BLACKROCK

2 April 2018

Securities and Futures Commission
35/F Cheung Kong Center
2, Queen's Road Central
Hong Kong
Submitted via email to: utc-consultation@sfc.hk

RE: SFC Consultation Paper on Proposed Amendments to the Code on Unit Trusts and Mutual Funds

BlackRock, Inc. (together with its affiliates, "**BlackRock**") is pleased to comment on the Securities and Futures Commission ("**SFC**") Consultation Paper on Proposed Amendments to the Code on Unit Trusts and Mutual Funds ("**Consultation**").

<u>Key Operators – Management Companies</u>

Question 1:
Do you have any comments on the proposed increased minimum capital for management companies?

1.1 BlackRock views the increase in the minimum capital of a management company managing public funds in Hong Kong to HK$10 million as reasonable.

Question 2:
Do you have any comments on the proposals to provide flexibility for well-established fund management groups to leverage group investment expertise and experience?

2.2 BlackRock welcomes the SFC's proposals to provide flexibility for fund management groups to leverage group investment expertise and experience.

2.3 In support of this, BlackRock would suggest that any change to investment manager/adviser of a fund be considered an "Immaterial Change" (to be added to FAQ 9 under Section 2 of the Frequently Asked Questions on Post Authorization Compliance Issues of SFC-authorised Unit Trusts and Mutual Funds) as long as the new/replacement/remaining investment manager/adviser is an "existing manager" (i.e. already approved to manage SFC-authorised funds).

<u>Key Operators - Trustees and Custodians</u>

Question 3:
Do you have any comments on the proposals regarding the enhanced obligations of trustees and custodians?

3.1 BlackRock welcomes the clarification of the obligations of the Trustees and Custodians but would invite the SFC to also state that it is the Trustee/Custodian's responsibility to ensure the functional separation proposed in paragraph 25. BlackRock would invite the SFC to also provide a list of approved trustees and custodians to assist with transparency.

Question 4:
Do you have any comments on the proposals to enhance the periodic reviews of the internal controls and systems of trustees and custodians?

4.1 BlackRock welcomes the codification of existing requirements which it has already implemented with its Trustees and Custodians.

Question 5:
What other measures do you think are appropriate to strengthen the regulations for trustees and custodians of public funds in Hong Kong?

5.1 BlackRock supports the SFC's proposals as they clarify the SFC's expectations of trustees and custodians as well as their responsibilities.

Illiquid Assets

5.2 In relation to the proposed amendment to paragraph 7.3A of Chapter 7 of the Code, we would point out that certain assets which were initially liquid can subsequently become illiquid in unpredictable circumstances (e.g. if trading in listed securities is suddenly halted on the relevant exchange). Although BlackRock would take all reasonable measures to ensure that the fund's illiquid assets do not exceed 15% of its total net asset value, this may not be possible in circumstances which affect the entire market and which are beyond the control of any single investment manager and we would therefore request confirmation from the Commission that assets which were liquid upon acquisition are not to be included in this 15% limit where they subsequently became illiquid due to circumstances beyond the investment manager's control.

Derivative Instruments

Question 6:
Do you have any comments on the proposal to introduce an overall limit on derivatives investments for a plain vanilla public fund? Do you consider the proposed 50% limit appropriate? Please explain your views.

6.1 While BlackRock is not opposed to disclosing to investors the extent to which derivatives are used by a fund, it must be emphasized that the extent of use of derivatives can be a misleading indicator of the risk attached to investing in that fund, particularly where measurement of derivatives usage can only be calculated using the Commitment approach. The VaR approach is in considered a more appropriate measurement tool for certain products as it is highlights the risks more clearly than using the Commitment approach (which can lead to the risk being understated or overstated, particularly where non-linear derivatives such as options are being used).

6.2 It is important to note that derivatives can be used for many reasons, aside from risky or speculative investment. These include hedging (mitigating) risks to which the portfolio is subject, managing volatility, reducing costs and enabling better liquidity. Whilst we recognize that the SFC is proposing to exclude derivatives used for hedging purposes from the commitment calculation, the very granular nature of any definition of "hedging" means that the calculation will in many cases appear inflated as it also captures derivatives used to manage volatility and/or liquidity. We also believe not all derivatives should be treated the same way when assessing the associated risk or complexity (for example, buying a call option vs selling a call option, trading listed/cleared derivatives vs. over-the-counter (OTC) derivatives).

6.4 The Commission is proposing to impose a requirement to calculate the use of derivatives for all funds (complex and non-complex) using only the Commitment approach (i.e. without the option of using the VaR approach instead). This approach is more restrictive than under the UCITS regime which relies on the VaR approach for monitoring the use of derivatives by complex funds. The Commission has also defined the categories of derivatives which may be excluded from the calculation using the Commitment Approach more narrowly than is the case under the UCITS regime in which the carve-outs for hedging and efficient portfolio management better reflect the risks and benefits of using derivatives.

