

**Panel on Financial Affairs
Meeting on Friday, 5 July 2013**

(a) Regulation of Collective Investments Schemes

1. This part sets out an overview of the role and powers of the Securities and Futures Commission ("SFC") in relation to the regulation of collective investment schemes under the Securities and Futures Ordinance ("SFO") at the Panel's request.

Definition of "collective investment scheme"

2. "Collective investment scheme" ("CIS") is a term defined in Schedule 1 to the SFO to mean investment products of a collective nature and embraces familiar market concepts such as unit trusts and mutual funds.
3. CIS is broadly defined under the SFO and has four relevant elements in general:
 - (i) it must involve an arrangement in respect of property;
 - (ii) participants do not have day-to-day control over the management of the property even if they have the right to be consulted or to give directions about the management of the property;
 - (iii) the property is managed as a whole by or on behalf of the person operating the arrangements, and/or the contributions of the participants and the profits or income from which payments are made to them are pooled; and
 - (iv) the purpose of the arrangement is for participants to participate in or receive profits, income or other returns from the acquisition or management of the property.
4. To provide flexibility to address changing market conditions and the development of new products, the definition of CIS in the SFO further provides that the Financial Secretary is empowered under section 393 of the SFO to prescribe by notice in the Gazette that certain products are, or are not, to be regarded as CIS.
5. The detailed definition of "collective investment scheme" is attached as Appendix 1.

Authorization regime and approval procedures for collective investment schemes under Part IV of the SFO

General

6. It is an offence under section 103 of the SFO to issue, or possess for the purposes of issue, an advertisement, invitation or document which is or contains an invitation to the Hong Kong public to acquire an interest or participate in a CIS unless the issue is authorized by the SFC or an exemption applies.
7. The above offence does not apply to an offer that is not made to the Hong Kong public, for example where the offer is made by way of a private placement. In addition, there are a number of specified exemptions from the offence including the following major ones:
 - (i) an offer to professional investors as defined under the SFO as extended by the Securities and Futures (Professional Investor) Rules;
 - (ii) the issue of a prospectus registered under the Companies Ordinance;
and
 - (iii) an offer only to persons outside Hong Kong.

Application and authorization process for CIS

8. The SFC is empowered to authorize CIS and their offering documents under sections 104 and 105 of the SFO respectively. In considering an application for authorization, the SFC is empowered under those sections of the SFO to impose such authorization conditions as it considers appropriate, and may refuse to authorize any scheme or document where it is not satisfied that the authorization is in the interest of the investing public.
9. CIS are generally authorized by the SFC on the basis of their structural features and compliance with product codes published by the SFC under section 399 of the SFO. The SFC has published such product codes in respect of various types of CIS being offered to Hong Kong public. Each product code sets out the general guidelines and bases of authorization for that product and its offering documents, which mainly focus on disclosure obligations and structural features, such as eligibility of scheme operators and investment restrictions. For example, the fund manager of a unit trust or mutual fund has to be a management company which is either licensed by the SFC or, where applicable, licensed in an overseas

jurisdiction that is considered acceptable for the purpose of managing SFC-authorized funds and that has a satisfactory co-operation arrangement with the SFC.

10. Authorization of a CIS product under the SFO would normally be granted together with the authorization of its offering documents. To apply for authorization, the applicant needs to submit a written application for authorization of the CIS under section 104 of the SFO and the offering documents under section 105 of the SFO. The application documents to be submitted to the SFC would generally consist of a completed application form, the draft constitutive and offering documents of the product and the prescribed application fee. The SFC has published different application forms that are designed for different types of products to be authorized in order to reflect the nature or features of the product type as well as the specific requirements under the applicable SFC product code.
11. Generally, the offering documents of the CIS must contain the information necessary for investors to be able to make an informed judgment of the investment proposed to them, including all of the key features of the scheme and the key risks. The CIS must also meet appropriate structural requirements to ensure that the rights and interests of the investing public are reasonably protected.
12. Advertisements and other invitations to invest in a CIS must comply with the advertising guidelines under the relevant product code. The guiding principle under these guidelines is that advertisements for a CIS should not be false, biased or misleading, and should be clear and fair. All advertisements must be submitted to the SFC for authorization prior to their issue or publication in Hong Kong, unless exempted under the SFO.

Ongoing monitoring of authorized CIS

13. After a CIS has been authorized by the SFC, it continues to be subject to the specific ongoing compliance obligations set out in the relevant product code. For example, pursuant to the Code on Unit Trusts and Mutual Funds, proposed changes to a unit trust or mutual fund such as changes to its key operators, investment objectives and restrictions or other changes that may materially prejudice the CIS holders' rights or interests are subject to the SFC's prior approval. Normally, prior written notice must also be given to holders.

14. In addition, most CIS are also required to comply with various ongoing disclosure requirements. For example, unit trusts and mutual funds, being the more commonly available types of CIS, are required to inform holders as soon as reasonably practicable of any information concerning the scheme which is necessary to enable holders to appraise the position of the scheme. They are also required to publish at least two reports in respect of each financial year, of which the annual report must be audited for the scheme.

