

MEMO# 30989

December 21, 2017

HK SFC Concludes Consultation on Asset Management Framework and Point-Of-Sale Transparency

[30989]

December 21, 2017 TO: ICI Global Members

ICI Global Regulated Funds Committee SUBJECTS: International/Global RE: HK SFC

Concludes Consultation on Asset Management Framework and Point-Of-Sale Transparency

Last month, the Hong Kong Securities and Futures Commission (“SFC”) issued its Consultation Conclusions on Proposals to Enhance Management Regulation and Point-of-sale Transparency and Further Consultation on Proposed Disclosure Requirements Applicable to Discretionary Accounts (“Conclusions”) [\[i\]](#).

The Conclusions introduce changes to both the Fund Manager Code of Conduct (“FMCC”) and the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (“Code of Conduct”). Amendments to the FMCC will become effective on 17 November 2018 and those to the Code of Conduct will become effective on 17 August 2018. The SFC in parallel initiated an additional further consultation on disclosure requirements applicable to discretionary accounts (which are in the form of an investment mandate or a pre-defined model investment portfolio). Further guidance to the industry will be made available by way of a set of Frequently Asked Questions (“FAQs”).

KEY ELEMENTS OF THE REVISED ASSET MANAGEMENT FRAMEWORK

Amendments to the FMCC

The main changes to the FMCC relate to: (i) scope of its application; (ii) liquidity risk management; (iii) leverage disclosure; (iv); securities lending and repurchase agreements (“repos”); and (v) custody of fund assets.

Scope of application of the FMCC

The scope of the revised FMCC is considerably broader than the current FMCC in force. It will apply not only to licensed and registered persons (and their representatives) whose businesses involve the management of collective investment schemes (whether authorised or not by the SFC) but also to intermediaries that manage discretionary accounts (in the

form of an investment mandate or pre-defined model investment portfolio). The rational draws on the similarity of investment functions between the business activities of fund management and discretionary account management.

There are specific carve-outs of requirements applicable to discretionary account managers set out in **Appendix 1** to the revised FMCC. These carve-outs are to address concerns of discretionary account managers where certain requirements of the FMCC are not relevant to services provided to their clients. However, there are two new additional requirements on discretionary account managers to: (i) enter into written client agreements which satisfying new content requirements; and (ii) provide reports on performance review and valuation at regular intervals unless clients opt out.

Certain enhancement requirements under the FMCC will only be applicable to fund managers that are "responsible for the overall operation of a fund" (references to the concept of "de facto control" included during the consultation stage were removed). Whether a person is "responsible for the overall operation of a fund" [\[ii\]](#) is a factual question. Citing the existence of a governing body to support an argument that a fund manager is not "responsible for the overall operation of the fund" may not be acceptable going forward merely because it does not formally make final decisions or enter into legal agreements.

Liquidity risk management

Fund managers will be required to (i) maintain liquidity management policies and monitor the liquidity risk of relevant fund or funds with reference to their obligations and redemption policy, if any (the SFC expects fund managers to adopt a proportionate approach to liquidity management and to consider the extent of the applicability of the proposed liquidity risk management requirements to the specific funds they manage and to ensure that their activities are commensurate with the liquidity profiles of those funds); (ii) perform liquidity stress testing on its funds on an ongoing basis to assess the impact of plausible severe adverse changes in market conditions; and (iii) disclose the liquidity risks involved in investing in a fund, the liquidity management policies and an explanation of any tools or exceptional measures that could affect redemption rights in the fund's offering documents or made such information available to fund investors.

Leverage disclosure

Fund managers should disclose the expected maximum leverage. There is no prescribed method on how leverage should be calculated, but fund managers should ensure the disclosure is based on a reasonable and prudent calculation methodology and that such disclosure is fair, and not misleading.

