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

Summary of views submitted by organizations/individuals on the Securities and Futures and Companies Legislation (Structured Products Amendment) Bill 2010 and Response by the Administration and the Securities and Futures Commission

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Contents

Part		**Page**
A.	General views on the Bill	1-3
B.	Exemptions from authorization for issue of advertisements, invitations or document (clause 4 - amendments to section 103 of SFO)	3-5
C.	Currency-linked instruments, interest rate-linked instruments and currency and interest rate-linked instruments issued by authorized financial institutions (clause 4(5) - proposed section 103(3)(ea), and clause 15(7) - proposed definitions in Part 1 of Schedule 1 to SFO)	5-8

Part		Page
D.	Authorization of structured product (clause 5 - proposed section 104A of SFO)	8-10
E.	Financial Secretary to prescribe interests, etc. as securities, etc. (clause 13 - proposed section 392 of SFO)	10
F.	Definition of "debenture" (clause 15(2) - proposed amendment to the definition in section 1 of Part 1 of Schedule 1 to SFO)	11
G.	Definition of "securities" (clause 15(4) to (6) - proposed amendments to the definition in section 1 of Part 1 of Schedule 1 to SFO)	11-14
H.	Definition of "structured product" (clause 15(8) - proposed section 1A of Schedule 1 to SFO)	14-16
I.	Savings and transitional provisions (clause 17)	16-17
J.	Safe harbours in the CO (clause 22)	17-21
K.	"Professional investors"	21-22
L.	Regulated investment agreement	22
M.	Other issues	22-24

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A. General views on the Bill		
Organizations	**Views/Concerns**	**Response by the Administration/SFC**
The Hong Kong Society of Financial Analysts	Support the object of the Bill. The proposed changes in the regulatory framework can remove the potential use of the safe harbours in the CO by financial intermediaries to offer structured products to the public without proper regulatory review of the risk disclosure and product explanation of the subject structured products. Hong Kong should adhere to her long-established disclosure-based regulatory regime for the financial markets. Structured products have been developed to meet investors' desired risk and return requirements. Over-regulation of structured products offerings to individual investors may hinder the development of Hong Kong as the wealth management hub.	The SFC will continue to engage the market to ensure that regulation of unlisted structured products is appropriate, balancing the needs of investor protection and market development.
Clifford Chance	Support the object of the Bill.	Noted.
Allen & Overy	Very supportive of the proposal to rationalize and harmonize the two existing offering regimes.	Noted
Mr YEUNG Wai-sing, member of the Eastern District Council	If structured products issued by local banks, due to the existing regulatory arrangement under which the banking industry falls within the regulatory purview of HKMA, are not subject to the regulation of SFC, confusion may be resulted.	The proposed exemption in section 103(3)(ea) refers only to specific types of banking products (i.e. currency-linked, interest rate-linked and currency and interest rate-linked instruments) issued by authorized institutions. This is in line with the existing arrangements for banking products. We

		believe there is no confusion in the market. Please also refer to LC Paper No. CB(1)466/10-11(01).
ISDA and ASIFMA	Support the Government's efforts to harmonize the two existing offering regimes.	Noted.
Hong Kong Bar Association	Support the legislative amendments to unify the regulation of public offers of structured products under the SFO. The proposed legislative amendments would reduce the potential for regulatory arbitrage. It makes sense to place structured products with other investment products such as collective investment schemes. The SFO allows for a more comprehensive regime than the CO does for the regulation of increasingly complex structured products.	Noted.
Hong Kong Securities Professionals Association	In view of financial innovations and hence the need to strengthen investor protection, the Association supports the legislative proposals in principle. It is important to ensure that the proposed new definitions and amendments to definitions are sufficiently clear and precise without giving rise to grey areas. For example, the Government should clarify how depositary receipts will be regulated.	We have considered the proposed definitions very carefully and believe that they are sufficiently clear. Public offers in Hong Kong of depository receipts are, and will continue to be, regulated under the Companies Ordinance. We believe this is clear under the proposed legislation.
Hong Kong Financial Planners General Union	Support the legislative proposals in principle. There is a need to enhance the disclosure of the features of	The SFC has already issued relevant codes (e.g. the Code on Unlisted Structured Investment Products and the Code on Unit Trusts and Mutual Funds, the latter of which applies to

	financial products, e.g. exchanged traded funds. The relevant authorities should put more efforts on education and training for financial planners and other intermediaries.	exchange-traded funds) on various investment products to set out its key requirements, including disclosure regarding product features, on them. The SFC will keep in view market development and update its Codes from time to time.

B. Exemptions from authorization for issue of advertisements, invitations or document (clause 4 - amendments to section 103 of SFO)		
Organizations	**Views/Concerns**	**Response by the Administration/SFC**
Baker & McKenzie	Agree with SFC's recommendation to exempt employee incentive schemes (such as phantom share option offers) from the prohibition in section 103. Proposed section 103(2)(e)(iii) appears to limit the operation of the exemption only to structured products *of* the corporation to its employees. The words "structured products of the corporation", however, seem rather vague and could give rise to ambiguities as to its scope. It should be clarified as to how proposed section 103(2)(e)(iii) is intended to operate in the context of the exclusion in the proposed definition of "structured product" (proposed section 1A(2)(f)(i) of Schedule 1) which provides that a "structured product" does not include - *"(f) a product that is offered by a corporation only to a person who is -* *(i) a bona fide employee or former employee of the corporation or of another corporation in the same group of companies;"* The proposed drafting would potentially apply to a wide range of employee incentive schemes. The exclusion would potentially capture any structured product offered to an employee by the employer, regardless of whether such	The policy intention is to exclude employee incentive schemes (such as phantom share option schemes) from the regulatory regime for structured products. Such employee incentive schemes should, in the context of structured products, be limited to those issued by the corporation and referenced to securities of the corporation itself or a related corporation. We note the comment that the exclusion under the proposed section 1A(2)(f) is potentially too wide. We would tighten up the wording so that the exclusion will only apply to employee incentive schemes issued by the corporation and referenced to securities of the corporation itself or a related corporation. We would also refine the wording in section 103(2)(e)(iii) to set out more clearly its operation in relation to employee incentive schemes. We intend to introduce Committee Stage Amendments to effect the above changes and will submit the draft for Member's consideration in due course.

