SECURITIES AND FUTURES COMMISSION
證券及期貨事務監察委員會

SFC
證監會

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

December 2017

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Foreword

The Securities and Futures Commission (SFC) invites market participants and interested parties to submit written comments on the proposals discussed in this consultation paper or to comment on related matters which might have a significant impact upon the proposals by no later than 19 March 2018. Any person wishing to comment on the proposals on behalf of any organisation should provide details of the organisation whose views they represent.

Please note that the names of the commentators and the contents of their submissions may be published on the SFC's website and in other documents to be published by the SFC. In this connection, please read the Personal Information Collection Statement attached to this consultation paper.

You may not wish your name and/or submission to be published by the SFC. If this is the case, please state that you wish your name and/or submission to be withheld from publication when you make your submission.

Written comments may be sent as follows:

By mail to:	Securities and Futures Commission 35/F Cheung Kong Center 2 Queen's Road Central Hong Kong Re: Consultation Paper on Proposed Amendments to the Code on Unit Trusts and Mutual Funds
By fax to:	(852) 2877 0318
By online submission at:	http://www.sfc.hk/edistributionWeb/gateway/EN/consultation/
By e-mail to:	utc-consultation@sfc.hk

All submissions received before the expiry of the consultation period will be taken into account before the proposals are finalised and a consultation conclusions paper will be published in due course.

Securities and Futures Commission
Hong Kong

18 December 2017

Personal information collection statement

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Retention

5. Personal Data provided to the SFC in response to this consultation paper will be retained for such period as may be necessary for the proper discharge of the SFC's functions.

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1 Personal Data means personal data as defined in the Personal Data (Privacy) Ordinance (Cap. 486).

2 The term "relevant provisions" is defined in section 1 of Part 1 of Schedule 1 to the Securities and Futures Ordinance (Cap. 571) and refers to the provisions of that Ordinance together with certain provisions in the Companies (Winding up and Miscellaneous Provisions) Ordinance (Cap. 32), the Companies Ordinance (Cap. 622) and the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance (Cap. 615).

Enquiries

6. Any enquiries regarding the Personal Data provided in your submission on this consultation paper, or requests for access to Personal Data or correction of Personal Data, should be addressed in writing to:

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

7. A copy of the Privacy Policy Statement adopted by the SFC is available upon request.

Proposed amendments to the Code on Unit Trusts and Mutual Funds

Executive summary

Background and objectives

1. Unit trusts and mutual funds (funds)[3] constitute a large portion of the financial products authorized by the Securities and Futures Commission (SFC) for offering to the Hong Kong public (SFC-authorized funds) as collective investment schemes (CIS) under Part IV of the Securities and Futures Ordinance (SFO) pursuant to the Code on Unit Trusts and Mutual Funds (UT Code).

2. Since the global financial crisis, the asset management industry has posted robust growth and there have been significant international regulatory developments, particularly in relation to the regulation of public funds. The International Organization of Securities Commissions (IOSCO) has issued or enhanced many standards in areas such as custody of assets, liquidity risk management, money market funds and valuations. To strengthen financial systems and increase the stability of international financial markets, the Financial Stability Board (FSB) has also issued policy recommendations covering securities lending, repo transactions and other issues, and addressing structural vulnerabilities from asset management activities. Ensuing regulatory changes have been made in major jurisdictions including the United States and Europe.

3. Locally, the SFC adopted a strategy to strengthen Hong Kong as an international, full-service asset management centre. An important part of this strategy involved the conclusion of mutual recognition of funds arrangements with the Mainland in July 2015 and with Switzerland and France in December 2016 and July 2017, respectively. The SFC will continue to pursue mutual market access arrangements with other jurisdictions. Furthermore, the SFC has played an active role in supporting renminbi internationalisation by facilitating the expansion of renminbi investment product offerings in Hong Kong, including renminbi unlisted funds and exchange-traded funds (ETFs) investing onshore in the Mainland securities markets[4]. These and other initiatives have driven the growth of Hong Kong domiciled public funds in recent years[5].

4. In view of international and local market developments, the SFC has conducted a holistic review of the UT Code to ensure that regulations in Hong Kong are aligned with international requirements and those of major overseas markets. The proposals in this consultation also seek to ensure that the regulatory regime for SFC-authorized funds is up-to-date and

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3 As of 30 September 2017, there were 2,188 public funds authorized by the SFC (of which 1,435 (66%) are overseas domiciled funds and 753 (34%) are Hong Kong domiciled funds). These funds represented 79% of all the CIS authorized by the SFC.

4 These unlisted funds and ETFs are renminbi-denominated funds which primarily invest in Mainland securities markets through the Renminbi Qualified Foreign Institutional Investor (RQFII) quota, Stock Connect and the China Interbank Bond Market (CIBM).

5 As of 30 September 2017, there were 753 Hong Kong domiciled SFC-authorized funds and their assets under management (AUM) amounted to US$151 billion. The number of Hong Kong domiciled SFC-authorized funds has almost doubled and their AUM has increased by 158% since 2012.

appropriately addresses the opportunities and risks presented by financial innovation and market development.

Summary of key proposals

5. The SFC invites comments on proposed amendments to the UT Code. The proposals aim to modernise the current requirements under the UT Code to facilitate market development and enhance investor protection as well as to align the regulatory regime for SFC-authorized funds with international standards.

6. The main areas for consultation include:

   (a) Key operators – proposals to provide flexibility and strengthen requirements for management companies, trustees and custodians:

      (i) increase the minimum capital requirement for management companies to HK$10 million to better reflect the financial standing and commitment expected of them;

      (ii) provide flexibility to allow management companies with multi-national presence to leverage group resources in meeting the five-year public fund investment management experience requirement for key personnel;

      (iii) enhance obligations of trustees and custodians in view of their key role in safeguarding fund assets and providing independent oversight of the management of SFC-authorized funds; and

      (iv) expand the scope of and enhance the requirements for the annual independent audit review of the internal controls and systems of trustees and custodians to strengthen ongoing monitoring.

   (b) Investments – modernisation to provide greater investment flexibility with enhanced safeguards:

      (i) introduce an overall limit of 50% on the use of derivatives for investment purposes by plain vanilla public funds to allow flexibility in the deployment of investment objectives and strategies to deliver value to investors (such as yield enhancement, risk reduction, access to restricted markets and cost efficiency); and

      (ii) enhance and introduce additional safeguards on the use of derivatives and securities lending, repo and reverse repo transactions.

   (c) Specialised schemes – proposals to introduce new types of funds and enhance existing requirements:

      (i) introduce new chapters in the UT Code for listed open-ended funds (also known as active ETFs) and closed-ended funds to facilitate the development of new products; and

(ii) enhance requirements on money market funds to ensure robust requirements aligned with the relevant IOSCO standards.

7. We also propose to codify various existing requirements and practices, including, among others, requirements for the general obligations of management companies, eligibility of trustees and custodians, valuation of fund assets, liquidity risk management and streamlined measures for handling scheme changes.

8. The proposed amendments to the UT Code are set out in Appendix A. These have been formulated after soft consultation with industry participants and relevant stakeholders, including various associations of funds, trustees, banks and accountants, as well as the SFC's Products Advisory Committee.

9. The SFC invites comments on the proposed amendments to the UT Code. A consultation conclusions paper will be published as soon as practicable after the end of the consultation period.

Section 1 – Proposals on amendments to the UT Code

I. Key operators

A. Management companies

10. Each SFC-authorized fund must appoint a management company acceptable to the SFC. The UT Code sets out the eligibility criteria and general obligations of a management company.

Key proposals

Minimum capital requirement

11. At present, a management company for SFC-authorized funds must have minimum issued and paid-up capital and capital reserves (Minimum Capital Requirement) of HK$1 million or its equivalent. This amount has remained unchanged for over two decades.

12. Apart from the Minimum Capital Requirement, SFC-licensed or registered corporations for Type 9 regulated activity are subject to financial resources rules (FRR) on an ongoing basis. The purpose of the FRR is to ensure that SFC-licensed or registered corporations have sufficient financial resources to cover risks associated with the regulated activities which they engage in.

13. Notwithstanding the current Minimum Capital Requirement, most management companies for SFC-authorized funds have minimum capital of over HK$10 million.

14. To better reflect the expected financial standing and commitment of management companies for SFC-authorized funds, we propose to increase the minimum capital of a management company managing public funds in Hong Kong to HK$10 million or its equivalent.

Investment expertise and experience

15. Currently, key personnel (at least two) of a management company must be dedicated full-time staff and possess at least five years investment experience in managing public funds with reputable institutions (Key Personnel Requirement).

16. It is common for fund management groups with a multinational presence to pool resources across group entities. To enable management companies to leverage group resources and expertise from different offices, whilst maintaining the requirement for key personnel to possess at least five years investment experience, we propose that the Key Personnel Requirement on public funds investment management experience would be satisfied if the management company:

    (a) belongs to a well-established fund management group; and

    (b) is able to demonstrate that, on a group-wide basis, it possesses the requisite experience and resources as well as an appropriate oversight system to administer public funds.

17. In considering whether the fund management group is well-established, the SFC will take into account the group's overall experience, resources and capabilities, including the number of years that the group has been managing public funds, its regulatory record, assets under management attributable to public funds, group-wide internal controls and risk management systems for the management of public funds, and the jurisdictions where the related investment functions and operations of the group are based.

General obligations of management companies

18. We propose to codify existing requirements for the general obligations of management companies such as those requiring proper risk management systems to ensure that funds are designed fairly and operate as designed[6].

Self-managed schemes

19. As each SFC-authorized fund must appoint a management company which is acceptable to the SFC, a self-managed scheme (ie, one which is managed by the scheme's own board of directors instead of a management company) will not be accepted unless a satisfactory delegation arrangement is put in place whereby the fund's investment management function is delegated at all times to a qualified investment manager in compliance with Chapter 5 of the UT Code. Accordingly, we propose to codify this requirement in the UT Code.

Amendments to the UT Code

20. Details of the above proposed amendments are set out in Chapter 5 of the draft amended UT Code (Appendix A).

Questions

Question 1:	Do you have any comments on the proposed increased minimum capital for management companies?
Question 2:	Do you have any comments on the proposals to provide flexibility for well-established fund management groups to leverage group investment expertise and experience?

6 "Circular to Product Providers of SFC-authorized unit trusts and mutual funds, SFC-authorized investment-linked assurance schemes and SFC-authorized unlisted structured investment products on Guidance on Internal Product Approval Process" (revised as of 4 March 2016).

B. Trustees and custodians

Background

21. Each SFC-authorized fund must appoint a trustee (in the case of a unit trust) or a custodian (in the case of a mutual fund corporation) which is responsible for the custody of fund assets and other monitoring and oversight functions.

22. The increased internationalisation of fund portfolios has led to a growth in funds with sub-custodians in foreign jurisdictions. This has amplified the complexity of custody chains and the risks and challenges of protecting fund assets. As a consequence, IOSCO has developed specific standards for the custody of assets of collective investment schemes[7]. Major overseas fund jurisdictions have also strengthened their regulations on trustees and custodians and their respective safe custody regimes for collective investment schemes[8].

23. To align Hong Kong's regulatory requirements with international standards and enhance investor protection, the following amendments are proposed.

Key proposals

Appointment of and eligibility of trustees and custodians

24. We propose to codify the existing requirements and specify that a trustee or custodian must be:

    (a) a bank licensed under section 16 of the Banking Ordinance (Chapter 155 of Laws of Hong Kong);

    (b) a trust company registered under Part VIII of the Trustee Ordinance (Chapter 29 of Laws of Hong Kong) which is a subsidiary of a bank under (a) or a banking institution falling under (d);

    (c) a trust company registered under Part VIII of the Trustee Ordinance (Chapter 29 of Laws of Hong Kong) and approved by the Mandatory Provident Fund Scheme Authority (MPFA) pursuant to Section 20 of the Mandatory Provident Fund Schemes Ordinance (Chapter 485 of Laws of Hong Kong); or

    (d) a banking institution incorporated outside Hong Kong which is subject to prudential regulation and supervision on an ongoing basis acceptable to the SFC.

25. Although the trustee or custodian and the management company must be persons who are independent of each other, they are permitted to be subsidiaries of the same holding company if specified conditions are met to ensure functional independence to address the potential conflicts of interest

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7 *Standards for the Custody of Collective Investment Schemes' Assets*, a final report issued by IOSCO in November 2015.

8 For example, in Europe, a revision of the UCITS directive (UCITS V) was made in 2014 with an aim to further enhance retail investor protection through the introduction of a range of corresponding measures (including enhanced requirements on the eligibilities, duties, responsibilities and liability of depositaries of UCITS). Besides, Australian Securities and Investments Commission also strengthened the financial requirements for custodial and depository service providers in 2013.

issues which may arise. We propose to codify the existing practice where the parties should have systems in place to ensure the trustee or custodian is functionally independent of the management company.

General obligations of trustees and custodians

26. To align with IOSCO standards on the custody of CIS assets and with those in other major overseas jurisdictions, we propose to require trustees and custodians to:

(a) exercise due skill, care and diligence in discharging their obligations including the selection and monitoring of agents, nominees and delegates;

(b) maintain proper records of fund property which cannot by its nature be held in custody[9];

(c) segregate fund property from:

(i) property of the management company, investment delegates, their connected persons as well as property of the trustee or custodian and any nominees, agents or delegates throughout the custody chain; and

(ii) property of other funds and clients (unless held in an omnibus account[10] with adequate safeguards);

(d) properly monitor the fund's cash flows;

(e) maintain appropriate measures to verify ownership of fund property; and

(f) maintain a clear mechanism for prompt escalation to senior management of the trustee or custodian and the management company of potential breaches of obligations and duties and timely reporting to the SFC on material breaches.

Periodic review of the internal controls and systems of trustees and custodians

27. Currently, a trustee or custodian must appoint an independent auditor to periodically review its internal controls and systems. Appendix G to the UT Code sets out the guidelines for such reviews.

28. In view of the important role of trustees and custodians in a fund and because suitable, effective internal controls are essential for the performance of their duties, we propose to expand the scope and enhance the level of review currently set out in Appendix G by:

(a) expanding the scope of the review by setting out the minimum areas in which the control objectives and policies must be covered;

9 For example, over-the-counter (OTC) derivatives.

10 The term "omnibus account" generally refers to the holding of fund assets in an account in the name of the trustee or custodian or its nominee (and marked as fund assets, ie, not as assets of the trustee or custodian or its nominee itself), that holds the assets of various funds, rather than in individual accounts for each underlying fund.

(b) raising the level of independent auditor's review to include opinions covering the design suitability and operating effectiveness of controls; and

(c) requiring the independent auditor to report material weaknesses or failures in controls or control systems identified and provide recommendations for improvement (including the response from the trustee or custodian's management).

Amendments to the UT Code

29. Details of the proposed amendments are set out in Chapter 4 and Appendix G of the draft amended UT Code (Appendix A).

Questions

Question 3:	Do you have any comments on the proposals regarding the enhanced obligations of trustees and custodians?
Question 4:	Do you have any comments on the proposals to enhance the periodic reviews of the internal controls and systems of trustees and custodians?
Question 5:	What other measures do you think are appropriate to strengthen the regulations for trustees and custodians of public funds in Hong Kong?

II. Investments

A. Modernisation of the core investment requirements

30. The core investment requirements for SFC-authorized funds contained in Chapter 7 of the UT Code (Core Investment Requirements) set out clear rules for funds' investments which provide important safeguards for investor protection.

31. However, the existing Core Investment Requirements do not contain specific provisions covering investment activities such as securities lending, sale and repurchase (repo) and reverse repurchase (reverse repo) transactions (collectively, Securities Financing Transactions). The requirements for investments in derivatives are limited and outdated, as financial market development and innovation has led to the emergence of many new forms of derivatives. Increasingly, asset managers use derivatives to deliver value to their funds (eg, for the purposes of yield enhancement, risk reduction, access to restricted markets and cost efficiency). With proper safeguards, we believe that the use of derivatives could benefit fund investors.

32. In view of the above, we propose to modernise the Core Investment Requirements by including provisions to govern Securities Financing Transactions and introducing a balanced approach to provide greater flexibility for investments in derivatives. The proposals aim to reflect market development and financial innovation and to put in place appropriate safeguards which are consistent with relevant international standards and practices.

B. Diversification, liquid assets, loans and borrowings

Key proposals

Diversification requirements

33. We propose the following enhancements on the spread of investments by introducing:

    (a) a group limit where the aggregate value of a fund's investments in or exposure to entities within the same group may not exceed 20% of the fund's net asset value (NAV); and

    (b) a separate diversification limit on cash deposits where the value of a fund's cash deposits made with the same entity or entities within the same group may not exceed 20% of the fund's NAV.

34. Entities included in the same group for the purposes of consolidated financial statements prepared under internationally recognised accounting standards are proposed to be regarded as entities within the same group for the purposes of the proposed investment limits in paragraph 33 of this consultation paper.

35. The proposals also take into account industry comments and permit cash deposits to exceed the 20% limit in specific circumstances upon the launch, merger or termination of a fund.

Illiquid assets

36. Managing liquidity to meet regular redemption requests from open-ended funds is important[11]. Hence, SFC-authorized funds are expected to invest in liquid assets. Investments in illiquid assets are subject to a maximum limit of 15% of the fund's NAV. We propose to clarify that illiquid assets are assets which cannot be readily convertible into cash at limited cost.

Loans and borrowings

37. We propose a number of enhancements to strengthen investor protection, including:

(a) prohibiting funds from engaging in lending (excluding permitted reverse repo transactions and investments in fixed income securities), guarantee and other activities which may lead to direct or contingent liabilities or obligations; and

(b) lowering a fund's borrowing limit to 10% of its NAV.

C. Derivatives investments

Background

38. Hong Kong domiciled SFC-authorized funds are subject to different limits on investments in derivatives based on the type of fund.

(a) Chapter 7 funds (plain vanilla funds)

Plain vanilla funds may only invest in three specific types of derivatives (namely, futures, options and warrants) with separate limits[12].

(b) Chapter 8.9 funds (funds with extensive derivatives investments)

These funds may invest in different types of derivatives to achieve their investment objectives up to 100% of their NAV based on the commitment approach – where derivatives positions acquired for

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11 In July 2017, IOSCO published a public consultation on recommendations and good practices in liquidity risk management for funds, entitled *Consultation on CIS Liquidity Risk Management Recommendations* (Liquidity Recommendations) and *Open-ended Fund Liquidity and Risk Management – Good Practices and Issues for Consideration*. These papers consulted on various additional guidance and new recommendations to supplement the *Principles of Liquidity Risk Management for Collective Investment Schemes* published by IOSCO in 2013. In response to the *Policy Recommendations to Address Structural Vulnerabilities from Asset Management Activities* (12 January 2017) published by FSB, IOSCO is expected to issue the final report on the Liquidity Recommendations by the end of 2017.

12 The requirements for investments in futures, options and warrants are currently set out in 7.6 to 7.10 of the UT Code. A plain vanilla fund may enter into futures contracts for non-hedging purposes provided that the net total aggregate value of contract prices, together with the aggregate value of holdings of physical commodities and commodity based investments, may not exceed 20% of the fund's NAV. The value of a fund's investment in warrants and options for non-hedging purposes in terms of the total amount of premium paid may not exceed 15% of its NAV; and the writing of call options on portfolio investments may not exceed 25% of its NAV in terms of exercise price.

investment (ie, non-hedging) purposes[13] are converted into their equivalent prevailing market values in their underlying assets (Commitment Approach).

(c) Chapter 8.7 funds (retail hedge funds)

These funds generally adopt alternative strategies such as long/short exposures, high leverage (either by synthetic techniques through derivatives investments or financial borrowings) and hedging and arbitrage techniques. These funds may invest in derivatives without a prescribed limit subject to various enhanced requirements, including minimum initial subscription, enhanced risk management requirements, additional risk warnings, disclosures and reporting to investors.

39. Many overseas markets impose limits on derivatives investments held by public funds but different calculations may be used, such as limits on the net derivatives exposure including derivatives for investment (ie, non-hedging) purposes only, or gross/notional derivatives exposure including derivatives for both investment and hedging purposes, or the overall leverage of a fund including that arising from derivatives investments.

(a) In Europe, UCITS funds may either be subject to a limit on derivatives investments of 100% of the fund's NAV based on the Commitment Approach, or use a value-at-risk (VaR) approach where no limit on derivatives investments is imposed.

(b) In the US, there are rules and guidance on derivatives transactions engaged by public funds such as a requirement on coverage on obligations under such transactions[14]. Based on an analysis conducted by the US Securities and Exchange Commission (SEC), most of the public funds in the US did not engage in derivatives transactions and among those funds that did, the vast majority had derivatives exposures that did not exceed 50% of the funds' NAV[15].

(c) In mainland China, the overall leverage level of a public fund, which may arise from derivatives investments, financing transactions and other liabilities of the fund, may not exceed 40% of the fund's NAV.

(d) In Taiwan, public funds may only invest in specific types of derivatives and the total exposure to such derivative investments may not exceed 40% of the fund's NAV.

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13 Derivative positions for hedging arrangements are excluded under the Commitment Approach.

14 *Investment Company Act of 1940 (1940 Act)*, *Securities Trading Practices of Registered Investment Companies, Investment Company Act Release No. 10666* issued in 1979 and no-action letters issued by SEC staff published on the SEC website.

15 Section III.B.1.c of *Use of Derivatives by Registered Investment Companies and Business Development Companies* published by the SEC in December 2015 – The White Paper entitled "*Use of Derivatives by Investment Companies*" prepared by SEC's Division of Economic and Risk Analysis in December 2015 showed that more than 70% of the sampled mutual funds (other than alternative strategy funds) did not engage in any derivatives transactions and only about 6% had derivatives exposures in excess of 50% of the funds' NAV.

(e) Under the Asia Region Funds Passport (ARFP)[16], the exposure of a passport fund (other than an index fund) to derivatives investments, together with other specified transactions which may involve liabilities, may not exceed 20% of the fund's NAV.

Key proposals

A clear overall limit on derivatives investments by Chapter 7 funds (plain vanilla funds)

40. The SFC recognises that financial innovation and changing investment needs have led to increased use of derivatives by funds. Accordingly, we propose to remove the requirement that plain vanilla funds may only invest in futures, options and warrants for non-hedging purposes.

41. Whilst expanding the types of derivatives which plain vanilla funds may invest in, it is necessary to improve transparency and the overall regulation of funds using derivatives investments.

42. In line with practices of other major jurisdictions where a clear overall limit is imposed on a fund's derivatives investments, we propose to apply an overall limit of 50% of the fund's NAV based on the Commitment Approach. We also propose enhanced requirements for funds' counterparties to over-the-counter (OTC) derivatives, asset coverage and collateral (see paragraphs 49, 55 and 56 of this consultation paper).

43. We consider that applying a 50% limit on plain vanilla funds is proportionate for the following reasons:

(a) Derivatives-based fund products

Under the UT Code, derivatives-based funds which invest extensively in derivatives (ie, Chapter 8.9 funds) are those which may invest up to 100% of their NAV in derivatives. A derivatives investment limit lower than 100% would be appropriate for plain vanilla funds (ie, funds that do not invest in derivatives for investment purposes to a material extent or non-derivative based fund products).

(b) Net derivatives exposure

Since hedging activities aim to off-set or reduce risk, derivatives positions for hedging will not be included.

16 ARFP is an initiative which facilitates the cross-border offering of eligible collective investment schemes. Please refer to the passport rules under Annex 3 to the *Memorandum of Cooperation on the Establishment and Implementation of the Asia Region Funds Passport (MOC)*, which has been signed by representatives from Australia, Japan, Korea, New Zealand and Thailand and came into effect on 30 June 2016. Activation of this fund passport will occur after any two participating economies complete the implementation of their domestic arrangements under the MOC.

(c) Investor expectations

In a retail investor study recently conducted by the Investor Education Centre (IEC)[17(a)], a vast majority (81%) of surveyed Hong Kong investors perceived derivatives as high risk investments which topped the list of all common investment products. Among those who invested in funds, 91%[17(b)] did not expect plain vanilla equity or bond funds to invest more than 50% in derivatives. Further, 88% indicated that information concerning how much derivatives will be used by a fund should be covered in its offering documents.

(d) Local landscape

According to the results of a survey we conducted in June 2016 on derivatives investments made by 1,576 Hong Kong domiciled plain vanilla funds and UCITS funds authorized by the SFC for public offering in Hong Kong[18], the use of derivatives for investments was not extensive. All Hong Kong domiciled plain vanilla funds and over 99% of these surveyed UCITS funds had a synthetic leverage (from derivatives investments) of below 50% of NAV based on the Commitment Approach.

44. We have also considered the different approaches used to calculate derivatives limits in other markets. The gross/notional value approach, which includes all derivatives positions (including those for hedging purposes), might overstate the total market exposure of a fund as it does not allow offsetting of positions which might decrease or eliminate risks in a fund. Separately, VaR is only a risk monitoring or measurement tool and not a measure of synthetic leverage. Some UCITS funds using the VaR approach could have derivatives investments exceeding 900% of NAV under the gross/notional approach and 500% of NAV under the Commitment Approach. On the other hand, the Commitment Approach focuses on measuring the use of derivatives for investment purposes (ie, derivatives for hedging purposes are excluded). Furthermore, the Commitment Approach is consistent with the spirit of Chapter 7 of the UT Code which allows plain vanilla funds to use derivatives for hedging purposes without a specified limit.

45. Taking the above into account, as well as the nature of plain vanilla public funds and the expectations of Hong Kong retail investors, we believe that the Commitment Approach is a more balanced measure of a fund's synthetic leverage arising from derivatives investments.

17(a) Established in 2012 and supported by the Education Bureau and all four financial regulators, the Investor Education Centre, a subsidiary of the SFC, is dedicated to improving financial literacy in Hong Kong. In the second half of 2017, IEC conducted a retail investor study (comprising focus group discussions and a survey) to understand investors' perceptions and behaviour concerning financial products investments – *Retail Investor Study Research Report* (December 2017).

17(b) When asked the extent that they would expect a plain vanilla equity or bond fund to expose to derivatives, ranging from none to more than 100% of the fund's NAV, 74% of the surveyed Hong Kong investors thought the exposure should be less than 50% of the fund's NAV and another 17% expected no investment in derivatives at all.

18 These UCITS funds disclosed their use of derivatives for investments was not extensive and accounted for over 80% of the total number of UCITS funds authorized by the SFC for public offering in Hong Kong at the time of the survey.

46. We envisage that SFC-authorized funds (domiciled in Hong Kong or overseas including UCITS funds) with derivatives investments over the 50% limit will be regarded as derivative products subject to the enhanced distribution requirements under 5.1A and 5.3 of the Code of Conduct for Persons Licensed by or Registered with the SFC.

Disclosure to investors

47. To enhance transparency and facilitate comparison by investors, we propose that all SFC-authorized funds (domiciled in Hong Kong or overseas including UCITS funds) must disclose in the product key facts statements (KFS) the purpose of, and expected maximum leverage arising from, derivatives investments based on the Commitment Approach. This will provide a level-playing field with respect to all SFC-authorized funds offered to the Hong Kong public. A sample disclosure in the KFS is set out below:

> **Use of derivatives / investment in derivatives**
>
> - The fund may use derivatives for hedging purposes only. The fund is not expected to incur any leverage arising from the use of derivatives.
>
> *Or*
>
> - The fund may use derivatives for investment (non-hedging) purposes. The fund's expected maximum leverage arising from investments in derivatives is [up to 50%] / [more than 50% and up to 100%] / [more than 100% and up to [x]%] of the fund's NAV.

48. We also propose to require that the interim and annual financial reports of Hong Kong domiciled funds include disclosures on the leverage arising from derivatives investments calculated under the Commitment Approach.

Other safeguards

49. We propose the following requirements regarding derivatives investments for all Hong Kong domiciled SFC-authorized funds (other than Chapter 8.7 funds (retail hedged funds)) to enhance investor protection:

(a) Diversification

Exposure to a reference entity of a derivative, together with other investments of the fund, are subject to:

(i) a single entity limit of 10% of the fund's NAV; and

(ii) a group limit of 20% of the fund's NAV (see paragraph 33(a) of this consultation paper).

(b) Counterparties in OTC derivatives transactions

A counterparty in an OTC derivatives transaction or its guarantor should be a substantial financial institution (defined under the UT Code)[19].

A fund's net exposure to a single counterparty in OTC derivatives transactions may not exceed 10% of its NAV.

The aggregate value of a fund's net exposure to an OTC derivatives counterparty, together with the fund's other investments, are subject to:

(i) a single entity limit of 10% of the fund's NAV; and

(ii) a group limit of 20% of the fund's NAV (see paragraph 33(a) of this consultation paper).

When a fund receives collateral from an OTC derivatives counterparty, to limit its exposure to this counterparty, the type of collateral must comply with the enhanced requirements described in paragraph 55 of this consultation paper.

(c) Asset coverage

A fund should at all times be able to meet all of its payment and delivery obligations under all derivatives transactions. The management company must monitor and ensure that derivatives transactions are adequately covered on an ongoing basis.

Questions

Question 6:	Do you have any comments on the proposal to introduce an overall limit on derivatives investments for a plain vanilla public fund? Do you consider the proposed 50% limit appropriate? Please explain your views.
Question 7:	Do you have any comments on the proposed enhanced disclosures regarding derivatives investments in the fund's KFS and financial reports?

D. Securities Financing Transactions

Background

50. Globally, there has been an increasing trend of funds entering into Securities Financing Transactions for the purpose of enhancing yield or managing liquidity. The SFC has published guidance explaining that SFC-authorized funds should only engage in these types of transactions if (i) it is

[19] It is proposed to amend the definition of "substantial financial institution" to mean an authorized institution as defined in section 2(1) of the Banking Ordinance (Chapter 155 of Laws of Hong Kong) or a financial institution which is on an ongoing basis subject to prudential regulation and supervision, with a minimum NAV of HK$2 billion or its equivalent in foreign currency.

in the best interests of holders to do so; (ii) associated risks have been properly addressed; and (iii) the minimum disclosure requirements in the fund's offering documents have been met.

51. We propose to implement the guidance on Securities Financing Transactions in line with FSB requirements[20] and to introduce additional safeguards to enhance investor protection.

Key proposals

Additional safeguards including enhancement of disclosures to investors

52. We propose to introduce explicit provisions in the Core Investment Requirements to require that:

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

(b) counterparties must be substantial financial institutions (as defined under the UT Code)[19];

(c) a fund should have at least 100% collateralisation[21] marked to market daily to ensure that there is no uncollateralised counterparty risk exposure arising from these transactions;

(d) all revenue arising from Securities Financing Transactions, net of direct or indirect expenses as reasonable and normal compensation in relation to the services rendered, should be returned to the fund;

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

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

53. The FSB has set out recommendations[20] to address financial stability risks relating to securities lending and repo transactions. We propose to adopt the FSB's recommendations to require funds to include additional information in their interim and annual financial reports, including the amounts and other specific details (such as currency denomination, maturity and tenor) for each type of Securities Financing Transactions, concentration information on counterparties and returns (and any direct or indirect expenses) arising from each type of Securities Financing Transactions.

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20 *Strengthening Oversight and Regulation of Shadow Banking: Policy Framework for Addressing Shadow Banking Risks in Securities Lending* and *Repos* (29 August 2013); and *Transforming Shadow Banking into Resilient Market-based Finance: Regulatory framework for haircuts on non-centrally cleared securities financing transactions* (12 November 2015).

21 The collateral received under Securities Financing Transactions must meet the enhanced collateral requirements as discussed under paragraph 55 in this consultation paper.

Questions

Question 8:	Do you agree with the proposed framework for Securities Financing Transactions? Please explain your views.
Question 9:	Do you consider indemnification by securities lending agents is a necessary and appropriate safeguard? Please explain your views.
Question 10:	Do you consider an overall transaction limit should be imposed on Securities Financing Transactions (other than the additional safeguards proposed)? Please explain your views (with any suggested overall transaction limit, if applicable).

E. Collateral

Background

54. At present, requirements concerning collateral and related disclosures are set out under Chapter 8.8 of the UT Code which governs structured funds. In connection with our preceding proposals to modernise the investment requirements for funds, we propose to consolidate the requirements relating to collateral which will have general application under Chapter 7.

Key proposals

Enhancements on collateral requirements including disclosure to investors

55. To reduce the counterparty risk arising from OTC derivatives investments and Securities Financing Transactions and to mitigate the incremental risks and additional leverage resulting from the reinvestment of collateral received by a fund, we propose to introduce the following enhanced requirements for collateral:

(a) Prudent haircut policy

Haircuts should be based on the market risks of the assets used as collateral to cover the potential maximum decline in collateral value during liquidation, with consideration of the stress period and the volatility of the relevant markets. The price volatility of the asset used as collateral should be taken into account when designing the haircut policy. Other specific characteristics of the collateral, including asset type, issuer creditworthiness, residual maturity, price sensitivity, optionality, expected liquidity in stress periods, impact of foreign exchange, and correlation between securities accepted as collateral and the securities involved in the transaction, should also be considered.

(b) Re-investment of collateral

Non-cash collateral received may not be sold, re-invested or pledged.

Cash collateral received may only be reinvested in short-term deposits, high-quality money market instruments and money market funds authorized under Chapter 8.2 of the UT Code or regulated in a manner generally comparable with the authorization requirements of the SFC. Investment restrictions or limitations under the Core Investment Requirements will apply to such assets. Cash collateral received cannot be engaged in Securities Financing Transactions.

(c) Prohibited assets as collateral

Generally, collateral should not include structured products whose payouts rely on embedded derivatives or synthetic instruments; securities issued by special purpose vehicles, special investment vehicles or similar entities; securitised products or unlisted collective investment schemes.

These proposals are in line with international practices and requirements, including the FSB's recommendations.

56. To enhance disclosure to investors, we propose to require proper disclosure of information regarding collateral to be set out in the funds' offering documents and financial reports.

Questions

Question 11:	Do you think that the proposed collateral requirements are sufficient to safeguard investor interests? What additional criteria should be considered?
Question 12:	Do you agree with the proposed disclosure requirements concerning collateral? Please explain your views.

F. Investments in other funds

57. Currently, a fund is permitted to invest in other funds subject to the requirements and limitations set out in different chapters of the UT Code. To consolidate and streamline the relevant provisions and to codify existing practices, we propose to:

(a) delete the section on unit portfolio management funds (UPMF), commonly known as funds of funds, from Chapter 8 as these funds will be subject to the respective requirements under the Core Investment Requirements in Chapter 7; and

(b) amend the definition of a feeder fund to mean a fund which may invest 90% or more of its NAV (replacing the current definition which refers to all of a fund's assets) in a single fund, being the master fund.

58. Existing UPMFs would be classified as Chapter 7 funds and subject to the Core Investment Requirements under the proposed amended UT Code.

Question

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

G. Structured funds

59. Currently, all synthetic ETFs authorized by the SFC are subject to the requirement of 100% collateralisation to ensure there is no uncollateralised derivatives counterparty risk exposure. We propose to codify this requirement in Chapter 8.8 (structured funds) of the UT Code which will also be applicable to unlisted structured funds.

Question

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

H. Amendments to the UT Code

60. Details of the proposed amendments are set out in the following parts of Appendix A:

(a) Core Investment Requirements – Chapter 7;

(b) enhancements to disclosures in funds' offering documents – Appendix C;

(c) enhancements relating to financial reports – Appendix E; and

(d) structured funds – Chapter 8.8.

III. Money market funds

Background

61. Events during the 2008 global financial crisis exposed the potential for money market funds to spread or amplify risks throughout financial systems. In October 2012, IOSCO published a report setting out 15 policy recommendations which provide common standards for the regulation and management of money market funds across jurisdictions, articulating key principles with respect to maturity, liquidity, credit risks and money market fund practices in relation to repo transactions. US, European and other markets have been implementing these requirements.

62. We propose to enhance the UT Code requirements for money market funds to ensure that our regulatory requirements are robust and in alignment with relevant IOSCO recommendations.

Key proposals

Definition of money market funds

63. We propose to clarify the definition of a money market fund to mean a fund which invests in short-term, high quality money market instruments and which seeks to offer returns in line with money market rates. Under this definition, funds which present the characteristics of a money market fund or which are presented as having similar investment objectives (eg, funds named as liquid funds or cash funds) would also be subject to the applicable requirements even if the funds are not marketed as money market funds.

Permitted assets

64. In view of the IOSCO recommendations that requirements for money market funds should include restrictions on the type of assets which may be held, we propose to enhance the relevant requirements by stating that a money market fund may only invest in short-term deposits, high quality money market instruments and money market funds which are authorized by the SFC or regulated in a manner generally comparable with the authorization requirements of the SFC.

65. Under this proposal, “money market instruments” will refer to securities normally dealt on the money market, for example, government bills, certificates of deposit, commercial papers, short-term notes and bankers’ acceptances. In assessing whether a money market instrument is high quality, at a minimum, its credit quality and liquidity profile must be taken into account.

66. It is also proposed that money market funds will be permitted to invest in asset-backed securities as long as they do not exceed 15% of the fund’s NAV. We also propose to codify an existing requirement that money market funds may use derivatives for hedging purposes only.

Repo transactions and safeguards

67. Under IOSCO's recommendations, securities regulators should develop guidelines governing the use of repo transactions and other similar techniques by money market funds, where appropriate.

68. In addition to the Core Investment Requirements governing Securities Financing Transactions, we propose the following additional limits on money market funds: (a) the amount of cash received under a repo transaction may only be up to 10% of the fund's NAV; and (b) the aggregate amount of cash provided to the same counterparty in reverse repo agreements may not exceed 15% of the fund's NAV.

Portfolio maturity limits

69. In line with IOSCO's recommendations, we propose to modify the requirements for portfolio maturity to require a money market fund to maintain a portfolio with a weighted average maturity which does not exceed 60 days and a weighted average life which does not exceed 120 days.

In this connection:

(a) "weighted average maturity" will be a measure of the average length of time to maturity of all the underlying securities in the fund weighted to reflect the relative holdings in each instrument, and will be used to measure the sensitivity of a money market fund to changing money market interest rates;

(b) "weighted average life" will be the weighted average of the remaining life of each security held in a fund, and will be used to measure the credit risk as well as the liquidity risk; and

(c) generally, the use of interest rate resets in variable or variable-rate notes would not be permitted to shorten the maturity of a security for the purpose of calculating weighted average life, but may be permitted for the purpose of calculating weighted average maturity.

Minimum liquid asset level

70. In line with IOSCO's recommendations, we propose to require money market funds to hold at least 10% of their NAV in daily liquid assets and at least 30% of their NAV in weekly liquid assets.

71. Having considered comparable requirements in other major fund jurisdictions, "daily liquid asset" will refer to cash, instruments or securities which are convertible into cash (whether by maturity or through exercise of a demand feature) within one working day and the amount receivable and due unconditionally within one working day on pending sales of portfolio securities. "Weekly liquid assets" will refer to cash, instruments or securities which are convertible into cash (whether by maturity or through exercise of a demand feature) within five working days and the amount receivable and due unconditionally within five working days on pending sales of portfolio securities.

Safeguards for amortised cost accounting and constant NAV

72. We propose to provide explicit provisions that a money market fund which offers a stable/constant NAV (or which adopts amortised cost accounting for valuing its assets) will only be considered by the SFC on a case-by-case basis. The SFC will have to be satisfied that the measures and safeguards put in place to address risks associated with these features are proper and compliant with the relevant IOSCO recommendations on money market funds.

Amendments to the UT Code

73. Details of the proposed amendments are set out in Chapter 8.2 (money market funds) of the draft amended UT Code (Appendix A).

Question

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

IV. Unlisted index funds and index tracking exchange traded funds

Background

74. Unlisted index funds and index tracking exchange traded funds (also known as passive ETFs) are subject to the requirements under Chapter 8.6 of the UT Code. In addition, synthetic index funds or passive ETFs as well as futures-based index funds or passive ETFs have to comply with the requirements for structured funds under Chapter 8.8 and for futures and options funds under Chapter 8.4A respectively. Additional guidance on passive ETFs is also set out in the Guidelines for regulating index tracking exchange traded funds in Appendix I to the UT Code.

75. In recent years, international standards and practices for index funds and passive ETFs have evolved alongside global market developments. We propose to modernise the requirements for index funds and passive ETFs in certain areas, to clarify and consolidate existing requirements and to codify existing practices.

Key proposals

Clarify requirements for funds which adopt hybrid index tracking strategies through derivatives investments

76. We have seen a number of passive ETFs using a hybrid of physical and synthetic replication strategies to track underlying indices through derivatives investments.

77. To provide clarification to the industry on the requirements governing funds which adopt such hybrid strategies, and in view of the proposed derivatives investment limit under the Core Investment Requirements in Chapter 7, we propose that an index fund or a passive ETF must, in addition to complying with the requirements under Chapter 8.6, also comply with the requirements under Chapter 8.8 if the fund's derivatives investments in any form exceeds 50% of its NAV based on the Commitment Approach.

Enhancing the "broadly based" requirement for an underlying index

78. One of the key criteria for the acceptability of an index is that it should in general be broadly based, as set out in Chapter 8.6(e)(ii). The note to Chapter 8.6(e)(ii) further explains that an index with a single constituent security weighting of more than 40% or with its top five constituent securities weighting of more than 75% would generally be considered too concentrated.

79. The SFC notes that overseas jurisdictions including the Europe and Singapore require underlying indices to be more diversified. For example, an index tracking UCITS or UCITS ETF is not allowed to invest in an index which has a single component weighting of more than 20%. If justified by exceptional conditions in markets where certain securities are highly dominant, the weighting limit for the largest single component in an index may be increased to 35%. Singapore has similar diversification requirements.

80. In view of the above and to align with comparable requirements in overseas markets, we propose that an index would generally be considered too concentrated if it has a single constituent security weighting of more than 20%. If justified by exceptional conditions in markets where certain securities are highly dominant, the weighting limit for the largest single component in an index may be increased to 35%.

81. Although an index with few constituent securities (for example, five) may technically be able to meet the 20 or 35% requirements, such an index would not be broadly based. We propose to set out in the UT Code that an index with few constituent securities will be considered too concentrated.

Codifying the market maker requirement for passive ETFs

82. Market makers play an important role in trading SFC-authorized passive ETFs by providing secondary market liquidity. This is particularly relevant to retail investors, who typically can only buy and sell ETFs on the secondary market. To minimise the impact of an abrupt cessation of market making activities on secondary market liquidity, a manager of SFC-authorized passive ETFs is generally expected to use its best endeavours to have arrangements in place so that there is at least one market maker for each trading counter of the ETF who will give not less than three months' notice prior to terminating market making arrangements.

83. These expectations are proposed to be set out in the UT Code.

Enhanced disclosure requirements for Securities Financing Transactions by passive ETFs

84. A passive ETF may enter into Securities Financing Transactions to reduce tracking errors and enhance performance. Given that the nature of a passive ETF is to track, replicate or correspond to the performance of an underlying index, it is generally expected that any Securities Financing Transaction undertaken by an ETF shall not substantially change the replication strategy or risk profile of the ETF.

85. In view of the proposed enhanced safeguards and disclosures in relation to Securities Financing Transactions under the Core Investment Requirements in Chapter 7, it is proposed that Securities Financing Transactions undertaken by a passive ETF will also be subject to these enhanced requirements.

86. We also propose to codify existing practice that where the Securities Financing Transactions undertaken by a passive ETF exceed 50% of its NAV, the passive ETF should make available the information on the Securities Financing Transactions undertaken (such as the counterparties and their relevant exposures, details of collateral information and the fee split between the passive ETF and its manager and any other operating parties of the income derived from such transaction) to investors on an ongoing basis through the ETF's website or other acceptable channels. The offering documents should direct investors to the website or other channels where this information is published.

Listed and unlisted share class for index funds and passive ETFs

87. Subject to the provisions of its constitutive documents, it is legally possible for an unlisted index fund to set up a listed share class for listing and trading on a stock exchange. The listed and unlisted share classes would co-exist within a single fund pursuing the same investment strategy. Such a structure may provide additional distribution channels for an unlisted index fund via the secondary market. Conversely, it is also possible for a passive ETF to set up an unlisted share class for distribution in the primary market. In view of the above and since this structure is new to the Hong Kong market, we propose that subject to consultation with the SFC, funds under Chapter 8.6 of the UT Code may have unlisted and/or listed units or share classes provided that the dealing arrangements and risks associated with both share classes are clearly disclosed in the offering documents. The unlisted class and listed class shall comply with the requirements for index fund and passive ETF in Chapter 8.6 of the UT Code respectively.

