

## Intermediaries and Investment Products Division



(left to right):  
Richard Yin, Director, Intermediaries Supervision  
Andrew Procter, Executive Director  
Leo Lee, Director, Licensing  
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## Highlights

- ❖ Published surveys on the business activities of registrant firms
- ❖ Conducted a review of the licensing regime in Hong Kong
- ❖ Assisted in the drafting of the Securities (Margin Financing) (Amendment) Bill 1999
- ❖ Continued and enhanced its integrated approach to prudential supervision so as to better protect clients' interests and to ensure systemic integrity of markets
- ❖ Conducted more than 380 inspections of intermediaries to ensure compliance with provisions of various Ordinances as well as more than 280 inspections of Year 2000 compliance audits
- ❖ Assisted the fund industry to deal with issues arising from capital controls imposed by the Malaysia government
- ❖ Worked with MPFA to ensure prompt implementation of the MPF system
- ❖ Authorised 332 unit trusts and mutual funds, bringing the total number of authorised funds to 1,608

### FUNCTIONS

The Intermediaries and Investment Products Division has three departments:

*Licensing Department* administers the licensing requirements for securities and commodities dealers, investment advisers, leveraged foreign exchange traders and their representatives, and monitors their ongoing fitness and propriety.

*Intermediaries Supervision Department* supervises licensed and registered persons to ensure that they are financially sound, adhere to good business practices, and comply with regulatory requirements.

*Investment Products Department* regulates the marketing to the public of unit trusts, mutual funds and other collective investment schemes.

### 1. LICENSING DEPARTMENT

#### 1.1 Trends

While the number of applications during the year for registration under the Securities Ordinance and the Commodities Trading Ordinance decreased by 1,291 to 5,510, representing a decrease of 19%, (Table 1) the size of the registrant population, increased from 20,180 to 20,549, representing a marginal growth of 1.8% (Table 2). There were 198 exempt dealers and 40 exempt investment advisers.

This can partly be explained by the registrants' decisions to retrench non-income generating staff such as research analysts and back office staff to generate more commission income for the firms. Many of the retrenched staff, however, became registered after joining rival firms.

Sole proprietorships continued to be incorporated or acquired by larger firms. The number of sole proprietorships fell from 159 as at 31 March 1998 to 138 as at 31 March 1999.



Licensing counter

The Asian financial turmoil has caused a slight decrease in participation in the Hong Kong market by intermediaries from other parts of Asia, particularly from Japan. However, the participation rate from the Mainland, Malaysia and Singapore remained steady. Participation by firms from Taiwan has notably increased.

## Securities and Commodities Intermediaries

Table 1  
**Applications for Registration**  
for the period 1 April 1998 to 31 March 1999

Securities Dealers	Individual	Corporation	Partnership	Dealing Directors	Representatives	Total	% Change
Applications received	0 (1)	43 (68)	0 (0)	327 (371)	2,486 (3,286)	2,856 (3,726)	
Applications approved	0 (1)	44 (68)	0 (0)	300 (336)	2,573 (3,115)	2,917 (3,520)	
Applications refused	0 (0)	0 (0)	0 (0)	0 (0)	4 (4)	4 (4)	
Applications withdrawn	0 (1)	3 (1)	0 (0)	39 (38)	85 (125)	127 (165)	
Securities Investment Advisers	Individual	Corporation	Partnership	Investment Adviser Directors	Representatives	Total	
Applications received	1 (3)	75 (78)	0 (0)	308 (357)	884 (1,092)	1,268 (1,530)	
Applications approved	3 (1)	52 (75)	0 (0)	254 (342)	847 (1,090)	1,156 (1,508)	
Applications refused	0 (0)	0 (0)	0 (0)	0 (0)	0 (0)	0 (0)	
Applications withdrawn	2 (1)	12 (8)	1 (0)	36 (26)	26 (42)	77 (77)	
Commodity Dealers	Individual	Corporation	Firm	Accredited Dealers	Representatives	Total	
Applications received	0 (0)	14 (15)	0 (0)	88 (103)	1,084 (1,201)	1,186 (1,319)	
Applications approved	0 (0)	11 (15)	0 (0)	70 (104)	1,071 (1,163)	1,152 (1,282)	
Applications refused	0 (0)	0 (0)	0 (0)	0 (0)	0 (0)	0 (0)	
Applications withdrawn	0 (0)	0 (4)	0 (0)	9 (19)	30 (53)	39 (76)	
Commodity Trading Advisers	Individual	Corporation	Firm	Accredited Advisers	Representatives	Total	
Applications received	0 (0)	19 (24)	0 (0)	64 (67)	117 (135)	200 (226)	
Applications approved	0 (0)	17 (20)	0 (0)	56 (59)	129 (110)	202 (189)	
Applications refused	0 (0)	0 (0)	0 (0)	0 (0)	0 (0)	0 (0)	
Applications withdrawn	0 (0)	3 (1)	0 (0)	8 (5)	6 (5)	17 (11)	
Applications received (Grand Total)						5,510 (6,801)	-19

Note : 31 March 1998 data in brackets.