	product is in respect of the securities of the employer or employer group company.	
The Hong Kong Association of Banks	Exemptions for employee incentive schemes in sections 103(2)(e) and in the definition of "structured product" should have a consistent scope and mirror the existing exemption for employee incentive schemes under paragraph 8 of the Seventeenth Schedule to the CO.	The purpose of the Bill is to transfer the regulation of public offers of structured products that are in the form of shares or debentures from the CO to the SFO, as such the exemptions in the SFO should apply. The Bill does not intend to amend the exemption in the CO in relation to employee incentive scheme.
The Law Society of Hong Kong	There should be an exemption for all share option schemes. The exemption should not be limited to share options schemes which are only offered to employees.	We consider it inappropriate to extend the exemption to share options schemes not offered to employees.
Clifford Chance	Regarding the proposed amendments to sections 103(2)(a), 103(5)(a) and 103(6)(a), the opportunity should be taken to extend these provisions to Type 9 licensed or registered intermediaries (which have the benefit of being able to conduct an incidental Type 1 regulated activity) in the context of their managing collective investment schemes that are authorized under section 104.	The effect of amending section 103(2)(a), (5)(a) and (6)(a) is to narrow down the scope of the existing exemption for Types 1, 4 and 6 licensees and subject such offer documents and advertisemnts of unlisted structured product to the SFC's authorization. We consider it inappropriate to widen the current exemptions to licensees of another type of regulated activity.
The Hong Kong Association of Banks ISDA and ASIFMA	The Association requests that sections 103(3)(h) and (i) of the SFO, which exempt listed products from the offer authorization regime, be amended to include a reference to "structured products". Under the current drafting of these provisions, a structured product that falls within paragraphs (a) to (f) of the definition of "securities" would be exempt, but any other type of structured product would not. This results in an anomalous and unsatisfactory regulatory approach.	Sections 103(3)(h) and (i) relate to offers of securities that are listed or traded on the recognized stock market. All listed and traded structured products on the recognized stock market are in the form of securities (as defined under sections (a) to (f) of the definition of "securities") therefore the proposed amendment is unnecessary. With respect to the suggestion in respect of section 103(11A), as explained in the preceding paragraph, all listed and traded structured products on the recognized stock market are in the form of securities (as defined under

	Under proposed new section 103(11A), exemption from authorization provided in section 103(2)(i) does not apply to any structured products that: (a) are not authorized by the Commission under section 104A; or (b) are not listed securities. The Association asks that the second limb in section 103(11A) ("are not listed securities") be amended to state "are not listed securities **or structured products**". The reason is that the definition of "securities" for the purposes of Part IV of the SFO (which is set out in section 102) will capture some, but not all, structured products. The Association suggests that this exemption should apply to all types of listed products.	sections (a) to (f) of the definition of "securities") therefore the proposed amendment is unnecessary.

C. Currency-linked instruments, interest rate-linked instruments and currency and interest rate-linked instruments issued by authorized financial institutions (clause 4(5) - proposed section 103(3)(ea), and clause 15(7) - proposed definitions in Part 1 of Schedule 1 to SFO)		
Organizations	**Views/Concerns**	**Response by the Administration/SFC**
Clifford Chance ISDA and ASIFMA	SFC has noted in its Consultation Conclusions that the authorized financial institutions would need to ensure that any features that are attached to currency-linked instruments and interest rate-linked instruments do not contain any derivative element. The meaning of "derivative element" is unclear and therefore further guidance will be needed as to what products will constitute currency-linked instruments and interest rate-linked instruments and, in particular, as to what is the meaning of "derivative element". The use of the word "only" in the definitions should be replaced with "predominantly".	**Derivative element** – The phrase "derivative element" was used in the consultation conclusions paper to describe in layman terms the policy intent of the framework and was not used in the Bill. We believe that "derivative element" in the definitions of "currency-linked instrument", "interest rate-linked instrument" and "currency and interest rate-linked instrument" as well as in the definition of "structured product" are sufficiently clear in the following phrase – "…some or all of the return or amount due….or the method of settlement is determined by reference to one of more of….".

