

Consultation Conclusions on the
Proposed CIS Internet Guidance Note

[Guidance Note for Persons
Advertising or Offering
Collective Investment Schemes
on the Internet]

May 2001

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Introduction

1. A draft Guidance Note for Persons Advertising or Offering Collective Investment Schemes on the Internet (the CIS Internet Guidance Note, or the Note) was published by the Securities and Futures Commission for public consultation on 24 November 2000. This document summarises the responses received and the Commission's conclusions.
2. The consultation period ended on 31 December 2000 but late submissions were accepted and considered. A total of 11 submissions were received. A list of the respondents is annexed (Annex 1).
3. In addition to comments, certain respondents sought clarification of a number of issues. Clarifications have been made to the Note provisions where they are conducive to the general understanding of the Note by the industry. Other more specific issues were discussed with the respondents directly.

Consultation Responses and Conclusions

4. This section sets out the consultation responses and should be read in conjunction with the Note. References are made to the specific paragraphs as they appeared in the draft Note.

Chapter 1 and Chapter 2 – Introduction and Scope of the CIS Internet Guidance Note

Comments

5. Respondents welcomed the issuance of the Note to reduce regulatory uncertainties. They commended the Commission for its recognition of the practical realities the market is faced with.
6. While acknowledging the Commission's effort to address online marketing and offering issues, one submission however commented that the Note might have specified additional elements that were not direct requirements under existing law.

The Commission's views

7. The Commission reiterates that the Note does not seek to impose new rules or requirements. It clarifies the SFC's expectations about the marketing and offering of collective investment schemes (CIS) on the Internet. As such, the

draft Note has proposed measures and safeguards that the SFC regards as appropriate and necessary for investor protection. It is possible therefore that certain regulatory requirements may manifest themselves in the Internet environment in such a way that they may be perceived as new or different requirements to paper-based regulations, when in fact they have stemmed from the same regulatory principles.

8. In this connection, the Commission wishes to take this opportunity to further explain the regulatory basis of the proposals. Broadly speaking, the proposals may reflect requirements under the following categories: statutory requirements; obligations imposed under conditions of authorisation; fit and proper requirements of SFC registrants; and general good business practice.
9. Firstly, as noted in Paragraph 2.2 of the Note, the Note should not be interpreted in any manner that would override any applicable law. Fund management companies and other financial intermediaries (the relevant persons) must still ensure that they comply with the requirements of all applicable law.
10. Secondly, CIS that are authorised by the SFC under the Securities Ordinance and CIS marketing materials authorised under the Protection of Investors Ordinance may be subject to conditions in addition to the general obligations of the codes or advertising guidelines that set out the criteria for authorisation.
11. Thirdly, the SFC expects that all SFC registrants must be fit and proper in relation to the manner in which they conduct the business for which they are registered.
12. Fourthly, certain proposals are considered good business practice that should be upheld by all CIS intermediaries in the interest of investors.
13. Those who market or offer CIS via the Internet should consider, having regard to their own circumstances, which of the Note's requirements might apply to them (Paragraph 2.3). If in doubt, they are welcome to consult the Commission.

Comments

14. One submission suggested that the SFC consider online investing in a broader perspective and provide functional guidance instead of technology specific guidance.

The Commission's views

15. The Commission agrees that a broad perspective is important. Its Online Trading Working Group has therefore proposed amendments to the Guidance Note on Internet Regulation¹ (the GNIR) to reflect the expected use of media other than the Internet. The GNIR sets out the fundamental issues of online trading and should be read in conjunction with the CIS Internet Guidance Note. The Commission believes that it is desirable to publish the CIS Internet Guidance Note as the Internet has so far been the most commonly used medium for electronic offering and advertising of CIS. The Commission has in the past also received specific industry enquiries relating to CIS activities on the Internet and the Note would serve to address those enquiries.
16. The Commission keeps in view developments such as the use of other electronic media for CIS offering and advertisements. The Commission is always open to suggestions from practitioners as to whether further regulatory guidance is necessary.

Chapter 4 – Advertisements on the Internet

Paragraphs 4.2 and 4.4

Comments

17. One respondent said the submission of a hardcopy of webpages and other media presentation for prior approval would pose a serious practical difficulty for most CIS providers because Internet advertisements tended to be updated very frequently. Personalisation of webpages would add complexity.

