

# **Code on Unit Trusts and Mutual Funds**

First Edition pursuant to the Securities and Futures Ordinance (Cap.571)

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## AMENDMENT

Particulars	Paragraph	Chapter	Effective Date
The Constitution of the Committee On Unit Trusts	2.2	2	6 June 2003
Inspection Regimes		Appendix A2	1 August 2003
Prohibition on Real Estate Investments	7.14	7	22 April 2005
Hedge Fund Guidelines	8.7	8	30 September 2005
Interpretation	3.1A 3.1B 3.11A 3.12A	3	1 August 2008
Operational Requirements for Investment Plans	6.9 (e)	6	1 August 2008
Reporting Requirements for Index Funds	8.6 (f)	8	1 August 2008
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Guidelines for Regulating Index Tracking Exchange Traded Funds	2, 14, 24-26	Appendix I	1 August 2008

## INSERTION

<b>Particulars</b>	<b>Paragraph</b>	<b>Chapter</b>	<b>Effective Date</b>
Guidelines for Regulating Index Tracking Exchange Traded Funds		Appendix I	24 October 2003

## DELETION

<b>Particulars</b>	<b>Paragraph</b>	<b>Chapter</b>	<b>Effective Date</b>
Advertising Guidelines		Appendix F	1 August 2008

**Explanatory Notes:**

- (a) The Securities and Futures Commission is empowered under s.104(1) of the Securities and Futures Ordinance (“Ordinance”) to authorize collective investment schemes. By virtue of s.104(1), the authorization may be granted subject to such conditions as the Commission considers appropriate. This Code establishes guidelines for the authorization of collective investment schemes in the nature of mutual fund corporations or unit trusts, and codifies practices established in relation to the former Code on Unit Trusts and Mutual Funds published pursuant to the Securities and Futures Ordinance.**
- (b) The Commission may review its authorization at any time and may modify, add to or withdraw such authorization as it deems fit.**
- (c) The issue of an advertisement or invitation to the public in Hong Kong to invest in an unauthorized collective investment scheme may amount to an offence under s.103 of the Ordinance.**
- (d) This Code does not have the force of law.**

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## PART I: GENERAL MATTERS

### Chapter 1: Authorization Procedures

#### **Schemes Established in Hong Kong or Elsewhere**

- 1.1 Schemes to be established in Hong Kong or elsewhere are expected to comply with the provisions of this Code in order to be authorized in Hong Kong.

Applications for authorization which seek waivers of any of these provisions must give detailed reasons why waivers are sought.

#### **Scheme Established in Recognized Jurisdictions**

- 1.2 This Code accepts that some schemes already comply with certain provisions of this Code by virtue of prior authorization in a regulated jurisdiction. It therefore recognizes the types of scheme in jurisdictions listed in Appendix A1. Applications for authorization of recognized jurisdiction schemes will generally be reviewed on the basis that the scheme's structural and operational requirements, and core investment restrictions, already comply in substance with this Code. Applicants should note however that the SFC expects a scheme to comply in all material respects with this Code and reserves the right to require such compliance as a condition of authorization [see Appendix A1].

#### **Documents to be supplied to the Commission**

- 1.3 An applicant for authorization of a scheme must submit a completed Application Form as set out in Appendix B. The Application Form must be accompanied by the following:-
- (a) the scheme's offering and constitutive documents, including its Hong Kong Offering Document [see 3.6 and 3.9];
  - (b) the scheme's latest audited report (if any) and if more recent, the latest unaudited report;
  - (c) management company profile [if applicable - see Appendix B];
  - (d) the trustee/custodian's latest audited report [if applicable - see Appendix B];
  - (e) letter of consent to the appointment from the trustee/custodian (not required for recognized jurisdiction schemes or schemes already in existence);
  - (f) application fee in the form of a cheque payable to the "Securities & Futures Commission".
  - (g) The letter nominating an individual to be approved by the Commission as an approved person [see 1.5] containing the individual's name,

employer, position held and contact details, including, in so far as applicable, the address, telephone and facsimile numbers, and electronic mail address.

The current fee schedule is available on request from the Commission.

In addition to the above, applicants for authorization of a non Hong Kong-based scheme must supply the following:-

- (h) Hong Kong Representative Agreement and Undertaking [see Chapter 9];

Applicants for authorization of a recognized jurisdiction scheme must also supply:-

- (i) evidence of the scheme's authorized status in that jurisdiction.

#### **Amendments to Documents**

- 1.4 In cases where it may not be suitable to amend documentation to comply with a requirement of this Code, the Commission may accept a written undertaking from the relevant party that they will comply with the requirement, together with disclosure in the Hong Kong Offering Document regarding compliance.

#### **Nomination of an individual as approved person**

- 1.5 According to sections 104(2) and 105(2) of the Ordinance, an individual must be approved for the purposes of being served by the Commission with notices and decisions for, respectively, the scheme and the issue of any related advertisement, invitation or document. An applicant for authorization is, therefore, required to nominate an individual for approval by the Commission as an approved person.
- 1.6 An approved person should:
  - (a) have his/her ordinary residence in Hong Kong;
  - (b) inform the Commission of his/her current contact details, including, in so far as applicable, the address, telephone and facsimile numbers, and electronic mail address;
  - (c) be capable of being contacted by the Commission by post, telephone, facsimile and electronic mail during business hours;
  - (d) inform the Commission of any change in his/her contact details within 14 days after the change takes place; and
  - (e) comply with any other requirements as the Commission considers appropriate.



- 1.7 An individual approved by the Commission as an approved person for a scheme shall generally be approved also for the issue of any advertisement, invitation or document made in respect of that scheme.

## Chapter 2: Administrative Arrangements

- 2.1 The Commission has delegated its powers under s.104 of the Ordinance with respect to collective investment schemes to the Committee on Unit Trusts, the Executive Director (Intermediaries and Investment Products) and the Director (Investment Products). Powers are normally exercised by the Committee when new management groups or new policy issues are considered; otherwise powers are normally exercised by the Director (Investment Products).
- 2.2 The Commission has established the Committee on Unit Trusts under s.8 of the Ordinance for the purposes of:-
- (a) authorizing collective investment schemes under s.104(1) of the Ordinance;
  - (b) imposing conditions when authorizing collective investment schemes (s.104(1) of the Ordinance);
  - (c) granting waivers from this Code; and
  - (d) considering whether there should be any amendments to the legislation relating to collective investment schemes and to this Code and making recommendations to the Commission accordingly.

The constitution of the Committee is:-

### *Chairman*

Any Executive Director of the SFC;

### *Members (14)*

Non-executive Director of the SFC;  
Director (Investment Products), SFC (ex-officio and deputises as Chairman in the absence of the Chairman);  
Representative of the Mandatory Provident Fund Schemes Authority;  
Chairman of the Hong Kong Investment Funds Association (ex-officio);  
Four persons from fund management companies;  
Two persons from trustee companies;  
Person nominated by the SFC;  
Appointments I and II ad personam; and  
Actuary member

### *Alternate Members (8)*

Five persons from fund management companies;  
Two persons from trustee companies; and  
Alternate actuary member

## **Quorum and Meetings**

The quorum for any meeting of the Committee is five members, one of whom must be an Executive Director or Director of the Commission and one of whom must be employed by a fund management company.

The Committee has appointed a Senior Manager (Investment Products), SFC as Secretary. The Secretary attends the Committee's discussions but has no vote.

- 2.3 On request, the Commission will give reasons for decisions reached.
- 2.4 Under s.10(4) of the Ordinance, the Commission may concurrently perform any function, power or duty which it has delegated but the Commission does not intend to exercise this right by reviewing a decision of the Committee except where there has been:-
- (a) a manifest error; or
  - (b) an application of defective procedures; or
  - (c) a manifest misinterpretation of this Code.

## **Procedure for Amendments to this Code**

- 2.5 The Committee may make recommendations to the Commission whenever it considers that the provisions of this Code should be amended. If the Commission accepts the Committee's recommendation, any such change or amendment will be made known to the industry and transitional periods for compliance will be allowed where necessary.

## **Data Privacy**

- 2.6 The information requested under the Code may result in the applicant providing the Commission with personal data as defined in the Personal Data (Privacy) Ordinance. The data supplied will only be used by the Commission to perform its functions, in the course of which it may match, compare, transfer or exchange personal data with data held or obtained by the Commission, government bodies, other regulatory authorities, corporations, organizations or individuals in Hong Kong or overseas for the purpose of verifying those data. Subject to the limits in s.378 of the Ordinance, the Commission may disclose personal data to other regulatory bodies. You may be entitled under the Personal Data (Privacy) Ordinance to request access to or to request the correction of any data supplied to the Commission, in the manner and subject to the limitations prescribed. All enquiries should be directed to the Data Privacy Officer at the SFC.

### **Chapter 3: Interpretation**

*Unless otherwise defined, words and expressions used in this Code are as defined in the Securities and Futures Ordinance.*

- 3.1A “Advertising Guidelines” means the Advertising Guidelines Applicable to Collective Investment Schemes Authorized under the Product Codes.
- 3.1B “Capital markets scheme” means a scheme, the primary objective of which is to invest in debt securities which have a remaining term to maturity of one year or more.
- 3.2 “Collective investment scheme” or “scheme” means collective investment schemes commonly regarded as mutual funds (whether they appear in the legal forms of contractual model, companies with variable capital or otherwise) and unit trusts as are contemplated in this Code.
- 3.3 “Commission” or “SFC” means the Securities and Futures Commission referred to in section 3(1) of the Ordinance.
- 3.4 “Committee” means the Committee on Unit Trusts.
- 3.5 “Connected person” in relation to a company means:-
- (a) any person or company beneficially owning, directly or indirectly, 20% or more of the ordinary share capital of that company or able to exercise directly or indirectly, 20% or more of the total votes in that company; or
  - (b) any person or company controlled by a person who or which meets one or both of the descriptions given in (a); or
  - (c) any member of the group of which that company forms part; or
  - (d) any director or officer of that company or of any of its connected persons as defined in (a), (b) or (c).
- 3.6 “Constitutive documents” means the principal documents governing the formation of the scheme, and includes the trust deed in the case of a unit trust and the Articles of Association of a mutual fund corporation and all material agreements.
- 3.7 “Distribution function” refers generally to those functions described in 9.3 (a) to (d) of this Code.
- 3.8 “Holder” in relation to a unit or share in a scheme means the person who is entered in the register as the holder of that unit or share or the bearer of a bearer certificate representing that unit or share.
- 3.9 “Hong Kong Offering Document” means an offering document for distribution in Hong Kong containing the information required by Appendix C

of this Code, and any other information necessary for investors to make an informed judgement about the scheme.

- 3.10 “Offering document” means that document, or documents issued together, containing information on a scheme to invite offers by the public to buy units/shares in the scheme.
- 3.11 “Ordinance” means the Securities and Futures Ordinance.
- 3.11A “Product Code” means any of the following codes administered by the Commission:
- (a) Code on Unit Trusts and Mutual Funds
  - (b) Code on Investment-Linked Assurance Schemes
  - (c) Code on Pooled Retirement Funds
  - (d) SFC Code on MPF Products
- 3.12 “Recognized jurisdiction scheme” means a scheme authorized pursuant to overseas laws as listed in Appendix A1 of this Code.
- 3.12A “Registered person” means a “registered institution” and, except where the context otherwise requires, includes a “relevant individual” as defined in section 20(10) of the Banking Ordinance (Cap. 155).
- 3.13 “Substantial financial institution” means an authorized institution as defined in section 2(1) of the Banking Ordinance or financial institution with a minimum paid-up capital of HK\$150,000,000 or its equivalent in foreign currency.
- 3.14 “Trustee/custodian”, “trustee” or “custodian” means the entity appointed pursuant to 4.1 of this Code.

## PART II: AUTHORIZATION REQUIREMENTS

### Chapter 4: Trustee/Custodian

#### Appointment of Trustee/Custodian

- 4.1 Every collective investment scheme for which authorization is requested must appoint a trustee/custodian acceptable to the Commission.

*Notes (1): Schemes established under trust must have a trustee and mutual fund corporations must have a custodian. This chapter lists the general obligations of the trustee/custodian, whichever is appointed. Trustees are expected to fulfill the duties imposed on them by the general law of trusts. In the case of a mutual fund corporation, the responsibilities of a custodian should be reflected in a constitutive document such as a Custodian Agreement. [see Appendix D]*

*Notes (2): An acceptable trustee/custodian should either:*

- (i) on an ongoing basis, be subject to regulatory supervision; or*
- (ii) appoint an independent auditor to periodically review its internal controls and systems on terms of reference agreed with the SFC and should file such report with the SFC.*

*[see Appendix G - "Guidelines for Review of Internal Controls and Systems of Trustees/Custodians"]*

- 4.2 A trustee/custodian must be:-
- (a) a bank licensed under Section 16 of the Banking Ordinance; or
  - (b) a trust company which is a subsidiary of such a bank; or
  - (c) a trust company registered under Part VIII of the Trustee Ordinance; or
  - (d) a banking institution or trust company incorporated outside Hong Kong which is acceptable to the Commission.
- 4.3 A trustee/custodian must be independently audited and have minimum issued and paid-up capital and non-distributable capital reserves of HK\$10 million or its equivalent in foreign currency.
- 4.4 Notwithstanding 4.3 above, the trustee/custodian's paid-up capital and non-distributable capital reserves may be less than HK\$10 million if the trustee/custodian is a wholly-owned subsidiary of a substantial financial institution (the holding company); and

- (a) the holding company issues a standing commitment to subscribe sufficient additional capital up to the required amount, if so required by the Commission; or
- (b) the holding company undertakes that it would not let its wholly-owned subsidiary default and would not, without prior approval of the Commission, voluntarily dispose of, or permit the disposal or issue of any share capital of the trustee/custodian such that it ceases to be a wholly-owned subsidiary of the holding company.