		Replace "only" with "predominantly" – This is inappropriate. The use of "only" is to limit these products to ones which are linked to interest rates and/or currency exchange rates as these are banking products. The suggestion will widen the scope of these definitions and may extend to non-banking products, which is not our intention.
ISDA and ASIFMA	Currency rate-linked and interest rate-linked instruments (and hybrids thereof) issued by authorized financial institutions should be carved out from the definitions of "securities" and "structured products", rather than just being exempt from section 103(1).	The proposal to exempt these banking products from the prohibition in section 103(1) is consistent with the treatment of other banking products - see section 103(3)(e).
The Hong Kong Association of Banks	All currency and interest-rate linked products issued by authorized financial institutions should be regulated uniformly, irrespective of their form. To achieve this, the proposed exemption in section 103(3)(ea) for such products should be moved into the definitions of "securities" and "structured product" in Part 1 of Schedule 1, and the word "instrument" should be replaced with "product". The present proposal of inserting the exclusion into section 103 means that these products will fall out of the proposed paragraph (g) of the definition of "securities"; they will continue to be "securities" if they fall within the existing paragraphs (a) to (f) of that definition; and they will also continue to be "structured products", which means that they may be unintentionally regulated in future. Currency-linked products should include those that are linked to the price of gold or silver. These products are	We do not agree with these suggestions. The exemption in section 103(3)(ea) for currency and interest rate linked instruments issued by banks is appropriate as it is consistent with the policy intent and existing treatment of other banking products in the SFO. The reason for the suggestion to use the word "product" instead of "instrument" in the definitions is unclear. We believe this may create ambiguity and a narrower scope of coverage. This may result in products falling outside the regulatory regime for structured products. In the absence of specific examples, we do not see any unintentional regulation of these products. It is also inappropriate for these definitions to be extended so that bank issued instruments linked to gold and/or silver are also exempted from the authorization requirements. This

	important for a number of banks' treasury functions. Secondly, the prices per troy ounce of gold and silver are quoted and traded in the same way as currency. The proposed definitions of "interest rate-linked instrument" and "currency and interest rate-linked instrument" should be refined to refer to paragraph 2(e) of the definition of "structured product" in Part 1A of that Schedule, to clarify that a floating rate debenture that falls within paragraph 2(e) of the definition of "structured product" is also an "interest rate-linked instrument"	will make the exemption too wide. Floating rate debenture, as described in paragraph 2(e) of the definition of "structured product", is proposed to be carved out from the definition of "structured product". Public offers of floating rate debentures should remain to be regulated under the prospectus regime under the CO. It is unnecessary to link up such definition with interest rate-linked instrument which is exempted from the prohibition under section 103(1) of the SFO if the instrument is issued by an authorized institution.
Hong Kong Bar Association (HKBA)	The three types of instruments have been generally regarded more as banking instruments than investment products. Their nature and use put them next to traditional banking activities. The proposed exception for the three types of instruments applies only if they are issued by banks. This potentially creates a disparity between banks and securities firms. As a matter of principle, this is undesirable. However, given the policy rationale for these instruments, restricting the exception to instruments issued by banks is quite understandable. Moreover, Hong Kong's laws provide for separate regulation of different types of intermediaries, namely banks, securities firms, and insurance companies. Given this overall framework, there will inevitably be some situations where different intermediaries engaging in seemingly the same activities are subject to different requirements. On balance, the proposed exception appears reasonable. But the HKBA urges the Government and the regulatory authorities to monitor the banks' offering of the three types of instruments, so as to identify any concerns about investor protection and, where	For protection of investors, the HKMA monitors banks' selling of investment products (including interest rate-linked instruments, currency-linked instruments, and currency and interest rate-linked instruments) in the day-to-day supervisory process. The HKMA carries out supervision through regular surveys, on-site examinations, mystery shopping and off-site surveillance. The HKMA will continue to monitor the offering of investment products (including the three types of instruments concerned) by banks to identify any concerns about investor protection, and take appropriate actions where necessary. Please also refer to LC Paper No. CB(1)788/10-11(03) and LC Paper No. CB(1)968/10-11(04).

	appropriate, to vary or even disable this exception.	

D. Authorization of structured product (clause 5 – proposed section 104A of SFO)		
Organizations	**Views/Concerns**	**Response by the Administration/SFC**
Civic Party	The Civic Party has reservation on the proposal to empower SFC to authorize structured products by replicating section 104, since it is questionable whether the existing regulatory arrangements for collective investment schemes have proven to be effective. The Civic Party considers that the relevant authorities should strengthen their staffing establishment and employ more "technical" managerial personnel to cope with the developments of the financial markets.	The power to authorize a structured product under the proposed section 104A and the manpower of the SFC are two different issues. As noted in the October 2009 Consultation Paper, SFC's authorization under section 104A will depend upon compliance with the codes and guidelines (e.g. the Code on Unlisted Structured Investment Products). The Code establishes guidelines for the authorization of the relevant products (from the enactment of the Bill), and the issue of offering documents and advertisements for the relevant products offered to the public in Hong Kong. An offering document complying with the Code will need to contain the information necessary for investors to be able to make an informed judgment of the investment. SFC's authorization, however, does not mean that a specific product is suitable for every investor as each product is subject to its investment risks.
The Hong Kong Association of Banks	It is stated in the Administration's Batch 1 replies to the legal adviser of the Bills Committee that- *"[a]uthorization of a structured product under the SFO would normally be granted together with the authorization of its offering document under section 105 of the SFO. It is the general policy of the SFC not to consider authorizing a product under the SFO without a concurrent authorization of its offering document(s)".* This statement is inconsistent with the distinction made in the SFO between offer authorization under section 105 and	We do not agree that there is any inconsistency. Section 105 relates to authorization of the relevant documents whereas section 104 and the proposed section 104A relate to authorization of collective investment schemes and structured products, respectively. In general policy of the SFC is that authorization of a product under sections 104 or 104A will not be granted without authorization of the relevant documents under section 105. Section 103(11A) relates to section 103(2)(i) and limits the exemption in section 103(2)(i) so that a person who is

