立法會
Legislative Council

LC Paper No. CB(1)1804/10-11

Ref: CB1/BC/11/09

Paper for the House Committee meeting on 8 April 2011

Report of the Bills Committee on Securities and Futures and Companies Legislation (Structured Products Amendment) Bill 2010

Purpose

This paper reports on the deliberation of the Bills Committee on Securities and Futures and Companies Legislation (Structured Products Amendment) Bill 2010 ("the Bills Committee").

Background

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, while 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.

4. In SFC's 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), it was 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 reasonably have been in contemplation when the law was enacted.

5. SFC conducted a two-month consultation on Possible Reforms to the Prospectus Regime in CO and the Offers of Investments Regime in the SFO from 30 October 2009 and published its consultation conclusions on 22 April 2010. On 3 May 2010, the Administration consulted the Panel on Financial Affairs on the proposal to transfer the regulation of public offers of structured products in the form of shares or debentures from the prospectus regime of CO to the offers of investments regime of SFO.

The Bill

6. The Bill was gazetted on 2 July 2010 and introduced into the Legislative Council on 14 July 2010. The object of the Bill is to transfer the regulation of public offers of structured products in the form of shares or debentures from the prospectus regime of CO to the offers of investments regime of SFO and to make consequential and related amendments. The Bill contains the following major proposals -

A. Disapplication in CO and definition of "structured product"

(a) the provisions of CO prospectus regime to be dis-applied to structured products (clauses 19 and 20);

(b) a definition for "structured product" is proposed (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 CO (clause 15);

(d) 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);

B. *Authorization of structured products*

(e) extending the regulation by SFC of offering documents to those in respect of structured products (clause 4(1)), empowering the SFC to authorise a structured product with the authorization power set out in a new section 104A of SFO (clause 5);

(f) decisions made by SFC in respect of structured products to be subject to review by the Securities and Futures Appeals Tribunal (clause 16);

C. *Safe harbours and exemptions*

(g) the safe harbours in the Seventeenth Schedule to CO are not 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

D. *Listed structured products*

(i) the Stock Exchange of Hong Kong will remain the frontline regulator responsible for reviewing and approving listing documents for listed structured products.[1]

The Bills Committee

7. At the House Committee meeting on 8 October 2010, Members agreed to form a Bills Committee to study the Bill. Under the chairmanship of Hon Starry LEE Wai-king, the Bills Committee has held eight meetings. The membership list of the Bills Committee is at **Appendix I**. The public including relevant trade and professional organizations have been invited to give views on the Bill. The Bills Committee received oral representations from deputations at the meeting on 6 December 2010. A list of the organizations and individuals which/who have submitted views to the Bills Committee is at **Appendix II**.

[1] 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.

Deliberations of the Bills Committee

Scope of application of the offers of investments regime under Part IV of SFO

Invitation/offer to the public

8. Noting that the scope of application of Part IV of SFO is confined to financial products offered to the public and offering documents containing an invitation to the public to invest in financial products, the Bills Committee has sought clarification on the notion of "invitation/offer to the public" in SFO. In this connection, members have expressed concern that the lack of a clear demarcation between private placement and public offer of investment products in law may cause confusion to investors and create loopholes for abuse. Members have also referred to the scenario where an intermediary solicits selected clients to invest in an investment product, which is not widely publicized and the relevant offer documents are not on public display, and queried whether such scenario would constitute an offer to the public.

9. SFC has advised that the notion of "invitation/offer to the public" was brought down from the repealed Protection of Investors Ordinance to SFO when SFO was enacted. The concept of "invitation/offer to the public" was discussed at the Bills Committee on the Securities and Futures Bill and Banking (Amendment) Bill 2000. It was then agreed that a broad notion of "invitation to the public" was necessary in order to protect the interests of investors and the court should be the ultimate authority to interpret and decide whether an advertisement or a document contains an invitation to the public, based on the facts of individual cases. Research conducted by SFC shows that there is no case law in Hong Kong regarding the interpretation of "invitation/offer to the public". In the United Kingdom ("UK") and Australia, case law broadly suggests that there is no numerical bright-line test for defining "public"; and that an invitation does not have to be "universal" but has to be general in its nature. In the United States ("US"), there is case law which suggests that certain considerations have to be taken into account in deciding whether an offer is made to the public. The factors that would be taken into account include the number of offerees, their relationship with one another and the issuer, the nature of the offerees (such as their degree of sophistication), the offerees' ability to have access to information, and the manner and the size of the offer, etc. Hence there can be no simplistic bright-line test.

10. SFC has advised that the notion of "invitation/offer to the public" has existed for a long time under the SFO for regulation of public offer of products. Accordingly SFC considers it inappropriate to alter the concept of

"invitation/offer to the public" in the existing SFO under the current Bill. SFC has further advised that at present, the issue of advertisements and/or documents for public offers of securities and structured products are already subject to authorization by SFC, unless otherwise exempted. Issuers should be aware that various relevant factors would need to be taken into account in determining whether an offer is a public offer or a private placement, and should avail themselves of legal advice if needed. Once the offering documents have been authorized by SFC for public offering, the next step would be the manner and approach adopted by an intermediary in providing an authorized offering document to the public, which is a separate issue that concerns the intermediary's obligations under the relevant code of conduct.

Scope of offer documents subject to authorization by SFC

11. Section 103 of SFO[2] prohibits a person from issuing, or possessing for the purposes of issue, whether in Hong Kong or elsewhere, an advertisement, invitation or document which to the person's knowledge is or contains an invitation to the public to enter into or offer to enter into an agreement to acquire or dispose of, subscribe for or underwrite securities, a regulated investment agreement ("RIA"), or to acquire an interest in or participate in a collective investment scheme ("CIS") unless the advertisement, invitation or document is authorised by SFC under section 105 or is otherwise exempted.

12. The Bills Committee has sought explanation on the meaning of the term "advertisement, invitation or document", and the application of the prohibition under section 103(1) in real life situations. The Administration and SFC have explained that there are three folds to the prohibition under section 103(1):

(a) It applies to "any person" who "issues".

(b) The subject matter has to be an "advertisement", "invitation" or "document"; and

(c) The advertisement, invitation or document must knowingly be or contain an invitation to the public regarding securities, RIA or CIS.