### **General Obligations of Trustee/Custodian**

4.5 The trustee/custodian must:-

- (a)
  - (i) take into its custody or under its control all the property of the scheme and hold it in trust for the holders (in the case of a unit trust) or the scheme (in the case of a mutual fund corporation) in accordance with the provisions of the constitutive documents;
  - (ii) register cash and registrable assets in the name of or to the order of the trustee/custodian; where borrowing is undertaken for the account of the scheme, such assets may be registered in the lender's name or in that of a nominee appointed by the lender; and
  - (iii) be liable for the acts and omissions of its nominees and agents in relation to assets forming part of the property of the scheme;
- (b) take reasonable care to ensure that the sale, issue, repurchase, redemption and cancellation of units/shares effected by a scheme are carried out in accordance with the provisions of the constitutive documents;
- (c) take reasonable care to ensure that the methods adopted by the management company in calculating the value of units/shares are adequate to ensure that the sale, issue, repurchase, redemption and cancellation prices are calculated in accordance with the provisions of the constitutive documents;
- (d) carry out the instructions of the management company in respect of investments unless they are in conflict with the provisions of the offering or constitutive documents or this Code;
- (e) take reasonable care to ensure that the investment and borrowing limitations set out in the constitutive documents and the conditions under which the scheme was authorized are complied with;
- (f) issue a report to the holders to be included in the annual report on whether in the trustee/custodian's opinion, the management company has in all material respects managed the scheme in accordance with the provisions of the constitutive documents; if the management company

has not done so, the respects in which it has not done so and the steps which the trustee/custodian has taken in respect thereof; and

- (g) take reasonable care to ensure that unit/share certificates are not issued until subscription moneys have been paid.

#### **Retirement of Trustee/Custodian**

- 4.6 The trustee/custodian may not retire except upon the appointment of a new trustee/custodian and subject to the prior approval of the Commission. The retirement of the trustee/custodian should take effect at the same time as the new trustee/custodian takes up office.

#### **Independence of Trustee/Custodian and the Management Company**

- 4.7 The trustee/custodian and the management company must be persons who are independent of each other.
- 4.8 Notwithstanding 4.7 above, if the trustee/custodian and the management company are both bodies corporate having the same ultimate holding company, whether incorporated in Hong Kong or outside Hong Kong, the trustee/custodian and the management company are deemed to be independent of each other if:-

- (a)
  - (i) they are both subsidiaries of a substantial financial institution;
  - (ii) neither the trustee/custodian nor the management company is a subsidiary of the other;
  - (iii) no person is a director of both the trustee/custodian and the management company; and
  - (iv) both the trustee/custodian and the management company sign an undertaking that they will act independently of each other in their dealings with the scheme; or
- (b) the scheme is established in a jurisdiction where the trustee/custodian and the management company are required by law to act independently of one another.



## Chapter 5: Management Company and Auditor

### Appointment of the Management Company

- 5.1 Every collective investment scheme for which authorization is requested must appoint a management company acceptable to the Commission, except as provided for self-managed schemes below.

*Note: The investment management operations of a fund management company or those of the investment adviser (where the latter has been delegated the investment management function) should be based in a jurisdiction with an inspection regime acceptable to the Commission. A list of inspection regimes is set out in Appendix A2. The Commission will consider other jurisdictions on their merits and may accept an undertaking from the management company that the books and records in relation to its management of a scheme will be made available for inspection by the Commission on request.*

- 5.2 A management company must:-

- (a) be engaged primarily in the business of fund management;
- (b) have sufficient financial resources at its disposal to enable it to conduct its business effectively and meet its liabilities; in particular, it must have a minimum issued and paid-up capital and capital reserves of HK\$1 million or its equivalent in foreign currency;
- (c) not lend to a material extent; and
- (d) maintain at all times a positive net asset position.

- 5.3 Indebtedness owed by the management company to its parent company will be considered as part of capital for the purpose of 5.2(b) in the following circumstances:-

- (a) the indebtedness must not be settled without the prior written consent of the Commission; and
- (b) the indebtedness must be subordinated to all other liabilities of the management company, both in terms of its entitlement to income and its rights in a liquidation.

### *Qualifications of Directors*

- 5.4 The directors of the management company must be of good repute and in the opinion of the Commission possess the necessary experience for the performance of their duties. In determining the acceptability of the management company, the Commission may consider the qualifications and experience of persons employed by the management company and any appointed investment adviser.

### *Criteria for Acceptability of Management Company*

- 5.5 The acceptability of the management company will be assessed on the following criteria:
- (a) The key personnel of the management company or those of the investment adviser (where the latter has been delegated the investment management function) are expected to possess at least five years investment experience managing unit trusts or other public funds with reputable institutions. The expertise gained should be in the same type of investments as those proposed for the funds seeking authorization.
  - (b) Key personnel must be dedicated full-time staff with a demonstrable track record in the management of unit trusts or mutual funds. In assessing the qualifications of the personnel of the management company, the Commission may request resumes of the directors of the management company and its delegates (if any). [see 2.6.]
  - (c) Sufficient human and technical resources must be at the disposal of the management company, which should not rely solely on a single individual's expertise.
  - (d) The Commission must be satisfied with the overall integrity of the applicant management company. Reasonable assurance must be secured of the adequacy of internal controls and the existence of written procedures, which should be regularly monitored by its senior management for updatedness and compliance. Conflicts of interests must be properly addressed to safeguard investors' interests.
  - (e) Where the investment management functions are delegated to third parties, there should be on-going supervision and regular monitoring of the competence of the delegates by the management company to ensure that the management company's accountability to investors is not diminished. Although the investment management role of the management company may be sub-contracted to third parties, the responsibilities and obligations of the management company may not be delegated.

### *Licensing Requirement*

- 5.6 The type of licence required depends on the functions performed by the management company in Hong Kong. A management company should be properly licensed or registered under Part V of the Ordinance to carry on its regulated activities.

### *Self-managed Schemes*

- 5.7 Notwithstanding 5.1, a scheme could be managed by its own board of directors who perform the functions of a management company. In this case, references in this Code to the directors of a management company are deemed to be references to the directors of a self-managed scheme.

- 5.8 The directors of a self-managed scheme are prohibited from dealing with the scheme as principals.
- 5.9 The regulations of a self-managed scheme must contain the following provisions:-
- (a) that holders could convene a meeting and, by way of an ordinary resolution, remove any of the directors considered no longer fit and proper to manage the scheme's assets; and
  - (b) that the directors' fees and remuneration should be fixed by the holders at a general meeting.

### **General Obligations of a Management Company**

- 5.10 A management company must:-
- (a) manage the scheme in accordance with the scheme's constitutive documents in the exclusive interest of the holders. It is also expected to fulfill the duties imposed on it by the general law;
  - (b) maintain or cause to be maintained the books and records of the scheme and prepare the scheme's accounts and reports. At least two reports must be published in respect of each financial year. These reports must be sent to all registered holders and filed with the Commission within the time frame specified in 11.6; and
  - (c) ensure that the constitutive documents are made available for inspection by the public in Hong Kong, free of charge at all times during normal office hours at its place of business or that of its Hong Kong Representative and make copies of such documents available upon the payment of a reasonable fee.

### **Retirement of a Management Company**

- 5.11 The management company must be subject to removal by notice in writing from the trustee or the directors of a mutual fund corporation in any of the following events:-
- (a) the management company goes into liquidation, becomes bankrupt or has a receiver appointed over its assets; or
  - (b) for good and sufficient reason, the trustee or the directors of a mutual fund corporation state in writing that a change in management company is desirable in the interests of the holders; or
  - (c) in the case of a unit trust, holders representing at least 50% in value of the units outstanding (excluding those held or deemed to be held by the management company), deliver to the trustee a written request to dismiss the management company.

- 5.12 In addition, the management company must retire:-
- (a) in all other cases provided for in the constitutive documents; or
  - (b) when the Commission withdraws its approval of the management company.
- 5.13 The Commission must be informed by the trustee or the directors of a mutual fund corporation of any decision to remove the management company.
- 5.14 Upon the retirement or dismissal of the management company, the trustee or the directors of a mutual fund corporation must appoint a new management company as soon as possible, subject to the approval of the Commission.

**Appointment of the Auditor**

- 5.15 The management company or the directors of a mutual fund corporation must, at the outset and upon any vacancy, appoint an auditor for the scheme.
- 5.16 The auditor must be independent of the management company, the trustee/custodian, and, in the case of a mutual fund corporation, the directors.
- 5.17 The management company must cause the scheme's annual report to be audited by the auditor, and such report should contain the information in Appendix E.

## Chapter 6: Operational Requirements

### Scheme Documentation

#### *Matters to be Disclosed in Offering Document*

- 6.1 Authorized schemes must issue an up-to-date offering document, which should contain the information necessary for investors to be able to make an informed judgement of the investment proposed to them, and in particular should contain the information listed in Appendix C.

*Note: Provided that the Commission is satisfied that the overall disclosure of required information is clear, a scheme may supplement an overseas offering document with a Hong Kong Covering Document. The Commission however specifically encourages the use of a short, clearly written Hong Kong Offering Document.*

#### *English and Chinese Offering Documents*

- 6.2 Except as provided herein, the information required in Appendix C must be provided in the English and Chinese languages. The Commission may waive the requirement that the information be provided in both languages on a case by case basis where the management company satisfies the Commission that the scheme will only be offered to persons who are fully conversant in the language in which it is intended to publish the information.

#### *Accompaniment to Offering Document*

- 6.3 The offering document must be accompanied by the scheme's most recent audited annual report and accounts together with its semi-annual report if published after the annual report.
- 6.4 No application form may be supplied to any person not a holder unless accompanied by the offering document, except that an advertisement or report containing all the requirements of Appendix C may be allowed to incorporate an application form.

#### *Inclusion of Performance Data*

- 6.5 If performance data or estimated yield is quoted, the Commission may require supporting documentation. No forecast of the scheme's performance may be made. The publication of a prospective yield does not constitute a forecast of performance.

#### *Contents of Constitutive Documents*

- 6.6 The constitutive documents of a scheme should contain the information listed in Appendix D. Nothing in the constitutive documents may provide that the trustee/custodian, management company or directors of the scheme can be

exempted from any liability to holders imposed under Hong Kong law or the law of the scheme's place of domicile or breaches of trust through fraud or negligence, nor may they be indemnified against such liability by holders or at holders' expense.

#### *Changes to Scheme Documentation*

- 6.7 The constitutive documents may be altered by the management company and trustee/custodian, without consulting holders, provided that the trustee/custodian certifies in writing that in its opinion the proposed alteration:-
- (a) is necessary to make possible compliance with fiscal or other statutory or official requirements; or
  - (b) does not materially prejudice holders' interests, does not to any material extent release the trustee/custodian, management company or any other person from any liability to holders and does not increase the costs and charges payable from the scheme property; or
  - (c) is necessary to correct a manifest error.

In all other cases no alteration may be made except by a special or extraordinary resolution of holders or the approval of the Commission.

#### **Member Register**

- 6.8 The scheme, or in the case of a unit trust, the trustee or the person so appointed by the trustee must maintain a register of holders. The Commission must be advised on request of the address(es) where the register is kept.

#### **Investment Plans**

- 6.9 If investment plans are offered:-
- (a) before contracting for a plan, a prospective planholder must be given full details in writing of his rights and obligations, of all costs and charges levied on planholders and of the consequences of terminating his plan;
  - (b) unless he has requested to the contrary, each planholder must be advised at least once every quarter of the opening balance of units, latest transaction details and closing balance of units;
  - (c) the plan must include a direction to potential investors that they should refer to the offering document of the scheme to which they are considering linking their plan;

- (d) an investment plan leaflet to be distributed in Hong Kong must not solicit investment in schemes which have not been authorized by the Commission; and
- (e) in respect of any increase of initial fee of investment plans up to the maximum permitted level, no less than one month's prior notice must be given to holders concerned.

## **Pricing, Issue & Redemption of Units/Shares**

### *Initial Offers*

- 6.10 If an initial offer is made, no investment of subscription money can be made until the conclusion of the first issue of units/shares at the initial price.

### *Valuation & Pricing*

- 6.11 Offer and redemption prices should be calculated on the basis of the scheme's net asset value divided by the number of units/shares outstanding. Such prices may be adjusted by fees and charges, provided the amount or method of calculating such fees and charges is clearly disclosed in the offering document.