	product authorization under the existing section 104 and the proposed section 104A. Furthermore, section 104A is only relevant to the exception in section 103(11A)(a). That is, as currently proposed, product authorization under section 104A is only required where a person wishes to: (a) offer a structured product that is not a listed security; and (b) rely on the exemption from offer authorization in section 103(2)(i). If the "general policy" is that the offer needs to be authorized anyway, section 103(2)(i) becomes meaningless for any structured product that is not a listed security. There should be greater clarity about the intended purpose and function of the proposed section 104A to address the SFC's comments in its Consultation Conclusions that *"this enhanced approach should not be equated with "product" or "merit" regulation"*. In its submission to the Bills Committee, the Association has made a comparison showing the differences between the existing section 104 and the proposed section 104A, and finds that the only substantive differences between the two sections appear in the opening words of paragraphs (1) and (3) and are shown in tracking as follows: - *"On an application ~~to the Commission~~ <u>by any person</u>, the Commission may~~, where it considers appropriate~~, authorize…".* The Association supports the movement toward using plain language drafting. However, to ensure consistent product regulation and authorization procedures, the Association suggests that either:	engaged in the business of selling or buying property (other than securities or structured products) cannot issue advertisements, invitations or documents in respect of securities or structured products that have not been authorized. The approach mirrors that for collective investment schemes under section 103(11). SFC's authorization under section 104A will depend upon compliance with the codes and guidelines (e.g. the Code on Unlisted Structured Investment Products). Regarding the drafting of section 104A, the intention is to achieve the same legal effect as the existing section 104. The Department of Justice is committed to plain language drafting and the new section 104A is drafted accordingly. It is not necessary to combine sections 104 and 104A.

	(a) section 104A use the same language as section 104, with necessary changes to reflect that section 104A concerns structured products; or (b) section 104A be consolidated into section 104.	

E. Financial Secretary to prescribe interests, etc. as securities, etc. (clause 13 - proposed section 392 of SFO)		
Organizations	**Views/Concerns**	**Response by the Administration/SFC**
The Civic Party	The Civic Party has reservation on the proposal to expand section 392 to empower the Financial Secretary to prescribe, by notice published in the Gazette, that any interests, rights or property are to be or not to be regarded as, among other things, structured products. The Party doubts whether there are officials within the Administration who keep abreast of the changes of the financial markets and hence in a position to advise the Financial Secretary to make such prescriptions. The Party is also concerned whether there are conflicts or overlaps between the responsibilities of the relevant government officials and the financial regulatory authorities.	Under existing SFO provisions, the Financial Secretary has a similar power to declare any interests, rights or property as "securities". We believe the proposal to expand section 392 to empower the Financial Secretary to prescribe, by notice published in the Gazette, that any interests, rights or property are to be or not to be regarded as, among other things, structured products is appropriate and practical to cater for financial innovation. Market participants are at the forefront of financial innovation. In practice, the Administration and relevant regulators liaise closely on the need to draw up appropriate regulatory arrangements in view of market innovation. In the process, market participants' feedback will be taken into account.
Mr YEUNG Wai-sing, member of the Eastern District Council	Empowering the Financial Secretary to prescribe, by notice published in the Gazette, that any interests, rights or property are to be or not to be regarded as, among other things, structured products is a clever approach.	Noted.
Hong Kong Bar Association	The proposal builds into the regime the flexibility to react and adapt to innovation in investment products.	Noted.

F. Definition of "debenture" (clause 15(2) - proposed amendment to the definition in section 1 of Part 1 of Schedule 1 to SFO)		
Organizations	**Views/Concerns**	**Response by the Administration/SFC**
The Hong Kong Association of Banks	The definition of "debenture" should specify that deposits are not debentures, to address the absence of a clear common law position on this issue. A similar clarification should be made to the definition of "specified debt securities".	"Deposit" is already defined in the Banking Ordinance and we do not find it necessary to make amendments. It should be noted that publicly offered equity-linked deposits are already subject to the offers of investments regime of the SFO (as "regulated investment agreements") and are not subject to the prospectus regime of the CO (as "debentures").

G. Definition of "securities" (clause 15(4) to (6) - proposed amendments to the definition in section 1 of Part 1 of Schedule 1 to SFO)		
Organizations	**Views/Concerns**	**Response by the Administration/SFC**
Mr YEUNG Wai-sing, member of the Eastern District Council	Agree to the proposal to apply the regulatory requirements on "securities" only to structured products the offering documents for which the SFC authorization is required.	Noted.
Clifford Chance	The definition of "securities" in Schedule 1 as now amended is unclear. Clifford Chance understands that the intention is for only structured products authorized under section 105 to be included in the Schedule 1 amended definition of "securities". If a structured product was required to be authorized under section 103, and was not, then that would be a breach of section 103 itself. Clifford Chance recommends that the current wording be revisited to ensure that this intention is clear.	We believe the intention is clear that structured products that do not fall under the current definition of securities (i.e., limbs (a) to (f) of the definition) are to be treated as securities, if invitations, advertisements or documents in respect of such structured products are required to be authorized (under section 103) or are authorized (under section 105).
The Hong Kong Association of Banks	The definition of "securities" should not be expanded until the implications of that expansion are reviewed holistically. This requires closer examination, further consideration and separate market consultation, to ensure that any necessary adjustments to subsidiary legislation and regulatory codes, guidelines and circulars can be made in parallel to the changes made to this definition.	At present, the majority of the most common structured products that are publicly offered are securities-based and already subject to the regulatory requirements on "securities" in the SFO. The SFC originally proposed, in its October 2009 consultation paper, to add structured products to the definition of "securities" in section 1 of Part 1 of Schedule 1 to the SFO, so that all structured products will be subject to