The Commission's views

18. It should be noted that under the Advertising Guidelines of the respective product codes, where materials such as updates or fact sheets are issued on a regular basis in a standard format, there is no need to submit every issue once the standard format has been approved. The same principle applies to webpage materials of a similar nature. Furthermore, the Commission is prepared to accept the submission of the relevant graphics, wordings, scripts and text fonts etc that may be used in personalised webpages for approval,

¹ The Guidance Note on Internet Regulation was issued in June 1999. A Consultation Paper on the Regulation of Online Trading of Securities and Futures was published in December 2000 to invite comments by 16 February 2001.

instead of requiring the submission of each and every personalised webpage. As each case may have to be considered on its merits, practitioners are encouraged to discuss this with Commission staff. For example, the Commission must be satisfied that appropriate risk warnings are indeed present in the webpages where necessary and the approval of the wording only may not be sufficient. The requirement on this matter has been clarified in the Note.

Paragraph 4.6

Comments

19. A general issue raised by respondents concerned the use of hyperlinks and the lack of control over the contents of third party websites which might contain unauthorised CIS materials. It was said that it would be practically impossible, for instance, for an independent financial adviser (or intermediary) to continuously monitor the links to other websites to ensure accuracy of the contents. It was also submitted that, for similar reasons, independent financial advisers should bear no responsibility for the accuracy and timeliness of the distributed electronic prospectus.

The Commission's views

20. The Commission reminds those who market or offer CIS, that advertisements that are not targeted at the Hong Kong public do not generally trigger the regulatory concern of the Commission. Reference should be made to the GNIR for further guidance².
21. It should further be noted that the Note imposes no new requirement. Reference should be made to the Protection of Investors Ordinance (PIO), in particular section 4 regarding the general prohibition on the issuance of advertisements and documents relating to investments. It would therefore be prudent to ascertain whether a person's websites are linked to unauthorised CIS advertisements or documents. It should be noted, however, that whether an offence under the PIO has been committed by a person depends on the facts and circumstances of each individual case. Market practitioners should consider seeking legal advice where necessary.
22. In relation to the need to provide an up-to-date prospectus, the Commission believes that it is a general responsibility for a relevant person to make all *reasonable efforts* to ensure that information provided on its website to

² Please see in general section 7.4 of the GNIR (March, 1999), and in particular paragraphs 7.4.3 and 7.4.4

investors, either directly or through hyperlinks, is up-to-date and accurate. The Note has been slightly amended.

Chapter 5 – Offering of CIS on the Internet

Paragraph 5.1

Comments

23. One respondent suggested that the term “prospectus” be changed to “offering document” for consistency with the Code on Unit Trusts and Mutual Funds (Unit Trusts Code).

The Commission’s views

24. As the Note is applicable also to other types of collective investment schemes, the term “prospectus” is given a broader meaning than “offering document” as used in the Unit Trusts Code.

Comments

25. An enquiry was made as to whether “summary offering documents” that have been prepared by fund houses and which detail a list of funds being offered, with a brief description of each fund and its risk factors, are acceptable as a prospectus for the purpose of the Note.

The Commission’s views

26. If the “summary offering documents” have been approved by the Commission as the “prospectus” (the meaning of which is defined in the Note) for distribution in Hong Kong, they may be accepted for the purpose of this Note.

Paragraph 5.2

Comments

27. Some respondents asked for further clarification of the meaning of offering CIS online.

The Commission's views

28. In general, offering a CIS online in the context of the Note means making the CIS available for subscription online or providing for online switching. Normally, it involves the provision of dealing facilities or transaction capabilities such as an application form or a webpage for giving instructions for the execution of an order.
29. For the avoidance of doubt, placing CIS advertisements on a website only without the provision of transaction capability online is generally not regarded as offering a CIS online for the purpose of this Note. Similarly, the provision of an address box on the website where an investor may ask for an application form to be sent to him or her by post is not regarded as online offering for the purpose of the Note. In this case, the application form shall be accompanied by a paper prospectus.
30. The interpretation of online offering has been further clarified in the final Note in light of the market responses.

Paragraph 5.3

Comments

31. One respondent said that provided that the software required to read the prospectus was also required to read the application form on the website, it would seem unnecessary to compel funds to provide it to investors. In such circumstances, an investor who could not access the prospectus would also not be able to access the application form. It would then be a decision for the relevant person to decide whether the necessary software should be provided.

The Commission's views

32. The Commission agrees. The final Note has been clarified to reflect the comment.

Paragraph 5.4

Comments

33. One respondent suggested that the Note state clearly that printed copies of a prospectus may be obtained at the registered office of the fund house or the office of a distributor (including banks, financial advisers and other intermediaries).