Table 2  
**Number of Registered Securities and Commodities Intermediaries**  
as at 31 March 1999

	Securities				Commodities				Grand Total	% Change
	SEHK Members	Total	% Change	HKFE Members	Total	% Change				
Dealers, comprising	1,458	1,933 (1,958)	-1.30	411	480 (502)	-4.40	2,413 (2,460)	-1.90		
Individuals	102	110		-	-					
Corporations	400	578		134	159					
Partnerships	2	2		0	0					
Directors	954	1,243		277	321					
Dealer's Representatives	7,163	9,851 (9,295)	6.00	3,383	3,730 (3,500)	6.60	13,581 (12,795)	6.10		
Advisers, comprising		1,607 (1,710)	-6.00		316 (313)	1.00	1,923 (2,023)	-4.90		
Individuals		25			3					
Corporations		592			130					
Partnerships		0			0					
Directors		990			183					
Adviser's Representatives		2,398 (2,699)	-11.20		234 (203)	15.30	2,632 (2,902)	-9.30		
Grand Total		15,789 (15,662)	0.80		4,760 (4,518)	5.40	20,549 (20,180)	1.80		

Note : 31 March 1998 data in brackets.

## Leveraged Foreign Exchange Traders and Representatives

Table 3  
**Applications for Licenses**  
 for the period 1 April 1998 to 31 March 1999

Leveraged Foreign Exchange Traders	Trader Discretionary A/C	Trader Non-discretionary A/C	Trader Introducing Agent	Trader's Representatives	Introducing Agent's Representatives	Total	% Change	
Applications - received	0	1	1	216	2	220	(296)	-25.70
Applications - approved	0	0	0	188	0	188	(298)	
- refused	0	0	0	0	0	0	(1)	
- withdrawn	0	1	0	14	0	15	(26)	

Note : 31 March 1998 data in brackets.

Table 4  
**Number of Licensed Leveraged Foreign Exchange Traders & Representatives**  
 as at 31 March 1999

Trader			% Change
Discretionary A/C	9	(11)	
Non-discretionary A/C	6	(7)	
Introducing Agent	2	(2)	
Total	17	(20)	-15.00
Trader's Representative			
Responsible Director	42	(53)	
Representative	905	(1,203)	
Introducing Agent	0	(16)	
Total	947	(1,272)	-25.60
GRAND TOTAL	964	(1,292)	-25.40

Note : 31 March 1998 data in brackets.

Following last year's trend, the leveraged foreign exchange industry remained sluggish. Applications under the Leveraged Foreign Exchange Trading Ordinance during the year decreased by 76 to 220 representing a decrease of 25.7% (Table 3). The number of licensed traders dropped to 17 and the number of representatives decreased from 1,272 to 947 (Table 4). There were 36 exempt leveraged foreign exchange traders as at 31 March 1999.

## 1.2 Monitoring

### *Disciplinary Action*

Disciplinary action is an important means to ensure registered persons remain fit and proper. A total of 118 formal inquiries were conducted during the year through the joint efforts of the Enforcement Division and Licensing Division. Among these, 85 cases were concluded with some form of disciplinary action.

The nature of the inquiries included trading malpractices, unregistered dealing, misappropriation of clients' funds, internal control weaknesses, and late submission of audited accounts.

As a result of the inquiries, the SFC revoked 15 registrations, suspended 22 registrants, and issued 48 reprimands. 107 warning letters were issued to registrants, with most related to deficiencies of internal control, breach of Exchange Rules and breach of the Code of Conduct.

A further 54 cases were referred to the SEHK concerning misconduct of its members or members' representatives.

### 1.3 Particular cases of interest

#### *Lippo Securities Limited (Lippo)*

An inquiry revealed that Lippo had failed to adopt practices to adequately safeguard its clients' assets, failed to maintain proper books and records, and to demonstrate its ability to maintain sufficient liquid capital and erred in the computations of the Financial Resources Rules (FRR). As a result, Lippo was publicly reprimanded.