### *Valuation of Unquoted Securities*

- 6.12 The value of investments not listed or quoted on a recognized market should be determined on a regular basis by a professional person approved by the trustee/custodian as qualified to value such investments. Such professional person may, with the approval of the trustee/custodian, be the management company.

### *Dealing*

- 6.13 There must be at least one regular dealing day per month. Any offer price which the management company or the distribution company quotes or publishes must be the maximum price payable on purchase and any redemption price must be the net price receivable on redemption.
- 6.14 The maximum interval between the receipt of a properly documented request for redemption of units/shares and the payment of the redemption money to the holder may not exceed one calendar month.

## **Meetings**

- 6.15 A scheme should arrange to conduct general meetings of holders as follows:-
- (a) Holders must be able to appoint proxies;
  - (b) Votes should be proportionate to the number of units/shares held or to the value of units/shares held where there are accumulation units/shares;

- (c) The quorum for meetings at which a special or extraordinary resolution is to be considered should be the holders of 25% of the units or shares in issue and 10% if only an ordinary resolution is to be considered;
- (d) If within half an hour from the time appointed for the meeting a quorum is not present, the meeting should be adjourned for not less than 15 days. The quorum at an adjourned meeting will be those holders present at the adjourned meeting in person or by proxy;
- (e) If the possibility exists of a conflict of interest between different classes of holders there should be provision for class meetings;
- (f) An Extraordinary General Meeting should be called for the following purposes:
  - (i) to modify, alter or add to the constitutive documents, except as provided in 6.7;
  - (ii) to terminate the scheme (unless the means of termination of the scheme are set out in the constitutive documents, in which case termination must be effected as required);
  - (iii) to increase the maximum fees paid to the management company, trustee/custodian or directors of the scheme; or
  - (iv) to impose other types of fees.
- (g) Where bearer units are in issue, provision must be made for notification to bearer holders in Hong Kong of the timing and agenda of forthcoming meetings and voting arrangements;
- (h) The directors of the scheme, the trustee/custodian, the management company, investment adviser and their connected persons must be prohibited from voting their beneficially owned shares at, or counted in the quorum for, a meeting at which they have a material interest in the business to be contracted;
- (i) An ordinary resolution may be passed by a simple majority of the votes of those present and entitled to vote in person or by proxy at a duly convened meeting; and
- (j) A special or extraordinary resolution may only be passed by 75% or more of the votes of those present and entitled to vote in person or by proxy at a duly convened meeting.



## Fees

- 6.16 The level/basis of calculation of all costs and charges payable from the scheme's property must be clearly stated, with percentages expressed on a per annum basis [see C14 of Appendix C]. The aggregate level of fees for investment management or advisory functions should also be disclosed.

*Note: Percentage-based transaction fees payable to the management company or any of its connected persons may be disallowed as inconsistent with the management company's fiduciary responsibility.*

- 6.17 If a performance fee is levied, the fee can only be payable:-
- (a) no more frequently than annually; and
  - (b) if the net asset value per unit/share exceeds the net asset value per unit/share on which the performance fee was last calculated and paid (i.e. on a "high-on-high" basis).
- 6.18 The following fees, costs and charges must not be paid from the scheme's property:-
- (a) commissions payable to sales agents arising out of any dealing in units/shares of the scheme;
  - (b) expenses arising out of any advertising or promotional activities in connection with the scheme;
  - (c) expenses which are not ordinarily paid from the property of schemes authorized in Hong Kong; and
  - (d) expenses which have not been disclosed in the constitutive documents as required by D10 of Appendix D.

## Chapter 7: Investment: Core Requirements

*This Chapter sets out the core requirements of the investment limitations and prohibitions of a collective investment scheme, other than a specialized scheme under Chapter 8.*

### *Spread of Investments*

- 7.1 The value of a scheme's holding of securities issued by any single issuer may not exceed 10% of its total net asset value.

*Notes: (1) An issuer of investments based on an underlying security (such as an issuer of covered warrants) is treated separately from an issuer of the underlying security, provided that the 10% restriction applicable to any single issuer is not exceeded if and when any rights of convertibility are exercised.*

*(2) A waiver of this section can be considered on a case-by-case basis for a scheme whose sole objective is to track an index with constituent stocks exceeding 10%.*

- 7.2 A scheme may not hold more than 10% of any ordinary shares issued by any single issuer.

- 7.3 The value of a scheme's holding of securities neither listed nor quoted on a market may not exceed 15% of its total net asset value.

*Note: Market means any stock exchange, over-the-counter market or other organized securities market that is open to the international public and on which such securities are regularly traded.*

- 7.3A Notwithstanding 7.1, 7.2, and 7.3, where direct investment in a market is not in the best interests of investors, a scheme may invest through a wholly-owned subsidiary company established solely for the purpose of making direct investments in such market. In this case:-

- (a) the underlying investments of the subsidiary, together with the direct investments made by the scheme, must in aggregate comply with the requirements of this Chapter;
- (b) any increase in the overall fees and charges directly or indirectly borne by the holders or the scheme as a result must be clearly disclosed in the offering document; and
- (c) the scheme must produce the reports required by 5.10(b) in a consolidated form to include the assets (including investment portfolio) and liabilities of the subsidiary company as part of those of the scheme.

### *Government and Other Public Securities*

- 7.4 Notwithstanding 7.1 and 7.2, up to 30% of a scheme's total net asset value may be invested in Government and other public securities of the same issue.
- 7.5 Subject to 7.4, a scheme may invest all of its assets in Government and other public securities in at least six different issues.

*Notes: (1) "Government and other public securities" means any investment issued by, or the payment of principal and interest on, which is guaranteed by the government of any member state of the Organization for Economic Co-operation and Development (OECD) or any fixed interest investment issued in any OECD country by a public or local authority or nationalized industry of any OECD country or anywhere in the world by any other body which is, in the opinion of the trustee/custodian, of similar standing.*

*(2) Government and other public securities will be regarded as being of a different issue if, even though they are issued by the same person, they are issued on different terms whether as to repayment dates, interest rates, the identity of the guarantor, or otherwise.*

### *Warrants and Options*

- 7.6 (a) A scheme may invest in options and warrants for hedging purposes.
- (b) In addition to (a) above, the value of a scheme's investment in warrants and options not held for hedging purposes in terms of the total amount of premium paid may not exceed 15% of its total net asset value.
- 7.7 The writing of uncovered options is prohibited.
- 7.8 The writing of call options on portfolio investments may not exceed 25% of a scheme's total net asset value in terms of exercise price.

### *Futures and Commodities*

- 7.9 A scheme may enter into financial futures contracts for hedging purposes.
- 7.10 In addition to 7.9, a scheme may enter into futures contracts on an unhedged basis provided that the net total aggregate value of contract prices, whether payable to or by the scheme under all outstanding futures contracts, together with the aggregate value of holdings of physical commodities and commodity based investments may not exceed 20% of the total net asset value of the scheme.

*Notes: (1) "physical commodities" includes gold, silver, platinum or other bullion.*

- (2) *"commodity based investments" does not include shares in companies engaged in producing, processing or trading in commodities.*

*Investment in Other Schemes*

- 7.11 The value of a scheme's holding of units or shares in other collective investment schemes may not in aggregate exceed 10% of its total net asset value. In addition, such scheme's objective may not be to invest primarily in any investment prohibited by this Chapter, and where such scheme's objective is to invest primarily in investments restricted by this Chapter, such holdings may not be in contravention of the relevant limitation.
- 7.12 Notwithstanding 7.11, a scheme may invest all of its assets in a single collective investment scheme and be authorized as a feeder fund. In this case:-
- (a) the underlying scheme must be authorized by the Commission;
  - (b) the offering document must state that:-
    - (i) the scheme is a feeder fund into the underlying scheme;
    - (ii) for the purpose of complying with the investment restrictions, the scheme and its underlying fund will be deemed a single entity;
    - (iii) the scheme's annual report must include the investment portfolio of the underlying fund as at the financial year end date; and
    - (iv) the aggregate amount of all the fees and charges of the scheme and its underlying fund must be clearly disclosed.
  - (c) the borrowing of the feeder fund may not exceed 10% of its total net asset value and should be restricted to facilitating redemptions or defraying operating expenses.
- 7.13 No increase in the overall total of initial charges, management company's annual fee, or any other costs and charges payable to the management company or any of its connected persons borne by the holders or by the scheme may result, if the schemes in which a scheme invests are managed by the same management company or by a connected person of that company.

*Prohibition on Real Estate Investments*

- 7.14 A scheme may not invest in any type of real estate (including buildings) or interests in real estate (including options or rights, but excluding shares in real estate companies and interests in real estate investment trusts (REITs) that are listed on a stock exchange).

*Note: In the case of investments in such shares and listed REITs, they shall comply with the investment limits as set out in Chapters 7.1 and 7.2.*

*Short Selling Limitations*

- 7.15 No short sale may be made which will result in the scheme's liability to deliver securities exceeding 10% of its total net asset value.
- 7.16 The security which is to be sold short must be actively traded on a market where short selling activity is permitted [see Note to 7.3].

*Limitations on Making Loans*

- 7.17 A scheme may not lend, assume, guarantee, endorse or otherwise become directly or contingently liable for or in connection with any obligation or indebtedness of any person without the prior written consent of the trustee/custodian.

*Unlimited Liability*

- 7.18 A scheme may not acquire any asset which involves the assumption of any liability which is unlimited.

*Limitations on Securities in which Directors/Officers have Interests*

- 7.19 A scheme may not invest in any security of any class in any company or body if any director or officer of the management company individually owns more than 0.5% of the total nominal amount of all the issued securities of that class, or, collectively the directors and officers of the management company own more than 5% of those securities.

*Limitations on Nil-Paid/Partly Paid Securities*

- 7.20 The portfolio of a scheme may not include any security where a call is to be made for any sum unpaid on that security unless that call could be met in full out of cash or near cash by the scheme's portfolio, the amount of which has not already been taken into account for the purposes of 7.8.

*Limitations on Borrowing*

- 7.21 The maximum borrowing of a scheme may not exceed 25% of its total net asset value (except for a capital markets scheme which may not exceed 10%). For the purposes of this section of the Code, back-to-back loans do not count as borrowing.

*Applicability of Restrictions to Umbrella Funds*

- 7.22 The provisions of this Chapter apply to each sub-fund of the umbrella fund as if each sub-fund were a single scheme, except for 7.2, where the total collective investment by the sub-funds in any ordinary shares issued by any single issuer may not exceed 10%.

*Breach of Investment Limits*

- 7.23 If the investment limits in Chapter 7 and 8 are breached, the management company should take as a priority objective all steps as are necessary within a reasonable period of time to remedy the situation, taking due account of the interests of the holders.

*Name of Scheme*

- 7.24 If the name of the scheme indicates a particular objective, geographic region or market, the scheme should invest at least 70% of its non-cash assets in securities and other investments to reflect the particular objective or geographic region or market which the scheme represents.

## Chapter 8: Specialized Schemes

*This chapter sets out the guidelines for various types of specialized schemes. A specialized scheme means any scheme whose primary objective is not investment in equities and/or bonds, any scheme falling under the categories in this Chapter, or which otherwise does not meet the requirements of Chapter 7.*

*In addition to the specialized schemes mentioned in this Chapter, application may be made for other specialized schemes pursuant to this Chapter. Each such scheme will be considered by the Commission on a case-by-case basis, pending the issue, if appropriate, of further guidelines.*

### 8.1 Unit Portfolio Management Funds

- (a) A scheme that invests all of its assets in other collective investment schemes may be authorized as a unit portfolio management fund (UPMF). A UPMF may hold cash for ancillary purposes and enter into financial futures contracts for hedging purposes.

#### *Investment and Borrowing Limitations*

- (b) Subject to 8.1(a), a UPMF may only invest in units/shares of schemes authorized by the Commission or in recognized jurisdiction schemes (whether authorized or not) , except that not more than 10% of the UPMF's total net asset value may be invested in non-recognized jurisdiction schemes not authorized by the Commission.
- (c) Notwithstanding 8.1(b), no investment may be made in any scheme whose objective is to invest primarily in any investment prohibited by Chapter 7 of this Code. In the case of investments limited by Chapter 7, such holdings may not be in contravention of the relevant limitation.
- (d) A UPMF, except with the approval of the Commission, must invest in at least five schemes, and not more than 30% of its total net asset value may be invested in any one scheme.
- (e) A UPMF may not invest in another UPMF.
- (f) A UPMF may borrow up to 10% of its total net asset value but only on a temporary basis for the purpose for meeting redemption requests or defraying operating expenses.
- (g) A UPMF may not invest more than 10% of its total net asset value in warrant, leveraged, and futures and options funds unless its primary objective is to invest in warrant, leveraged, or futures and options funds, in which case the provisions applicable to such specialized funds in this Chapter will be extended to such UPMF, as appropriate.

### *Limitation on Charges*

- (h) Where a UPMF invests in schemes managed by the same management company or its connected persons, all initial charges on the underlying schemes must be waived.
- (i) The management company of a UPMF may not obtain a rebate on any fees or charges levied by an underlying scheme or its management company.

