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February 24, 2017

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

Dear Sir,

<u>Re: Consultation paper on Proposals to Enhance Asset Management Regulation and Point-of-sale Transparency ("CP")</u>

On behalf of the Hong Kong Investment Funds Association ("HKIFA"), I would like to express support to the SFC for spearheading the initiative to enhance the regulation of the asset management industry in Hong Kong. In principle, we support the proposed enhancements as encapsulated in the CP as they are in line with international best practices.

However, we believe that there are certain basic assumptions and issues that need to be addressed and/or clarified so as to ensure that we can come up with a framework that is pragmatic and practicable.

We outline our key concerns as follows. For details please refer to the attached table (Appendix 1), which sets out the feedbacks that we gather from member firms to the 21 questions raised in the CP.

(1) *<u>Making the assumption that fund managers are responsible for the overall operation of a fund/have de facto control</u>*

We note that the CP is underlined by a basic assumption that most fund managers are in substance responsible for the overall operation of the fund (or have the de facto control of the fund).

Para 13, (similarly in Para 42):
"...In this connection, the SFC notes that despite the board of directors of a fund may be the legal party responsible for formally making decisions relating to the fund (such as appointing a custodian and issuing the offering documents of the fund), in practice, funds are often structured by fund managers to meet the objectives of clients or target clients and the fund managers may in substance be responsible for the overall operation of the fund (or may have de facto control). Hence, various principles and standards proposed to be adopted as enhancements will be applicable to the fund manager where it is, in substance, responsible for the overall operation of a fund (or has de facto control of the oversight or operation of the fund)

notwithstanding that legally it is not the entity responsible for formally making decisions relating to the fund."

We have huge reservations regarding this assumption, which does not take into account the way that funds are typically run - just because a fund is structured by the fund manager does not necessarily mean that the manager will in substance be in control of the fund. A distinction has to be made between the pre- and post-setup phases: while fund managers may be the sponsors and are typically involved in most of the set-up works; once a fund has been set up and throughout its life, a large part of the work are assumed by the third parties.

This is in line with the requirements and obligations to ensure that there is clear segregation of duties, proper oversight, and checks and balance to safeguard the interest of investors. Also, there is an increasing trend of outsourcing of the non-core functions, so that managers can focus on their core competence, i.e. investment management.

Amongst the four areas that are listed out in the CP in Para 10 (security lending and repo, custodian/safe custody, liquidity risk management and disclosure of leverage), the extent to which the fund managers can exercise control varies.

One area that is particularly problematic is in relation to the "appointment of custodians as well as the custody of assets" as this is generally outside the remit of the fund managers. Typically, it is the trustees which select/terminate, appoint and monitor the custodians which in turn will select and monitor the sub-custodians. In fact, more often than not, the manager is not a party to the custodian agreement, which is signed by the trustee and the custodian; or directly between the client and the custodian. As for the other three functions, the practice is more diverse and is manager- and products/mandates-dependent.

Thus, we don't think it is appropriate to assume away that fund managers are invariably responsible for the overall operation and control. If the requirements as outlined in the CP were to be implemented, it would mean that there would be major ramifications to the relationships between the respective parties within the value chain, and with that the respective obligations and liabilities. This will trigger a wholesale review of the contractual requirements and a re-work of the agreements. However, we have qualms as to what additional benefits this can bring to investors and how it would be conducive to other regulatory outcomes.

On various discussions, we note that the SFC has cited the example of liquidity management to illustrate that managers are in effect responsible for the day-to-day operation of the fund: the SFC opines that it is the investment manager which determines the haircut policy, what collaterals would be used, and how to manage liquidity in anticipation of subscriptions and redemptions. However, the fact that managers are actively involved in execution does not mean they have de facto control. Ultimately, it is the trustee which owes the fiduciary duties to the investors, and it is against this principle that it monitors the manager and other relevant parties on an on-going basis. The policies adopted – be it liquidity management or on the use of leverage - and any changes thereto have to be signed off by the trustee. In the day-to-day running of the fund, if there are any issues to be resolved, the manager may come up with suggested solutions, but it needs to get the green light from the trustee.

(2) Extending the application of fund-level regulation to the manager level

(a) Per the CP – Para 18 , "*...the proposed enhancements aim to reflect the latest international regulatory standards governing the conduct of fund managers, regardless of whether they are managing public or private funds, in order to reinforce good governance standards and enhance transparency. These IOSCO principles / FSB recommendations and other international regulations on CIS also do not specifically distinguish between public and private funds in their application. Instead, they focus on the activity of asset management and requirements at the fund manager level.* " As such, the requirements as stated in the CP would almost apply across the board.

As mentioned in (1), the responsibilities assumed by fund managers differ by the types of products and mandates. For instance, while we believe that for HKSFC authorized funds that are domiciled in HK, HK licensed entities ("LE") will generally assume most of the functions (except for custodian-related works), that would be substantially less so for offshore domiciled authorized funds, private funds and discretionary mandates.

Take the case of authorized funds that are domiciled in Luxembourg, Ireland and the U.K. – the typical jurisdictions where funds are domiciled – most of the functions mentioned in the CP rest with non-HK-based entities. For details of the roles and works performed by the Lux/Dublin/U.K., please refer to the attached table. But according to Para. 15 of the CP, *as long as the representatives of the fund manager and/or its affiliates constitute a majority of the board of the fund,* the manager would be deemed to have de facto control... and thus have to comply with all the FMCC requirements. This would mean that most of these funds would be caught and thus their HK managers.

However, since they are already governed by regulations in the jurisdictions in which they are domiciled; and there are detailed regulations and requirements on the respective areas, we are concerned that this would potentially bring an additional layer of regulation and even conflicting requirements, and thus increase the complexity in compliance. Hence, we would exhort the SFC to provide a carve-out for HK managers which act in the capacity as investment managers/advisors of offshore funds.

In developing the framework, we have to be mindful of a key feature of the HK market – it is an open platform, and unlike the U.S., Europe, Australia and many other jurisdictions where local-domiciled funds are the norm; offshore funds are still the prevailing mode. As such, an appropriate balance should be struck to reflect market reality, and to prevent regulatory duplication which would inevitably result in an increase in the costs to investors.

To address this issue, we believe that we can scope the example used in Para 15 more specifically:

"...the representatives of the fund manager and/or its ***Hong Kong subsidiaries*** ~~affiliate(s)~~ constitute a majority of the board of directors of the fund".

We don't think this would compromise investor protection because for all HKSFC authorized funds (irrespective of whether they are HK or overseas domiciled), they are already subject to the Unit Trust Code requirements, which are already very detailed and robust. Also, it won't compromise the objective of addressing systemic risks because there are already subject to very prescriptive requirements.

(b) Discretionary accounts management

We believe the list of exempted items as provided in the CP Appendix 1 is helpful. However, as discretionary agreements are typically concluded on a one-on-one basis and very often, clients have bespoke and specific requirements, we believe that more flexibility should be provided and the list should be expanded. For suggestions on additions, please refer to the attached table.

(c) Application of the CP-FMCC to MPF

Based on our understanding, the requirements as outlined in the CP-FMCC would be applicable to investment managers that manage MPF funds (both constituent funds and apifs).

We would respectfully exhort the SFC and MPFA to review whether it is appropriate to transpose the requirements to the MPF space.

First and foremost, trustees play a pivotal role in the MPF system, and thus, the basic premise that fund managers have de facto control is fundamentally not congruous with the MPF regime.

As the FMCC is a principle-based regime, how would that dovetail and reconcile with the MPF requirements, which are very detailed and prescriptive? To complicate this further, the CP adds a new dimension, i.e. it extends the product-level regulation to the manager level and this means that in effect, a MPF manager has to look at each activity against two product codes. For instance, on securities lending and cash collaterals, the CP provides certain principles (e.g. haircut policy, cash collaterals), but there are already detailed provisions under the MPF legislation and Guidelines. However, the respective focuses and approaches are different; and it makes mapping extremely difficult, if not possible. Thus, for a MPF manager, how should it reconcile the two sets of requirements? And if there are inconsistencies or even conflicting requirements, which will prevail?

We believe that in view of the fact that the MPF framework already provides detailed rules and guidelines; and the past 17 years have proved that the MPF framework is very robust (in fact generally more prescriptive than the SFC one), MPF managers should be treated as "deemed compliant", i.e. as long as the investment managers are in compliance with the MPF rules and guidelines, they should be deemed as meeting the requirements of the revamped FMCC. The deemed compliance approach has been used by the SFC in other areas, such as RJS, and has proved effective and pragmatic and we believe that it is appropriate to apply this to this context. By so doing, it would help to prevent the imposition of an additional layer of compliance, which would invariably result in additional costs. As the Government's policy intent is to drive down MPF costs, we believe that it is all the more important to avoid taking any measures that would not be in line with this objective.

(3) *Code of Conduct – requiring the intermediary to disclose to potential investors a range on how much of the management fees are paid to the intermediary*

We understand that certain jurisdictions, such as the U.K. and Australia, have imposed a ban on commissions to address the issue of conflict of interests. However, the jury is still out as to whether this approach (i.e. banning commissions) would be in the best interests of investors. Already, it is noted that this measure has given rise to unintended consequences, notably advice gap, which effectively means that a segment of investors is deprived of advice.

Based on what is laid out in the CP, we understand that the SFC has adopted a more pragmatic approach – instead of trying to mandate or prescribe/prohibit a particular model, SFC has focused on enhancing disclosures so as to address the issue of conflict of interests.

We support this approach because:

- Based on a survey that HKIFA commissioned in Q4 of 2016, more HK investors prefer the commission-based model over the fee-based model (See Appendix 2 – investor survey findings);
- We believe that both models have their respective merits and it should be best left to the investors to choose the one that best fits their circumstances and needs. The role of the regulator and the industry is to provide adequate information so that investors would know the pros and cons of each model and make informed decisions accordingly.

As for details on disclosure, the CP suggests to disclose the range, i.e. 40-60% of the annual management fees. We believe that disclosing the maximum % (i.e. 60%) may be more useful to potential investors. Key reasons are as follows:

- Investors are already inundated with a lot of information when they make a fund purchase;
- If we are going to provide them with more information, the additional information provided should be laser-focused so as to be impactful;
- If one wishes to highlight the potential conflict of interests (assuming this assumption is valid), the maximum % figure would arguably be the most indicative;
- If one provides the range, it can potentially raise more questions than answers, and result in digressions. It can increase the complexity of the decision-making-process for the investors. This may potentially undermine the key objective, which is to raise the awareness about the potential conflict.

