

Highlights

- Reminder on prudent risk management
- Guidance to REIT managers
- Initiatives to streamline vetting of notices and advertisements
- SFC's review of the Exchange's listing functions
- Third Quarterly Report for the financial year 2007-08

Introduction

The SFC has continued its efforts to provide practical guidance to market practitioners, which will assist them in closely observing relevant codes and guidelines.

In January, we issued a circular to the management companies of SFC-authorized real estate investment trusts (REITs) to clarify the requirements for market unit repurchases by REITs, and issued a new set of Frequently Asked Questions on a number of REITs-related matters. More recently, we issued a circular to licensed corporations on the importance of prudent risk management and highlighted some of the deficiencies that firms may have in this area.

As part of the initiative to improve time and cost efficiency of the market, we consulted the public on our proposal to streamline the vetting of notices and advertisements of collective investment schemes authorized by the SFC. We will issue a conclusion paper on the comments received in due course.

In February, we published our third report on the review of the Exchange's performance in its listing functions and concluded that the operational procedures and decision-making processes reviewed were appropriate in maintaining an orderly, informed and fair market in 2006. The report also identifies certain areas where we recommend that the Exchange continue efforts to enhance its performance.

Licensed Corporations Reminded to Exercise Prudent Risk Management

The SFC has recently issued a circular to all licensed corporations highlighting possible deficiencies in risk management practices as observed in recent inspections.

The unacceptable practices highlighted include:

- Absence of formal risk management policies and procedures.
- Failure to ensure that such policies and procedures are observed and strictly enforced.
- Failure to conduct comprehensive reviews of these practices at suitable intervals or wherever there is any significant change in business or operations.
- Imprudent credit policies including failure to apply a sufficient haircut to

securities, and excessive exposure to individual clients or particular securities held against client receivables.

- Failure to institute effective measures to prevent clients from exceeding pre-set limits, including intra-day exposure limits on day-traders.
- Lax margin call procedures where there have been successive outstanding margin calls, allowing a client to continue buying stocks on credit.
- Allowing cash clients long credit periods to settle trades or allowing cash clients to trade in circumstances when their accounts are significantly under-secured.
- Taking on settlement obligations that significantly exceed the aggregate of a licensed corporation's available cash and banking facilities.

We would like to stress that these types of deficiencies will not be tolerated and where identified we will not hesitate to take firm regulatory action to address them. This action may include imposing restrictions on the manner in which licensed corporations are permitted to conduct their business in order that risk management deficiencies are addressed.

Licensed corporations are reminded to periodically refer to the relevant requirements in the Code of Conduct and Internal Control Guidelines, critically assess the appropriateness of their risk management policies and procedures, and rectify any deficiencies as soon as they are identified.

For details of the circular, please follow this [link](#). If you have any queries regarding its contents, please contact our Intermediaries Supervision Department.

Guidance to REIT Managers

We have recently issued a [circular](#) to managers of SFC-authorized real estate investment trusts (REITs) to clarify that REITs may purchase their own units on the Stock Exchange of Hong Kong subject to similar requirements to those applicable to listed companies under the Exchange's Listing Rules.

We have also posted a new set of [Frequently Asked Questions](#) on our website to provide guidance on other practical matters concerning REITs, including top-up placings, secondary offerings, adoption of incentive plans, valuation requirements, interim/annual reports and results announcements, annual general meetings and format of accountants' reports.

This guidance was issued as part of our ongoing initiative to give informative and practical guidance to market practitioners and to facilitate capital-raising for REITs.

Initiatives to Streamline Vetting of Notices and Advertisements

The SFC has proposed streamlining the vetting of notices and advertisements of collective investment schemes authorised by the SFC by replacing the current pre-vetting practice with on-going post issue monitoring as far as the law permits.

In January, the SFC started a public consultation on the necessary amendments to the Code on Unit Trusts and Mutual Funds, the Code on Investment-Linked Assurance Schemes, the Code on Pooled Retirement Funds and the Code on MPF Products (collectively, the "Product Codes").

The key aspects of the proposal are to remove pre-vetting for most notices and advertisements falling within permitted exemptions under the Securities and Futures Ordinance, to establish a common set of advertising guidelines for all schemes

authorised under the Product Codes, and to invite comments on whether back-tested and simulated performance information should be allowed for passively managed formula funds.

The SFC believes that the proposed changes will help improve the timeliness of notification to investors and the promotion of products, and reduce costs to the market. The proposed changes would also better align Hong Kong's regulatory requirements with international standards and practices in this area.

