



SECURITIES AND  
FUTURES COMMISSION  
證券及期貨事務監察委員會

## A Consultation Paper on Hedge Funds Reporting Requirements

《對沖基金匯報規定》諮詢文件

Hong Kong  
September 2002

香港  
2002年9月



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1. This Personal Information Collection Statement (“PICS”) is made in accordance with the guidelines issued by the Privacy Commissioner for Personal Data. The PICS sets out the purposes for which your Personal Data<sup>1</sup> will be used following collection, what you are agreeing to with respect to the SFC’s use of your Personal Data and your rights under the PDPO.

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The Data Privacy Officer  
The Securities and Futures Commission  
12/F, Edinburgh Tower  
15 Queen’s Road, Central  
Hong Kong

**A copy of the Privacy Policy Statement adopted by the SFC is available upon request.**

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<sup>1</sup> Personal Data means personal data as defined in the Personal Data (Privacy) Ordinance, Cap 486 (“PDPO”)

# **A CONSULTATION PAPER ON HEDGE FUNDS REPORTING REQUIREMENTS**

## **INTRODUCTION**

1. The Securities and Futures Commission (SFC) invites comments from the public on the proposed guidelines on hedge funds reporting requirements (the Guidelines), for incorporation into the Code on Unit Trusts and Mutual Funds (the Code).

## **BACKGROUND**

2. In May 2002, the SFC promulgated the Guidelines on Hedge Funds that sets out the criteria for the authorization of public hedge funds.
3. As stated in the Consultation Conclusions on the Offering of Hedge Funds that was released at the same time, the SFC will issue additional guidelines to provide further guidance to management companies of authorized hedge funds regarding their on-going reporting obligations to holders.
4. Such proposed Guidelines may be found in **Annex I** and these should be read in conjunction with the Guidelines on Hedge Funds and the rest of the Code. Interested parties may refer to the SFC website ([www.hksfc.org.hk](http://www.hksfc.org.hk)) for the full text of the Code and the Hedge Funds Guidelines (which form part of the Code under Chapter 8.7).

## **DISCUSSION**

### **General Approach**

5. The SFC recognizes the general concern over the potential complexity of investment strategies and diversity of management approaches of hedge funds. In order to ensure proper protection of retail investor interests and promotes public confidence, we believe it is important that timely, meaningful and useful information would be provided to investors so that they can make informed investment decisions.
6. The SFC is conscious that the cost of regulation must be commensurate with its benefits. In this connection, the desirability of full position transparency must be weighed against the extent to which such disclosures may jeopardize the position of the fund (and ultimately, the interests of investors). In addition, the usefulness of any such information to investors must also be considered.
7. We also believe that it is important to achieve comparability as far as possible so that SFC authorized hedge funds, regardless of their domicile, would report their financial performance or conduct valuations based on a common platform.

8. Certain proposals under the Guidelines differ from the existing requirements for traditional funds, for example, the adoption of International Accounting Standards. However, the SFC has no plan at this time to extend these hedge funds related proposals to traditional funds.
9. The SFC would like to stress that no decisions have been made in respect of the proposed Guidelines in Annex I. We have an open mind on the proposals and await comments from the public in this consultation.
10. Due to the wide variety of strategies adopted by hedge funds, the Guidelines are unlikely to be a set of “one size fits all” standards. For this reason, the Guidelines are not intended to be exhaustive. They are designed to provide a framework of minimum disclosures only. The SFC encourages full disclosure and management companies are in the best position to consider what are the additional information that may be necessary for investors to understand the investment strategy and the risks inherent in their specific hedge funds.

#### **Why Do We Need to Look at Reporting Requirements for Hedge Funds?**

11. Hedge fund managers have often argued that total transparency may undermine the existence of hedge funds. By disclosing their full portfolio positions, the unique investment strategies of hedge funds could be easily replicated and the investment opportunities identified by the hedge fund managers foregone.
12. The SFC believes that, given the complex and sometimes opaque investment strategies of hedge funds, investors should be empowered with user-friendly information on a regular basis in order to allow them to examine the activities and monitor the level of risks undertaken by the fund manager with respect to the fund.
13. According to a recent survey conducted by the Hong Kong Investment Funds Association, out of those investors who indicated that they are not interested in hedge funds, 42% of fund investors and 51% of non-fund investors cited unfamiliarity with hedge funds operations as the reason for their disinterest.
14. The SFC, in the public consultation for the Guidelines on Hedge Funds, has specifically asked for comments on the content requirements of hedge fund reports. The aim was to gather industry experts’ views in order to strike a right balance between providing sufficient information to investors versus preserving the proprietary trade information of hedge fund managers. There was, however, little industry input in this area.
15. It appears that the Guidelines on Hedge Funds have aroused strong public interest in hedge funds. Therefore, the SFC believes it is appropriate to ask the public again on its views in respect of the reporting requirements for hedge funds.

