

# Communications from Collective Investment Schemes Authorized in Hong Kong: A Snapshot of SFC Proposals

*Proposed changes will reduce regulatory burdens by dispensing with pre-vetting by the SFC of a wide range of notices and advertisements issued by collective investment schemes authorized by the SFC. At the same time, they will harmonize requirements for advertisements. However, the changes introduce now complexity into the regulatory regime and shift greater responsibility and liability on the issuers of such notices and advertisements.*

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On January 29, 2008, the Securities and Futures Commission (“SFC”) proposed changes to the regulatory regime for notices and advertisements issued by collective investment schemes (“**authorized schemes**”) authorized by the SFC. The changes are intended to harmonize and simplify requirements for advertisements for, and other communications with investors in, unit trusts, mutual funds, Mandatory Provident Fund (“MPF”) schemes, investment linked assurance schemes and pooled retirement funds.

These are laudable objectives. However, the manner in which some of these changes have been proposed appear to limit the benefits of these changes and may create confusion and uncertainty. At the same time, these changes will shift a greater degree of responsi-

bility and liability to managers of authorized schemes.

## Background

Broadly, the Consultation Paper on the Proposed Streamlining of the Pre-Vetting of Notices and Advertisements of Relevant Authorized Collective Investment Schemes (“**Consultation Paper**”) proposes that the SFC will no longer vet:

- a range of notices, letters and public announcements (together “**notices**”) to investors of authorized schemes which do not contain an invitation to the public to acquire or dispose of an interest in such schemes, and
- advertisements or other documents (together “**adver-**

tisements”) to the public which contain an invitation to the public to acquire or dispose of an interest in an authorized scheme if such advertisements are issued in circumstances where authorization is not required under the Securities and Futures Ordinance (“SFO”).

### Statutory Framework for Investment Offers

By way of background, the SFO and the Companies Ordinance (“CO”) together establish the statutory framework for the regulation of collective investment schemes. Broadly, there are 2 elements to the framework, namely authorization of the collective investment scheme itself and authorization for each marketing communication.

#### Authorization of Schemes

Under the SFO, the SFC may authorize a collective investment scheme subject to conditions it considers appropriate. Historically, the SFC has imposed 2 such conditions. The first condition is that all notices, letters and public announcements to existing investors be submitted to the SFC for prior approval. The second condition is that the authorized scheme comply with the applicable product code, such as the Code on Unit Trusts and Mutual Funds (“UT Code”) in the case of an authorized scheme in the form of a unit trust or mutual fund or the Code on Investment-Linked Assurance Schemes (“ILAS Code”) in the case of an authorized scheme in the form of an insurance policy.

#### Authorization of Advertisements

Separately, the SFO requires SFC authorization for each advertisement. The CO establishes similar requirements for SFC authorization for collective investment schemes in the form of a company. These requirements for SFC authorization under the SFO and the CO apply even if the scheme itself is an authorized scheme but do not apply if the issue is exempted under either the SFO or the CO, as the case may be.

#### Authorization of Notices

There is no requirement under the statutory framework for SFC approval of notices to investors of authorized schemes as such do not contain an invitation to the public to acquire or dispose of an interest in such schemes. However, as a result of the 2 statutory conditions described above, for authorized schemes, the requirement for SFC approval applies to (i) all notices even though authorization is not required under the SFO, and (ii) all advertisements even if they fall within an exemption under the SFO from the authorization requirement. In this latter regard, this is because the product codes require authorization of all advertisements whether or not required under the SFO.

#### Proposal to Reduce Vetting of Notices

Broadly, the Consultation Paper takes the position that the time and cost of prior SFC approval of notices, other than in respect of

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major changes, is not justified by investor protection concerns. It proposes:

- to replace the statutory condition that requires authorized schemes to submit to the SFC for prior approval, all notices, letters and public announcements to investors with a new condition for approval only of notices to investors related to the withdrawal of authorization or mergers or termination and for filing within 2 weeks of issuance of all notices to investors not approved by the SFC, and
- to amend the relevant product codes so that notices to holders of authorized schemes will no longer be subject to a requirement for prior approval by the SFC except in relation to changes in the constitutive documents or the offering document, notices of such changes, increases in fees, withdrawal of authorization and mergers or termination of the scheme.

