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31 December 2009

Dear Sirs,

Consultation on proposals to enhance protection for the investing public

We welcome the opportunity to provide comment on the Consultation Paper on Proposals to Enhance Protection for the Investing Public (the "**Consultation Paper**") issued by the Securities and Futures Commission (the "**Commission**") on 25 September 2009.

We recognise the need for Hong Kong to review and consider clarification and enhancements to its existing regulatory regime and investor protection to address the matters highlighted by the sale of Lehman Minibonds. In particular, **the core objective must be to ensure that the protection of retail investors in Hong Kong is enhanced in a proportionate manner; the measures must not overly limit the choice of products available to investors nor inhibit Hong Kong's development as a competitive and innovative international financial centre.** A balance needs to be achieved to ensure that an additional compliance burden is not imposed unduly on any one group of market participants, nor such that it unnecessarily frustrates and limits the retail market.

The Consultation Paper addresses a significant number of wide ranging proposals which when read at face value would appear to heavily impact the manner and cost of doing business for a variety of market participants in Hong Kong, including those issuing and distributing retail investment products to the Hong Kong public, whether from inside or outside Hong Kong. However, during the soft consultation process with the Commission, it is apparent that this is not necessarily the Commission's intention, and that in some cases the new or revised rule as drafted overreaches the underlying, specific intention. Therefore, whilst we acknowledge the Commission's principles based approach to regulation (and welcome it), we think it would be helpful for the industry to understand more specifically the Commission's concerns behind certain proposals – and consequently understand more clearly the practical impact of them. We have indicated at relevant places in this response where a "Note" or clarification to certain Handbook or Code of Conduct requirements might be helpful.

We further appreciate proposals for an Investor Education Council are in the making, and are of the view that it is essential for parallel efforts to be directed towards enhancing investment literacy of investors.

Disclosure can only go so far in achieving better protection for the investing public. This is particularly important for example in relation to the **issues surrounding the KFS** which we would urge the Commission to take particular note of. Other **key aspects of concern** to us include the **disclosure of monetary benefits and changes to investor classification**. In addition, there are particular concerns about the proposals in relation to the **regulation of structured products and the new structured products code** which are drawn to the attention of the Commission below.

We are of the strong view that further consultation on key issues will be important to ensure a proportionate and balanced result before any decisions are made to formulate specifically and issue additional or replacement regulation.

Following consultation with a number of our clients, whose names are set out in Schedule 1 of this response paper (this working group is together referred to in this response as the "**Group**"), we have provided responses to those questions posed in the Consultation Paper on which the Group has particular views.

Defined terms used in this response paper are set out in Schedule 2 or otherwise in the Consultation Paper.

The Consultation Paper, and correspondingly this response, covers many varied issues. We would be happy to discuss any part with the Commission further or answer any questions you may have. Whilst there has been a team of individuals with experience in the areas covered by the Consultation Paper working with the Group in preparing this response, in the first instance please feel free to contact Mark Shipman, Paget Dare Bryan, Charlotte Robins or Francis Edwards.

Yours faithfully,

Clifford Chance

RESPONSE TO SFC CONSULTATION PAPER
PROPOSALS TO ENHANCE PROTECTION FOR THE INVESTING PUBLIC
(ISSUED IN SEPTEMBER 2009)

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1. CONSULTATION IN RELATION TO THE OVERARCHING PRINCIPLES SECTION OF THE HANDBOOK

Question (1)

Do you have any comments on the Overarching Principles Section of the Handbook generally or any particular provisions in the Section? Please explain your views.

The Group has the following comments on the Overarching Principles Section of the Handbook.

Overarching Principles: Chapter 4.1(c) - General duties and obligations

The requirement for the product provider to inform the Commission promptly of any breach of the Handbook should be qualified by materiality.

Overarching Principles: Chapter 4.2 -Avoidance of conflicts of interest

In common with many industries, conflicts of interests may exist within financial institutions, in particular where a broad range of products and services are provided. While the Group recognises the importance of identifying and addressing potential conflicts of interest, the Group requests the Commission to recognise the practical difficulties involved.

The Group requests that the Commission provide additional guidance as to the potential conflicts of interest which are of concern to the Commission. In addition, members of the Group would be pleased to discuss further with the Commission the methods that may be applied to address such potential conflicts of interest.

Overarching Principles: Chapter 5 - General Requirements

Selection of distributors – OP 5.3

OP 5.3 introduces a new regulatory obligation on product providers to "*exercise due care and diligence in the selection and appointment of distributors for a product, in particular, having regard to whether such distributor is suitably qualified and competent to discharge its obligations properly*".

The Group considers it to be inappropriate, as a matter of principle, for product providers to be tasked with assessing the suitability and competence of individual intermediaries to offer the provider's products in general, or indeed in relation to individual products, when the intermediaries are already licensed by or registered with the Commission for such activities and are subject to the Code of Conduct.

Product providers will generally as a matter of good practice conduct their own assessment of distributors for their own prudent business, reputational and risk management purposes; however to turn this into a regulatory requirement will mean that product providers will be subject to a new form of regulatory liability for the performance of the intermediaries that they select, over and above the common law. The Group does not believe that this can be the intention of the Commission because, as presently drafted in the Handbook, this would have the effect of imposing general, wide and uncertain obligations and liability on product providers which would be very difficult for product providers to manage.

Whilst it is acknowledged that the Commission is legitimately entitled to be concerned to ensure that obviously inappropriate choices of distributor are eradicated, the Group is concerned that such a loosely drafted principle (unless suitably qualified and illustrated by examples) may in the fullness of time be used more broadly – and with the benefit of hindsight - than was originally intended. It would be undesirable to see in due course (if unfortunately a problem occurs with a specific structured product which is significantly loss-making for investors), such a principle being used as a basis to embark on a microscopic examination of every single aspect of the interaction between the product provider and the distributor or distributors, with the imposition of detailed standards and requirements that were simply not envisaged at the time the principle was enunciated.

The Group considers that it is, and should remain, the responsibility of the relevant intermediary to ensure it has appropriate policies in place and that its firm and staff are competent to understand and offer particular/individual products.

If such a requirement is to be imposed on product providers (which the Group strongly disagrees with for the reasons set out above), then the Group would urge the Commission to at the very least address the following four main points:

First, for the reasons set out above, the Group objects to the inclusion of the words "*in particular, having regard to whether such distributor is suitably qualified and competent to discharge its obligations properly*". The Group urges the Commission not to frame the requirement in this way and to remove these words from the Handbook, as such a requirement would be extremely open-ended and difficult to assess.

Second, the requirement that "due care and diligence" be exercised seems as a legal matter to be overstating the requirement and to be exceeding the intentions of the Commission. Based on discussions with the Commission, the Group understands that the Commission does not intend strict liability to be imposed on product providers for the acts of intermediaries and therefore the Group recommends that any such requirement, if imposed, be expressed by reference to an objective test of reasonableness, i.e. as a requirement that "*reasonable* care and diligence" be exercised.

Third, the Group urges the Commission to provide additional guidance as to the extent of the procedures it would consider to be appropriate for product providers to discharge this obligation, as currently the requirement is too widely expressed.

Fourth, the Group requests the Commission to clarify that product providers will not be responsible for ensuring the competence of intermediaries or the compliance by intermediaries with the Code of Conduct.

Language of Offering Documents – OP 5.6

A large proportion of potential investors in retail products may have Chinese as their first language and therefore the Group recognises that the offering documents for investment products should be published in both English and Chinese. This has been the position prior to the implementation of the SP Code and is consistent with the approach under Chapter 15A of the Stock Exchange Listing Rules and Chapter 6.2 of the UT Code.

Under the usual procedure, offering documents for retail products requiring SFC authorisation are prepared and reviewed by all parties (including the Commission) in English, before finally being translated into Chinese shortly prior to issuance. Both the English and Chinese versions are then authorised by the Commission.

In terms of investors' reliance on documentation used for the marketing and offering of products, the Group recognises that it will be the case that Chinese speaking investors will use and rely upon the Chinese version of the Offering Document, while English speaking investors will look to the English version in making their investment decision. Nevertheless, the Chinese version is just a translation and the Group feels that it should be possible to disclose against this.

It is also worth noting that, during translation into Chinese, inconsistencies may arise between the English and Chinese versions of the offering documentation, purely through matters of interpretation which may exist between English and Chinese expressions that are used. If both versions are formally given equivalent standing, there could be an opportunity for bilingual investors to arbitrage between the two versions and choose which version to rely on legally when bringing any claim.

The Group recommends that, if the English version of the disclosure in the Offering Document cannot generally prevail over the Chinese version, the English version should prevail with respect to:

(a) the terms and conditions of the product (which forms the contract between the issuer and the investor); and

(b) the financial statements which are included in the Offering Document.

In the case of the terms and conditions, there will only be one contract with the investor, which will be the English language contract and therefore, to the extent that there are any differences in interpretation between the English and Chinese versions, the English contract must prevail. Any deviation from this approach would be a significant deviation from international market practice, and the practice in other markets in Hong Kong, and would require very considerable changes to how structured products are offered in Hong Kong. It should be borne in mind that the approach that the original English contract prevails is already commonly accepted with respect to many retail products in Hong Kong, for example, saving accounts and credit cards.

In the case of the financial statements, these documents are by necessity technical documents published by Issuers with the assistance of professional accountants in order to comply with complex and technical rules of accounting. In the case of the Group, these accounting rules are not in Chinese. As a consequence, the Chinese versions of these financial statements are by necessity translations of the technical document in the original language and this should be recognised and accepted by the Commission so that the English version prevails.

In addition, the Group would expect the SP Code to follow the same approach for language translations with respect to the on-going disclosure requirements but this requires further clarification in the SP Code.

Overarching Principles: Chapter 6 - Disclosure Requirements

Product Key Facts Statements – OP 6.5-6.8

The Group supports the proposal that a product summary in the form of a Key Facts Statement be prepared for all products and recognises that this proposal is favoured by many regulators in other leading jurisdictions. However, in relation to unlisted structured products, the Group has some concerns about the detail of the proposals for the KFS which are set out below. In relation to the consultation on the UT Code as it relates to KFS and fund products, the Group's responses are set out in the responses to Questions 12 and 14 below as these questions specifically address KFS in relation to fund products.

In relation to unlisted structured products, the Group strongly objects to the proposal that the Key Facts Statement should be limited to four pages in length. Structured products by their nature have a broad range of key features and risks that may not be capable of being condensed into a four page document and may result in insufficient disclosure to investors. The Group notes that the template set out in Appendix B to the Handbook is itself close to four pages long with no product specific content.

The Group would add that, just because more than four pages is required for an appropriately worded KFS, does not of itself mean that the product has a complexity that renders it inherently unsuitable for retail investors.

While the Group agrees that the KFS should not become a simplified or mini-prospectus, in the case of anything but the most simple products there are likely to be benefits to investors having a fuller explanation of the key features of structured products than it would be possible to achieve within a four page limit.

It should be noted that structured products by their nature may have a range of structures and the terms may also vary between the different categories of product, for example, equity, credit and commodity linked products. Therefore using a one-size-fits-all template would present considerable difficulties. There would also be a risk that the differences between different types of structured products might not be sufficiently clearly set out in the KFS for structured products where the KFS was prepared from a single mandatory template for all structured products.

Rather than the imposition of a prescribed format and content for the KFS for structured products, it would therefore be preferable for Issuers to have the latitude to summarise the key features and risks of the product in the way they regard as being most appropriate, which might require exceeding the four page limit. However, the Commission would of course have the final say in determining whether the KFS prepared by the Issuer does not achieve the aim of the SP Code in providing a concise description of the key features and risks of the product.

In respect of the liability of the Issuer for the statements in the KFS, the Group supports the proposal[1] that the KFS will form part of the Offering Document and in particular that the investors should not invest in the product based solely on the KFS. Please also refer to the Group's response to Question 12 below.

However while the Group recognises the benefits of the KFS being a concise and brief document which investors can review to get an understanding of the key features and risks of a product, an inevitable consequence of this is that there may be risks that are not included in the KFS for the sake of brevity but which subsequently eventuate and result in investors achieving a lower return on an investment than they may otherwise have received. In the same way, there may be features of a product which while not necessarily the "key" features of the product, may result in the investor getting a reduced return on their product. Again all features of the product could not be included for the sake of brevity and conciseness.

[1] A minority of group members have a dissenting opinion that the KFS should NOT necessarily have to form part of the offering document but that the KFS be read together with the offering document. We understand others have suggested the Commission consider allowing product providers the option to decide whether the KFS: (i) is to be read together and handed out with the prospectus but does not form part of the offering document; or (ii) forms part of the offering document. To the extent the Commission is able to provide flexibility, this would be preferred to either deciding for one proposal or the other.

As a consequence, the Group requests that the Commission include wording to further clarify the liability of Issuers for the KFS by making clear that to the extent that the KFS does not contain any inaccuracy, no additional liability shall attach to Issuers for the KFS, i.e. that Issuers shall be liable for the disclosure contained in the Offering Documents read as a whole and not separately liable for the content of the KFS.

In this regard, the Group also wishes to note its concern that the requirement for KFS in SP Code 6.3 is that the KFS shall contain "*sufficient* information to enable investors to comprehend the key features and risks of the relevant product". This is different from the requirement in Chapter 6.7 of the Overarching Principles in the Handbook which is that the KFS should contain "information to enable investors to comprehend the key features and risks of the relevant product". The Group assumes that it is not intended that a higher standard for KFS should apply for structured products than for other products in this regard and would therefore urge the Commission to delete the word "*sufficient*" from SP Code 6.3.

The Group opposes the use of the word "*sufficient*" because it suggests that if any information about the key features and risks of the product is missing from the KFS then liability would attach because it did not contain "*sufficient*" information. The Group respectfully submits that the requirement for sufficiency of information would apply to the prospectus as a whole but should not apply to the KFS which is necessarily a brief summary of the key features and risks and is not intended to replace the Offering Document.

Use of disclaimers – OP 6.12

The Group considers that clarification is needed from the Commission about the requirement that "*disclaimers may only be used where it is permitted under the applicable product code and any disclaimer shall be reasonable*".

First, and in particular, there seem to be no provisions in the Handbook which expressly set out which disclaimers would be permitted.

Second, the word "disclaimers" does not have a single, widely understood meaning. It is routine for product providers to establish the parameters of their legal relationship with investors by, for example, stating that they are not providing investment advice to investors or that investors should themselves consider whether an investment is a suitable investment for them given their current circumstances. It is hard to see how such statements can be objectionable.

Where obligations are imposed on product providers by regulation or by law which are not as a matter of regulation or law capable of being excluded by contract or representation, then any language attempting to do so will be ineffective. Therefore the second requirement that

"*Use of disclaimers to exclude or limit the relevant party's obligations towards investors which are otherwise imposed on it at law and/or under any other applicable rules, codes or guidelines shall be avoided*" seems to be redundant.

The Commission is requested to clarify what is intended by OP 6.12 and also to consider whether these requirements are necessary given the other specific requirements of the Overarching Principles and the product codes which are proposed.

Overarching Principles: Chapter 3.4 and Chapter 7 - Monitoring of the product and information to investors

On-going Disclosure –General Principle 2 (Chapter 3.4) and OP 7.1

The Group supports the proposals to provide information to investors on an on-going basis. However, the Group has a number of concerns on the detail of the proposals which are set out below. In particular, the Commission is requested to provide additional guidance in the Handbook as to what it would consider to be "effective measures" for "timely disseminating information to investors".

The current practice, which reflects the position under the Code of Conduct, is for information to be provided by product providers to the intermediaries which sold the product and for those intermediaries to provide the information to their customers.

The Group considers that this continues to be the most appropriate and effective method by which information can be disseminated to investors. This is because intermediaries have a direct ongoing relationship with their customers whereas the product providers do not. In fact, product providers are not in a position to know who the ultimate investors are.