## How Did We Arrive at the Guidelines?

16. The SFC has studied a number of private sector-led initiatives<sup>2</sup> and public sector-led initiatives<sup>3</sup> that were aimed at enhancing hedge funds disclosure and transparency practices. These initiatives, however, were not catered to disclosure relevant to retail investors and at times were over-burdened with technical jargon that may be incomprehensible to the layman. Hence, only limited relevant findings from these initiatives were adopted in these Guidelines.
17. An independent consultant was also engaged to do research on the interim and annual reporting requirements as seen in hedge funds reports covering four major jurisdictions: U.S., U.K., Ireland and Switzerland<sup>4</sup>. The findings indicate that there are no hedge fund-specific disclosure requirements in these jurisdictions.
18. The SFC has performed additional research on industry's best practices regarding hedge funds disclosure to investors, and consulted with various members of the hedge funds community in order to arrive at a workable set of proposals for the Guidelines.
19. The Guidelines encompasses the following elements:
  - Appropriate accounting standards;
  - Disclosures currently applicable to traditional funds<sup>5</sup>; and
  - Disclosures specific to hedge funds.

## SUMMARY OF KEY FEATURES OF THE GUIDELINES

### Appropriate Accounting Standards

20. Hedge funds generally employ, though to different extent, unique strategies in achieving their investment objectives. Due to the illiquid nature of their underlying instruments, their values may not be readily ascertainable in the market. Management companies and/or the valuation agents usually adopt estimations derived from different valuation models in preparing hedge funds financial reports.

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<sup>2</sup> For example, reports on "Findings on Disclosure for Institutional Investors in Hedge Funds", by the **Investor Risk Committee of International Association of Financial Engineers**; and "Year-end 2001 Institutional Survey on Alternative Investment Trends", by **Deutsche Bank**.

<sup>3</sup> For example, "Final Report to Basel Committee on Banking Supervision, Committee on the Global Financial System of the G-10 central banks, International Association of Insurance Supervisors and International Organisation of Securities Commissions", 26 April 2001, by the **Multidisciplinary Working Group on Enhanced Disclosure**; and various reports of the **Financial Stability Forum** on Recommendations and Concerns Raised by Highly Leveraged Institutions.

<sup>4</sup> U.S. and U.K. are selected because they both have fund-specific accounting standards and regulatory requirements. Ireland is selected because it has emerged as a popular hedge funds administration centre. Switzerland is chosen because it is one of the few jurisdictions in the world that permits retail offerings of hedge funds.

<sup>5</sup> Appendix E of the Code on Unit Trusts and Mutual Funds sets out the content requirements for financial reports of SFC authorized funds.

In addition, the levels of disclosure by hedge funds are extremely diverse. Discrepancies in measurement and presentation are often aggravated when different accounting standards are adopted in the preparation of financial reports.