ISDA and ASIFMA	The Bill proposes to change the exclusion in (f)(vi) of the definition to read: *"(vi) any debenture that specifically provides that it is not negotiable or transferable (excluding a debenture that is a structured product);"* The Association seeks explanation as to why SFC pursues this proposal, and suggests that it be reconsidered. Alternatively, the Association suggests the exclusion be refined as follows- *"(vi) any debenture that specifically provides that it is not negotiable or transferable (excluding a debenture that is a structured product in respect of which the issue of any advertisement, invitation or document that is or contains an invitation to the public to do any act referred to in section 103(1)(a) of this Ordinance is authorized, or required to be authorized, under section 105(1) of this Ordinance);"* so that it does not cast an unnecessarily wide net over structured products that do not require authorization under the SFO. The proposed expanded definition of "securities" (albeit already narrowed from the original proposal to classify all structured products as "securities") will nonetheless have far reaching and potentially unintended consequences throughout the rest of the SFO, its subsidiary legislation and other non-statutory regulatory literature. The two Associations believe further review and market consultation is necessary before the Bill is implemented, in order to ensure that all consequential amendments accord with the provisions in the Bill.	the existing regulatory requirements on "securities". However, there are market concerns that this proposal may be too sweeping with implications in particular for the market in bilateral transactions which are not offered to the public. The Bill therefore now proposes to apply the regulatory requirements on "securities" only to structured products the offering documents for which the SFC authorization is required (i.e. where the offering documents contain an invitation to the public but no exemption applies). We believe this proposal achieve the objective of enhancing protection for investors who are offered with these structured products. It can also pre-empt the possibility of the market devising non securities-based structured products to avoid such regulatory requirements on "securities" in the future. The policy intent is to provide that non-negotiable/transferable debenture-type structured products only become securities if they are publicly offered. We agree with the deputation's proposed amendment to paragraph (vi) of the definition of "securities". We will provide our proposed Committee Stage Amendment for Members' consideration in due course.

Hong Kong Bar Association	Under the legislative proposals, the relationship between securities and structured products is quite convoluted. The ambit of the definitional provision for "securities" will depend on the operation of a substantive provision. In addition, this will be on top of an already lengthy section 103, which contains numerous exceptions and exceptions to the exceptions. According to the Government, the reason for the proposed wordings is to bring structured products offered to the public, and the activities of intermediaries relating thereto, but not structured products that are no offered to the public, nor the activities of intermediaries in relation thereto, within regulation under the SFO. As any statutory regime grows over time, and as new matters are added to fit with existing provisions, complication to the legislative language is inevitable. Moreover, the users of Part IV of the SFO are mostly industry participants and their legal advisers. For these reasons, the difficult language is not a cause of serious concern. Nonetheless, HKBA notes that the Government and the regulatory authorities have planned a major exercise to review the regulation of public offers as a whole. This might well serve also as an opportunity to reorganize the statutory provisions.	
The Hong Kong Association of Banks	The Association welcomes the exclusion, from the definition of "structured products", of debentures and subscription warrants issued for capital fund raising	We believe that such exclusion is inappropriate as it will result in activities relating to these products (i.e., convertible bonds, exchangeable bonds, subscription warrants etc)

	purposes that are convertible into shares of the issuer or a related corporation. However, these products should also be excluded from the definition of "securities", to ensure that the products are regulated exclusively under the CO.	falling outside other regulatory requirements under the SFO, i.e., none of the licensing, supervision, market misconduct requirements would apply.

H. Definition of "structured product" (clause 15(8) - proposed section 1A of Schedule 1 to SFO)		
Organizations	**Views/Concerns**	**Response by the Administration/SFC**
Mr YEUNG Wai-sing, member of the Eastern District Council	Support the adoption of a wide definition for "structured product". However, apart from convertible and exchangeable bonds and subscription warrants, the industry should be consulted as to what other instruments should be excluded from the definition of "structured product".	The SFC consulted the public on the definition of "structured product" and the exclusions in its Consultation paper on Possible Reforms to the Prospectus Regime in the Companies Ordinance and the Offers of Investments Regime in the Securities and Futures Ordinance issued in October 2009. The Bill has taken into account comments and suggestions on the definition and exclusions received during the consultation.
Clifford Chance	Clifford Chance notes that there is a separate regulatory regime for futures contracts and thus assumes that the definition is not meant to cover futures contracts. With respect to proposed section 1A(2)(e), Clifford Chance proposes to add after *"periodically"* the wording *"or by reference to a period"* to deal with the situations when there may be only one reset. The word *"securities"* should read *"security"* in proposed sections 1A(1)(a)(i) and 1A(1)(a)(ii).	**Futures contracts –** Invitations, advertisements or documents in respect of futures contracts that are issued by persons who are licensed or registered to conduct the regulated activities of dealing in or advising on futures contracts are exempted from the prohibition in section 103(1). If such invitations, advertisements or documents are issued by other persons, the documents should be prohibited unless authorized. **The proposed section 1A(2)(e) in Part 1 of Schedule 1 to SFO –** This is a description of floating rate notes that are excluded from the definition of "structured product" so that they remain to be regulated under the CO prospectus regime. We believe that the word "periodically" is sufficient to cover

