TOPIC 8 - OVERVIEW

1. RULES GOVERNING LISTING

- Listing is the process by which an issue of securities is **admitted for trading on a stock exchange**.
- The SEHK **administers** listing matters as part of its responsibility to perform its function of providing a fair, orderly and efficient market for the trading of securities.
- The Listing Rules are intended to ensure:
  - the suitability of applicants for listing;
  - the fair and orderly issue and marketing of securities;
  - the provision of sufficient, material and timely information by issuers which might concern the investors and the public and affect the prices of listed securities;
  - the fair and equal treatment of shareholders;
  - that the directors act in the interests of the shareholders as a whole, particularly where the public shareholders are a minority; and
  - that all new issues are first issued to existing equity shareholders as rights issues unless they agree otherwise
- There are also Listing Rules covering listings on GEM, which tend to follow the structure and content of the Main Board rules
- GEM has been positioned as a “buyers beware” market designed to accommodate companies to which a higher investment risk may be attached

1.1 Persons Involved in Listings

- These include the issuer and its directors, authorized representatives, sponsors, overall coordinators, compliance advisers, IFAs, promoters and reporting accountants

1.1.1 Directors

- Directors of an issuer are expected to:
  - fulfill fiduciary duties (skill, care and diligence); and
  - comply with the **Model Code for Securities Transactions by Directors of Listed Issuers (the Model Code)**
- Every board of a listed issuer must have at **least three independent non-executive directors** (INEDs), at least one of whom must have appropriate professional qualifications or accounting/financial management expertise. At least one-third of the board of an issuer must be INEDs

- INEDS must submit to the SEHK a written confirmation of their independence. The following circumstances can compromise independence:
  - The person holds more than 1% of number of issued shares
  - The person has received an interest in any securities of the listed issuer as a gift or has other financial assistance from the listed issuer or a core connected person
  - The person is a director/partner/principal of a professional adviser which provides (or has provided within 1 year) services to the listed issuer or any of its group companies or a controlling shareholder
  - The person has a material interest in any principal business activity/dealings with the listed issuer or any of its group companies
  - The person is on the board to protect the interests of an entity whose interests are not the same as the shareholders as a whole
  - The person is/was connected with a director/CEO/substantial shareholder within 2 years of appointment to the board
  - The person is financially dependent on the listed issuer or any of its group companies

- To comply with the Listing Rules, the directors will need to establish an audit committee, a remuneration committee and a nomination committee involving non-executive directors and INEDs. Committee terms of reference come from the Board of Directors

1.1.2 Controlling Shareholders

- As per the Listing Rules, a controlling shareholder is:

  "any person or group of persons who exercise or control either 30% or more of the voting shares or who are in a position to control the composition of a majority of the board of directors of an issuer"

- The **sponsor will need to identify** who are to be regarded as controlling shareholders in view of both pre-listing and post-listing considerations
- The sponsor must undertake **appropriate due diligence** to identify the controlling shareholders – a review of the shareholder register would not be sufficient
- Where a **corporate body is a controlling shareholder**, it will be necessary to determine whether any of its shareholders should be treated as controlling shareholders

1.1.3 Authorised Representatives

- Every listed issuer must appoint two authorized representatives. who act as the listed issuer's principal channel of communication with the SEHK
- The two representatives must be:
  - Main Board: two directors or one director and the company secretary
  - GEM: any two from executive directors and company secretary

1.1.4 Sponsors, Overall CoordinatorsCompliance Advisers and Independent Financial Advisers

- Sponsors, compliance advisers and IFAs must perform their duties without bias and comply with the listing rules

Sponsors

- New applicants must appoint at least one sponsor to assist with their listing application
- At least one sponsor must be independent of applicant
- A sponsor must hold a Type 6 license
- Every sponsor must:
  - Comply with the listing rules
  - Ensure all information provided to SEHK is true and complete
  - Submit sponsor declaration to the SEHK before listing
  - Promptly report to the SEHK if it subsequently becomes aware of any non-compliance with the Listing Rules or other legal requirements – this obligation continues beyond ceasing to act
  - Cooperate in any investigation conducted by the Listing Division/Committee and/or the SFC
  - Promptly report to the SEHK reasons for ceasing to act as a sponsor
- A sponsor is required to:
  - Be closely involved in preparation of listing documents
  - Conduct reasonable due diligence procedures to be able to make a relevant declaration
  - Address all SEHK queries promptly
  - Accompany new applicant to any meetings with SEHK

