

MEMO# 31111

February 28, 2018

Summary of Potential Comments on Hong Kong Securities and Futures Commission's Proposed Amendments to the Code on Unit Trusts and Mutual Funds

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February 28, 2018 TO: Derivatives Markets Advisory Committee RE: Summary of Potential Comments on Hong Kong Securities and Futures Commission's Proposed Amendments to the Code on Unit Trusts and Mutual Funds

In late December, the Hong Kong Securities and Futures Commission (“SFC”) published a consultation paper (“Consultation”) on proposed amendments to the Code on Unit Trusts and Mutual Funds (“UT Code”).[\[1\]](#) The SFC is seeking to update the UT Code to ensure that Hong Kong’s regulatory regime for SFC-authorized unit trusts and mutual funds is up-to-date and appropriately addresses the opportunities and risks presented by financial innovation and market developments. Funds offered to the retail public in Hong Kong, whether domiciled in Hong Kong or elsewhere, are required to be authorized by the SFC.

Among the proposed amendments, the SFC is proposing to impose restrictions on a fund’s use of derivatives. In particular, the SFC proposes to impose differing requirements on three categories of funds: plain vanilla funds, derivatives-based funds, and retail hedge funds. The SFC proposes to permit “plain vanilla funds” to invest up to 50 percent of their net asset value in derivatives under a proposed commitment approach.[\[2\]](#) The SFC would permit other funds known as “derivatives-based funds” to invest up to 100 percent of their net asset value in derivatives under a proposed commitment approach, provided they provide additional risk disclosures. Finally, the SFC would permit “retail hedge funds” to invest in derivatives without any limit, subject to enhanced requirements, including a minimum initial subscription of at least \$50,000 US.

ICI Global will be submitting comments on the Consultation, which are due by March 19, 2018. Attached is a short outline summarizing the comments that we propose to make, based on ICI Global member calls and feedback gathered over the past month. We are drafting the response and will circulate a draft letter to members. If you have any questions on the summary, please reach out to me by email or phone.

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[Attachment](#)

endnotes

[1] The Hong Kong Securities and Futures Commission Consultation Paper on Proposed Amendments to the Code on Unit Trusts and Mutual Funds is available at: <http://www.sfc.hk/edistributionWeb/gateway/EN/consultation/openFile?refNo=17CP8>. For a summary of the Consultation, *please* see ICI Memorandum No. 31065 (Feb. 1, 2018), available at: <https://www.iciglobal.org/iciglobal/pubs/memos/memo31065>.

[2] Under the proposed commitment approach, derivatives positions acquired for investment (i.e., non-hedging purposes) are converted into the equivalent prevailing market values in their underlying assets. The SFC generally would consider derivatives to be 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 the same underlying asset, they should relate to the same asset class with high correlation in terms of risk 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. See proposed Chapter 7.25 of the UT Code.