Streamlining other requirements

88. In addition, we propose a number of amendments in relation to passive ETFs under Appendix I to the UT Code, including, among others, (i) removing "Acceptable ETF Regime" in view of our policy of pursuing mutual recognition of publicly-offered funds with overseas jurisdictions; (ii) removing "Product Description Document" so that all ETFs are subject to the same disclosure requirements; (iii) providing a level playing field for trading information disclosure for overseas and local ETFs, and (iv) moving relevant provisions in Appendix I to Chapter 8.6.

Amendments to the UT Code

89. Details of the proposed amendments are set out in Chapter 8.6 (unlisted index funds and index tracking ETFs) of the draft amended UT Code (Appendix A).

Questions

Question 16:	Do you agree with the proposed amendments to the requirements for unlisted index funds and passive ETFs using index tracking strategies which substantially invest in derivatives? Please explain your views.
Question 17:	Do you agree with the proposed enhanced diversification requirements for indices? Please explain your views.
Question 18:	Do you agree with the proposed arrangement for setting up listed and/or unlisted units or share classes for index funds and passive ETFs? Please explain your views.
Question 19:	Do you agree with the other proposed amendments related to unlisted index funds and passive ETFs under Chapter 8.6 of the UT Code?

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

Background

90. Currently, the UT Code only covers passively managed ETFs which track the performance of indices or benchmarks.

91. In recent years, there has been noticeable growth of active ETFs in various overseas jurisdictions. Some industry participants have expressed interest in launching active ETFs in Hong Kong. In view of this, we propose to introduce a new chapter for active ETFs in the UT Code to offer more investment choices for investors.

Key proposals

92. An active ETF is a fund which is listed and traded on The Stock Exchange of Hong Kong Limited (SEHK). Unlike an index tracking ETF, an active ETF is actively managed and does not track the performance of an index or a benchmark.

93. When considering our regulatory requirements for active ETFs, we noted that the portfolio transparency requirement has been the subject of debate. Fund managers have concerns about disclosing the full portfolio of an active ETF to the public on a daily basis because of front running risks as well as the risk that the manager's strategy could be reverse engineered. Different regulatory approaches have been adopted in overseas jurisdictions. While some regulators require full portfolio disclosure on a daily basis, many others[22] permit the disclosure of an active ETF's portfolio only to participating dealers and market makers ahead of the public. We observed from the overseas development of active ETFs and industry feedback that imposing the public disclosure of the full portfolio on a daily basis appears to have hindered the growth of active ETFs. We also note that existing SFC-authorized passive ETFs are allowed to provide portfolio information to participating dealers and market makers ahead of the public. We are not aware of any major issues with this practice.

94. Making daily portfolio information available to participating dealers and market makers is necessary to facilitate the provision of liquidity and the performance of effective arbitrage for the active ETF. This ultimately enables the secondary trading price of an active ETF on a stock exchange to be closer to its NAV. In addition, making sure that the indicative NAV of the active ETF is available throughout the trading session will enable the public to assess the value of their investments and make decisions about trading in the secondary market.

95. In view of the above, on balance, we believe that it would be in the public interest not to require full portfolio disclosure to the public on a daily basis while allowing the provision of portfolio information to participating dealers and market makers ahead of the public. This would facilitate both secondary market pricing and the longer-term development of active ETFs. Investors would also benefit from more product choice.

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22 For example, Canada, Australia, Germany, UK and Ireland.

96. A new Chapter 8.10 of the UT Code will be introduced to cater for active ETFs. The key features of and proposed regulatory requirements for active ETFs are set out below:

(a) Authorization

Active ETFs should be authorized by the SFC under section 104 of the SFO for public offering in Hong Kong.

(b) Dealing

Similar to index tracking ETFs, active ETFs can be dealt in both in the primary and secondary markets. Active ETFs will be listed on the SEHK for trading and retail investors can buy and sell active ETF units or shares on the SEHK's platform. Creation and redemption of active ETF units or shares in the primary market will be conducted through participating dealers.

(c) Investment restrictions

Investment restrictions for active ETFs should follow the Core Investment Requirements in Chapter 7 of the UT Code.

(d) Benchmark

Where the performance of an active ETF makes reference to a benchmark, the relevant benchmark should be disclosed in the fund's offering documents.

(e) Portfolio transparency

Active ETFs must publish full portfolio information to the public on a monthly basis (with no more than a one-month delay).

(f) Dissemination of trading information

Active ETFs should update and publish indicative NAV per unit or share every 15 seconds during trading hours on the SEHK.

(g) Market maker

There should be at least one market maker for units or shares (traded in each counter) of active ETFs.

97. Subject to consultation with the SFC, an unlisted fund may set up a listed share class for the purpose of listing on the SEHK and such listed share class should comply with the requirements for active ETFs in Chapter 8.10 of the UT Code.

Amendments to the UT Code

98. Details of the proposed amendments are set out in Chapter 8.10 (listed open-ended funds (also known as active ETFs)) of the draft amended UT Code (Appendix A).

Question

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

VI. Closed-ended funds

Background

99. Closed-ended funds are generally subject to redemption restrictions and are typically used to invest in relatively less liquid assets or restricted markets. As closed-ended funds do not have to maintain the same liquidity buffers to meet regular redemption requests from investors as open-ended funds, they may also be able to fully invest their assets to generate returns for investors. Further, given they may have fewer ongoing costs associated with subscriptions and redemptions, some closed-ended funds may be subject to lower expense ratios.

Key proposals

100. The new Chapter 8.11 mainly seeks to codify existing requirements applicable to closed-ended funds seeking authorization of the SFC under the UT Code[23]. Some flexibility from strict compliance with the relevant investment restrictions requirements in Chapter 7 and/or Chapter 8 of the UT Code may also be allowed (for example, with respect to the holding of illiquid securities) taking into account the fund's investment strategy. Applicants should consult the SFC early on any flexibility to be sought.

101. In line with current practice, the following provisions are proposed for new Chapter 8.11:

(a) <u>Fund to be widely held</u>

The fund must have procedures and mechanisms in place to ensure that it is widely held. This is important for subsequent liquidity in the secondary market and to demonstrate that there is sufficient interest in the fund's units/shares to be offered to justify a listing. In this connection, it is expected that the fund should have a broad base of holders having regard to the adequate shareholder spread requirement for listings of investment companies under the Listing Rules[24].

(b) <u>Trading discount</u>

It is fairly common that listed closed-ended funds, both locally and abroad, are traded at a significant discount to their NAV for prolonged periods. Having regard to our Guidelines on Internal Product Approval Process[25], it is proposed that a closed-ended fund must put in place measures and mechanisms with a view to address any prolonged significant discount of its trading price on the SEHK

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23 Currently, closed-ended funds are acceptable and authorized by the SFC under the UT Code subject to the additional conditions and requirements set out in FAQ 6 of the FAQ on Exchange Traded Funds and Listed Funds in view of their closed-ended nature.

24 Investment companies listed on SEHK under Chapter 21 of the Listing Rules are required, among other things, to have at least 300 shareholders and no person shall control 30% or more of the votes exercisable at any general meeting of the investment company.

25 "Circular to Product Providers of SFC-authorized unit trusts and mutual funds, SFC-authorized investment-linked assurance schemes and SFC-authorized unlisted structured investment products on Guidance on Internal Product Approval Process" (revised as of 4 March 2016) – In particular, one of the principles is that the product should be fairly designed to deliver a fair outcome to the target market.

to its NAV. Such measures and mechanisms should be fair and equitable to holders and properly disclosed.

(c) Redemptions, takeovers and mergers

In view of its closed-ended nature, which is a characteristic shared with listed companies, any form of redemption, takeover or merger activities proposed to be undertaken by a closed-ended fund should be carried out in a manner which is fair and equitable to all holders. As such, it is proposed that the management company and the trustee or custodian of a closed-ended fund should as soon as practicable consult with the SFC on the manner in which these activities could be carried out.

Amendments to the UT Code

102. Details of the proposed amendments are set out in Chapter 8.11 (closed-ended funds) of the draft amended UT Code (Appendix A).

Question

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

VII. Operational matters and on-going disclosure and reporting requirements

Background

103. The UT Code sets out requirements relating to the operations and dealings of SFC-authorized funds. To improve investor protection, we propose to enhance the requirements governing funds' operations and management in alignment with standards and good practices published by IOSCO in areas on valuations, fees and expenses, liquidity management and termination of CIS. We also propose to codify certain existing requirements and practices.

Key proposals

Valuation and pricing

104. At present, any incorrect pricing of 0.5% or more of a fund's NAV per unit or share must be corrected as soon as possible. Affected investors and the fund should be compensated in accordance with requirements under the UT Code. The trustee or custodian and the SFC must also be informed immediately.

105. We propose to require that the trustee or custodian must be informed of any pricing error in a timely manner. A pricing error (individually or in aggregate resulting from incidences which occur in a simultaneous or successive manner) amounting to 0.5% or more of the fund's NAV must be reported to the SFC.

Withdrawal of fund authorization

106. Currently, if the management company does not wish to maintain a fund's SFC authorization, an application must be made to the SFC for withdrawal of the fund's authorization. Having considered IOSCO's good practices for the termination of funds[26], we propose to state that in cases where the withdrawal of authorization is not due to a merger or the termination of the fund, the SFC must be satisfied that the interests of investors (since they may continue to be invested in the fund after the fund ceases to be authorized by the SFC) will be safeguarded before granting its approval for withdrawal.

Financial reports

107. Financial reports containing the information provided in Appendix E to the UT Code must be published and distributed to holders within the prescribed timeframe.

108. We propose to clarify that:

(a) annual reports must be prepared in compliance with internationally recognised accounting standards, which include Hong Kong Financial Reporting Standards (HKFRS), International Financial Reporting

[26] *IOSCO Report on Good Practices for the Termination of Investment Funds* issued by IOSCO in November 2017 – sets out various good practices for the voluntary termination process for investment funds taking into account the interests of investors.

Financial Standards (IFRS) or such other accounting standards that are acceptable to the Commission;

(b) interim reports must apply the same accounting policies and computation methods as those used in the annual reports; and

(c) to facilitate operational efficiency, interim reports and annual reports will be permitted to cover an extended reporting period where a fund is first launched or upon its termination.

109. In light of the developments in accounting standards for financial reporting, we also propose to enhance requirements for the content of financial reports in Appendix E of the UT Code.

Codification of existing requirements and practices

110. In addition to the above proposals, we propose to codify the following existing requirements and practices in the UT Code:

(a) the principles and requirements for the valuation of fund assets and the liquidity risk management of the fund as set out in the SFC's published circulars[27];

(b) disclosure requirements with respect to the calculation basis of performance fees charged by a fund[28];

(c) streamlined measures for handling scheme changes[29] (with further clarification of the requirements for the notification of investors); and

(d) requirements regarding the fair treatment of the interests of holders in the case of fund termination[30].

Amendments to the UT Code

111. Details of the proposed amendments are set out in Chapters 6, 10 and 11 and Appendix E of the draft amended UT Code (Appendix A).

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27 "Circular to Management Companies and Trustees/Custodians of SFC-authorized Funds – Relating to Fair Valuation of Fund Assets" (20 July 2015) and "Circular to management companies of SFC-authorized funds on liquidity risk management" (4 July 2016).

28 The disclosure requirements for performance fees are currently set out in the "Guide on Practices and Procedures for Application for Authorization of Unit Trusts and Mutual Funds" (Application Guide) published by the SFC and posted on the SFC's website. The requirements are in line with IOSCO's recommended good practices in its report *Good Practice for Fees and Expenses of Collective Investment Schemes* published on 25 August 2016.

29 In recent years, the SFC introduced streamlined measures for handling scheme changes to enhance operational efficiency without compromising investor protection. On 14 June 2013, the SFC issued a circular entitled "Circular to Management Companies of SFC-authorized Funds – Streamlined Measures to Enhance the Processing of Application for Scheme Changes and Revision of Offering Documents of SFC-authorized Funds". On 30 June 2017, a further circular entitled "Circular to Management Companies of SFC-authorized unit trusts and mutual funds – Launch of pilot revamped process to enhance the processing of post authorization applications" was published.

30 Currently, the management company is required to put in place measures to minimise the opportunity for any holders to benefit from more favourable or advantageous conditions in the case of scheme termination. This requirement is in line with *IOSCO Report on Good Practices for the Termination of Investment Funds* issued by IOSCO in November 2017.

Question

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

VIII. Miscellaneous

A. Streamlining of specialised schemes in the UT Code

112. Chapter 8 of the UT Code sets out specific requirements for specialised schemes.

113. In view of the proposed amendments to the Core Investment Requirements in Chapter 7, we propose to remove Chapter 8.3 (warrant funds)[31] and Chapter 8.4A (futures and options funds). In future, existing futures and options funds, depending on their investment strategies and risk profiles, should comply with the requirements either under Chapter 8.9 (funds with extensive derivatives investments) or Chapter 8.7 (retail hedge funds).

114. We propose to consolidate the requirements for guarantors and disclosures in offering documents for funds which have guaranteed features (ie, funds which contain a structure whereby a guaranteed amount will be paid to investors on a specified date) into the Core Investment Requirements in Chapter 7 and to remove Chapter 8.5 (guaranteed funds).

B. Other amendments to the UT Code

115. The draft amended UT Code is set out in Appendix A to this consultation paper reflecting the key proposals as discussed above and other proposed revisions to the UT Code.

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

116. Where applicable, certain consequential amendments are proposed to be made to the relevant provisions of the SFC Code on MPF Products (MPF Code), the Code on Pooled Retirement Funds (PRF Code) and the Code on Investment-Linked Assurance Schemes (ILAS Code) along with some other amendments for housekeeping purposes. The proposed amendments are set out in Appendices C, D and E to this consultation paper.

Questions

Question 23:	Do you agree with the proposed streamlining of specialised schemes in the UT Code? Please explain your views.
Question 24:	Do you agree with the proposed consequential amendments to the MPF Code? Please explain your views.
Question 25:	Do you agree with the proposed consequential amendments to the PRF Code? Please explain your views.
Question 26:	Do you agree with the proposed consequential amendments to the ILAS Code? Please explain your views.

[31] Currently, there is no warrant fund authorized by the SFC.

Section 2 – Application of proposed amendments to UCITS funds[32]

General

117. Currently, UCITS funds account for a significant number[33] of SFC-authorized funds in Hong Kong. The SFC has adopted a streamlined approach to the authorization of UCITS funds in accordance with the interim measures published in March 2005 and March 2007 (Interim Measures)[34]. Having considered the local laws and regulations governing UCITS funds and arrangements for cross-border cooperation and exchange of information, UCITS funds from relevant jurisdictions are deemed to have complied in substance with the relevant provisions of the UT Code.

118. The SFC intends to maintain the current streamlined measures for processing applications for the authorization of UCITS funds. In light of our proposals discussed in Section 1 of this consultation paper, we have set out the application of the proposed amended UT Code to UCITS funds in Appendix B to this consultation paper to provide transparency and clarity for the industry. Subject to any necessary amendments upon the conclusion of this consultation, Appendix B will be published on the SFC website as guidance to replace the existing Interim Measures.

Minimum initial subscription by investors (for UCITS funds with derivatives investments of more than 100% of the fund's NAV)

119. Under the existing UT Code, Hong Kong domiciled funds which invest in derivatives exceeding 100% of the fund's NAV under the Commitment Approach will fall under Chapter 8.7 (retail hedge funds) of the UT Code, which are subject to a minimum initial subscription by an investor of not less than US$50,000 or its equivalent.

120. We note that some of the UCITS funds authorized by the SFC in Hong Kong may have a high level of leverage. In order to apply a consistent treatment for all highly leveraged public funds in Hong Kong and facilitate further product differentiation by investors when making their investment decisions, we propose to apply the same minimum initial subscription (ie, US$50,000 or the equivalent) to UCITS funds which have derivatives investments of more than 100% of their NAV based on Commitment Approach.

Disclosure of use of derivatives / investment in derivatives

121. At present, UCITS funds that are offered to the public in Hong Kong are required to disclose in the fund's KFS whether the fund may use derivatives extensively for investment purposes.

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32 UCITS funds referred to under Section 2 of this consultation paper means UCITS funds domiciled in Luxembourg, Ireland and the United Kingdom.

33 As at 30 September 2017, UCITS funds account for more than 60% of the total number of SFC-authorized funds.

34 "General Circular to SFC-approved Fund Management Companies - Interim Measures on the Disclosure and Submission Requirements for the authorization of UCITS III Funds domiciled in Luxembourg, Ireland and the United Kingdom by the SFC" (31 March 2005) and "Circular to Fund Management Companies of SFC-authorized Funds - Streamlined Measures for Processing UCITS III Schemes with Special Features" (30 March 2007).

122. To provide a level-playing field with respect to disclosure requirements for all SFC-authorized funds and to facilitate comparison by investors, we propose to apply the same KFS disclosure requirement as discussed in paragraph 47 of this consultation paper to UCITS funds authorized by the SFC for public offering in Hong Kong.

Questions

Question 27:	Do you agree that a minimum initial subscription by investors to be consistently applied to all highly leveraged funds? Do you consider the proposed US$50,000 or the equivalent threshold appropriate? Please explain your views.
Question 28:	Do you agree that the requirement on disclosure of the purpose of, and expected maximum leverage arising from, derivatives investments should be consistently applied to all SFC-authorized funds? Please explain your views.

Section 3 – Implementation timeline

123. The proposals set out in this consultation paper will be subject to a three-month public consultation. A consultation conclusions paper will then be issued together with the final form of the proposed revised UT Code, taking into account consultation feedback, which will become effective upon its gazettal (Effective Date).

124. We appreciate that management companies and other relevant stakeholders may wish to make appropriate arrangements, such as enhancements of systems and controls, to align with the final proposals. We have also considered the fact that many of the proposed enhancements are codifications of existing requirements or practices. The SFC proposes that a 12-month transition period from the Effective Date will generally be allowed for compliance with amendments to the amended UT Code unless otherwise indicated as being immediately effective in the implementation table below.

125. For the purpose of the implementation of the proposed amended UT Code:

(a) "New Schemes" refer to funds which apply for the SFC's authorization on or after the Effective Date;

(b) "New Operators" refer to management companies which do not manage any SFC-authorized funds as at the Effective Date (New Management Companies); and trustees and custodians which do not act as the trustee or custodian of any SFC-authorized funds as at the Effective Date (New Trustees/Custodians);

(c) "Existing Schemes" refer to funds which are authorized by the SFC as at the Effective Date; and

(d) "Existing Operators" refer to management companies which are managing SFC-authorized fund(s) as at the Effective Date (Existing Management Companies); or trustees and custodians which are acting as the trustee or custodian of SFC-authorized fund(s) as at the Effective Date (Existing Trustees/Custodians).

126. For the enhanced disclosure for the use of derivatives or investments in derivatives in the fund's KFS (Enhanced KFS Disclosure) as discussed in paragraphs 47 and 122 of this consultation paper, the Enhanced KFS Disclosure will become immediately effective upon the Effective Date with respect to all New Schemes with New Operators (ie, New management companies and New Trustees/Custodians). A 12-month transition period from the Effective Date will generally be allowed for compliance with the Enhanced KFS Disclosure for Existing Schemes and other New Schemes.

127. For the minimum initial subscription by investors (for UCITS funds with derivatives investments of more than 100% of the fund's NAV) as discussed in paragraph 120 of this consultation paper, a 12-month transition period from the Effective Date will generally be allowed for compliance by Existing Schemes. For UCITS funds which are New Schemes, this new requirement will become immediately effective upon the Effective Date.

128. The amended MPF Code and the PRF Code will take effect on the Effective Date. Where the provisions under the proposed amended UT Code apply to the MPF Code or PRF Code, the same implementation arrangement will apply. Existing SFC-authorized pooled retirement funds will be grandfathered in respect of the proposed enhanced eligibility requirements for substantial financial institutions (defined under Chapter 3.13 of the PRF Code) to act as guarantors as set out under Chapter 9.1 in the "Proposed consequential amendments to the PRF Code" (Appendix D).

129. The amended ILAS Code will take effect on the Effective Date. Existing SFC-authorized investment-linked assurance schemes will be grandfathered in respect of the proposed enhanced eligibility requirements for substantial financial institutions (defined under Chapter 3.17 of the ILAS Code) to act as guarantors as set out under Chapter 4.4 and Chapter 6.1 in the "Proposed consequential amendments to the ILAS Code" (Appendix E).

Questions

Question 29:	Do you agree with the proposed implementation timetable for the proposed amended UT Code? If not, please set out your reasons and what you think is an appropriate transition period.
Question 30:	Do you agree with the proposed implementation timetable for the proposed amended MPF Code? If not, please set out your reasons and what you think is an appropriate transition period.
Question 31:	Do you agree with the proposed implementation timetable for the proposed amended PRF Code? If not, please set out your reasons and what you think is an appropriate transition period.
Question 32:	Do you agree with the proposed implementation timetable for the proposed amended ILAS Code? If not, please set out your reasons and what you think is an appropriate transition period.

Implementation table of the proposed amended UT Code

Topics	Provisions of the amended UT Code	New Schemes with New Operators (ie with New Management Companies and New Trustees/ Custodians)	New Schemes with New Management Companies but Existing Trustees/ Custodians	New Schemes with New Trustees/ Custodians but Existing Management Companies	New Schemes with Existing Operators	Existing Schemes
I. Key operators						
Trustees and custodians	4.1 to 4.4 and 4.8	Immediately effective				
	4.5	Immediately effective	12-month transitional period	Immediately effective	12-month transitional period	12-month transitional period
Management companies	5.2(b)	Immediately effective	Immediately effective	12-month transitional period	12-month transitional period	12-month transitional period
	5.1, 5.5(a), 5.5(b), 5.10 and 5.11(c)	Immediately effective				
II. Investment						
Core Investment Requirements	Chapter 7	Immediately effective	12-month transitional period			12-month transitional period (except for 7.39(a) – Grandfathered (with respect to existing guarantors))

Topics	Provisions of the amended UT Code	New Schemes with New Operators (ie with New Management Companies and New Trustees/ Custodians)	New Schemes with New Management Companies but Existing Trustees/ Custodians	New Schemes with New Trustees/ Custodians but Existing Management Companies	New Schemes with Existing Operators	Existing Schemes
Money market funds	8.2	Immediately effective				12-month transitional period
Unlisted index funds and index tracking exchange traded funds	8.6	Immediately effective	12-month transitional period			
Structured funds	8.8	Immediately effective	12-month transitional period			
Funds that invest extensively in derivatives	8.9	Immediately effective	12-month transitional period			
Listed open-ended funds (also known as active ETFs)	8.10	Immediately effective				Not applicable
Closed-ended funds	8.11	Immediately effective				
Unit portfolio management funds	Not applicable	Not applicable				12-month transitional period[35]

35 Existing unit portfolio management funds are expected to comply with the requirements under Chapter 7.

Topics	Provisions of the amended UT Code	New Schemes with New Operators (ie with New Management Companies and New Trustees/ Custodians)	New Schemes with New Management Companies but Existing Trustees/ Custodians	New Schemes with New Trustees/ Custodians but Existing Management Companies	New Schemes with Existing Operators	Existing Schemes
Futures and options funds	Not applicable	Not applicable				12-month transitional period[36]
III. Disclosure and reporting						
Offering documents	Appendix C	Immediately effective	12-month transitional period			
Constitutive documents	Appendix D	Immediately effective	12-month transitional period			
Financial reports[37]	Appendix E	Immediately effective	12-month transitional period			
Review on internal controls and systems of trustees and custodians[38]	Appendix G	Immediately effective	12-month transitional period	Immediately effective	12-month transitional period	12-month transitional period

36 Existing futures and options funds are expected to comply with the requirements either under Chapter 8.9 (funds with extensive derivatives investments) or Chapter 8.7 (retail hedge funds).

37 The 12-month transition period for the enhanced disclosure in a fund's interim and annual reports as set out in Appendix E of the amended UT Code means that the interim and annual reports with a financial period or financial year starting on a date after 12 months from the Effective Date should comply in full with the new requirements.

38 The 12-month transition period for the review on the internal controls and systems of trustees and custodians in accordance with Appendix G of the amended UT Code means that the review reports of trustees and custodians with a financial year starting on a date after 12 months from the Effective Date should comply in full with the new requirements.

Topics	Provisions of the amended UT Code	New Schemes with New Operators (ie with New Management Companies and New Trustees/ Custodians)	New Schemes with New Management Companies but Existing Trustees/ Custodians	New Schemes with New Trustees/ Custodians but Existing Management Companies	New Schemes with Existing Operators	Existing Schemes
IV. Operational and post-authorization requirements						
Operational matters	Chapters 6 and 10	Immediately effective				
Scheme changes, notifications and reporting	Chapter 11	Immediately effective				
V. Others						
Additional requirements for non-Hong Kong based schemes	Chapter 9	Immediately effective				
General matters	Chapters 1, 2 and 3	Immediately effective				

Seeking comments

130. The SFC welcomes any comments from the public and the industry on the proposals made in this consultation paper and the indicative draft of the proposed amendments to the UT Code in **Appendix A** to this consultation paper. Please submit comments to the SFC in writing by no later than 19 March 2018.

Appendix A

Proposed amendments to the UT Code

SECURITIES AND FUTURES COMMISSION
證券及期貨事務監察委員會

SFC
證監會

Code on Unit Trusts and Mutual Funds

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Part I: General matters

Chapter 1: Authorization procedures

Schemes established in Hong Kong or elsewhere

1.1 Schemes to be established in Hong Kong or elsewhere are normally expected to comply with the applicable provisions of the Handbook, including without limitation, all of the applicable provisions of this UT Code in order to be authorized in Hong Kong by the SFC pursuant to section 104 of the SFO.

Applications for authorization which seek waivers of any of these provisions must give detailed reasons why waivers are sought.

Scheme established in recognized jurisdictions

1.2 This UT Code accepts that some schemes already comply with certain provisions of this UT Code by virtue of prior authorization in a regulated jurisdiction. It therefore recognizes the types of scheme in jurisdictions set out in the list of recognized jurisdictions published on the Commission's website. Applications for authorization of recognized jurisdiction schemes will generally be reviewed on the basis that the scheme's structural and operational requirements, and core investment restrictions, already comply in substance with this UT Code. Applicants should note however that the SFC expects a scheme to comply in all material respects with this UT Code and reserves the right to require such compliance as a condition of authorization.

Documents to be supplied to the Commission

1.3 An applicant for authorization of a scheme must submit a completed Application Form and an Information Checklist as set out on the Commission's website. The application must also be accompanied by the following and such other documents as may be required by the Commission from time to time:

(a) the scheme's offering and constitutive documents, including its Hong Kong Offering Document and Product KFS [see 3.6, 3.9 and 3.11B];

(b) ~~the scheme's latest audited report (if any) and if more recent, the latest unaudited report;~~[deleted]

(c) ~~management company profile [if applicable - see Application Form];~~[deleted]

(d) ~~the trustee/custodian's latest audited report [if applicable - see Application Form];~~[deleted]

(e) ~~letter of consent to the appointment from the trustee/custodian (not required for recognized jurisdiction schemes or schemes already in existence);~~[deleted]

(f) application fee in the form of a cheque payable to the "Securities ~~&~~ and Futures Commission"; and

Note: The current fee schedule is available on the Commission's website.

(g) the letter nominating an individual to be approved by the Commission as an approved person [see 1.5] containing the individual's name, employer, position held and contact details, including, in so far as applicable, the address, telephone and facsimile numbers, and electronic mail address.

~~The current fee schedule is available on the Commission's website.~~

In addition to the above, applicants for authorization of a non Hong Kong-based scheme must supply the following:

(h) A written undertaking from the Hong Kong Representative ~~Agreement and Undertaking~~ [see ~~Chapter~~ 9.7];.

~~Applicants for authorization of a recognized jurisdiction scheme must also supply:~~

(i) ~~evidence of the scheme's authorized status in that jurisdiction.~~[deleted]

Amendments to documents

1.4 In cases where it may not be suitable to amend documentation to comply with a requirement of the Handbook or this UT Code, the Commission may accept a written undertaking from the relevant party that they will comply with the requirement, together with disclosure in the Hong Kong Offering Document regarding compliance.

Nomination of an individual as approved person

1.5 According to sections 104(2) and 105(2) of the SFO, an individual must be approved for the purposes of being served by the Commission with notices and decisions for, respectively, the scheme and the issue of any related advertisement, invitation or document. An applicant for authorization is, therefore, required to nominate an individual for approval by the Commission as an approved person.

1.6 An approved person should:

(a) have his/her ordinary residence in Hong Kong;

(b) inform the Commission of his/her current contact details, including, in so far as applicable, the address, telephone and facsimile numbers, and electronic mail address;

(c) be capable of being contacted by the Commission by post, telephone, facsimile and electronic mail during business hours;

(d) inform the Commission of any change in his/her contact details within 14 days after the change takes place; and

(e) comply with any other requirements as the Commission considers appropriate.

1.7 An individual approved by the Commission as an approved person for a scheme shall generally be approved also for the issue of any advertisement, invitation or document made in respect of that scheme.

Chapter 2: ~~Products Advisory Committee~~Administrative arrangements

Product advisory committee

2.1 According to section 8 of the SFO, the Commission is empowered to set up committees, whether for advisory or other purposes. The Commission will establish a Products Advisory Committee for the purpose of consultation and advice on matters which may relate to collective investment schemes within the scope of this UT Code of the Handbook. The remit of the Products Advisory Committee and its membership will be set out in its Terms of Reference.

2.2 [deleted]

2.3 [deleted]

2.4 [deleted]

2.5 [deleted]

Data privacy

2.6 The information requested under this UT Code may result in the applicant providing the Commission with personal data as defined in the Personal Data (Privacy) Ordinance. The data supplied will only be used by the Commission to perform its functions, in the course of which it may match, compare, transfer or exchange personal data with data held or obtained by the Commission, government bodies, other regulatory authorities, corporations, organizations or individuals in Hong Kong or overseas for the purpose of verifying those data. Subject to the limits in section 378 of the SFO, the Commission may disclose personal data to other regulatory bodies. You may be entitled under the Personal Data (Privacy) Ordinance to request access to or to request the correction of any data supplied to the Commission, in the manner and subject to the limitations prescribed. All enquiries should be directed to the Data Privacy Officer at the SFC.

Chapter 3: Interpretation

Unless otherwise defined, words and expressions used in this UT Code are as defined in the SFO.

3.1A "Advertising Guidelines" means the Advertising Guidelines Applicable to Collective Investment Schemes Authorized under the Product Codes.

3.1B ~~"Capital markets scheme" means a scheme, the primary objective of which is to invest in debt securities which have a remaining term to maturity of one year or more.~~[deleted]

3.2 "Collective investment scheme" or "scheme" means collective investment schemes commonly regarded as mutual funds (whether they appear in the legal forms of contractual model, companies with variable capital or otherwise) and unit trusts as are contemplated in this UT Code.

3.3 "Commission" or "SFC" means the Securities and Futures Commission referred to in section 3(1) of the SFO.

3.4 [deleted]

3.5 "Connected person" in relation to a company means:-

(a) any person or company beneficially owning, directly or indirectly, 20% or more of the ordinary share capital of that company or able to exercise directly or indirectly, 20% or more of the total votes in that company; or

(b) any person or company controlled by a person who or which meets one or both of the descriptions given in (a); or

(c) any member of the group of which that company forms part; or

(d) any director or officer of that company or of any of its connected persons as defined in (a), (b) or (c).

3.6 "Constitutive documents" means the principal documents governing the formation of the scheme, and includes the trust deed in the case of a unit trust and the Articles of Association of a mutual fund corporation and all material agreements.

3.7 "Distribution function" refers generally to those functions described in 9.3 (a) to (d) of this UT Code.

3.7A "Financial derivative instruments" refers to financial instruments which derive their value from the value and characteristics of one or more underlying assets.

3.8 "Holder" in relation to a unit or share in a scheme means the person who is entered in the register as the holder of that unit or share or the bearer of a bearer certificate representing that unit or share.

3.8A "Hong Kong Representative" or "Representative" means the Hong Kong representative appointed pursuant to 9.1 of this UT Code.

3.9 "Hong Kong Offering Document" means an offering document for distribution in Hong Kong containing the information required by Appendix C of this UT Code, and any other information necessary for investors to make an informed judgement about the scheme.

3.9A "Investment delegate" means an entity that has been delegated the investment management function of a scheme.

3.9B "Management company" means the entity appointed pursuant to 5.1 of this UT Code.

3.10 "Offering document" means that document, or documents issued together, containing information on a scheme to invite offers by the public to buy units/shares in the scheme.

3.10A "Reverse repurchase transactions" means transactions whereby a scheme purchases securities from a counterparty of sale and repurchase transactions and agrees to sell such securities back at an agreed price in the future.

3.10B "Sale and repurchase transactions" means transactions whereby a scheme sells its securities to a counterparty of reverse repurchase transactions and agrees to buy such securities back at an agreed price with a financing cost in the future.

3.10C "Securities financing transactions" has the meaning ascribed to it in 7.32 of this UT Code.

3.10D "Securities lending transactions" means transactions whereby a scheme lends its securities to a security-borrowing counterparty for an agreed fee.

3.11 "SFO" means the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong).

3.11A "Product Code" means any of the following codes administered by the Commission:

(a) Code on Unit Trusts and Mutual Funds
(b) Code on Investment-Linked Assurance Schemes
(c) Code on Pooled Retirement Funds
(d) SFC Code on MPF Products

3.11B "Product KFS" means the Product Key Facts Statement which is the statement required pursuant to 6.2A.

3.12 "Recognized jurisdiction scheme" means a scheme authorized pursuant to overseas laws as listed in the list of recognized jurisdiction schemes which is published on the Commission's website as amended from time to time.

3.12A "Registered person" means a "registered institution" and, except where the context otherwise requires, includes a "relevant individual" as defined in section 20(10) of the Banking Ordinance (Chapter 155 of Laws of Hong Kong).

3.13 "Substantial financial institution" means an authorized institution as defined in section 2(1) of the Banking Ordinance (Chapter 155 of Laws of Hong Kong) or a financial institution which is on an ongoing basis subject to prudential regulation and supervision, with a minimum ~~paid-up capital~~net asset value of HK$~~150,000,000~~2 billion or its equivalent in foreign currency.

3.14 “Trustee/custodian”, “trustee” or “custodian” means the entity appointed pursuant to 4.1 of this UT Code and, for the avoidance of doubt, refers to the trustee of a scheme in the case of a unit trust and the custodian of a scheme in the case of a mutual fund corporation.

3.15 ~~“UCITS scheme” means a collective investment scheme which is already authorized under the relevant national legislation of a member state of the European Union implementing the “Council Directive 85/611/EC of 20 December 1985 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS)” (as amended).~~[deleted]

Part II: Authorization requirements

Chapter 4: Trustee/Custodian

Appointment of ~~Trustee/Custodian~~trustee/custodian

4.1 Every collective investment scheme for which authorization is requested must appoint a trustee~~/~~ (in the case of a unit trust) or a custodian (in the case of a mutual fund corporation) acceptable to the Commission and shall comply with this Chapter on an ongoing basis.

Notes (1): Schemes established under trust must have a trustee and mutual fund corporations must have a custodian. In this context, ~~This~~ this chapter lists the general obligations ~~of the~~applicable equally to both trustee~~/~~ and custodian, whichever is appointed. The constitutive documents [see Appendix D] of the scheme must conform in substance to the intended operative effect of the provisions in this Chapter 4. Trustees are expected to fulfill the duties imposed on them by the general law of trusts. In the case of a mutual fund corporation, the responsibilities of a custodian ~~should~~ under Chapter 4 may be reflected in ~~a constitutive document such as a Custodian Agreement. [see Appendix D]~~the custodian agreement and/or the management agreement instead of the articles of association, where appropriate.

~~*Notes (2):*~~ *An acceptable trustee/custodian should ~~either:~~*

~~*(i)*~~ *~~on an ongoing basis,~~ be subject to ~~regulatory~~ prudential regulation and supervision on an ongoing basis. Trustee/custodian shall appoint an independent auditor to periodically review its internal controls and systems on terms of reference agreed with the Commission [see Appendix G] and should file such report with the Commission, unless such trustee/custodian is prudentially regulated and supervised by an overseas supervisory authority acceptable to the Commission.~~; ~~or~~*

~~*(ii) appoint an independent auditor to periodically review its internal controls and systems on terms of reference agreed with the SFC and should file such report with the SFC.*~~

~~*[see Appendix G -"Guidelines for Review of Internal Controls and Systems of Trustees/Custodians"]*~~

4.2 A trustee/custodian must be:~~-~~

(a) a bank licensed under section 16 of the Banking Ordinance (Chapter 155 of Laws of Hong Kong); or

(b) a trust company registered under Part VIII of the Trustee Ordinance (Chapter 29 of Laws of Hong Kong) which is a subsidiary of such a bank or a banking institution falling under 4.2(d); or

Note: In determining the acceptability of a subsidiary of a banking institution falling under 4.2(d), the Commission will take into account factors

including the level of oversight and supervision from such banking institution.

(c) a trust company registered under Part VIII of the Trustee Ordinance (Chapter 29 of Laws of Hong Kong) and approved by the Mandatory Provident Fund Schemes Authority pursuant to Section 20 of the Mandatory Provident Fund Schemes Ordinance (Chapter 485 of Laws of Hong Kong) (as may be amended from time to time); or

(d) a banking institution ~~or trust company~~ incorporated outside Hong Kong which is subject to prudential regulation and supervision on an ongoing basis, and acceptable to the Commission.

4.3 A trustee/custodian must be independently audited and have minimum ~~issued and~~ paid-up share capital and non-distributable capital reserves of HK$10 million or its equivalent in foreign currency.

4.4 Notwithstanding 4.3 ~~above~~, the trustee/custodian's paid-up share capital and non-distributable capital reserves may be less than HK$10 million if the trustee/custodian is a wholly-owned subsidiary of a substantial financial institution (the holding company); and

(a) the holding company issues a standing commitment to subscribe sufficient additional capital up to the required amount, if so required by the Commission; or

(b) the holding company undertakes that it would not let its wholly-owned subsidiary default and would not, without prior approval of the Commission, voluntarily dispose of, or permit the disposal or issue of any share capital of the trustee/custodian such that it ceases to be a wholly-owned subsidiary of the holding company.

General obligations of trustee/custodian

4.5 The trustee/custodian must:~~.~~

(a)

(i) take into its custody or under its control all the property of the scheme and hold it in trust for the holders (in the case of a unit trust) or the scheme (in the case of a mutual fund corporation) in accordance with the provisions of the constitutive documents;

Note: With respect to property of the scheme which by nature cannot be held in custody, the trustee/custodian shall maintain a proper record of such property in its books under the name of the scheme.

(ii) register cash and registrable assets in the name of or to the order of the trustee/custodian; ~~where borrowing is undertaken for the account of the scheme, such assets may be registered in the lender's name or in that of a nominee appointed by the lender; and~~

(iii) be liable for the acts and omissions of ~~its~~ nominees, ~~and~~ agents and delegates in relation to assets forming part of the property of the scheme;

Note: Any nominees, agents and delegates which are appointed for the custody and/or safekeeping of the property of the scheme shall be subject to prudential regulation and supervision; unless such nominees, agents and delegates which are not subject to prudential regulation and supervision, are required by the local laws to hold the relevant property of the scheme, and no other local entities being prudentially regulated and supervised are allowed to hold such property of the scheme.

(iv) segregate the property of the scheme from the property of:

(1) the management company, investment delegate and their respective connected persons;

(2) the trustee/custodian and any nominees, agents or delegates throughout the custody chain; and

(3) other clients of the trustee/custodian and nominees, agents or delegates throughout the custody chain, unless held in an omnibus account with adequate safeguards in line with international standards and best practices to ensure that the property of the scheme is properly recorded; and

(v) put in place appropriate measures for the verification of ownership of the property of the scheme;

(b) take reasonable care to ensure that the sale, issue, repurchase, redemption and cancellation of units/shares effected by a scheme are carried out in accordance with the provisions of the constitutive documents;

(c) take reasonable care to ensure that the methods adopted by the management company in calculating the value of units/shares are adequate to ensure that the sale, issue, repurchase, redemption and cancellation prices are calculated in accordance with the provisions of the constitutive documents;

(d) carry out the instructions of the management company in respect of investments unless they are in conflict with the provisions of the offering or constitutive documents or this UT Code;

(e) take reasonable care to ensure that the investment and borrowing limitations set out in the constitutive documents and the conditions under which the scheme was authorized are complied with;

(f) issue a report to the holders to be included in the annual report on whether in the trustee/custodian's opinion, the management company has in all material respects managed the scheme in accordance with the provisions of the constitutive documents; if the management company has not done so, the respects in which it has not done so and the steps which the trustee/custodian has taken in respect thereof; ~~and~~

(g) where applicable, take reasonable care to ensure that unit/share certificates are not issued until subscription moneys have been paid~~.~~;

(h) ensure that the cash flows of the scheme are properly monitored, and in particular, that all the payments made by, or on behalf of, investors upon subscription of units/shares of the scheme have been received, and that all cash of the scheme has been booked in the cash accounts of the scheme;

Note: For the purpose of satisfying the obligations in 4.5(h), the trustee/custodian shall comply with the requirements set out in paragraph 8.A(c)(12) of Appendix G.

(i) exercise reasonable care and diligence in the selection, appointment and ongoing monitoring of nominees, agents and delegates appointed by the trustee/custodian as well as any nominees, agents and delegates which are appointed for the custody and/or safekeeping of scheme's property [see 4.5(a)(iii)]; and be satisfied that any nominees, agents and delegates appointed for the functions or operations that are relevant in discharging the obligations and duties of a trustee/custodian remain suitably qualified and competent on an ongoing basis to provide the relevant services and/or perform the delegated duties [see Note to paragraph 1 of Appendix G];

(j) fulfil such other duties and requirements imposed on it as set out in this UT Code; and exercise due skill, care and diligence in discharging its obligations and duties appropriate to the nature, scale and complexity of the scheme; and

Note: In discharging its obligations, trustee/custodian shall make reference to the minimum requirements on the terms of reference for the review of internal controls and systems of trustee/custodian as set out in Appendix G.

(k) establish clear and comprehensive escalation mechanism to deal with potential breaches detected in the course of discharging its obligations and report to the Commission on material breaches in a timely manner.

Note: Among others, the trustee/custodian is expected to (i) update the management company and report to the Commission (either directly or via the management company) on any material issues or changes that may impact its eligibility/capacity to act as trustee/custodian of a scheme and (ii) inform the Commission promptly of any material breach of this UT Code and applicable provisions of the Handbook with respect to the scheme to their reasonable knowledge, which has not been otherwise reported to the Commission by the management company.

Retirement of trustee/custodian

4.6 The trustee/custodian may not retire except upon the appointment of a new trustee/custodian and subject to the prior approval of the Commission [see 11.1]. The retirement of the trustee/custodian should take effect at the same time as the new trustee/custodian takes up office.

Independence of trustee/custodian and the management company

4.7 The trustee/custodian and the management company must be persons who are independent of each other.

4.8 Notwithstanding 4.7 ~~above~~, if the trustee/custodian and the management company are both bodies corporate having the same ultimate holding company, whether incorporated in Hong Kong or outside Hong Kong, the trustee/custodian and the management company are deemed to be independent of each other if:~~-~~

(a)

(i) ~~they are both subsidiaries of a substantial financial institution;~~[deleted]

(ii) neither the trustee/custodian nor the management company is a subsidiary of the other;

(iii) no person is a director of both the trustee/custodian and the management company; and

(iv) both the trustee/custodian and the management company sign an undertaking that they will act independently of each other in their dealings with the scheme~~; or~~.

Note: Among others, there should be systems and controls in place to ensure that the persons fulfilling the custodial function / the safekeeping of the scheme's assets are functionally independent from the persons fulfilling the scheme's management or administration functions, for example, with an independent board, separate governance structure / lines of reporting to the management of the trustee/custodian and separate operational teams within the same corporate group.

(b) ~~the scheme is established in a jurisdiction where the trustee/custodian and the management company are required by law to act independently of one another.~~[deleted]

Chapter 5: Management company and auditor

Appointment of the management company

5.1 Every collective investment scheme for which authorization is requested must appoint a management company acceptable to the Commission~~, except as provided for self-managed schemes below~~ and shall comply with this Chapter on an ongoing basis.