6.5 BlackRock would therefore invite the Commission to amend the definition of "hedging" as follows:

- 7.25 Note (1)(a) by adding the word "primarily" as follows:

  "…they are not primarily aimed at generating an investment return";

- 7.25 Note (1)(b) by replacing the word "solely" with "primarily" as follows:

  "…they are primarily intended for the purpose of limiting, offsetting or eliminating the probability of loss or risks arising from the investments being hedged; and";

6.6 BlackRock would also recommend including the following further carve-outs:

- Restricted Access and Liquidity:
  - Derivatives are required to manage market exposure. For example, during the stock suspensions in 2016, some China-related products held illiquid positions but investors were able to benefit from lower liquidity risk using China stock index futures. Another example is the use of index futures to obtain market exposure whilst direct investment accounts are still being opened in certain markets which can take months. Such derivatives usage that provides access or liquidity without magnifying economic exposure should be carved out.

- Cash management:
  - Derivatives are also often used for short term cash management and allocation changes. For instance, before a creation order settles in an ETF, it is usual to use derivatives to "hedge" the cash flow and ensure that tracking error is reduced during the settlement period. Depending on the size of the flow, this could lead to potentially large (but short term) derivative usage. It should be permitted to cave out the use of derivatives for such cash equitization purposes.

- Efficient Portfolio Management (EPM):
  - For instance, where the purpose of the derivative is simply to get the same exposure as a physical investment, but in a more cost-efficient and risk-aware manner.

- Benchmark Hedging:
  - Where a fund is running against a benchmark, derivatives may be used to reduce risk versus that benchmark. This cannot, however, be classed as hedging if the fund does not hold any physical position against which such a risk can be offset. In particular, this can affect global bond funds that want to hedge their currency exposure versus a benchmark.

6.7 Regarding the proposed 50% limit on plain vanilla funds, we have concerns that this is out of line with other markets and potentially restrict investment choices for certain Hong Kong investors. Most European markets allow 100% exposure for plain vanilla funds using the Commitment Approach, and whilst Taiwan has a 40% limit as per paragraph 39(d), the local regulator is able to grant waivers to exceed this level upon satisfactory request without restricting or changing the status of the public funds (in addition the to providing a clear calculation methodology of the 40% threshold using actual not expected usage). The US SEC survey results referred to in paragraph 39(b) may not be particularly applicable given that a greater proportion of US funds are (i) domestically invested (hence less impacted by liquidity, access and EPM issues than HK authorised funds), and (ii) index funds (which inherently use fewer derivatives). Please see BlackRock's response to that SEC paper at the following link: https://www.sec.gov/comments/s7-24-15/s72415-169.pdf

6.8 We would also suggest that the threshold not be based on disclosure of an "expected maximum", but instead on a historical average or weighted average of actual commitment levels. This information would be much more useful to investors. Requiring an expected maximum leverage will force fund managers to err on the side of caution and provide a higher (buffered) figure than will normally materialize, thereby overstating the actual extent to which derivatives are used by that fund.

6.9 Should the Commission maintain the requirement for an "expected maximum", we would request clarification as to:

(i) Whether that is an absolute maximum that must not be exceeded;

(ii) How occasional spikes should be treated;

(iii) The circumstances in which a fund would change classification; and

(iv) Implications to end-investors of a fund changing classification, especially if the fund has more than one change of classification over time.

6.10 In the event that a fund's strategy is expected to shift fundamentally as to its utilization of derivatives, how much advance notice and through what channels should the management company notify investors about the potential change in usage of derivatives for investment purposes? In such a case, we would suggest a principles-based approach for the purpose of determining the "expected maximum". It should be a maximum in normal market conditions, disregarding occasional spikes regardless of the reason for such spikes. By "occasional spikes", we mean that, under normal market conditions, the fund's commitment leverage should not exceed the relevant threshold for a prolonged or extended period of time, and over a given period, such spikes should not be too frequent. We do not recommend the setting of quantitative limits to the duration of time or the frequency of exceeding the threshold and it should be up to the discretion of the management company to satisfy itself that, on an on-going basis, the disclosure relating to the extent of a fund's use of derivatives is commensurate with the strategy of the fund.

6.11 We would be grateful if the Commission could also clarify the rules to be followed when calculating commitment leverage, and provide FAQs as and when management companies identify ambiguities, for example, as to the manner in which certain investments should be classified, whether certain positions can be netted off, etc.

6.12 BlackRock is not opposed to disclosing the extent to which derivatives are used by a fund, provided such disclosure does not restrict access by the Hong Kong retail investor to low-risk products which have been authorised for retail distribution in Hong Kong by the Commission. With this in mind, BlackRock would propose that the Commission introduce a risk-rating system for funds similar to the Synthetic Risk and Reward Indicator ("SRRI") included in the Key Investor Information Document ("KIID") under the UCITS regime or the Chinese regime which requires fund managers to provide distributors with a risk rating of between 1 to 5 for each fund (cf. AMAC's *Management Measures on the Investors' Suitability of Fund Raising Entities (Pilot)*) and that the Commission specify clearly that distributors in Hong Kong may rely on such risk rating when carrying out the suitability assessment.

