APPENDIX C

SUMMARY OF POINTS TO NOTE WHEN REVIEWING PROSPECTUSES AND MARKETING MATERIALS

To facilitate Subcommittee members' understanding of the internal guidance which has been in existence since 2005, set out below is a summary of points compiled from such internal guidance that SFC staff should note when reviewing draft prospectuses and marketing materials of structured notes offered to the public. These points serve as internal guidance only and do not have force of law. The guidance may not be applicable in every case depending on the nature and structure of the particular structured notes being offered. Where applicable, these points indicate disclosures which reviewers should request issuers to consider including in the relevant prospectuses where such disclosures are not made in the drafts submitted.

Summary of points to note when reviewing prospectuses and marketing materials

1. Programme Prospectus

Responsibility statement –

1.1. If the obligations of the issuer are guaranteed, the guarantor must also take responsibility. If it is a fund-raising exercise for the guarantor group, the directors of the guarantor will also need to take responsibility in the same way as directors of the issuer.

Reliance on distributors – reference to "noteholders"

1.2. For a programme where the legal holder of the notes is the depositary (in the case of a global bearer note) or the nominee of the clearing system (in the case of a global registered note), the prospectus to disclose that references to "noteholders" do not mean individual investors. A distributor will, as a direct or indirect participant, hold such interests on behalf of investors either in its own account with the clearing system or through another entity.

1.3. The prospectus to state that investors are bound by the terms and conditions of the notes they buy.

Limited recourse programmes –

1.4. The prospectus to disclose whether there is any negative pledge provision.

False market / Ongoing disclosure –

1.5. The prospectus to contain an undertaking from the issuer (and the guarantor where applicable) to give notice to the noteholders of any information about the issuer (and the guarantor where applicable) which is necessary to avoid the establishment of a false market in the notes, or which may significantly affect their ability to make payments on the notes (or the ability of the guarantor to honour the guarantee where applicable).

Investor compensation fund not applicable –

1.6. The prospectus to state whether investors are covered by the investor compensation fund.

Statement of class exemptions relied on –

1.7. The prospectus should either contain a statement required by section 10 of the Companies Ordinance (Exemption of Companies and Prospectuses from Compliance with Provisions) Notice ("**Exemption Notice**")[5], or the issuer has to seek an exemption on the "unnecessary" ground (on the basis that the issuer is exempted from compliance by virtue of the class exemption notice).

Accountants –

1.8. For overseas issuers / guarantors, they will usually need to apply for a waiver from the requirement in paragraph 43 of the Third Schedule to the CO for the accountants' report to be prepared by accountants qualified under the Professional Accountants Ordinance.

Risk management policies –

1.9. To urge the issuer/guarantor to set out its risk management system or policies (usually extracted from annual report, if any,) in the prospectus as an appendix.

Limited recourse programmes –

1.10. In the case of limited recourse programmes, the prospectus to state the SPV issuer has no assets other than the collateral and swap arrangements which secure each series of its notes. Investors' claims against the issuer are limited to the realised value of the collateral and such amounts (if any) due to the issuer from the swap counterparty as a result of the termination of the swap.

The prospectus to set out the security arrangements (i.e. how the notes are secured) and the priority of noteholders in the ranking of claims against the issuer in connection with the enforcement of the collateral.

Collateral and swap arrangements –

1.11. Where the notes are in effect a replica of the collateral with the terms of the notes providing for the straight pass through of the economic benefit of the collateral, investors are in fact taking the credit risk of the collateral issuer/guarantor (but note swap guarantor is different and see paragraph 1.13 below). In such cases, the latest financial information of the collateral issuer/guarantor is to be provided in the prospectuses. The argument for this requirement is based on paragraph 3 of the Third Schedule to the CO. Where the swap counterparty swaps the amount of interest and principal received on the collateral into amounts an issuer needs to pay out on its notes, investors would also be taking the credit risk of the swap counterparty. Reviewers could also rely on paragraph 3 of the Third Schedule to the CO and require disclosure of the swap counterparty's financial information.

[5] "Where a prospectus is issued in reliance of any exemption under this Notice, it must contain a statement identifying the exemptions that the issuer of the prospectus has relied on under this Notice."

1.12. In light of the recent credit crunch resulting from the US sub-prime mortgage situation, reviewers to inquire in each case of collateralised issue whether the collateral will consist of collateralised debt obligations (CDOs) or other asset backed securities. If the collateral consists of CDOs backed by mortgages, reviewers would need to ensure that appropriate risk disclosure is made in the prospectus. Even if CDOs are unrelated to sub-prime mortgages or are AAA-rated, reviewers to also request specific disclosure about the potential lack of liquidity in CDOs which may affect their value as collateral.

