey but were not so engaged in the previous survey. Seven are recently licensed with the SFC. These 76 firms comprised securities brokers, asset management firms and investment advisors.
16. The 76 firms were individually small in terms of transaction amount (save for one, generally less than 1% to the aggregate transaction amount) and together they contributed a total transaction amount of \$22 billion or 5% to the aggregate transaction amount. Products sold included collective investment schemes and fixed income products.
17. 137 firms reported to have engaged in the sale of investment products to individual investors in both surveys. These firms recorded a net increase of \$5 billion in transaction amount. 77 firms reported an increase in transaction amount of \$206 billion while 60 firms reported a decrease in transaction amount of \$201 billion. One firm accounted for about 80% of the drop after the international financial conglomerate to which it belongs ceased to carry out the sale of investment products to individual investors through an SFC-licensed corporation following the folding of this business into its banking arm.

Sale of investment products by type of firm

18. Structured investment products, swaps and repos were mainly sold by a few international financial conglomerates. Securities brokers mainly focused on the sale of fixed income products while investment advisors and asset management firms mainly focused on the sale of collective investment schemes. The observations were similar in both surveys.

The top 10 firms

19. The top 10 firms accounted for 79% of the aggregate transaction amount in 2014 (\$371 billion), slightly down from 84% in the previous survey (\$427 billion). One firm, which mainly served non-retail high net worth individuals, dominated the total sales of investment products among licensed corporations and accounted for about half of the aggregate transaction amount. As shown in Chart 4, the majority of firms each accounted for less than 1% of the aggregate transaction amount.

Chart 3: Aggregate transaction amount for the top 10 firms and other firms

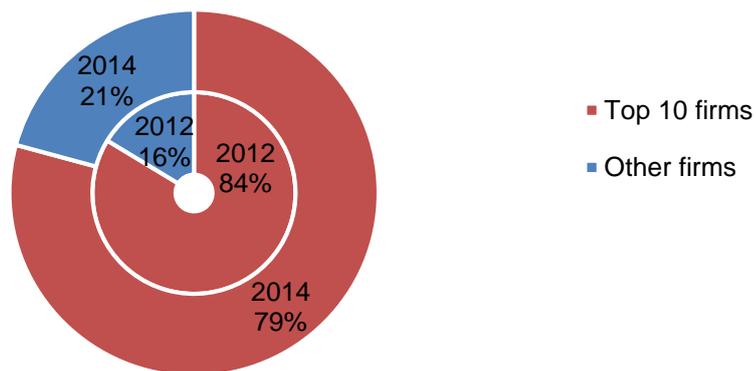
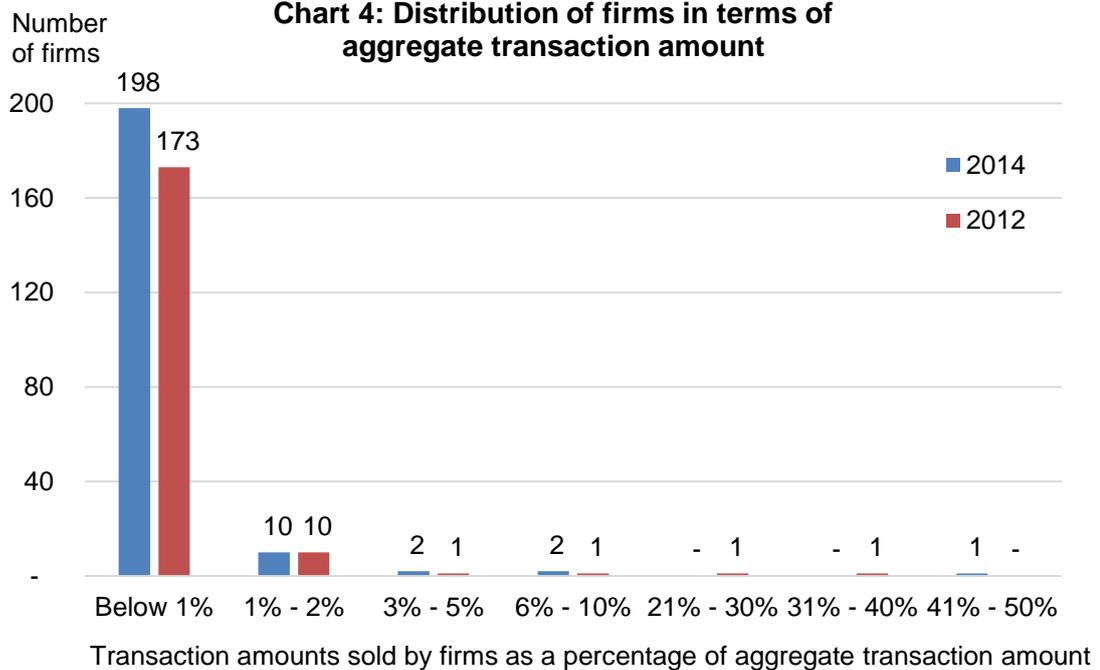
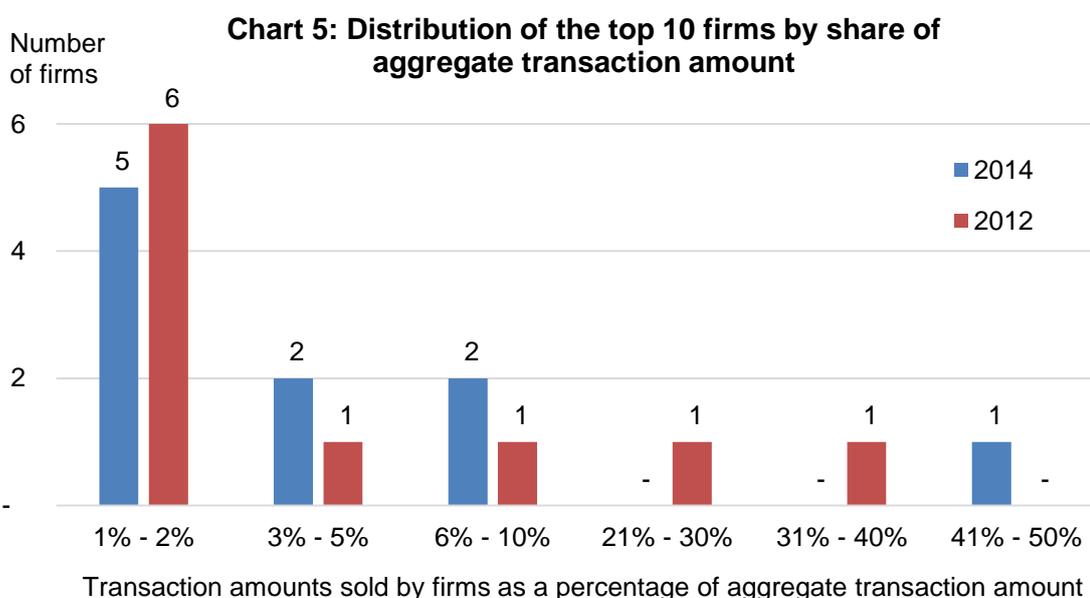


Chart 4: Distribution of firms in terms of aggregate transaction amount



20. Only five of the top 10 firms in the previous survey remained in the top 10 this year. There was one Hong Kong-centric securities broker among the top 10 firms this year and it mainly engaged in the sale of equity-linked structured investment products to individual investors. The table below gives the composition of the top 10 firms in the two surveys:

Type of firms	2014	2012
Affiliate of international financial conglomerate	5	5
Affiliate of China/Taiwan based financial group	3	3
Asset management firm	1	2
Hong Kong-centric securities broker	1	0



21. In terms of transaction amount, structured investment products were the principal products reported sold by the top 10 firms. Swaps and repos were mainly sold by a few international financial conglomerates among the top 10 firms.
22. The remaining 203 firms were a mix of securities brokers, asset management firms and investment advisors. As with the previous survey, fixed income products and collective investment schemes accounted for the majority of the total transaction amount for the investment products sold to individual investors by these firms.

