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INVESTMENTS

31 December 2009 **By Hand**

Mrs Alexa Lam
Executive Director and Deputy Chief Executive Officer
Policy, China and Investment Products
Securities and Futures Commission
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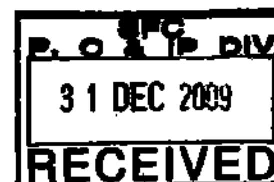

Dear Alexa

Response to Consultation Paper on Proposals to Enhance Protection for the Investing Public (the "Paper")

Franklin Templeton Investments (Asia) Limited ("**FTIA**") is grateful for the opportunity to provide our observations and thoughts in relation to the proposals set out in the Paper published by the Securities and Futures Commission (the "**Commission**").

As a whole, we welcome the proposals to enhance protection for the investing public. We believe the proposals represent a solid platform to further improve investor confidence in Hong Kong.

Under Annex A, we seek to address the specific questions set out in the Paper concerning:

(a) the overarching principles section of the proposed product handbook;

(b) the proposed revised Code on Unit Trusts and Mutual Funds;

(c) the regulation of intermediary conduct and selling practices; and

(d) the proposed post-sale arrangements.

Meanwhile, we, as part of a global investment management organization having, *inter alia*, a distribution network encompassing more than 30 jurisdictions worldwide for an umbrella UCITS, feel appropriate to share our views on two specific proposals in the main body of this response concerning, respectively, the proposed "Product Key Facts Statements" and "cooling-off period".

Proposed Product Key Facts Statements ("Product KFS")

We share the desire for clear and accurate disclosure of information to investors in a form that helps them to understand a fund and to compare it with other funds. We agree that this proposal to provide investors with fair, clear, concise and non-misleading information would increase both investors' protection and understanding.

As a general observation, we believe that the Product KFS would fundamentally be a tool for helping retail investors to make informed investment decisions. We consider that unit trusts and mutual funds authorized by the Commission should not be obliged to produce or deliver the

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Product KFS for "professional investors" within the meaning of the Securities and Futures Ordinance (Cap 571) and/or any rules made thereunder. We further believe that unit trusts and mutual funds authorized by the Commission should be free to decide whether or not to produce or deliver the Product KFS for professional investors.

We welcome and appreciate that the Commission is "... open minded about the possibility of UCITS schemes using the KIDs that satisfy their home E.U. regulator's requirements, provided that the KIDs in substance provide the same information, and their format and presentation also adhere to the principle of providing information in a manner which is user friendly and easy for investors to understand ..." (paragraph 165 of Part II of the Paper). In this connection, we recognize that the Commission would like the Product KFS to include, in general, the name of the management company, the scheme's investment strategy, key risks (and/or key risk factors), asset allocation, fees and charges, whether the scheme utilizes FDI for investment purposes and, if so, the associated risks (paragraph 166 of Part II of the Paper).

Based on the internal discussions with our colleagues in Luxembourg, we believe that the proposed KIDs, to be finalised in the E.U. by July 2010, would capture most of the information to be covered in the Product KFS as proposed by the Commission. We further believe that the Commission has been in dialogue with the Committee of European Securities Regulators on the proposed KIDs given the fact that more than 70% of the unit trusts and mutual funds currently authorized by the Commission are UCITS schemes.

We hope that the Commission would adopt a pragmatic and reasonable approach and allow UCITS schemes authorized by the Commission to use KIDs in Hong Kong that fulfill the corresponding regulatory requirements in the E.U. to satisfy the proposed Product KFS requirements. In this connection, we further hope that the Commission would implement the proposed Product KFS requirements upon the implementation of the corresponding E.U. requirements for KIDs.

With a view to further enhancing the coherence and consistency of the proposed regulatory platform, we believe that the Code of Conduct should also be revised so that an intermediary dealing in or advising on an investment product authorized by the Commission is explicitly required to provide a copy of the Product KFS that satisfies the corresponding product code requirements to an investor, unless the investor is qualified as a professional investor.

Proposed Cooling-off Period

We recognize that a cooling-off period would be beneficial for investors investing in products that have a lock-up period or an early surrender penalty.

However, for investment products that do not have a lock-up period or an early surrender penalty, the cooling-off period proposal would, in our view, have the unintended and adverse consequences of promoting short-term and unnecessary trading activities.