13. The terms "advertisement", "document", "invitation" and "issue" are defined in section 102. Depending on the facts of each case, if any material (which may be an offering document or advertisement) or contents thereof, fall(s) within the definitions of "advertisement", "invitation" or "document", and

[2] To avoid repetition, unless otherwise specified, all the legislative provisions referred to in this report are provisions in SFO.

is/are published, circulated, distributed or otherwise disseminated, and knowingly contain(s) such an invitation to the public regarding securities, RIAs or CIS, the prohibition in section 103 would apply. As such, the issue of such material must be authorized by SFC under section 105 unless it is exempted. The prohibition applies to any person who "issues" the material in question.

14. Consistent with the applicability of section 103, the rules regarding advertisements under the Code on Unlisted Structured Investment Products ("SIP Code"), notably the Advertising Guidelines (Appendix D of the SIP Code) apply to advertisements regardless of whether the issuer of the advertisement and the issuer of the product are the same person.

15. Hon Audrey EU has expressed concern that during the sales process of investment products, an intermediary may use, in addition to SFC's authorized documents, materials (such as staff notes) which do not "contain an invitation to the public" to enter into an agreement to acquire the products, and as such the intermediary may not be considered as contravening section 103(1). SFC has responded that in accordance with the authorization regime for offer documents of investment products, the information given by an intermediary to an investor should be based on the offer documents authorized by SFC. The behaviour of an intermediary during the sales process is subject to regulation as stipulated in the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission ("Code of Conduct"). The financial institution concerned is required to ensure that the sales staff are properly briefed and would provide appropriate information to investors to enable the latter to make informed investment decisions.

<u>Commencement and fees - clause 2 and new clause 30</u>

16. At present, applicants for SFC's authorization for registration of a prospectus for shares and debentures (including structured products in such legal forms) under CO have to pay relevant fees to SFC, being $30,000 as prescribed under item 21(f) of Schedule 1 in the Securities and Futures (Fees) Rules ("Fees Rules") (Cap. 571AF). Cap. 571AF is subsidiary legislation prescribing all the fees charged by SFC[3]. For structured products not in the legal form of shares or debentures, applicants for SFC's authorization of their offer documents under SFO have to pay the same level of fees (i.e. $20,000 for application and $10,000 for authorization) to SFC as prescribed in the Fees Rules. The Administration proposes that after the proposed transfer of

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[3] Section 395 provides that the Chief Executive in Council may, after consultation with SFC, make rules to, inter alia, require and provide for the payment to SFC of, and prescribe, fees for an application to SFC under or pursuant to any of the relevant provisions.

authorization regime takes effect, the existing fees for authorization of offer documents will remain unchanged.

17. Apart from transferring the regulation of public offers of structured products in the form of shares or debentures from CO to SFO, the Bill also proposes empowering the SFC to authorize structured products under the new section 104A. For this new power to authorize structured products, SFC has proposed a corresponding product authorization fee – $2,000 for application and $1,000 for authorization. Having regard to the feedback to SFC's soft consultation with the key market players, the Administration considers that the proposed fee is reasonable and modest. Furthermore, the Administration and SFC propose that an incidental fee of $3,000 be chargeable for the modification of a previous authorization for the offering documents for a structured product. Such modification fee level is also in line with the current modification fee charged for documents authorized under section 105.

18. The Administration's original plan was to amend after enactment of the Bill the Fees Rules to provide for the new fees by way of separate subsidiary legislation, which is subject to negative vetting by the Legislative Council. In this connection, clause 2 of the Bill currently provides that the enacted Ordinance comes into operation on a day to be appointed by the Secretary for Financial Services and the Treasury by notice published in the Gazette. To enable early implementation of the proposals in the Bill, the Administration now proposes to provide for the new fees and include in the Bill the amendments to the Fees Rules for the purpose by moving a Committee Stage amendment ("CSA") to the Bill. The Administration also proposes moving a CSA to delete the commencement clause for the Bill so that the provisions of the Bill will come into operation on gazettal of the enacted Ordinance.

19. Members have expressed concern whether the proposed new arrangement of moving a CSA to provide for the new fees in the Bill is legally in order and whether the relevant stakeholders have been consulted on the fee proposals. The Administration has advised that the legal advice of the Department of Justice confirms that the proposed new arrangement is legally in order and the proposed CSAs are within the ambit of the Bill. SFC has soft consulted the major market participants on the fee levels of the proposed product authorization fee and they have no objection.

Offence to issue advertisements, invitations or documents relating to investments in certain cases and exemptions - clause 4

20. Clause 4 amends section 103 so that the section will apply to structured products. The effect of the amendments is to prohibit the issue of advertisements, invitations or documents in relation to a public offer of structured products without authorization under section 105(1). Certain exemptions in section 103 that currently apply in relation to securities are extended to apply also to structured products.

Retention of reference to regulated investment agreement in section 103(1)

21. Noting that a RIA is included in the definition of "structured product" under the Bill, the Bills Committee has enquired about the regulatory arrangements for RIA and sought explanation on why reference has to be made to "RIA" as well as "any other structured product" in section 103(1)(a)(ii).

22. SFC has explained that there are certain similarities between the definition of RIA and that proposed for "structured product". The definition and regulation of RIAs was first provided in the Protection of Investors Ordinance in 1974, and was later transferred to SFO in 2002. Although advertisements, invitations and documents inviting the Hong Kong public to invest in RIAs require SFC's authorization, RIAs are not "securities" and are therefore not subject to the licensing, conduct and other requirements in SFO in relation to regulated activities. Accordingly, SFC is taking this opportunity to regulate the offer of RIAs by subsuming "RIA" into the definition of "structured product" so that RIAs will be regulated as structured products under the offers of investments regime of SFO. By virtue of the extended definition of “securities” contemplated in the Bill under the new limb (g), structured products offered to the public (whether or not they originally are securities) will be deemed “securities”, thus public offers of RIAs will be subject to SFC’s oversight under the various regulatory pillars. The Administration has also advised that since RIAs have existed in the market for some years, they are well understood in the market and hence by keeping "RIA" in SFO, it would help avoid misunderstanding. In terms of drafting, as structured products can either be an agreement or an instrument, for grammatical reasons it is necessary to refer separately to "RIA" and "any other structured product" in section 103(1)(a)(ii).

Excluding unlisted structured products from the exemption in the existing sections 103(2)(a), 103(5)(a) and 103(6)(a) - clauses 4(2), 4(7) and 4(8)

23. The Bills Committee notes that the amended section 103(2)(a) has the effect of narrowing down the exemption provision by excluding unlisted securities that are structured products from the exemption.

24. The Bills Committee has sought explanation on the respective purposes and scopes of the exemption provisions under existing sections 103(2)(a), 103(5)(a) and 103(6)(a), and asked the Administration to review the effect of the proposed addition of "excluding unlisted securities that are structured products" to these exemption provisions.