6.13 We would also request confirmation from the Commission that there is no need to market a plain vanilla ETF with the annotation that it is a synthetic ETF if its intended derivatives usage is less than 50%.

Question 7:
Do you have any comments on the proposed enhanced disclosures regarding derivatives investments in the fund's KFS and financial reports?

7.1 No, subject to our response to Question 6 above regarding the calculation methodology to be used.

Securities Financing Transactions

7.2 We commend the SFC for publishing guidance in line with FSB requirements as it relates to securities financing transactions ("**SFTs**"). SFTs play an essential role in supporting fully functioning capital markets and, as the SFC has highlighted, there has been an increasing trend of funds entering into SFTs to enhance yield/returns or manage liquidity.

Question 8:
Do you agree with the proposed framework for Securities Financing Transactions? Please explain your views.

8.1 We are supportive of the proposed guidance and safeguards that will enhance disclosures to fund investors. It is important that investors are able to weigh the costs, performance and risk of engaging in SFTs. However, we would like to highlight following points that the Commission should consider further with respect to the requirements described in paragraph 52 (a), (c), (e) and (f), respectively:

(a) A fund may engage in Securities Financing Transactions if it is in the best interests of holders to do so and associated risks have been properly addressed;

8.2 We believe that a fund should only engage in SFTs if (i) it is in the best interests of the fund investors, (ii) the associated risks have been properly communicated, and (iii) the level of risk and the risk management practices of that particular fund are acceptable to the investors. BlackRock has an independent risk management function that partners with the fund managers to manage and monitor risks associated with each fund inclusive of SFTs, provide a robust assessment of counterparties and set prudent collateral standards and management.

8.3 The consultation suggests that the “associated risks be properly addressed” without regard for the need to tailor differing investment funds to the expectations of differing investors. In this regard, we would point out that investors have differing goals including the level of risk they find acceptable for their respective return expectations.

(c) A fund should have at least 100% collateralization marked to market daily to ensure that there is no uncollateralized counterparty risk exposure arising from these transactions;

8.4 The degree of haircut should be left to the discretion of the fund manager based on their judgment of the market risk.

8.5 It is important to differentiate collateralization practices for different SFTs:

a. Securities Lending: In most jurisdictions, collateral must be adequate and be at least equal in value, at the time of the transfer to the firm or its agent, to the value of the securities lent out. BlackRock agrees that collateral should be at least 100% of the value of the securities loan and marked-to-market daily. When acting as a lending agent, BlackRock typically requires borrowers to post collateral between 102% and 112% of the value of the securities lent. The over-collateralization percentage varies depending on the type of collateral posted.

b. Repurchase agreements / reverse repurchase agreements: If repos or reverse repos are used as an investment by the fund, we agree that the collateral should be at least 100% of the value of the repo (or reverse repo) and marked-to-market daily. However, if repos (or reverse repos) are used as a means of a hedge, common market practice is to post collateral sufficient to execute the transaction, which could be less than 100%.

(e) A fund should ensure that it is able at any time to recall all the securities or the full amount of cash involved or terminate the Securities Financing Transactions;

8.6 While many investors may require the ability to recall lent securities as an integral part of any securities lending program they choose to engage in, others will prefer to engage in term structures in order to generate more lending income. As with many aspects of a securities lending program, BlackRock believes that clear disclosure of a specific fund’s recall practices is the appropriate way to ensure that clients are making informed choices.

(f) Indemnification should be provided by securities lending agents to protect a fund against counterparty default

8.7 While practices around providing borrower default indemnification vary in the securities lending industry, typically, indemnification is a service that is negotiated between the asset owner and its securities lending agent. During the client due diligence process, whether or not a lending agent offers indemnification is one of many service aspects that an asset owner will consider in their decision to select a lending agent. This would typically be considered in addition to the risk management practices of the lending program, the manner in which the lending agent is compensated and the performance of the lending program.

8.8 Importantly, when indemnification is provided by securities lending agents it does not cover the entire value of the lent security nor does it guarantee the performance of the securities lending transaction or cash re-investment vehicle. Rather, in the event of a borrower default, the securities lending client has the right to claim for itself any collateral transferred by the borrower in order to repurchase the loaned securities. The indemnification covers any shortfall in the amount needed to complete the repurchase after first looking to the collateral.

8.9 Some asset owners will place a high value on indemnification and require it as a condition of participating in a securities lending program while other clients will have other areas of focus and may find it reasonable to engage in securities lending on a non-indemnified basis. BlackRock has agreed to provide certain clients with borrower default indemnification.

