

**立法會**  
*Legislative Council*

LC Paper No. CB(1)937/10-11  
(These minutes have been seen  
by the Administration)

Ref : CB1/BC/11/09/2

**Bills Committee on Securities and Futures and Companies Legislation  
(Structured Products Amendment) Bill 2010**

**Second meeting on  
Thursday, 25 November 2010, at 8:30 am  
in Conference Room B of the Legislative Council Building**

**Members present** : Hon Starry LEE Wai-king, JP (Chairman)  
Hon Albert HO Chun-yan  
Hon James TO Kun-sun  
Hon Audrey EU Yuet-mee, SC, JP  
Hon WONG Ting-kwong, BBS, JP  
Hon Ronny TONG Ka-wah, SC  
Hon CHIM Pui-chung  
Hon Mrs Regina IP LAU Suk-ye, GBS, JP

**Members absent** : Hon CHAN Kam-lam, SBS, JP  
Hon Miriam LAU Kin-ye, GBS, JP

**Public officers attending** : Financial Services and the Treasury Bureau  
  
Mr Anthony LI  
Principal Assistant Secretary (Financial Services)  
  
Ms Jane LEE  
Assistant Secretary (Financial Services)

Hong Kong Monetary Authority

Ms Meena DATWANI  
Executive Director  
Banking Conduct

Ms Alice LEE  
Senior Manager  
Banking Conduct

Department of Justice

Mr Paul O'BRIEN  
Senior Assistant Law Draftsman

**Attendance by invitation** : Securities and Futures Commission

Mr Brian HO  
Executive Director, Corporate Finance

Ms Alice LAW  
Senior Director  
Policy, China and Investment Products

Ms Alexandra YEONG  
Director, Corporate Finance

**Clerk in attendance** : Ms Anita SIT  
Chief Council Secretary (1)5

**Staff in attendance** : Mr KAU Kin-wah  
Assistant Legal Adviser 6

Mr Noel SUNG  
Senior Council Secretary (1)4

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Action

**I Confirmation of minutes and matters arising**

(LC Paper No. CB(1)511/10-11 — Minutes of the meeting on  
26 October 2010)

The minutes of the meeting held on 26 October 2010 were confirmed.

## II Meeting with the Administration

### Follow-up to issues raised at the meeting on 26 October 2010

(LC Paper No. CB(1)429/10-11(01) — List of follow-up actions arising from the first meeting on 26 October 2010 prepared by the Legislative Council Secretariat

LC Paper No. CB(1)429/10-11(02) — Administration's paper on comparison between the existing and the proposed arrangements for regulation of public offers of structured products

LC Paper No. CB(1)486/10-11(01) — Administration's paper on definitions of key terms

LC Paper No. CB(1)429/10-11(03) — Administration's paper on analysis of the market development of structured products in Hong Kong

LC Paper No. CB(1)466/10-11(01) — Administration's paper on regulation of currency-linked, interest rate-linked and currency and interest rate-linked instruments

LC Paper No. CB(1)466/10-11(02) — Administration's paper on whether the principles in the Code on Unlisted Structured Investment Products could be specified in the legislation)

2. The Committee deliberated (Index of proceedings attached at **Appendix**).

### Follow-up actions to be taken by the Administration

3. The Administration was requested to provide the following information:

- (a) definition of "professional investors", and an update on the progress on reviewing/amending the definition;
- (b) the existing regulatory arrangements for currency-linked, interest rate-linked and currency and interest rate-linked instruments issued

by Authorized Institutions, including the relevant codes/guidelines issued by the Hong Kong Monetary Authority, and the common types and respective quantities of these products in the Hong Kong market;

- (c) the meaning of "advertisement, invitation or document" in the relevant provisions, and the scope of application of the regulatory regime in real life situations; and
- (d) the meaning of "persons outside Hong Kong" in the relevant provisions, and the regulatory arrangements for the disposal of unlisted structured products to intermediaries or persons outside Hong Kong, where the transaction or part of the transaction process took place in Hong Kong.

*(Post-meeting note: The Administration and Securities and Futures Commission's responses were circulated to members vide LC Paper Nos. CB(1)788/10-11 and CB(1)813/10-11(01) on 14 and 15 December 2010 respectively.)*

### **III Any other business**

#### Date of next meeting

- 4. Members noted that the next meeting would be held on 6 December 2010 to receive the views from deputations.
- 5. There being no other business, the meeting ended at 10:25 am.

