



SECURITIES AND
FUTURES COMMISSION
證券及期貨事務監察委員會

Consultation Conclusions on proposed amendments to Schedule 5 to the Securities and Futures Ordinance

Hong Kong
September 2005

INTRODUCTION

1. On 23 February 2005, the Securities and Futures Commission (the “Commission”) issued a consultation paper (the “Consultation Paper”) inviting the public to comment on proposed amendments to Part 2 of Schedule 5 to the Securities and Futures Ordinance (Cap. 571) (the “SFO”) (the “Proposed Amendments”).
2. The Proposed Amendments were made in light of the development of the industry and comments received from market participants and industry associations on the new licensing regime under the SFO.
3. Part 2 of Schedule 5 to the SFO contains definitions of the different types of regulated activities that are available under the new licensing regime and principally impacts licensing and registration matters under Part V of the SFO.
4. The Proposed Amendments are summarised as follows: -
 - (a) Amend the definition of “asset management” (i.e. Type 9 regulated activity) to additionally include real estate investment scheme management¹;
 - (b) Amend the definition of “dealing in securities” (i.e. Type 1 regulated activity) to carve out the related dealing activities carried on by an approved money broker within the meaning of section 2(1) of the Banking Ordinance (Cap. 155) where the transaction concerned is conducted on behalf of authorized financial institutions;
 - (c) Amend the definitions of “advising on securities” (i.e. Type 4 regulated activity) and “advising on futures contracts” (i.e. Type 5 regulated activity) to carve out related advisory activities conducted by a person who manages a portfolio of securities and futures contracts under a collective investment scheme² where such advisory activities are conducted solely for the purposes of carrying on Type 9 regulated activity which he is already licensed or registered for; and
 - (d) Amend the definition of “dealing in securities” so that the exclusion in paragraph (v)(B) for dealings by a person as principal only applies when a person as principal acquires, subscribes for or underwrites securities but not when such a person disposes of securities.
5. The consultation period ended on 15 March 2005. A total of 13 written submissions were received. Two respondents confirmed that they had no comments on the Proposed Amendments. The remaining 11 respondents

¹ “Real estate investment scheme management” in relation to a person, means providing a service of operating a collective investment scheme for another person by the person, where the property that is being managed under the scheme consists primarily of immovable property; and the scheme is authorised under section 104 of the SFO.

² The term “collective investment scheme” is defined under Part 1 of Schedule 1 to the SFO.

submitted comments on various sections of the Proposed Amendments and/or raised further suggestions.

6. This document analyses the comments received in relation to the Proposed Amendments and explains the conclusions drawn by the Commission. This paper should be read in conjunction with the Consultation Paper.
7. All the submissions, save those where consent for publication had been withheld, and the Consultation Paper are published on the Commission's website at <http://www.sfc.hk>.

SUMMARY OF COMMENTS AND COMMISSION'S RESPONSES

8. The respondents were in general receptive to the majority of the Proposed Amendments. The comments were mostly in relation to the amendments to the provision of incidental advice by fund managers and to the proposed redressing of disposal of securities to non-professional investors.
9. The comments received and the Commission's respective responses are summarised below.

Amendment (a) – Licensing of managers of Real Estate Investment Trust (“REIT”)

Comments

10. Three respondents commented on this proposed amendment. Two supported the proposal whilst the third requested the proposed definition of “real estate investment scheme management” under the SFO be aligned with the definition in the Code on REITs. The third respondent also sought clarification that the management of an unauthorised REIT would not need to be licensed and further asked whether the present Type 9 licences would need to be reissued if the proposed amendment was brought in. It also suggested a minor amendment of “and/or” to the legal wording “securities or futures” to cater for portfolios that can consist of either or both securities and futures.

Commission's Responses

11. The proposed definition of “real estate investment scheme management” under the SFO is consistent with the definition in the Code on REITs (the “Code”) which states that “a REIT is a collective investment scheme constituted as a trust that invests primarily in real estate with the aim to provide returns to holders derived from the rental income of the real estate”. In addition, the definition of “real estate” in the Code is covered by “immovable property” as defined in the Interpretation and General Clauses Ordinance (Cap. 1). It is important that the definition be aligned with the statutory terminology, including the definition of “collective investment scheme” in the SFO. No further amendments are considered necessary in this regard.
12. In so far as managers of unauthorised REITs are concerned, they will not need to be licensed under the proposed amendment. In addition, under the

proposed amendment, current Type 9 licences will not need to be reissued, as the law will be applied prospectively. The Commission considers that the wording “portfolio of securities or futures contracts” will not exclude a portfolio which includes securities and futures contracts.

