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23 April 2009

Market Conduct Policy Division
Capital Markets Department
Monetary Authority of Singapore
10 Shenton Way
MAS Building
Singapore 079117

Dear Sir,

RE: Review of the Regulatory Regime Governing the Sale and Marketing of Unlisted Investment Products

I refer to the above invitation for public comment. The following are my feedback. All references to "FAs" and "FA Reps" refer to both licensed and exempt financial advisers and financial adviser representatives. All feedback and comments are my personal opinions only.

Q1: MAS seeks views on the proposal to require issuers to prepare a Product Highlights Sheet to accompany an offer of an unlisted investment product where the offer requires a prospectus to be issued.

Q2: MAS seeks views on the proposed form and content of the Product Highlights Sheet.

Q3: MAS invites suggestions on how the Product Highlights Sheet can be made more readable and useful for investors.

Q4: MAS invites suggestions on additional information and specific features that should be disclosed in the Product Highlights Sheet for particular products.

The proposal of having a Product Highlights Sheet is similar to the Benefit Illustration (BI) that is required to be provided for the sale of life insurance products. In recent years, the BI has become an incomprehensible and complicated document which frequently contains more pages than the actual policy document. The usefulness of the BI is debatable.

The BI is useful for those who are seeking "no-advice" option since this group of public solely relies on the available information.

Unfortunately the BI is not very useful for the public seeking "product-advice", "specified-needs advice" and "full-advice." Often, the public relies on the recommendation of the FA Rep. If the FA Rep is incompetent, the public will still be at a disadvantage.

Q7: MAS seeks views on the proposal to require marketing and advertising materials for all unlisted investment products to give a fair and balanced view of the product.

Q8: MAS seeks views on the proposal to introduce restrictions on marketing and advertising materials for unlisted investment products.

Under the SFA, marketing materials for securities must not provide information not included in the prospectus. However, the prospectus itself cannot be fully relied on by the public. The disclaimers in a typical prospectus are:

"The Authority assumes no responsibility for the contents of this Prospectus. Registration of this Prospectus by the Authority does not imply that the Securities and Futures Act (Cap. 289) or any other legal or regulatory requirements have been complied with. The Authority has not, in any way, considered the investment merits of the Schemes."

Since there is no assurance that the prospectus itself is legal (as compliant with the relevant law is not guaranteed) and the merit of the investment was not considered, the investment public needs to have both a fair and objective view of the product from other sources.

To have both a fair and objective view of the product, the product manufacturer cannot be the party providing this because of conflict of interest.

If we would to follow the model of bond credit rating agencies, they will not be able to provide a fair and objective view too. This is demonstrated by the current market turmoil in which it has been shown that due to the same conflict of interest, rating agencies have done a poor job in rating debentures.

I would like to suggest that:

1. Setup an independent body of financial experts. The body must not be paid by the product manufacturers to prevent conflict of interest. It will be best that the body of experts be paid by the government to maintain unbiasness. The organization should be linked directly or indirectly to government agencies such as NTUC.

2. The body of experts are than tasked to vet the product's marketing materials and
3. To provide with an unbiased report with regard to the merits and the risks of the products.

Q9(a): MAS seeks views on the alternative proposals:

> ***(i) to prohibit the use of the term "capital/principal protected"; or***
>
> ***(ii) for the industry to develop a standard definition for the term "capital/principal protected" for unlisted investment products.***

Q9(b): MAS invites suggestions on how the terms "capital/principal protected" and "capital/principal guaranteed" can be accurately translated into other languages.

In recent times, there is no longer a significance difference in "capital/principal protected" and a "capital/principal guaranteed" product. In both cases, the product is subjected to the credit risk of the counterparty. Even a fixed deposit (which is a capital guaranteed "product") is no longer a necessarily safe vehicle. Take for instance at this time of writing, 25 banks in the US that have collapsed starting from the beginning of year 2009. In this example, the counterparty risk of fixed deposit is the collapse of the bank. Fortunately, most of the depositors money are insured against such losses.