Question 9:
Do you consider indemnification by securities lending agents is a necessary and appropriate safeguard? Please explain your views.

9.1 As mentioned above, practices around providing borrower default indemnification vary in the securities lending industry, typically, indemnification is a service that is negotiated between the asset owner and its securities lending agent. In our experience, during the client due diligence process, whether or not a lending agent offers indemnification is one of many service aspects that an asset owner will consider in their decision to select a lending agent. This would typically be considered in addition to the risk management practices of the lending program, how the lending agent is compensated, and the performance of the lending program. Some asset owners will place a high value on indemnification and require it as a condition of participating in securities lending program while other clients will have other areas of focus and may find it reasonable to engage in securities lending on a non-indemnified basis. BlackRock has negotiated with certain clients and funds to provide borrower default indemnification.

Question 10:
Do you consider an overall transaction limit should be imposed on Securities Financing Transactions (other than the additional safeguards proposed)? Please explain your views (with any suggested overall transaction limit, if applicable).

10.1 No. SFTs play an essential role in supporting fully functioning capital markets. The imposition of an overall transaction limit could constrain liquidity and it would increase settlement issues and trade fails. If the proposed safeguards are implemented, there should be no need for an overall limit.

<u>Collateral</u>

Question 11:
Do you think that the proposed collateral requirements are sufficient to safeguard investor interests? What additional criteria should be considered?

11.1 We believe that the proposed collateral requirements are sufficient to safeguard investor interests. However, as we mentioned previously, different collateralization should be required for different SFTs.

Question 12:
Do you agree with the proposed disclosure requirements concerning collateral? Please explain your views.

12.1 We agree with the proposed disclosure requirements concerning collateral. In securities lending transactions, BlackRock does *not* re-hypothecate non-cash collateral. In BlackRock's current securities lending program, the borrower posts all non-cash collateral directly to a custodial account for the benefit of the lender. The non-cash collateral is not used by either the lender or lending agent, except in the event that the borrower defaults, at which time the collateral would be liquidated with the proceeds used to repurchase the lent securities.

<u>Investments in other funds</u>

Question 13:
Do you have any comments on the proposals on investment in other funds?

13.1 BlackRock welcomes the deletion of the section on unit portfolio management funds and the clarification of the definition of feeder fund but would request the Commission allow feeder funds to invest more than 90% into a master fund that is not authorised by the Commission provided it is authorised in a jurisdiction with an equivalent regulatory regime (e.g., funds domiciled in the United States or in Recognised Jurisdictions).

13.2 We consider this particularly relevant in the context of ETFs. In order to provide Hong Kong retail investors with the opportunity to diversify their portfolios, it is important to allow them the opportunity to invest into local unlisted funds or ETFs which then feed into overseas funds (including overseas ETFs) which are regulated in a recognized jurisdiction. Such feeder funds could be launched with minimal capital and enjoy increased scalability with the ability to maintain regulatory oversight from the Commission and operational efficiency as well as low tracking error in the case of feeders into overseas ETFs and operational efficiency. The master fund may even enjoy greater tax treaty benefits from the countries in which it invests which would in turn improve the performance of its Hong Kong feeder fund. The dual-listing of any such master fund would not be

successful as the feeder fund would invariably trade at a wider spread to the master fund and institutional investors are likely to trade in the master fund which will normally be more liquid thereby making the dual-listed line even less attractive to the retail investor. Feeder funds that invest into overseas ETFs are also likely to be the only ETFs likely to attract southbound investors on ETF Connect as most Hong Kong ETFs invest mainly into PRC and Hong Kong stocks.

13.3 We also consider many of these arguments (e.g. beneficial tax treaties, scale benefits, wider investment choice) to be highly relevant for HK-domiciled unit trusts and mutual funds where the master fund is not domiciled or authorised in Hong Kong. Local retail feeder funds into non-authorised overseas funds already feature on Japanese and Australian markets.

13.4 Currently, in order for a fund to be authorised to invest 90% or more of its NAV in another single underlying fund ("Feeder Fund"), 7.12(a) of the UT Code requires that the underlying master fund must also be SFC-authorised. In our view, this restriction in effect makes the use of Feeder Fund structures somewhat redundant because if the underlying master fund also needs to be SFC-authorised, the use of a Feeder Fund (which is also SFC authorised) would appear superfluous[1]. BlackRock would therefore recommend that this restriction be relaxed, such that the master fund need not be SFC-authorised.

