

**立法會**  
*Legislative Council*

LC Paper No. CB(1)198/10-11

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

**Background Brief**

**Purpose**

This paper provides background information on the Securities and Futures and Companies Legislation (Structured Products Amendment) Bill 2010 (the Bill), and summarizes members' concerns raised during the relevant discussion at the Panel on Financial Affairs (FA Panel).

**Background**

Existing arrangements

2. Under existing legislation, when investment products are offered to the public in Hong Kong, the offering documentation must be authorized by the Securities and Futures Commission (SFC) unless an exemption applies. The requirements for authorizing offering documentation are set out in Companies Ordinance (Cap. 32) (CO) and the Securities and Futures Ordinance (Cap. 571) (SFO). They are two separate regimes. Under CO, it is the prospectus regime for shares and debentures. Under SFO, it is the offers of investments regime under Part IV of SFO for securities and regulated investment agreements.

3. Under the existing legislative framework, the public offer of structured products, depending on their legal form, may be subject to different regimes, even though such structured products may have similar economic risk and return profiles. For example, equity-linked notes and equity-linked instruments are structured products that have similar risk and return profiles. As equity-linked notes are in the legal form of a debenture, prospectuses of equity-linked notes are regulated under the CO prospectus regime. On the other hand, offer documents of equity-linked instruments are regulated under the SFO offers of investments regime since they are in the legal form of securities or regulated investment agreements or a hybrid of securities and regulated investment agreements.

### Review of the public offering regimes

4. SFC in its report on issues raised by the Lehmans Minibonds Crisis submitted to the Financial Secretary at the end of December 2008 (paragraphs 25.1 and 25.2) stated that the all-embracing definition of “debenture” in CO enabled issuers of an investment arrangement or instrument to structure it as a debenture in order to bring it within the CO prospectus regime. It also recognized that such arrangements or instruments could not have been in contemplation of the provisions when the law was enacted.

5. SFC conducted a two-month consultation on Possible Reforms to the Prospectus Regime in CO and SFO from 30 October 2009 and published its consultation conclusions on 22 April 2010. During the consultation period, SFC had received 13 written submissions and held more than 16 meetings to discuss aspects of the consultation paper with industry representatives. A copy of the executive summary of consultation conclusions is at **Appendix I**.

### **Proposals under the Bill**

6. The Bill was gazetted on 2 July 2010 and introduced into the Legislative Council on 14 July 2010. The Bill covers the following major proposals -

#### *Disapplication in the CO and definition of "structured product"*

- (a) the provisions of the CO prospectus regime to be dis-applied to structured products (clauses 19 and 20);
- (b) a wide definition for “structured product” is proposed to avoid the possibility of issuers designing new products to fall outside the definition but in reality embed derivatives or have similar economic risk and return profiles (clause 15);
- (c) convertible and exchangeable bonds and subscription warrants are carved out from the definition of “structured product” to retain public offer of shares and debentures for equity or debt capital-raising purposes under the prospectus regime in the CO (clause 15);
- (d) to allow flexibility and cater for financial innovation, the Financial Secretary is empowered to prescribe by notice published in the Gazette that any interests, rights or property are to be or not to be regarded as structured products (clause 13);

*Authorization of structured products*

- (e) extending the regulation by SFC of offering documents to those in respect of structured products (clause 4(1)), with the authorization process set out in a new section 104A of SFO (clause 5)<sup>1</sup>;
- (f) decisions made by SFC in respect of structured products to be subject to review by the Securities and Futures Appeals Tribunal (clause 16);

*Safe harbours and exemptions*

- (g) the safe harbours in the Seventeenth Schedule to CO have not been replicated in SFO and thus will no longer be available to structured products;
- (h) certain exemptions in section 103 of SFO that currently apply in relation to securities are extended to apply also to structured products (Clause 4); and

*Listed structured products*

- (i) the Stock Exchange of Hong Kong is, and will remain, the frontline regulator responsible for reviewing and approving listed documents for listed structured products.<sup>2</sup>

**Major views and concerns expressed by members**

7. On 3 May 2010, the Administration and SFC briefed the FA Panel on the legislative proposals. Individual members expressed the following concerns -

- (a) how the proposed transfer of the authorization regime from CO to SFO would enhance the protection for investors;
- (b) which of the safe harbour arrangements in the CO would continue to apply and what exemptions in the SFO would apply to public offers of structured products after the transfer;

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<sup>1</sup> According to the Legislative Council Brief, the authorization process will depend on compliance with codes and guidelines issued by SFC. SFC has issued a new Code on Unlisted Structured Investment Products on 25 June 2010.

