SFC
證監會

SFC Alert

A bi-monthly newsletter for investors and intermediaries

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An additional investment choice

Code on REITs published

With the publication of the SFC's Code on Real Estate Investment Trusts (REITs) in July, the market can submit applications to the SFC to sell REITs to the public, giving investors an additional choice of investment products.

A REIT is a collective investment scheme that owns and manages income-generating real estate, such as shopping malls, offices, hotels, and residential properties. It typically focuses on property investments and pays out its taxable income to scheme holders in the form of dividends.

The SFC issued a Consultation Paper on the draft Code on REITs in March. We received 52 submissions from investment bankers, fund managers, lawyers, property managers / developers, surveyors and accountants, etc.

In light of the comments received, we have revised a broad range of key requirements so as to strike a balance between safeguarding investor protection and facilitating industry development.

We will allow REITs to invest in real estate through Special Purpose Vehicles so that they can benefit from the same tax treatment as property companies.

On operational issues, the changes include: the management company may choose between internal management and external management; the borrowing limit of a REIT is 35% of the value of gross assets (original proposal was 35% of the value of net assets); dividend payout is 90% of net income after tax (original threshold was 100%), annual valuation instead of quarterly, etc.

> *The primary objective in authorising REITs is to give retail investors in Hong Kong an additional product choice.*

More importantly, REITs may invest in properties such as hotels, theme parks and other income generating property undertakings. The SFC notes that in more developed REITs markets such as Australia, REITs have invested in hotels, theme parks, shopping malls and even hospitals.

Given that these are a new product for Hong Kong, SFC-authorised REITs will initially be restricted to Hong Kong properties. This is in line with our primary objective to give investors an additional product choice which can bring in relatively stable returns and the underlying investments of which they readily understand. There is a clear and familiar legal framework for property ownership in Hong Kong, and a ready

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Our new offices

The SFC's new offices on the 6th to 9th floors of the Chater House in Central became fully operational on 30 June.

The new offices are conveniently located for easy access by investors and market practitioners, and will enable us to continue to discharge our responsibilities effectively and provide quality services.

We moved our offices to Chater House in June after being given notice to vacate The Landmark.

The relocation process was smooth and we managed to keep related costs, including fitting out expenses, to a minimum. We have adopted a modest fitting standard and reused old furniture as far as possible.

The picture above shows the reception area of the SFC's new offices.

INSIDE

Know the SFC

A new video series now available

How much do you know about the SFC? As a member of the public, do you know how we handle your complaints? As an intermediary, do you fully understand how our partnership operates?

You can get the answers to all these questions in the informative "Know the SFC" video launched in July.

This is the first time the SFC has produced a documentary-drama to give an account of its work to the public. The series comprises nine episodes and aims to explain the SFC's regulatory role, objectives and functions, and how it carries out its work. It also highlights some of the improvements in the regulatory framework under the Securities and Futures Ordinance.

The nine episodes cover the following topics:

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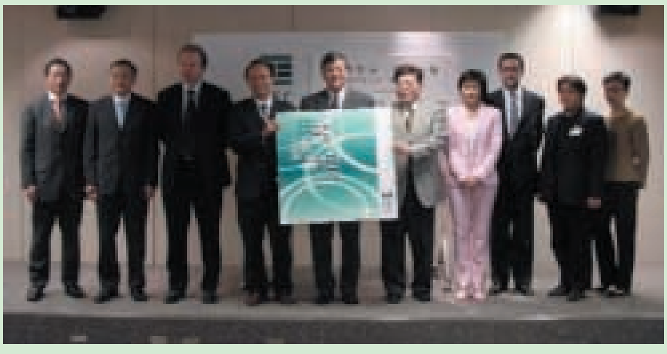

Launching ceremony of the "Know the SFC" video.

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HK remains a major fund management centre

Survey shows industry more energetic

An SFC survey has found that Hong Kong remains a major fund management centre in the Asia-Pacific region for attracting overseas funds for management. It also shows continuous growth in Hong Kong's own market in 2002.

Some key findings of the Fund Management Services Survey 2002 are as follows (value in HK$ as of 31 December 2002):

- There were 192 companies that provided fund management or advisory services and derived gross operating income from such activities (172 in 2001).
- 36 firms reported Hong Kong as their Asian headquarters (34 in 2001).
- Total assets under management (AUM) amounted to $1,491 billion (+0.4%). Of these, 63% were sourced from overseas investors.
- AUM sourced from Hong Kong investors totalled $558 billion (+23%). This also marked the second consecutive growth year for money sourced from Hong Kong.
- Total assets managed in Hong Kong, excluding the amount of assets sub-contracted or delegated overseas, amounted to $739 billion (+11%). The figure has increased for the third consecutive year. These assets accounted for 42.2% of total AUM in 2000, rising to 49.6% in 2002. In 2002, equities were the most significant asset class and accounted for 59% of the total assets managed in Hong Kong.
- There were 856 investment professionals in the industry. They mainly specialised in equities and were proficient in investing in the Asia-Pacific region, and particularly in Mainland China and Hong Kong.

