

## Highlights

- Growth in fund management business supported by SFC's facilitative approach
- More local start-up hedge fund managers in 1H 2007
- Licensees urged to review anti-money laundering procedures
- Dual filing update: provide details of the use of IPO proceeds

## Welcome to the New SFC Bulletin

Welcome to the first issue of the SFC Bulletin, a newsletter which replaces the SFC Alert. With a new design and layout, the SFC Bulletin will focus on issues relevant to intermediaries and other market practitioners. We aim to provide the market with useful information relating to regulatory developments and practice.

The SFC Bulletin complements the SFC's other newsletters on more specialised subjects, such as the Enforcement Reporter and the Takeovers Bulletin. It will be published every two months and be available as an online version only.

If you want to subscribe and receive the SFC Bulletin by email, simply register for the SFC's Website Update Email Alert service on our homepage and select SFC Bulletin, or send a message to [sfcbulletin@sfc.hk](mailto:sfcbulletin@sfc.hk). Intermediaries licensed by the SFC receive the SFC Bulletin via their FinNet email accounts. If you have subscribed for the SFC Alert before, you will continue to receive the SFC Bulletin without re-subscription.

We would like to hear your feedback on this new publication, which can be sent to [sfcbulletin@sfc.hk](mailto:sfcbulletin@sfc.hk).

## Growth of Fund Management Business

Hong Kong is the premier centre for global capital and wealth management in the region. To help maintain this status the SFC adopts a regulatory approach which, while still mindful of investors interests, facilitates market development and innovation.

Hong Kong's continued strength in fund management is reflected in the findings of our latest Fund Management Activities Survey.

The annual survey report published in July found that assets of the combined fund management business in Hong Kong were \$6,154 billion at the end of 2006 – up 36% from a year ago. Asset management, the largest component, recorded 27.5% growth, while advisory business and other private banking activities grew 67.1% and 54.5% respectively. The latter indicates a broadening in the range of fund management activities conducted in Hong Kong.

The survey also found that 62% of non-REIT fund management business was sourced from non-Hong Kong investors, showing a consistently strong flow of international investment capital. (For more information, follow this [link](#) to the detailed report.)

Against this background, the SFC will continue to look for ways to simplify and make easier our licensing processes, in order to facilitate market development, without reducing the high standards international investors expect in the Hong Kong market.

In June, we announced measures to streamline and simplify the licensing processes of overseas hedge fund managers. We have simplified these processes for firms that are already regulated as investment managers or advisers in the US or UK, and which only serve professional investors and have good compliance records. Responsible Officers (ROs) of hedge fund managers may be exempted from the local regulatory examination if they fulfil the necessary criteria.

We have reminded the industry that a licence is not required for firms which merely provide research to their group companies outside Hong Kong. We have also clarified the SFC's policies concerning the use of serviced offices and the need for ROs to be physically present in Hong Kong. (Follow this [link](#) for more details.)

This year has seen an increase in newly approved hedge fund managers, many of which are local start-ups. Please see the article below for the typical profile of these local start-up hedge fund managers.

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## More local start-up hedge fund managers

In the first half of 2007, the SFC approved licences for 20 new hedge fund managers\*. 14 of these were local start-ups and the rest were affiliates of established overseas hedge fund managers. We met with eight local start-ups to discuss their operations and understand their business profile.

We found that typically these hedge fund managers were boutique-sized firms with four to seven staff. Altogether they managed/advised 20 hedge funds (17 single hedge funds and three fund of hedge funds) with total assets under management amounting to approximately US\$1.7 billion.

All of the founders were experienced practitioners formerly from large international financial institutions. These founders included both local and overseas investment professionals. The reasons for setting up their business in Hong Kong included the close proximity to China and Japan, clean government, rule of law, well-balanced regulatory system, large pool of talent and efficient workforce.

From our discussion with the eight local start-ups, we learnt the following:

- their hedge funds mainly adopted an equity long/short strategy;
- their investment was mainly in the Asia Pacific region;
- they invested mainly in listed equities. Some had minor exposure in OTC derivatives, listed futures and options etc, for hedging purposes;
- they did not have excessive leverage. The majority had leverage of 120% or below\*\*. Some did not use any leverage at all and only one had leverage at slightly over 200%;
- their clients were mainly overseas high-net-worth individuals and institutional investors; and
- founders or portfolio managers usually used their own capital as seed money for their funds.

Hong Kong has always been a place for entrepreneurs to start up business. The SFC welcomes these new start-ups. Of course, while smaller hedge fund managers may reap the benefit of nimbleness because of their size, they should not neglect operational controls, such as segregation of duties. Key duties and functions should, as far as possible, be appropriately segregated and subject to effective oversight. Control processes must be put in place to prevent and detect errors or abuses which may be detrimental to the firm or expose its clients to unnecessary risks.

\* Firms whose business involved the management of and/or provision of advisory services to hedge funds.

