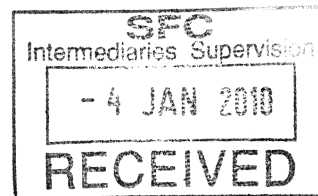


Securities and Futures Commission  
8<sup>th</sup> Floor, Chater House  
8 Connaught Road, Central  
Hong Kong



31 December 2009

Attention: Consultation on proposals to enhance protection for the investing public

Dear Sir/Madam

We enclose our response to the SFC proposals affecting Unit Trusts and Mutual Funds.

Our key concerns are set out below:

1. *To ensure that Hong Kong remains a leading asset management centre and does not adopt fund management rules in the SFC Handbook which conflict with UCITS Regulations adversely affecting UCITS Funds.* Some of the proposed additions potentially subject a UCITS fund authorised for sale in Hong Kong to conflicting fund management rules in Hong Kong compared with the rules applicable in their home jurisdiction. An example would be the eligibility criteria for acceptable collateral under 8.8(e) of Section II of the Proposed SFC Handbook for Unit Trusts and Mutual Funds, Investment-Linked Assurance Schemes and Unlisted Structured Products (the “**Handbook**”).

While we appreciate SFC’s desire to offer adequate protection to Hong Kong investors, we submit that UCITS funds should continue to be managed in accordance with UCITS requirements instead of competing SFC requirements. It is important for fund managers like us who offer UCITS funds in multiple jurisdictions that investors in the same product are treated fairly globally, including those in Hong Kong. We would recommend moving those sections in 8.8 which affect fund management [such as 8.8(e)(iv)] to 8.9 so it is clear that it applies only to non-UCITS funds.

2. *Imposing personal liability on the directors of the management company in accordance with Appendix C paragraph 25A.* While the management company is responsible for ensuring that each fund is managed in accordance with its investment policy in order to achieve its investment objective and the other responsibilities set out in the Investment Management Agreements we previously filed with the SFC, the directors of the fund company which issues the funds have assumed responsibility for the day-to-day operations, including reviewing and approving the contents in offering documents. This would not be the responsibility of the investment manager which does not issue the fund and only ensures that the fund is properly managed. The SFC is thus imposing an unnecessary and inappropriate layer of fiduciary responsibilities on the directors of the investment management company of the mutual funds and unit trusts.

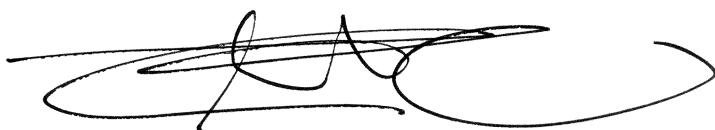
In addition, there is a clear and necessary distinction between the responsibilities of the fund company and the management company which are clearly set out in the Investment Management Agreement and this is essential since:

- (a) We appreciate that the SFC requires the fund company and the investment manager to be independent of each other. The investment manager and its directors should not influence the fund company and its directors on the level of disclosure. The fund company has its own legal advisors and should make its decision on whether such disclosure is appropriate based upon its own legal advice, without being subject to the views of the investment manager.
- (b) The market standard position would be that the investment manager is an independent contractor whom the fund and its directors may decide to remove or replace at any time. To place an obligation on the fund company to ensure that it obtains a responsibility statement from the investment manager's directors would fetter its discretion to replace or remove the investment manager. That is, before the fund company can remove the current investment manager, it will need to find a replacement investment manager whose directors are willing to provide such a responsibility statement in the offering documents. This would be extremely difficult to achieve since the replacement investment manager was not involved in the drafting of the offering documents. Consequently, after the introduction of these proposals, the fund company may be very hesitant to replace the investment manager due to the difficulties that this will create.
- (c) On the basis of specifying clearly the investment manager's responsibilities, the investment manager is able to provide a competitive investment management fee. A change in this position may result in significantly higher investment management fees which would be borne by investors.

We would respectfully submit that these proposals are unnecessary and would result in negative consequences for the market.

We set out in the attached appendix a list of our comments on the other proposals set out in the Handbook. We would be grateful if we could meet with you to discuss these proposals in the Handbook and our response before they are finalised.

Yours sincerely

A handwritten signature in black ink, appearing to be 'Christopher Chan', written over a horizontal line.