For unit trusts and mutual funds with a daily valuation and dealing frequency, short-term trading activities would be detrimental to the interests of long-term investors due to the operational, administrative, transitional and other costs involved. Such activities would, in our view, not be beneficial to the sustainable growth of the fund industry in Hong Kong. As such, we share the view that the cooling-off period proposal should not be implemented for ordinary unit trusts and

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mutual funds with a daily valuation and dealing frequency.

We would be most grateful if the Commission could consider our observations and thoughts when finalizing the proposals in the Paper.

Yours sincerely

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Regional Head (Greater China)

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Annex A

List of consultation questions in Part II

Consultation questions in relation to Overarching Principles Section (i.e. Section I)

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.

Section I – 2.2

We welcome the initiative of the Commission to further streamline the authorization process by formalizing the function of the Products Advisory Committee as purely advisory in nature covering all functionally substitutable products.

Section I – 4.1(c)

We would appreciate the Commission's advice as to whether it is the intention of the Commission to create two reporting thresholds under the proposed Product Handbook and the existing Code of Conduct. Under the proposed Product Handbook, it is provided that the Product Provider shall inform the Commission promptly should there be any breach. Under 12.5(a) of the existing Code of Conduct, a licensed or registered person is required to report to the Commission any material breach, infringement of or non-compliance with any applicable statutory and regulatory requirements. With a view to enhancing the coherence and consistency of the reporting requirements, we believe the proposed Product Handbook should adopt the threshold as currently set out in 12.5(a) of the existing Code of Conduct.

Section I – 7.2

We would appreciate the Commission's advice as to whether it is the intention of the Commission to allow only the licensed responsible officers or licensed representatives (and not compliance officers) to be the delegates for reviewing product advertisements by requiring such delegates to be duly authorized to issue such advertisements. Under Part V of the Securities and Futures Ordinance ("**SFO**"), the issuance of product advertisements would likely fall within one of the regulated activities. However, according to the licensing-related FAQ posted by the Commission on 11 May 2009, the Commission will not normally license back office staff, including compliance officers and in-house legal counsels. In light of the foregoing, we would welcome further clarification from the Commission on whether compliance officers would be accepted as the delegates as part of the due review process for advertisements.

Section I – 7.4

As regards investment products distributed by intermediaries licensed by or registered with the Commission, we believe that it would be sufficient for the corresponding offering documents to generically indicate that if investors have complaints about such intermediaries, they could file the complaints to the complaints officer of such intermediaries.

Consultation questions in relation to the revised UT Code (i.e. Section II)

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 views.

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Annex A

Section II – 8.8 (Proposal 1) and 8.9 (Proposal 2)

We welcome the initiative of the Commission to codify under 8.8 the prevailing practices and approaches adopted for authorizing structured funds in the past. With a view to further enhancing clarity, we would appreciate it if the Commission would elaborate on the notion of "investing substantially in financial derivative instruments" in percentage terms. We also welcome the initiative to rationalize the regime for non-UCITS schemes in terms of the rules for investments in FDIs.

Section II – 7.11 to 7.12 (Proposal 3)

We support the proposal. It further enhances investment flexibility while not compromising investor protection (given the 10% restriction on exposure to non-recognized jurisdiction schemes and non-authorized schemes).

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.

Section II – 11.16 (Proposal 4)

We note the Commission's proposal in paragraphs 161 and 188 of Part II of the Paper that the publication of a Chinese language annual report is voluntary for SFC-authorized schemes that are recognized jurisdiction schemes, provided that distributors of such schemes marketed to the public in Hong Kong would take steps to make investors aware that the annual reports would only be available in English. We support this pragmatic proposal and hope that 11.6 of the UT Code would be updated to reflect such proposal ongoing forward. As an aside, to avoid double regulation, it seems appropriate to further clarify that the 11.6 requirements do not apply to collective investment schemes that fall under the MPF regime as there are separate accounting, auditing and reporting requirements for MPF products.

Section II – 6.3 (Proposal 5)

Our views on the Product KFS are set out in the main body of our response.

Question 13 – Do you have any comments on the revisions to the UT Code generally? Please explain your views.

Section II – 6.15 & 11.8

We generally support the proposals covering: (a) connected party transactions; (b) criteria for appointment of Hong Kong representative; (c) performance fees; (d) maximum interval for payment of redemption amounts; (e) sub-managers of multimanager schemes; (f) distribution of financial reports; and (g) maintenance of a website.