Amendment (b) – Money brokers exemption

Comments

13. Four submissions were received on this issue. One respondent suggested the exemption be extended to other persons who deal solely with or for professional investors, whilst another respondent suggested extending the exemption to those money brokers who facilitate transactions between authorised institutions and professional investors under Schedule 1 to the SFO.
14. On the other hand, two respondents queried whether this exemption should be allowed if traditional brokers acting as introducing agents were required to be licensed, unless the Commission was satisfied that the Hong Kong Monetary Authority’s (“HKMA”) rules and regulations were on par with the Commission’s. In addition, an exemption for approved money brokers dealing with professional investors already existed in the SFO and as such further exemptions were not required. In fact, further exemptions would create an uneven playing field and may also create a regulatory vacuum in which dealing practices and securities activities fall short of the standards in the SFO.

Commission’s Responses

15. It is not the Commission’s intention that the exemption be further extended, as the amendment is meant to enable approved money brokers to carry on the existing dealing activities between authorised institutions which were not precluded under the former regime. The Commission considers the exemption appropriate from the perspective of investor protection, as the parties to the transactions concerned are authorised institutions. The Commission had already examined the adequacy of the regulation of money brokers with the HKMA prior to the issuance of the Consultation Paper.
16. It should be noted that the present professional investor exemption available in Part 2 of Schedule 5 to the SFO is structured specifically for persons acting as principal and not those dealing as agent. Further exemption in this respect would require more in-depth examination of the regulatory regime, including the threshold as professional investors for the purposes of investor protection.

Amendment (c) – Incidental advice of fund managers

Comments

17. Five respondents submitted similar comments on this issue. They welcomed the proposal but also suggested that the carve out should be broadened to include asset management services relating to portfolios of securities and futures contracts (i.e. managed accounts) in general, which command similar competence to managing collective investment schemes. One respondent

further submitted that the exemption be “incidental” rather than “solely for the purpose of providing” the Type 9 services, as the latter is too narrow.

Commission’s Responses

18. The Commission notes that the market welcomes this proposal. The carve-out is extended to those fund managers that operate collective investment schemes and give advice or issue analyses/reports solely for the purposes of providing the collective investment schemes that they manage. Other than the Code of Conduct for Persons Licensed by or Registered with the Commission, they are also subject to the Fund Manager Code of Conduct. These fund managers are already well versed in the characteristics and risk aspects of the collective investment schemes under their management. Accordingly, to give advice on such products, they are well equipped to understand them vis-à-vis the suitability of the products for their clients. On the contrary, if they give advice on other products that they do not manage, considerable due diligence is expected on their part before they can advise on the products to the clients.
19. The carve-out would thus serve in a practical manner for which the fund managers could introduce their products to the market without having to obtain a separate licence for advising on their products. The expression “incidental” seems inappropriate as the Commission intends to allow a fund manager to give investment advice for the purpose of introducing its collective investment scheme(s) to a client, prior to the actual carrying on of such asset management services. Furthermore, it is noted that there is a similar proviso in paragraph (xiv) of the definition of “dealing in securities” which reads “... *except where the person is licensed or registered for Type 9 regulated activity and performs the act solely for the purposes of carrying on that regulated activity*”.

Amendment (d) – Redress disposal of securities to non-professional investors

Comments

20. The majority of the comments were in relation to the proposed deletion of “disposes of” from the definition of “dealing in securities” in Part 2 of Schedule 5 to the SFO. Eight respondents commented on this deletion in various respects including:
 - (a) the regulation of public offer documents under Part IV of the SFO, in particular, section 103;
 - (b) that the exemption under sub-paragraph (v)(B) does not render the exemption under sub-paragraph (v)(A) redundant as sub-paragraph (v)(A) is wider, covering activity constituting “dealing in securities” rather than simply ‘acquiring, disposing of, subscribing for or underwriting securities’ which sub-paragraph (v)(B) covers;
 - (c) if this amendment was brought in, persons disposing of securities in off-market transactions to investors other than professional investors (e.g. by settlements, estate or trust arrangements) would need a licence and other persons would unnecessarily be affected by this amendment (e.g. trustees,

company secretarial firms selling offshelf shell companies, associated entities holding client securities, etc.); and

- (d) private share issues by companies, where their Articles do not limit the number of members to 50, could then fall under Part V of the SFO.

Commission's Response

- 21. The Commission notes that while two of the respondents noted that the current exemption for disposal of securities as principal is too broad, all the respondents expressed reservation about the proposed amendment. Although, by and large, the amendment would not have any impact if the persons concerned are not carrying on dealing as a business, or the offer documents are authorised under section 105 of the SFO, there are, however, other related issues raised by the market that warrant consideration. In light of these issues and their impact to the market, the Commission is of the view that further examination and consultation on the intricacy of the related matters, would be necessary as a separate exercise before implementing any amendment in this respect. While seeking to enhance investor protection, the Commission is mindful to avoid any unintentional effect that the proposed amendment may bring.

Other suggestions

- 22. Many respondents also took the opportunity to seek clarification of certain applications of and/or suggest other amendments to Part 2 of Schedule 5 to the SFO. The Commission is continuing its review of these additional items. Where appropriate, they will be considered for future consultations or clarified by way of Questions and Answers on the Commission's website.