## **8.2 Money Market/Cash Management Funds**

- (a) A money market/cash management fund means a collective investment scheme, the sole objective of which is to invest in short-term deposits and debt securities.

### *Offering Document*

- (b) The offering document must clearly highlight that the purchase of a unit/share in a scheme is not the same as placing funds on deposit with a bank or deposit-taking company, that the management company has no obligation to redeem units/shares at the offer value and that the scheme is not subject to the supervision of the Hong Kong Monetary Authority.

### *Name of Scheme*

- (c) The scheme's name must not appear to draw a parallel between the scheme and the placement of cash on deposit.

### *Filing Requirement*

- (d) The scheme must file with the Commission within seven days from the last working day of each month details of the total funds subscribed to the scheme that month, and details of the total funds under management at the end of that month.

### *Investment Limitations*

- (e) Subject to the provisions below, a scheme may only invest in deposits and debt securities.
- (f) A scheme must maintain an average portfolio maturity not exceeding 90 days and must not purchase an instrument with a remaining maturity of more than one year, or two years in the case of Government and other public securities [see 7.5 Notes 1 & 2].
- (g) The aggregate value of a scheme's holding of instruments and deposits issued by a single issuer may not exceed 10% of the total net asset value of the scheme except:-



- (i) where the issuer is a substantial financial institution and the total amount does not exceed 10% of the issuer's issued capital and published reserves, the limit may be increased to 25%; or
- (ii) in the case of Government and other public securities, up to 30% may be invested in the same issue; or
- (iii) in respect of any deposit of less than US\$ 1,000,000 or its equivalent in the base currency of the scheme, where a scheme cannot otherwise diversify as a result of its size.

*Limitations on Borrowing*

- (h) The scheme may borrow up to 10% of its total net asset value but only on a temporary basis for the purpose of meeting redemption requests or defraying operating expenses.

### **8.3 Warrant Funds**

*The following criteria apply to collective investment schemes, the principal objective of which is investment in warrants.*

- (a) The core requirements in Chapter 7 will apply except for 7.2, 7.3, 7.6(b), 7.10, and 7.21.
- (b) The value of a scheme's holding of warrants issued by any single issuer may not exceed 10% of its total net asset value.

The following additional provisions will apply:-

*Investment Limitations*

- (c) Not less than 90% of warrants held by the scheme must carry the right to acquire securities listed on a market [see Note to 7.3].
- (d) Investment in forward currency contracts and financial futures contracts is permissible for hedging purposes only.
- (e) Investment in physical commodities, including bullion, options on commodities and commodity based investments is prohibited [see Note(2) to 7.10].

*Limitations on Borrowing*

- (f) The scheme may borrow up to 10% of its total net asset value but only on a temporary basis for the purpose of meeting redemption requests or defraying operating expenses.

*Offering Document*

- (g) The offering document must explain the nature of warrants as an investment and contain a detailed description of the risks inherent in investment in warrants.
- (h) The offering document and any advertising material must contain the following warning:-

"Prices of warrants may fall just as fast as they may rise, therefore this scheme carries a significant risk of loss of capital. It is suitable only for those investors who can afford the risk involved."

*Name of Scheme*

- (i) The word "Warrant" must appear in the name of the scheme.

**8.4 Leveraged Funds**

*The following general criteria apply to leveraged funds. However, applicants for authorization of leveraged funds should note that additional criteria, including the maximum permitted leverage, will apply depending on the nature of the scheme, and would be advised to consult the Commission to discuss the specific principles applicable to a particular case.*

- (a) A scheme that utilises a borrowing capacity or other form of leverage greater than that permitted in Chapter 7 of this Code may, subject to this Chapter, be authorized as a leveraged fund.

*Limited Liability*

- (b) The liability of holders must be limited to their investment in the scheme.

*Specialist Expertise*

- (c) The management company (and, if applicable, the investment adviser) must satisfy the Commission that it is appropriately qualified in the type of leveraged investment of the scheme for which authorization is sought.

*Certification by Trustee/Custodian*

- (d) The trustee/custodian must certify to the Commission that suitable control procedures are in place for monitoring the maximum leverage of the scheme and any other conditions imposed by the Commission.

*Disclosure*

- (e) The offering document must carry a detailed explanation of the type of leverage to be utilised by the scheme and the risks inherent in such leverage.
- (f) The offering document and any advertising material must contain a warning statement appropriate to the degree of risk inherent in the scheme.
- (g) The word "leveraged" must appear in the name of the scheme.

**8.4A Futures and Options Funds**

*The following criteria apply to collective investment schemes, the principal objective of which is investment in future contracts (including commodities and financial futures) and/or in options.*

*Investment Restrictions*

- (a) The scheme may only enter into futures and options contracts dealt with on a futures, commodities or options exchange or any over-the-counter derivative approved by the trustee/custodian.
- (b) At least 30% of the net asset value of the scheme must be held on deposit or invested in liquid short term debt instruments and may not be used for margin requirements. Not more than 70% of the net asset value of the scheme may be committed as margin for futures or options contracts, and/or premium paid for options purchased (including put and/or call options).
- (c) The scheme may not invest in commodity contracts other than commodity futures contracts. However, the scheme may acquire precious metals which are negotiable on an organized market.
- (d) Premiums paid to acquire options outstanding with identical characteristics may not exceed 5% of the net asset value of the scheme.
- (e) The scheme may not hold open contract positions in any futures contract month or option series for which the combined margin requirement represents 5% or more of the net asset value of the scheme.
- (f) The scheme may not hold open positions in futures or options contracts concerning a single commodity or a single underlying financial instrument for which the combined margin requirement represents 20% or more of the net asset value of the scheme.

#### *Limitations on Borrowing*

- (g) The scheme may borrow up to 10% of its total net asset value but only on a temporary basis for the purpose of meeting redemption requests or defraying operating expenses.

#### *Limited Liability*

- (h) The liability of holders must be limited to their investment in the scheme.

#### *Specialist Expertise*

- (i) The applicant management company (and, if applicable, the investment adviser) must satisfy the Commission that it has specific experience in the field of futures and options. In determining the acceptability of the management company, the Commission may also consider the qualifications and experience of persons employed by the management company or the investment adviser. An applicant must provide details of the performance of all futures funds under its management or the management of the employees responsible for the applicant scheme for the preceding five years.

#### *Certification by Trustee/Custodian*

- (j) The trustee/custodian must certify to the Commission that suitable control procedures are in place for monitoring the investment restrictions of the scheme. The trustee/custodian must demonstrate that they have the relevant experience in this respect.

#### *Disclosure*

- (k) The offering document must:-
  - (i) provide a detailed explanation of the type(s) of futures contracts (and, if appropriate, options) that the scheme will invest in, the risks inherent in such investment and the trading strategy to be adopted;
  - (ii) disclose in one place all management, advisory and brokerage fees payable by the scheme; and
  - (iii) clearly disclose the nature and size of transaction costs that are expected to be incurred by the scheme and the implications of expected greater number of transactions on the amount of these costs.
- (l) The offering document and any advertising material must contain a warning statement appropriate to the degree of risk inherent in the

scheme. The warning statement must be prominently displayed on the front cover of the offering document.

- (m) The words "leveraged", "futures" and/or "options" must appear in the name of the scheme.
- (n) The annual financial statements of the scheme must disclose the total transaction costs incurred.
- (o) Any advertisement must contain a statement that investors should refer to the risk factors set out in the offering document of the scheme.

#### *Acknowledgement*

- (p) The application form must, in a prominent place, contain an acknowledgement to be signed by the investor at the time of subscription confirming that he has read the offering document of the scheme and is fully aware of the nature of the scheme and the risks associated with it.

## **8.5 Guaranteed Funds**

*The following criteria apply to collective investment schemes which contain a structure whereby a guaranteed amount will be paid to investors who hold units/shares in the scheme at a specified date in the future.*

- (a) The core requirements in Chapter 7 and relevant provisions in Chapter 8 should apply to the scheme where appropriate, depending on the nature and the underlying investments of the scheme.

#### *Guarantor*

- (b) The guarantor must be:
  - (i) a licensed banking institution authorized under the Banking Ordinance; or
  - (ii) an authorized insurer authorized under the Insurance Companies Ordinance.

*Note: The Commission may consider other substantial financial institutions to act as guarantor on a case-by-case basis. The Commission must be satisfied that the institution is, on an on-going basis, subject to regulatory supervision and of acceptable financial standing.*

*Disclosure in the offering document*

Apart from the standard disclosure requirements in Appendix C, the offering document of the scheme must contain: -

- (c) Information about the guarantor
  - (i) its name;
  - (ii) nature of its business; and
  - (iii) information on its financial position, including paid-up share capital, total net assets or shareholders' funds, and where applicable, credit rating and any other relevant information.

- (d) Information about the guarantee
  - (i) the terms of the guarantee, including the scope and validity of the guarantee and the circumstances under which the guarantee may be terminated;

*Note: The deed of guarantee must form part of the offering document.*

- (ii) an illustration or description to clearly demonstrate the guarantee mechanism and how potential returns in excess of the guaranteed amount are calculated;

*Notes: (1) Where an indicative participation rate is shown, the illustration should use the quoted indicative rate as the basis for calculation.*

*(2) Assumptions used in the illustration should be clearly stated. It should be stated that the rates of return shown are for illustrative purpose only and that the actual return may be different.*

- (e) A detailed description of the nature of the underlying investments, including:
  - (i) the proposed percentage, or an estimate thereof, of the scheme to be invested in fixed-interest securities and that in other investments at the time of publication of the offering document;
  - (ii) the issuers/counter-parties of the underlying investments, or the criteria for the selection of such parties;
  - (iii) the valuation methodology of the underlying investments;

- (iv) the liquidation mechanism of the underlying investments to meet redemption requests; and
- (v) where relevant, the participation rate or an estimate thereof at the time of publication of the offering document. It should be stated that the actual participation rate may be different from the indicative rate. An analysis of the factors that will impact on the final determination of such rate should also be given.

*Note: Where applicable, it should be stated when the actual participation rate will be determined and how such information will be communicated to investors.*

(f) Risk warnings

These should include, but not limited to:

- (i) a statement to the effect that due to the guarantee structure, there will be a dilution of performance;
- (ii) a statement to the effect that potential returns in excess of the guaranteed amount are subject to investment risk and are not guaranteed;
- (iii) a statement to the effect that the scheme is subject to the credit risk of the guarantor and the issuers of the underlying investments;
- (iv) a statement to the effect that the scheme is subject to the liquidity risk of the underlying investments;
- (v) risks, if any, associated with conflicts of interest that may arise amongst different operating parties;
- (vi) a warning statement that the scope or validity of the guarantee may be affected under certain circumstances including, where relevant, the condition that the guarantee only applies to investors who hold their investments until the date specified in the guarantee and that dealings before such date are fully exposed to fluctuations in the value of the scheme's assets; and
- (vii) where applicable, the mechanism of any up-front charging fee structure and the cost implications to investors.

*Jurisdiction*

- (g) Nothing in the deed of guarantee may exclude the jurisdiction of the courts of Hong Kong to entertain an action concerning the scheme or the guarantee.

### *Name of scheme*

- (h) The name of the scheme should accurately reflect the nature of the guarantee.

### *Reporting Requirement*

- (i) The management company of the scheme should report to the Commission as soon as practicable if it becomes aware of any events which may affect the guarantee or undermine the ability of the guarantor to act as such.

*Note: Where the guarantor of a scheme is neither a licensed banking institution nor an authorized insurer as described in 8.5(b)(i) and (b)(ii) respectively, the manager of the scheme must notify the Commission on an annual basis the regulatory status of the guarantor.*

### *Advertisements*

- (j) Any advertisement or marketing material must contain the following:
  - (i) the name of the guarantor;
  - (ii) where relevant, a statement that certain fees are charged up-front and the aggregate amount thereof;
  - (iii) where an indicative participation rate is quoted, the date of reference should be stated and there should be a warning that the actual participation rate may be different from the indicative rate;
  - (iv) the statement in 8.5(f)(vi) above; and
  - (v) a statement directing investors to read the offering document for further details of the guarantee.

## **8.6 Index Funds**

*The following criteria apply to index funds.*

### *General*

- (a) An index fund is a collective investment scheme, the principal objective of which is to track, replicate or correspond to an index on equities, debts or other securities, with an aim of providing or achieving investment results or returns that closely match or correspond to the performance of the index.



- (b) An index fund may seek to track an index by investing all or substantially all of its assets in the constituent securities of the underlying index, broadly in proportion to the respective weightings of the securities. Where the scheme invests in a representative sample of constituent securities of the index, this should closely reflect the overall characteristics of the index.

*Note: The use of sampling where certain securities in the portfolio are not the constituent securities of the index is acceptable if the portfolio matches the characteristics of the index and this method is necessary for the reduction of tracking error.*

- (c) In achieving its investment objective, the scheme may invest in other appropriate investment instruments, such as derivatives permitted under the Code or otherwise accepted by the Commission, in accordance with the scheme's disclosed investment strategies and restrictions.
- (d) In general, the Commission will consider authorizing an index fund only if the underlying index is acceptable to the Commission. Such acceptance does not imply official approval or endorsement of the index. The Commission reserves the right to withdraw the authorization if the index is no longer considered acceptable.

