

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

**Follow-up Issues of the 1 March 2011 Bills Committee Meeting**

**Purpose**

This paper sets out the Administration's response in respect of the issue of exclusion for non-negotiable and non-transferable debentures from the definition of "securities" and the suggestion of making it a mandatory requirement for all intermediaries licensed by the Securities and Futures Commission ("SFC") to make audio recording of the sales process.

**Non-transferable and Non-negotiable Debentures not Offered to the Public**

2. At the meeting of the Bills Committee held on 1 March 2011, during discussion on the draft Committee Stage Amendment ("CSA") to amend the exclusion for non-transferable and non-negotiable debentures from the definition of "securities" in Part I of Schedule 1 to the Securities and Futures Ordinance ("SFO"), Members requested the Administration and the SFC to consider whether the scope of the exclusion for non-negotiable and non-transferable debentures from the definition of "securities" should be made more restrictive by specifying more clearly the actual types of debentures that were to be excluded.

3. Under the current SFO definition, non-transferable and non-negotiable debentures are excluded from the definition of "securities" in the SFO. The exclusion was carried down from the now repealed Securities Ordinance ("SO"). The proposed amendment in the Bill together with the proposed CSA in question is to limit the exclusion so that it does not apply to structured products that are in the form of non-transferable and non-negotiable debentures and 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 the SFO is authorized, or required to be authorized, under section 105(1) of the SFO. The purpose is to ensure that where structured products that are in the form of non-transferable and non-negotiable debentures

are publicly offered, they will be “securities” for the purposes of the SFO and the SFO provisions (e.g., licensing, conduct regulation and enforcement etc.) relating to securities will apply to them.

4. This approach is in line with the proposal in the Bill to expand the definition of “securities” by adding a new limb (g) which includes structured products that do not fall under limbs (a) to (f) of the existing definition of “securities” but 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 the SFO is authorized, or required to be authorized, under section 105(1) of the SFO. These amendments do not change the current approach to the regulation of offers under the SFO (and the Companies Ordinance (“CO”)) in that only documents containing public offers are subject to authorization requirements.

5. On the suggestion of specifying the actual types of non-negotiable and non-transferable debentures to be excluded from the definition of “securities”, we would like to highlight that the proposed CSA in question would already limit the scope of the exclusion so that it will not apply if the non-transferable and non-negotiable debentures are structured products and are offered to the public. To further restrict the exclusion to specific types of non-negotiable and non-transferable debentures would in effect subject all other non-negotiable and non-transferable debentures to the regulatory requirements for securities under the SFO, even though they are not offered to the public.

6. The concept of an offer to the public underpins Hong Kong’s regulatory regime for offers in both the CO prospectus regime and the offers of investments regime in Part IV of the SFO. These two regulatory regimes cover offers of shares, debentures, other securities and other investment products. The issue of whether certain private offers of non-transferable and non-negotiable debentures should be regulated cannot be decided in isolation of the regulation of offers of other investment products under the CO and SFO, as it requires a detailed and holistic review of the implications and a wide market consultation. The SFC will bear in mind Members’ comments raised in the meeting as and when a wholesale review of the offer regimes under the CO and the SFO is undertaken.

## **Investors to Make Audio Recording of the Sales Process**

7. As regards the issue of audio recording of the sales process, our view is that audio recording is only one of the means to maintain records for the sales process and should not be made mandatory. The SFC currently already requires intermediaries to document and record contemporaneously the information given to each client and the rationale for recommendations given to the client, including any material queries raised by the client and the responses given by the intermediary. The SFC has made reference to international practices and noted that the existing regulatory requirements are in line with overseas practices.

8. The SFC had consulted the public on the proposal to make audio recording of the selling process mandatory and the majority of the respondents did not support this proposal as they considered the existing record keeping requirements sufficient.

9. The SFC will continue to identify ways to further improve the existing regime to enhance investor protection. The SFC will also further look into the suggestion of requiring intermediaries to advise investors that they might make audio recording of the sales process themselves.

**Financial Services and the Treasury Bureau  
Securities and Futures Commission  
March 2011**