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8th Floor, Chater House
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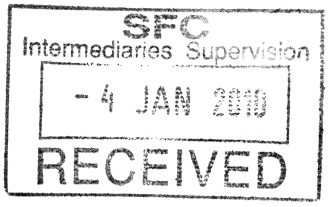

Attn: Consultation on proposals to enhance protection for the investing public

BY HAND

Dear Sirs

SFC Consultation Paper on Proposals to Enhance Protection for the Investing Public (the "Consultation") – Code on Unit Trusts and Mutual Funds ("UT Code")

We are grateful for the opportunity to submit written comments on the Consultation Paper.

Please accept this submission as responses prepared by Simmons & Simmons on behalf of UBS to selected proposals in connection with the UT Code, which is the subject matter of the attached paper.

We hope our comments are helpful. Should you have any queries please do not hesitate to contact our Paul Li at 2583 8269.

For the sake of completeness we should mention that UBS has separately submitted other comments on the Consultation Paper.

Yours faithfully

Simmons & Simmons

Simmons & Simmons

Copy to :

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UBS response to the SFC Consultation Paper on Proposals to Enhance Protection for the Investing Public

1. Overarching Principles

	"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."

1.1 We generally support the Overarching Principles Section of the Handbook and the high-level principles identified by the Commission. In particular, we support the Commission's objective of seeking to adopt a consistent regulatory approach to the regulation of retail investment products across product types.

1.2 We recognize the need to enhance regulatory framework and investor protection relating to sale of retail products in Hong Kong, however, we respectfully submit that a balanced approach should be adopted to protect investor interest, together with suitable level of disclosure without restrictions on choice of products. A greater choice of products available to potential investors will facilitate investment risk diversification, product innovation and conducive to Hong Kong's development as a competitive global financial center.

Regulatory Approach

1.3 We believe that it would be inappropriate to adopt a single inflexible application of those principles across the product types. The structure of the Handbook itself recognises that different products have different features which require a different regulatory response. Thus, for example, while the ideal of clear and effective disclosure remains a constant, what is appropriate and necessary in the practical application of that objective will vary depending on the risk profile and complexity of the product.

1.4 By their nature high-level principles are broadly expressed. This is understandable but it inevitably creates a degree of uncertainty as the market is unclear how they will be applied given the latitude that they confer. We believe it would assist in providing certainty if the Commission were to provide further guidance on the proposed approach in applying the Overarching Principles in practice.

Comments on Specific Provisions

1.5 UBS has submitted separately comments in relation to the proposals in relation to unlisted structured products from the perspective of a product provider. In those submissions comments were made in relation to certain specific provisions which are of equal to concern of Product Providers in the context of the UT Code.

(A) Selection of distributors. We strongly believe that the onus should not be on Product Providers to assess whether distributors are "suitably qualified and competent". What is proposed may be interpreted as a requirement to assess a licensed entity or licensed person's fitness and properness beyond that conducted by the Commission. In any event it would be difficult for Product Providers to demonstrate compliance, and impractical to ensure on-going compliance, in respect of a third party. We urge that this requirement may be satisfied by Product Providers having clear internal policies and guidelines on the due diligence to be

conducted on selection of distributors and that the reference to "due care and diligence" should be replaced by "reasonable care and diligence".

(B) Chinese and English language versions of offering documents. There is a practical concern in relation to the requirement that equal weighting be given to both versions of the document. The requirement poses a technical difficulty as perfect consistency between different languages is not possible. We recommend that Product Providers should be permitted to elect one language to prevail over the other in the event of inconsistency. We further submit that the requirement for equal weighting to be given to English and Chinese language versions applies only to offering documents and not to any ongoing disclosure provided by Product Providers.

(C) Product Key Facts Statement ("PKFS"). We support the introduction of the PKFS and understand and agree with the objective of ensuring that it is no longer than necessary. However, there may be circumstances where it is appropriate for the PKFS and in the interest of the investors for it to be more than four pages. We trust the four page expectation will be applied flexibly taking into account the risk profile and complexity of the product being offered.

1.6 The elaboration of General Principle 4 – Avoidance of conflicts of interest – at paragraph 4.2 of the Handbook appears to go beyond what is contemplated in GP4 itself. GP4 provides that:

> "Product Providers .... shall avoid being placed in a conflicts of interest position that may undermine the interests of the investors of the relevant product" (emphasis added).