Overall Coordinators

- An overall coordinator is a capital markets intermediary that will undertake the **overall management of the offering**, including:
  - Coordinating **bookbuilding** activities
  - Advising listing applicant on the **offer price**
  - Making allocation recommendations to the listing applicant
  - **Exercising discretion** around share allocation
- The listing applicant will need to observe the "**sponsor coupling**" requirement: each independent sponsor appointed must also be appointed as an overall coordinator, or there must be an overall coordinator appointed from the same group of companies as the independent sponsor
- Sponsors that are not independent will need written confirmation that the listing applicant has already made an appointment that satisfies the sponsor coupling requirement

Compliance Advisers

- Listed issuers must appoint a compliance adviser when it initially lists and the appointment must continue up to:
  - The publication of financial results for **first full financial year** after listing for **Main Board** listings
  - The publication of financial results for **second full financial year** after listing for **GEM** listings
- The SEHK may direct a listed issuer to appoint a compliance adviser after the specified minimum period
- Listed issuers should seek advice from their compliance advisers in prescribed circumstances (eg before publishing a regulatory announcement)

Independent Financial Advisers (IFAs)

- IFAs are required by listed issuers in situations such as:
  - A transaction is subject to the vote of independent shareholders
  - An offer is received subject to the Takeovers Code
- An IFA is required to:
  - Be appropriately licensed/registered with the SFC
  - Discharge its responsibilities with due care and skill
  - Be independent from the issuer
  - Act impartially
  - Comply with the listing rules
- An IFA must satisfy itself that:
  - There is a reasonable basis for making statements
  - There is no reason to believe any information is not true or omits a material fact

1.1.5 Audit Committee

- Every listed issuer must establish an audit committee comprising non-executive directors only
- There should be a minimum of 3 members, the majority being INEDs
- At least one INED should have appropriate professional qualifications or accounting/financial management expertise
- The chairman should be an INED

1.2 Methods of Listing

- The methods of listing shares for new listing applicants are:
  - Offer for subscription
  - Offer for sale
  - Placing
  - Introduction
- Once an issuer is listed, new shares may also be listed via any of the following methods:
  - Rights issue
  - Open offer
  - Capitalization issue
  - Consideration issue
  - Exchange or substitution
  - Transfer from GEM to Main Board

1.3 Listing Procedures and Criteria

1.3.1 Equity Securities

- A new applicant must have a trading record of **at least three financial years** under substantially the same management and ownership
- The issuer must satisfy at least one of the following three quantitative tests:

Profit Test

- Profits for the most recent year must **not be less than HK$35 million** and those of the **two preceding years** must not be, **in aggregate**, less than **HK$45 million**

Market Capitalisation/Revenue/Cash Flow Test

- The issuer must have:
  - A **market capitalization** of at least **HK$2 billion** at time of listing
  - **Revenue** of at least **HK$500 million** for the most recent audited financial year
  - **Positive cash flow** of at least **HK$100 million** in aggregate for the three preceding financial years

Market Capitalisation/Revenue Test

- The issuer must have:
  - A **market capitalization** of at least **HK$4 billion** at time of listing
  - **Revenue** of at least **HK$500 million** for the most recent audited financial year
- There must be a minimum of 300 shareholders for all three tests
- At the time of listing, the issuer must have a minimum market capitalisation of HK$500 million, including a public float of at least HK$125 million
- For GEM listing, the track record must cover at least two years under substantially the same management

1.3.2 Biotech Companies

- A Biotech Company is a company **primarily engaged in using science and technology** to research, develop, apply and commercialise products that have a medical or other biological application
- Variations on listing requirements enable pre-revenue Biotech Companies to gain access to the public capital market during their period of development, however they must have a two-year trading record under substantially the same management
- While the above three quantitative tests are not applicable, an initial market capitalisation of HK$1.5 billion is required and a public float of at least HK$375 million

1.3.3 Special Purpose Acquisition Companies (SPACs)

- A SPAC is created to raise funds that will be used to acquire a business
- Gross funds raised in an initial offering must not be less than HK$1 billion
- SPAC securities can only be marketed to and traded by professional investors
- A SPAC is admitted to listing subject to a pre-defined time period (usually 24 months) within which it must acquire a suitable business in what is known as a “De-SPAC Transaction”
- The De-SPAC transaction must be completed within 36 months of the listing date
- A SPAC must appoint at least one sponsor for the listing application
- A sponsor will also be needed for the De-SPAC Transaction as the company will need to meet the same listing requirements