The Commission's views

34. The Commission does not seek to prescribe exactly where printed copies of a prospectus can be obtained as long as it is available at an address in Hong Kong and access is reasonably convenient. In light of the comment, the Note has been amended to state it is acceptable to make the prospectus available at the suggested locations.

Paragraph 5.6

Comments

35. It was submitted that the use of prospectuses in paper form should be allowed for Internet offering of CIS. It was said that if, for example, an intermediary made CIS from third party fund companies available for offering and some had electronic prospectuses while others did not, the intermediary should be allowed to offer the CIS by making the paper prospectuses available.
36. The respondent suggested that investors should be urged to obtain a prospectus and to read it carefully before making their investment. It proposed that in order to facilitate access to a prospectus, investors should be provided with an e-mail address and/or a phone number for the purpose of obtaining a prospectus, on a page appearing on or prior to the trading page.

The Commission's views

37. The requirement to make a prospectus available to an investor is to ensure that the investor has convenient and free access to all information that he or she may reasonably need before making an investment decision. This fundamental principle of ensuring that investors can make informed investment decisions should be observed by all persons registered with the SFC and upheld as best practice by all intermediaries. Consistent with this principle, various CIS product codes of the Commission stipulate that no application form may be supplied to a member of the public unless it is accompanied by a prospectus³.

³ Please see Chapter 6.4 of the Unit Trusts Code, Chapter 6.6 of the Code on Investment-linked Assurance Schemes, Chapter 8.3 of the Code on Pooled Retirement Funds, and Chapters 10.3 and 10.4 of the Code on Immigration-linked Investment Schemes.

38. Furthermore, the Commission believes that an investor should not be discouraged from accessing or reading a prospectus. The most convenient way of making an electronic prospectus available for a CIS offering on a website is by posting the prospectus on the website or through a hyperlink to the prospectus on another website. Nevertheless, it should be noted that the Note recognises that other forms of electronic offering may take place. For example, if an application form is contained in a CD-ROM or sent to an investor by e-mail, the availability of an electronic prospectus on the CD-ROM and in the e-mail respectively would be acceptable.
39. In summary, it is generally expected that the prospectus and the application form are available in the same medium. This “pairing” concept of making available the prospectus in the same way as the application form was strongly supported by one of the respondents.
40. The Commission is not alone on this issue. The policy of the Australian Securities and Investments Commission is that an electronic offer of securities cannot be made unless accompanied by an electronic prospectus⁴. In the US, if a CIS makes an electronic offering to investors, it generally must deliver a prospectus at the same time and it is considered that the only practical and timely way to deliver a prospectus in connection with an electronic offering is to provide the prospectus electronically. In the UK, the Financial Services Authority requires that a Key Features document be provided online for an Internet offering of packaged products.
41. The SFC considers it appropriate to maintain its general stance on the proposal. Paragraph 5.6 has been modified to state clearly in the affirmative that in general, an electronic prospectus should be made available in an online CIS offering and in the same way the electronic application form is made available to investors. In order to enhance clarity, the paragraph has also been moved forward while Paragraph 5.5 has been deleted.
42. Notwithstanding the above, in recognition of the practical circumstances in the market, the Commission is prepared to consider, on a case by case basis, alternative proposals that may achieve the fundamental objective of the prospectus requirement. Relevant persons are expected to provide detailed procedures and investor protection safeguards. The Commission will exercise its discretion judiciously to ensure a balance between investor protection and facilitation of market development.

⁴ See ASIC Policy Statements 107 and 150.

Paragraph 5.7

Comments

43. One respondent said the requirement was overly onerous from a technical point of view, and unnecessary from an investor protection perspective. In its case, the respondent said a booklet summarising the explanatory memoranda of its funds was sent to its clients when they first set up an account. It said a prominent reminder to read the prospectus would be adequate if all prospectuses were available on the website.

The Commission's views

44. It is important that investors may make their decisions based on the most up-to-date prospectus. The prospectus requirement in the Note aims to ensure an investor has convenient and easy access to the relevant and most up-to-date prospectus, and is considered necessary for investor protection. A general reminder is not considered adequate for this purpose.
45. In the example given by the respondent, since all the prospectuses are already available, it is considered that establishing the proper pages or links would not be unduly burdensome.

Comments

46. The same respondent considered that the proposed confirmation facility, whereby investors are asked to declare that they have been provided with sufficient opportunity to access or read the prospectus, was unnecessary if the client agreement already contained a similar confirmation.

The Commission's views

47. The Commission is prepared to consider and accept if appropriate, on a case by case basis, proposed alternative arrangements to the confirmation facility.