Paragraph 4.2 provides that potential conflicts of interests must be avoided at all times and safeguards are appropriate only if a conflict cannot be avoided. In practice there may situations where there is a potential for a conflict of interests but, provided safeguards are put in place, the interests of investors are not undermined. This is of particular relevance in relation to Proposal 1 in relation to structured funds where it is proposed that the issuer of any financial derivative instruments ("FDI") must be "independent" of the management company. We comment on that requirement in greater detail in section 2 below. We believe that in the present context, paragraph 4.2 of the Handbook is overly prescriptive and that an intra-group relationship should not be prohibited as a matter or principle. We urge clarification from the Commission that potential conflicts of interest of this kind may be addressed effectively by disclosure in the offering document.

2. Proposal in relation to Investment Activities

	"Question (11): In relation to proposals regarding investment activities set out in Proposal 1 (structured funds), Proposal 2 (funds that invest in FDI) and Proposal 3 (investment in other schemes), other than the proposed general requirements, what other requirements do you think should be imposed. Please explain your views."

2.1 We preface our response to Question 11 by acknowledging the Commission's objective, among other things, to codify existing practice. The greater certainty and transparency this brings for Product Providers planning new collective investment schemes is welcomed. It is with this objective in mind that we frame our response to Question 11.

Proposal 1 – structured funds

2.2 Management company/FDI issuer. It is proposed that the management company of a structured fund and the issuer of any FDI, in which the fund invests, must be "independent" of each other. We note the guidance in Note 1 to paragraph 8.8(a)[1] and the requirement at paragraph 8.8(b)[2]. We believe that, in all other instances, potential conflicts of interest of this kind may be addressed effectively by disclosure in the offering document.

2.3 The extent of intended overlap between paragraph 8.8(a) of the Handbook and GP4 is unclear. It would be helpful to have clarification whether or not it would be regarded as a potential for a conflict of interest where a structured fund invests in an FDI issued by an affiliate of the management company. We have commented at paragraph 1.5 above that the proposal in the Handbook for dealing with potential conflicts of interest is overly prescriptive. Provided that the potential for conflict is properly managed, investors stand to benefit from the relationship between a Product Provider and the issuer of FDIs in which a fund invests.

(A) New products are often developed collaboratively between a Product Provider and an FDI counterparty. A Product Provider will work with a potential counterparty to structure a bespoke FDI specific to the needs of the proposed fund. It is preferable for this process to be done intra-group for reasons of confidentiality as a Product Provider will not wish to share its proprietary product ideas with a third party which is affiliated to a competitor.

(B) Permitting intra-group Product Provider facilitates better pricing. In view of the close working relationship and operational efficiencies of intra group entities, pricing offered by Product Provider to an intra group fund would be tighter than what would be offered to non affiliated third parties. Such costs savings may be passed onto investors. It is more likely that a non-affiliated FDI counterparty will fully price-in its costs, such as product development, compliance with on-going obligations etc. as it has less incentive effectively to subsidise the branded product of a competitor group.

If Product Providers are prohibited from offering FDIs to intra-group funds, this will hamper product innovation and may impact pricing. This, in turn, may adversely affect investors' choice and the ability to diversify their investment risk.

2.4 Mark to market valuation. It is proposed that the mark to market valuation be conducted "independently". The Commission will be aware that the valuation of FDI is complex. The valuation model used will depend on a number of factors, including assumptions as to market volatility and (where relevant) interest rates and foreign currency fluctuation. Unless the same assumptions are used there will be a difference between the fund's valuation and the mark to market valuation done by the FDI issuer in the normal course of its business. It is not clear what benefit there would be to the investor.

2.5 In the circumstances, we believe that it would be impractical to insist on "independent" valuation of FDI because third parties often would not have the means to value bespoke non vanilla FDIs. In practice valuations of FDIs are normally provided by FDI issuers based on proprietary model based valuation methodologies which combine empirical data and certain assumptions. Valuations will vary depending upon the empirical data input and assumptions selected by an FDI issuer. Empirical data is often a combination of

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1 The management company cannot also act as the issuer of an FDI in which the structured fund invests.

2 Where the scheme is a mutual fund company, the majority of the board of directors of the scheme shall be independent directors (for example, persons who are not employees or officers of the derivative counterparty).

market based information (where available) and internally sourced (may not be construed as "independent"). We are strongly of the view that the following (replacing the requirement that valuations be conducted independently) would be sufficient in safeguarding investor interest in respect of provision of marked to market FDI valuation:

(A) an FDI issuer would be required to confirm that (i) it has adopted a consistent approach in calculating the value of FDI of the same type or class to ensure that there is no cherry picking and (ii) it has in its view adequate internal controls in relation to provision of FDI valuations; and

(B) permitting the administrator to rely on the value of the FDI as calculated by the FDI issuer to work out the net asset value of the Fund, without requiring the administrator to calculate the value of the FDI itself (which, as explained above, is not practical), provided that such reliance is subject to the performing of tolerance checks by the administrator as to the data furnished by the FDI issuer.