1.3.4 Companies with Weighted Voting Rights

- Different listing requirements apply to companies with weighted voting rights (WVR), also known as a dual-class share structures
- A holder of one WVR share will have **more voting power** than a holder of one ordinary share
- This voting structure is designed for innovation and growth companies , however one of the following two tests still needs to be satisfied:
  - Market capitalisation at time of listing must be at least **HK$40 billion**; or
  - Market capitalisation at time of listing must be at least **HK$10 billion** and revenue for the most recent audited financial year must be at least **HK$1 billion**

1.3.5 Share Option Schemes

- The total number of securities which may be issued upon exercise of all options to be granted must not exceed **10%** of the relevant class of securities
- The exercise period must not exceed 10 years from the date of grant of option
- The life of the scheme must not exceed 10 years
- An grant of options to a director, chief executive or substantial shareholder must be approved by the INEDs (excluding any INED who has been granted options)

1.3.6 Price Stabilization

- Price stabilization occurs when issuers or underwriters of newly issued securities may buy or sell the stock to prevent or minimize **a decline in the price**
- The SFC considers that it is in the **public interest** to permit and regulate price stabilizing action connected with public offerings
- The **Securities and Futures (Price Stabilizing) Rules** provide a safe harbour for permitted stabilizing activity (otherwise it would be considered stock market manipulation – a form of market misconduct)

1.4 Notifiable and Connected Transactions

- For certain types of transactions (eg substantial acquisitions/disposals), listed issuers must disclose details of the transaction – **notifiable** transactions
- Rules provide certain safeguards against listed issuers' directors, chief executives or substantial shareholders taking advantage of their positions when the listed issuer enters into '**connected transactions**'
- Connected transactions should be disclosed and are subject to shareholders' approval

1.5 Trading Halt, Suspension, Cancellation and Withdrawal of Listings

- The SEHK may, at any time, where considered necessary for the **protection of the investor** or **maintenance of an orderly market**, direct a trading halt or suspend dealings in any securities, whether or not requested by the issuer
- A **trading halt** is an interruption of trading for no more than two trading days and will be necessary when the issuer:
  - Has material information to be disclosed to avoid a false market under the MBLR;
  - Needs to disclose inside information
  - Is to issue an announcement regarding market commentaries or rumours
- The SEHK may direct a trading halt or suspend dealings where:
  - an issuer **fails in a material matter** to comply with the Listing Rules;
  - the SEHK considers that there are **insufficient shares in the hands of the public**;
  - it considers that the **issuer does not have sufficient level of operations** or sufficient assets to warrant a continued listing; or
  - it considers that the issuer is **no longer suitable for listing**

- The SEHK may cancel a listing where:
  - it considers that the **issuer does not have sufficient level of operations** or sufficient assets to warrant a continued listing;
  - an issuer suspends operations following financial difficulties/insolvency
  - the SEHK considers that there are **insufficient shares in the hands of the public**
  - it considers that the issuer is **no longer suitable for listing**
  - **An issuer has been suspended from trading for a continuous period of 18 months**
- The SEHK requires an **issuer-requested suspension to be kept as short** as possible
- The **SFC** has the power to direct the SEHK to suspend dealings in any securities under certain circumstances
- An issuer may not voluntarily withdraw its listing unless it has met the required shareholders' approval requirements

1.6 Disciplinary Procedures – Listing Rules

- The Listing Committee can commence disciplinary proceedings against a listed issuer and specified persons in four circumstances:
  1. Breaching an obligation imposed by the Listing Rules
  2. Failing to comply with a requirement of the Listing Division of Listing Committee
  3. Causing or knowingly participating in 1 or 2
  4. Contravening an undertaking given to or agreement with the SEHK
- The SEHK will always encourage a listed issuer to comply with the rules
- The SEHK can impose the following sanctions:
  - Private reprimand
  - Public reprimand
  - Reporting conduct to SFC/other regulatory body
  - Banning a professional adviser from representing a listed issuer or appearing before the Listing Division or the Listing Committee
  - Requiring remedial action to be taken
  - Prohibiting listed issuer from using market facilities
  - Suspension or cancellation of listing
- If requested, the Listing Committee can give it's reasons in writing for disciplinary actions taken – the disciplined party may have the decision referred to the Listing Review Committee for a further and final review
- The SFC can request the Listing Review Committee to review any decision of the Listing Committee, including disciplinary decisions