However, product providers do recognise that, with the development of technology, webpages may also provide a useful way of providing information to investors and, in that regard, would urge the Commission to establish a webpage similar to the webpage run by the Stock Exchange of Hong Kong on which key information about each product which is authorised by the Commission could be published, including the prospectuses for the product and any further information which is published by issuers or intermediaries from time to time.

In addition, where appropriate, product providers may be able to maintain their own websites, on which relevant information in respect of an investment product may be posted. However the Group considers it inappropriate for it to be mandatory that product providers maintain their own websites for the purposes of publishing such information.

The Group considers that the best approach is for issuers to have the flexibility to choose how the information is disseminated to investors and that, although each of the above-mentioned options should be available, it will as a general matter be appropriate for the financial

institution that sold the product to the investor to be the one that communicates the information to that investor. The Group does not consider that one particular method of disseminating information should be mandatory for all types of information and all products.

The Group also urges the Commission to recognise when issuing its guidance on this requirement that the meaning of "timely dissemination" will need to take into account the fact that the majority of unlisted structured products are buy-to-hold products which are not intended to be tradeable products. In this regard, it is not necessary that information be provided on a short timetable and the Commission should take into account the time required for preparing and translating the documents which contain the relevant information to be disclosed.

The Group also urges the Commission to clarify that where product providers provide information to an intermediary so that this information can be provided to the customers of that intermediary, the product provider is not responsible for ensuring that the information does in fact reach these customers. Such a requirement would be unnecessary as the intermediary would already be obliged to provide this information either under the Code of Conduct or under the distribution terms agreed between the product provider and the intermediary. It would be very difficult for a product provider to comply with such a requirement in practice.

Issue of Advertisements – OP 7.2

The Group notes that each advertisement will undergo a "due review process" carried out by a "competent delegate" designated by the issuer's senior management. The Group requests that the Commission clarify certain issues pertaining to this requirement: first, that this delegate could be appointed internally and would occupy a senior position; second, and in relation to SPVs, could the relevant delegate be a duly authorised person of the Product Arranger and third, could the Commission indicate what persons it would regard as "competent" to fulfil this role?

While the delegate is specifically designated by the issuer's senior management to be responsible for reviewing the advertisement, the Group notes that Chapter 7.2 also states that "*such delegate shall be duly authorised to issue the advertisement on behalf of the issuer of the advertisement*". The Commission should therefore clarify if, in any circumstances, the delegate will assume individual liability towards investors for the accuracy of advertisements that the delegate has reviewed, in which case defences should be made available for the delegate.

Finally, where appropriate, the delegate should also be able to further delegate the review responsibility if the Issuer has consented to this.

The Commission is requested to clarify if it is the intention for the delegate to issue the advertisement following his review and, in doing so, bind the Issuer who would remain solely responsible for the advertisement, as contemplated by paragraphs 25-27 of Appendix D.

Investor Education – OP 7.3

The Group supports the initiative to improve investor education but the Group does not support any proposal that would make it a regulatory requirement for product providers to directly "provide investor education" to investors. The Group urges the Commission to preserve the distinction between the role of the product provider and the intermediary, who, in the latter case, at all times remains in immediate contact with the investor and controls the selling and marketing initiative. Ultimately, it is a primary function of the intermediary to explain the features and risks of the product to its retail client as a potential investor and to fully develop that investor's understanding of the product's risks and rewards.

Separately, it is unclear from a practical perspective what the Commission envisages would be the role of product providers in providing investor education and to what extent this might result in a regulated activity licensing requirement. For example, what education material should be produced beyond the requisite disclosure that explains and describes the product in offering documentation? It is also unclear who would be the appropriate personnel to undertake face-to-face training or presentations directly with investors.

Product providers are also concerned about the liability that would arise from product providers being mandatorily required to have direct interaction with investors to explain products to them and being seen to adopt one of the roles of the intermediaries as the primary conduit for investor education as a result of a regulatory requirement.

While product providers may in certain circumstances consider it appropriate to become involved in initiatives to improve investor education, which of course should be permitted, the Group resists a mandatory requirement to this effect.

The Group believes that efforts to improve investor education should be channelled through the Investor Education Council. Product providers can assist in the overall education initiative by providing necessary information or guidance material to the Investor Education Council and the Products Advisory Committee for products that are new to the Hong Kong market.

2. CONSULTATION IN RELATION TO THE SP CODE (QUESTIONS 2 TO 4)

In relation to the Commission's proposals in respect of the SP Code generally, the Group recognises the benefits in enhancing investor protection which can be achieved by increased product regulation. If appropriately implemented, such protections may have the very beneficial effect of developing and encouraging the market for investment products which are available to retail investors in Hong Kong.

However, it is clear to the Group, and the Commission has itself publicly stated, that care needs to be taken to ensure that the regulatory requirements imposed are proportionate to the protections achieved and that they do not stifle the vibrant and innovative nature of the Hong Kong market for retail structured products.

While there will clearly be an increased cost and burden of compliance for product providers as a consequence of the proposed SP Code, and the Group accepts this, it should be appreciated that where the associated costs are significantly increased, they are likely in the first instance to undermine the returns available to investors in structured products. In some cases, there is also a risk that certain products which would otherwise be appropriate for investors may not be viable, with the result that products which are available to retail investors in other developed markets are not available to investors in Hong Kong.

In addition, in the case of some of the SP Code proposals, the significant increase in potential liability for product providers due to the SP Code may result in it becoming difficult for product providers to accept the liability associated with issuing structured products in Hong Kong. This may discourage the involvement of some product providers in the Hong Kong market, which may narrow the range of offerings and types of products available to retail investors in Hong Kong.

The particular concerns of the Group from a liability perspective have been raised in the response below and include, for example, those relating to certain of the requirements for ongoing disclosure by product providers (including the requirement that product providers disclose the reasons for material fluctuations in the valuation of structured products), the requirement that product providers confirm to the Commission that a product has been designed fairly and is appropriate for the target market, the ability of the Commission to require product providers to give wide-ranging and unspecified undertakings to the Commission at any time (including after a product is issued), the requirement that product providers use due care and diligence in selecting distributors (and, in particular, that they assess their suitability and competence), the onerous requirements that are imposed on issuances of structured products by special purpose vehicles (including the requirements applicable to collateral) and the ability granted to the Commission to insist that a product provider give compensation to investors for any failure to comply with Handbook (which creates uncertain potential liability for product providers and by its express inclusion suggests greater potential liability than exists under the existing legal system in Hong Kong).

The Group is certain that these consequences are not intended by the Commission as it is clearly important to both the Commission, the industry and retail investors that a vibrant and innovative financial services market is available to investors in Hong Kong. However the Group feels it necessary to highlight its concerns and these are set out below.

The Group urges the Commission to work with product providers and other interested parties to ensure that a proportionate regulatory framework is established in Hong Kong to allow investors continued access to products which are suitable for their investment needs, while at the same time allowing product providers to appropriately identify and control their potential costs and liabilities associated with providing structured products to retail investors in Hong Kong.

Question (2)

What are your views on the proposed disclosure requirements in Appendix C (Information to be Disclosed in Offering Documents for Unlisted Structured Products) and Appendix D (Advertising Guidelines Applicable to Unlisted Structured Products) to the SP Code?

We set out below the Group's comments in relation to the disclosure requirements.

Disclosure Requirements in Appendix C (information to be disclosed in the offering documents)

The Group generally supports the proposals designed to support the overarching principle that issuers must "provide information necessary for investors to be able to make an informed judgment of the investment". However, the Group are concerned that some of the detailed requirements in Appendix C are unduly onerous. These are set out below.

Paragraph 1(e) – the Issuer and other key parties

The address for service of process should be the registered office or address for service of process of the relevant issuer, guarantor and/or key product counterparty and not of the directors of those entities as is currently stated in the Handbook.

Paragraph 2(f) - Key components of the structure and any embedded derivatives

While the Group agrees that disclosure of the existence of embedded derivatives in a product is useful and important, the Group does not regard it as feasible to set out the "key components of the structure". The Group assumes that this means the underlying options and strategies comprising the relevant structured product. However, if this is what is intended,

the Group submits that disclosure of such information would draw investors' focus away from the actual product pay-off, which is the critical feature which is relevant to investors. The requirements of 2(d), 2(h) and 2(i) of Appendix C already provide sufficient disclosure.

Paragraph 2(l) – How rights on an event of default or termination event can be enforced

The Group requests the Commission to provide further guidance on how much detail is required to be included in the Offering Document in relation to how the rights of investors can be enforced and any risks or limitations affecting such rights. In common with many legal matters relating to enforcement, not least in the context of an insolvency, complex issues are involved for any investment product, whether or not it is a structured product, and the Group questions the utility of providing lengthy and detailed legal analysis of these questions in the prospectus and, in addition, whether such a requirement is proportionate.

Paragraph 10(c)(iv) – Market statistics for a period of at least 5 but not more than 6 years

The Group considers that it is unduly onerous that there be included the market statistics and other information set out in paragraph 10(c)(iv) "*for a period of at least 5 but not more than 6 years or a period equal to the maximum tenor of the structured product, whichever is the longer*". The inclusion of this information is excessive and seems to be of limited utility to investors. This requirement would be particularly onerous where a product is linked to the performance of a basket of multiple shares, each requiring separate disclosure against these requirements.

Paragraph 36 – Taxation

The Group considers it inappropriate for the Offering Documents to contain details on "tax implications for investors". The Group strongly urges the Commission to maintain the current practice where Offering Documents provide an overview on taxation matters, together with a statement that investors should seek independent advice (including those pertaining to taxation matters). This should be sufficient, given that the tax analysis for a particular product may vary widely depending on the status of the relevant investor, and that product providers are not acting in a capacity as tax advisor to investors.

Advertising Guidelines Applicable to Unlisted Structured Products in Appendix D

The new advertising guidelines for structured products in Appendix D to the SP Code will present some difficulty in practice in view of the competing pressures to issue advertisements, with adequate risk disclosures, and be succinct. In addition, some guidelines (e.g. para 13) are impractical and onerous in non-print media.

Advertisements – SP Code 6.7

The Group requests the Commission to provide clarification on SP Code 6.7 in relation to the circumstances in which it will withdraw its authorisation for an advertisement.

Question (3)

What are your views on the requirement for Issuers to provide ongoing disclosure of the types of information set out in 7.6 of the SP Code throughout the term of a structured product? Please explain the reasons for your views. Are there any other matters which you think an Issuer should be obliged to disclose to investors on an ongoing basis?

We set out below our comments in relation to the on-going disclosure requirements.

Post-Sale Disclosure

As mentioned above in the comments on the Overarching Principles**,** the Group acknowledges the importance of providing information to investors on an on-going basis and agrees that this is a necessary and important part of the product life-cycle. However, the Group wishes to seek clarification on a number of the proposals and also has some concerns about the detail of the proposals which are set out below.

While the Group acknowledges the importance of providing information to investors on an on-going basis after the issuance of the product, the Group believes that the information required by the SP Code to be provided to investors should fall into three categories:

Category 1: disclosure of any material change in the financial condition of the Issuer guarantor and/or (in the case of SPV issuances) the Key Product Counterparty, that may affect its ability to meet its obligations under the structured product;

Category 2: disclosure to intermediaries of indicative secondary market prices of the structured product on a regular basis, which the Group strongly believes will provide investors with the primary information that they require to track the performance of the product; and

Category 3: notices to investors where operative provisions in the terms and conditions of the structured product have been triggered by specified events or circumstances, including those relating to the Reference Assets, e.g. a credit event may trigger an early redemption of a credit-linked product or a merger event may trigger a change in the entity which is the

Reference Asset for an equity-linked product. In these cases, once these events occur, as a matter of the terms and conditions of the product which have developed by market practice, such events would be notified to investors to explain to them the effect of these events on the product.

In particular, for the reasons set out below, the Group considers that it is not appropriate for product providers to be required, after the issuance of the product, actively and as a matter of specific regulatory requirement, to provide information to investors through the information channels about:

(a) the Reference Assets for the product, except as referred to in Category 3 above; or

(b) with the exception of information relating to the Issuer or the Guarantor of the type set out in Category 1 above, events or circumstances which may affect the price or value of the product.

The Group believes that the Handbook is broadly consistent with this approach, however the Group notes the following points:

Material fluctuation in the indicative valuation of the product

The Group strongly opposes the requirement of SP Code 7.4 that "where there is a material fluctuation in the indicative valuation of the product, the Issuer should provide a timely and effective explanation to investors." This is for the following reasons:

First, the Group is not aware of any other equivalent requirements in the jurisdictions of other developed economies.

Second, the meaning of material fluctuation is inherently vague and would provide very little guidance to Issuers as to when this disclosure obligation would be triggered. Investors might regard any change in the value of their product as material to them.

Third, it would be very inadvisable to require Issuers to explain to investors why there had been such a change in the value of the product. The value of any product is inherently a composite of a broad range of factors and, in even the most simple cases, it would be very difficult for Issuers to explain to investors exactly why the value had been affected. Many times the value of Reference Assets is affected by market rumours, which may subsequently dissipate, and it would be inadvisable for Issuers to effectively be required to broadcast these market rumours to investors which may result in the development of a false market.

Fourth, events affecting the value of a Reference Asset and consequently the value of the product are constantly evolving, often at a very fast pace. To require Issuers to produce information to investors on an ongoing basis, explaining the reasons for these changes, would

result in a flood of information much of which would simply fuel speculation and uncertainty and may create panic in the market. In addition, this information would need to be provided in both Chinese and English, which would increase the cost of providing the information while also affecting the speed at which this information could be provided.

Fifth, it is an obvious point to make and unarguable that investors should take responsibility for their investment choices and should actively monitor their investments. Product providers are not in a position to perform this role for investors.

Sixth, the Group is also concerned about the liability which may attach to such notices, as by implication investors may use the information in these notices to decide whether to exit or remain in the product. In this case, there is a high risk that investors may seek to bring actions for negligent misstatement against Issuers if they consider that the information provided did not sufficiently explain the reasons for the price movement or, as a result of the evolving fact pattern, the information provided in the notice proved not to have emphasised the factors that proved to be most important.

For these reasons the Group considers this proposal to be unworkable in practice and would be likely to lead to product providers being reluctant to issue structured products in Hong Kong.

Significance of secondary market bid prices

As is discussed in further detail in the response to Question 8 below, the Group considers that secondary market bid prices are the most accurate indicator of the value of a product to the investor.

In addition, it is the Group's view that secondary market bid prices represent the most significant indicator to investors of the performance of the product.

In this regard, if investors are provided with secondary market bid prices on a regular basis, the Group considers that this should provide investors with the primary information they need from Issuers as to how their product is performing. Consequently, where investors are provided with secondary market bid prices on a regular basis, product providers should not as a matter of regulatory requirement be obliged to provide further ongoing information to investors about the Reference Assets for the product or the performance of the product, except as set out above. If there is a substantial drop or rise in the secondary market bid prices for a product, then investors may make further inquiries as to the reasons for this, either by making their own investigations or by contacting the intermediaries that sold them the product in order to find out more information about the change in the value of the product.

Aside from those matters mentioned in the Commission's proposals, and as discussed in this response, there are no other matters which the Group considers that Issuers should disclose to investors on an on-going basis.

SP Code 7.6(a) - Annual report and financial statements of the issuer, guarantor or key product counterparty to be provided to the Commission and made available to investors

Financial Statements (Post-Sale)

The Group accepts the proposal for financial information to be made available during the lifetime of the product.

However, the Group sees no reason why the ongoing requirements for disclosure of financial information in respect of unlisted structured products should extend beyond those disclosure requirements for listed structured products and, in this regard, suggests that the requirements do not exceed those under Chapter 15A of the Listing Rules of the Hong Kong Stock Exchange. The Group notes that the proposals in SP Code 7.6 differ from Chapter 15A by requiring the financial statements of the Key Product Counterparty to be disclosed.

SP Code 7.6(a) raises several important issues which are set out below.