1.13. Where the security for notes issued by orphan SPV issuers under a secured limited recourse programme comprises or will comprise swap arrangements and third party AAA-rated collateral, some issuers (through their legal advisers) have put up arguments that although the swap guarantor technically falls within the definition of "guarantor corporation" in sections 38(8)/342(8) of the CO, the underlying credit risk for the notes is that of the AAA-rated collateral, and the swap guarantor in such cases could be exempt from compliance with the Third Schedule disclosure requirements (i.e. an exemption from section 38(7)/342(7) is sought):-

a. This is because these AAA-rated collateral are the source of the principal repayment and interest payments used to service the repayment of principal and the payment of interest on the notes. The collateral, and all cashflows received from it, are subject to strict security arrangements in favour of the trustee for the noteholders. The collateral is held by a custodian and cash receipts are dealt with by the custodian and paying agent subject to the power of the trustee to intervene under the security arrangements.

b. The swap arrangements are documented under a market standard ISDA master agreement which is tailored to fit with the security arrangements and the limited recourse nature of the notes. Under the ISDA documentation, all exchanges under the swap arrangements between the note issuer and the swap counterparty are inter-conditional so that either party may refuse to pay if the other party does not pay. This extends to the existence of an event of default or potential event of default so that if such an event applies to the swap counterparty, the note issuer would be entitled not to make its side of the exchange until the swap counterparty had made its payment.

c. For cross currency exchanges, there is an irreducible minimum settlement risk for normal exchanges known as "Herstatt risk". This applies because a payment of, for example, an Asian currency must be made during the day in the Asian time zone; but the exchange payment in a European currency or in US dollars, even though it is for value the same date, could only be made in the later European or US time zone. There is therefore an intraday payment risk which is borne by the payor of the currency in the earlier time zone. This risk is controlled by the inter-conditionality feature of the documentation which references a potential event of default; and by the payment mechanisms set up under the documentation under which irrevocable confirmations of payment are exchanged from the parties' paying banks on the day before the due date for payment.

d. Given an investor's investment risk attaches to the third party collateral and not to the swap guarantor, an exemption from compliance with section 38(7)/342(7) could be considered on the "irrelevant" and "unnecessary" statutory grounds.

International Financial Reporting Standards –

1.14. In view of the adoption of the IFRS by the EU since 1 January 2005, financial statements of companies incorporated in the EU for the 2005 financial year will need to be presented in accordance with IFRS. Given structured note issuers are required to produce 2 years' financial statements in the prospectus, some explanation to be given in the prospectus as to the principal reclassifications and restatements made to the 2005 financials as a result of the change in accounting standards from national GAAP to IFRS, so that a meaningful comparative analysis can be made with the 2004 financials prepared in accordance with national GAAP. This should be of little concern in cases of issues in 2007 or after (as the requirement for 2 years' audited financial statements goes back to 2005 only), but reviewers should remain alert in the event that 2004 financial information is referred to.

Auditors' reports –

1.15. Paragraph 31 of the Third Schedule to the CO provides that a prospectus must contain audited financial information of the issuer (or the guarantor corporation by virtue of section 38(7)/342(7) of CO) in respect of each of the 3 financial years immediately preceding the issue of the prospectus (or, in an offer of unlisted debentures, in reliance on section 8(3)(b)(i) of the Exemption Notice, 2 financial years, i.e. $Year_{-1}$ and $Year_{-2}$ only, exempting $Year_{-3}$). It further provides that if no accounts have been made up in respect of any part of the period of 3 (or 2 where section 8(3)(b)(i) of the Exemption Notice applies) years ending on a date 3 months before the issue of the prospectus, the prospectus must contain a statement of that fact. Such statement to be set out in an issue prospectus for a particular offer of notes.

Statement of reliance –

1.16. Section 10 of the Exemption Notice provides that where a prospectus is issued in reliance of any exemption under the Exemption Notice, it must contain a statement identifying the exemptions relied upon. For instance, where the programme prospectus provides 2 (instead of 3) years' audited financial information in reliance of the Exemption Notice, and a statement identifying the exemption and citing reliance thereon is contained in the prospectus, a question arises as to whether or not a similar statement of reliance is required in the issue prospectus. There are arguments for and against its inclusion, and the present approach is that the issuer and its legal advisers should formulate a logical and reconcilable explanation for consideration.

Unaudited quarterly or interim accounts –

1.17. Under the CO, there is no statutory requirement for the disclosure of unaudited quarterly or interim accounts in a prospectus. It is the issuers' responsibility under paragraph 3 of the Third Schedule to the CO to ensure that there are sufficient particulars and information in the prospectus at the time of issue to enable investors to form a valid and justifiable opinion of the shares/debentures being offered and the financial condition and profitability of the issuer/guarantor, and to come to an informed investment decision. There is no firm policy view on whether an issuer needs to include published interims (including half-yearly or quarterly financial statements) in an issue prospectus (or an addendum to the programme prospectus) for a proposed issue.

Almost all issuers now prefer to register their unaudited quarterly/interim reports (or those of its guarantor or swap guarantor) as an addendum to the programme prospectus to avoid, for example, an inequality of information between the US and Hong Kong markets because Forms 10Q are publicly available on the SEC website as part of US banks' regulatory filings in the US. This approach would avoid selective disclosure of information to the detriment of investors in Hong Kong.

Due to the implementation of the EU *Transparency Directive* in 2007/08, issuers/guarantors incorporated in the EU member states whose shares are listed/admitted to trading on an EU regulated market should now be required to publish quarterly "interim management statements" ("IMS"), being a narrative update with minimal specific content requirements covering either the first quarter results or the cumulative third quarter results. As the EU and the US (which requires "full" quarterly reporting) both require some form of quarterly reporting, going forward reviewers to request EU issuers to include their quarterly IMS as part of their offer documentation.