13.5 The benefits to investors in a SFC-authorised Feeder Fund that feeds into an offshore master fund include the potential for access to increased liquidity and lower ongoing charges. The rationale is the same as that discussed above in the context of FOFs – to allow investors to access the scale of certain offshore funds (where such offshore funds themselves are domiciled in jurisdictions that are highly regulated, for example, Luxembourg, Ireland, United Kingdom or the United States). Such Feeder Funds also enjoy a lower bar to entry (as a feeder structure requires minimal launch capital) and increased scalability (as feeder funds require less AUM to run efficiently and, in the case of a feeder into an index fund, to maintain low tracking error), which means that more funds could be launched and maintained in Hong Kong. In some cases, the underlying master fund may be domiciled in a jurisdiction which enjoys more tax treaty benefits from the countries in which it invests, which would indirectly improve the performance of the Feeder Fund.

13.6 Investors investing in a Feeder Fund obtain exposure to the benefits and risks of the underlying master fund. BlackRock fully appreciates the policy concerns the Commission may have in relation to regulatory handle on the underlying master fund but it would invite the Commission to consider the following points:

- The Feeder Fund is itself SFC-authorised and must therefore comply with the UT Code and any conditions of its authorisation by the Commission. Furthermore, where Feeder Funds are managed in Hong Kong (which is likely to be the case), the investment manager is also subject to the licensing and conduct requirements of the Commission. Moreover, we note that the Commission has also proposed to increase capital requirements for investment managers of SFC-authorised funds (which we support) and we would submit that this change would also increase regulatory handle. Therefore, we respectfully submit that the Commission already has a very strong regulatory handle as it can hold the Feeder Fund (and the trustee and investment manager) to account.

- Sufficient regulatory handle may be achieved via means other than SFC-authorisation of the underlying master fund. Referring to the Appendix – Australia, Singapore and Taiwan are examples of jurisdictions that permit local retail funds to be set up as feeders into masters which are not locally authorised. Our understanding is that regulatory handle in these jurisdictions ranges from disclosure-based requirements to recognition that certain fund types/domiciles may be treated differently. For example, Australia does not impose any limits on investments in local or offshore underlying funds, but typically where the investment in an underlying fund is material, additional disclosure is expected regarding that underlying fund, including risks associated with that underlying fund. Singapore adopts the concept of comparable jurisdictions as a starting point. Taiwan is slightly more restrictive, in that only ETFs are allowed to be authorised as Feeder Funds and must only feed into a single underlying offshore ETF.

[1] Our understanding is that, currently, Feeder Funds authorised in accordance with 7.12(a) of the UT Code (i.e. requiring the master fund to also be SFC-authorised) are typically used to create slightly different versions of the underlying vehicle (for example, versions with currency hedging, alternative fee structure or RMB-denominated offering). We suggest that another, more efficient way to create these exposures would be via share classes of the existing vehicle. We would be happy to separately provide further information on this topic, if helpful.

- For Hong Kong, to increase the level of regulatory handle, in addition to the references offered by other jurisdictions, we note the following concepts already exist in the Hong Kong regulatory landscape:

    - The Commission can consider extending the RJS concept to the Feeder Funds regime, such that local retail funds can feed only into RJS (which are not SFC-authorised).

    - The Commission has recently proposed categorising investments products based on complexity. In the *Consultation Paper on the Proposed Guidelines on Online Distribution and Advisory Platforms* dated May 2017, the Commission emphasised the importance of robust customer protection in connection with complex products and proposed additional conduct requirements in relation to the distribution of complex products. We submit that this is a concept the Commission may consider extending to the Feeder Fund situation – i.e. SFC authorisation should only be required for master funds which are complex in nature.

    - The MPFA already adopts the concept of "approved stock exchanges" – as long as an index-tracking fund is listed on an approved venue and satisfies certain eligibility criteria, the MPFA does not require the ETF to additionally seek SFC authorisation[2].

  The above are only a few examples. We submit that there may be many other criteria or combinations of criteria that could be set around a regime which allows Feeder Funds into offshore master funds whilst providing sufficient regulatory handle.

13.7 For the asset managers, if offshore master funds did not have to seek SFC authorization (but still address the Commission's concerns regarding regulatory handle, for example via additional disclosure and/or differentiating between simple underlying funds vs complex underlying funds, as noted above), this could materially decrease the compliance burden and costs to offshore funds. This will expand the universe of underlying funds for the feeder funds to choose from and allow Hong Kong investors to tap into the depth, cost efficiency and, in some cases, liquidity of certain offshore funds.

13.8 Furthermore, we would highlight that the manager of a Feeder Fund is still engaged in asset management, albeit not of the underlying investments of the master fund. The manager of a Feeder Fund needs to perform functions such as, without limitation, manage/oversee any FX overlays, manage cash balances and flows into/out of the master fund, and manage/determine dividend distributions. Thus managing Feeder Funds would still require a material asset management presence in Hong Kong. Our view is therefore that such a framework would encourage development of Hong Kong as an Asian investment funds hub and asset management centre.

Structured funds

Question 14:
Do you agree with the proposal to require a structured fund to be subject to 100% collateralization?

14.1 BlackRock agrees with the Commission's proposal to require structured funds to be subject to 100% collateralization.