Note: The ~~investment management operations of a fund~~ management company or ~~those of the investment adviser (where the latter~~ the investment delegate (who has been delegated the investment management function~~)~~ of a scheme) should either be licensed or registered in Hong Kong [see 5.6] or based in a jurisdiction with an inspection regime acceptable to the Commission. A list of acceptable inspection regimes is published on the Commission's website. The Commission will consider other jurisdictions on their merits and may accept an undertaking from the management company that the books and records in relation to its management of a scheme will be made available for inspection by the Commission on request.

5.2 A management company must:~~-~~

(a) be engaged primarily in the business of fund management;

(b) have sufficient financial resources at its disposal to enable it to conduct its business effectively and meet its liabilities; in particular, it must have ~~a~~ minimum ~~issued and~~ paid-up share capital and non-distributable capital reserves of HK$~~1~~ 10 million or its equivalent in foreign currency;

(c) not lend to a material extent; and

(d) maintain at all times a positive net asset position.

5.3 Indebtedness owed by the management company to its parent company will be considered as part of capital for the purpose of 5.2(b) in the following circumstances:~~-~~

(a) the indebtedness must not be settled without the prior written consent of the Commission; and

(b) the indebtedness must be subordinated to all other liabilities of the management company, both in terms of its entitlement to income and its rights in a liquidation.

Qualifications of ~~Directors~~directors

5.4 The directors of the management company must be of good repute and in the opinion of the Commission possess the necessary experience for the performance of their duties. In determining the acceptability of the management company, the Commission may consider the qualifications and experience of persons employed by the management company and any appointed investment ~~adviser~~delegate.

Criteria for ~~Acceptability~~ acceptability of ~~Management Company~~management company

5.5 The acceptability of the management company will be assessed on the following criteria:

(a) The key personnel of the management company ~~or~~ and those of the ~~investment adviser (where the latter has been delegated the investment management function)~~investment delegate are expected to possess at least five years investment experience in managing ~~unit trusts or other~~ public funds with reputable institutions. The expertise gained should be in the same or similar type of investments as those proposed for the funds seeking authorization.

Notes: (1) With respect to a management company belonging to a well-established fund management group, the requirement for the key personnel to possess public funds experience may be satisfied if the management company on a group-wide basis is able to demonstrate that it possesses the requisite experience and resources as well as appropriate oversight, monitoring and supervision systems to administer public funds (i.e. a fund management group of at least five years of establishment in managing public funds and with good regulatory records). The Commission will take into account various factors in assessing the fund management group's relevant overall experience, resources and capabilities, including, without limitations, the amount of assets under management attributable to public funds, the group-wide internal controls and risk management systems in place in connection with the management of public funds, and the jurisdiction(s) where the related investment management function(s) and operation(s) of the group is/are based in (with reference to the list of acceptable inspection regimes published on the Commission's website [see Note to 5.1]). The Commission may require substantiation on the experience in managing public funds and the track record of the management company and its group companies, where applicable.

(2) For the avoidance of doubt, the key personnel are expected to possess at least five years investment experience notwithstanding Note(1) to 5.5(a).

(b) Key personnel ~~must be dedicated full-time staff with~~ shall have a demonstrable investment track record in the management of ~~unit trusts or mutual funds~~public funds in accordance with 5.5(a) and must dedicate sufficient time, resources and attention in the management of a scheme. ~~In assessing the qualifications of the personnel of the management company, the Commission may request resumes of the directors of the management company and its delegates (if any).~~

Notes: (1) In general, there must be at least two key personnel designated for each of the management company and investment delegate (if any) in managing the scheme seeking authorization. In any event, the management company should maintain proper up-to-date records regarding the key personnel of the scheme from time to time and such records must be made available to the Commission upon request.

(2) In the case of a multimanager scheme which is generally expected to have at least three sub-managers delegated with investment function

in managing the scheme's assets under the active monitoring of the management company, the Commission may accept that the key personnel of such sub-managers have demonstrable investment experience in areas not limited to that relating to public funds on a case-by-case basis. The offering document of the scheme should clearly disclose, among others, the due diligence processes adopted by the management company in selecting and monitoring the sub-managers on an ~~on-going~~ongoing basis.

(c) Sufficient human and technical resources must be at the disposal of the management company, which should not rely solely on a single individual's expertise.

(d) The Commission must be satisfied with the overall integrity of the applicant management company. Reasonable assurance must be secured of the adequacy of internal controls and the existence of written procedures, which should be regularly monitored by its senior management for updatedness and compliance. Conflicts of interests must be properly addressed to safeguard investors' interests.

(e) Where the investment management functions are delegated to third parties, there should be ~~on-going~~ongoing supervision and regular monitoring of the competence of the delegates by the management company to ensure that the management company's accountability to investors is not diminished. Although the investment management role of the management company may be sub-contracted to third parties, the responsibilities and obligations of the management company may not be delegated.

Licensing ~~Requirement~~requirement

5.6 The type of licence required depends on the functions performed by the management company in Hong Kong. A management company should be properly licensed or registered under Part V of the SFO to carry on its regulated activities.

Self-managed ~~Schemes~~schemes

5.7 Notwithstanding 5.1, a scheme could be managed by its own board of directors who perform the functions of a management company where the scheme's investment management function is delegated at all times to a qualified investment delegate in compliance with this Chapter. In this case, references in this UT Code to the directors of a management company are deemed to be references to the directors of a self-managed scheme.

5.8 The directors of a self-managed scheme are prohibited from dealing with the scheme as principals.

5.9 The regulations of a self-managed scheme must contain the following provisions:-

(a) that holders could convene a meeting and, by way of an ordinary resolution, remove any of the directors considered no longer fit and proper to manage the scheme's assets; and

(b) that the directors' fees and remuneration should be fixed by the holders at a general meeting.

General obligations of a management company

5.10 A management company must:~~.~~

(a) manage the scheme in accordance with the scheme's constitutive documents and in the best interests of the holders. It is also expected to fulfill the duties imposed on it by the general law;

(b) maintain or cause to be maintained the books and records of the scheme and prepare the scheme's ~~accounts and~~financial reports. ~~At least two reports must be published in respect of each financial year.~~ These reports must be ~~sent~~ prepared and made available to all registered holders and filed with the Commission ~~within the time frame specified~~ in a manner in accordance with 11.6, 11.6A and 11.8; ~~and~~

(c) ensure that the constitutive documents are made available for inspection by the public in Hong Kong, free of charge at all times during normal office hours at its place of business or that of its Hong Kong Representative and make copies of such documents available upon the payment of a reasonable fee;~~.~~

(d) take all reasonable steps to ensure that the trustee/custodian is properly qualified for the performance of its duties and functions and discharging its obligations in respect of custody of a scheme's property, having regard to the requirements as set out in Chapter 4;

Note: For the avoidance of doubt, the management company should comply with all applicable legal and regulatory requirements in respect of custody of the scheme's property.

(e) at all times demonstrate that those representatives and agents (including for example, administrators, sub-custodians, brokers, valuation agents) appointed by it or engaged for the scheme possess sufficient know-how, expertise and experience in dealing with the underlying investments of the scheme;

(f) put in place proper risk management systems to effectively monitor and measure the risks of the positions of the scheme and their contribution to the overall risk profile of the scheme's portfolio; and

Note: Among others, the management company must:

(1) put in place suitable and adequate risk management and control systems to monitor, measure, and manage all the relevant risks (including risks associated with financial derivative investment activities) in relation to the scheme. The risk management and control systems must (i) be commensurate with the nature and scale of the transactions and investment activities (including those related to financial derivative instruments) that are undertaken for the scheme, bearing in mind the retail nature and risk profile of the scheme and (ii) be able to deal with normal and exceptional circumstances including extreme market conditions. The management

company must maintain at all times effective risk management and control systems;

(2) at all times be adequately and suitably resourced (including having sufficient human resources) in order to properly implement its risk management policy and procedures;

(3) maintain and implement effective liquidity risk management policies and procedures (including stress testing, where applicable) to monitor the liquidity risk of the scheme, taking into account factors including the investment strategy and objectives, investor base, liquidity profile, underlying obligations and redemption policy of the scheme;

(4) maintain and implement effective internal policies and procedures in assessing the credit risk of securities or instruments invested by the scheme. External ratings shall only be one of the factors to take into consideration in assessing the credit quality of an instrument. Mechanistic reliance on external ratings should be avoided; and

(5) comply with all applicable legal and regulatory requirements concerning the risk management of a scheme.

(g) ensure the scheme is designed fairly, and operated according to such product design on an ongoing basis, including, among others, managing the scheme in a cost-efficient manner taking into account the size of the scheme and the level of fees and expenses etc.

Retirement of a management company

5.11 The management company must be subject to removal by notice in writing from the trustee or the directors of a mutual fund corporation in any of the following events:-

(a) the management company goes into liquidation, becomes bankrupt or has a receiver appointed over its assets; or

(b) for good and sufficient reason, the trustee or the directors of a mutual fund corporation state in writing that a change in management company is desirable in the interests of the holders; or

(c) in the case of a unit trust, holders representing at least 50% in value of the units outstanding ~~(excluding those held or deemed to be held by the management company)~~, deliver to the trustee a written request to dismiss the management company.

5.12 In addition, the management company must retire:-

(a) in all other cases provided for in the constitutive documents; or

(b) when the Commission withdraws its approval of the management company.

5.13 The Commission must be informed by the trustee or the directors of a mutual fund corporation of any decision to remove the management company.

5.14 Upon the retirement or dismissal of the management company, the trustee or the directors of a mutual fund corporation must appoint a new management company as soon as possible, subject to the approval of the Commission.

Appointment of the auditor

5.15 The management company or the directors of a mutual fund corporation must, at the outset and upon any vacancy, appoint an auditor for the scheme.

5.16 The auditor must be independent of the management company, the trustee/custodian, and, in the case of a mutual fund corporation, the directors.

5.17 The management company must cause the scheme's annual report to be audited by the auditor, and such report should contain the information in Appendix E.

Chapter 6: Operational requirements

Scheme documentation

Matters to be disclosed in offering document

6.1 Authorized schemes must issue an up-to-date offering document, which should contain the information necessary for investors to be able to make an informed judgement of the investment proposed to them, and in particular should contain the information listed in Appendix C.

Note: Provided that the Commission is satisfied that the overall disclosure of required information is clear, a scheme may supplement an overseas offering document with a Hong Kong Covering Document. The Commission however specifically encourages the use of a short, clearly written Hong Kong Offering Document.

English and Chinese offering documents

6.2 Except as provided herein, the information required in Appendix C must be provided in the English and Chinese languages. The Commission may waive the requirement that the information be provided in both languages on a case by case basis where the management company satisfies the Commission that the scheme will only be offered to persons who are fully conversant in the language in which it is intended to publish the information.

Product KFS

6.2A An authorized scheme must issue a Product KFS. Such statement shall be deemed to form a part of the offering document and shall contain information that enables investors to comprehend the key features and risks of the scheme.

Notes: (1) The Commission may, on an exceptional basis, allow the Product KFS not to be deemed to form a part of the offering documents of certain foreign schemes, on the basis of overriding legal requirements of the home jurisdiction.

(2) Illustrative templates of the Product KFS are available on the Commission's website.

Accompaniment to offering document

6.3 The offering document must be accompanied by the scheme's most recent audited annual report ~~and accounts~~ together with its ~~semi-annual~~interim report if published after the annual report.

Application form

6.4 No application form may be ~~supplied~~ provided to any ~~person not a holder~~member of the public unless it is accompanied by the offering document~~, except that an advertisement or report containing all the requirements of Appendix C may be allowed to incorporate an application form~~.

Inclusion of performance data

6.5 If performance data or estimated yield is quoted, the Commission may require supporting documentation. No forecast of the scheme's performance may be made. The publication of a prospective yield does not constitute a forecast of performance.

Contents of constitutive documents

6.6 The constitutive documents of a scheme should contain the information listed in Appendix D. Nothing in the constitutive documents may provide that the trustee/custodian, management company or directors of the scheme can be exempted from any liability to holders imposed under Hong Kong law or the law of the scheme's place of domicile or breaches of trust through fraud or negligence, nor may they be indemnified against such liability by holders or at holders' expense.

Changes to scheme documentation

6.7 The constitutive documents may be altered by the management company and trustee/custodian, without consulting holders, provided that the trustee/custodian certifies in writing that in its opinion the proposed alteration:~~-~~

(a) is necessary to make possible compliance with fiscal or other statutory, regulatory or official requirements; or

(b) does not materially prejudice holders' interests, does not to any material extent release the trustee/custodian, management company or any other person from any liability to holders and does not increase the costs and charges payable from the scheme property; or

(c) is necessary to correct a manifest error.

In all other cases involving any material changes, no alteration may be made except by a special or extraordinary resolution of holders or the approval of the Commission.

Member register

6.8 The scheme, or in the case of a unit trust, the trustee or the person so appointed by the trustee must maintain a register of holders. The Commission must be advised on request of the address(es) where the register is kept.

~~Investment plans~~

6.9 ~~If investment plans are offered:-~~ [deleted]

~~(a) before contracting for a plan, a prospective planholder must be given full details in writing of his rights and obligations, of all costs and charges levied on planholders and of the consequences of terminating his plan;~~

~~(b) unless he has requested to the contrary, each planholder must be advised at least once every quarter of the opening balance of units, latest transaction details and closing balance of units;~~

~~(c) the plan must include a direction to potential investors that they should refer to the offering document of the scheme to which they are considering linking their plan;~~

~~(d) an investment plan leaflet to be distributed in Hong Kong must not solicit investment in schemes which have not been authorized by the Commission; and~~

~~(e) in respect of any increase of initial fee of investment plans up to the maximum permitted level, no less than one month's prior notice must be given to holders concerned.~~

Pricing, issue ~~&~~and redemption of units/shares

Initial offers

6.10 If an initial offer is made, no investment of subscription money can be made until the conclusion of the first issue of units/shares at the initial price.

Valuation ~~&~~and pricing

6.11 Offer and redemption prices should be calculated on the basis of the scheme's net asset value divided by the number of units/shares outstanding. Such prices should fairly reflect the value of a scheme's assets and may be adjusted by fees and charges, provided the amount or method of calculating such fees and charges is clearly disclosed in the offering document.

6.11A The management company should establish appropriate policies and procedures for independent valuation of each type of assets held by a scheme in consultation with the trustee/custodian. Such policies and procedures should seek to detect, prevent and correct pricing errors and be consistently applied. The management company should review the valuation policies and procedures on a periodic basis to ensure their continued appropriateness and effective implementation. The valuation policies and procedures and the valuation process should be reviewed by an independent third party at least annually.

Notes: (1) Where fair value adjustments are necessary in view that market value of a scheme's assets is unavailable, or reasonably considered to be not reliable or reflective of an exit price upon current sale, the management company shall conduct such adjustments with due skill, care and diligence, and in good faith, in consultation with trustee/custodian.

(2) The management company must comply with all applicable legal and regulatory requirements in respect of the valuation of a scheme's assets.

(3) For the purpose of satisfying the requirement on independent review of valuation policies and procedures and the valuation process, the management company shall prepare the annual report of a scheme in a manner in accordance with 5.17, 11.6, 11.6A and Appendix E.

6.11B Assets of a scheme should be valued on a regular basis and in any event, on the days that the scheme's units/shares are offered or redeemed in accordance with the

constitutive documents. Valuation frequency and the basis of valuation of a scheme's assets should be clearly disclosed in the offering document.

6.11C Where a third party is engaged in the valuation of a scheme, the management company shall exercise reasonable care and diligence in the selection, appointment and ongoing monitoring of such third party in ensuring such entity possesses the appropriate level of knowledge, experience and resources that commensurate with the appropriate valuation policies and procedures for each scheme. The valuation activities of such third party should be subject to ongoing supervision and periodic review by the management company.

Valuation of unquoted securities

6.12 The value of investments not listed or quoted on a recognized market should be determined on a regular basis by a professional person approved by the trustee/custodian as qualified to value such investments. Such professional person may, with the approval of the trustee/custodian, be the management company.

Dealing

6.13 There must be at least one regular dealing day per month except for a closed-ended fund authorized pursuant to 8.11 of this UT Code. Any offer price which the management company or the distribution company quotes or publishes must be the maximum price payable on purchase and any redemption price must be the net price receivable on redemption.

Notes: (1) The management company should ensure that it sets a dealing frequency for units/shares in the scheme which is appropriate for its investment objectives and approach, taking into account its liquidity risk management process that enables effective processing of redemptions and other payment obligations. The management company should give due consideration to the structure of the scheme and the appropriateness of the dealing frequency having regard to, among others, the investor base, investment objectives and strategy and also the nature and expected liquidity of the underlying assets of the scheme.

(2) Subscription or redemption of a scheme's units/shares must be effected on the basis of an unknown/forward price to ensure incoming, existing and outgoing investors are treated fairly and equitably.

6.14 The maximum interval between the receipt of a properly documented request for redemption of units/shares and the payment of the redemption money to the holder may not exceed one calendar month unless the market(s) in which a substantial portion of investments is made is subject to legal or regulatory requirements (such as foreign currency controls) thus rendering the payment of the redemption money within the aforesaid time period not practicable. In such case, the extended time frame for the payment of redemption money shall reflect the additional time needed in light of the specific circumstances in the relevant market(s).

Meetings

6.15 A scheme should arrange to conduct general meetings of holders as follows:-

(a) Holders must be able to appoint proxies;

(b) Votes should be proportionate to the number of units/shares held or to the value of units/shares held where there are accumulation units/shares;

(c) The quorum for meetings at which a special or extraordinary resolution is to be considered should be the holders of 25% of the units or shares in issue and 10% if only an ordinary resolution is to be considered;

(d) If within half an hour from the time appointed for the meeting a quorum is not present, the meeting should be adjourned for not less than 15 days. The quorum at an adjourned meeting will be those holders present at the adjourned meeting in person or by proxy;

(e) If the possibility exists of a conflict of interest between different classes of holders there should be provision for class meetings;

(f) ~~An Extraordinary G~~general ~~M~~meeting should be called for the following purposes:

(i) to modify, alter or add to the constitutive documents, except as provided in 6.7; or

(ii) to terminate the scheme (unless the means of termination of the scheme are set out in the constitutive documents, in which case termination must be effected as required) [see D17 of Appendix D];

(iii) ~~to increase the maximum fees paid to the management company, trustee/custodian or directors of the scheme; or~~[deleted]

(iv) ~~to impose other types of fees.~~[deleted]

(g) ~~Where bearer units are in issue, provision must be made for notification to bearer holders in Hong Kong of the timing and agenda of forthcoming meetings and voting arrangements;~~[deleted]

(h) The directors of the scheme, the trustee/custodian, the management company, investment ~~adviser~~ delegate and any of their connected persons must be prohibited from voting their beneficially owned shares at, or counted in the quorum for, a meeting at which they have a material interest in the business to be contracted;

Note: For the purposes of 6.15(h), the management company and its connected persons are entitled to vote their beneficially owned units/shares on any resolution(s) to appoint or dismiss the management company and be counted for the purpose of passing such resolution(s) at the meeting.

(i) An ordinary resolution may be passed by a simple majority of the votes of those present and entitled to vote in person or by proxy at a duly convened meeting; and

(j) A special or extraordinary resolution may only be passed by 75% or more of the votes of those present and entitled to vote in person or by proxy at a duly convened meeting.

Note: For the avoidance of doubt, any general meeting at which a special resolution is to be proposed shall be convened on at least 21 days' prior notice and that any general meeting at which an ordinary resolution is to be proposed shall be convened on at least 14 days' prior notice.

Fees

6.16 The level/basis of calculation of all costs and charges payable from the scheme's property must be clearly stated, with percentages expressed on a per annum basis [see C14 of Appendix C]. The aggregate level of fees for investment management ~~or advisory~~ function~~s~~ should also be disclosed.

~~*Note: Percentage-based transaction fees payable to the management company or any of its connected persons may be disallowed as inconsistent with the management company's fiduciary responsibility.*~~

6.17 If a performance fee is levied, clear disclosure of the calculation methodology must be set out in the offering document. Performance fee should be calculated in a manner that is objective, verifiable and unambiguous to enable investors to obtain a fair and proportionate share of the investment return of scheme. ~~the~~Performance fee can only be payable:~~-~~

(a) no more frequently than annually; and

(b) if the net asset value per unit/share exceeds the net asset value per unit/share on which the performance fee was last calculated and paid (i.e. on a "high-on-high" basis). The basis of calculation of net asset value per unit/share used for performance fee calculation should be consistently applied.

Notes: (1) Notwithstanding 6.17(b), the performance fee may also be calculated with reference to the performance of a benchmark or an asset class and the performance fee is only payable upon outperformance of the net asset value per unit/share (net of all other fees and expenses charged) vis-à-vis that of the benchmark or asset class.

(2) Various methodologies may be used for the charging and accrual of performance fees based on the basic principle in 6.17. The Commission may require illustrative examples to be given in the offering document to demonstrate the charging method where it considers appropriate.

(3) Where a scheme intends to achieve equalisation for the calculation of performance fees, its offering document must disclose the mechanism adopted to achieve equalisation.

(4) Where a scheme does not intend to achieve equalisation of performance fees, its offering document must clearly disclose this fact and how the absence of equalisation may affect the amount of performance fees to be borne by investors.

6.18 The following fees, costs and charges must not be paid from the scheme's property:-

(a) commissions payable to sales agents arising out of any dealing in units/shares of the scheme;

(b) expenses arising out of any advertising or promotional activities in connection with the scheme;

(c) expenses which are not ordinarily paid from the property of schemes authorized in Hong Kong; and

(d) expenses which have not been disclosed in the constitutive documents as required by D10 of Appendix D.

Chapter 7: Investment: core requirements

This Chapter sets out the core requirements of the investment limitations and prohibitions of a ~~collective investment~~ scheme. ~~, other than a~~A specialized scheme under Chapter 8 shall also comply with the core requirements in this Chapter subject to any modifications, exemptions or additions as set out in Chapter 8.

Spread of ~~Investments~~investments

7.1 The aggregate value of a scheme's ~~holding of securities issued by~~investments in, or exposure to, any single ~~issuer~~ entity through the following may not exceed 10% of its total net asset value:~~.~~

(a) investments in securities issued by that entity;

(b) exposure to that entity through underlying assets of financial derivative instruments [see 7.27]; and

(c) net counterparty exposure to that entity arising from transactions of over-the-counter financial derivative instruments [see 7.28(c)].

Notes: (1) ~~An issuer of investments based on an underlying security (such as an issuer of covered warrants) is treated separately from an issuer of the underlying security, provided that the 10% restriction applicable to any single issuer is not exceeded if and when any rights of convertibility are exercised.~~[deleted]

(2) ~~A waiver of this section can be considered on a case-by-case basis for a scheme whose sole objective is to track an index with constituent stocks exceeding 10%.~~[deleted]

(3) For the avoidance of doubt, restrictions and limitations on counterparty as set out in 7.1, 7.1A and 7.28(c) will not apply to financial derivative instruments that are:

(a) transacted on an exchange where the clearing house performs a central counterparty role; and

(b) marked-to-market daily in the valuation of their financial derivative instrument positions and subject to margining requirements at least on a daily basis.

(4) 7.1 will also apply in the case of 7.36(e), 7.36(j) and Note to 7.39(a).

7.1A Subject to 7.1 and 7.28(c), the aggregate value of a scheme's investments in, or exposure to, entities within the same group through the following may not exceed 20% of its total net asset value:

(a) investments in securities issued by those entities;

(b) exposure to those entities through underlying assets of financial derivative instruments [see 7.27]; and

(c) net counterparty exposure to those entities arising from transactions of over-the-counter financial derivative instruments [see 7.28(c)].

Notes: (1) For the purposes of 7.1A and 7.1B, entities which are included in the same group for the purposes of consolidated financial statements prepared in accordance with internationally recognized accounting standards are generally regarded as "entities within the same group".

(2) 7.1A will also apply in the case of 7.36(e), 7.36(j) and Note to 7.39(a).

7.1B The value of a scheme's cash deposits made with the same entity or entities within the same group [see Note(1) to 7.1A] may not exceed 20% of its total net asset value.

Notes: (1) For the purposes of 7.1B, cash deposits generally refer to those that are repayable on demand or have the right to be withdrawn by the scheme and not referable to provision of property or services.

(2) The cash deposits made with the same entity or entities within the same group may exceed the prescribed 20% limit in the following circumstances:

(a) cash held before the launch of a scheme; or

(b) cash proceeds from liquidation of investments prior to the merger or termination of a scheme, whereby the placing of cash deposits with various financial institutions would not be in the best interests of investors.

7.2 A scheme may not hold more than 10% of any ordinary shares issued by any single ~~issuer~~entity.

7.3 The value of a scheme's ~~holding of~~investments in securities that cannot be readily converted into cash at limited cost in an adequately short timeframe thereby impairing the scheme's ability in satisfying its redemption and other payment obligations (including securities that are neither listed, quoted nor dealt in on a market) may not exceed 15% of its total net asset value.

Note: Market means any stock exchange, over-the-counter market or other organized securities market that is open to the international public and on which such securities are regularly traded.

7.3A Notwithstanding 7.1, 7.1A, 7.2, and 7.3, where direct investment by a scheme in a market is not in the best interests of investors, a scheme may invest through a wholly-owned subsidiary company established solely for the purpose of making direct investments in such market. In this case:-

(a) the underlying investments of the subsidiary, together with the direct investments made by the scheme, must in aggregate comply with the requirements of this Chapter;

(b) any increase in the overall fees and charges directly or indirectly borne by the holders or the scheme as a result must be clearly disclosed in the offering document; and

(c) the scheme must produce the reports required by 5.10(b) in a consolidated form to include the assets (including investment portfolio) and liabilities of the subsidiary company as part of those of the scheme.

Government and other public securities

7.4 Notwithstanding 7.1, 7.1A and 7.2, up to 30% of a scheme's total net asset value may be invested in Government and other public securities of the same issue.

7.5 Subject to 7.4, a scheme may invest all of its assets in Government and other public securities in at least six different issues.

Notes: (1) "Government and other public securities" means any investment issued by, or the payment of principal and interest on, which is guaranteed by ~~the~~ a government ~~of any member state of the Organization for Economic Co-operation and Development (OECD) or any fixed interest investment issued in any OECD country by a public or local authority or nationalized industry of any OECD country or anywhere in the world by any other body which is, in the opinion of the trustee/custodian, of similar standing.~~, or any fixed-interest investment issued by its public or local authorities.

(2) Government and other public securities will be regarded as being of a different issue if, even though they are issued by the same person, they are issued on different terms whether as to repayment dates, interest rates, the identity of the guarantor, or otherwise.

~~*Warrants and options*~~

7.6 ~~(a) A scheme may invest in options and warrants for hedging purposes.~~[deleted]

~~(b) In addition to (a) above, the value of a scheme's investment in warrants and options not held for hedging purposes in terms of the total amount of premium paid may not exceed 15% of its total net asset value.~~

7.7 ~~The writing of uncovered options is prohibited.~~[deleted]

7.8 ~~The writing of call options on portfolio investments may not exceed 25% of a scheme's total net asset value in terms of exercise price.~~[deleted]

~~*Futures and commodities*~~*Commodities*

7.9 ~~A scheme may enter into financial futures contracts for hedging purposes.~~[deleted]

7.10 ~~In addition to 7.9, a scheme may enter into futures contracts on an unhedged basis provided that the net total aggregate value of contract prices, whether payable to or by the scheme under all outstanding futures contracts, together with the aggregate value of~~ A scheme may not invest in~~holdings of~~ physical commodities ~~and commodity based investments may not exceed 20% of the total net asset value of the scheme~~unless otherwise approved by the Commission on a case-by-case basis taking into account the liquidity of the physical commodities concerned and availability of sufficient and appropriate additional safeguards where necessary.

Notes: (1) *~~"physical commodities" includes gold, silver, platinum or other bullion.~~[deleted]*

(2) *~~"commodity based investments" does not include shares in companies engaged in producing, processing or trading in commodities.~~[deleted]*

Investment in other schemes

The following provisions govern the spread of investments in other collective investment schemes. 7.1, 7.1A, 7.2 and 7.3~~,~~ are not applicable to such investments, unless otherwise stated.

Note: For the avoidance of doubt, exchange traded funds that are:

(i) authorized by the Commission under 8.6 or 8.10 of this UT Code; or

(ii) listed and regularly traded on internationally recognized stock exchanges open to the public (nominal listing not accepted) and:

- *the principal objective of which is to track, replicate or correspond to a financial index or benchmark, which complies with the applicable requirements under 8.6 of this UT Code; or*

- *the investment objective, policy, underlying investments and product features of which are substantially in line with or comparable with those set out under 8.10 of this UT Code,*

may either be considered and treated as (a) listed securities for the purposes of and subject to the requirements in 7.1, 7.1A and 7.2; or (b) collective investment schemes for the purposes of and subject to the requirements in 7.11, 7.11A and 7.11B. However, the investments in exchange traded funds shall be subject to 7.3 and the relevant investment limits in exchange traded funds by a scheme should be consistently applied and clearly disclosed in the offering document of a scheme.

7.11 The value of a scheme's ~~holding of~~investment in units or shares in other collective investment schemes (namely, "underlying schemes") which are ~~non-recognized jurisdiction schemes and~~ not authorized by the Commission or not eligible schemes [see Note to 7.11A] may not in aggregate exceed 10% of its total net asset value.

7.11A A scheme may invest in one or more underlying schemes which are either ~~recognized jurisdiction schemes or schemes~~ authorized by the Commission or eligible schemes. The value of a scheme's ~~holding of~~investment in units or shares in each such underlying scheme may not exceed 30% of its total net asset value, unless the underlying scheme is authorized by the Commission, and the name and key investment information of the underlying scheme are disclosed in the offering document of the scheme.

Note: The Commission has set out the eligible schemes for investment pursuant to 7.11A in the list of ~~recognised~~ recognized jurisdictions ~~those categories of recognised jurisdiction schemes that are eligible for investment pursuant to 7.11A~~.

7.11B In addition, each underlying scheme's objective may not be to invest primarily in any investment prohibited by this Chapter, and where such scheme's objective is to invest primarily in investments restricted by this Chapter, such ~~holdings~~ investments may not be in contravention of the relevant limitation.

Notes: (1) ~~*Where a scheme exclusively invests in underlying schemes, it shall comply with the provisions in 8.1.*~~*[deleted]*

(2) The Commission generally does not require the management company to adopt a "see-through" approach in their investments in underlying schemes, except in the case where the underlying schemes are managed by the same management company as that of the scheme that invests in them, or by other companies within the same group that the management company belongs to, then 7.1, 7.1A, 7.2 and 7.3 are also applicable to investments of the underlying schemes.

(3) For the avoidance of doubt, a scheme may invest in scheme(s) authorized by the Commission under Chapter 8 (except for hedge funds under 8.7 of this UT Code), eligible scheme(s) [see 7.11A] of which the global exposure calculated under the commitment approach [see Note to 7.26] relating to financial derivative instruments does not exceed 100% of its total net asset value, and exchange traded funds satisfying the requirements in the Note under "Investment in other schemes" of this Chapter in compliance with 7.11 and 7.11A.

(4) An underlying scheme may not invest more than 10% of its total net asset value in other collective investment scheme(s), whether individually or on an aggregate basis.

Limitation on charges

7.11C Where a scheme invests in any underlying scheme(s) managed by the same management company or its connected persons, all initial charges and redemption charges on the underlying scheme(s) must be waived.

7.11D The management company of a scheme or any person acting on behalf of the scheme or the management company may not obtain a rebate on any fees or charges levied by an underlying scheme or its management company, or any quantifiable monetary benefits in connection with investments in any underlying scheme.

Feeder fund

7.12 ~~Notwithstanding 7.11, a~~A scheme may invest ~~all of~~ 90% or more of its total net asset~~s~~ value in a single collective investment scheme and will ~~and~~ be authorized as a feeder fund. In this case:~~-~~

(a) the underlying scheme ("master fund") must be authorized by the Commission;

(b) the offering document must state that:

(i) the scheme is a feeder fund into the ~~underlying scheme~~master fund;

(ii) for the purpose of complying with the investment restrictions, the ~~scheme~~ feeder fund and its ~~underlying~~ master fund will be deemed a single entity;

(iii) the ~~scheme's~~ feeder fund's annual report must include the investment portfolio of the ~~underlying~~ master fund as at the financial year end date; and

(iv) the aggregate amount of all the fees and charges of the ~~scheme~~ feeder fund and its ~~underlying~~ master fund must be clearly disclosed;

(c) ~~the borrowing of the feeder fund may not exceed 10% of its total net asset value and should be restricted to facilitating redemptions or defraying operating expenses; and~~[deleted]

(d) no increase in the overall total of initial charges, redemption charges, management company's annual fee, or any other costs and charges payable to the management company or any of its connected persons borne by the holders or by the ~~scheme~~ feeder fund may result, if the ~~schemes~~ master fund in which ~~a scheme~~the feeder fund invests ~~are~~is managed by the same management company or by a connected person of that company~~.~~; and

Note: The SFC may consider on a case-by-case basis allowing additional fees to be payable to the management company or its connected persons in respect of additional or different services and expertise provided by the management company or its connected persons for the benefit of the scheme.

(e) notwithstanding Note(4) to 7.11B, the master fund may invest in other collective investment scheme(s) subject to the investment restrictions as set out in 7.11, 7.11A and 7.11B.

7.13 [deleted]

Prohibition on real estate investments

7.14 A scheme may not invest in any type of real estate (including buildings) or interests in real estate (including options or rights, but excluding shares in real estate companies and interests in real estate investment trusts (REITs)).

Note: In the case of investments in such shares and REITs, they shall comply with the investment limits as set out in 7.1, 7.1A, 7.2, 7.3 and 7.11, where applicable. For the avoidance of doubt, where investments are made in listed REITs, 7.1, 7.1A and 7.2 apply and where investments are made in unlisted REITs, which are either companies or collective investment schemes, then 7.3 and 7.11 apply respectively.

Short selling limitations

7.15 No short sale may be made which will result in the scheme's liability to deliver securities exceeding 10% of its total net asset value.

Note: For the avoidance of doubt, a scheme is prohibited to carry out any naked or uncovered short sale of securities and short selling should be carried out in accordance with all applicable laws and regulations.

7.16 The security which is to be sold short must be actively traded on a market where short selling activity is permitted [see Note to 7.3].

Limitations on making loans

7.17 A scheme may not lend, assume, guarantee, endorse or otherwise become directly or contingently liable for or in connection with any obligation or indebtedness of any person ~~without the prior written consent of the trustee/custodian~~.

Note: For the avoidance of doubt, reverse repurchase transactions in compliance with the requirements as set out in 7.32 to 7.35 are not subject to the limitations in 7.17.

Unlimited liability

7.18 A scheme may not acquire any asset or engage in any transaction which involves the assumption of any liability which is unlimited.

Limited liability

7.18A The liability of holders must be limited to their investments in the scheme.

Limitations on securities in which directors/officers have interests

7.19 A scheme may not invest in any security of any class in any company or body if any director or officer of the management company individually owns more than 0.5% of the total nominal amount of all the issued securities of that class, or, collectively the directors and officers of the management company own more than 5% of those securities.

Limitations on nil-paid/partly paid securities

7.20 The portfolio of a scheme may not include any security where a call is to be made for any sum unpaid on that security unless that call could be met in full out of cash or near cash by the scheme's portfolio~~, the amount of which has not already been taken into account for the purposes of 7.8~~ whereby such amount of cash or near cash has not been segregated to cover a future or contingent commitment arising from transaction in financial derivative instruments for the purposes of 7.29 and 7.30.

Limitations on borrowing

7.21 The maximum borrowing of a scheme may not exceed ~~25~~10% of its total net asset value ~~(except for a capital markets scheme which may not exceed 10%)~~. For the purposes of ~~this section of this UT Code~~7.21, back-to-back loans do not count as borrowing.

Note: For the avoidance of doubt, securities lending transactions and sale and repurchase transactions in compliance with the requirements as set out in 7.32 to 7.35 are not subject to the limitations in 7.21.

~~*Applicability of restrictions to umbrella funds*~~

7.22 ~~The provisions of this Chapter apply to each sub-fund of the umbrella fund as if each sub-fund were a single scheme, except for 7.2, where the total collective investment by the sub-funds in any ordinary shares issued by any single issuer may not exceed 10%.~~[restated in 7.40]

~~*Breach of investment limits*~~

7.23 ~~If the investment limits in Chapter 7 and 8 are breached, the management company should take as a priority objective all steps as are necessary within a reasonable period of time to remedy the situation, taking due account of the interests of the holders.~~[restated in 7.41]

~~*Name of scheme*~~

7.24 ~~If the name of the scheme indicates a particular objective, geographic region or market, the scheme should invest at least 70% of its non-cash assets in securities and other investments to reflect the particular objective or geographic region or market which the scheme represents.~~[amended and restated in 7.42]

Financial derivative instruments

7.25 A scheme may acquire financial derivative instruments for hedging purposes.

Notes: (1) For the purposes of 7.25, financial derivative instruments are generally considered as being acquired for hedging purposes if they meet all the following criteria:

(a) they are not aimed at generating any investment return;

(b) they are solely intended for the purpose of limiting, offsetting or eliminating the probability of loss or risks arising from the investments being hedged;

(c) although they may not necessarily reference to the same underlying assets, they should relate to the same asset class with high correlation in terms of risks and return, and involve taking opposite positions, in respect of the investments being hedged; and

(d) they exhibit price movements with high negative correlation with the investments being hedged under normal market conditions.

(2) Hedging arrangement should be adjusted or re-positioned, where necessary and with due consideration on the fees, expenses and costs, to enable the scheme to meet its hedging objective in stressed or extreme market conditions.

7.26 A scheme may also acquire financial derivative instruments for non-hedging purposes ("investment purposes") subject to the limit that the scheme's global exposure relating to these financial derivative instruments does not exceed 50% of its total net asset value.

Note: For the purpose of calculating global exposure, the commitment approach shall be used, whereby the positions of financial derivative instruments acquired by a scheme for investment purposes are converted into the equivalent position in the underlying assets of the financial derivative instruments, taking into account the prevailing market value of the underlying assets, the counterparty risk, future market movements and the time available to liquidate the position. For the avoidance of doubt, financial derivative instruments acquired for hedging purposes under 7.25 will not be counted towards the 50% limit referred to in 7.26 so long as there is no residual global exposure calculated under the commitment approach arising from such hedging arrangement.

7.27 Subject to 7.26, a scheme may invest in financial derivative instruments provided that the exposure to the underlying assets of the financial derivative instruments, together with the other investments of the scheme, may not in aggregate exceed the corresponding investment restrictions or limitations applicable to such underlying assets and investments as set out in 7.1, 7.1A, 7.1B, 7.4, 7.5, 7.11, 7.11A, 7.11B and 7.14.

7.28 The financial derivative instruments invested by a scheme may be either listed/quoted on a stock exchange or dealt in over-the-counter market, provided that:

(a) the underlying assets consist solely of shares in companies, debt securities, money market instruments, units/shares of collective investment schemes, deposits with substantial financial institutions, government and other public securities, highly-liquid physical commodities, financial indices, interest rates, foreign exchange rates, currencies, or other asset classes acceptable to the Commission, in which the scheme may invest according to its investment objectives and policies;

Notes: (1) "Highly-liquid physical commodities" includes gold, silver, platinum and crude oil.

(2) Where a scheme invests in index-based financial derivative instruments, the underlying assets of such financial derivative instruments are not required to be aggregated for the purposes of the investment restrictions or limitations set out in 7.1, 7.1A and 7.1B.

(b) the counterparties to transactions of over-the-counter financial derivative instruments or their guarantors are substantial financial institutions;

Note: The Commission may consider to accept other entity falling outside the definition of "substantial financial institution" on a case-by-case basis taking into account factors such as the regulatory status of the entity or the group to which it belongs and the net asset value of the entity.

(c) subject to 7.1 and 7.1A, the scheme's net exposure to a single counterparty of over-the-counter financial derivative instruments may not exceed 10% of the net asset value of the scheme [see 7.36]; and

Note: Exposure to a counterparty of over-the-counter financial derivative instruments should be measured based on the maximum potential loss that may be incurred by the scheme and should be calculated with reference to the positive mark to market value of the over-the-counter derivative instruments with that counterparty, if applicable. Such

exposure may be lowered by the collateral received by the scheme in respect of transactions on the over-the-counter financial derivative instruments entered between the scheme and such counterparty.

(d) the valuation of the financial derivative instruments is marked-to-market daily, subject to regular, reliable and verifiable valuation conducted by the management company or the trustee/custodian or their nominee(s), agent(s) or delegate(s) independent of the issuer of the financial derivative instruments through measures such as the establishment of a valuation committee or engagement of third party services. The financial derivative instruments can be sold, liquidated or closed by an offsetting transaction at any time at their fair value at the scheme's initiative. Further, calculation agent/fund administrator should be adequately equipped with the necessary resources to conduct independent marked-to-market valuation and to verify the valuation of the financial derivative instruments on a regular basis.

Cover

7.29 A scheme should at all times be capable of meeting all its payment and delivery obligations incurred under transactions in financial derivative instruments (whether for hedging or for investment purposes). The management company should, as part of its risk management process, monitor to ensure that the transactions in financial derivative instruments are adequately covered on an ongoing basis.

Note: For the purposes of 7.29, assets that are used to cover the scheme's payment and delivery obligations incurred under transactions in financial derivative instruments should be free from any liens and encumbrances, exclude any cash or near cash for the purpose of meeting a call on any sum unpaid on a security [see 7.20], and cannot be applied for any other purposes.

7.30 Subject to 7.29, a transaction in financial derivative instruments which gives rise to a future commitment or contingent commitment of a scheme should be covered as follows:

(a) in the case of financial derivative instruments transactions which will, or may at the scheme's discretion, be cash settled, the scheme should at all times hold sufficient assets that can be liquidated within a short timeframe to meet the payment obligation; and

(b) in the case of financial derivative instruments transactions which will, or may at the counterparty's discretion, require physical delivery of the underlying assets, the scheme should hold the underlying assets in sufficient quantity at all times to meet the delivery obligation. If the management company considers the underlying assets to be liquid and tradable, the scheme may hold other alternative assets in sufficient quantity as cover, provided that such assets may be readily converted into the underlying assets at any time to meet the delivery obligation.

Note: In the case of holding alternative assets as cover, the scheme should apply safeguard measures such as to apply haircut where appropriate to ensure that such alternative assets held are sufficient to meet its future obligations.

Embedded financial derivatives

7.31 Where a financial instrument embeds a financial derivative, 7.25 to 7.30 will also apply to the embedded financial derivative.

Note: An embedded financial derivative is a financial derivative instrument that is embedded in another security, namely the host contract.

Securities financing transactions

7.32 A scheme may engage in securities lending, sale and repurchase and reverse repurchase transactions (collectively, "securities financing transactions"), provided that they are in the best interests of holders to do so and the associated risks have been properly mitigated and addressed.

Note: The counterparties to securities financing transactions should be subject to the same requirement for the counterparties to over-the-counter financial derivative transactions or their guarantor under 7.28(b).

7.33 A scheme should have at least 100% collateralization in respect of the securities financing transaction(s) into which it enters to ensure there is no uncollateralized counterparty risk exposure arising from these transactions [see 7.36].

7.34 All the revenues arising from securities financing transactions, net of direct and indirect expenses as reasonable and normal compensation for the services rendered in the context of the securities financing transactions, should be returned to the scheme.

7.35 A scheme should ensure that:

(a) it is able at any time to recall the securities or the full amount of cash (as the case may be) subject to the securities financing transaction(s) or terminate the securities financing transaction(s) into which it has entered; and

(b) indemnification is provided by securities lending agents to protect the scheme against counterparty default.

Collateral

The following provisions apply to the collateral held by a scheme.

Note: For the avoidance of doubt, the invested assets under an unfunded swap structure should be treated as collateral and subject to the requirements in 7.36 to 7.38.

7.36 To limit the exposure to each counterparty as set out in 7.28(c) and 7.33, a scheme may receive collateral from such counterparty, provided that the collateral complies with the requirements set out below:

(a) Liquidity – collateral must be sufficiently liquid and tradable in order that it can be sold quickly at a robust price that is close to pre-sale valuation. Collateral should normally trade in a deep and liquid marketplace with transparent pricing;

(b) Valuation – collateral should be marked-to-market daily by using independent pricing source;

(c) Credit quality – asset used as collateral must be of high credit quality and should be replaced immediately as soon as the credit quality of the collateral or the issuer of the asset being used as collateral has deteriorated to such a degree that it would undermine the effectiveness of the collateral;

(d) Haircut – collateral should be subject to prudent haircut policy;

Note: Haircuts should be based on the market risks of the assets used as collateral in order to cover potential maximum expected decline in collateral values during liquidation before a transaction can be closed out with due consideration on stress period and volatile markets. The price volatility of the asset used as collateral should be taken into account when devising the haircut policy. Other specific characteristics of the collateral, including, among others, asset types, issuer creditworthiness, residual maturity, price sensitivity, optionality, expected liquidity in stressed period, impact from foreign exchange, and correlation between securities accepted as collateral and the securities involved in the transactions, should also be considered where appropriate.