Intermediaries' conduct regulation at point-of-sale

15. Intermediaries carrying on the regulated activities of dealing in securities and advising on securities, including interests in CIS are required to be licensed or registered under the SFO. These intermediaries are subject to the *Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission* ("Code of Conduct").
16. The requirements set out in the Code of Conduct include, amongst others, the obligation under paragraph 5.2 which provides that an intermediary should, when making a recommendation or solicitation, ensure the suitability of the recommendation or solicitation for that client is reasonable in all the circumstances.

Offences and enforcement

17. There are a number of relevant criminal offences and civil actions provided for under the SFO relevant to the offering and sale of securities including interests in CIS, including:

Criminal offences

- (i) Offence to issue, or possess for the purposes of issue, an advertisement, invitation or document which is or contains an invitation to the Hong Kong public to acquire an interest or participate in a CIS unless the issue is authorized by the SFC or an exemption applies (section 103).
- (ii) Offence to make any fraudulent or reckless misrepresentation for the purpose of inducing another person to acquire an interest in or participate in a CIS (section 107).
- (iii) Offence for the disclosure of false or misleading information about securities or futures that is likely to induce transactions (section 298).

- (iv) Offence involving the use of fraudulent or deceptive devices, etc. in transactions in securities, futures contracts or leveraged foreign exchange trading (section 300).
- (v) Offence involving the provision of false or misleading information under any requirement of the SFO or Parts II and X of the Companies Ordinance (section 384).

Civil proceedings

- (vi) Right of action for a person to seek compensation for any pecuniary loss sustained in consequence of the reliance by the person on any fraudulent, reckless or negligent misrepresentation made to induce the person to invest in a CIS (section 108).
- (vii) Civil market misconduct of disclosure of false or misleading information about securities or futures that is likely to induce transactions (section 277).
- (viii) Right of action for a person to seek compensation for any pecuniary loss sustained as a result of civil market misconduct (section 281).
- (ix) Right of action for a person to seek compensation for any pecuniary loss sustained as a result of criminal market misconduct (section 305).

Securities and Futures Commission

14 June 2013

Appendix 1

Extract from Schedule 1 to the SFO on the definition of “collective investment scheme”

Chapter:	571	Title:	Securities and Futures Ordinance	Gazette Number:	L.N. 95 of 2012
Schedule:	1	Heading:	Interpretation and General Provisions	Version Date:	01/01/2013

[sections 2, 19, 66, 102, 164,
171, 174, 175, 202 & 406
& Schs. 9 & 10]
(Amended 8 of 2011 s. 14)

Part 1

Interpretation

1. Interpretation of this Ordinance

In this Ordinance, unless otherwise defined or excluded or the context otherwise requires-

collective investment scheme (集體投資計劃) means-

- (a) arrangements in respect of any property-
 - (i) under which the participating persons do not have day-to-day control over the management of the property, whether or not they have the right to be consulted or to give directions in respect of such management;
 - (ii) under which-
 - (A) the property is managed as a whole by or on behalf of the person operating the arrangements;
 - (B) the contributions of the participating persons and the profits or income from which payments are made to them are pooled; or
 - (C) the property is managed as a whole by or on behalf of the person operating the arrangements, and the contributions of the participating persons and the profits or income from which payments are made to them are pooled; and
 - (iii) the purpose or effect, or pretended purpose or effect, of which is to enable the participating persons, whether by acquiring any right,

interest, title or benefit in the property or any part of the property or otherwise, to participate in or receive-

(A) profits, income or other returns represented to arise or to be likely to arise from the acquisition, holding, management or disposal of the property or any part of the property, or sums represented to be paid or to be likely to be paid out of any such profits, income or other returns; or

(B) a payment or other returns arising from the acquisition, holding or disposal of, the exercise of any right in, the redemption of, or the expiry of, any right, interest, title or benefit in the property or any part of the property; or

(b) arrangements which are arrangements, or are of a class or description of arrangements, prescribed by notice under section 393 of this Ordinance as being regarded as collective investment schemes in accordance with the terms of the notice,

but does not include-

(i) arrangements operated by a person otherwise than by way of business;

(ii) arrangements under which each of the participating persons is a corporation in the same group of companies as the person operating the arrangements;

(iii) arrangements under which each of the participating persons is a bona fide employee or former employee of a corporation in the same group of companies as the person operating the arrangements, or a spouse, widow, widower, minor child (natural or adopted) or minor step-child of such employee or former employee;

(iv) franchise arrangements under which the franchisor or franchisee earns profits or income by exploiting a right conferred by the arrangements to use a trade name or design or other intellectual property or the goodwill attached to it;

(v) arrangements under which money is taken by a solicitor from his client, or as a stakeholder, acting in his professional capacity in the ordinary course of his practice;

(vi) arrangements made for the purposes of any fund or scheme maintained by the Commission, or by a recognized exchange company, recognized clearing house, recognized exchange controller or recognized investor compensation company, under any provision of this Ordinance for the purpose of providing compensation in the event of

default by an exchange participant or a clearing participant;

(vii) arrangements made by any credit union in accordance with the objects thereof;

(viii) arrangements made for the purposes of any chit-fund permitted to operate under the Chit-Fund Businesses (Prohibition) Ordinance (Cap 262);

(ix) arrangements made for the purposes of the Exchange Fund established by the Exchange Fund Ordinance (Cap 66);

(x) arrangements which are arrangements, or are of a class or description of arrangements, prescribed by notice under section 393 of this Ordinance as not being regarded as collective investment schemes in accordance with the terms of the notice;

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