Paragraphs 23-25, Third Schedule to the CO –

1.18. Where waivers are sought in respect of paragraphs 23 – 25 of the Third Schedule to the CO (usually in cases where information required by such paragraphs on bank overdrafts, hire purchase commitments, guarantees or other material contingent liabilities and outstanding debentures of the issuer/guarantor corporation (usually a global financial services provider) needs to be updated to the latest practicable date or date of issue of the prospectus as required by paragraph 3) on the basis that further particulars of such items are unnecessary as:

a. they relate to the financial position of the issuer/guarantor corporation;

b. it has been confirmed in the prospectus that, taking into account the nature of the notes being offered, there has been no material change in the financial position of the issuer/guarantor corporation since the date of its latest audited financial statements; and

c. such latest financial statements contain sufficient particulars of such items at that date and are included in the programme prospectus,

The issuer/guarantor corporation will need to confirm to the SFC in the exemption application letter *that "where waivers are sought on the grounds that the information required is "unnecessary", the prospectus (assuming the waivers are granted) will comply with paragraph 3 of the Third Schedule to the CO.*" A paragraph 25 waiver to SPV issuers under a limited recourse programme would also be considered on the basis that each series of notes is secured on a separate batch of collateral and the noteholders of each such series have limited recourse to the extent of the collateral on which the particular series is secured (i.e. particulars of authorised debentures of the issuer would not impact on prospective investors' investment decision).

Estate duty –

1.19. With the passage by LegCo of the Revenue (Abolition of Estate Duty) Bill 2005 on 2 November 2005, estate duty was abolished as from 11 February 2006. Estate duty chargeable in respect of deaths occurring on or after 15 July 2005 but before 11 February 2006 will be reduced with retrospective effect to a nominal duty of HK$100 for estates of assessed value exceeding HK$7.5 million. Any estate duty overpaid will

be refunded. The description of HK estate duty in the "taxation" section of the programme prospectus to reflect this.

SFC disclaimers –

1.20. "The SFC has authorised this programme prospectus for registration by the Registrar of Companies. SFC authorisation does not imply the SFC's endorsement or recommendation of any offer contained or referred to in this document."

Board resolutions approving programme prospectus and authorising registration –

1.21. For HK incorporated issuers, section 38D(3) of the CO requires the prospectus to be signed by "every director and proposed director or by his agent authorised is writing" and there is no need to produce a copy of the board resolution approving the issue of the prospectuses. For non-HK incorporated issuers, section 342C(3) of the CO requires certification by 2 members of the governing body of the issuer or by their agents that the prospectus has been approved by the board[6]. Overseas issuers normally submit a copy of the relevant board resolutions. In the case of HK/UK incorporated issuers, London Counsel's opinion (obtained in a different context) was to the effect that under Hong Kong/English law, a board resolution has to approve a specific prospectus tabled before the board and not a document that has not even come into existence. Accordingly no "forward-looking" board resolutions are acceptable for HK/UK incorporated issuers. In the case of issuers incorporated other than in HK/UK, reviewers should check to see whether the board resolutions relied upon for the purposes of meeting the registration requirements of section 342C(3) of the CO (i.e. the copy of the prospectus proposed to be registered needs to be certified by 2 members of the governing body of the company or by their agents authorised in writing as "*having been approved by a resolution of the governing body*") provides for blanket approval in respect of future prospectuses (e.g. a board resolution in 2004 approving a note programme and future programme/issue prospectuses). If so, reviewers will require confirmation that "forward-looking" board resolutions under the laws of the country of incorporation of the issuer are sufficiently wide to cover approval of the prospectuses in question.

2. Issue Prospectus

Paragraphs 1.1, 1.7, 1.11, 1.12 and 1.18 of "Programme Prospectus" apply equally to issue prospectuses.

Principal-protected vs principal-guaranteed? –

2.1. There is an important distinction between a product which is principal protected and one which is principal guaranteed. In both cases, the payout at maturity will, in the absence of default, always be 100% of the principal amount (irrespective of, for example, the share price performance of the underlying shares).

Principal protection means that redemption at 100% of the principal on maturity depends on the note issuer receiving, for example, the corresponding payment on the collateral and the swap arrangements i.e. the investor's principal is protected by, say,

[6] The prospectus must be certified by 2 members of the governing body of the company or by their agents authorised in writing "as having been approved by resolution of the governing body" – see section 342C(3). This usually means board resolution (for approval of prospectus), power of attorney and/or signing authority (for authorisation of agents).

AAA-rated collateral but if the collateral issuer/collateral guarantor defaults, the investor could lose his principal.

Principal guarantee means that repayment of 100% of the principal at maturity is guaranteed by a guarantor of the issuer's obligations under the notes pursuant to a deed of guarantee.

It is important to disclose with clarity to which type a product belongs. This is because a principal protected product, albeit so called, is nevertheless subject to how the credit market performs, whilst a principal guaranteed product is subject to the credit quality of that particular guarantor.

Notification –

2.2. In any issue where the terms and conditions cater for the possibility of changes, after the issue of the issue prospectus, to the issue date, initial price, fixing date or trade date, the possibility of such changes should be disclosed in the issue prospectus. Furthermore, where coupon rates and manner/basis of redemption are determined by reference to share price performance, issuers should notify investors (through distributors) of the actual coupon and redemption amounts.