First, as mentioned above, the method of disseminating information to investors must be practical and cost-effective. The Group considers that sending hard copies of the financial statements to investors would not be practical. The Group proposes that internet-based disclosure of financial statements on a webpage of the Commission should be sufficient as this is a practice that is already followed in respect of listed structured products.

Second, the Group is concerned about the implications arising from the requirement for information to be made available in English and Chinese. There are significant cost implications in translating this financial information into Chinese, not just in terms of the cost of translating the documents themselves, but also in view of the fact that auditors generally prefer to review and provide their approval to the translation. These costs and the time required for this should not be underestimated particularly given that, if the Issuer is an SPV, the Key Product Counterparty is also included. In addition to the costs associated with other proposals, the full extent of these translation costs are likely to be passed on to the investor. In addition, this translation work may represent a barrier to entry for issuers with small retail platforms which do not in the usual course prepare their financial information in Chinese.

Third, there is some concern amongst the Group as to whether a four month period after the end of the relevant accounting period will be sufficient for certain issuers to distribute the financial information given the initial delay in obtaining the English version and the need for lengthy translations with the auditor's added review. In the case of listed structured products,

this timeframe is already challenging for issuers, including those issuers who produce their financial statements in a language other than English and are required to translate these into English. For those issuers, the problem will be exacerbated if the financial statements once translated into English are then required to be translated into Chinese. For the reasons given above and based on experience with listed products, the Group requests that the Commission consider extending the four month deadline for all issuers.

It is also worth noting that potential liabilities may arise from any discrepancy between the English and Chinese versions of the document particularly to the extent these can occur inherently when translating English to Chinese. The Group therefore urges the Commission to accept that for liability purposes the English version of financial statements will prevail over the Chinese version. Please refer to the position of the Group which is set out in further detail in the responses to Question 1 (in respect of OP 5.6).

The Group objects to the requirement that the Issuer, and where applicable, the Guarantor or the Key Product Counterparty must provide full details of financial information provided any other securities or financial regulator, stock exchange or market. This will result in a considerable excess of information which is not necessarily helpful to an investor. Issuers would have to establish or modify internal systems and processes to capture this information, the cost of which would further undermine a product's return. In addition, it is unclear what information this requirement is intended to capture and the Group expects this to give rise to disproportionate difficulties from an administration and compliance perspective. Although the Group is opposed to this requirement for the reasons set out above, if such a requirement were to be imposed, clarification would need to be provided by the Commission that this requirement is intended only to refer to publicly available filings which are made to the relevant regulator, stock exchange or market, as it should not cover any information which is provided to a regulator or stock exchange in confidence.

In addition, the Group considers that only the financial statements contained in an interim report published by an issuer should need to be disclosed and translated and not any additional disclosure, for example, the "Letter from the Chairman".

For the purposes of disseminating the information required under SP Code 7.6(a) to investors, the Group recommends that web-based disclosure should be accepted by the Commission as an appropriate method of disclosing information to investors. However in this regard please refer to the Group's responses to Question 1 (in respect of the General Principles in Chapter 3.4 and Chapter 7 of the SP Code) which are set out above.

SP Code 7.6(b) ─ Issuer to inform the Commission and make available for investors any material adverse change in the financial condition or business of the issuer, the guarantor or their respective corporate groups.

SP Code 7.6(c) – Issuer to inform the Commission (and make available to investors) of any changes in circumstances that may have a material negative effect on the issuer, the guarantor or the key product counterparty to fulfil its commitments

In respect of SP Code 7.6(b) and 7.6(c), the Group acknowledges the need for enhanced disclosure of significant information and other developments affecting the Issuer for the duration of the investment. The Group recommends that any disclosure should only relate to matters affecting the financial condition of the Issuer or the Guarantor, and not the general business of the Issuer or the Guarantor. This is because the only relevant concern to investors should be whether the Issuer or Guarantor is capable of meeting its financial obligations in respect of the product.

The Group is therefore opposed to the requirements in their current form for the reasons set out below.

First, Issuers will inevitably be uncertain in their assessment of what constitutes a "material adverse change in the financial condition or business" of the Issuer which might reasonably be expected to be material to an investor's interests. For Issuers which operate in a multitude of jurisdictions and business types, there may be well-publicised circumstances or events that appear relatively confined without any clear connection to Hong Kong or the Issuer's ability to perform its obligations in respect of the particular structured product held by an investor. Yet, the consequences and materiality of those circumstances may need to be continually re-assessed and the final outcome may not be ascertained for an extended period of time.

It will always be easier in hindsight for issues to be considered to have been "reasonably expected" to be material to investor's interests. The reference to the "business of the Issuer, the Guarantor and their respective corporate groups" makes the scope of this requirement all-encompassing and the monitoring needed to discharge the SP Code's disclosure standard will represent a disproportionate practical and cost burden.

Second, since Issuers will be concerned about potential liability for failure to identify and effectively communicate to investors any information, circumstances or other events which, in retrospect, did reflect a material adverse change in financial condition, there will be a tendency for Issuers to take a cautious view and issue numerous notices to investors for any type of development which may in the future be regarded as "material" in hindsight. Given this overload of information, many disclosure announcements may prove unfounded or immaterial and this is certain to confuse, rather than inform, investors.

Third, it is unclear whether the term "commitments" in SP Code 7.6(c) is intended to only address the Issuer's payment obligations or extends beyond this.

The Group therefore suggests that a more targeted and immediate assessment of whether an

event affects or is of relevance to a Hong Kong investor is whether that event materially affects the Issuer's ability to perform its payment obligations in respect of the particular structured product in Hong Kong.

This seems to be the best means of applying the Commission's general test of determining if an event will create a "material negative effect". The Group therefore suggests that SP Code 7.6(b) and SP Code 7.6(c) be merged and formulated within this more focussed approach. This would also ensure the requirements for unlisted and listed structured products become more harmonised.

The Group therefore proposes the following requirement:

> *"The Issuer shall keep the Commission and all investors in the structured product informed as soon as reasonably practicable of any material adverse change in the financial condition of the Issuer or the Guarantor which could reasonably be expected to materially affect the ability of the Issuer or the Guarantor to perform its obligations under the structured product".*

SP Code 7.6(d) ─ Issuer to notify the Commission and all investors of any failure of a material portion of the collateral or any breach of the requirements of the Code by any trustee/custodian.

The Group regards this as an extremely onerous obligation. It is not clear whether "failure" relates to a technical defect regarding the collateral held (such as the discovery of defective title, the occurrence of an event of default or a mandatory early redemption relating to the collateral or any security arrangements proving invalid or unenforceable) or if the emphasis is a severe reduction or total loss in the valuation of the collateral. Clarification from the Commission should be provided.

In addition, what will be regarded as a "material portion" will inevitably change with the benefit of hindsight and may be determined according to a variety of factors, including simply the size of the amount of collateral concerned, the rating of the collateral or its liquidity.

Finally, in addition to monitoring the collateral, SP Code 7.6(d) will require the Issuer to supervise and monitor the trustee or custodian to assess daily whether the eligibility requirements under Appendix B remain satisfied. This will represent another cost which will undermine the return of a structured product and bring into question its long-term viability for a product provider. The Group expects that, in practice, Issuers will be forced to pursue a cautious approach by providing notices on an overly regular basis where Issuers are uncertain of whether the failure is "material".

SP Code 7.8 – Additional obligations in the event of failure to continue to meet requirements of the Handbook

The Group strongly objects to the current formulation in SP Code 7.8 that if a structured product after it has been authorised, fails to meet the applicable requirements under the Handbook, the Issuer must inform the Commission, "take remedial action to rectify the situation and, where appropriate, provide compensation to investors to ensure that investors are therefore not disadvantaged because of [the relevant] failure".

This requirement seems to create an unpredictable and open-ended liability for product providers which is very different to the legal liability under contract and tort that product providers would be exposed to in the usual course and which would override the existing legal process for resolving issues of liability. The phrase "where appropriate" is very broad and general language and it is not clear how this would be viewed and applied by the Commission. Further consultation is recommended to discuss whether this phrase can be "unbundled", perhaps by reference to examples of the sorts of situation that might arise in which, in principle, the Commission appears to expect at least some degree of compensation to be provided, and how it would see the question of potential compensation addressed as between the different parties involved – the product provider and the distributors respectively.

Question (4)

What are your views on the eligibility requirements for Issuers and Guarantors of unlisted structured products proposed by the Commission?

The Group agrees with the introduction of eligibility requirements. Some of the requirements are relatively familiar and many Issuers and Guarantors will already need to comply with certain requirements in the transaction documentation (for example, SP Code 3.2 (a) and (b)).

Jurisdictions acceptable to the Commission

SP Code 3.2 ─ Issuer to satisfy requirements as to due incorporation or establishment in a jurisdiction acceptable to the Commission and compliance with its constitutive documents and issuance and offering of the structured product to be consistent with the Handbook

The Group notes that the Commission has provided some initial guidance as to what jurisdictions it will regard as acceptable or consistent with the Handbook. One factor relates to whether the jurisdiction's laws would prevent any enforcement action taken by the investor against the Issuer or the enforcement of any judgment or award granted by a Hong Kong

court. It will be useful to clarify what level of comfort the Commission requires. Many jurisdictions have insolvency proceedings with wide-ranging stay regimes or court-sanctioned standstills that protect an insolvent company (for example, Chapter 11 in U.S. and administration in U.K.) and would prevent most types of enforcement or litigation action being taken against such a company. In addition, cross-border enforcement of court judgments (particularly between common law and civil law jurisdictions and in the context of an insolvency) can become difficult and a residual degree of uncertainty always exists which is likely to be reflected as reservations in any legal opinion.

The Commission has also suggested that it will examine whether the jurisdiction imposes restrictions which might adversely affect the investors' acquisition or divestiture of the structured product. This will need to be further clarified and carefully considered in respect of any relevant securities laws relating to the Issuer, particularly in the US that restrict the sale or transfer of notes.

The Group suggests that the Commission produce and publish a defined list of acceptable jurisdictions.

SP Code 3.3(a) - Eligibility Requirements for Non-SPV Issuers

The Group notes that the core requirements which apply to Issuers other than SPVs are similar to those applicable to issuers of listed structured products under Chapter 15A of the Hong Kong Stock Exchange Listing Rules and no objection is raised regarding these core requirements.

However, the Group considers that the scope of SP Code 3.3(a)(ii) is overly wide and excessively burdensome:

> *"it shall be an entity which… is in good standing and in particular, it is not the subject of any disciplinary proceeding in respect of its licence or registration to conduct any regulated activity, is not subject to any action by an exchange, regulated market or self-regulatory organisation for breach of any applicable rules, and has never been convicted of any offence under applicable securities or corporate laws or other laws involving fraud or dishonesty"*

This requirement will be extremely difficult or virtually impossible to satisfy for any financial institution with global operations, particularly given their size, global presence and considerable history of operations. The Group notes that, beyond matters relating to the Issuer's licensing of regulated activity in one jurisdiction, the requirement extends to the rules of exchanges and regulated markets as well. The inclusion of these and those of self-regulating organisations would allow for a whole host of technical breaches that would impact eligibility.

It is not evident how a specific disciplinary action relating to a particular incident in one business area in another jurisdiction should relate to the issuance of a structured product by an entirely separate business in Hong Kong, particularly if it was not a recent event. Even within Hong Kong, there are different business areas within large financial institutions. Given this, sanctions relating to wealth management, for example, should not affect an issuer's eligibility for issuing structured products. It is for these reasons that the Group suggests that both a materiality and time qualification should be applied to disciplinary proceedings, breaches or offences and only public sanctions should be disclosed. The same amendment should be made to the obligations under SP Code 3.5(c).

Finally, the use of the term "good standing" would be difficult to interpret and to our knowledge has no legal meaning in Hong Kong. Presumably, it may address a wide range of concepts, including solvency, compliance with corporate filings or compliance with any laws as well as regulatory rules. It would be clearer for SP Code 3.2(a)(ii) to refer to regulatory aspects only and this would mirror the approach adopted in SP Code 4.2(b) regarding the eligibility of Product Arrangers.

Continuing Eligibility Requirements

The Group firmly believes that the eligibility requirements should only apply at the time that a structured product is issued. As currently drafted, the consequences of a breach of these requirements can be disproportionately severe and do raise difficult practical questions.

The Group notes that if the relevant Issuer is in technical breach of an eligibility requirement (for instance, due to a credit rating downgrade), then SP Code 7.8 requires that the Issuer and, where applicable, each Product Arranger must "cease to advertise, invite offers or subscriptions for, or offer the structured product to the public in Hong Kong". The SP Code provides that the Issuer must inform the Commission and "take remedial action to rectify the situation and, where appropriate, provide compensation to investors to ensure that investors are therefore not disadvantaged because of [the relevant] failure". Will a breach in all circumstances therefore lead to a mandatory buy-back of the structured product? What remedial action would be expected where the Issuer is in technical breach of eligibility?

Once a structured product is issued, the Group considers that the emphasis of the Handbook should be the on-going requirements of market making, provision of indicative pricing and further disclosure. The Issuer will have contractual debt obligations owed to the investors and, in this context, the performance by the Issuer of its obligations and the onset of insolvency of the Issuer should be a matter for the investors with respect to enforcing their contractual rights. While credit rating downgrades, the loss of regulated status or material regulatory disciplinary action may disqualify an Issuer from launching new products, these

should not form grounds by which the Handbook may interfere with the existing contractual framework through which investors seek recourse. Please also refer to the Group's further responses in respect of SP Code 7.8 under Question 3 above.

General Obligations of Issuers

Many of the general obligations contained in SP Code 3.5 to 3.7 reinforce and restate obligations set down in other areas of the Handbook and the SP Code. We have provided responses to these obligations according to the relevant sections of the Handbook and the SP Code where these first appear and we refer the Commission to these with respect to our response regarding SP Code 3.5 and 3.6.

The Group considers that the obligation under SP Code 3.7 has significant ramifications and its effects may be wide-ranging:

> *"an Issuer shall provide information and undertakings to the Commission in such form as the Commission may require from time to time."*

In theory, this obligation will allow the Commission to alter and tailor its requirements for individual Issuers by imposing added responsibilities at any time and presumably at short notice. Moreover, SP Code 3.7 will lead to the possibility of individual Issuers not operating on a level-playing field or individual types of structured products being subject to additional criteria, effectively generating a regime of Issuer- and product-specific SP Codes.

A key success factor for an international financial centre such as Hong Kong is that market participants have a sufficiently high degree of certainty as to their obligations, which would be undermined by the open-ended nature of the proposed obligation. As currently drafted, this provision also creates an unquantifiable and unpredictable compliance and commercial burden on Issuers which may result in Issuers being reluctant to issue structured products to retail investors in the future. This will result in reduced product choice to the detriment of Hong Kong investors and the market generally. This is of considerable concern to product providers and the Group strongly urges the Commission to clarify, as soon as possible and with as much detail as possible, the nature, content and purpose of these undertakings (some templates will be helpful), the circumstances under which the Commission will exercise this power and the procedures, checks and balances which it will establish. For example:

- How much notice will the Commission provide Issuers before imposing an undertaking? Will a review, consultation or appeal process be available?

- Will additional information and undertakings be required from Issuers for the purposes of meeting eligibility requirements or as part of product approval before sale or will additional requirements be imposed at any stage in a structured product's lifecycle and on an on-going basis?

- Is the Commission intending to introduce additional product-specific requirements?
- Will new types of penalties, disciplinary action or other consequences follow for any breach of such additional undertakings?

SP Code 5.2 - Independence from any Key Product Counterparty

The Group requests the Commission to clarify what is meant by "independence". The Group does not believe that it will be commercially feasible to create structures where a swap counterparty is entirely unconnected with the Issuer. It is common place for the swap counterparty to be an affiliate of the arranger of a structured product and this may be desirable from a risk management perspective. We understand that the Commission has stated that it will be sufficient for internal business teams of an Issuer to represent an independent Key Product Counterparty on the basis that adequate checks and balances are established which uphold the integrity and separation of front, middle and back office functions, whereby conflicts of interests are disclosed and the relevant transaction is conducted at fair value and on a fully arms' length basis. The Commission is therefore requested to reflect this position in the SP Code.