Christopher Chan  
For and on behalf of Barclays Capital

## APPENDIX

	<b>Part I – Independence of Fund Manager and Issuer of FDI</b>
<b>Reference :</b>	<b>Proposals No. 135 (a), p. 42</b>
	<ul style="list-style-type: none"> <li>This should be clarified so that the fund issuers understand the specific requirements which they must satisfy in order to establish independence from the swap counterparty. Based on discussions with the SFC, we understand that different legal entities within the same corporate group should be permitted. We also understand that the SFC expects that the swap counterparty and fund should have an independent board of directors. The SFC should clarify if there are any other requirements which need to be satisfied in order to establish independence.</li> </ul>
	<b>Part II – Consultation on the proposed SFC Handbook for Unit Trusts and Mutual Funds, Investment-Linked Assurance Schemes and Unlisted Structured Products</b>
<b>Reference :</b>	<b>Section I: Overarching Principles</b> Chapter 3, GP3 - Proper protection of assets
Barclays Comment:	<ul style="list-style-type: none"> <li>Please advise if the protection of assets will be in accordance with normal market practice. For example, certain assets may be held via sub-custodians or through banks and in each case, the sub-custodian or bank would not provide any ownership rights to such assets. Instead, they may only owe a debt to the account holder.</li> </ul>
<b>Reference :</b>	<b>Section I: Overarching Principles</b> Chapter 7, 7.3 – Investor Education
Barclays Comment:	<ul style="list-style-type: none"> <li>We are of the view that education on new or novel products will be provided by the Product Provider to the intermediaries who are then obliged to educate their retail clients.</li> </ul>
<b>Reference :</b>	<b>Section II: Code on Unit Trusts and Mutual Funds</b> Chapter 1, Authorisation procedures, 1.5 – 7 - Nomination of an individual as approved person
Barclays Comment:	<ul style="list-style-type: none"> <li>We would like to clarify the role of the Approved Person. Is this just a liaising role or otherwise?</li> </ul>
<b>Reference :</b>	<b>Section II: Code on Unit Trusts and Mutual Funds</b> Chapter 7 - Investment: core requirements, 7.7-7.8 – Investment in other schemes
Barclays Comment:	<ul style="list-style-type: none"> <li>In order to ensure consistency with the UCITS requirements for fund of funds structures, we propose that SFC allows UCITS schemes to follow UCITS regulations for the purpose of investing in other collective investment schemes. Based on the new UCITS IV directive, which will allow managers to establish schemes in other EU member states and also allow cross border merger of UCITS, these could potentially lead to non-compliance with SFC's proposed additions .</li> </ul>
<b>Reference :</b>	<b>Section II: Code on Unit Trusts and Mutual Funds</b> Chapter 8 - Specialised Schemes, 8.8- Structured funds

Barclays Comment:	<ul style="list-style-type: none"> <li>In order to ensure consistency with the view on global exposure, we submit that the SFC should not treat Repo transactions as FDIs as indicated by paragraph 133 on page 41 of the Consultation Paper. Repo transactions are essentially a form of secured lending that are not governed by the ISDA framework which FDIs are subject to.</li> </ul>
Reference :	<b>Section II: Code on Unit Trusts and Mutual Funds</b> <i>Chapter 8 - Specialised Schemes, 8.8(a)- Structured funds</i>
Barclays Comment:	<ul style="list-style-type: none"> <li>Please confirm what steps are required in order to satisfy the requirement for independence. We would submit that an independent board of directors together with separate legal entities would be sufficient. We would submit that separate reporting lines should not be a criteria to establish independence since this is an unclear concept.</li> </ul>
Reference :	<b>Section II: Code on Unit Trusts and Mutual Funds</b> <i>Chapter 8 - Specialised Schemes, 8.8(a)(2)- Structured funds</i>
Barclays Comment:	<ul style="list-style-type: none"> <li>These requirements are unclear. We submit that SFC should consider the requirements of the UCITS framework on the eligibility criteria of financial indices are sufficient to ensure that investors are adequately protected. European regulators authorizing UCITS schemes, such as IFSRA may require the submission of financial indices referenced in the offering documents of a fund for their review before a fund manager is allowed to reference them for the fund to ensure that investor's interests are properly protected. We respectfully submit that the SFC's requirements should be restricted to imposing additional disclosure requirements.</li> </ul>
Reference :	<b>Section II: Code on Unit Trusts and Mutual Funds</b> <i>Chapter 8 - Specialised Schemes, 8.8(c)- Structured funds</i>
Barclays Comment	<ul style="list-style-type: none"> <li>Please clarify the requirements with respect to the fund administrator. For example, please what is meant by "a regular basis"? The UCITS framework provides guidance on the frequency of valuation of FDIs and we respectfully submit that the SFC should follow this framework to ensure that Hong Kong follows international standards.</li> </ul>
Reference :	<b>Section II: Code on Unit Trusts and Mutual Funds</b> <i>Chapter 8 - Specialised Schemes, 8.8(d) - Structured funds</i>
Barclays Comment:	<ul style="list-style-type: none"> <li>Please clarify that the generic market standard opinions would be acceptable (e.g. opinions given by ISDA's lawyers to all ISDA members).</li> </ul>
Reference :	<b>Section II: Code on Unit Trusts and Mutual Funds</b> <i>Chapter 8 - Specialised Schemes, 8.8(e)(i) - Structured funds</i>
Barclays Comment:	<ul style="list-style-type: none"> <li>How is "short settlement cycles" defined. We propose using seven business days as a gauge of liquidity.</li> </ul>
Reference :	<b>Section II: Code on Unit Trusts and Mutual Funds</b> <i>Chapter 8 - Specialised Schemes, 8.8(e)(iii) - Structured funds</i>