Of course, as there are a number of assumptions that underline the percentage numbers, there should be educational initiatives by the regulator and the industry to explain the limitations of the numbers (e.g. there may be over-estimation); and what one can and cannot glean from the numbers.

We can review the effectiveness of this exercise in a few years (say three years)' time after implementation. HKIFA is in full support of the initiative to enhance transparency, but we believe that it is important to strike an appropriate balance so as to best serve the interests of investors.

(4) *<u>Providing further guidance/implementation support</u>*

We believe that more support should be provided to the industry to facilitate implementation:

(a) Based on the preliminary discussions with the SFC, it seems that SFC opines that whether a fund manager has de facto control is based on facts. So, how would this be translated into actions? Does it mean that the fund manager has to demonstrate that it does *not* have de facto control so that it can dis-apply the additional requirements as stated in the revamped Code? If yes, what needs to be put in place to evidence this? But if there isn't such a requirement and a manager opines that it does not have de facto control, but further down the road, the SFC comes back to challenge this, what would this entail? We would exhort the SFC to provide clear guidance about the expectations and how it envisages that this would be put in place.

(b) there should be sufficient lead time provided, at least 12 months, after the revamped Code comes into effect; and

(c) there should be more clarity, e.g. to provide two checklists to itemise provisions with which managers have to comply – one for managers that have de facto control and one for those that do not have.

We wish to reiterate that we fully subscribe to the principles that underline the CP, but we believe that the draft as it currently stands raises a number of fundamental and structural issues, which need to be properly addressed so as to ensure that the desired outcomes can be achieved.

We would very much look forward to having the opportunity to work with your team to go through the concerns and come up with pragmatic and workable solutions.

Yours sincerely

Appendix 1

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Comments/Questions by HKIFA members on SFC's Consultation Paper ("CP") on Proposals to Enhance Asset Management Regulation and Point-of-sale Transparency (February 24, 2017)

Seq.	CP Para. or Section of FMCC/Code of Conduct	Comments/Questions
Key proposals in the Fund Manager Code of Conduct ("FMCC") – Part I		
Question 1: Do you have any comments on the proposed clarification that the FMCC applies to the business activities carried out by Fund Managers which would include the management of discretionary accounts?		
1.	CP Para. 22	● We note a change in the approach adopted, i.e. instead of just focusing on investor protection, the Consultation Paper ("CP") also aims to address systemic risks. We believe that this is in line with international trends and we are committed to lending full support to enable this to come to fruition. However, we are concerned that the proposals put forward in the CP do not reflect a full understanding of how the asset management industry works and the roles of the respective parties within the value chain. We believe that certain key concepts and assumptions need to be addressed and resolved, so as to ensure that a meaningful and practical framework be developed.
Question 2: Under the current proposal, some of the proposed enhancements are not applicable to all Fund Managers but only to those responsible for the overall operation of a fund or having de facto control of the oversight or operation of the fund. Do you agree with such an approach? If so, do you have any views on which of the proposed enhancements should only be applicable to those Fund Managers who are responsible for the overall operation of a fund or have de facto control of the oversight or operation of the fund? Please explain your views.		
2.	CP Para. 15	● It is important that the SFC clarifies the definition "fund managers responsible for the overall operation of a fund or with de facto control of the oversight or operation of the fund" and scopes it more precisely and narrowly. We would strongly exhort SFC to allow "carve-outs" to factor in market practices. ● Based on the current wording, it seems that fund-level enhancements (on liquidity risk management, disclosure of leverage, custody of fund assets, valuation, etc.) will apply beyond SFC-authorized funds to "fund managers responsible for the overall operation of a fund or with de facto control of the oversight or operation of the fund". That could potentially mean that overseas funds would also have to comply with the FMCC requirements at the fund level (e.g. US 40 Act Funds or SICAVs

Seq.	CP Para. or Section of FMCC/Code of Conduct	Comments/Questions
		managed by overseas affiliates – they may be SFC-authorized or they may not be). It is very likely that for these finds, the senior management of the affiliate companies constitute a majority of the board of directors of the fund; but in most cases, the HK manager does not have control over the overall operation of the fund. However, based on the current wording, the HK fund manager will be caught. The issue is that these funds are already governed by fund level regulations in the jurisdiction in which they are authorized/domiciled, e.g. UCITS regulations, US 40 Act. These regulations already include, amongst others, disclosure or risk management requirements. By including fund related requirements in the FMCC, it would potentially result in conflicts in regulations with other jurisdictions. We do not think there are any compelling reasons for the duplication in regulation, and we would strongly exhort the SFC to allow carve-outs in the revised FMCC for offshore-domiciled funds. ● The revamped FMCC seems to assume that HK fund managers have overall control of the funds that are delegated from their affiliates. However, in actual practice, this is just not the case. ● In a typical UCITS structure, there is a management company (“manco”) appointed by the board of directors. The manco is responsible for the overall management, operation and administration of the UCITS. The investment management functions may be delegated to different investment managers which can be entities within the same group or from external parties, including a HK fund manager for say an Asian sub-fund of HK sub-fund. The HK manager can manage the entire portfolio of the sub-fund or a portion of the sub-fund, depending on the investments strategies. In such a structure which is very common, it is the manco which is responsible for the overall operation of a fund or has de facto control of the oversight or operation of the fund. ● However, if CP Para. 15 were to be applied, the delegated HK fund manager is taken as responsible for the overall operation of a fund or having de facto control of the oversight or operation of the fund purely because the board is composed of representatives of the HK fund managers’ affiliated entities; and thus all requirements in the proposed FMCC will apply. (In practice, it is typically the representatives of the HK fund manager’s affiliates (other group entities) that are members of the board of the UCITS.) ● The following examples will show that the assumptions taken in the FMCC are flawed: - Under UCITS regulation and Luxembourg/Dublin laws, ➢ The ‘fund manager’ is the manco, and the HK fund manager is only the delegated investment manager appointed by the manco. All governance/controls are at the manco level; and the revamped FMCC’s assumption that the

Seq.	CP Para. or Section of FMCC/Code of Conduct	Comments/Questions
		delegated fund manager in HK has overall control of the fund is unfounded. More importantly, it would give rise to local regulatory issues if the Lux/Dublin manco is deemed as giving away the overall control of the fund to the HK fund manager. ➢ Fund valuation – Typically, it is the manco which performs the valuation. The HK fund manager, as an investment manager, may be asked to provide comments on the valuation of the underlying securities of the fund, if necessary; but it cannot have a say nor be a voting member at the Valuation Committee. ➢ Investment licenses – All investment licenses of the delegated funds are applied and overseen by the manco or a fund administrator appointed by the board of directors, but not by the HK fund manager. ➢ All service providers such as auditor, local tax consultants, custodians etc. are appointed by the manco/the fund board. The HK fund manager has no contractual relationships with them. ➢ Shareholders' record of the funds are not maintained by the HK manager. - Another example: A fund is an international partnership formed pursuant to BVI Partnership Act which operates as a mutual fund. Such partnership implements its strategy by investing all of its assets in a master fund which utilizes the investment management services of the HK Type 9 Licensed Corporations ("LC") to invest the assets of the partnership (i.e. managed solely by the HK Type 9 LC). The general partner ("GP") (which is NOT the HK Type 9 LC) (1) exercises ultimate authority over the partnership, (2) is responsible for day-to-day operations of the Partnership, (3) is governed by a board of directors (NONE of the directors is from the HK Type 9 LC) and (4) delegates the investment management of the partnership to the HK Type 9 LC. The partnership and the master fund appoint the fund administrator while the master fund appoints the custodian (HK Type 9 LC is not a party to the respective agreements). Even though the HK Type 9 LC is the sole manager of the master fund, it is not appropriate to take it that the LC has de facto control as it is the GP which has the ultimate authority over the partnership which invests its assets in the master fund to achieve the partnership's investment objective. The HK Type 9 LC does not sit on the board of the GP. ● In view of the above, we would suggest to amend as "…the representatives of the fund manager and/or its ***Hong Kong subsidiaries*** ~~affiliate(s)~~ constitute a majority of the board of directors of the fund" such that overseas funds [i.e. those delegated to Hong Kong affiliates for investment management (as investment manager or sub-manager)] would not be subject to the fund level requirements in FMCC. This carve-out would apply to both SFC authorized and non-authorized funds.