25. The Administration and SFC have explained that section 103(2) exempts from the prohibition in section 103(1) advertisements, invitations or documents that are, among other things, made by or on behalf of persons licensed or registered for the regulated activities of dealing in securities, advising on securities or corporate finance where the advertisement, invitation or documents is in respect of securities [i.e. section 103(2)(a)]. The general rationale for such exemption is that these persons are already regulated by SFC and accordingly, subject to conduct requirements in SFO and the Code of Conduct. It would be unnecessary to impose additional regulations on these persons. The current drafting in clause 4(2) of the Bill in effect excludes unlisted structured products from the exemption in the existing section 103(2)(a). This is to achieve the policy intent that offer documents and advertisements in respect of unlisted structured products (whether in the form of securities or otherwise) would require prior SFC's authorization, regardless of whether they are made by or on behalf of persons holding relevant licences.

26. As regards the exemptions in existing section 103(5) which closely mirror those in section 103(2)(a)–(c), the Administration and SFC have checked that pursuant to Paper No. CSA03/01 presented to the then Bills Committee on Securities and Futures Bill and Banking (Amendment) Bill 2000, section 103(5) was added by way of a CSA. It was explained in that paper that "As the conduct of an intermediary is regulated under Part VII, issue of advertisement, invitation or document by it should be exempted here to avoid double regulation, rationale similar to the exemption granted under section 102(3) [now section 103(3) of the SFO]. This also reflects the existing practice". The Administration and SFC have further advised that from SFC's experience in administering section 103, it appears that section 103(5) does not provide any protection or exemption in addition to that provided under section 103(2). Since the market is familiar with section 103(2) and (5) and these two subsections are consistent with one another, repealing section 103(5) is

considered not necessary. The amendment to section 103(5)(a) proposed in the Bill mirrors the proposed amendment to section 103(2)(a), otherwise section 103(5)(a) would provide a wider exemption than that in amended section 103(2)(a), and this would not be concordant with the policy intention.

27. As for section 103(6), the Administration and SFC have advised that the provision complements the exemption in section 103(2) in that section 103(2) provides an exemption to certain intermediaries for the issuing of certain documents to investors, and section 103(6) provides an exemption to a person (e.g. product manufacturer) for the issuing of certain documents to certain intermediaries. For example, under section 103(6)(a), where a product issuer issues documents in respect of securities to a licensed securities dealer, these documents do not require the SFC's authorization. Since the Bill proposes excluding unlisted structured products from the exemption in section 103(2)(a), the same exclusion has to be effected for section 103(6)(a).

Exemptions under section 103(2)(e) - clause 4(3)

28. The existing section 103(2)(e) provides an exemption to the issue, or the possession for the purposes of issue, of any advertisement, invitation or document made by or on behalf of a corporation in respect of securities of the corporation, or of a related corporation of the corporation, to -

(i) holders of securities of the corporation or related corporation;

(ii) creditors of the corporation or related corporation;

(iii) employees employed by the corporation or related corporation; or

(iv) agents acting in a professional capacity on behalf of the corporation or related corporation.

29. According to SFC, the proposed addition of the reference to "structured product" to section 103(2)(e) under the Bill is originally intended to facilitate employee incentive schemes in the form of "structured product". Some deputations have queried how the proposed section 103(2)(e)(iii) will operate in view of the exclusion of employee incentive schemes under the new section 1A (which defines "structured product") in Part 1 of Schedule 1 of the SFO. To address the concern, the Administration and SFC have reviewed the effect of the proposed amendment to section 103(2)(e), and concluded that since employee incentive schemes would be excluded from the definition of "structured product", it would not be necessary to again provide an exemption for employee

incentive schemes in the form of structured products in the proposed section 103(2)(e). The Administration will move CSAs accordingly.

30. The Administration and SFC have also reviewed the existing exemption in section 103(2)(e) in respect of other parties (i.e. holders of securities and creditors of a corporation, and agents acting in a professional capacity on behalf of the corporation or related corporation), and concluded that this exemption should not apply to structured products (be they in the form of securities or not). The exemption under section 103(2)(e) should also not cover offers to holders of structured products (be they in the form of securities or not) issued by the corporation. The Administration will move CSAs to reflect the policy intent.

Exemption for non-securities or non-structured product property businesses - clauses 4 (4) and 4(9))

31. Section 103(2)(i) exempts public offer documents issued by non-securities property businesses in the ordinary course of that business from SFC's authorization.

32. Clause 4(4) adds the reference of "structured products" to section 103(2)(i) to reflect the policy intention of exempting public offer documents issued by non-securities or non-structured product property businesses in the ordinary course of that business. Clause 4(9) adds a new section 103(11A) to limit the exemption in section 103(2)(i) so that these businesses are not able to make use of this exemption to issue structured products to investors outside their ordinary course of business.

33. Members have expressed concern that the scope of exemption under the existing section 103(2)(i) appears to be very wide and that the actual effect of the proposed new section 103(11A) is not clear. Upon review of section 103(2)(i) and proposed section 103(11A) in the light of members' concerns, the Administration and SFC have advised, using the case of a property developer as an example, that a property developer, who provides an arrangement possibly constituting a structured product which is part and parcel of a property transaction, would be covered by the exemption in section 103(2)(i) since the property transaction and the arrangement would be in the ordinary course of the business of selling and purchasing property other than securities or structured products. On the other hand, if the developer issues, as a standalone transaction, a structured product, e.g. equity-linked note, to investors, this would not be regarded as issuing the structured product in the ordinary course of "that business" (namely, property development) and the developer would not be covered by section 103(2)(i). As such, proposed section 103(11A) is unnecessary and the Administration will move a CSA to delete it from the Bill.

Exemption for currency-linked instruments, interest rate-linked instruments and currency and interest rate-linked instruments issued by authorized financial institutions - clauses 4(5) and 15(7)

34. Proposed section 103(3)(ea) provides that offer documents made in respect of the issue of a currency-linked instrument, interest rate-linked instrument or currency and interest rate-linked instrument ("ILCL instruments") by an authorized financial institution are exempted from the authorization requirement under section 103(1). The ILCL instruments are defined under clause 15(7) of the Bill. According to the Administration, ILCL instruments are essentially banking products that typically do not fall under the securities and futures regulatory regime, but they will be caught by the wide definition of "structured product" proposed in the Bill. In order not to affect the existing arrangement and inadvertently catch ILCL instruments issued by Authorized Institutions ("AIs"), the Bill provides that ILCL instruments issued by AIs are exempted from SFC's authorization.