#### *Daiwa Securities (H.K.) Limited (Daiwa)*

An inquiry revealed that Daiwa's internal control procedures were inadequate to monitor its credit and margin lending operations. It did not have an adequate organisation structure, management system or risk control framework and it had not established and maintained proper "Chinese Walls" for its proprietary trading operations.

Daiwa and its former dealing director, Mr Osamu Semba, were publicly reprimanded. Daiwa also voluntarily suspended its proprietary trading operation for a period of three months.

### 1.4 Special Regulatory Issues and Review

#### *Review of Licensing Regime*

The SFC has begun a review of its licensing regime for securities, futures and leveraged foreign exchange trading intermediaries. The review is in response to changes in industry practice and the products being offered. The review will consider: the introduction of a single licence concept, whereby each intermediary will be granted the same licence but with conditions specifying which functions they are permitted to perform; the introduction of examination and continuous education requirements and regulation of the professional market. The review will be followed by public consultation.

#### *Professional Ethics Programme*

Jointly with the Independent Commission Against Corruption and other regulatory and industry professional bodies, Licensing had participated in the Professional Ethics Programme to enhance the standard of professional ethics of the securities, futures and investment intermediaries in Hong Kong and to reinforce registrants' understanding of the importance of ethical practices.

#### *Survey of Registrants' Business Activities*

In November 1998, SFC published its findings from the survey of registrants' business activities for the years 1996 and 1997.

*Primary business activities:* Most dealers engaged in brokering activities whilst most advisers engaged in either fund/portfolio management or plain investment advisory activities.

*Human resources profile:* The number of staff employed in the industry exceeded 30,000 in 1997. The real growth was estimated to be 5.5%.

*Client profile:* The survey recorded a 22% increase in the number of clients with local retail clients being a substantial portion. Foreign clients contributed over 43% of the industry's gross operating income. This suggests that the momentum of local capital and finance market depends significantly on overseas and Mainland investors.

## 2. INTERMEDIARIES SUPERVISION DEPARTMENT

### 2.1 Major Regulatory Initiatives

#### *Continuous Monitoring of Securities Margin Finance Providers*

In a year of tight credit environment and volatility in the markets, the SFC has continued its integrated approach to prudential supervision. Three key components underpin this approach.

First, a framework that identifies and prioritises systemic or institutional problems. The SFC identified two material risks during the year:

- (i) whether securities margin finance providers were soundly financed and
- (ii) whether investors assets were adequately protected.

Second, a differentiated inspection approach was adopted for different types of registrants, reflecting the risk associated with their structure, size and activities.

74 stockbrokers and 54 associated finance companies were inspected during the period from April to June 1998. The main objective of these quick reviews was to examine liquidity, solvency and client asset protection measures.

As a result of these inspections, actions have been taken to improve instances of financial instability and to rectify any identified shortcomings in systems and controls. These actions, with the cooperation of securities margin finance providers, include transferring securities margin finance business to broker firms (24 firms); segregating finance company's client monies into trust accounts (\$380 million by 29 firms); and increasing the capital base of finance companies (\$1,236 million by 21 firms).

Third, where possible, we adopted a group-wide supervision approach. This group-wide approach has given us a greater understanding of the level and nature of the risk within the group, where such level or nature may affect the financial health of a particular regulated part of the group.

#### *Proposed Regulation on Securities Margin Financing*

To ensure an appropriate supervisory response to a marked increase in retail participation in the securities market and a substantial rise in margin trading through largely unregulated securities

margin finance providers, a Working Group was set up under the Financial Services Bureau (FSB). The Working Group recommended, in May 1998, that these securities margin financing activities be subject to supervision by the SFC.

The proposed draft legislation on securities margin financing has been introduced in the Legislative Council (LegCo) as the Securities (Margin Financing) (Amendment) Bill 1999.

#### *Revised Financial Resources Rules*

The FRR form an important part of the overall regulatory framework for the securities margin financing business, and the Working Group led by FSB has considered it essential to develop appropriate FRR to better capture risks arising from securities margin financing.

On this basis, revised FRR have been prepared after consultation with the Financial Secretary.

## **2.2 Review of the Members' Surveillance Functions of the Stock Exchange of Hong Kong Limited**

SFC has completed a review of the members' surveillance functions of the SEHK in accordance with S.4(d) of the Securities and Futures Commission Ordinance.

