

Guide to

Legislative Proposals on

Offers of Investments

(to be included in the Securities and Futures Bill)

5th July 1999

Introduction

1. The Securities and Futures Commission (the “Commission”) is responsible for regulating offers of investments in Hong Kong. Investment products such as unit trusts, mutual funds, investment-linked assurance schemes, pooled retirement funds, immigration-linked investment schemes and other forms of investment arrangements require authorization by the Commission before they may be offered to the public in Hong Kong.
2. At present, the offering of investments in Hong Kong is mainly governed by the Protection of Investors Ordinance (the “PIO”). Broadly speaking, the Commission is empowered, under section 4(2)(g) of the PIO, to authorize advertisements, invitations and documents relating to securities or investment arrangements. The definition of investment arrangements in the PIO has a potentially very wide coverage and can capture a variety of investment products and arrangements, including all of the products mentioned above. The Commission is also empowered, under section 15 of the Securities Ordinance (the “SO”), to authorize the offering to the public of unit trusts and mutual funds.
3. Under section 2A of the PIO, the Financial Secretary has a certain degree of power to specify, by notice in the Gazette, what are and are not within the definition of “Investment Arrangements”.

Present Problems

4. The Commission has encountered some practical difficulties when exercising its existing powers under the current legislation to regulate investment products that are offered to the public.

Power of Financial Secretary Limited

5. The power currently exercisable by the Financial Secretary under section 2A of the PIO is rather limited. It only covers investment arrangements relating to real property and does not apply to a wide range of products that involve obtaining an interest in the profits or income derived from investments of other kinds. This is out of step with developments in the market, and the power needs to be expanded. A wide variety of products are now being packaged for offering to the public. Investors in Hong Kong should have available to them as wide a range of investment options as markets can offer, and the regulatory framework should be such that the Commission is properly able to protect the interests of those investors.

Power under PIO Implicit rather than Explicit

6. It has been argued that the PIO empowers the Commission to authorize the “advertisement, invitation and document” relating to a product rather than the product itself. This argument casts doubts on whether the Commission can impose structural and operational requirements on the product when granting authorization to issue an advertisement relating to it, pursuant to the PIO. Furthermore, the power of the Commission to authorize advertisements under the PIO is by “implication” only since this section refers to exemptions rather than the actual power of authorization. The absence of an explicit power for the Commission to authorize the issue of advertisements is anomalous and lacking in transparency. The Commission’s power to perform the investor protection work already undertaken in this regard should be expressly clarified.

Power under SO does not Cover New Products

7. Under section 15 of the SO, the Commission is empowered to authorize only unit trusts and mutual funds but not other investment products that fall outside those two types. Increasingly, products emanating from Europe involve the offer of an interest in securities or other property rights through a structure that is neither a unit trust nor a mutual fund corporation (e.g. certain Luxembourg investment funds such as Société d'Investissement à Capital Variable and Fonds Commun de Placement). There is no jurisdiction for the Commission to authorize such products for public offering and no power to protect investors in such products. This gap in the law should be filled.

Lack of Power to Withdraw Authorization

8. Neither the SO nor the PIO explicitly empower the SFC to withdraw authorization once granted. This sometimes poses problems for the Commission when the product, or its operators, breach the conditions for authorization. The Commission is left with no express power to withdraw authorization in order to protect investors. This deficiency should be rectified. The present state of affairs is detrimental to the interests of the investing public.

Major Proposed Amendments under the Composite Bill

9. The proposed Securities and Futures Bill (the “Composite Bill”) will include new provisions and amendments to existing provisions to rectify the deficiencies described above.

Power of Financial Secretary Expanded

10. The Composite Bill will provide the Financial Secretary with wider powers to specify products which do or do not fall within the enlarged definition of “investment arrangements”. The term “investment arrangements” will be expanded to cover arrangements in relation to any property, including money and securities. This revised definition is similar to that provided in section 226 of the Financial Services and Markets Bill in the U.K.

Power under SO and PIO Expanded and Clarified

11. The Composite Bill will empower the Commission to authorize a wider variety of investment products. A new defined term, “collective investment scheme”, will be created to include mutual funds, unit trusts and any other investment arrangements. This will ensure the Commission’s jurisdiction to authorize products keeps pace with developments in the market, and will serve to facilitate business and provide greater protection to the investing public. The Composite Bill will also explicitly empower the Commission to authorize any collective investment scheme, i.e. the product itself, and removes the previous ambiguity in the PIO.

Power to Authorize Advertisements

12. The Composite Bill will continue the Commission’s power to authorize advertisements, currently under section 4(2)(g) and (7) of the PIO.

Power to Withdraw Authorization

13. The Composite Bill will provide the Commission with the power to withdraw authorizations. This will ensure that operators of collective investment schemes abide by the codes and the conditions of authorization, thus enhancing protection of the interests of investors. As a matter of procedural fairness, the Commission will be required to notify a scheme operator (or the operator's delegate in Hong Kong) of its intention to withdraw authorization, and to afford the operator an opportunity to be heard. The Commission may satisfy this notification obligation by proof that notification has been delivered to the last known address. This will ensure that scheme operators do not simply avoid communication with the Commission by not supplying current contact information.

Enhanced Transparency of the Commission's Processes

14. Decisions with respect to authorization or withdrawal of authorization of a product to be offered to the public and the approval of advertisements will be appealable to the proposed Securities and Futures Appeals Tribunal. This constitutes a change from the current situation with respect to the Securities and Futures Appeals Panel, and is designed to add to the transparency of the Commission's processes. For more details, see the *Guide to Legislative Proposals on Establishing a Securities and Futures Appeals Tribunal*.
15. Aspects of the Commission's functions to authorize investment products and advertisements, like other areas of its work, are necessarily subject to privacy and confidentiality requirements of law. Specific information cannot always be publicly disclosed. To bridge this gap, an independent panel to review the

Commission's internal processes will be established. As currently envisaged, the panel will comprise a majority of independent, prominent public persons, to be appointed by the Chief Executive, as well as some non-executive directors of the Commission. The panel will make its report to the Financial Secretary.

Public Consultation

16. The above proposals are necessary in order for the Commission to perform its investor protection function properly. The Government and the Commission recognise that administrative authority must be placed within a system of checks and balances. As discussed above, the Composite Bill will establish a Securities and Futures Appeals Tribunal with jurisdiction to review many important decisions of the Commission, including decisions with respect to authorization of products to be offered to the public and approval of advertisements. In addition, as mentioned above, we are presently undertaking a major initiative to subject the Commission to external review of its internal processes by an independent panel.
17. The Government and the Commission believe the proposals detailed in this Guide will improve the regulatory framework and put it on a par with the best of international standards, thereby enhancing Hong Kong's competitiveness as an international financial centre. Comments and views are sought from the financial community and general public. Please write to the Securities and Futures Commission, 12th Floor, Edinburgh Tower, The Landmark, 15 Queen's Road Central, Hong Kong, or email to newbill@hksfc.org.hk. In

view of the tight legislative timetable, we would be grateful if your comments and suggestions could reach the Commission before 6 August 1999.