

The Renewed Death of Contract?

Post-crisis Financial Product Conduct Reforms

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“Que faut-il faire pour vous aider?” asked Colbert.

“Nous laisser faire,” answered Legendre.¹

Post-crisis financial re-regulation in place or underway in Hong Kong and elsewhere includes restrictions on forms of contracting and new rules governing business and financial product conduct. Measures of this kind may dampen activity but do little to protect investors or other users, nor mitigate against future instability. They resemble a swing towards state incursion on contracting of a kind regularly identified by legal scholars. To the extent that the state wishes to protect the interests of retail investors or speculative users of complex financial instruments there may be more merit in requiring “intelligent disclosure” specific to each class of instrument, and extending the doctrine of unconscionability to include financial instruments, as in certain circumstances in Australia. Outright contractual bans are an unreasonable and costly extension of state policy, the underlying purpose of which is to divert popular attention from regulatory failure, while highly prescriptive point of sale rules may make it less likely for legitimate complaints of mis-selling to succeed.

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¹ J.M. Keynes, *The End of Laissez-faire* (1926), II, n. 2, in D. Moggridge (ed.) *The Collected Writings of John Maynard Keynes, Vol. 9, Essays in Persuasion* (London, Macmillan, 1971), reconstructing a 17th century exchange between Louis XIV’s commerce minister and an aggrieved merchant.

1. Introduction

Post-crisis re-regulation of the global financial sector includes measures that will deliberately reduce the contractual freedom of both financial intermediaries and their counterparties. This trend is evident in Hong Kong, Singapore, the EU and US, and in more extreme forms through prohibitions on the sale of broad classes of instruments, as for example in Norway. It results from political demands for enhanced investor or consumer protection in response to mis-selling, or as part of a wish to contain systemic risks popularly associated since 2008 with complex financial instruments or derivatives. It differs from traditional point of sale regulation and sanctions against misconduct, and in Hong Kong and the UK, for example, signifies a failure of confidence in principles based regulation.²

The sweep of regulation with which this article is concerned seeks to heighten investor protection through new product or business conduct rules. Product conduct regulation includes limits on uses of financial products such as credit linked or structured notes, credit default swaps, synthetic exchange traded funds (ETFs) and certain other transaction types with embedded derivatives, while rules over business conduct extend in prescriptive detail generally accepted provisions against mis-selling.³ Both trends raise concerns that re-regulation may conflict unreasonably with contracting party autonomy.

² Principles based regulation may take several distinct forms, *see* J. Black (2010) “The Rise, Fall and Fate of Principles Based Regulation” LSE Legal Studies Working Paper No. 17/2010, available at <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1712862> (visited 25 April 2013). It is treated here as favouring regulatory guidance over prescriptive rules. The UK regulator’s change in practice was signalled as a shift towards “outcomes based regulation” by the Financial Services Authority (FSA), *see* A. Turner, *The Turner Review* (London, FSA, 2009) pp 86-91, and characterised as “a more intrusive and direct regulatory style than the FSA has previously adopted [... requiring] a ‘braver’ [sic.] approach to decision making by supervisors”, *see* FSA (2009) “A Regulatory Response to the Global Banking Crisis”, Discussion Paper 09/2, p 186 (available at <<http://www.fsa.gov.uk/library/policy/dp/2009>> (visited 25 April 2013).

³ Product or business conduct rules also differ from quantitative rules that directly affect financial practice and are typically introduced for stability reasons, notably simple restrictions on bank leverage or the ratio of new property loans to collateral value, both of which are commonly used in Asia.

Some states have traditionally required that regulators explicitly sanction new financial instruments, without which any contract of sale might be invalid or an instrument made unenforceable within the jurisdiction. Others grant national regulators broad executive powers, making their consent to new products a practical though non-specific necessity. Thus formal product approvals were required in Germany and Austria, for example, prior to the implementation of measures contributing to the EU's single market in financial services including the investor protection focused Directive on Markets and Financial Instruments (MiFID),⁴ while Singapore has operated a less formal regime with prior approval of its Monetary Authority (MAS) customarily necessary for financial intermediaries to engage in new transactions with domestic counterparties, although historically with little or no statutory interference over contractual design. That financial contracts might be considered unenforceable has been associated with the treatment from time-to-time by certain jurisdictions of aleatory or gaming contracts, an approach resembling one suggested recently as a means to discourage speculative uses of certain derivative contracts.⁵

This article will suggest that a compression of contractual freedom by product conduct regulation will reduce the choices reasonably available to both retail and other non-professional financial market participants without lowering the potential for mis-selling or systemic instability. It will also argue that certain aspects of business conduct regulation may

⁴ Dir 2004/39/EC OJ L145.

⁵ Courts in England and New York have found financial derivatives to be properly commercial rather than aleatory contracts that might be considered unenforceable, even when used for purposes accepted as speculative, *see Morgan Grenfell & Co. Ltd. v Welwyn & Hatfield D.C.* [1995] 1 All ER 1 (not fully reported); *Korea Life Insurance Co. v Morgan Guaranty Trust Co. of New York* [2003] 269 F.Supp.2d 424. An alternative view is that the uncertain outcome associated with many derivatives is tantamount to gambling such that they would be unenforceable in US common law were it not for supervening legislation, *see* L. Stout (2011) "Derivatives and the Legal Origin of the 2008 Credit Crisis", 1 *Harv Bus L Rev* 1, 1. A separate contention is that English courts have difficulty in enforcing some (but not all) derivatives where they concern intangible subjects, that is, for lack of an existing or material underlier at the time of execution, *see* H. Collins, *Regulating Contracts* (Oxford, Oxford University Press, 1999), pp 209-218. This helps explain contracts being made in private organised markets or exchanges, the rules for enforcement of which participants are willing to accept. Many states eliminate such uncertainty with laws exempting financial contracts from gambling restrictions, and in the UK recent legislation removed any residual doubt that aleatory contracts were necessarily unenforceable (Gambling Act 2005 c.19 s.335). Some states treat derivative contracts as enforceable only when used for non-speculative purposes, as for example as Thailand, *see* S. Henderson, *Henderson on Derivatives*, 2d ed. (London, LexisNexis, 2010), pp 536-9.

not assist in providing the investor with more complete or usable information, and may even weaken the position of non-professional investors seeking remedies for mis-selling, especially since the courts in Hong Kong and England have been reluctant to recognize retail users of complex or new products as non-professional. Many current reforms may also be seen in a longer-term perspective as a shift in the balance between contractual autonomy and state involvement in commercial activity, once characterised as a steady decline in freedom of contract under English law from a libertarian Victorian peak.⁶

An alternative approach that would not involve a loss of welfare would be:

- First, to require transaction arrangers to ensure that pertinent disclosure of how financial instruments function is made in dealings with retail and other non-professional investors, whether or not they enjoy direct contact with those investors. This conforms with Hong Kong Monetary Authority (HKMA) guidance to banks (as licensed Authorised Institutions and not in a specific transactional capacity) but may have been weakened as a statutory requirement as the result of 2011 legislative changes initiated by the Securities and Futures Commission (SFC).⁷
- Second, to extend the applicability of contractual unconscionability to include the mis-selling of financial services and instruments to retail investors or consumers of financial products where those contracts result from great bargaining inequality.⁸

⁶ P. Atiyah, *The Rise and Fall of Freedom of Contract* (Oxford, Oxford University Press, 1979). Atiyah later partly recanted (as if acknowledging political shifts in the UK and US) by suggesting that the law oscillated between contractual freedom and state regulation, *see idem* “Freedom of Contract and the New Right”, in P. Atiyah, *Essays on Contract* (Oxford, Clarendon Press, 1988), p 355.

⁷ *See* HKMA circular “Selling of Investment Products”, 5 January 2012 and *see* n 61 below and accompanying text.

⁸ As allowed in certain circumstances in Australia, *see* Australian Securities and Investments Commission Act 2001 Sect. 12CA & 12CB, and more recently in Singapore as a result of the Consumer Protection (Fair Trading) (Amendment) Act 2008 (Act 15 of 2008). US federal law has since 1965 allowed the court to declare unenforceable all or part of a contract found unconscionable at the time of execution (codifying earlier decisional law), *see* U.C.C. §2-302. The doctrine has generally been disfavoured by the courts in England and Hong Kong and confined by statute to the sale of goods.

Ignoring instances of business misconduct including fraud, negligence or misrepresentation at the point of sale, such provisions would have allowed considerable protection to non-professional buyers of complex instruments of the types arranged by Lehman Brothers and sold extensively in a number of jurisdictions from 2000 until mid-2008.⁹

This article will outline the perceived need for re-regulation and the measures adopted so far in Hong Kong and certain other jurisdictions towards those ends, before proposing an alternative approach to reform. It deals with most publicly distributed financial instruments whether or not listed on an organised exchange or regarded as securities in law, but especially those commonly regarded as complex, including structured notes, deposits and synthetic ETFs. The remarks it contains are not intended as a discussion of the individual's rights or obligations or of positive or negative freedoms; no absolute freedom exists even if confined to the right to engage in trade or exchange.¹⁰ They will not address fraud, bargains involving negligent mis-statement or misrepresentation at the point of sale, nor the mis-selling of consumer credit or loans, although similar principles may apply to the last example.¹¹ Intermediaries are taken to function as transaction *arrangers* or *distributors*, the latter engaging with investors at the point of sale. A single organisation may take both roles through separate legal or administrative entities.