21. The Guidelines proposes the adoption of International Accounting Standards (IAS) to provide standard measurement and presentation bases for the preparation of hedge funds financial reports, regardless of the domicile of the hedge funds and their management companies. It promotes consistency, comparability and transparency of hedge funds financial information.
22. Various parts of IAS would be particularly relevant to hedge funds. In particular, there is wide coverage on the accounting bases and disclosure in the scheme financial reports for different financial instruments (including those of derivatives and hedging instruments) under IAS.
23. For example, IAS 39 covers valuation and methodologies. It provides extensive guidelines on the recognition and measurement of financial instruments, and promotes greater use of “fair value accounting”. IAS 32, in addition, focuses on detailed disclosure and presentation requirements in relation to financial instruments. This includes disclosure of the “fair value” of financial assets, their gains and losses, their inherent risks and the related risk management strategy.
24. The SFC believes that IAS is the emerging global standard, strongly advocated by both the European Commission and the International Organization of Securities Commissions. Yet, the SFC notes that many existing hedge funds originated from the United States or managed by U.S. fund managers may be more familiar with U.S. generally accepted accounting principles (U.S. GAAP). In addition, there are other existing hedge funds that may adopt accounting standards differing from IAS and U.S. GAAP.
25. The SFC does not wish to preclude or discourage existing hedge funds that do not apply IAS from seeking authorization and offering their investments to Hong Kong retail investors.
26. Mandatory adoption of IAS will address consistency in measurement and presentation for the underlying financial instruments, and allows meaningful comparisons to be made between different hedge funds. The drawback is that investors may be deprived of opportunities to invest in certain hedge funds that do not wish to adhere IAS.
27. ***The SFC believes this is a very important issue for the market and would like to invite specific comments on whether it is desirable to require SFC authorized hedge funds to adopt IAS on a mandatory basis.***

#### **Disclosures Currently Applicable to Traditional Funds**

28. The Code already has a set of fund-specific reporting requirements for authorized funds under its Appendix E (**Annex II**). With slight modifications, Appendix E

requirements could be and should be applied to hedge funds to fill the gap in that IAS is not specifically catered to funds.

29. That said, Appendix E was developed in consultation with the industry at a time when only traditional funds were authorizable as public investment vehicles. The SFC thus considers it necessary to revisit the full applicability of Appendix E to hedge funds.
30. Industry practitioners in general agree that Appendix E requirements are also applicable to hedge funds except for the “Investment Portfolio” subsection which requires detailed information on each individual holding of the fund to be disclosed. Concerns were raised that total portfolio transparency may, in some cases, be commercially sensitive, and may jeopardize the proprietary trading strategies of some hedge funds.
31. Some institutional investors also suggested that they would not wish to force full disclosure where such would be adverse to the hedge funds, and therefore to their investment<sup>6</sup>. By disclosing their full portfolio positions, the unique investment strategies of hedge funds could be easily replicated and the investment opportunities identified by the hedge fund manager foregone. It should also be mentioned that full position transparency might not be meaningful to investors, unless the management company discloses how the different holdings inter-relate to the investment strategy.
32. The SFC encourages full disclosure of individual holdings of the scheme. Yet, the SFC is prepared to be flexible in this area subject to the views of industry practitioners and investors.
33. In the case where the management company is satisfied that full disclosure of scheme holdings may be unduly burdensome or would jeopardize the position of scheme investors, the proposal is that it may adopt alternative disclosures that the management company considers the most appropriate and informative, taking into account the objective and strategy of the hedge fund. The Guidelines provides two examples of minimum acceptable disclosures in lieu of full position transparency - the hedge fund’s exposures by categories, and the hedge fund’s top ten positions.
34. *The SFC would like to invite specific comments on the adequacy of the alternative disclosures. It is open to other suggestions that would provide meaningful disclosures to retail investors.*

#### **Additional Disclosures Specific to Hedge Funds**

35. As mentioned above, Appendix E was not designed for hedge funds. Therefore, additional hedge fund specific disclosures are appropriate for the Guidelines. Due regard is made to the types of information that would be most relevant to retail investors.

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<sup>6</sup> According to the findings by the Investor Risk Committee of the International Association of Financial Engineers.

### *Annual Reports*

36. Apart from the information in Appendix E already applicable to traditional funds, The SFC considers that the fund auditors should report on the amount of assets with prime broker(s)<sup>7</sup>, the amount and calculation basis of performance fees paid at the scheme level on an annual basis.