Money Market Funds

Question 15:
Do you agree with the proposed requirements for money market funds? Please explain your views.

15.1 No comment.

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[2] MPFA, III.10 Guidelines on Index-Tracking Collective Investment Schemes

Unlisted index funds and index tracking exchange traded funds

Question 16:
Do you agree with the proposed amendments to the requirements for unlisted index funds and passive ETFs using index tracking strategies which substantially invest in derivatives? Please explain your views.

16.1 Yes, BlackRock welcomes the proposed amendments to requirements for unlisted index funds and index-tracking ETFs which substantially invest in derivatives.

Question 17:
Do you agree with the proposed enhanced diversification requirements for indices? Please explain your views.

17.1 It is not always possible to achieve the exact weightings of constituents, especially in exceptional circumstances such as where trading in securities has been suspended or cash is required in order to fund redemptions, etc. BlackRock invites the Commission to factor in a certain level of tolerance for circumstances which are beyond the fund manager's control as is the case under the UCITS regime under which these diversification requirements were first imposed. It should be possible to exceed the 20% group limit for cash deposits and the requirement to achieve weightings of constituents for a reasonable length of time in order to deploy cash, liquidate or reallocate assets or fund redemptions as well as in exceptional circumstances such as the launch, merger or termination of the fund.

Question 18:
Do you agree with the proposed arrangement for setting up listed and/or unlisted units or share classes for index funds and passive ETFs? Please explain your views.

18.1 No comment.

Question 19:
Do you agree with the other proposed amendments related to unlisted index funds and passive ETFs under Chapter 8.6 of the UT Code?

19.1 BlackRock would invite the Commission to please amend the proposed amendment to 8.6 (j) (iii) of the Code requiring disclosure of the top 10 largest constituent securities of the index in the Key Fact Statement rather than the offering document as the offering document cannot be amended as easily. Neither the fund manager, nor the passive ETF itself, is in a position to publish the constituents of an index on a "publicly available website" – this can only be done by the index provider on its own website. BlackRock already discloses the top 10 holdings of its ETFs each day. BlackRock cannot provide and publish data on the index itself without first obtaining a license from the index provider which might not be possible. The index provider may be subject to restrictions itself in relation to the publication of data (e.g. the index provider might be under an obligation to ensure weights are not published on any external public website) or it may insist on a delay before publication of the data. If granted, there may be substantial additional fees and costs associated with such license.

19.2 BlackRock would propose that the Commission add the word "material" before "information or transaction concerning the passive ETF…" and it delete 8.6(q) (i) and (ii) as these are both already covered by 8.6(q) (iii). We would also appreciate confirmation from the Commission that this requirement would be fulfilled by publication of the announcement on the investment manager's website.

19.3 Although this does not relate to a proposed change, BlackRock invites the Commission to remove the requirement in 8.6 (u) (i) of the Code to publish the indicative net asset value of a passive ETF on that passive ETF's own website. An indicative NAV could be provided by the data providers (Reuters, Bloomberg, etc.) instead. It is not appropriate for it to be published on the website of the fund manager or the passive ETF as the fund manager does not control the calculation methodology for producing the indicative NAV and an indicative NAV may not be helpful information for investors in the case of securities which are traded across different time zones as the prices are stagnant while the local exchange is closed. The delays and inconsistencies in pricing and calculation methodologies between different service providers or Funds could be misleading.

19.4 BlackRock also requests confirmation from the Commission that in paragraph 8.6 (u) (ii), the reference to "last closing net asset value per unit/share" refers to the latest net asset value per unit/share on the primary market for that ETF.

Listed open-ended funds (also known as active ETFs)

Question 20:
Do you agree with the proposed requirements for listed open-ended funds? Please explain your views.

20.1 No comment.

Closed-ended funds

Question 21:
Do you agree with the proposed requirements for closed-ended funds? Please explain your views.

21.1 It is extremely difficult, if not impossible, to monitor the number of investors on a look-through basis to "ensure that it is widely held" given the extensive use of nominees and omnibus accounts in Hong Kong and the fact that the registry only maintains information on the nominee investors and not the end investor(s) who invest via those nominees. BlackRock would therefore invite the Commission to remove the proposed requirement in the Note to 8.11 (b) of the Code that the scheme is expected to have procedures and mechanisms in place to ensure that it has a broad base of shareholders.

Operational matters and on-going disclosure and reporting requirements

Question 22:
Do you agree with the proposed amendments to the provisions in the UT Code relating to operational requirements and financial reporting? Please explain your views.

22.1 The proposed materiality threshold for reporting errors to the SFC of 0.5% is standard and acceptable but we would question the value of reporting every single error to the trustee/custodian without regard for materiality, especially as the trustee has often already been informed of everything if its affiliate is calculating the Net Asset Value of the fund. It should not be necessary to inform the trustee of every single inconsequential pricing error and BlackRock would propose this obligation be limited to pricing errors of at least some minimal level.