<table>
<tr><th>Seq.</th><th>CP Para. or Section of FMCC/Code of Conduct</th><th>Comments/Questions</th></tr>
<tr><td>3.</td><td>CP Para. 12 to 15</td><td>
Strongly exhort SFC to “carve out” funds under the trust structure:
The “de facto control”/“overall operation of the fund” in a trust setting
Most of the funds in HK are formed under a trust structure. Under such a structure, the trustee, per the trust law, are generally recognized as the entity which has the duty to oversee the overall operation of the trust. There is clear separation of powers and duties as stipulated by the trust deed; with the trustee assuming the central and pivotal role.
Examples to illustrate the operation/division of work between the fund manager and the trustee:
In unit trust/UCITS structure, the fund manager (i.e. the party involved in the investment management of the fund) is typically not the governance body of the fund and the manager is appointed by the governance body (e.g. manco/unit trust jointly set up the trust with the trustee) to manage the investment management function of the fund. For the overall operation of a fund, it is commonly stated in the trust deed that both the manager and the trustee’s agreement will be required for making changes. The manager alone does not have the power to determine the operation of a fund. This requirement that both the manager and the trustee’s joint agreement is required for making a change is important for investor protection. Ultimately, the trustee has the fiduciary responsibility to ensure end investors’ interest is being protected. Trust deed provisions generally require the trustees to certify any changes to the trust deed (the terms of which govern the operation of the fund) would be in the best interests of unitholders. So without the trustee’s approval, the fund manager cannot make related changes.
The appointment of the custodian is definitely in the hands of trustee, but <u>not</u> the manager. Fund operations such as determination of fair value of illiquid assets require joint agreement between manager and trustee, and the manager cannot determine it on its own. Any changes to the offering documents of the fund that the manager may initiate also require the agreement of the trustees before a change can be proceeded.
Overseas affiliates (e.g. Fund managers based in the US, UK, Australia) delegated by HK manager as investment manager or sub-manager of the fund
As mentioned above, if the HK manager is responsible for the overall operation of authorized/unauthorized funds, the revamped FMCC stipulates that the HK manager is responsible for setting certain policies and standards according to the FMCC requirements for the management of the funds. If the SFC prescribes the overseas delegates to also fully comply with the FMCC standards and conduct requirements, this may give rise to potential conflicts in regulations with other jurisdictions.
We believe that the SFC should restrict FMCC requirements to HK-based managers only. It can take reference from the SFC Circular re liquidity risk management for SFC-authorized funds can be adopted – it has specifically
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Seq.	CP Para. or Section of FMCC/Code of Conduct	Comments/Questions
		provided that SFC licensed managers are required to enhance the internal liquidity risk management process according to the circular but managers based in a jurisdiction that is subject to an acceptable inspection regime or a mutual recognition of funds arrangement are expected to have in place liquidity risk management practices in accordance with requirements in their home jurisdiction.
4.	CP Para. 18	● For consistency and clarity purposes, we would strongly exhort SFC to spell out clearly which proposals are applicable to public funds only, but not to private funds and mandate accounts which may not have offering documents or specific reporting requirements.
Securities lending, repo, collateral management		
Question 3: Do you have any comments on the above proposals which will be applicable to a Fund Manager which engages in securities lending, repo and similar OTC transactions on behalf of the funds it manages?		
5.	CP Para. 23 to 34	● The CP mentions "securities lending, repo and similar OTC transactions" on a number of occasions, and different obligations are imposed if the fund manager undertakes these activities. Can SFC clarify and provide examples of what are "<u>similar</u> OTC transactions"? For example, would foreign exchange forward contracts, foreign exchange non-deliverable contracts, interest rate swap contracts be considered as "similar OTC transactions"? ● Can SFC spell out the main differences in a fund manager's obligations for SFC-authorized funds and non-authorized funds with respect to securities lending, repo and collateral management and valuation policies and disclosures? Under the proposal, for non-SFC authorized funds, a fund manager can have non-cash collateral re-hypothecated but this is not allowed for a manager of authorized funds. Are there any additional restrictions/requirements imposed on manager of authorized funds?
Question 4: Do you have any views or comments on the proposal that Fund Managers should design their haircut methodologies which should reflect the standards set by the FSB in its recommendations?		
6.	CP Para. 27 to 28	● Although FSB has come up with standards for haircut methodologies in its recommendation, flexibility should be allowed for fund managers to have their own haircut methodologies like Basel's capital calculation.

Seq.	CP Para. or Section of FMCC/Code of Conduct	Comments/Questions
7.	CP Para. 27 to 28	● HKMA has issued a final draft "Non-centrally Cleared OTC Derivatives Transactions – Margin and Other Risk Mitigation Standards" early December 2016 after this CP, where the haircuts standards are already proposed. Would the SFC adopt a similar approach as the funds are managed under the HK regulatory framework and deal with HK counterparties, which are regulated by HKMA?
Question 5: Is the requirement to disclose details of non-cash collateral re-hypothecation sufficient to enable investors to understand the relevant risks and exposures to the fund? Please explain your views.		
8.	N/A	● No comments
Question 6: Do you have any comments on the proposed requirements on reporting to fund investors? In particular, do you have any comments on the minimum disclosure requirements proposed?		
9.	CP Para. 33 and Appendix C	● Can SFC clarify what is required as part of the OTC transactions report? ● What is the implementation timeline? We suggest a lead time of at least 12 months.
Custodian/safe custody of fund assets		
Question 7: Do you have any comments on the above proposals regarding custodian and safe custody of fund assets?		
10.	CP Para. 35 to 43	● We wish to reiterate that for unit trusts, it is **<u>NOT</u>** the fund managers which appoint the custodian/sub-custodian as the appointment/sub-appointment would be performed by the trustee. The fund manager is **<u>NOT</u>** empowered to make the appointment. The custodian is appointed by either the trustee/manco/fund board (for CIS) and/or the client (for segregated mandates), and the sub-custodian is appointed by the custodian. The fund manager has no authority whatsoever over the custodian as they have to maintain independence from the fund's assets. The proposed SFC requirements raise serious concerns (e.g. fund managers are not empowered to select, appoint and perform ongoing monitoring of the custodians. These responsibilities fall within the remit of the trustee and/or the client). Therefore the requirement for the fund manager to appoint custodians should not be applicable to unit trust structure; and we would strongly exhort SFC to remove this requirement. ● These paragraphs in the CP seem to mix up the concept laid down under the SFC Code on Unit Trusts and Mutual Funds ("UT

Seq.	CP Para. or Section of FMCC/Code of Conduct	Comments/Questions
		Code") and the law of trusts about the trustee's responsibility to safe keep the assets, ensure segregation of assets etc. All these paragraphs impose certain duties on fund managers, which should be put on the trustee/custodian as they are within their remit. Under a trust structure, the trust will be jointly set up by the trustee and the manager, and in a fund company setting, the company appoints the custodian. As such, the duties to comply with such requirements should fall under the trustee/custodian – which the UT Code stipulates clearly. Similar to the existing FMCC, there should be wordings like "If the fund manager is responsible for making custody arrangements"…so as to draw the differences. CP Para. 40 – It does not fit in a trust scenario, i.e. the setup of the Fund is jointly done by the trustee and the manager, but is not done unilaterally and thus it is not something that is "appointed by the manager". CP Para. 42 – It contradicts with what is spelt out in the UT Code which imposes such duties on the trustee. For these paragraphs, similarly there is a need to have carve-outs for unit trusts, under which the trustee is responsible for the control over the assets of the trust. Under a unit trust, the manager generally does not have de facto control of the oversight or operation of the fund - the trustee and the manager is each responsible for its own parts which are spelt out in the trust deed. Chapter 4 of the UT Code requires CIS established under a trust structure to have a trustee and mutual fund corporation to have a custodian and it also lays down the general obligations of trustee/custodian including the safe custody of fund assets. The question is for CP Para. 35-43 where it refers to custodian, does it also mean trustee in the case of a fund established under trust? If this is the case, how would CP Para. 42-43 be interpreted in a trust structure when it is the trustee who appoints the custodian but not the fund manager?
11.	CP Para. 40 to 41	● Does the SFC refer to "SFC-authorized funds" for CP Para. 40 and "non-SFC authorized funds" for "private funds" for CP Para. 41? ● Can SFC clarify how this requirement works, if at all – it expressly requires the fund manager to appoint a custodian per CP Para. 40, when at the same time, according to CP Para. 41, "self-custody" arrangement is still acceptable?

Seq.	CP Para. or Section of FMCC/Code of Conduct	Comments/Questions
12.	CP Para. 42 to 43	● CP Para. 42: please elaborate what is meant by "*…funds are structured by the fund manager itself*"? And if possible, provide examples too. ● CP Para. 42: please clarify whether the fund manager of a fund structured in a corporate form is also expected to be responsible for appointing the custodian if the fund is NOT structured by the manager itself? If yes, how to put this into practice (i.e. how to involve the fund managers in a decision which is normally made by the board? ● CP Para. 43: whether the fund manager is still required to ensure inclusion of the requested provisions about the scope of responsibility and liability of the custodian in the custody agreement even though the manager is NOT a party to the custody agreement? For example the custody agreement may be between the fund and the custodian.
13.	CP Para. 44	● Can the SFC elaborate on its expectations with respect to disclosure to investors – what sort of disclosures in the offering document or other forms of reporting/notification would be required? How frequent should the disclosure be made? Also, the expected level of details to be disclosed? Especially if it is not self-custody, what sort of details about the custody arrangement would the SFC expect to see? ● Very often in a custody arrangement, the trustee/manco/fund board appoints a global custodian, which then appoints local custodians in each country. CP Para. 44 requires investors be informed of any significant changes in the custody arrangement. But would any change in local custodians constitute significant changes? We believe that a balance should be struck and such type of information would not be required, or else investors would be inundated by too much information.
Liquidity risk management		
Question 8: Do you have any comments on the above proposals regarding liquidity risk management?		
14.	CP Para. 54 (Also Section 3.14.2 of FMCC)	● In the case of an authorized or an unauthorized fund, there may be situations during the fund launch that a preferential management fee rate would be provided to investors who would provide seed capital to the fund for a certain period of time. Would this be viewed as side letters that needs to be disclosed to potential and existing fund investors? ● Can the SFC explain what is the expected disclosure to be made to investors where side letters have been entered into? Again, we believe it is important to strike a balance - there should be a general statement about the availability of the side letter, but we don't think it is appropriate to disclose the terms so as to allow managers to maintain flexibility.