### *Quarterly Reports*

37. Quarterly reports are to be issued in English and Chinese and provided to holders four times a year. Their required contents are set out in Paragraph 11 of the Guidelines. Where management companies wish to report to holders via monthly reports, there is no need to prepare quarterly reports provided that the same requirements for quarterly reports are complied with in the monthly reports.
38. The SFC recognizes that either qualitative discussion or quantitative information alone is inadequate for investors to make an informed judgment. While qualitative discussion may allow investors to better understand the activities of hedge funds, quantitative information should form an essential foundation for the qualitative discussion.
39. The Guidelines requires both a Management Commentary (in narrative form) as well as a Portfolio Review (with key quantitative information). These are the parameters that the SFC feels would be directly relevant to retail investors.
40. For the ease of comparison by investors of different hedge funds, the Guidelines proposes the disclosure of a number of performance and risk measures in standardized format (please see the Appendix to the Guidelines). These include actual monthly returns, annualised returns, annualised standard deviation, Sharpe ratio, highest and lowest NAV per unit/share, and maximum drawdowns for the last three individual calendar years and since launch.
41. The SFC believes such standardized reporting would facilitate investors in attaining key performance indicators of the fund and thus achieving a better understanding of specialized products such as hedge funds. Standardization would also help investors in comparing across different hedge funds.
42. Where quarterly reports are intended for distribution to non-holders (ie. persons who are not existing fund investors), it is proposed that they must be accompanied by the fund prospectuses. This is to facilitate investors to interpret the information set out in the quarterly reports in the proper context.
43. ***The SFC is particularly interested in receiving comments on the content requirements of the quarterly report.***

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<sup>7</sup> Pursuant to Chapter 8.7(b)(iii) of the Code on Unit Trusts and Mutual Funds, assets charged to the prime broker(s) must remain in a segregated custody account, in the name or held to the order of the trustee/custodian of the fund.

### *Recommended Practices*

44. Lastly, the Guidelines outlines a few parameters for recommended disclosure under Paragraph 12 of the Guidelines.

### **Timeliness of the Reports**

45. The time required to audit a hedge fund primarily depends on the complexity of the investment strategy, the number of prime brokers utilized, the extent to which illiquid securities are held, and the portfolio turnover. Some industry practitioners (and in particular, managers of fund-of-hedge-funds) have expressed difficulties in completing fund audits within the normal four-month period for traditional funds. They argue that a six months deadline is more realistic. Concerns were expressed that a four-month deadline may be overly aggressive and may compromise the quality of the reports.
46. On the basis of genuine practical difficulties, the SFC is prepared to allow a slightly longer filing period for fund-of-hedge-funds. The proposed filing deadlines are set out in Paragraph 1 of the Guidelines, namely:
- Annual reports – four months after end of scheme financial year (except for fund-of-hedge funds, in which case, the deadline is six months);
  - Semi-annual reports – two months after the relevant reporting period; and
  - Quarterly reports – one month after the relevant reporting period.
47. *The SFC is particularly interested to receive comments on the reasonableness of the proposed timeframe for reporting to holders.*

### **Others**

48. The SFC will take into account the results of the consultation before publishing the Guidelines in its final form. The SFC will implement the Guidelines in a pragmatic manner and, where applicable, review it from time to time to ensure a robust yet facilitative regime.

## Guidelines On Hedge Funds Reporting Requirements

### Introduction

The Securities and Futures Commission (the Commission) has published the Guidelines on Hedge Funds Reporting Requirements (the Guidelines). The Guidelines sets out the minimum amount of information that is required to be disclosed in regular reporting to holders.

1. Pursuant to Chapters 5.17 and 11.6 of the Code on Unit Trusts and Mutual Funds (the Code), authorized schemes are required to publish at least two reports in respect of each financial year, of which the annual report must be audited by the auditor for the scheme. Pursuant to Chapter 8.7(v) of the Code, authorized hedge funds are also required to publish quarterly reports for holders. The following scheme reports should be distributed to holders and filed with the Commission within the stipulated timeframe:

<b>Nature of reports</b>	<i>No. of reports for each scheme financial year</i>	<i>Timeframe for filing and distribution to holders</i>
Annual report	One	Within four months of the end of the relevant financial year, [except for fund of hedge funds (FoHFs) where the timeframe for filing and distribution to holders is within six months of the end of the relevant financial year].
Semi-annual report	One	Within two months of the end of the relevant period
Quarterly reports	Four	Within one month of the end of the relevant period

*Note: Where the management company wishes to report to holders via monthly reports, there is no need to prepare quarterly reports provided that the same requirements for quarterly reports are complied with in the monthly reports.*

2. These Guidelines aims to provide further guidance to management companies regarding the on-going reporting requirements of authorized hedge funds. *The Commission reserves the right to require additional disclosure to be made.*
3. For the ease of understanding by holders, where technical terms are used in the scheme reports, the management company should include a glossary to explain their meaning and their implications to investors.
4. Where the provisions refer to the scheme, this means the authorized hedge fund.