A report on the review was issued to the SEHK in August 1998. Areas for improvement identified during the review were discussed with senior management of the SEHK.

Following the recent proposal for securities and futures market reform, a working group comprising representatives from the Exchanges and the SFC has been set up to study the future structure and division of responsibility for the supervision of market participants.

### 2.3 Leveraged Foreign Exchange Trading (LFET)

As at 31 March 1999, the total number of licensed traders including introducing agents have further dropped to 13, with 11 of them in operation. The total paid up share capital including share premium of the 11 licensed operating traders was HK\$1,012 million. The volume of aggregate gross position, the present commonly used indicator in measuring the LFET market by the SFC, was HK\$12,564 million and the market was dominated by five traders who accounted for 94% of the market share.

### 2.4 Year 2000 Compliance

As most registered/licensed intermediaries are highly dependent upon their computer systems to process large volumes of routine transactions and provide key management information, and for interfacing with third parties, there is concern about their capability to tackle the Year 2000 issue. Failure to take proper action to address the issue could cause substantial losses to their organisations, clients and business counterparts.

In view of the concern, a survey on Year 2000 readiness of registered intermediaries was completed in May 1998. Survey findings indicated that an overwhelming majority of the intermediaries was aware of the issue. However, considerable work still needed to be done to adequately address and resolve the Year 2000 problems of many intermediaries.

The SFC, in collaboration with the SEHK and the HKFE, has required intermediaries to submit a report on their Year 2000 compliance status on a quarterly basis, commencing in the quarter ended 30 September 1998.

A dedicated Year 2000 team was set up to conduct on site inspections and telephone enquiries on intermediaries that are selected on a risk-based approach. The SFC would consider pooling resources with the two exchanges to tackle the Year 2000 issues by conducting joint inspection visits. As for fund managers, trustees and custodians of

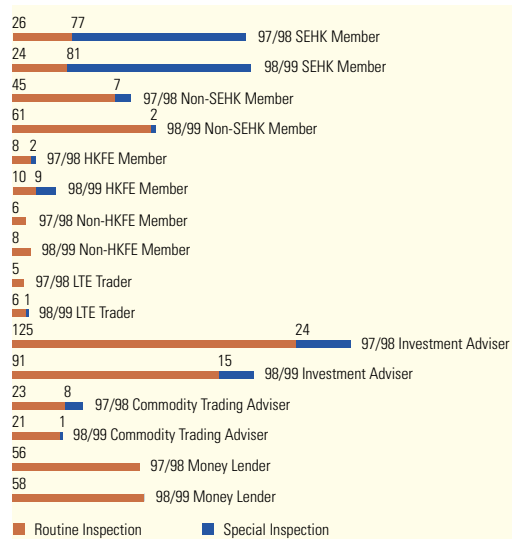
authorised investment products, a questionnaire was sent in March 1998 requesting information on their awareness and preparedness in dealing with the Year 2000 issue. The SFC considers it important that individual entities review their current operations and evaluate them in light of potential disturbances arising from Year 2000. To assess if the management companies and trustees/custodians of authorised products are prepared to deal with disruptions in case of unforeseen events, the SFC further requested these companies to submit a copy of their contingency plan.

### 2.5 Current Inspection Programs

#### Inspection statistics

A breakdown of inspections undertaken for the year 1998-99 is as follows (Figure 1):

Figure 1  
Inspections for the Year



The SFC has carried out a series of special inspections on dealers and associated finance companies during the year to ensure adequate protection of investors' securities and trust monies. In addition to this general investor protection programme, the SFC has also conducted the following theme inspections to address specific risks:

#### *Inspection of Runner-Brokers*

A joint inspection with the SEHK of a number of runner-brokers was initiated in April-May 1998, focusing on the safeguarding of clients' assets and the protection of investors generally. The inspections revealed that investors might not be aware of the risks involved in dealing with runner-brokers and that operational controls might be insufficient to safeguard the interests of clients dealing through runner-brokers.

A joint letter from the SFC and the SEHK, highlighting the operational arrangements and controls which should be put in place for the proper protection of investors' interests when providing services through runner-brokers, was issued to member brokers for their guidance.

#### *Review of the Trading Activities of Futures Brokers*

The SFC conducted a review of trading activities of a number of members of the HKFE in August 1998 to assess trading practices of floor traders and compliance with the rules and regulations of HKFE.

The review revealed various instances of breach of the rules and regulations and deficiencies in internal controls and risk management. The findings have been referred to the HKFE for development of an enhanced surveillance/enforcement programme.