(e) Diversification – collateral must be appropriately diversified so as to avoid concentrated exposure to any single entity and/or entities within the same group. The scheme's exposure to the issuer(s) of the collateral should be taken into account in compliance with the investment restrictions and limitations set out in 7.1, 7.1A, 7.1B, 7.4, 7.5, 7.11, 7.11A, 7.11B and 7.14;

Note: By way of illustration, the value of collateral and the scheme's other investments in, or exposure to, any single entity or entities within the same group may not exceed 10% or 20% of the scheme's net asset value respectively [see 7.1 and 7.1A]. Where the collateral is in the form of (i) cash; (ii) government and other public securities; (iii) collective investment schemes [see 7.36(l)]; and (iv) REITs, the applicable investment limitations and restrictions under (i) 7.1B; (ii) 7.4 and 7.5; (iii) 7.11, 7.11A and 7.11B; and (iv) 7.14 apply respectively, together with the scheme's other investments or exposure.

(f) Correlation – the value of the collateral should not have any significant correlation with the creditworthiness of the counterparty or the issuer of the financial derivative instruments, or the counterparty of securities financing transactions in such a way that would undermine the effectiveness of the collateral. As such, securities issued by the counterparty or the issuer of the financial derivative instruments, or the counterparty of securities financing transactions or any of their related entities should not be used as collateral;

(g) Management of operational and legal risks – the management company must have appropriate systems, operational capabilities and legal expertise for proper collateral management;

(h) Independent custody – collateral must be held by the trustee or custodian of the scheme;

(i) Enforceability – collateral must be readily accessible / enforceable by the trustee/custodian of the scheme without further recourse to the issuer of the financial derivative instruments, or the counterparty of the securities financing transactions;

(j) Re-investment of collateral – cash collateral received may only be reinvested in short-term deposits, high quality money market instruments and money market funds authorized under 8.2 of this UT Code or regulated in a manner generally comparable with the requirements of the Commission and acceptable to the Commission, and subject to corresponding investment restrictions or limitations applicable to such investments or exposure as set out in this Chapter [see 7.36(e)]. Non-cash collateral received may not be sold, re-invested or pledged;

Notes: (1) Money market instruments refer to securities normally dealt in on the money markets, for example, government bills, certificates of deposit, commercial papers, short-term notes and bankers' acceptances, etc. In assessing whether a money market instrument is of high quality, at a minimum, the credit quality and the liquidity profile of the money market instruments must be taken into account.

(2) The portfolio of assets from re-investment of cash collateral shall comply with the requirements as set out in 8.2(f) and 8.2(n).

(3) Cash collateral received is not allowed to be further engaged in any securities financing transactions.

(4) When the cash collateral received is reinvested into other investment(s), such investment(s) is/are not allowed to be engaged in any securities financing transactions.

(k) Collateral should be free of prior encumbrances; and

(l) Collateral generally should not include (i) structured products whose payouts rely on embedded financial derivatives or synthetic instruments; (ii) securities issued by special purpose vehicles, special investment vehicles or similar entities; (iii) securitized products; or (iv) unlisted collective investment schemes.

7.37 A scheme should disclose the information relating to its collateral policy as required under Appendix C.

7.38 A scheme shall disclose in the scheme's interim and annual reports a description of collateral holdings as required under Appendix E.

Guaranteed features

7.39 The following requirements apply to a scheme which contains a structure whereby a guaranteed amount will be paid to investors who invest in units/shares in the scheme at a specified date in the future (with or without conditions):

(a) The guarantor must be:

(i) a substantial financial institution; or

(ii) an authorized insurer authorized under the Insurance Ordinance.

Note: A scheme's net single counterparty exposure to the guarantor should be taken into account in compliance with the limits on single entity and/or entities within the same group under 7.1 and 7.1A respectively. In addition, the scheme's net single counterparty exposure to the guarantor may not exceed 10% of its net asset value at all times.

(b) Apart from the standard contents requirements in Appendix C, the offering document of the scheme must contain:

(i) Information about the guarantor

(1) its name;

(2) nature of its business; and

(3) information on its financial position, including paid-up share capital, total net assets or shareholders' funds, and where applicable, credit rating and any other relevant information.

(ii) Information about the guarantee

(1) the terms of the guarantee, including the scope and validity of the guarantee and the circumstances under which the guarantee may be terminated; and

Note: The offering document should contain a summary of the key terms and features of the guarantee.

(2) an illustration or description to clearly demonstrate the guarantee mechanism and how potential returns in excess of the guaranteed amount are calculated.

Notes: (1) Where an indicative participation rate is shown, the illustration should use the quoted indicative rate as the basis for calculation.

(2) Assumptions used in the illustration should be clearly stated. It should be stated that the rates of return shown are for illustrative purpose only and that the actual return may be different.

(iii) A detailed description of the nature of the underlying investments, including:

(1) the proposed percentage, or an estimate thereof, of the scheme to be invested in fixed-interest securities and that in other investments at the time of publication of the offering document;

(2) the issuers/counterparties of the underlying investments, or the criteria for the selection of such parties;

(3) the valuation methodology of the underlying investments;

(4) the liquidation mechanism of the underlying investments to meet redemption requests; and

(5) where relevant, the participation rate or an estimate thereof at the time of publication of the offering document. It should be stated that the actual participation rate may be different from the indicative rate. An analysis of the factors that will impact on the final determination of such rate should also be given.

Note: Where applicable, it should be stated when the actual participation rate will be determined and how such information will be communicated to investors.

(iv) Risk warnings, which should include, but not limited to:

(1) a statement to the effect that due to the guarantee structure, there will be a dilution of performance;

(2) a statement to the effect that potential returns in excess of the guaranteed amount are subject to investment risk and are not guaranteed;

(3) a statement to the effect that the scheme is subject to the credit risk of the guarantor and the issuers of the underlying investments;

(4) a statement to the effect that the scheme is subject to the liquidity risk of the underlying investments;

(5) risks, if any, associated with conflicts of interest that may arise amongst different operating parties;

(6) a warning statement that the scope or validity of the guarantee may be affected under certain circumstances including, where relevant, the condition that the guarantee only applies to investors who hold their investments until the date specified in the guarantee and that dealings before such date are fully exposed to fluctuations in the value of the scheme's assets; and

(7) where applicable, the mechanism of any up-front charging fee structure and the cost implications to investors.

(c) Nothing in the deed of guarantee may exclude the jurisdiction of the courts of Hong Kong to entertain an action concerning the scheme or the guarantee.

(d) The name of the scheme should accurately reflect the nature of the guarantee.

(e) The management company of the scheme should report to the Commission as soon as practicable if it becomes aware of any events which may affect the guarantee or undermine the ability of the guarantor to act as such.

Note: Where the guarantor of a scheme is neither a licensed banking institution authorized under the Banking Ordinance nor an authorized insurer authorized under the Insurance Ordinance, the management company of the scheme must notify the Commission on an annual basis the regulatory status of the guarantor.

(f) Any advertisement or marketing material must contain the following:

(i) the name of the guarantor;

(ii) where relevant, a statement that certain fees are charged up-front and the aggregate amount thereof;

(iii) where an indicative participation rate is quoted, the date of reference should be stated and there should be a warning that the actual participation rate may be different from the indicative rate;

(iv) the statement in 7.39(b)(iv)(6); and

(v) a statement directing investors to read the offering document for further details of the guarantee.

Applicability of restrictions to umbrella funds

7.40 The provisions of this Chapter apply to each sub-fund of the umbrella fund as if each sub-fund were a single scheme, except for 7.2, where the total collective investment by the sub-funds in any ordinary shares issued by any single entity may not exceed 10%.

Breach of investment limits

7.41 If the investment limits in Chapter 7 and 8 are breached, the management company should take as a priority objective all steps as are necessary within a reasonable period of time to remedy the situation, taking due account of the interests of the holders.

Name of scheme

7.42 If the name of the scheme indicates a particular objective, investment strategy, geographic region or market, the scheme should, under normal market circumstances, invest at least 70% of its total net asset value in securities and other investments to reflect the particular objective, investment strategy or geographic region or market which the scheme represents.

Chapter 8: Specialized schemes

This ~~chapter~~ Chapter sets out the ~~guidelines~~requirements for various types of specialized schemes. A specialized scheme means any scheme whose primary objective is not investment in equities and/or bonds, any scheme falling under the categories in this Chapter, or which otherwise does not meet the relevant requirements of Chapter 7 associated with any particular or special feature(s) of the scheme.

For any scheme that has features falling within the scope of one or more specialized scheme(s) under this Chapter, the scheme shall comply with the relevant requirements under this Chapter where applicable, in addition to the requirements under Chapter 7 with modifications, exemptions or additions as set out in this Chapter. ~~For example, where a guaranteed fund or index fund that seeks to achieve its investment objective through investment in, or use of, financial derivative instruments, the requirements regarding (i) collateral as set out in 8.8(e) of this UT Code and (ii) exposure to counterparty risk as set out in 8.8(d) of this UT Code must be complied with, in addition to requirements set out in 8.5 or 8.6 of this UT Code.~~

In addition to the specialized schemes mentioned in this Chapter, application may be made for other specialized schemes pursuant to this Chapter. Each such scheme will be considered by the Commission on a case-by-case basis, taking into account the applicable requirements set out in this Chapter and Chapter 7, or pending the issue, if appropriate, of further guidelines.

8.1 ~~Unit portfolio management funds~~[deleted]

~~(a) A scheme that invests all of its assets in other collective investment schemes may be authorized as a unit portfolio management fund (UPMF). A UPMF may hold cash for ancillary purposes and enter into financial futures contracts for hedging purposes.~~

~~*Investment and borrowing limitations*~~

~~(b) Subject to 8.1(a), a UPMF may only invest in units/shares of schemes authorized by the Commission or in recognized jurisdiction schemes (whether authorized or not) , except that not more than 10% of the UPMF's total net asset value may be invested in non-recognized jurisdiction schemes not authorized by the Commission.~~

~~(c) Notwithstanding 8.1(b), no investment may be made in any scheme whose objective is to invest primarily in any investment prohibited by Chapter 7 of this UT Code. In the case of investments limited by Chapter 7, such holdings may not be in contravention of the relevant limitation.~~

~~(d) A UPMF, except with the approval of the Commission, must invest in at least five schemes, and not more than 30% of its total net asset value may be invested in any one scheme.~~

~~(e) A UPMF may not invest in another UPMF.~~

~~(f) A UPMF may borrow up to 10% of its total net asset value but only on a temporary basis for the purpose for meeting redemption requests or defraying operating expenses.~~

~~(g) A UPMF may not invest more than 10% of its total net asset value in warrant funds, and futures and options funds unless its primary objective is to invest in warrant, or futures and options funds, in which case the provisions applicable to such specialized funds in this Chapter will be extended to such UPMF, as appropriate.~~

~~*Limitation on charges*~~

~~(h) Where a UPMF invests in schemes managed by the same management company or its connected persons, all initial charges on the underlying schemes must be waived.~~

~~(i) The management company of a UPMF may not obtain a rebate on any fees or charges levied by an underlying scheme or its management company.~~

8.2 Money market ~~/ cash management~~ funds

(a) A money market ~~/ cash management~~ fund means a ~~collective investment~~ scheme which invests in short-term and high quality money market investments and seeks to offer returns in line with money market rates~~, the sole objective of which is to invest in short-term deposits and debt securities~~.

Note: Collective investment schemes which present the characteristics of a money market fund or which are presented to investors or potential investors as having similar investment objectives (e.g. funds named as "liquid funds" or "cash funds") should also be subject to the requirements under 8.2 of this UT Code, notwithstanding that such schemes are not marketed as "money market fund".

Offering document

(b) The offering document must clearly highlight that the purchase of a unit/share in a scheme is not the same as placing funds on deposit with a bank or deposit-taking company, that the management company has no obligation to redeem units/shares at the offer value and that the scheme is not subject to the supervision of the Hong Kong Monetary Authority.

Name of scheme

(c) In addition to 7.42, ~~The~~ the scheme's name must not appear to draw a parallel between the scheme and the placement of cash on deposit.

Filing requirement

(d) The scheme must file with the Commission within seven days from the last working day of each month details of the total funds subscribed to the scheme that month, and details of the total funds under management at the end of that month.

Investment limitations

The core requirements on investments as set out in Chapter 7 will apply with the following modifications, exemptions or additional requirements:

(e) Subject to the provisions below, a scheme may only invest in short-term deposits and ~~debt securities~~high quality money market instruments [see Note(1) to 7.36(j)], and money market funds that are authorized by the Commission under 8.2 of this UT Code or regulated in a manner generally comparable with the requirements of the Commission and acceptable to the Commission.

Note: Subject to 8.2(j), money market instruments may include asset-backed securities such as asset-backed commercial papers.

(f) A scheme must maintain ~~an~~ a portfolio with weighted average ~~portfolio~~ maturity not exceeding ~~90~~60 days and a weighted average life not exceeding 120 days and must not purchase an instrument with a remaining maturity of more than 397 days, or two years in the case of Government and other public securities [see ~~7.5~~ Notes (1) ~~&~~and (2) to 7.5].

Notes: (1) Weighted average maturity is a measure of the average length of time to maturity of all the underlying securities in the scheme weighted to reflect the relative holdings in each instrument; and is used to measure the sensitivity of a scheme to changing money market interest rates.

(2) Weighted average life is the weighted average of the remaining life of each security held in a scheme; and is used to measure the credit risk, as well as the liquidity risk.

(3) The use of interest rate resets in variable-notes or variable-rate notes generally should not be permitted to shorten the maturity of a security for the purpose of calculating weighted average life, but may be permitted for the purpose of calculating weighted average maturity.

(g) Notwithstanding 7.1 and 7.1B, ~~The~~ the aggregate value of a scheme's holding of instruments and deposits issued by a single ~~issuer~~ entity may not exceed 10% of the total net asset value of the scheme except:

(i) where the ~~issuer~~ entity is a substantial financial institution and the total amount does not exceed 10% of the ~~issuer's~~ entity's ~~issued~~ share capital and ~~published~~ non-distributable capital reserves, the limit may be increased to 25%; or

(ii) in the case of Government and other public securities, up to 30% may be invested in the same issue; or

(iii) in respect of any deposit of less than US$ 1,000,000 or its equivalent in the base currency of the scheme, where a scheme cannot otherwise diversify as a result of its size.

(g)(a) Notwithstanding 7.1A and 7.1B, the aggregate value of a scheme's investments in entities within the same group [see Note(1) to 7.1A] through instruments and deposits may not exceed 20% of its total net asset value.

Notes: (1) 8.2(g)(a) will not apply in respect of cash deposit of less than US$ 1,000,000 or its equivalent in the base currency of the scheme, where a scheme cannot otherwise diversify as a result of its size.

(2) where the entity is a substantial financial institution and the total amount does not exceed 10% of the entity's share capital and non-distributable capital reserves, the limit may be increased to 25%.

Limitations on borrowing

(h) Notwithstanding 7.21, ~~The~~ the scheme may borrow up to 10% of its total net asset value but only on a temporary basis for the purpose of meeting redemption requests or defraying operating expenses.

Underlying assets requirements

(i) The value of a scheme's holding of money market funds that are authorized by the Commission under 8.2 of this UT Code or regulated in a manner generally comparable with the requirements of the Commission and acceptable to the Commission may not in aggregate exceed 10% of its total net asset value.

(j) The value of a scheme's holding of investments in the form of asset-backed securities may not exceed 15% of its total net asset value.

(k) Subject to 7.32 to 7.38, a scheme may engage in sale and repurchase, and reverse repurchase transactions in compliance with the following additional requirements:

(i) the amount of cash received by a scheme under sale and repurchase transactions may not in aggregate exceed 10% of its total net asset value;

(ii) the aggregate amount of cash provided to the same counterparty in reverse repurchase agreements may not exceed 15% of the net asset value of the scheme;

(iii) collateral received may only be short-term deposits or high quality money market instruments [see Note(1) to 7.36(j)]; and

(iv) the holding of collateral, together with other investments of the scheme, must not contravene the investment limitations and requirements set out in 8.2 of this UT Code.

(l) The scheme may use financial derivative instruments for hedging purposes only [see Notes(1) and (2) to 7.25].

(m) The currency risk of a scheme should be appropriately managed. In particular, any material currency risk should be appropriately hedged where a scheme invests in assets that are not denominated in the base currency of the scheme.

(n) The scheme must hold at least 10% of its total net asset value in daily liquid assets and at least 30% of its total net asset value in weekly liquid assets.

Notes: (1) Daily liquid assets refers to (i) cash; (ii) instruments or securities convertible into cash (whether by maturity or through exercise of a demand feature) within one working day; and (iii) amount receivable and due unconditionally within one working day on pending sales of portfolio securities.

(2) Weekly liquid assets refers to (i) cash; (ii) instruments or securities convertible into cash (whether by maturity or through exercise of a demand feature) within five working days; and (iii) amount receivable and due unconditionally within five working days on pending sales of portfolio securities.

(3) In addition, it is expected that periodic stress testing to be carried out by the management company in monitoring the scheme's liquidity.

(o) A scheme that offers a stable or constant net asset value or which adopts an amortized cost accounting for valuation of its assets may only be considered by the Commission on a case-by-case basis.

Note: Among others, the Commission must be satisfied with the overall measures and safeguards put in place by the scheme to properly address relevant risks associated with these features, having taken into account applicable international regulatory standards and requirements. Non-exhaustive examples of safeguards may include setting out clear and reasonable criteria for the types of instruments and the circumstances under which a scheme may use amortized cost accounting, ongoing monitoring of the difference between the amortized cost of an instrument and its market value or the difference between the constant net asset value of the scheme and its marked-to-market net asset value (as the case may be), procedures in place to ensure appropriate actions to be taken promptly in the interests of the investors when such difference exceeds a pre-determined threshold.

8.3 ~~Warrant funds~~[deleted]

~~The following criteria apply to collective investment schemes, the principal objective of which is investment in warrants.~~

~~(a) The core requirements in Chapter 7 will apply except for 7.2, 7.3, 7.6(b), 7.10, and 7.21.~~

~~(b) The value of a scheme's holding of warrants issued by any single issuer may not exceed 10% of its total net asset value.~~

~~The following additional provisions will apply:-~~

~~*Investment limitations*~~

~~(c) Not less than 90% of warrants held by the scheme must carry the right to acquire securities listed on a market [see Note to 7.3].~~

~~(d) Investment in forward currency contracts and financial futures contracts is permissible for hedging purposes only.~~

~~(e) Investment in physical commodities, including bullion, options on commodities and commodity based investments is prohibited [see Note(2) to 7.10].~~

~~*Limitations on borrowing*~~

~~(f) The scheme may borrow up to 10% of its total net asset value but only on a temporary basis for the purpose of meeting redemption requests or defraying operating expenses.~~

~~*Offering document*~~

~~(g) The offering document must explain the nature of warrants as an investment and contain a detailed description of the risks inherent in investment in warrants.~~

~~(h) The offering document and any advertising material must contain the following warning:-~~

~~"Prices of warrants may fall just as fast as they may rise, therefore this scheme carries a significant risk of loss of capital. It is suitable only for those investors who can afford the risk involved."~~

~~*Name of scheme*~~

~~(i) The word "Warrant" must appear in the name of the scheme.~~

8.4 [deleted]

8.4A ~~Futures and options funds~~[deleted]

~~*The following criteria apply to collective investment schemes, the principal objective of which is investment in future contracts (including commodities and financial futures) and/or in options.*~~

~~*Investment restrictions*~~

~~(a) The scheme may only enter into futures and options contracts dealt with on a futures, commodities or options exchange or any over-the-counter derivative approved by the trustee/custodian.~~

~~(b) At least 30% of the net asset value of the scheme must be held on deposit or invested in liquid short term debt instruments and may not be used for margin requirements. Not more than 70% of the net asset value of the scheme may be committed as margin for futures or options contracts, and/or premium paid for options purchased (including put and/or call options).~~

(c) The scheme may not invest in commodity contracts other than commodity futures contracts. However, the scheme may acquire precious metals which are negotiable on an organized market.

(d) Premiums paid to acquire options outstanding with identical characteristics may not exceed 5% of the net asset value of the scheme.

(e) The scheme may not hold open contract positions in any futures contract month or option series for which the combined margin requirement represents 5% or more of the net asset value of the scheme.

(f) The scheme may not hold open positions in futures or options contracts concerning a single commodity or a single underlying financial instrument for which the combined margin requirement represents 20% or more of the net asset value of the scheme.

Limitations on borrowing

(g) The scheme may borrow up to 10% of its total net asset value but only on a temporary basis for the purpose of meeting redemption requests or defraying operating expenses.

Limited liability

(h) The liability of holders must be limited to their investment in the scheme.

Specialist expertise

(i) The applicant management company (and, if applicable, the investment adviser) must satisfy the Commission that it has specific experience in the field of futures and options. In determining the acceptability of the management company, the Commission may also consider the qualifications and experience of persons employed by the management company or the investment adviser. An applicant must provide details of the performance of all futures funds under its management or the management of the employees responsible for the applicant scheme for the preceding five years.

Certification by trustee/custodian

(j) The trustee/custodian must certify to the Commission that suitable control procedures are in place for monitoring the investment restrictions of the scheme. The trustee/custodian must demonstrate that they have the relevant experience in this respect.

Disclosure

(k) The offering document must:-

(i) provide a detailed explanation of the type(s) of futures contracts (and, if appropriate, options) that the scheme will invest in, the risks inherent in such investment and the trading strategy to be adopted;

(ii) disclose in one place all management, advisory and brokerage fees payable by the scheme; and

(iii) clearly disclose the nature and size of transaction costs that are expected to be incurred by the scheme and the implications of expected greater number of transactions on the amount of these costs.

(l) The offering document and any advertising material must contain a warning statement appropriate to the degree of risk inherent in the scheme. The warning statement must be prominently displayed on the front cover of the offering document.

(m) The words "leveraged", "futures" and/or "options" must appear in the name of the scheme.

(n) The annual financial statements of the scheme must disclose the total transaction costs incurred.

(o) Any advertisement must contain a statement that investors should refer to the risk factors set out in the offering document of the scheme.

Acknowledgement

(p) The application form must, in a prominent place, contain an acknowledgement to be signed by the investor at the time of subscription confirming that he has read the offering document of the scheme and is fully aware of the nature of the scheme and the risks associated with it.

8.5 Guaranteed funds[deleted]

The following criteria apply to collective investment schemes which contain a structure whereby a guaranteed amount will be paid to investors who hold units/shares in the scheme at a specified date in the future.

(a) The core requirements in Chapter 7 and relevant provisions in Chapter 8 should apply to the scheme where appropriate, depending on the nature and the underlying investments of the scheme.

Guarantor

(b) The guarantor must be:

(i) a licensed banking institution authorized under the Banking Ordinance; or

(ii) an authorized insurer authorized under the Insurance Companies Ordinance.

Note: The Commission may consider other substantial financial institutions to act as guarantor on a case-by-case basis. The Commission must be satisfied that the institution is, on an on-going basis, subject to regulatory supervision and of acceptable financial standing.

Disclosure in the offering document

Apart from the standard contents requirements in Appendix C, the offering document of the scheme must contain: -

(c) Information about the guarantor

(i) its name;

(ii) nature of its business; and

(iii) information on its financial position, including paid-up share capital, total net assets or shareholders' funds, and where applicable, credit rating and any other relevant information.

(d) Information about the guarantee

(i) the terms of the guarantee, including the scope and validity of the guarantee and the circumstances under which the guarantee may be terminated;

Note: The deed of guarantee must form part of the offering document.

(ii) an illustration or description to clearly demonstrate the guarantee mechanism and how potential returns in excess of the guaranteed amount are calculated;

Notes: (1) Where an indicative participation rate is shown, the illustration should use the quoted indicative rate as the basis for calculation.

(2) Assumptions used in the illustration should be clearly stated. It should be stated that the rates of return shown are for illustrative purpose only and that the actual return may be different.

(e) A detailed description of the nature of the underlying investments, including:

(i) the proposed percentage, or an estimate thereof, of the scheme to be invested in fixed-interest securities and that in other investments at the time of publication of the offering document;

(ii) the issuers/counter-parties of the underlying investments, or the criteria for the selection of such parties;

(iii) the valuation methodology of the underlying investments;

(iv) the liquidation mechanism of the underlying investments to meet redemption requests; and

(v) where relevant, the participation rate or an estimate thereof at the time of publication of the offering document. It should be stated that the actual participation rate may be different from the indicative rate. An analysis of

the factors that will impact on the final determination of such rate should also be given.

Note: Where applicable, it should be stated when the actual participation rate will be determined and how such information will be communicated to investors.

(f) Risk warnings

These should include, but not limited to:

(i) a statement to the effect that due to the guarantee structure, there will be a dilution of performance;

(ii) a statement to the effect that potential returns in excess of the guaranteed amount are subject to investment risk and are not guaranteed;

(iii) a statement to the effect that the scheme is subject to the credit risk of the guarantor and the issuers of the underlying investments;

(iv) a statement to the effect that the scheme is subject to the liquidity risk of the underlying investments;

(v) risks, if any, associated with conflicts of interest that may arise amongst different operating parties;

(vi) a warning statement that the scope or validity of the guarantee may be affected under certain circumstances including, where relevant, the condition that the guarantee only applies to investors who hold their investments until the date specified in the guarantee and that dealings before such date are fully exposed to fluctuations in the value of the scheme's assets; and

(vii) where applicable, the mechanism of any up-front charging fee structure and the cost implications to investors.

Jurisdiction

(g) Nothing in the deed of guarantee may exclude the jurisdiction of the courts of Hong Kong to entertain an action concerning the scheme or the guarantee.

Name of scheme

(h) The name of the scheme should accurately reflect the nature of the guarantee.

Reporting Requirement

(i) The management company of the scheme should report to the Commission as soon as practicable if it becomes aware of any events which may affect the guarantee or undermine the ability of the guarantor to act as such.

Note: Where the guarantor of a scheme is neither a licensed banking institution nor an authorized insurer as described in 8.5(b)(i) and (b)(ii) respectively,

~~*the manager of the scheme must notify the Commission on an annual basis the regulatory status of the guarantor.*~~

~~*Advertisements*~~

~~(j) Any advertisement or marketing material must contain the following:~~

~~(i) the name of the guarantor;~~

~~(ii) where relevant, a statement that certain fees are charged up-front and the aggregate amount thereof;~~

~~(iii) where an indicative participation rate is quoted, the date of reference should be stated and there should be a warning that the actual participation rate may be different from the indicative rate;~~

~~(iv) the statement in 8.5(f)(vi) above; and~~

~~(v) a statement directing investors to read the offering document for further details of the guarantee.~~

8.6 Unlisted ~~Index~~ index funds and index tracking exchange traded funds

~~The following criteria apply to index funds.~~

General

(a) An "unlisted index fund" is a ~~collective investment~~ scheme, the principal objective of which is to track, replicate or correspond to a financial index or benchmark, with an aim of providing or achieving investment results or returns that closely match or correspond to the performance of the index. Such unlisted index fund authorized by the Commission will be referred to as "index fund" in this UT Code.

(a)(a) An index tracking exchange traded fund means an index fund as defined in 8.6(a) the units/shares of which are listed and traded on a securities exchange. Such index tracking exchange traded fund authorized by the Commission will be referred to as "passive ETF" in this UT Code.

(a)(b) The term "index" used in 8.6 of this UT Code shall mean an index or a benchmark as the context requires.

(a)(c) Subject to consultation with the SFC, a scheme under 8.6 of this UT Code may have unlisted and/or listed unit/share classes. The unlisted class and listed class shall comply with the requirements on index fund and passive ETF in 8.6 of this UT Code respectively.

Index funds

The criteria set out in 8.6(b) to 8.6(m) apply to index funds.

(b) An index fund may seek to track an index by one or a combination of the following strategies:

(i) full replication by investing all or substantially all of its assets in the constituents of the underlying index, broadly in proportion to the respective weightings of the constituents;

(ii) a representative sampling by investing in a portfolio featuring a high correlation with the underlying index; and

Note: The use of sampling where certain securities in the portfolio are not the constituent securities of the index is acceptable if the portfolio matches the characteristics of the index.

(iii) ~~Synthetic~~ synthetic replication through the use of financial derivative instruments to replicate the index performance.

(c) In achieving its investment objective, ~~the scheme~~ an index fund may invest in other appropriate investment instruments, such as ~~derivatives~~financial derivative instruments permitted under this UT Code or otherwise accepted by the Commission, in accordance with the ~~scheme's~~index fund's disclosed investment strategies and restrictions.

(c)(a) ~~Where the management company of the~~An index fund ~~adopts a synthetic replication strategy,~~must also comply with the requirements ~~set out under~~in 8.8 of this UT Code ~~regarding structured funds are also applicable.~~if the index fund's global exposure relating to financial derivative instruments for investment purposes [see Note to 7.26] exceeds 50% of its total net asset value.

(d) In general, the Commission will consider authorizing an index fund only if the underlying index is acceptable to the Commission. Such acceptance does not imply official approval or endorsement of the index. The Commission reserves the right to withdraw the authorization if the index is no longer considered acceptable.

Note: The management company should immediately consult the Commission if for any reasons the index might likely cease or has ceased to be acceptable. The management company should as a priority objective propose remedial actions or alternatives that are acceptable to the Commission.

Acceptable ~~Indices~~indices

(e) The acceptability of an index will be assessed on the following criteria:

(i) The index should have a clearly defined objective and/or the market or sector it aims to represent should be clear~~.~~;

Note~~s~~: (1) The Commission must be satisfied that the index appropriately reflects the characteristics of the market or sector. The index should be able to, where applicable, reflect the price movements in its underlying constituents and change the composition and weightings of these constituents to reflect changes in the underlying market or sector. The Commission may, where relevant, request information on the market capitalisation of the constituent securities in relation to the total

value of the market or sector that an index purports to represent.

(2) Where the index relates to a single commodity or interest rate for money market, it should be well-recognized and representative of the relevant market or sector.

(ii) The index should in general be broadly based;

Note: An index with a single constituent security weighing more than ~~40% or with its top five~~20% (or 35% where that proves to be justified by exceptional conditions in markets where certain securities are highly dominant and provided that each remaining constituent ~~securities weighing more than 75%~~security does not exceed 20%) or having few constituent securities would generally be considered too concentrated. Exceptions may be made on a case by case basis, particularly where the constituent securities are Government or other public securities~~.~~, or the index relates to a single commodity or interest rate for money market.

(iii) The index should be investible, where applicable~~.~~;

Note: The Commission expects that the constituent securities should be sufficiently liquid (taking into account their respective weightings and trading volume), and may be readily acquired or disposed of under normal market circumstances and in the absence of trading restrictions.

(iv) The index should be transparent and published in an appropriate manner~~.~~; and

Note: The ~~latest~~ last closing index level and other important news should be either published in Hong Kong daily newspapers or conveniently accessible by investors (for example, by enquiring of the Hong Kong Representative or through relevant websites). The Commission may also consider whether the index is easily accessible through market data vendors.

(v) The index should be objectively calculated and rules-based. The index provider is expected to possess the necessary expertise and technical resources to construct, maintain and review the methodology/rules of the index. The methodology/rules should be well documented, consistent and transparent.

Notes: (1) The Commission may request the submission of the methodology/rules of the index.

(2) Where the index provider is the management company of the index fund (or its connected persons), effective arrangements for management of conflicts of interests should be put in place.

Reporting requirements

(f) The Commission should be consulted on any events that may affect the acceptability of the index. Significant events relating to the index should be notified to the holders as soon as practicable. These may include a change in the methodology/rules for compiling or calculating the index, or a change in the objective or characteristics of the index.

Investment restrictions

(g) The core requirements in Chapter 7 will apply with the modifications or exceptions as set out in ~~the following (h) and (i) and paragraph 11 of Appendix I of this UT Code - Guidelines for Regulating Index Tracking Exchange Traded Funds.~~8.6(h) to 8.6(i).

(h) Notwithstanding 7.1, more than 10% of the net asset value of an index fund may be invested in constituent securities issued by a single issuer provided that:

(i) it is limited to any constituent securities that each accounts for more than 10% of the weighting of the index; and

(ii) the ~~scheme's~~ index fund's holding of any such constituent securities may not exceed their respective weightings in the index, except where weightings are exceeded as a result of changes in the composition of the index and the excess is only transitional and temporary in nature.

~~*Note: A waiver of (h)(ii) may be granted on a case-by-case basis, after considering factors including whether the waiver is necessary for the scheme to achieve its objective to track the index.*~~

(h)(a) Investment restrictions in 8.6(h)(i) and (ii) do not apply if:

(i) an index fund adopts a representative sampling strategy which does not involve the full replication of the constituent securities of the underlying index in the exact weightings of such index;

(ii) the strategy is clearly disclosed in the offering document of the index fund;

(iii) the excess of the weightings of the constituent securities held by the index fund over the weightings in the index is caused by the implementation of the representative sampling strategy;

(iv) any excess weightings of the index fund's holdings over the weightings in the index must be subject to a maximum limit reasonably determined by the index fund after consultation with the Commission. In determining this limit, the index fund must consider the characteristics of the underlying constituent securities, their weightings and the investment objectives of the index and any other suitable factors;

(v) limits laid down by the index fund pursuant to 8.6(h)(a)(iv) must be disclosed in the offering document; and

(vi) disclosure must be made in the index fund's interim and annual reports as to whether the limits imposed by the index fund itself pursuant to 8.6(h)(a)(iv) have been complied with in full. If there is non-compliance with the said limits during the relevant reporting period, this must be reported to the Commission on a timely basis and an account for such non-compliance should be stated in the report relating to the period in which the non-compliance occurs or otherwise notified to investors.

(h)(b) Due to its index tracking nature, the Commission may, upon sufficient justification, consider not requiring index fund to strictly comply with the investment restrictions in 7.1A and 7.1B on a case-by-case basis.

(i) ~~Subject to 8.6 (g) and (h) above,~~ Subject to the approval of the Commission, the 30% limit in 7.4 may be exceeded, and an index fund may invest all of its assets in Government and other public securities in any number of different issues despite 7.5.

Disclosure

(j) In addition to the requirements under Appendix C, the offering document of an index fund must make the following disclosure and warnings:~~-~~

(i) a description of the market or sector the index aims to represent;

(ii) the characteristics and general composition of the index and, where applicable, concentration in any economic sectors and/or issuers;

(iii) the weightings of the top 10 largest constituent securities of the index ~~as of a date within a month of the date of the offering document~~ and a publicly accessible website where the latest top 10 largest constituent securities of the index are published;

(iv) where necessary, a statement to the effect that the investment of the ~~scheme~~ index fund may be concentrated in the securities of a single issuer or several issuers;

(v) a warning of lack of discretion to adapt to market changes due to the inherent investment nature of index funds and that falls in the index are expected to result in corresponding falls in the value of the ~~scheme~~index fund;

(vi) a statement to the effect that there is no guarantee or assurance of exact or identical replication at any time of the performance of the index;

(vii) circumstances that may lead to tracking errors and the related risks, and strategies employed in minimising such errors;

(viii) a brief description of the index methodology/rules and/or the means by which investors may obtain such information (for example, by providing the website address of the index provider);

(ix) the means by which investors may obtain the latest index information and other important news of the index;

(x) a warning that index composition may change and securities may be delisted;

(xi) any circumstances that may affect the accuracy and completeness in the calculation of the index;

(xii) a warning in relation to any licensing conditions (including indemnity given to the index provider, if any) for using the index, and the contingency plan in the event of cessation of the availability of the index;

(xiii) a statement on whether the index provider and the management company of the ~~scheme~~index fund (or its connected persons) are independent of each other. If not, the means by which possible conflicts of interests may be addressed;

(xiv) the Commission reserves the right to withdraw the authorization of the ~~scheme~~ index fund if the index is no longer considered acceptable; and

(xv) any other information which is relevant and material for investors to make an informed investment decision.

Replacement of the underlying index

(k) Following the authorization of the ~~scheme~~index fund, a replacement of the underlying index may only be made in accordance with the provisions of its offering and constitutive ~~document~~documents and with the prior approval of the Commission.

Note: A replacement of the underlying index may be necessary under circumstances including where the index is no longer available or considered acceptable.

~~*Financial statements*~~

(l) ~~The interim and annual financial statements of the scheme must disclose a list of those constituent securities, if any, that each accounts for more than 10% of the weighting of the index as at the end of the relevant period and their respective weightings. The statements must also provide a comparison of the scheme performance and the actual index performance over the relevant period.~~[deleted]

Name of ~~scheme~~index fund

(m) The name of the ~~scheme~~ index fund must reflect the nature of an index fund.

Note: ~~The~~ Except with the approval of the Commission, the words "index", "tracking" and/or "tracker" are expected to appear in the name of the ~~scheme~~index fund.

Passive ETFs

The criteria set out in 8.6(n) to 8.6(y) apply to passive ETFs:

(n) Passive ETFs must comply with the requirements in this UT Code not otherwise modified below. In particular, the requirements on index funds in 8.6 of this UT Code are broadly applicable to passive ETFs.

(o) It is a condition for authorizing a passive ETF that it must be listed and traded on The Stock Exchange of Hong Kong Limited (the "SEHK").

(p) The management company of a passive ETF is generally expected to use its best endeavours to put in place arrangements so that there is at least one market maker for the units/shares (traded in each counter) of the passive ETF and at least one market maker for (each counter of) the passive ETF will give not less than three months' notice prior to terminating the market making arrangement. The appointed market maker shall observe the applicable requirements concerning market making activities issued by the SEHK.

(q) The management company of a passive ETF shall inform the Commission and holders by way of public announcement, in the manner as may be required by the Commission, and publish as soon as reasonably practicable any information or transaction concerning the passive ETF which:

(i) is necessary to enable holders to appraise the position of the passive ETF;

(ii) is necessary to avoid a false market in the units/shares of the passive ETF; or

(iii) might be reasonably expected to materially affect market activity in the passive ETF or affect the price of the units/shares of the passive ETF.

(r) Name of a passive ETF under note to 8.6(m) – The note to 8.6(m) is amended to the effect that except with the approval of the Commission, the words "index", "tracking", "tracker" and/or "ETF" are expected to appear in the name of a passive ETF.

(s) The notification requirements under 10.7 and 11.1A are modified to the following extent:

(i) Suspension of dealing in 10.7 – The management company must immediately notify the Commission as soon as practicable if dealing in units/shares on the SEHK ceases or is suspended.

(ii) Increase in fees and charges in 11.1A – Any increase in fees and charges from the current level up to the permitted maximum level as disclosed in the Hong Kong Offering Document is subject to at least one week's prior notice to holders.

(iii) All notices and public announcements made by passive ETFs in accordance with this UT Code must be prepared in both English and Chinese.

Note: For avoidance of doubt, nothing in 8.6(s) shall exempt a passive ETF from compliance with 11.1, 11.4 and 11.5.

(t) Where a passive ETF ceases trading on the SEHK as a result of proposed termination and/or deauthorization and delisting, the requirements in 6.1, 8.6(u)(i) and (ii), 10.7 and 11.1B may be modified and/or not be applicable depending on the specific circumstances of each case and subject to such conditions and requirements as may be imposed by the Commission.

(u) In addition to information commonly available for stocks during the trading hours of the SEHK (e.g. bid/ask prices and queuing displays), a passive ETF must, except with the approval of the Commission, provide the following trading information to the public through the passive ETF's own website or such other channels as the Commission considers appropriate:

(i) real time or near-real time indicative net asset value per unit/share (updated at least every 15 seconds during trading hours);

(ii) last closing net asset value per unit/share and last closing net asset value of the passive ETF (updated on a daily basis); and

(iii) full holdings of the passive ETF (updated on a monthly basis within one month of the end of each month).

Notes: (1) Indicative net asset value per unit/share means a measure of the intraday value of the net asset value per unit/share of a passive ETF based on the most up-to-date information.

(2) For a passive ETF with multiple trading counters, the relevant information shall be provided for each counter.

(3) The offering document shall disclose the policy regarding disclosure of holdings of the passive ETF.

(4) The offering document shall direct investors to the website or other channels where the above information is published.

(5) Where the full holdings of the passive ETF is provided to the public on a more frequent basis (e.g. daily), the passive ETF is not required to comply with 8.6(u)(iii).

(v) If a passive ETF's global exposure relating to financial derivative instruments for investment purposes exceeds 50% of its total net asset value, the passive ETF shall make available, through the passive ETF's own website or other acceptable channels, the information on financial derivative instruments acquired by the passive ETF (such as counterparty exposure and collateral information) to investors on an ongoing basis. The offering document should direct investors to the website or other channels where this information is published.

(w) Where securities financing transactions undertaken by a passive ETF exceed 50% of its total net asset value, the passive ETF should make available, through the passive ETF's own website or other acceptable channels, the information on

securities financing transactions undertaken by the passive ETF (such as counterparty exposure and collateral information) to investors on an ongoing basis. The offering document should direct investors to the website or other channels where this information is published.

(x) A passive ETF must ensure that the following documents are made readily available to Hong Kong investors through any of the passive ETF's own website or such other channels as the Commission considers appropriate:

(i) offering document (including Product KFS);

(ii) latest version of the interim and annual reports of the passive ETF; and

(iii) all notices and public announcements (including notices for suspension and resumption of trading) issued by the passive ETF in Hong Kong.

Note: Where a passive ETF is listed and traded on the SEHK, it may, but is not required to, make available the abovementioned documents to investors in Hong Kong by way of hyperlinks to the HKEx website.

(y) The Commission may enter into any mutual recognition arrangement with other jurisdictions from time to time to facilitate cross-listing and offering of exchange traded funds in each other's market. Please refer to the relevant circular published on the Commission's website at www.sfc.hk for the specific relief granted to overseas exchange traded funds under the relevant mutual recognition arrangement.

8.7 Hedge funds

Foreword

The following criteria apply to collective investment schemes that are commonly known as hedge funds (or alternative investment funds or absolute return funds). Hedge funds are generally regarded as non-traditional funds that possess different characteristics and utilize different investment strategies from traditional funds. In considering an application for authorization, the Commission will, among other things, consider the following:

(i) the choice of asset class; and
(ii) the use of alternative investment strategies such as long/short exposures, leverage, and/or hedging and arbitrage techniques.

Due to the wide array of schemes that may fall under this category, the Commission will exercise its discretion in imposing additional conditions to each scheme on a case-by-case basis as appropriate.

Where a scheme invests all its non-cash assets in other hedge funds, it may be authorized as a fund of hedge funds (FoHFs).

~~Where a scheme has a capital guarantee feature, it may be authorized as a capital guaranteed hedge fund. In this case, provisions of 8.5 and 8.7 may apply to the scheme where relevant, depending on the nature of the scheme.~~

~~Unless otherwise specified, the provisions in other Chapters of this UT Code shall apply. Where the provisions refer to the scheme, this means the applicant scheme.~~

The management company

(a) The management company of a scheme must satisfy the requirements set out in Chapter 5 unless otherwise specified in this Chapter. For the avoidance of doubt, the Commission will consider, among others, the following factors when assessing the acceptability of the management company:

(i) The management company must have the requisite competence, expertise and appropriate risk management and internal controls systems. It must also be adequately and suitably staffed in order to properly manage the risks and operational issues in connection with its hedge funds business;

(ii) the experience of the key ~~investment~~ personnel of the management company and those of the investment ~~adviser~~ delegate (where the latter has been delegated the investment management function) in managing hedge funds;

Note: The key personnel of the management company of either a single hedge fund[1] or a FoHFs must be dedicated full-time staff with a demonstrable track record in the management of hedge funds.

The Commission will take into account various factors in assessing the acceptability of the key personnel for a scheme. These factors may vary from a single hedge fund to a FoHFs having regard to the different strategies and operational differences of these funds.

There must be at least two key personnel in the management company each having at least five years' relevant experience. The management company must demonstrate that out of these five years' relevant experience, the two key personnel must each have at least two years' specific experience:

(a) In the case of a single hedge fund manager, the Commission will normally consider it acceptable if each of the two key personnel has at least two years' specific investment management experience in the same strategy as that of the scheme.

(b) In the case of a FoHFs manager, the Commission will normally consider it acceptable if each of the two key personnel has at least two years' specific investment management experience as a FoHFs manager.