#### Consistency With Regulatory Trend

The proposal appears to be sensible and is consistent with trends in the SFC's recent practice. For example, as from November, 2001, the SFC no longer required notices of suspension in dealings to be submitted to the SFC for prior approval before issuance but instead, required such notices to contain minimum prescribed content. Equally, for example, as from February, 2006, the SFC no longer required notices relating to routine administrative and operational matters to be submitted to

the SFC for prior approval before issuance.

It is also consistent with a broader regulatory trend towards placing greater responsibility on issuers of notices. The Stock Exchange of Hong Kong itself proposed in January, 2008 that it would cease pre-vetting of a wide range of notices issued by listed companies, relying instead on post-publication monitoring and enforcement to ensure that such companies satisfied their regulatory obligations.

#### Drafting Point

While the shift in regulatory philosophy on notices is sensible, it is not clear why it remains necessary at all for the SFC to impose a statutory condition for approval of any notices if there is a statutory condition to comply with the applicable product code and the applicable product code sets out definitively the approval requirements for communications.

#### Proposal To Permit Use of Offer Exemptions for Advertisements

The Consultation Paper separately proposes that all advertisements of an authorized scheme be submitted to the SFC for authorization prior to their issue unless such authorization is not required under the SFO. This differs from current product code requirements in which all advertisements, whether or not exempted from authorization under the SFO or CO, must be authorized. Collateral changes are proposed in this regard, including a new statutory condition for the issuer to cease issuing an advertisement on request of the SFC and a require-

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*The Consultation Paper further proposes that all advertisements and other invitations to invest in an authorized scheme be submitted to the SFC for authorization prior to their issue provided that such authorization will not be required where the issue is exempted under the SFO.*

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ment to keep records of advertisements issued for 3 years.

### Advertisements Issued by Securities Dealers and Advisers

As issuers of advertisements for authorized schemes will be able under the proposals to take advantage of exemptions under the SFO, the Consultation Paper suggests that it will be possible to dispense with SFC authorization for the issuance of advertisements of an authorized scheme where the advertisement is issued by a person licensed or registered for dealing in or advising on securities. At first glance, this would appear to remove the need for authorization of fund fact sheets, billboard, newspaper and magazine advertisements and radio, television and internet advertisements of an authorized scheme issued by a manager or Hong Kong representative who is licensed to deal in or advise on securities. However, there are major reservations.

- Where advertisements are issued on behalf of an authorized scheme which is in the form of a company, such advertisements may constitute prospectuses which will nevertheless require authorization under the CO. This is because even though the SFO exempts the issue of advertisements issued by or on behalf of persons licensed or registered for dealing in or advising on securities, the CO does not.
- The exemption from authorization for advertisements issued by or on behalf of persons licensed or registered for dealing in or advising on securities only

applies to securities. Under the SFO, the term “securities” excludes certain collective investment schemes, including MPF schemes and investment linked insurance contracts. Thus, advertisements for MPF schemes and investment linked insurance contracts will still require SFC authorization unless an alternative exemption avails.

In light of the foregoing, it appears that the main beneficiaries of the proposal to permit usage of statutory exemptions are authorized schemes in the form of unit trusts. However, even then, such a scheme may not have access to a person licensed or registered to deal in or advise on securities who is willing to issue advertisements on its behalf. For example, an authorized scheme may have a Hong Kong manager who is not licensed or registered to deal in or advise on securities. In the absence of a person licensed or registered for dealing in or advising on securities to issue the advertisement, the advertisement may still require SFC authorization unless an alternative exemption avails.

Where it is not possible to rely upon exemption as a result of an advertisement being issued by a person licensed or registered to deal in or advise on securities, other exemptions may apply. However, the availability of these exemptions will depend to some degree on the form of the authorized scheme.

