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21 December 2012

The Securities and Futures Commission
8th Floor, Chater House
8 Connaught Road Central
Hong Kong

Dear Sir/Madam,

Submission on Consultation Paper on proposals to enhance the regulatory regime for non-corporate listed entities

We thank the Commission for the opportunity to provide our comments on the Consultation Paper on proposals to enhance the regulatory regime for non-corporate listed entities ("Consultation Paper") issued on 23 November 2012.

Our comments focus specifically on the Commission's proposals outlined in Paragraphs 1(a) and (b) of the Consultation Paper in relation to amending Parts VIII, X, XIII, XIV, XV and XIVA of the SFO to expressly cover listed entities that are not in corporate form.

Parts XIII and XIV of the SFO

Question 1. *Do you agree that Parts XIII and XIV of the SFO should be amended so that these Parts expressly cover listed entities that are not in corporate form?*

Subject to our comments below, we believe the extension of Parts XIII and XIV of the SFO to cover listed entities that are not in corporate form is appropriate, and will offer greater certainty to market participants on the application of the market misconduct provisions. We welcome the Commission's proposals to establish a consistent regulatory regime that provides investors in all listed entities with the same protection against market misconduct activities.

We accept that it will be necessary to amend/add certain defined terms to give effect to the application of Parts XIII and XIV to non-corporate entities such as trusts and partnerships, as contemplated in paragraphs 14 and 16 of the Consultation Paper. However, this needs to be considered in light of the fundamental structural and conceptual differences between a listed company and other types of non-corporate entities.

For example, a trust (which is merely an "arrangement" with no legal personality) will typically involve a number of external parties, including a separate manager and trustee/custodian who will each provide services to the trust in a professional capacity. A manager will typically be responsible for the overall portfolio, financial and strategic management of the trust. The trustee, in addition to its custodial role, is responsible for overseeing the activities of the manager in accordance with its relevant constitutive documents and the applicable regulations to ensure the activities carried out by the manager are in line with the objectives and policies of the trust and are in the interests of the holders. Accordingly, we submit that the drafting of the defined terms should take into account the nature and extent of liability of the relevant parties having regard to their respective roles and responsibilities. We therefore trust that the Commission will take care to ensure that the operation of such terms do not give rise to unintended consequences.

By way of example, the term "associate" in Parts XIIII and XIV of the SFO is used in the context of a person committing a market misconduct. The Consultation Paper proposes that the term "associate" shall include, in the case of an entity, the manager, trustee, custodian or partner of the entity and each officer or employee of any such manager trustee, custodian or partner.

In the context of a non-corporate entity, since the manager will generally be perceived as the mind of the entity, we agree that a manager should be regarded as an "associate" of the entity (provided that the manager is in fact acting in its capacity as the manager of the non-corporate entity and in accordance with its constitutive documents and applicable laws). As for the other parties, such as the trustee or custodian, their relationship with the entity may vary based on the precise nature of the arrangements (for example, whether the custodian is a bare custodian), and we would ask the Commission to consider if relevant carve-outs or tests should be included to reflect these variations in the drafting of the definition.

In this regard, we would also welcome some clarity from the Commission as to how the definitions of "controller", "subsidiary" and "related corporation" are intended to apply to the various counterparties in the context of a non-corporate entity.

Separately, we note the Commission's proposal to amend the definitions of "corporation" and "company" in Schedule 1 to the SFO to include any entity for the purposes of all Parts of the SFO, other than Parts III and IV. Such an amendment will have a consequential effect on many other provisions of the SFO. One example is how the definitions of "substantial shareholder" and "associate" for the purposes of Part V of the SFO will be amended to cater for the fact that a "substantial shareholder" of a licensed corporation may not take a corporate form.

Part XV of the SFO

Question 2. *Do you agree that Part XV of the SFO should be amended so that it expressly covers listed entities that are not in corporate form?*

We agree with the proposal to extend Part XV of the SFO to expressly cover listed non-corporate entities (other than listed open-ended CIS). In the context of listed REITs, we note that since December 2005, the Commission has required REITs to adopt in their trust deeds provisions substantially equivalent to those in Part XV of the SFO, and we support the codification of these requirements in the SFO. We also accept in principle the suggested amendments to Part XV (and other relevant provisions) that will need to be made to reflect the proposals and we look forward to reviewing the draft language in due course.

We would be grateful if the Commission would confirm that if any corresponding amendments are required to be made to the trust deeds of REITs as a result of the amendments to the SFO, no specific approval from unitholders will be required on the basis of Rule 9.6 of the REIT Code. We would also like confirmation that the Commission will provide a reasonable period of time to trustees and REIT managers to prepare supplemental deeds and relevant unitholder announcements at the appropriate time.

Parts VIII and X of the SFO

Question 3. *Do you agree that Parts VIII and X of the SFO should be amended to extend the SFC's powers under these Parts to all listed entities?*

We agree with the rationale set out in paragraph 27 of the Consultation Paper and accept that it would not be practical to give effect to the proposals in respect of Parts XIII-XV without also extending the Commission's powers under Parts VIII and X to listed non-corporate entities.