Chart 6a: Transaction amount by product type, top 10 firms

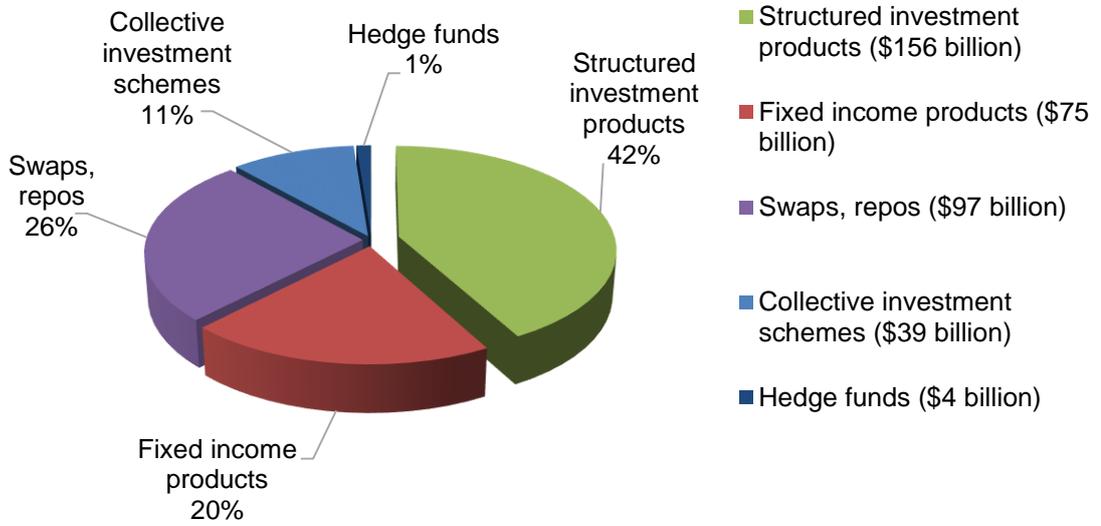
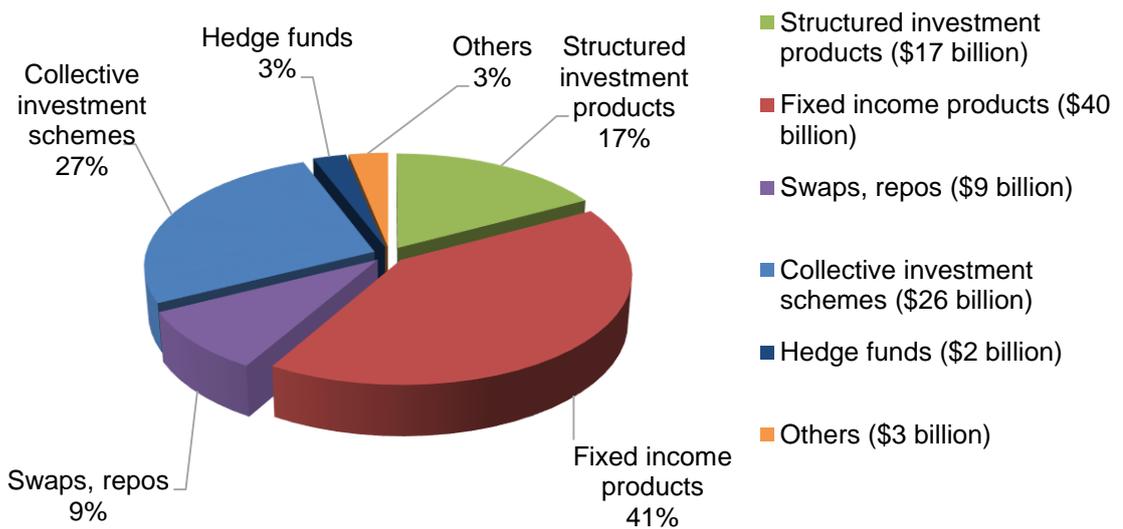