2. OTHER TYPES OF LISTED SECURITIES

Depositary Receipts

- **Overseas issuers** may list depositary receipts on the SEHK
- Depositary receipt holders are to be treated as generally having equivalent rights and obligations as shareholders in the issuer
- The entity acting as the depositary must be suitably authorized/regulated and acceptable to SEHK
- There is no provision for listing depositary receipts on GEM

Warrants

- Warrants are issued by a company and give the holder the right, not an obligation, to subscribe for shares in that company at the exercise price
- SEHK will only approve an issue if it does not exceed **20%** of the number of issued shares
- The warrants must expire not less than **1 year and not more than 5 years** from the date of issue/grant
- The warrants cannot be convertible into further subscription rights

Derivative Warrants

- Derivative warrants are issued by a third party, usually an investment bank, independent of the issuer of the underlying assets
- They give the holder the right to buy or sell a specified number of securities at a predetermined exercise price (or receive a cash settlement)
- The issuer must be incorporated, not a private company and, in the case of non-collateralised warrants, have:
  - NAV of not less than **HK$2 billion**
  - Have the required credit rating, or be regulated by SFC/HKMA or be a government or state
- Where derivative warrants are to be guaranteed, the guarantor must not be a private company and must meet the same requirements as an issuer of derivative warrants

Debt Securities

- Bonds or notes where the entity promises to repay the holder the total amount borrowed at maturity, with a fixed or floating rate interest payment (coupon) during the term
- Holders are creditors not owners of equity
- Examples are exchange fund notes issued by the HKMA and by the HK Mortgage Corporation Limited
- SFC has stated that listed debt securities are unsuitable for sale to retail investors, while the MBLR state that debt securities should only be issued to professional investors

3. TAKEOVERS AND MERGERS AND SHARE BUY-BACKS

3.1 The Codes on Takeovers and Mergers and Share Buy-backs

- The Codes apply to takeovers, mergers and share buy-backs affecting:
  - **Public companies** in Hong Kong
  - **Companies with a primary listing** of their equity securities in Hong Kong
  - Real estate investment trusts (**REITs**) with a primary listing of their units in Hong Kong
- The **Executive Director of the Corporate Finance Division** (Executive) of the SFC (including any of his delegates) is responsible for the day-to-day administration of the Codes
- The **Listing Rules require compliance with the Codes**, therefore a breach of the Codes will be a breach of the Listing Rules

3.1.1 General Principles

- The Codes are based on 10 general principles which are considered to reflect good standards of conduct for persons engaged in takeovers, mergers and repurchases. The principles include provision for:
  - equal treatment of shareholders, the provision of accurate and sufficient information and advice to them;
  - the making of general offers to be made if control of a company changes, is acquired or is consolidated;
  - full and prompt disclosure of information by persons concerned with offers;
  - offerors to ensure when making an offer that they will be able to meet their obligations;
  - rights of control to be exercised in good faith and without oppressing minority and non-controlling shareholders;
  - directors of offeror and offeree companies to provide disinterested advice to their shareholders; and
  - the board of an offeree company in an offer situation not to take any action likely to frustrate the offer without the approval of the shareholders in general meeting

3.2 Mandatory Offers

- The general principle underlying a mandatory offer is that if the control of a company changes or is acquired or consolidated, a general offer to all other shareholders is normally required

- A **mandatory offer** is required to be made when:
  - any person (or two or more persons acting in concert*) acquires, whether by a series of transactions over a period of time or not, 30% or more of the voting rights of a company (**trigger**); or
  - any person (or two or more persons acting in concert*) who owns between 30% to 50% (inclusive) of the voting rights of a company, acquires at least an extra 2% of the voting rights within a 12 month period (**creeper**)

  * Persons are acting in concert if they, pursuant to an agreement or understanding, actively co-operate to obtain or consolidate control of a company through the acquisition by them of voting rights of the company

- All mandatory offers must include a cash component and must be at a price not less than the highest price paid by the offeror, or any person acting in concert, within **6 months** prior to the start of the offer period
- The Executive has the **power to grant a dispensation** from the need to make a mandatory offer under certain circumstances, although it cannot be guaranteed

3.3 Voluntary Offers

- A voluntary offer is any offer that is not a mandatory offer, but the offeror is still bound by the Takeovers Code
- A voluntary offer does not need a cash component
- The price must not be less than the highest price paid within **3 months** prior to the start of the offer period

