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The Securities and Futures Commission
35/F, Cheung Kong Center
2 Queen's Road Central
Hong Kong

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

Ladies and Gentlemen:

Morningstar Investment Management Asia Limited ("MIM Asia") appreciates the opportunity to comment on the Securities and Futures Commission Consultation Paper on Proposed Amendments to the Code on Unit Trusts and Mutual Funds ("Consultation Paper").

About MIM Asia and Morningstar, Inc. ("Morningstar")

MIM Asia is a subsidiary of Morningstar, a leading provider of independent investment research in North America, Europe, Australia, and Asia. The Morningstar group of companies offer an extensive line of products and services for individual investors, financial advisors, asset managers, retirement plan providers and sponsors, and institutional investors in the private capital markets. Morningstar and its affiliates provide data and research insights on a wide range of investment offerings, including managed investment products, publicly listed companies, private capital markets, and real-time global market data. Morningstar also offer investment management services through its investment advisory subsidiaries, with more than US$195 billion in assets under advisement and management as of 31 December 2017. In Hong Kong, investment research and investment advisory services are provided by MIM Asia, which is licensed by the Securities and Futures Commission to provide investment advice (type 4) to professional investors only. The company has operations in 27 countries.

Morningstar established an ETF research team (part of Manager Research) in the U.S. in 2008, and has since been providing research on the ETF industry. In November 2016, we also unveiled qualitative, forward-looking ratings – Morningstar Analyst Ratings – on over 250 ETFs globally and the list has expanded since. We therefore have a distinctive global perspective on the questions the Commission asked in relation to ETFs as part of the proposed amendments to the UT Code. Our feedback is set out below.

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.

Yes. In particular, we believe that full collateralisation and the relevant disclosure of the collateralisation policy and collateralisation level can help safeguard investors.

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

We agree with the proposed enhanced diversification requirements for indices, where the amended magnitude of diversification is similar to that required for UCITS funds. We also agree with the exceptions made for indices related to single commodities or interest rate-related benchmarks for money market-like exposures.

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.

We agree with the proposed arrangement for setting up listed and/or unlisted units and share classes for index funds and passive ETFs as this will increase the number of distribution channels through which the funds are available. Investors will benefit from greater breadth of choice and easier access to certain strategies via the ETF structure. Nevertheless, it is important that relevant information related to the share class (e.g. name, fees, etc.) is clearly stated in the prospectus, product key facts statement and other relevant documents and marketing materials (such as websites). We view that it is important for investors to be able to clearly distinguish the different share classes and are equipped with the sufficient information to make investment decisions.

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?

Yes. Nonetheless, we would emphasise the importance of transparency for passive ETFs. Specifically, as it pertains to the portfolio holdings of the passive ETF (8.6(u)(iii)), we prefer to see daily disclosure of the full portfolio from index-tracking ETFs. The changes recommended are a good step and we would hope to see continued progress towards the daily standard over time.

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

We generally agree with the proposed requirements. There does need to be a delineation between disclosure made to a market maker and that made to the public. While selective disclosure can create equity issues in a market, we note that there is a common interest in an investment manager selecting a market maker who only uses portfolio information for the stated purpose of making a market. The SFC may also consider utilizing words to enforce that principle in the guidelines. The public disclosure requirements in the document are a positive step and we would ask for consideration of two additional points. Portfolio disclosure be made in a machine readable format including security identifiers. Secondly, consideration be given to portfolio disclosure for unlisted managed funds – see additional details below.

We suggest the names of actively managed ETFs be easily distinguished from passively managed ETFs. Specifically, we would recommend that the words "active ETF" be included in the name of the listed share class. Alternatively, a distinctive set of exchange stock codes can be used, and/or, referencing the current treatment for synthetic ETFs, an annotation "(*this is an active ETF)" could be appended to these funds' names.

Paragraph 96(e) states "Active ETFs must publish full portfolio information to the public on a monthly basis (with no more than a one-month delay)." The reality today is that unlisted managed funds in Hong Kong are behind many markets on the issue of portfolio holdings disclosure ("PHD"). An extract of the 2017 Morningstar Global Fund Investor Experience Study dealing with PHD is attached for reference. The report notes the global trend towards monthly disclosure of portfolios, with a median lag of 55 days. Within Hong Kong most portfolios are currently provided on a half-yearly basis although monthly portfolios are received for 35% of funds. There is a considerable delay between the disclosure of portfolios within annual statements and half yearly report (60 days) and when they are available in the Morningstar database (113 days) because there is no requirement to make this information available in a machine-readable format requiring manual data entry in many instances. There is a large gap between the proposed requirements for Active ETFs and the current practice for unlisted managed funds and we would ask the SFC to consider measures that help to reduce this gap.

Please don't hesitate to contact Jackie Choy at jackie.choy@morningstar.com if you have any questions or require further information about our response.

Sincerely,

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