My suggestions as follows:

1. Prohibit the use of the words "capital/principal protected" and "capital/principal guaranteed" since the word "guaranteed" is also subjected to the credit risk of the counterparty
2. It is more important to disclose under what circumstances that the investment will lose money. ALL investment has the probability of losing money. It is only a matter of how will it be lost. There should be disclosure on how this will happen and whether the lost is insured. If the lost is insured, the identity of the insurer needs to be disclosed in the relevant documents. If the insurer is the government, which government and its credit standing need to be disclose. In addition, what amount is insured and whether is there any excess and co-insurance.

Q11: MAS seeks views on the proposal to enhance existing documentation requirements by requiring FAs to set out in more detail the basis for their recommendation.

Q12: MAS seeks views on the proposal that representatives make reasonable enquiries to obtain key information from the customer.

Q13: MAS seeks views on the proposal to make it an obligation for FA companies to put in place effective systems and internal controls to ensure that their representatives fulfil these obligations.

The root cause of problems we are seeing today is not about the lack of documentation. There are already too many documents. Increasing documentations do not enhance the financial advisory process but only increases cost which ultimately will be passed on to the client directly or indirectly through higher embedded fees. There are technology providers that are able to automate the entire advisory process and generate reports that are aimed at ensuring sufficient documentation but this in no way enhance the advisory process.

I would like to point out that other non-financial advisory professionals do not have so much documentation and yet their professionalism is better respected as compared with the financial advisory industry. The key is with regard to the lack of professionalism in the financial industry.

Therefore, I opposed the proposal for increased documentation.

Instead I would like to suggest the following:

1. A good recommendation requires two things to happen: the client must disclose all relevant details and the FA Rep must be competent to advice. Thus, we should remove the “product-advice” and “specified-needs” advice options. Instead, only permit the “Full advice” and “no-advice” options. In the event which the client select the “Full advice” option, the FA Reps will have to conduct a comprehensive needs analysis. In the event which the client select “no-advice,” this client is considered a DIY investor and hence will not require the assistance from the FA Rep.
2. Enhancement to the “Guidelines on Fit and Proper Criteria” is definitely required but regardless of any updates in this document, it is not legally enforcement. Institutions will and probably have ignored this document in its entirety. Any enhancement is only effective if it is legally (a) enforcement and (b) will be enforced. As long as either of these two factors is not present, any enhancement will not be effective.
3. To improve professionalism, the barrier to entry to the profession has to be increased. Currently, the minimum academic qualification is the “O” level. Other professionals in the industry such as doctors, lawyers, accountants, professional engineers, architects and dentists all required them to have at least

a bachelor degree. The financial adviser representatives only require an "O" level which brings a mockery to the professionalism. The CMFAS exams are so easy that it only take at most 2 weeks of full time study to pass. How could anyone call himself or herself a professional financial adviser when both the academic requirement and the amount of time devoted to studies is set at such low level?

4. With regard to Q13, we can look at how other professions do it. In the field of Professional Engineers (PE), junior engineers who have yet to obtain their PE status are required to work under the supervision of an existing PE holder. The ultimate responsibility of any work done vest on the supervisor. It is only after 4 years of experience would the junior engineer be permitted to apply for a PE license from the Professional Engineering Board. The award is not automatic as it involves interviews and the testimonial support from two unrelated practitioners. Currently, any FA Rep who has passed the CMFAS exams (and obtained their MAS license in the case of non-exempt) is permitted to provide direct financial advice to their clients. An improvement to the system would be a requirement that all such activity be supervised by someone senior and who holds the ultimate responsibility for the advice given. It is only after a few years in the job would the person be permitted to provide financial advice and held directly accountable.

Q14: MAS seeks views on the proposal that FAs may dispense with giving advice only when the customer contacts the FAs on his own initiative to purchase the investment product.

Q15: MAS seeks views on the proposal to require that FAs warn customers in writing that the customer is waiving his right to receive advice as to whether a product is suitable for him under the FAA.

The principle of protecting client's interest should be symmetrically apply in all situation – regardless of whether the client approaches the FAs or the other way round. Thus, I am against the asymmetric approach as proposed by the consultation paper.

My suggestion as follows:

1. Regardless of who approaches whom, the FA Rep must offer the client the chance to opt for "full advice.".
2. If the client refuses, the FA will document this down and ask the client to sign on the waiver form.