The SFC is committed to further enhancing Hong Kong's advantage as the preferred location for fund management business in Asia.

Copies of the survey report are available at the SFC office and on its website.

MoU with ASIC

Co-operation on fund management supervision strengthened

Co-operation with overseas regulatory bodies is vital to effective supervision of the market.

In late June, we signed a Declaration on Co-operation and Supervision of Cross-Border Investment Management Activity (MoU) with the Australian Securities and Investments Commission (ASIC).

Under the MoU, the SFC and ASIC may exchange information and offer assistance to each other concerning the activities of fund managers licensed in their own jurisdiction. This facilitates the SFC in its supervision and inspection of fund managers that are licensed with ASIC and managing SFC authorised funds.

Based on this co-operative regulatory platform, the SFC has revised the Code on Unit Trusts and Mutual Funds to include Australia as an Acceptable Inspection Regime (AIR).

Currently, the US, UK, France, Germany, Luxembourg and Ireland are AIRs. The Code amendment to include Australia as an AIR was gazetted on 1 August 2003.

Fund managers licensed with ASIC will be eligible to manage SFC authorised funds if they meet certain criteria and other applicable basic eligibility conditions such as financial resources and management expertise.

SFC Chairman Mr Andrew Sheng welcomes the entrance of Australian fund managers to the Hong Kong market. He believes the Hong Kong market would benefit from their expertise in managing a wide range of investment funds.

ASIC chairman Mr David Knott says Australia greatly values its close working relationship with the Hong Kong SFC.

The MoU is posted on the SFC website. Please click "Employment and Miscellaneous"- "Cross Border Co-operation".

Quarterly results

In mid-August, the SFC published its latest Quarterly Report covering the months April to June 2003. It reports that the SFC recorded a deficit of $7.4 million, 70% lower than the projected deficit. Reserves stood at $558 million on 30 June.

Total income rose to $93.5 million, 3% higher than a year ago. The increase was due to higher-than-projected market turnover and the receipt of dual filing fees from HKEx.

Total expenditure also rose 3% to $100.8 million. The rise was attributed to the office relocation and additional staff who were hired to administrate the dual filing.

Based on current information and by keeping a tight rein on expenditures, SFC Chairman Mr Andrew Sheng expected the projected $21.9 million deficit for the next quarter would not be exceeded.

For more details, please view the Quarterly Report on the SFC website. Printed copies are also available at the SFC office.

SHORTS

- **Fees**

  The government's Working Group on the Business Environment of the Stockbroking Industry has recommended that, in order to enhance transparency of securities fees and charges, both the SFC and HKMA should accord priority to the brokerage fee categorisation exercise.

  In this regard, the SFC has worked with the HKMA to consult the banking sector on a proposal to classify securities-related fees and charges into broad categories. The proposal was made by a working group, comprising representatives of the SFC and the brokerage industry. The working group is now considering the views received. A market-wide consultation is hoped to be conducted in the third quarter and the categorisation is expected to be implemented by year-end.

- **Price Stabilizing Rules**

  The SFC proposes to amend the Securities and Futures (Price Stabilizing) Rules (PS Rules) to recognise the UK Price Stabilizing Rules. The related consultation ended on 18 August. The PS Rules prescribe the circumstances in which price stabilizing action will not be regarded as market misconduct. The SFC's intention has been to recognise certain overseas jurisdictions which provide similar regulatory safeguards against market manipulation for the purpose of PS Rules.

- **Appointment**

  Mr Raymond Kwok was re-appointed as a Non-Executive Director for one year until 31 July 2004.

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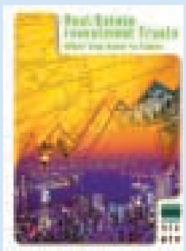
Additional choice

pool of intermediaries to service this market. We will set up a task force to examine the geographical restriction as the REITs market develops.

The SFC will keep the Code under review *(see also Investor Focus on page 4).*

Copies of the Code and the related Consultation Conclusions Paper and investor education pamphlet are available at the SFC office and on its website.



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Outline on disclosure of interests

Updated outline to provide additional guidance

The SFC is committed to protecting the interest of investors and raising market quality. Disclosure of interests by corporate insiders such as directors and substantial shareholders helps raise transparency and allows investors to have more complete and better quality information so as to make informed investment decisions. We therefore take a serious view on non-disclosure and false or misleading disclosure.