### Advertisements for Unit Trusts and Investment Limited Insurance Contracts

In the case of an authorized scheme in the form of a unit trust or invest-

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ment linked insurance contract, it is possible that the professional investors exemption will not be available. The SFO exempts from the authorization requirement advertisements made in respect of interests in collective investment schemes which are or are intended to be disposed of *only* to professional investors. Whilst the better view may be that the SFO exempts from authorization an advertisement for an authorized scheme *to the extent* that interests in the scheme are disposed of only to professional investors, it is at least arguable on the statutory language that authorization will be required if even a single interest in the scheme is disposed of to a person who is not a professional investor.

Equally, for an authorized scheme in the form of a unit trust or investment linked insurance contract, it seems that a private placement cannot be effected. This is because private placements of such schemes are not the subject of any express exemption. Instead, they simply fall outside the ambit of the authorization requirement under the SFO whereas the draft language in the Consultation Paper suggests an exemption is specifically required. In any event, it is also unclear if it is possible as a matter of statutory interpretation of the SFO to effect a private placement alongside a public offer of interests in an authorized scheme.

### Advertisements for Mutual Funds

On the other hand, in the case of an authorized scheme in the form of a company, it appears that authorization would no longer be required for the issue of advertise-

ments where the minimum investment size is HK\$500,000 or where the offer is limited to professional investors as defined under the SFO. There is no reference in the proposals to the exemption under the CO for advertisements issued only to persons whose ordinary business is to buy and sell shares or debentures.

## Proposals for Advertisements in Standard Format But Updated Content

The Consultation Paper proposes that once an advertisement for a scheme is authorized by the SFC, performance information of the scheme and general market commentary thereon may be updated in the advertisement without further authorization provided that the content and the format of such advertisement remain fundamentally the same as the version submitted for authorization and the information within the advertisement remains current. Thus, for example, it ought to be possible to authorize presentation materials for an authorized scheme and to update the performance information in these materials from time to time without obtaining further SFC authorization.

### Significance of Proposal

The significance of this proposal appears limited to cases where the advertisements are not exempted. However, to the extent the proposal will apply, it effectively extends the current SFC practice of authorizing the standard format of fund fact sheets and newsletters, without requiring further versions

of those publications, with content contemplated within the format updated from time to time, to be authorized.

### Uncertain Application to Offering Documents

Because the SFC has indicated that it wishes to specifically approve changes to offering documents, it is not clear whether under this proposal it will be possible to obtain SFC authorization for an offering document which will be updated from time to time with the latest performance information and to dispense with further SFC approval each time the offering document is updated with the latest performance information.

### Statutory Compliance

In any event, whilst the proposal would likely facilitate advertising of authorized schemes, it does not address uncertainty as to statutory compliance. Under the SFO, unless exempted, each advertisement must be authorized by the SFC. Where the content of an advertisement changes from version to version, even if the format remains the same, it is at least arguable that each version of the advertisement which contains different content must be authorized by the SFC on the basis that each version is a different advertisement.

In practice, it is unlikely that the SFC itself would take enforcement action for failure to obtain authorization for each version of an advertisement. However, if authorization of each advertisement is in fact required by the SFO and

this is not done, other persons (e.g. the Secretary for Justice on behalf of the Government of the HKSAR) may prosecute. Furthermore, there may be civil consequences. As a result, it may be desirable for the standard SFC authorization for advertisements to provide wider language not just for approval of the format but also for approval of all versions of the advertisement contemplated by the format.

### Responsibility of Management Companies

A point closely tied to dispensation with the requirement for SFC pre-vetting of notices and advertisements is the corresponding potential increased liability for management companies of authorized schemes in preparing such communications.

### Codification of Issuer Liability

The Consultation Paper itself proposes that the management company has the responsibility to ensure that notices to investors in an authorized scheme are not misleading and contain accurate and adequate information to keep investors informed. However, this does no more in essence than re-state the current statutory position. Under the SFO, a management company that materially participates in or approves the making or issuing of a communication may bear statutory liability if the communication is false or misleading in a material particular and it knows that, or is reckless or negligent as to whether the communication is false or misleading.