3.4 Share Buy-backs

- A share buy-back is an offer to buy-back, redeem or acquire shares of the offeror which is made by the offeror itself
- It can include a privatization, scheme of arrangement or other forms or reorganization
- The Code extends to all classes of shares, including warrants and convertible bonds

3.5 Disciplinary Proceedings – Takeovers/Share Buy-backs

- If the Takeovers Panel finds there has been a breach of one of the Codes or of a ruling, it may impose any of the following sanctions:
  - private reprimand;
  - issuance of a public statement which involves criticism;
  - public censure;
  - reporting the offender's conduct to a regulatory authority;
  - requiring intermediaries (dealers and advisers) not to act or continue to act for a stated period in any (or a stated) capacity for the guilty person;
  - banning advisers from appearing before the Executive or the Panel for a stated period; and/or
  - requiring further action to be taken as the Panel thinks fit

4. SFC AUTHORIZED PRODUCTS

- This topic focuses on the SFC's power to authorize CISs and structured products for offer to the public. It also considers advertisements and other documents that contain an offer to the public.

4.1 Part IV SFO: Collective Investment Schemes

4.1.1 Definition of CIS

- The SFO defines a CIS as:
  - An arrangement in respect of a property under which the management of the property is **not** subject to the day-to-day control of the scheme's participants, and either:
    - The property is managed as a whole by or for the person operating the arrangement; or
    - The participants' contributions and accruing profits or income are pooled; and
  - The purpose of the arrangement is to enable the participants to receive profits, income or other payments or returns from the property or dealings relating to it
- Excluded from the definition are:
  - Arrangements where the participants and the operator of the arrangement belong to the same group of companies
  - Franchise arrangements
  - Arrangements where a solicitor acting in his professional capacity holds money from clients during the course of his work
- The definition can be extended by the Financial Secretary
- The intention is to make the definition flexible to ensure any new products are properly regulated

4.1.2 Authorization of CISs

- There are only two circumstances in which a CIS may be offered/marketed to the public in Hong Kong. It must be either:
  - Structured as a company which is listed on the SEHK; or
  - Authorized by the SFC (the most common approach)
- The SFC may authorize, refuse to authorize, withdraw an authorization or grant authorization subject to 'any other conditions it considers appropriate'
- The specific requirements for CIS authorization by the SFC are contained in the Code on Unit Trusts and Mutual Funds (CUTMF)

4.1.3 Advertisements

- Advertisements inviting the public to respond to the following opportunities must be **authorized by the SFC**:
  - To enter into:
    - an agreement to acquire, dispose of, subscribe for or underwrite securities; or
    - a regulated investment agreement
  - To acquire an interest in or participate in a CIS

- **Exemptions** to the requirement to have advertisements authorized by the SFC include:
  - prospectuses complying with the Companies (Winding Up and Miscellaneous Provisions) Ordinance;
  - listing documents in relation to SEHK
  - advertisements, invitations and documents issued by certain licensed corporations (see below);
  - advertisements in relation to interests in CISs only offered to PIs;
  - sellers or publishers of newspapers and other publications containing such advertisements; and
  - conduits or live broadcasters issuing such prohibited material in the ordinary course of their business

- The SFC's authorization requirement no longer applies to Advertisements placed by **Type 1, 4 or 6 licensees** in respect of securities (except for unlisted securities that are structured products and unauthorized CISs)

4.1.4 Misrepresentations

- It can be a criminal or a civil offence to make any **fraudulent or** reckless misrepresentation to encourage someone to invest in/dispose of investments

- Although **journalists** are exempt from licensing requirements, they may still be prosecuted for making false or misleading statements

4.2 Part IV SFO: Structured Products

4.2.1 Definition

- "Structured product" is defined as:
  - A regulated investment agreement; and
  - Any instrument under which the return or amount due of the method of settlement is determined by reference to either:
    - Changes in the price, value or level of other financial products; or
    - The occurrence or non-occurrence of specified events
- Specific exclusions from the definition include CISs, convertible debentures and subscription warrants
- A structured product will be regarded as a security if it is part of an offer to the public which requires authorization under the SFO

