

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

**Whether the principles in the Code on Unlisted Structured
Investment Products could be specified in the legislation**

Purpose

This paper sets out the Administration's response to the issue of whether the principles for the regulation of public offers of structured products in the Code on Unlisted Structured Investment Products ("SIP Code") could be separated from the technical provisions and specified in the legislation.

Background

2. At the Bills Committee meeting held on 26 October 2010, Members considered that the exercise of powers by the Securities and Futures Commission ("SFC") in the authorization of structured products should be supported by clear policy objectives and principles stipulated in legislation. The Administration was requested to consider the issue and to provide information on the relevant arrangements in comparable jurisdictions.

Authorization Powers of the Securities and Futures Commission

3. Under the Bill, public offers of structured products are prohibited unless the offer document or marketing material is authorized by the SFC¹. The SFC may grant authorization, subject to any conditions it considers appropriate. We also propose under the Bill that the SFC be empowered to authorize a structured product, subject to any conditions it considers appropriate, and specify that the SFC may refuse to grant authorization if it is not satisfied that the authorization is in the

¹ In accordance with section 103(1) of the Securities and Futures Ordinance ("SFO"), a person commits an offence if he issues an offer document or marketing material which invites the public to enter into, among other things, a structured product, unless the issue is authorized by the SFC under section 105(1) of the SFO or otherwise exempted.

interest of the investing public². Hence, under the Bill, the SFC will be given a fairly wide power to decide whether to authorize or refuse to authorize a structured product and the related offer document and marketing material, and to impose appropriate conditions when granting an authorization.

The SIP Code

4. The SFC will make reference to the SIP Code in considering whether an offer document or marketing material of structured product should be authorized. The SIP Code forms part of the SFC Handbook for Unit Trusts and Mutual Funds, Investment-Linked Assurance Schemes and Unlisted Structured Investment Products (“Handbook”). The following overarching principles are set out in the Handbook:

- (a) GP1. Acting fairly – Product Providers shall act honestly, fairly and professionally.
- (b) GP2. Disclosure – Disclosure shall be complete, accurate and fair, and be written and presented in a clear, concise and effective manner and in such manner as to be readily understood by the investing public. Information provided shall not be false or misleading nor be presented in a deceptive or unfair manner. Where ongoing disclosure is required, the relevant information shall be disseminated in a timely and efficient manner.
- (c) GP3. Proper protection of assets – Where assets are specifically required by the applicable product code to be held for the benefit of investors, all such assets shall be properly protected.
- (d) GP4. Avoidance of conflicts of interest – Product Providers, counterparties and service providers shall avoid being placed in a conflicts of interest position that may undermine the interests of the investors of the relevant product.
- (e) GP5. Regulatory compliance – Product Providers shall ensure that all applicable legal and regulatory requirements are complied with and shall respond to requests and

² See the new section 104A(5) as proposed under the Bill.

enquiries from the regulators in an open and co-operative manner.

- (f) GP6. Diligence – Product Providers shall discharge their functions with due skill, care and diligence.
- (g) GP7. Marketing – Advertisements for a product shall be clear, fair and present a balanced picture with adequate and prominent risk disclosure in compliance with all applicable regulations. Advertisements shall not be false, biased, misleading or deceptive.

5. The Handbook is published under section 399 of the Securities and Futures Ordinance (“SFO”). Section 399 of the SFO gives the SFC powers to publish codes and guidelines for providing guidance for the furtherance of any of its regulatory objectives, or in relation to its functions or the operation of any provision in the SFO. The SFC’s regulatory objectives, as set out in section 4 of the SFO, include maintaining and promoting the fairness, efficiency, competitiveness, transparency and orderliness of the securities and futures industry; providing protection for members of the public investing in or holding financial products; etc. As set out in section 5 of the SFO, the functions of the SFC are, so far as reasonably practicable, to take such steps as it considers appropriate to maintain and promote the fairness, efficiency, competitiveness, transparency and orderliness of the securities and futures industry; to secure an appropriate degree of protection for members of the public investing in or holding financial products, having regard to their degree of understanding and expertise in respect of investing in or holding financial products; etc.

6. The SFC is bound to observe these regulatory objectives and functions in drawing up codes and guidelines under section 399. The seven general principles set out in paragraph 4 above are consistent with the SFC’s regulatory objectives and functions. It would be unnecessary to specify these general principles again in the SFO.

Implications of Non-compliance

7. While failure by a person to comply with the provisions in the Handbook is not illegal, the Handbook may be admissible in

evidence in any proceedings under the SFO before any court. Failure in compliance may also cause the SFC to consider whether it adversely reflects on the person's fitness and properness in so far as the person is licensed or registered under the SFO. In addition, such failure may cause the SFC to consider whether it adversely reflects on whether the product, the offer document and/or marketing materials should remain authorized, and whether future products issued by such person should be granted authorization in the interest of the investing public. Such failure may also cause the SFC to impose additional authorization conditions.

8. As such, while the above overarching principles are not prescribed in the law, effective arrangements are already in place to encourage compliance with such principles. After all, non-compliance with the SIP Code may render the SFC not authorizing the structured product / offer document / marketing materials, and the SFC may refuse authorization in the interest of the investing public³. The structured product / offer document / marketing materials will then be prohibited from being issued to the public.

9. Indeed, to cater for the rapid development of the financial market, it will be more appropriate for the SFC to set out such principles and detailed guidelines for authorizing structured products and their offer documents and marketing materials by way of codes. This would allow more flexibility for new principles and guidelines be introduced in light of market innovation.

Overseas Arrangements

10. Hong Kong is the first major international financial market to implement a specific regulatory regime for structured products. There are therefore no comparable arrangements in major overseas markets.

Financial Services and the Treasury Bureau Securities and Futures Commission November 2010

³ See the new section 104A(5) as proposed under the Bill and the existing section 105(5).