The Securities and Futures Ordinance (SFO) has tightened the requirements on disclosure. For example, the threshold for disclosure of interests has been reduced from 10% to 5% for a shareholder. The notification period is reduced from five business days to three business days.

To assist the market in complying with the requirements, we published an Outline of Part XV of the SFO in March 2003. Since then we have received enquiries from the market and decided that an update would be useful.

In the revised Outline which we posted on the website in August, we have addressed issues concerning disclosure obligations arising in the case of placings and top-ups, the exemption from aggregation of interests of controlled corporations, the interaction of the wholly owned group exemption with the exemptions under the Disclosure of Interests - Securities Borrowing and Lending Rules, and a number of other detailed issues.

We hope that the market will have better understanding of the disclosure obligations by reading the Outline. We would also like to remind market participants that we adopt a serious view on any non-compliance with the law.

In enforcing Part XV, we will focus on, in order of priority, non-disclosure of interests, false or misleading disclosure and late disclosure.

The updated Outline of Part XV is available on the SFC website under the section of "Bills, Legislation and Codes" - "Securities and Futures Ordinance" - "Part XV - Disclosure of Interests".

Shareholders Group

The SFC Shareholders Group held its 14th meeting in June. Members were consulted on the drafts of HKEx's revised Code of Best Practice and content requirements for the Corporate Governance Report listed companies would be required to publish under HKEx's proposed corporate governance-related Listing Rules changes.

Members made comments on both substance and presentation matters. In general, they supported the establishment of a Corporate Governance Report by listed companies and commented that the draft revised Code of Best Practice was an improvement to the existing Code.

SFC incorporated members' comments in its submission to HKEx.

(continued from page 1)

Know the SFC

- the art of financial regulation
- tackling market manipulation
- penalty on insider dealers
- licensing: the gatekeeper
- regulatory partnership with intermediaries
- disciplinary actions and investor compensation
- fair dealing in takeovers
- fund authorisations
- how complaints are handled

The abridged version of the series, (with each episode running for about five minutes), has been aired on Cable TV recently. However, if you have missed it, you can still watch the series in its full version. With some episodes lasting up to seven minutes, the full version is available in VCD format and on the Electronic Investor Resources Centre (www.hkeirc.org).

We have also published a Chinese language leaflet which contains a synopsis of each episode.

Copies of the VCD and the leaflet have been sent to licensed corporations, which are encouraged to show the video at their offices.

We believe that enhancing public understanding of SFC's work will lead to more effective regulation of the market and greater investor confidence.

The public can request free copies of the VCD and the leaflet at the SFC office.

Faster processing of licence applications

New performance pledges introduced

Intermediaries can expect their applications for licences to be handled more swiftly under a new set of performance pledges the SFC put in place in July.

The SFC has introduced new pledges and improved those existing ones (see table).

Although our manpower resources are tight, we are confident we can process applications faster due to the streamlined procedures and an enhanced computer system. For example, applicants are no longer required to submit certain supporting documents such as educational certificates or employer references, and no duplicate information will be requested.

We will be able to meet the pledges except in cases where the applicants submit incomplete documentation, additional licensing conditions need to be applied, or in contentious cases such as where there is concern about the fitness and properness of an applicant.

The new pledges are brought in to raise our service level despite the overwhelming workload. With the implementation of the Securities and Futures Ordinance (SFO), we are handling the migration of about 27,000 existing licences to the new regime without extra resources.

During the first four months of the new regime, 34 corporations and 1,377 representatives, together representing about 7 % of the industry total, have successfully converted their old licences to the new SFO licences. Another 53 corporations and about 1,000 representatives have also submitted their migration applications and will be getting their new licences soon.

To facilitate the migration process, licensed persons under the old regime can find some sample completed migration application forms on our website. We have also simplified the procedures for transferring licensing conditions to the new licences, in order to speed up the migration process.

Since 1 April 2003, we have received 1,373 applications from new industry entrants. 20 are from corporations and 1,353 from individuals, of which 21% opted for the fast track provisional licence.

As part of our efforts to help market participants understand the new regulatory regime, more commonly identified or revised questions and answers on licensing and other matters are posted on the SFC website.

performance pledges

Acknowledging applications	2 business days
Processing of applications:	
Representatives (provisional licence)	7 business days
Representatives (normal licence)	8 weeks
Representatives (responsible officer)	10 weeks
Corporations	15 weeks
Change of accreditation	7 business days

INVESTOR FOCUS

How much do you know about REITs?

It is important to do your homework

Real Estate Investment Trusts represents a new investment choice. All REITs that are sold to the public will have to be listed on the Stock Exchange of Hong Kong.