Paragraph 5.13

Comments

48. One submission said that rather than specifying additional disclosure, the Note should suggest broadly that it should be clear to investors what text was and what was not part of the prospectus. Practitioners should be allowed to

accomplish this by a number of means, which may include language providing appropriate demarcations.

The Commission's views

49. The Commission agrees that the objective of the original proposal would not be compromised as long as the appropriate measures are taken or language is used. Paragraph 5.13 has been amended to provide greater flexibility.

Paragraph 5.14

Comments

50. An enquiry was made as to whether this proposal restricts an electronic prospectus from hyperlinking to other websites such as a financial information or analysis website.

The Commission's views

51. It is considered that hyperlinks from a prospectus to websites that provide analyses or commentaries on investment or market trends are inappropriate lest they might confuse investors as to the content of the offering itself.
52. Instead, the proposal has been modified to expand the scope of permissible hyperlinks to include those that lead to websites that are directly referred to in the prospectus.

Paragraphs 5.15-5.16

Comments

53. One respondent said it was almost impossible to apply for a waiver on the grounds that the relevant person must ensure that an investor was conversant with a particular language, as the websites were accessible by the general public. It said since the company could hardly predict who the visitors were, it could not know which language they were conversant with.

The Commission's views

54. The Commission wishes to clarify that the general requirement under the CIS codes to have a prospectus in both English and Chinese languages is imposed at the time of the authorisation of the CIS. Thereafter, where a prospectus is required to be provided to an investor, it is the responsibility of

the relevant person to ensure that the investor is provided with a prospectus in a language that he or she is conversant with. The Commission accepts that in general, it would be reasonable to expect that an investor who may browse through webpages at his or her own pace in either the English or Chinese language, is conversant with that language, and therefore a prospectus in only that language would be sufficient for the purpose of the Note, provided that the application form is also only in that language. No additional waiver application would be necessary.

55. The proposal has been amended to reflect the comment. It is also stated that a relevant person should take reasonable steps to ascertain whether an investor is in fact conversant with the language of the prospectus before accepting an application if it has reasons to believe that the investor is not.

Chapter 7 – Communication with CIS Investors via Electronic Means

Paragraph 7.2

Comments

56. An enquiry was made as to where hard copies of information that has been distributed by electronic means after obtaining investors' consent, should be made available to investors.

The Commission's views

57. Documents may be sent by electronic means in place of paper copies only to clients who have consented to such arrangement. The relevant person and the clients may agree on where hard copies may be available if these clients revoke their consent and seek to obtain paper copies. The Note has been slightly amended for clarity.

Comments

58. It was submitted that the SFC should allow for the possibility of CIS companies and brokerage firms to operate entirely in electronic media, and therefore the Note should not advise that paper-based information "cannot be dispensed with at this time".

The Commission's views

59. The Commission has no objection in principle to purely electronic offering and communication which may emerge as the market and technology

continues to develop, provided that investors have been made fully aware of the implications. The Note has been amended in light of the comment.

Paragraph 7.4

Comments

60. One submission said this paragraph seemed to suggest that online CIS trading should be accompanied by online access to annual and semi-annual reports.

The Commission's views

61. The Commission wishes to clarify that the paragraph only served as an example. For the avoidance of doubt, it has been amended appropriately.

Other Issues

Implementation of the Note

62. Certain amendments have been made to the provisions of the Note and some footnotes have been added in light of the market responses. There are also certain minor stylistic changes.
63. The final Note will have immediate effect upon its publication. All new applications will be reviewed accordingly. There will be a grace period of three months for existing websites that do not meet the Note requirements to make the appropriate amendments. In any event, the SFC will adopt a pragmatic approach in the implementation of the Note. Relevant persons are also encouraged to discuss with the SFC any difficulties.
64. Finally, the Commission would like to thank the respondents and other interested persons who have made valuable suggestions and comments.

Securities and Futures Commission
May 2001

Annex 1

A list of respondents by alphabetical order is as follows:

1. American Express International, Inc
2. Charles Schwab, Hong Kong, Limited/ Hutchison CSFBdirect Ltd/ TD Waterhouse Investor Services (Hong Kong) Ltd - a joint submission
3. Hong Kong Investment Funds Association
4. Hong Kong Monetary Authority
5. JF Asset Management Limited
6. Linklaters
7. Lloyds TSB Pacific Ltd
8. Office of the Commissioner of Insurance
9. Prudential Assurance Company Limited, The
10. Tai Fook Securities Company Limited
11. Towry Law (Asia) HK Limited