*Note: The management company should immediately consult the Commission if for any reasons the index might likely cease or has ceased to be acceptable. The management company should as a priority objective propose remedial actions or alternatives that are acceptable to the Commission.*

#### *Acceptable Indices*

- (e) The acceptability of an index will be assessed on the following criteria:
- (i) The index should have a clearly defined objective and/or the market or sector it aims to represent should be clear.

*Note: The Commission must be satisfied that the index appropriately reflects the characteristics of the market or sector. The index should be able to reflect the price movements in its underlying constituents and change the composition and weightings of these constituents to reflect changes in the underlying market or sector. The Commission may, where relevant, request information on the market capitalisation of the constituent securities in relation to the total value of the market or sector that an index purports to represent.*

- (ii) The index should in general be broadly based.

*Note: An index with a single constituent security weighing more than 40% or with its top five constituent securities weighing more than 75% would generally be considered too concentrated. Exceptions may be made on a case by case basis, particularly where the constituent securities are Government or other public securities.*

- (iii) The index should be investible.

*Note: The Commission expects that the constituent securities should be sufficiently liquid (taking into account their respective weightings and trading volume), and may be readily acquired or disposed of under normal market circumstances and in the absence of trading restrictions.*

- (iv) The index should be transparent and published in an appropriate manner.

*Note: The latest index level and other important news should be either published in Hong Kong daily newspapers or conveniently accessible by investors (for example, by enquiring of the Hong Kong Representative or through relevant websites). The Commission may also consider whether the index is easily accessible through market data vendors.*

- (v) The index provider is expected to possess the necessary expertise and technical resources to construct, maintain and review the methodology/rules of the index. The methodology/rules should be well documented, consistent and transparent.

*Note: The Commission may request the submission of the methodology/rules of the index.*

#### *Reporting Requirements*

- (f) The Commission should be consulted on any events that may affect the acceptability of the index. Significant events relating to the index should be notified to the holders as soon as practicable. These may include a change in the methodology/rules for compiling or calculating the index, or a change in the objective or characteristics of the index.

#### *Investment Restrictions*

- (g) The core requirements in Chapter 7 will apply with the following exceptions (h) and (i).

- (h) Notwithstanding Chapter 7.1, more than 10% of the net asset value of an index fund may be invested in constituent securities issued by a single issuer provided that:
  - (i) it is limited to any constituent securities that each accounts for more than 10% of the weighting of the index; and
  - (ii) the scheme's holding of any such constituent securities may not exceed their respective weightings in the index, except where weightings are exceeded as a result of changes in the composition of the index and the excess is only transitional and temporary in nature.

*Note: A waiver of (h)(ii) may be granted on a case-by-case basis, after considering factors including whether the waiver is necessary for the scheme to achieve its objective to track the index.*

- (i) Subject to (h) above, the 30% limit in Chapter 7.4 may be exceeded. Furthermore, subject to (h) above, an index fund may invest all of its assets in Government and other public securities in any number of different issues despite Chapter 7.5.

#### *Disclosure*

- (j) In addition to the requirements under Appendix C, the offering document of an index fund must make the following disclosure and warnings:-
  - (i) a description of the market or sector the index aims to represent;
  - (ii) the characteristics and general composition of the index and, where applicable, concentration in any economic sectors and/or issuers;
  - (iii) the weightings of the top 10 largest constituent securities of the index as of a date within a month of the date of the offering document;
  - (iv) where necessary, a statement to the effect that the investment of the scheme may be concentrated in the securities of a single issuer or several issuers;
  - (v) a warning of lack of discretion to adapt to market changes due to the inherent investment nature of index funds and that falls in the index are expected to result in corresponding falls in the value of the scheme;
  - (vi) a statement to the effect that there is no guarantee or assurance of exact or identical replication at any time of the performance of the index;

- (vii) circumstances that may lead to tracking errors and the related risks, and strategies employed in minimising such errors;
- (viii) a brief description of the index methodology/rules and/or the means by which investors may obtain such information (for example, by providing the website address of the index provider);
- (ix) the means by which investors may obtain the latest index information and other important news of the index;
- (x) a warning that index composition may change and securities may be delisted;
- (xi) any circumstances that may affect the accuracy and completeness in the calculation of the index;
- (xii) a warning in relation to any licensing conditions (including indemnity given to the index provider, if any) for using the index, and the contingency plan in the event of cessation of the availability of the index;
- (xiii) a statement on whether the index provider and the management company of the scheme (or its connected persons) are independent of each other. If not, the means by which possible conflicts of interests may be addressed;
- (xiv) the Commission reserves the right to withdraw the authorization of the scheme if the index is no longer considered acceptable; and
- (xv) any other information which is relevant and material for investors to make an informed investment decision.

*Replacement of the Underlying Index*

- (k) Following the authorization of the scheme, a replacement of the underlying index may only be made in accordance with the provisions of its constitutive document and with the prior approval of the Commission.

*Note: A replacement of the underlying index may be necessary under circumstances including where the index is no longer available or considered acceptable.*

*Financial Statements*

- (l) The interim and annual financial statements of the scheme must disclose a list of those constituent securities, if any, that each accounts for more than 10% of the weighting of the index as at the end of the

relevant period and their respective weightings. The statements must also provide a comparison of the scheme performance and the actual index performance over the relevant period.

### **Name of Scheme**

- (m) The name of the scheme must reflect the nature of an index fund.

*Note: The words “index”, “tracking” and/or “tracker” are expected to appear in the name of the scheme.*

## **8.7 Hedge Funds**

### *Foreword*

*The following criteria apply to collective investment schemes that are commonly known as hedge funds (or alternative investment funds or absolute return funds). Hedge funds are generally regarded as non-traditional funds that possess different characteristics and utilize different investment strategies from traditional funds. In considering an application for authorization, the Commission will, among other things, consider the following:*

- (i) the choice of asset class; and*
- (ii) the use of alternative investment strategies such as long/short exposures, leverage, and/or hedging and arbitrage techniques.*

*Due to the wide array of schemes that may fall under this category, the Commission will exercise its discretion in imposing additional conditions to each scheme on a case-by-case basis as appropriate.*

*Where a scheme invests all its non-cash assets in other hedge funds, it may be authorized as a fund of hedge funds (FoHFs).*

*Where a scheme has a capital guarantee feature, it may be authorized as a capital guaranteed hedge fund. In this case, provisions of Chapters 8.5 and 8.7 may apply to the scheme where relevant, depending on the nature of the scheme.*

*Unless otherwise specified, the provisions in other Chapters of the Code shall apply. Where the provisions refer to the scheme, this means the applicant scheme.*

### *The Management Company*

- (a) The management company of a scheme must satisfy the requirements set out in Chapter 5 unless otherwise specified in this Chapter. For the avoidance of doubt, the Commission will consider, among others, the

following factors when assessing the acceptability of the management company:

- (i) The management company must have the requisite competence, expertise and appropriate risk management and internal controls systems. It must also be adequately and suitably staffed in order to properly manage the risks and operational issues in connection with its hedge funds business;
- (ii) the experience of the key investment personnel of the management company and those of the investment adviser (where the latter has been delegated the investment management function) in managing hedge funds;

*Note: The key personnel of the management company of either a single hedge fund<sup>1</sup> or a FoHFs must be dedicated full-time staff with a demonstrable track record in the management of hedge funds.*

*The Commission will take into account various factors in assessing the acceptability of the key personnel for a scheme. These factors may vary from a single hedge fund to a FoHFs having regard to the different strategies and operational differences of these funds.*

*There must be at least two key personnel in the management company each having at least five years' relevant experience. The management company must demonstrate that out of these five years' relevant experience, the two key personnel must each have at least two years' specific experience:*

- (a) *In the case of a single hedge fund manager, the Commission will normally consider it acceptable if each of the two key personnel has at least two years' specific investment management experience in the same strategy as that of the scheme.*
- (b) *In the case of a FoHFs manager, the Commission will normally consider it acceptable if each of the two key personnel has at least two years' specific investment management experience as a FoHFs manager.*

*A key personnel may satisfy this five years' relevant experience by a combination of both of his specific experience mentioned above and general experience relating to hedge funds. With respect to general*

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<sup>1</sup> "Single hedge fund" in the context of Chapter 8.7 means hedge funds that are not in the form of FoHFs.

*experience, the Commission will normally consider the following types of experience acceptable:*

- (1) proprietary trading experience in securities, derivatives or other investment instruments which are of a similar nature to those contemplated by the scheme; or*
- (2) carrying out investment strategies in the context of investment management or securities dealing business in similar nature to the one contemplated for the scheme; or*
- (3) prior experience in evaluating or selecting hedge funds for investment purposes.*

*However, general experience acquired through academic research, sales or marketing or back-office administration of hedge funds is unlikely to be considered acceptable for meeting the requirement in Chapter 8.7(a).*

*For the avoidance of doubt, to the extent that Chapter 5.5(a) requires the key personnel to possess specific public funds experience, this requirement may be satisfied if the management company on a firm-wide basis is able to demonstrate that it possesses the requisite experience and resources to administer public funds.*

*The Commission may require independent substantiation of the management experience and track record of the key personnel, the management company and the group companies (where appropriate).*

*The experience requirement of the investment personnel of the underlying funds of a FoHFs is set out in the “Fund of Hedge Funds” section below.*

- (iii) amount of assets under management;*

*Note: The Commission would generally expect at least US\$100 million for the total amount of assets under management that follow hedge fund strategies. While assets under management may include proprietary funds, the Commission will generally look for experience in managing third-party funds.*

- (iv) the risk management profile and internal control systems of the management company; and*

*Note: The management company must have in place suitable internal controls and risk management systems*

*commensurate with the company's business and risk profile, including a clear risk management policy and written control procedures.*

*It must continuously deploy such necessary resources and be vigilant to ensure that all the relevant risks in connection with the management of the scheme are properly monitored and controlled in accordance with the investment strategy of the scheme.*

*The management company must demonstrate that those representatives and agents (including for example, administrators, custodian, brokers, valuation agents) appointed by it possess sufficient know-how and experience in dealing with hedge funds.*

*In the case of the management of a FoHFs, the management company must:*

- (a) have in place a due diligence process for the selection of the underlying funds and on-going monitoring of their activities;*
- (b) demonstrate its ability to assess and monitor the performance of the managers of the underlying funds, and the ability to replace the underlying funds whenever necessary to protect the interests of holders; and*
- (c) submit a plan to explain its due diligence and on-going monitoring processes (containing, among others, the frequency of reporting and evaluation of the underlying funds, and measures adopted by the management company to ensure investment and operational risks of the underlying funds are analysed and controlled) and include a summary of the plan in the offering document of the scheme.*

*The management company must ensure that its risk management process is able to deal with normal and exceptional circumstances including extreme market conditions.*

*The management company must take all reasonable care in the selection of its distribution agents engaged in the selling of hedge funds and provide all necessary information and training to these agents for the purpose of selling the scheme.*

- (v) the investment management operations of the scheme must be based in a jurisdiction with an inspection regime acceptable to the Commission.*



*Note: Whilst reference would be made to the list of acceptable inspection regimes set out in Appendix A2, it is noted that the regulation of offshore hedge funds vs. onshore funds may be different in some jurisdictions. The acceptability of an inspection regime for a scheme may need to be considered on a case-by-case basis.*

*Prime Broker*

- (b) Where a scheme appoints a prime broker, the following shall apply:
- (i) the prime broker must be a substantial financial institution subject to prudential regulatory supervision;
  - (ii) where assets of the scheme are charged to the prime broker for financing purpose, such assets must not, at any time, exceed the level of the scheme's indebtedness to the prime broker;

*Note: Where assets of the scheme may be used as collateral or security for financing to be provided by the prime broker, disclosure must be made in the offering document of the risks associated with the collateralisation, for example, foreclosure or re-hypothecation of these assets by the prime broker and any consequential impact to the scheme and its investors.*

- (iii) the assets charged to the prime broker must remain in a segregated custody account, in the name or held to the order of the trustee/custodian; and
- (iv) the scheme's offering document must disclose the profile of the prime broker and its relationship with the scheme.

*Note: Before a prime broker is appointed by the scheme, the scheme or the management company (as the case may be) must conduct due diligence on the prime broker and be reasonably satisfied with the prime broker's suitability and competence.*

*Apart from disclosing the profile of the prime broker, the offering document must disclose the role(s) of the prime broker in relation to the hedge fund, whether the prime broker is subject to any regulatory supervision, and if so, a brief description of its licensing status in the relevant jurisdiction. Where appropriate, disclosure of the risks relating to any conflicts of interest between the prime broker and the scheme has to be made in the offering document.*

### *Minimum Subscription*

- (c) The minimum level of initial subscription by each investor in a scheme must not be less than US\$50,000\*, except for FoHFs, where the minimum initial subscription must not be less than US\$10,000\*. No minimum subscription level will apply to a scheme which provides at least 100% capital guarantee.