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		● Regarding stress tests: Typically fund managers would undertake stress tests (on both the assets and liabilities of a fund) to identify potential problems, potential opportunities for risk reduction, so as to facilitate contingency plans to be set. However, we have reservations regarding the proposal to rely on stress tests as a way *of predicting future liquidity crises; and to use the results of stress tests to tailor the fund's asset composition.* Members opine that this approach as imprudent, misaligned with the interests of investors, and prevents managers from fulfilling their obligations. ● We hope that the SFC understands that fund managers generally have robust system to manage liquidity risks. The following are typical measures adopted and we exhort SFC to factor them in and refrain from imposing detailed requirements on how managers should manage liquidity risks: *"An example - The company's approach to the management of liquidity risk is founded on two important principles. Firstly, the need to meet fiduciary obligations by focusing on what has been agreed in investment management agreements, prospectuses and in all relevant documentation; and secondly, to ensure decisions and actions are fair to all investors. In the case of open-end funds this means ensuring that the interests of those investors seeking to redeem do not negatively impact those investors who remain invested.* The following forms the basis of companies' approach to achieving these objectives: - Clear and transparent fund literature; - Thoughtful management of capacity at both the strategy and fund level so funds are "soft closed" proactively; - Where regulations permit, the use of swing pricing or similar anti-dilution mechanisms to help ensure the remaining investors do not subsidies investors redeeming from or investing in funds; - The ability to, where possible, defer redemptions on any one day if a judgment is made that there is insufficient liquidity in the underlying investment market. While this process is not always popular, the company recognizes that doing so is in the general best interests of remaining investors; and - In exceptional cases, where permitted the company may choose to suspend subscriptions and redemptions from funds. When using swing price, deferring redemptions and, on rare occasions, deciding to suspend funds, managers are fully aware of the potential impact on the shape, characteristics and liquidity of the remaining portfolio once the most liquid assets have been

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		sold to meet redemptions. However not all dilution mechanisms are currently permissible in all jurisdictions and the industry would very much hope that changes can be introduced to address this. Given the challenges associated with measuring liquidity, predicting investor behavior and liquidity crises, our members place significant emphasis on the use and application of practical mechanisms to manage systemic market liquidity events which can neither be predicted nor influenced by individual market participants. Provided that these mechanisms are permitted by the laws, do not compromise the fair treatment of all investors, and funds are not managed in such a way that the investment strategy places heavy reliance on the availability of these measures, members believe such mechanisms help to provide a strong practical foundation for robust liquidity management. To the extent that these mechanisms are compatible with meeting all local regulatory and legal requirements, the key foundations that underlie the approach are as follows: - Funds enable investors to receive, net of costs, the returns from the funds' underlying investments. - Funds do not act as transformations vehicles but simply pass-through the risks and rewards of the underlying investments. - The liquidity of a fund is a function solely of the market liquidity of the fund's underlying assets. - Investors should be made aware of and accept all risks associated with investing, including liquidity risk. - While a liquidity monitoring framework is established, it must be recognized that it is not possible to be completely certain of either market liquidity or investor behavior. - Remaining investors in a fund must not be adversely impacted by investors who choose to redeem holdings. - Funds and their supervisory bodies (e.g. fund boards) should be permitted to use as many tools as necessary to help ensure fairness to all investors (e.g. semi-swinging prices, deferred redemptions and in extreme situations, suspension of subscription and redemptions, etc.)."
Question 9: Do you have any suggestions on any particular liquidity management measures which a Fund Manager should put in place for effective liquidity management, for example, in terms of setting liquidity targets or stress testing?		
15.	CP Para. 47 to 48	● Managers should be allowed flexibility to adopt appropriate measures, e.g. liquidity targets and stress testing thresholds, so that they can design an appropriate risk management framework to take into account the specific characteristics of a fund. Members strongly believe the SFC should not mandate specific tools or measures, which should be best left with the

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		managers. ● For reasons outlined below, there are concerns by members with the proposal to impose "liquidity targets", particularly if the regulator's expectations are that funds should hold sufficient liquidity to meet stressed market conditions. Given the challenges associated with measuring liquidity, predicting investor behavior and liquidity crises, it is hard to see how fund managers can reasonably be expected to understand how much liquidity would be sufficient to cover the liquidity demands in ***all*** conditions. Instead, we believe that managers should be allowed flexibility to use and apply practical mechanisms to manage systemic market liquidity events which can neither be predicted nor influenced by individual market participants. 1. Challenges associated with predicting investor behavior - Attempting to predict the behavior of the investors in a fund is at least as difficult, if not more difficult, than trying to measure and predict market liquidity, as: ➢ The fund manager does not have perfect 'look through' into the end clients' circumstances nor can it be expected to do so given the use of nominee structures and platforms that aggregate holdings; ➢ Even where investors are on the register directly, the manager typically does not have a direct relationship with the investors as the fund is sold through distributors, hence the manager will lack the requisite knowledge of their habits and behavior; ➢ Any attempt to look at investor behavior using historical inflows and outflows is complicated by the fact that the fund manager is only able to review them in aggregate and there are intrinsic limitations to any model which seeks to predict the behavior of the current investors in the fund; ➢ Investor redemption behavior can change substantially as markets change so even if a manager has data on the historical behavior of the investors in the fund, it would not necessarily help them to build a perfect picture of what may happen in stressed conditions; ➢ Products are typically held with 3-year, 5-year or longer time horizons and the majority of investors see their fund holdings as a buy and hold investment. Whilst we do see heightened redemptions during periods of market dislocation, concerns relating to material redemptions has not materialized across open-ended funds except for some cases relating to specific asset classes. 2. Challenges associated with measuring market liquidity - Model subjectivity: the process for measuring liquidity is highly subjective and requires judgments as to the practical ability of a fund to sell a security, assumptions and/or the use of proxies where data availability is limited or thought to

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		be unreliable. Market liquidity can be difficult to measure, partly because the liquidity observed in an unstressed market cannot always be relied upon to accurately estimate risk during periods of market stress. There are considerable challenges with information gaps and the general unpredictability of markets. As an example, for fixed income securities, the commonly adopted measure of liquidity (the bid-ask spread) can be flawed and assets that don't trade regularly aren't always illiquid. - Limitations of stress testing and the unpredictable nature of financial markets: stress testing has it value, but the binary nature of liquidity means that in extreme market events, liquidity shocks usually occur quickly and cannot easily be predicted by any model. - Notwithstanding the argument that the estimation of market liquidity and the classification of position holdings according to their relative "spectrum" of liquidity helps to paint a picture of market liquidity, it is opined that it is possible to predict the occurrence of material systemic failures of liquidity. History has shown that market liquidity can change rapidly. By way of example, term securitization was one of the most "liquid" markets, as defined by relatively tight bid/offer spreads, pre-2008 crisis but liquidity evaporated rapidly during the crisis, making it one of the most illiquid markets. - It is acknowledged that the limitations related to monitoring market liquidity as a way of attempting to predict rapid and material declines in liquidity. Last year's market volatility in the China equity and fixed income markets supports the idea that liquidity cannot always be measured nor can illiquidity be predicted. 3. Conflicts with the fiduciary responsibilities of the fund manager - Measuring liquidity and calculating suitable liquidity metrics – while they do have value, using these information to infer a set of metrics which must be used for fund construction is imprudent. Given investor expectations that funds will invest in accordance with their investment objective, it is difficult to justify how substituting a portion of a fund's investments for cash is in the interests of investors (particularly those who do not have a preference for liquidity). The use of imperfect metrics to calculate additional liquidity buffers prevents fund managers from fulfilling their fiduciary obligations and meeting the agreed investment objective. Further, requiring managers to hold additional liquidity to meet potential future redemptions might also encourage "first-mover advantage", which is precisely what the regulator's recommendations set out to prevent.

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		4. Investor preference for liquidity is not always aligned - Even within the same fund, it is important to recognize that investor preference for liquidity ahead of other drivers such as return, capital preservation and other motivations is not homogeneous. Investors that wish to match longer term liabilities are likely to have more stable redemption/subscription behavior and be less concerned about short term volatility and falls in asset prices. - Liquidity demands on a fund of relatively less liquid assets (e.g. bank loans, private equity or real estate) held by long-term investors who understand and seek the risk premium illiquidity brings could be lower versus another fund of assets deemed to have some level of liquidity by asset-analysis, but which is subject to significant levels of short-term investor trading.
16.	CP Para. 49 to 50	● Regarding the requirement that stress test results should be reviewed by a committee responsible for liquidity risk management and/or senior management, we believe that flexibility should be given on the stress test governance structure/mechanisms to allow managers to design a risk management framework that takes into account the characteristics of the funds/mandates as well as the relevant overseas regulatory requirements. We do not see why prescribing a particular structure or mechanism would be in the interests of investors. ● Re. SFC's expectation of fund manager to have in place action plans regarding "*how it would meet the fund's liquidity needs should any of the **stress scenarios** materialize*": - Would the Liquidity Risk Management tools stated in the SFC's Circular to management companies of SFC-authorized funds on liquidity risk management (issued on July 4, 2016) (point 27a to 27c refers) be acceptable? Apart from these, are there other acceptable action plans from the SFC's point of view? - *27(a): tools and practices to delay and/or limit redemption, and/or to allow managers to process redemptions in an orderly manner;* - *27(b): tools to allocate the costs of redemption to redeeming investors and to mitigate first mover advantage; and* - *27(c): other sources of liquidity (e.g. borrowings/credit lines)* - SFC should be mindful of the limitations of any action points: action plans might not be appropriate or applicable at all times when the stress scenarios materialize. The action plans set should only be preliminary. The fund manager should have the discretion to decide whether to execute the action plans set when the stress scenarios really happen. For example, some action plans that have been set cannot be implemented due to a change in market situations. The fund

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		manager should have the discretion to review and adjust the action plans if and when needed. ● Re. stress scenarios: - Stress scenarios are usually associated with market-wide systematic risk/black swan events (e.g. 911 back in 2001, Global Financial Crisis in 2008, Market Turbulence in China in 2015 (i.e. large no. of stocks suspended), etc.). Fund managers would not be able to predict the exact timing of the stress scenarios. To generate such an expectation is unrealistic. It is more realistic to include in the disclosure documents to alert investors about the potential liquidity risk in distress. - Besides, there are some asset classes that are not liquid/less liquid by nature (e.g. private equity or even emerging market fixed income). Fund managers can only provide sufficient risk disclosure about the liquidity risks involved, but cannot have action plans to ensure redemption can be met in all circumstances. - It is necessary to distinguish the liquidity risks that are caused by the investment strategy (which is under the control of fund managers) from those that are caused by the nature of the asset class or general market condition (outside control of fund managers). For example, fund managers can design an investment strategy as diversified as possible and have tighter single issue limit so that liquidity risk can be minimized. However, fund managers cannot be expected to create liquidity when the market is in a stress scenario.
Disclosure of leverage		
Question 10: Do you consider it appropriate for Fund Managers to disclose the maximum leverage of the fund it manages to fund investors?		
17.	CP Para. 58	● We welcome SFC's effort to assess the robustness of existing control frameworks relating to funds that employ material leverage to enhance investor returns; of specific interest might be the evolving range of some "absolute return" funds or guaranteed funds, where specific stresses could mean that such funds could default on their derivative obligations. Also we welcome any efforts to agree on a definition of economic leverage and enhance the current measures of leverage. ● However, some members have expressed reservations regarding the assertion that "leverage within investment funds" represents a material risk to the broader financial system as it is believed that this risk is generally well controlled as part of existing regulatory frameworks (e.g. UCITS, AIFMD, etc.); with the possible exception of highly leveraged hedge funds which are not captured by regulatory control frameworks. ● It would enhance transparency that fund managers disclose the expected as well as the maximum leverage of the funds they

