HKGCC

Hong Kong General Chamber of Commerce
香港總商會 1861

香港總商會
香港金鐘道統一中心廿二樓
Hong Kong General Chamber of Commerce
22/F United Centre,
95 Queensway, Hong Kong
Tel (852) 2529 9229
Fax (852) 2527 9843
Email chamber@chamber.org.hk
www.chamber.org.hk

Helping Business since 1861

5 March, 2014
Ref: CC031

Ms Grace Chan
Director, Investment Promotion
Securities and Futures Commission
35/F Cheung Kong Center
2 Queen's Road, Central
Hong Kong

Dear Ms Chan

<u>Consultation on Amendments to the Code on Real Estate Investment Trusts</u>

Thank you for sparing time from your busy schedule to enlighten members of the Hong Kong General Chamber of Commerce on the key features of the Consultation Paper on Amendments to the Code on Real Estate Investment Trusts on 14 February, 2014.

2. While real estate investment trusts ("REITs") have been an important financial instrument globally, they have not been as popular in Hong Kong. We welcome the Securities and Futures Commission's initiatives to introduce more flexibility to facilitate market development of REITs in Hong Kong by aligning the Code on Real Estate Investment Trusts with codes and guidelines of overseas jurisdictions. REITs provide investors with a lower risk, and fairly predictable investment vehicle which produces reliable and stable dividend returns through rental income. Enabling REITs to better manage their yields are crucial for healthy growth of the market. At the same time, we are mindful that protection of investors' interest and market integrity should be ensured. It is also important to strike the right balance between market development and risk-taking, and between compliance with international standards and consumer protection. In fact, lower risk is a core ingredient of the policy logic for the REIT industry in most jurisdictions. Therefore, any proposed changes to the REIT code need to examine the extent to which the risk profile is changed for better or worse and by how much.

3. On the proposal for allowing REITs to invest in properties under development or property development activities, while we agree that the proposal is in line with the global norms and should enhance returns for shareholders, it must be made clear that REITs

should not engage in buying and holding vacant land for speculative purposes. Whilst introducing flexibility should facilitate market development of REITs, the proposed 10% cap may imply that smaller Hong Kong REITs would not be able to participate in development projects in Hong Kong. In addition, property funds with greater emphasis on property development with high leverage may not only increase Hong Kong REITs' exposure to development activities, but also reduce their ability to distribute dividends and in turn affect investors' return. All in all, our view is that Hong Kong REITs should be allowed to engage in property development other than speculative land projects, and the maximum proposed by the SFC of 10% of gross asset value is appropriate and should not unduly enhance risk profiles.

4. As for the other proposal for introducing flexibility through relaxing the restriction of investments in financial instruments for cash management purposes, we believe there could be some leeway in allowing REITs to better manage their cash balances. The investment instruments being proposed for investment by REITs may materially impact financial risk and could impose unwelcome liquidity constraints. The recommended categories of financial instruments such as unlisted debt securities may include structured products which are of high risk and suitable only for institutional investors. The proposals for relaxing the restrictions of investments in financial instruments should be confined to high quality, short-term and liquid fixed income instruments to ensure that the risk profile of the REIT is not materially affected in an adverse way and it should not substantially affect the income and dividend producing nature of REITs for shareholders. Investments in equities and structured fixed income securities should be restricted as REIT managers' primary responsibility is to manage the underlying property asset portfolios and not to invest in high risk and speculative securities for cash management purposes.

5. We would like to stress that while further developing the REIT market is important for Hong Kong to maintain its status as an international financial centre, there is a need to ensure that investors' protection should not be compromised as retail investors may not be able to assess the additional risk created by allowing Hong Kong REITs to engage in development activities and investments in financial instruments. To safeguard unit holders' interests in REITs, there should be specific guidelines stating the types of prohibited investments (such as high-risk structured securities) under the proposed relaxation of investment in financial instruments.

6. In order to obtain a more effective evaluation of the effect of the proposals on the market, a more comprehensive impact assessment study would be necessary.