⁹ Including notably its Minibond brand of structured notes sold mainly in Hong Kong and Singapore in the period 2002-08. A generic description of the Minibond structure appears in P. Lejot (2008) "Dictum Non Meum Pactum: Lehman's Minibond Transactions" 38 *HKLJ* 3, 585, although the design varied in detail between issues. The final transactions completed in 2008 were the largest of their respective Hong Kong and Singapore programmes, and were sold in Singapore one month prior to Lehman's bankruptcy filing on 15 September 2008 and in Hong Kong three months earlier.

¹⁰ See M. Pettit (1999) "Freedom, Freedom of Contract, and the "Rise And Fall"" 79 *BU L Rev* 263, 282. Contrary examples exist where the courts have enforced contracts allowing odious debts to be recovered by distressed debt funds against very low income states despite their representing a moral abuse and contrary to public policy, see notably the English case *Donegal International Ltd. v Zambia* [2007] EWHC 197 (Comm), where the court found for the claimant but acknowledged that doing so offended against the G-8 economies agreeing in 2005 a part annulment of external claims against certain highly indebted poor states. Odious debts are liabilities incurred by a prior regime of a state that has undergone democratic reform.

¹¹ This has been subject to considerable academic and legislative attention in the US due to its experience with predatory and subprime mortgage lending, one analysis being instrumental in the creation of a federal Bureau of Consumer Finance Protection under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. 111-203, §§1001-1100, see O. Bar-Gill & E. Warren (2008) "Making Credit Safer" 157 *U Pa L Rev* 1.

2. The need for re-regulation

Hong Kong and Singapore are singular in that in each case many individual investors were impacted directly by Lehman Brothers' bankruptcy filing in September 2008.¹² Recovery prospects for Hong Kong holders of the firm's structured notes were unpredictable until July 2009, unquantifiable until June 2011 or May 2012 depending on which series of notes were held, and are still uncertain for a minority that became general creditors of the Lehman estate.¹³ The SFC's head gave a plain defence of caveat emptor to a Legislative Council panel within one month of the filing, stating that for buyers of structured notes arranged by Lehman "the requirement is to understand the features of the product" and "ask 'why does it pay me more than the normal deposit of the bank?'"¹⁴ He also quoted without attribution passages from Lehman Minibond prospectuses stating that the defaulting issues "were backed by triple A collaterals [sic.] and the likely cumulative historical rate of failure for triple A collaterals over the past 25 years between 1981 and 2006 is 0.09 percent for the first three years."¹⁵

¹² Distress in other jurisdictions was largely confined to claimants in the bankruptcy, systemic problems associated with financial contagion and losses among professional counterparties on holdings of complex securities.

¹³ Recovery rates for most Minibond series were between 73.5 and 95.1 per cent of principal, *see* HKMA press release "Further recovery of Minibond collateral", 4 June 2012 (available at <<http://www.hkma.gov.hk/eng/key-information/press-releases/2012/20120604-3.shtml>> visited 25 April 2013), far exceeding early expectations (excluding four series in which the collateral included direct obligations of Lehman). Public anger encouraged Hong Kong regulators to agree to cease investigating non-criminal point of sale misconduct in consideration for the main Minibond distributors repurchasing notes from most retail holders at discounts varying according to the noteholder's status, the eventual value of realized collateral and a share of commissions paid to distributors by Lehman, *see* HKMA & SFC press release "SFC, HKMA and 16 banks reach agreement on Minibonds", 22 July 2009 (available at <<http://www.sfc.hk/sfcPressRelease/EN/sfcOpenDocServlet?docno=09PR100>> visited 25 April 2013), and *see* also n 40 below. These settlements together covered approximately HK\$9.5 billion (US\$1.2 billion) of outstanding principal. Separate repurchases were negotiated in 2010-11 with Hong Kong distributors of other Lehman structured notes. Singapore's approach was more granular but realised similar recovery rates to Hong Kong. The MAS first prohibited several distributors from dealing in structured products, then gave support and guidance to individual complainants to seek redress from distributors, which it separately encouraged to settle but without the public general agreement concluded in Hong Kong. In both cases favourable repurchase terms were offered to the elderly and in some cases to noteholders with limited educational attainment.

¹⁴ Testimony of Martin Wheatley, LC Paper No. CB (2) 216/08-09 at 37.

¹⁵ *Ibid.* Three years was the contractual tenor of most Minibonds. The reference to historical default probability is identical to an assertion in the 2008 Minibond Series 36 issue prospectus at p 54, available at <http://www.sfc.hk/sfc/html/EN/general/general/lehman/lehman_structure_products.html>

This seems also to have been a defence of supervisory performance, either in suggesting that the risks associated with Lehman's products were small until the firm's collapse or that the SFC had earlier been justified in believing that they were. Losses suffered by most investors eventually proved modest (due to the regulators' non-judicial negotiations and lapse of time allowing collateral to be fairly valued) but can largely be attributed to the transaction structure being poorly understood and subject to notable though inconspicuous legal risks. One further possibility is thus that the SFC may not have understood the transactions or the consequences of their design, with two results. First, conditions in the markets for many asset backed securities and CDOs softened in late 2006 and worsened materially from mid-2007, yet the SFC took no precautionary action in relation to new retail issues over the period through to October 2008 nor made any public warning of increasing risk.¹⁶ Second, the SFC required inclusion of too little usable information in prospectuses and transaction sale documents to allow most complex issues to be assessed and valued by any party other than arrangers such as Lehman or in some cases their distributors.¹⁷

It is certainly appropriate to ask if complex instruments represent unequal bargains, either generically or within any single class of instrument, and to question the extent to which the many financial techniques and instruments developed in the two decades to 2008 has benefited the broader economy.¹⁸ What is the proper scope for their sale and is disclosure of

(visited 25 April 2013). The statement misleadingly conflates the default performance of AAA corporate debt issues with those of AAA collateralised debt obligations (CDOs). The phrase "backed by [...] collateral" also wrongly suggests that during the life of the notes the principal outstanding would have been matched by the value of that collateral.

¹⁶ Albeit that few reductions in credit ratings for structured issues were made until mid-2008.

¹⁷ See Lejot n 9 above, p 592.

¹⁸ The value of financial activity when not facilitating commerce, consumption or capital investment has long been disputed and not only in radical criticism of finance capitalism, see for example, C. Kindleberger, *World Economic Primacy: 1500-1990* (Oxford, Oxford University Press, 1996), pp 212-5, for whom it becomes synonymous with economic decline. Many post-crisis polemics using similar arguments are attributable to establishment commentators, see for example, W. Buiter, *Useless Finance, Harmful Finance and Useful Finance*, 12 April 2009, available at <<http://blogs.ft.com/maverecon/2009/04/useless-finance-harmful-finance-and-useful-finance/#axzz20LQTj8dx>> (visited 25 April 2013); J. Stiglitz, *Freefall: Free Markets and the Sinking of the Global Economy* (London, Allen Lane, 2010); Turner, *The Turner Review*, see n 2 above).

their main commercial terms and payment outcomes sufficient for a buyer's decision to be fairly informed, even with the imperative that they be presented in plain language as the SFC now requires?¹⁹ Was the Minibond debacle so clear a regulatory failure as to prompt a new approach? All genuinely new products challenge regulation because their novelty implies that they will not have been considered by regulators.²⁰ Complex instruments are usually proprietary and may be contractually intensive and subject to legal uncertainty,²¹ making meaningful disclosure critical to investor assessment, especially with regard to a transaction's purpose and how that is met by contractual structure. The need is shared equally by sophisticated and other users and regardless of any user's motives or preferences. It is especially important since arrangers and distributors of structured products are commonly separate legal or administrative entities and investors must be assured that distributors fully share the arranger's product knowledge.²²

Judging the welfare contribution of financial instruments is inevitably subjective, and a problem for regulators since they "cannot directly observe the preferences of their constituents, nor [...] have any practical means of aggregating these preferences into a social welfare function", see D. Awrey (forthcoming 2012) "Complexity, Innovation and the Regulation of Modern Financial Markets" 2 *Harv Bus L Rev*. This makes the regulator's choice of policies indeterminate in their effect on general welfare, and increase the propensity for shocks or crises to result in retaliatory regulation.

¹⁹ See n 61 below and accompanying text.

²⁰ J. Dalhuisen, *Dalhuisen on Transnational Comparative, Commercial, Financial, and Trade Law* (Oxford, Hart, 2010), pp 477-8. This need not create insuperable problems nor justify extensive product restrictions since modern finance has arguably produced few genuine transactional innovations but relies on an adaptive and marketing oriented process to suggest the contrary, see Q. Liu, P. Lejot & D. Arner, *Finance in Asia, Institutions, Regulation and Policy* (London, Routledge, forthcoming 2013), Ch. 7.

²¹ For example, Lehman's Hong Kong structured product prospectuses made no reference to some issues containing "flip clauses" that might materially alter the recovery rates of noteholders after a failure of the arranger. Flip or insolvency protection clauses are common in structured finance. They provide for the subordination of the claim of a swap counterparty (usually associated with the transaction arranger) to those of noteholders in the event of embedded swaps being terminated. Their aim is to maintain the priority of noteholders over transactional collateral prevailing prior to a termination event, which would otherwise be upset by standard International Swaps and Derivative Association (ISDA) practice. Lehman's flip clauses were tested in litigation after the firm's bankruptcy with conflicting results in England, where the Supreme Court found that they caused no loss in value to the bankrupt estate and thus did not offend a common law anti-deprivation rule (*Belmont Park Investments Pty. Ltd. v BNY Corporate Trustee Services Ltd. & Lehman Brothers Special Financing Inc.* [2011] UKSC 38), and in New York, where they were found to conflict with the US Bankruptcy Code and thus ruled invalid (*Lehman Brothers Special Financing Inc. v BNP Corporate Trustee Services Ltd.*, Summary Judgment No. 09-01242 (JMP), US Bankruptcy Court, SDNY 25 January 2010). The decision in *Belmont* was welcomed by market participants but it has been argued that special circumstances might limit its application, see S. Worthington (2012) "Good Faith, Flawed Assets and the Emasculation of the UK Anti-Deprivation Rule" 75 *MLR* 1, 112. Uncertainty as to the effectiveness of flip clauses is certain to prompt revisions to standardised documentation.