<sup>2</sup> According to the Legislative Council Brief, under the current regulatory framework, listed structured product issuers generally issue marketing materials via relevant SFC licencees without having to seek SFC's prior authorization. These are Type 1 (dealing in securities), Type 4 (advising on securities) and Type 6 (advising on corporate finance) licensed intermediaries.

- (c) whether the proposed legislative framework would provide sufficient safeguards to regulate public offers of structured products by issuers located overseas;
- (d) whether the Stock Exchange of Hong Kong had a conflict of interest in performing its regulatory role for listed structured products; and
- (e) regulation of structured products by different departments in SFC might give rise to the problem of regulatory arbitrage.

8. Subsequent to the Panel meeting, SFC provided supplementary information, vide LC Paper No. CB(1)2094/09-10(02) at **Appendix II**, to address members' concerns set out in (a) and (b) above. Regarding public offers of structured products by issuers located overseas, SFC advised at the Panel meeting that a new requirement would be included in the new Code on Unlisted Structured Investment Products to require an issuer located overseas to have a licensed person or an arranger in place in Hong Kong to take care of the matters concerning the offer of structured products.

9. On the issue of regulatory arbitrage, SFC advised that the Corporate Finance Division of SFC was responsible for the products regulated under the CO while the Investment Product Department was responsible for other products. Following the changes brought by the proposed transfer, the Corporate Finance Division would be responsible for investment products such as ordinary shares and debentures of non-structured types while the Investment Product Department would take care of other investment products including structured products.

### **Relevant papers**

10. The relevant papers are available at the following links:

Legislative Council Brief on Securities and Futures and Companies Legislation (Structured Products Amendment) Bill 2010  
[http://www.legco.gov.hk/yr09-10/english/bills/brief/b34\\_brf.pdf](http://www.legco.gov.hk/yr09-10/english/bills/brief/b34_brf.pdf)

Legal Service Division Report on Securities and Futures and Companies Legislation (Structured Products Amendment) Bill 2010  
<http://www.legco.gov.hk/yr09-10/english/hc/papers/hc1008ls-89-e.pdf>

Code on Unlisted Structured Investment Products issued by SFC (June 2010)  
[http://www.sfc.hk/sfc/doc/EN/intermediaries/products/handBooks/Eng\\_SIP.pdf](http://www.sfc.hk/sfc/doc/EN/intermediaries/products/handBooks/Eng_SIP.pdf)

Administration's paper on "Legislative proposals to transfer the regulation of public offers of structured products from the Companies Ordinance to the Securities and Futures Ordinance" (LC Paper CB(1)1728/09-10(04))

<http://www.legco.gov.hk/yr09-10/english/panels/fa/papers/fa0503cb1-1728-4-e.pdf>

Administration's paper on "Legislative proposals to transfer the regulation of public offers of structured products from the Companies Ordinance to the Securities and Futures Ordinance" (follow-up paper) (LC Paper CB(1)2094/09-10(02))

<http://www.legco.gov.hk/yr09-10/english/panels/fa/papers/fa0503cb1-2094-2-e.pdf>

Minutes of meeting of Panel on Financial Affairs on 3 May 2010 (paragraph 29 to 44)

<http://www.legco.gov.hk/yr09-10/english/panels/fa/minutes/fa20100503.pdf>

Background Brief on legislative proposals to transfer the regulation of public offers of structured products from the Companies Ordinance to the Securities and Futures Ordinance (LC Paper CB(1)1727/09-10)

<http://www.legco.gov.hk/yr09-10/english/panels/fa/papers/fa0503cb1-1727-e.pdf>

Consultation Conclusions on Possible Reforms to the Prospectus Regime in the Companies Ordinance and the Offers of Investments Regime in the Securities and Futures Ordinance (April 2010)

<http://www.sfc.hk/sfc/doc/EN/speeches/consult/ConsultationConclusions22April2010English.pdf>

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 by Securities and Futures Commission (October 2009)

