

**Axiom**  
INVESTMENT MANAGEMENT  
LIMITED

5<sup>th</sup> November 2001

Investment Products Department  
Securities and Futures Commission  
12/F Edinburgh Tower  
The Landmark  
Central  
HONG KONG

**RE: CONSULTATION PAPER ON THE OFFERING OF HEDGE FUNDS**

Dear Sir/Madam:

We are pleased to be invited to submit our comments on the above Consultation Paper. We wish to congratulate the SFC on this initiative and look forward to participate in this process in order to contribute, in a small way, to the recognition of this important asset class in Hong Kong.

**Hedge Fund Comments**

**Item 41:** The 'proposed requirement of \$100 million under management' may be counterproductive in many ways and may not be a suitable measure of experience or integrity.

Many hedge funds were started by managers branching out of large institutions with hundreds of millions of dollars under 'mismanagement'. Most of these managers will usually succeed in raising much less than \$100 million at the outset or may not even wish to start with such a large amount until they feel comfortable that they can implement their strategies and manage the growth of their portfolio.

Many large traditional asset management firms have, due to historical reasons, more than \$100 million under management. Many of these managers are managing 'Index Funds' or closet-index funds tied to a benchmark and therefore holding mainly the large caps found in the relevant benchmark/index. Such an approach to managing assets does not in any way provide the necessary experience to manage a hedge fund nor to implement strategies that may require non-directional exposure. Most managers in large asset management companies dealing mostly with mutual funds only have a cursory knowledge of short selling, despite their claim to the contrary.

Hence setting an arbitrary level of asset under management may make it difficult for new managers to launch a new firm/product, and thus limit the growth of this part of the investment industry in Hong Kong.

Most investors dealing with hedge fund understand that a new small fund is by its very nature generally more risky. Full and accurate disclosure of the size of the assets under management and of the experience of the manager are much more useful in determining whether a potential investor should consider a particular hedge fund and whether the investing public, in its broadest sense, should be exposed to this investment opportunity.

**Items 48-49 Dealing:** The minimum number of dealing days should be left to the managers/trustees. They should, however, be clearly spelt out in any offering document. A dealing day should not necessarily mean both a subscription and redemption day. Furthermore, establishing a requirement to provide an independent calculation of the Net Asset Value (nav) on a regular basis is far more important than setting a requirement for a specific number of dealing days for all funds regardless of their assets under management or of their respective strategies.

**Item 51 Disclosure:** Such limits should be clearly described in any Offering Memorandum or other documents describing the risks of the fund/strategy.

**Item 52 Performance Fees:** In the hedge fund industry, the performance fee represents the bulk of a manager's income. The SFC should not be determining salary/remuneration levels, as it has no way to determine the effort/expertise required to generate the returns. For instance, high returns may be generated by a manager that takes (disclosed) high risks. However, it is quite possible that such a manager is generating poor returns on a risk-adjusted basis as determined by various models integrating the volatility of the returns. It is highly doubtful that the SFC has the competence to evaluate such matters or that it would want to get involve in matters that can be entirely subjective and could lead to endless debates.

It is clear that the investors will be in a far better position to assess whether they wish to compensate a manager in a certain way or not. The investor has full control in this case, as he/she can always decline to invest if the fee structure is considered out of line with the performance or unreasonable.

The above comments are meant to point out that one should be wary of the 'law of unintended consequences'. We understand and support the fact that the SFC needs to set rules in order to allow this asset class to be offered to the investing public. In our view, institutional investors such as pension funds and insurance funds should be the first one allowed to allocate part of their assets under management to this type of investment. This would probably be an excellent way for the public to gain more experience with the long-term results generated by this kind of investment. High net worth individuals capable of allocating a minimum of HKD500,000 per investment may also represent a suitable group of investors.

We thank the SFC for making a genuine effort to consult the industry on this important matter and will be glad to maintain a dialogue with any relevant party and to provide clarifications on any of the views expressed in this letter.

For and on behalf of  
Axiom Investment Management Limited



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Michel Lahaie  
Managing Director