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		manage. However, it is important that the industry and the regulators work closely together to agree on the definitions and the computation method. Also, some members have suggested to distinguish between the different uses of leverage, to generate more consistent cross-jurisdictional measures; and to increase investors' awareness of individual fund's potential (rather than current) leverage. ● Further work and clarifications are required on: - Regarding disclosure of maximum level of leverage by taking into account financial leverage as well as synthetic leverage (from FDI), clarification is required as to whether this is only applicable to HK Unit Trusts prospectus or to offshore SICAV funds as well, - the format of the disclosure (e.g. if it is similar to the requirements on total expense ratio/tracking difference being put on KFS); and if change of such a ratio is subject to the regulator's approval, - Whether the disclosure requirement applies to funds that involve borrowing for specific purpose only (e.g. solely for redemption or payment of expenses).
Question 11: Do you have any comments on how leverage should be calculated?		
18.	CP Para. 59	● We recommend that further work should be undertaken to identify more relevant approaches to calculating instrument leverage. These measures should also take into account principles (i) to (iv) identified by the SFC (as part of CP Para. 10) as well as any exposures generated through funding leverage. We believe the outcome of this work will help arrive at a better considered position on what types of leverage to permit and to what extent. We also hope to have more opportunities to discuss with SFC on this topic in the upcoming UT Code revamp. ● In coming up with the computation methodologies, some have suggested to take reference from something similar to exposure calculation for open positions on Futures and Options. - Funds should retain the flexibility to determine the basis of calculation as the appropriate approach to measuring leverage may vary depending on the type of instruments involved and the purpose for which they are employed. There is no one-size-fits-all measure for different types of funds and asset classes. - Different asset classes, investment objectives, risk profiles may have different types of leverage. We suggest that the SFC and the industry work together to come up with some standards regarding how to calculate leverage. The cost and implication for additional disclosure requirement should also be considered.

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		● To avoid any misleading information for investors while giving flexibility to fund managers to use the most relevant methodology to their strategy, some have suggested that leverage should be disclosed based on gross estimates without any netting nor hedging as well as any complementary leverage measure considering netting and/or hedging at the discretion of the fund manager. However, there are others who opine that the calculation of gross leverage (which includes both the short and long positions in securities), divided by a fund net asset value is less informative. This measure considers long and short positions as mutually independent sources of risk, while in many cases they might be part of a single transaction (i.e. used for hedging purposes) or if not, it is assumed that these positions are non-correlated. For example, a hedge share class of a UCITS sub-fund which holds long only securities together with a single forward foreign exchange contract used as a total portfolio hedge is considered, under UCITS rules, to be leveraged 100% of the fund's net assets. This method disregards the fact that the financial derivatives instrument is being utilized as a hedge and would make no distinction between this fund and a similar fund which holds the forward foreign exchange contract as part of a currency investment strategy (rather than a hedge). However, there will be circumstances where the forward foreign exchange contract (and indeed other derivative contracts) will need to be collateralized and the impact of this will require more detailed studies. Net leverage, which calculates the difference between both long and short positions, does not account for the risk created by long or short positions that are effectively independent bets (which could, in addition, be subject to stress from collateralization). Thus this measure could, in certain circumstances understate risk. ● Noting that the SFC will follow the international regulatory requirements, the framework may change. Can the SFC provide what may be the timeline to implement this new requirement?
Other amendments		
Question 12: Do you have any comments on the other amendments proposed to the FMCC?		
19.	Section 5.3.1 to 5.3.7 of FMCC	● Only 5.3.1, 5.3.4, 5.3.5 (disclosure part) refer to funds that fund manager is responsible for the overall operation, does it imply the rest applies to all funds? ● S.5.3.1 regarding Fund Portfolio Valuation requires that "*valuation methodologies are consistently applied to the valuation of the assets across all funds managed by the fund manager*". There would be difficulties in implementing this. A fund manager may be managing funds under different umbrellas, which would have their own valuation policies and methodologies to the respective funds/sub-funds (already set out in the prospectus), and the fund manager must follow those. Inevitably there

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		would be differences in the way securities are valued in the different funds that a fund manager manages. This may be so even if the fund manager has overall/de facto control over those funds. We therefore believe the specific requirement about applying the same valuation methodologies across all funds should be removed.
20.	Section 5.3.6 of FMCC	● Under s.5.3.6(b) on fair value of unlisted or unquoted securities that are not actively traded, suggest SFC to consider to give flexibility to fund manager on fair value (i.e. remove the prescriptive elements of (b)(i) to (iii) or keep it as high level principle based on "fair value" suffices or add wordings "if considers appropriate") given the valuation policies are clearly stated in the offering document and fund manager often needs to do this with approval/in consultation with the trustee. ● The required procedures for fund manager in relation to inactive/suspended listed securities have been changed from "or" to "and" and therefore, fund manager will be obliged to make sure that all the three procedures as stated should be in place. s.3.6(d)(i) requires that the fund manager should maintain procedures to "demonstrate that it will actively seek independent confirmation of the appropriate price for the security from suitable brokers or market makers." Fund managers may have difficulties in obtaining such confirmation as brokers or market makers may not be willing/able to provide such price quotes because of inactive market/suspension of the securities.
21.	Section 5.3.7 of FMCC	● The proposed FMCC s.5.3.7 states that *"The valuation policies and procedures and the valuation process should be periodically reviewed (at least annually) by a competent and functionally-independent party."* In practice, the valuation for funds is usually performed by the trustee instead of the fund manager. As such, guidance is required as to the meaning/definition of functionally-independent party. E.g. Would the fund manager's in-house Pricing Committee meet this requirement? How about a professional firm? (Generally funds are subject to annual audit which includes the review of valuation. In this regard, would fund audits carried out by the auditors suffice? ● Could SFC clarify if s.5.3.7 has any potential overlap with the s.5.3.3 in which the model is about the fund manager outsourcing the valuation function?
22.	CP Para. 62	● In the para where it mentions *"…Independent valuation of fund assets and periodic review of valuation policies and procedures…"* can the trustee of the fund be considered as an independent valuation agent? ● Could SFC confirm that an in-house pricing committee comprising the Risk Management Officer, the Compliance Officer and

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		other senior person in the entity be considered functionally independent?
23.	CP Para. 63 (Also Section 5.2.1 of FMCC)	● S.6.1(b) of the proposed FMCC requires that a fund manager should "disclose the financial condition of its business to a fund upon request". For consistency, it is suggested to also revise s.5.2.1 as "… The audited accounts of the fund manager should … be made available to the fund *upon request*". Also, we understand that such proposed amendment to s.5.2.1, together with the requirement per s.6.1(b), are applicable to discretionary accounts as Appendix 1 of the proposed FMCC does not provide exemption of s.5.2.1 or s.6.1(b) to discretionary accounts. Please advise if the understanding is incorrect.
24.	CP Para. 64 to 65	● Regarding s.1.7.1 of FMCC: It may not be necessary for the FMCC to require fund managers in HK to establish a risk management function if the same has already been covered by a centralized risk team in its group/parent company or affiliates. We believe that intra-group delegation of this function should satisfy this requirement. Can SFC confirm on this point?
25.	CP Para. 64 to 65	● S.3.11.1 of FMCC: *"For risk management at the fund level, a fund manager should implement adequate risk management procedures…"* What does it mean by "at the fund level"? Does it mean that managers in HK which only manage a portion of a fund do not have to comply with s.3.11.1 and s.3.11.2?
26.	CP Para. 69	Regarding s.3.12 of FMCC: ● Does the SFC intend to apply the disclosure requirements only to SFC-authorized funds of which the fund manager is responsible for the overall operation of the fund; or will the requirements be extended to non-SFC authorized funds as well? ● Can the SFC confirm that the disclosure requirement would not be applicable to funds which do not use derivatives instrument for EPM and investment purpose at all? ● Can the SFC confirm that the disclosure requirement does NOT apply to discretionary mandates? Leverage disclosure is currently NOT listed in Appendix 1 to the draft. We believe that this requirement should not be applied to mandates.
27.	CP Para. 72 and Section 3.8.2 of FMCC	● Clarification is required: counterparties selection should not only depend on financial interest (connected party), but on credit risks and materiality.

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Question 13: Under the existing requirement, where a client's order has been aggregated with a house order, the client's order must take priority in any subsequent allocation of partially filled orders. Are there any circumstances where it is in the best interests of clients to aggregate their orders with house orders? What are those circumstances which justify that they are in the best interests of clients? Are there any circumstances in which an institutional professional investor should be able to request pro rata allocation of aggregated but partially filled orders, on the terms specified by such an investor? What are those circumstances? Does the investor who request pro rata allocation have concerns that the flexibility can be abused by the licensed manager?		
28.	N/A	● No comments
Question 14: Do you have any comments on the suggested risk-management control techniques and procedures as set out in Appendix 2?		
29.	Appendix 2	● Could the SFC clarify whether the suggested risk management control techniques and procedures are for reference only but not something mandatory? ● Could the SFC clarify whether all the requirements of risk management apply to discretionary mandates as well? The suggested risk management controls about "Liquidity Risk" and "Issuer and counterparty credit risk" outlined in Appendix 2 of the revised FMCC may not be relevant for a discretionary mandate if the asset class chosen by client is not liquid and of high credit risks. ● For "B. Market Risk": (a) Usage of methodology to estimate potential loss (VaR), should be supplemented by a robust framework to assess the domain of validity of these models; (b) For portfolios which are actively managed against a benchmark, it would be difficult to set a limit on an absolute term basis. Suggest to use a measure relative to their benchmark/universe when appropriate; (c) Applying stress testing program to all the funds should be a good practice in line with the global regulatory reform, but we believe that the use of any program, if at all, should be best left with managers on a selective and justified approach. ● For "D. Issuer and counterparty credit risk": can the SFC clarify the term "credit rating system"? For example, does the SFC refer to in-house rating system or credit quality framework? Not all fund managers have in-house credit rating review for each counterparty. We would exhort SFC to allow flexibility to take into account the resources of different scale of firms.
Appendix 1 to the FMCC – Requirements for licensed or registered persons conducting discretionary accounts management		
Question 15: Do you have any comments on the requirements set out in Appendix 1?		