*(\*) or the currency equivalent*

### *Limited Liability*

- (d) The liability of holders must be limited to their investment in the scheme and this must be clearly stated in the offering document.
- (e) Where the scheme is a sub-fund of an umbrella fund, the scheme will be required to demonstrate to the Commission that there are legally enforceable provisions to ring-fence the scheme assets from the liabilities of other sub-funds. A brief description of such ring-fencing arrangement must be made in the offering document.

*Note: The Commission may require an independent legal opinion or regulatory confirmation regarding the enforceability of the ring-fencing provisions.*

### *Investment and Borrowing Restrictions*

- (f) The scheme must have a set of clearly defined investment and borrowing parameters in its constitutive and offering documents. The offering document must clearly explain the types of financial instruments in which the scheme will invest; the extent of diversification or concentration of investments or strategies; the extent and basis of leverage (including the maximum level of leverage); and the related risk implications of the investment and borrowing parameters.
- (g) The core requirements in Chapter 7 will not apply except for 7.12, 7.13, 7.14, 7.17, 7.18, 7.22 and 7.23.

### *Name of Scheme*

- (h) If the name of the scheme indicates a particular objective, geographic region or market, the scheme must utilize at least 70% of its non-cash assets for the purposes of pursuing the objective or geographic region or market.

### *Performance Fees*

- (i) If a performance fee is levied, the scheme must comply with Chapter 6.17. Full and clear disclosure of the calculation methodology must be set out in its offering document.

Chapter 6.17 does not apply to the underlying funds of a FoHFs. For FoHFs, the offering document of the scheme must disclose whether a performance fee is levied at both the scheme level and the underlying funds level. It must also summarize the bases of how performance fees are calculated and paid by the underlying funds. Appropriate warnings must be made in the offering document about the possibility of charging performance fees at various levels within a FoHFs and the implications to investors.

*Note: The Commission notes that various methodologies may be used for the charging and accrual of performance fees based on the basic principle in Chapter 6.17.*

*The Commission may require illustrative examples to be given in the offering document to demonstrate the charging method where it considers appropriate.*

*Where a scheme intends to achieve equalisation for the calculation of performance fees, its offering document must disclose the mechanisms adopted to achieve equalisation.*

*Where the scheme does not intend to achieve equalisation of performance fees, its offering document must clearly disclose this fact and how the absence of equalisation may affect the amount of performance fees to be borne by investors.*

#### *Fund of Hedge Funds*

*The following provisions apply to FoHFs in lieu of the provisions of Chapter 8.1.*

- (j) The FoHFs must comply with the following:
  - (i) a FoHFs must invest in at least five underlying funds, and not more than 30% of its total net asset value may be invested in any one underlying fund; and

*Note: One of the underlying assumptions of a FoHFs is that it can achieve diversification through investing in a range of funds that employ different investment strategies and/or utilise the skills of different fund managers.*

*Any scheme applying for authorisation as a FoHFs should clearly explain its diversification strategy in the offering document.*

*A FoHFs authorised pursuant to the Code is expected to achieve investment return through the performance of its underlying funds rather than direct investments in securities, futures, options, derivatives, currency or*

*other investments through proprietary trading or “managed accounts”. It is therefore generally not acceptable for a FoHF to carry out proprietary trading directly or through the use of “managed accounts”.*

- (ii) a FoHFs may not invest in another FoHFs.
- (k) The management company of the FoHFs must ensure that:
- (i) each of the key personnel of the management company of an underlying fund possesses at least two years’ experience in the relevant hedge fund investment strategy, provided however that up to 10% of the net asset value of the FoHFs may comprise of underlying funds managed by investment personnel with less experience;
  - (ii) there is an independent trustee/custodian to safe keep the assets of the underlying funds;
  - (iii) where a FoHFs invests in underlying funds managed by the same management company or its connected persons, all initial charges on such underlying funds are waived;
  - (iv) neither the management company of the FoHFs nor its connected persons retain a rebate (whether in cash or in kind) on any fees or charges levied by such underlying funds, their management company or any of their connected persons;
  - (v) the offering document of the FoHFs clearly discloses the aggregate amount or give an indicative range of all the fees and charges of the FoHFs and each of its underlying funds; and
  - (vi) where the FoHFs invests in hedge funds not authorized by the SFC, such fact is disclosed in the offering document of the FoHFs. A warning must be included to the effect that some or all of the underlying funds of the FoHFs and their fund managers are not subject to the regulation of the Commission and that such funds may not be subject to rules similar to those of the Commission that are designed to protect investors.

#### *Dealing*

- (l) There must be at least one regular dealing day per month.
- (m) The maximum interval between the lodgement of a properly documented redemption request for redemption of units/shares (whether a notice period is required or not) and the payment of redemption money to the holder may not exceed 90 calendar days.

*Note: A scheme may only effect redemption in specie with the prior consent of individual redeeming holder. The offering document must disclose the possibility of redemption in specie and the need to obtain prior consent from an individual holder for making such redemption.*

*A scheme may not effect compulsory redemption except where the management company is reasonably satisfied that it is in the overall benefit of the scheme to do so. Examples where the management may effect compulsory redemption include the circumstances where the continuous holding of the scheme's interest by a particular holder will cause the scheme to be in breach of any laws or regulations governing the scheme, or result in adverse financial consequences to the scheme such as tax penalties.*

*Subject to the foregoing, the offering document must disclose the circumstances under which compulsory redemption may be effected and the length of notice for such redemption.*

- (n) The offering document of the scheme must include a warning to the effect that the redemption price may be affected by the fluctuations in value of the underlying investments during the period between the lodgement of the redemption request and the date when the redemption price is calculated.

#### *Valuation*

- (o) The investments of the scheme must be independently and fairly valued on a regular basis. Where appropriate, generally accepted accounting principles and industry's best practices should be applied on a consistent basis.

*Note: It is incumbent upon the management company to demonstrate that the scheme's investments will be independently and fairly valued.*

*In considering whether the management company is able to demonstrate that a scheme's investments are independently valued, the Commission may take into account a number of factors including the following:*

- a) *The duties and functions of the party carrying out the valuation (the "valuation agent") is expected to be segregated from those of the party carrying out the investment management function for the scheme e.g. the appointment of an independent administrator. Disclosure of how the segregation is achieved must be made in the offering document;*
- b) *There should be checks and balances to ensure that the valuation process and policy is consistently followed;*

- c) *The pricing data should be gathered from reliable sources;*
- d) *Where necessary, safeguarding measures should be implemented for the valuation to be carried out independently; and*
- e) *The selection of the valuation agent by the management company is based on due process.*

*Disclosure must be made of (1) the selection criteria of the valuation agent and the relationship between the management company, its group of companies and the valuation agent; and (2) any limitations and constraints of the valuation policies and methodologies.*

*The above factors are not exhaustive and the Commission may take into account other relevant factors in assessing the compliance with the independence requirement.*

- (p) Full particulars of the valuation frequency, the valuation methods of the scheme's investments, the identity and qualifications of the valuation agent(s), the experience of the valuation agent(s) in evaluating hedge fund assets and the relationship of the agent(s) with the scheme's management company or its group of companies and, where applicable, with the prime broker must be disclosed in the offering document.
- (q) The offering document of the scheme must include a warning to the effect that some of the underlying investments of the scheme may not be actively traded and there may be uncertainties involved in the valuation of such investments. Potential investors must be warned that under such circumstances, the net asset value of the scheme may be adversely affected.

*Disclosure*

- (r) The front cover of the offering document must display prominently the following warning statements:
  - (i) the scheme uses alternative investment strategies and the risks inherent in the scheme are not typically encountered in traditional funds;
  - (ii) the scheme undertakes special risks which may lead to substantial or total loss of investment and is not suitable for investors who cannot afford to take on such risks;
  - (iii) investors are advised to consider their own financial circumstances and the suitability of the scheme as part of their investment portfolio; and

- (iv) investors are advised to read this offering document and should obtain professional advice before subscribing to the scheme.

*Note: The text of the warning statements may be varied but the message must be clear and not disguised.*

- (s) For the purpose of Chapter 6.1, the offering document must disclose all relevant matters relating to the investment operations and risk management aspects of the scheme and give lucid explanations of the investment strategy of the scheme and the risks inherent in the scheme.

*Note: For example, explanations should be given on the nature of the scheme; the markets covered; the instruments used; the risk and reward characteristics of the strategy; the circumstances under which the scheme would work best and the circumstances hostile to the performance of the scheme; the risk management and internal control mechanism, including the setting of investment and borrowing parameters to control the risks; the terms of the offering; the on-going monitoring of the scheme's investment and asset allocation process and the performance of the scheme; the on-going monitoring of the standards of the services provided by key service providers, for example, prime brokers and administrators and the replacement process of these service providers and the responsibilities of each of the relevant parties.*

*The offering document should be written in plain language. The Commission specifically encourages the use of a glossary to explain technical terms.*

*Details of unauthorized funds must not be shown in the offering document. Where names of such funds are mentioned, these must be clearly marked as unauthorized and not available to Hong Kong residents.*

- (t) The management company must disclose the measures and safeguards put in place for the management of conflicts of interest in relation to the operation of the scheme.
- (u) All advertisements must prominently display the warning statements referred to in 8.7(r) above.

#### *Application Form*

- (v) All application forms of the scheme must state prominently that the scheme is a hedge fund and there are special risks involved with investment in the scheme, and direct investors to read the offering document.

*Financial Reports*

- (w) The management company must issue regular reports to holders on the scheme activities at least on a quarterly basis. Reports must be prepared and distributed in accordance with the Guidelines on Hedge Funds Reporting Requirements [see Appendix H].



## **Chapter 9: Additional Requirements For Non-Hong Kong Based Schemes**

### **Appointment of Representative**

- 9.1 A scheme will be required to appoint a Representative in Hong Kong if its management company is not incorporated and does not have a place of business in Hong Kong.
- 9.2 If a Representative is appointed, the scheme has to maintain the Representative throughout the period it is authorised in Hong Kong.

### **Functions of a Representative**

- 9.3 The Representative is not required to take responsibility for the acts and omissions of the management company or, in the case of the scheme being a company, the directors of the scheme. It must, however, be authorized on behalf of the scheme and the management company to:-
- (a) receive applications and money for units/shares from persons in Hong Kong;
  - (b) issue receipts in respect of the application moneys received in accordance with (a);
  - (c) issue contract notes to the applicants in accordance with the terms of the scheme;
  - (d) receive redemption notices, transfer instructions and conversion notices from holders for immediate transmission to the management company or the scheme;
  - (e) accept any notices or correspondence, including service of process, which holders may wish to serve on the scheme, trustee/custodian or the management company;
  - (f) notify the Commission immediately if redemption of units/shares ceases, or is suspended;
  - (g) make available for public inspection in Hong Kong, free of charge, and offer for sale at a reasonable price copies of all constitutive documents of the scheme;
  - (h) provide holders with information on the scheme including the scheme's financial reports and sales literature;
  - (i) deliver to the Commission, if it requests, all accounts and records relating to the sale and redemption of units/shares of the scheme in Hong Kong; and

- (j) represent the scheme and the management company in relation to all matters in which any holder normally resident in Hong Kong has a pecuniary interest or which relate to units/shares sold in Hong Kong.

### **Criteria for Appointment**

- 9.4 Where the functions (including the distribution function) of the Representative amount to dealing in securities, the Representative must:-
  - (a) be licensed or registered to carry on Type 1 regulated activity under the Ordinance; or
  - (b) appoint another entity that satisfies (a) of this paragraph.
- 9.5 If an entity is appointed pursuant to 9.4(b), the Representative should be a branch or subsidiary of the management group.
- 9.6 The Representative must be properly appointed to represent the scheme and the management company.

### **Written Undertaking**

- 9.7 The Representative must provide the Commission with a written undertaking that it will perform the duties required of a Representative under this Code.

### **Retirement and Replacement of the Representative**

- 9.8 Should the Representative retire or be dismissed, it must be replaced as soon as possible, by another Representative whose appointment is subject to the approval of the Commission.

### **Hong Kong Representative Agreement**

- 9.9 Details of all contracts between the Representative, the scheme and/or the management company must be supplied to the Commission. Any subsequent amendments of these contracts must be notified to the Commission.

### **Jurisdiction**

- 9.10 Nothing in the constitutive documents may exclude the jurisdiction of the courts of Hong Kong to entertain an action concerning the scheme.

## **PART III: POST-AUTHORIZATION REQUIREMENTS**

### **Chapter 10: Operational Matters**

#### **Valuation and Pricing**

- 10.1 A scheme must be valued and priced in accordance with the provisions of its offering and constitutive documents and the provisions of Chapter 6.

#### **Pricing Errors**

- 10.2 If an error is made in the pricing of units/shares, the error should be corrected as soon as possible and any necessary action should be taken to avoid further error. If the error results in an incorrect price of 0.5% or more of scheme's net asset value per unit/share, the trustee/custodian and the Commission must be informed immediately. In such a case, investors should be compensated as follows, unless determined otherwise by the trustee/custodian with justification to the Commission:-

- (a) where total loss to individual investors (either purchasing or redeeming) is more than HK\$100 or such lesser amount as the management company may decide, investors should be compensated in such manner as the management company should determine with the approval of the trustee/custodian; and
- (b) where the loss is to the management company, no compensation should be paid.