		situations where there is only one reset and the suggestion to add "or by reference to a period" is unnecessary. **Sections 1A(1)(a)(i) and 1A(1)(a)(ii) –** The term "securities" in these provisions refers to "securities" as defined in Part 1 of Schedule 1 to the SFO. We believe it is wrong to use the term "security".
Allen & Overy	Seek clarification on whether a collective investment scheme in the form of a mutual fund (i.e. a company) would continue to be regulated under the CO prospectus regime. Propose to include a definition of "depositary receipt", which is excluded from the proposed definition of "structured product", in the legislation.	**Mutual funds –** The Bill seeks to transfer the offering regime for structured products from the CO to the SFO. It does not affect the existing regulatory arrangement for collective investment scheme. Collective investment schemes, whether in the form of unit trusts or mutual funds, continue to be subject to the authorization requirements under section 104 of the SFO if offered to the public. **Depositary receipt –** This term is already used in the SFO without definition: see paragraph (d) of the definition of "derivatives" in sections 245(2) and 285(2) of the SFO, and paragraph (d) of the definition of "equity derivatives" in section 308(1) of the SFO. We do not think it is necessary to define this term under the Bill.
The Law Society of Hong Kong	Propose the following revisions to the proposed definition of "structured product" - (a) for subsections (2)(a) and (2)(b), to add ***"or as consideration or part consideration for the acquisition of any assets or to satisfy any obligations on the part of the issuer or of a related corporation"*** after *"issued for capital fund raising purposes"*; and	(a) We believe the subsections (2)(a) and (2)(b) are sufficient to cater for convertible bonds, exchangeable bonds and subscription warrants that are issued for capital fund raising purposes. We do not see the need of amending these subsections. (b) As regards subsection 2(f), mentioned in our response to the first item under clause 4, we would tighten up the

	(b) for subsection (2)(f), to add ***"or of another corporation which is its related corporation"*** after *"in the same group of companies"*.	wording in the proposed section 1A(2)(f) so that the exclusion will only apply to employee incentive schemes issued by the corporation and referenced to securities of the corporation itself or a related corporation. We will propose a Committee Stage Amendment accordingly and provide draft wording for Members' consideration in due course.
The Hong Kong Association of Banks ISDA and ASIFMA	Futures contracts should be expressly excluded from the definition of "structured product" to avoid overlap and unintended regulatory consequences.	Invitations, advertisements or documents in respect of futures contracts that are issued by persons who are licensed or registered to conduct the regulated activities of dealing in or advising on futures contracts are exempted from the prohibition in section 103(1). If such invitations, advertisements or documents are issued by other persons, the documents should be prohibited unless authorized.
Hong Kong Bar Association	The definition appears sufficient to cover the presently known kinds of structured products.	To cater for financial innovation, it is proposed that section 392 be extended to empower the Financial Secretary to prescribe other products as structured products.

I. Savings and transitional provisions (clause 17)		
Organizations	**Views/Concerns**	**Response by the Administration/SFC**
The Hong Kong Association of Banks	The proposed transitional provisions in Schedule 10 to the SFO should be enhanced to ensure that there is adequate time to prepare for, and implement, the changes described in the Bill. In particular, the Association requests that: (a) legitimate product offers made before the implementation of the Bill be appropriately grandfathered, even if they have not been authorized and registered under the CO. The suggested period is no more than 6 months; and	(a) **6 month grace period to grandfather product offers before implementation of the Bill** – We consider it inappropriate to replicate the safe harbours provided for under the CO prospectus regime in the SFO offers of investments regime. Hence, we also consider it inappropriate to provide the suggested grace period which would in effect delay the commencement of the Bill.

	(b) a 12 month grace period be allowed for licensing, to reflect that: (i) the application process can take over four months from the date of application, plus preparation time (for example, to ensure that appropriate compliance procedures are in place); and (ii) the Association expects that the SFC cannot issue a licence in relation to structured products that do not currently fall within the definition of "securities" in advance, before the commencement of the Bill.	(b) **a 12 month grace period be allowed for licensing –** The SFC believes a 6-month transitional period for licensing is appropriate. The Hong Kong Association of Banks mentioned 2 issues – (i) whether market participants will have sufficient time to secure Type 1 licences during a 6 month transitional period; and (ii) whether, during that time, the SFC will be able to cope with the influx of licence applications arising out of the enactment of the amending legislation. In relation to the first issue, the market should be well aware of the proposed changes. We believe that most corporations and representatives which will be affected by the enactment of the Bill already hold Type 1 licences, hence this would not appear to be a particularly onerous obligation to impose on the market participants. As such, the SFC should be able to cope with such inflow of applications as there might be within the transitional period of 6 months after the commencement date.

J. Safe harbours in the CO (clause 22)		
Organizations	**Views/Concerns**	**Response by the Administration/SFC**
Clifford Chance		
	Clifford Chance believes that the safe harbours contained in the Seventeenth Schedule to the CO should be available for securities (including structured products). In particular, the "no more than 50 persons" safe harbour should be preserved. The safe harbour was introduced into the CO in 2004 on the basis that, in practice, offers to less than 50 persons had been considered as an appropriate benchmark for private placements that did not constitute an offer to "the public".	The concerns with respect to the loss of the CO safe harbours, in particular the "no more than 50 persons safe harbour" and the "minimum denomination $500,000 safe harbour" are noted. These safe harbours are currently available only under the CO and not the SFO which has its own exemptions. From the perspective of investor protection and in light of development of the structured products market in the past few years, we consider it inappropriate to relax the public offering regime by replicating these CO safe harbours.