Board Resolutions approving issue prospectus and authorising registration –

2.3. Please refer to paragraph 1.21 of "Programme Prospectus" which also applies to issue prospectus.

Classes of assets to which the notes are linked -

2.4. The following classes of assets are generally considered acceptable:-

a. a single class of shares which satisfies the requirements of (i) Rule 15A.30(1) or 15A.30(2), and (ii) Rule 15A.35[7], of the Main Board Listing Rules;

b. shares which are listed on SEHK with a trading history of less than 60 consecutive business days and a minimum market capitalisation in public hands of HK$10 billion as of the issue date of the relevant structured products;

c. overseas listed stocks - (i) must be listed on a recognized overseas stock exchange; (ii) the list of overseas listed stocks must be approved by the SFC prior to launch; (iii) the relevant notes must be cash settled (following the requirement in Rule 15A.45 of the Main Board Listing Rules).

A few criteria that reviewers should take into account in considering whether to grant approval for overseas listed stocks to be the underlying for equity-linked notes:

- whether the overseas company has a corporate/investor relations website which contains at the minimum the annual and interim/quarterly financial statements for the 2 most recent financial years;

[7] Pursuant to Rule 15A.35 of the Main Board Listing Rules, SEHK publishes a "*Stock Eligibility Schedule*" quarterly setting out those stocks (includes exchange traded funds) listed on SEHK which are eligible for listed structured product issuance, whether as single or basket scheduled stocks. For unlisted structured products reviewers should track SEHK's practice and only consider those stocks which are in the Stock Eligibility Schedule. Reviewers will be provided with the most recent Stock Eligibility Schedule from time to time.

- whether information in relation to the stock is available in English (a Japanese stock has been turned down by SEHK as its corporate website does not have an English version);

- whether stock quote information is freely available either on the overseas company's website or the relevant exchange's website (since unlisted equity-linked notes are designed to be held to expiry, delayed stock quotes are acceptable);

- whether the stock is a constituent of a leading index in the market where it is listed;

- where the overseas company is listed on an exchange which requires a minimum percentage of shares to be in public hands, whether the public float capitalisation of such shares is of an amount equivalent to (or exceeds) HK$4 billion or, if such exchange does not impose a minimum public float requirement, whether the market capitalisation of the shares is equivalent to (or exceeds) HK$10 billion and where the SFC is satisfied with the liquidity of the market for the shares.

d. a basket of underlying securities which satisfies the requirements of Rules 15A.32 and 15A.35[8] of the Main Board Listing Rules;

e. a basket of underlying shares (comprising no more than 10 shares) which are not listed on SEHK, but listed or dealt in on another regulated, regularly operating, open stock market recognised for this purpose by the SFC (see the criteria in (c) above);

f. shares of companies incorporated in the People's Republic of China and listed on the Shanghai Stock Exchange and/or the Shenzhen Stock Exchange in the bank sector and/or the industrial transportation sector of the FTSE/Xinhua China A50 Index (as a type of overseas listed stocks, which has been considered and approved in previous cases);

g. indices - (i) must be those which are approved by the SEHK as underlyings for listed structured products (currently comprising Hang Seng Index, Hang Seng China Enterprises Index, Dow Jones Industrial Average Index, Nasdaq 100 Index, Standard & Poor's 500 Index, MSCI Taiwan Index, MSCI World Index, MSCI AC Asia-Pacific exJapan Index, MSCI India Index, MSCI Korea Index, Nikkei 225 Stock Average Index, KOSPI 200 Index and Reuters/Jefferies CRB Index); and (ii) must be cash settled (following SEHK practice);

h. funds - e.g. ETFs such as the Tracker Fund and the A50 China Tracker; listed REITS such as the Link REIT which satisfy the requirements of: in the case of a single fund, Rule 15A.30(1) or 15A.30(2), or, in the case of a basket of funds, Rule 15A.32, and in both cases, Rule 15A.35[8], of the Listing Rules.

Describing companies to which the notes are linked –

2.5. When considering the adjectives used by an issuer to describe the underlying companies, reviewers should ensure that the comment is limited to asking issuers to substantiate/explain the choice of words when in doubt as to the appropriateness of the words used (as opposed to asking issuer to delete the words in question). For example, when corporations with global operations that most ordinary persons on the

street should know of are chosen as the underlying, the use of "international", "well-known" and "household names" to describe such corporations should be acceptable. Such words are neutral in the sense that it is factually correct that a corporation is "international" if it has worldwide operations, and it could also be "well-known" or become a "household name" for positive or negative reasons. In addition, the use of "blue chips" and "red chips" to describe the 43 HSI constituent stocks and 30 HSCCI (Hang Seng China-Affiliated Corporations Index) constituent stocks respectively should also be acceptable as they are known in the market as such. The use of the words "large cap" to describe companies which are constituent stocks of the Hang Seng HK LargeCap Index should also be acceptable. Reviewers can obtain a list of the current constituents of the various indices on the website of HSI Services Limited at www.hsi.com.hk. under the folder "Constituents".