MAS will also need to consider practical problems that will arise. In many instances, it is unclear which party approaches whom. For instance, the client may response to a newspaper or an E-mail marketing advertisement from a FA. In this case, who was the first to "initiate"?

Q16: MAS seeks views on the proposal to prohibit bank tellers from referring customers to representatives for the purchase of investment products.

The activity which the bank tellers are doing in referring clients to their other colleagues is what we call “lead generating” activities. There are countless ways of generating leads. The reason why there had been so many complains with regard to the bank tellers referral activity is the manner which how the leads are generated. The leads are generated based on the principle of disrespecting clients’ privacy. Prohibiting bank tellers from generating leads is not addressing the root problem. The root problem is that these leads are generated based on privileged information. Thus, unless customers’ privacy is respected, the financial institutions will find other ways of generating leads through means that infringes on privacy. For example, telemarketing is another problem because the telemarketer would often be given names after the institutions have done some “data mining” exercise. The data mining exercise is itself an infringement of clients’ privacy.

My suggestions:

1. Within the organization, there should be a “firewall” between FA Representatives and other staff. FA Representatives who are in the job of providing regulated financial advisory service should not have access to these customers’ financial information. The onus is on the customer to provide these information to the FA Rep. Similarly, the organization’s staff (e.g. bank tellers) who has access to the client’s information should be prohibited from using those information to generate leads.
2. Another way is to separate the traditional banking business (i.e. depositing taking and loans) and the financial advisory service by creation of separate subsidiaries. This will provide a natural “firewall”.
3. The referral activity is nothing wrong by itself. Instead, MAS may want to encourage those engaging in referrals to leverage upon the existing regulations with regard to the role of the Introducer.
4. Implement a robust privacy law to provide a long term solution.

Q17: MAS invites suggestions on how remuneration structures can better align the interests of representatives with those of customers.

MAS may need to know that a good financial advice often do not result in a product sale. For example, helping the client to manage his cash flow, credit management, education planning, tax planning, protection planning, retirement planning and estate planning are part and parcel of financial planning. Yet if the practitioner is only compensated when a sale of a product is made, this will result in areas that will be neglected and other areas over emphasized (thus creating an incentive for mis-selling).

Currently, commissions from sale of product is the most common form of remuneration. Even salaried FA Reps tend to skew their recommendations towards certain products because commissions given to their FA firms are higher and this ultimately affects the FA Rep's year end bonus.

Commissions have resulted in the following problems in the industry:

1. Churning. The frequent buying and selling of products with no good reason. Each churn generates commissions.
2. Tendency to sell certain products over another. For example, the tendency to sell whole life insurance/ILP than a term insurance because the former's commission is higher than the latter. That is why the LIA statistic has shown that the average death benefit claims payout work out to be just average $38,380 per policy in the fourth quarter 2008.
3. Lack of after-sale service. Advisers "disappearing" when there are insurance claims to be made or when the investments are in the red. There is no commission to be earned from processing a claim and there is nothing to earn for briefing the client on the investment and economy situation.
4. Since commissions are only earned upon a sale of a product, the system rewards advisers who tend to have a better selling skill. However, selling skill has nothing to do with good financial advice. Those who stay on in the industry on a longer term basis tend to be those with better salesmanship.
5. Similarly, the commission structure penalizes those who lack salesmanship but have the competency to provide good advice.
6. Since the FA Rep earns nothing until a sale is done and since a sale cannot be assured in all cases, clients who buy products subsidies those who does not. This means that clients who buy products are unfairly charged.
7. Some products pay outrageous commissions for little work done. This is unfair to the client afterall the client is the one who ultimately pays the commission.
8. Some products pay insignificant commissions despite the large amount of work that the adviser has to do. Thus, the adviser is under paid;
9. Many superior products pay no commission and thus advisers have no incentive to recommend these if they are relying on commissions.
10. Moral hazards – imagine a doctor who only earns from commission selling drugs but cannot charge a consultation fee. Can anyone imagine the risk of being prescribed unnecessary drugs just because of the doctor's compensation cannot be derived from consultation fees? The moral hazards of wide-spread mis-selling for financial products is a testimony that the hazard is very real and is and will continue to happen unless commissions are outlawed.
11. Good advice frequently will not necessarily result in product sale. The FA Rep works for "free" in such cases and yet remains liable for the advice given. The following are examples of common activities that pays no commission because there will not be any product sale:
    a. Minimizing income tax
    b. Debt/credit management;
    c. Cash flow, Balance Sheet and Ratio Analysis;
    d. Advice on the selection of client's employer sponsored insurance;
    e. Investment planning and advice using passive funds like ETFs;
    f. Mortgage loan and installment calculation;