22.2 BlackRock supports the rest of the SFC's proposals regarding the financial reporting requirements and welcomes codification of existing practices and existing FAQ guidance.

Miscellaneous

Streamlining of specialized schemes in the UT Code

Question 23:
Do you agree with the proposed streamlining of specialised schemes in the UT Code? Please explain your views.

23.1 No comment.

Consequential amendments to the SFC Code on MPF Products, the Code on Pooled Retirement Funds and the Code on Investment-Linked Assurance Schemes

Question 24:
Do you agree with the proposed consequential amendments to the MPF Code? Please explain your views.

24.1 No comment.

Question 25:
Do you agree with the proposed consequential amendments to the PRF Code? Please explain your views.

25.1 No comment.

Question 26:
Do you agree with the proposed consequential amendments to the ILAS Code? Please explain your views.

26.1 No comment.

Section 2 – Application of proposed amendments to UCITS funds

Question 27:
Do you agree that a minimum initial subscription by investors to be consistently applied to all highly leveraged funds? Do you consider the proposed US$50,000 or the equivalent threshold appropriate? Please explain your views.

27.1 No. As highlighted in our response above to Question 6, funds that use derivatives extensively can still be lower-risk products overall, and potentially suitable for a large portion of the public in Hong Kong in which case they should not be subject to the same minimum subscription requirement as an authorised hedge fund. If a minimum subscription amount of USD 50,000 is imposed, it may put such products beyond the affordability of suitable investors and restrict their choice unnecessarily.

Question 28:
Do you agree that the requirement on disclosure of the purpose of, and expected maximum leverage arising from, derivatives investments should be consistently applied to all SFC-authorised funds? Please explain your views.

28.1 Yes, BlackRock agrees that the disclosure requirements in relation to the purpose of the leverage and the expected maximum leverage arising from derivatives investments should be consistently applied to all authorised funds subject to our response to Question 6 above and the calculation methodology used. This should be coupled with clear guidance that the expected maximum leverage level of a fund is not a suitable indicator of whether a product is higher or lower risk for the purposes of the suitability assessment. For example, a China A-Shares equity fund with 0% expected maximum leverage may be a more risky fund than a global investment grade bond fund with over 100% expected maximum leverage.

Implementation timeline

Question 29:
Do you agree with the proposed implementation timetable for the proposed amended UT Code? If not, please set out your reasons and what you think is an appropriate transition period.

29.1 BlackRock respectfully requests that the Commission extend the transition period from 12 months to 18 months so that market participants have sufficient time to ensure all necessary systems and operational changes are made (particularly in relation to investment restrictions and diversification requirements) and all necessary amendments are made to retail fund documentation.

Question 30:
Do you agree with the proposed implementation timetable for the proposed amended MPF Code? If not, please set out your reasons and what you think is an appropriate transition period.

30.1 No comment.

Question 31:
Do you agree with the proposed implementation timetable for the proposed PRF Code? If not, please set out your reasons and what you think is an appropriate transition period.

31.1 No comment.

Question 32:
Do you agree with the proposed implementation timetable for the proposed amended ILAS Code? If not, please set out your reasons and what you think is an appropriate transition period.

32.1 No comment.

APPENDIX – Survey of FOF and Feeder Fund regulation in other jurisdictions

Please note that the information in this Appendix is intended to provide a high level overview of our understanding of the rules relevant to FOF and Feeder Funds in the relevant jurisdictions. BlackRock does not purport to provide definitive legal or regulatory advice on the matters set out below.

	FOF regulation[3]	Feeder Fund regulation
	1. Can retail funds registered in the relevant jurisdiction ("Local Funds") invest in underlying funds and, if yes, what investment limits apply? 2. Can Local Funds be structured as FOFs?	3. Can Local Funds be structured as Feeder Funds and, if yes, what requirements apply?
UCITS[4]	1. Yes, Local Funds can invest in underlying funds subject to the following limits: • Max 20% of NAV in any one underlying fund[5]; and • Max 30% of NAV in aggregate in non-UCITS underlying funds.[6] 2. Yes, Local Funds can be structured as FOFs in accordance with the above limits.	3. Yes. A feeder UCITS is a UCITS fund (or sub-fund) which invests at least 85% of its assets into units of another UCITS fund (or sub-fund of another UCITS). A master UCITS is a UCITS fund (or sub-fund) which must have among its unitholders at least one feeder UCITS, is not itself a feeder UCITS, and does not hold units of feeder UCITS.
Singapore	1.Yes, Local Funds can invest in underlying funds if the underlying fund falls into one of the following categories: (a) an authorised/recognised fund[7]; (b) a fund which is (i) constituted and regulated in a comparable jurisdiction[8]; (ii) substantially complies with the Singapore CIS Code[9] requirements; and (iii) has a manager that is supervised by an acceptable regulator; or	3. Yes, if the Local Fund invests substantially all its assets in one or more underlying funds, each underlying fund will need to fall into either limb (a) or (b) of the response to question 1.