Council Business Division 1  
Legislative Council Secretariat  
29 December 2010

**Proceedings of the  
Bills Committee on Securities and Futures and Companies Legislation  
(Structured Products Amendment) Bill 2010  
Second meeting on Thursday, 25 November 2010, at 8:30 am  
in Conference Room B of the Legislative Council Building**

Time Marker	Speaker	Subject(s)	Action Required
000424 – 000705	Chairman	(a) Confirmation of minutes of meeting on 26 October 2010 (LC Paper No. CB(1)511/10-11)  (b) Introductory remarks	
000706 – 001906	Administration	Briefing by the Administration on the proposals in the Bill (LC Paper No. CB(1)429/10-11(02)).	
001907 – 002341	Mr WONG Ting-kwong Securities and Futures Commission (SFC)	(a) Mr WONG Ting-kwong was concerned whether there was a clear definition of "professional investor" (PI) as an offer to PIs would be exempted from authorization by SFC.  (b) SFC explained that there were 2 levels to the definition of PI. The first level relates to offers and safe harbours – the definition of a PI for this was clear. For the purposes of the offer regime, the definition of PI was in Part 1 of Schedule 1 to the Securities and Futures Ordinance (Cap. 571) ("SFO"). This definition sets out a list of specific persons as well as persons set in the Securities and Futures (Professional Investors) Rules (Cap. 571 sub. leg. D) ("PI Rules"). The PI Rules include high net worth individuals with a portfolio of not less than HK\$8 million (or the equivalent in foreign currency). The second level related to Intermediaries' conduct during the sale process and there were additional requirements under the SFC's Code of Conduct that an intermediary must ensure before a client who met the requirements under the PI Rules could be classified as a PI under the Code. In relation to the requirements under the Code of Conduct, the SFC had conducted a consultation in 2009. SFC was also currently undertaking a public consultation regarding the evidential requirements under the PI Rules. Currently, intermediaries must rely on specific documents that were obtained within a certain	

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		<p>period before the offer date in order to ascertain whether their clients met the asset thresholds (e.g. HK\$ 8 million). The SFC was now consulting on whether it would be appropriate to adopt a principle-based approach in relation to the evidential requirements as long as the intermediary's evidence showed that the investor met the asset threshold on the offer date.</p>	
002342 – 003109	Ms Audrey EU SFC	<p>(a) In reply to Ms Audrey EU's enquiry, the Administration advised that the definition of PI under the SFO and the Companies Ordinance (Cap. 32) was the same.</p> <p>(b) Ms Audrey EU was concerned about ways to establish that an intermediary was providing advice to customers on securities, as many bank staff would recommend certain securities to the customers. However, they sometimes claimed they were making product recommendations, and they were not licensed or registered for Type 4 regulated activity, i.e. advising on securities. Ms EU was also concerned as to how an intermediary was considered to have solicited and/or recommended a customer to buy securities.</p> <p>(c) SFC responded that a person licensed or registered for Type 1 regulated activity, i.e. dealing in securities, would be deemed to be licensed or registered for Type 4 activity, and was subject to regulation by the relevant code of conduct and guidelines issued by SFC when he was involved in advising on securities. SFC added that whether an intermediary was considered to have solicited business and/or recommended securities to customers would depend on the actual facts of individual cases.</p>	
003110 – 003737	Mrs Regina IP Administration	<p>(a) Mrs Regina IP opined that the on-paper differentiation between being licensed for Type 1 and 4 regulated activities was not meaningful in the case of frontline bank staff.</p> <p>(b) Mrs Regina IP considered it necessary to review the definition of PI.</p>	

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		(c) The Administration agreed to provide information on the definition of PI, and an update on the progress on reviewing/amending the definition.	The Administration to take action as per paragraph 3(a) of the minutes
003738 – 003911	Mr WONG Ting-kwong	Mr WONG Ting-kwong opined that the existing arrangement where the securities business of banks was regulated by two regulatory bodies, namely SFC and the Hong Kong Monetary Authority (HKMA) had given rise to grey areas.	
003912 – 004746	Mrs Regina IP Administration SFC	<p>(a) In response to Mrs IP's enquiry, SFC remarked that there was no application for authorization, nor application for renewal of authorization under the Companies Ordinance in 2009 for offering document of structured notes after the Lehman Minibonds Incident. There was a general lack of market demand. In 2010, SFC had authorized four applications under the S.F.O. for offering documents of equity linked deposit, and six applications for equity linked investment.</p> <p>(b) Separately, on authorized funds, SFC in response to Mrs. IP's enquiry responded that the number of applications for authorization of offering documents for funds had increased in 2010. The number of fund applications went hand in hand with market conditions. Fund issuers were conversant with the relevant authorization requirements, and they might not pursue their applications if they believed they might be unable to comply, or if they decided not to introduce the relevant funds to the market. Issuers and intermediaries were allowed to distribute only the offering documents and marketing materials authorized by SFC to their customers, unless exempted.</p> <p>(c) Mrs Regina IP enquired whether the issuers were required to list out all relevant fees in the offering documents and/or marketing materials for funds.</p> <p>(d) SFC responded that in the case of authorized funds, the offering documents should disclose details of the fees payable to the fund manager and the custodian. Details of the charges were also disclosed in annual reports of the funds. In 2009, SFC consulted the public on</p>	

