Comments from Schroder Hedge Funds on

A Consultation Paper on Hedge Funds Reporting Requirements
(Securities and Futures Commission, SFC)

Having reviewed the documents we have some suggestions to make from our perspective as managers of both single strategy hedge funds (SSHFs) and funds of hedge funds (FoHFs).

In general we find the paper to take a thoughtful approach to the conundrum of balancing investors' needs of transparency with the hedge fund manager's fears of having their current positions exposed. We do, however, have some specific comments which we hope are helpful. We have restricted our responses to comments on the specific points made in the paper / related documents and present them under the corresponding headings below.

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Consultation Paper

SUMMARY OF KEY FEATURES OF THE GUIDELINES

Appropriate Accounting Standards

27. We can see advantages in adoption of IAS for new funds but would welcome it if US GAAP were also acceptable for funds currently employing these standards.

Quarterly Reports

37. We consider that it will be a burden for many hedge funds to produce quarterly reports in Chinese. This would present more of a difficulty for FoHFs which may already struggle with the proposed reporting deadlines.

Timeliness of the Reports

46. -The production of quarterly reports one month after the relevant reporting period could pose challenges for FoHFs. Since they have to collate the information received from multiple underlying hedge funds they may struggle to meet this deadline if any one fund is slow in reporting to the FoHF. It would seem logical to allow FoHFs more time to report than SSHFs.
-The difficulty in meeting such deadlines would rise as the burden of disclosure rose. For example, providing reports in Chinese language form would add to the time taken to collect performance.
-We suggest that 45 days from month end would be a more reasonable deadline.

Annex 1

Contents of Financial Reports

Requirements Applicable to Both Annual and Semi-Annual Reports

7. -Providing full disclosure of underlying holdings is problematic for a FoHF because they will be unlikely to have full transparency of holdings from all the underlying SSHFs that they are invested in. Furthermore, given the lack of standard presentation of such information, even if made available, it would be non-trivial to aggregate the data on underlying holdings in a diversified FoHF. We would also agree with the comments made in the paper that full transparency is not especially useful to investors and rarely gives a clear indication of risks faced.
-The alternative for FoHFs to name all the SSHFs they are invested in does not provide a good solution since it is unlikely that all the desired information on these underlying funds would be in the public domain.

Contents of Quarterly Reports
Portfolio Review
11. (b) Leverage

-For FoHFs it may be difficult to provide a measure of leverage for the same reasons as mentioned in regard to paragraph 7. Not all underlying funds within a FoHF will provide details of leverage. Furthermore, the measures provided may not easily be compared – making it difficult to construct a composite measure of leverage.
-In terms of providing a measure of leverage at the fund level we see less difficulty. For example, consider a fund has that assets of HKD1bn and borrows a further HKD1bn – hence investing HKD2bn in underlying SSHFs. Its leverage is straightforward to calculate and could reasonably be disclosed.

11.(e) Illiquid holdings

Disclosure of illiquid holdings may present problems for FoHFs for the same reasons as mentioned in 7 and 11.(b) above.

11.(g) Additional disclosures for FoFHs

(i) We would point out that a simple consideration of the liquidity profile is not fully meaningful if it does not consider if there will be exit penalties levied by the underlying hedge funds. Furthermore, most hedge fund managers grant themselves the flexibility to refuse redemption requests under certain circumstances – meaning that the liquidity of the FoHF's investments are not guaranteed.

(ii) A distinction between a fund being closed to new investors or closed to current investors should be made. A fund may be closed to new investors but capacity may have been guaranteed to certain current investors.

Appendix

Note (6)

The use of a zero risk-free rate in calculating the Sharpe ratio is neither especially realistic nor the standard way in which this measure is commonly used. However, we recognise that the benefits of the simplicity and comparability that this will provide outweigh these two considerations.