4.2.2 Authorization of Structured Products

- There are two circumstances in which a structured product may be offered or marketed to the Hong Kong public:
  - It is listed on the SEHK; or
  - It is authorized by the SFC (the most common approach)
- The SFO requires that at least one SFC approved individual be available to receive notices and decisions served by the SFC relating to an authorized structured product (must be a Type 1or Type 4 license holder)
- The specific requirements for authorization of structured products are set out in the Structured Investment Product (SIP) Code – see below

4.3 Codes and Guidelines Issued by SFC

- As with all codes, these **do not have the force of law**, but failure to comply may reflect adversely on the person's fitness and properness and the suitability of CISs to remain authorized

4.3.1 Handbook

- The SFC has issued a Handbook for Unit Trusts and Mutual Funds, Investment-Linked Assurance Schemes and Unlisted Structured Investment Products, establishing codes and guidelines for product authorization

- The handbook sets out seven general principles (GP) which all product providers must follow:

  GP1: Product providers shall act honestly, fairly and professionally

  GP2: Disclosures must be complete, accurate and, where ongoing disclosure is required, disseminated in a timely and efficient manner

  GP3: Assets specifically required by the applicable product code to be held for the benefit of investors must be properly protected

  GP4: Product providers, counterparties and service providers shall avoid conflicts of interest that may undermine the interests of the investors of the relevant product

  GP5: Applicable legal and regulatory requirements must be complied with including co-operation with regulators

  GP6: Product providers shall discharge their functions with due skill, care and diligence

  GP7: Advertisements for a product shall be clear, fair and present a balanced picture with adequate and prominent risk disclosures

- Product providers are:
  - **CIS**: the CIS management company; the CIS itself; or the board of directors of a mutual fund company
  - **SIP**: the issuer

- Offering documents for both CISs and SIPs should contain the information necessary for investors to make informed investment decisions

4.3.2 Code on Unit Trusts and Mutual Funds (CUTMF)

- Cornerstone of CIS regulation
- Offering documents should contain:
  - Investment objectives and restrictions
  - Collateral policy and criteria
  - Application and redemption procedures
  - Fees and charges
  - Risk warning statements
  - Circumstances in which the CIS may be terminated

- Provides requirements for CIS authorization
- Sets out requirements for document submission, scheme procedures and the form and substance of adverts

4.3.3 Structured Investment Product (SIP) Code

- The SIP Code covers authorization guidelines for unlisted SIPs offered to the Hong Kong public
- Requirements are specified for product structures, offering documents and advertisements
- Issuers must provide unlisted SIP investors with a “cooling-off” period
- Sets out post-sale continuing obligations on issuers, including disclosures to investors and market-making

4.3.4 The Code on Real Estate Investment Trusts

- Establishes guidelines for the authorization of REITs as a specific form of CIS
- SFC has modeled Code on principles developed by **IOSCO**
- The management company, the trustee and their agents or delegates are expected to comply with the Code

4.3.5 Fund Manager Code of Conduct

- Covered in Topic 5

4.4 Mandatory Provident Fund Products

- MPFA is the primary regulator for the MPF system under the MPFSO, responsible for the overall management and administration of the MPF system
- The SFC retains regulatory oversight over the MPF as follows:
  - It is responsible for authorizing offer documents and marketing materials
  - It has issued the **SFC Code on MPF Products** applied to authorization
  - It approves investment managers of scheme products

4.5 SFC's Special Requirements for Parties involved in Authorized CISs

4.5.1 Trustees/Custodians

- Unit trusts – require trustees
- Mutual fund corporations – require custodians
- Trustees/custodians do not perform 'regulated activities' and therefore do not need to be licensed/registered
- For a CIS to obtain authorization from the SFC, its trustee/custodian must be acceptable to the SFC.
- To satisfy the SFC's key requirements, a trustee/custodian must be:
  - A bank licensed under the Banking Ordinance;
  - A trust company which is the subsidiary of such a bank; or
  - A trust company registered under the Trustee Ordinance; or
  - A banking institution or trust company incorporated outside Hong Kong, which is acceptable to the SFC; and
  - Independently audited; and
  - Have a minimum issued and paid-up capital and non-distributable capital reserves of HK$10 million

4.5.2 Management Companies

- Every authorized CIS is required to **appoint a management company acceptable to the SFC**, whether or not the management company requires to be licensed/registered with the SFC
- **Self-managed schemes** may be managed by the CIS board, in which case the directors will be prohibited from dealing with the scheme as principals
- A management company must:
  - be engaged principally in fund management;
  - have adequate financial resources, specifically paid-up capital and capital reserves of HK$10m;
  - ensure that any indebtedness to a holding company be acceptable as part of that capital
  - have no material lending;
  - have positive net assets at all times; and
  - satisfy the SFC, if so required, regarding the qualifications and experience of its employees and any appointed investment adviser