Chart 6b: Transaction amount by product type, firms other than the top 10

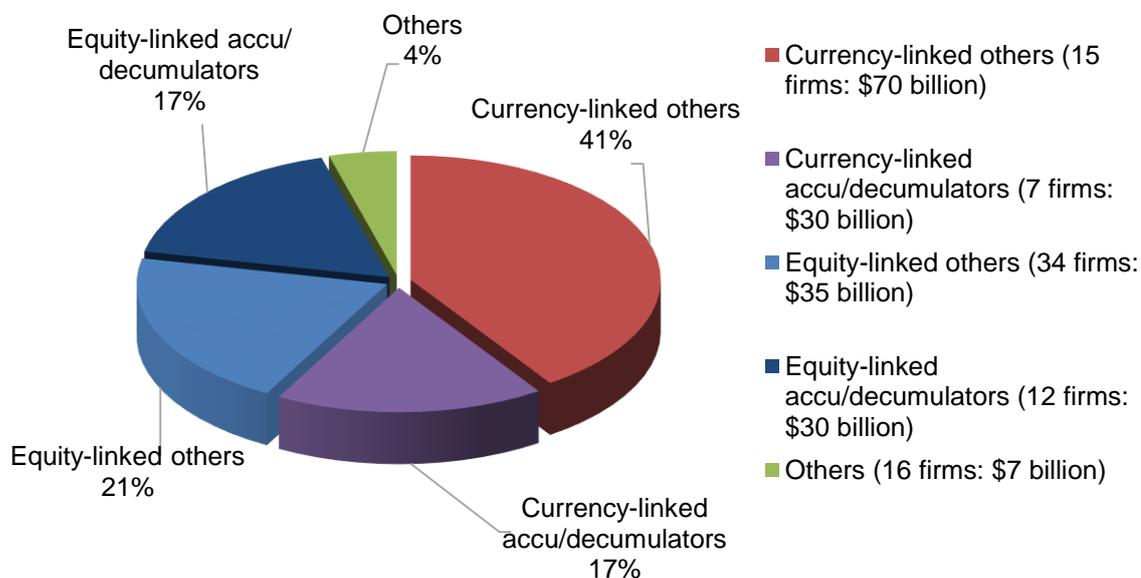


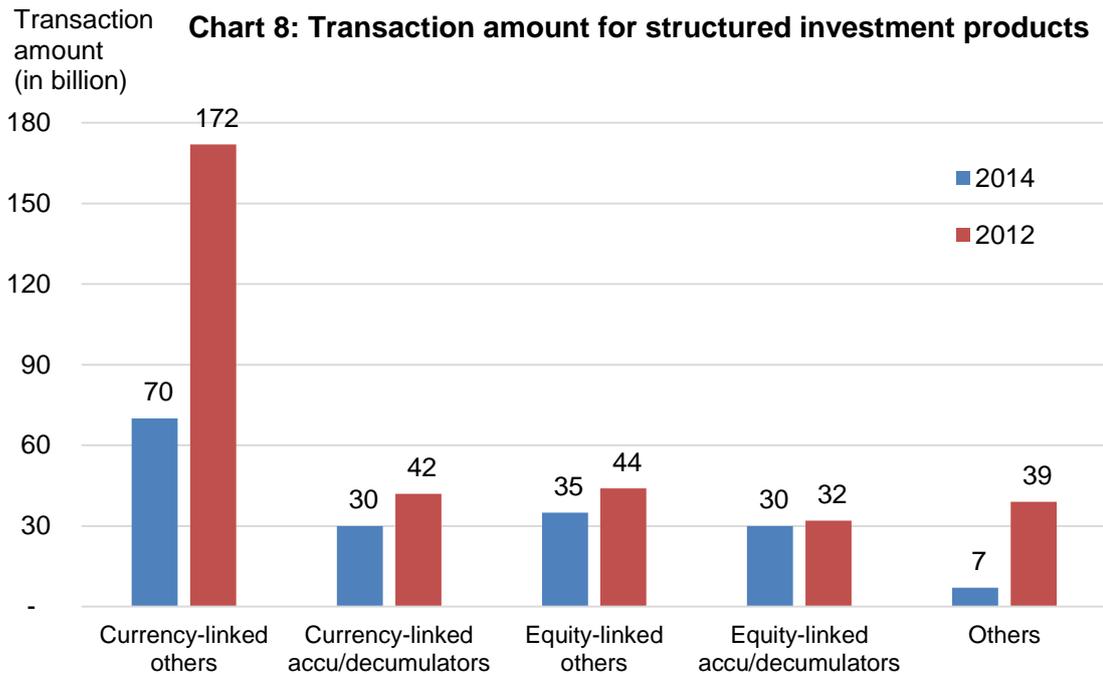
Analysis by product type

Structured investment products (40 firms, total transaction amount: \$172 billion; 2012: 47 firms, \$329 billion)

23. The number of licensed corporations which engaged in the sale of structured investment products and the total transaction amount for structured investment products both decreased compared to the previous survey. The drop in transaction amount was spread across different types of structured investment products with currency-linked structured investment products (including currency-linked accumulators and decumulators) dropping the most, falling about \$114 billion. We observed that some international financial conglomerates which were active in the sale of structured investment products in the previous survey reported significant decreases in the transaction amount for structured investment products. In particular, two international financial conglomerates which were active in the sale of structured investment products have moved such business to the banking arm of the group or sold such business to another banking group. About three-fourths of the 40 firms reported that they sold structured investment products to individual investors in both surveys.
24. Currency-linked structured investment products (including currency-linked accumulators and decumulators) were the most common type of structured investment products sold, with a total transaction amount of \$100 billion. Equity-linked structured investment products (including equity-linked accumulators and decumulators) were the second most common with a total transaction amount of \$65 billion. Currency and equity-linked structured investment products accounted for 96% of the total transaction amount for structured investment products. Currency and equity-linked accumulators and decumulators accounted for about one-third of the transaction amount for structured investment products sold to individual investors.

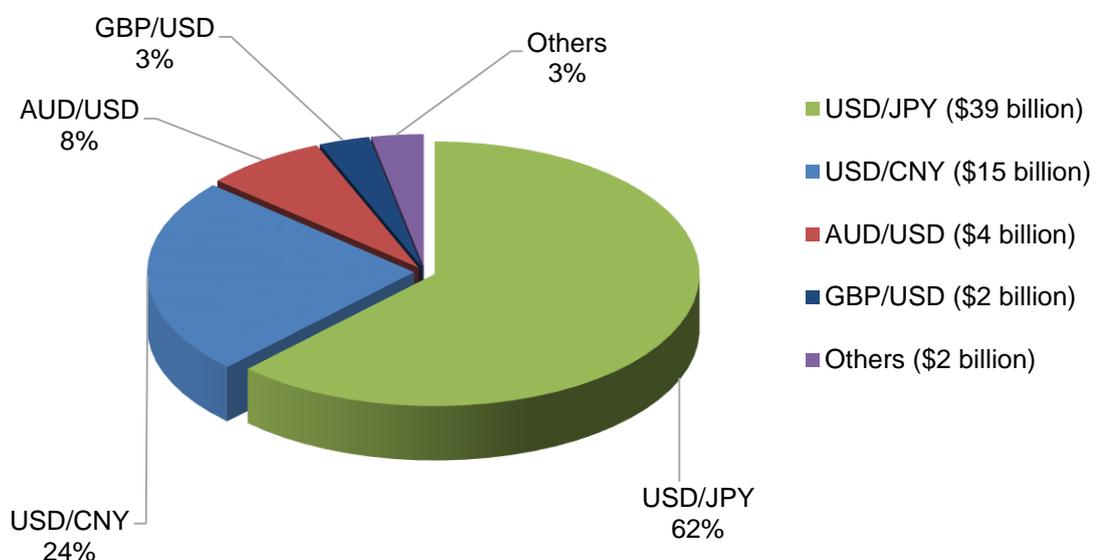
Chart 7: Transaction amount for structured investment products





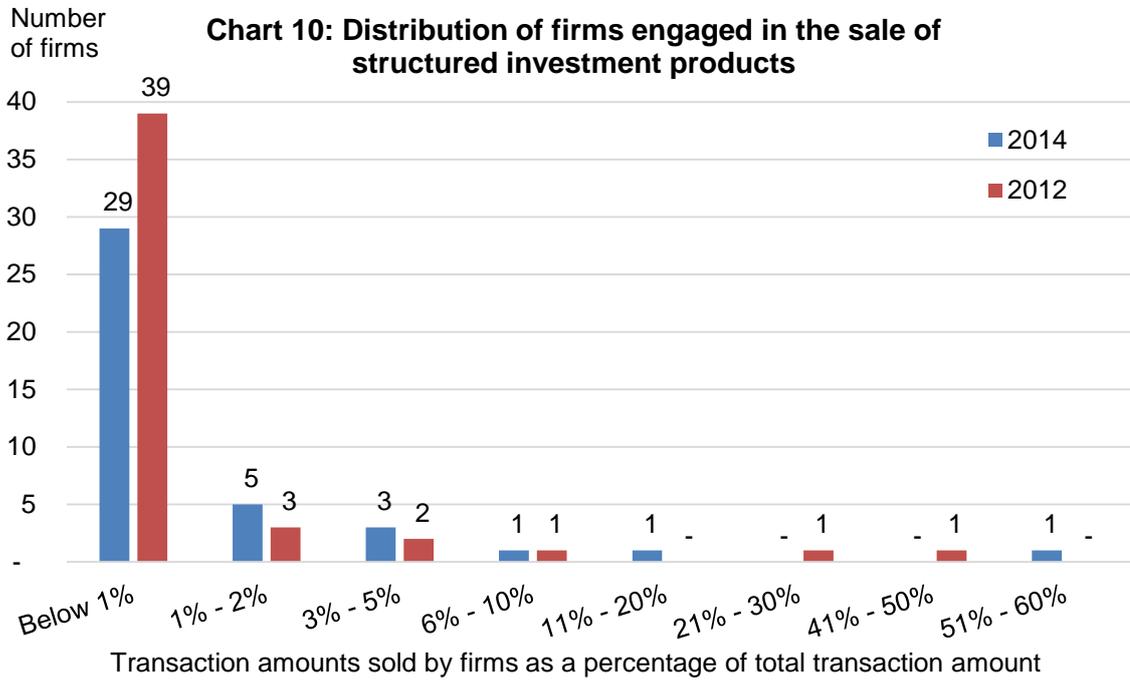
25. Based on an analysis of the top five products reported by each survey respondent⁴, which in this category amounted to \$62 billion altogether, US dollar was the main currency traded in the currency pairs for currency-linked structured investment products (including currency-linked accumulators and decumulators). US dollar against the Japanese yen (62%), renminbi (24%) and Australian dollar (8%) were the most common currency pairs noted in currency-linked structured investment products.