In addition, the Group requests the Commission to expressly state in the SP Code that the requirements relating to Key Product Counterparties only apply to issuances of structured products by SPVs and, in particular, that there is no intention to regulate how non-SPV Issuers should enter into their private hedging transactions for the structured products which they issue.

SP Code 5.7 – Any agreement described in SP Code 5.4 and 5.5 to be subject to non-exclusive jurisdiction of Hong Kong courts

The Group does not object to the terms and conditions of structured products issued to retail investors in Hong Kong being subject to Hong Kong law and to the non-exclusive jurisdiction of the Hong Kong courts.

However, the Group questions whether it is proportionate to require all other agreements and obligations described in SP Code 5.4 and 5.5 to be subject to the non-exclusive jurisdiction of the courts of Hong Kong. For example, some institutions, when acting as guarantor, require the relevant guarantee as a matter of policy to be in standardised form on a global basis and this would include the governing law. In addition, this may require the renegotiation of a broad range of documentation between an Issuer and its service providers.

Nomination of an individual as an approved person – SP Code 1.5

The Commission is requested to clarify why there is a requirement for that an individual who is an approved person must have both a Type 1 and a Type 4 licence.

3. CONSULTATION IN RELATION TO SP CODE – SPV ISSUERS (QUESTIONS 5 AND 6)

Question (5)

(a) What are your views on the proposed requirements applicable to SPV Issuers?

Eligibility criteria for SPV with a Guarantor

The eligibility criteria for a SPV whose obligations have been guaranteed entails treating the relevant Guarantor as if it were the Issuer, so the Guarantor itself must satisfy both the core requirements in Appendix A and the good standing test as to the absence of regulatory disciplinary action. In this regard, please see our comments above. In addition, we note the relevant guarantee must satisfy the requirements in SP Code 5.9 and 5.10 as to the terms of the guarantee and that the guarantee is validly authorised and not in conflict with the Guarantor's constitutive documents or the laws of its jurisdiction. The Group agrees with these requirements.

Eligibility criteria for SPV with collateral

The eligibility criteria for collateralised SPVs addresses both necessary corporate characteristics directly relating to the SPV and qualities relating to the collateral. The Group supports the corporate requirements (including the need for limited recourse and non-petition arrangements and the use of independent directors). The Group considers, however, that collateral criteria under SP Codes 5.12 to 5.22 will severely restrict the types of collateral that can be held by a SPV. It would appear that only cash or a cash-like instrument (i.e. a government bond) will be sufficient (please refer to our responses to Question 6(a) for further detail). This will prevent many SPV transactions from being viable and is likely to minimise or end SPV transactions as a structured product device that would otherwise boost product range and innovation for the benefit of investors and which has been shown to provide successful investor protection against the onset of insolvency affecting a SPV's arranger.

In the context of collateralised SPVs, an issue of particular concern is the requirement that investors' claims are prioritised above those of the swap counterparty. This is a fundamental departure from the ethos of structured products and would discourage the participation of a swap counterparty in the future, without which very many structured products would be impossible (please refer to our responses to Question 6(c) for this).

Overall, the Group believes the proposed requirements relating to SPVs, particularly with respect to collateral, investor priority and the role of the Product Arranger, is very likely to deter most SPV-issued products and asset repackagings as they will no longer be

economically viable. This will drastically reduce the structuring flexibility, design and innovation of structured products for the future development of the Hong Kong market and reduce the access for Hong Kong investors to certain specific asset classes and types in contrast to investors beyond Hong Kong.

Question (5)

(b) What are your views on the current proposal to mandate the appointment of a Hong Kong-licensed Product Arranger for structured products issued by an SPV and make such Product Arranger responsible for ensuring an SPV Issuer's compliance with the SP Code throughout the term of the structured product?

Product Arranger

The appointment of a Hong Kong-licensed Product Arranger is clearly a marked departure from previous practice involving SPV transactions and the Group notes that this will mean an extensive array of responsibilities and corresponding liabilities which will need to be quantified and will ultimately produce additional costs for the investor. The role of the Product Arranger would mean the establishment of added infrastructure, reporting systems and procedural arrangements and other internal policies. The Group believes that this role is only necessary where structured products are issued by SPVs without any Guarantor, where neither the Issuer nor any Guarantor is present as a Regulated Entity of operating substance to comply with the Handbook.

In addition, there are legal concerns that the Product Arranger may be regarded as a shadow director of the SPV and will inherit a wider set of corporate liabilities. It will be necessary at the very minimum to establish arms' length contractual arrangements between the SPV and its Product Arranger with an arms' length fee payable by the SPV to the Product Arranger which will undermine the return that may be achieved under a structured product.

SP Code 4.2 - Product Arranger to be licensed or registered in Hong Kong for Type 1 (dealing in securities) and Type 4 (advising on securities) regulated activities and not be the subject of any disciplinary proceedings or been convicted of any offence under securities laws or laws involving fraud and dishonesty.

We understand that SP Code 4.2 merely requires the Product Arranger to be regulated in Hong Kong and licensed pursuant to section 116 of the SFO. This is a similar theme in the eligibility requirements for non-SPV Issuers and Guarantors under SP Code 3.3(a). We assume therefore that there is no other specific rationale for referring to a Type 4 licence, given that the Product Arranger will in fact not be fulfilling any active advisory function with respect to investors. The Group requests clarification from the Commission in this regard.

The Group considers that, certainly, both a materiality and time qualification should be applied before recognising any past disciplinary actions which deny the eligibility of a Product Arranger. This follows the Group's comments in Question 4.

In addition, the Group considers that these criteria should only apply as at the issue date of a product. The criteria should not be relevant after issuance. This also follows the Group's views with respect to the eligibility of Issuers and Guarantors under Chapter 3 of the SP Code. Even if a technical breach of the requirements under SP Code 4.2 did occur, it is not obvious what measures or consequences would be appropriate or workable. Undoubtedly, in reality, it would be extremely difficult to locate a substitute Product Arranger within a short timeframe who was willing or able to take responsibility for a structured product with which the Product Arranger was not familiar. In any event, it is unclear why, and in what circumstances, another entity would agree to step into this role.

SP Code 4.3 – Multiple Product Arrangers

SP Code 4.3 contemplates an Issuer appointing more than one Product Arranger in respect of a single product. This appears hard to envisage and the Commission is asked to clarify under what circumstances it would expect or require more than one Product Arranger to be appointed. It seems unlikely that two separate financial institutions would wish to work so closely together with respect to a single structured product given the co-ordinated systems and infrastructure needed to support the on-going post-sale responsibilities.

SP Code 4.4 - Product Arranger shall at all times ensure that the Issuer complies with the Handbook

The precise nature of the liability that the Product Arranger will assume is a key focus for the Group. We consider that SP Code 4.4 is too onerous and should be rephrased to require the Product Arranger "to use reasonable efforts to ensure that the Issuer complies with the Handbook". In any event, the Group also queries, given the requirement that the Product Arranger be independent of the Issuer and strictly outside the Product Arranger's control, how in practice, the Product Arranger can ensure that the Issuer complies with the Handbook. It is worth considering that the Product Arranger will wish to be adequately compensated for the degree of responsibility it will shoulder under the SP Code. This compensation will inevitably be extracted from a product's return and this may jeopardise the commercial rationale for making that product available to retail investors.

SP Code 4.6 – a Product Arranger shall provide information and undertakings to the Commission in such form as the Commission may require from time to time

The Commission should clarify what "undertakings" are likely to be required. Please see our comments above in respect of SP Code 3.7 under the heading "General obligations of Issuers" which are mirrored here.

Question (5)

(c) Do you think a Product Arranger should also be appointed for structured products issued by Issuers (whether SPVs or not) or guaranteed by Guarantors where these entities are not local Regulated Entities (i.e. where the Issuers/Guarantors are not licensed banks regulated by the HKMA or corporations licensed by the Commission pursuant to section 116 of the SFO)?

We consider that an Issuer or Guarantor which is a Regulated Entity under the supervision of a foreign regulator but whose Hong Kong business and operations are substantial enough to contemplate issuing a structured product through a variety of distributors in Hong Kong is, in reality, likely to be licensed or registered in Hong Kong for Type 1 (dealing in securities) and Type 4 (advising on securities) regulated activities such as not to warrant the need for a separate Product Arranger.

Meanwhile, we wish to emphasise that the Product Arranger role should only be necessary in the context of a collateralised SPV Issuer, which is not itself a Regulated Entity or where no Regulated Entity is present in the role of Guarantor with whom the Commission and investors would otherwise regularly deal.

Question (5)

(d) Other than what has been proposed, what other obligations or requirements (if any, both before and after an offering), do you think a Product Arranger should be made subject to? Please give a list of any such additional obligations with reasons.

Please explain your views.

The Group does not propose any additional obligations or requirements on a Product Arranger.

Question (6)

(a) What are your views on the proposed eligibility criteria for collateral in respect of structured products?

Eligibility criteria for collateral

As a whole, the Group is supportive of improving product transparency for the benefit of investors and welcomes the Commission's commitment to a disclosure-based regime expressed in paragraphs 27 and 28 of Part II of the Consultation Paper.

However, in this context, the Group is of the view that the restrictions regarding collateral will constitute a form of product regulation that severely restricts the design and innovation for structured products for the future of the market and, above all, reduces the choice of investments available to investors. Product providers should be given sufficient flexibility in their design and manufacturing of structured products, including the choice of collateral, to maximise the range of products available to investors. In response to this, the Group considers that product transparency should be enhanced on the basis of the full disclosure and explanation of a product's features and inherent risks as the predominant emphasis, not by inadvertently stifling the development and variety of product types, so that investors are able and continue to make their own investment decisions. It is this philosophy which drives the Commission's efforts to develop investor education. Ultimately, in seeking an ideal disclosure-based regime, it is paramount to preserve the flexibility of employing a wide universe of collateral, provided that all necessary information and risks are disclosed to the investor to enable the investor to make an informed investment decision independently.

While certain collateral requirements are acceptable, the Group believes several should be removed and simply addressed instead by way of full and frank disclosure. Therefore, as an alternative, the Group suggests that what information and inherent risks regarding the collateral must be disclosed can be formed by reference to a prescribed list of factors and characteristics based on the proposed criteria.

In addition, the Group considers that any eligibility requirements should apply at the point of issuance following the design stage and not on an-ongoing basis. After issuance, the collateral and its valuation may inevitably change in view of market events. Any change or deterioration in the characteristics or valuation of the collateral should be addressed purely as a matter of disclosure to investors pursuant to the requirements of Chapter 7 of the SP Code and in accordance with those contractual terms of the product designed to protect the investor.

The Group has the following specific comments regarding the eligibility criteria:

SP Code 5.13(a) - the collateral shall be in cash or shall be liquid and tradable

> It would be helpful if the Commission provides specific guidance as to those types of collateral that it would regard as being liquid and tradable, which may effectively serve as pre-approved collateral, given that certain types of collateral such as money market funds (typically regarded as cash equivalent) are strictly not readily

transferable. In addition, as many bonds are traded over-the-counter there may be circumstances where even the bonds of highly rated entities will not have continuously available liquidity.

SP Code 5.13(b) - there shall be an active secondary market for the relevant assets comprising the collateral, with trading carried out by a number of dealers, and trading prices in such market shall be continuously available

The Group is of the view that whether or not there is an active secondary market for the collateral is a matter beyond the control of the Issuer or Product Arranger. Provided that full and accurate disclosure is made, the product provider should be free to select less liquid assets as collateral.

SP Code 5.13(c) – the collateral shall have one of the top three investment grade ratings

Similarly, to the extent that adequate, full and frank disclosure is made, the choice should remain available for product providers and investors to employ and rely upon lower rated collateral. In addition, it is worth noting that a credit rating per se gives no indication or certainty as to the liquidity or ultimate suitability of a particular type of collateral.

SP Code 5.13(e) – the issuer of any such collateral shall not be related to the Issuer or any Product Arranger in respect of the structured product which the collateral supports or any party who is or will be a Key Product Counterparty

This requirement may be practically difficult to achieve although the meaning of "related" must be clarified. The Group considers that any instruments issued by the Product Arranger's affiliates or a Key Product Counterparty's affiliates should be permitted as eligible collateral but the flexibility of using a related collateral issuer must be retained to support product providers. The fact that the collateral issuer is related should simply be disclosed.

SP Code 5.13(h) – the collateral shall be selected for the purpose of securing the interests of investors

As a general matter, collateral is, in fact, strictly held to secure the interests of all secured creditors who participate to allow the structured product to function, including the swap counterparty, the custodian, the trustee, any agent or other third parties providing a role for the product. This requirement should refer to secured parties rather than just investors.

SP Code 5.13(j) – the collateral shall be appropriately diversified

It is traditionally market practice that one type of instrument is selected as collateral with respect to a particular structured product which forms a ring-fenced series of notes, as opposed to a pool containing a variety of different types of collateral assets. It is not clear what factors should be addressed to achieve appropriate diversification (collateral type, collateral issuer, regional or industry-focus). The Group considers that SP Code 5.13(j) is one example of a collateral requirement that is best and simply addressed with disclosure. One may also argue that this requirement appears to contradict the wider goal of achieving simple structures with risks which are easy to explain.

SP Code 5.13(k) – the collateral shall not subject investors to any undue risks

The term "undue risks" is virtually impossible to define objectively and the concept appears practically unworkable. It is clear that investors may need to be subjected to inherent risks relating to the collateral but it would be very difficult to assess in what way those risks will be regarded as "undue" or (objectively) unacceptable? There is also a concern that compliance with this requirement will tend to be judged with the benefit of hindsight. The Group submits that fundamentally the readiness to assume any such risks must surely be a subjective decision for the investor. The Group considers that this proposal should be withdrawn or, at the very least, the Commission should provide scenarios, examples or other objective factors as indications of "undue risks", particularly where other collateral requirements have still been satisfied. Equally, as indicated for the comments to SP Code 5.13(a) above, it will be helpful if the Commission indicates what types of collateral would be eligible or at least would not fail this "undue risk" requirement. The Group would expect that highly-rated corporate and sovereign bonds should remain eligible collateral notwithstanding that certain inherent investment risks will always remain in respect of any such investments.

SP Code 5.14 – the collateral shall be marked to market daily. The issuer shall ensure that such valuation is verifiable and independently conducted on the basis of a reliable up-to-date market value of each relevant asset according to established valuation policies consistently applied and disclosed in the offering document

The Group proposes that collateral valuation is performed on a weekly basis in line with the proposed approach for the provision of indicative pricing in respect of the relevant product overall (see the response to Question 8). Meanwhile, it is not evident if the need for independent valuation necessarily implies the appointment of a third party valuer or if it is satisfactory to use an internal valuation team operating with

sufficient checks and balances to uphold and preserve the integrity and separation of front, middle and back office functions. Further clarification is needed from the Commission in this regard. In any event, it is also worth noting, it may not be possible to accurately disclose valuation policies as this will often be sensitive proprietary information.

SP Code 5.15 – in structuring the structured product and selecting the collateral, the Issuer shall use best efforts to ensure that, in the absence of a default or early termination, the value of the collateral as of the date the structured product matures or expires will be at least equal to the notional amount of the issue

The Group considers that it is the actual redemption proceeds, rather than the mere value of the collateral that is truly important. It is also unclear if, at the time of selecting collateral, the Issuer must select collateral with the very minimum of market value risk or, more likely, the Issuer will need to provide a sufficient degree of over-collateralisation. This will represent a considerable cost component that will also erode the potential reward and appeal of a product to an investor.

SP Code 5.17(d) – the Issuer shall make all necessary arrangements to eliminate or mitigate any risks that would impede or prevent efficient and timely realisation of the proceeds of the collateral for the benefit of investors, including conflict of laws or cross-border insolvency issues

No risks are capable of being eliminated from a technical perspective. It would be helpful for the Commission to indicate what mitigants it would expect to see in place to address conflict of laws or cross-border insolvency issues.