\*\* Calculated as long positions plus short positions and divided by the net assets value of the fund.

## Keeping an Eye on Money Laundering

The SFC is calling on licensed corporations to further strengthen compliance with requirements on anti-money laundering and terrorist financing.

In June, the SFC, the Narcotics Division, the Department of Justice, and the Joint Financial Intelligence Unit (JFIU) discussed these issues with more than 500 representatives of licensed corporations. Licensed corporations were reminded to report suspicious transactions to the JFIU.

Licensees were advised that our inspections of licensed entities last year identified compliance deficiencies of varying seriousness. We will continue to focus on compliance with anti-money laundering and terrorist financing requirements and licensees were urged to review their own procedures.

The SFC has developed a self-assessment programme for use by firms so they can assess the extent of their compliance with key anti-money laundering requirements. The programme, which doubles up as a survey, has also helped us gauge the general compliance status of the industry and assess the need for further guidance and assistance.

The SFC will continue to work with the industry and experts to make our financial system more difficult for criminals to use for money laundering, and to increase our ability to detect such activities. This is important for the integrity of the securities and futures sector as well as Hong Kong's position as an international financial centre.

If you wish to discuss the above issues with us, please contact Kammy Kwok at 2840 9455.

If you want to know more about our guidance notes, please follow this [link](#).

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## Proper Disclosure of Use of IPO Proceeds

The importance of providing meaningful details of the use of IPO proceeds is highlighted in the latest quarterly update on the Dual Filing arrangements.

Under Dual Filing, the SFC also reviews IPO listing applications. In several cases in the period under review, the listing applicants gave a general description in their draft prospectus to the effect that a substantial portion of the listing proceeds would be used to expand their production capacities. However, there was no quantitative information about the existing capacity, the actual production volume, utilisation rates etc to enable investors to assess the extent of expansion in production capacity and how the scale of expansion was justified. In one case, the applicant failed to adequately explain how the expansion fitted into its business strategies.

We would like to stress that listing applicants intending to tap the market for funds should articulate clearly how they intend to use the money for the benefit of their business. Investors need sufficient relevant information before making investment decisions.

If you would like to know more about the update on Dual Filing, please follow this [link](#) to our press release dated 18 June 2007.

## Ethics – The Core Value of Leadership

Applying ethical standards in our fast moving world is a challenge for all of us, especially directors of companies. All those with an interest in this key facet of modern management are invited to enrol in an ICAC forum.

The 2007 Directors' Forum will take place on 14 September in Hong Kong. It is the first training programme on directors' ethics the ICAC has organised together with the SFC, other regulators and some major professional bodies and chambers of commerce.

The Financial Secretary, the Hon John Tsang Chun-wah, will give the opening address. Dr Victor Fung and the Hon Laura Cha will deliver the keynote address and the luncheon speech respectively. The Forum will also include a case study which will enable company directors to critically examine the best practices and strategies in mastering ethical challenges.

For registration or more details, please visit [www.icac.org.hk/hkedc/forum2007](http://www.icac.org.hk/hkedc/forum2007).

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## Publications & Circulars

The following publications and circulars have been published since the release of the last newsletter. Publications are available on the SFC website under 'Speeches, Publications & Consultations' – 'Publications'. Circulars can be found under 'Legislation & Regulatory Handbook' – 'Regulatory Handbook' – 'Codes, Guidelines and Circulars'.

### Publications

1. Fund Management Activities Survey 2006 (19.7.2007)
2. SFC Enforcement Reporter – July 2007 (18.7.2007)
3. SFC Annual Report 2006-2007 (6.6.2007)
4. SFC Quarterly Bulletin – Spring 2007 (5.6.2007)
5. Report on Findings of Second Round of Thematic Inspection of Licensed Investment Advisers (31.5.2007)

### Circulars

1. Circular to Intermediaries Acting as Sponsors - Increase in the Minimum Paid-up Share Capital Requirement for Sponsors (6.7.2007)
2. Circular to Licensed Corporations and Associated Entities – Apply for a New Password to Access Joint Financial Intelligence Unit's New Website (22.6.2007)
3. Circular to Licensed Corporations and Associated Entities – Anti-Money Laundering / Combating Terrorist Financing (1) United Nations Sanctions (Cote d'Ivoire) Regulation 2007 (2) US President's Executive Order 13224 (12.6.2007)
4. SFC Adopts a Pragmatic Approach to Licensing Fund Managers (11.6.2007)
5. Circular to Management Companies of SFC-authorized Real Estate Investment Trusts – Electronic Dissemination of Public Announcements of SFC-authorized REITs (5.6.2007)

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The SFC Bulletin is available under 'Speeches, Publications & Consultations' – 'Publications' of the SFC website at <http://www.sfc.hk>.

Feedback and comments are welcome and can be sent to [sfcbulletin@sfc.hk](mailto:sfcbulletin@sfc.hk)

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