[3] Please note that in this column, we highlight only restrictions placed on a Local Fund's investment in underlying funds as a % of the Local Fund's NAV. For the relevant jurisdictions, there may be additional restrictions, for example limitations on the value/amount of an underlying fund's NAV that the Local Fund may hold (commonly referred to as "control limits") but we do not list them here, as the primary purpose of this column is to show diversification requirements.

[4] The observations in this table pertain to our understanding of the Irish and Luxembourg regulations only; other UCITS jurisdictions may have slightly different rules.

[5] For umbrella funds, in Ireland this limit is applied at the sub-fund level, while in Luxembourg this limit is applied at umbrella level.

[6] Non-UCITS must have investor protection measures and regulations equivalent to UCITS. Whether a specific jurisdiction will deem a non-UCITS as having investor protection measures and regulation equivalent to UCITS will depend on that relevant jurisdiction.

[7] Authorised and recognised funds are considered to have the same status in the sense that both types are funds that are registered for retail distribution in Singapore. The difference is that an authorised fund refers to a Singapore domiciled (i.e. locally manufactured) fund whereas a recognised fund is a foreign constituted fund that the MAS "recognised" (i.e. registered) for retail distribution.

[8] To our knowledge, the MAS has not published a list of comparable jurisdictions but the general understanding is that Luxembourg, Ireland and France are considered comparable and "gold standard" jurisdictions. In general, UCITS is considered to be comparable and acceptable. In the past (before 2012 when the CIS Code was amended), the industry's experience was that the MAS would usually deem UCITS to substantially comply with the CIS Code requirements and their review would be more straightforward. However, they have since indicated that this is no longer a blanket rule and our understanding is that they would still (especially for UCITS funds with more complex features or strategies) look into the investment restrictions/guidelines before making the decision if it substantially complies and may ask the product provider questions on this in their review if this information is not apparent in the application

[9] CIS Code:
http://www.mas.gov.sg/~/media/MAS/Regulations%20and%20Financial%20Stability/Regulations%20Guidance%20and%20Licensing/Securities%20Futures%20and%20Fund%20Management/Regulations%20Guidance%20and%20Licensing/Codes/CIS%20CODE%201%20JAN%202016.pdf

	(c) a fund which is invested in permissible investments, commodities or real estate and meets the requirements of the CIS Code and is listed for quotation and traded on an organised exchange. Generally, if the underlying funds fall into limb (a) or (b) categories, no further limits would be applied. However, if they fall into limb (c), there will be further limits. If they fall into limb (c) and the underlying fund is invested in permissible investments or real estate, there is a 10% NAV limit. If they fall into limb (c) and the underlying fund is invested in commodities, there is an additional alternative exposure limit. Please refer to para 2.13 in page 32 of the CIS Code for a description of this limit. 2. Yes, if the Local Fund invests substantially all its assets in one or more underlying funds, each underlying fund will need to fall into either limb (a) or (b) above.	
Australia	1. Yes, Local Funds can invest in underlying funds with no investment limits. There is no requirement for any underlying fund to be registered in Australia. Typically where an underlying fund is a material component of the Australian retail fund, disclosure of the underlying fund would be expected. 2. Yes, Local Funds can be structured as FOFs; no investment limits apply.	3. Yes, Local Funds can be structured as Feeder Funds; no investment limits apply. "Look through" disclosure to the underlying fund would be provided.
Taiwan	1. Yes – Local Funds can invest in underlying funds, subject to an aggregate limit of 20% of NAV in all underlying funds. 2. Yes; the exception to the above rule is for a Local Fund structured as a FOF. A Taiwan FOF can invest in Taiwan domiciled funds, offshore funds registered in Taiwan, ETFs listed in all stock exchanges in the world (e.g. Taiwan stock exchange, NYSE, London stock exchange etc.) and OTC markets that are approved by the Taiwan Financial Supervisory Commission. However, Taiwan FOFs are not allowed to invest in private placement funds and other FOFs. In addition, a Taiwan FOF is required to invest at least 70% of its NAV at least 5 underlying funds or ETFs. The assets that are not invested into underlying funds or ETFs have to be cash or cash equivalent (such as repos, short term bills etc. that are issued or guaranteed by institutions that meet a certain rating).	3. Yes, but only Taiwan-listed ETFs are permitted to be structured as Feeder Funds. The Feeder ETF is only permitted to invest in a single offshore ETF that is registered and managed in a country which is recognized and publicly announced by the Taiwan government. In addition, the underlying ETF cannot invest in gold, commodities or real estate, cannot invest more than 70% of its assets in the Taiwan stock market, cannot be denominated in NTD (Taiwan currency) and has to be approved by its domicile's regulator and be publicly listed.