Chart 9: Transaction amount for currency-linked structured investment products by pairs of currencies



⁴ In the design of the survey, firms were requested to provide details such as names, issuers, etc. of the top five products which accounted for the highest transaction amount for each type of product. The details enabled further analysis of the products sold, including their product features.

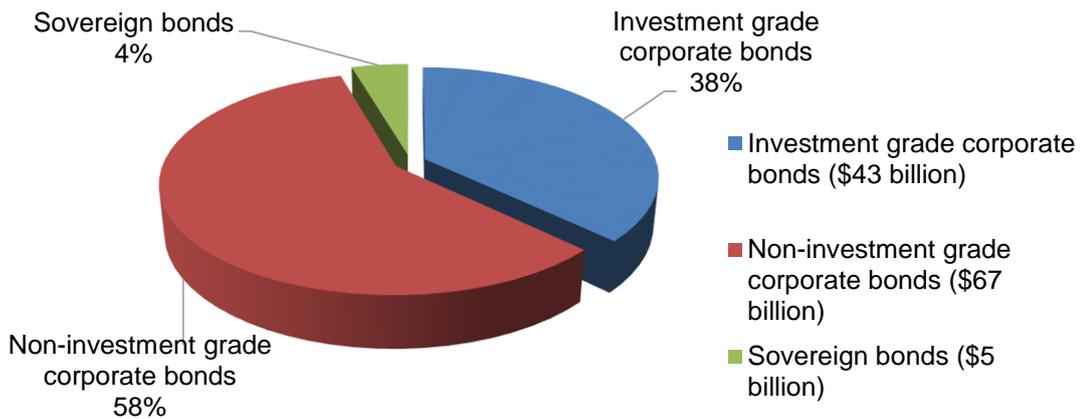
26. Of the total reported transaction amount for structured investment products, the top 10 firms continued to account for the majority (90%; 2012: 92%). However, the proportion sold by the international financial conglomerates in the top 10 firms dropped from 88% in the previous survey to 77% in this survey.



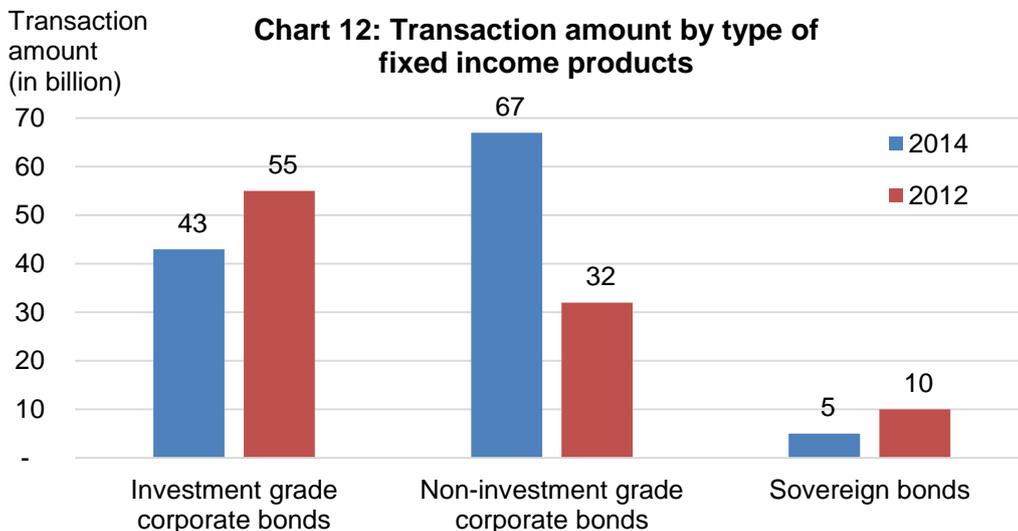
Fixed income products (104 firms, total transaction amount: \$115 billion; 2012: 74 firms, \$97 billion)

27. As shown in Chart 11, non-investment grade corporate bonds made up 58% of the fixed income products reported sold to individual investors. Corporate bonds significantly outsold sovereign bonds, which only contributed around 4% of the total transaction amount. The sale of fixed income products by the top 10 firms accounted for about 65% of the total transaction amount (2012: 69%).

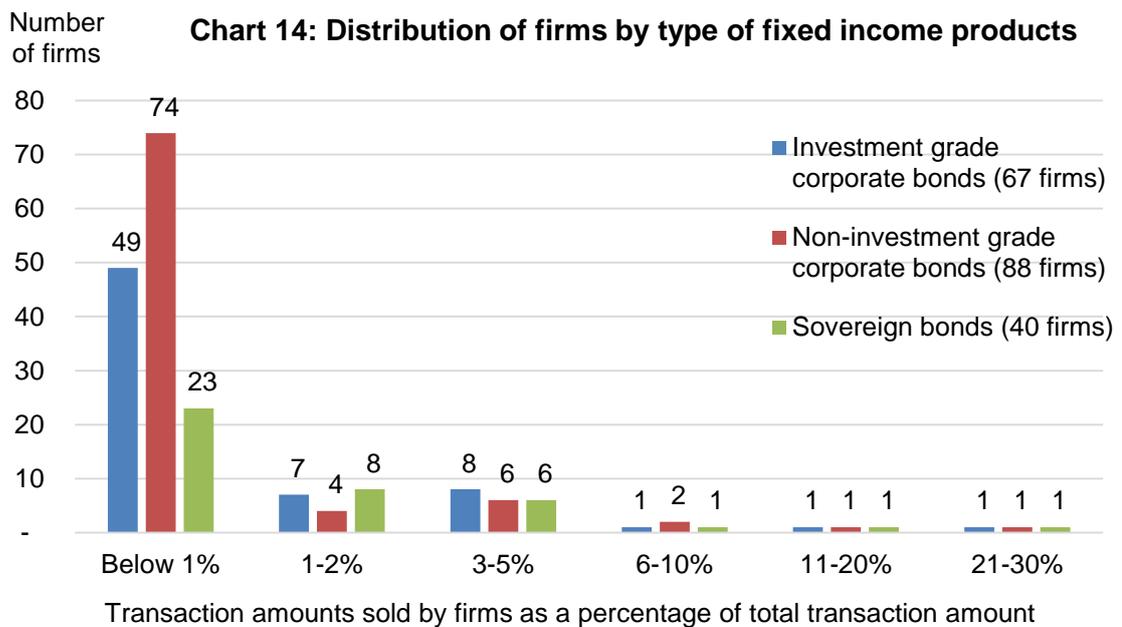
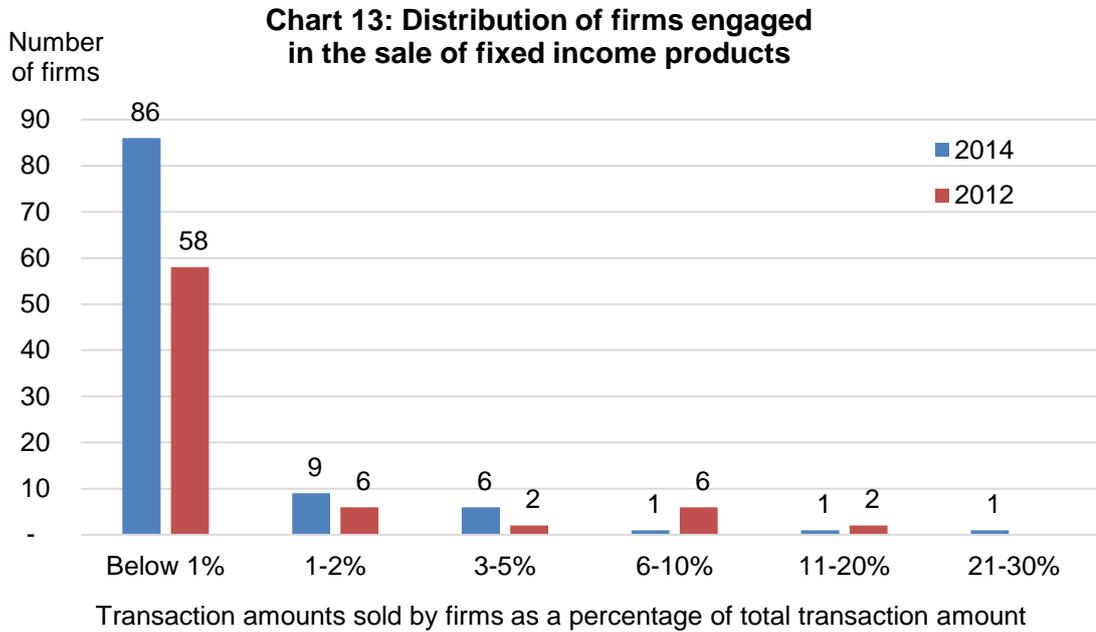
Chart 11: Transaction amount for fixed income products