Name of a series –

2.6. Reviewers should also consider whether the name given to a particular series of notes or a particular feature of the notes is misleading to prospective investors. For example, it may not be appropriate to label a series of notes with a "step-up" feature where, for example, where redemption is possible at half-yearly intervals and a bonus amount equal to 2% of its nominal value is payable if redemption occurs at 6 months, 4% at 12 months, 6% at 18 months and 8% at 24 months, the rate payable on such redemption dates on an annualised basis is 4%, therefore, there is no actual "step-up" in the bonus rate.

For equity linked notes –

2.7. If no closing price is available for one underlying share (out of a basket) on a valuation or observation date due to a market disruption event, what is the treatment for the affected share and the unaffected shares?

a. Would closing prices of unaffected shares on the original valuation/observation date be used for calculation purposes, whilst the valuation/observation date for the affected share would be the next following scheduled trading day on which there is no market disruption event i.e. a closing price for the affected share is published (unless no closing price is available for each of the following 5 or 8 scheduled trading days, in which case the calculation agent (acting as the agent of the issuer) will in good faith estimate the closing price of the affected share on that 5^{th}/8^{th} scheduled trading day); or

b. Would the valuation/observation date be postponed for all shares in the basket?

2.8. For ELNs with a daily accrual feature, if no closing price is published for one or more shares in the basket due to a market disruption event, what is the treatment for the affected share and the unaffected shares?

a. if no closing price for one or more (but not all) shares (out of a basket) are available on an exchange business day due to a market disruption event, would closing prices of the unaffected shares on that exchange business day be used for calculation purposes, whilst the closing price(s) of the affected share(s) on that day will be the closing price(s) on the next following exchange business day on which the closing price(s) of the affected share(s) is/are available?

b. if no closing price is available for ALL shares in the basket on an exchange business day due to a market disruption event, what is the treatment? Would

such day be deemed not to be an exchange business day for calculation purposes?

2.9. Reviewers should request issuers to state whether the number of shares to be physically delivered on maturity (if redemption is by way of physical delivery rather than repayment of the principal amount) will be determined on a per-note or aggregated basis, and to state whether extra interest or amount will be paid for any delay in payment or delivery of shares.

2.10. In the summary box or "at a glance" section of an IP, ensure that the worst case scenario (minimum fixed return over maximum tenor plus physical delivery of worst performer) is stated prominently in the box as this will usually be extracted to form part of the marketing materials. Example: "*The notes are not principal protected and may be redeemed by physical delivery of the worst performing share which may be worth substantially less than the principal amount of the notes. Investors may only receive the minimum fixed coupon of [*]% over the 2-year term of the notes.*" Such worst case scenario to be prominently stated in each of the marketing materials beneath the visual.

2.11. Hypothetical examples/scenario analyses to be inserted in an issue prospectus so that prospective investors can better understand how the notes work. To get a balanced picture across to prospective investors, the best, moderate and worst case scenarios to be presented.

2.12. If the term "guaranteed" coupon is used by issuers under a non-guaranteed programme, when all they mean is that the coupon is fixed, reviewers to request issuers to use the term "fixed" coupon as the word "guarantee" may mislead prospective investors into thinking that the notes are guaranteed.

For credit linked notes –

2.13. The "redemption on maturity" section in the summary of the features of the notes to include a prominent statement, after "100% of principal amount", to the effect that if a credit event occurs, the credit event redemption/cash settlement amount payable to investors is likely to be less, and could be substantially less, than the principal amount of the notes. This is to ensure that if the summary section is extracted to form an advertisement, a balanced view highlighting the credit-linked risks of the notes is presented.

2.14. The issue prospectus to state whether interest will be paid for any part of the interest period during which a credit event happens or an early redemption (whether due to an event of default, illegality, taxation reasons or otherwise) is made. In most instances, the commercial deal is that no interest will accrue.

2.15. Reference obligations are used as a benchmark to determine the credit event redemption amount if a credit event occurs to a reference entity. Where the reference obligation of a reference entity is a subordinated obligation, the issue prospectus should state the credit rating of the subordinated obligation as opposed to that of the reference entity's long-term senior unsecured debt (or state both sets of ratings), since investors are exposed to a subordinated debt which is more likely to cause greater loss upon a credit event than if the reference obligation is a senior debt.

2.16. Where the term of a CLN is, say, 5.5 years and different interest rates apply to different periods, some issuers present the applicable interest rates in the following format:

Years 1 – 4: [X]% p.a.

Year 5 – 5.5: [Y]% p.a.

Confusion may arise from the adoption of this format as it may appear to investors at first blush that [Y]% is only applicable to the last half-year of the investment period whereas it is applicable to the last 1.5 years. A clearer presentation format would be as follows:

First 4 years: [X]% p.a.

Last 1.5 years: [Y]% p.a.

Additional points

Past performance –

2.17. Where past performance of an underlying (i.e. the subject matter to which the notes are linked) (in terms of historical share prices) is set out in the prospectus, the duration covered should be of at least 5 but not more than 6 years or of a period equal to the maximum tenor of the notes, whichever is the longer (in cases where the underlying share has been listed for less than 5 years, since the date of listing). Where the underlying share has less than a year's trading record, reviewers should check whether the issue prospectus has appropriate risk disclosure regarding the listed entity not having an established trading record and that price and volume volatility may be higher than those with an established trading record. The price charts should be set out horizontally over a page, with a maximum of 2 charts to one page. This will avoid issuers cherry-picking the best results.

