

## **LegCo Panel on Financial Affairs**

### **Follow-up to the Special Meeting on 16 October 2006**

#### **Progress Report on the Implementation of Proposals for Strengthening the Regulatory Framework for the Derivative Warrants Market**

#### **PURPOSE**

At the Panel's special meeting on 16 October 2006, Members requested the Administration to liaise with the Securities and Futures Commission ("SFC") for providing the Panel with a progress report on the proposals put forward by the SFC in November 2005 for strengthening the existing regulatory framework following its comprehensive review of the derivative warrants market. This paper sets out the required information prepared by the SFC.

#### **BACKGROUND**

2. On 25 November 2005, SFC issued a comprehensive report on Hong Kong's derivative warrants market entitled "*A Healthy Market for Informed Investors – A Report on the Derivatives Warrants Market in Hong Kong*". The report proposed a Six-Point Plan for strengthening the relevant regulatory regime and enhancing investor understanding as follows –

- (a) to tighten liquidity provider provisions;
- (b) to facilitate further and identical issues;
- (c) to ban commission rebates and other incentive schemes offered by issuers;
- (d) to publish new marketing guidelines;
- (e) to require the use of plain language and summaries; and
- (f) to enhance investor education and information dissemination

The report invited comments from interested parties. 27 submissions from 29 respondents were received by end-March 2006. The response suggested that most people saw benefit in maintaining a derivative warrants market in Hong Kong. Most of the specific proposals were well received although some attracted different views.

## **MARCH 2006 PAPER**

3. On 31 March 2006, the SFC issued a further paper (“**the March Paper**”) entitled “*Hong Kong’s Derivative Warrants Market – the Way Forward, Results of the Consultation on the SFC’s Six-Point Plan*”. The March Paper sets out how the SFC proposed to take forward the Six-Point Plan having considered the comments received. Specifically, it was proposed to take forward all the proposals, subject to the following modifications –

- (a) The initial proposal to tighten liquidity provider provisions included a proposal to prohibit the appointment of external liquidity providers. This proposal was modified to allow issuers to continue appointing external liquidity providers, but subject to certain conditions designed to ensure that issuers have direct control over the liquidity provision.
- (b) The initial proposal to facilitate further issues included a proposal to increase the maximum percentage of an existing issue that an issuer may hold when making a further issue. The March Paper clarified that the increase would be from 20% to 50%.
- (c) The initial proposal to facilitate identical issues included a proposal to relax the minimum life and minimum price requirements for identical issues. The March Paper clarified that the new minimum life and price requirements for identical issues would be relaxed to three months and 15 cents respectively, but with a degree of flexibility to better manage unwinding activities towards maturity.

4. The March Paper also explained that some of the proposals in the six-point plan would require changes to the Listing Rules, which would in turn require the approval of the Listing Committee. The SFC expected that most proposals would be implemented or should be in good progress by the end of 2006.

## **LATEST PROGRESS**

5. Since end-March 2006, work on the Six-Point Plan has progressed steadily. Specifically –

### **(A) Investor Education and Information Dissemination**

The SFC has been working and will continue to work on a number of investor education initiatives that focus specifically on derivative warrants. These include issuing a number of education articles, launching TV and radio programmes and an open Investor Story competition. The SFC will continue its investor education efforts vis-à-vis derivative warrants into 2007. Meanwhile, to enhance information dissemination, the Hong Kong Exchanges and Clearing Limited (“the Exchange”) introduced a web-based Derivative Warrant Resources Centre (“DWRC”) on 15 May 2006. The DWRC offers investors easy access to information on derivative warrants for educational and reference purposes.

### **(B) Facilitating Further and Identical Issues**

The proposals to facilitate further and identical issues (save in one respect, which will be discussed below) and to ban commission rebates and other incentive schemes have been implemented by amending the relevant provisions of the Listing Rules, which have come into effect on 30 September 2006.

The one aspect of the proposal to facilitate further issues that has yet to be implemented concerns reducing the processing time for further issues from four days to two days. Efforts are being made to develop a workable solution that will allow applications to be processed within the shorter two-day period.

### **(C) Issuing New Marketing Guidelines**

The proposal to issue new marketing guidelines has been implemented. New guidelines were put out for consultation in March 2006. A total of 5 responses were received. The respondents generally supported the principles-based approach adopted in the new guidelines. The final version of the guidelines was amended to take into account comments received. The new guidelines were published on 19 September 2006 and came into effect on 1 October.

**(D) Remaining Proposals**

The two remaining proposals, i.e. to tighten liquidity provider provisions and require the use of plain language and summaries, will also require changes to the Listing Rules, and hence approval by the Listing Committee. The SFC is currently working with the Exchange and the market on progressing these.

**Securities and Futures Commission  
November 2006**