Question (6)

(b) Do you think that collateral should be subject to any additional eligibility criteria? If so, what criteria?

The Group does not propose any additional eligibility criteria.

Question (6)

(c) What are your views on the requirement that investors' claims to collateral proceeds should be accorded priority and should not be subordinated to claims by counterparties to transactions with the Issuer that are related to the structured product?

Priority of investors' claims

The Group has strong misgivings about, and does not support, this proposal. This is a highly contentious area and contrary to market practice. It fundamentally undermines the very business rationale for most transactions and contradicts the very nature of structured products.

In practice, the swap counterparty provides the necessary economic exposure to enable the structured product to function as an investment while providing investors with enhanced potential returns not otherwise possible. The rationale for the swap counterparty being willing to provide this facility as well as inherit the obligations and related risks arising under the swap is that it is given and takes comfort from having a secured claim that is senior to the investors. Accordingly, this is priced into structured products so that investors enjoy a higher level of potential return given that they take the risk of their claims being subordinated to the swap counterparty. Under the Commission's proposal, the swap counterparty will be unable to recover its costs in an enforcement or other liquidation scenario and this leaves little or no incentive for any swap counterparty to participate in the structured product. Where the collateral has passed the Commission's eligibility requirements, it seems unsound for the swap counterparty to guarantee investors' claims by withdrawing its own claims where it has merely provided the facility of an asset swap for the benefit of investors. If this proposal is adopted, it is highly likely that swap counterparties will be unwilling or reluctant to enter into transactions and a variety of products would become unavailable from the market. If investor priority is codified as an essential requirement, this would encourage non-SPV issuances where presumably the unwind cost of the Issuer's own hedging arrangements would anyway first be recoverable. Certainly, investors' returns will be necessarily reduced.

In addition, it is also unlikely any trustee organisations will wish to participate as bond trustee or security trustee in any structured product transactions if the fees for their service and any indemnity claims are subordinated to investors.

It is also unclear whether this provision is intended to apply not merely to default and enforcement but to all types of liquidation scenarios and this should be clarified.

The Group resists any proposal to prioritise investors' claims over those of the swap counterparty. Consistent with a disclosure-based regime, the Group recommends that the investors' subordination is properly disclosed instead.

4. CONSULTATION IN RELATION TO THE SP CODE (QUESTIONS 7 TO 10)

Question (7)

Do you believe that the Commission should take into account any additional eligibility criteria for reference assets, or any other factors, when considering whether or not to accept a proposed reference asset or asset class for a structured product? If so, please list such additional criteria / factors and give an explanation for each.

Reference Assets

The Group recognises that only Reference Assets which are acceptable to the Commission will be permitted. However, the Group believes that a clearer set of criteria could usefully be included in the SP Code and requests that the Commission work with the industry to provide guidance to product providers as to what will be regarded as acceptable Reference Assets.

The Group understands why it is important to the Commission that sufficient information about a Reference Asset be publicly available in English and Chinese. However, the Group is concerned that the practical consequence of this requirement is that the only Reference Assets which will be acceptable to the Commission will be the shares or other securities of companies that are listed on the Hong Kong stock exchange, in that these companies will already be obliged to publish price sensitive information about their businesses in Chinese and in English. In addition, there may also be some PRC, Taiwanese or Singaporean listed companies that may be eligible where such information is published in Chinese, although this would be limited to the extent that equivalent information is not published in English.

The Group considers that it will in almost all cases not be practical or cost effective for an Issuer to translate information published by a non-Hong Kong company or index provider into Chinese or English and to provide this information to investors. This is because typically companies and index providers publish a great deal of information about themselves and it would be completely impractical for the Issuer to be obliged to translate this information into Chinese. In addition, the Issuer would not be in a position to try to select only relevant information for translation. This would make the Issuer responsible for determining which information is relevant to investors and an unacceptable level of potential liability would attach to this.

The Group understands from its discussions with the Commission that it is not the Commission's intention to restrict the range of possible Reference Assets to the shares or other securities of companies that are listed on the Hong Kong stock exchange, as this would severely limit the range of possible investment opportunities for retail investors in Hong

Kong. Therefore the Group recommends that where information about a Reference Asset is not expected to be publicly available in both Chinese and English, this fact should be disclosed in the prospectus with appropriate risk warnings to investors about their ability to monitor developments in respect of the Reference Assets if they are not able to read the information published to them.

The Group is also concerned about the use of the word "transparent" as a benchmark for determining whether a Reference Asset is suitable. This is because the word "transparent" is inherently vague. Instead the Group urges the Commission to provide additional guidance in the SP Code as to how the Commission will satisfy itself that the required levels of information about a Reference Asset will be available to investors.

Product Structure – Confirmations to the Commission - SP Code 5.1

The Group has serious concerns about the requirement of Chapter 5.1 of the SP Code that the Issuer shall satisfy itself and confirm to the Commission that a structured product is designed fairly and is appropriate for the market for which it is intended. It is generally the case that absent such a requirement in the SP Code, Issuers would in any event conduct an internal product approval process. However, the Group has the following objections to Chapter 5.1 of the SP Code.

First, and most fundamentally, there is the uncertainty in what is to be regarded as the "market" for a particular structured product. There is, in reality, no single "market" for any particular product. The Group believes that it cannot be right to regard the market as the class of all retail investors. Further, the Group believes that it would be artificial, and bring with it its own inherent problems, to seek to sub-divide and categorise retail investors into different sub-categories. Fundamentally, it must be for the distributors of specific products, who interface with individual investors, to look at the individual circumstances of each investor, including but not limited to risk appetite, knowledge and experience, market view, investment objectives and the make-up of the investors' investment portfolio as disclosed to the distributor, and to ensure that the investor is in a position to understand the specific products' features and make a genuinely informed decision as to whether to invest in the products. The Group believes that what can be expected of product providers is that they will make a proper assessment of the features of each product, in terms of its risk-return profile, and how it would perform dependent on the behaviour of relevant market variables, and its complexity, and ensure that the documentation relating to the product appropriately describes the product and enables, as a result, distributors to identify for what sorts of investors the product will be suitable. However the Group does not consider that it can be appropriate for product providers to be required to provide risk ratings of products in a numerical or other codified form because the non-linear nature of risk makes such a system inherently

oversimplified and misleading. The Group believes that the approach set out above is consistent with, and is the only approach consistent with, a disclosure-based regulatory regime.

Second, and related to the first point, the Group is very concerned about the breadth and brevity with which the requirement is expressed, which leads them to conclude that this requirement could be used to penalise product providers where a product does not perform as hoped for by investors. In particular, such a requirement as currently expressed in the SP Code could be used in a historic and backward-looking way to conclude that a product which resulted in investors losing money on their investment could not have been fair or appropriate for the target market, whatever "target market" may be regarded as meaning.

Third, and again relating to the first point, the Group understands that it is not the intention of the Commission that such an assessment of fairness and appropriateness would be a substitute for the assessment of appropriateness and suitability by intermediaries under the Code of Conduct. Accordingly, the Group would encourage the Commission to include a provision in the SP Code which expressly clarifies this. In addition, the Group understands that the Commission does not intend to involve the product providers in determining whether a product is suitable for an individual investor's needs and this suitability assessment, as is the current position, will be required to be conducted by intermediaries under the Code of Conduct.

In addition, the Group strongly objects to being required to confirm in writing to the Commission that the SP Code is designed fairly and is appropriate for the market(s) for which it is intended. The Group is not aware of any equivalent confirmation requirement in any other relevant jurisdiction and considers that such a requirement is excessive.

Question (8)

(a) Should indicative valuations of structured products be required to be provided daily? Do you think there are additional or other measures which could help investors to assess the performance of their investments? If so, please provide details.

(b) With regard to the proposal to provide liquidity by way of making firm price quotations, do you think an exemption is justifiable for structured products with a short scheduled tenor, e.g. of one month or less? How often do you think Issuers or their market agents should provide liquidity by way of making firm price quotations? Do you think that there are other circumstances or periods during the term of certain structured products in which liquidity provision should not be required or could not reasonably be provided? If so, why?

Indicative valuations

The Group considers that indicative valuations are not the best method of providing investors with information about the performance of their product. This is because valuations are generally made at mid-market rates with funding and other assumptions that the product will remain outstanding until maturity. As a result a valuation may not necessarily reflect the price at which an investor could exit the product prior to maturity.

As a consequence, the Group recommends that, instead of indicative valuations, information should be provided to investors of indicative bid prices for the product, being an indication of the price at which the Issuer would buy back the product, as this will give investors a more accurate view of what the product would be worth to them if they exit the product prior to maturity.

The Group considers that daily information about the valuation or bid price of a structured product is excessive for the following reasons.

First, most structured products are structured and sold as buy-to-hold investments and as a consequence investors will not be expected to make decisions on a daily basis as to whether or not to remain in the product.

Second, as the products are normally structured as buy-to-hold investments the provision of daily valuations or pricing may risk creating the impression for investors that these products are tradable products, which is not the case.

Third, providing daily valuations or pricing for all unlisted structured products would be a very onerous obligation and would require a very substantial amount of infrastructure, including staffing and information technology investment, none of which would be warranted for the reasons set out above.

Liquidity and Secondary Market-Making

The Group considers that given the buy-to-hold nature of structured products, it is reasonable for Issuers, either themselves, or through their market agents, to provide pricing information to intermediaries on a weekly basis in respect of the majority of structured products.

It should be noted that for structured products it is not appropriate for Issuers to publish firm price quotations because the price for a structured product will be dependent on a number of market factors, each of which may be time sensitive and subject to market volatility.

In addition, as the investors in structured products are normally not the customers of the Issuer, Issuers are not in a position to give firm pricing directly to investors.

As a result the Group would recommend that price quotations be given to intermediaries on an indicative basis and that these prices are then provided by intermediaries to their clients.

If a client wishes to sell back the product then the client should inform the intermediary who sold it the product and thereafter the Issuer will be in a position to give a firm price to the intermediary on which the client would be able to transact through the intermediary.

There are also significant issues with making provision of pricing mandatory. While the Group recognises the benefits of there being a channel through which investors are able to sell back their products, there may be circumstances in which it will be difficult for Issuers to provide pricing. Examples of this may include where there is market disruption or where there is insufficient liquidity for the Issuer to transact its hedges in relation to the termination of products. The Group would therefore urge the Commission to require the provision of indicative prices on a reasonable efforts basis with an acknowledgement that there may be circumstances where such prices cannot be provided, including for the reasons set out above.

In addition, typically limitations on order size are imposed by an Issuer when an indicative price is given, because where these order sizes are exceeded, changes are required to be made to the pricing to take into account funding, liquidity and other assumptions. The Group would therefore urge the Commission to include a recognition in the SP Code that a limitation on order size will be acceptable.

If a cooling-off period is imposed by the Commission (in relation to which please see the responses to Questions 29 to 32 below), then the Group considers that for structured products with a tenor which is longer than 6 months, the SP Code should specify that indicative pricing will only be required to begin after the first three months has elapsed after a product has been issued. This is because most structured products are buy-to-hold products and therefore it should not be necessary for investors to exit the product for the first three months after issuance. After the three month period, investors would have full access to the secondary market making facility referred to above.

In respect of products with a tenor shorter than 6 months, the Group considers that it should not be necessary for indicative pricing to be provided by the Issuer.

Question (9)

Please give your views on the use of annualised returns in offering documents and advertisements for structured products.

The Group agrees with the Commission's proposal on disclosures in relation to annualised rate of expected return.

Question (10)

Please provide your views on the length of the transition period for compliance with SP Code requirements for unlisted structured products where the issue of documents has been authorized prior to the date of the SP Code's effectiveness.

The Group requests that the Commission provide a confirmation that the SP Code will only apply to structured products which are offered or issued after the implementation of the SP Code.

5. CONSULTATION IN RELATION TO THE UT CODE

Question (11)

In relation to proposals regarding investment activities set out in Proposal 1 (Structured funds), Proposal 2 (funds that invest in FDIs) and Proposal 3 (investments in other schemes), other than the proposed general requirements, what other requirements do you think should be included? Please explain your view.

Proposal 1 and 2 – Application of Chapters on Structured Funds and Funds that invest in FDIs (UT Code Chapter 8.8 and 8.9)

The Group welcomes the introduction of *Structured Funds* and *Funds that Invest in Financial Derivative Instruments* in Chapter 8.8 and Chapter 8.9 respectively. Given that it is increasingly common for schemes to invest primarily in FDIs and the Commission is already authorising such schemes, setting out the requirements for Structured Funds in the UT Code (Chapter 8.8) will enhance transparencies and the market development in this area. On the other hand, the introduction of Funds that Invest in FDIs (Chapter 8.9) will provide a more comprehensive platform for non-UCITS schemes investing in FDIs.

The relationship between Chapter 8.8 and Chapter 8.9 in the context of UCITS III schemes is not entirely clear though. How would a UCITS III scheme be categorized for SFC authorization going forward? Whilst Chapter 8.9 clearly only applies to non-UCITS III schemes (except for Chapter 8.9 (j) and (k) which also apply to UCITS schemes using FDIs for investment purposes), the same is not clear on the face of Chapter 8.8. The prevailing view seems to be that by not abolishing the Interim Measures and the Streamlined Measures for Processing UCITS Schemes with Special Features (which were issued in March 2005 and 2007 respectively), the Commission is minded to maintain the status quo for UCITS III schemes which will continue to be authorized pursuant to the procedures and requirements stipulated in the Interim Measures and the Streamlined Measures for Processing UCITS Schemes with Special Features. What if a UCITS III scheme meets the definition of "structured fund" in Chapter 8.8 - do the Chapter 8.8 requirements then apply in addition to the streamlined measures? If not, to what extent would the Commission nonetheless adopt these requirements as a matter of practice when authorizing a UCITS III fund that invests substantially all of its assets in one FDI?

As a related point, the Group would like to seek clarification that Chapter 8.8 is not intended to apply to a UCITS III scheme using FDIs for investment purposes where it does not meet the "substantial" test in Chapter 8.8 (see below).

More generally, can the Commission share its thinking behind the decision not to codify the Interim Measures and the Streamlined Measures for Processing UCITS Schemes with Special Features at this juncture? Whilst it is understood that the UCITS regime is evolving over time and there will be new rules coming out soon, a codification of the core principles considered by the Commission as important when authorizing a UCITS scheme would nonetheless be helpful to industry practitioners who wish to bring a UCITS product to the Hong Kong retail market.

Proposal 1 – Structured Funds (UT Code Chapter 8.8)

(a) ***Definition of Structured Funds (UT Code Chapter 8.8)***

If a Guaranteed Fund meets the definition of "structured funds", which chapter of the UT Code applies - Chapter 8.5 on Guaranteed funds or Chapter 8.8 on Structured Funds?

It is recommended that the Commission clarify the interpretation of "substantially" in the criteria of structured funds in the first paragraph of Chapter 8.8. A more definitive test is required in order that the schemes are properly categorised. In order to ensure consistency with UCITS, we submit that the Commission should not treat repo agreements as FDIs and suggest the Commission clarify whether P-notes, ADR/GDR and other products are considered as FDIs pursuant to this chapter.

(b) ***Independence requirements (UT Code Chapter 8.8(a))***

The proposal that the management company of a structured fund and the issuer of the FDI must be independent requires (according to the "Notes") that the swap counterparty cannot be the same entity as the management company of the structured fund, although this is quite common for structured UCITS funds. It is assumed, and should be made clear that the management company and the issuer can be different entities of the same group as is consistent with the Commission's practice to date. Further, the Group suggests clarification be made on whether the management company and issuer can also be one and the same entity, but in different business divisions within the same entity provided there are other safeguards or measures in place, e.g. if the applicant can demonstrate there are different business objectives, different reporting lines, sufficient and clear segregation of duties and Chinese walls in place together with adequate disclosure. In which case it would be more appropriate for the Commission to describe the requirement as one of "functional independence". We suggest the Commission include any such principle-based criteria and/or guidance examples in the UT Code to avoid later obstacles.