<http://www.legco.gov.hk/yr09-10/english/panels/fa/papers/facb1-220-2-e.pdf>

Issues raised by the Lehmans Minibonds crisis: Report to the Financial Secretary by Securities and Futures Commission (December 2008)

<http://www.sfc.hk/sfc/doc/EN/general/general/lehman/Review%20Report/Review%20Report.pdf>

Council Business Division 1  
Legislative Council Secretariat  
25 October 2010



## Executive summary

1. On 30 October 2009, the Securities and Futures Commission (**SFC**) issued a 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 (**Consultation Paper**) for a two-month consultation period ending on 31 December 2009. The Consultation Paper invited comments on the proposals for transferring the regulation of public offers of structured products currently under the Companies Ordinance (Cap. 32) (**CO**) prospectus regime to the offers of investments regime in Part IV of the Securities and Futures Ordinance (Cap. 571) (**SFO**), under which the SFC would publish codes and guidelines setting out its regulatory policy on such products<sup>1</sup>. The overriding purpose of the proposals is to enhance protection for the investing public in Hong Kong by enhancing the regulatory regime governing public offers of structured products in Hong Kong.
2. The SFC received a total of 13 written submissions, mainly from market participants and professional bodies. Most respondents support, in principle, the transfer of the regulation of public offers of structured products from the CO to the SFO, subject to comments on the specific proposals. Concerns raised revolved around the following main areas:
  - (a) respondents generally supported the proposal to transfer the regulation of public offers of structured products to Part IV of the SFO but voiced significant 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 HK\$500,000 safe harbour which are commonly used to market structured products;
  - (b) respondents commented that the proposed definition of “structured product” is too wide and covers a wide range of derivatives that are currently not regulated under the SFO. Most respondents called for additional exclusions from the proposed definition;
  - (c) most respondents disagreed with the proposal to include “structured product” in the definition of “securities” in the SFO. They were concerned that it would have far reaching consequences causing regulation of non-securities based products to fall under SFO provisions that were designed for regulating securities;
  - (d) whilst respondents agreed that currency linked and money market instruments issued by authorized financial institutions should not require authorization under the SFO, they further suggested that these products be excluded from the definition of “structured product” so that they are not regulated under other parts of the SFO; and

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<sup>1</sup> It has been proposed that the SFC would issue a new SFC Handbook for Unit Trusts and Mutual Funds, Investment-Linked Assurance Schemes and Unlisted Structured Investment Products that would contain a new Code on Unlisted Structured Investment Products. The SFC Handbook sets out the criteria that the SFC would normally consider before exercising its power to authorize the issue of offer documents or advertisements for unlisted structured products with a view to enhancing product transparency and disclosure. The SFC Handbook is the subject of a separate consultation. See the Consultation Paper on Proposals to Enhance Protection for the Investing Public published by the SFC on 25 September 2009 (**September 2009 Consultation**) on the SFC’s website at [www.sfc.hk](http://www.sfc.hk).



- (e) most respondents agreed that the current regulatory framework for listed structured products should be maintained. However, some respondents took the view that there should be a level playing field for listed and unlisted structured products and the exemptions in sections 103(2)(a) and 103(5)(a) of the SFO should be retained for unlisted structured products.
3. In addition to written responses, the SFC has also held more than 16 meetings to discuss aspects of the Consultation Paper with industry representatives. The SFC's responses are based on both the submissions received and comments raised in the discussions.
4. The SFC has considered all responses and comments received in detail and has provided its recommendations to Government on the policy objectives of the proposals and amendments that should be made to the CO and the SFO to implement the policy. In summary, the SFC has recommended:
- (a) to proceed with the proposal in the Consultation Paper to disapply the CO prospectus provisions to structured products;
  - (b) the CO safe harbours should not be replicated in the SFO. However, pursuant to market responses, the SFC will review the evidential requirements in the Securities and Futures (Professional Investor) Rules (Cap. 571D) (**PI Rules**) for professional investors. This will be the subject of a separate consultation to be issued in due course;
  - (c) the proposed definition of "structured product" should be refined;
  - (d) the proposal to include all structured products in the definition of "securities" should be modified so that any structured product (not in the form of securities) in respect of which any offer document would be subject to section 103(1) of the SFO or any structured product which is listed on the Stock Exchange of Hong Kong Limited (**SEHK**) would be included as a security;
  - (e) currency linked instruments and interest rate linked instruments (referred to in the Consultation Paper as money market instruments) issued by authorized financial institutions should be exempted from the authorization requirements;
  - (f) the current regulatory framework for listed structured products should be maintained but the exemption in section 103(2)(a) of the SFO should be blocked for unlisted structured products; and
  - (g) to proceed with the proposal in the Consultation Paper to require unlisted structured products to be authorized under a new section 104A of the SFO.
5. The Government is in the process of drafting the amendments to the CO and the SFO. An amendment bill is expected to be gazetted in due course. Accordingly, indicative drafts of the amendments to the CO and the SFO are not provided in these conclusions.
6. The main comments and concerns raised, together with the SFC's responses to these, are discussed in greater detail below. A list of the respondents who sent in submissions is at **Appendix A** to this paper, and the full text of the submissions can be viewed at the SFC's website at [www.sfc.hk](http://www.sfc.hk).