Minimum transfer amount –

2.18. Issuers more often than not designate a minimum purchase amount for their notes (e.g. the notes are in denominations of HK$10,000 but an investor needs to purchase a minimum of, say, HK$30,000 or 3 notes). Reviewers should ask the issuers to confirm whether there is a minimum transfer amount and if so, whether it is the same as the minimum purchase amount (as the minimum transfer amount could be, say, HK$10,000 or 1 note). Where there is a minimum transfer amount, it should be clearly stated in the issue prospectus.

Good faith estimate –

2.19. In all ELN or ILN structures where closing prices or levels of the underlying stocks or indices on a valuation date (or during an observation period) have to be determined in order to calculate the relevant coupon/redemption amounts, issuers usually adopt the ISDA convention on postponement of a valuation date due to a market disruption event (e.g. postponement to the next following scheduled trading day when no market disruption event subsists unless there is a market disruption event on each of the following 5 or 8 scheduled trading days, in which case the calculation agent will do a good faith estimate of the relevant closing prices or levels).

2.20. The possibility of situations where the calculation agent appointed by the issuer needs to estimate in good faith the price or level of the underlying (linked) stocks or indices affected by the postponement of a valuation date is useful and relevant information for investors that should be highlighted in the front-end of the issue prospectus.

"No material adverse change" statement –

2.21. The issue prospectus for each offer to include a bring-down statement, i.e. in the context of the structured products being offered there is no material adverse change in the financial or trading position of the issuer (or the guarantor corporation) since the date to which its last published audited financial statements were made up. Issuers who include unaudited interim or quarterly financial statements in the prospectuses (and not as display documents) may peg such bring-down statement to the date of the unaudited interim or quarterly financial statements instead. This approach is acceptable provided there is no window period which is not covered, even though such financial statements are unaudited, as the issuers and their directors are subject to prospectus liability anyway.

Fees and charges –

2.22. Issuers to state in the issue prospectus whether there are any charges or fees involved in relation to the structuring of the notes. This is to mirror the following disclosure requirement (or a statement to the like effect) in respect of offer documents for equity-linked deposits, which are functionally similar to ELNs:

> "Although there are no explicit charges, any fees and charges incurred by the Issuer, whether to enter into underlying investments or hedging agreements or for operational or administrative purposes and profit margins, if any, are already indirectly contained in and subsumed into the calculation of the coupon(s) and the principal under the notes."

Application and authorisation fees –

2.23. In relation to the application for authorisation for registration of a prospectus (within the definition of CO), a fee of HK$30,000 is chargeable in accordance with item 21(f) of Schedule 1 to the Securities and Futures (Fees) Rules. In cases where two or more prospectuses are submitted for authorisation, in so far as the law would require a payment of that amount in respect of each prospectus, an application for waiver from the issuer would be considered, for example, on the basis that the offer contained in the prospectuses could have been made via a single prospectus and that it would therefore be duly burdensome or inappropriate to charge more.

Paragraphs 27 and 31 exemptions –

2.24. Reviewers to check whether issuers have complied with paragraphs 27 and 31 of the Third Schedule of the CO, and in particular, take note of the following:-

> Paragraph 27 of the Third Schedule:
>
> *"A statement as to the gross trading income or sales turnover (as the case may be appropriate) of the company during each of the 3 financial years immediately preceding the issue of the prospectus....."*

Paragraph 27 exemption will be required if the financial statements for the immediately preceding year are not available when a prospectus is issued.

Under paragraph 31 of the Third Schedule:

"*A report by the auditors of the company.....in respect of each of the 3 financial years immediately preceding the issue of the prospectus.....*"

Paragraph 31 exemption will be required if the financial statements for the immediately preceding year are not available when a prospectus is issued.

In addition, if the issuer is also relying on section 8(3)(b)(ii) of the Exemption Notice in respect of paragraph 31 (that the audited financial statements for the immediately preceding year (i.e. $Year_{-1}$) are not available), an appropriate statement regarding the unavailability of $Year_{-1}$'s financial statements to be set out in the issue prospectus (see also paragraph 1.15 above regarding section 8(3)(b)(i) of the Exemption Notice). If the issuer is applying for an exemption from paragraph 31 but NOT relying on the Exemption Notice, the issuer to insert a similar statement of the unavailability in the issue prospectus to ensure consistency in the level of disclosure among issuers.

Reviewers need to pay extra attention to this paragraph at the turn of every year before issuers publish the relevant audited financial statements for the immediately preceding year (e.g. when an issuer proposes to issue a prospectus in January 2008 whilst its immediately preceding financial year end is 31 December 2007).