#### *International Co-ordinated Visit*

In view of the success of last year's co-ordinated review, the SFC, the UK's Financial Services Authority (on behalf of the Investment Management Regulatory Organisation) and the US Securities and Exchange Commission (SEC) organised a co-ordinated inspection visit to another international fund management group this year. Local visits by each regulator were simultaneously conducted in October, followed by a joint global visit to the fund manager's global head office in the US. Findings were collated to identify any deficiencies in the areas of management control, risk management and information technology systems from a global perspective and gaps in regulatory compliance. A joint letter was issued to the group.

#### *Overseas Branch Visit*

Commission staff conducted on-site inspections of the Taiwan branches of some registered dealers in December in co-operation with the Securities and Futures Commission in Taipei pursuant to the Memorandum of Understanding entered on 7 February 1996. This was the first time SFC staff have visited a registrant's branch outside Hong Kong.

SFC staff also visited Taiwanese securities firms which have set up subsidiaries or acquired securities companies in Hong Kong to discuss their management oversight over the Hong Kong operations. SFC staff gained valuable experience and in-depth knowledge of the operation of the Taiwan market and its stockbrokers.

Table 5  
**Inspections Findings**  
Breaches of Ordinances & Non-compliance with Code of Conduct

Breaches by Dealers & Traders Noted During Inspections

Nature of Breaches*	SEHK Member	Non-SEHK Member Dealer	HKFE Member	Non-HKFE Member Dealer	LFE Trader
Failure to comply with Financial Resources Rules	12	11	0	2	1
Failure to safekeep clients' securities	21	11	0	1	1
Failure to maintain proper books	11	13	7	2	3
Failure to safekeep clients' money	12	5	5	2	4
Unregistered dealing & other registration issues	4	10	0	3	2
Breach of contract notes requirement	1	4	0	2	1
Failure to make filing/notification	5	5	2	0	4
Breach of margin requirement	0	0	4	0	2
Marketing of unauthorised funds	N.A.	1	N.A.	0	N.A.
Short selling of securities	3	1	N.A.	0	N.A.
Fictitious cross trades	2	1	0	0	0
Internal control weaknesses	31	26	6	5	4
Breach of Code of Conduct	63	62	23	15	11
Breach of Code on Unit Trusts & Mutual Funds	0	7	N.A.	0	N.A.
TOTAL	165	157	47	32	33

Note : \*A single inspection may reveal breaches of more than one provision.

Breaches by Advisers Noted During Inspections

Nature of Breaches*	Investment Adviser	Commodity Trading Adviser
Failure to comply with Financial Resources Rules	16	5
Failure to maintain proper books	17	5
Registration of reps & unregistered dealing	31	5
Breach of contract notes requirement	3	1
Failure to make filing/notification	9	0
Breach of licensing condition	5	2
Internal control weaknesses	40	7
Breach of Code of Conduct	82	13
Breach of Code on Unit Trusts & Mutual Funds	12	3
TOTAL	215	41

Note : \*A single inspection may reveal breaches of more than one provision.

## 2.6 Independent Compliance Review Conducted by External Auditors

As was the case last year, the SFC has made greater use of outside resources to assist in compliance monitoring of registered intermediaries. Where significant inadequacies in the internal control systems are identified in the course of an inspection visit, the SFC will require the intermediary to commission an independent compliance review by an external firm of professionals to detail the failures and to recommend improvements. There were eight compliance reviews during the year.

## 2.7 Other Significant Cases & Activities

### Significant Cases

Forlux Securities Limited (In liquidation)  
(Forlux Securities)

Forlux Finance Limited (In liquidation)  
(Forlux Finance)

On 5 May 1998, SFC staff inspected Forlux Securities and Forlux Finance and discovered that the dealing director of Forlux Securities and his brother had apparently left Hong Kong just prior to our visit. Forlux Securities had inadequate stocks with the Central Clearing and Settlement System (CCASS) to meet claims of clients and the two companies did not appear to have sufficient financial resources to meet their obligations to clients.

In the interest of the investing public, the SFC immediately issued a restriction notice on Forlux Securities, restricting it from dealing with its assets. A petition to wind up both Forlux Securities and Forlux Finance was presented under S.45 of the SFCO in order to protect and preserve the value of assets and to facilitate the quick and orderly return of assets to clients. The winding-up petition was heard and approved by the Court on 17 June 1998.