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## Risks of Proposal

Pre-vetting provides a degree of comfort as the SFC is unlikely to approve any notice or advertisement which it considers to be defective and the SFC is less likely to challenge any notice or advertisement it has approved. In the absence of pre-vetting, there is a higher risk that notices and advertisements may omit material information or may otherwise be false or misleading in a material particular. At the same time, there is a risk that notices or advertisements may need to be amended or clarified at the request of the SFC after their publication. Consequently, management companies may wish to rely more heavily on independent and competent outside counsel to review communications to manage this risk.

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*[T]he Consultation Paper proposes that advertisements including but not limited to those issued by licensed or registered persons acting as the distributors of the scheme (i) must comply with prescribed advertising guidelines, and (ii) must be submitted to the SFC for authorization prior to their issue or publication in Hong Kong unless exempted under the SFO.*

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## Advertising Guidelines

The Consultation Paper proposes new Advertising Guidelines, which will apply to all authorized schemes other than real estate investment trusts. These new Advertising Guidelines will harmonize requirements for different types of authorized schemes under different product codes. They are intended to simplify and codify requirements.

### Application of New Guidelines

The new Advertising Guidelines will apply to all forms of advertisement for an authorized scheme whether or not SFC authorization is required. Thus, for example, the Advertising Guidelines will apply to all fund fact sheets, billboard, newspaper and magazine adver-

tisements and radio, television and internet advertisements for authorized schemes.

## Content Requirements

The Advertising Guidelines will require advertisements for authorized schemes not to be false, biased, misleading or deceptive, to be clear and fair, to present a balanced picture of the scheme with adequate risk disclosures and to contain information that is timely and consistent with the offering document. At the same time, they will prescribe minimum content in the form of risk disclosures and warning statements and will establish parameters for the presentation of information, such as performance information.

## Concerns

The general principles of the Advertising Guidelines are sound. However, there may be concerns in requiring all advertisements for authorized schemes which are issued pursuant to exemptions from authorization requirements to comply with all aspects of the Advertising Guidelines. For example, the Advertising Guidelines limit references to past performance of unauthorized schemes when advertising an authorized scheme unless the authorized scheme is newly launched. If materials are used for a sales presentation to institutional investors, it may not be objectionable to refer to past performance of an unauthorized scheme. This would be particularly so if the presentation sought to cover the full range of authorized and unauthorized schemes available from the manager.

## Responsibility of Sales Intermediaries

As drafted, the Consultation Paper proposes that advertisements including but not limited to those issued by licensed or registered persons acting as the distributors of the scheme (i) must comply with prescribed advertising guidelines, and (ii) must be submitted to the SFC for authorization prior to their issue or publication in Hong Kong unless exempted under the SFO.

### Recommendations

The language including advertisements issued by licensed and registered persons acting as distributors suggests that recommendations prepared for clients by sales intermediaries of authorized schemes may now be subject to the Advertising Guidelines. However, presumably, SFC authorization of such recommendations would not

be required as such recommendations would in the normal course be exempt from authorization under both the SFO and the CO.

### Uncertain Application

At the same time, there is some uncertainty as to who is a “distributor” of an authorized scheme. For example, if a financial adviser licensed only for Type 4 (advising on securities) regulated activity prepares a note to a number of clients in identical form suggesting that they acquire interests in an authorized scheme, is the financial adviser a distributor within the Advertising Guidelines?

## Corporate and International Media Advertisements

The Consultation Paper proposes to remove from the Advertising Guidelines text which provides a

degree of safe harbour for corporate advertisements and advertisements in international media. In its stead, the Consultation Paper proposes that a separate FAQ will provide guidance on SFC policy in relation to when corporate communications may be regarded as containing an invitation to the public to acquire or dispose of an interest in a collective investment scheme and when international media communications may be regarded as being issued to the public in Hong Kong. ■

*TIMOTHY LOH, SOLICITORS serves as Hong Kong and International Legal Counsel to financial institutions. Since its establishment in 2004, its clients have included 10 financial institutions ranked in the FT Global 200 and it has been recommended each year by the Asia Pacific Legal 500 for its financial services and regulatory practice.*

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