Barclays Comment:	<ul style="list-style-type: none"> <li>How is "high credit quality" and "high price volatility" defined. The UCITS framework prescribes a minimum credit rating of "A" and we respectfully submit that the SFC should follow this framework to ensure that Hong Kong follows international standards.</li> </ul>
<b>Reference :</b>	<b>Section II: Code on Unit Trusts and Mutual Funds</b> <i>Chapter 8 - Specialised Schemes, 8.8(e)(iv) - Structured funds</i>
Barclays Comment:	<ul style="list-style-type: none"> <li>Diversification would add to the costs of holding collateral which would ultimately be passed onto the investors.</li> <li>UCITS funds do not allow securities issued by their derivatives counterparty to be posted as collateral. The only risk applicable to fund investors would arise if the issuer of the collateral and the derivative counterparty defaults at the same time but this risk should be low. Further, collateral is subject to daily monitoring and margining as funds must comply with counterparty credit exposure limits at all times to ensure that the fund and its investors are adequately protected.</li> <li>We would submit that the above safeguards would be sufficient and these proposals would be unduly onerous on UCITS funds which are already subject to collateral requirements in accordance with UCITS Regulations. The UCITS collateral requirements are different to the SFC's Chapter 7 and this would place UCITS funds under two conflicting collateral diversification regimes.</li> </ul>
<b>Reference :</b>	<b>Section II: Code on Unit Trusts and Mutual Funds</b> <i>Chapter 8 - Specialised Schemes, 8.8(e)(v) - Structured funds</i>
Barclays Comment:	<ul style="list-style-type: none"> <li>In our view, correlation may not be the most suitable metric as it may be measured differently by the various market participants and its value continuously changes over time.</li> <li>We would submit that SFC should consider disallowing securities issued by the same entity as the derivatives counterparty, or an entity whose securities cross-default with the derivatives counterparty.</li> </ul>
<b>Reference :</b>	<b>Section II: Code on Unit Trusts and Mutual Funds</b> <i>Chapter 8 - Specialised Schemes, 8.8(e)(g) - Structured funds</i>
Barclays Comment:	<ul style="list-style-type: none"> <li>The provider of the collateral would essentially be making public its holdings, which could potentially influence the type of securities it provides to the fund and hence, drive up costs. We also query the value-add of such disclosures, given the dynamic nature of collateral management such that the information would already be out-dated at the point of publication. It would be more helpful if the prospectus stated the eligible collateral with any credit rating requirements.</li> <li>Will the SFC consider alternative methods of publication, e.g. fund factsheets?</li> </ul>
<b>Reference :</b>	<b>Section II: Code on Unit Trusts and Mutual Funds</b> <i>Chapter 8 - Specialised Schemes, 8.9 - Structured funds</i>
Barclays Comment:	<ul style="list-style-type: none"> <li>The current drafting of 8.9 is unclear. Please could the wording be clarified by moving the 8.9(j) and (k) either to 8.8 or to a new 8.10. Since 8.9 has a negative impact on UCITS funds, it should be made absolutely clear that all of 8.9 does not apply to UCITS funds.</li> </ul>
<b>Reference :</b>	<b>Section II: Code on Unit Trusts and Mutual Funds</b> <i>Chapter 8 - Specialised Schemes, 8.9(j)(ii) - Structured funds</i>
	<ul style="list-style-type: none"> <li>We propose that rather than make the risk management and control</li> </ul>