#### *Ming Fung Group of Companies*

The staff of SFC and the SEHK jointly inspected Chark Fung Securities Company Limited (Chark Fung) and its associated finance company, Kee Fung Sing International Finance Company Limited (Kee Fung Sing) in May 1998. The inspection team noted discrepancies in accounts and substantial margin collateral shortfall. In view of these findings, other registered entities, Winton Commence Limited (Winton) and Ming Fung Bullion Company Limited (Ming Fung) were also inspected. The inspection indicated possible misappropriation of clients' funds and assets. The SFC issued restriction notices on Chark Fung, Winton and Ming Fung on 25 May 1998. Memberships of Chark Fung and Winton in the SEHK and the HKFE were also suspended simultaneously.

The SFC petitioned for the winding up of Chark Fung, Winton, Ming Fung and Kee Fung Sing. On 26 May 1998, provisional liquidators were appointed to these companies. Winding up orders were made for all four companies on 8 July 1998.

#### **Money Laundering**

The SFC participated in the second mutual evaluation on money laundering conducted by the Financial Action Task Force (FATF) in respect of Hong Kong in April 1998. The effort put in by the SFC and other agencies on anti-money laundering

was recognised by the FATF reviewers. In response to the FATF's evaluation report, a Working Group was set up to further improve the quality and quantity of reporting of suspicious transactions to the Joint Financial Intelligence Unit. The SFC is participating in this Working Group.

### **3. INVESTMENT PRODUCTS DEPARTMENT**

#### **3.1 Unit Trusts and Mutual Funds**

##### **Funds Activities**

Mergers among fund management companies and rationalisation of product ranges were the main themes of the year, reflecting the increasing difficulty of fund managers in attracting new funds in the current economic climate and efforts to save operating costs and improve competitiveness. As part of its routine monitoring process, in mid 1998, the Department undertook a review of authorised funds with small fund sizes, ranging between US\$1 million to US\$5 million, in two stages in April and July 1998. Fund managers were asked to review their ability to manage such funds economically in the interests of investors. The responses were generally positive with most fund managers indicating plans for liquidation or mergers. Others had voluntarily waived their management fees and negotiated a reduction of fees charged by fund service providers.



Investment products  
authorised by SFC

In mid 1998, in anticipation of the introduction of the Euro, the Department wrote to all fund managers who managed investment funds operating or investing in countries within the European Monetary Union. The purpose was to warn them of the likely impact of the Euro on their business operations and to remind them of their responsibilities to identify and address issues arising from the introduction of the Euro. In addition, the SFC sought co-operation from various overseas regulators on Euro issues including the exchange of information on dual registrants. The introduction of the Euro prompted rationalisation of fund ranges, resulting in liquidations, mergers and re-denomination of funds in Euro. New Euro funds were introduced by many fund companies. As at 31 March 1999, there were a total of 50 authorised Euro funds.

In May 1998, due to the political and economic turmoil in Indonesia, the trading of six authorised funds which principally invested in Indonesia was temporarily suspended. The suspension periods ranged from a few days to one week. Impact on investors was minimal.

In September 1998, as a result of the introduction of capital control measures by the Malaysian government, 16 SFC authorised funds were forced to suspend dealings. These were predominantly Malaysia/Singapore country funds and Asian equity funds with significant exposure to Malaysia. The main reason for suspension was the inability to convert Malaysian ringgit securities or ringgit deposits into foreign currencies for repatriation out of Malaysia. In addition, Asian funds with less significant exposure to Malaysia also faced the issue of adopting a reasonable exchange rate for US dollars versus Malaysian ringgits.

Under those circumstances, the Department took immediate actions to assist the industry as follows:

- (a) Contacted the Malaysian Securities Commission and sought clarification of the interpretation of the new rules.
- (b) Discussed with fund managers, trustees and custodians and overseas regulators on valuation issues that arose. The outcome was a set of “best practice” guidelines prepared by the Hong Kong Investment Funds Association (HKIFA) for its members.

### 3.2 Statistics

The number of SFC authorised funds reached an all time high at the end of March 1999. 332 funds were authorised during the period compared to 240 funds being de-authorised, bringing the total number of authorised funds to 1,608 as at 31 March 1999, compared to a total of 1,526 as at 31 March 1998. This represents an increase of 5.37% and the highest level yet achieved for authorised funds in Hong Kong. Of the 1,608 authorised funds, 1,228 were sub funds of umbrella funds, representing a 9.94% increase over the last year (Table 6).