Management and Internal Controls

- A management company's directors must be of good repute and possess the necessary experience
- The management company will be expected to possess:
  - Key personnel with at least 5 years' experience in managing reputable unit trusts
  - Full-time key personnel who have track records in management of unit trusts/mutual funds
  - Sufficient human/technical resources, not relying on a single individual
  - Adequate internal controls
  - Proper supervision of any person to whom investment management functions are delegated (management company is still responsible for the duties delegated)

4.5.3 Independence of Trustee/Custodian and Management Company

- The trustee/custodian and the management company must be independent of each other
- Where the companies have the same holding company, independence is dependent upon:
  - Both companies being subsidiaries of a substantial financial institution
  - Nether company being a subsidiary of the other
  - The companies not having a common director
  - Both companies signing an undertaking to act independently

4.5.4 Licensing or Registration

- A management company operating in Hong Kong will normally need to be licensed/registered as an asset manager (Type 9)
- CIS management companies based outside Hong Kong do not need to be licensed by the SFC – however, it must be subject to regulatory oversight in an overseas jurisdiction which is acceptable to the SFC
- A management company that is not incorporated, or is not based in Hong Kong, must appoint a representative in Hong Kong (which must be licensed/registered or a registered trust company)

4.6 SFC's Special Requirements for Parties involved in Authorized Unlisted Structured Investment Products

- An application for authorization of an unlisted SIP must include the nomination of an approved person who will be the SFC point of contact
- An approved person must be:
  - A director of the issuer; or a director of any guarantor; or a responsible officer; or an executive officer of a product arranger; and
  - Licensed or registered for Type 1 or Type 4 activities; and
  - Ordinarily resident in Hong Kong

4.6.1 Issuers

- Issuers must be incorporated in Hong Kong or another jurisdiction acceptable to the SFC.
- There are **two categories of eligible issuer**:
  1. The **first** requires an issuer to have a minimum net asset value of HK$2 billion and be:
     - A bank regulated by the HKMA; or
     - A corporation licensed by the SFC; or
     - An overseas bank acceptable to the SFC;

     or have a credit rating which is one of the top three investment grades awarded by at least one international rating agency
  2. The **second** provides eligibility if:
     - In the case of a non-collateralized SIP, the issuer's obligations are fully guaranteed; or
     - The issuer is a SPV and the SIP is fully collateralized
- Issuers should be independent of any trustee/custodian or any key product counterparty

4.6.2 Guarantors

- Where an authorized unlisted SIP is guaranteed, the guarantor must satisfy the same eligibility requirements as issuers above

4.6.3 Product Arrangers

- A product arranger must be appointed if the issuer is an SPV, or neither the issuer nor any guarantor is a bank regulated by the HKMA or a licensed corporation
- A product arranger:
  - must hold a Type 1license
  - must be independent of any trustee/custodian or any key product counterparty
  - must ensure compliance with Handbook requirements
  - is not responsible for the issuer's financial obligations

4.6.4 Trustee/Custodian

- Unlisted SIPs with collateralized structures must have the collateral held in a segregated arrangement with a trustee/custodian
- The trustee/custodian must be:
  - a licensed bank, a subsidiary of a licensed bank or an overseas equivalent
  - independently audited and have minimum capital of HK$10 million
  - independent of the issuer, any guarantor, product arranger and key product counterparty

4.6.5 Key Product Counterparty

- Where the success of a SIP relies on a counterparty to a contract performing payment obligations, the SIP is exposed to the creditworthiness of the counterparty, known as the key product counterparty (KPC)
- The SIP Code imposes three requirements:
  - The issuer/guarantor/trustee/custodian must be independent of any KPC
  - The KPC is selected on an objective basis
  - Transactions with KPCs are at fair market value and on best available terms

5. ALTERNATIVE METHODS OF ACCESSING PUBLIC CAPITAL

- The financial markets are ever evolving as new opportunities appear to satisfy new needs
- There is a growing international trend for start-up businesses to seek capital from their communities
- Crowdfunding is an example using financial technology (aka FinTech)