²² This is a concern of industry bodies such as ISDA, see Joint Associations Committee on Retail Structured Products (2007) "Retail Structured Products: Principles for managing the provider-

This suggests that *supervisory insight* is necessary, not mere point of sale regulation. By contrast, the risk of loss and difficulties in investor assessment are commonly taken for granted in ordinary shares, convertible bonds and other instruments, all supposedly non-complex claims.²³ The approach proposed here is consistent with the original objectives of the MiFID “information model”,²⁴ to recognise that financial regulation ought properly to accommodate bounded rationality as well as investor behaviour commonly accepted as rational, and so provide guidance or support to needful investors without unduly limiting the contractual freedom of those who do not want or have no need for excessive advice or assistance.²⁵

Complex products are conceptually easy to grasp and difficult to define, a combination analogous to their appeal to buyers. They may have many differing characteristics, and are often but not necessarily intended for risk preferring users. Complex instruments can be wholly unaggressive in both structure or intention, and designed according to demand for capital preservation or targeted to conservative investors just as often as they include leverage or uncertain outcomes for the risk preferring. They include instruments whose returns are contingent upon one or more exogenous events, and will often incorporate derivative

distributor relationship” July 2007, available at <<http://www.icmagroup.org/assets/documents/RSP%20Principles%20REVISEDFINAL.pdf>> (visited 25 April 2013). Information flows can be poor even when one organisation is both arranger and distributor, as in a leading English misrepresentation case where a credit linked deposit arranged by one unit was wrongly described by a second as constituting rights against the deposit’s reference entity (*Peekay Intermark Limited & Another v Australia and New Zealand Banking Group Ltd* [2005] EWHC 830 (Comm), [2006] EWCA Civ 386).

²³ Equities are customarily taken to represent easily assessed claims. Shareholders in the HSBC group received a 2010 annual report of 397 pages, including an eight page glossary of terms and 88 pages on risks within the bank but without mention of specific legal risks, for example those relating to US regulatory investigations into money laundering or mortgage lending conduct that became public in 2011-12. See also n 28 below.

²⁴ See L. Klöhn (2009) “Preventing Excessive Retail Investor Trading under MiFID: A Behavioural Law & Economics Perspective” 10 *EBOR* 437.

²⁵ *Ibid* at 440. The principle of libertarian (non-legal) paternalism accommodates bounded rationality and represents “an approach that preserves freedom of choice but that authorizes both private and public institutions to steer people in directions that will promote their welfare” R. Thaler & C. Sunstein (2003) “Libertarian Paternalism” 93 *Amer Econ Rev* 2, 175, 179. See also C. Sunstein & R. Thaler (2003) “Libertarian Paternalism is not an Oxymoron” 70 *U Chi L Rev* 4, 1159.

elements, in some cases subject to variation during the life of the transaction such as with many synthetic ETFs and accumulators, or rolling option contracts. Legislation may grant authority to a regulator to pronounce upon the complexity of an instrument, and in some cases make disclosure demands of its seller or indicate that the product may not be made available outside a defined constituency, for example a limited number of non-retail counterparties, a consumer protection approach to securities regulation originating in the US. Contractual complexity is taken here to mean debt instruments or shares in synthetic ETFs that have an embedded derivative content that is not ordinarily separable.²⁶ In these cases contracts may be simple to express and execute but their design will usually be intricate.

The growth in issuance of complex securities from the 1990s took two main forms, through widely distributed securitised transactions and by highly rated frequent borrowers using debt issuance programmes to sell bespoke structured notes. The latter are issued at the instigation of professional intermediaries or high net worth (HNW) investors to suit their risk-return preferences or expectations at any time, a process known as reverse enquiry. An investor believing that its needs are met by a three year US dollar note putable to the issuer during its life if aviation fuel doubles in price can value the required option (or ask its advisor to do so), discount the cost against an interest rate index benchmark and approach the World Bank, for example, asking that it issue notes on such terms in an amount of the investor's choice. If the proposal meets the World Bank's published target borrowing costs then the issue will be agreed, 'printed' and settled quickly, the cost of funds subsidised by the value of the option sold to the investor.

²⁶ Callable, convertible and exchangeable bonds can be similarly complex but by custom are treated otherwise and thus inconsistently excluded from definitions of "structured product" added to the Securities and Futures Ordinance (SFO) Cap 571 in 2011, *see* n 55 below. Cash and synthetic ETFs are taken here as respectively simple and complex arrangements, but this distinction is not formally recognised in Hong Kong, nor for example in new disclosure guidelines issued by the European Securities and Markets Authority (ESMA) intended "to protect investors by providing guidance on the information that should be communicated with respect to [...] ETFs", *see* ESMA "Guidelines on ETFs and other UCITS issues" Report & Consultation Paper 2012/474, 25 July 2012, p 43, available at <http://www.esma.europa.eu/system/files/2012-474_0.pdf> (visited 25 April 2013).

The terms of this example would be worthless or costly to most investors but might suit an airline treasury that expected to be cash rich unless aviation fuel rose unexpectedly in price within three years. This description differs in no material respect from complex issues sold to retail buyers except that it results from broadly equal bargaining, even in highly structured deals. While the HNW or professional investor can readily command the attention of the issuer or arranger, it is impossible for retail investors to match that positional equality since the transactions they enter are largely standardised and the result of proprietary sales rather than bargaining.²⁷ True negotiations would be impossible due to excessive costs and the statutory imperative for all investors to receive like information.

Three possible solutions with respect to retail investors are first, to prohibit all sales of complex transactions; second, to circumscribe the available choice of instruments or risks; and third, to compel intelligent disclosure so as to lessen their bargaining inequality. Only the third alternative allows broad contractual autonomy. Many jurisdictions adopt the second but the results can become arbitrary and more exculpatory than to serve investor protection.²⁸ Since retail buyers are unable to bargain with distributors they must have access to reasonably presented information sufficient to judge the expected risks and return associated with complex instruments and how they compare with competing transactions based on similar risks or underlying assets, including instruments commonly regarded as contractually simple.

²⁷ For an explanation of the dilemma of the courts as to whether to interfere in severely unequal contracts in standard form *see* F. Kessler (1943) “Contracts of Adhesion” 43 *Colum L Rev* 629, 633.

²⁸ For example, the SFC sought in 2010 to discourage retail buyers from participating in a new issue of ordinary shares by United Company Rusal Limited (Rusal) by requiring applications to be in amounts of no less than HK\$1.0 million and subsequent dealings to be in lots of at least 200,000 shares (representing a consideration of HK\$888,000 as at 29 June 2012). It also required the offering prospectus to carry an unusual warning stating “An investment in shares in [Rusal] involves significant risk. investors may lose part or all of the value of their investment. Shares [in Rusal] should only be bought and traded by persons who are particularly knowledgeable in investment matters and can afford to lose their investment”, *see* United Company Rusal Limited Global Offering Prospectus, Hong Kong, 31 December 2009. Rusal was loss making in the three six-monthly accounting periods prior to the date of the prospectus, which would ordinarily preclude a full Hong Kong listing. The SFC’s actions arguably lessen liquidity in Rusal shares, dilute the rights of shareholders in the event that the prospectus proved to contain material errors, introduce uncertainty in the application of Hong Kong’s listing rules, and may weaken the rights of any retail investors that chose to ignore the prospectus warning and buy shares in Rusal. Minimum subscriptions and denominations are common practice in the international debt capital markets for reasons of cost and often to allow exemption under Securities and Exchange Commission Rule 144A from US securities registration.

A buyer's autonomy implies a 'right to make a fool of [itself]',²⁹ but properly supervised intelligent disclosure is a safeguard for this to be generally acceptable. Disclosure of contractual risks and structure and of the arranger's commercial purpose are critical to any non-professional investor's assessment given the existence of unequal bargaining power. It also represents a demanding change from current practice.

3. Investor protection

The concerns of early investor protection law were price fairness and investment advice rather than product design.³⁰ The US adopted a consumer protection ethic in the 1930s, requiring securities to be registered if intended for sale to retail investors and allow issuer disclosure to be standardised. The means by which any instrument is sold has traditionally been a function of broader legal considerations in Anglo-American jurisdictions, so that product conduct was not a focus of supervisory attention. Most jurisdictions distinguish professional and retail users of financial products in order to focus investor protection on those assumed to be most in need, and as a corollary to allow relatively wider contractual freedom to others. Retail refers to a non-professional party expected to participate modestly in any transaction, and it is generally defined either by inference with the protagonist deemed not to be sophisticated or professional, or by proxy with a ceiling on net worth or income that suggests that financial losses would cause material harm to a less well resourced user. Hong Kong currently treats as professional any individual investor with securities, deposits and cash totalling HK\$8.0 million (US\$1.03 million).³¹

²⁹ L. Loss (1963) "The Protection of Investors: I The Role of Government" 80 *SALJ* 53, 60, cited in Klöhn *see* n 24 above, p 439.