## **A. Contents of Financial Reports**

### ***Requirements Applicable to Both Annual and Semi-Annual Reports***

5. [Annual and semi-annual reports of the scheme must be prepared in accordance with International Accounting Standards (IAS) as promulgated from time to time by the International Accounting Standards Board.

*Note: Where the scheme is an existing fund that adopts a different accounting standard from IAS and the financial year end for its annual report (or the end of the reporting period for its semi-annual report, if more recent) falls on a date within four months from the effective date of these Guidelines, the scheme is not required to prepare such report in accordance with IAS until the next reporting period provided that it discloses and explains differences of accounting practice between IAS and the accounting standard adopted by the scheme, and include a statement of the financial effect of any such material differences.]*

6. Annual and semi-annual reports of the scheme must contain the information as required by Appendix E of the Code, with the exceptions as provided in paragraph 7.
7. The Commission encourages full disclosure of individual holdings of the scheme. Where the management company is satisfied that full disclosure of such information may be unduly burdensome, it may adopt alternative disclosures in lieu of the disclosure as required in the Investment Portfolio subsection of Appendix E of the Code. In that case, the management company must choose the most appropriate and informative illustration of the scheme's holdings/exposures at the end of the relevant period, taking into account the objective and strategy of the scheme.

*[Note: The following will be regarded as minimum disclosures acceptable to the Commission:*

*(1) Exposures for the scheme (expressed in percentage terms of net asset value of the scheme) categorized by asset class, geographical region, industry, strategy, or some other basis that the management company considers the most appropriate, taking into account the objective and strategy of the scheme; and*

*(2) Top ten positions of the scheme in absolute terms (ie. counting both the long and short positions of the scheme). ]*

### ***Requirements Specific to Annual Reports***

8. Annual reports of the scheme must contain the following information:
  - (a) Where the scheme appointed prime broker(s) during the financial year, the name(s) of the prime broker(s), the amount of the scheme's assets held with the prime broker(s) as at the end of the financial year, and their respective maximum levels during the financial year; and

- (b) Where performance fees were borne by the scheme during the financial year, the amount of such performance fees expressed as a percentage of average net asset value of the scheme payable at the scheme level as at the end of the financial year and the calculation basis.

*Note: A nil statement is required if no performance fees were borne by the scheme during the financial year.*

## **B. Quarterly Reports**

### ***Distribution of Quarterly Reports***

9. Quarterly reports are required to be filed with the SFC and distributed to holders within the stipulated timeframe under paragraph 1 of these Guidelines.

*Note: Given the newness of these Guidelines to the market, measures would be taken to familiarise the management company with the reporting requirements and the disclosure standard expected of these reports. The first quarterly report of each scheme must obtain a “no objection” letter from the Commission before it is issued to persons in Hong Kong.*

10. Quarterly reports may not be distributed to non-holders unless accompanied by the offering document of the scheme.

### ***Contents of Quarterly Reports***

11. Quarterly reports must be provided in the English and Chinese languages, and should contain the following information regarding the scheme.

#### ***Management Commentary***

- (a) Performance review

A commentary by the management company that describes and explains the key factors impacting upon the scheme’s financial performance during the reporting period.

*Note: Where the scheme is a FoHFs, the management company is expected to explain what has driven performance in terms of different strategies.*

- (b) Market outlook

A discussion of the management company’s expectation of the primary risk factors to which the scheme is exposed to, and the outlook of the development of these factors as they relate to the scheme.

(c) Changes in key investment personnel

A discussion on the changes in composition of the key investment personnel (if any) and their impact on the scheme's overall strategy, risk profile or future performance.

*Portfolio Review*

(a) Fund size and NAV per unit/share

The scheme's total net asset value, net asset value per unit/share as at the end of the reporting period, and the percentage change in net asset value per unit/share since the last reporting period.

(b) Leverage

The amount of leverage at the scheme level and a summary of its calculation basis as at the end of the reporting period.

*Note: The management company is expected to choose the most appropriate and informative illustration of the scheme's leverage at the end of the relevant period, taking into account the objective and strategy of the scheme.*

(c) Performance and risk measures

[Disclosure of performance and risk measures of the scheme in tabular form. A sample format with the required parameters and time frames is set out in the **Appendix** to these Guidelines.]