CONSULTATION CONCLUSIONS

- 23. Consequently, the Commission will proceed with Amendments (a), (b) and (c) as proposed and will defer Amendment (d) accordingly.
- 24. The revised draft notice is at **Appendix 1**.

IMPLEMENTATION

- 25. The amendments will be effected pursuant to section 142 of the SFO by way of notice published in the Gazette. Subject to the legislative process, the commencement date will be 9 December 2005.
- 26. A list of respondents is attached at **Appendix 2**. The Commission would like to thank all the respondents who have provided submissions to the Proposed Amendments for their valuable comments and suggestions.

**SECURITIES AND FUTURES ORDINANCE (AMENDMENT OF
SCHEDULE 5) NOTICE 2005**

(Made by the Financial Secretary under section 142 of the
Securities and Futures Ordinance (Cap. 571))

1. Regulated activities

Part 2 of Schedule 5 to the Securities and Futures Ordinance
(Cap. 571) is amended -

(a) in the definition of "advising on futures
contracts", by adding -

"(iva) a person -

(A) who is licensed or registered for
Type 9 regulated activity;

(B) who provides a service of managing
a portfolio of futures contracts
under a collective investment
scheme for another person; and

(C) who gives such advice or issues
such analyses or reports solely
for the purposes of providing the
service described in subparagraph
(B);";

(b) in the definition of "advising on securities", by
adding -

"(iva) a person -

- (A) who is licensed or registered for Type 9 regulated activity;
- (B) who provides a service of managing a portfolio of securities under a collective investment scheme for another person; and
- (C) who gives such advice or issues such analyses or reports solely for the purposes of providing the service described in subparagraph (B);”;

(c) in the definition of “asset management” -

(i) by repealing ““asset management” (資產管理)” and substituting ““securities or futures contracts management” (證券或期貨合約管理)”;

(ii) in paragraph (h), by repealing the semicolon and substituting a full stop;

(d) in the definition of “dealing in securities” -

(i) in paragraph (xiii), by repealing “or” at the end;

(ii) in paragraph (xiv), by adding “or” at the end;

(iii) by adding -

“(xv) in any case where each of the parties to the transaction or

proposed transaction under which securities are or will be acquired, disposed of, subscribed for or underwritten as described in paragraph (a) is an authorized financial institution, is an approved money broker within the meaning of section 2(1) of the Banking Ordinance (Cap. 155) and performs the act for each of the parties to the transaction or proposed transaction;”;

- (e) in the definition of “securities margin financing”, in paragraph (vii), by repealing the full stop and substituting a semicolon;
- (f) by adding -

““asset management” (資產管理) means -

- (a) real estate investment scheme management; or
- (b) securities or futures contracts management;

“real estate investment scheme management” (房地產投資計劃管理), in relation to a person, means providing a service of operating a

collective investment scheme for another person by the person, where -

- (a) the property that is being managed under the scheme consists primarily of immovable property; and
- (b) the scheme is authorized under section 104 of this Ordinance;".

Financial Secretary

2005

Explanatory Note

This Notice amends Part 2 of Schedule 5 to the Securities and Futures Ordinance (Cap. 571) as follows -

- (a) the definitions of "advising on futures contracts" and "advising on securities" are amended so that the giving of advice by a person, who is licensed or registered for Type 9 regulated activity, solely for the purposes of carrying on securities or futures contracts management, as the case may be,

under a collective investment scheme is to be excluded from the definitions;

- (b) the definition of "asset management" is amended to become "securities or futures contracts management" and a new definition of "real estate investment scheme management" is introduced. These 2 kinds of investment management then constitute the newly defined "asset management"; and
- (c) the definition of "dealing in securities" is amended so that in a case where all parties to the dealing concerned are authorized financial institutions and the dealing is by an approved money broker who represents each of the parties concerned, the dealing is to be excluded from the definition.

List of Respondents (In alphabetical order)

Category A – Respondents with no objection to publication of name

Clifford Chance

Deacons

Freshfields Bruckhaus Deringer

Hong Kong Bar Association

Hong Kong Investment Funds Association

Hong Kong Stockbrokers Association

The Institute of Securities Dealers Ltd

The Law Society of Hong Kong

Linklaters on behalf of:

- Citigroup Global Markets Asia Limited
- Credit Suisse First Boston (Hong Kong) Limited
- Deutsche Bank AG, Hong Kong Branch
- Goldman Sachs (Asia) LLC
- JP Morgan Securities (Asia Pacific) Limited
- Lehman Brothers Asia Limited
- Merrill Lynch (Asia Pacific) Limited
- Morgan Stanley Dean Witter Asia Limited
- Nomura International (Hong Kong) Limited
- UBS AG.

Timothy Loh, Solicitors

Category B – Respondents that requested their submissions be published on a “no-name” basis

Three respondents