A key personnel may satisfy this five years' relevant experience by a combination of both his specific experience mentioned above and general experience relating to hedge funds. With respect to

[1] "Single hedge fund" in the context of 8.7 means hedge funds that are not in the form of FoHFs.

general experience, the Commission will normally consider the following types of experience acceptable:

(1) proprietary trading experience in securities, financial derivatives~~s~~ instruments or other investment instruments which are of a similar nature to those contemplated by the scheme; or

(2) carrying out investment strategies in the context of investment management or securities dealing business in similar nature to the one contemplated for the scheme; or

(3) prior experience in evaluating or selecting hedge funds for investment purposes.

General experience acquired through academic research, sales or marketing or back-office administration of hedge funds is unlikely to be considered acceptable for meeting the requirement in 8.7(a).

For the avoidance of doubt, to the extent that 5.5(a) requires the key personnel to possess specific public funds experience, this requirement may be satisfied if the management company on a firm-wide basis is able to demonstrate that it possesses the requisite experience and resources to administer public funds.

The Commission may require independent substantiation of the management experience and track record of the key personnel, the management company and the group companies (where appropriate).

The experience requirement of the investment personnel of the underlying funds of a FoHFs is set out in the "Fund of Hedge Funds" section below.

(iii) amount of assets under management;

Note: The Commission would generally expect at least US$100 million for the total amount of assets under management that follow hedge fund strategies. While assets under management may include proprietary funds, the Commission will generally look for experience in managing third-party funds.

(iv) the risk management profile and internal control systems of the management company; and

Note: The management company must have in place suitable internal controls and risk management systems commensurate with the company's business and risk profile, including a clear risk management policy and written control procedures.

It must continuously deploy such necessary resources and be vigilant to ensure that all the relevant risks in connection with the management of the scheme are properly monitored and controlled in accordance with the investment strategy of the scheme.

The management company must demonstrate that those representatives and agents (including for example, administrators, custodian, brokers, valuation agents) appointed by it possess sufficient know-how and experience in dealing with hedge funds.

In the case of the management of a FoHFs, the management company must:

(a) have in place a due diligence process for the selection of the underlying funds and ~~on-going~~ongoing monitoring of their activities;

(b) demonstrate its ability to assess and monitor the performance of the managers of the underlying funds, and the ability to replace the underlying funds whenever necessary to protect the interests of holders; and

(c) submit a plan to explain its due diligence and ~~on-going~~ongoing monitoring processes (containing, among others, the frequency of reporting and evaluation of the underlying funds, and measures adopted by the management company to ensure investment and operational risks of the underlying funds are analysed and controlled) and include a summary of the plan in the offering document of the scheme.

The management company must ensure that its risk management process is able to deal with normal and exceptional circumstances including extreme market conditions.

The management company must take all reasonable care in the selection of its distribution agents engaged in the selling of hedge funds and provide all necessary information and training to these agents for the purpose of selling the scheme.

(v) the investment management operations of the scheme must be based in a jurisdiction with an inspection regime acceptable to the Commission.

Note: Whilst reference would be made to the list of acceptable inspection regimes published on the Commission's website, it is noted that the regulation of offshore hedge funds vs. onshore funds may be different in some jurisdictions. The acceptability of an inspection regime in the context of a scheme that is subject to such regime and is seeking SFC authorization may need to be considered on a case-by-case basis.

Prime broker

(b) Where a scheme appoints a prime broker, the following shall apply:

(i) the prime broker must be a substantial financial institution subject to prudential regulatory supervision;

(ii) where assets of the scheme are charged to the prime broker for financing purpose, such assets must not, at any time, exceed the level of the scheme's indebtedness to the prime broker;

Note: Where assets of the scheme may be used as collateral or security for financing to be provided by the prime broker, disclosure must be made in the offering document of the risks associated with the collateralisation, for example, foreclosure or re-hypothecation of these assets by the prime broker and any consequential impact to the scheme and its investors.

(iii) the assets charged to the prime broker must remain in a segregated custody account, in the name or held to the order of the trustee/custodian; and

(iv) the scheme's offering document must disclose the profile of the prime broker and its relationship with the scheme.

Note: Before a prime broker is appointed by the scheme, the scheme or the management company (as the case may be) must conduct due diligence on the prime broker and be reasonably satisfied with the prime broker's suitability and competence.

Apart from disclosing the profile of the prime broker, the offering document must disclose the role(s) of the prime broker in relation to the hedge fund, whether the prime broker is subject to any <u>prudential</u> regulatory supervision, and if so, a brief description of its licensing status in the relevant jurisdiction. Where appropriate, disclosure of the risks relating to any conflicts of interest between the prime broker and the scheme has to be made in the offering document.

Minimum subscription

(c) The minimum level of initial subscription by each investor in a scheme must not be less than US$50,000*, except for FoHFs, where the minimum initial subscription must not be less than US$10,000*. No minimum subscription level will apply to a scheme which provides at least 100% capital guarantee.

(*) or the currency equivalent

Limited liability

(d) The liability of holders must be limited to their investment in the scheme and this must be clearly stated in the offering document.

(e) Where the scheme is a sub-fund of an umbrella fund, the scheme will be required to demonstrate to the Commission that there are legally enforceable provisions to ring-fence the scheme assets from the liabilities of other sub-funds. A brief description of such ring-fencing arrangement must be made in the offering document.

Note: The Commission may require an independent legal opinion or regulatory confirmation regarding the enforceability of the ring-fencing provisions.

Investment and borrowing restrictions

(f) The scheme must have a set of clearly defined investment and borrowing parameters in its constitutive and offering documents. The offering document must clearly explain the types of financial instruments in which the scheme will invest; the extent of diversification or concentration of investments or strategies; the extent and basis of leverage (including the maximum level of leverage); and the related risk implications of the investment and borrowing parameters.

(g) The core requirements in Chapter 7 will not apply except for 7.12(a), (b), (c) and (d), 7.14, 7.17, 7.18, ~~7.22~~7.40 and ~~7.23~~7.41.

Name of scheme

(h) If the name of the scheme indicates a particular objective, investment strategy, geographic region or market, the scheme must, under normal market circumstances, utilize at least 70% of its ~~non-cash assets~~total net asset value for the purposes of pursuing the particular objective, investment strategy or geographic region or market which the scheme represents.

Performance fees

(i) If a performance fee is levied, the scheme must comply with 6.17. Full and clear disclosure of the calculation methodology must be set out in its offering document.

6.17 does not apply to the underlying funds of a FoHFs. For FoHFs, the offering document of the scheme must disclose whether a performance fee is levied at both the scheme level and the underlying funds level. It must also summarize the bases of how performance fees are calculated and paid by the underlying funds. Appropriate warnings must be made in the offering document about the possibility of charging performance fees at various levels within a FoHFs and the implications to investors.

Note: The Commission notes that various methodologies may be used for the charging and accrual of performance fees based on the basic principle in 6.17.

The Commission may require illustrative examples to be given in the offering document to demonstrate the charging method where it considers appropriate.

Where a scheme intends to achieve equalisation for the calculation of performance fees, its offering document must disclose the mechanisms adopted to achieve equalisation.

Where the scheme does not intend to achieve equalisation of performance fees, its offering document must clearly disclose this fact and how the absence of equalisation may affect the amount of performance fees to be borne by investors.

Fund of hedge funds

~~The following provisions apply to FoHFs in lieu of the provisions of 8.1.~~

(j) The FoHFs must comply with the following:

(i) a FoHFs must invest in at least five underlying funds, and not more than 30% of its total net asset value may be invested in any one underlying fund; and

Note: One of the underlying assumptions of a FoHFs is that it can achieve diversification through investing in a range of funds that employ different investment strategies and/or utilise the skills of different fund managers.

Any scheme applying for ~~authorisation~~ authorization as a FoHFs should clearly explain its diversification strategy in the offering document.

A FoHFs ~~authorised~~ authorized pursuant to this UT Code is expected to achieve investment return through the performance of its underlying funds rather than direct investments in securities, futures, options, financial derivative~~s~~ instruments, currency or other investments through proprietary trading or "managed accounts". It is therefore generally not acceptable for a FoHF to carry out proprietary trading directly or through the use of "managed accounts".

(ii) a FoHFs may not invest in another FoHFs.

(k) The management company of the FoHFs must ensure that:

(i) each of the key personnel of the management company of an underlying fund possesses at least two years' experience in the relevant hedge fund investment strategy, provided however that up to 10% of the net asset value of the FoHFs may comprise of underlying funds managed by investment personnel with less experience;

(ii) there is an independent trustee/custodian to safe keep the assets of the underlying funds;

(iii) where a FoHFs invests in underlying funds managed by the same management company or its connected persons, all initial charges and redemption charges on such underlying funds are waived;

(iv) neither the management company of the FoHFs nor its connected persons retain a rebate (whether in cash or in kind) on any fees or charges levied by such underlying funds, their management company or any of their connected persons;

(v) the offering document of the FoHFs clearly discloses the aggregate amount or give an indicative range of all the fees and charges of the FoHFs and each of its underlying funds; and

(vi) where the FoHFs invests in hedge funds not authorized by the SFC, such fact is disclosed in the offering document of the FoHFs. A warning must be included to the effect that some or all of the underlying funds of the FoHFs and their fund managers are not subject to the regulation of the Commission and that such funds may not be subject to rules similar to those of the Commission that are designed to protect investors.

Dealing

(l) There must be at least one regular dealing day per month except for a closed-ended fund authorized pursuant to 8.11 of this UT Code.

(m) The maximum interval between the lodgement of a properly documented redemption request for redemption of units/shares (whether a notice period is required or not) and the payment of redemption money to the holder may not exceed 90 calendar days.

Note: A scheme may only effect redemption in specie with the prior consent of individual redeeming holder. The offering document must disclose the possibility of redemption in specie and the need to obtain prior consent from an individual holder for making such redemption.

A scheme may not effect compulsory redemption except where the management company is reasonably satisfied that it is in the overall benefit of the scheme to do so. Examples where the management may effect compulsory redemption include the circumstances where the continuous holding of the scheme's interest by a particular holder will cause the scheme to be in breach of any laws or regulations governing the scheme, or result in adverse financial consequences to the scheme such as tax penalties.

Subject to the foregoing, the offering document must disclose the circumstances under which compulsory redemption may be effected and the length of notice for such redemption.

(n) The offering document of the scheme must include a warning to the effect that the redemption price may be affected by the fluctuations in value of the underlying investments during the period between the lodgement of the redemption request and the date when the redemption price is calculated.

Valuation

(o) The investments of the scheme must be independently and fairly valued on a regular basis. Where appropriate, ~~generally accepted~~ internationally recognized accounting ~~principles~~ standards and industry's best practices should be applied on a consistent basis.

Note: It is incumbent upon the management company to demonstrate that the scheme's investments will be independently and fairly valued.

In considering whether the management company is able to demonstrate that a scheme's investments are independently valued, the Commission may take into account a number of factors including the following:

a) The duties and functions of the party carrying out the valuation (the "valuation agent") is expected to be segregated from those of the party carrying out the investment management function for the scheme e.g. the appointment of an independent administrator. Disclosure of how the segregation is achieved must be made in the offering document;
b) There should be checks and balances to ensure that the valuation process and policy is consistently followed;
c) The pricing data should be gathered from reliable sources;
d) Where necessary, safeguarding measures should be implemented for the valuation to be carried out independently; and
e) The selection of the valuation agent by the management company is based on due process.

Disclosure must be made of (1) the selection criteria of the valuation agent and the relationship between the management company, its group of companies and the valuation agent; and (2) any limitations and constraints of the valuation policies and methodologies.

The above factors are not exhaustive and the Commission may take into account other relevant factors in assessing the compliance with the independence requirement.

(p) Full particulars of the valuation frequency, the valuation methods of the scheme's investments, the identity and qualifications of the valuation agent(s), the experience of the valuation agent(s) in evaluating hedge fund assets and the relationship of the agent(s) with the scheme's management company or its group of companies and, where applicable, with the prime broker must be disclosed in the offering document.

(q) The offering document of the scheme must include a warning to the effect that some of the underlying investments of the scheme may not be actively traded and there may be uncertainties involved in the valuation of such investments. Potential investors must be warned that under such circumstances, the net asset value of the scheme may be adversely affected.

Disclosure

(r) The front cover of the offering document must display prominently the following warning statements:

(i) the scheme uses alternative investment strategies and the risks inherent in the scheme are not typically encountered in traditional funds;

(ii) the scheme undertakes special risks which may lead to substantial or total loss of investment and is not suitable for investors who cannot afford to take on such risks;

(iii) investors are advised to consider their own financial circumstances and the suitability of the scheme as part of their investment portfolio; and

(iv) investors are advised to read this offering document and should obtain professional advice before subscribing to the scheme.

Note: The text of the warning statements may be varied but the message must be clear and not disguised.

(s) For the purpose of 6.1, the offering document must disclose all relevant matters relating to the investment operations and risk management aspects of the scheme and give lucid explanations of the investment strategy of the scheme and the risks inherent in the scheme.

Note: For example, explanations should be given on the nature of the scheme; the markets covered; the instruments used; the risk and reward characteristics of the strategy; the circumstances under which the scheme would work best and the circumstances hostile to the performance of the scheme; the risk management and internal control mechanism, including the setting of investment and borrowing parameters to control the risks; the terms of the offering; the ~~on-going~~ongoing monitoring of the scheme's investment and asset allocation process and the performance of the scheme; the ~~on-going~~ongoing monitoring of the standards of the services provided by key service providers, for example, prime brokers and administrators and the replacement process of these service providers and the responsibilities of each of the relevant parties.

The offering document should be written in plain language. The Commission specifically encourages the use of a glossary to explain technical terms.

Details of unauthorized funds must not be shown in the offering document. Where names of such funds are mentioned, these must be clearly marked as unauthorized and not available to Hong Kong residents.

(t) The management company must disclose the measures and safeguards put in place for the management of conflicts of interest in relation to the operation of the scheme.

(u) All advertisements must prominently display the warning statements referred to in 8.7(r) ~~above~~.

Application form

(v) All application forms of the scheme must state prominently that the scheme is a hedge fund and there are special risks involved with investment in the scheme, and direct investors to read the offering document.

Financial reports

(w) The management company must issue regular reports to holders on the scheme activities at least on a quarterly basis. Reports must be prepared and distributed

in accordance with the Guidelines on Hedge Funds Reporting Requirements [see Appendix H].

8.8 Structured funds

The following general criteria shall apply to a ~~collective investment~~ scheme, known as structured fund, which seeks to achieve its investment objective primarily through ~~investing substantially~~investment in financial derivative instruments, for example futures, swap or market access products or similar arrangements. A structured fund is passively managed and usually tracks the performance of an index [see 8.6(e)] and/or offers structured pay-outs when certain pre-determined conditions are met and its global exposure relating to financial derivative instruments for investment purposes [see Note to 7.26] exceeds 50% of its total net asset value. ~~The provisions in other Chapters of this UT Code shall apply where appropriate~~The core requirements in Chapter 7 will apply with the modifications, exemptions or additional requirements as set out under 8.8 of this UT Code.

Notes: (1) The requirements under 8.9 of this UT Code are intended to apply to actively managed ~~funds~~ schemes that ~~invest in financial derivative instruments to~~ gain exposure by investing in ~~different derivatives~~ financial derivative instruments and therefore are not applicable to structured funds~~ other than those under 8.9(f) of this UT Code~~.

(2) An unlisted index fund or a passive ETF must also comply with the requirements in 8.8 of this UT Code if the unlisted index fund's or the passive ETF's global exposure relating to financial derivative instruments for investment purposes [see Note to 7.26] *exceeds 50% of its total net asset value.*

(a) The management company of a structured fund and the issuer of financial derivative instruments shall be independent of each other.

Notes: (1) The management company cannot also act as the issuer of financial derivative instruments.

(2) The index adopted by the scheme shall be objectively calculated, measurable and transparent to the public, for instance, the index is rules-based with minimal or no discretion exercisable by the issuer of the financial derivative instruments, and the index level or its calculation formula is accessible by the public. Where such index is provided for the use of the structured fund only, this would raise questions as to the propriety of the fund seeking exposure to such index.

(b) Where the scheme is a mutual fund company, the majority of the board of directors of the scheme shall be independent directors (for example, persons who are not employees or officers of the derivative counterparty).

(c) The valuation of the financial derivative instruments ~~has to be marked-to-market daily. There shall be regular, reliable and verifiable valuation conducted by the manager or trustee or their delegate independent of the issuer of financial derivative instruments, through measures such as the establishment of a~~

~~valuation committee or engagement of third party services. Further, the calculation agent/ fund administrator should be adequately equipped with the necessary resources to conduct independent marked-to-market valuation and to verify the valuation of the financial derivative instruments on a regular basis~~ must meet the requirements set out in 7.28(d)~~;~~.

(d) ~~Collateral has to be provided to limit the exposure of the scheme to the counterparty risk of the issuer of financial derivative instruments to no more than 10% of the net asset value of the scheme~~Notwithstanding 7.28(c), a structured fund should maintain full collateralization and there should be no net exposure to any single counterparty of over-the-counter financial derivative instruments [see Note to 7.28(c)].

Note: The management company shall demonstrate, where appropriate, with proper legal opinion in support, the collateral is held by the trustee-/ custodian of the fund and must be readily accessible / enforceable by it without further recourse to the issuer of the financial derivative instruments.

(e) ~~Collateral must meet the following requirements:~~The collateral requirements in 7.36 shall also be complied with by a scheme falling under 8.8 of this UT Code.

~~(i) Liquidity - sufficiently liquid in order that it can be sold quickly at a robust price that is close to pre-sale valuation. Collateral should normally trade in a deep and liquid marketplace with transparent pricing;~~

~~(ii) Valuation - mark to market daily;~~

~~(iii) Issuer credit quality – of high credit quality; collateral on assets that exhibit high price volatility may be accepted only if suitably conservative haircuts are in place;~~

~~(iv) Diversification – must be appropriately diversified so as to avoid concentrated exposure to any single issuer. The counterparty or other investment limit/exposure of the collateral as a percentage of a scheme's net asset value must not contravene the investment restrictions or limitations set out in Chapter 7;~~

~~*Note: By way of illustration, the value of collateral and the scheme's investment, if any, issued by any single issuer may not exceed 10% of the scheme's net asset value. Where the collateral is in the form of government and other public securities, 7.4 and 7.5 apply.*~~

~~(v) Correlation – correlation between the issuer of the financial derivative instruments and the collateral received must be avoided;~~

~~(vi) Management of operational and legal risks – there must be in existence appropriate systems, operational capabilities and legal expertise for proper collateral management;~~

~~(vii) Independent custody – must be held by the trustee or custodian of the scheme;~~

~~(viii) Enforceability – must be readily accessible / enforceable by the trustee/custodian of the scheme without further recourse to the issuer of the financial derivative instruments; and~~

~~(ix) Not available for secondary recourse – collateral cannot be applied for any purpose except for the purpose of being used as collateral.~~

~~*Note: Structured products whose payouts rely on embedded derivatives or synthetic instruments or securities issued by special purpose vehicles, special investment vehicles or similar entities, shall not be invested by the fund or held as collateral to cover or reduce the counterparty exposure.*~~

(f) The management company has to put in place detailed contingency plans regarding credit events like significant downgrading of credit rating and the collapse of the issuer of financial derivative instruments.

(g) ~~Where the aggregate value of all collateral held by a scheme represents 30% or more of its net assets value, it shall disclose in the scheme's annual and interim reports a description of collateral holdings as required under Appendix E~~The collateral disclosure requirements in 7.37 and 7.38 shall also be complied with by a scheme falling under 8.8 of this UT Code.

Disclosure

(h) In addition to the information in Appendix C, the offering document must contain the following:

(i) disclosure of the structure of the scheme, in plain language and supplemented by visual aids and diagrams (where appropriate);

(ii) description of any potential conflicts of interest and the related risks arising from the same entity or entities within the same group acting in different capacities in relation to the scheme; ~~and~~

(iii) description of any other relevant risks (legal or otherwise) arising from the structure of the scheme;

(iv) clear disclosure of the costs of entering into the swap or market access products or similar arrangements with the counterparty, and the maximum amount of redemption fee;

(v) in respect of the asset portfolio of a scheme investing in unfunded swap, the selection criteria and nature of the asset portfolio [see C2A of Appendix C]; and

(vi) in respect of the valuation of financial derivative instruments, the entity responsible for valuation and frequency of such valuation, the entity responsible for verification of valuation and frequency of such verification and any costs embedded in the valuation of the financial derivative instruments.

8.9 Funds that invest extensively in financial derivative instruments

The following general criteria shall apply to an actively managed ~~non-UCITS~~ scheme, the principal objective of which is investment in financial derivative instruments, or which seeks to acquire financial derivative instruments extensively for investment purposes, but does not meet the ~~specific criteria set out in respect of other scheme types in this chapter or~~ relevant provisions in Chapter 7. For the avoidance of doubt, the scheme shall also comply with provisions in Chapter 7 subject to the modifications, exemptions or additional requirements as set out in 8.9 of this UT Code. ~~other than those in respect of financial derivative instruments which are aggregated and covered under 8.9.~~

~~UCITS schemes that use financial derivative instruments for investment purposes have already complied with the relevant UCITS requirements and thus are not required to comply with 8.9 except for the disclosure requirements set out in 8.9(j) and (k).~~

~~*Financial Derivative Instruments Investments and Related Operational Requirements*~~ *Financial derivative instruments investments and related operational requirements*

(a) Notwithstanding 7.26, ~~A~~a scheme may acquire financial derivative instruments for investment purposes subject to the limit that the scheme's global exposure relating to these financial derivative instruments for investment purposes [see Note to 7.26] does not exceed 100% of the total net asset value of the scheme.

(b) ~~For the purpose of calculating global exposure, the commitment approach shall be used, whereby the derivative positions of a scheme are converted into the equivalent position in the underlying assets embedded in those derivatives, taking into account the prevailing value of the underlying assets, the counterparty risk, future market movements and the time available to liquidate the positions.~~[deleted]

(c) ~~Before undertaking any investment within this category, the management company must have put in place suitable and adequate risk management and control systems to monitor, measure, and manage all the relevant risks in relation to the scheme. The risk management and control systems must (i) be commensurate with the nature and scale of the financial derivative investment activities that it undertakes for the scheme, bearing in mind the retail nature and risk profile of the scheme and (ii) be able to deal with normal and exceptional circumstances including extreme market conditions. The management company must maintain at all times such risk management and control systems.~~[deleted]

(d) ~~The management company must at all times be adequately and suitably staffed in order to properly implement its risk management policy and procedures.~~[deleted]

(e) ~~The management company must at all times demonstrate that those representatives and agents (including for example, administrators, custodian, brokers, valuation agents) appointed by it possess sufficient know-how, expertise and experience in dealing with the underlying investments of the scheme.~~[deleted]

(f) ~~The financial derivative instruments invested by a scheme may be either listed/quoted on a stock exchange or dealt in over-the-counter, provided that:~~The

requirements on financial derivative instruments in 7.28(a), (b) and (d) shall also be complied with by a scheme falling under 8.9 of this UT Code.

~~(i) the underlying consists solely of shares in companies, debt securities, money market instruments, units/shares of collective investment schemes, deposits with substantial financial institutions, government and other public securities and physical commodities (primarily precious metals such as gold, silver, platinum or other bullion), financial indices, interest rates, foreign exchange rates or currencies, in which the scheme may invest according to its investment objectives and policies;~~

~~(ii) the counterparties to over-the-counter derivative transactions or their guarantors are substantial financial institutions; and~~

~~(iii) the valuation of the over-the-counter derivatives is marked-to-market daily, subject to regular, reliable and verifiable valuation and can be sold, liquidated or closed by an offsetting transaction at any time at their fair value at the scheme's initiative. [see also 8.8(c)]~~

(g) ~~The risk exposure to a counterparty of a scheme in an over-the-counter derivative transaction may not exceed 10% of its net asset value.~~The limitation on counterparty exposure in 7.28(c) shall also be complied by a scheme falling under 8.9 of this UT Code.

(h) ~~To limit the exposure to each counterparty as set out in (g) above, the scheme may receive collateral from such issuer, provided that the collateral complies with the requirements set out in 8.8(e).~~The collateral requirements in 7.36 shall also be complied with by a scheme falling under 8.9 of this UT Code.

(i) For the avoidance of doubt, financial derivative instruments acquired for hedging purposes will not be counted towards the 100% limit referred to in 8.9(a) ~~above~~.

Disclosure

(j) The offering document shall contain information in plain language to facilitate investors' understanding of the scheme's investment strategy and risk profile, including:

(i) additional risk disclosures including the risks associated with investments in financial derivative instruments;
(ii) a statement indicating how and where information regarding the risk management and control policy, procedures and methods employed by the scheme will be made available to Hong Kong investors upon request; and
(iii) a summary of the risk management policy and methods employed by the scheme to effectively measure and manage the risks associated with the investments in financial derivative instruments.

(k) The collateral disclosure requirements in ~~8.8(g) above~~ 7.37 and 7.38 shall also be complied with by a scheme falling under 8.9 of this UT Code.

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

(a) A listed open-ended fund/active ETF is a scheme that is listed and traded on the SEHK other than passive ETFs and closed-ended funds under 8.6 and 8.11 of this UT Code respectively.

(b) A listed open-ended fund shall also comply with provisions in Chapter 7 unless otherwise modified below.

(c) Subject to consultation with the SFC, an unlisted fund may set up a listed share class for the purpose of listing on the SEHK and such listed share class should comply with the requirements in 8.10 of this UT Code.

(d) A listed open-ended fund, or a listed share class shall comply with the criteria as set out in 8.6(o) to (q), (s) to (u), (w) and (x).

(e) Where the performance of a listed open-ended fund makes reference to a benchmark, the relevant benchmark shall be disclosed in its offering document.

8.11 Closed-ended funds

The following criteria shall apply to a scheme which is commonly regarded as a closed-ended fund. A closed-ended fund seeking an authorization shall also comply with other applicable provisions in this UT Code including the relevant investment restrictions under Chapter 7 and/or Chapter 8.

Notes: (1) Closed-ended funds are generally subject to redemption restrictions.

(2) For the avoidance of doubt, 8.11 of this UT Code does not apply to a scheme falling within 8.6 and/or 8.10 of this UT Code notwithstanding its units/shares are traded on the SEHK.

(3) Some flexibility from strict compliance of the relevant investment restrictions in Chapter 7 and/or Chapter 8 (for example, the requirements regarding holding of illiquid securities) may be allowed where appropriate taking into account the fund's closed-ended nature and investment strategy. An applicant should consult the SFC at the earliest possible time on any flexibility to be sought.

Listing and dealing

(a) The units/shares in the scheme must be listed and traded on the SEHK.

(b) The scheme must have procedure(s) and mechanism(s) in place to ensure that the scheme is widely held.

Note: The scheme is expected to have a broad base of holders having regard to the adequate shareholder spread requirement for listings of investment companies under the Listing Rules.

(c) The scheme must have in place measure(s) and mechanism(s) which are fair and equitable to holders to address any prolonged significant discount of its secondary trading price on the SEHK to its net asset value.

Note: This may include, for example, providing specified redemption window(s) to allow holders to redeem their units/shares at net asset value *in a manner which is compliant with 8.11(i).*

(d) The maximum interval between the lodgement of a properly documented redemption request for any redemption of units/shares (whether a notice period is required or not) and the payment of redemption money to holders may not exceed 90 calendar days.

Matters requiring holders' approval

(e) Holders' prior approval will be required for the following matters:

(i) retirement or removal of the management company and appointment of the replacement management company;
(ii) material changes in investment objective, policy or restrictions of the scheme;
(iii) new issue of units/shares following listing at a price below net asset value per unit; and
(iv) request for delisting or de-authorization.

Disclosure

(f) The scheme's last closing net asset value must be published on the scheme's website daily or at such times and in such manner as may be acceptable to the Commission.

(g) The potential risk factors regarding the closed-ended nature of the scheme must be fully and prominently disclosed to investors.

(h) The scheme must disclose in its offering document the measures and mechanism referred in 8.11(c), and make appropriate disclosures by way of announcement(s) or notice(s) prior to and after each occasion where any such measures and mechanism are conducted.

Redemptions, takeovers and mergers

(i) Where a scheme proposes any form of redemption, takeover, merger, amalgamation or restructuring, the scheme's management company and the trustee/custodian shall as soon as practicable consult with the Commission on the manner in which such activities could be carried out so that it is fair and equitable to all holders.

Note: The management company and the trustee/custodian should seek to ensure there is fair and equality of treatment of holders; timely and adequate disclosure of information to enable holders to make an informed decision as to the merits of the transaction; and there is a fair and informed market in the units/shares of the schemes affected by such activities.

Chapter 9: Additional requirements for Non-Hong Kong based schemes

Appointment of representative

9.1 A scheme will be required to appoint a Representative in Hong Kong if its management company is not incorporated and does not have a place of business in Hong Kong.

9.2 If a Representative is appointed, the scheme has to maintain the Representative throughout the period it is ~~authorised~~ authorized in Hong Kong.

Functions of a representative

9.3 The Representative is not required to take responsibility for the acts and omissions of the management company or, in the case of the scheme being a ~~company~~mutual fund corporation, the directors of the scheme. It must, however, be authorized on behalf of the scheme and the management company to:~~-~~

(a) receive applications and money for units/shares from persons in Hong Kong;

(b) issue receipts in respect of the application moneys received in accordance with 9.3(a);

(c) issue contract notes to the applicants in accordance with the terms of the scheme;

(d) receive redemption notices, transfer instructions and conversion notices from holders for immediate transmission to the management company or the scheme;

(e) accept any notices or correspondence, including service of process, which holders may wish to serve on the scheme, trustee/custodian or the management company;

(f) notify the Commission immediately if redemption of units/shares ceases, or is suspended [see 10.7];

(g) make available for public inspection in Hong Kong, free of charge, and offer for sale at a reasonable price copies of all constitutive documents of the scheme;

(h) provide holders with information on the scheme including the scheme's financial reports and ~~sales literature~~offering document, and relevant circulars, notices and announcements where applicable [see 11.7A];

(i) deliver to the Commission, if it requests, all accounts and records relating to the sale and redemption of units/shares of the scheme in Hong Kong; and

(j) represent the scheme and the management company in relation to all matters in which any holder normally resident in Hong Kong has a pecuniary interest or which relate to units/shares sold in Hong Kong.

Criteria for appointment

9.4 The management company is encouraged to appoint a Representative within the management group. The Representative must:-

(a) be licensed or registered under the SFO; or

(b) be a trust company registered under Part VIII of the Trustee Ordinance (Chapter 29 of the laws of Hong Kong) and such company is an affiliate of an authorized financial institution defined under the SFO and is acceptable to the Commission.

9.5 [deleted]

9.6 The Representative must be properly appointed to represent the scheme and the management company.

Written undertaking

9.7 The Representative must provide the Commission with a written undertaking that it will perform the duties required of a Representative under this UT Code.

Retirement and replacement of the representative

9.8 Should the Representative retire or be dismissed, it must be replaced as soon as possible, by another Representative whose appointment is subject to the approval of the Commission [see 11.1(b)].

~~Hong Kong representative agreement~~

9.9 ~~Details of all contracts between the Representative, the scheme and/or the management company must be supplied to the Commission. Any subsequent amendments of these contracts must be notified to the Commission.~~[deleted]

Jurisdiction

9.10 Nothing in the constitutive documents may exclude the jurisdiction of the courts of Hong Kong to entertain an action concerning the scheme.

Part III: Post-authorization requirements

Chapter 10: Operational matters

Valuation and pricing

10.1 A scheme must be valued and priced in accordance with the provisions of its offering and constitutive documents and the provisions of Chapter 6.

Pricing errors

10.2 If an error is made in the pricing of units/shares, the error should be corrected as soon as possible and any necessary action should be taken to avoid further error. Trustee/custodian should be informed of any error in the pricing of units/shares in a timely manner.

10.2A If the error results in an incorrect price of 0.5% or more of a scheme's net asset value per unit/share, the trustee/custodian and the Commission must be informed immediately.

Note: For the avoidance of doubt, any error that accounts for less than 0.5% of the scheme's net asset value per unit/share or net asset value individually but amounts to 0.5% of the scheme's net asset value per unit/share or net asset value or more in aggregate for incidences that occur in a simultaneous or successive manner, such errors should be reported to the Commission immediately.

10.2B For any error in the pricing of units/shares of a scheme referred to in 10.2A (and the Note), the affected investors (including former holders) and/or the scheme itself should be compensated for the loss incurred. In such a case, the affected ~~In such a case,~~ investors and/or the scheme should be compensated as follows, unless determined otherwise by the trustee/custodian with justification to the Commission:

(a) where total loss to individual investors (either purchasing or redeeming) is more than HK$100 or such lesser amount as the management company may decide, investors should be compensated in such manner as the management company should determine with the approval of the trustee/custodian; ~~and~~

(b) where the loss is to the management company, no compensation should be paid;~~.~~ and

(c) where the loss is to the scheme, the scheme should be compensated in all circumstances referred to in 10.2A.

Note: In the event that the management company is to compensate one or more affected investors for errors not falling under 10.2A, compensation to all other affected investors should be made on the same basis.

~~**Changes to dealing**~~

10.3 ~~Where a scheme deals at a known price, and based on information available, the price exceeds or falls short of the current value of the underlying assets by more than 5%, the~~

~~management company should defer dealing and calculate a new price as soon as possible.~~[deleted]

10.4 ~~A permanent change in the method of dealing may only be made after one month's notice to holders.~~[deleted]

10.5 ~~A temporary change may only be made:-~~[deleted]

~~(a) in exceptional circumstances, having regard to the interests of holders;~~

~~(b) if the possibility of a change and the circumstances in which it can be made have been fully disclosed in the offering document; and~~

~~(c) with the approval of the trustee/custodian.~~

Suspension and deferral of dealings

10.6 Suspension of dealings may be provided for ~~only in exceptional circumstances~~by the management company in consultation with the trustee/custodian, having regard to the best interests of holders. The management company must regularly review any prolonged suspension of dealings and take all necessary steps to resume normal operations as soon as practicable.

10.7 The management company or the Representative [see 9.3(f)] must immediately notify the SFC if dealing in units/shares ceases or is suspended. The fact that dealing is suspended must be published immediately following such decision and at least once a month during the period of suspension in an appropriate manner.

10.8 Where redemption requests on any one dealing day exceed 10% of the total net asset value or total number of units/shares in issue, redemption requests in excess of 10% may be deferred to the next dealing day.

Note: The Commission may on a case-by-case basis accept a higher or lower threshold to trigger deferral of dealing as reasonably determined by the management company, taking into account the specific circumstances of the scheme, provided that such threshold is clearly disclosed in the offering document.

Transactions with connected persons

10.9 No person may be allowed to enter on behalf of the scheme into underwriting or sub-underwriting contracts without the prior consent of the trustee/custodian and unless the scheme or the management company provides in writing that all commissions and fees payable to the management company under such contracts, and all investments acquired pursuant to such contracts, will form part of the scheme's assets.

10.10 If cash forming part of the scheme's assets is deposited with the trustee/custodian, the management company, ~~the~~ investment ~~adviser~~delegate or ~~with~~ any of their connected person~~s of these companies~~ (being an institution licensed to accept deposits), such cash deposit shall be maintained in a manner that is in the best interests of the holders, having regard to ~~interest must be received on the deposit at a rate not lower than~~ the prevailing commercial rate for a deposit of ~~that~~similar type, size and term negotiated at arm's length in accordance with ordinary and normal course of business.

10.11 All transactions carried out by or on behalf of the scheme must be executed at arm's length and in the best interests of the holders. In particular, any transactions between the scheme and the management company, investment ~~adviser~~delegate, ~~the~~ directors of the scheme or any of their connected person(s) as principal may only be made with the prior written consent of the trustee/custodian. All such transactions must be disclosed in the scheme's annual report [see item 2 under Notes to the Financial Reports in Appendix E].

10.12 Neither the management company, investment delegate nor any of ~~its~~ their connected persons may retain cash or other rebates from a broker or dealer in consideration of directing transactions in scheme property to the broker or dealer save that goods and services (soft dollars) may be retained if:~~-~~

(a) the goods or services are of demonstrable benefit to the holders;

(b) transaction execution is consistent with best execution standards and brokerage rates are not in excess of customary institutional full-service brokerage rates;

(c) adequate prior disclosure is made in the scheme's offering document the terms of which the holder has consented to [see C15 of Appendix C]; ~~and~~

(d) periodic disclosure is made in the scheme's annual report in the form of a statement describing the ~~manager's~~ soft dollar policies and practices of the management company or investment delegate, including a description of the goods and services received by ~~the manager.~~them [see item 3 under Notes to the Financial Reports in Appendix E]; and

(e) the availability of soft dollar arrangements is not the sole or primary purpose to perform or arrange transaction with such broker or dealer.

Note: Goods and services falling within 10.12(a) ~~above~~ may include: research and advisory services; economic and political analysis; portfolio analysis, including valuation and performance measurement; market analysis, data and quotation services; computer hardware and software incidental to the above goods and services; clearing and custodian services and investment-related publications. Such goods and services may not include travel, accommodation, entertainment, general administrative goods or services, general office equipment or premises, membership fees, employee salaries, or direct money payments.

10.13 In transacting with brokers or dealers connected to the management company, investment ~~adviser~~delegate, directors of the scheme, trustee/custodian or any of their connected persons, the management company must ensure that it complies with the following obligations:

(a) such transactions should be on arm’s length terms;

(b) it must use due care in the selection of brokers or dealers and ensure that they are suitably qualified in the circumstances;

(c) transaction execution must be consistent with applicable best execution standards;

(d) the fee or commission paid to any such broker or dealer in respect of a transaction must not be greater than that which is payable at the prevailing market rate for a transaction of that size and nature;

(e) the management company must monitor such transactions to ensure compliance with its obligations; and

(f) the nature of such transactions and the total commissions and other quantifiable benefits received by such broker or dealer shall be disclosed in the scheme's annual report.

Chapter 11: ~~Documentation~~Scheme changes, notifications and reporting

Scheme changes, notifications and ~~Ongoing~~ ongoing disclosures

11.1 The proposed changes to a scheme in respect of the following must be submitted to the Commission for prior approval:

(a) changes to constitutive documents (other than changes that have been certified by the trustee/custodian as provided under 6.7 or approved by holders or changes which do not require prior approval from the Commission);

(b) changes of ~~key operators (including~~ the trustee~~-~~/~~-~~custodian, management company~~, and its~~ investment delegates and Hong Kong ~~representative)~~Representative, and their regulatory status~~ and controlling shareholder~~;

(c) (i) material changes in investment objectives, policies and restrictions of the scheme (including expansion in the purpose or extent of use of financial derivative~~s~~ instruments for investment purposes [see 7.26])~~,~~;

(ii) ~~fee structure,~~introduction of new fees and charges, or increase in fees and charges payable out of the property of the scheme or by the investors (other than an increase within the permitted maximum level as disclosed in the Hong Kong Offering Document [see Note(3) to 11.1A]); and

(iii) material changes in dealing arrangements, ~~and~~ pricing arrangements or distribution policy of the scheme; and

(d) any other changes that may ~~materially prejudice~~ have a material adverse impact on holders' rights or interests (including changes that may limit holders' ability in exercising their rights).

11.1A For changes to a scheme that require the Commission's prior approval pursuant to 11.1, the Commission will determine whether holders should be notified and the period of notice (if any) that should be applied before the changes are to take effect as provided in 11.2. The revised Hong Kong Offering Document as a result of such changes should be submitted to the Commission for prior authorization.

Notes: *(1)* ~~*Normally, the Commission will expect that one month's prior written notice (or such longer period as required under applicable laws and regulations or the provisions as set out in the offering or constitutive documents) should be provided to holders in respect of the changes. However, the Commission may permit a shorter period of notice if the change is not significant or may require a longer period of notice (up to three months) in exceptional circumstances. [see also 6.7]*~~*[deleted]*

(2) ~~*For the purposes of 11.1A, significant changes would include, for example, changes in investment objectives or major investment policies, and fee structure.*~~*[deleted]*

(3) *For any increase in fees and charges from the current level ~~as stated in the Hong Kong Offering Document~~ up to the permitted maximum level ~~permitted by the constitutive documents~~as disclosed in the Hong Kong Offering Document, prior approval from the Commission is not required, but no less than one month's prior notice must be given to holders.*

11.1B For changes to a scheme that do not require the Commission's prior approval pursuant to 11.1, ~~unless there is a specified minimum prior notice period in this UT Code,~~ the management company should provide holders with reasonable prior notice, or inform holders as soon as reasonably practicable of any information concerning the scheme which is necessary to enable holders to appraise the position of the scheme as provided in 11.2. The Hong Kong Offering Document may be updated to incorporate such changes and reissued without further authorization provided that the content and format of such document remains fundamentally the same as the version previously authorized. The revised Hong Kong Offering Document must be filed with the Commission, together with a marked-up version against the previously filed version, within one week from the date of issuance.

Note: The management company should inform holders as soon as reasonably practicable of any material adverse change in the financial conditions or business of the key counterparties to a scheme that it is aware of. 'Key counterparties' include the management company, guarantor (where relevant), trustee/custodian and ~~swap~~ major counterparty of the fund for over-the-counter financial derivative instruments or securities financing transactions.

Notices to holders

11.2 Notification to holders must be made in the language(s) in which the scheme is offered to investors ~~in respect of any changes or proposed changes to the offering or constitutive documents as determined by the Commission pursuant to 11.1A~~. Reasonable notice period(s) should be provided to the holders in order to enable them to appraise the position of the scheme and to make an informed judgement of their investments in the scheme, where applicable.

Notes: In determining the notice period for changes to a scheme falling under 11.1 or 11.1B, the following shall apply:

(1) normally, one month's prior written notice (or such longer period as required under applicable laws and regulations or the provisions as set out in the offering or constitutive documents) is expected to be provided to holders unless as provided under Notes(2) or (3) to 11.2 or otherwise agreed by the Commission;

(2) a shorter prior notice period may be permitted where the proposed changes to the scheme are of demonstrable benefit to holders;

(3) unless otherwise specified by the Commission, holders should be informed as soon as reasonably practicable for changes to the scheme which are to provide clarification or relate to administrative matters; and

(4) ~~In~~ in the case of schemes domiciled outside Hong Kong, notwithstanding the notice provisions of a scheme's home jurisdiction, the Commission may require additional notice to ensure that Hong Kong investors have

sufficient time to consider and respond to the documentation. For example, any general meeting at which a special resolution is to be proposed shall be convened on at least 21 days' prior notice and that any general meeting at which an ordinary resolution is to be proposed shall be convened on at least 14 days' prior notice.

The management company is encouraged to consult the Commission in case of doubt.

11.2A Subject to 11.4 and 11.5 ~~below~~, notices to holders need not be approved by the Commission prior to issuance, but are required to be filed with the Commission within one week from the date of issuance of the notice. The Commission, however, retains its power to require issuers to submit draft notices for review where the Commission considers it appropriate. For the avoidance of doubt, matters relating to 11.1 should be approved by the Commission prior to the distribution of the relevant notices to holders.

11.2B The management company has the responsibility to ensure that notices to holders are not misleading and contain accurate and adequate information to keep investors informed. All notices should contain a Hong Kong contact number for investors to make enquiries.

Note: Notices should not include any reference to a specific date or timetable in respect of ~~the~~ any changes falling under 11.1 and consequential changes made to the offering or constitutive documents where such date or timetable has not been agreed in advance with the Commission.

11.3 (Repealed)

Withdrawal of authorization

11.4 Following the authorization of a scheme, ~~its management company~~an application for withdrawal of authorization of the scheme must be submitted to the Commission for prior approval. ~~should, s~~Subject to 11.5 ~~below~~, ~~give~~ at least three months' notice should be provided to holders of any intention not to maintain such authorization. Such notice should be submitted to the Commission for prior approval and contain information which is necessary to enable holders to make an informed judgement of the proposed withdrawal of authorization by the management company (including the reasons for the withdrawal of authorization, consequences of the withdrawal, any proposed changes in the operation of the scheme and their effects on existing investors, the alternatives available to investors (including, if possible, a right to switch without charge into another authorized scheme) and, where applicable, an estimate of any relevant expenses and who is expected to bear them).

Notes: (1) Subject to the scheme having served notice period for merger or termination under 11.5, the management company may apply for withdrawal of authorization of the scheme with immediate effect following the completion of the merger or termination (as the case may be).

