

## MESSAGE

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From: Swee-Mei.Chan@ubs.com  
Date: 28/12/2009 10:16 AM

Subject:	Summary to SFC
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Dear Martin,

We hope you and your family had a lovely Christmas.

Thank you for meeting with Allen and myself on Monday Dec 14. It was a very useful and productive meeting. As you have requested that we write down some of the suggestions we had mentioned at the meeting, I have provided in the Appendix below a few high level suggestions for your team's consideration (also cc to Alexandra). These suggestions follow your clarification that the proposed rule changes in the current consultations are to enhance investor protection in the sale of structured products, particularly of the retail segment, which we support. We hope they contain some helpful suggestions. Allen and UBS AG's Legal and Compliance team continue to make ourselves available to have continuing dialogue with you and your team.

Finally, I take this opportunity to wish you a well-deserved and relaxing break this holiday season, and a very Happy New Year.

Warmest wishes,

Swee Mei Chan

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## APPENDIX

- **Professional investors**

As the SFC's intention is to clearly delineate the segmentation between retail and professional investors, we propose that the criteria for the latter be simplified from the current (and proposed) requirements which include the annual submission of asset proof (account statements or audited accounts (for corporates and trusts)), the proposed proof of client's work experience or training or prior trading experience in 40 similar trades. If the professional investor regime is effectively streamlined, then the introduction of characterization of investor (with derivatives experience) would not also be necessary as there are other overarching principles (e.g., suitability obligations) already imposed under the current Code of Conduct. In order to avoid preventing new investors (e.g., high networth second generation) from investing in new products, we would suggest that banks be given the flexibility to determine whether a client has the sufficient product knowledge instead of similar product experience. The SFC could elaborate on some examples in clause 5.3 of the Code as to how a licensed person can assure itself that the client understands the nature and risks of the derivative product, but these could be descriptive rather than prescriptive.

- **Removal of minimum denomination/consideration exemption as safe harbour**

In our role as a product issuer, we understand that not only retail banks, but also private banks, rely on the HK\$500,000 minimum subscription safe harbour. However if the HK\$500,000 safe harbour is removed altogether, these banks will have one less route for private placement and this could increase the number of requests for authorisation by the SFC of structured products. If the authorisation process can be simplified (e.g., SFC providing a prescribed product programme such that only a registration with the SFC of the prescribed documentation of the product is necessary), this may avoid delay in the launch of a time-sensitive product. Perhaps this alternative suggestion can be considered instead of removing the HKD500,000 safe harbour altogether. The overarching principles (suitability assessment, etc) continue.

- **Extended definition of "securities" to include "structured products"**

The proposed definition of structured products is, in our view, too widely defined and would inadvertently capture traditional banking products such as currency-linked and money market instruments, structured deposits and OTC derivatives and even plain vanilla notes linked to equity and other underlyings, convertible bonds, exchangeable bonds and subscription warrants. If the intention is to protect retail clients by requiring all products to be authorised by the SFC prior to product launch, we believe that the clarification of the professional investor attributes and criteria would meet this intention without the need to create a new definition of "structured products".

- **Audio recording**

Given the different operating model and the tailor-made products offered to private bank clients (who are typically high net worth clients), this continues to be difficult for private bankers who frequently meet clients outside of their offices.

- **Disclosure of commission & other benefits/profit**

We support continuing with a *generic* disclosure for transactions where distributors act as principal (or when selling in-house products) and disclosure of a ceiling for transactions when acting on an agency and no risk principal basis.

- **Appointment and selection of distributors of a structured products by Issuer**

The draft product code requires that the Issuer shall exercise due care and diligence in any appointment and selection of any distributor of a structured product. Even if product providers can obtain detailed information about distributors' sales activities, product providers have no authority to critique their internal processes without knowledge of their client base and their internal organisation set-up. In addition, distributors are regulated entities, and product providers must take some comfort that their internal controls are in place and can be relied on. Product training (as to the type of investors for whom the product is structured and targeted) can be provided but implementation must be determined by the distributor.

- **Provision of independent daily indicative valuation**

Under the draft product code, product issuers are required to provide daily indicative valuation. Noting that these products are supposed to be “buy to hold”, therefore daily fluctuation of the value of these structured products should not be relevant to the investors. If the intention is to give the investors an opportunity to exit, then the information that the investors require is not the valuation but the indicative bid price offered by the issuer on a weekly basis for “buy to hold” products. In addition, the requirement for independent indicative valuation or pricing is not practical as it is generally not possible to obtain third party valuation or pricing for certain proprietary products. This is a more stringent requirement than actively traded listed products (e.g., liquidity providers for listed warrants are not required to be independent and can be the issuer of the product).

- **Requirement for Issuer to confirm to the SFC that a structured product is designed fairly**

While we understand the rationale behind paragraph 5.1 of the draft product code which requires issuers and product arrangers to “confirm to the SFC that a structured product is designed fairly”, we are concerned about its application and impact in practice. We are concerned that the terms “fair” or “appropriate” are inherently vague and open to subjective interpretations (investors may consider this to even mean risk free). In particular, the concept of “fairness” differs among investors with different investment strategies and investment objectives and it is against these benchmark that any assessment of fairness can be made. For example, the potential return for an equity linked investment product with limited upside may only be “fair” for investors who hold an investment strategy with a moderately bullish view on the underlying equity. There is a danger that a conclusion will be drawn with hindsight that such product could not have been fair for investors had they taken a more bullish view of the underlying equity. Therefore, a product provider will only be able to determine whether a product is “fair” for investors with a given investment strategy and investment objective *at the time* the product is purchased (not with hindsight) – these are usually explained in the form of an answer to the question “Who may consider buying the product” in the offering documents for retail structured products. We therefore urge the SFC to clarify this point in the product code.

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