2.6 Collateral. While recognising that the eligibility criteria for collateral are introduced to enhance investor protection, there is a concern that certain of the proposed criteria are overly onerous and difficult to comply with in practice. The requirements effectively limit the pool of qualifying assets to cash or an extremely narrow class of securities, which may have a significant impact on the structure of transactions and make it commercially unviable for Product Providers to provide new investment choices to investors.

2.7 Consistent with the disclosure-based approach we suggest that the current criteria for eligibility as collateral be used as the starting point for fund managers in their selection of collateral. To the extent that a collateral does not satisfy certain of the prescribed requirements, the use of that collateral should nevertheless be permitted so long as the associated risks are adequately disclosed in the prospectus together with the comparative cost to the investor of the collateral. Investors would then have the option to redeem their shares or units as they see fit.

2.8 Flexibility should also be built into the UT Code (for example, by providing that the relevant criteria may be modified or dispensed with as the SFC deems appropriate in light of the circumstances of each transaction) to enable it to develop alongside the market as new products evolve.

2.9 We have the following comments on certain of the specific requirements in relation to collateral:

(A) Paragraph 8.8(e)(i). The requirement for the collateral normally to trade in a deep and liquid marketplace with transparent pricing, on its face, may in practice preclude instruments such as money market funds from being used because there is no active secondary market, whereas in the professional market they are considered as cash equivalents.

(B) Paragraph 8.8(e)(iii). The requirement of the issuer of collateral must be of "high" credit quality should be augmented by an explanation of the criteria by which credit quality will be measured. It would also be helpful if the Commission were to publish indicative haircut percentages alongside a provision permitting it to adjust those percentages in response to market conditions.

(C) Paragraph 8.8(e)(iv). The requirement for the collateral "*must not be concentrated in one issue, sector or country*" seems unduly restrictive and would suggest, for example, that collateral consisting of Hong Kong listed securities only may not be acceptable. It also seems inconsistent with the fact that there is no corresponding requirement imposed on direct investments made by funds. Specifically, how does

this proposal impact the current practice of allowing a portfolio of Hong Kong listed equities to be used as collateral to reduce counterparty exposure risk?

(D) Paragraph 8.8(e)(v). We should be grateful for a more detailed explanation of what is meant by the "correlation between the issuer of the financial derivative instruments and the collateral received".

(E) Paragraph 8.8(e)(vi). We should be grateful for clarification of the meaning of "proper collateral management" and its requirements in practice, in particular, whether or not it is intended to connote anything beyond compliance with the collateral requirements of the UT Code.

(F) Paragraph 8.8(f). The objective of having in place a detailed contingency plan to address credit events experienced by an FDI issuer is understood. We suggest that this requirement is enforced on an, as needed, basis. Under normal market conditions it would be unduly onerous on a Product Provider to prepare detailed plans for each FDI counterparty in circumstances where the risk of a credit event is reasonably regarded as being remote. Further, a contingency plan prepared without knowledge of the prevailing market conditions at the relevant time would inevitably be expressed in such general terms as to be of limited value and may at worse, hamper the ability of the Fund to act freely in response to market events in the best interest of its holders.

Proposal 2 – funds that invest in FDI

2.10 We welcome the Commission's initiative to facilitate the authorisation of non-UCITS funds which invest in FDI.

2.11 We note in relation to such funds that the calculation of a fund's global exposure will initially be limited to the "commitment approach", which is a more restrictive approach than that permitted under the UCITS III regime. In sections 4.1 to 4.4 below, we suggest that a conformity between the regime under the UT Code and the UCITS III regime is potentially advantageous to the investing public of Hong Kong without derogating from the Commission's objective of enhancing investor protection.

2.12 As there are UCITS III schemes presently authorised in Hong Kong, and available to the public of Hong Kong, using other valuation methodologies, we are of the view that the same latitude should be granted to funds seeking authorisation under section 8.9 of the Handbook.

Proposal 3 – investment in other schemes

2.13 We welcome the Commission's initiative to provide authorised schemes the flexibility of investing more than 10% but less than 100% of its net asset value in other collective investment schemes. We have no additional comments in respect of the Commission's proposals.

3. Disclosure and Reporting Requirements

	"Question (12): In relation to the disclosure and reporting requirements set out in Proposal 4 (bilingual annual reports) and Proposal 5 (PKFS) do you agree with the proposals? Please explain your views." "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.