3. Marketing Materials

3.1. In general, reviewers should refer to the "*Guidelines on use of offer awareness and summary disclosure materials in offerings of shares and debentures under the Companies Ordinance"* issued by the SFC on 21 March 2003 (and in particular paragraphs 3, 5 and 6) for background information. SFC disclaimers and other legends which must be included in each of the marketing materials are as follows:

a. [ABC] Ltd. is the issuer of the notes. If it has already been identified as such in the front-end of the material e.g. the summary of terms in a factsheet/leaflet has already identified the note issuer, there is no need to do so in the legends. The need to identify the note issuer usually occurs in the case of bus panel or bus shelter ads, tentcards/leaflet holders, posters and print ads.

b. Investment involves risks.

c. To highlight to prospective investors that they should read the relevant prospectuses for detailed information about the issuer/guarantor and the offer of the notes, and ask the distributors for copies and whether any addendum has been published during the offer period before deciding whether to invest in the notes.

d. The material does not constitute an offer or an invitation to induce an offer by any person to acquire the notes. The offer of the notes is made solely on the basis of the information contained in the prospectuses and applications will only be taken on the basis of the prospectuses.

e. The material is issued by [identify the issuer of the material e.g. XYZ Securities Limited as the arranger of the notes], who takes responsibility for the issue and contents of the material.

f. The issue of the material has been authorised by the SFC under [section 38B(2A)(b) of the Companies Ordinance and] section 105(1) of the Securities and Futures Ordinance. SFC authorisation does not imply the SFC's endorsement or recommendation of the notes referred to in the material. The SFC accepts no responsibility for the contents of the material.

3.2. The above disclaimers and legends must be legible in the context of:

a. font size (paragraph 3.04 of the Guidelines requires that all warning statements and legal legends in the materials must be at least 40% of the font size of the predominant text and must not be presented in a style that is designed to reduce their impact). Such statements and legends must be capable of being read with ease by anyone scanning the material;

b. format/layout of the marketing material (i.e. with clear paragraph headings and spacing). When issuers decide what the marketing materials should say, they must ensure that everything that is said is readily readable. If this has an impact on the format/layout of the materials they produce, such that some formats are not suitable, so be it;

c. where the material will be displayed or published (e.g. a bus panel advertisement – the legends must not be clustered).

Emphasis –

3.3. The visual in an advertisement normally comes with a headline banner stating the maximum potential return of the notes. To achieve a balance, the worst case scenario should be stated in a prominent position beneath the graphic:

a. in the case of ELNs:

i) the notes are not principal protected;

ii) investors may only receive the minimum fixed coupon of [x]% during the [y]-year life of the notes;

iii) the notes may be redeemed by physical delivery of the worst performing share which may be worth substantially less than the principal amount of the notes.

b. in the case of CLNs:

i) the notes are not principal protected;

ii) if a credit event occurs, the credit event redemption/cash settlement amount is likely to be less and could be substantially less than the principal amount of the notes.

In addition, where subordinated obligations of the reference entities are used as reference obligations for the purposes of the calculation of the credit event

redemption amount upon the occurrence of a credit event, but the credit ratings shown in the main text of the marketing materials are those for senior unsecured debt of the reference entities (as opposed to the ratings applicable to the subordinated reference obligations), both sets of ratings (or those applicable to the reference obligations only) to be shown so that investors are not misled.

3.4. The prominence given to the figure representing the total maximum potential return (i.e. the font size used for such figure in the headline banner) to be balanced with the prominence given to the worst case scenario caption. To stress that this figure reflects the best case scenario and whether such return can be achieved depends on market performance of the underlying (e.g. share price performance or credit performance).

Visual and artwork –

3.5. As far as the marketing theme and artwork are concerned, anything associated with speed or racing is generally not acceptable (to avoid giving prospective investors the impression that investing in a structured product and obtaining the maximum return is fast/assured) (however, a visual showing a race car or an airplane without emphasising the motion or a helicopter on the launch pad has been accepted). A neutral theme is preferred (in the past, the use of "gold" and "diamonds" with toned-down sparkles have been allowed). Examples of rejection include rockets and fighter jets. Where a theme is considered to be unacceptable (or variations to an otherwise acceptable theme are required), the reviewers to alert the issuers in the first instance as they need time (and extra costs) to come up with an alternative theme.

Slogans –

3.6. The same applies to the marketing slogans proposed to be used. Reviewers to ask issuers to put the marketing slogans (as opposed to corporate branding slogans) used in their advertisements into the issue prospectus on the basis that the marketing materials should not contain any information that is not in the prospectus. To do otherwise will cloud the legal position, undermine the philosophy that the prospectus should contain everything an investor needs to know (and raise a valid question why the information is being provided but not in the prospectus), and potentially confuse investors. If an issuer wants some information in the marketing materials, then it should go in the prospectus.

Legibility –

3.7. Reviewers to ask the issuers/legal advisers to submit the smallest version of the print ad for review of legibility. In addition, a word version of the text for comment purposes to be submitted as well.

Tentcards –

3.8. Some issuers produce tentcards for holding SFC-authorised factsheets or leaflets. If such tentcards or leaflet holders contain only the visual/graphic with no text/slogans or reference to the offer of the relevant series, SFC authorisation may not be required (where authorisation is not required, a copy for reference will be needed). In determining whether any regulatory benefit is served by authorisation, the issuers need to show whether the "worst case scenario" caption will be "hidden" when the factsheets or leaflets are inserted into the holder. If it is so "hidden", the issuers to

state the “hidden” caption onto the tentcard/leaflet holders, thereby requiring authorisation.

LED display –

3.9. Where issuers propose to place an in-train advertising message on the LED display panel of MTR carriages, the SFC disclaimers must be displayed for a certain minimum period of time (normally not less than 2 seconds) depending on the amount of text set out in each frame.