28. The \$18 billion increase in the total transaction amount for fixed income products was the result of a \$35 billion increase in the sale of non-investment grade corporate bonds, offset by a drop of \$17 billion in the sale of investment grade corporate bonds and sovereign bonds. Respondents advised that the increase in the sale of non-investment grade corporate bonds was mainly attributable to clients' demand and active issuance and sale of fixed income products to individual investors by some firms.

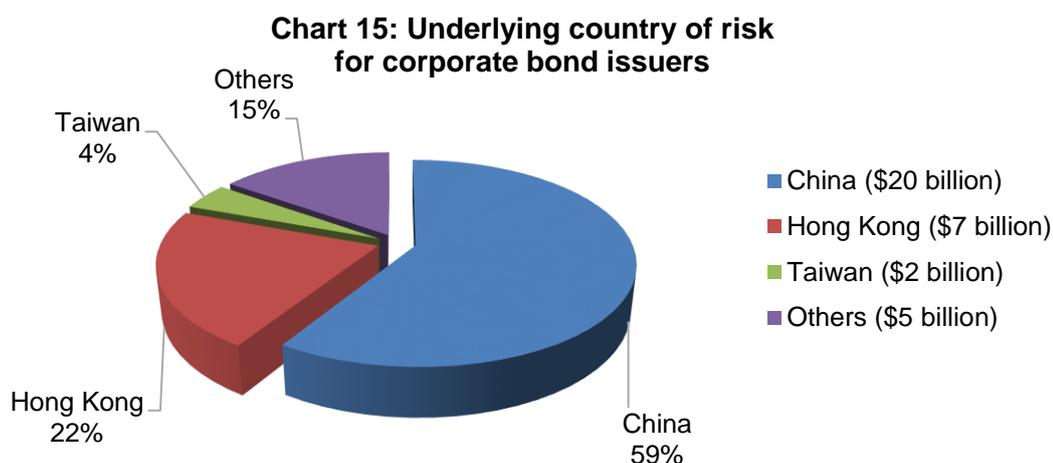


29. The majority of the firms which engaged in the sale of fixed income products were securities brokers. International financial conglomerates and securities brokers accounted for about 90% of the total transaction amount.

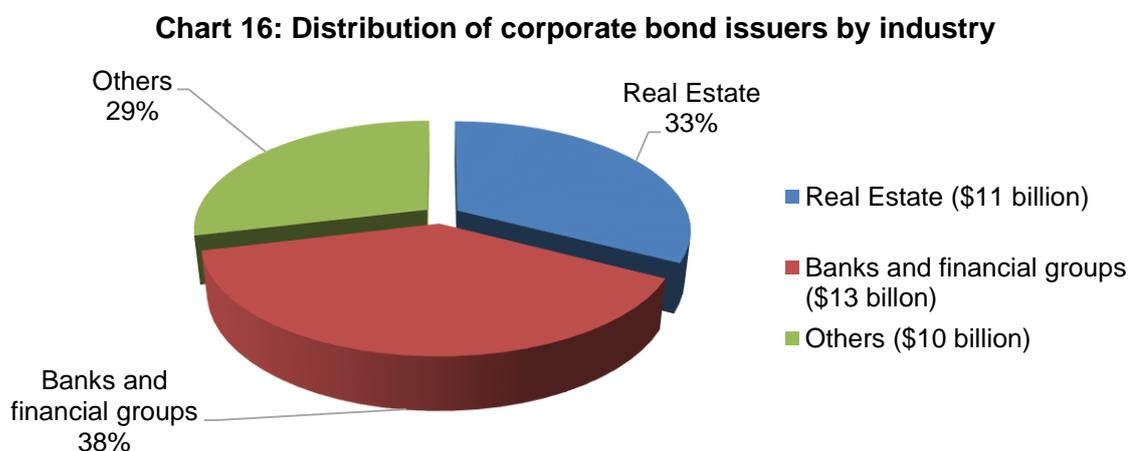


Corporate bonds (103 firms, total transaction amount: \$110 billion; 2012: 72 firms, \$87 billion)

30. We have analysed the underlying “country of risk”⁵ for the issuers of the top five investment and non-investment grade corporate bonds reported by each survey respondent (collectively known as the “top five corporate bonds”)⁶, which altogether amounted to \$34 billion. Mainland China and Hong Kong were the top underliers and accounted for around 59% and 22%, respectively, of the transaction amount for the top five corporate bonds. Other underlying countries included Taiwan, Russia and Singapore.



31. Based on an analysis of the top five corporate bonds reported, the industry sector issuing the most bonds was the financial sector (such as banks, financial services groups and insurance companies) (38%), followed by real estate (33%). Other sectors issuing bonds included transportation and telecommunication.