With respect to Chapter 8.8(a)(2), the Group is of the view that an index should not be disallowed solely because it is a proprietary index or a custom-made index. Nor would allowing proprietary indices and custom-made indices be inconsistent with the Commission's

practice to date. The key criteria for the acceptability of an index should be that the rules on which the index calculation is based and that the index levels are publicly available. As long as an index meets these key criteria, the Group believes that such an index should be acceptable, irrespective of whether it is a proprietary index or whether it was custom-made for a fund for the following reasons. First, in the case of proprietary indices, these are often compiled and maintained by the research department, which is separated from the sales and trading department by clearly defined firewalls and is typically subject to various compliance policies and procedures in order to promote integrity and impartiality . Second, the fact that an index was custom-made for a fund should not on its own reduce the acceptability of the index, as long as the key criteria above are met. Well-known third party sponsors (e.g. Hang Seng Indices, MSCI, etc) often custom-make indices for fund products (especially for exchange traded funds). Third, for certain products (such as products that adopt a constant proportion portfolio insurance (CPPI) quantitative investment strategy), the investment strategy is necessarily described in terms of a custom-made index. All these "custom-made" indices are not uncommon and adds to the breadth and depth of the products available to the public in Hong Kong.

Lastly, we assume this independence requirement only applies to Chapter 8.8 structured funds, and structured UCITS funds, and does not operate to exclude the management company from also being one of several swap counterparties to other types of funds (for example, Funds under Chapter 8.9) subject of course to appropriate disclosure.

(c) ***Valuation of the FDI and independence of valuation (UT Code Chapter 8.8 (c))***

The Group notes that for some OTC FDIs, valuations are based mainly on tools and methodologies of the swap counterparty, which may include an entity within the same group as the fund management company. Accordingly, for such instruments a fully independent party such as the calculation agent or administrator may not have the tools, knowhow or capability to perform the valuation. With this in mind, "independence" in this context must be clarified such that robust internal controls that demonstrate divisions between front, middle and back office, will be sufficient for the purposes of enabling an independent valuation for the purposes of this chapter. The emphasis should be on "functional" independence.

(d) ***Ascertainment of collateral held by the trustee/custodian of the fund (UT Code Chapter 8.8 (d))***

The Group is of the view that it may not be appropriate to obtain a legal opinion to ascertain whether the collateral is being held by the trustee or custodian. Such confirmation should be provided by the trustee or custodian and the legal adviser can only use this as an assumption in its legal opinion regarding enforceability, and so no useful purpose is served.

(e) ***Contingency plan (UT Code Chapter 8.8 (f))***

It is required that the management company must put in place a detailed contingency plan on credit events such as the collapse of the FDI issuer. It is unclear what the Commission expects to see in the contingency plan especially if the issuer has collapsed - is the fund expected to unwind the FDI and wind up? Referring to the consultation paper issued by Committee of European Securities Regulators ("CESR") on 8 July 09 on the Level 2 Measures Related to the UCITS Management Company Passport ("CESR Consultation Paper July 09"), it is stated that the contingency plan should take into account the outcomes of the stress tests and scenario analyses which management companies should perform for the purposes of liquidity risk management where appropriate.

(f) ***Collateral requirements (UT Code Chapter 8.8 (e))***

The Commission should clarify the requirements on collateral that it must have "short settlement cycles" and must be of "high credit quality". How are the diversification and correlation requirements defined? It is proposed that "collateral cannot be concentrated in one issue, sector or country" - does it mean that collateral based solely on Hong Kong stocks is not permitted? Diversification would also add to the costs of holding collateral and would particularly 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 Commission's proposal and would place UCITS funds under two conflicting collateral diversification regimes. Equally, it is important to try to achieve a level playing field as between UCITS and non-UCITS (or Hong Kong domiciled) funds.

Separately, the Group would also like to understand why the collateral requirement under this Chapter of the UT Code is inconsistent with the SP Code.

(g) ***Publication of collateral details on website (UT Code Chapter 8.8 (g))***

Where the aggregate value of all collateral held by a scheme represents 30% or more of its net asset value, it is required that the nature of such collateral should be published on the scheme's website at each quarter end within one month after the relevant quarter. This requirement appears to be quite onerous in terms of resource and cost, when compared with the likely benefit derived by fund investors from such information. It would be surprising if such information is frequently accessed or analysed in detail by the investing public, and question whether the average investor would have the capacity to understand the adequacy of specific collateral for a particular product. Ultimately, investors are relying on the manager to make informed investment decisions, not only as to the investments to be made, but also the collateral supporting a particular counterpart's obligation.

Proposal 2 – Funds that invest in FDI (UT Code Chapter 8.9)

(a) ***Definition of funds that invest FDIs***

The Commission should clarify the definition of "hedging" and whether it includes proxy hedging or efficient portfolio management? Are P-notes, ADR/GDR and other types of access products considered "financial derivative instruments" pursuant to this chapter?

(b) ***Calculation of global exposure (UT Code Chapter 8.9 (b))***

It is noted that funds that invest in FDIs are required to adopt the commitment approach to calculate their global exposure. In the recommendations set out in the consultation paper issued by the CESR on 15 June 2009 on the Technical Advice at Level 2 on Risk Measurement for the Purposes of the Calculation of UCITS' Global Exposure ("CESR Consultation Paper June 09"), the commitment approach is considered to be appropriate for measuring global exposure as required by Article 51(3) of the new UCITS Directive. Article 51(3) of UCITS IV requires that "a UCITS shall ensure that its global exposure relating to derivative instruments does not exceed the total net value of its portfolio". However, there is *no requirement* to use the commitment approach under either UCITS III or UCITS IV.

It is possible that when using VaR a scheme may generate higher levels of leverage than would be allowed were the same positions measured using the commitment approach. Whilst CESR notes that the commitment approach may be more precise in measuring leverage (or global exposure) on a conservative basis, the VaR approach is a better indicator of market risk.

Given there are no express requirements for the commitment approach by the E.U. regulators, it may be appropriate or applicable for certain schemes to adopt the commitment approach. We have already noted that a number of global fund houses commonly adopt a VaR methodology for calculation of global exposure, in connection with their existing more sophisticated UCITS funds. Such institutions adopting VaR methodology are likely to have developed their existing risk management procedures around this. Accordingly, the Commission's proposal may affect future funds seeking to be authorised by the Commission. E.g. if the Commission only allows the commitment methodology for domestic funds from the outset, we believe that a number of fund houses will simply choose not to take advantage of domestic fund structures for FDIs, and will instead continue to prefer establishing UCITS with an accompanying application for registration in Hong Kong so as to save time and resources in maintaining distinct calculation methodologies and risk management procedures.

If the Commission isn't prepared to specifically endorse a VaR approach, we recommend that the Commission at least build in sufficient discretion to enable it to accept alternative calculation methodologies on a case by case basis, perhaps by way of a "Note". This is

similar to the approach adopted in Singapore where the Monetary Authority of Singapore ("MAS") requires the commitment approach but also permits alternative calculation methods subject to prior consent by the MAS. This way the matter would be put in the hands of product providers to convince the Commission as to why the VaR approach may be appropriate and acceptable for a particular product, taking into account such product provider's risk management processes as a whole, and helps to provide a more level playing field.

(c) ***Risk management and control systems requirements (UT Code Chapter 8.9 (c))***

What are the requirements of the "suitable and adequate risk management and control systems to monitor, measure, and manage all the relevant risks" as required under Chapter 8.9(c)? Do these "systems" require the Commission's prior review and/or approval?

(d) ***Representative and agents requirements (UT Code Chapter 8.9 (e))***

How would the Commission expect a manager to satisfy the requirement where "the manager must at all times demonstrate that those representative and agents … possess sufficient know-how, expertise and experience in dealing with the underlying investment…" as required under Chapter 8.9(e)?

Proposal 3 – Investment in other schemes (UT Code Chapters 7.11-7.13

It is noted in Chapter 7.12 that a scheme is permitted to invest more than 10% of its net asset value in one or more underlying schemes which are either recognised jurisdiction schemes or schemes authorised by the Commission. If a scheme pursues a strategy of investing in underlying schemes in accordance with this paragraph, it will be in breach of Chapters 7.1-7.3 criteria on spread of investments, unless a waiver is obtained. The Group does not believe that it is the Commission's intention for issuers to apply for a waiver in such circumstances and therefore suggest the Commission clarify this in the UT Code by way of appropriate "Notes".

Question (12)

In relation to the disclosure and reporting requirements set out in Proposal 4 (bilingual annual reports) and Proposal 5 (Product KFS), do you agree with the proposals? Please explain your views.

Proposal 4 – Bilingual Annual Reports

The proposal for authorized schemes which are not recognized jurisdiction schemes to satisfy

the compulsory requirement to prepare annual reports in Chinese would create an unlevel playing field between recognised jurisdiction schemes and non-recognised jurisdiction schemes.

Given that the annual reports must be made available within four months of the financial year end and translation will likely take a fairly long time, it would be very difficult for fund houses to meet the four month deadline even if the Chinese version is permitted to be distributed, as proposed by the Commission within 2 weeks thereafter. The fund will also be required to bear the extra cost of translation. In addition, additional printing, mailing and auditors costs would be charged to the funds. Accordingly, is there any meaningful cost benefit here?

The Group suggests the Commission maintain the current arrangement, i.e. it be optional for fund houses to translate financial statements into Chinese but the Hong Kong representative or the fund manager should be available to translate the relevant parts of the financial statements into Chinese for the investors, if necessary. It should be noted that since constitutive documents (such as the trust deed and the memorandum and articles of association) are not required (and need not) be translated into Chinese, we do not consider that it is reasonable to impose such requirement on annual reports. The Group agrees that the fact that annual reports will not be available in Chinese should be clearly disclosed in the fund prospectus (which will be in Chinese).

If a Chinese translation is required, the preference would be to limit the translation to cover only a list of items that the Commission considers as important for investors. The Commission should clarify whether a translation certificate is required to be issued confirming the accuracy of the translation, similar to the existing practice for fund offering documents.

Instead of distributing printed financial reports, the Commission has suggested that investors may be "*notified of*" where the financial reports, in printed and electronic forms, can be obtained. Can such notification be sent in electronic format (e.g. an email containing a hyperlink to the relevant webpage)? If the notification must be sent out in hardcopies, is it possible to provide such in the form of a remark to the monthly statement?

Proposal 5 – Product Key Facts Statement

One of the main objectives of the "Handbook" introduced in Part II of the Consultation Paper is to enhance product disclosure in particular through the use of KFS, containing information that "enable investors to comprehend the key features and risks of the product". Although the Group recognises and generally agrees that it is desirable to provide concise information which investors can reasonably understand in order that they can reach an informed

investment decision, we consider this a challenging proposition given the summary nature required of the KFS. It is also important to bear in mind that KFS will only be helpful for those investors who already have a basic understanding of investment products and concepts.

More specifically whilst the format of the KFS should be recommended, manufacturers and product providers should be afforded certain discretion to omit information which is either not relevant or unavailable. It is noted that certain parts of the KFS templates are optional.

Four pages maybe too lengthy (KIDs under UCITS III will under current proposals be limited to two pages). If investors feel that the KFS is too comprehensive there is a risk that they will not invest the time to go through the KFS and the relevant sections in the main prospectus before they invest in a fund.

For UCITS funds, what will be the relationship between the KFS and KID? See our response to Question (14).

Positioning of the KFS

Whilst the Group agrees that the KFS "shall form a part of the offering"[2], it is important that the KFS for all products located in approximately the same place making it more user friendly for investors to compare the risks and key features of one product against another before making an investment decision.

KFS for each sub-fund of an umbrella fund

The Group suggests the Commission provide flexibility in its proposal to require a KFS to be produced for each sub-fund of an umbrella fund. Nevertheless, in *certain* circumstances it would be impractical to produce a separate KFS for each sub-fund of an umbrella fund. Investors are unlikely to go through each KFS fund-by-fund for those equities or bonds funds with very similar associated risks, hence it would seem more appropriate to produce one KFS at the umbrella fund level. Incorporating all requisite information across all sub-funds of an umbrella fund of this nature is likely to go over the four-page limit therefore such a limit should not be imposed in such circumstances. The KFS should include a summary of the key risks (similar to the upfront disclosure box in the offering documents as currently required by the Commission), brief description of the investment objectives of all the funds together with a table setting out the management/performance fees.

[2] A minority of group members have a dissenting opinion that the KFS should NOT necessarily have to form part of the offering document but that the KFS be read together with the offering document. We understand others have suggested the Commission consider allowing product providers the option to decide whether the KFS: (i) is to be read together and handed out with the prospectus but does not form part of the offering document; or (ii) forms part of the offering document. To the extent the Commission is able to provide flexibility, this would be preferred to either deciding for one proposal or the other.

Inclusion of performance data

It is inappropriate to allow performance data in the summary in the KFS; investors may be drawn away from, and pay less attention to, key information including risks. It would also mean that the KFS would, to remain accurate and not misleading, be updated and re-published more frequently than six months as proposed by the Commission. This could incur significant additional production expenses. Further, if the KFS is intended to be categorized differently from a mutual fund update or fund fact sheet which is used primarily as a marketing tool, it would be logical not to include performance data.

Distribution of the offering documents should already be accompanied by the relevant financial statements and should continue to be delivered to existing and prospective investors in these formats.

If in the case that performance data is provided, the Commission should make clear whether information would be required to be submitted to substantiate the performance data set out in the KFS, whether record of such information should be kept and for how long.

Liability

The Commission should provide further clarity on what additional liability to the issuer will attach to the KFS. We believe the responsibility on issuers should be to ensure there is no statement which is an inaccurate summary from that contained in the fund prospectus.

Question (13)

Do you have any comments on the revisions to the UT Code generally? Please explain your views.

We set out below our comments in relation to the revision to the UT Code.

Acceptability of management company (UT Code Chapter 5.5)

We welcome the Commission's proposals to consider on a case by case basis the acceptability of personnel of the sub-manager who do not necessarily have investment experience in public funds. However we are unclear why this flexibility is only proposed in the context of a multimanager scheme where there are at least 3 sub-managers.

As the term "key personnel" in Chapter 5.5(a) is not defined, newly established or overseas fund houses generally find this requirement unclear. In particular fund managers and sub-managers have generally been reluctant to be the "key personnel" without understanding what is being imposed on them.

Further from experience, when an investment adviser or a sub-investment manager has been delegated investment discretion, the Commission would expect such entity to have two key personnel that also satisfy the requirements under Chapter 5 of the UT Code although this is not spelt out in the UT Code. To reflect this we suggest Chapter 5.5 (a) be revised to read "the key personnel of the management company *'and'* those of an investment advisor exercising investment discretion" otherwise additional explanation should be provided. We are also of the view that it is unreasonable to expect such investment adviser or sub-investment manager to satisfy the same extent of requirements as one would expect for an investment manager under Chapter 5, particularly when it is clear that the responsibilities and obligations of the investment manager cannot be delegated (under Chapter 5.5 (e) of the UT Code); for example, why should the investment adviser or, sub-investment manager be required to have prior *public funds* experience when it is only a delegate? The Commission should consider this in the practical context; a manager with appropriate skills and interest in a good delegation will perform its own due diligence process whilst ultimately they still retain responsibility.

The Group considers that the five years of public funds experience should not be imposed across all products. For instance, in the case of certain UCITS III funds (e.g. 130/30 funds) that use financial derivatives for investment purposes, the Commission requires the relevant investment managers to possess five years of public funds experience. Given that the UCITS III has been in place for less than five years and investment managers would not have the power to manage such types of funds under the former UCITS I regime, it poses barriers to entry for the Commission to impose such requirement. The Commission are urged to take a more pragmatic approach in this regard.

Further the Commission should clarify the interpretation of "dedicated full time staff" under Chapter 5.5 (b). Currently it is unclear whether a person who does not contribute 100% of his time on a single fund would fall into this category.