In this regard, it is relevant to note the recent actions brought by the Commission under section 214 of the SFO which resulted in the court making compensation and/or disqualification orders against listed company directors for misconduct[1] . In light of these actions, it is important in our view to define more precisely in the SFO the nature and extent of liability of the relevant parties involved in the conduct of the business or affairs of the various non-corporate entities contemplated by the proposals.

[1] Securities & Futures Commission (SFC) v Cheung, Yeung, Li, Chan and Styland Holdings (HCMP 1702 of 2008); China Asean Resources Limited case

Part XIVA of the SFO

Question 4. *Do you have any comments on the proposal to extend the statutory disclosure requirement for PSI in respect of listed corporations under Part XIVA of the SFO to listed CIS and other listed entities?*

Subject to our comments below, we are supportive of the proposal to extend Part XIVA of the SFO to cover listed CIS and other listed entities and we agree that it is appropriate to provide a comparable statutory disclosure regime for the benefit of investors in all listed entities.

1. Defined terms and interpretation

We note the proposed amendments to extend the definition of "inside information" to include information about certain parties likely to be involved in listed non-corporate structures, as set out in paragraph 38(a)(iii) of the Consultation Paper. While we understand the underlying rationale for this proposal, we query whether expanding the definition of "inside information" by reference to information about other entities is the most appropriate way to achieve this.

We note that the existing definition of "inside information" in respect of listed corporations does not seek to capture information about counterparties with whom that listed corporation has a relationship, as it is the effect of the information on the price of the listed corporation's securities that is the key determinant. If information relating to a counterparty is sufficiently material to satisfy the elements of inside information under the SFO, it will logically be caught by the definition.

In our view, the proposed amendments to the definition are too broad and potentially too difficult to apply in practice, particularly as the counterparties contemplated in the Consultation Paper (such as the trustee or custodian) are independent, and typically unrelated, parties. In the context of REITs, we also note that the proposed amendments would be likely to capture additional types of information that were not previously contemplated by Rule 10.4 of the REIT Code.

If the purpose of the PSI amendments is to give statutory backing to an already existing disclosure obligation, we would expect the legislation to reflect, rather than expand, the obligations in the relevant regulations (such as the REIT Code).

We would submit that the term "inside information" in the context of non-corporate listed entities should be defined in the same manner as that in respect of listed corporations, without the need to include the parties proposed in paragraph 38(a)(iii) of the Consultation Paper. For the sake of clarity, it would be more appropriate in our view to provide specific guidelines on the type of information contemplated by the Commission, rather than amend the legislative definition of "inside information".

2. Corresponding changes to product codes and Listing Rules

We note the proposed changes to the Listing Rules to accommodate the new PSI disclosure regime as outlined in the HK Exchange's recent consultation conclusions[2] ("SEHK PSI Conclusions") and we would like to clarify if the Commission proposes to make corresponding amendments to the relevant product Codes.

We note for example, that Rules 10.3(a)-(c) of the REIT Code contain language broadly equivalent to the continuing obligations set out in Rules 13.09(a)-(c) of the Listing Rules. One of the changes proposed in the SEHK PSI Conclusions is to remove Rules 13.09(a) and (c) on the basis that they might duplicate the statutory disclosure obligation.

Does the Commission intend to undertake a similar review of the existing product Codes to ensure that any potential duplication or circumlocution is avoided in relation to the PSI disclosure requirements? If so, we trust that this will be the subject of a separate consultation by the Commission.

We also query if the Commission proposes to obtain the HK Exchange's views on amending the Listing Rules to extend the application of the PSI obligations to listed collective investment schemes?

3. Liability for breach of obligation

We assume that the disclosure obligation is only intended to apply to the listed entity, and not to any other person to which the definition of "inside information" is extended, such as the trustee, custodian or partner of the listed entity.

In the context of a listed REIT, for example, the disclosure obligation should apply only to the REIT manager, which has the primary responsibility under the REIT Code for making relevant disclosures on behalf of the REIT. Similarly, as an officer's personal liability (as contemplated by the PSI amendments) is intended to apply only to the officers of the "listed corporation", we assume that this means the officers of the REIT manager and not of any other entity. Likewise, as far as a listed ETF is concerned, we assume that the disclosure obligation would only apply to the ETF manager and that only the officers of the ETF managers will be subject to the personal liability.

Accordingly, in the context of a REIT or ETF, any liability for a failure to disclose inside information, or to take reasonable measures to ensure that proper safeguards exist to prevent a breach of the disclosure requirements, should be imposed only on the REIT or ETF manager and/or its officers.

[2] Rule Changes Consequential on the Enactment of the Securities and Futures (Amendment) Ordinance 2012 to Provide Statutory Backing to Listed Corporations' Continuing Obligation to Disclose Inside Information – November 2012

Conclusion

If the Commission adopts the proposals, we trust that it will proceed to publish its draft amendments to the SFO (including any ancillary guidelines) to give effect to the principles outlined in the Consultation Paper, and that further consultation will be sought once the proposed legislative language has been made clear to the public.

We look forward to the Commission's response. In the meantime, if you have any questions or wish to discuss any aspect of the above further, please do not hesitate to contact.

Kind regards

Baker & McKenzie