We will issue a conclusions paper and the revised Product Codes after considering all comments received and wish to thank all those who have contributed comments to the consultation.

SFC's Review of the Exchange's Listing Functions

The SFC has recently published its third Report on the Securities and Futures Commission's 2007 Annual Review of the Exchange's Performance in its Regulation of Listing Matters.

In March 2004, the Government published its Consultation Conclusions on Proposals to Enhance the Regulation of Listing. Among other matters, it recommended that the SFC prepare annual reports on its reviews regarding the Exchange's performance of its listing functions.

In our 2007 review, we considered that the operational procedures and decision-making processes reviewed were appropriate to enable the Exchange to discharge its statutory obligation to maintain an orderly, informed and fair market in 2006. We are satisfied that the Exchange has taken steps to address the recommendations made in our 2006 report and that its performance has improved over the past three years. The review also identified certain areas where we recommend that the Exchange continue efforts to enhance its performance.

For details of the report, please follow this [link](#).

Third Quarterly Report for the Financial Year 2007-08

The SFC has recently published its Quarterly Report for 1 October to 31 December 2007.

During the quarter, we continued efforts to facilitate the introduction of new financial products and introduced various measures to address market needs. These included the authorisation of the first retail UCITS III fund that can have significant exposure to the performance of hedge funds, and the approval of the first retail Islamic fund in Hong Kong.

The Report also highlighted measures introduced by the SFC to help market development. Greater flexibility was introduced for HSI and HSCEI futures and options contracts position limits, and also in fund managers' delegation of their investment management functions overseas. The SFC has also allowed issuers of listed structured products to apply for annual waivers from certain disclosure obligations, instead of requiring waiver applications for each individual product launched, as a new measure to reduce compliance burden and costs.

The Report is available on the SFC website and can also be accessed via this [link](#).

Publications & Circulars

The following publications and circulars have been published since the release of the last newsletter. Publications are available on the SFC website under 'Speeches, Publications & Consultations' – 'Publications'. Circulars can be found under 'Legislation & Regulatory Handbook' – 'Regulatory Handbook' – 'Codes, Guidelines and Circulars'.

Publications

1. Consultation Conclusions on Proposed Amendments to the Introduction to the Codes on Takeovers and Mergers and Share Repurchases and Proposed Procedures for Hearings under the Codes (05.03.2008)
2. SFC Quarterly Report - October to December 2007(29.02.2008)
3. Report on the Securities and Futures Commission's 2007 Annual Review of the Exchange's Performance in its Regulation of Listing Matters (19.02.2008)
4. Consultation Paper on the Proposed Streamlining of the Pre-vetting of Notices and Advertisements of Relevant Authorized Collective Investment Schemes (31.01.2008)

Circulars

1. Circular to Licensed Corporations and Associated Entities - Anti-Money Laundering / Combating Terrorist Financing - FATF Statement on Uzbekistan, Iran, Pakistan, Turkmenistan, São Tomé and Príncipe and the northern part of Cyprus (07.03.2008)
2. Circular to Licensed Corporations and Associated Entities - Anti-Money Laundering / Combating Terrorist Financing - (1) United Nations (Anti-Terrorism Measures) Ordinance (2) US President's Executive Order 13224 (27.02.2008)
3. Circular to All Licensed Corporations - Implementation of prudent risk management policies and procedures (25.02.2008)
4. Circular to Licensed Corporations which are Engaged in Asset Management and/or Giving Advice on Funds/Portfolios - Fund Management Activities Survey 2007 (25.02.2008)
5. Circular to Licensed Corporations and Associated Entities - Anti-Money Laundering / Combating Terrorist Financing - (1) United Nations Sanctions (Democratic Republic of the Congo) Regulation 2008 (2) United Nations Sanctions (Cote d'Ivoire) Regulation 2008 (05.02.2008)
6. Circular to Management Companies / Product Issuers of SFC-authorized Schemes - Streamlining of Pre-vetting of Notices and Advertisements of Authorised Collective Investment Schemes (31.01.2008)
7. Circular to Management Companies of SFC-Authorised Real Estate Investment Trusts - New Frequently Asked Questions (31.01.2008)
8. Circular to Management Companies of SFC-authorized Real Estate Investment Trusts - On-market Unit Repurchases by SFC-authorized REITs (31.01.2008)

The SFC Bulletin is available under 'Speeches, Publications & Consultations' – 'Publications' of the SFC website at <http://www.sfc.hk>.

Feedback and comments are welcome and can be sent to sfcbulletin@sfc.hk