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30.	CP Para. 77	● For a Discretionary Account Manager ("DAM"), the typical market practice is that the manager is responsible for investment activities only, and all the account set-up, custodian appointment, etc. will be made by the client directly. As such, the manager would NOT have de facto control, and a lot of the proposals in the CP should not apply. ● Suggest SFC to remove the requirement to have the discretionary mandate's performance reviewed against a benchmark because it is not uncommon that strategies are managed on an absolute return basis and do not track any particular benchmarks. Also, for bespoke mandates, it is often difficult to find a benchmark that is representative of the investment strategy. Performance of the mandate may be assessed according to whether it has increased or decreased in its net-asset-value over the specified time period.
31.	CP Para. 77	● The SFC proposes that client agreements should contain provisions covering amongst other things, the investment policy and objectives, asset classes, geographical spread and a performance benchmark. We believe the requirement for performance benchmarks should be removed because some strategies are managed on an absolute return basis and do not track any particular benchmarks. Also, for bespoke mandates, it is often difficult to find a benchmark that is representative of the investment strategy.
32.	CP Para. 77 (Also Section 3.13.1 to 3.13.8 of FMCC)	● The proposed requirements regarding securities lending, repo and collateral management are NOT listed in Appendix 1 to the draft revised FMCC which lists out those requirements which do not apply to a DAM. Does it mean that all such requirements are equally applicable to segregated mandates even if these are not required by the client? We believe that this should be included in Appendix 1 and if the client so requests, then the manager can provide – thus it would be subject to the terms of the client agreement rather than be mandatory.
33.	CP Para. 77 (Also Section 4.2.1 to 4.4.2 of FMCC)	● For the section "Custody", since the requirements are not mentioned under Appendix 1 in the draft that is not applicable to DAMs, does it mean such are applicable to segregated mandates? Typically it is the client who appoints the custodian and the fund manager is not involved at all. The manager would not have the power to influence the decision of appointment as well as the on-going monitoring of the custodian. We believe that this should not be applicable and exhort SFC to remove such a requirement.
34.	CP Para. 77 (Also Section 5.2.3 of	● For s.5.2.3 under section "Auditors and Audited Accounts", since the requirements are not mentioned in Appendix 1 that is not applicable to DAMs, does it mean that they are applicable to segregated mandates? We do not think they should be applicable to segregated portfolios since the annual reports will be prepared upon agreement with clients.

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	FMCC)	
35.	CP Para. 77 (Also Appendix 1 of FMCC)	**Particular requirements in the Code which are not applicable to DAMs** Liquidity Management ● Under the proposed Appendix 1, only the requirement in relation to the use of specific tools or exceptional measures which could affect redemption rights and corresponding explanation in the offering documents are not applicable to a DAM. In Appendix 1 to the draft revised FMCC, the SFC also makes a note that "The extent of application of other liquidity management principles will depend on the capital withdrawal policy set out in the discretionary client agreement". Can the SFC clarify how far the liquidity management requirements in the proposed FMCC will apply to discretionary mandates vis-a-vis the "capital withdrawal policy" set out in the discretionary client agreements? Can the SFC give examples to illustrate its expectations? ● (FMCC s.3.14.1 (a) & (d) and s.3.14.3): From the drafting of Appendix 1, licensed persons involved in the discretionary account management should observe "the requirements of this Code" unless otherwise stated under the "not applicable section". Given the diversity and customized nature of discretionary accounts as well as the fact that client has predominant influence over mandate requirements (e.g. liquidity target/portion of cash in portfolio), it may not be pragmatic for a ("DAM") to maintain separate liquidity management policies and procedures for each discretionary account and also to conduct stress testing regularly for discretionary mandates under its management. We hope that the SFC can consider allowing flexibility to DAM to agree the liquidity aspect with clients as appropriate at the time of agreeing the mandate. The DAM is considered fulfilling this Code requirements if subsequently the DAM manage liquidity in accordance with the agreed mandate (the same concept as the suitability FAQ) and waive the requirement on stress testing for discretionary accounts. Discretionary clients can always freely fully withdraw their capital investments with a DAM. Custody ● (s.4.1.2, s.4.2.1, s.4.3.1 to s.4.3.3 and s.4.4.1 of FMCC): For discretionary accounts, it is common for clients and/or their board to appoint their own trustee or custodian. It is the client's choice and is beyond the control of DAM, who has limited

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		information regarding client's selection process, as well as the custodian/sub-custodians or custody agreements. The DAM lacks the authority and ability to perform these responsibilities. We would exhort the SFC to allow carve-out by putting in Appendix 1 wordings such as "if the fund manager also provide custodian services". We note that SFC is already aware that DAM may not provide custody arrangement in the current draft wordings (e) under the "Minimum Content of discretionary client agreement". <u>Valuation frequency</u> ● Appendix 1 states that *"Where applicable, a Discretionary Account should observe the relevant requirements set out in paragraphs 5.3.1 to 5.3.7 (save for…. in paragraph 5.3.5)…"* does that imply if the DAM is not responsible for valuation, s.5.3.1 to s.5.3.7 does not apply to the DAM? As mentioned, very often, the valuation, its policies and procedures are under the control of client-selected trustee, and DAM has no control or authority to perform s.5.3.1 to s.5.3.7 in these cases. Suggest Appendix 1 include wordings such as "if the DAM provides valuation services". <u>Auditors and audited accounts</u> ● S.5.3.7 of FMCC: It is practically difficult to make it mandatory for "annual audit" on discretionary accounts and annual review of valuation policies and procedures and the valuation process as audit is not an existing requirement and in particular DAM has no authority to force the client to take this up obligation under s.5.3.7, especially when DAM is not performing valuation for the account. ● S.5.3.7 of FMCC: Would an in-house function (e.g. Internal Audit) or an external auditor satisfies the requirement as "competent" and functionally-independent party? Given the relationship structure and frequent interactions between discretionary client and DAM (any issues relating to valuation arrangement should be resolved on a timely basis between the DAM and the client), it would not be practical, and may significantly increase client's cost and compliance costs to require annual review of valuation process and polices, unlike in the public funds context. ● Suggest SFC to reconsider waiving s.5.3.7 for discretionary accounts. <u>Net Asset Value Calculation and Pricing:</u> ● The Note states that "*Where applicable, a Discretionary Account Manager should observe the requirements in relation to overall net asset value calculation of the Discretionary Account.*" Can SFC clarify what are its expectations concerning this part?

Seq.	CP Para. or Section of FMCC/Code of Conduct	Comments/Questions
36.	CP Para. 77 (Also Appendix 1 of FMCC)	**Additional requirements applicable to DAMs** ● Client agreements: - It seems that only the minimum content requirements for IMA are not applicable to institutional/corporate professional investors, but the performance review and reporting requirements are applicable to all clients (i.e. there is no express carve-out for institutional and corporate professional investors for reporting requirements). Thus, it means that fund managers would require explicit client's agreement/consent not to provide the specified information in the monthly reports. There should be a carve-out for institutional and corporate professional investors for the reporting requirements, as they are in a position to specify their own reporting requirements. ● Performance Review and Valuation Reports - For Section 2 (b): "*provide valuation reports to the client on a monthly basis or at such shorter intervals as provided in the Discretionary Client Agreement…*" The frequency of valuation reports is mutually agreed with the clients if the clients are PIs. Does such a rule only apply to clients that are not PIs? - For Section 2 (b) (iii), some fund houses' practice is to only show current but not previous month-end market value, as the client can get this information by comparing month-end files sent out by the fund house on a monthly basis, and there has not been much client demand to have both set of numbers in one file. We believe that fund houses should not be mandated to show both the previous and the current month-end market value of the discretionary account.
37.	CP Para. 77 (Also Appendix 1 of FMCC)	**Minimum content of discretionary client agreement** ● Point (b) listed the elements of client's investment policy and objectives that are required to be included. However, due to diverse and customized nature of discretionary accounts by institutional/corporate clients, it may not necessarily all clients will provide "geographical spread" or "performance benchmark". ● Suggest SFC to add wordings of "where applicable/relevant" to give DAM some flexibility.
38.	N/A	● Can the SFC clarify whether the proposed requirements have retrospective effect on existing discretionary mandates/funds? We strongly believe that the requirements should be forward looking rather than be applied retrospectively.

Seq.	CP Para. or Section of FMCC/Code of Conduct	Comments/Questions
Question 16: Do you think a 6-month transition period following gazettal of the final form of the amendments to the FMCC is appropriate? If not, what do you think would be an appropriate transition period and please set out your reasons.		
39.	N/A	● 6-month transition period would not be sufficient. We would exhort SFC to allow a 12-month transition period given the potential substantial impacts on operation, systems and documentation as well as client communications. ● We assume that the requirements will not be applied retrospectively. Please confirm that this understanding is correct.
Key proposals in the Code of Conduct for Persons Licensed by or Registered with the SFC ("Code of Conduct")		
Question 17: What is your view on a pay-for-advice model for Hong Kong? Do you have any comments on our suggested approach to addressing the inherent conflicts of interest arising from receipt of commissions by intermediaries from other parties including product issuers?		
40.	CP Para. 87 to 91	● For HK retail investors, based on market surveys, such as the one HKIFA commissioned in Q4 2016, the pay-for-advice model may not be suitable as most retail investors are not familiar with this model. It would be more meaningful to do more education for HK retail investors about the benefit of pay-for-advice model first. In addition, a holistic advisory service model is currently not offered to HK retail investors and the pool of salespersons may not be capable of delivering professional advisory services to their clients For HK institutional investors, the feasibility of pay-for-advice model can be further explored. In some circumstances, the rebate may be beneficial to the investors and do not raise any "conflict of interest" issue.
Question 18: Do you have any comments on the proposed disclosure requirement in relation to independence set out above?		
41.	CP Para. 92 to 94 (In particular Section 10.2 (b) of FMCC)	● The wordings may give rise to confusion where the product issuer and the intermediary are group entities as the current wordings stipulate "*it should not have any links or other legal or economic relationships with product issuers…*" Suggests to make it clear this does not apply to intragroup relations if the entities are acting independently despite its group relations.
42.	CP Para. 92 to 94	● Can SFC confirm if the below understanding is correct? The proposals are only applicable to SFC licensed intermediaries ("LIs") who enter into transaction with end investors. LIs may include independent financial advisers (IFAs), banks and fund houses ("act as distributors") who may receive fees from the end investors, and the product issuer for investing into certain funds promoted/sold by the distributors. These two