#### **Changes to Dealing**

- 10.3 Where a scheme deals at a known price, and based on information available, the price exceeds or falls short of the current value of the underlying assets by more than 5%, the management company should defer dealing and calculate a new price as soon as possible.
- 10.4 A permanent change in the method of dealing may only be made after one month's notice to holders.
- 10.5 A temporary change may only be made:-
- (a) in exceptional circumstances, having regard to the interests of holders;
  - (b) if the possibility of a change and the circumstances in which it can be made have been fully disclosed in the offering document; and
  - (c) with the approval of the trustee/custodian.

## **Suspension and Deferral of Dealings**

- 10.6 Suspension of dealings may be provided for only in exceptional circumstances, having regard to the interests of holders.
- 10.7 The management company or the Representative must immediately notify the SFC if dealing in units/shares ceases or is suspended. The fact that dealing is suspended must be published immediately following such decision and at least once a month during the period of suspension, in the newspaper(s) in which the scheme's prices are normally published.
- 10.8 Where redemption requests on any one dealing day exceed 10% of the total number of units/shares in issue, redemption requests in excess of 10% may be deferred to the next dealing day.

## **Transactions with Connected Persons**

- 10.9 No person may be allowed to enter on behalf of the scheme into underwriting or sub-underwriting contracts without the prior consent of the trustee/custodian and unless the scheme or the management company provides in writing that all commissions and fees payable to the management company under such contracts, and all investments acquired pursuant to such contracts, will form part of the scheme's assets.
- 10.10 If cash forming part of the scheme's assets is deposited with the trustee/custodian, the management company, the investment adviser or with any connected person of these companies (being an institution licensed to accept deposits), interest must be received on the deposit at a rate not lower than the prevailing commercial rate for a deposit of that size and term.
- 10.11 All transactions carried out by or on behalf of the scheme must be at arm's length. In particular, any transactions between the scheme and the management company, investment adviser, the directors of the scheme or any of their connected persons as principal may only be made with the prior written consent of the trustee/custodian. All such transactions must be disclosed in the scheme's annual report.
- 10.12 Neither the management company nor any of its connected persons may retain cash or other rebates from a broker or dealer in consideration of directing transactions in scheme property to the broker or dealer save that goods and services (soft dollars) may be retained if:-
  - (a) the goods or services are of demonstrable benefit to the holders;
  - (b) transaction execution is consistent with best execution standards and brokerage rates are not in excess of customary institutional full-service brokerage rates;

- (c) adequate prior disclosure is made in the scheme's offering document the terms of which the holder has consented to [see C15 of Appendix C]; and
- (d) periodic disclosure is made in the scheme's annual report in the form of a statement describing the manager's soft dollar practices, including a description of the goods and services received by the manager.

*Note: Goods and services falling within (a) above may include: research and advisory services; economic and political analysis; portfolio analysis, including valuation and performance measurement; market analysis, data and quotation services; computer hardware and software incidental to the above goods and services; clearing and custodian services and investment-related publications. Such goods and services may not include travel, accommodation, entertainment, general administrative goods or services, general office equipment or premises, membership fees, employee salaries, or direct money payments.*

10.13 Brokers or dealers connected to the management company, investment adviser, directors of the scheme or any of their connected persons may not in aggregate account for more than 50% of the scheme's transactions in value in any one financial year of the scheme. The Commission may consider each case on its merits and may permit the 50% to be exceeded if the connected broker or dealer offers advantages to the scheme not available elsewhere.

## Chapter 11: Documentation and Reporting

### Scheme Changes

- 11.1 The proposed changes to a scheme in respect of the following must be submitted to the Commission for prior approval:
- (a) changes to constitutive documents;
  - (b) changes of key operators (including the trustee / custodian, management company and its delegates and Hong Kong representative) and their regulatory status and controlling shareholder;
  - (c) changes in investment objectives, policies and restrictions (including the purpose or extent of use of derivatives), fee structure and dealing and pricing arrangements; and
  - (d) any other changes that may materially prejudice holders' rights or interests.
- 11.1A For changes to a scheme that require the Commission's prior approval pursuant to 11.1, the Commission will determine whether holders should be notified and the period of notice (if any) that should be applied before the changes are to take effect. The revised Hong Kong Offering Document as a result of such changes should be submitted to the Commission for prior authorization.
- Notes:*
- (1) *Normally, the Commission will expect that one month's prior written notice (or such longer period as required under applicable laws and regulations or the provisions as set out in the offering or constitutive documents) should be provided to holders in respect of the changes. However, the Commission may permit a shorter period of notice if the change is not significant or may require a longer period of notice (up to three months) in exceptional circumstances. [see also 6.7]*
  - (2) *For the purposes of 11.1A, significant changes would include, for example, changes in investment objectives or major investment policies, and fee structure.*
  - (3) *For any increase in fees and charges from the current level as stated in the Hong Kong Offering Document up to the maximum level permitted by the constitutive documents, prior approval from the Commission is not required, but no less than one month's prior notice must be given to holders.*
- 11.1B For changes to a scheme that do not require the Commission's prior approval pursuant to 11.1, unless there is a specified minimum prior notice period in this Code, the management company should inform holders as soon as reasonably practicable of any information concerning the scheme which is

necessary to enable holders to appraise the position of the scheme. The Hong Kong Offering Document may be updated to incorporate such changes and reissued without further authorization provided that the content and format of such document remains fundamentally the same as the version previously authorized. The revised Hong Kong Offering Document must be filed with the Commission, together with a marked-up version against the previously filed version, within two weeks from the date of issuance.

## **Notices to Holders**

- 11.2 Notification to holders must be made in the language(s) in which the scheme is offered to investors in respect of any changes or proposed changes to the offering or constitutive documents as determined by the Commission pursuant to 11.1A.

*Note: In the case of schemes domiciled outside Hong Kong, notwithstanding the notice provisions of a scheme's home jurisdiction, the Commission may require additional notice to ensure that Hong Kong investors have sufficient time to consider and respond to the documentation. For example, any general meeting at which a special resolution is to be proposed shall be convened on at least 21 days' prior notice and that any general meeting at which an ordinary resolution is to be proposed shall be convened on at least 14 days' prior notice.*

- 11.2A Subject to 11.4 and 11.5 below, notices to holders need not be approved by the Commission prior to issuance, but are required to be filed with the Commission within two weeks from the date of issuance of the notice. The Commission, however, retains its power to require issuers to submit draft notices for review where the Commission considers it appropriate. For the avoidance of doubt, matters relating to 11.1 should be approved by the Commission prior to the distribution of the relevant notices to holders.

- 11.2B The management company has the responsibility to ensure that notices to holders are not misleading and contain accurate and adequate information to keep investors informed. All notices should contain a Hong Kong contact number for investors to make enquiries.

*Note: Notices should not include any reference to a specific date or timetable in respect of the changes made to the offering or constitutive documents where such date or timetable has not been agreed in advance with the Commission.*

- 11.3 (Repealed)

## **Withdrawal of Authorization**

- 11.4 Following the authorization of a scheme, its management company should, subject to 11.5 below, give at least three months' notice to holders of any intention not to maintain such authorization. Such notice should be submitted to the Commission for prior approval and contain the reasons for the withdrawal of authorization, consequences of the withdrawal, any proposed changes in the operation of the scheme and their effects on existing investors, the alternatives available to investors (including, if possible, a right to switch without charge into another authorized scheme) and, where applicable, an estimate of any relevant expenses and who is expected to bear them.

## **Merger or Termination**

- 11.5 If a scheme is to be merged or terminated, in addition to following any procedures set out in the scheme's constitutive documents or governing law, notice must be given to investors as determined by the Commission. Such notice should be submitted to the Commission for prior approval and contain the reasons for the merger or termination, the relevant provisions under the constitutive documents that enable such merger or termination, the consequences of the merger or termination and their effects on existing investors, the alternatives available to investors (including, if possible, a right to switch without charge into another authorized scheme), the estimated costs of the merger or termination and who is expected to bear them.

## **Reporting Requirements**

### *Reporting to Holders*

- 11.6 At least two reports must be published in respect of each financial year. Annual reports and accounts containing the information provided in Appendix E must be published and distributed to holders within four months of the end of the scheme's financial year and interim reports must be published and distributed to holders within two months of the end of the period they cover.
- 11.7 The scheme's latest available offer and redemption prices or net asset value must be published at least once a month in at least one leading Hong Kong English language and one Chinese language daily newspaper. However, if a waiver has been given by the Commission under 6.2, publication need only be made in the language approved for that scheme. If dealing is suspended, this must be published in accordance with 10.7.



### *Reporting to Commission*

- 11.8 Subsequent to the authorization of the scheme, all financial reports produced by or for the scheme, its management company and trustee/custodian must be filed with the Commission within the time frame specified in 11.6.
- 11.9 The management company or the Representative must supply to the Commission, upon request, all information relevant to the scheme's financial reports and accounts.
- 11.10 The management company or the Representative should notify the Commission as soon as possible of any change to the data in the application form.

### **Advertising Materials**

- 11.11 Advertisements and other invitations to invest in a scheme, including but not limited to those issued by licensed or registered persons acting as the distributors of the scheme, must comply with the Advertising Guidelines. All advertisements must be submitted to the Commission for authorization prior to their issue or publication in Hong Kong, unless exempted under section 103 of the Ordinance. For the avoidance of doubt, even if an advertisement is exempted from obtaining authorization from the Commission under the Ordinance, the issuer must still ensure that the advertisement or invitation complies with the Advertising Guidelines.
- 11.12 Where authorization by the Commission is required, it is recommended that the issuer of advertisements nominate one person, such as the Approved Person, the Hong Kong Representative or any other persons acceptable to the Commission, based in Hong Kong to liaise with the Commission. Authorization may be varied or withdrawn by the Commission as it deems fit. Once authorized, the advertisement may be used in any distribution media and reissued without further authorization with updated performance information of schemes and general market commentary provided that the content and format of such advertisement remain fundamentally the same as the version previously authorized and the advertisement, when reissued, is in compliance with the Advertising Guidelines.

*Note: For radio, television, cinema or other time-limiting advertisements / broadcasts that require authorization by the Commission, the script of any verbal statements in such advertisements should be submitted for the Commission's advance clearance, followed by the demo of the broadcast (e.g. digital files) for formal authorization.*

- 11.13 Issuers must keep adequate records of the advertisements issued, either in actual form or by way of a copy of the final proof, and the relevant supporting documents for substantiation of information presented thereon. Such records must be retained for at least 3 years from the latest date of publication /

distribution of an advertisement and made available to the Commission upon request.

### **Mention of SFC Authorization**

- 11.14 Where a scheme is described as having been authorized by the Commission it must be stated that authorization does not imply official recommendation.

## Appendix A1

### Recognized Jurisdiction Schemes

Applications for recognized jurisdiction schemes will generally be reviewed on the basis that the scheme's structural and operational requirements and core investment restrictions (except where noted) already comply in substance with this Code. However, exemptions are not given for approval of management companies or trustees, specialized schemes [see Chapter 8], Hong Kong-specific disclosure and reporting requirements, and post- authorization requirements as set out in this Code.

Applicants should note that the SFC expects recognized jurisdiction schemes to comply in all material respects with this Code and reserves the right to require such compliance as a condition of authorization. Jurisdictions are recognized on the SFC's understanding that the types of scheme referred to are governed by laws and regulations which are comparable to this Code or offer equivalent investor protection. However, laws and regulations, and this Code, are subject to amendment from time to time, and discrepancies may emerge which require the SFC to seek further assurance about compliance with specific provisions.<sup>1</sup>

While the SFC makes every effort to streamline procedures for recognized jurisdiction schemes, it must be understood that authorization in Hong Kong carries additional obligations as set out in this Code and applicants should familiarise themselves with these.

<b>Jurisdiction</b>	<b>Applicable Law</b>	<b>Scheme Type</b>
France	Law of 23 December 1988	General collective investment schemes in securities (OPCVM)
Germany	Investment Companies Act of 1970	Securities mutual funds (UCITS)
Guernsey	Protection of Investors Law, 1987	Class A1 Section 8 schemes
Ireland	European Communities (UCITS) Regulations 1989	Unit Trusts & Investment companies
Isle of Man	Financial Supervision Act 1988	Section 3 authorized collective investment schemes
Jersey	Collective Investment Funds (Recognized Funds) (General Provisions) Order, 1988	Article 5 Recognized schemes
Luxembourg	Law of 30 March 1988 on collective investment undertakings	Part I schemes
United Kingdom	Financial Services Act 1986	Section 78 schemes
United States of America	Investment Company Act	Registered investment companies <sup>2</sup> .

<sup>1</sup> Some of the laws and regulations of the jurisdictions listed in this appendix have been amended and are currently being reviewed by the Commission.

<sup>2</sup> Applicants for U.S. funds should note that while waivers are generally given from compliance with structural requirements such as the requirement for a supervisory custodian, compliance with investment restrictions and other operational requirements as set out in this Code is expected. Applicants should seek guidance from SFC staff regarding precedent waivers.