(2) For an application for withdrawal of authorization in cases other than in connection with a merger or termination of a scheme, the management company must demonstrate to the satisfaction of the Commission that proper measures have been put in place to ensure that the interests of holders who may remain to be invested in the scheme will be

safeguarded (e.g. for a scheme domiciled outside Hong Kong, the scheme will continue to be regulated or supervised in a jurisdiction acceptable to the Commission).

Merger or termination

11.5 If a scheme is to be merged or terminated, ~~in addition to~~the management company should follow~~ing any~~ the procedures as set out in the scheme's constitutive documents or governing law~~, notice must~~. Notice should be given to investors as determined by the Commission. Such notice should be submitted to the Commission for prior approval and contain information necessary to enable holders to make an informed judgement of the proposed merger or termination by the management company (including the reasons for the merger or termination, the relevant provisions under the constitutive documents that enable such merger or termination, the consequences of the merger or termination and their effects on existing investors, the alternatives available to investors (including, if possible, a right to switch without charge into another authorized scheme), the estimated costs of the merger or termination and who is expected to bear them).

Notes: (1) Normally, the Commission will expect that at least one month's prior written notice (or such longer period as required under applicable laws and regulations or the provisions as set out in the offering or constitutive documents) to be provided to holders.

(2) In effecting a merger or termination, the management company must put in place proper measures to minimize the opportunity of any holders to benefit from more favourable or advantageous conditions of the scheme, taking due account of the interests of the holders.

Reporting requirements

~~*Reporting*~~ *Financial reports to holders*

11.6 ~~At least two reports~~Financial reports of a scheme must be published in respect of ~~each~~ its financial year. Annual reports ~~and accounts~~ containing the information provided in Appendix E must be published and distributed to holders within four months of the end of the scheme's financial year and interim reports containing information required in Appendix E must be published and distributed to holders within two months of the end of the period they cover.

As an alternative to the distribution of printed financial reports, holders may be notified of where such reports, in printed and electronic forms, can be obtained within the relevant time frame.

Notes: (1) Where a scheme does not issue bilingual annual and interim reports, the offering document of the scheme shall clearly disclose that annual and interim reports are available in English or Chinese language only, as the case may be.

(2) The Commission may accept the annual reports and interim reports to cover an extended reporting period in cases when the scheme is first launched or upon its termination.

11.6A The annual reports must be prepared in compliance with internationally recognized accounting standards and the interim reports must apply the same accounting policies and method of computation as are applied in the annual reports of the scheme.

Note: For the purposes of 11.6A, internationally recognized accounting standards may include Hong Kong Financial Reporting Standards (HKFRS) or International Financial Reporting Standards (IFRS) or such other accounting standards acceptable to the Commission.

Publication of prices of a scheme

11.7 The scheme's latest available offer and redemption prices or net asset value must be calculated and made public free of charge on every dealing day in an appropriate manner. If dealing is suspended, this must be published in accordance with 10.7.

Note: Means of dissemination may include newspapers, telephone hotlines and websites.

Maintenance of a website

11.7A A scheme should, as a matter of best practice, maintain a website for publication of its offering document, circulars, notices, announcements, financial reports and the latest available offer and redemption prices or net asset value of the scheme.

Reporting to Commission

11.8 Subsequent to the authorization of the scheme, all financial reports produced by or for the scheme~~, its management company and trustee/custodian~~ must be filed with the Commission within the time frame specified in 11.6.

11.9 The management company or the Representative must supply to the Commission, upon request, all information relevant to the scheme's financial reports and accounts.

11.10 ~~The management company or the Representative should notify the Commission as soon as possible of any change to the data in the application form.~~[deleted]

Advertising materials

11.11 Advertisements and other invitations to invest in a scheme, including but not limited to those issued by licensed or registered persons acting as the distributors of the scheme, must comply with the Advertising Guidelines. All advertisements must be submitted to the Commission for authorization prior to their issue or publication in Hong Kong, unless exempted under section 103 of the SFO. For the avoidance of doubt, even if an advertisement is exempted from obtaining authorization from the Commission under the SFO, the issuer must still ensure that the advertisement or invitation complies with the Advertising Guidelines.

11.12 Where authorization by the Commission is required, it is recommended that the issuer of advertisements nominate one person, such as the Approved Person, the Hong Kong Representative or any other persons acceptable to the Commission, based in Hong Kong to liaise with the Commission. Authorization may be varied or withdrawn by the Commission as it deems fit. Once authorized, the advertisement may be used in any

distribution media and reissued without further authorization with updated performance information of schemes and general market commentary provided that the content and format of such advertisement remain fundamentally the same as the version previously authorized and the advertisement, when reissued, is in compliance with the Advertising Guidelines.

Note: For radio, television, cinema or other time-limiting advertisements / broadcasts that require authorization by the Commission, the script of any verbal statements in such advertisements should be submitted for the Commission's advance clearance, followed by the demo of the broadcast (e.g. digital files) for formal authorization.

11.13 Issuers must keep adequate records of the advertisements issued, either in actual form or by way of a copy of the final proof, and the relevant supporting documents for substantiation of information presented thereon. Such records must be retained for at least 3 years from the latest date of publication / distribution of an advertisement and made available to the Commission upon request.

Mention of SFC authorization

11.14 Where a scheme is described as having been authorized by the Commission it must be stated that authorization does not imply official recommendation by adding a prominent note in the following terms to the offering document and advertisements and other invitations to invest in the scheme:

SFC authorization is not a recommendation or endorsement of a scheme nor does it guarantee the commercial merits of a scheme or its performance. It does not mean the scheme is suitable for all investors nor is it an endorsement of its suitability for any particular investor or class of investors.

Appendix A1

~~[Recognized jurisdiction schemes]~~

~~[To be set out in the Commission's website to facilitate future updates]~~

(deleted)

Appendix A2

~~[Inspection regimes]~~

~~[To be set out in the Commission's website to facilitate future updates]~~

(deleted)

Appendix B

~~[Application form]~~

~~[To be set out in the Commission's website to facilitate future updates]~~

(deleted)

Appendix C

Information to be disclosed in the offering document

This list is not intended to be exhaustive. The directors of the scheme (in the case of a mutual fund corporation) or the management company are obliged to disclose any information which may be necessary for investors to make an informed judgement. For the avoidance of doubt, the offering document should contain all applicable disclosure as required by this UT Code.

Constitution of the scheme

C1 Name, registered address and place and date of creation of the scheme, with an indication of its duration if limited.

Investment objectives and restrictions

C2 Details of investment objectives and policy, including a summary of investment and borrowing restrictions [see Chapter 7 and Chapter 8 (for specialized schemes)]. If the nature of the investment policy so dictates (such as in the case of hedge funds under 8.7 of this UT Code, or a scheme for which its investment objective is achieved primarily through investments in financial derivative instruments or extensive use of financial derivative instruments for investment purposes, ~~as in the case of UCITS schemes with expanded investment powers and schemes~~ under 8.7, 8.8 and 8.9 of this UT Code), a warning that investment in the scheme is subject to abnormal risks, a description of the risks involved, and where appropriate, the risk management policy in place.

If applicable, details of securities financing transactions of the scheme including, at a minimum, the following:

(a) general description of the use of these transactions;

(b) treatment of all revenue generated from such transactions and all the direct and indirect expenses to be incurred. In particular, details and basis of the direct and indirect expenses to be borne by the scheme and paid to any operating party;

(c) criteria for selecting the counterparties, including legal and regulatory status, country of origin and minimum credit rating;

(d) form and nature of the collateral to be received by the scheme, including cash and non-cash assets;

(e) maximum and expected level of the scheme's assets available for these transactions expressed as proportion of the net asset value of the scheme, and the type of assets that can be subject to these transactions;

(f) involvement of any connected person(s) of the management company, investment delegate, or trustee/custodian in these transactions and details of the arrangement (such as securities lending agent);

(g) custody / safekeeping arrangement of assets subject to these transactions (such as with the trustee/custodian of the scheme); and

(h) risks associated with these transactions, such as operational, liquidity, counterparty, custody and legal risks.

Collateral policy and criteria

C2A Selection criteria, nature and policy of the collateral held by the scheme and description of the holdings of collateral, including:

(a) the nature and quality of the collateral, including asset type (e.g. cash, cash equivalents and money markets; government or corporate (whether investment grade / non-investment grade); and others), issuer, maturity and liquidity;

(b) ~~identity of counterparty providing the collateral~~criteria for selecting counterparties, including legal and regulatory status, country of origin and minimum credit rating;

(c) the source and basis of valuation of collateral, including marked-to-market arrangements;

(d) circumstances under which the collateral may be enforced and whether it will be subject to any net-off or set-off;

(e) description of haircut policy ~~(if any)~~;

(f) ~~description of~~ collateral diversification ~~requirements~~and correlation policies ~~(if any)~~; ~~and~~

(g) ~~value of the scheme (by percentage) secured/ covered by collateral with breakdown by asset class/ nature and credit ratings.~~[deleted]

(h) policies on re-investment of cash collateral, including the maximum amount available for cash collateral re-investment;

(i) (applicable to hedge funds) maximum amount available for collateral re-use or re-hypothecation;

(j) custody / safekeeping arrangement (such as with the trustee/custodian of the scheme) of collateral received and provided; and

(k) risks associated with collateral management and, if applicable, re-investment of cash collateral.

Valuation of property and pricing

C2B A summary of the valuation policies and procedures of the scheme, including the basis and frequency of valuation for the assets to be held by the scheme, and the circumstances under which fair value adjustments may be employed and the relevant procedures to be undertaken (including consultation with trustee/custodian of the scheme) and the pricing policies, including the methods of pricing, methods of calculating the scheme's net asset value and issue and redemption prices and the circumstances under which they can change.

Liquidity risk management

C2C Details of liquidity risk management of the scheme, including:

(a) description of liquidity risks and the associated impact on the scheme and holders;

(b) summary of the liquidity risk management policy and process; and

(c) description of liquidity risk management tools that may be employed, including the circumstances in which the tools may be activated and the impact on the scheme and holders upon activation [see C11 of this Appendix].

Operators and principals

C3 The names and registered addresses of the following parties (where applicable):-

(a) the directors of the scheme~~/~~ (in the case of mutual fund corporation), and the management company and its board of directors;
(b) the trustee/custodian;
(c) the investment ~~adviser~~delegate;
(d) the Hong Kong Representative;
(e) the Hong Kong distribution company, if different from C3(d) ~~above~~;
(f) the auditors; and
(g) the registrar.

Characteristics of units/shares

C4 Minimum investment and subsequent holding (if any).

C5 A description of the different types of units/shares, including their currency of denomination.

C6 Form of certification.

C7 Frequency of valuation and dealing, including dealing days.

Application and redemption procedures

C8 Dedicated channel(s) for dissemination of price information [see 11.7].

C9 Procedure for subscribing/redeeming units/shares, and in the case of umbrella funds, conversion of units/shares.

C10 The maximum interval between the request for redemption and the despatch of the redemption proceeds [see 6.14 and D9 (b) of Appendix D].

C11 A summary of the circumstances in which dealing in units/shares may be deferred or suspended.

C12 Statement that no money should be paid to any intermediary in Hong Kong who is not licensed or registered to carry on Type 1 regulated activity under Part V of the SFO.

Distribution policy

C13 The distribution policy and the approximate dates on which dividends (if any) will be paid (if applicable).

Fees and charges

C14

(a) the level of all fees and charges payable by an investor [see 6.16 to 6.18], including all charges levied on subscription, redemption and conversion (in the case of umbrella funds);

(b) the level of all fees and charges payable by the scheme, including management fees, performance fees (where applicable), trustee/custodian fees and start-up expenses; and

(c) the notice period for fee increases [see 11.1A, 11.1B and 11.2].

Notes: (1): In the case of indeterminable fees and charges, the basis of calculation or the estimated ranges should be disclosed.

(2): Where performance fee is levied, the calculation methodology together with illustrative examples to demonstrate the charging method and the impact of the absence of equalization arrangement should be disclosed.

C15 Where ~~a connected person of~~ the management company, ~~or the~~ investment ~~adviser~~delegate, or any of their connected persons receives goods or services from a broker or dealer [see 10.12], a summary ~~of the terms under which such goods or services are received~~ describing the presence of such policies and practices, the types of goods and services that may be acquired through soft dollar policies and practices, and the measures taken to manage and minimize conflict of interest should be disclosed. In addition, a nil statement regarding retention of cash rebates by any of these persons.

Taxation

C16 Details of Hong Kong and principal taxes levied on the scheme's income and capital, including tax, if any, deducted on distribution to holders.

Financial ~~R~~reports ~~and accounts~~

C17 The date of the scheme's financial year.

C18 Particulars of what reports will be sent or made available to registered holders and when [see 11.6]. ~~If there are bearer units in issue, information must be given on where in Hong Kong reports can be obtained.~~

C18A A statement whether the annual and interim reports would be published in English and/or Chinese.

Warnings

C19 Statements/warnings must be prominently displayed in the offering document as follows:~~-~~

(a) "Important - if you are in any doubt about the contents of this offering document, you should seek independent professional financial advice".

(b) other warnings as required by this UT Code.

Product KFS

C19A A Product KFS which is deemed to form a part of the offering document [see ~~notes~~ Notes to 6.2A].

General information

C20 A list of constitutive documents and an address in Hong Kong where they can be inspected free of charge or purchased at a reasonable price.

C21 The date of publication of the offering document.

C22 A statement that the management company or ~~and~~ the directors of the scheme (in the case of a mutual fund corporation) accept full responsibility for the accuracy of the information contained in the offering document and confirm, having made all reasonable enquiries, that to the best of their knowledge and belief there are no other facts the omission of which would make any statement misleading.

C22A If available, website address of the scheme which contains publication of its offering document, circulars, notices, announcements, financial reports and the latest available offer and redemption prices or net asset value. A statement that such website has not been reviewed by the Commission, if applicable.

C23 Details of unauthorized schemes must not be shown in the offering document. Where names of such schemes are mentioned, these must be clearly marked as unauthorized and not available to the public in Hong Kong ~~residents~~.

Termination of scheme

C24 A summary of the circumstances in which the scheme can be terminated.

C25 A summary of the arrangements handling unclaimed proceeds of holders during the termination process, including the minimum period of which such proceeds must be maintained prior to any reallocation, and the procedures to be adopted upon the lapse of such minimum period.

Custody arrangements

C26 A summary of the custody arrangements in respect of the scheme's assets and the material risks associated with such arrangements (if any).

Appendix D

Contents of the constitutive documents

This Appendix intends to set out the core requirements with respect to the contents of the constitutive documents. For the avoidance of doubt, the constitutive documents, among others, must conform in substance to the intended operative effect of the provisions in Chapter 4.

D1 Name of scheme

D2 Participating parties

A statement to specify the participating parties including the management company, the Hong Kong representative, trustee/custodian, and investment ~~adviser~~ delegate (if any).

D3 Governing law

Note: See 6.6 and 9.10.

D4 For unit trusts only:-

(a) A statement that the deed is binding on each holder as if he had been a party to it and so to be bound by its provisions and authorizes and requires the trustee and the management company to do as required of them by the terms of the deed.

(b) A provision that a holder is not liable to make any further payment after he had paid the purchase price of his units and that no further liability can be imposed on him in respect of the units which he holds.

(c) A declaration that the property of the scheme is held by the trustee on trust for the holders of the units pari passu according to the number of units held by each holder. (This may be modified as appropriate for schemes offering income and accumulation units).

(d) A statement that the trustee will report to holders in accordance with 4.5(f) and to list out the obligations of the trustee as set out in 4.5.

(e) A statement that the trustee should retire in the manner as stipulated in 4.6.

D5 For mutual fund corporations only:-

(a) A declaration that the property of the scheme is held by the custodian on trust for the scheme.

(b) A statement to list the obligations of the custodian as set out in 4.5.

(c) A statement that the custodian should retire in the manner as set out in 4.6.

Note: See Note(1) to 4.1.

D6 Management company

(a) A statement to list the obligations of the management company as set out in 5.10.

(b) A statement that the management company should retire as set out in 5.11.

Note: See Note(1) to 4.1.

D7 Investment and borrowing restrictions

A statement to list the restrictions on the investment ~~of the deposited property~~ and the maximum borrowing limit of the scheme. [see Chapter 7 and Chapter 8 (for specialized ~~funds~~schemes)]

D8 Valuation of property and pricing

The following rules on valuation of property and pricing must be stipulated: –

(a) the method of determining the value of the assets and liabilities of the property of the scheme and the net asset value accordingly;

(b) the method of calculating the issue and redemption prices; and

(c) the method of pricing and the circumstances under which it can change.

D9 Suspension and deferral of dealing

The following must be stated:-

(a) the circumstances under which the dealing of units/shares can be deferred or suspended; and

(b) the maximum interval between the receipt of a properly documented request for redemption of units/shares and the payment of the redemption money to the holder, which may not exceed one calendar month.

D10 Fees ~~&~~and charges

A statement to list out the fees and charges payable out of the property of the scheme. ~~The following must be stated:-~~

(a) ~~the maximum percentage of the initial charge payable to the management company out of the issue price of a unit/share;~~[deleted]

(b) ~~the maximum fee payable to the management company out of the property of the scheme, expressed as an annual percentage;~~[deleted]

(c) ~~fee payable to trustee/custodian;~~[deleted]

(d) ~~preliminary expenses to be amortized against the property of the scheme; and~~[deleted]

(e) ~~all other material fees and charges payable out of the property of the scheme.~~[deleted]

D11 Meetings

Provisions on the manner in which meetings are conducted in accordance with 6.15.

D12 Transactions with connected persons

The following must be stated:~~-~~

(a) cash forming part of the property of the scheme may be placed as deposits with the trustee/custodian, management company, ~~the~~ investment ~~adviser~~delegate or ~~with~~ any of their connected persons ~~of these companies~~ (being an institution licensed to accept deposits), so long as such cash deposit shall be maintained in a manner that is in the best interests of holders, having regard to the prevailing ~~so long as that institution pays interest thereon at no lower rate than is, in accordance with normal banking practice, the~~ commercial rate for a deposit~~s~~ of similar type, ~~the~~ size ~~of the deposit in question~~ and term negotiated at arm's length in accordance with ordinary and normal course of business;

(b) money can be borrowed from the trustee/custodian, management company, ~~the~~ investment ~~adviser~~delegate or any of their connected persons (being a bank) so long as that bank charges interest at no higher rate, and any fee for arranging or terminating the loan is of no greater amount than is in accordance with normal banking practice, the commercial rate for a loan of the size and nature of the loan in question negotiated at arm's length;

(c) any transactions between the scheme and the management company, the investment ~~adviser~~delegate, directors of the scheme or any of their connected persons as principal may only be made with the prior written consent of the trustee/custodian; and

(d) all transactions carried out by or on behalf of the scheme must be at arm's length and executed on the best available terms.

D13 Distribution policy and date

Distribution policy and approximate date when income will be distributed (if applicable).

D14 ~~Annual accounting period~~Financial year

Calendar year date on which the ~~annual accounting period~~ financial year ends. In the case of an umbrella fund, the ~~accounting period~~ financial year should be the same for all constituent funds.

D15 Base currency

A statement of the base currency of the scheme.

D16 Modification of the constitutive documents

A statement of the means by which modifications to the constitutive documents can be effected [see 6.7].

D17 Termination of scheme

A statement of the circumstances in which the scheme can be terminated.

Appendix E

Contents of financial reports

Introduction

Pursuant to 11.6, financial reports of a scheme must be prepared and published in respect of its financial year.

Annual reports must be prepared in compliance with internationally recognized accounting standards pursuant to 11.6A, and contain all the information required in this ~~appendix~~ Appendix and a report issued by the trustee/custodian to holders as required by 4.5(f).

Interim reports must apply the same accounting policies and methods of computation as are applied in the annual reports of the scheme pursuant to 11.6A and disclose a statement to such effect or include a description of the nature and effect of any change in these policies and methods. Interim reports must at least contain the information/items listed under the Statement of Assets and Liabilities, Revenue Statement, Statement of Movement in Capital Account, ~~and the~~ Investment Portfolio and Holdings of Collateral. For the avoidance of doubt, if no annual report has been prepared and published pursuant to 11.6 for the relevant reporting period immediately preceding the publication of an interim report (e.g. in the case of a newly launched scheme), such interim report must disclose the accounting policies and methods of computation that are significant for holders to appraise the financial position and performance of a scheme. Where the scheme has paid or proposes to pay an interim dividend, the amount of dividend should be disclosed.

All financial reports must contain comparative figures for the previous period except for the Investment Portfolio and Holdings of Collateral.

The mention of any unauthorized schemes in the financial reports must be indicated as “Not authorized in Hong Kong and not available to ~~Hong Kong Residents~~the public in Hong Kong”.

For all financial reports, ~~The~~ the items listed under the Statement of Assets and Liabilities, Revenue Statement, ~~Distribution Statement,~~ Statement of Movements in Capital Account and the Notes to the ~~Accounts~~Financial Reports, where applicable, must be disclosed separately. It is however, not mandatory to adopt the format as shown or to disclose the items in the same order and a scheme may use different titles for these statements.

While the SFC recognizes that financial reports of recognized jurisdiction schemes [see 1.2] will vary in content, financial reports are expected to offer investors comparable disclosure as set out in this ~~appendix~~Appendix. Although financial reports of recognized jurisdiction schemes will generally be reviewed on the basis that they already comply in substance with this ~~appendix~~Appendix, disclosure must be made of transactions with connected persons and soft ~~commission~~ dollar arrangements [see items 2 and 3 under Notes to the ~~Accounts~~Financial Reports in this Appendix~~(2) and (3)~~]. The SFC reserves the right to require additional disclosure.

Statement of ~~assets~~ Assets and ~~liabilities~~Liabilities

The following must be separately disclosed, where applicable:~~-~~

1. Total value of investments

2. Bank balances

3. ~~Formation costs~~[deleted]

4. Dividends and other receivables

5. Amounts receivable on subscription

6. Bank loans and overdrafts or other forms of borrowings

7. Amounts payable on redemption

8. Distributions payable

9. Total value of all assets

10. Total value of all liabilities

11. Net asset value

12. ~~Number of units/shares in issue~~[deleted]

13. ~~Net asset value per unit/share~~[deleted]

Revenue ~~statement~~Statement

1. Total investment income~~ net of withholding tax~~, broken down by category

2. Total other income, broken down by category

3. ~~Equalization on issue and cancellation of units/shares~~[deleted]

4. An itemized list of various costs which have been debited to the scheme including, where applicable:-

   (a) fees paid to the management company (e.g. management fee and performance fee)
   (b) remuneration of the trustee/custodian
   (c) fees paid to investment ~~adviser (if any)~~delegate
   (d) ~~other~~respective amounts paid to any connected persons of the management company, investment delegate, directors of the scheme or trustee/custodian
   (e) ~~amortization of~~ formation costs
   (f) directors' fee and remuneration
   (g) safe custody and bank charges
   (h) auditors' remuneration
   (i) interest on borrowings
   (j) legal and other professional fees
   (k) ~~any other expenses borne by the scheme~~transaction costs
   (l) any other expenses borne by the scheme

5. Taxes (including withholding tax)

6. Amounts transferred to and from the ~~capital account~~Statement of Movements in the Capital Account

7. Net income ~~to be carried forward for distribution~~

~~Distribution statement~~

~~1. Amount brought forward at the beginning of the period~~

~~2. Net income for the period~~

~~3. Interim distribution per unit/share and date of distribution~~

~~4. Final distribution per unit/share and date of distribution~~

~~5. Undistributed income carried forward~~

Statement of ~~movements~~ Movements in ~~capital account~~Capital Account

1. Number of units/shares in issue and ~~Value~~value of the scheme as at the beginning of the period

2. Number of units/shares issued and the amounts received upon such issuance (after equalization if applicable)

3. Number of units/shares redeemed and the amount paid on redemption (after equalization if applicable)

4. Any items resulting in an increase/decrease in value of the scheme not recognized in the Revenue Statement, including:~~-~~
   (a) surplus/loss on sale of investments
   (b) exchange gain/loss
   (c) unrealized appreciation/diminution in value of investments
   (d) net income for the period less distribution

5. Amounts transferred to and from the ~~revenue account~~Revenue Statement

6. Number of units/shares in issue and ~~Value~~value of the scheme as at the end of the period

Notes to the ~~accounts~~Financial Reports

The following matters should be set out in the notes to the ~~accounts~~financial reports, where applicable:~~-~~

1. Principal accounting policies

   State the principal accounting policies in preparing the financial reports for reporting the financial position and performance of a scheme, including the following:

   (a) the basis of valuation of the assets of the scheme including the basis of valuation of unquoted and unlisted securities

   (b) the revenue recognition policy regarding dividend income and other income

   (c) foreign currency translation

(d) the basis of valuation of ~~forward foreign exchange and futures contracts~~financial derivative instruments

(e) ~~the basis of amortization of formation costs~~[deleted]

(f) taxation

(g) any other accounting policy adopted to deal with items which are judged material or critical in determining the transactions and in stating the disposition of the scheme

Any changes to the above accounting policies and their financial effects upon the accounts should also be disclosed.

2. Transactions with connected persons

The following should be disclosed:~~-~~

(a) a description of the nature and the amounts of any transactions entered into during the period between the scheme and the management company, investment ~~adviser~~delegate, ~~the~~ directors of the scheme, trustee/custodian or any ~~entity in which those parties or~~ of their connected persons ~~have a material interest~~, together with a statement confirming that these transactions have been entered into in the ordinary course of business and on normal commercial terms;

(b)

(i) the total aggregate value of the transactions of the scheme effected through a broker who is a connected person of the management company, ~~the~~ investment ~~adviser~~ delegate, ~~or the~~ directors of the scheme, or trustee/custodian;

(ii) the percentage of such transactions in value to the total transactions in value of the scheme during the year;

(iii) the total brokerage commission paid to such broker in relation to transactions effected through it; and

(iv) the average rate of commission effected through such broker~~.~~;

(c) details of all transactions, including the nature and amounts, which are outside the ordinary course of business or not on normal commercial terms entered into during the period between the scheme and the management company, investment ~~adviser~~delegate, ~~the~~ directors of the scheme, trustee/custodian or ~~any entity in which these parties or~~ any of their connected persons ~~have a material interest~~;

(d) name of the management company, investment delegate, ~~the~~ directors of the scheme, trustee/custodian or any of their connected persons ~~of such company or director~~ if any of them becomes entitled to profits from transactions in units/shares or from management of the scheme, and the amount of profits to which each of them becomes entitled;

(e) where the scheme does not have any transactions with the management company, investment delegate, directors of the scheme, trustee/custodian or any of their connected persons during the period, a nil statement to that effect; and

(f) the basis of the fee charged for the management of the fund and the name of the management company and investment delegate. In addition, where a performance fee is charged to the scheme, the basis of calculation and amount of performance fee charged should be separately disclosed. ~~For Futures and Options Funds [see 8.4A], the total transactions costs must also be disclosed.~~

3. Soft dollar arrangements

Details of any soft ~~commission~~dollar arrangements relating to dealings in the property of the scheme, including the amounts of transactions executed; the related commissions that have been paid for the transactions; and description of goods and services received by the management company or investment delegate, or a nil statement if no such arrangements exist during the period.

4. Borrowings

State whether the borrowings are secured or unsecured and the duration of the borrowings.

5. Contingent liabilities and commitments

Details of any contingent liabilities and commitments of the scheme.

6. If the free negotiability of any asset is restricted by statutory or contractual requirements, this must be stated.

7. Formation costs

Accounting treatment of formation costs and the basis of amortization, including the amounts unamortized and the remaining amortization period.

8. Distribution

Details of any distribution, including the following:

(a) Amount brought forward at the beginning of the period;

(b) Net income for the period;

(c) Interim distribution per unit/share and date of distribution;

(d) Final distribution per unit/share and date of distribution; and

(e) Undistributed income carried forward.

9. Details on units/shares

Number of units/shares in issue and the net asset value per unit/share as at the end of the period.

Contents of the auditors' report

The report of the Auditor should state:-

1. Whether in the auditor's opinion, the ~~accounts~~financial reports prepared for that period have been properly prepared in accordance with the relevant provisions of the Trust Deed (~~if~~ in the case of a unit trust) or Articles of Association (~~if~~ in the case of a mutual fund) and this UT Code;

2. Without prejudice to the foregoing, whether in the auditor's opinion, a true and fair view is given of the disposition of the scheme at the end of the period and of the transactions of the scheme for the period then ended;

3. If the auditor is of the opinion that proper books and records have not been kept by the scheme and/or the ~~accounts~~financial reports prepared are not in agreement with the scheme's books and records, that fact; and

4. If the auditor has failed to obtain all the information and explanations which, to the best of his knowledge and belief, are necessary for the purposes of the audit, that fact.

Investment ~~portfolio~~Portfolio

1. Number or quantity of each holding together with the description and market value. Distinguish between listed and unlisted and categorize by asset class (such as equities, bonds and collective investment schemes etc.) and country. ~~For investments in schemes by a UPMF , the place of incorporation of the schemes should be disclosed.~~

2. The total investment stated at cost.

3. The value of each holding as a percentage of net asset value.

4. Statement of movements in portfolio holdings since the end of the preceding accounting period.

   Notes: (1) The management company is expected to choose the most appropriate illustration of movement in the portfolio holdings taking into account the objective and nature of ~~the fund~~ a scheme. Any one of the following methods may be considered acceptable to the Commission:

   (a) detailed holdings in individual securities; or
   (b) holdings in different sectors of a particular market; or
   (c) holdings in different countries (in the case of, for example, a global equity fund); or
   (d) holdings in various kinds of securities such as equities, bonds, warrants and options etc. (in the case of a diversified fund).

   (2) Except for ~~(a) above~~Note(1)(a) of item 4 under Investment Portfolio in this Appendix, movements in portfolio holdings can be expressed in percentages.

5. Details in respect of financial derivative instruments:

   (a) the underlying assets of financial derivative instruments; and

(b) the identity of the issuer(s)/counterparty(ies) of these financial derivative instruments.

6. Details in respect of securities financing transactions and securities borrowing transactions:

(a) the securities involved in each type of securities financing transactions and securities borrowing transactions;

(b) global data:

(i) amount of securities on loan as a proportion of the scheme's total lendable assets and of the scheme's total net asset value; and

(ii) respective absolute amounts of each type of securities financing transactions and as a proportion of the scheme's total net asset value;

(c) concentration data:

(i) top 10 largest collateral issuers across all securities financial transactions with details on the amounts of collateral received by the scheme; and

(ii) top 10 counterparties of each type of securities financing transactions, including name of counterparty and gross amounts of outstanding transactions;

(d) aggregate transaction data for each type of securities financing transactions and securities borrowing transactions:

(i) the amount (including the currency denomination);

(ii) maturity tenor, including open transactions;

(iii) identity and country of the counterparty(ies);

(iv) settlement and clearing means (e.g. tri-party, central counterparty, bilateral); and

(v) collateral received by the scheme to limit counterparty exposure with details required under items 1(a) and 1(e) of Holdings of Collateral in this Appendix;

(e) amount of revenue, and the direct and indirect expenses incurred relating to each type of securities financing transactions (e.g. the amount of revenue retained by the scheme and the amount of direct and indirect expenses borne by the scheme and paid to the management company, investment delegate, trustee/custodian or any of their connected persons or other parties);

(f) (i) details on re-investment of cash collateral required under item 1(f) of the Holdings of Collateral in this Appendix; and

(ii) (applicable to hedge funds) details on re-use or re-hypothecation of collateral required under item 1(g) of the Holdings of Collateral in this Appendix; and

(g) details on custody / safe-keeping arrangement of collateral under item 1(h) of the Holdings of Collateral in this Appendix.

7. For money market funds:

(a) the weighted average maturity and the weighted average life of the portfolio of the scheme; and

(b) amounts of daily liquid assets and weekly liquid assets and as a percentage of the scheme's total net asset value.

Holdings of ~~collateral~~Collateral

1. ~~For schemes holding collateral of more than 30% of the net asset value of the schemes, d~~Description of holdings of collateral, including:

(a) nature of the collateral, including asset types (e.g. cash, cash equivalents and money markets; government or corporate (whether investment grade / non-investment grade); and others) and currency denomination;

(b) identity of counterparty providing the collateral;

(c) value of the scheme (by percentage) secured/covered by collateral, with breakdown by asset class/nature and credit rating (if applicable); ~~and~~

(d) credit rating of the collateral (if applicable)~~.~~;

(e) maturity tenor of the collateral, including open transactions;

(f) data on re-investment of cash collateral:

(i) share of cash collateral received that is re-invested, compared to the maximum amount specified in the offering document; and

(ii) returns from re-investment of cash collateral;

(g) (applicable to hedge funds) data on re-use or re-hypothecation of collateral:

(i) share of collateral received that is re-used or re-hypothecated, compared to the maximum amount specified in the offering document; and

(ii) information on any restrictions on type of collateral received; and

(h) custody / safe-keeping arrangement, including:

(i) number and names of custodians and the amount of collateral received / held by each of the custodians for the scheme; and

(ii) the proportion of collateral posted by the scheme which are held in segregated accounts, pooled accounts, or in any other accounts.

Performance table

1. A comparative table covering the last 3 financial years and including, for each financial year, at the end of the financial year:-

   (a) the total net asset value; and

   (b) the net asset value per unit/share.

2. A performance record over the last 10 financial years; or if the scheme has not been in existence during the whole of that period, over the whole period in which it has been in existence, showing the highest issue price and the lowest redemption price of the units/shares during each of those years.

Information on leverage arising from financial derivative instruments

1. The lowest, highest and average leverage arising from the use of financial derivative instruments during the period in respect of the following:

   (a) Gross amounts of leverage arising from the use of financial derivative instruments for any purposes, with reference to equivalent market value of the underlying assets of the financial derivative instruments, as a proportion to the scheme's total net asset value; and

   (b) Amounts of leverage arising from the use of financial derivative instruments for investment purposes under the commitment approach [see Note to 7.26] as a proportion to the scheme's total net asset value.

Appendix F

(Deleted)

Appendix G

Guidelines for review of internal controls and systems of trustees ~~-~~ / ~~-~~ custodians

Introduction

1. Pursuant to 4.1 ~~of this UT Code~~, trustees/custodians of collective investment schemes are required to ~~be approved by the SFC. An acceptable trustee/custodian should either:~~appoint an independent auditor to periodically review its internal controls and systems ("internal control review") on terms of reference agreed with the Commission and file such report ("review report") with the Commission, unless the trustees/custodians are prudentially regulated and supervised by overseas supervisory authorities acceptable to the Commission. Trustees/custodians should ensure that adequate policies and procedures of its internal controls and systems are maintained to ensure compliance with the requirements of Chapter 4.

~~(a) on an ongoing basis, be subject to regulatory supervision; or~~

~~(b) appoint an independent auditor to periodically review its internal controls and systems on terms of reference agreed with the SFC and should file such report with the SFC.~~

Note: Where nominees, agents or delegates of a trustee/custodian, or, if applicable, other service providers, are engaged to carry out functions or operations that are relevant in discharging the responsibilities and obligations of the trustee/custodian, there should be ongoing supervision (in the case of appointment by the trustee/custodian) and regular monitoring on these parties by the trustee/custodian to ensure the accountability of the trustee/custodian to the scheme and investors is not diminished and the obligations of the trustee/custodian as set out in Chapter 4 are duly discharged. Although a third party may be engaged to assume the operations and functions of a trustee/custodian, the responsibilities and obligations of the trustee/custodian may not be delegated and shall remain with the trustee/custodian of the scheme.

2. ~~As a general guide, in determining the acceptability of an overseas supervisory authority, the SFC will have to be satisfied that either the overseas regulatory authority or its delegate carries out regular inspection of trustees/custodians within its jurisdiction or the latter is subject to regular review in a manner generally consistent with the SFC requirement. In the latter case, the auditor's report should be filed with the SFC.~~[deleted]

Purpose of the ~~Guidelines~~guidelines

3. ~~These Guidelines~~This Appendix provides further guidance to trustees ~~and~~ /custodians of scheme regarding compliance with the periodic internal control review requirement of this UT Code. ~~These Guidelines~~This Appendix sets out the minimum ~~best practice~~requirements for trustees/custodians and auditors ~~of scheme~~ in order to facilitate the agreement of the scope of an internal control review on terms which will be acceptable to the SFC. ~~These Guidelines have been developed in consultation with the Hong Kong Trustees Association and the Hong Kong Society of Accountants~~A variety of internal controls and systems can be adopted to achieve the same internal control objectives. Trustees/custodians should exercise professional judgement in deciding the appropriate policies and procedures of its internal controls and systems in a given circumstance.

4. For the purposes of ~~these Guidelines~~this Appendix, the term "auditor~~s~~" refers to the independent ~~reporting~~ professional accountant~~s~~ who ~~are~~is engaged in ~~reporting on~~ reviewing the internal controls and systems of the trustee/custodian of a scheme and issuing the required auditor's report (included in the review report) provided herein.

Scope of review

5. The internal control review should be conducted with the objective to assess and evaluate whether the internal controls and systems of a trustee/custodian are adequate and sufficient for the compliance with the requirements of Chapter 4. The internal control review should involve all material procedural and control elements that are relevant and necessary to discharge the responsibilities and obligations of trustees/custodians in relation to scheme.

Notes: (1) In determining whether the control objectives as set out under paragraph 8.A of this Appendix have been achieved, the scope of internal control review should cover the internal controls and systems of the trustee/custodian in monitoring the performance of any third party (such as sub-custodian, administrator, transfer agent and registrar) who is appointed/engaged to carry out certain functions and operations that are relevant for the trustee/custodian in discharging its responsibilities and obligations. In this case, the relevant third party is expected to establish policies and procedures in its internal controls and systems in support of the trustee/custodian to discharge its responsibilities and obligations.

(2) For the purposes of Note(1) to paragraph 5 of this Appendix, the trustee/custodian should establish policies and procedures in its internal controls and systems to ensure the related functions and operations are properly carried out, implemented and monitored irrespective of the parties designated to perform or handle these functions and operations [see Note to paragraph 1 of this Appendix].

5A. In selecting samples for the internal control review, the auditor should include, where available, different types of scheme(s) authorized by the SFC of which the entity concerned is acting as trustee/custodian. As part of the internal control review, the auditor should also review whether different classes of investors of a scheme are treated fairly under the control framework of the trustee/custodian.

5B. The internal control review should be conducted to provide reasonable assurance in accordance with ~~generally~~ internationally acceptable ~~international auditing practices~~[1]review standards.

6. The engagement letter between the trustee/custodian and the auditor should incorporate or refer to the ~~following~~ terms of reference ("Terms of Reference") under paragraph 8 of this Appendix which sets out, ~~as~~at a minimum, the scope of review for compliance with the requirements of this UT Code. The trustee/custodian may engage the auditor to expand the scope of the internal control review, and it is important that this is agreed with the auditor before the commencement of the internal control review.

7. ~~Where the trustee/custodian or an associated company carries on part of its responsibilities outside Hong Kong in a jurisdiction in which the SFC considers that there~~

[1] ~~For example: *Practice Note 860.2* issued by the Hong Kong Society of Accountants; or *Technical Release AUDIT 4/97* issued by the Institute of Chartered Accountants in England and Wales (ICAEW) in the UK.~~

~~is inadequate regulatory supervision or review (as described in paragraph 2), then the scope of the review should include those functions undertaken outside Hong Kong in a way which satisfies the auditor issuing the report. Notwithstanding that an offshore company may be appointed trustee/custodian, if the trustee/custodian confirms that all relevant functions are carried out by it or its delegates in Hong Kong, the scope of the review can be so limited.~~[deleted]

Terms of ~~reference~~Reference

8. The precise terms of the internal control review engagement will be as agreed between the trustee/custodian and the auditor in each particular case. ~~Terms of Reference for the review should be incorporated in the review engagement letter and should,~~ The review report should ~~as~~ at a minimum, include the following Terms of Reference:

A. Report by the management of the trustee/~~-~~custodian

The management of the trustee/custodian must issue a report ("trustee/custodian's report") to describe the control ~~objectives~~environment and the policies and procedures of its internal controls and systems that are designed for the compliance with the requirements of Chapter 4 and the control objectives as set out in this Appendix. ~~As~~ At a minimum, the internal control policies and procedures are expected to cover the control objectives ~~should include the following~~under each of the areas described below:

Note: For the purposes of paragraph 8.A of this Appendix, "nominees, agents and delegates" refers to parties appointed by the trustee/custodian whereas "service providers" refers to parties appointed/engaged (irrespective of whether they are appointed by the trustee/custodian) to carry out certain functions and operations that are relevant for the trustee/custodian in discharging its responsibilities and obligations as set out in Chapter 4.

(a) Maintenance of a control environment

(1) General

(i) Possession of relevant knowledge, skills, qualifications, experiences, resources and operational capabilities commensurate with the nature, scale and complexity of the scheme.

(ii) Devise and tailor appropriate and specific procedures (subject to regular and frequent review and update) for acting as the trustee/custodian of the scheme concerned, including ongoing monitoring on nominee(s), agent(s), delegate(s) and service provider(s).

(iii) Establish clear and comprehensive escalation mechanism to deal with potential breaches detected in the course of discharging its obligations and report to the SFC on material breaches in a timely manner.

(2) Corporate governance

(i) Establishment of corporate governance framework, including, where applicable, the oversight from the licensed bank on the

trustee/custodian business/operation or its subsidiary acting as trustee/custodian.

(ii) Actions taken by the management company are in the best interests of holders.

(iii) Timely reporting and involvement of senior management of the trustee/custodian and the management company on matters and issues that may lead to breach of relevant laws and regulations or applicable legal and regulatory requirements.

(iv) Escalation of issues identified to senior management of the trustee/custodian and the management company and ongoing assessment, monitoring of the progress and development.

(3) Risk management framework

(i) Establishment of risk management framework.

(ii) Identification, monitoring and controlling of relevant risks for acting as the trustee/custodian of a scheme, including but not limited to, operational risks and regulatory risks.

(iii) Supervision from senior management of the trustee/custodian and ongoing communication with the management company.

(4) Business continuity plan

(i) Establishment of business continuity plan.

(ii) Regular testing on the effectiveness of the business continuity plan which is subject to review and revision on an ongoing basis.

(iii) Exceptions reporting to senior management of the trustee/custodian and the management company.

•(b)Compliance with applicable legal and regulatory requirements

(5) Compliance function and review (including but not limited to capital adequacy and independence requirements)

(i) Formation and documentation of a compliance programme approved by the management of the trustee/custodian for the obligations under Chapter 4 as well as addressing any compliance / breach issues.

(ii) Development and maintenance of a compliance policy to provide specific guidance to its staff and nominee(s), agent(s), delegate(s) and service provider(s) in discharging its obligations as trustee/custodian.

(iii) Sufficient and adequate compliance resources, including human resources, for monitoring and supervision of the compliance programme.

(iv) Possession of relevant knowledge, skills, qualifications and experience for staff to effectively execute their duties.

(v) Periodic review on the monitoring and reporting procedures of nominee(s), agent(s), delegate(s) and service provider(s).

(vi) Communication and training to directors, staff and nominee(s), agent(s), delegate(s) and service provider(s) on compliance programme.

(vii) Compliance of regulatory reporting requirements.

(viii) Regular reporting to senior management of the trustee/custodian and communication with the management company.

(ix) Procedures for dealing with complaints.

(6) Breach reporting

(i) Procedures and mechanisms to identify breaches.

(ii) Formation and monitoring of rectification plans and remedial actions, including relevant involvement and coordination with the management company.

(iii) Reporting to senior management of the trustee/custodian and the management company and recording of breaches.

(iv) Notification mechanism to relevant regulatory bodies (including the SFC) on material breaches.

• (c) Compliance with control policies and procedures

(7) Oversight of management company's performance in managing the scheme in accordance with the provisions of the constitutive documents and applicable legal and regulatory requirements

(i) Verification of instructions given by the management company.

(ii) Escalation and communication with the management company on breaches identified.

(8) Appointment of and oversight on nominee(s), agent(s) and delegate(s), and oversight on service provider(s) that are relevant for the trustee/custodian in discharging its obligations as set out in Chapter 4

(i) Selection and due diligence of nominee(s), agent(s) and delegate(s), including an assessment on their competency, regulatory and financial status, and capabilities in discharging their delegated function(s) / operation(s) and their internal controls and systems, covering the respective control objectives and internal control policies and procedures provided in this Appendix with respect to the relevant delegated function(s) / operations(s) by the trustee/custodian.

(ii) Ongoing monitoring and review (on-site and off-site) of nominee(s), agent(s), delegate(s) and service provider(s) to ensure the delegated function(s) / operation(s) are performed in compliance with relevant

legal and regulatory requirements.