The number of applications continued to increase steadily with standard equity/bond funds still being the dominating fund types (Table 7). While Asian funds faced net redemptions, global funds and European funds were becoming more popular.

Table 7  
**Authorised Unit Trusts and Mutual Funds**  
as at 31 March 1999

	Total			
	Number	%	NAV* (US\$ Million)	%
Bond	261	18	28,890.9	15.8
Equity	905	61	124,840.1	68.2
Diversified	84	6	14,266.3	7.8
Money Market	157	11	12,675.7	6.9
UPMF	40	3	1,035.5	0.6
Warrant	8	1	305.7	0.2
Other specialised #	20	1	1,077.8	0.6
	1,475	100	183,092.0	100
Umbrella structures	133			
No. of Authorised Funds	1,608			

\* Net Asset Value as at 31/12/98; based on information available  
# Includes: Futures & Options Funds; Guaranteed Funds & Leveraged Funds.

Table 6  
**Origin/Net Asset Value of Authorised Funds**  
 as at 31 March 1999

	Umbrella Number	Sub-funds Number	Single funds Number	Total			
				Number	%	NAV* (US\$ Million)	%
Hong Kong	4	10	67	81	5	2,116.4	1.2
Jersey	6	56	1	63	4	3,826.6	2.1
Luxembourg	49	679	19	747	46	79,912.5	43.6
Ireland	35	196	8	239	15	20,980.0	11.5
Guernsey	8	146	16	170	11	5,653.7	3.1
United Kingdom	1	30	25	56	4	20,172.2	11.0
Other Europe	0	0	9	9	1	7,512.9	4.1
Bermuda	4	31	16	51	3	1,499.5	0.8
Bahamas	1	6	0	7	0	169.5	0.1
British Virgin Islands	3	13	15	31	2	2,017.6	1.1
Cayman Islands	20	58	64	142	9	4,712.4	2.6
Others	2	3	7	12	1	34,518.6	18.9
<b>No. of Authorised Funds</b>	<b>133</b>	<b>1,228</b>	<b>247</b>	<b>1,608</b>	<b>100</b>	<b>183,092.0</b>	<b>100</b>

\* Net asset value as at 31/12/98: based on information available (excluding "umbrella funds")

Despite the entrance of a number of new management groups, mostly overseas groups, restructuring and amalgamation of some existing fund management groups had caused the number of fund management groups to decline slightly. As at 31 March 1999, the number of fund management groups authorised to market their funds in Hong Kong totaled 92 compared to 93 at the end of March 1998.

Authorised funds in Hong Kong continue to be predominantly international in origin (Figure 2). Although Hong Kong authorised funds are domiciled in 19 jurisdictions, some 51% of authorised funds are managed or advised by Hong Kong domiciled fund managers, with the remaining being managed or advised in places such as UK, Luxembourg and United States (Figure 3).

Figure 2  
**Authorised Unit Trusts & Mutual Funds by Jurisdiction**

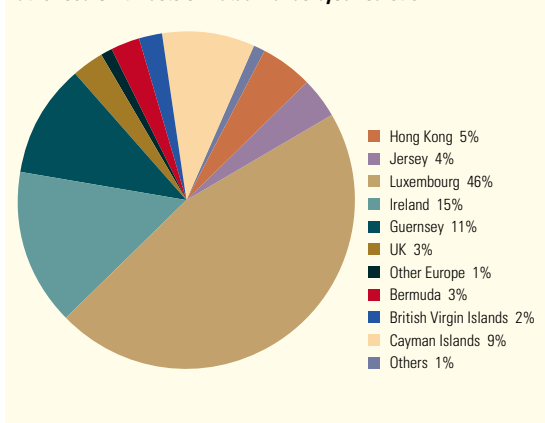
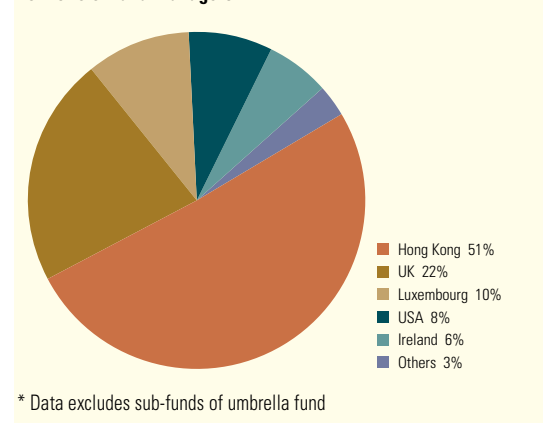


Figure 3  
**Domicile of Fund Managers**



During the period, 118 mutual fund prospectuses were authorised for registration under the Companies Ordinance.