Securities lending and repos

Enhanced requirements will apply to fund managers (whether or not the fund manager is responsible for the overall operation of the fund) which engage in securities lending, repos and reverse repos on behalf of the funds managed by them, such as establishment of a collateral valuation and management policy and a cash collateral re-investment policy.

Custody of fund assets

Fund managers will be required to exercise due skill, care and diligence in the selection,

arranging for the appointment and ongoing monitoring of the custodian. The custodian should be functionally independent from the fund manager. Custodial arrangements (and any changes to it) should be disclosed to investors. In addition to the requirements to segregate between fund assets and fund manager's assets, where fund assets are held in a client omnibus account, the fund manager must ensure that appropriate safeguards are put in place to ensure that the fund assets belonging to each client are appropriately recorded and reconciled.

Other changes

There are other changes concerning priority of house orders, and a new exemption from the requirement to separate investment decision-making process and dealing process which will be available to small-scale fund managers. There is also a new Appendix 2 to the FMCC which includes the SFC's suggested risk management control techniques and procedures

Amendments to the Code of Conduct

Deferred adoption of a pay-for-advice model

The SFC addressed the conflicts of interest arising from intermediaries receiving benefits from other parties in the sale of investment products by way of disclosure. While it has been decided not to adopt a pay-for-advice model (which would effectively be a ban on commissions) at this stage, the SFC will, however, keep under active consideration the merits of pay-for-advice models, taking into account local as well as international market and regulatory developments in this area.

Restriction on the use of the term "independent" and timing of disclosure

The new Code of Conduct restricts intermediaries from representing themselves as being "independent". An intermediary cannot describe itself as being "independent" if it receives monetary benefits from other parties in relation to the distribution of an investment product. An intermediary is also prevented from describing itself as being "independent" in circumstances where there are close links [\[iii\]](#) or other legal or economic relationships [\[iv\]](#) which are likely to impair the independence of the intermediary to favour a particular class of investment products or a product issuer.

Intermediaries are required, to disclose prior to (or at the point of) entering into a transaction with clients whether or not it is independent, and the basis for such determination. Such disclosure should be made, as a minimum, on a one-off basis and upon any changes [\[v\]](#). The SFC prescribed the content of such disclosure in a new Schedule 9 to the Code of Conduct.

Enhancing disclosure requirements

Where the monetary benefits that intermediaries may receive during a year are not quantifiable prior to (or at the point of) entering into a transaction (trailer fees as example [\[vi\]](#)) with clients, intermediaries must now disclose the maximum percentage of the management fees receivable [\[vii\]](#) and such disclosure has to be made prior to (or at the point of) entering into a transaction. While intermediaries may choose to also disclose trailer fees receivable in dollar terms, if they do, the maximum dollar amount receivable each year based on certain assumptions must be disclosed to ensure fair and comparable

disclosure to investors [viii]

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endnotes

[i] The Hong Kong Securities and Futures Commission Consultation Conclusions on Proposals to Enhance Management Regulation and Point-of-sale Transparency and Further Consultation on Proposed Disclosure Requirements Applicable to Discretionary Accounts are available at

<http://www.sfc.hk/edistributionWeb/gateway/EN/consultation/conclusion?refNo=16CP5>

[ii] The SFC will provide further guidance on the meaning of the term “responsible for the overall operation of a fund” in FAQs

[iii] Entities which are within the same group of companies will be regarded as having “close links” to one another

[iv] The SFC will provide further guidance on the meaning of “other legal or economic relationships” in FAQs

[v] Subsequent disclosure of changes can be either in the form of an update or a specific disclosure for each transaction in respect of which there is a change from the one-off disclosure

[vi] The SFC stressed that such enhanced disclosure requirements are not restricted to trailer fees but also cover other non-quantifiable monetary benefits receivable for distribution of funds (for example volume-based service fees)

[vii] Intermediary may comply with this requirement by disclosing the range of trailer fees receivable on an annualised basis as long as the maximum percentage receivable is disclosed

[viii] Further guidance will be provided by the SFC on this point in FAQs

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