³⁰ Dalhuisen, *see* n 20 above, p 470, and *see* n 43 below.

³¹ SFO Cap 571 Sch. 1 Part 1 s 1 and Securities and Futures (Professional Investor) Rules, Cap 571D s 3. In addition, HKMA business conduct rules categorise private bank investor clients by reference to minimum investible funds or assets under management, which serves further to isolate the retail segment by inference, *see* HKMA circular "Selling of Investment Products to Private Banking Customers", 12 June 2012, available at <<http://www.hkma.gov.hk/media/eng/doc/key-information/guidelines-and-circular/2012/20120612e1.pdf>> (visited 25 April 2013).

Although modern investor protection law and regulation hope to protect the retail segment this lack of an accepted definition (other than as a indication of what it is not) often leaves the courts to decide the status of an investor by enquiring into its past behaviour and expressed preferences at the point of sale. The results are twofold. First, an investor's financial literacy is habitually generalised when complaints are heard, with experience in one activity leading the courts to connote knowledge of another or risk behaviour being assumed to be constant over time. Second, it has become standard practice even when not a matter of law or regulation for distributors of financial instruments to require investors to make formal declarations at the time of sale that absolve the distributor from liability in contract formation or prevent a later claim being made for mis-selling. The practice of contractual estoppel may contribute to efficiency when involving professional parties but is limiting and potentially oppressive when a retail investor is seeking redress.

More generally the lack of an explicit understanding of what constitutes a retail investor has made the courts in Hong Kong and England reluctant to protect those that they consider apparently active or sophisticated traders, in some cases with unpredictable results.³² There have thus been few recent successful actions for mis-selling even in the post-2008 period, and a number of cases where the court's assessment of evidence in dismissing a complaint would have surprised informed financial sector opinion. The leading English misrepresentation case *Peekay* is one such illustration.³³ An investor suffered material losses from a credit linked bank deposit referenced to domestic Russian treasury bills (GKOs). A credit event occurred in August 1998 and the deposit lost most of its value when Russia declared a payment moratorium on domestic state debt. The bank accordingly settled the investor's claim with a

³² Conforming with a traditional reluctance to examine the motives of parties entering financial contracts in the absence of malfeasance, although several recent English cases dealing with contractual ambiguities have been decided not on a literal reading of terms but what the court considered a reasonable interpretation of intent, *see Rainy Sky S.A. & Others v Kookmin Bank* [2011] UKSC 50; *in re Sigma Finance Corporation (in administrative receivership) and in re the Insolvency Act 1986* [2009] UKSC 2.

³³ *See* n 22 above.

partial payment of the nominal value of the deposit. Expecting to have retained either direct or subrogated rights over GKO, the investor began an action to recover its loss by complaining of having entered the transaction as a result of misrepresentations. The high court found for the investor but was overruled on appeal.

The deposit was arranged and marketed to investors by units of ANZ Bank including one dealing with HNW clients; Peekay was a corporate vehicle used by one such client, a Mr Pawani. Evidence considered in the case showed that individuals concerned with the transaction in both arranging and distribution sections of ANZ did not fully understand its structure and commercial terms, and these were misrepresented to the investor orally and through an indicative term sheet prior to its agreeing in principle to the trade. The bank repeatedly made errors in communications with the investor, including issuing a contract confirmation between execution and settlement mischaracterising the deposit as a direct claim against the underlier, inadvertently confirming the investor's understanding of the deal from earlier exchanges. ANZ's appeal was allowed on two grounds; first, that pre-completion misrepresentations were cured by the investor subsequently signing (although without fully reading) a second term sheet that for the most part gave a correct description of the deposit; and second, a five page standard form risk disclosure statement also signed by the investor at the time of execution constituted a contractual estoppel that prevented Peekay from claiming not to have understood the risk of the transaction and by implication its structure, which had been the reason for the complaint.³⁴

Without questioning the intention of its eventual finding, the case raises three concerns, the first being the high court's assessment of Mr Pawani's standing as an investor. Siberry, Dep.

J. stated that:

³⁴ ANZ's risk disclosure statement included the paragraph addressed to the investor "Before making any investment in an emerging markets instrument, you should [...] ensure that you fully understand the nature of the transaction and contractual relationship into which you are entering and the nature and extent of your exposure to risk of loss [...]."

'Mr Pawani has considerable investment experience, and is clearly a man of substantial means. He was described by Mr Gordon Wood, formerly of ANZ and one of the Claimants' witnesses as "a sophisticated individual and an experienced trader." He has, for example, traded in bullion since 1984. Mr Pawani gave evidence that Peekay's investments would typically include instruments such as bonds, bills, emerging market instruments, bullion, currencies and derivatives with major international banks. He first started investing in emerging market instruments [sic.] with ANZ in 1996.'³⁵

The investor was taken to be sophisticated and risk preferring, and by implication either had adequate knowledge of synthetic credit instruments and the permissibility of non-domestic parties acquiring interests in GKO's, or the means to become satisfied as to such questions. His reported behaviour suggests otherwise. Product specialisation is common in the financial sector, meaning that insight into one market is no necessary indication of knowledge of a second. Contracts and practices in market segments are often highly dissimilar and an expert in one field will typically know only superficially about others. Mr Pawani agreed to make the deposit believing that it would represent a direct claim against the reference entity rather than a conditional claim against ANZ. The bank was itself confused as to whether and how it was permitted to hold GKO's (and the court was not told whether ANZ had hedged its GKO risk) but its contact with Mr Pawani made representations to the effect that the investor would buy an interest in a GKO with its rouble return hedged into US dollars. A truly experienced and sophisticated investor would have known such a claim to be unreliable.

³⁵ [2005] EWHC 830 (Comm), para 6, whose assessment was accepted by the appeal court. By contrast a later English mis-selling case involving similar but far greater losses included an exhaustive enquiry to establish whether the investor was sophisticated, so allowing the court to define the scope of duties owed by the selling bank to the investor, see *JP Morgan Chase Bank and others v Springwell Navigation Corp.* [2008] EWHC 1186 (Comm); [2010] EWCA Civ 1221..

A second concern was acknowledged at first instance and appeal, that the bank as both arranger and distributor had a demonstrable lack of understanding of its product. ANZ devised the deposit only weeks before beginning investor marketing, its experience of synthetic or direct GKO risk being confined to distributing deals arranged by a more proficient competitor with operations in Russia. ANZ made errors in product design, point of sale conduct and post-execution administration, and several bank witnesses engaged in the transaction admitted their confusion in evidence. Although the text of the final term sheet sent to Mr Pawani was broadly accurate, it included an erroneous heading of “USD hedged Russian Treasury Bill” and several other errors of detail. The header encapsulated Mr Pawani’s understanding of the transaction resulting from the earlier misrepresentations and he and a colleague signified in writing Peekay’s agreement to the transaction without fully reading the document. This failure of compliance by a sophisticated party (however common in practice) provided grounds for the appeal court’s decision, with Peekay’s professed confidence that ANZ would behave competently and professionally being one element in that failure. The investor’s deemed status meant that it was owed no broad duty of care by ANZ, either as arranger or distributor. The courts did not discuss whether a more narrowly drawn duty existed for ANZ to avoid negligence in presenting and negotiating the transaction, especially since it was initiated by the distribution unit soliciting a trade. The bank failed to notify Peekay of the credit event and the resulting early termination of the deposit, and the court heard evidence (incredulous to an observer) that several employees debated how the claim represented by the deposit might participate in post-moratorium negotiations, that is, to ignore the contractual provisions of the deposit.

The third concern arises in a wider context from the appeal court’s decision that the investor was prevented from claiming that it entered the transaction as a result of misrepresentation having signed the distributor’s risk disclosure statement when agreeing the final term sheet. The statement required the investor to warrant that it had read and understood the terms of the transaction and was held to function as a contractual estoppel to prevent Peekay from

asserting that it had not done so. According to Chadwick, LJ, ‘[t]herefore Peekay must be taken to have accepted that ANZ would have assumed that Peekay fully understood the nature of the transaction into which it was entering.’³⁶ This decision could forestall enquiry into reasonable complaints in a context where bargaining is less equal even than Peekay. It also represents an example of divergence between law and market practice that may be known and accepted by professional parties but is baffling to others.

Similar questions as to the completeness of information provided to investors and the court’s assessment of investor sophistication arose in two Hong Kong criminal cases. Both ended in the acquittal of employees of the largest local distributor by volume of Lehman structured products, Bank of China Hong Kong Ltd (BOCHK), on charges of fraudulently or recklessly inducing others to invest money. In the first example a BOCHK officer who had marketed financial products to bank clients since 2002 was acquitted of nine offenses, the District Court finding prosecution evidence given by several aggrieved holders of Lehman structured products to be unreliable and contradictory, but noting that the distributor’s point of sale procedures were poor.³⁷

³⁶ [2006] EWCA Civ 386 at para 70.