The average authorisation time for standard funds remained about three weeks. The Department maintained its processing efficiency.

### **3.3 Regulation of Trustees and Custodians of Collective Investment Schemes**

Trustees and custodians play an important role in the supervision of activities of fund managers of collective investment schemes. They are expected to monitor the day-to-day activities of fund managers to ensure that investors' interests are properly safeguarded. To this end, a new requirement was added to the Code on Unit Trusts and Mutual Funds and the Code on Pooled Retirement Funds when the two codes were revised in December 1997. Trustees and custodians of authorised collective investment schemes are required to either be subject to regulatory supervision on an ongoing basis, or appoint an independent auditor to periodically review its internal controls and systems on terms of reference agreed with the SFC.

The Department intends to issue a set of Guidelines for Review of Internal Controls and Systems of Trustees/Custodians to clarify issues with respect to compliance with the requirement. The Department is drafting the Guidelines in consultation with the Hong Kong Trustees' Association and the Hong Kong Society of Accountants.

The Department is also seeking co-operation from overseas regulators on cross-border supervision of trustees/custodians. Reviews of the supervisory regime in a number of overseas jurisdictions will be conducted to consider their acceptability for the purpose of the Code requirement.

### **3.4 Fund Management Activities Survey**

In December 1998, the Department conducted its first full-scale fund management activities survey to gain a better understanding of the local industry. The survey would enable the SFC to better assess the competitiveness of the local fund management industry in the region and facilitate industry development. It was also envisaged that the information would be shared with the industry on an aggregate level, where appropriate. The industry is generally supportive of the initiative. However, due to the diversity of sizes, organisation structures and systems of different fund management groups, obtaining the desired information in a readily comparable form has proven difficult. The Commission has undertaken to review the survey questionnaire and to streamline this to facilitate completion in future.

### **3.5 Mandatory Provident Fund Schemes (MPFS)**

The Mandatory Provident Fund Schemes Ordinance (MPFSO) was passed in the summer of 1995 to provide financial independence and security on retirement for the workforce of Hong Kong. The subsidiary regulations made under the MPFSO were enacted on 1 April 1998. SFC requires persons marketing the MPFS to be licensed as an investment adviser or representative if they provide investment advice to investors on securities. It is envisaged that the major marketing force of the MPFS will come from the insurance intermediaries.

The working population in the insurance industry was estimated at about 40,000 at the end of 1998 and it is anticipated that a major portion of this population will apply for a license with the SFC. The first batch of registration certificates is scheduled to be issued in the first quarter of 2000.

Liaison between the SFC and the MPF Office intensified with an effort to ensure that preparation work for the eventual implementation of the MPFS could begin as soon as possible. Under the current regulatory framework, all master trust schemes and industry schemes would require authorisation from the SFC as well as registration by the MPF Authority. In addition, the underlying pooled investment funds of the schemes would also require approval from both authorities.

While the MPF Authority will be the primary regulator responsible for the overall administration of the MPFS, the SFC will be responsible for the supervision of investment managers and the authorisation of the offering documents and marketing materials of master trust schemes, industry schemes and the underlying pooled investment funds. To this end, the SFC will be issuing a code on MPF products detailing the disclosure requirements for offering documents and the qualifications of investment managers.

### **3.6 Investment-Linked Assurance Schemes and Pooled Retirement Funds**

While the market for investment-linked assurance schemes grew slightly, the year saw some consolidation in the pooled retirement fund market as employers took a wait-and-see attitude ahead of the MPF. Several funds were also taken over by competition as the economy slowed. Promoters were busy revising their existing pooled retirement funds to comply with the newly revised Code on Pooled Retirement Funds and to interface with the future MPF.

Documentation was authorised for 114 investment-linked assurance schemes and pooled retirement funds. 62 were investment-linked assurance schemes and 52 were pooled retirement funds. The number of management groups or companies decreased by one to 46.

### **3.7 Immigration-Linked Investment Schemes**

The SFC authorised five immigration-linked investment schemes during the year, making a total of 68 authorised schemes. All immigration schemes authorised so far originated from Canada. The Canadian government has announced that it would revise its Immigrant Investor Program beginning 1 April 1999. Among other things, the investment amount will be raised to C\$400,000 which represents a substantial increase from the current C\$250,000 (lower tier).