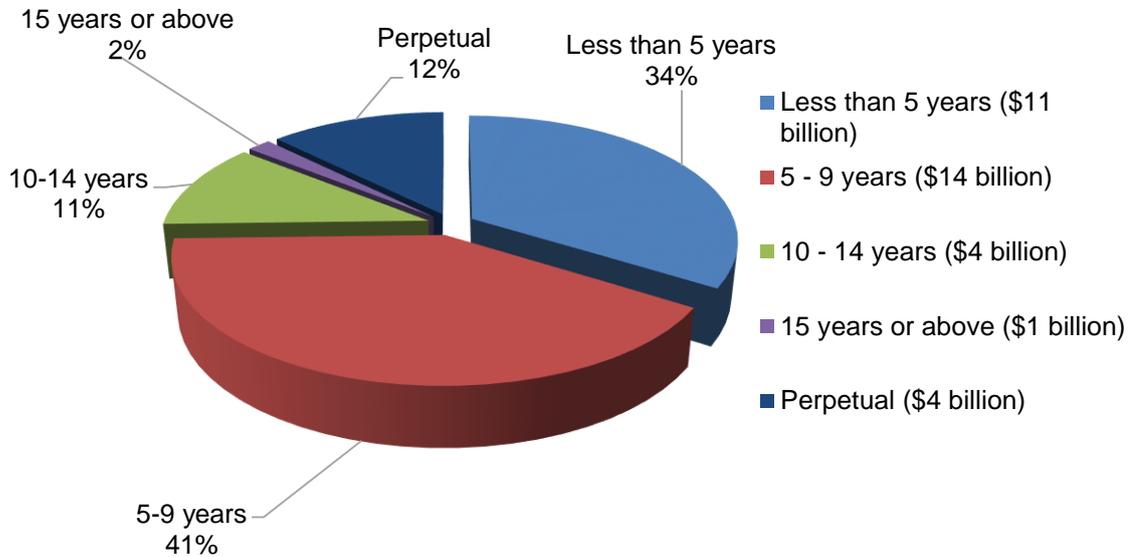


⁵ The issuer’s underlying “country of risk” information included here is sourced from an external market data provider. We understand that the provider has considered a number of criteria, including the issuer’s country of domicile, the primary stock exchange on which it trades, the location from which the majority of its revenue comes, and its reporting currency in the determination of “country of risk”.

⁶ All the specific information on fixed income products, eg, underlying country of risk, coupon rate and maturity, were sourced from market data.

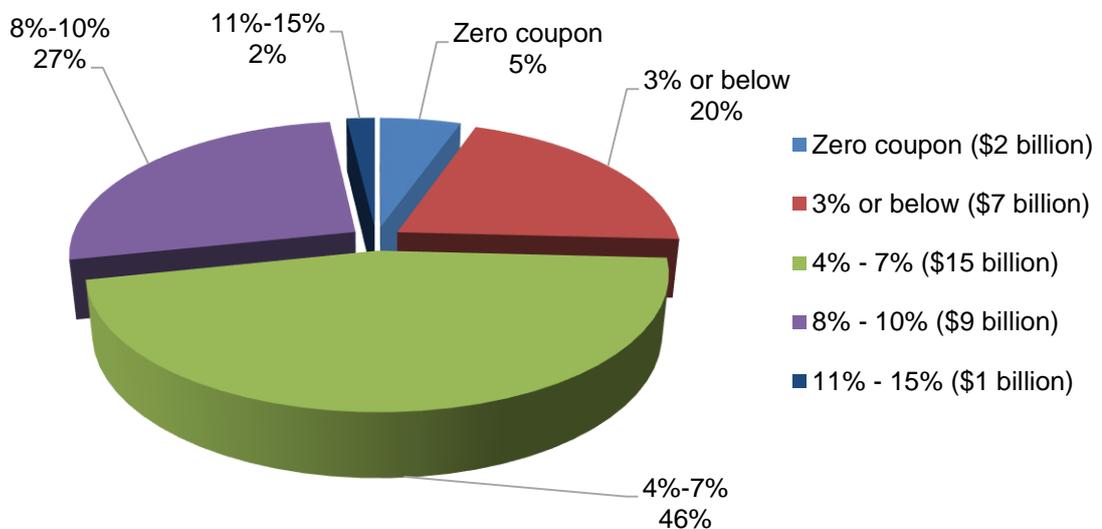
32. In terms of maturity, 75% of the top five corporate bonds had an original maturity of less than ten years, while around 12% were perpetual in duration.

Chart 17: Maturity profile of corporate bonds



33. By coupon type, 85% of the top five corporate bonds were fixed-rate instruments. About half of the top five corporate bonds had a current coupon rate of 4-7% per annum. More than one-fourth had a current coupon rate of 8% per annum or higher, while 5% were zero coupon instruments.

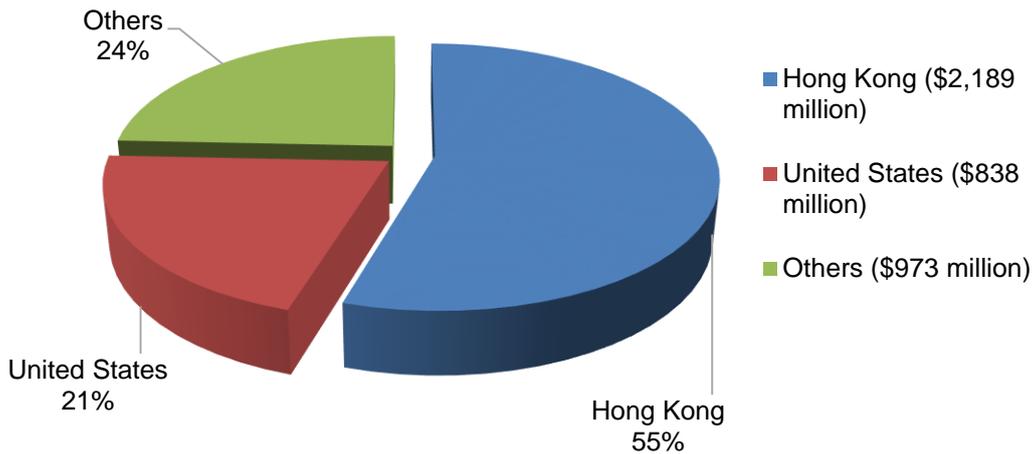
Chart 18: Coupon rate range of corporate bonds



Sovereign bonds (40 firms, total transaction amount: \$5 billion; 2012: 36 firms, \$10 billion)

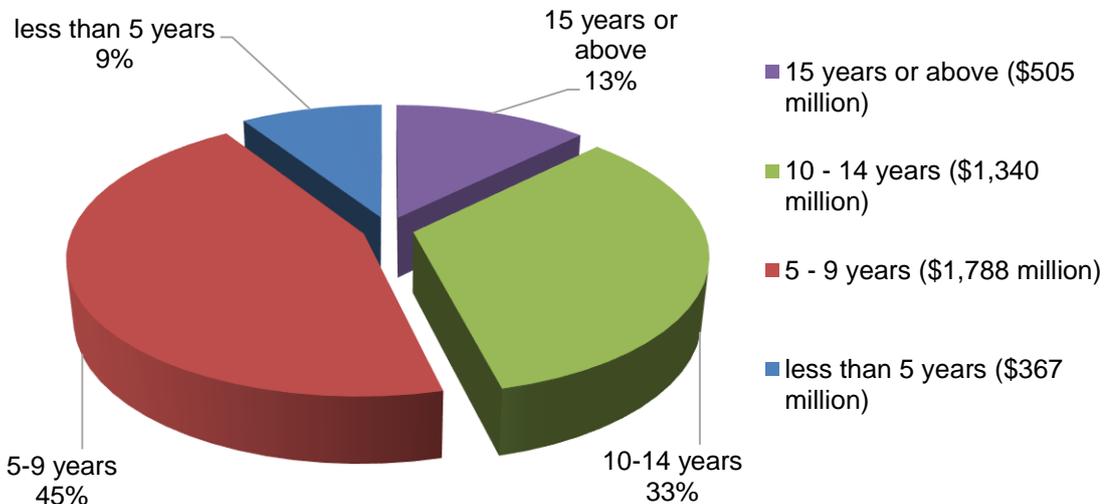
34. Based on an analysis of the top five sovereign bonds reported by each survey respondent, which altogether amounted to \$4 billion, Hong Kong and US government instruments were the most common sovereign bonds purchased by individual investors (accounting for 76% of the total). Other sovereign bond exposure included to the United Kingdom, Japan and Korea. The exposure to other EU countries or emerging markets was considered to be minimal.