(iii) Oversight on nominee(s), agent(s), delegate(s) and service provider(s) that all the necessary internal controls and systems are established and maintained effectively, in carrying out the delegated function(s) / operation(s).

(iv) Documented procedures for the appointment and monitoring of nominee(s), agent(s) and delegate(s) and in the case of service provider(s), monitoring of such parties.

(v) Contingency plan on nominee(s), agent(s), delegate(s) and service provider(s), including actions and measures to be taken on breaches and solvency matters / issues relating to the nominee(s), agent(s), delegate(s) and service provider(s).

(vi) Policies and measures to address conflicts of interests.

(9) Subscription and redemption

(i) Subscription and redemption orders are carried out in accordance with the provisions of the constitutive documents and applicable legal and regulatory requirements.

(ii) Transactions controls and recording systems are in place.

(iii) Timely issuance and cancellation of units/share certificate.

(iv) Reconciliation and verification on subscription and redemption on a regular basis, such as reconciling the subscription/redemption orders with the proceeds received/paid and the number of units issues/cancelled.

(v) Frequency of reconciliation and verification consistent with flow of subscriptions and redemptions.

(vi) Timely settlement of the subscription and redemptions transactions and follow-up actions on exceptions, including communication with senior management of the trustee/custodian and the management company on the exceptions identified.

(vii) Proper documentation and records of the considerations taken with respect to suspension of dealing of units/shares of the scheme, including the consultation process and communication between the trustee/custodian and the management company.

(10) Valuation / Price / net asset value calculation

(i) Methodology adopted in calculating net asset value per unit/share is in accordance with the provisions of the constitutive documents and applicable legal and regulatory requirements.

(ii) Accuracy of net asset value calculation, including interest income, dividend and fee calculation.

(iii) Valuation methodology is in place for each type of investments held by the scheme, including illiquid or hard-to-value assets.

(iv) Establishment of policies and procedures in relation to the use of the fair value adjustments considered by the management company for valuing different types of assets of a scheme, including the circumstances that trigger the use of fair value adjustments, and the governance structure and review process for fair value adjustments and consultation with the trustee/custodian where appropriate.

(v) Periodic review of valuation policies and procedures, including effectiveness, appropriateness and consistency of their application.

(vi) Proper documentation and records on the considerations taken with respect to the suspension of calculation of valuation / price/ net asset value of the scheme, including the consultation process and communication between the trustee/custodian and the management company.

(vii) Establish clear and comprehensive escalation mechanism to deal with errors or exceptions in the pricing of the units/shares of the scheme that has come to the attention of the trustee/custodian in the course of discharging its obligations, including proper documentation of the mechanism, compensation arrangements to the scheme and/or holders, communication between the trustee/custodian and the management company and timely reporting to the SFC on the pricing errors in accordance with 10.2A.

(viii) Proper recording of interest income, dividend income and other corporate actions.

(11) Distribution

(i) Calculation of distribution is carried out in accordance with the provisions of the constitutive documents and applicable legal and regulatory requirements.

(ii) Ensure completeness and accuracy of distribution payment.

(iii) Establish clear and comprehensive escalation mechanism to deal with exceptions detected in the course of discharging its obligations; including proper documentation of the mechanism, communication between the trustee/custodian and the management company and reporting to the SFC on material exceptions in a timely manner.

(12) Cash

(i) Proper cash account opening; obtain proper prior written consent from the trustee/custodian in the case where cash is placed with the management company, investment delegate, directors of the scheme or any of their connected persons.

(ii) Safeguards and measures, including oversight on the cash management policy of the management company, in addressing conflicts of interests where cash is placed with the entities under 10.10 and ensure the arrangement is in the best interests of the

investors.

(iii) Ensure proper receipt of subscription proceeds and payment of redemption proceeds.

(iv) Execution and verification of management company's instructions.

(v) Accuracy of cash record and cash reconciliation against third party, such as reconciliation of its own records with records of the management company.

(vi) Transactions controls and recording systems are in place.

(vii) Timely settlement of transactions and follow-up on exceptions detected.

(viii) Identification of unusual significant cash flow.

(ix) Periodic review of cash monitoring policy.

(x) Escalation procedures with senior management of the trustee/custodian and the management company when exception is detected in the course of carrying out its duties and the follow-up actions taken.

(13) Investment

(i) Proper execution and verification of instructions of the management company.

(ii) Monitoring investment and borrowing limits.

(iii) Accuracy of investment record and investment reconciliation against third party.

(iv) Transactions controls and recording systems are in place.

(v) Timely settlement of transactions and exceptions detection and follow-up actions taken.

(vi) Establishment of system of recording and reporting pertaining to securities financing transactions.

(vii) Possession of relevant knowledge for staff who are responsible for monitoring and recording securities financing transactions.

(viii) Formulation and regular update of the authorized list of eligible counterparties.

(ix) Development and maintenance of proper documentation on the margin requirement for different types of investment.

(x) Verification of daily mark to market value on collateral and reconciliation of reports provided by counterparties.

(14) Accounting system and record keeping

(i) Establishment of proper and appropriate accounting recording systems and record keeping requirements for each scheme.

(ii) Adoption of consistent accounting treatment in accordance with the constitutive documents and relevant accounting standards.

(iii) Timely issuance and distribution of financial reports.

(15) Connected party transactions

(i) Safeguards and measures, including oversight on the management company, ensuring that transactions are executed at arm's length and in the best interests of holders, addressing conflicts of interests on transactions with the management company, investment delegate, directors of the scheme and any of their connected persons.

(ii) Obtain proper prior written consent from the trustee/custodian on transactions between the scheme and the entities under 10.11 and proper documentation on justifications in approval of these transactions.

(iii) Ensure that conflicts of interests identified are properly disclosed.

(d) Safekeeping of assets against loss

(16) Custody and safeguarding of assets

(i) Segregation of assets of the scheme from the assets of:

(I) the management company, investment delegate and their respective connected persons;

(II) the trustee/custodian and any nominees, agents or delegates throughout the custody chain; and

(III) other clients of the trustee/custodian and nominees, agents or delegates throughout the custody chain, unless held in an omnibus account with adequate safeguards in line with international standards and best practices to ensure that the assets of the scheme is properly recorded with frequent reconciliations.

(ii) Segregation of duties in trustee/custodian's operations.

(iii) Safeguard of physical assets of the scheme.

(iv) Payment and asset transfer on behalf of the scheme.

(v) Reconciliation of assets against third party records on a regular basis.

(vi) Regular verification of ownership and maintenance of proper and accurate records for assets of the scheme that cannot be held in custody.

(vii) Proper registration of the scheme's assets.

(viii) Assess and monitor custody risk with adequate organizational arrangement to minimize risk of loss.

(ix) Escalation and rectification procedures on issues and exceptions identified.

(e) Handling of different investors

(17) Whether different classes of investors are treated fairly under the trustee/custodians' control framework, such as control procedures in ensuring accuracy in the calculation of net asset value of a scheme with multiple classes.

(f) Sound information technology (IT) control processes

(18) IT controls on the IT systems involved in the trustee/custodian businesses, including logical and physical access controls; system application controls; system change management controls and testing; IT operations; system resilience and disaster recovery planning; incident management; and technology service providers management.

(19) Risk assessment performed by the trustee/custodian on the IT-related risks of the trustee/custodians' businesses/operations and adequacy of the IT controls to address the IT-related risks identified in the risk assessment.

Note: Please note that the above control objectives are not meant to be exhaustive.

The controls designed to meet the above objectives may vary from firm to firm. The SFC does not mandate specific controls to meet the control objectives. It is the responsibility of the management of the trustee/custodian to design suitable controls and ensure that these are adequate, effective and properly implemented for the purpose of achieving the control objectives so identified.

~~In addition, the report should describe the internal control policies and procedures designed for achieving the control objectives.~~

B. Objective of the review engagement

The objective of the engagement is to review the control objectives and procedures as described in the ~~report issued by the~~ trustee/custodian's report and to report on the findings of the review to the management of the trustee/custodian.

(1) Auditor's work should be planned and conducted so as to have a reasonable expectation of:

(i) confirming whether the control procedures as described by the trustee/custodian's management are suitably designed and adequate to ensure meeting the stated control objectives and compliance with Chapter 4 during the period under review;

(ii) confirming whether the trustee/custodian's report in paragraph 8.A of this Appendix describes fairly the control procedures in place during the period under review;

(iii) confirming whether the specific control procedures tested (with details described) operated effectively during the period under review; and

(iv) detecting material weakness in controls or failure in control systems (whether by design or implementation) and providing recommendations for improvement.

(2) In assessing whether a control is suitably designed and adequate, the auditor should:

(i) assess whether the control individually or in combination with other controls would, when complied satisfactorily, provide reasonable assurance that the control objectives stated in the description of its internal controls and systems by the management of the trustee/custodian are achieved; and

(ii) take into account the nature of business and size of the operation of the trustee/custodian.

C. Report by the auditor

The auditor should issue a report ("auditor's report"), addressed to the management of the trustee/custodian, detailing the scope of the review work carried out relating to the report by management and the conclusions reached. The auditor's report should state, ~~as~~at a minimum:

(i) a summary of the terms of engagement containing the Terms of Reference (or attach a copy of the letter of engagement);

(ii) the respective responsibilities of the management of the trustee/custodian and the auditor;

(iii) the basis of the auditor's opinion (detailing the scope of work); ~~and~~

(iv) the auditor's opinion~~.~~ (see Part D of this Appendix); and

(v) where applicable, a description of material weakness and/or failure in the internal controls and systems identified and recommendations made to management of the trustee/custodian (or attach a copy of the letter or memorandum) (see Part E of this Appendix).

D. Auditor's opinion

As a minimum requirement, the auditor's opinion should state:

(i) ~~whether the accompanying report by the management of the trustee/ custodian describes fairly the control procedures in place~~ the control procedures as described by the trustee/custodian's management were suitably designed and adequate to ensure meeting the stated control objectives and compliance with Chapter 4 during the period under review; ~~and~~

(ii) ~~whether~~ the ~~specific~~ control procedures ~~tested (with details described) operated~~ as described ~~during~~were properly implemented by the trustee/custodian throughout the period under review;~~.~~

(iii) the controls tested, which were those necessary to provide reasonable assurance that the control objectives stated in the trustee/custodian's description of its control objectives and procedures were achieved, operated effectively throughout the period under review;

(iv) the trustee/custodian has complied with Chapter 4 during the period under review; and

(v) where applicable, the licensed bank's corporate governance was adequate to ensure that the licensed bank exercises adequate oversight from its senior management over the trustee/custodian business during the period under review.

Where applicable, the auditor should state the limitations to the tests performed and whether such limitations have any material impact on the auditor's opinion.

E. Recommendation for internal controls and systems

Upon detecting any material control weakness or failure in the internal controls and systems or areas for improvement, the auditor's report should contain:

(a) if any material weakness in controls or failure in control systems has been identified during the auditor's review, the auditor is required to issue a letter/memorandum to management of the trustee/custodian, and provide a copy of such letter/memorandum to the SFC. The letter/memorandum should include (i) a description of the material internal control weakness or failure in the internal controls and systems together with (ii) auditor's recommendation for improvement and response from the management of trustee/custodian; or

(b) in cases where no material control weakness or failure in the control systems has been identified, and the auditor has made certain recommendations for improvement to trustee/custodian's internal controls and systems, the auditor should issue a letter/memorandum to management of the trustee/custodian setting out the relevant recommendations for improvement, and provide a copy of the letter/memorandum to the SFC.

Period under ~~Review~~review

9. The period under review should be for a period of at least twelve months and should coincide with the financial year of the trustee/custodian unless otherwise agreed with the SFC.

Notes: For trustee/custodian which is not currently acting as trustee/custodian for schemes authorized by the SFC ("new trustee/custodian"):

(i) where the review represents the first internal control review of the new trustee/custodian which is conducted in accordance with this Appendix, the SFC may consider accepting a shorter review period (e.g. covering a period of six months) which may not coincide with the financial year end of the new trustee/custodian. In any event, the auditor should issue the auditor's report on the internal control review of the trustee/custodian within four months from the end of the review period and submit to the SFC at the time of submission of the application of the relevant scheme seeking SFC's

authorization or the scheme change application in relation to 11.1(b) in support of such application(s); and

(ii) in the case where the new trustee/custodian has yet to come into operations, the SFC may consider on a case-by-case basis to accept separate review reports which opine on the design suitability and operating effectiveness of its internal controls and systems respectively. The internal control review report which opine on the operating effectiveness may not need to be submitted at the time of application. However, the new trustee/custodian should consult and agree with the SFC in advance regarding the timeframe for submission of such report.

Filing of ~~Reports~~ reports with the SFC

10. The management of the trustee/custodian should file the review report, which comprises of a copy of the auditor's report and the trustee/custodian's report (as described in paragraph 8) with the SFC within four months from the end of the period under review. Where applicable, management response to the auditor's report should also be attached. ~~The reports should be sent to:~~

~~Investment Products Division~~
~~Securities & Futures Commission~~
~~35/F, Cheung Kong Center~~
~~2 Queen's Road Central~~
~~Hong Kong~~

Frequency of ~~Review~~review

11. The review of internal controls and systems of trustees/custodians of scheme should be conducted on an annual basis. The SFC reserves the right to demand more frequent review of a trustee ~~or~~ /custodian should this be deemed necessary.

Appendix H

Guidelines on hedge funds reporting requirements

Introduction

The Commission has published the Guidelines on Hedge Funds Reporting Requirements (the Guidelines). The Guidelines set~~s~~ out the minimum amount of information that is required to be disclosed in regular reporting to holders. The Commission advocates additional information to be disclosed if it is deemed to be appropriate and informative to holders, taking into account the objective and strategy of the scheme.

1. Pursuant to 5.17 and 11.6 ~~of this UT Code~~, financial reports of authorized schemes are required to be published ~~at least two reports~~ in respect of ~~each~~ its financial year, of which the annual report must be audited by the auditor for the scheme. Pursuant to 8.7(w) ~~of this UT Code~~, authorized hedge funds are also required to publish quarterly reports for holders. The following scheme reports should be distributed to holders and filed with the Commission within the stipulated timeframe:

Nature of reports	No. of reports for each scheme financial year	Timeframe for filing and distribution to holders
Annual report	One	Within four months of the end of the relevant financial year, except for funds of hedge funds (FoHFs) where the timeframe for filing and distribution to holders is within six months of the end of the relevant financial year.
~~Semi-annual~~Interim report	One	Within two months of the end of the relevant period.
Quarterly reports	Four	Within one month of the end of the relevant period, except for FoHFs where the timeframe for filing and distribution to holders is within six weeks of the end of the relevant period.

Note: Where the management company wishes to report to holders via monthly reports, there is no need to prepare quarterly reports provided that the same requirements for quarterly reports are complied with in the monthly reports.

2. These Guidelines aim~~s~~ to provide further guidance to management companies regarding the ~~on-going~~ongoing reporting requirements of authorized hedge funds. *The Commission reserves the right to require additional disclosure to be made.*

3. For the ease of understanding by holders, where technical terms are used in the scheme reports, the management company is specifically encouraged to include a glossary to explain their meaning and their implications to investors. Where financial terms are used in the scheme reports, the management company must provide their calculation bases, definitions, and any underlying assumptions.

4. Where the provisions refer to the scheme in this Appendix, this means the authorized hedge fund.

A. Contents of financial reports

Requirements applicable to both annual and ~~semi-annual~~interim reports

5. Annual and ~~semi-annual~~interim reports of the scheme must contain the information as required by Appendix E ~~of this UT Code~~, with the exceptions as provided in paragraph 6 of this Appendix.

6. The Commission encourages full disclosure of individual holdings of the scheme. Where the management company is satisfied that full disclosure of such information may be unduly burdensome, it may adopt alternative disclosures in lieu of the disclosure as required in the Investment Portfolio ~~subsection~~ of Appendix E ~~of this UT Code~~. In that case, the management company must choose the most appropriate and informative illustration of the scheme's holdings/exposures at the end of the relevant period, taking into account the objective and strategy of the scheme.

   Note: The following will be regarded as minimum disclosures acceptable to the Commission. The Commission reserves the right to require disclosure of the full position of the scheme for the purposes of carrying out its regulatory functions. Such disclosures to the Commission will be subject to the Commission's preservation of secrecy provisions.

   With respect to any scheme that is a FoHFs, the management company should disclose:

   a. *Exposures (including cash and cash equivalent holdings*) for the scheme at the scheme level as of the reporting date (expressed in percentage terms of net asset value of the scheme) categorized by geographical region, industry, strategy, or some other basis that the management company considers the most appropriate, taking into account the objective and strategy of the scheme;*

   b. *The names and percentage values (based on net asset value of the scheme) of the top five underlying funds held by the scheme as of the reporting date;*

   c. *The number of underlying funds and the number of underlying fund managers included in the scheme as of the reporting date; and*

   d. *(Where the scheme is a multi-strategy FoHFs) disclosure of the number of underlying funds and underlying fund managers under each hedge fund strategy.*

   With respect to other schemes, the management company should disclose:

   a. *Exposures (including cash and cash equivalent holdings*) for the scheme as of the reporting date (expressed in percentage terms of net asset value of the scheme) categorized by asset class, geographical region, industry,*

strategy, or some other basis that the management company considers the most appropriate, taking into account the objective and strategy of the scheme;

b. *The names and amounts of the top five long positions and top five short positions held by the scheme on a gross basis as of the reporting date; and*

c. *The aggregated gross long and short positions held by the scheme as of the reporting date (expressed in percentage terms of the net asset value of the scheme).;*

* *"Cash equivalent holdings" are defined as those assets with a maturity of less than one year and which are readily transactable in an arm's length transaction between willing and knowledgeable parties.*

Requirements specific to annual reports

7. Where performance fees were borne by the scheme during the financial year, the annual reports of the scheme must contain the amount of such performance fees payable at the scheme level expressed as a percentage of average net asset value of the scheme as at the end of the financial year and the calculation basis.

   Note (1): A nil statement is required if no performance fees were borne by the scheme during the financial year.
   (2): Where the scheme is a FoHFs, only performance fees at the FoHFs' level need to be disclosed.

B. Quarterly reports

Distribution of quarterly reports

8. The Commission requires that quarterly reports be distributed to holders to keep them informed of the scheme activities on a timely basis.

9. Quarterly reports are required to be filed with the SFC and distributed to holders within the stipulated timeframe under paragraph 1 of these Guidelines.

   Note: Given the newness of these Guidelines to the market, measures would be taken to familiarise the management company with the reporting requirements and the disclosure standard expected of these reports. The first quarterly report of each scheme must obtain a "no objection" letter from the Commission before it is issued to persons in Hong Kong. In order to facilitate the vetting procedures, upon request from the management company, Commission staff may review and provide comments on the format of the first quarterly report of each scheme before its contents are ready.

10. Quarterly reports may not be distributed to non-holders unless accompanied by the offering document of the scheme.

Contents of quarterly reports

11. Quarterly reports must be provided in the English and Chinese languages, and must contain the following information regarding the scheme.

Management commentary

12. A statement to the effect that the directors of the scheme and/or the management company accept responsibility for the information contained in the quarterly reports as being accurate as at the date of publication.

(a) Performance review

A commentary by the management company that describes and explains the key factors impacting upon the scheme's financial performance and any style drifts in the scheme during the reporting period.

Note: Where the scheme is a FoHFs, the management company is expected to explain what has driven performance in terms of different strategies.

(b) Market outlook

A discussion of the management company's expectation of the primary risk factors to which the scheme is exposed to, and the outlook of the development of these factors as they relate to the scheme.

(c) Changes in key investment personnel

A discussion on the changes in composition of the key investment personnel (if any) at the scheme level and their impact on the scheme's overall strategy, risk profile or future performance.

(d) Lawsuits

Details of any lawsuits that may have a financial impact on the scheme during the reporting period.

Portfolio review

(e) Fund size and ~~NAV~~ net asset value per unit/share

The scheme's total net asset value, net asset value per unit/share as at the end of the reporting period, and the percentage change in net asset value per unit/share since the last reporting period.

(f) Cash borrowings and other sources of leverage

The amount of cash borrowings and other sources of leverage at the scheme level and a summary of how leverage is calculated as at the end of the reporting period.

Note: The management company is expected to choose the most appropriate and informative illustration of the scheme's leverage, consistent with disclosures in the scheme's offering document, taking

into account the objective and strategy of the scheme. Where the scheme is a FoHFs, disclosure is only required at the FoHFs' level.

(g) Performance and risk measures

Disclosure of performance and risk measures of the scheme in tabular form. A sample format with the required parameters and time frames is set out in the ~~**Appendix**~~ **Annex** to these Guidelines.

The management company is encouraged to disclose other appropriate performance and risk measures, taking into account the objective and strategy of the scheme (e.g. Value at Risk (VaR), Alpha, Sortino ratio, additional Sharpe ratios using alternative risk free rates other than zero, aggregated risk/return statistics, full position disclosure of derivatives and their basis of calculation, time to recovery periods, % of down months, % of up months, delta equivalent of option positions etc.).

The management company must provide the calculation basis, definition and any underlying assumptions of each performance and risk measure either alongside the performance and risk measure or in a separate glossary.

(h) Amount of seed money

Disclosure of the amount of seed money expressed in percentage terms of the net asset value of the scheme contributed by the management company or its connected persons as at the end of the reporting period.

(i) Illiquid holdings

With respect to any scheme that is a FoHFs, the management company must disclose:

(i) The name(s) of any underlying fund(s) suspended during the reporting period;
(ii) The acquisition cost of such underlying funds; and
(iii) The latest status of such underlying funds as at the end of the reporting period.

With respect to other schemes, the management company must disclose the name(s) and acquisition costs of all illiquid holdings* held by the scheme as at the end of the reporting period, categorized by:

(i) Derivatives; and
(ii) Non-derivatives.

* *"Illiquid holdings" are defined as assets for which there are no readily available market values to be transacted between knowledgeable and willing parties in an arm's length transaction, or with no registered turnover in the last 30 days prior to and including the reporting date.*

(j) Concentrated exposures

With respect to any scheme that is a FoHFs, the management company should disclose:

(i) Exposures (including cash and cash equivalent holdings) for the scheme at the scheme level as of the reporting date (expressed in percentage terms of net asset value of the scheme) categorized by geographical region, industry, strategy, or some other basis that the management company considers the most appropriate, taking into account the objective and strategy of the scheme;

(ii) The number of underlying funds and the number of underlying fund managers included in the scheme as of the reporting date; and

(iii) (Where the scheme is a multi-strategy FoHFs) disclosure of the number of underlying funds and underlying fund managers under each hedge fund strategy.

With respect to other schemes, the management company should disclose:

(i) Exposures (including cash and cash equivalent holdings) for the scheme as of the reporting date (expressed in percentage terms of net asset value of the scheme) categorized by asset class, geographical region, industry, strategy, or some other basis that the management company considers the most appropriate, taking into account the objective and strategy of the scheme; and

(ii) The aggregated gross long and short positions held by the scheme as of the reporting date (expressed in percentage terms of the net asset value of the scheme).

Note (1): "Cash equivalent holdings" are defined as those assets with a maturity of less than one year and which are readily transactable in an arm's length transaction between willing and knowledgeable parties.

(2): The Commission reserves the right to require disclosure of the full position of the scheme for the purposes of carrying out its regulatory functions. Such disclosures to the Commission will be subject to the Commission's preservation of secrecy provisions.

~~Appendix~~Annex

Information to be Disclosed under ~~Section~~ paragraph B.12(g) of the Guidelines on Hedge Funds Reporting Requirements

Actual Monthly Returns in the Last Three Calendar Years (net of all fees and charges)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD Actual
Year (T-2)													
Year (T-1)													
Year T													

Summary Data

	Year T[3] (annualised year to date)	**Year (T –1)**	**Year (T – 2)**	**Since Launch[4]** [*specify launch date*]
Performance Statistics				
Annual Return				
Annualized Standard Deviation[5]				
Sharpe Ratio[6]				
Fund Statistics				
Highest NAV per unit/share				
Lowest NAV per unit/share				
Maximum drawdown [7]				

[*Display prominent warning statements to the effect that:* "**Investment involves risk, please see the offering document for further details. Past performance figures shown are not indicative of future performance**.*"*]

Notes:

(1) Calculations must be net of all fees and charges borne by the scheme, with the calculation basis clearly stated.

(2) As per paragraph 3 of the Guidelines, the management company should include a glossary of technical terms to explain their meaning and implications to investors (e.g. the higher the number, the riskier the scheme etc.).

(3) "Year T" denotes the current scheme financial year.

(4) Statistics since launch can only be shown if the scheme has been in existence for one year or longer.

(5) “Annualized standard deviation” is defined as the square root of the squared deviations of the actual returns from the simple average return based on the dealing days of the scheme, divided by the number of observations, shown on an annualised basis.
(6) “Sharpe ratio” is defined as annual return divided by the annualised standard deviation.
Note: For the sake of simplicity, a zero risk free rate is adopted in the calculation for “Sharpe Ratio”
(7) “Maximum drawdown” is the maximum amount of loss from an equity high until a new equity high, expressed as a percentage of the previous equity high.

Appendix I

~~Guidelines for regulating index tracking exchange traded funds~~

(deleted)

~~Introduction~~

~~1. These guidelines apply to passively managed index tracking exchange traded funds (which will be referred to as "Exchange Traded Funds" or "ETFs" throughout these guidelines)[1] authorized pursuant to this UT Code. These guidelines form part of 8.6 of this UT Code and are to be read in conjunction with this UT Code for an overall view of the regulatory framework for ETFs. In case of doubt, an applicant should consult the SFC at the earliest possible time on the application of these guidelines to an Exchange Traded Fund seeking authorization under this UT Code.~~

~~2. These guidelines are devised on the basis that ETFs, whether established in Hong Kong or overseas, should comply with common principles for safeguarding investors' interests if they seek to be authorized by the SFC. Local and overseas ETFs may seek to rely on the general relief granted in these guidelines from strict compliance with certain UT Code requirements including investment restrictions and prescribed risk warnings.~~

~~3. Overseas ETFs that meet the core requirements for authorized schemes under this UT Code and are governed by a regulatory framework considered acceptable in these guidelines may seek the SFC authorization by way of a streamlined process. Depending on the specific product type and the way they are governed in their home jurisdictions, overseas ETFs may be deemed to have complied with some or all of the requirements in 8.6 of this UT Code in relation to investment restrictions and strategies, index acceptability and the documentation requirements such as constitutive documents, product disclosure documents and financial reports in other parts of this UT Code.~~

~~4. These guidelines also require ETFs that are primarily listed on the local exchange of Hong Kong to adopt an enhanced disclosure regime for real time or near-real time trading information. Overseas ETFs that are primarily listed on overseas exchanges are recommended but are not obliged to comply with this enhanced disclosure regime for real time or near-real time overseas trading information.~~

~~[1] An "index tracking ETF" means an index fund (as defined in Chapter 8.6) and whose units/shares are traded on a securities exchange. For avoidance of doubt, the term "ETF" used in these guidelines does not cover actively managed non-index tracking funds.~~

Basic requirements for ETFs

5. ETFs, whether local or overseas, must comply with the structural, operational and core investment requirements under this UT Code. They must also abide by the on-going compliance and reporting requirements under this UT Code subject to the applicable relief laid down in these guidelines if they seek authorization from the SFC.[2]

6. ETFs that do not conduct initial public offerings or any forms of public sales or subscriptions are not obliged to produce a Hong Kong Offering Document as stated in 6.1 of this UT Code. Instead, they must prepare a Product Description Document in both English and Chinese. The term "offering document" shall be replaced by the term "Product Description Document" wherever the former appears in this UT Code (see Paragraph 10 below) in relation to this type of ETFs.

7. Given ETF are index funds, the requirements set out in 8.6 (a) to (e) of the UT Code are broadly applicable to ETFs, unless otherwise stated in this appendix.

Note: ETFs holding physical commodities of precious metals may be considered on a case-by-case basis.

7A. Where an ETF adopts the strategy of investing in financial derivative instruments or synthetic replication for the purpose of achieving its investment objective, the requirements set out in 8.8 of this UT Code must also be complied with.

8. It is a condition for authorizing an ETF that intends to be primarily traded in Hong Kong and authorized under this UT Code (referred to as "Local ETFs" in these guidelines), that it must be either listed or traded on the Stock Exchange of Hong Kong Limited (the "SEHK").

Streamlined regulatory regime for ETFs

9. ETFs must comply with this UT Code requirements not otherwise modified or waived by these guidelines.

10. Except as provided in paragraph 24(e) below, an ETF that is not conducting initial public offerings, or any forms of public sales or subscriptions in Hong Kong need not prepare a Hong Kong Offering Document in accordance with 6.1 of this UT Code. This ETF must prepare a Product Description Document in both English and Chinese that meets the content requirements in Appendix C of this UT Code (as modified by these guidelines) which is more particularly set out in **Annex (I)** to these guidelines.

General relief from 8.6

Unless otherwise stated in these guidelines, ETFs, whether local or overseas, must comply with all the applicable provisions governing index funds in 8.6 of this UT Code.

[2] For avoidance of doubt, the term "ETFs" in these guidelines shall, where the context applies, mean ETFs authorized under the Code.

11. *Relief from 8.6(h)*: Investment restrictions in 8.6(*h*)(i) and (ii) do not apply if:

(a) an ETF adopts a representative sampling strategy which does not involve the full replication of the constituent securities of the underlying index in the exact weightings of such index;

(b) the strategy is clearly disclosed in the Product Description Document/Hong Kong Offering Document of the ETF (as the case may be);

(c) the excess of the weightings of the constituent securities held by the ETF over the weightings in the index is caused by the implementation of the representative sampling strategy;

(d) any excess weightings of the ETF holdings over the weightings in the index must be subject to a maximum limit reasonably determined by the ETF after consultation with the SFC. In determining this limit, the ETF must consider the characteristics of the underlying constituent securities, their weightings and the investment objectives of the index and any other suitable factors;

(e) limits laid down by the ETF pursuant to paragraph 11(d) above must be disclosed in the Product Description Document/Hong Kong Offering Document (as the case may be);

(f) disclosure must be made in the ETF's semi-annual and annual reports as to whether the limits imposed by the ETF itself pursuant to paragraph 11(d) have been complied with in full. If there is non-compliance with the said limits during the relevant reporting period, this must be reported to the SFC on a timely basis and an account for such non-compliance should be stated in the report relating to the period in which the non-compliance occurs or otherwise notified to investors; and

(g) nothing in paragraphs 11(d), (e) and (f) above applies to an overseas ETF governed by an Acceptable ETF Regime or by the relevant overseas jurisdiction (see the Note to paragraph (d) in **Annex (III)** to these guidelines).

12. *Disclosure of Risk Warnings under 8.6*(j): Provisions relating to disclosure of index funds information in 8.6(j) do not apply where **Annex (I)** does not require the same. In particular, where proper risk warnings are disclosed, provisions relating to disclosure of risk warnings in 8.6(j)(iv), (v), (vi), (vii), (x), (xi), (xii) and (xiv) need not be strictly adhered to.

13. *Name of the ETF under 8.6(*m*)*: 8.6(m) does not apply if the name adopted is not misleading or deceptive as to the nature of the ETF and its investment objectives and strategy.

Modified post-authorization notification and approval procedures

14. The notification and approval requirements under 11.1A and 10.7 of this UT Code are modified or supplemented to the following extent:

(a) *Increase in Fees and Charges in 11.1A*: The prior notice requirements under 11.1A does not apply to adjustments in management fees if:

(i) the proposed adjustments in management fees do not require holders' approval; and

(ii) either a notice for the fee adjustments is published as stated in paragraph 14(c) or where the ETF is governed by an Acceptable ETF Regime or in the relevant overseas jurisdiction (see the Note to paragraph (d) in **Annex (III)**), there is no notification requirement for this type of fee adjustments in that jurisdiction;

(b) *Suspension of Dealing in 10.7*: The management company must immediately notify the SFC as soon as practicable if dealing in units/shares on the SEHK ceases or is suspended.

(c) Unless otherwise waived or provided for in paragraph 24(g) below, all notices and public announcements made by ETFs in accordance with this UT Code and these guidelines must be prepared in both English and Chinese.

Note: for avoidance of doubt, nothing in paragraph 14 shall exempt an ETF from compliance with 11.1, 11.4 and 11.5 of this UT Code.

15. [deleted]

16. [deleted]

Dissemination of trading information by ETFs

Local ETFs

17. In addition to information commonly available for stocks during the trading hours of the SEHK (e.g. bid/ask prices and queuing displays), local ETFs must provide the following trading information to the public on a real time or near- real time basis unless otherwise waived, via any suitable channels in paragraph 18 below:

(a) Estimated NAV or R.U.P.V.[3]
(b) Last closing NAV;
(c) Notices for suspension and resumption of trading; and
(d) Composition of constituent securities (where practicable).

17A. Where an ETF adopts synthetic replication through the use of financial derivative instruments to replicate the index performance, the ETF should also publish the gross

[3] R.U.P.V. as used on the information pages of information vendors in relation to ETFs listed on the SEHK stands for "Reference Underlying Portfolio Value" which is updated at 15-second intervals during trading hours and is equivalent to the aggregate of the total value of the Index Basket Shares per Creation Unit (which is calculated by multiplying the nominal price of the Index Basket Share by the number of the respective Index Basket Shares) and the prior day estimated total cash component per Creation Unit divided by the number of Units in a Creation Unit.

and net exposure to each counterparty and the value, nature and composition of collateral received (as a percentage of the ETF's NAV), where applicable.

18. Information in paragraphs 17(a) to (d) above may, where applicable, be made available to investors in Hong Kong through one or more of the following means:

(a) ETF's own website; or
(b) A hyperlink of (a) to the website of Hong Kong Exchange and Clearing Limited ("HKEx"); or
(c) Information pages of information vendors which disseminate trading information of ETFs in their ordinary course of business and whose information is accessible by retail brokers in Hong Kong (whether as paid services or not); or
(d) Any other channels that the SFC considers acceptable.

Overseas ETFs that have cross-listing or cross-trading status on the SEHK

19. Overseas ETFs authorized by the SFC that are cross-listed or cross-traded on the SEHK must provide local trading information in relation to their trading on the SEHK. Local trading information includes notices for suspension and resumption of trading on the SEHK. It is a recommended best practice for such overseas ETFs to provide their overseas markets' trading information that is of the same nature as described in paragraphs 17(a) to (d) above where trading hours of the relevant overseas market and those of the SEHK overlap.

20. Information provided to investors according to paragraph 19 may be made available via any of the channels stated in paragraph 18 or via the website of overseas exchanges on which such ETFs are traded.

Prior disclosure in the product description document/Hong Kong offering document

21. ETFs, whether local or overseas, must make prior disclosure of the types of trading information and channels through which such information is made available to investors in their Product Description Document/Hong Kong Offering Document (as the case may be). An ETF should also disclose the type of trading information (falling within the recommended best practices in these guidelines) that is not made available to investors in its Product Description Document/Hong Kong Offering Document (as the case may be).

21A. An ETF (whether local or overseas) should disclose the estimated total expense ratio of the scheme in the Product Description Document or Offering Document, where applicable.

Publication of ETFs' materials in Hong Kong

22. An ETF, whether local or overseas, must ensure that the following documents are made readily available to Hong Kong investors through any of the ETF's own website or such other channels as the SFC considers appropriate:

(a) Product Description Document/Hong Kong Offering Document (as the case may be);
(b) The ETF's offering document or prospectus (as the case may be) prepared in accordance with the regulations of the Acceptable ETF Regime or the relevant

overseas jurisdiction (see the Note to paragraph (d) in **Annex (III)**) ("ETF's Overseas Offering Document") (where applicable);

(c) Product KFS (where applicable);

(d) Latest version of the semi-annual and annual financial reports of the ETF; and

(e) All notices and public announcements issued by the ETF in either the Acceptable ETF regime or the relevant overseas jurisdiction (see the Note to paragraph (d) in **Annex (III)**) and in Hong Kong.

Note: Where an ETF is listed or traded on the SEHK, it may, but is not required to, make available the abovementioned documents to investors in Hong Kong by way of hyperlinks to the HKEx website.

Streamlined recognition process for overseas ETFs listed in an acceptable ETF regime

23. An overseas ETF that meets the core structural and operational requirements in this UT Code and is regulated in an Acceptable ETF Regime, may be authorized through a streamlined recognition process. The specific relief in paragraph 24 applies to this type of overseas ETF such that they will be deemed to have complied with certain UT Code requirements including constitutive documentation requirements, index acceptability and the prescribed contents for financial reports.

*Note: In determining whether a regime is an Acceptable ETF Regime, the regulatory principles set out in **Annex (III)** would be considered.*

24. An overseas ETF that complies with the conditions set out in **Annex (IV)** may rely on the following specific relief for a streamlined process for authorization in addition to the general relief in paragraphs *11* to *14*.

(a) *Acceptability of Index in 8.6(e)*: The index that such an overseas ETF tracks will be deemed to have complied with 8.6(e)(i) to (v) except where such index or its methodology contradicts the fundamental principles of a representative, diversified, investible and transparent index.

(b) *Reporting Requirements in 8.6(f)*: 8.6*(f)* only applies to (i) any significant events relating to the index that might affect the authorization or listing status of an overseas ETF in an Acceptable ETF Regime; and (ii) any other events in relation to the index that the Acceptable ETF Regime would require notification to investors. Notification of these events must be published in Hong Kong in both English and Chinese and notified to the SFC on a timely basis.

(c) *Replacement of Index in 8.6(k):* Subject to paragraphs *24*(a) and *24*(g) of these guidelines, 8.6(k) does not apply to the replacement of index. Any replacement of index must be notified to investors and the SFC on a timely basis.

(d) *Disclosure in Financial Reports in 8.6(l) and Appendix E*: ETFs that have prepared their semi-annual and annual financial reports in accordance with their own governing overseas regulations, which reports are not qualified by their auditors, will be relieved from full compliance with the content requirements of 8.6(l) and Appendix E.

(e) *Product Description Document*: Notwithstanding paragraph 10 above, the Product Description Document for an ETF from an Acceptable ETF Regime does not have to set out all the details of the information stated in **Annex (I)** to these guidelines if:

(i) The Product Description Document takes the form of a summary of the salient features of the ETF including appropriate risk warnings as to the level of disclosure contained in it. This Product Description Document has to be prepared in both English and Chinese;

(ii) The ETF's Overseas Offering Document is available to investors in Hong Kong via the ETF's own website, the website of the overseas exchange on which it is primary listed or the HKEx website (if applicable); and

(iii) The ETF's Overseas Offering Document mentioned in paragraph 24(e)(ii) may be made available in either English or Chinese.

(f) *Constitutive Documents*: The constitutive documents will be deemed to have complied with Appendix D of this UT Code in so far as these are related to the structural and operational aspects of the ETF.

Note: ETFs fall within the categories of Specialized Schemes under Chapter 8 of this UT Code and the concept of Recognized Jurisdiction Schemes is not directly applicable. However, in considering whether the constitutive documents of an ETF from an Acceptable ETF Regime is in compliance with this UT Code requirements, for example, Appendix D, the SFC would consider whether the home regulations in the Acceptable ETF Regime share similar principles in providing structural safeguards for investor protection. Accordingly, strict compliance with Appendix D and other operational requirements may not be required.

(g) *Notification and Language Requirement in respect of Notices under 11.1 to 11.2B:* Notices in relation to ongoing disclosures that require the SFC's prior approval pursuant to 11.1 of an ETF that is primarily regulated in an overseas jurisdiction have to be published or made generally available to investors in Hong Kong. Unless otherwise waived, these notices must be in both English and Chinese, and be published on a timely basis and in such manner as the ETF considers appropriate.

24A. The SFC may enter into any mutual recognition arrangement with other jurisdictions from time to time to facilitate cross-listing and offering of ETFs in each other's market. Please refer to the relevant circular published on the SFC's website at www.sfc.hk for the specific relief granted to overseas ETFs under the relevant mutual recognition arrangement.

Miscellaneous

25. These guidelines do not apply retrospectively to index tracking exchange traded funds already authorized on or before 24 October 2003.

26. With respect to ETFs that have been submitted to the SFC for approval pursuant to this UT Code but have not been authorized before 24 October 2003, they may elect to comply with this UT Code as amended by these guidelines.

~~27. These guidelines do not preclude the right of the SFC to impose any conditions for the authorization of an ETF as may be reasonable in the circumstances.~~

~~Annex (I)~~

~~Information to be disclosed in the product description document~~

~~This list is not intended to be exhaustive. The SFC may require further information to be disclosed which may be necessary for investors to make an informed investment decision.~~

~~Summary of Information to be Disclosed~~	~~Sections under Appendix C and Chapters of this UT Code and Other Relevant Information for ETFs Authorized Pursuant to the ETF Guidelines~~
~~Constitution of the ETF~~	~~C1~~
~~Investment Objectives and Restrictions~~	~~C2~~
~~Description of Underlying Index~~	~~• 8.6(j)(i)~~ ~~• 8.6(j)(ii)~~
~~Other Information regarding the Index~~	~~8.6(j)(xiii)~~
~~Means by which investors may obtain relevant information regarding the ETF and the index~~	~~• Types of real time or near-real time information of the ETF that is made available and the sources from which these information could be obtained, e.g. stock code, ticker symbol, website of the ETF etc.~~ ~~• 8.6(j)(viii)~~ ~~• 8.6(j)(ix)~~
~~Collateral policy and criteria~~	~~• C2A~~
~~Operators and Principals~~	~~• C3 + any other relevant operators such as participating dealers etc.~~
~~Characteristics of Units/Shares~~	~~• C4 (if applicable) + trading lot size~~ ~~• C5~~ ~~• C6~~ ~~• C7~~
~~Creation and Redemption Procedures~~	~~• C9 (if applicable) + procedures for buying/selling units/shares on the stock exchange + creation and redemption procedures of the underlying basket of stocks by participating dealers~~ ~~• C10 (if applicable)~~ ~~• C11~~ ~~• C12~~
~~Distribution Policy~~	~~• C13~~
~~Fees and Charges~~	~~• C14(a) (if applicable)~~ ~~• C14(b) (see 6.16 and 6.18)~~ ~~• Fees borne by investors trading on the stock exchange, e.g. brokerage fee, transaction levy, stamp duty etc.~~ ~~• C14(c) (as amended by these guidelines)~~ ~~*Note: Fees should be clearly presented in tabular form*~~
~~Connected Party Transaction~~	~~C15~~
~~Taxation~~	~~C16~~

~~Reports and Accounts~~	• ~~C17~~ • ~~C18 or the website address on which the financial reports are published~~ • ~~C18A~~
~~Warnings~~	• ~~C19~~ • ~~Proper risks warnings suitable for index tracking ETFs, including those for tracking errors, liquidity of underlying securities, circumstances that may affect the accuracy and completeness in the calculation of the index etc. Note: With proper risk warnings, 8.6(j)(iv)- (vii), (x) – (xii) and (xiv) need not be strictly adhered to.~~
~~General Information, e.g. date of publication of the Product Description Document, constitutive documents available for inspection etc.~~	• ~~C20~~ • ~~C21~~ • ~~C22~~ • ~~C22A~~ • ~~C23~~ • ~~6.15~~ • ~~Provisions on stock lending~~
~~Termination of the ETF~~	~~C24 (see 11.4 and 11.5)~~
~~Authorization conditions and Waivers Granted to the ETF~~	• ~~Self-imposed limits for any excess weightings of the ETF holdings over the weightings in the index~~ • ~~Waivers granted from compliance with this UT Code and/or any authorization conditions imposed on the ETF~~

~~Annex (II)~~

~~[deleted]~~

~~Annex (III)~~

~~General principles for an acceptable ETF regime~~

~~In determining whether a regime is an Acceptable ETF Regime, the following regulatory principles would be considered:~~

~~(a) The availability of a mutual co-operation and assistance agreement for fund management activities between the principal securities regulator of the Acceptable ETF Regime and the SFC;~~

~~(b) The similarity or comparability of the overall securities regulatory framework provided by the overseas jurisdiction where there is substantial interest in the ETF and in which it is primarily listed. The SFC will consider the extent to which these overseas jurisdictions' structural and operational requirements and disclosure standards on ETFs are comparable or equivalent to the principles adopted by the SFC for regulating collective investment schemes;~~

~~(c) The overall and combined effect of the rules and regulations, the regulatory infrastructure of an Acceptable ETF Regime where the ETF is primarily listed and in which there is substantial interest and the effectiveness of the administration of these rules and regulations, should be able to afford comparable investor protection to that provided under the Hong Kong regulatory framework; and~~

~~(d) The overseas stock exchange on which primary listing of the ETF takes place should provide a system for efficient public dissemination of trading and other information relevant to the trading of ETFs. Information about the index which the ETF tracks is either published generally or otherwise made readily available to the public in electronic or other means.~~

~~*Note: It is acknowledged that the regulatory framework for ETFs in some overseas jurisdictions may meet substantially but not all of the above principles in* **Annex (III)** *for recognition as an Acceptable ETF Regime. In these circumstances, the SFC would consider on a case-by-case basis the extent to which these ETFs may be granted partial relief under these guidelines and if any corresponding or alternative safeguards for investor protection should be imposed in consideration of the relief being granted.*~~

~~Once it is established that an overseas ETF is regulated in an Acceptable ETF Regime, such ETF must also comply with the conditions in **Annex (IV)** in order to be eligible for the specific relief in paragraphs 23 and 24 of the guidelines.~~

~~Annex (IV)~~

~~Compliance conditions for overseas ETFs~~

~~An overseas ETF that seeks to rely on the specific relief in paragraphs 23 and 24 of the guidelines must comply with the following conditions:~~

~~(a) Compliance with the applicable laws and regulations of the relevant Acceptable ETF Regime;~~

~~(b) Compliance with the applicable listing rules and trading rules of the overseas exchange on which the ETF is primarily listed;~~

~~(c) There are no changes in the laws and regulations of the Acceptable ETF Regime and the relevant overseas listing rules governing the offering and the listing of the ETF that would materially affect the Acceptable ETF Regime's comparability with that of Hong Kong. Where any material changes would be made to the securities regulations or the applicable listing rules of the Acceptable ETF Regimes thereby affecting their comparability with those of Hong Kong, the ETF or its management company must inform the SFC as soon as practicable; and~~

~~(d) The ETF complies in full with the applicable provisions in the guidelines.~~

Appendix B

Application of the UT Code on UCITS funds

Application of the UT Code on UCITS funds[39]

The SFC intends to continue to adopt the current streamlined approach in processing the authorization of UCITS funds. To provide further guidance to the industry, the SFC sets out below the relevant provisions in the UT Code (with reference to the proposed amended UT Code) that are applicable to UCITS funds for better transparency and clarity.