³⁷ Re Cheung Kwai Kwai DCCC 526/2010, per Tallentire, J. stated at para 157 of the accused “You also took us through the procedure for the completion of the forms which I accept was not totally ideal. You fairly accepted that your preparation and study of the leaflet, and especially the prospectus had not been as deep or as comprehensive as one would have wished [...] you made no written notes about your advice to each of your customers.” He also stated at para 126 that “a person selling such bonds and notes had a duty to give sufficient information to the public so an informed decision could be made as to whether or not to accept the high risk in return for relatively high interest rates [...]”. As part of evidence to an earlier legislative enquiry BOCHK’s chief executive was asked, “Did BOCHK have any mechanism to vet/review the contents and presentation of the marketing materials vis-à-vis the offer documentation such as the prospectus? [...] If no, how did BOCHK ensure that there was no misrepresentation of product information and adequate disclosure of risks in such materials?” The bank replied “BOCHK did not vet or review the contents and presentation of the marketing materials vis-à-vis the offer documentation. It was the responsibility of Lehman Brothers Asia Ltd as the arranger and Sun Hung Kai Investment Services Limited as the co-ordinating dealer to prepare the marketing materials and submit them to the SFC for approval” *see* He Guangbei, written statement to Hong Kong Legislative Council Subcommittee to Study Issues Arising from Lehman Brothers-related Minibonds and Structured Financial Products, SC Ref.No.SC(1)-W40(C), September 2010 at Question 22, available at <http://www.legco.gov.hk/yr08-09/english/hc/sub_com/hs01/report/documents/w40c-e.pdf> (visited 25 April 2013). Asked to explain the structure and cash flow of Minibonds Series 35, BOCHK’s submission merely repeated a brief summary of terms identical to those headlined in Lehman marketing material, with no mention of how the structure of the issue functioned, *see* *ibid.* at Question 3.1. This enquiry took no evidence from former Lehman employees who arranged structured

Identical problems of witness reliability were found in the second case, in which a further matter resembles the finding as to investor sophistication in *Peekay*.³⁸ The court heard that one witness and Lehman noteholder:

“agreed in cross examination that in her witness statement she had said that she had no previous experience in buying and selling bonds. Clearly that was not true. The court was unable to accept that this was just a minor unwitting mistake. Although PW1 was a housewife [sic.], she had prior investment experience [and] the Minibond investment was not her first. Despite her claims in only investing in low risk conservative investments it was elicited in cross-examination that *she had previously subscribed to a high risk product which was an equity linked deposit*.³⁹ Her low risk investments were inconsistent with her [investment preference questionnaire] in which she indicated that her investment preference was assessed as moderate or moderate aggressive.

Thus the purchase on one occasion of an equity linked note contributed to the court finding the witness unreliable and not unsophisticated. These are criminal cases with demanding evidential standards but nonetheless suggest how a retail investor’s modest prior activity can be judged risk preferring.⁴⁰ An equity linked note does not necessarily entail high risk, and

transactions nor from Sun Hung Kai Investment Services, which instigated the Minibond programme with Lehman, but only from banks and government officials, perhaps because the subcommittee’s political focus was with the SAR government and the HKMA.

³⁸ HKSAR v. Tai Ching DCCC 527 and 1272/2010.

³⁹ Emphasis added. Complexity and risk are not synonymous, just as simplicity and risk are not antonyms.

⁴⁰ This principle appears (although more generously to noteholders) in the settlement conditions of Minibond claims negotiated with Hong Kong distributors, *see* n 13 above. The recovery outcomes were more favourable for noteholders aged over 65, and the settlement excluded investors deemed to be experienced, that is, those of any age “who in the three years preceding their first purchase of Minibonds, executed five or more transactions in Leveraged Products or Structured Products”, as defined in the SFO, *see* *ibid.* HKMA & SFC press release at Note 2. The MAS behaved similarly using age and education levels as proxies for financial literacy and thus influencing the scale of the noteholder’s recovery.

investor preferences change over time, indeed Minibonds and similar products were transparently riskier in 2007-08 than three or four years earlier.⁴¹ As with *Peekay*, it is unclear from these verdicts whether the distributor or its employees understood the product sufficiently to present an appropriate explanation to any investor, and the value of representations made by non-professional investors as to point of sale conduct must in turn be subject to doubt. However confused the witnesses may have been, their declarations of modest risk preferences were additionally taken to conflict with past behaviour.⁴²

4. Post-crisis regulatory reform

Popular and political fury has driven much post-crisis re-regulation, leading inevitably to overreaction in Hong Kong and elsewhere.⁴³ The clearest example of widespread post-crisis sale restrictions may be in Norway, where the Financial Supervisory Authority (Kredittilsynet) prohibited dealing in structured instruments with non-professional parties in 2008, despite simultaneously adopting MiFID as a basis for domestic regulation. Kredittilsynet was responding to public disquiet over transaction losses suffered by several

⁴¹ Large banks featured less prominently as distributors in the final issues although this may have perversely led to more aggressive selling by less capable firms. BOCHK declined to distribute the final Hong Kong issue due to its perception of worsening general conditions, an action that at the time might have deserved regulatory attention and being made public, stating later that “Having considered the uncertain market conditions [in March 2008] BOCHK did not participate in the distribution of Series 36”, see statement of He Guangbei, n 37 above. Most distributors procured orders for Lehman notes rather than bought and sold at issue so BOCHK’s decision to withdraw from marketing a product with which it had been prolifically engaged for five years was not based on exposure to market risk.

⁴² A related point concerns society’s expectations of the behaviour of the reasonable investor and how this might influence the courts, see J. Heminway (2009) “Female Investors and Securities Fraud: Is the Reasonable Investor a Woman?” 15 *Wm & Mary J Women & L* 291. Empirical studies controlling for financial literacy suggest that women are more risk averse in considering investments and other financial decisions than men, see *ibid.* at n 9. If an investor’s preferences are to be judged as risk preferring or risk averse in a mis-selling dispute it may be unreasonable for the court to base the outcome on a notion of what is reasonable for the average male, given that the court is unlikely in either case to consider bounded rationality in forming a view. What the courts see as “reasonable” in this regard may be gender based.

⁴³ This is not an entirely new phenomenon. US public anger after the 1929 Great Crash produced “insistent demand for federal legislation” see E.M. Dodd (1942) “Investor Protection by Administrative Agency: The United States Securities and Exchange Commission 5 *MLR* 3-4, 174, 175.

local authorities,⁴⁴ and forced the closure of the securities firm that interceded between municipal officials and transaction arrangers. Kredittilsynet presupposed that “structured products or other complex products [should not be sold] to customers who cannot be regarded as professional investors”,⁴⁵ although defining “professional” narrowly to mean financial intermediaries and exclude commercially sophisticated parties as well as retail users.⁴⁶ Norway’s highly risk averse approach can be contrasted with customary regulation of the sale of goods, for example to require that a vehicle or refrigerator be fit for purpose or meet safety and environmental standards. It is understandable that loss aversion encourages cautious regulation even when no systemic concerns arise,⁴⁷ nonetheless the results may be less successful than intelligent reforms of compliance and disclosure standards, as well as unnecessarily reducing contractual autonomy.

National and transnational reforms agreed by the G-20 states in 2009 represent a shift from principles based models and include a withdrawal from MiFID-style objectives. Certain states set new wide ranging missions, for example the US Wall Street Financial Reform and Consumer Protection Act of 2010 seeks presumptively “to protect consumers from abusive financial services practices”,⁴⁸ although it is unclear that its implementation will make a material difference to consumers except in relation to loans. The FSA conducted a review of UK structured retail product conduct in 2009-12, concluding with recommendations for

⁴⁴ Two municipal authorities contracted in off market interest rate swaps involving expected future revenues, using the resulting upfront payments to buy CDOs that later collapsed in value. The transactions were entered partly to circumvent borrowing restrictions imposed by central government, the use of proceeds was a failure in compliance and the local government officers concerned demonstrably failed to understand the swap or CDO transactions. The domestic courts ruled that the swaps were loans, and consequently void since the authorities were empowered to borrow only for public works and purposes defined by law. Norway’s media portrayed rogue financiers tricking hapless public servants and incited sharp political and regulatory responses. An English court later allowed a claim in restitution by the swap counterparty to recover sums paid to the authorities, *see Haugesund Kommune, Narvik Kommune v. Depfa ACS Bank, Wikborg Rein & Co* [2009] EWHC 2227.

⁴⁵ Kredittilsynet’s Securities Institutions Section head stated that the prohibition reflected complex products being sold not “in a regulated market, but in a non-transparent, shady market; [...] they were elements in the current financial turmoil” *see* E. Kleven “Supervision and Regulation of the Structured Products Market in Norway” Structured Products Europe Conference, London, 12 November 2008.

⁴⁶ *Ibid.*

⁴⁷ *See* C. Sunstein (2003) “Beyond the Precautionary Principle” 151 *U Pa L Rev* 3, 1003.

⁴⁸ Dodd-Frank Act Pub. L. 111-203.

compliance within financial intermediaries and other service providers such as the establishment of internal product review committees.⁴⁹ The FSA declines to categorise its proposals as a framework for supervisory conduct, even though the authority is able so to act through being empowered to provide de facto approval of contract terms,⁵⁰ as will be its successor Financial Conduct Authority (FCA) from 2013.

The extent to which regulators use discretion to intervene in product conduct is controversial, both in relation to permissible instruments and the nature of disclosure to investors. This is shown in exchanges between the FSA and a UK parliamentary committee and which bear on developments in Hong Kong. The committee observed that post-crisis re-regulation will include “a more proactive approach to conduct regulation, with a clear focus on consumer outcomes”,⁵¹ and approvingly proposed “judgement-led product intervention by the regulator”,⁵² including passing to the FCA authority currently held by the FSA to make public warnings over specific products.⁵³ Yet mild activism of this kind was rejected by the FCA’s chief executive designate, who cited his SFC experience in stating that pre-approval of simple financial products was too burdensome for regulators, with products:

⁴⁹ FSA, “Retail Product Development and Governance: Structured Products Review: Finalised Guidance”, March 2012 (available at <http://www.fsa.gov.uk/library/policy/final_guides/2012/fg1209> visited 25 April 2013). A more developed proposal would align regulatory requirements with internal bank “new product committee” procedures to provide a self-certification mechanism and avoid regulatory capture, see M. Armstrong, G. Cornut, S. Delacôte, M. Lenglet, Y. Millo, F. Muniesa, A. Pointier & Y. Tadjeddine, (2012) “Towards a Practical Approach to Responsible Innovation in Finance: New Product Committees Revisited” 20 *J F R & C* 2, 147.