The management company is encouraged to disclose other appropriate performance and risk measures, taking into account the objective and strategy of the scheme (eg. value-at-risk (VaR), % of down months, % of up months etc.).

(d) Amount of seed money

Disclosure of the amount of seed money contributed by the management company or its connected persons as at the end of the reporting period.

(e) Illiquid holdings

Disclosure of any scheme holdings as at the end of the reporting period for which there is no readily available market value, how the value of these holdings are ascertained, and by whom.

*Note: For the purposes of presentation, such illiquid holdings should be classified into different categories, eg. securities and derivatives.*

(f) Concentrated exposures

Exposures for the scheme (expressed in percentage terms of net asset value of the

scheme) categorized by asset class, geographical region, industry, strategy, or some other basis that the management company considers the most appropriate and informative, taking into account the objective and strategy of the scheme, and the top five positions of the scheme in absolute terms (ie. counting both long and short positions of the scheme).

*Note: The Commission reserves the right to require disclosure of the full position of the scheme for the purposes of carrying out its regulatory functions. Such disclosures to the Commission will be subject to the Commission’s preservation of secrecy provisions.*

(g) Additional disclosures for FoHFs

Where the scheme is a FoHFs, the management company should include:

- (i) A liquidity profile of the holdings of the FoHFs as at the end of the reporting period. A sample format with the required parameters is set out as follows;

<b>Liquidity Profile of Holdings of [the FoHFs] as at [date]</b>	<b>%</b>
Holdings with less than 30 days to cash	[ ]
Holdings with 30 to 59 days to cash	[ ]
Holdings with 60 to 89 days to cash	[ ]
Holdings with 90 to 179 days to cash	[ ]
Holdings with 180 or more days to cash	[ ]
Total scheme net asset value	100%

- (ii) A “percentage closed” figure for the FoHFs (defined as the percentage of the FoHFs’ capital dollars invested in underlying funds that would be closed to further subscriptions by the FoHFs as at the end of the reporting period divided by total capital dollars across all underlying funds); and

*Note: “Percentage closed” gives an indication of the FoHFs’ investment in underlying funds that have reached their full capacity with reference to the FoHFs, and whether new subscriptions into the FoHFs are likely to face diluted allocations. It is recognized that funds closed may re-open in future and vice versa, and thus the figure is disclosed as an indication only.*

- (iii) The number of underlying funds and number of underlying fund managers included in the FoHFs as at the end of the reporting period.

**C. Recommended Practices**

- 12. In addition to the minimum disclosure requirements, the Commission encourages inclusion of the following voluntary disclosures in the scheme’s reports:

(a) Information on inflows and outflows of money

Disclosure of total subscriptions and redemptions of the scheme during the relevant period.

(b) Information on intraperiod holdings

Disclosure of intraperiod investment activities in terms of the highest, median and lowest holdings of the portfolio categorized by asset classes, geographical region, industry, strategy, or some other basis that the management company considers the most appropriate, taking into account the objective and strategy of the scheme.

(c) Information on intraperiod risk measures

Risk measures, including its definition adopted by the management company in preparing the scheme report, of the relevant portfolio in terms of the highest, median and lowest values over the reporting interval and at period end.

## Appendix

### Information to be Disclosed under Section B.11(f) of the Guidelines on Hedge Funds Reporting Requirements

#### Actual Monthly Returns in the Last Three Calendar Years (net of all fees and charges)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD Actual
Year (T-2)													
Year (T-1)													
Year T													

#### Summary Data

	Year T	Year (T-1)	Year (T-2)	Since Launch <sup>4</sup> [specify launch date]
<b>Performance Statistics</b>				
Annual Return				
Annualized Standard Deviation <sup>5</sup>				
Sharpe Ratio <sup>6</sup>				
<b>Fund Statistics</b>				
Highest NAV per unit/share				
Lowest NAV per unit/share				
Maximum Drawdown <sup>7</sup>				

*[Display prominent warning statements to the effect that: “Investment involves risk, please see the offering document for further details. Past performance figures shown are not indicative of future performance.”]*