Seq.	CP Para. or Section of FMCC/Code of Conduct	Comments/Questions
		proposals are not applicable to LIs who market funds to distributors who then promote and distribute the funds to end investors on the basis that the LIs do not enter into transactions with or have any contractual relationships with the end investors. The LIs may receive both quantifiable and non-quantifiable benefits from the product issuer for the distribution of the funds to investors via the distributors. ● For the suggested disclosure, does it apply on a "per fund" basis, or can it be done on a generic basis, covering a range of funds? If it is on a per fund basis, it would significantly increase the administrative work in preparing/updating the disclosure, as it's generally being disclosed in application documents (e.g. application form). Besides, typically, in a global fund setting, the fund manager will appoint regional distributors which will then share part of the regional distribution fees (practically also a portion of management fees) with the HK distributor. In such circumstances, what's the expected disclosure for the HK distributor? Is it necessary to still refer back to the pro-rated percentage of the management fees?
Question 19: Do you have any comments on the enhanced disclosure proposed with regard to monetary benefits received or receivable by intermediaries that are not quantifiable prior to or at the point of entering into a transaction (and in particular, in relation to specific types of investment products)?		
43.	CP Para. 95 to 102	Can SFC confirm if the below understanding is correct? ● The proposals are only applicable to distributors' marketing or sales materials (which is distributed at the point of sale) but not to the offering document/KFS of the fund. ● Same comment as the 1st bullet point of Seq. 42.
Question 20: Do you have any comments on the suggested manner of disclosure of trailer fees (in the context of funds) set out in the sample disclosure above? Do you have any other suggestions to ensure the disclosure of non-quantifiable monetary benefits relating to other types of investment products will be clear, fair, meaningful and easily understood by investors?		
44.	CP Para. 95 to 102	● Will the proposed disclosure requirements only apply to situations whereby the discretionary portfolio manager buys an investment product (on a discretionary basis) for his client's discretionary mandate, and in turn receives a rebate or trailer fee from the product issuer? If so, can the disclosure be in the form of a statement in the client agreement in relation to the retention of rebates? This is consistent with s.13.2 of the Code of Conduct.

Seq.	CP Para. or Section of FMCC/Code of Conduct	Comments/Questions
45.	CP Para. 95 to 102	● The trailer fee for investment funds could be calculated in various forms as follows: - A percentage range of management fee of the fund, which is similar to the circular sample described; - A percentage range on the AUM of the fund held by the intermediary for their customers. For instance, 0.5% to 0.75% of USDXXX,XXX. For the aforesaid trailer fee calculation, instead of disclosing the percentage range, some have suggested to disclose the maximum percentage that the intermediaries are to receive (For example: disclose 60% instead of 40-60%). This could relieve intermediaries' administrative burden should there are any changes on the fee arrangement without affecting negatively the transparency to customers. ● In some circumstances, the intermediary and the fund house are affiliates from the same group, and there may not be any trailer fee arrangement, or the trailer fee rebate will first be given to an offshore regional distributor who then in turn appoints a local intermediary. Please clarify what would be the disclosure requirements for this kind of relationship? In the latter case, it is difficult to quantify in the fund's selling document at the local intermediary level as the calculation of fee basis may not be based entirely on the management fee, but on the fee sharing between the regional distributor and local intermediaries.
46.	CP Para. 97 to 98 and Code of Conduct s.8.3, s.8.3(A)	● It is acknowledged that it is a global trend to increase transparency in disclosing the incentives to investors and move away from paying the distributors by product issuers to a model of paying of investment advice by investors. That said, there may be practical issues for the proposed disclosure method. For instance, to disclose the range of relevant monetary benefits receivable on an annualized basis and maximum dollar amount of such monetary benefits receivable per year – this may be potentially confusing to end investors as the disclosure does not take into account possible changes of NAV and different services level by different distributors. Also, the disclosure needs to be over a 12 month period and it is assumed there are no changes of NAV, which are unrealistic. If the point of disclosure is to clarify, maybe more useful just to disclose the % but not the absolute dollar amount. ● Can SFC confirm if the understanding listed below are correct:- - Based on the marked up change in s.8.3 of the Code of Conduct, under part (a) Specific disclosure, wordings of "…quantifiable prior to or at the point of entering into a transaction" are added. Does it mean that going forward even distributors are going under "Explicit remuneration arrangement" (i.e. through agreement) cannot do specific disclosure but has to disclose under s.8.3(b)(ii) for monetary benefits such as trailer fees as trailers are not quantifiable at point of sale? Under what circumstances can "Specific disclosure" of "a percentage ceiling of the investment amount" be used

Seq.	CP Para. or Section of FMCC/Code of Conduct	Comments/Questions
		as investment amount/asset size is usually unknown until later calculation period? - If tiered rate based on certain fixed investment amount being reached is included in the distribution agreement, can Specific Disclosure (s.8.3(a)(i)) be used? - For enhanced disclosure that has to be on a transaction basis, disclosure is only required for fund(s) that are involved in that particular transaction. - For sample disclosure, can a distributor use the hypothetical $10,000 investment amount to give an idea to investors? We presume it does not have to use the actual investment amount into the fund to compute? Please confirm. - What is the expectation of SFC with respect to how to disclose the maximum HK dollar amount for tiered rate situation (are fund managers obliged to disclose the maximum trailer fee rate applicable to the highest AUM tier)? In reality, a distributor may never achieve the higher fee rate because it never reaches that highest tier of AUM. This will result in gross overstatement of the fees received by distributor. Thus, how meaningful would this piece of information would be to investors? - Would SFC consider s.8.3(A)(iv) monetary benefits disclosure be one-off (i) when enhanced disclosure becomes effective and (ii) where there are changes to the one-off disclosure to provide an updated one-off disclosure instead of on a transaction basis which repeated disclosure may not add further value to investor given the investor has been made aware? Besides, given the trailer fees would be impacted by any change in the annual management fees ("AMF"), disclosure would need to be revised and this would trigger updated One-off Disclosure (i.e. to align s.8.3(A)(iv) with proposed s.8.3A(b) changes). - Given the trailer fees would be impacted by any change in the AMF there is a high dependency on product issuers to provide timely notice of AMF change to distributors. Generally, a lead time of at least three months is required for distributors to update the disclosure. - For the monetary benefits disclosure, we understand that the range is supposed to reflect any possible "tiered fee" arrangement (i.e. where different rates are applicable to different bands of AUM for a given fund/product issuer). Please confirm that this understanding is correct.

Seq.	CP Para. or Section of FMCC/Code of Conduct	Comments/Questions
Question 21: Do you think a 6-month transition period following gazettal of the final form of the amendments to the Code of Conduct is appropriate? If not, what do you think would be an appropriate transition period and please set out your reasons.		
47.	N/A	● For "enhanced monetary benefit" disclosure, a 12-month transition period would be required. Some intermediaries may be carrying a few hundred funds. Considerable effort is needed for intermediaries to prepare all the required information and robustly validate with all manufacturers. More importantly, major system enhancement with procedural changes are needed to incorporate such disclosure in the sales documents which demands significant IT resources and efforts.
Other Comments on the proposed amendments to FMCC and Code of Conduct		
48.	FMCC Section 2.1.1(a)	RE: Staff ethics ● We believe that the current "annual" requirement should suffice given the relevant persons are already required to obtain prior written permission for personal account dealing from the compliance officer/person designated by senior management, as required by s.2.1.1 (b).
49.	FMCC Section 3.12, 3.13.8, 3.14.1	RE: Disclosure on leverage; securities lending, repo and OTC; liquidity management in offering document In relation to SFC-authorized funds, SFC may wish to consider that the disclosure requirements in FMCC are deemed to have been met if the disclosures in the offering documents already comply with the UT Code.
50.	FMCC Section 3.15	RE: Fund Management: Compliance ● Understand that the rule applies also to non-authorized funds and segregated mandates. Does it mean for all material non-compliance matters regarding these funds/mandates, fund managers are required to report to the SFC? What's the objective and will the SFC take any action? ● Can the SFC clarify the scope of making reporting to SFC in relation to "all material non-compliance matters"? For example, do passive investment guidelines breaches require reporting? Does SFC refer to "material non-compliance with the FMCC"? ● The Code of Conduct s.12.5 has specified the requirements and obligations to report on material non-compliance matters. Is the expectation the same under both Code of Conduct and FMCC?

Seq.	CP Para. or Section of FMCC/Code of Conduct	Comments/Questions
51.	FMCC Section 3.9.1	Re: Cross Trades ● *"A fund manager should only undertake sale and purchase transactions between client accounts (cross trades) where: .... (d) such ~~activity is~~ activities are disclosed to ~~the~~ both clients."* Suggest these to be included as "good practices" and independent review should be required for such activities.
52.	N/A	RE: Exemption for Professional Investors under Code of Conduct Can SFC confirm if the below understanding is correct? ● s.15.4 (c) of the Code of Conduct states that the need to disclose transaction related information (s.8.3A of the Code of Conduct) is exempt for Institutional Professional Investors and certain Corporate Professional Investors subject to compliance with s.15.3A and 15.3B ("Qualified PIs"). Under s.8.3A, s.8.3 (re. disclosure of monetary and non-monetary benefits) also falls under the scope of the "transaction related information" required to be delivered to the client prior to or at the point of entering into the transaction. The two proposals on point-of-sale transparency will be reflected in s.8.3 and 8.3A Code of Conduct. Accordingly, when LIs deal with Qualified PIs, they will continue to be exempt from s.8.3 and s.8.3A of the Code of Conduct including the related proposed changes. In other words, LIs will be subject to the proposed disclosures requirements in s.8.3 and s.8.3A of the Code of Conduct when dealing with Corporate Professional Investors who are not Qualified PIs and Individual Professional Investors.