⁵⁰ *Ibid* at 34. The FSA may challenge the fairness of contracts under the Unfair Terms in Consumer Contracts Regulations 1999 but is not empowered to judge whether fairness is met by any subsequent modification in terms. This may not represent an enhanced formula for point of sale regulation but is certainly a shift from principles based regulation, which itself can be a complex interaction between regulation instigated by legislation, common law and the soft law that results from industry guidance or that of the International Organization of Securities Commissions (IOSCO), see J. Benjamin and D. Rouch (2007) “Providers and Distributors: Responsibilities in Relation to Retail Structured Products” 1 *LFMR* 6, 413, 419.

⁵¹ House of Commons Treasury Committee, *Financial Conduct Authority* (HC 1574) January 2012, para 138.

⁵² *Ibid* at para 145.

⁵³ *Ibid* at para 160.

“brought to you half-baked, because the industry wants to rush the products out. The regulator ends as up as the spell check for the industry, because they bring such poorly thought through products in the hope that they will have a place in the window. I think pre-approval is quite a difficult process and has many more negatives.”⁵⁴

These remarks might surprise Hong Kong finance specialists who see the approach to new issues and products of the SFC and the stock exchange’s listing department as heavily procedural, contributing more to the length and homogeneity of disclosure documents than to useful content. Of greater concern is that they suggest a desire to avoid accountability that cannot be reconciled with recent regulatory failures, and that might be characterised as an unreasonable extension of a public interest indemnity.

Post-crisis product reforms introduced in Hong Kong since 2010 involve changes to the Companies Ordinance and SFO, regulations issued under the SFO covering point of sale conduct and the scope of engagement by the SFC, and additions to the SFC’s codes of conduct and guidance handbooks for industry participants, the latter constituting neither primary nor subsidiary legislation. Four elements are relevant to this discussion:

- Prospectus rules for most structured products (as defined in the SFO) are no longer subject to the Companies Ordinance and associated with unlisted debentures but included in the SFO and now relate to securities. This could ostensibly allow closer regulation of their content except that the SFC’s functional focus appears to be with business conduct.

⁵⁴ Ibid at para 187, and see n 14 above and accompanying text.

- Amendments to the SFO permit the SFC to authorize or withhold authorisation for the sale of structured products,⁵⁵ or impose conditions on a product or its uses.⁵⁶ They also allow the SFC to designate additional instruments as structured products, while excluding certain others, presumably due to their supposed familiarity to investors. The distinction is arbitrary, implying that not all complex financial instruments are apparently structured products. Expressly excluded from the definition are convertible and exchangeable bonds, equity warrants, and all products authorised under the Betting Duty Ordinance, Gambling Ordinance or Government Lotteries Ordinance.⁵⁷ A new template indicates information required by the SFC when asked to authorise a structured issue, which includes self-certification by arrangers or issuers of their compliance with SFC guidance, but the framework is procedural rather than capturing the commercial and structural core of a proposed transaction.⁵⁸
- Business conduct guidelines issued by the SFC acknowledge the bargaining inequality associated with retail sales of structured instruments by suggesting a cooling off period of at least five days is granted between deal execution and settlement, during which the buyer may elect not to proceed with the purchase.⁵⁹ This may be a valuable example of libertarian paternalism but is not without cost.⁶⁰ Extended and uncertain settlement periods will typically raise the price to the buyer,

⁵⁵ See Securities and Futures and Companies Legislation (Structured Products Amendment) Ordinance 2011 (8 of 2011 s. 14) and SFO s 104A. Structured product (結構性產品) is now defined as inter alia “an instrument under which some or all of the return or amount due [...] or the method of settlement is determined by reference to one or more of (i) changes in the price, value or level (or a range within the price, value or level) of any type or combination of types of securities, commodity, index, property, interest rate, currency exchange rate or futures contract; (ii) changes in the price, value or level (or a range within the price, value or level) of any basket of more than one type, or any combination of types, of securities, commodity, index, property, interest rate, currency exchange rate or futures contract; or (iii) the occurrence or non-occurrence of any specified event or events (excluding an event or events relating only to the issuer or guarantor of the instrument or to both the issuer and the guarantor) [...] see Cap 571 Sched. 1 Pt. 1 s.1A.

⁵⁶ SFO s 104A(1).

⁵⁷ See also n 26 above.

⁵⁸ See SFC, Form of Information and Undertakings for Unlisted Structured Investment Products, available at <<http://www.sfc.hk/web/EN/forms/products/forms.html>> (visited 25 April 2013).

⁵⁹ See SFC, Handbook for Unit Trusts and Mutual Funds, Investment-Linked Assurance Schemes and Unlisted Structured Investment Products, May 2012, Part IV Ch. 8, available at <http://en-rules.sfc.hk/en/display/display_main.html?rbid=3527&element_id=3038> (visited 25 April 2013). Sales of products with tenors of up to 365 days are excluded from the guideline.

⁶⁰ See Sunstein & Thaler n 25 above, p 1187.

is confined to “structured products” as now defined in the SFO, and does nothing to ensure that a willing but uncertain buyer has access to usable information while considering its decision, even if it takes advice from an unconnected source. One further effect is to lessen the likelihood of the buyer succeeding in a subsequent mis-selling complaint, a problem shared by other point of sale provisions.

- The same guidelines also require transaction arrangers to provide potential buyers with a statement of “Product Key Facts” based on a template that resembles provisions in MiFID and the EU Prospectus Directive,⁶¹ but lacks the imperative for completeness of pertinent, usable information that would allow an informed purchase or meaningful product comparisons. The result also resembles the practices described by BOCHK.⁶²

Such measures may have been politically expedient but were rushed, are incomplete, and dilute the rights provided to investors in new issues by existing legislation and as a result of representations made in prospectuses. This weakens disclosure and forestalls questions at the time when an issuer or arranger is most open to respond. They might also be seen as facilitating arbitrary regulatory behaviour, and an erosion of the rule of law associated with a leading international financial centre.

Migrating structured product prospectus rules to the SFO’s investment regime means that they would not be affected if a recent SFC proposal is implemented adding provision in the Companies Ordinance for sponsors of new share issues to be liable for prospectus due

⁶¹ SFC, Illustrative Template for Product Key Facts Statements, Unlisted Structured Investment Products, available at <http://www.sfc.hk/sfc/html/EN/intermediaries/products/pkfStatements/pkfStatements.html> (visited 25 April 2013). The Prospectus Directive (Council Directive (EC) 2003/71) stipulates that retail securities offerings must include a “Key Investor Information Document” written in plain language.

⁶² See n 37 above.

diligence.⁶³ This is regrettable. Many structured financial instruments are issued through offshore special purpose vehicles established on the transaction arranger's behalf, as with programmes such as Lehman's, so that the arranger effectively sponsors the issue on behalf of an insubstantive vehicle of its own design. Placing a new responsibility on such sponsors would create incentives for more complete and informative disclosure. The SFC proposes that a sponsor of conventional new listings should "reasonably satisfy itself that all information provided to the regulators is accurate, complete and not misleading",⁶⁴ and intends that sponsors be included in Companies Ordinance provisions specifying civil and criminal liabilities for untruths contained in a prospectus, including any material omissions.⁶⁵ The corollary is that it would become incumbent on a sponsor to ensure that issue documents are such as to allow a reasonable person to form a fair opinion of the condition and profitability of the issuer. This is also a provision of the exchange's listing rules, albeit that their guidance as to the content of prospectuses is unspecific and procedural.⁶⁶

A comparison with reforms introduced in Singapore suggests a more effective and less arbitrary approach. First, changes to consumer protection legislation in 2009 increased the scope for complainants to bring actions for mis-selling by making it possible for sales of financial services and products to be held contractually unconscionable, similar in effect to provisions of Australian federal law.⁶⁷ Second, the MAS introduced rules in January 2012 that involve part of the proposals of this article, albeit without reforming requirements for disclosure. Intermediaries must assess the experience of retail investors before marketing

⁶³ The proposal would augment existing directors' duties, *see* SFC, "Consultation Paper on the Regulation of Sponsors", May 2012, available at <<http://www.sfc.hk/sfcConsultation/EN/sfcConsultFileServlet?name=sponsorrslt&type=1&docno=1>> (visited 25 April 2013).

⁶⁴ *Ibid.* p 5.

⁶⁵ See Cap 32 ss 40 & 40A.

⁶⁶ The listing rules state at LR 11.07 that a equity new issue prospectus should include "information which, according to the particular nature of the issuer and the securities for which listing is sought, is necessary to enable an investor to make an informed assessment of the activities, assets and liabilities, financial position, management and prospects of the issuer and of its profits and losses and of the rights attaching to such securities." Prospectus content guidance is given in appendices 1C and 1D respectively for debt securities and structured products, available at <<http://www.hkex.com.hk/eng/rulesreg/listrules/mbrules/vol2.htm>> (visited 25 April 2013).