#### Notes:

- (1) Calculations must be net of all fees and charges borne by the scheme, with the calculation basis clearly stated.
- (2) “Year T” denotes the current calendar year.
- (3) As per paragraph 3 of the Guidelines, the management company should include a glossary of technical terms to explain their meaning and implications to investors (e.g. the higher the number, the riskier the scheme etc.).
- (4) Statistics since launch can only be shown if the scheme has been in existence for one year or longer.
- (5) “Annualized standard deviation” is defined as the square root of the squared deviations of the actual returns from the simple average return based on the dealing days of the scheme, divided by the number of observations, shown on an annualised basis.
- (6) “Sharpe ratio” is defined as annual return divided by the annualised standard deviation.  
*NB: For the sake of simplicity, a zero risk free rate is adopted in the calculation for “Sharpe Ratio”*
- (7) “Maximum drawdown” is the maximum amount of loss from an equity high until a new equity high, expressed as a percentage of the previous equity high.

## **Appendix E of the Code on Unit Trusts and Mutual Funds**

### **Contents of Financial Reports**

Annual reports must contain all the information required in this appendix and a report issued by the trustee/custodian to holders as required by 4.5(f).

Interim reports must at least contain the Statement of Assets and Liabilities and the Investment Portfolio. Where the scheme has paid or proposes to pay an interim dividend, the amount of dividend should be disclosed.

All reports must contain comparative figures for the previous period except for the Investment Portfolio.

The mention of any unauthorised schemes in the reports must be indicated as "Not authorised in Hong Kong and not available to Hong Kong Residents".

The items listed under the Statement of Assets and Liabilities, Revenue Statement, Distribution Statement, Statement of Movements in Capital Account and the Notes to the Accounts, where applicable, must be disclosed. It is however, not mandatory to adopt the format as shown or to disclose the items in the same order.

While the SFC recognizes that reports of recognized jurisdiction schemes will vary in content, reports are expected to offer investors comparable disclosure as set out in this appendix. Although reports of recognized jurisdiction schemes will generally be reviewed on the basis that they already comply in substance with this appendix, disclosure must be made of transactions with connected persons and soft commission arrangements [see Notes to the Accounts (2) and (3)]. The SFC reserves the right to require additional disclosure [see Appendix A1].

### **Statement of Assets and Liabilities**

The following must be separately disclosed -

1. Total value of investments
2. Bank balances
3. Formation costs
4. Dividends and other receivables
5. Amounts receivable on subscription
6. Bank loans and overdrafts or other forms of borrowings
7. Amounts payable on redemption
8. Distributions payable
9. Total value of all assets

10. Total value of all liabilities
11. Net asset value
12. Number of units/shares in issue
13. Net asset value per unit/share

### **Revenue Statement**

1. Total investment income net of withholding tax, broken down by category
2. Total other income, broken down by category
3. Equalization on issue and cancellation of units/shares
4. An itemized list of various costs which have been debited to the scheme including:
  - (a) fees paid to the management company
  - (b) remuneration of the trustee/custodian
  - (c) fees paid to investment adviser (if any)
  - (d) other amounts paid to any connected persons of the scheme
  - (e) amortization of formation costs
  - (f) directors' fee and remuneration
  - (g) safe custody and bank charges
  - (h) auditors' remuneration
  - (i) interest on borrowings
  - (j) legal and other professional fees
  - (k) any other expenses borne by the scheme
5. Taxes
6. Amounts transferred to and from the capital account
7. Net income to be carried forward for distribution

### **Distribution Statement**

1. Amount brought forward at the beginning of the period
2. Net income for the period
3. Interim distribution per unit/share and date of distribution
4. Final distribution per unit/share and date of distribution
5. Undistributed income carried forward

### **Statement of Movements in Capital Account**

1. Value of the scheme as at the beginning of the period

2. Number of units/shares issued and the amounts received upon such issuance (after equalization if applicable)
3. Number of units/shares redeemed and the amount paid on redemption (after equalization if applicable)
4. Any items resulting in an increase/decrease in value of the scheme including:
  - (a) surplus/loss on sale of investments
  - (b) exchange gain/loss
  - (c) unrealized appreciation/diminution in value of investments
  - (d) net income for the period less distribution
5. Amounts transferred to and from the revenue account
6. Value of the scheme as at the end of the period

## **Notes to the Accounts**

The following matters should be set out in the notes to the accounts:

1. Principal accounting policies
  - (a) the basis of valuation of the assets of the scheme including the basis of valuation of unquoted and unlisted securities
  - (b) the revenue recognition policy regarding dividend income and other income
  - (c) foreign currency translation
  - (d) the basis of valuation of forward foreign exchange and futures contracts
  - (e) the basis of amortization of formation costs
  - (f) taxation
  - (g) any other accounting policy adopted to deal with items which are judged material or critical in determining the transactions and in stating the disposition of the scheme

Any changes to the above accounting policies and their financial effects upon the accounts should also be disclosed.