g. CPF related advice such as amount eligible for mortgage, Minimum Sum Scheme, CPF Life, etc;
h. Removing duplicate insurance policies and unnecessary riders;

The only other model that is not commission based is when the client agrees to compensate the FA Rep for service rendered. Popularly known as the fee-based model, this is probably the only other alternative that can align the interest of the client with the adviser.

The advantage of fee-based remuneration as follows:

1. Transparency – the client knows how much they are paying.
2. All clients pay according to the actual work done. A simple case cost less than a complex case. No cross-subsidy between clients.
3. Advisers are free to recommend without worrying about their compensation since this is already decided upfront;
4. Superior products with no commission payable will be considered by the adviser.
5. Advisers will focus on the quality of his advice instead of salesmanship.
6. Many industry problems will disappear such as churning. There is no incentive to churn since there is no commission for doing so.
7. There is also no more bias with regard to certain products over others (ILPs vs Term) since they pay no commission. Advice will be based purely on client's interest and not product's commission.
8. If the client expect certain after-sales service, the adviser is free to charge the necessarily fee for providing this on-going service.
9. The system rewards those who are truly professional and penalizes the salesman type.

However, the fee-based has some problems:

1. Very few clients would pay fee for advice because the industry lacks professionalism. Professionalism need to improve to justify the fee. As I pointed out above, raising the barrier of entry is one way of improving professionalism.
2. Due to human psychology, clients generally do not mind paying huge embedded commissions but dislike paying a separate fee for service rendered. It is perceived that fee-based is more expensive than commissions. It is also perceived fee-based is only meant for the rich.
3. If commissions are outlawed, there is a possibility for clients to approach the product manufacturer directly (since there is no commission embedded in the product) and bypassing the financial advisers. This should not be a too serious of a problem as these customers will be seeking "no-advice" option and will have little protection from the FAA anyway. However, the product manufacturer must obtain a waiver of advice from the client to prevent any misunderstanding.

Here are my suggestions:

1. The FA Rep should disclose to their customers from the onset the type of remuneration they will be receiving – whether it is commissions, fee-based or bonuses linked to product sales production.
2. These customers will be required to sign and acknowledge the conflict of interest that will arise for FA Reps who are not fee-based. Customers will also need to be informed in writing and signed acknowledging that they could seek an unbias advice from others who are fee-based.
3. For FA Reps who are fee-based,
    a. A disclosure in writing that there are no known conflict of interest.
    b. how the fees are charge (e.g. lump sum, hourly, etc) should be disclosed in writing and signed by the customer.
    c. On whether will the FA Rep be providing after-sales service (e.g. portfolio rebalancing) and the method of how the after-sales service fee is calculated (e.g. % on AUM, or a fixed retainer fee)
4. To ensure professional standards are met to justify the fee, legislation may want to mandate the fee-based adviser to possess the relevant professional qualification such as CFP/ChFC for financial planning and CFA for investment.

Q18(a): MAS seeks views on the proposal to define a complex investment product based on whether or not derivatives are embedded in the investment product.

Q18(b): MAS invites suggestions on how the definition of "complex investment products" may better capture the differences between simpler and more exotic derivatives.

Derivatives are double edged sword. There are two groups of investors who use derivatives – these are the hedgers and the speculators. The former seeks to transfer financial risks while the latter gladly accept risks in hope of earning spectacular returns. Therefore, it is not appropriate to label a product as "complex" based on whether there exists derivatives embedded since the intended use depends on the context.

On the other hand, many investors bought products without realizing that they have become counterparties to derivative transactions. In the appendix attached to this document is a simple example of an Equity-Linked-Note which although on the surface seems to be a debenture providing a steady interests to the investor but is in reality a derivative transaction for which the investor is acting as a put option writer. In layman terms, the investor has become an insurer for the counterparty.