⁶⁷ See n 8 above.

certain products including some of moderate complexity, and offer to provide advice if it is thought lacking. The client can elect to transact without taking advice but in doing so will have been given notice far more adequate than contained in a risk disclosure statement or point of sale questionnaire. A contract entered this way becomes a deliberate action and likely to be less unequal. It might be argued that the force of these pre-contractual procedures will diminish through repetition but the investor's knowledge and experience would at the same time increase. The MAS has made it clear since 2009 in guidance to arrangers and distributors operating in Singapore that its business conduct concerns over complex instruments are largely confined to retail investors.⁶⁸

Post-crisis bans and restrictions recall a continuing debate as to how law and regulation can properly incur upon freedom of contract, including an irresolvable question as to the appropriateness of the state's involvement in commercial activity. A trend is nonetheless clear, that since the late eighteenth century primary legislation and subsidiary regulation have set limits to commercial freedom for reasons associated with general welfare or prevailing public policy, albeit that the notion of welfare is subject to inherent subjectivity.⁶⁹ This began sporadically, becoming increasingly accepted from the mid-nineteenth century as industrialisation greatly increased the numbers formally engaged in commercial activity and standardised contracts grew common. The resulting incursion into contractual freedom has been variously idiosyncratic,⁷⁰ associated with the ethics or needs of a particular period,⁷¹ practical,⁷² or concerning matters of general policy such as employment standards, consumer

⁶⁸ See MAS, "Review of the Regulatory Regime Governing the Sale and Marketing of Unlisted Investment Products" Consultation Paper P001-2009, March 2009.

⁶⁹ See also n 18 above.

⁷⁰ US law forbids onions from use as a derivative contract underlier, see US Commodity Exchange Act 7 USC 1 §13-1(a). The ban was procured in the mid-1950s by a farming lobby hostile to Chicago's commodity trading and subsists because the onion is cheap, easily degradable and unpromising as a derivative underlier but represents a modest welfare loss given that there is no evidence that trading in onion futures or options formerly caused injury to farmers.

⁷¹ Notably limits in many jurisdictions to gambling or the sale of alcohol.

⁷² For example, many jurisdictions limit the use of non-indemnity insurance to avoid moral hazard, discourage gambling on exogenous events, and because the nature of the insured subject cannot always be certain when the contract begins, see *Liu, Lejot & Arner, Finance in Asia* n 20 above, Ch. 11 n 3 and accompanying text.

safety or contracts to commit crime.⁷³ From a strong libertarian perspective the law of contract is itself regulation.⁷⁴

Nineteenth century English common law relied on a moral view of contractual obligations drawn from a utilitarian notion of promise associated with a “natural” freedom to enter any commercial agreement. Contracts were seen as freely struck bargains that assumed an equality between parties,⁷⁵ although this was clearly unreliable in the case of many employment contracts, for example. Where the law was ready to interfere in contract formation or performance it was justified by a Hobbesian view of the perfidy of contracting parties. Since the world was populated by cheats who would naturally wish to evade any promise or contractual obligation, the law needed to provide a corrective sanction in damages.⁷⁶

Writing in the mid-1970s, Atiyah saw a zenith of English contractual freedom occurring in 1875 and captured by Jessel, MR:

⁷³ There are nonetheless examples of contractual freedom defeating accepted policy aims, as with litigation over the past decade in England, Hong Kong and New York for the recovery of debt claims against poor highly indebted states, *see* n 10 above.

⁷⁴ Gilmore separately suggests (as part provocation) that modern Anglo-American contract law had become part of tort, and that the idea of contract as a bargain was corroded by new doctrines of restitution, promissory estoppel, and lessening reliance on consideration, *see* G. Gilmore, *The Death of Contract* (Columbus, Ohio State University Press, 1974).

⁷⁵ D. Hughes Parry, *Sanctity of Contract: Hamlyn Lectures 1958* (London, Stevens & Sons, 1959).

⁷⁶ *See* T. Hobbes, *Leviathan*, 1651 (Oxford, Oxford University Press, 1996) Pt. I, Ch. XIV. The argument neglects incentives for compliance arising from the reputational effects of reneging, in some cases within a social or business community, or the enforcement mechanisms that such a community might develop, *see* P. Milgrom, D. North & B. Weingast, *The Role of Institutions in the Revival of Trade: The Law Merchant, Private Judges, and the Champagne Fairs*, 2 *Econ. Politics* 1, 1. Relational contract theory suggests these exist except in exceptional cases where two parties enter and complete a single contract knowing with certainty that they will never do so again, which is not characteristic of financial activity, *see* I. Macneil, *The New Social Contract: An Inquiry into Modern Contractual Relations* (New Haven CT: Yale University Press, 1980). Relational contract theory also points to the importance of disclosure in financial supervision. The Hobbesian view is echoed in a post-Lehman papal encyclical, “Economy and finance, as instruments, can be used badly when those at the helm are motivated by purely selfish ends. Instruments that are good in themselves can thereby be transformed into harmful ones. But it is man's darkened reason that produces these consequences, not the instrument per se.” *see* Benedict XVI, *Caritas in Veritate*, July 2009, Ch. 3.

“[If] there is one thing which more than another public policy requires it is that men of full age and competent understanding shall have the utmost liberty of contracting, and that their contracts when entered into freely and voluntarily should be held sacred [...]”⁷⁷

The truly libertarian soon passed, unsurprisingly since the “optimistic creed” of contracts as freely achieved and equal bargains made the courts “extremely hesitant to declare contracts void as against public policy.”⁷⁸ Atiyah argued that contractual freedom began declining after 1890, but his analysis was made (and partly expressed political preferences) both at a time of relatively strong state capitalism in Europe, and before the collapse of the Bretton Woods agreements initiated a global increase in private financial contracting. It suggested, for example, that the state had become dominant and directly involved in resource allocation, price and wage manipulation, and “other legal and fiscal arrangements which depress demand for this product or stimulate demand for that.”⁷⁹ In such a quasi-command economy:

“the growth of the activities of the state has inevitably led to a great increase in the number of situations in which relationships between the citizen and the government, or some public authority, are now governed by public law rather than private law.”⁸⁰

It can also be characterized as an ethical shift from contractual freedom and high party autonomy towards cooperative and fair means to correct market failure, especially in the operation of remedies for contractual disputes.⁸¹ The debate says nothing about the political

⁷⁷ *Printing and Numerical Registering Co v Sampson* [1875] L.R. 19 Eq. 462, 465. The archaic language hides the question of gender differences in saving and investment behaviour, *see* n 42 above. The first US case settled by considering contractual freedom is said to have been heard in 1886, prior to which the term was unknown, *see* R. Pound (1909) “Liberty of Contract” 18 *Yale LJ* 454, 455.

⁷⁸ *See* Kessler n 27 above at pp 630-1.

⁷⁹ *See* Atiyah, *Rise and Fall* n 6 above p 717. Atiyah confined formal analysis to English law but believed his arguments applied broadly in Western Europe and the US, *see* *ibid.* at viii.

⁸⁰ *Ibid.* at 719.

⁸¹ For example, *see* H. Collins *The Law of Contract* (Cambridge, Cambridge University Press, 4 edn. 2003).

limits of the welfare state or whether market based solutions assist with problems of establishing or maintaining the collective commons or supposedly public goods.⁸²

Conditions changed markedly after 1980, when the Reagan-Thatcher era of deregulation and privatisation began to reduce the Anglo-American state's direct commercial engagement in the economy. Even recently, generally liberalising moves have occurred in global financial regulation, so for example MiFID is complex and demanding in its original form but supports the premise of contractual freedom as a core objective for national regulators. MiFID became effective only in late 2007 in the gathering crisis and some of its principles will be sacrificed in a re-regulatory wave through amendments and with the introduction of regional EU supervisory agencies for banking, securities and insurance, and a new European Market Infrastructure Regulation (EMIR) requiring implementation by 2013 of the G-20 and Financial Stability Board recommendations on contracting in financial derivatives.⁸³

5. Rethinking re-regulation

Re-regulation as now planned or implemented will risk leaving an unequal, less open system, meaning that private organisations and the very wealthy will have access to whatever products they wish but the efficiencies of modern finance will be withheld from those that remain. The premise of this article is that regulation of financial activity has become excessively complex, costly, risk averse and intrusive, and that in certain market segments an alternative to outright restriction can be found in the proposition that welfare enhancing behavioural change can be encouraged through non-coercive means. An alternative approach

⁸² Profound differences occur in the treatment of public goods between states and in scholarly opinion, as with the archetypal lighthouse, which is often wrongly taken to be a "pure" public good and universally funded by the state, *see* R. Coase (1974) "The Lighthouse in Economics" 7 *JL & Econ* 35.

⁸³ Financial Stability Board, Progress since the Washington Summit in the Implementation of the G-20 Recommendations for Strengthening Financial Stability, 8 November 2010, 12 (available at <http://www.financialstabilityboard.org/publications/r_101111b.htm> visited 25 April 2013). EMIR was proposed in 2010 and adopted by the EU Parliament in July 2012.

involving intelligent disclosure must question whether banning or severely restricting access to certain instruments represents an erosion of commercial freedom that might be justified by supervening welfare effects, notably the avoidance of systemic volatility. Do dangers associated with complex instruments as unequal bargains that are prone to deliberate or inadvertent mis-selling justify heightened supervision and appropriate public responsibility but not outright prohibition or sectoral bans? The premise of an alternative is that requiring intelligent disclosure may encourage cooperation rather than regulatory capture, and reduce the incentives for intermediaries to game the regulatory system.