Section II – 11.1B Note

We would appreciate it if the Commission could provide examples of the notion of "material adverse change in the financial conditions or business".

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Annex A

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

Our views on the Product KFS are set out in the main body of our response.

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 (paragraph 191)?

We suggest that the Product KFS be implemented when the KIDs are introduced for UCITS schemes in the E.U.

List of consultation questions in Part III

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?

With a view to enhancing clarity and consistency, it seems appropriate for the new requirements under the proposed 5.1A to cover "structured products" to be regulated under the proposed SP Code rather than "unlisted derivative products". If the suggestion is adopted by the Commission, there would be a coherent regulatory framework covering "structured products" from both the product and conduct perspectives. In this connection, we support the proposal that structured products should only be promoted by intermediaries to clients characterized as a "client with structured product knowledge" based on: (a) undergoing training or attending courses on structured products; (b) prior trading experience in structured products; or (c) current or previous work experience related to structured products.

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?

We generally support the proposal which further clarifies whether certain requirements mentioned in 15.5 of the Code of Conduct should be waived from the investor protection perspective. However, we would appreciate the Commission's clarification on whether the proposed knowledge and

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expertise requirements are intended to apply separately to the term "professional investor" as defined in the SFO and the rules thereunder. As there are no separate proposals to incorporate the knowledge and expertise requirements into statutory definition of "professional investor", we believe that it is not the intention of the Commission to restrict scope of the existing exemptions under the SFO for professional investors (such as those set out under sections 103(3)(k), 174(2)(a) and 175(5)(d)).

Question 21: What amount should the minimum portfolio requirement be set at? Please give your reasons.

We agree that any excessive increase in the minimum portfolio requirement may have the unintended and adverse consequences as outlined in the consultation paper [i.e. (i) adversely affecting the private placement activities in Hong Kong and (ii) hindering the market practice of the direct placement of a newly listed company's shares in an initial public offering to professional investors in Hong Kong]. We believe that the more appropriate approach would be to implement the investor characterization proposal for structured products rather than increasing the minimum portfolio amount.

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

With a view to striking the right balance, it seems more appropriate to require intermediaries to first provide the proposed generic disclosure (i.e. option 1.3) to clients. Upon specific requests from clients, intermediaries should then be required to disclose the ceiling (i.e. option 1.2).

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)?

We do not have specific views on the percentage bands as we believe intermediaries should be required to first provide the generic disclosure (i.e. option 1.3) and, only if specifically asked by the clients, disclose the ceiling (i.e. option 1.2).

Question 24: Where a distributor does not explicitly receive any 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

With a view to striking the right balance, it seems more appropriate to require intermediaries to first provide the proposed generic disclosure (i.e. option 2.2) to clients. Upon specific requests from clients, intermediaries should then be required to disclose the distribution reward (i.e. option 2.1).

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

With a view to striking the right balance, it seems more appropriate to require intermediaries to first provide the proposed generic disclosure (i.e. option 3.2) to clients. Upon specific requests from clients, intermediaries should then be required to disclose the trading profit (i.e. option 3.1).

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?

We believe that there should be a level playing field between licensed corporations and authorized financial institutions that are subject to the regulatory regime administered by the Hong Kong Monetary Authority. In light of the foregoing, we generally support the proposal to regulate the use of gifts when promoting a specific investment product to a client.

Question 27: Do your 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?

Given the new knowledge and expertise requirements to be introduced under 15.3, we would recommend the Commission to consider including 8.3A as one of the requirements to be waived for professional investors under 15.5.

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.

We believe that there should be a level playing field between licensed corporations and authorized financial institutions that are subject to the regulatory regime administered by the Hong Kong Monetary Authority. In light of the foregoing, we generally support the proposal to standardize the application of the audio recording requirements.

List of consultation questions in Part IV

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?

Our views on the cooling-off period proposal are set out in the main body of the response.

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.

Given the market volatility, we believe the proposal would invite disputes between investors and intermediaries, resulting in complaints to regulatory authorities.

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.

We believe the matter should be addressed by the proposed resolution arrangement involving the financial services ombudsman.

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.

Our views on the cooling-off period proposal are set out in the main body of the response.