Chart 19: Country of risk of sovereign bonds



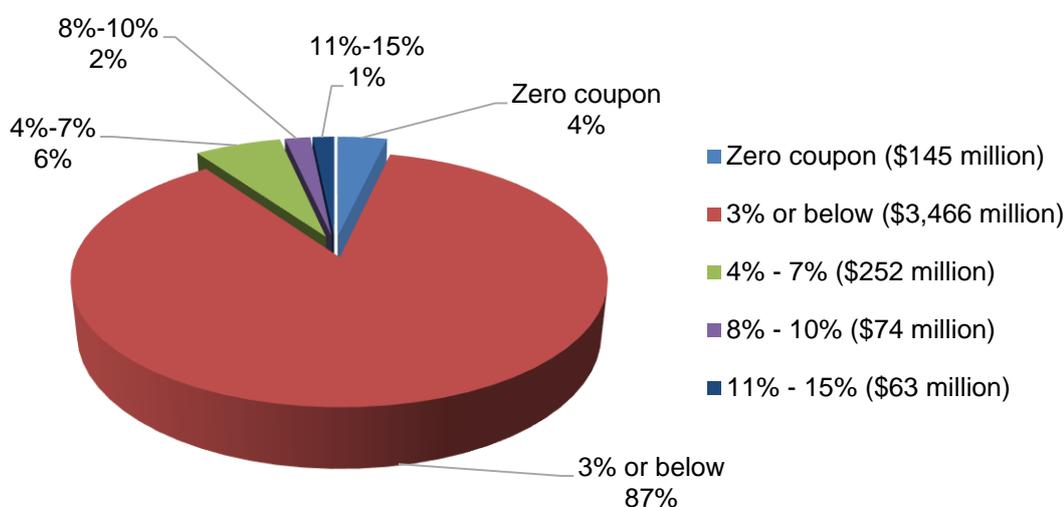
35. In terms of maturity, 45% of the top five sovereign bonds had an original maturity of 5 to 9 years, followed by 33% with original maturity of 10 to 14 years.

Chart 20: Maturity profile of sovereign bonds



36. 96% of the top five sovereign bonds were with a fixed coupon rate. 91% of the sovereign bonds bore a current coupon rate of 3% or below per annum or zero coupon.

Chart 21: Coupon rate range of sovereign bonds



Fixed income products with non-viability loss absorption features:

37. In recent years, financial groups and banks have issued bonds with new features to raise capital from the financial market. These fixed income products are often attached with conversion option or loss absorption features which are triggered when the issuer's regulatory capital ratio drops to a certain level or upon the occurrence of specific government or regulatory action in the event the issuer faces financial difficulties (ie, non-viability events).
38. Out of the 104 firms which reported selling fixed income products, 14 indicated that they sold fixed income products with non-viability loss absorption features to individual investors with a total transaction amount of \$2.1 billion.
39. The top five non-viability loss absorption bonds sold in terms of transaction amount, as reported by each firm, accounted for \$1.8 billion. Over 60% of them were issued by European banks, followed by over 35% by Asian banks.
- More than half of the non-viability loss absorption bonds sold to investors had temporary write-down⁷ features. Other features included permanent write-down and conversion into equity.
 - Around half of these bonds had an original maturity between 5 and 10 years while around 30% of them were perpetual.
 - Around 70% of these bonds were not rated and 20% of them were non-investment grade.

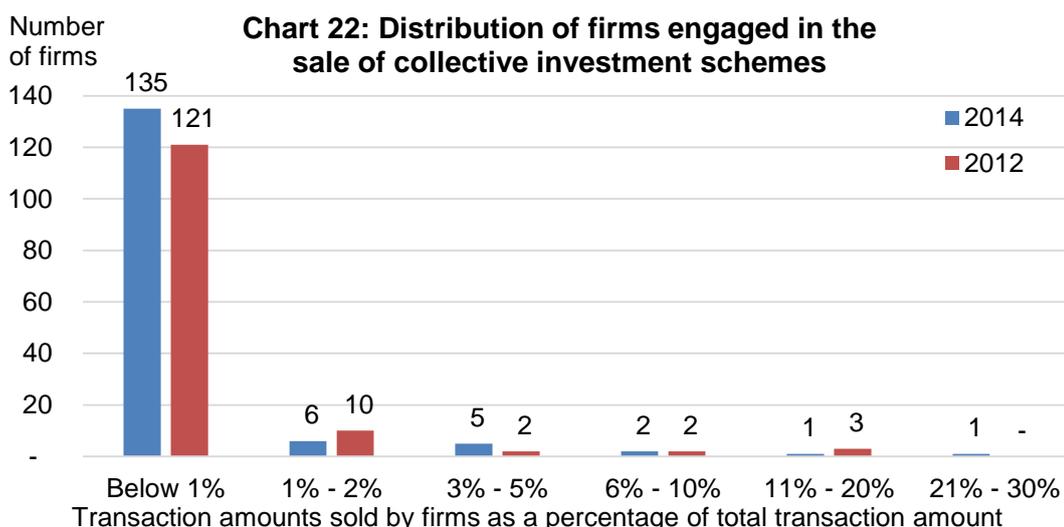
⁷ Under a temporary write-down, the principal amount of the bond would be written down fully or partially upon the occurrence of a triggering event. However, if the issuer's financial position subsequently improved and met certain requirements, the principal amount of the bond could be reinstated fully or partially.

- About 80% of these bonds bore a variable coupon rate⁸, and the remainder had fixed coupon rates.
- Around 60% of these bonds had a current coupon rate of 3-6% per annum and around 30% had a current coupon rate of 7-9% per annum.

⁸ Variable coupon rate means the coupon rate or the payment terms of the bond will change based on the terms specified in the prospectus.

Collective investment schemes (150 firms, total transaction amount: \$65 billion; 2012: 138 firms, \$47 billion) and hedge funds (52 firms, total transaction amount \$7 billion; 2012: 58 firms, \$6 billion)

40. Collective investment schemes continued to be the product sold by the majority of the licensed corporations which engaged in the sale of investment products. Over 70% of the firms sold collective investment schemes during the reporting period. 100 firms, which were mainly asset management firms or investment advisors, reported that they only sold collective investment schemes or interests in hedge funds during the period. It was further noted that asset management firms tend to sell funds managed by their groups while investment advisors tend to sell external parties' managed funds to individual investors.
41. The increase in the transaction amount for collective investment schemes suggested that there was an increase in investors' appetite for collective investment schemes. For firms that engaged in the sale of collective investment schemes in both surveys (101 firms), 55 firms reported an increase in the sale of collective investment schemes in this survey with the total transaction amount increasing by \$28 billion. Among these 55 firms, an international financial conglomerate accounted for about half of this increase because it launched new funds and share classes during the reporting period that attracted more fund subscriptions. 46 firms reported a drop in the sale of collective investment schemes to individual investors with the total transaction amount decreasing by \$9 billion.
42. The top 10 firms accounted for 60% and 64% of the total transaction amount for collective investment schemes and hedge funds respectively (2012: 50% and 44% respectively).