	SFC has acknowledged, in paragraph 9 of the Consultation Paper, that the private placement exemption is retained in concept in the SFO. Unfortunately, the concept of "the public" has not been authoritatively defined by the courts, nor the Bill or any relevant statutes, and this has and would continue to lead to considerable uncertainty as to whether any given offer would be prohibited under the SFO.	The concept of an invitation to the public in section 103(1) of the SFO has been operating without problems since the inception of the SFO as well as in the repealed Protection of Investors Ordinance. We do not believe that it will create problem for the structured product business when other market participants have not encountered real difficulties. Adopting a bright line test might attract abuse to the regulatory arrangement – e.g. issuers might issue a certain structured product to 49 persons and repeat such arrangement with a largely similar structured product to get around with the bright line test.
	When relying on the "50 persons" safe harbour, the offeror is required to comply with the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission, including the "know-your-client" requirements in paragraph 5.2 and 5.3, as well as the recently introduced new paragraph 5.1A. This means that investors who purchase structured products offered in reliance on the "50 persons" safe harbour are subject to the same standards of suitability as retail investors.	This is correct.
Allen & Overy	In view of the significant adverse impact the removal of the safe harbours on Hong Kong's structured products market and Hong Kong's competitiveness as an international financial hub, further consideration should be given to incorporating the following safe harbours into the SFO regime - (a) an offer to not more than 50 persons; (b) an offer with a minimum denomination of HK$500,000; and (c) an offer with a maximum size of HK$5 million,	Please refer to the response under the first item of clause 22.

	The concept of "public" under section 103 and other relevant sections of the SFO should be clarified. Many market participants are eager to seek confirmation and clarity that an offer to not more than 50 persons will not constitute an offer to the public.	
The Law Society of Hong Kong	The "no more than 50 persons" and the minimum denomination of HK$500,000 safe harbours, which market participants have in the past relied upon and which in fact work, should be preserved, unless there are strong policy reasons for removing them.	Please refer to the response under the first item of clause 22.
Chinese Securities Association of Hong Kong	Some members of the Association consider that the removal of the safe harbours, in particular the minimum denomination of HK$500,000 safe harbour, would hinder the development and sale of various structured products. Such changes may affect product innovation and may reduce the range of products which otherwise should be available to clients who are more experienced than ordinary retail clients but who are not professional investors.	Please refer to the response under the first item of clause 22.
The Hong Kong Association of Banks	If the "no more than 50 persons" safe harbour is not provided under the SFO authorisation regime, the change should be accompanied by regulatory guidance in relation to the meaning of an "offer to the public" for the purpose of section 103 of the SFO. This is important because: (a) SFC and the Legislative Council appear to have different views about the implications of this change; (b) the Hong Kong financial services industry needs to understand how section 103 of the SFO will be interpreted and enforced by Hong Kong regulators,	Please refer to the response under the first item of clause 22.

	and a court in Hong Kong is likely to take into account the policy intention of this change; and (c) the common law does not recognise a numerical limit to determine whether an offer is made "to the public". Case law suggests that the number of offers is a relatively minor part of the equation.	
ISDA and ASIFMA	With the loss of the "no more than 50 persons" safe harbour, clear regulatory guidance as to the meaning of "public" and what amounts to an "invitation to the public" in the SFO is required. Such guidance may be in the form of (a) a clear definition of "public" to replace the existing definition in Schedule 1 of the SFO; (b) subsidiary legislation; or (c) non-statutory guidelines issued by SFC.	Please refer to the response under the first item of clause 22.
Mr YEUNG Wai-sing, member of the Eastern District Council	It should not be a cause of concern that the disapplication of the safe harbours in the CO would hinder the development of the structured products market; the market will adjust itself to offer structured products in a timely and cost-effective manner in order to meet the authorization requirements.	Noted.
Hong Kong Bar Association	Whether the minimum denomination of HK$500,000 safe harbour should be imported into the SFO is more a policy than a legal choice. Given the recent rise in complaints and public concerns about misselling of investments in general and mistreatment of lay consumers as sophisticated investors in particular, prudence is well justified. HKBA supports the present legislative proposals, which would not import the HK$500,000 exemption into the SFO, and would in effect end this exemption for offers of structured products.	Noted.

Hong Kong Securities Professionals Association	The Association agrees that the safe harbours in the CO should not replicated in the SFO. SFC should ensure that issuers fully disclose the risks of structured products in their offer documents.	Noted.

K. "Professional investors"		
Organizations	**Views/Concerns**	**Response by the Administration/SFC**
The Hong Kong Society of Financial Analysts	Under the new regulatory regime for structured products, high net-worth individual investors (HNWI) will have limited access to the offerings of structured products from financial intermediaries unless they are classified and agree to be treated as "professional investors" (PI) under the Securities and Futures (Professional Investor) Rules (Cap. 571D). Suggest that the PI regime be reviewed to allow the offering of unauthorized investment products including structured products to HNWI, who have the relevant investment knowledge and experience but not comfortable to be treated as PI, on the basis that the financial intermediaries have fulfilled their fiduciary responsibilities in product education, information disclosure, as well as the assessment of the product suitability.	There appears to be a misunderstanding of our requirements. In practice, the current regime operates in the following manner - Once a HNWI is qualified to be a PI under the Securities and Futures (Professional Investor) Rules, an intermediary may make solicitation or recommendation as regards unauthorised investment products to him without having to ensure suitability. If the HNWI refuses to be "treated" as a PI for the purpose of the SFC's Code of Conduct, the intermediary may continue to serve him as if he is a client without the PI status. The Bill will not change the existing arrangements for PI.
ISDA and ASIFMA	The proposed relaxation of evidential requirements of the PI Rules should coincide with the end of the Bill's proposed transitional period, such that market participants will be better able to avail themselves of the professional investor exemption.	In October 2010, the SFC published a separate consultation paper on the Evidential Requirements under the Securities and Futures (Professional Investor) Rules. The SFC is currently considering public comments received in response to the consultation. Such evidential requirements are not specific to high net worth professional investors of structured products, but for all high net worth professional investors.

