

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

**Comparison between the existing and the proposed arrangements
for regulation of public offers of structured products**

Purpose

This paper briefs Members on the major differences between the existing regime and the proposed regime under the Bill in the regulation of public offers of structured products, and the justifications for the proposed arrangements.

The Major Differences

2. The products of which the public offer would be affected by the Bill are structured products in the form of debentures (or shares¹). In gist, the main difference between the existing regime and the proposed regime under the Bill would be that, after enactment of the Bill, the public offer of **structured products in the form of debentures (or shares)** would no longer follow the regulatory regime under the prospectus regime in the Companies Ordinance (CO); instead, it would be regulated under the offers of investments regime in the Securities and Futures Ordinance (SFO).

3. A new definition of structured product will be introduced in the Bill, and publicly offered structured products that are not in the form of securities will be deemed to be “securities” to ensure that the regulatory pillars in the SFO on licensing, inspection, enforcement will apply to them.

4. There will be no change in respect of the applicable regime (i.e., the CO prospectus regime and the SFO offers of investments regime) for the public offer of –

¹ So far, there have been no publicly offered structured products that are in the form of shares.

- (a) shares and debentures which are not structured products (i.e. continue to be subject to SFC's authorization under the CO); and
- (b) products² that are currently regulated under the SFO (i.e. continue to be subject to SFC's authorization under the SFO).

Justifications

5. Currently, there is no concept or definition of structured products in the CO or the SFO. The public offer of structured products would be conducted in accordance with the CO if they are in the form of debentures (or shares), or in accordance with the SFO if they are products³ regulated under the SFO. Accordingly, even though certain structured products may have similar risk and return profiles, different regimes may apply to their public offers depending on their legal form. For example, equity linked-notes and equity linked-investments are structured products with similar risk and return profiles. Equity linked-notes are debentures and their public offers are regulated under the CO prospectus regime. As equity linked-investments are not debentures, public offers of these fall under the SFO offers of investments regime.

6. The proposed transfer is to align the regulation of structured products so that public offers of structured products (regardless of their legal form) will be regulated under the SFO offers of investments regime. The SFC has issued a Code on Unlisted Structured Investment Products that sets out the criteria that the SFC would normally consider before exercising its authorization powers in respect of unlisted structured investment products commonly regarded by the market as equity, index, commodity and credit linked-products.

7. The table at the Annex compares the existing CO prospectus regime and the existing SFO offers of investments regime. The Bill will also make certain consequential amendments to the existing SFO

² Securities (other than shares and debentures), regulated investment agreements and collective investment schemes.

³ See footnote 2.

offers of investments regime and these amendments are marked-up in the table.

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

**Comparison between the CO Prospectus Regime and the SFO Offers of Investments Regime,
with Amendments to the SFO Offers of Investments Regime as proposed by the Bill marked up**

	CO Prospectus Regime	SFO Offers of Investments Regime
Authorization requirements	<p>Prospectuses are required to be authorized by the SFC.</p> <p>A prospectus is required to state the matters and reports specified in the Third Schedule to the CO – i.e. the overall disclosure requirements (sufficient particulars and information to enable a reasonable person to form a valid and justifiable opinion on the shares or debentures and financial condition and profitability of the company) and specific content requirements (e.g. name/address of directors/auditors; shares/debentures issued in the two preceding years; voting rights of shares; indebtedness of the company; auditors’ reports)</p>	<p>Offer documents and marketing materials are required to be authorized by the SFC.</p> <p><u>The SFC is empowered to authorize structured products.*</u></p> <p>The SFC may publish codes and guidelines in relation to the operation of any provision of the SFO.</p> <p>In June 2010, the SFC issued a Code on Unlisted Structured Investment Products that sets out the criteria (e.g. eligibility of issuers and guarantors, product structure, on-going disclosure obligation) that the SFC would normally consider before exercising its authorization powers in respect of unlisted structured products.</p>

	CO Prospectus Regime	SFO Offers of Investments Regime
Exemptions from authorization	<p>Examples of exemptions:</p> <ul style="list-style-type: none"> - an offer to not more than 50 persons; - an offer with a minimum subscription size of \$500,000; - an offer with a maximum size of \$5 million - an offer to professional investors. 	<p>Examples of exemptions:</p> <ul style="list-style-type: none"> - an offer to professional investors - an offer made by or on behalf of intermediaries licensed or registered for Type 1, Type 4 or Type 6 regulated activity⁴ in respect of securities, <u>other than unlisted structured products</u>*; - an offer to persons outside Hong Kong; - the issue of a prospectus registered under the CO.
Products the offer documents of which are regulated	<p>Examples:</p> <ul style="list-style-type: none"> - Equity-linked notes** - Credit-linked notes** - Initial public offering of shares - Convertible bonds and exchangeable bonds issued for capital fund raising purposes 	<p>Examples:</p> <ul style="list-style-type: none"> - Equity-linked investments - Equity-linked deposits - <u>Equity-linked notes</u>* - <u>Credit-linked notes</u>*

*Those underlined are added by the Bill.

**Those crossed out are removed by the Bill.

⁴ The relevant regulated activities are – Type 1: dealing in securities; Type 4: advising on securities; Type 6: advising on corporate finance.