

MEMO# 31124

March 9, 2018

Draft Letter on Hong Kong SFC's Proposed Amendments to the Code on Unit Trusts and Mutual Funds; Member Comments due Wednesday, March 14

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March 9, 2018 TO: Derivatives Markets Advisory Committee

ICI Global Pacific Chapter

ICI Global Regulated Funds Committee

ICI Global Trading & Markets Committee RE: Draft Letter on Hong Kong SFC's Proposed Amendments to the Code on Unit Trusts and Mutual Funds; Member Comments due Wednesday, March 14

In late December, the Hong Kong Securities and Futures Commission (SFC) published a [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.

The main changes proposed by the SFC include:

1. strengthening requirements for key operators (such as management companies, trustees and custodians);
2. providing greater flexibility and enhanced safeguards for funds' investment activities (such as restrictions related to derivatives and securities lending, and repo and reverse repo transactions); and
3. new chapters for certain specialised fund types (such as active exchange-traded funds).^[2]

We welcome your feedback on the attached draft comment letter by COB Wednesday, March 14. Please provide your comments to Eva Mykolenko (emykolenko@ici.org or 202-326-5837). We intend to file the letter by the end of Friday, March 16 (responses must be filed with the SFC by Monday, March 19, Hong Kong time).

Our comments on the Consultation include the following:

- **Proposed Derivatives Classifications and Restrictions:** The SFC's proposal to classify funds and impose additional restrictions on funds' derivatives use based on the commitment approach could unnecessarily hamstring a fund's ability to use derivatives in ways that are beneficial to investors. First, the proposed commitment approach imposes arbitrary limits that do not provide a good measure of economic exposure or risk. As a result, some funds will be mischaracterized and treated as being riskier than they truly are, exposing them to additional regulatory requirements and severe practical repercussions. Second, the proposed definition of "for hedging purposes" is too narrow and lacks clarity. We urge the SFC to eliminate the classifications and limits based on the proposed commitment approach. Additionally, if the SFC were to proceed with the proposed commitment approach, we urge it to disconnect the automatic tie between funds that use derivatives more frequently and "derivatives products" under the Code of Conduct (with additional distribution and disclosure requirements).
- **Investment Experience and Expertise:** We request 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 request 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 request that the note on investments in other schemes clearly state that a determination of how an exchange traded fund is treated (whether considered a listed security or a collective investment scheme) is to be made at an individual fund level.
- **Counterparties:** We request that the requirement for a counterparty to a securities financing transaction to be a "substantial financial institution" as defined in the UT Code be deleted and instead left to the discretion of the fund manager.
- **Securities Financing Transactions Indemnification:** We request that the requirement for securities lending agents to indemnify a fund against counterparty default be deleted.
- **Collateral Requirements:** We request that the SFC confirm that a fund can determine that for certain assets based on an assessment of the market risks of the assets it would be appropriate not to take any haircut.
- **Valuation and Pricing:** We request 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 request that the SFC provide a 24-month transition period where a 12-month period is currently proposed.

[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.

[2] An earlier memorandum summarizing the Consultation, dated February 1, 2018, is *available at* <https://www.iciglobal.org/iciglobal/pubs/memos/ci.memo31065.global>.

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