A REIT is a "trust" which has a well-defined investment policy and invests primarily in income-generating real estate. When you buy a REIT, you are looking to the "management company" to properly manage the portfolio of properties so as to generate a recurrent income for the unit holders.

On the other hand, if you choose to invest in the shares of a property company, you are relying on the company's board of directors to profitably manage the business, which may not be confined to property investment and property development.

REITs let you participate in a diversified portfolio of large-scale and quality properties even though you only have a limited investment outlay. Your investment is relatively more liquid compared to holding properties directly.

Also, a REIT needs to distribute at least 90% of its net income after tax as dividend to its holders. In the case of a property company, it could vary its dividend policy from time to time, depending on the business climate. Investors should also note that there will be a maximum borrowing limit of 35% of total assets imposed on REITs whereas such restriction is not applicable to listed property companies.

Remember to read the offering document before you buy any units in a REIT. Look for the following information:

- The quality of the underlying properties in terms of their location, tenancy mix, lease length, any rental payments in arrears.
- The dividend policy, fees and charges.
- The terms of the rental guarantee if there is one, such as the length of the guarantee and the properties covered.

Investing inevitably carries risk. REITs are no exception. The total return from a REIT is subject to the performance of the property market. It is possible that it may not pay any dividends if it reports an operating loss, say, after adjusting for losses from property disposal or revaluation. As such, it is important that you understand the key factors that can influence the property market, such as interest rates, economic prospects, property and rental cycles before investing.

To be a wise investor, study the risks of a REIT, the expected yield and the quality of the underlying properties to assess if it suits you.

To know more about REITs, you can read the investor brochure "Real Estate Investment Trusts - What You Have to Know". Copies of the brochure are available at the SFC office and on its website under the section of "Advice to Investors"- "Investor Education Programmes".

Get Ready to Invest

What should investors find out before subscribing for shares in an Initial Public Offering? Do you fully understand the procedures involved in different transactions, from margin trading to accepting offers in a takeover bid?

Find the answers to these questions easily by reading our latest education booklet - *Get Ready to Invest*.

In this booklet, we meet Carl, a fictitious character. We follow his experiences in trading stocks, funds, etc, and see how he selected his old school friend, Kate, as his broker. His experience shows us that investment is more than a mere buy-low-and-sell-high strategy, and by studying Carl's experience, investors can learn how to avoid mistakes.

The booklet contains 14 chapters covering wide-ranging topics including how to find the right broker and procedures involved in conducting transactions.

The booklet is supplemented by two new series of feature articles, *Get Ready to Invest* and *Futures and Option*, on the Electronic Investor Resources Centre (www.hkeirc.org).

The booklet is available free at the SFC office and the Consumer Advice Centres of the Consumer Council. It is also available on the SFC website under the section of "Advice to Investors" - "Investor Education Programmes".

Beware of "boiler rooms"

If you receive unsolicited calls asking you to make investments in some financial products overseas, they may have come from "boiler room" operators. Remember to verify the callers' legitimacy, check the authenticity of the products and never send money to them before verification. If you have doubts about any operators, report to us immediately.

We have recently re-issued the warning to investors because these activities have become rampant again - 13 more "boiler rooms" were put on our Alert List in June and July and more Hong Kong investors are being targeted.

"Boiler rooms" refer to groups of professional-sounding salespersons who cold-call to urge potential investors to buy real or bogus investments. They operate from virtual offices, approach investors in another country by telephone or email and never meet their clients face-to-face. Using high-pressure sales tactics, they may persuade investors to invest in financial products overseas. Once money is sent, the operators will disappear.

We have maintained an Alert List of unlicensed overseas companies, of which some are possible boiler rooms, on the SFC website. Please click "Advice to Investors"-"Investor Alert"-"Alert List".

Watch out with Exotic Warrants

We have recently received a number of complaints about the performance of exotic warrants. We therefore issue the following advice.

"Exotic warrants" are a special class of derivative warrants with features that are different from standard call or put warrants. Their names displayed on the Teletext carry a symbol "X" for easy identification.

Most of the complaints on exotic warrants seem to have arisen from a lack of understanding of the product features, and the risk and return profile. You should read the listing documents of exotic warrants and understand the terms and conditions. This helps you understand their unique features and how they work.

Should you want to learn more about exotic warrants, you can read a new article, *Exotic Warrants*, that we have posted on our Electronic Investor Resources Centre (eIRC) at www.hkeirc.org. In the article, we explain the features of some exotic warrants and their differences from a standard warrant.

We have previously published introductory articles on the characteristics of derivative warrants and the commonly used terms; the role of liquidity providers; and how to choose and trade derivative warrants. All of them are available on the eIRC.

Securities and Futures Commission

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