L. Regulated investment agreement		
Organizations	**Views/Concerns**	**Response by the Administration/SFC**
The Hong Kong Association of Banks	The concept of "regulated investment agreement" should be removed from the SFO regime to avoid duplication and confusion. Historical reasons should not be the determining factor in deciding how products should be regulated in Hong Kong and any concerns about the market understanding that these products are still regulated should be addressed either by adjusting the definition of "structured product" or through non-statutory guidance.	While the coverage of paragraph 1(a) of the "structured product" definition is wide, it is not the same as that of "regulated investment agreement" ("RIA"). The incorporation of RIA into the definition of "structured product" is the simplest and clearest way to ensure the market participants understand that RIAs are to be regulated as structured products. This will also ensure that products that fall within the RIA definition do not fall outside the definition of "structured products" due to differences in the definitions and accordingly circumventing the regulatory regime for structured products. The fact that RIAs have been in the SFO since its inception is purely to explain that the market should not be confused with this concept since it is nothing new.

M. Other issues		
Organizations	**Views/Concerns**	**Response by the Administration/SFC**
The Hong Kong Association of Banks	Parallel legislative changes should be made to complement the consolidation of product regulation that is proposed in the Bill. In particular: (a) amendments to the evidentiary requirements under the Securities and Futures (Professional Investor) Rules (Cap. 571D), which are the subject of a separate consultation process, should be implemented at the same time as the Bill comes into effect; (b) section 404 of the SFO should be amended to clarify that products regulated under the SFO are excluded	(a) The SFC is currently considering public comments received in response to the consultation on the proposals in respect of the evidential requirements under the Securities and Futures (Professional Investor) Rules (Cap. 571D). Such evidential requirements are not specific for investors of structured products, but for all investors. (b) Exclusion 2(g)(i) of the "structured product" definition clearly excludes "a product that may be possessed, promoted, offered, sold, printed or published only under a licence, permission or other authorization under the

	from the Betting Duty Ordinance (Cap. 108); and (c) structured products should be carved out from the definition of "deposit" in the Banking Ordinance (Cap. 155) and from the types of loans caught by the Money Lenders Ordinance (Cap. 163)	Betting Duty Ordinance..". It follows that any products regulated by the Betting Duty Ordinance will not be structured products regulated under the SFO. The proposed amendment to section 404 of the SFO is not necessary. (c) The definition of "deposit" is arguably the cornerstone of the regulatory regime within the Banking Ordinance ("BO"). The activity of taking "deposits" requires authorization under the BO and with that authorization comes the requirement to comply with the prudential requirements set out in the BO (fitness and propriety; adequate capital and liquidity; adequate control systems; conduct of business with integrity, prudence and competence; etc). Excluding a class of financial product from the definition may have far-reaching consequences. The exclusion of structured products could potentially facilitate significant fund gathering from the public by institutions engaged in financial activity, without such institutions being subject to the prudential regime within the BO. This in turn could create an unlevel playing field as against authorized institutions which are subject to the BO's prudential regime and could confuse the public, as many structured products can essentially appear as deposits bundled with some form of embedded derivative. In these circumstances, we see no compelling case for the exclusion of structured products from the definition of "deposits" in the BO and, on the contrary, have serious concerns about unintended consequences that might result.

The Hong Kong Association of Banks	Additional non-statutory guidance should be provided about: (a) the features of a currency and/or interest-rate linked product issued by an authorized financial institution that are acceptable and will not alter the exemption of such products from the SFO offer authorization regime; (b) the "widely quoted" reference rates that can be used for a floating rate debenture to qualify for the proposed exclusion in paragraph 2(e) of the definition of "structured product"; and (c) the regulatory treatment of shares, repackagings and securitizations that could be interpreted as "structured products" in certain circumstances.	(a) Under the Bill, currency linked instruments, interest rate linked instruments and currency and interest rate linked instruments that are issued by banks will be exempted from the prohibition in section 103(1) of the SFO. As the definitions proposed in the Bill for currency linked instrument, interest rate linked instrument and currency and interest rate linked instrument are clear, we believe no guidance is needed on when these products will be exempted. (b) These are rates that are widely used by banks in borrowing funds from other banks in the interbank market and as reference rates for financial instruments e.g., LIBOR, HIBOR etc. This was explained in SFC's consultation conclusions (page 14). (c) If shares or other structures fall within the definition of "structured product", public offers of such shares or structures are to be regulated under Part IV of the SFO. It is premature and inappropriate to provide guidance on how the definition should be applied to different types of structures as this would depend on the product it structured and can only be considered on a case by case basis.

Note: Unless otherwise specified, all the provisions referred to in this summary are those provisions contained in the Securities and Futures Ordinance (Cap. 571)

Abbreviations

CO	Companies Ordinance
HKMA	The Hong Kong Monetary Authority
ISDA and ASIFMA	International Swaps and Derivatives Association, Inc. and Asia Securities Industry and Financial Markets Association
SFC	The Securities and Futures Commission
SFO	Securities and Futures Ordinance