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Your reference:

The Securities and Futures Commission
8th Floor, Chater House
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21 December 2012

Dear Sirs

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

We welcome the opportunity to comment on the Consultation Paper on Proposals to Enhance the Regulatory Regime for Non-Corporate Listed Entities (Consultation Paper) issued by the Securities and Futures Commission (SFC) on 23 November 2012.

We support the SFC's rationale for enhancing the regulatory regime for non-corporate listed entities. Recognising that market participants should be offered greater certainty with the introduction of well defined rules, the SFC should seek to meet its objective to enhance investor protection in a proportionate manner within its rules covering market misconduct, disclosure of interest and price sensitive information.

As a general comment, a real estate investment trust (REIT) or exchange traded fund (ETF) is effectively managed by its management company, with oversight from a trustee or custodian. It is therefore not appropriate to treat the trustee or custodian as someone with powers or responsibilities similar to the manager. This differentiation means that trustees and custodians should not be subject to all of the requirements proposed by the SFC and where this is the case, it is highlighted in our response.

Whilst we support in principle the SFC's proposals to enhance the regulatory regime for non-corporate listed entities, it is important that the consequential amendments to the Securities and Futures Ordinance (SFO) properly reflect the nature of non-corporate listed entities. This

is to ensure the extended regulatory framework for these entities can be applied meaningfully in practice by market participants, supported by relevant new or updated guidelines and circulars. We would also wish to understand how existing SFC Guidelines might be affected by the proposed statutory changes to the SFO. We suggest the SFC consult the public on the draft SFO language and guidelines when they become available.

Our comments are set out in response to the questions raised in the Consultation Paper and have been prepared in consultation with market participants.

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?

We agree in principle that Parts XIII and XIV of the SFO should be amended to cover listed entities that are not in corporate form to enhance investors' protection against market misconduct.

The extended market misconduct provisions however should not be applicable to passively managed ETFs established to track an index (whether physically or synthetically). The objective of the market misconduct regime as noted by the SFC is to promote fairness, protect the investing public and minimize crime and misconduct. By the very nature of index tracking ETFs they must be able to buy and sell shares to replicate the composition of the underlying index therefore the market misconduct provisions should not apply to them.

The inclusion of "manager" under the definition of "associate" in paragraph 16(e) is correct but we do not agree that the "trustee" or "custodian" should be included in the definition.

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 that listed open-ended CIS should be excluded from Part XV of the SFO.

However, we query whether the SFC should introduce Part XV to closed end funds or other types of vehicles such as business trusts and partnerships. Given the complexity of Part XV, we are concerned that investors in such entities will be burdened with some of the complex features currently found in Part XV.

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 that Parts VIII and X of the SFO should be amended to extend the SFC's powers under these Parts to all listed entities subject to our comments in Question 1.

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?

We do not agree with the SFC's proposal to extend the statutory disclosure requirement for PSI in respect of listed corporations under Part XIVA of the SFO to listed CIS.

First, CISs traditionally operate on a low total expense ratio - imposing the disclosure requirements on these CISs could increase the compliance burden and cost significantly.

Secondly, the key to Part XIVA is that a listed corporation must as soon as reasonably practicable after inside information has come to its knowledge disclose the information to the public. In the case ETFs whose value of the units or shares depends on the securities composition in the index replicated, the obligation to disclose price sensitive information is of significantly lower relevance.

In addition, the reporting of material changes in an ETF is already dealt with under the disclosure requirement in Chapter 11 of the Code on Unit Trusts and Mutual Funds in the SFC Handbook[1] as well as the joint circular[2] issued by the SFC and Hong Kong Exchanges and Clearing Limited (HKEx) in November 2010 containing a list of potential events that may trigger ongoing disclosure. We do not see any apparent benefit in extending the new Part XIVA PSI regime to ETFs.

Notwithstanding our views above, we have the following comments to these specific paragraphs:

- Paragraph 35. The SFC has already noted in paragraph 34 that there are hardly any events that could have a material effect on the price of an ETF that tracks the performance of a financial index or benchmark, hence there would be few circumstances justifying PSI disclosure. Similar to physical ETFs, synthetic ETFs' management decisions are governed by their index tracking nature though the methodologies they used be different. The risks for synthetic ETFs identified by the SFC should already be disclosed in the product documentation. There is no apparent benefit in subjecting ETFs, synthetic or not, to PSI disclosure.

- Paragraph 38. We do not consider it reasonable to extend the obligation or the power of the court to sanction non-compliance of the obligation to a trustee or custodian of

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1 SFC Handbook for Unit Trusts and Mutual Funds, Investment-Linked Assurance Schemes and Unlisted Structured Investment Products.

2 SFC and HKEx joint circular to management companies of SFC-authorised ETFs on a list of potential events triggering ongoing disclosure dated 18 November 2010.

the entity. As in the case of the Code on Real Estate Investment Trusts (REIT Code), the responsibility of disclosure / reporting lies with the manager and we feel that the REIT Code distributes the responsibilities more appropriately. It would not be helpful to introduce inconsistent provisions in the SFO.

- Paragraph 38(a)(ii). Given the manager, and not the unit holders of the entity, controls the ETFs and its underlying investments which form the ETFs' value, it does not make sense to include information about unit holders of the entity under the definition of "inside information".

- Paragraph 38(a)(iii) and (b)(i). It is not clear what a partner of the entity is intended to cover here.

- Paragraph 38(b). We query the need to extend the power of the court to sanction other parties for an ETF that is already in a corporate form and has a board of directors.

As mentioned, it would be helpful for the SFC to consult the public on the draft language of the Ordinance.

Question 5: Do you have any comments on the examples of events or circumstances where the management company of a listed CIS/other listed entity should consider whether a disclosure obligation of PSI would arise under the SFO?

Some of the examples do not appear to be applicable in the context of passively managed ETFs, for instance, "changes in performance, or the expectation of the performance, of the business" or "changes in auditors or any other information related to the auditors' activity". Even if the manager of a passively managed ETF is aware of certain changes in the performance or a change of auditors of one of the constituent stocks, they need to track the relevant index in accordance with its investment objective/strategy.

Please also refer to our answer in Question 4.

Question 6: Do you have any comments on our proposal set out in paragraph 45 above?

We agree with the change recognising that the issuer for the purposes of the SFO is the issuer of the underlying shares rather than the depositary bank. This is consistent with the listing regime – the 'issuer' for the purposes of the listing application and the issuer's continuing obligations is the issuer of the underlying shares – and with international market practice. It is also consistent with investors actually investing in the issuer of the underlying shares rather than the depositary bank.

Question 7: Do you agree with our proposals set out in paragraphs 58 and 59 above?

The exclusion from the disclosure of interests regime of entities whose only listed securities are debentures is sensible and reflects the reality of the current situation – where most corporations seeking to list debentures apply for an exemption from the obligation to comply.

Whilst the information disclosed would be of relevance to shareholders (it may have a real bearing on the value of their investments) this is not the case for debenture holders. The exception to this is probably for holders of bonds which are convertible into equity but this has been recognised in the consultation paper and issuers of convertible bonds will not benefit from the exemption.

Should the SFC wish to discuss any of our comments, please do not hesitate to contact

Yours faithfully

Clifford Chance

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