35. Some members including Hon James TO, Hon CHAN Kam-lam, Hon Albert HO have raised concerns about this proposed arrangement. Hon CHAN Kam-lam has pointed out that there may be confusion in the market or allegation of favouritism to banks, if offer documents issued by AIs in respect of ILCL instruments are exempted from SFC's authorization, whilst the offer documents of similar investment instruments issued by other financial institutions or overseas banks are subject to SFC's authorization. Hon James TO has raised concern that ILCL instruments could be very complex products and could cause great losses to the investors holding the instruments. Hon Albert HO has opined that the primary objective of the present proposal was to enhance investor protection and queried the appropriateness of having two regulatory bodies, i.e. SFC and the Hong Kong Monetary Authority ("HKMA"), to regulate the public offers of different types of structured products. He also considers that HKMA's regulatory functions focus on prudential regulation of banks rather than investor protection. In view of members' concerns, the Bills Committee has requested the Administration to critically re-consider the proposed arrangement.

36. The Administration has advised that the proposed arrangement is in line with the practices in other major markets such as the UK, US and Singapore. ILCL instruments are products of the foreign exchange or treasury desks of banks and issuers of these products are typically AIs (e.g. banks and restricted licence banks). Investors of ILCL instruments are normally exposed to interest rate risk, foreign currency exchange rate risk and credit risk of the issuing AI only. In this aspect, these instruments are similar to ordinary banking deposit

products and different from other structured investment products such as equity-linked instruments.

37. According to the Administration, the key requirements for structured products set out in the SIP Code (e.g. eligibility of issuers/guarantors, criteria for reference assets, criteria for collateral) are irrelevant to ILCL instruments because: (a) the issuers are AIs (i.e. the direct counterparty to the ILCL instrument is an AI with substantive assets), (b) the "reference assets" are currencies or interest rates, which are very different from shares or bonds, and (c) as the direct counterparty to the ILCL instrument is an AI with substantive assets, there is no collateral. The SFO regulatory framework is designed primarily for regulating the securities and futures market; it is not intended for the regulation of banking activities. Besides, AIs and banking business are subject to HKMA's prudential supervision which regulates the safety, soundness and risk management systems of AIs, and through these, an AI's obligation to its customers. HKMA also exercises supervision over AIs' sale of ILCL instruments through its day-to-day supervision. The sale conduct requirements are similar to those for other investment products. In view of the above reasons and the practices in other major markets, the Administration considers that the interests of investors in ILCL instruments are safeguarded properly under HKMA's current regulatory regime.

38. As regards the concern about possible inconsistency arising from the arrangement for HKMA to supervise the sale of ILCL instruments issued by an AI in Hong Kong, and SFC to regulate any such products issued by non-AIs, SFC has advised that it has not received any applications from non-AIs to offer ILCL instruments to the Hong Kong public. In fact, in light of the nature of ILCL instruments as explained above, SFC considers it hard to foresee that any non-AI would have the basis or business case as a bank to publicly offer such instruments.

39. To enable the Bills Committee to consider the issue comprehensively, the Bills Committee has sought further information in respect of ILCL instruments as follows -

(a) the common types and quantities of ILCL instruments in the Hong Kong market, and the respective market shares of AIs incorporated in Hong Kong and those incorporated outside Hong Kong;

(b) the regulatory approach and actions taken by HKMA on the sale of ILCL instruments by AIs;

(c) the legal backing for the regulatory actions taken by HKMA on the sale of unlisted investment products by AIs; and

(d) a comparison between the protection afforded by the Banking Ordinance (Cap. 155) ("BO") for investors of unlisted investment products not regulated under SFO and the protection afforded by SFO for investors of unlisted investment products regulated under SFO.

40. The Administration, SFC and HKMA have provided relevant information in respect of the issues set out in paragraph 38(a) to (c)[4]. As regards the issue in paragraph 38(d), HKMA has responded[5] that it has noted members' views on the importance of affording the same protection to investors with regard to the sale of unlisted investment products by AIs regardless of whether the sale of such products is regulated under BO or SFO. HKMA has also assured the Bills Committee that it will review the adequacy of its regulatory actions on the sale of unlisted investment products by AIs having regard to its regulatory experience and market development, and identify any need for amending the BO to enhance investor protection. The Bills Committee considers that it would be more appropriate to pursue relevant issues outside the context of the Bill, such as at the Panel on Financial Affairs.

41. The Bills Committee notes that the Administration will move a CSA to clause 15(7) to amend the Chinese text of the definition of "currency and interest rate-linked instrument" in order to more explicitly spell out the concept of "combination".

Regulatory arrangements for the disposal of unlisted structured products to intermediaries or persons outside Hong Kong - Clause 4(6)

42. The Bills Committee notes that under the existing section 103(3)(j), the authorization requirement under section 103(1) is not applicable to invitations in respect of securities, or interests in any CIS or RIA, which are or are intended to be disposed of only to persons outside Hong Kong. The Bill amends section 103(3)(j) to include invitations in respect of structured products.

43. In light of the experience of the Lehman Brothers Minibonds Incident, Hon Albert HO and Hon Ronny TONG have expressed concern whether exemption from the authorization requirement under section 103(1) should be given to offers made only to persons outside Hong Kong, especially for high

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[4] LC Papers No. CB(1)466/10-11(01), CB(1)968/10-11(03) and CB(1)1093/10-11.
[5] LC Paper No. CB(1)1192/10-11(02).

risk structured products. Hon Albert HO has pointed out that the exemption may create a loophole whereby high risk financial products originated/packaged in Hong Kong sold to investors overseas are not subject to proper regulation, and this may potentially tarnish Hong Kong's reputation as an international financial centre. The Bills Committee has requested the Administration to explain the meaning of "persons outside Hong Kong" in section 103(3)(j), and review the regulatory arrangements for the disposal of unlisted structured products to persons outside Hong Kong, where the transaction or part of the transaction process takes place in Hong Kong.

44. The Administration and SFC have advised that the combined effect of sections 103(1) and 103(3)(j) is that if a person issues an advertisement, invitation or document containing an invitation to the public of Hong Kong, the issue of such advertisement, invitation or document would require an authorization from SFC. Whether the offer document is issued in Hong Kong or elsewhere and whether part of the transaction process takes place in Hong Kong are irrelevant. In considering whether the authorization requirements in Part IV of SFO will apply to a specific offer, the totality of all the facts of the offer needs to be considered. In general, the offers of investments regime of SFO regulates public offers targeting the public within Hong Kong. This approach is broadly similar to the regulatory approach adopted in other major markets like the UK, Australia and Singapore. These common law jurisdictions have also built in a territorial concept in their securities law regimes when regulating public offers.