Changes to scheme documentation (UT Code Chapter 6.8)

The constitutive documents of a scheme may only be altered without consulting holders provided that the trustee or custodian of the scheme certifies in writing that in its opinion the proposed change meets one of the conditions described in Chapter 6.8. In the case of a mutual fund which has its own board of directors, there is no trustee and the custodian's role is typically limited to ensuring the safekeeping of scheme assets, and complying with the requirements of Chapter 4.5 (general obligations of trustee/custodian) but no more. The custodian is not necessarily best placed or indeed willing to confirm that, for example, a proposed change does not materially prejudice unit holders' interest. In practice, getting such a confirmation from the custodian has proven to be quite challenging for precisely this reason. Would the Commission be amenable to accepting a certification from the board of directors

of the scheme instead, bearing in mind the fact that the directors have the ultimate responsibility of ensuring that the fund is being managed or operated in the best interests of the fund investors and owe fiduciary duties to the fund?

Performance fee (UT Code Chapter 6.18)

The current performance fee calculation basis may be too restrictive especially in a falling market therefore the Group generally supports the Commission's proposal to allow performance fee calculation with reference to the performance of a benchmark or an asset class. It is important that the benchmark must be reasonable given the investment objectives and consistently applied. In terms of disclosure, the basis on which the benchmark is determined or the calculation method should be made clear to investors in plain language. It should be clarified that a performance fee can be calculated and accrued – e.g. for NAV purposes – more regularly than annually, even if it is only paid annually.

Acceptable indices (UT Code Chapter 8.6(f))

Chapter 8.6(f)(iii) requires that the index should be "investible". The Group requests that the Commission consider removing this requirement for the following reasons: (i) if the fund adopts synthetic replication, "investibility" is irrelevant; (ii) if there are trading or foreign ownership restrictions, the fund will seek exposure through FDIs therefore the fund can still track the index despite "non-investibility"; and (iii) for ETFs that track for example the price of gold, there is no real "investibility" in the sense intended by the rule.

It is further noted in Chapter 8.6(f)(v) that an index "must be objectively calculated". Where the rules allow the index compiler certain discretion in the constituent screening process, the Group request that the Commission consider imposing a "rule based" criteria and provide examples for clarity.

Index funds (UT Code Chapter 8.6(n))

The Group's understanding is that the Commission would not permit the use of the word "index" in the name of a fund if it will also invest in cash, money market instruments and short term debt securities to supplement a swap to track the performance of an index; the Commission considers such funds as non-index-tracking funds (i.e. they are not passively managed) and would normally proceed to consider these applications in accordance with the rules applicable to an equity fund. The Group believes that the above investment strategy is fairly common and suggest the Commission clarify that the requirements under Chapter 8.6 would or would not be applicable to such funds.

Criteria for appointment (UT Code Chapter 9.4)

It is noted in Chapter 9.4 that the management company is "*encouraged"* to appoint a

representative within the management group and such HK representative must be a licensed or registered intermediary under the SFO, or be a trust company registered under Part VIII of the Trustee Ordinance. Currently, there are HK representatives who are not licensed or registered intermediaries and instead they rely on the chaperone exception by appointing Type 1 licensed intermediary to distribute the funds. In such case, the HK representative may assume a role which is more of a coordination nature to facilitate communication between the distributors and the overseas administrators. Whilst the Consultation Paper only "encourages" the need for a Hong Kong representative to be regulated, the current arrangement where they are not – and do not need to be – may not be feasible after the proposed change. The Commission should clarify in what circumstances a regulated Hong Kong representative is required or – more preferably – leave the original requirement and allow whether a Hong Kong representatives remit requires it to be regulated to be assessed by the Fund on appropriate advice.

Material adverse change ("MAC") in the financial conditions or business of the key counterparties (UT Code Chapter 11.1B)

A proposed new note under Chapter 11.1B states:

"Note: The management company should inform holders as soon as reasonably practicable of any material adverse change in the financial conditions or business of the key counterparties to a scheme that it is aware of. 'Key counterparties' include the management company, guarantor (where relevant), trustee/custodian and swap counterparty of the fund."

The Group is of the opinion that this reference to material adverse change is onerous and the scope of what could be deemed a MAC is unclear. We fear that only with hindsight will it be possible to tell if a particular change turns out to be a MAC, and such a wide requirement simply leads to uncertainty of potential liability for management companies. The UT Code should at least clarify that the MAC must have the potential to be materially detrimental to the scheme or its investors.

Rather than the foregoing general requirement, the Commission should be more specific about what would be classified as a MAC, and perhaps concentrate on credit ratings – such that there is something concrete for management companies to monitor and identify as a change to be notified.

The Group assumes that this requirement should not apply to all the fund's swap counterparty's but only those which represent a significant credit risk to the fund (e.g. for a structured fund). Additional guidance here would be helpful.

Maintenance of a website (UT Code Chapter 11.8/Appendix C26)

Although the Group agrees that some investors may find information published on websites useful, maintenance of a website to provide all the information suggested by the Commission would be onerous and costly for the scheme – and indirectly its investors. Considering the cost-benefit factor, the Group does not believe that it should be a regulatory requirement to maintain such a website, and that there should be flexibility in the choice of the most appropriate method of dissemination – see our response to overarching principles Chapter 3.4 and Chapter 7.

Holdings of collateral (UT Code Appendix E)

It is noted a scheme is required to publish the nature of collateral as at each quarter end within one month after the relevant quarter where the aggregate value of all collateral held by a scheme represents 30% or more of its NAV. The Commission should clarify whether the 30% limit applies to the position as at the financial year end of the fund or at any point in time during the financial year.

Acceptable inspection regimes ("AIR")

For AIRs, Japan & Singapore are not included in the list. This is not ideal and goes against the trend of globalization of fund management groups as well as the importance from a management and exposure perspective of establishing regional hubs closer to the markets where the funds invest. The Commission should consider whether it is, or will soon be, in a position to include these jurisdictions, although the Group appreciates that it will be necessary first to negotiate and enter into an appropriate memorandum of understanding with local regulators.

Counterparty risk

Counterparty risk is applicable to a broad range of funds. The revised UT Code does not include any of the requirements set out in the Commission's "Letter to Management Companies of SFC-authorised Funds" dated 27 November 2008 with regard to ongoing monitoring of counterparty risks of SFC-authorised funds. Given the letter is not readily available from the Commission website the requirements should be codified for the purposes of clarity.

Practically product providers would conduct other due diligence on distributors however this should not be a requirement pursuant to the Handbook.

Open ended investment companies

While outside the scope of this consultation exercise, we would mention that thought should be given to changing the corporate regime to permit domestic funds to be structured as open ended investment companies.

Question (14)

What are your views about the idea of UCITS schemes which have issued KIDs under their own E.U. regulator's regime using those KIDs in place of the Product KFS? The issue here is how we should balance the importance of developing broadly standardized Product KFS across all products sold to the Hong Kong public so that it is easy for Hong Kong investors to understand and compare different products, and the commercial needs of individual fund houses to reduce costs and lessen administrative burdens. Also, if a large number of SFC-authorized funds adopt KIDs instead of Product KFS, it may defeat the purpose of comparability under the Product KFS proposal. The SFC would like to hear your views.

Key fact statements

The Group agrees with the Commission that one objective of the KFS is to allow an investor to easily compare funds in an attempt that they can make a more informed decision regarding their investment. However, we do not agree with the idea of simply replacing KFS with the key information document ("KID") required pursuant to UCITS European Directive. It is understood that the content of the draft KID is similar to that proposed for a KFS (for instance, objectives and investment policy, charges and past performance) and that the Commission is open minded about the possibility of UCITS schemes using KIDs that satisfy their home regulator's requirements. However the formats differ in both subject matter and presentation. Whilst this would likely be welcomed by the UCITS schemes, such adoption may result in inconsistency across the information provided to Hong Kong investors. Without a standardization of information, there is a concern that it will be difficult for investors to ensure meaningful comparability of funds with differing disclosure requirements.

In CESR's Technical Advice on the Level Measures Related to the Format and Content of Key Information Document Disclosures for UCITS issued on 28 October 2009 ("CESR Advice October 09"), CESR proposed that the KIDs adopt a synthetic risk and reward indicator ("SRRI") supplemented by a narrative explanation of the main limitations of the indicator and the material risks relevant to the fund which are not fully captured by the methodology for the synthetic indicator. Recognising it is not possible to adopt an SSRI without agreeing on a convention, CESR provided details on the underlying methodology.

This is different to the KFS which requires that the key risks to be stated (i.e. a narrative approach). The differences in the presentation of risks for funds that are of similar nature may send a misleading message to Hong Kong investors.

Past performance is required to be disclosed in KIDs under the relevant requirements. It is noted that the disclosure of past annual performance information in the KFS is optional. If performance information is included in a KFS, it should, amongst other things, cover a minimum of five years which is contrary to the ten-year requirement for KID. The CESR has also introduced measures to harmonise the calculation rules for past performance in KIDs to improve comparability whereas no such rules have been suggested by the Commission. Discrepancies between the requirements of past performance information amongst the UCITS schemes and non-UCITS schemes may be misleading to Hong Kong investors. Given that it is inevitable that investors will, to some extent, interpret past performance as indicative of future performance, it is important that standardised rules should be adopted. Having said that, please also note the view expressed in response to Question (12) - that it is inappropriate to include performance data in the summary.

The proposed KFS has four pages whereas the CESR has suggested that KIDs should be kept to two pages (or three pages in the case of specific complicated funds). Again the difference does not encourage direct comparability between funds. Please also see our response to Question (12).

Although it may be more practical for recognized jurisdiction schemes qualifying as UCITS, which may currently or in future be required to issue a KID by its home state regulator, to adopt the KID for use in Hong Kong in replacement of the proposed local format KFS, it would only be meaningful if general content requirements of the two documents were broadly similar.

Whilst the timing of implementation of KID in Europe is still not certain, it is unclear whether or how this might impact the Commission's proposed requirements on the KFS. A gap analysis between the requirements applicable to the KID and those applicable to the KFS would be very important before the Commission finalises the requirements on the KFS, otherwise those UCITS funds that are authorised in HK will have the difficulty of trying to reconcile the two sets of requirements which are not entirely consistent with each other. Accordingly the Commission are encouraged to engage with European regulators of key offshore fund jurisdictions to discuss and potentially adopt to a broadly common approach to the content requirements of KFS and KIDs.

The Group nevertheless urges the Commission to take a consistent approach to UCITS and non-UCITS schemes to avoid confusion, while nonetheless simplifying the papering exercise for the benefit of investors, and their understanding and comparison of different fund products and their features.

Question (15).

Do you agree that the proposed approach to implementation of the revised UT Code is acceptable and practicable, taking into account the needs and circumstances of various stakeholders? Do you have any particular views as to exactly how long the transition period should be for Existing Schemes to fully comply with the Product KFS and Other Disclosure Requirements (Consultation Paper paragraph 191)?

The transition period for existing schemes to comply with the KFS and other disclosure requirements should be at least 9 months.

6. CONSULTATION IN RELATION TO THE REVISED ILAS CODE

Question (16)

Do you have any comments on (1) the Product KFS requirements, (2) the enhanced disclosure requirements on "with-profit" features and internal funds, (3) the deletion of Chapters 5, 8 and 9 of the current ILAS Code, and (4) the codification of the existing practices regarding the computation of surrender values and the notification requirements on scheme changes?

The Commission notes that ILAS are insurance products that are issued by insurance companies regulated under the Insurance Companies Ordinance to carry on the relevant class of insurance business in Hong Kong, thus Chapter 5 is not relevant. The Commission via "Circular Clarifying the Licensing Requirements arising out of the Promotion Offering or Sale of Investment-Linked Assurance Schemes to the Public" dated 13 August 2009 has also discussed this issue. Given ILAS is a bilateral contract between the insurance company and the insured, we believe ILAS is a regulated investment agreement and not strictly speaking a collective investment scheme ("CIS"). However, if the intention is that ILAS should be treated as a CIS (and there could be unintended consequences treating it as a regulated investment agreement, particularly with amendments proposed to the Companies Ordinance and SFO for structured products), the Commission should consider further enhancement to the SFO (and the definition of CIS) to clarify this.

Question (17)

Do you agree that the proposed approach to implementation of the revised ILAS Code as acceptable and practicable, taking into account the needs and circumstances of various stakeholders? Do you have any particular views as to exactly how long the transition period should be for Existing Schemes to fully comply with the Product KFS and Other Disclosure Requirements (Consultation Paper paragraph 214(c))?

The transition period for existing schemes to comply with the KFS and other disclosure requirements should be at least 9 months.

7. CONSULTATION IN RELATION TO INTERMEDIARIES CONDUCT (Part III of the Consultation)

Question (18)

Do you agree that some of the proposals in this part of the consultation paper should only apply to unlisted investment products? Please explain your views.

We agree that some of the proposals in Part III of the Consultation Paper should only apply to unlisted structured products. We would be happy to discuss this further.

The proposals that intermediaries should, as part of the "know your client" procedures, obtain information about clients' knowledge of derivatives and characterize those clients as "clients with derivative knowledge" (Investor Characterization) and to fine-tune the requirement to assess "knowledge, expertise and investment experience" of a professional investor should not apply to listed investment products for the following reasons:

(i) listed investment products are also subject to the Hong Kong Stock Exchange rules which already provide sufficient protection to investors;

(ii) applications of IPO are usually very time sensitive. If listed investment products are also subject to the investor characterization and professional investor proposals, it will reduce the chance for investors (who are not active investors) to apply for the IPO within the tight time frame as they will need to go through investor characterization and professional investors classification process;

(iii) listed products are highly standardised as the listing rules contain detailed requirements in relation to the permissible payout structures (e.g. call or put), eligible underlyings, minimum term, etc; and

(iv) investors are mostly self directed i.e. the intermediary's role is more akin to execution only.

Question (19)

Do you think that intermediaries should, as part of their "know your client" procedures, seek clients' information about their knowledge of derivatives and characterize those clients (other those professional investors) with such knowledge as "clients with derivative knowledge" to assist intermediaries in ensuring that the investment advice and products offered in relation to unlisted derivative products are suitable?

Please give your views on the contents of the proposed measures for intermediaries to assess whether investors have knowledge of derivatives.

The Group understands that the requirement to obtain information about clients' knowledge of derivatives is intended to form part of the suitability assessment conducted by intermediaries. As intermediaries are already required under the Code of Conduct to have in place adequate internal know your client ("KYC") procedures to capture client's information including investment experience, the Group considers obtaining information about clients' knowledge of derivatives as an additional KYC requirement in chapter 5.1A potentially places the wrong emphasis on form over substance. Whilst the Commission brings forward requirements for intermediaries to adopt suitable criteria for characterizing investors, it should be clear that these requirements are not separate in their own right but form part of the overall obligation of suitability that would not undermine the pre-sale processes. If clients have no derivative knowledge then they logically do not satisfy the knowledge requirement, and suitability tests should apply. Adopting this reasoning, the requirement to obtain information about clients' knowledge should be a preliminary filter, and so we would suggest this requirement should be a "Note" to Chapter 5.2/5.3.

The Commission should clarify whether the knowledge test is applicable for structured funds, UCITS III (or those that adopt expanded powers under UCITS III) and/or funds using FDI under the UT Code. The Group can understand why they should apply to structured funds, but would resist application to funds simply because they employ derivative techniques to achieve the stated investment objectives (for example, by way of synthetic replication) where the product structure is otherwise not "derivative" in nature.

Where a client who does not have derivative knowledge wishes to purchase an unlisted derivative product on his own initiative, the Commission has proposed that the intermediary should warn the client about the proposed transaction and provide appropriate advice to him, including assessment of the suitability of the transaction. The Group believes the same "appropriateness" test should apply to suitability generally to be consistent with the reasoning above.

Question (20)

Should a high net worth investor be considered to have specific knowledge and expertise if:

(a) he is currently working, or has previously worked in the relevant financial sector for at least one year in a professional position that involves the relevant product; or

(b) he has undergone training or studied courses which are related to the relevant product?