Time Marker	Speaker	Subject(s)	Action Required
		the disclosure of fees/commissions payable to intermediaries.	
004747 – 005548	Administration	Briefing by the Administration on the proposals in the Bill relating to currency-linked, interest rate-linked and currency and interest rate-linked instruments (LC Paper No. CB(1)466/10-11(01)).	
005549 – 010704	Mr James TO SFC HKMA	<p>(a) Mr James TO was concerned that Authorized Institutions (AIs) might issue very complex currency-linked investment instruments such as currency accumulator, and whether public offers of such non-principal protected investment instruments should be subject to authorization by SFC and any regulation by HKMA.</p> <p>(b) The Administration responded that the existing regulatory regime for sale of currency-linked, interest rate-linked and currency and interest rate-linked investment instruments issued by AIs was in line with international practice, and the "disclosure based" principle.</p> <p>(c) HKMA supplemented that for the sale of such investment instruments by AIs, although the products and their offering documents did not require prior approval by SFC or HKMA under the law, according to HKMA's guidelines, AIs were required to make full disclosure of the risks involved, assess the suitability of such instruments for individual customers, and advise customers that the instruments were not protected under the Deposit Protection Scheme. The marketing materials for such instruments should also be concordant with relevant codes and guidelines issued by SFC.</p>	
010705 – 011108	Mrs Regina IP Chairman James TO	The Administration was requested to provide information on the existing regulatory arrangements for currency-linked, interest rate-linked and currency and interest rate-linked instruments issued by AIs, including the relevant codes/guidelines issued by HKMA, and the common types and respective quantities of these products in the Hong Kong market.	The Administration to take action as per paragraph 3(b) of the minutes



Time Marker	Speaker	Subject(s)	Action Required
011109 – 011748	Mr James TO SFC	<p>(a) Noting that under the Bill, the offering documents of convertible bonds for capital fund raising purpose were regulated under the CO prospectus regime while the offering documents of equity-linked notes were regulated under the SFO offers of investment regime, Mr James TO was concerned whether there was a clear distinction between such convertible bonds and equity-linked notes.</p> <p>(b) SFC responded that "convertible bond for capital fund raising purpose" was defined as "a debenture issued for capital fund raising purposes that is convertible into or exchangeable for shares (whether issued or unissued) of the issuer of the debenture or of a related corporation of the issuer" in the Bill. The main distinction between "convertible bonds" and "equity-linked notes" was that the reference assets of "convertible bonds" must be the shares of the issuer of the convertible bond or a related corporation of the issuer. There was no grey area between the two types of products. In practice, issuers of such convertible bonds were invariably listed companies which were subject to regulation of the SFO.</p>	
011749 – 013753	Ms Audrey EU SFC	<p>(a) Ms Audrey EU enquired about the proposal to empower SFC to authorize structured products.</p> <p>(b) SFC advised that the policy intent was that structured products offered to the public in Hong Kong would be subject to the prior authorization of SFC unless an exemption applies to their offering documents or advertisements. The new section 104A in the SFO would subject structured products to an authorization process similar to section 104 for collective investment schemes. SFC's authorization would be based on the requirements set out in the Code on Unlisted Structured Investment Products (the Code), including requirements on some of the features of the product, such as issuer and collateral eligibility requirements. These requirements were imposed in line with public interest. Nonetheless, in line with the practice in other major financial centres, the</p>	

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		<p>regulatory regime would continue to be disclosure-based, supported by intermediary conduct regulation, to assist investors to make an informed investment decision.</p> <p>(c) Ms Audrey EU enquired about the existing exemption for an offer made by or on behalf of intermediaries licensed or registered for Type 1, 4 or 6 regulated activity in respect of securities, and the reason for excluding "unlisted structured products" from this exemption under the Bill.</p> <p>(d) SFC responded that as the intermediaries concerned were subject to regulation by the relevant licensing legislation and codes of conduct issued under SFO, offering documents and marketing materials for offers of specified investment products issued by the licensed intermediaries were exempted from the SFC authorization requirement. However, the policy intent was to bring all offering documents and marketing materials for unlisted structured products within the requirement to seek prior SFC authorization. Hence, the Bill provided that the existing exemption in section 103(2)(a) and section 103(5)(a) did not apply to offering documents and marketing materials for unlisted structured products.</p> <p>(e) Ms Audrey EU was concerned about the scope of "marketing materials" subject to SFC's authorization. She was particularly concerned whether the marketing materials used at the point of sale, which might not be the same as the marketing materials of the issuer, required prior authorization by SFC.</p> <p>(f) SFC explained that "marketing materials" was a generic term commonly used in the market only. Under s.103 of the SFO, any person that issued an "advertisement, invitation or document" regarding specified investment products that he knew was, or contained, an invitation to the public had to be authorized by SFC, unless otherwise exempted. SFC explained that the Code was gazetted and became effective on 25 June this year. The Code included a set of Advertising Guidelines</p>	