Proposal 4 - bilingual annual reports

3.1 The proposal is for annual reports be published in both English and Chinese for schemes authorised by the Commission and which have Hong Kong investors. The requirement would apply schemes for the financial year ending on or after 31 December 2010. It does not apply to interim reports.

3.2 As a global Product Provider which may wish to make available existing foreign collective investment schemes to Hong Kong investors, we welcome the fact that the publication of Chinese annual reports will be voluntary for approved recognised jurisdiction schemes. We support this pragmatic proposal and hope that Chapter 11.6 of the UT Code would be updated to reflect such proposal.

3.3 The rationale for the proposed requirement is understood. In deciding which of the three options proposed by the Commission is most appropriate, and how they might be implemented, we believe that a cost / benefit analysis is appropriate.

3.4 Given that the cost of translation (and the time required to complete the task) may be significant, we are of the view that Option 2, which provides for an abridged Chinese version of the annual report is the preferred option. We believe that, in view of the timing proposed by the Commission, namely that the translation would need to be available within four months of the financial year end, the abridged version should be limited to the financial statements themselves and their notes.

Proposal 5 – PKFS

3.5 Our general observations in relation to PKFS is provided in section 1 above.

3.6 We note the Commission's present position in relation to whether or not a key information document ("KID"), which is contemplated for European funds, would be an adequate substitute for a PKFS. We appreciate that the Commission is not in a position to reach a conclusive view on this issue given that the consultation process for KID is on-going. We believe it would be appropriate to revisit this specific issue in relation to PKFS, when there is greater certainty in relation to what will be required in Europe. In this context, we would restate that, as a general principle, it is desirable where possible for there to be a harmonised approach between the regime under the Handbook and UCITS III.

4. Other comments

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

Harmonising the UT Code with the UCITS III regime

4.1 We note that certain criteria governing the quality of collateral proposed under the new UT Code differs from that required under the UCITS III regime.

4.2 As a Product Provider which operates globally, we believe that it would be to benefit of investors, in terms of choice, if the Commission were to remove such additional requirements with a view to harmonising the two regimes. We believe that this may be done safely without adversely affecting the quality of investor protection.

4.3 The differing requirements of the two regimes has the practical effect of deterring Product Providers from introducing overseas proven and popular products to the Hong Kong market. Given the comparatively small size of the Hong Kong market it is not always commercially viable to modify an existing fund to accommodate the additional requirements of the UT Code. The proposed collateral provisions provide one such example. It would be difficult in practice (without materially increasing the product costs) for overseas Product Providers to modify the existing collateral portfolio of their UCITS III compliant funds for the purpose of satisfying the additional UT Code requirements.

4.4 As observed at the outset, broadening the offering of investment products to the retail public facilitates investment diversification. UCITS III funds represent a substantial body of potential investment products which might be made available to the Hong Kong retail market. It would, however, require greater harmonisation of the UCITS III regime and the UT Code. We believe that this may be done without materially affecting the protection offered to investors by the UT Code.

Proposal 6 – miscellaneous

4.5 "On going disclosure". We believe that the "on going disclosure" requirement (Paragraph 11.1B of the UT Code) on the management company to inform holders "as soon as reasonably practicable" of "material adverse change in the financial conditions or business of the key counterparties to the scheme" maybe difficult to comply with in practice. We would be grateful for guidance from the Commission on what may constitute material advise change (objective measures such as credit downgrades etc?), especially in the context of third parties. This requirement would pose most difficulty in the context of third party key counterparties where the fund would rely on such third party to provide such relevant information in order to notify investors in a "timely and efficient manner" as required by GP2.

4.6 Investments underlying FDI. Paragraph 8.9(f) sets out the permitted underlying investments for FDI in which an authorised scheme may invest. It appears implicitly to exclude physical commodities other than precious metals. We believe that exchange traded FDI referencing other physical commodities should be permitted provided that there is adequate disclosure. This is consistent with a disclosure based regime.

4.7 Connected party transactions. The Commission's proposal to focus on substantive principles to guide conduct rather than imposing prescriptive limits in governing connected party transactions is another positive development.

4.8 "Cooling off" period. Although not directly relevant to the consultation in relation to the UT Code, we take this opportunity to respond to the consultation questions in respect of whether or not a cooling off period would be desirable in connection with mutual funds and unit trusts. Our view is that existing requirement for one dealing day per calendar month is reasonable in the context of investment funds and provides investors an appropriate opportunity to exit the investment should the individual change his/her mind.

5. Implementation and transitional provisions

	"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)?"

5.1 We urge that the transition period for Existing Schemes to comply with the PKFS and other disclosure requirements should be at least 9 months.