A simple comparison illustrates the intention. A sign on a sea wall above Hong Kong's East Lamma Channel reads:

“Danger. Please keep away from the promenade under the strong winds and billow.”

This is a sensible non-technical warning of principle. It does nothing to block a pedestrian approaching the sea in harsh weather but cautions against recklessness and acts to encourage responsible behaviour.⁸⁴ Failing to do so may have costs, for the individual as well as for the emergency services sent to perform a rescue in a hazardous sea, but those costs are not systemic such as to demand a physical obstruction. Contrast this with the language carried by marketing materials for complex retail financial products in Hong Kong and elsewhere, and shown here in the form negotiated by the SFC with arrangers such as Lehman Brothers.

“The notes are not principal protected.”

⁸⁴ Flora Leung has helpfully indicated that the Chinese text is nearly identical, 危險. 請勿在風浪大時靠近海濱長堤.

This is a nonsensical and misconceived way to emphasise risk that has been encouraged by the SFC. It is assumed that the warning means that repayment of principal is contingent upon the occurrence of non-default events but it fails to say this plainly, indeed a conventional debt claim cannot be said to be “principal protected” unless secured and defeased with a cash deposit in the same currency as the claim. By implication it also signifies that other instruments may be “safe” if they are “principal protected”⁸⁵ The same material carries the injunction:

“These Minibonds are on offer for a **limited period** only,⁸⁶ so act now and talk to one of our customer service representatives today.”

All product conduct rules must be intelligent, ethical, and avoid the secondary effects of providing an exculpatory path for regulators or intermediaries. They need instead to engage the regulator. The intention of intelligent disclosure can be shown in four material omissions from Lehman’s Minibond prospectuses until 2008, all of which were known to structured finance professionals:

- Exorbitant seller incentives. The SFC has since acknowledged this absence by indicating in its code of conduct that distributors should disclose the scale of fees paid by transaction arrangers.⁸⁷
- Lehman’s core transaction purpose, to sell securities inventory and buy third party credit protection, which by inference became the investor’s embedded but undisclosed obligation.

⁸⁵ An early Minibond issue was “principal protected” meaning that it was unconditionally guaranteed by Lehman Brothers.

⁸⁶ Original emphasis.

⁸⁷ See n 59 above.

- No reference was made over the life of the programme to changing general market conditions and asset prices, which would in transactions arranged by reverse enquiry justify varying levels of supporting collateral.
- The legal and commercial consequences of the contractual structure, including the investor's lack of rights against the arranger for inadequate disclosure.⁸⁸

The SFC reacted by imposing unprecedented point of sale requirements for a contractually simple new issue of small denomination Renminbi fixed income notes in July 2009 by China Development Bank, presumably fearing that any instrument targeted to retail buyers might be confused with a complex product. The prospectus carried a reasonable warning in simple language:

“This is an investment product. This is not equivalent to a time deposit, and is not protected under the Hong Kong Deposit Protection Scheme. [...] Under the code of conduct for persons licensed by or registered with the SFC, the placing bank who sells our bonds to you is required to assess whether our bonds are suitable for you having regard to your financial situation, investment experience and investment objectives. You should not invest in our bonds unless such placing bank has explained to you that our bonds are suitable for you having made such an assessment.”⁸⁹

⁸⁸ The issue prospectus (*see* n 15 above) stated at p 4 “Security: AAA-rated collateralised debt obligations (CDO) as collateral and swap arrangements with Lehman Brothers Special Financing Inc. as swap counterparty for the payment of principal and interest [...]. The CDO will be linked to a portfolio of international credits. The CDO will not be an asset-backed securities CDO [nor] linked to asset-backed or mortgage-backed securities. [...] Repayment in full of the principal of our notes at maturity will be dependent upon the redemption in full of the CDO and as such the CDO is a significant component of the risk and return profile of our notes.” It thus made no mention of the factor that caused the value of the notes to collapse.

⁸⁹ China Development Bank, Rmb 2.45% Bonds due 2011 Prospectus, 24 July 2009.

The warning was coupled with a less satisfactory exculpatory declaration that the investor would be required to sign when placing an order for bonds:

”You have read and understood the terms and conditions of the bonds and application procedures set out in this prospectus and agree to be bound by them [...]. You have read and understood this prospectus *and have relied on no other information or material* relating to the bonds.”⁹⁰

The statement signifies a fiction common in professional market practice. The terms of the issue were unusual in at least several respects:

- An unusually long grace period was allowed before payment defaults could be declared. This could weaken the status of the noteholders vis-à-vis other senior unsecured bondholders.
- All bondholders must separately declare an event of default for their respective claims to be recognised.
- No requirement is made for the bonds to fall immediately due for payment upon an event of default.
- No indication is given as to how illiquidity in the offshore Renminbi market might affect the bonds, with the listed “Risk factors” only stating that the concern exists.

None of these points was highlighted for the purpose of risk evaluation or comparison with other transactions, which is something an engaged regulator could easily have required.

⁹⁰ Ibid. p 12. Emphasis added. The exclusion covers anything said or written by a distributor at the point of sale.

Product conduct regulation as now contemplated provides powerful cover for regulatory failure, and it is thus unclear that incentives exist for effective and enquiring supervision. The reforms highlighted in the preceding section unreasonably assume rational investor behaviour, have no influence on usable information, and are likely to strengthen the defence of distributors in complaints for mis-selling, making it easier to claim that the investor “was given adequate information ...” An alternative approach that would not involve a loss of welfare would be:

- First, to require that arrangers ensure that pertinent disclosure of how financial instruments function is made in transactional dealings with retail and other non-professional parties, including cases where separate intermediaries function as arranger and distributor. This would represent a non-contractual duty of care separate from a distributor’s statutory point of sale obligations or any duties of care owed by distributors to retail investor clients, and reinforce any common law obligation for the arranger to avoid negligence. It conforms with industry recommendations for the guidance arrangers must provide to product distributors.⁹¹
- Second, to extend the doctrine of contractual unconscionability to include the mis-selling of financial services and instruments to retail investors or consumers of financial products where those contracts result from great bargaining inequality.⁹²

⁹¹ See Joint Associations Committee, n 22 above. This proposal also conforms with IOSCO guidelines that “It is the responsibility of securities regulators to ensure the appropriate level of transparency about products and markets and the integrity of information provided to the market. [...] Enhancing the transparency around financial products should give investors the necessary information to assess the risks attached to them and, as a result, make better investment choices. Opacity, especially in an overconfident market, can encourage collective behaviour which can lead eventually to widespread losses, with adverse consequences for the real economy”, see IOSCO “Mitigating Systemic Risk: A Role for Securities Regulators, Discussion Paper OR01/11 February 2011. IOSCO’s focus here is mainly with lessening investor reliance on credit ratings but it is unclear that this would have made a difference after 2007-08 since all benchmarking encourages herd behaviour.

⁹² See n 8 above.

The first proposal accords with HKMA guidance that banks “should make adequate disclosure of relevant material information [...] to customers prior to or at the point of sale. It is not sufficient to provide such information after a transaction has been executed. [...] Banks] should therefore not rely solely on the Product Key Facts Statement for risk disclosure purposes [but also] direct customers to the detailed risk disclosures in the offering documents.”⁹³ It also accords with prospectus provisions contained in the Companies Ordinance that until 2011 applied to structured instruments.

Intelligent disclosure requirements would include a means for investors to compare instruments, as contained in Australian regulations since 2011,⁹⁴ avoid prospectuses and similar material being merely a “disclosure of descriptive information with little or no analysis on its relevance or impact”,⁹⁵ and make prospectuses available well before an issue takes place, as with Securities Commission Malaysia’s prospectus exposure arrangement, which releases prospectuses for inspection and discussion prior to registration. They would also recognise that certain contracts have value to users associated with bounded rationality, and consider removing the conventional “investment cloak” and instead provide clear warnings.

To question increasing limits to contractual freedom is not necessarily to advocate a dogmatic laissez-faire economic system nor to encourage the courts to apply severe caveat emptor principles. All regulation is a limitation on contractual freedom. The present need is to address two questions, how much is acceptable as contractual restraint in terms of social policy, and is there a more favourable solution in respect of complex and other financial

⁹³ See HKMA circular, n 7 above.

⁹⁴ Australian Securities and Investments Commission, “Prospectuses: Effective Disclosure for Retail Investors”, Regulatory Guide 228, 2011, available at <<http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/rg228-published-10-November-2011-1.pdf>> (visited 25 April 2013).

⁹⁵ Idem., “Prospectus Disclosure: Improving Disclosure for Retail Investors”, Consultation Paper 155, April 2011, p 7, available at <<http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/CP155-Published-12-April-2011.pdf>> (visited 25 April 2013).

transactions? Intelligent disclosure represents guidance rather than stricture. The argument here is that expediency caused the HKMA and SFC to pursue an extra-judicial block settlement to their local Lehman problem. The outcome may have been commercially favourable for most noteholders but leaves contractual autonomy weaker and non-accountable supervision stronger and more arbitrary. A lack of remedies (through litigation or arbitration) against distributors for want of evidence or arrangers for due to the absence of either a contractual nexus or informed disclosure requirements suggests that the law of contract will suffer a further little death. Breach of increasingly arduous HKMA and SFC codes of conduct provides a license threatening sanction against banks or securities dealers but leaves the investing public with fewer remedies, and reliant on the moral authority of unchallengeable regulators.