	<p>policy, procedures and methods available to the end-investors, it would suffice for the document to be sighted by the distributors and intermediaries, as part of their due diligence review of the funds. While we support the need for transparency and disclosure, it is just as important to balance that with not loading investors with too much technical information that could confuse them instead.</p>
<b>Reference :</b>	<b>Section II: Code on Unit Trusts and Mutual Funds</b> <i>Chapter 11: Documentation and reporting, 11.1B</i>
Barclays Comment:	<ul style="list-style-type: none"> <li>• What constitutes “material adverse change in the financial conditions or business of the key counterparties to a scheme”?</li> <li>• Changing swap counterparty should remain at the discretion of the investment manager as long as it complies with SFC’s requirements.</li> </ul>
<b>Reference :</b>	<b>Section II: Code on Unit Trusts and Mutual Funds</b> <i>Chapter 11: Documentation and reporting, 11.14:</i>
Barclays Comment:	<ul style="list-style-type: none"> <li>• We would like to understand the rationale of the 3 year retention period for the final proof of advertisement and supporting materials for substantiation of information presented thereon.</li> </ul>
<b>Reference :</b>	<b>Section II: Code on Unit Trusts and Mutual Funds</b> <i>Chapter 11: Documentation and reporting, 11.6:</i>
Barclays Comment:	<ul style="list-style-type: none"> <li>• Please ensure that the drafting in 11.6 matches the SFC’s proposal. That is, 11.6 should make clear that the requirement to translate financial reports into Chinese is voluntary with respect to offshore funds.</li> </ul>
<b>Reference :</b>	<b>Section II: Code on Unit Trusts and Mutual Funds</b> <b>Appendix C – 25A</b>
Barclays Comment:	<ul style="list-style-type: none"> <li>• In addition to our views highlighted in the main letter, the directors of the management company would be unable to accept full responsibility for information provided by third parties. As the SFC is aware, index funds will need to disclose information on the underlying index. Such information is obtained from the index sponsor (eg Hang Seng Indices) and the index sponsor would refuse to provide assurances to the fund and management company that the information provided is accurate. It would not be equitable to expect that the directors of the management company to accept full responsibility for information received from third party providers. It would also be equitable if the directors would only be liable for ensuring that the information is <b>materially</b> accurate.</li> </ul>
<b>Reference :</b>	<b>Section II: Code on Unit Trusts and Mutual Funds</b> <b>Appendix C – 26</b>
Barclays Comment:	<ul style="list-style-type: none"> <li>• Please confirm whether this is the minimum required information to be maintained on a scheme’s website.</li> </ul>
<b>Reference :</b>	<b>Product Key Facts Statements</b>
Barclays Comment:	<ul style="list-style-type: none"> <li>• We propose for SFC to allow overseas fund houses to use the Key Investor Information (to be produced under UCITS IV for the European markets) in HK, while making clear that such European equivalent</li> </ul>

does not form part of the HK prospectus and therefore must be read together with the HK prospectus. When adopted into HK, the KII would be amended to meet SFC requirements and this can be made available for prior approval by the SFC.

- It does not appear appropriate to include performance information (although optional), as these will go out-of-date very quickly. Same reasoning applies with respect to total assets.
- We propose that the Key Facts Statement (“KFS”) be read together with the offering documents **but** it does not form part of the offering documents. Investors should also not make their decision based on the KFS alone. The concern here is that distributors would only distribute and investors would only read the KFS without receiving or reading the prospectus. Consequently, investors would not receive full disclosure since it would not be possible to summarise all the information in the prospectus to just 4 pages. The solution would be to make clear that the KFS should be read together with the prospectus but not form part of the prospectus. Consequently, both the distributors and investors are aware of that it is not sufficient to read the KFS alone. In this situation, funds issuing the KFS would have the same liabilities with respect to the KFS as they would with respect to other marketing materials. The SFC should make this clear in their Handbook and it should also be clear that the KFS is not intended to represent complete disclosure on the fund and therefore must be read together with the prospectus.
- Scenario analysis required for guaranteed funds and structured payout funds: The scenario analysis provided to investors would normally be a simplified so that investors can easily understand the scenarios and therefore such scenarios would be subject to extensive assumptions and qualifications. The currently page limit would make it extremely difficult to list those assumptions and qualifications. Failing to provide such assumptions and qualifications may result in such scenarios being potentially misleading.
- If these template KFS are completed, it is unlikely that, with the required information, they will be 4 pages or shorter in length. We would suggest that whilst the format should be recommended, manufacturers and product providers shall be afforded certain discretions to omit information which is either not relevant or unavailable. We note that certain parts of the KFS templates are optional, e.g. the past performance section in the General Funds template, which would not be relevant for a new fund being launched. Our suggestion would be that product providers be given a greater discretion as to which information to include, whilst complying with the spirit of the KFS templates.