5.1 Crowdfunding

- Crowdfunding typically takes place via a website-based platform that connects smaller businesses in need of capital with a large number of investors willing to provide the capital
- When the investor has an interest in the equity of the business, it is known as equity crowdfunding (ECF)
- When the investor has provided loan capital to the business, it is known as peer-to-peer lending (P2P)
- Persons promoting ECF or P2P investments will need to consider whether their activities constitute a regulated activity requiring a Type 1 license

5.2 Virtual Assets

Introduction

- Since the first Bitcoin was issued in January 2009, **a wide range of different types of virtual assets have been issued**, based on some form of blockchain or distributed ledger technology
- Billions of dollars have been invested in virtual assets**, in primary market capital raisings and in subsequent secondary market activity**, frequently in the absence of the usual regulatory oversight mechanisms that are normally in place in traditional markets
- The resulting significant investor protection risks have required regulatory agencies globally to consider how such virtual assets and related activities, **should be treated under current laws and regulations**
- Under the approach taken in Hong Kong, a virtual asset that is a cryptographically secured digital representation of value will be regulated under either:
  - The **SFO** where the virtual asset constitutes a securities or futures contract, as defined in the SFO (central bank digital currencies are excluded); or
  - The Anti-Money Laundering and Counter-Terrorist Financing Ordinance (**AMLO**), where the virtual asset does not fall under the SFO

Regulation by the SFO

- A virtual asset will be considered to be a security under the SFO if:
  - It might represent equity or ownership interests in a corporation
  - It might represent a debt or liability
  - It might have proceeds managed on a collective basis as a CIS

Regulation by the AMLO

- Virtual assets will be regulated by the AMLO if they:
  - Are expressed as a **unit of account or a store of economic value**
  - Can be used as a **medium of exchange**
  - Can be **transferred, stored or traded electronically**
  - Satisfy characteristics as prescribed by the SFC
- **Any person operating an exchange, trading virtual assets** falling under the above definition, **will need to be licensed by the SFC** under AMLO provisions
- Under the AMLO, **a virtual asset exchange means** an entity providing services through electronic facilities
  - that offers to sell/purchase virtual assets which can be made binding; or
  - that enables persons to negotiate or conclude sales or purchases of virtual assets in a way that forms a binding transaction

Dual Licensing Regime for Platforms

- **Platforms that trade virtual assets must be licensed** according to the nature of the virtual assets traded on the platform:
  - A platform that trades one or more virtual assets that constitutes securities under the SFO will need to be **licensed/registered under the SFO**, typically for Type 1 and Type 7 regulated activities
  - A platform that trades one or more virtual assets that are not securities under the SFO and meet the definition of virtual assets under the AMLO will need to be **licensed under the AMLO**
  - A platform that engages in both trading activities will **need to be licensed under both the SFO and the AMLO**

Regulated Activities Under the SFO

- Where an investment portfolio is **structured as a CIS**, activities in relation to the CIS's shares or units will be subject to the SFO even though the underlying assets consist solely of virtual assets that are neither securities nor futures
- For **futures contracts on virtual assets**, dealing and advising are covered by regulated activities 2 and 5
- Licensed corporations/registered institutions who provide virtual asset services to their clients must partner with SFC licensed virtual asset trading platforms and must be type 1 licensed
- Any plan to start providing trading or asset management services involving virtual assets will require a significant change in activities notification to the SFC

Investor Risks

- The SFC has listed the following set of **risks associated with investing in virtual assets**:
  - **Valuation, volatility and liquidity** – tokens are typically not backed by underlying physical assets or government guarantees, and price is frequently affected by short term speculation and small and fragmented liquidity pools
  - **Accounting and auditing** – there are no agreed standards among the accounting profession to ascertain ownership or reasonableness of valuations
  - **Cybersecurity and safe custody of assets** –billions of dollars have been lost through cyber attacks
  - **Market integrity** – markets that have formed around virtual assets are unregulated and subject to abusive practices
  - **Risk of money laundering and terrorist financing** – owing to the typically anonymous basis on which virtual assets are held and traded, there is a risk they may be used in connection with money laundering and terrorist financing
  - **Conflicts of interest** – operators of virtual platforms providing trading venues may act in various capacities that give rise to unregulated conflicts of interest
  - **Fraud** – insufficient due diligence may have been done in relation to disclosures made in relation to a virtual asset, raising the risk of fraudulent behaviour
  - **Different levels of regulatory safeguards** – not all virtual assets admitted to trade on a licensed platform are subject to the same level of statutory protection