Do you have any other suggestions?

Yes, if this is a preliminary filter as part of the wider suitability obligation.

Guidance to assess the sophistication of an investor should be practical and non prescriptive.

Question (21)

What amount should the minimum portfolio requirement be set at? Please give your reasons.

Feedback received during the soft consultation did not support raising the existing minimum portfolio requirement because it adversely affects the private placement activities in Hong Kong and hinders the market practice of the direct placement of a newly listed company's shares in an IPO to professional investors in Hong Kong. Adjusting the threshold is probably not the most important issue here. The focus should be on how to adjust the requirement on knowledge and expertise in trading in the relevant product while keeping the minimum portfolio at HK$8 million.

Question (22)

Where a distributor and/or any of its associates explicitly receives or will receive monetary benefits from a product issuer (directly or indirectly), which of the following three disclosure options would be more appropriate? Please explain your views.

Option 1.1 – Disclosure of dollar amount or percentage

Option 1.2 – Disclosure of percentage bands or ceiling (i.e. "x% to y%" or "up to y%")

Option 1.3 – Generic disclosure

Disclosing monetary benefits in dollar amounts is the most relevant and easily understandable information to investors, but this option would reveal sensitive commercial information and whilst it provides full transparency in practical terms does not provide any greater meaningful disclosure than using percentage bands or ceilings. Distributors are unlikely to welcome this option, and is probably unnecessary in such detail. Clearly, the industry would prefer to keep to generic disclosure but this gives investors very little helpful information – something they didn't already know.

The option of disclosure of percentage bands or ceilings – the Group prefers ceilings, but would be happy to leave it to distributors as to which they would adopt in each case - will provide sufficiently useful information to investors to make informed decisions whilst preserving sensitive commercial information for distributors. The Group is aware that some market practitioners have specifically suggested the Commission standardize the percentage bands.

The Commission should also distinguish between those investment products which are funds and those which are not and differentiate the fee disclosure accordingly. E.g. for funds we should have a maximum percentage/ceiling disclosure (i.e. "up to x% of the investment amount formulation"). Also, in the case of funds their distributors will often receive trailer commissions, as well as initial charges (and/or sometimes exit charges) in which case ceilings are preferable. Alternatively the approach could be left to distributors as to which to adopt in each case – some flexibility needs to be retained.

Question (23)

Do you have any suggestions as to how the percentage bands referred to in Question 22 should be set (e.g. up to 1%, over 1% to 2%, etc)?

While percentage bands should be meaningful, it is noted that for retail products, the band may need to be quite broad, as retail product commission varies largely depending on the product in question. The bands will vary depending on, amongst other things, tenure of the product, and we expect that standard products will generally have a lower percentage / band than longer tenure products. It would therefore seem impractical to provide for specified bands. However, on the other hand, the bands should not be so broad as to be completely meaningless.

Question (24)

Where a distributor does not explicitly receive any monetary benefits for distributing an investment product, which of the following disclosure options would be more appropriate? Please explain your views.

Option 2.1 – Specific disclosure of distribution reward

Option 2.2 – Generic disclosure

The proposed specific disclosures under Business Model 2 may not necessarily be helpful to investors. Under Option 2.1, the distribution reward received by external distributors may not be the same as the reward received by the in-house distributors. Accordingly, to require an in-house distributor to disclose such amount may not give the investor accurate and useful information, as the disclosed amount is merely a rough estimate with little basis. Parameters used for calculating costs of in-house distributed products would likely be different from that of an external distributor. Where there is no external distributor, the suggestion of an estimate "with a view to recovering its costs and making a profit" seems arbitrary. Intermediaries may derive different estimate models based on their own funding costs, pricing methodology, internal guidelines etc. Disclosure of an amount estimate calculated this way may not necessarily be helpful to the investor particularly when the investor is trying to compare this with (1) estimates made by intermediaries based on the Commission's guidelines but calculated using different models, (2) amounts disclosed by an intermediary selling the same product but sourced from an external issuer; as the disclosed amounts are derived using different sets of data and calculation methods. Hence we support a generic

disclosure only. Any generic disclosure should however be sufficiently prominent and not lost in the small print. Clearly, if an in-house distributor is appointed on arm's length terms and remunerated accordingly, the in-house distributor should be caught under Business Model 1, and disclosed accordingly.

If the Commission is minded to require disclosure in percentage bands or ceilings under Business Model 2, then it is necessary to ensure fair (or a fair basis for) comparisons being calculated and disclosed by different houses. Different distributors should be free to calculate the notional benefit for disclosure as they see fit, but should disclose the basis for the calculation e.g. on a cost or cost plus basis; or a transfer pricing basis; or under an internal revenue sharing arrangement; or on the basis of the level (average level) of commissions paid to third parties e.g. under Business Model 1.

It is also worth noting that in the fund context the fund manager often assumes a distributor role, in which case the distributor fee will be a component of the management fee (in so for that the manager will not pay any trailer commission). The manager's management fee is disclosed in the fund prospectus, so this is already disclosed to investors. It will be difficult, and seem very arbitrary, for the manager to segregate the fee ascribed to the distributor function and that related to its asset management functions (for example, a manager will have different trailer and other fee arrangements with different distributors). Hence specific disclosure of distribution reward is not appropriate for fund managers undertaking their own internal distribution.

Question (25)

Where a distributor makes a trading profit from a back-to-back transaction, which of the following disclosure options would be more appropriate? Please explain your views.

Option 3.1 – Disclosure of specific trading profit

Option 3.2 – Generic disclosure

In the case of a back-to-back principal to principal transaction which is more akin to an agency transaction economically (as opposed to any hedging arrangements entered into for the purposes of providing a product), which is intended to be settled to the investor within a T+2 settlement period after the relevant product is purchased by the intermediary and where the intermediary benefits from an immediately quantifiable return (for example, a percentage of the notional amount) without any exposure to market or other risks, it may be relevant to equate the mark-up to investors as the "trading profit", in which case a disclosure of specific trading profit (or for consistency with Business Models 1 and 2, a band or ceiling) may be

appropriate. However, the Group feels strongly that in general disclosure of specific trading profit can be misleading to investors for the following reasons: (1) the price at which the product is sourced by the distributor would depend amongst other things, on time of purchase, size of purchase and bargaining power; (2) mark-up again is dependent upon the price at which the product is sourced, so the same amount disclosed by two firms may not necessary mean the investor is getting the same product at the same price; (3) in sourcing a product, the distributor needs to consider funding costs, credit and market risk, balance sheet requirements etc which may affect the mark-up, and these factors would vary from firm to firm; and (4) disclosure of absolute trading profit amount in the way suggested by the Commission may reveal commercially sensitive information. Hence support is given to a generic disclosure only, and accepted it is important the intermediary should disclose the capacity in which it is acting (principal or agency). Any disclosure should be sufficiently prominent.

Question (26)

Do you consider it appropriate to restrict distributors from offering investors supermarket gift coupons, audio visual equipment and other kinds of gifts having monetary value (except discount of fees and charges) in promoting a specific investment product to investors?

This issue of gifts is of lesser importance by comparison. If some of the other measures proposed in the Consultation Paper were to be adopted, a restriction on the use of gifts by distributors is probably not meaningful because the basis for the purchase of the investment product is not as a result of a gift.

In any event, there is no practice within the private banking sector of giving gifts or coupons to customers tied to the promotion of a specific investment product. However, should a general caution on use of gifts be considered applicable by the Commission, we suggest that the question of whether it constitutes an inappropriate inducement or undue influence, taking into consideration all circumstances of the case including its nature and quantum, whether aggressive sales tactics had been employed or sufficient time allowed for client to consider investment purchase etc, be the criteria of assessment, instead of an outright prohibition on gifts having monetary value.

Members of the Group do not consider it necessary to restrict the offering of gifts to clients for conclusion of a sale. If intermediaries have put in place robust systems and controls in selling unlisted investment products to clients which the local regulators are promoting, gift offering should not be disallowed. However, there are some in the Group that consider it to be inappropriate to offer gifts to clients for the conclusion of a sale.

Question (27)

Do you have any comments on the proposed information content of the Sales Disclosure Document which includes (a) capacity (principal or agent); (b) affiliation with product issuer; (c) monetary and non-monetary benefits; and (d) discount of fees and charges available to investors?

The Group agrees in principle to the proposed disclosures in the Sales Disclosure Document, subject to comments given above on the monetary and non-monetary benefits. It is relevant to note that such information is typically already disclosed in term sheets, marketing materials, confirmations, account opening documents, subscription forms and/or otherwise captured in the subscription process through audio recording. In practice presenting numerous documents which contain similar information to customers may actually discourage customers from reading them all (or any of them). Therefore a separate Sales Disclosure Document would seem unnecessary, although the contents should be disclosed.

If the Sales Disclosure Document is required, given time sensitivities on certain types of transactions, an alternative is for the distributor to provide the document after the trade on T+2, particularly if there is a cooling-off period or other liquidity for the product. In any event, it should be clear that the distributor takes responsibility for suitability whether acting as agent or principal where it gives advice or makes a recommendation.

Question (28)

Do you think audio recording of the client risk profiling process and the advisory or selling process for investment products should be made mandatory or the current record keeping requirements are sufficient? If audio recording is made mandatory, how long do you think these audio records should be kept for? Please explain your views.

Audio recording of the client risk profiling process and the advisory or selling process for investment products should not be made mandatory. The Group considers the record keeping requirements under the current Code of Conduct and relevant guidelines and the fact that Banks have already started to audio record the client risk profiling process and the advisory or selling process for investment products, pursuant to HKMA's circular issued on 25 March 2009 should be sufficient to protect investors. Also, it is not practical to impose strict audio recording requirements in certain cases: e.g. in the Private Banking business, where the risk

profiling, selling and other processes typically do not take place in venues where audio recording can be implemented or where the on-boarding or selling process may take place over time and during several/many conversations.

8. CONSULTATION IN RELATION TO THE POST-SALE ARRANGEMENTS (Part IV of the Consultation)

Question (29) Do you believe that a cooling-off period would generally be beneficial for investors, or do you believe that costs associated with its implementation would outweigh the benefits for investors?

The introduction of a cooling-off period is controversial; it could be argued that given the proposed improvements to the selling process and the potential introduction of an Investor Education Council (which is to be consulted on separately), a post-sale cooling-off period should not be necessary. Further, it is questionable as to how a cooling-off period would assist as a deterrent against mis-selling. There are many practical questions surrounding the operation of a cooling-off period that require careful consideration. It is noted that cooling-off periods already exist under the ILAS Code. However further consideration should be given to the appropriateness of a cooling-off period in the proposed context as it applies to different products.

It is proposed that a cooling-off period should be considered in circumstances where a product locks investors in for a considerable period of time either because of the maturity of the product or because of an illiquid secondary market. The Group understands the rationale for this.

In respect of fund products, given most SFC authorized funds (approved under the UT Code) have a frequent (often daily or weekly, and at least monthly) dealing cycle and that no lock-up applies to the investment (with the exception of, for example, closed ended funds, although these are listed on the Stock Exchange of Hong Kong), a cooling-off arrangement would be unnecessary or inappropriate.

For the same reason, in respect of structured products where regular market making is provided by Issuers of structured products, the Group questions whether there is any benefit to a cooling-off right being given to investors.

However, if the Commission considers it necessary to impose a cooling-off period for certain structured products, the Group requests the Commission to make clear that the amount refunded to the investor would be reduced by the unwind costs of the Issuer, which would include the cost to the Issuer of unwinding or adjusting any of its hedges in respect of the product, and a reasonable deduction for administration costs. In this regard, the amount returned to an investor by the Issuer would be the same as if the investor had used the Issuer's

market making facility to sell back the product back to the Issuer. The Group does not have strong views as to whether investors should be entitled to a refund of the selling distributor's commissions.

In addition, if the Commission were to make cooling-off mandatory, the Group would urge the Commission to treat the pre-trade and post-trade situations equally as regards the ability of the product provider to recover its unwind costs. This is because, while for some products no pre-trade hedging may occur, for other products pre-trade hedging may be required. For example where products with fixed specified coupons are offered to the public during an offer period, the product provider may need to enter into arrangements to hedge its obligation to pay these fixed coupons if the product is ultimately purchased. The possibility of any such pre-trade hedging, and the resultant unwind costs if a cooling-off right is exercised, would be appropriately addressed by disclosure to investors.

Question (30)

Please provide your views on whether investors should be given a period of time after placement of their orders during which execution of the trade is delayed and the investor is given an opportunity to cancel the order before the trade is executed. If your view is that this would generally be beneficial to investors, please provide your views on the types of investment products for which it should be considered and the appropriate cooling-off timeframe.

The Group does not expect that such an approach would be beneficial to investors as it would simply add to the administrative burden for investors in committing to the purchase of a product with little added benefit to investors. An investor is any event free of its own accord either to commit to the purchase of a product or to delay in committing to such a purchase.

Question (31)

Please provide your views on whether, and in what circumstances, you think a window could or should be provided to investors after the date the trade in the relevant product is executed during which an issuer should be required to buy back the product at an investor's request.

If any cooling-off is imposed by the Commission, the Group considers that the period during which the right may be exercised should be no longer than 5 days after the date on which the investor purchases the product.

Question (32)

On the basis that a cooling-off period is incorporated in an investment product and a client has exercised his right under the mechanism, do you consider that a distributor should promptly pass on to the client the full amount of refund (including the sales commission) received from the product issuer less a reasonable administrative charge? Please explain your views.

The Group does not express a view on this proposal.

SCHEDULE 1
Participants in the Consultation

Alliancebernstein Hong Kong Limited

Barclays Bank PLC

BNP Paribas

BlackRock (Hong Kong) Limited

Credit Suisse (Hong Kong) Limited

Deutsche Bank AG Hong Kong branch

Goldman Sachs (Asia) LLC

JPMorgan Chase Bank, NA

Legg Mason Asset Management Hong Kong Limited

Macquarie Capital Securities Limited

Merrill Lynch International

Morgan Stanley Asia Limited

Nomura International (Hong Kong) Limited

PIMCO Asia Limited

Standard Chartered Bank (Hong Kong) Limited

The Royal Bank of Scotland plc

UBS AG

SCHEDULE 2
Definitions

In this response paper we use the following defined terms to have the following meaning:

Code of Conduct	-	Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission
GP	-	the General Principles set out in Chapter 3 of the Overarching Principles Section of the Hand Book (Section I)
Handbook	-	the draft *Proposed SFC Handbook for Unit Trusts and Mutual Funds, Investment-Linked Assurance Schemes and Unlisted Structured Products* which is set out at Appendix A of the Consultation Paper
intermediary	-	a distributor firm that is licensed under the Code of Conduct and which is appointed by the product provider to distribute a investment products to retail investors
investors	-	retail investors in an investment product
information channels	-	the information channels by which information is passed from a product provider to a investors in a structured product as further described in the response above relating to General Principal 2 (Chapter 3.4) and OP 7.1
ILAS Code	-	a revised Code on Investment-Linked Assurance Schemes (the revised ILAS Code) appearing in Section III of the Handbook
Issuers	-	means issuers of structured products or where Issuers are SPVs, the Issuer and the Product Arranger
KFS	-	Product key fact statement
product provider	-	any issuer issuing structured products from its own balance sheet and, where appropriate any guarantor and, in addition, where appropriate any issuer which is a special purpose vehicle and the product arranger which takes responsibility for the special purpose vehicle's obligations
professional investors	-	as defined under the Securities Futures Ordinance and the Securities and Futures (Professional Investor) Rules

OP	-	the Overarching Principles set out in the Overarching Principles Section of the Hand Book (Section I)
SP Code	-	the draft Code on Unlisted Structured Products set out at Section IV of the Handbook
SPV	-	a special purpose vehicle which meets the requirements of the SP Code
UT Code	-	Code on Unit Trusts and Mutual Funds (the revised UT Code) appearing in Section II of the Handbook