**Legislative Council Panel on Financial Affairs  
Meeting on 3 May 2010**

**Legislative Proposals to Transfer the Regulation of  
Public Offers of Structured Products  
from the Companies Ordinance (“CO”) (Cap. 32) to the  
Securities and Futures Ordinance (“SFO”) (Cap. 571)**

**Request for Information**

To provide information, in tabular form, on how the proposed transfer of the authorization of offering documentation in relation to structured products from the CO to the SFO would strengthen protection for investors -

<b>Change</b>	<b>Explanation</b>
Alignment of regulation	Currently, two regulatory regimes apply (i.e. the CO prospectus regime and offers of investment regime in Part IV of the SFO) to offer documents and marketing materials of products sold to the public. The public offer of structured products, depending on their legal form, may be subject to different regimes even where two structured products have similar economic risk and return profiles. Under the proposed transfer, the regulation of public offers of structured products will be aligned so that one regime (i.e. Part IV of the SFO) will apply, regardless of the legal form of the product.
Enhanced transparency and flexibility to regulate under codes and guidelines	<p>The CO prospectus regime is less flexible than Part IV of the SFO in that under the SFO, the Securities and Futures Commission (“SFC”) may issue codes and guidelines to set out its regulatory policy on relevant products.</p> <p>The SFC launched separately a public consultation in late 2009 on, amongst others, a proposed Code for Unlisted Structured Investment Products. The proposals under the Code include (a) eligibility requirements for an issuer or a guarantor; (b) eligibility</p>



	<p>requirements for collateral (where applicable); (c) continuous disclosure requirements; and (d) the requirement for key fact statements.</p> <p>Many of these had in the past been applied in practice by way of administrative measures. The SFC considers it helpful to codify in the Code certain existing administrative practices and requirements.</p> <p>The SFC plans to publish in Q2 2010 conclusions of the consultation on the Code and other matters.</p>
Including certain structured products as “securities”	Under the proposals, all structured products marketed publicly (including those which are currently not classified as “securities”) will be subject to the existing regulatory requirements on “securities” as stipulated in the SFO.

To explain in detail the changes to the safe harbour arrangements upon the transfer of the authorization regime from the CO to the SFO, and under what circumstances the exemptions under the SFO would be applicable after the transfer -

Under the transfer proposals, regulation of public offers of structured products that are in the form of shares or debentures will be transferred from the CO to Part IV of the SFO. The safe harbours in the Seventeenth Schedule of the CO (including the “not more than 50 persons” safe harbour and the “minimum denomination \$500,000” safe harbour) will not be replicated in Part IV of the SFO and will not be applicable to offers of structured products. The authorisation requirements under Part IV of the SFO apply only where a product is offered to the public. Part IV of the SFO has its own set of exemptions, as set out under section 103(2) and 103(3) of the SFO.

The following are the more commonly relied upon exemptions in Part IV of the SFO that will be applicable to structured products –

- (a) the issue of any advertisement, invitation or document made in respect of structured products which are intended to be disposed of only to professional investors; and

- (b) the issue of any advertisement, invitation or document by an authorised financial institution in respect of traditional banking products, e.g., bank issued leveraged foreign exchange contracts, certificates of deposits, currency linked instruments and interest rate linked instruments.

**Financial Services and the Treasury Bureau  
Securities and Futures Commission  
May 2010**