(End)

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Fund investors identify room for improvement in the transaction process: survey reveals

55% of Hong Kong investors and 86% of Mainland investors are quite or very satisfied with their most recent fund purchases, according to a survey commissioned by the Hong Kong Investment Funds Association ("HKIFA") amongst Hong Kong and Mainland retail fund investors.

The survey, conducted by Cimigo on behalf of HKIFA in October 2016, aims to understand more about the perception and needs of Hong Kong and Mainland fund investors. (Note 1)

Out of the 760 Hong Kong investors who responded to the survey, 56% opine that there are unnecessary steps in the fund purchase process.

As to how to streamline the process, 52% of the aforesaid 56% (i.e. 29%) consider audio recording of the risk assessment process can do away with; while 47% (i.e. 26%) think the risk profile assessment can be removed altogether.

Similarly, 54% of Mainland investors regard that some steps can be removed, with most see audio-recording of risk profile assessment as being redundant.

Gen X and Gen Y from both markets have in particular expressed a strong desire to see the process streamlined. (Table 1)

Table 1: Citing there are unnecessary step(s) during fund sales process

	Hong Kong investors			**Mainland investors**		
	Baby Boomers (age 52 or above)	**Gen X (age 35-51)**	**Gen Y (age 30-34)**	**Baby Boomers (age-52 or above)**	**Gen X (age 35-51)**	**Gen Y (age 30-34)**
Yes	41%	64%	62%	22%	64%	74%
No	59%	36%	38%	78%	36%	26%
Out of those who answered YES: Types of process(es) to be removed						
Conduct risk profile assessment	47%	48%	45%	40%	64%	30%
Audio recording of risk profile assessment	51%	52%	54%	53%	62%	68%
Review the fund's offering document	28%	27%	36%	27%	31%	48%
Audio recording of sales process	26%	25%	17%	27%	31%	30%

While respondents generally acknowledge the value of the risk profile assessment, 56% of Hong Kong respondents believe that they should have the right/freedom to override the result of the assessment and invest in mismatched products if they explicitly state to the Investment advisors ("IAs") that they can and are willing to accept the risks.

Mainland investors are more ready to invest in mis-matched products, with 82% saying they should have such a right. Baby boomers in particular hold such a view. (Table 2)

Table 2: Risk profile assessment						
	Hong Kong investors			**Mainland investors**		
	Baby Boomers	**Gen X**	**Gen Y**	**Baby Boomers**	**Gen X**	**Gen Y**
"I should have the **right/freedom to invest in mismatched products** if I declare to the IA that I can and is willing to accept the risks." *% of the respondents who "totally agree" or "mostly agree" to this statement.*	55%	58%	53%	91%	80%	76%

Perception of "Suitability"

Close to 90% of Mainland investors believe that the products recommended by the IAs are very or quite suitable for them. Amongst the different cohorts, Baby boomers seem to be the most satisfied.

In contrast, only 59% of Hong Kong investors think the products are suitable, and the gap is more acute for Gen Y. (Table 3)

Table 3: Suitability level of products recommended by IAs						
	Hong Kong investors			**Mainland investors**		
	Baby Boomers	**Gen X**	**Gen Y**	**Baby Boomers**	**Gen X**	**Gen Y**
Top 2	***66%***	***55%***	***44%***	***89%***	***83%***	***87%***
Very suitable	7%	9%	7%	37%	23%	16%
Quite suitable	59%	46%	37%	52%	60%	71%

As to how investors define "suitability", respondents from both markets generally see it in terms of investment outcome rather than risks.

The top three criteria being cited for finding a product suitable are "the product provided the expected level of income for me" (47%), "I received dividend income" (47%) and "the product fits my return requirement" (42%).

In contrast, very few respondents assess suitability in terms of risks - only 19% consider it in terms of whether the products fit their risk appetite, and 15% take investment duration into account.

Commission-based vs. fee-based model

More Hong Kong fund investors prefer a commission-based model over a fee-based one, with 57% indicating so. Mainland investors' views are mixed, with a slightly higher percentage opting for a fee-based model. (Table 4)

Table 4: Preference of the charging model		
	Hong Kong investors	**Mainland investors**
Charging annual fee is better	29%	39%
Charging fees/commission based on each transaction is better	57%	36%
Neither nor	14%	25%

Those who prefer a commission-based model opine that it is fairer and easier to understand. They also think that a fee-based model is not optimal as they don't make fund transactions frequently.

On the contrary, respondents who make frequent transactions prefer the annual fee model. Supporters also expect a wider choice of products will be made available under this model and there would be less conflict of interests.

Product-by-product vs. portfolio-based approach

As to whether respondents prefer to receive advice on a product-by-product basis or a portfolio-based approach, slightly more Hong Kong investors favor the former whereas more mainland investors opt for the latter. (Table 5)

Table 5: Product-by-product approach vs. portfolio-based approach		
	Hong Kong investors	**Mainland investors**
By product is better	28%	19%
By portfolio is better	25%	34%
Both are good	39%	41%
Neither nor	8%	6%

Out of those who prefer the portfolio approach and those who think both are good, 42% are willing to disclose their total asset to the IAs.

In reviewing the findings, Mr Art Bacci, Chairman of HKIFA said, "the study provides important insights into the perception of Hong Kong and Mainland fund investors."

We welcome the FAQ issued recently by the SFC which provides that licensed/registered persons have to consider the overall effect of their recommended products on clients' portfolios when performing suitability assessment (Note 2). This seems to allow retail banks some leeway to take a portfolio-based approach.

"We will continue to work closely with the relevant authorities and distributors to see how to further enhance investor experience, enable investors to use mutual funds effectively for their financial management needs; and at the same time, ensure that their interests would be adequately protected."

"To complement these efforts, the HKIFA will also continue to work with the relevant institutions on investor education. We hope to foster appropriate investment behavior and enhance the overall financial literacy of the community."

Based on the survey findings, HKIFA has prepared a set of FAQ (see Appendix 1) which aims to address certain commonly raised questions and misperceptions noted; and we plan to continue to build up on this.

Notes:

1. There are two parts to the survey: qualitative and quantitative. For the questionnaire survey, Cimigo interviewed more than 950 investors from Hong Kong and the Chinese Mainland. The quantitative survey was preceded by 5 focus group discussions.

The respondents of the survey include those who are currently investing/have experience in retail fund investment in the past 12 months and take part in investment decisions on their own or with references from Bank's investment advisors/independent financial advisor. Those who invest in funds only via MPF/unit-linked insurance products are excluded.

2. Question 5 of the SFC FAQs (updated Dec 23, 2016):

"Suitability involves licensed or registered persons matching the risk return profile of each recommended investment product with each client's personal circumstances.

... Where licensed or registered persons recommend investment products to their clients, as part of the suitability assessments, they should consider the overall effect of their recommended investment products on their clients' portfolios. For example, for a client with low or medium risk profile, a proportion of high risk products in his portfolio may not be unsuitable so long as this is commensurate with the risk return profile of the portfolio and the licensed or registered persons are able to satisfy itself that any investment products recommended are likely to meet the investment objectives and other personal circumstances of the client."

3. HKIFA has 70 fund management companies as full and overseas members. It has 63 affiliate and associate members which include lawyers, accountants, trustees and other professionals that are involved in the creation and administration of funds.

(End)

Hong Kong Investment Funds Association

Appendix 1

Frequently Asked Questions on the Purchase Process of Investment Funds through Banks

1. Why does an investor need to complete risk profile assessment before buying an investment fund through a bank? Is such assessment required for each and every fund purchase?

In order to recommend suitable product(s) to a customer, banks will collect and take into consideration relevant customer information including investment objectives, investment experience and knowledge, financial situation, and risk tolerance, etc.. A common way for banks to collect such information is by conducting a customer risk profile assessment generally in the form of questionnaire.

Customers do not need to complete a risk profile assessment for each and every fund purchase. If the customer has already completed an assessment before and the results are still valid (validity usually lasts for one or two years depending on different banks' policies), the bank can proceed on recommending suitable investment fund(s) to the customer without carrying out risk profile assessment again. If the customer has significant changes in relevant information, he/she should inform the bank so as to update the assessment.

The bank will also disclose and explain the risks and features of the recommended fund(s), so as to assure the customer understands the fund(s). Then, the bank could execute the transaction.

2. Why do retail banks audio-record risk profile assessment and selling process of funds, and do they have to audio-record every risk profile assessment and the selling process of each and every fund purchase?

Audio-recording is an important investor protection measure. Audio-recording the risk profile assessment and the selling process can help ensure such processes are properly conducted (e.g. to guard against misrepresentation or omission in the profiling and risk disclosure processes). The audio record can also serve as important evidence in any customer complaints or disputes, and can facilitate regulators' supervision of the business conduct and investigation of any customer complaints.

Not every risk profile assessment nor every fund purchase require audio-recording. While banks are required to audio-record the first-time face-to-face risk profile assessment process for retail customers, banks may provide other risk profiling channels, such as online assessment where audio-recording is not required. Also, banks may conduct subsequent regular review of customer risk profile online or via written confirmation with customers, where audio-recording is not applicable.

In general, banks do not need to audio-record face-to-face selling process of funds for retail customers, unless those funds are not authorized by the SFC, or involve risk-mismatch, derivatives or complex and high-yield bonds.

3. Can an investor buy a fund with a risk rating that is higher than his risk tolerance level?

A bank may recommend a customer to buy a fund with risk- mismatch, if it is suitable to the customer. For example, it may be suitable for a customer with a low or medium risk profile to buy a high risk fund if the fund only constitutes a small portion of the customer's portfolio and could meet the investment objectives and other circumstances of the customer.

Where a bank does not consider it suitable to recommend a fund with risk-mismatch but the customer requests to purchase it, the bank may execute the customer's order provided that it documented the customer's reasons for the transaction.

4. Can a bank simply execute an investor's purchase order if he/she has a specific investment fund in mind?

In general, a bank can execute an investor's purchase order for a specific investment fund without involving any investment recommendation or solicitation from the bank.

However, if the fund involves derivatives, and the investor has no knowledge of derivatives, the bank should warn the investor about the transaction and provide appropriate advice to the investor as to whether or not the transaction is suitable for him/her.

5. Apart from bank branches, do banks provide other channels for investors to buy funds?

Banks may also offer, for example, phone or online trading channels to investors. Audio-recording is not applicable to online channel.

(End)