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		<p>for structured investment products, setting out SFC's requirements for the authorization of advertisements issued to the public regarding structured investment products. SFC explained that the manner in which advertisements were displayed was an issue falling within the conduct regulation of intermediaries. The use of unauthorized marketing materials for the promotion and sale of specified investment products was prohibited under the SFO, unless exempted.</p> <p>(g) Ms Audrey EU enquired as to what enhanced investor protection requirements would be imposed under the proposed transfer of the regulation of public offers of structured products from the CO prospectus regime to the SFO offers of investments regime.</p> <p>(h) SFC responded that pursuant to the proposed new section 104A, SFC might issue product codes and guidelines to set out the bases for the authorization. The Code issued in June 2010 had laid down requirements regarding the minimum capital requirement of the issuers of structured products, eligibility criteria for reference assets, the criteria for the collateral of the structured products, e.g. the collateral must be liquid and could not be structured products, and the requirement for continued disclosure of information by the issuer, and that the issuer had to provide post-sale market-making and cooling-off. Under the prospectus regime of the CO, such requirements could only be implemented as administrative arrangements.</p> <p>(i) The Administration was requested to provide information on the meaning of "advertisement, invitation or document" in the relevant provisions, and the scope of application of the regulatory regime in real life situations.</p>	<p>The Administration to take action as per paragraph 3(c) of the minutes</p>
013754 – 014619	Mr Albert HO SFC	<p>(a) Mr Albert HO doubted, based on the experience of the Lehman Brothers Minibonds Incident, whether exemption should be given to offers made only to persons outside Hong Kong, especially for high risk structured products. Mr HO pointed out that the</p>	

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		<p>Lehman Brothers Minibonds had been sold to PIs in Hong Kong and then re-sold to overseas investors in places like Taiwan. He was concerned that the exemption would create a loophole whereby high risk financial products originated/packaged in Hong Kong sold to investors overseas were not subject to proper regulation, and this might potentially tarnish Hong Kong's reputation as an international financial centre.</p> <p>(b) SFC responded that the disposal of structured products in an overseas jurisdiction, notwithstanding that they might be originated in Hong Kong, would primarily be subject to the regulatory regime of the overseas jurisdiction concerned. SFC further explained that due to jurisdiction principles, difficulties would arise in the application and enforcement of Hong Kong laws in a foreign jurisdiction.</p>	
014620 – 015114	Mrs Regina IP SFC	<p>(a) Mrs Regina IP expressed concern about the existing regulatory arrangement on the collaterals of credit linked structured products. Mrs IP further enquired about the regulation of structured products which had no credit rating.</p> <p>(b) SFC responded that prior to the issue of the Code in June 2010, SFC had made reference to the requirements relevant to listed structured products in regulating the collateral for unlisted structured products, namely the collateral should have a 2A credit rating. After the issue of the Code, the criteria for collateral of structured products had been beefed up, in that the collateral should not be structured products. SFC added that the latest international development on regulation of the use of credit ratings was that the regulatory authorities should not place heavy or sole reliance on credit ratings in its regulatory functions. SFC added that it has conducted a consultation recently regarding whether a licensing mechanism should be put in place for credit rating agencies. SFC elaborated that it was important to take a holistic view in relation to the offering of structured products. Equally, point-of-sale</p>	

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		conduct of intermediaries, including suitability obligations of "know your product", was a key regulatory pillar that played an important role in the offering of structured products.	
015115 – 015305	Mr Ronny TONG Chairman	Mr Ronny TONG echoed Mr Albert HO's concern and highlighted Hong Kong's special position of being a gateway to the Mainland market in respect of financial products/services. He requested the Administration to review the regulatory arrangements for the disposal of unlisted structured products to persons outside Hong Kong, where the transaction or part of the transaction process took place in Hong Kong.	The Administration to take action as per paragraph 3(d) of the minutes
015306 – 015325	Chairman	Date of next meeting.	