2. Transactions with Connected Persons

The following should be disclosed -

- (a) a description of the nature of any transactions entered into during the period between the scheme and the management company, investment adviser, the directors of the scheme or any entity in which those parties or their connected persons have a material interest, together with a statement confirming that these transactions have been entered into in the ordinary course of business and on normal commercial terms;

- (b) (i) the total aggregate value of the transactions of the scheme effected through a broker who is a connected person of the management company, the investment adviser, or the directors of the scheme;
  - (ii) the percentage of such transactions in value to the total transactions in value of the scheme during the year;
  - (iii) the total brokerage commission paid to such broker in relation to transactions effected through it; and
  - (iv) the average rate of commission effected through such broker.
  - (c) details of all transactions which are outside the ordinary course of business or not on normal commercial terms entered into during the period between the scheme and the management company, investment adviser, the directors of the scheme or any entity in which these parties or their connected persons have a material interest;
  - (d) name of the management company, the director of the scheme or any connected persons of such company or director if any of them becomes entitled to profits from transactions in units/shares or from management of the scheme, and the amount of profits to which each of them becomes entitled;
  - (e) where the scheme does not have any transactions with connected persons during the period, a nil statement to that effect; and
  - (f) the basis of the fee charged for the management of the fund and the name of the management company. In addition, where a performance fee is charged to the scheme, the basis of calculation and amount of performance fee charged should be separately disclosed. For Futures and Options Funds [see 8.4A], the total transactions costs must also be disclosed.
3. Details of any soft commission arrangements relating to dealings in the property of the scheme or a nil statement if no such arrangements exist during the period.
  4. Borrowings  
State whether the borrowings are secured or unsecured and the duration of the borrowings.
  5. Contingent liabilities and commitments  
Details of any contingent liabilities and commitments of the scheme.
  6. If the free negotiability of any asset is restricted by statutory or contractual requirements, this must be stated.

## **Contents of the Auditors' Report**

The report of the Auditor should state:

1. Whether in the auditor's opinion, the accounts prepared for that period have been properly prepared in accordance with the relevant provisions of the Trust Deed (if a unit trust) and the Code;

2. Without prejudice to the foregoing, whether in the auditor's opinion, a true and fair view is given of the disposition of the scheme at the end of the period and of the transactions of the scheme for the period then ended;
3. If the auditor is of the opinion that proper books and records have not been kept by the scheme and/or the accounts prepared are not in agreement with the scheme's books and records, that fact; and
4. If the auditor has failed to obtain all the information and explanations which, to the best of his knowledge and belief, are necessary for the purposes of the audit, that fact.

## **Investment Portfolio**

1. Number or quantity of each holding together with the description and market value. Distinguish between listed and unlisted and categorize by country. For investments in schemes by a UPMF, the place of incorporation of the schemes should be disclosed.
2. The total investment stated at cost.
3. The value of each holding as a percentage of net asset value.
4. Statement of movements in portfolio holdings since the end of the preceding accounting period.

*Note (1): The management company is expected to choose the most appropriate illustration of portfolio holdings taking into account the objective and nature of the fund. Any one of the following methods may be considered acceptable to the Commission:*

- (a) detailed holdings in individual securities;*
- (b) holdings in different sectors of a particular market;*
- (c) holdings in different countries (in the case of, for example, a global equity fund); or*
- (d) holdings in various kinds of securities such as equities, bonds, warrants and options etc. (in the case of a diversified fund).*

*(2): Except for (a) above, movements in portfolio holdings can be expressed in percentages.*

## **Performance Table**

1. A comparative table covering the last 3 financial years and including, for each financial year, at the end of the financial year:
  - (a) the total net asset value; and
  - (b) the net asset value per unit/share.
2. A performance record over the last 10 financial years; or if the scheme has not been in existence during the whole of that period, over the whole period in which it has been in existence, showing the highest issue price and the lowest redemption price of the units/shares during each of those years.