45. While noting the advice of the Administration and SFC, Hon Albert HO has expressed the view that the credibility of financial products issued in Hong Kong should be protected, even though these products may be sold only to persons outside Hong Kong. Pointing out that investors located in the Mainland and Taiwan may be interested in buying investment products issued in Hong Kong based on the belief that investors' interests are protected under Hong Kong's regulatory regime, Mr HO has opined that for the long term benefit of Hong Kong's financial market, it may be desirable to extend the authorization regime to include financial products issued in Hong Kong and sold only to persons outside Hong Kong. The Administration has stressed that the existing regulatory regime targeted at financial products offered to the public in Hong Kong is in line with the practices of other major financial markets. The Administration does not consider it appropriate to extend the regulatory regime to cover financial products offered only to persons outside Hong Kong.

Regulatory arrangements for the disposal of unlisted structured products to professional investors - Clause 4(7)

46. Noting that certain legal restrictions on intermediaries including those under section 103 will not apply in respect of professional investors, the Bills Committee has sought information on the definition of "professional investor", implications of being a professional investor, and measures to safeguard investors' interests given the various exemptions from legal and regulatory requirements in respect of professional investors.

47. The Administration and SFC have provided a paper[6] to the Bills Committee to explain in detail the definition of "professional investor" as provided in SFO and prescribed under the Securities and Futures (Professional Investor) Rules (Cap. 571D) ("PI Rules"), as well as the requirements under the Code of Conduct on an intermediary in serving a professional investor as classified under the PI Rules. In gist, pursuant to section 103(3)(k), offering documents of investment products regulated under SFO which are only targeted to professional investors need not obtain SFC's authorization. However, before offering such products to individual professional investors, an intermediary will have to ascertain that the individual has a portfolio of not less than HK$8 million as prescribed under the PI Rules. For the purpose of the Code of Conduct, prior to treating a client as a professional investor, an intermediary should assess and be reasonably satisfied that the individual is knowledgeable and has sufficient expertise in the relevant products and markets and obtain a written and signed declaration from that client that the consequences of consenting to being treated as a professional investor and the right to withdraw from being treated as such have been explained to him and that he wishes to be treated as a professional investor. In addition, similar to selling any other securities to the rest of the public, intermediaries have to comply with all relevant requirements under the Code of Conduct, for example, in relation to derivative products, the intermediary should still comply with the "know your client" requirement in paragraph 5.3 of the Code of Conduct – i.e., it should assure itself that the individual understands the nature and risks of the products and has sufficient net worth to be able to assume the risks and bear the potential losses of trading in the products.

48. In relation to high net worth individuals, the Bills Committee has requested SFC to include a standard statement to explain the risks of agreeing to be treated as a "professional investor" in the relevant declaration form to be signed by investors, and consider requiring intermediaries to remind the "professional investors" at regular intervals, such as on an annual basis, of the

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[6] LC Paper No. CB(1)788/10-11(02)

protection not available to them by virtue of their being treated as a "professional investor", and the option of opting out from being treated as a "professional investor".

49. SFC has advised that the "risks and consequences" for a person being treated as a professional investor are that the intermediary serving him is not required to comply with those regulatory requirements set out in paragraph 15.5 of the Code of Conduct. In addition to the abovementioned written declaration, for the purpose of the Code of Conduct, prior to treating a client as a professional investor, intermediaries are also required to provide the client with a written explanation in relation to the risks and consequences of being treated as a professional investor[7]. Intermediaries are also required to put in place procedures to enable them to carry out a confirmation exercise annually so as to ensure that the relevant clients who have elected to be treated as "professional investors" continued to fulfil the requisite requirements under the PI Rules. In view of members' comments, SFC has undertaken to remind intermediaries that when they carry out the annual confirmation envisaged under the Code of Conduct, they have to remind the clients of the consequences of being treated as a "professional investor" and the option for them to opt out as a "professional investor".

Authorization of structured products by SFC - clause 5

50. Clause 5 adds a new section 104A to SFO. The new section empowers SFC to authorize a structured product and sets out the authorization process. The provisions of the new section are similar to the existing section 104 for authorizing CIS.

51. The Bills Committee has enquired about the policy intent of the proposed new section 104A and sought clarification on whether the proposed authorization regime is a result of a change of regulatory policy, as the "disclosure based" principle has been adopted in the past in the regulation of the public offers of structured products.

52. The Administration has advised that under the existing CO prospectus regime, the disclosure requirements regarding the prospectuses of shares and debentures focus on the financial performance and prospects of the company concerned as the offers are considered to be for the purposes of equity or debt capital-raising. For structured products, investors would also need to know the issuers' creditworthiness, the reference assets, and other relevant information including the structural features and risks of the products. The policy intent of

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[7] The items of the risks and consequences to be included in the written explanation issued by intermediaries are set out in LC Paper No. CB(1)968/10-11(02).

section 104A is that structured products offered to the public in Hong Kong would be subject to the prior authorization of SFC unless an exemption applies to their offering documents or advertisements. SFC's authorization will be based on the requirements set out in the SIP Code, including requirements on some of the features of the product, such as issuer and collateral eligibility requirements. Nonetheless, in line with the practice in other major financial centres, the regulatory regime will continue to be disclosure-based, supported by intermediary conduct regulation, to assist investors to make informed investment decisions.

Regulatory principles for authorization

53. The Bills Committee notes that in applying the authorization requirements under the offers of investments regime of SFO, SFC refers to product codes and guidelines it has issued in respect of these products. For authorization of structured products, SFC will refer to the SIP Code which sets out, amongst other things, (a) eligibility requirements for an issuer or a guarantor; (b) eligibility requirements for collateral (where applicable); (c) continuous disclosure requirements; and (d) the requirement for key fact statements.

54. Hon Albert HO has opined that SFC's exercise of powers in the authorization of structured products should be supported by clear policy objectives and principles stipulated in legislation. Hence, the principles for the regulation of public offers of structured products in the SIP Code should be separated from the technical provisions and be specified in the legislation. In this regard, he has enquired about the relevant arrangements of other major overseas markets.

55. SFC has advised that 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"), and seven overarching principles are set out in the Handbook. The Handbook is published under section 399 of SFO, which confers on SFC the power 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 SFO. It is SFC's policy and established practice that any codes and guidelines and their revisions will be made only after consultation with the public and market participants, and published in the Gazette. An appeal mechanism is in place to deal with appeals relating to the implementation of codes and guidelines.

