

MEMO# 31143

March 23, 2018

Comment Letter on Hong Kong SFC's Proposed Amendments to the Code on Unit Trusts and Mutual Funds

[31143]

March 23, 2018 TO: ICI Members
ICI Global Members
Derivatives Markets Advisory Committee
ICI Global Pacific Chapter
ICI Global Regulated Funds Committee
ICI Global Trading & Markets Committee SUBJECTS: International/Global
MiFID, EMIR, AIFMD, UCITS V RE: Comment Letter on Hong Kong SFC's Proposed
Amendments to the Code on Unit Trusts and Mutual Funds

On 18 March we submitted the attached comment letter responding to the Hong Kong Securities and Futures Commission's (SFC) [consultation](#) (Consultation)^[1] on proposed amendments to the Code on Unit Trusts and Mutual Funds (UT Code). 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.

In our letter, we commended the SFC for undertaking a holistic review of the UT Code to ensure that regulations in Hong Kong are aligned with global standards and those of international fund markets. We noted that this work will benefit investors, fund managers, and the Hong Kong financial services industry as a whole by, among other things, increasing trust and confidence in the regulatory framework. We expressed our support for SFC's proposed inclusion of a separate appendix specifying the provisions that would be applicable to UCITS authorized by the SFC, which was a recommendation we made previously.

Despite our overall support for the update of the UT Code, there are a number of areas where we expressed concern with the SFC's proposed approach. Below is a summary of our suggested revisions to the proposed UT Code.

- **Proposed Derivatives Classifications and Restrictions.** We urged the SFC to eliminate the proposed classifications and limits based on the calculation of notional exposure

because this type of approach would impose arbitrary limits that do not reflect economic exposure or risk. We stated that, if the SFC were to proceed with the proposed approach, to reduce its negative effects the SFC should: disconnect the automatic designation of funds that use derivatives more frequently as “derivatives products” under the Code of Conduct for Persons Licensed by or Registered with the SFC (Code of Conduct) (with significant additional distribution and disclosure requirements); eliminate the minimum subscription amounts required based on notional exposures; and expand and clarify the “for hedging purposes” exclusion.

- **Investment Experience and Expertise.** We requested that the SFC permit fund managers to effect an investment manager change without prior SFC approval so long as certain conditions are met.
- **Diversification Requirements.** We requested that the proposed diversification provision limiting the value of a fund’s cash deposits with the same entity to 20 percent include additional exemptions for unusual circumstances to make the exemptions useful and practically workable.
- **Investment in Other Schemes.** We requested that the Note on investments in other schemes clearly state that a determination of how an exchange traded fund (ETF) is treated (whether considered a listed security or a collective investment scheme) is to be made at an individual fund level.
- **Counterparties.** We requested that the SFC delete the requirement for a counterparty to a securities financing transaction to be a “substantial financial institution” as defined in the UT Code and instead allow the fund manager to have discretion to determine the appropriateness of a fund’s counterparty.
- **Securities Financing Transactions Indemnification.** We requested the removal of the requirement for securities lending agents to indemnify a fund against counterparty default.
- **Collateral Requirements.** We requested that the SFC confirm that the fund manager may determine that, for certain assets, it would be appropriate not to take any haircut based on the fund manager’s assessment of the market risks of those assets.
- **Money Market Funds.** We requested that the SFC clarify and expand the guidelines regarding reverse repurchase agreement collateral to include specifically government securities. Additionally, we requested that the liquid asset definitions be expanded to include government securities.
- **Valuation and Pricing.** We requested that the SFC confirm that the requirement to notify the fund’s trustee/custodian of any pricing error applies only to a material error that would impact the price as published to the public.
- **Implementation Timeline.** We requested that the SFC provide a 24-month transition period rather than the 12-month period as currently proposed.

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[Attachment](#)

endnotes

[\[1\]](#) The Hong Kong Securities and Futures Commission Consultation 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>.

Corresponding amendments are also proposed to relevant provisions of various SFC product codes.

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