Webpages –

3.10. Some issuers would like to submit webpages (being part of its or the arranger’s website) as marketing materials for authorisation. Whilst the review of such materials relating to the features of the particular products will be no different from other forms of marketing materials (e.g. leaflets), the issuer or the arranger is to demonstrate how the screenflow is set out, and in particular reviewers must be aware of hyperlinks and icons unrelated to the product. Furthermore, a disclaimer is to be inserted on the first webpage which a viewer sees when entering the section or folder about structured products. The disclaimer must clearly state which webpages have been authorised by the SFC and carve out all others where SFC authorisation is not required. All hyperlinks and unrelated banner advertisements appearing on the webpages would also need to be carved out.

E-mail/website attaching authorised marketing –

3.11. There are cases where distributors wish to send out non-SFC-authorised e-mails or hard copy letters to their existing customers attaching an SFC-authorised factsheet/leaflet. The text of the e-mail or letter must be such that no reference is made to the features of the notes being offered, apart from something generic or neutral such as “*Series X notes issued by ABC Ltd. now on offer. Please see attached.*” In the case of e-mails, there must be a link to a locked PDF version of the relevant prospectuses. In the case of letters, investors’ attention must be drawn to where they may obtain copies of the relevant prospectuses.

Where distributors wish to post SFC-authorised marketing on their websites, reviewers should ask the legal advisers to submit the proposed screenflow for review.

3.12. Since the e-mail/letter makes only neutral passing reference to the notes being offered and refers to and encloses the SFC-authorised factsheet/leaflet, it does not give any cause for concern from a regulatory or disclosure perspective. No regulatory purpose would be served by the SFC taking regulatory or legal action under section 38B(1) if such an e-mail or letter were issued without SFC authorisation.

Online banner advertisement –

3.13. Where issuers/arrangers propose to place banner advertisements on webpages of the distributors or other online media, reviewers should request them to provide the screenflow of such banners. The information that can be displayed on such banners is very limited, for example, title of series, nature of underlyings and maximum coupon amount, due to the lack of memory storage space available for such banners on the relevant webpages. Reviewers must ensure that the text displayed on such banners is legible and investors are given sufficient time to read each individual frame. The banners to also at least display the following information :-

- Investment involves risk
- The notes are principal/non-principal protected, and, if applicable, warning statements regarding the minimum (or nil) coupon amount and/or physical delivery of the worst performing share
- Investors must read the prospectuses
- Who is responsible for the issue and contents of the relevant banner
- SFC disclaimers

Hyperlinks to locked PDF formats of the prospectuses on such banners would also be acceptable.

Bonus gifts for successful subscriptions –

3.14. Bonus gifts (in the form of cash coupons and electronic or other products) offered by distributors for successful subscriptions of a certain size are now a regular side-feature of a note offer. It used to be the case that all the terms and conditions relating to the redemption and use of such gifts are inserted in the relevant marketing materials – so much so that it clutters, and may discourage people from reading, information relating to the notes themselves.

3.15. Although issuers have discretion as to what they wish to put in their advertisements (provided the contents are accurate, clear, unambiguous and not misleading), reviewers should suggest to them that it should not be done at the expense of cluttering the space used to describe the notes. Reviewers to advise issuers that the following approach is preferable:

Minimum "gift" information required for advertisement as follows:

- "Terms and conditions apply – please ask your distributor for full details relating to availability, delivery/collection, warranty and liability prior to purchase of Notes." This is to be preceded, where applicable, by a description of the gift(s) (and their approximate retail value(s)), terms relating to the level of successful subscription before qualifying for gift redemption, as well as whether investors can choose a combination of gifts if their subscriptions exceed a certain level.

3.16. Full terms and conditions of the gift scheme will have to be documented and made available for collection by investors via distributors (and copied via e-mail to the SFC with a confirmation that no material terms have been omitted). This approach can also work for gifts relating to credit card bonus points and air miles – since prospective investors need to be the holder of the relevant credit card or member of the relevant mileage programme before they can qualify for gift redemption, the full terms and conditions should point out to investors that they will be bound by the separate terms and conditions which govern the use of such credit card or mileage programme.

3.17. The above principle can also be applied where there is information that does not appear to add value for investors' understanding. For example, a list in the advertisement which sets out a host of defined terms and asks investors to read the issue prospectus for detailed definitions. Again, reviewers to suggest to issuers that they may wish to consider whether this clutters information relating to the main features and risks of the notes, when they will have already asked prospective investors to read the prospectuses before making an investment decision.

Hypothetical examples –

3.18. Where hypothetical examples are used in a marketing material, they should be balanced with emphasis on both the upside and the downside risk. Reviewers should request the worst case scenario to be inserted, unless the structure of the particular product is such that it makes little sense to have such a demonstration (e.g. where the product is principal protected, or where the parameters are such that the chance of the worst case scenario is not quite realistic - e.g. where strike price for physical delivery is 1% of the initial price.

References to websites –

3.19. Where there are references to websites in the marketing materials, the SFC authorisation wording should be such that prospective investors are left in no doubt as to the extent of authorisation. Example: "*SFC authorisation does not imply SFC's endorsement or recommendation of the Notes nor its endorsement of the information contained in any website referred to in this [description of document].*"