56. The Administration and SFC have further pointed out that SFC's regulatory objectives and functions are stipulated in sections 4 and 5 of SFO respectively. The seven general principles set out in the Handbook are consistent with SFC's regulatory objectives and functions. It is unnecessary to specify these general principles again in SFO. To cater for the rapid development of the financial market, it is more appropriate for SFC to set out such principles and detailed guidelines for authorizing structured products and their offer documents by way of codes. As Hong Kong is the first major international financial market to implement a specific regulatory regime for structured products, there are no comparable arrangements in major overseas markets.

Investigatory powers of SFC in relation to structured products - clauses 7, 8 and 10

57. The Bills Committee notes that the proposed scope of the amended section 182 empowering SFC to investigate into offences relates to all structured products, including those that would not require authorization under SFO, and has sought explanation for the proposed amendments. SFC has explained that sections 107 and 108 cover offences involving fraudulent misrepresentation or reckless misrepresentation for the purpose of inducing another person to invest in a financial product regulated under SFO, and amendments are proposed under clauses 7 and 8 of the Bill to extend these provisions to cover all structured products, including those that would not require SFC's authorization. Since sections 107 and 108 have been extended to cover misrepresentations in respect of structured products that would not require SFC authorization, it follows that section 182 should be expanded as proposed under clause 10 of the Bill to cover these structured products as well, so that when there is a breach of these provisions, SFC will have investigatory powers to look into such breaches. SFC has further explained that the current scope of sections 107 and 108 already cover products which are not SFC authorized and therefore there is no change in policy with the proposed amendments to sections 107, 108 and 182. The policy intent is to provide the same protection for investors of all financial products when misrepresentations were used to induce the investments.

Carving out of non-negotiable and non-transferable debentures - clause 15(6)

58. At present, non-negotiable and non-transferable debentures are excluded from the definition of "securities" in in Part 1 of Schedule 1 to SFO. In connection with the introduction of the concept of and definition for "structured product" in SFO, SFC considers it necessary to specify that the existing carve-out from the definition of "securities" for non-negotiable and non-transferable debentures does not apply if they are structured products. In

this regard, clause 15(6) amends the existing exclusion provision for non-negotiable and non-transferable debentures under the definition of "securities" in Part 1 of Schedule 1 to SFO as underlined below:

> *"(vi) any debenture that specifically provides that it is not negotiable or transferable <u>(excluding a debenture that is a structured product)</u>;"*

59. A deputation[8] has opined that the above provision should be refined as follows-

> *"(vi) any debenture that specifically provides that it is not negotiable or transferable (excluding a debenture that is a structured product <u>in respect of which the issue of any advertisement, invitation or document that is or contains an invitation to the public to do any act referred to in section 103(1)(a) of this Ordinance is authorized, or required to be authorized, under section 105(1) of this Ordinance</u>);"*

60. The Administration has confirmed that the policy intent is to provide that non-negotiable/non-transferable debenture-type structured products only become securities, hence subject to the regulatory requirements for securities, if they are publicly offered. The Administration agrees with the deputation's proposed amendment, and proposes to move a CSA to clause 15(6) accordingly.

61. Hon James TO has expressed concern that under the proposed CSA, non-negotiable and non-transferable debentures which are structured products but are not offered to the public will be excluded from the definition of "securities" and thus will not be regulated under the SFO. He has pointed out that the arrangement may give rise to abuse when such products, which may be complicated and high-risk products, are offered to a selected group of persons who are not aware of the structural features of the products and the risks involved. Mr TO has requested the Administration and SFC to consider whether the scope of the exclusion for non-negotiable and non-transferable debentures from the definition of "securities" should be made more restrictive by specifying more clearly the actual types of debentures that are to be excluded.

62. The Administration and SFC have responded that the current exclusion of non-transferable and non-negotiable debentures from the definition of “securities” in SFO was carried down from the now repealed Securities Ordinance. The proposed amendment in the Bill together with the proposed CSA in question is to ensure that where structured products that are in the form

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[8] The Hong Kong Association of Banks

of non-transferable and non-negotiable debentures are publicly offered, they will be “securities” for the purposes of SFO and the SFO provisions relating to securities (e.g., licensing, conduct regulation and enforcement etc.) will apply to them. This approach is in line with the proposal in the Bill to expand the definition of “securities” by adding a new limb (g) which includes structured products that do not fall under limbs (a) to (f) of the existing definition of “securities” but in respect of which the issue of any advertisement, invitation or document that is or contains an invitation to the public to do any act referred to in section 103(1)(a) is authorized, or required to be authorized, under section 105(1). These amendments do not change the current approach to the regulation of offers under SFO (and CO) in that only documents containing public offers are subject to authorization requirements.

63. On Mr TO's suggestion of specifying the actual types of non-negotiable and non-transferable debentures to be excluded from the definition of “securities”, the Administration and SFC have stressed that the proposed CSA in question will already limit the scope of the exclusion so that it will not apply if the non-transferable and non-negotiable debentures are structured products and are offered to the public. To further restrict the exclusion to specific types of non-negotiable and non-transferable debentures would in effect subject all other non-negotiable and non-transferable debentures to the regulatory requirements for securities under SFO, even though they are not offered to the public. The concept of an offer to the public underpins Hong Kong’s regulatory regime for offers in both the CO prospectus regime and the offers of investments regime of SFO. These two regulatory regimes cover offers of shares, debentures, other securities and other investment products.

64. The Administration and SFC have further advised that the issue of whether certain private offers of non-transferable and non-negotiable debentures should be regulated cannot be decided in isolation of the regulation of offers of other investment products under CO and SFO, as it requires a detailed and holistic review of the implications and a wide market consultation. SFC will bear in mind members’ comments as and when a wholesale review of the offer regimes under CO and SFO is undertaken.

65. The Bills Committee notes that the Administration will move a CSA to amend the Chinese text of new paragraph (g) of the definition of "securities" (i.e. clause 15(5)) so as to align the Chinese wording used in paragraphs (vi) and (g) of the definition.

Definition of "structured product" - clause 15(8)

66. Clause 15(8) of the Bill proposes adding a new section 1A to Part 1 of Schedule 1 to SFO to provide for the definition of structured products. According to SFC, Hong Kong is the first place to lay down a statutory definition of "structured product".

Carving out of convertible bonds

67. The Bills Committee notes that under the Bill, convertible bonds are defined as "a debenture issued for capital fund raising purposes that is convertible into or exchangeable for shares of the issuer of the debenture or of a related corporation of the issuer", and is carved out from the definition of "structured product". The regulation of public offers of convertible bonds, being a type of debenture, will be preserved under the CO prospectus regime.