There are many examples of structured products in which investors are not aware that they are acting as counterparties to a derivative transaction. Therefore, may I suggest that an investment product be labeled as "complex" when on analysis the investor is a counterparty acting as:

1. Selling a put option
2. Buying a put option
3. Selling a call option
4. Buying a call option
5. Acting as a swap counterparty
6. Entering into a forward contract
7. Entering into a futures contracts

In addition, the financial adviser or institutions handling the transaction should be required to be regulated either as exempt or licensed under the relevant SFA and FAA relating to derivatives afterall the client is in principle entering into a derivative contact.

Since a derivative is either meant to hedge risk or to accept risk for spectacular gains, the relevant documents such as the prospectus and Product Highlight Sheet can provide the information required on whether the product is meant for the hedger or the speculator or both.

Since it will not be the interest of the distributor and issuer to disclose these facts due to conflict of interest, the independent body can provide this service.

> ***Q22: MAS seeks views on the proposal to require issuers and distributors of complex investment products to incorporate a "health warning" on all disclosure documents, and marketing and advertising materials.***

The "health warning" label seems to overlap the proposal for the Product Highlight Sheets.

> ***Q25: MAS seeks views on the proposal for a cooling off period of seven days for unlisted debentures.***

There is an inconsistency on why life insurance policies free-look period is 14 days while CIS is 7 days. I suggest CIS and unlisted debentures have a free-look period of 14 days in order to be consistent with life insurance.

Yours sincerely,

Ling Siew Wee Wilfred

Appendix – An example of purchaser for an ELN that is a short put option

This is a simple example of an equity-linked note, The note is linked to one company share.

1. On each quarterly observation dates, as long as the share price is above a predetermined value, the investor receives an interest.
2. On maturity, if the share price is below a strike price (say equal to 70% of the initial share price of the stock) the investors receives the shares instead of his capital. The total number of shares received is = capital / initial share price.
3. On maturity, if the share price is above the strike price, he receives his capital in full.

The following is an example how an independent body of financial experts can provide to the consumer:

On analysis, the above example of a ELN is make up of two components namely:

1. A zero coupon bond that will provide the par value on maturity and
2. A short put option the investor is providing.

Of concern is the short put option. The investors are actually writing a put option for the investment bank. Investors are acting as the "short". The counterparty for this is the investment bank that is purchasing a put option from the investor. The investment bank is the "long". Recall that a long put option provides the option buyer the right (but not the obligation) to sell an underlying security at a predetermined price. However, opposite side of the transaction is the short who has the obligation to buy the securities at the predetermined price in the event the long exercises its right.

Since the investor is acting as the short, it means that the maximum gain he will have in such an investment is the option premium (which in the above ELN example is the regular interest receives on the observation dates). The worst case downside in this example is when he is required to buy the worthless shares at the initial price. Thus, the maximum downside is that he will lose his entire capital.

Besides being exposed to the downside risk of the short, the investor is exposed to the credit risk bond issuer.

For a plain vanilla short put option, the short do not provide an outlay of any capital initially but in fact receives cash inflow due to option premium. However, in the ELN example, the investor has to provide an outlay of capital so as to eliminate the default risk associated with the short.

Thus this "ELN" product is complex because in reality:

1. The investment bank is limiting its own investment loses through hedging. To provide the hedging facility, it transfers this financial risk to the investor.
2. The investment bank enjoy unlimited upside since an appreciation of the underlying has no cap to it.
3. The investor acts as an insurer providing the service of absorbing the financial risk transferred to him.
4. As an insurer, the investor receives compensation in the form of regular interest (which is actually a form of option premium) and
5. Knowing that there is a possibility that the investor can default in the event when the put option is to be exercise, the investment bank eliminates the default risk by having the investor advance a lump sum capital and place it in a zero coupon bond.

Suitability:
The ELN is only suitable for the sophisticated investor who has an identical but opposite position which in this case will be a long put. The short put and long put neutralized each other eliminating investment risks. The gain to the investor is the spread achieved at no risk. In this context, if the option premium received for the short exceeds the option premium paid for the long, the investor gain through this spread.