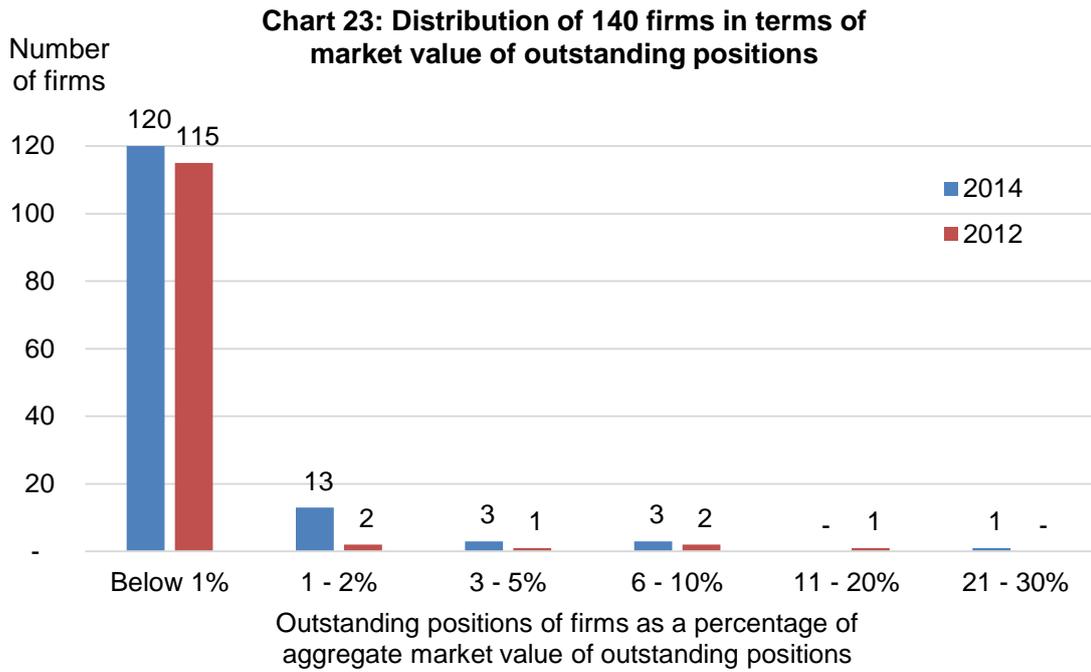
Swaps and repos (13 firms, total transaction amount: \$106 billion; 2012: 10 firms, \$22 billion)

43. Out of 213 firms, 13 engaged in the sale of swaps and repos. \$97 billion or about 92% of the total transaction amount came from three of the top 10 firms which were mainly international financial conglomerates. The increase in the transaction amount for swaps was mainly due to meeting a few clients' demand for interest rate swaps.

Outstanding contracts

44. Among the 213 licensed corporations selling investment products, 140 firms (including all the top 10 firms) or their related companies held outstanding positions as custodians on behalf of their clients or as contracting parties themselves. The market value of outstanding positions held by these licensed corporations amounted to \$229 billion, representing a decrease of 42% (or \$163 billion) when compared to the previous survey. The reduction mainly resulted from the decrease in outstanding positions in both fixed income products and structured investment products.
45. We noted that the decrease in outstanding positions in fixed income products was mainly because at a few international financial conglomerates either clients cease to trade through the firm or the firm itself ceased to engage in the sale of investment products to individual investors through an SFC-licensed corporation.
46. The drop in outstanding positions in structured investment products was mainly caused by a drop in the sale of structured investment products to individual investors.
47. Collective investment schemes and fixed income products continued to account for a substantial portion of outstanding positions.

Product types	Market value of outstanding positions on 31 March (in \$ million)					
	2014				2012	
	Authorized products	Unauthorized products	Total		Total	
Structured investment products	13	21,661	21,674	9%	91,762	23%
- <i>Equity-linked (including accu/decumulators)</i>	13	9,116	9,129	4%	24,750	6%
- <i>Currency-linked (including accu/decumulators)</i>	-	9,152	9,152	4%	57,151	15%
- <i>Others</i>	-	3,393	3,393	1%	9,861	2%
Fixed income products	-	81,594	81,594	36%	154,988	40%
- <i>Investment grade corporate bonds</i>	-	33,682	33,682	15%	100,719	26%
- <i>Non-investment grade corporate bonds</i>	-	42,507	42,507	19%	45,955	12%
- <i>Sovereign bonds</i>	-	5,405	5,405	2%	8,314	2%
Swaps and repos	-	1,605	1,605	1%	2,723	1%
Collective investment schemes	69,324	34,612	103,936	45%	99,062	25%
Hedge funds	232	17,365	17,597	8%	15,812	4%
Others	-	2,303	2,303	1%	27,309	7%
Total	69,569	159,140	228,709	100%	391,656	100%



48. The top 10 firms accounted for 44% of the market value of outstanding positions. This was consistent with these 10 firms' dominance of the sale of investment products, as mentioned above.

Active clientele

49. The 213 licensed corporations reported a total of 52,420 clients who had conducted transaction(s) in investment products (2012: 187 firms, 54,675 clients). The top 10 firms reported a total of 18,658 clients, representing 36% (2012: 37%) of total clients.
50. Around 85% (2012: 83%) of the firms reported that clients had opened accounts with them directly. The remaining 15% (2012: 17%) reported that they served 2,926 clients (2012: 4,723 clients) who had opened accounts with their overseas affiliates. It was noted that the number of clients under such arrangements dropped when compared to the previous survey as a few firms that mainly served clients of their overseas affiliates had ceased to carry out the sale of investment products through licensed corporations.
51. About 11% or 5,596 (2012: 6% or 3,477) clients had been treated as professional investors under the Code of Conduct⁹.

	The top 10 firms	Other firms	Total
No. of firms	10	203	213
-No. of clients	18,658	33,762	52,420
-No. of clients treated as professional investor under the Code of Conduct	2,953	2,643	5,596
No. of firms	4	28	32
-No. of clients opened accounts with overseas affiliates	2,213	713	2,926
-% of overseas affiliates' clients	12%	2%	6%

Investment product issuers

Top investment product issuers concentrated in the top 10 firms or their related companies

52. Each respondent firm reported its top five investment product issuers. Altogether about 300 investment product issuers were reported, representing a total transaction amount of \$351 billion (2012: \$373 billion). These investment product issuers included financial institutions, government or government agencies, and local or overseas corporations. This demonstrated that investment products from a wide range of investment product issuers were offered to individual investors.
53. Out of the transaction amount for the top five investment product issuers reported, \$283 billion or 81% of it (2012: 307 billion or 82%) was issued by the top 10 firms or their related companies. The top 10 firms were both the major sellers and investment product issuers for investment products sold to individual investors.
54. The five international financial conglomerates in the top 10 firms or their related companies had issued \$251 billion of investment products based on the top five investment product issuers reported. The products were mainly structured investment products, swaps or repos and sold by the five international financial conglomerates themselves.

⁹ Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission

Manpower

55. As at 31 March 2014, 5,258 (2012: 6,736) licensed representatives were reported to be engaged in the sale of investment products. The top 10 firms reported having 812 (2012: 1,649) licensed representatives engaged in the sale of investment products, accounting for 15% (2012: 24%) of the total.