68. Hon James TO has expressed concern whether there is a clear distinction between convertible bonds and equity-linked notes, the latter of which will be regulated under SFO offers of investment regime as proposed in the Bill. SFC has advised that the carve-out in the definition of “structured product” applies only to convertible bonds that are issued for capital fund raising purposes and that are convertible or exchangeable into shares of the issuer of the convertible bond or its related corporation. The main distinction between "convertible bonds" and "equity-linked notes" is that the reference assets of "convertible bonds" must be the shares of the issuer of the convertible bond or a related corporation of the issuer. The two types of products are distinguishable. In practice, issuers of convertible bonds are invariably listed companies which are subject to regulation of SFO.

Carving out of employees incentive schemes

69. Paragraph (2)(f) of the proposed definition of "structured product" specifies that a structured product does not include a product that is offered by a corporation only to a person who is –

(i) a bona fide employee or former employee of the corporation or of another corporation in the same group of companies; or

(ii) a spouse, widow, widower, minor child (natural or adopted) or minor step-child of a person referred to in subparagraph (i).

70. A deputation[9] has expressed concern that the above exclusion is potentially too wide as it could include any structured product offered by a corporation to its employees regardless of whether it is referenced to the securities of the corporation itself or a related corporation. In the light of the deputation's concern, the Administration has reviewed the above exclusion and will move a CSA to amend it to the effect that the exclusion will only apply to employee incentive schemes issued by the corporation and referenced to securities of the corporation itself or a related corporation.

Safe harbours in CO - clause 22

71. The Bills Committee notes that after the transfer of the regulation of public offers of structured products in the form of shares or debentures from CO to SFO, the safe harbours in CO would not be applicable to structured products. SFO offers of investments regime has its own safe harbours and once the transfer is effective, structured products in the form of shares and debentures would follow SFO safe harbours instead. Some deputations have expressed concerns about this proposed arrangement and request in particular that the "no more than 50 persons" safe harbour be preserved. The deputations submitted that the safe harbour was introduced into CO in 2004 on the basis that, in practice, offers to less than 50 persons had been considered as an appropriate benchmark for private placements that did not constitute an offer to "the public". Besides, SFC had acknowledged, in its relevant consultation paper, that the private placement exemption is retained in concept in SFO. Since the concept of "the public" has not been authoritatively defined by the courts, nor the Bill or any relevant statutes, the removal of the safe harbour would continue to lead to considerable uncertainty as to whether any given offer would be prohibited under SFO.

72. In response to the deputations' views, that Administration and SFC have advised that the safe harbours were introduced into CO in 2004 as part of the measures to facilitate the development of retail bonds and other financial products. At that time, those safe harbours were not envisaged for use by complicated products like structured products. With the significant development of the structured products market in recent years and from the investor protection perspective, it is not considered appropriate to replicate the CO safe harbours in SFO. In addition, it has always been clear that SFO only regulate offers to the public. SFC does not believe that it will create problem for the structured product business when other market participants have not encountered real difficulties. An introduction of CO safe harbours into SFO

9 Baker & McKenzie

could lead to abuse and also affect products such as CIS currently regulated under Part IV of SFO.

Conflict of interests

73. Some members including Hon Albert HO, Hon James TO and Hon Ronny TONG have expressed concern whether the existing regulatory arrangements are adequate to deal with situations where intermediaries have a potential or actual conflict of interests in providing services to investors, e.g. when an intermediary is selling an investment product issued as principal or under a back-to-back trading situation.

74. Regarding the intermediaries licensed by SFC, SFC has advised that the "conflict of interests" issue is generally addressed by existing requirements in the Code of Conduct which provides that -

(a) an intermediary should try to avoid conflicts of interest, and when they cannot be avoided, should ensure that its clients are fairly treated; and

(b) where an intermediary has a material interest in a transaction with or for a client or a relationship which gives rise to an actual or potential conflict of interest in relation to the transaction, it should neither advise, nor deal in relation to the transaction unless it has disclosed that material interest or conflict to the client and has taken all reasonable steps to ensure fair treatment of the client.

75. The Code of Conduct also provides that an intermediary should act in the best interests of its clients in providing services or recommending the services of an affiliated person to its clients. Further, under the Securities and Futures (Contract Notes, Statements of Accounts and Receipts) Rules (Cap. 571Q), where an intermediary enters into a relevant contract with or on behalf of a client, it shall indicate in the contract note when it acts as principal. Following a review of the regulations governing sale of investment products to enhance investor protection, SFC has issued a revised Code of Conduct which will be implemented in June 2011. Distributors will be required to disclose sales related information to investors prior to or at the point of sale which includes whether the distributor is acting as principal or agent, whether it is affiliated with the product issuer, and the benefits it receives from a product issuer for distributing investment products.

76. As regards AIs, HKMA has advised that they are required to follow the SFC's regulatory standards in their sale of securities or futures products. The

banking industry has adopted the following measures to address potential or actual conflict of interests in the sale of investment products to customers -

(a) It is a usual practice among many AIs to act as principal in transactions with customers on a back-to-back basis. For back-to-back transactions, the AI's open positions arising from investment products sold to customers are fully covered through purchasing the same products from other counterparties which are usually financial institutions.

(b) One of AIs' common measures to safeguard customers' interests for transactions in investment products is to seek quotations from several counterparties in addition to the AI's own dealing desk, and to select the offer (which may be from an external counterparty or the AI itself) with the best terms for customers.

As part of its day-to-day regulation, HKMA reviews AIs' compliance with regulatory standards, including those on conflict of interests, during on-site examinations.

77. On Hon Albert HO's further view that the disclosure requirement alone is inadequate for protecting investors' interests, SFC has responded that the regulatory arrangements regarding avoidance and declaration of conflict of interests are based on guidelines issued by the International Organization of Securities Commissions.

78. Some other members consider that Hong Kong should keep pace with the international developments on the regulation of intermediaries regarding avoidance and declaration of conflict of interests. At this stage, it may not be appropriate to take too big a stride in tightening the regulatory requirements with regard to situations involving actual or potential conflict of interests.

<u>Regulation of sale of investment products</u>

79. The Bills Committee notes that since March 2009, AIs in their sale of investment products are required to adopt a series of new measures arisen from the recommendations in the Report of the HKMA on Issues Concerning the Distribution of Structured Products Connected to Lehman Group Companies. One of these measures is that AIs are required to make audio recording of the assessment of a customer's risk profile, the sales process and ancillary arrangements. On the other hand, SFC has not imposed the audio-recording requirement on its licensees. Some members including Hon Albert HO and Hon James TO are of the view that the requirement for audio-recording of the

sales process is important for preventing and/or resolving disputes regarding mis-selling of financial products.