	Relevant provisions in the proposed amended UT Code applicable to UCITS funds
1. Key operators	
Trustees and custodians	Chapter 4, except for 4.5 (other than 4.5(f)[40])
Management companies	Chapter 5
Investment delegates (who have been delegated the investment management function of a scheme)	5.5(a), (b) and (c)
Hong Kong representatives	Chapter 9
2. Operational requirements	
Scheme documentation, pricing, issue and redemption of units/shares, fees	Chapter 6, except for 6.6 to 6.8 and 6.15
Valuation and pricing, pricing errors, suspension and deferral of dealings, transactions with connected persons	Chapter 10
3. Investment requirements	
Investments in other funds	7.11D, 7.12
Derivatives investments	UCITS funds are subject to the disclosure requirement in the fund's KFS (as discussed in paragraphs 122 under Section 2 of this consultation paper) (Enhanced KFS Disclosure). UCITS funds with derivatives investments of more than 100% of the fund's NAV based on the Commitment Approach will be further subject to a minimum initial subscription by investors under Chapter 8.7 (as discussed in paragraphs 120 under Section 2 of this consultation paper).
Guaranteed features	7.39

39 UCITS funds referred to under Appendix B to this consultation paper means UCITS funds domiciled in Luxembourg, Ireland and the United Kingdom.

40 "Information Checklist for Application for Authorization of Unit Trusts and Mutual Funds under the Revamped Process" by the SFC (last updated 14 July 2017) – For the purposes of 4.5(f), UCITS domiciled in Luxembourg may prepare a long form audit report as required under Luxembourg's rules or regulations which assesses the control environment of the scheme(s) and the service providers (including the custodian).

	Relevant provisions in the proposed amended UT Code applicable to UCITS funds
4. Specialised schemes	
Money market funds	For UCITS money market funds which have complied with the Europe Money Market Funds Regulation[41], 8.2(b), (c), (d) and (o)
Unlisted index funds and index tracking exchange traded funds	8.6, except for 8.6(a) to (a)(b), 8.6(b) to (c), 8.6(g) to (i) and 8.6(r)
Hedge funds	8.7 and Appendix H
Structured funds	8.8, except for 8.8(c), 8.8(e) and 8.8(g)
Funds that invest extensively in financial derivative instruments	8.9(j)
Listed open-ended funds (also known as active ETFs)	8.10, except for 8.10(b)[42]
5. Disclosure and reporting requirements	
Scheme changes, notifications, ongoing disclosures, reporting, withdrawal of authorization, merger or termination	Chapter 11
Information to be disclosed in the offering document	Appendix C, except for C2 (regarding Securities Financing Transactions) and C2A
Contents of the constitutive documents	Constitutive documents of UCITS funds are generally deemed to have complied with Appendix D provided that they comply with all applicable home jurisdiction's laws and regulations and home regulator's requirements and 9.10. UCITS funds are required to provide confirmation on compliance with D12 of Appendix D regarding connected party transactions.
Content of financial reports	Notes to the Financial Reports (2) and (3) of Appendix E

Notwithstanding the above, management companies are reminded that the SFC may impose or vary the requirements and/or conditions in respect of specific funds or types of funds as it may deem fit at any time before granting authorization or allowing the authorization to remain in force.

41 Regulation (EU) 2017/1131 of the European Parliament and of the Council of 14 June 2017 on money market funds.

42 UCITS listed open-ended funds should comply with the requirements under Chapter 7 of the UT Code that are applicable to UCITS.

Appendix C

Proposed consequential amendments to the MPF Code

Proposed consequential amendments to the MPF Code

Chapter 1: Authorization Matters

1.3 Applications of MPF schemes and pooled investment funds should be made to both authorities ~~concurrently~~ under separate cover. Under the current arrangement, an application will first be reviewed by the MPFA. Upon clearance by the MPFA, the Commission will proceed to review the application in accordance with the provisions of this Code.

Chapter 3: Interpretation

3.12 "Delegate~~ of the investment manager~~" means the person to whom the investment manager has delegated its investment management functions.

3.14A "Investment manager" means the entity appointed pursuant to 6.1 of this Code.

3.18B "SFO" means the Securities and Futures Ordinance (Chapter 571 of Laws of Hong Kong).

3.22 "UT Code" means the Code on Unit Trusts and Mutual Funds.

Chapter 4: Application Procedures

Documents to be supplied to the Commission

4.5 Each application must contain a ~~copy of the~~ completed Application Form as ~~prescribed by the MPFA~~ set out on the Commission's website~~.~~ and ~~The Application Form must~~ also be accompanied by the following and such other documents as may be required by the Commission from time to time:

(e) checklist of compliance ~~(see **Appendix B**)~~. This checklist is available for download from the Commission's website ~~*http://www.hksfc.org.hk*~~;

(i) application fee in the form of a cheque payable to the "Securities ~~&~~ and Futures Commission"; and

Note: The current fee schedule is available on the Commission's website.

Chapter 6: Investment Manager

Appointment of Investment Manager

6.1 An investment manager appointed for an MPF scheme or pooled investment fund must comply with ~~the following requirements~~this Chapter on an ongoing basis.

6.2 An investment manager must:

(e) have sufficient financial resources at its disposal to enable it to conduct its business effectively and meet its liabilities; in particular, it must have a minimum paid-up share capital and non-distributable capital reserves of HK$10 million;

Criteria for Acceptability of Investment Manager

6.6 The acceptability of the investment manager will be assessed on the ~~following~~ criteria~~:~~ set out in 5.5 of the UT Code. Applicants should refer to 6.8 to 6.9 for requirements on the delegation of investment management functions to third parties.

(a) ~~The key personnel of the investment manager or its delegate (if any) are expected to possess at least five years investment experience managing pooled retirement funds or other public funds with reputable institutions. The expertise gained should be in the same type of investments as those proposed for the pooled investment fund or constituent fund(s) of the MPF scheme seeking authorization.~~ [deleted]

(b) ~~Key personnel must be dedicated full-time staff with a demonstrable track record in the management of pooled retirement funds, unit trusts or mutual funds. In assessing the qualifications of the personnel of the investment manager, the Commission may request resumes of the directors of the investment manager and its delegates (if any). (see 2.5)~~ [deleted]

(c) ~~Sufficient human and technical resources must be at the disposal of the investment manager, which should not rely solely on a single individual's expertise.~~ [deleted]

(d) ~~The Commission must be satisfied with the overall integrity of the investment manager. Reasonable assurance must be given of the adequacy of internal controls and the existence of written procedures, which should be regularly monitored by its senior management for updatedness and compliance. Conflicts of interests must be properly addressed to safeguard interests of scheme participants or fund holders.~~ [deleted]

(e) ~~Applicants should refer to 6.8 to 6.9 for requirements on the delegation of investment management functions to third parties.~~ [deleted]

Delegation of Investment Management Functions

6.8 Where the investment management functions are delegated to third parties, there should be on-going supervision and regular monitoring of the competence of the delegates by the investment manager to ensure that investor protection and the investment manager's accountability to scheme participants or fund holders is not diminished. Although the investment management role of the investment manager may be sub-contracted to third parties, the responsibilities and obligations of the investment manager may not be delegated.

Note : ~~*The investment management operations of an investment manager's delegate(s) should be based in a jurisdiction with an inspection regime acceptable to the Commission. A list of acceptable inspection regimes is set out in Appendix C. The Commission will consider other jurisdictions on their merits.*~~*The delegate (who has been delegated the investment management function of an MPF scheme or pooled investment fund) should either be licensed or registered in Hong Kong or based in a jurisdiction with an inspection regime acceptable to the Commission. A list of acceptable inspection regimes is published on the Commission's website. The Commission will consider other jurisdictions on their merits and may accept an undertaking from the delegate that the books and records in relation to its management of an MPF scheme or pooled investment fund will be made available for inspection by the Commission on request.*

General Obligations of an Investment Manager

6.10 An investment manager must manage the MPF scheme or pooled investment fund in accordance with its constitutive documents and in the exclusive interests of the scheme participants or fund holders. It is also expected to fulfill the duties imposed on it by the general law.

Chapter 7: Operational Requirements

Name of Constituent Fund and Pooled Investment Fund

7.5 If the name of the constituent fund or pooled investment fund indicates a particular objective, investment strategy, geographic region or market, the constituent fund or pooled investment fund should invest at least 70% of its ~~non-cash~~total net asset~~s~~ value in securities and other investments to reflect the particular objective, investment strategy or geographic region or market which the constituent fund or pooled investment fund represents.

Chapter 8: Post-Authorization Requirements

Scheme Changes

8.2 The proposed changes to the offering document of an MPF scheme or pooled investment fund as a result of the following must be submitted to the Commission for prior approval:

(b) changes of ~~key operators (including~~ the applicant, the trustee / custodian and investment manager and its delegates~~)~~ and their regulatory status ~~and controlling shareholder~~;

(c) 11.1(c) of the UT Code applies; and ~~changes in investment objectives, policies and restrictions (including the purpose or extent of use of derivatives), fee structure and dealing and pricing arrangements; and~~

(d) 11.1(d) of the UT Code applies. ~~any other changes that may materially prejudice rights or interests of scheme participants or fund holders.~~

8.2A For changes to the offering document of an MPF scheme or pooled investment fund that require the Commission's prior approval pursuant to 8.2, the Commission will determine whether the scheme participants or fund holders should be notified and the period of notice (if any) that should be applied before the changes are to take effect (as provided in 8.3).

Notes: (1) ~~*Normally, the Commission will expect that one month's prior written notice (or such longer period as required under applicable laws and regulations or the provisions as set out in the offering or constitutive documents) should be provided to scheme participants or fund holders in respect of the changes. However, the Commission may permit a shorter period of notice if the change is not significant or may require a longer period of notice (up to three months) in exceptional circumstances.*~~ *[deleted]*

(2) ~~*For the purposes of 8.2A, significant changes would include, for example, changes in investment objectives or major investment policies, and fee structure.*~~ *[deleted]*

(3) *Note (3) in 11.1A of the UT Code applies.* ~~*For any increase in fees and charges from the current level as stated in the offering document, prior approval from the Commission is not required, but no less than one month's prior notice must be given to scheme participants or fund holders.*~~

8.2B For changes to the offering document of an MPF scheme or pooled investment fund that do not require the Commission's prior approval pursuant to 8.2, ~~unless there is a specified minimum prior notice period in this Code,~~ the applicant should provide scheme participants or fund holders with reasonable prior notice, or inform scheme participants or fund holders as soon as reasonably practicable of any information concerning the MPF scheme or pooled investment fund which is necessary to enable scheme participants or fund holders to appraise the position of the MPF scheme or pooled investment fund (as provided in 8.3). The offering document may be updated to incorporate such changes and reissued without further authorization provided that the content and format of such document remains fundamentally the same as the version previously authorized. The revised offering document must be filed with the Commission, together with a marked-up version against the previously filed version, within two weeks from the date of issuance.

Note: The Note in 11.1B of the UT Code applies and references therein to "management company" shall mean "applicant" for the purposes of this Code.

Notices to Scheme Participants and Fund Holders

8.3 11.2 of the UT Code applies, except where a waiver is granted under 5.1 of this Code, notification to participants of an MPF scheme or holders of a pooled investment fund must be made in both the English and Chinese languages in respect of any changes or proposed changes to the offering documents of the MPF scheme or pooled investment fund.

8.3B 11.2B of the UT Code applies and references therein to "management company" shall mean "applicant" for the purposes of this Code. ~~The applicant has the responsibility to ensure that notices to scheme participants or fund holders are not misleading and contain accurate and adequate information to keep investors informed. All notices should contain a Hong Kong contact number for investors to make enquiries.~~

~~*Note: Notices should not include any reference to a specific date or timetable in respect of the changes made to the offering or constitutive documents where such date or timetable has not been agreed in advance with the Commission.*~~

Withdrawal of Authorization

8.5 11.4 of the UT Code applies and references therein to "management company" shall mean "applicant" for the purposes of this Code. ~~Following the authorization of an MPF scheme or pooled investment fund, the applicant should, subject to 8.5A below, give at least three months' prior notice to scheme participants or fund holders of any intention not to maintain such authorization. Such notice should be submitted to the Commission for prior approval and contain the reasons for the withdrawal of authorization, consequences of the withdrawal, any proposed changes in the operation of the MPF scheme or pooled investment fund and their effects on existing scheme participants or fund holders, the alternatives available to scheme participants or fund holders (including, if possible, a right to switch without charge into another authorized MPF scheme or pooled investment fund) and, where appropriate, an estimate of any relevant expenses and who is expected to bear them.~~

Merger or Termination

8.5A 11.5 of the UT Code applies and references therein to "management company" shall mean "applicant" for the purposes of this Code. ~~If an MPF scheme or pooled investment fund is to be merged or terminated, in addition to following any procedures set out in the scheme's constitutive documents or governing law, notice must be given to investors as determined by the Commission. Such notice should be submitted to the Commission for prior approval and contain the reasons for the merger or termination, the relevant provisions under the constitutive documents that enable such merger or termination, the consequences of the merger or termination and their effects on existing scheme participants or fund holders, the alternatives available to scheme participants or fund holders (including, if possible, a right to switch without charge into another authorized MPF scheme or pooled investment fund), the estimated costs of the merger or termination and who is expected to bear them.~~

Mention of SFC Authorization

8.9 Where an MPF scheme or pooled investment fund is described as having been authorized by the Commission, it must be stated that authorization does not imply official recommendation~~.~~ by adding a prominent note in the following terms to the offering document and advertisements and other invitations to invest in the MPF scheme or pooled investment fund:

SFC authorization is not a recommendation or endorsement of an MPF scheme or pooled investment fund nor does it guarantee the commercial merits of an MPF scheme or pooled investment fund or its performance. It does not mean the MPF scheme or pooled investment fund is suitable for all scheme participants or fund holders nor is it an endorsement of its suitability for any particular scheme participant or fund holder.

Appendix A

A3 Hong Kong Investment Management Activity

1. Number of fund managers/ description of size of fund management operation/ research - in house/ third party?
3. Administration (where/ how are administrative arrangements carried out?)

Appendix B

~~**COMPLIANCE CHECKLIST**~~

(Deleted)

Appendix C

~~**ACCEPTABLE INSPECTION REGIMES**~~

(Deleted)

Appendix D

Proposed consequential amendments to the PRF Code

Proposed consequential amendments to the PRF Code

Chapter 1: Authorization Procedures

Documents to be supplied to the Commission

1.6 An ~~applicant~~ application for authorization of a pooled retirement fund ~~should lodge with the Commission~~must contain a completed Application Form as set out on the Commission's website and be accompanied by the following and such other documents as may be required by the Commission from time to time:

(c) All other sales literature, proposed advertisements and printed material intended to be issued in Hong Kong to prospective investors, where applicable;

(d) A checklist of compliance with the Code ~~(see Appendix C)~~;

(f) The application fee in the form of a cheque payable to the "Securities ~~&~~and Futures Commission"~~. The current fee schedule is available on request from the Commission~~; ~~and~~

Note: The current fee schedule is available on the Commission's website.

(g) The letter nominating an individual to be approved by the Commission as an approved person containing the individual's name, employer, position held and contact details, including, in so far as applicable, the address, telephone and facsimile numbers, and electronic mail address; and

(h) A written undertaking from the Hong Kong Representative, where applicable (see 7.3).

Offer of pooled retirement funds and investment portfolios

1.7 Pooled retirement funds and investment portfolios shall only be available to ORSO schemes, employers and/ or members of ORSO schemes.

Chapter 3: Interpretation

Unless otherwise defined, words and expressions used in this Code are as defined in the SFO.

3.6A "Hong Kong representative" or "representative" means the Hong Kong representative appointed pursuant to 7.1 of this Code.

3.9A "investment delegate" means an entity that has been delegated the investment management function of a pooled retirement fund.

3.9B "management company" means the entity appointed pursuant to 5.1 of this Code.

3.9C "ORSO schemes" means occupational retirement schemes as defined under the Occupational Retirement Schemes Ordinance (Chapter 426 of Laws of Hong Kong).

3.10 "pooled retirement fund" or "scheme" has the same meaning as "pooling agreement" in the Occupational Retirement Schemes Ordinance (Chapter 426 of Laws of Hong Kong).

3.11 "principal brochure" means that offering document issued by an applicant company, containing information on a pooled retirement fund as stipulated in Appendix A.

3.12A "SFO" means the Securities and Futures Ordinance (Chapter 571 of Laws of Hong Kong).

3.13 "substantial financial institution" means an authorized institution as defined in section 2(1) of the Banking Ordinance (Chapter 155 of Laws of Hong Kong), or a financial institution which is on an ongoing basis subject to prudential regulation and supervision, with a minimum net asset value ~~paid-up capital~~ of HK$~~150,000,000~~2 billion or its equivalent in foreign currency.

3.14 "Trustee" means the entity appointed pursuant to 6.1 of this Code.

3.15 "UT Code" means the Code on Unit Trusts and Mutual Funds.

Chapter 5: Management Company

Appointment of Management Company

5.1 Every pooled retirement fund must have a management company acceptable to the Commission and shall comply with this Chapter on an ongoing basis, unless the fund is the subject of or regulated by an insurance arrangement (see 5.11 below).

Note: The investment delegate (who has been delegated the investment management function of a pooled retirement fund) should either be licensed or registered in Hong Kong (see 5.6 below) or based in a jurisdiction with an inspection regime acceptable to the Commission. A list of acceptable inspection regimes is published on the Commission's website. The Commission will consider other jurisdictions on their merits and may accept an undertaking from the investment delegate that the books and records in relation to its management of a pooled retirement fund will be made available for inspection by the Commission on request.

5.2 5.2 of the UT Code applies. ~~*A management company must:*~~

~~(a) be engaged primarily in the business of fund management;~~

~~(b) have sufficient financial resources at its disposal to enable it to conduct its business effectively and meet its liabilities; in particular, it must have a minimum issued and paid-up capital and capital reserves of HK$1 million or its equivalent in foreign currency;~~

~~(c) not lend to a material extent; and~~

~~(d) maintain at all times a positive net asset position.~~

Qualifications of Directors

5.4 The directors of the management company must be of good repute and in the opinion of the Commission possess the necessary experience for the performance of their duties. In determining the acceptability of the management company, the Commission may consider the qualifications and experience of persons employed by the management company and any appointed investment ~~adviser~~delegate.

Criteria for Acceptability of Management Company

5.5 5.5 of the UT Code applies. ~~*The acceptability of the management company will be assessed on the following criteria:*~~

~~(a) The key personnel of the management company or those of the investment adviser (where the latter has been delegated the investment management function) are expected to possess at least five years investment experience managing pooled retirement funds or other public funds with reputable institutions. The expertise gained should be in the same type of investments as those proposed for the funds seeking authorization.~~

~~(b) Key personnel must be dedicated full-time staff with a demonstrable track record in the management of pooled retirement funds or other public funds. In assessing the qualifications of the personnel of the management company, the Commission may request resumes of the directors of the management company and its delegates (if any) (see 2.2).~~

~~(c) Sufficient human and technical resources must be at the disposal of the management company, which should not rely solely on a single individual's expertise.~~

~~(d) The Commission must be satisfied with the overall integrity of the management company. Reasonable assurance must be secured of the adequacy of internal controls and the existence of written procedures, which should be regularly monitored by its senior management for updatedness and compliance. Conflicts of interests must be properly addressed to safeguard investors' interests.~~

~~(e) Where the investment management functions are delegated to third parties, there should be on-going supervision and regular monitoring of the competence of the delegates by the management company to ensure that the management company's accountability to investors is not diminished. Although the investment management role of the management company may be sub-contracted to third parties, the responsibilities and obligations of the management company may not be delegated.~~

Chapter 6: Trustee

Appointment of Trustee

6.1 Every pooled retirement fund must be governed by a trust with a trustee acceptable to the Commission and shall comply with this Chapter on an ongoing basis, unless the fund is the subject of or regulated by an insurance arrangement.

Note: An acceptable trustee should ~~either:~~

~~(i) on an ongoing basis, be subject to regulatory supervision~~ be subject to prudential regulation and supervision on an on-going basis. Trustee shall appoint an independent auditor to periodically review its internal controls and systems on terms of reference agreed with the Commission (see Appendix E) and should file such report with the Commission, unless such trustee is a trust company registered under Part VIII of the Trustee Ordinance (Chapter 29 of Laws of Hong Kong) approved by the Mandatory Provident Fund Schemes Authority pursuant to Section 20 of the Mandatory Provident Fund Schemes Ordinance (Chapter 485 of Laws of Hong Kong) (as may be amended from time to time).~~ ~~; or~~

~~(ii) appoint an independent auditor to periodically review its internal controls and systems on terms of reference agreed with the SFC and should file such report with the SFC (See Appendix E).~~

6.2 A trustee must be:

(a) 4.2(a) of the UT Code applies~~a bank licensed under section 16 of the Banking Ordinance~~;

(b) a trust company registered under Part VIII of the Trustee Ordinance (Chapter 29 of Laws of Hong Kong) which is a subsidiary of such a bank or a banking institution falling under 6.2(d) or of an insurance company authorized in Hong Kong;

Note: In determining the acceptability of a subsidiary of a banking institution falling under 6.2(d), the Commission will take into account factors including the level of oversight and supervision from such banking institution.

(c) 4.2(c) of the UT Code applies~~a trust company registered under Part VIII of the Trustee Ordinance~~; or

(d) 4.2(d) of the UT Code applies~~a banking institution or trust company incorporated outside Hong Kong which is acceptable to the Commission~~.

6.3 4.3 of the UT Code applies~~A trustee must be independently audited and have minimum issued and paid-up capital and non-distributable capital reserves of HK$10 million or its equivalent in foreign currency~~.

6.4 Notwithstanding 6.3 above, the trustee's paid-up share capital and non-distributable capital reserves may be less than HK$10 million if the trustee is a wholly-owned subsidiary of a bank or an insurance company (the holding company); and

(a) 4.4(a) of the UT Code applies~~the holding company issues a standing commitment to subscribe sufficient additional capital up to the required amount, if so required by the Commission~~; or

(b) 4.4(b) of the UT Code applies~~the holding company undertakes that it would not let its wholly-owned subsidiary default and would not, without prior approval of the Commission, voluntarily dispose of, or permit the disposal or issue of any share capital of the trustee such that it ceases to be a wholly-owned subsidiary of the holding company~~.

Retirement of Trustee

6.4A 4.6 of the UT Code applies.

Independence of Trustee and Management Company

6.6 4.8 of the UT Code applies.~~Notwithstanding 6.5 above, if the trustee and the management company are both bodies corporate having the same ultimate holding company, whether incorporated in Hong Kong or outside Hong Kong, the trustee and the management company are deemed to be independent of each other if:~~

~~(a) they are both subsidiaries of a bank, an insurance company or a holding company of a bank or insurance company;~~

~~(b) neither the trustee nor the management company is a subsidiary of the other;~~

~~(c) no person is a director of both the trustee and the management company; and~~

~~(d) both the trustee and the management company sign an undertaking that they will act independently of each other in their dealings with the pooled retirement fund.~~

Chapter 7: Hong Kong Representative

Retirement or Dismissal of Representative

7.4 Should the representative retire or be dismissed, it must be replaced as soon as possible by another representative whose appointment is subject to the approval of the Commission (see 10.1(b)).

~~Hong Kong Representative Agreement~~

7.5 [deleted]

Chapter 8: Operational Requirements

Pooled Retirement Fund Documentation

Application Form

8.3 Subject to 1.7, ~~No~~ no pooled retirement fund application form may be provided to any member of the public unless it is accompanied by the principal brochure. To that end the application form should include a statement to the effect that it should only be issued in conjunction with the principal brochure.

Fees and Charges

8.8 The level/basis of calculation of all costs and charges payable must be clearly stated, with percentages expressed on a per annum basis, where applicable. The aggregate level of fees for investment management ~~or advisory~~ function~~s~~ should also be disclosed.

Chapter 9: Guaranteed Funds

Guarantor

9.1 If the guarantor is an entity other than the insurance company which issues the policy, it must be a substantial financial institution~~ acceptable to the Commission~~.

Chapter 10: Post-authorization Requirements

Scheme Changes

10.1 The proposed changes to a scheme in respect of the following must be submitted to the Commission for prior approval:

(a) changes to constitutive documents (other than changes that have been certified by the trustee as provided under 10.2 of this Code or changes which do not require prior approval from the Commission;

(b) 11.1(b) of the UT Code applies (and includes changes to the applicant company); ~~changes of key operators (including the applicant company, trustee / custodian, management company and its delegates and Hong Kong representative) and their regulatory status and controlling shareholder;~~

(c) 11.1(c) of the UT Code applies; and ~~changes in investment objectives, policies and restrictions (including the purpose or extent of use of derivatives), fee structure and dealing and pricing arrangements; and~~

(d) 11.1(d) of the UT Code applies~~any other changes that may materially prejudice investors' rights or interests~~.

10.1A 11.1A of the UT Code applies. ~~For changes to a scheme that require the Commission's prior approval pursuant to 10.1, the Commission will determine whether investors should be notified and the period of notice (if any) that should be applied before the changes are to take effect. The revised principal brochure as a result of such changes should be submitted to the Commission for prior authorization.~~

~~Notes: (1) Normally, the Commission will expect that one month's prior written notice (or such longer period as required under applicable laws and regulations or the provisions as set out in the principal brochure or constitutive documents) should be provided to investors in respect of the changes. However, the Commission may permit a shorter period of notice if the change is not significant or may require a longer period of notice (up to three months) in exceptional circumstances.~~

~~(2) For the purposes of 10.1A, significant changes would include, for example, changes in investment objectives or major investment policies, and fee structure.~~

~~(3) For any increase in fees and charges from the current level as stated in the principal brochure up to the maximum level permitted by the constitutive documents, prior approval from the Commission is not required, but no less than one month's prior notice must be given to investors.~~

10.1B 11.1B of the UT Code applies and references therein to "management company" shall mean "applicant company" for the purposes of this Code~~For changes to a scheme that do not require the Commission's prior approval pursuant to 10.1, unless there is a specified minimum prior notice period in this Code, the applicant company should inform investors as soon as reasonably practicable of any information concerning the scheme which is necessary to enable investors to appraise the position of the scheme. The principal brochure may be updated to incorporate such changes and reissued without further authorization provided that the content and format of such document remains fundamentally the same as the version previously authorized.~~ except that t~~T~~he revised principal brochure must be filed with the Commission, together with a marked-up version against the previously filed version, within two weeks from the date of issuance.

10.2 The constitutive documents may be altered by the trustee and management company without consulting investors, provided that the trustee certifies in writing that in its opinion the proposed alteration:

(a) is necessary to make possible compliance with fiscal or other statutory, regulatory or official requirements; ~~or~~

(b) does not materially prejudice investors' interests, does not to any extent release the parties from any liability to investors and does not increase the costs and charges payable under the pooled retirement fund; or

(c) is necessary to correct a manifest error.

In all other cases involving any material changes, no alteration may be made except with the approval of the Commission.

Withdrawal of Authorization

10.5 11.4 of the UT Code applies and references therein to "management company" shall mean "applicant company" for the purposes of this Code. ~~Following the authorization of a pooled retirement fund, the applicant company should, subject to 10.6 below, give at least three months' notice to investors of any intention not to maintain such authorization. Such notice should be submitted to the Commission for prior approval and contain reasons for the withdrawal of authorization, consequences of the withdrawal, any proposed changes in the operation of the pooled retirement fund and their effects on existing investors, the alternatives available to investors (including, if possible, a right to switch without charge into another authorized pooled retirement fund) and, where applicable, an estimate of any relevant expenses and who is expected to bear them.~~

Merger or Termination

10.6 11.5 of the UT Code applies and references therein to "management company" shall mean "applicant company" for the purposes of this Code. ~~When a pooled retirement fund or any of its fund options is to be merged or terminated and there are investors remaining in the fund, in addition to following any procedures set out in the constitutive documents or governing law, notice shall be given to those investors. Such notice should be submitted to the Commission for prior approval and shall contain the reasons for the merger or termination, the relevant provisions under the constitutive documents that enable such merger or termination, the alternatives available to investors (including, if possible, a right to switch without charge into another authorized pooled retirement fund or fund option), the estimated costs of the merger or termination and who is expected to bear them.~~

Rebates

10.10 10.12 of the UT Code applies (except for 10.12(d)). ~~Neither the applicant/management company nor any of its connected persons may retain cash or other rebates from a broker or dealer in consideration of directing transactions in the investments of the pooled retirement fund to the broker or dealer save that goods and services (soft dollars) may be retained if:~~

~~(a) the goods or services are of demonstrable benefit to the investors;~~

~~(b) transaction execution is consistent with best execution standards and brokerage rates are not in excess of customary institutional full-service brokerage rates;~~

~~(c) adequate prior disclosure is made in the pooled retirement fund's principal brochure.~~

~~*Note: Goods and services falling with (a) above may include: research and advisory services; economic and political analysis; portfolio analysis, including valuation and performance measurement; market analysis, data and quotation services; computer hardware and software incidental to the above goods and services; clearing and custodian services and investment-related publications. Such goods and services may not include travel, accommodation, entertainment, general*~~

~~*administrative goods or services, general office equipment or premises, membership fees, employee salaries, or direct money payments.*~~

Notices to Investors

10.11 11.2 of the UT Code applies. ~~Notification to investors must be made in the language(s) in which the pooled retirement fund is offered to investors in respect of any changes or proposed changes to the principal brochure or constitutive documents as determined by the Commission pursuant to 10.1A.~~

10.13 11.2B of the UT Code applies and references therein to "management company" shall mean "applicant company" for the purposes of this Code. ~~The applicant company has the responsibility to ensure that the notices to investors are not misleading and contain accurate and adequate information to keep them informed. All notices should contain a Hong Kong contact number for investors to make enquiries.~~

~~*Note: Notices should not include any reference to a specific date or timetable in respect of the changes made to the principal brochure or constitutive documents where such date or timetable has not been agreed in advance with the Commission.*~~

Mention of SFC Authorization

10.14 Where a pooled retirement fund is described as having been authorized by the Commission, it must be stated that authorization does not imply official recommendation by adding a prominent note in the following terms to the principal brochure and advertisements and other invitations to invest in the pooled retirement fund:

SFC authorization is not a recommendation or endorsement of a scheme nor does it guarantee the commercial merits of a scheme or its performance. It does not mean the scheme is suitable for all investors nor is it an endorsement of its suitability for any particular investor or class of investors.

Appendix A

Information to be disclosed in the Principal Brochure

(b) *Parties Involved*

The names and registered addresses of all parties involved in the operation of the pooled retirement fund with a brief description of the applicant company.

Appendix B

Contents of the Constitutive Documents

(f) *Contributions*

(iv) How it is paid and the options if any for payment.

Appendix C

~~Compliance Checklist~~

(Deleted)

Appendix E

Guidelines for Review of Internal Controls and Systems of Trustees/Custodians

INTRODUCTION

1. Pursuant to Chapter 6.1 of this Code, trustees/custodians of collective investment schemes are required to be approved by the SFC. An acceptable trustee/custodian should ~~either:~~be subject to prudential regulation and supervision on an on-going basis. Trustee shall appoint an independent auditor to periodically review its internal controls and systems on terms of reference agreed with the Commission and should file such report with the Commission, unless such trustee is a trust company registered under Part VIII of the Trustee Ordinance (Chapter 29 of Laws of Hong Kong) approved by the Mandatory Provident Fund Schemes Authority pursuant to Section 20 of the Mandatory Provident Fund Schemes Ordinance (Chapter 485 of Laws of Hong Kong) (as may be amended from time to time).

   ~~(a) on an ongoing basis, be subject to regulatory supervision; or~~

   ~~(b) appoint an independent auditor to periodically review its internal controls and systems on terms of reference agreed with the SFC and should file such report with the SFC.~~

SCOPE OF REVIEW

5. The internal control review should involve all material procedural and control elements relevant and necessary to the responsibilities of trustees/custodians in relation to a scheme. The review should be conducted to provide reasonable assurance in accordance with ~~generally~~ internationally acceptable ~~international auditing practices~~review standards.

Appendix E

Proposed consequential amendments to the ILAS Code

Proposed consequential amendments to the ILAS Code

Chapter 1: Authorization procedures

Documents to be supplied to the Commission

1.7 An applicant for authorization of a scheme must submit a completed~~should complete and submit the~~ Application Form and an Information Checklist as set out in the Commission's website. The application must also be accompanied by the following and such other documents as may be required by the Commission from time to time~~ together with the following to the Commission upon application for authorization~~:

(b) [deleted]~~Information Checklist;~~

~~Note: The Information Checklist is available on the Commission's website.~~

(c) [deleted]~~such other documents as may be required by the SFC from time to time;~~

(d) application fee in the form of a cheque payable to the "Securities ~~&~~ and Futures Commission"; and

Note: The current fee schedule is available on the Commission's website.

Authorized Insurer

1.8 Insurers are required to obtain authorization to carry on Class C of Long Term Business under the Insurance ~~Companies~~ Ordinance (Chapter 41 of the Laws of Hong Kong) before applying for authorization of its investment-linked assurance schemes.

Chapter 2: Administrative arrangements

~~Administrative arrangements~~Product Advisory Committee

Chapter 3: Interpretation

3.4 "Authorized Insurer" means an insurance company authorized under the Insurance ~~Companies~~ Ordinance to carry on a relevant class of insurance business in Hong Kong.

3.8A "investment delegate" means an entity that has been delegated the investment management function of a scheme.

3.9 "investment-linked assurance scheme" means an insurance policy of the "linked long-term" class as defined in Part 2 of Schedule 1 to the Insurance ~~Companies~~ Ordinance, other than a policy of which the predominant purpose is life assurance and not investment.

3.17 "substantial financial institution" means an authorized institution as defined in section 2(1) of the Banking Ordinance (Chapter 155 of the Laws of Hong Kong), or a financial institution which is on an ongoing basis subject to prudential regulation and supervision, with a minimum ~~paid-up capital~~net asset value of HK$2 billion~~150,000,000~~ or its equivalent in foreign currency.

3.18 "UF-driven changes" means changes to an investment option falling within 7.1 of this ILAS Code that solely reflect changes made to the corresponding underlying SFC-authorized fund and such underlying fund changes have been approved, or are not required to be approved by the Commission pursuant to the Code on Unit Trusts and Mutual Funds.

Chapter 4: Applicant company

Responsibilities of applicant company

4.4 If a scheme contains a guaranteed investment option, such guarantee should be provided either by the applicant company or a substantial financial institution ~~acceptable to the Commission~~.

4.6 The applicant company must ensure the scheme is designed fairly, and operated according to such product design on an ongoing basis, including, among others, managing the scheme in a cost-efficient manner taking into account the size of the scheme and the level of fees and expenses etc.

Chapter 5: Operational requirements

Fees and charges

5.15 The level/basis of calculation of all costs and charges payable from the scheme's property must be clearly stated, with percentages expressed on a per annum basis, where applicable. The aggregate level of fees for investment management ~~or advisory~~ function~~s~~ should also be disclosed.

Chapter 6: Guarantee and with-profits or similar features

Guarantor

6.1 If the guarantor is an entity other than the Authorized Insurer which issues the policy, it must be a substantial financial institution ~~acceptable to the Commission~~.

Chapter 7: Post-authorization requirements

Scheme changes

7.1 The proposed changes to a scheme (other than UF-driven changes) in respect of the following must be submitted to the Commission for prior approval:

(a) changes to constitutive documents (other than changes that have been certified by the Authorized Insurer as provided under 7.4 or changes which do not require prior approval from the Commission);

(b) changes of ~~key operators (including~~ the applicant company / management company and investment ~~its~~ delegates~~),~~ and their regulatory status ~~and controlling shareholder~~;

(c) (i) material changes in investment objectives, policies and restrictions of the scheme (including expansion in the purpose or extent of use of financial derivative~~s~~ instruments for investment purposes)~~,~~;

(ii) introduction of new fees and charges, or increase in fees and charges (other than an increase within the permitted maximum level as disclosed in the offering document)~~fee structure~~; and

(iii) material changes in dealing arrangements, ~~and~~ pricing arrangements or distribution policy of the scheme; and

(d) any other changes that may have a material adverse impact on ~~materially prejudice~~ scheme participants' rights or interests (including changes that may limit scheme participants' ability in exercising their rights).

7.2 For changes to a scheme that require the Commission's prior approval pursuant to 7.1, the Commission will determine whether scheme participants should be notified and the period of notice (if any) that should be applied before the changes are to take effect as provided under 7.11. The revised offering document as a result of such changes should be submitted to the Commission for prior authorization.

Notes: (1) *[deleted]~~Normally, the Commission will expect that one month's prior written notice (or such longer period as required under applicable laws and regulations or the provisions as set out in the offering document or constitutive documents) should be provided to scheme participants in respect of the changes. However, the Commission may permit a shorter period of notice if the change is not significant or if it is not practicable for the applicant to do so due to circumstances beyond its control. The Commission may also require a longer period of notice (up to three months) in exceptional circumstances.~~*

(2) *[deleted]~~For the purposes of 7.2, significant changes would include, for example, changes in investment objectives or major investment policies, and fee structure.~~*

(3) *For any increase in fees and charges from the current level ~~as stated in the principal brochure~~ up to the permitted maximum level ~~permitted by the constitutive documents~~as disclosed in the offering document, prior approval from the Commission is not required, but no less than one month's prior notice must be given to scheme participants. However, ~~the Commission may permit~~ a shorter period of notice may be permitted ~~if the change is not significant or~~ if it is not practicable for the applicant to do so due to circumstances beyond its control.*

7.3 For changes to a scheme that do not require the Commission's prior approval pursuant to 7.1, ~~unless there is a specified minimum prior notice period in this ILAS Code,~~ the applicant company should provide scheme participants with reasonable prior notice, or inform scheme participants as soon as reasonably practicable of any information concerning the scheme which is necessary to enable scheme participants to appraise the position of the scheme as provided under 7.11. The offering document may be updated to incorporate such changes and reissued without further authorization provided that the content and format of such document remains fundamentally the same as the version previously authorized. The revised offering document must be filed with the Commission, together with a marked-up version against the previously filed version, within one week from the date of issuance.

7.4 The constitutive documents may be altered by the Authorized Insurer without consulting scheme participants provided that the Authorized Insurer certifies in writing that in its opinion the proposed alteration:

(a) is necessary to make possible compliance with fiscal or other statutory, regulatory or official requirements; ~~or~~

(b) does not materially prejudice scheme participants' interest, does not to any extent release the parties from any liability to participants and does not increase the costs and charges payable under the scheme; or~~.~~

(c) is necessary to correct a manifest error.

In all other cases involving any material changes, no alteration may be made except by the approval of the Commission.

Withdrawal of authorization

7.6 Following the authorization of a scheme, an application for withdrawal of authorization of the scheme must be submitted to the Commission for prior approval.~~the applicant company should,~~ ~~s~~Subject to 7.7 below, at least ~~give~~ three months' notice, or any shorter notice period as may be permitted ~~allowed by the Commission~~ if it is not practicable for the applicant company to do so due to circumstance beyond its control, should be provided to scheme participants of any intention not to maintain such authorization. Such notice should be submitted to the Commission for prior approval and contain information necessary to enable scheme participants to make an informed judgement of the proposed withdrawal of authorization by the applicant company (including reasons for the withdrawal of authorization, consequences of the withdrawal, any proposed changes in the operation of the scheme and their effects on existing scheme participants, the alternatives available to scheme participants (including, if possible, a right to switch without charge into another authorized scheme) and, where applicable, an estimate of any relevant expenses and who is expected to bear them).

Note: Subject to the scheme having served notice period for merger or termination under 7.7, the applicant company may apply for withdrawal of authorization of the scheme with immediate effect

following the completion of the merger or termination (as the case may be).

Merger or termination

7.7 Where a scheme or an investment option linked to the scheme is to be merged or terminated, the applicant company should ~~in addition to~~ follow~~ing~~ ~~any~~the procedures as set out in the constitutive documents or governing law., ~~n~~Notice ~~shall~~ should be given to scheme participants. ~~-~~ Such notice should be submitted to the Commission for prior approval and ~~shall~~ contain information necessary to enable scheme participants to make an informed judgement of the proposed merger or termination by the applicant company (including the reasons for the merger or termination, the relevant provisions under the constitutive documents that enable such merger or termination, the consequences of the merger or termination and their effects on existing scheme participants, the alternatives available to scheme participants (including, if possible, a right to switch without charge into another authorized scheme or investment option), the estimated costs of the merger or termination and who is expected to bear them).

Notes: (1) Normally, the Commission will expect that at least one month's prior written notice (or such longer period as required under applicable laws and regulations or the provisions as set out in the offering or constitutive documents) to be provided to scheme participants. However, a shorter period may be permitted if it is not practicable for the applicant company to do so due to circumstances beyond its control.

(2) In effecting a merger or termination, the applicant company must put in place proper measures to minimize the opportunity of any scheme participants to benefit from more favourable or advantageous conditions of the scheme, taking due account of the interests of the scheme participants.

Notices to scheme participants

7.11 Notification to scheme participants must be made in the language(s) in which the scheme is offered to them ~~in respect of any changes or proposed changes to the scheme, the offering document or constitutive documents as determined by the Commission pursuant to 7.2~~. Reasonable notice period(s) should be provided to the scheme participants in order to enable them to appraise the position of the scheme and to make an informed judgement of their investments in the scheme, where applicable.

Notes: In determining the notice period for changes to a scheme falling under 7.1 or 7.3, the following shall apply:

(1) normally, one month's prior written notice (or such longer period as required under applicable laws and regulations or the provisions as set out in the offering or constitutive documents) is expected to be provided to scheme participants unless as provided under Notes (2) or (3) to 7.11 or otherwise agreed by the Commission;

(2) a shorter prior notice period may be permitted where the proposed changes to the scheme are of demonstrable benefit to scheme participants or if it is not practicable for the applicant company to do so due to circumstances beyond its control; and

(3) unless otherwise specified by the Commission, scheme participants should be informed as soon as reasonably practicable for changes to the scheme which are to provide clarification or relate to administrative matters.

The applicant company is encouraged to consult the Commission in case of doubt.

7.13 *Note: Notices should not include any reference to a specific date or timetable in respect of any changes falling under 7.1 and consequential~~the~~ changes made to the principal brochure or constitutive documents where such date or timetable has not been agreed in advance with the Commission.*