80. SFC has advised that during the consultation exercise on proposals to enhance the protection for the investing public conducted in September 2009, the majority of the respondents did not consider that audio recording should be made a mandatory requirement on intermediaries for the sale of investment products, as the existing record keeping requirements of SFC were considered adequate for regulatory purposes. SFC has since further looked into the issue and considers that audio recording of the sales process would provide more protection for intermediaries than investors, and the regulatory arrangements taken as a whole provides adequate protection for investors.

81. At the Bills Committee's request, SFC has researched into the audio recording requirements of some major overseas jurisdictions, namely the US, UK and Australia, and noted that audio recording of the sales process is generally not mandatory in these jurisdictions although such may be required under specific circumstances such as order placement.

82. Having regard to SFC's explanation, Hon James TO and Hon Albert HO remain concerned that there are different regulatory requirements on AIs and other financial institutions for the sale of investment products. They consider that the experience of the Lehman Brothers Minibonds Incident shows that audio records of the sales process are useful for investors to seek redress for mis-selling of investment products by banks. In light of members' views, the Bills Committee has requested the Administration and SFC to consider requiring intermediaries to make audio recording of the sales process for certain types of investment products/investors and/or under specific circumstances, as well as the alternative arrangement that intermediaries be required to advise the investors that they may audio-record the sales process themselves.

83. SFC has responded that it has carefully considered members' suggestion and concluded that the existing record-keeping requirements are appropriate and in line with international practice.

84. The Administration has been requested to advise the Bills Committee of its stance on the suggestion of making it a mandatory requirement for all intermediaries to make audio recording of the sales process for certain types of investment products/investors or under certain circumstances; and/or a requirement for intermediaries to advise investors that they might make audio recording of the sales process themselves. The Administration and the SFC have responded that audio recording is only one of the means to maintain records for the sales process and should not be made mandatory. SFC currently already

requires intermediaries to document and record contemporaneously the information given to each client and the rationale for recommendations given to the client, including any material queries raised by the client and the responses given by the intermediary. SFC will further look into the suggestion of requiring intermediaries to advise investors that they might make audio recording of the sales process themselves.

Committee Stage amendments

85. The Bills Committee agrees to the Administration's proposed CSAs, which are set out in **Appendix III**. The Bills Committee has not proposed any CSA to the Bill.

Recommendation

86. The Bills Committee supports the resumption of the Second Reading debate on the Bill on 4 May 2011.

Advice sought

87. Members are invited to note the Bills Committee's deliberations and recommendation in paragraph 86.

Council Business Division 1
Legislative Council Secretariat
6 April 2011

Appendix I

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

Membership list

Chairman	Hon Starry LEE Wai-king, JP
Members	Hon Albert HO Chun-yan Hon James TO Kun-sun Hon CHAN Kam-lam, SBS, JP Hon Miriam LAU Kin-yee, GBS, JP Hon Audrey EU Yuet-mee, SC, JP Hon WONG Ting-kwong, BBS, JP Hon Ronny TONG Ka-wah, SC Hon CHIM Pui-chung Hon Mrs Regina IP LAU Suk-yee, GBS, JP
	(Total: 10 Members)
Clerk	Ms Anita SIT
Legal Adviser	Mr KAU Kin-wah
Date	26 October 2010

Appendix II

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

List of organizations/individuals which/who have submitted views to the Bills Committee

1. Civic Party

2. The Hong Kong Society of Financial Analysts

3. Clifford Chance

4. Hong Kong Securities Professionals Association

5. Hong Kong Financial Planners General Union

6. Hong Kong Bar Association

*7. Baker & McKenzie

*8. The Law Society of Hong Kong

*9. Mr YEUNG Wai-sing, MH, member of the Eastern District Council

*10. Allen & Overy

*11. Chinese Securities Association of Hong Kong

*12. The Hong Kong Association of Banks

*13. International Swaps and Derivatives Association, Inc. / Asia Securities Industry and Financial Markets Association

* *submitted written views only*

SECURITIES AND FUTURES AND COMPANIES LEGISLATION (STRUCTURED PRODUCTS AMENDMENT) BILL 2010

COMMITTEE STAGE

Amendments to be moved by the Secretary for Financial Services and the Treasury

Clause	Amendment Proposed
2	By deleting the clause.
4(3)	In the proposed section 103(2)(e), by deleting “or structured products” and substituting “(excluding securities that are structured products)”.
4(3)	In the proposed section 103(2)(e)(i), by adding “(excluding securities that are structured products)” after “securities”.
4	By deleting subclause (9).
15(5)	In the proposed paragraph (g), in the Chinese text, by deleting “屬或載有邀請公眾作出本條例第103(1)(a)條提述的作為的任何廣告、邀請或文件，已根據本條例第105(1)條獲認可” and substituting “載有請公眾作出本條例第103(1)(a)條提述的作為的邀請(或屬該等邀請)的廣告、邀請或文件，已根據本條例第105(1)條獲認可，”.

15(6) By adding “in respect of which the issue of any advertisement, invitation or document that is or contains an invitation to the public to do any act referred to in section 103(1)(a) of this Ordinance is authorized, or required to be authorized, under section 105(1) of this Ordinance” after “structured product”.

15(7) In the Chinese text, in the proposed definition of “貨幣及利率掛鈎票據”, in paragraph (a), by deleting “結合參照以下因素” and substituting “參照以下因素的組合”.

15(8) By deleting the proposed section 1A(2)(f) and substituting –

“(f) a product under which some or all of the return or amount due (or both the return and the amount due) or the method of settlement is determined by reference to securities of a corporation, or of a related corporation of the corporation, and that is issued by the corporation only to a person who is –

(i) a bona fide employee or former employee of the corporation or of a related corporation of the corporation; or

(ii) a spouse, widow, widower, minor child (natural or adopted) or minor step-child of a person referred to in subparagraph (i);".

New By adding –

"Securities and Futures (Fees) Rules

30. Schedule 1 amended (Fees)

(1) Schedule 1 to the Securities and Futures (Fees) Rules (Cap. 571 sub. leg. AF) is amended, after item 5, by adding –

"5A.	Fee payable on an application under section 104A(1) of the Ordinance for authorization of a structured product	$2,000
5B.	Fee payable in respect of authorization of a structured product under section 104A of the Ordinance	$1,000".

(2) Schedule 1 is amended, in item 8, by adding –

“(d)	any structured product	$3,000”.”.