## Appendix A2

### Inspection Regimes

The following jurisdictions for investment management firms are regarded as subject to an acceptable inspection regime for the purposes of 5.1 of this Code. Applicants should note that **this list is not exhaustive** and does not imply that other jurisdictions are necessarily unacceptable. As a general guide, the Commission looks to the following matters in determining the acceptability of an overseas supervisory authority:-

- (a) the overseas regulatory authority or its delegate carries out inspections of investment management firms within its jurisdiction in a manner generally consistent with the SFC; and
- (b) the SFC and the overseas regulatory authority have satisfactory procedures for the timely exchange of information regarding investment management firms.

Jurisdiction	Regulatory Authority	Notes
Australia	Australian Securities and Investments Commission (ASIC)	The Fund Manager has to hold either an Australian Financial Services license authorizing it to operate a registered managed investment scheme (MIS), or a dealer's license from ASIC authorizing the fund manager to operate registered MIS of the kind of financial assets. <sup>1</sup>
France	Commission des Operations de Bourse (COB)	Authorized asset management firms
Germany	Bundesanstalt fur Finanzdienstleistungsaufsicht (BAFin) (German Financial Supervisory Authority)	Authorized credit institutions for investment fund business

<sup>1</sup> The licence should be free of any conditions or constraints that are not generally applied by ASIC on licensees authorizing a fund manager to operate MIS. In addition, ASIC licensed fund managers should meet the following specific conditions:

- a) the fund manager must be managing the registered MIS immediately before it applies to the SFC for recognition under the Code, and shall remain as such during the life of any SFC authorized fund that is managed by the fund manager; and
- b) the fund manager has to supply to the SFC a compliance plan and any related supplements for the proposed SFC authorized fund and its related fund management activities. The compliance plan should follow the requirements as set out by the Australian Corporations Act 2001 with respect to MIS.

Ireland	Central Bank of Ireland (CBI)	Subject to additional procedures as agreed with the CBI
Hong Kong	Securities and Futures Commission	Persons licensed with the Commission for carrying on regulated activities, including asset management
Luxembourg	The Commission de Surveillance de Secteur Financier (CSSF)	Subject to additional audit review as agreed with the CSSF and advised to the SFC
United Kingdom	Financial Services Authority (FSA)	Persons registered with the FSA for carrying out regulated activities including management of, advising on, or establishing collective investment schemes
United States of America	Securities and Exchange Commission	Registered investment advisers

## Appendix B

### Application Form

	<b>Details of the Scheme</b>	<b>Notes</b>
<b>B1</b>	Name of the scheme	<i>If umbrella fund, include names of all sub funds applying for authorisation</i>
<b>B2</b>	Structure of the scheme	<i>Unit trust/mutual fund/other (specify)</i>
<b>B3</b>	Domicile of scheme	<i>State applicable laws</i>
<b>B4</b>	Recognized jurisdiction scheme?	<i>Y/N [see Appendix A1]</i>
<b>B5</b>	Date of creation of scheme	<i>Specify for each sub fund</i>
<b>B6</b>	Launch date and place	<i>Specify for each sub fund</i>
<b>B7</b>	Quotation on any stock exchange?	<i>Y/N (state name of stock exchanges)</i>
<b>B8</b>	Scheme Type	<i>Bond/Equity/Specialized (state applicable Chapter 8 guideline)/Other</i>
<b>B9</b>	Investment objective(s)	<i>Specify for each sub fund</i>
<b>B10</b>	Currency of denomination	<i>Specify for each sub fund</i>
<b>B11</b>	Fund size	<i>Specify for each sub fund</i>
<b>B12</b>	Level of all charges payable by investor	
<b>B13</b>	Level/basis of calculation of all charges payable by the scheme	<i>State current and maximum levels of charges, if applicable</i>
<b>B14</b>	Performance fees charged?	<i>Y/N [see 6.17]</i>
<b>B15</b>	Valuation and dealing frequency	<i>Daily/Weekly/Other</i>
<b>B16</b>	Pricing method	<i>Forward/Historic/Other</i>
<b>B17</b>	Financial year end date of scheme	<i>For new schemes, the first annual report date. If feeder fund, year end dates for both feeder fund and underlying fund</i>
<b>B18</b>	Minimum initial subscription and minimum subsequent holding	<i>Specify for each sub fund</i>

<b>B19</b>	List of scheme documents	<i>Constitutive documents and date executed</i>
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### Details of Parties to the Scheme

<b>B20</b>	Name, registered/business address, name of ultimate holding company of the following parties: - management company - trustee/custodian - investment adviser (if any) - Hong Kong representative/ distribution company (if any) - principal broker (if any)	<i>See Chapter 5 See Chapter 4 (Where the trustee/custodian has not been previously approved by the Commission, the most recent audited financial report)</i>
<b>B21</b>	For the trustee/custodian, management company and investment adviser:- (a) which, if any, of these companies are connected persons (b) name anyone who holds appointments, as director or officer, with more than one of these companies	<i>See Chapter 3.5</i>
<b>B22</b>	For the management company, trustee/custodian, Hong Kong representative:- - Person(s) for contact with SFC	<i>Specify person(s) for contact in relation to:  - compliance matters  - administrative matters (eg. SFC fee collection)</i>
<b>B23</b>	Place where the investment management activities of the scheme(s) are being carried out and by which party	<i>Specify for each sub fund, if different</i>
<b>B24</b>	For the entities which carry out the investment management functions:- (a) names and registration status with the SFC or other regulatory authority (b) inspection regime to which they are subject	<i>Specify for each sub fund, if different See Appendix A2</i>
<b>B25</b>	Place where books and records of scheme are kept	

<b>B26</b>	Name, registered/business address of the following parties: - The auditor of the scheme - The solicitors in Hong Kong (if any)	
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**Waiver Requests** (if applicable)

<b>B27</b>	Provide submission of detailed arguments under separate cover	<i>Arguments should be specific to the circumstances of the case, and any alternative safeguarding arrangements should be presented.</i>
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**Additional Information Required from New Management Groups**

<b>B28</b>	The most recent audited financial report and semi-annual report (if more recent) of the management company	
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**B29** Management group profile Complete the following:

**I. Organisation**

1. Brief corporate history/ownership
2. Management & organisational structure (include organisation chart)

**II. Global Investment Management Activity**

3. Assets under management (Global/Hong Kong)
4. Types of assets under management/Client base (Global/Hong Kong)
5. List of public authorized funds (where authorized/domiciled)

**III. Hong Kong Investment Management Activity (if applicable)**

6. No. of fund managers/description of size of fund management operation/research - in house/third party?
7. Investment approach (main asset classes/markets/use of derivatives)
8. Administration (where/how are administrative arrangements carried out)



#### **IV. Compliance Arrangements**

9. Summary of compliance arrangements, including (if applicable) procedures for compliance with Fund Manager Code of Conduct
10. Connected transactions:
  - (a) Percentage of business placed with connected brokers?
  - (b) Any connected corporate finance house? Please specify.
  - (c) Any deposits placed with connected bank? Please specify.

## Appendix C

### Information to be Disclosed in the Offering Document

This list is not intended to be exhaustive. The directors of the scheme or the management company are obliged to disclose any information which may be necessary for investors to make an informed judgement.

#### *Constitution of the Scheme*

- C1** Name, registered address and place and date of creation of the scheme, with an indication of its duration if limited.

#### *Investment Objectives and Restrictions*

- C2** Details of investment objectives and policy, including a summary of investment and borrowing restrictions. If the nature of the investment policy so dictates, a warning that investment in the scheme is subject to abnormal risks, and a description of the risks involved.

#### *Operators and Principals*

- C3** The names and registered addresses of the following parties (where applicable):-
- (a) the directors of the scheme/management company and its board of directors;
  - (b) the trustee/custodian;
  - (c) the investment adviser;
  - (d) the Hong Kong Representative;
  - (e) the Hong Kong distribution company, if different from (d) above;
  - (f) the auditors;
  - (g) the registrar.

#### *Characteristics of Units/Shares*

- C4** Minimum investment and subsequent holding (if any).
- C5** A description of the different types of units/shares, including their currency of denomination.
- C6** Form of certification.
- C7** Frequency of valuation and dealing, including dealing days.

#### *Application and Redemption Procedures*

- C8** Names of the Hong Kong daily newspapers in which prices will be published [see 11.7].

- C9** Procedure for subscribing/redeeming units/shares, and in the case of umbrella funds, conversion of units/shares.
- C10** The maximum interval between the request for redemption and the despatch of the redemption proceeds [see 6.14 and D9 (b)].
- C11** A summary of the circumstances in which dealing in units/shares may be deferred or suspended.
- C12** Statement that no money should be paid to any intermediary in Hong Kong who is not licensed or registered to carry on Type 1 regulated activity under Part V of the Securities and Futures Ordinance.

#### *Distribution Policy*

- C13** The distribution policy and the approximate dates on which dividends (if any) will be paid (if applicable).

#### *Fees and Charges*

- C14**
- (a) the level of all fees and charges payable by an investor [see 6.16 to 6.18], including all charges levied on subscription, redemption and conversion (in the case of umbrella funds);
  - (b) the level of all fees and charges payable by the scheme, including management fees, custodian fees and start-up expenses; and
  - (c) the notice period for fee increases [see 11.1A].

*Note: In the case of indeterminable fees and charges, the basis of calculation or the estimated ranges should be disclosed.*

- C15** Where a connected person of the management company or the investment adviser receives goods or services from a broker or dealer [see 10.12], a summary of the terms under which such goods or services are received. In addition, a nil statement regarding retention of cash rebates by any of these persons.

#### *Taxation*

- C16** Details of Hong Kong and principal taxes levied on the scheme's income and capital, including tax, if any, deducted on distribution to holders.

#### *Reports and Accounts*

- C17** The date of the scheme's financial year.
- C18** Particulars of what reports will be sent to registered holders and when [see 11.6]. If there are bearer units in issue, information must be given on where in Hong Kong reports can be obtained.

### *Warnings*

- C19** Statements/warnings must be prominently displayed in the offering document as follows:-
- (a) "Important - if you are in any doubt about the contents of this offering document, you should seek independent professional financial advice".
  - (b) other warnings as required by the Code .

### *General Information*

- C20** A list of constitutive documents and an address in Hong Kong where they can be inspected free of charge or purchased at a reasonable price.
- C21** The date of publication of the offering document.
- C22** A statement that the directors of the scheme or the management company accept responsibility for the information contained in the offering document as being accurate at the date of publication.
- C23** Details of unauthorized schemes must not be shown in the offering document. Where names of such schemes are mentioned, these must be clearly marked as unauthorized and not available to Hong Kong residents.

### *Termination of Scheme*

- C24** A summary of the circumstances in which the scheme can be terminated.

## Appendix D

### Contents of the Constitutive Documents

**D1** Name of Scheme

**D2** Participating Parties

A statement to specify the participating parties including the management company, the representative, trustee/custodian, and investment adviser (if any).

**D3** Governing Law

**D4** For Unit Trusts only:-

- (a) A statement that the deed is binding on each holder as if he had been a party to it and so to be bound by its provisions and authorizes and requires the trustee and the management company to do as required of them by the terms of the deed.
- (b) A provision that a holder is not liable to make any further payment after he had paid the purchase price of his units and that no further liability can be imposed on him in respect of the units which he holds.
- (c) A declaration that the property of the scheme is held by the trustee on trust for the holders of the units *pari passu* according to the number of units held by each holder. (This may be modified as appropriate for schemes offering income and accumulation units).
- (d) A statement that the trustee will report to holders in accordance with 4.5(f).
- (e) A statement that the trustee should retire in the manner as stipulated in 4.6.

**D5** For Mutual Fund Corporations only:-

- (a) A declaration that the property of the scheme is held by the custodian on trust for the scheme.
- (b) A statement to list the obligations of the custodian as set out in 4.5.
- (c) A statement that the custodian should retire in the manner as set out in 4.6.

**D6** Management Company

- (a) A statement to list the obligations of the management company as set out in 5.10.

- (b) A statement that the management company should retire as set out in 5.11.

**D7 Investment and Borrowing Restrictions**

A statement to list the restrictions on the investment of the deposited property and the maximum borrowing limit of the scheme. [see Chapter 7 and Chapter 8 (for specialized funds)]

**D8 Valuation of Property and Pricing**

The following rules on valuation of property and pricing must be stipulated –

- (a) the method of determining the value of the assets and liabilities of the property of the scheme and the net asset value accordingly;
- (b) the method of calculating the issue and redemption prices; and
- (c) the method of pricing and the circumstances under which it can change.

**D9 Suspension and Deferral of Dealing**

The following must be stated:-

- (a) the circumstances under which the dealing of units/shares can be deferred or suspended; and
- (b) the maximum interval between the receipt of a properly documented request for redemption of units/shares and the payment of the redemption money to the holder, which may not exceed one calendar month.

**D10 Fees & Charges**

The following must be stated:-

- (a) the maximum percentage of the initial charge payable to the management company out of the issue price of a unit/share;
- (b) the maximum fee payable to the management company out of the property of the scheme, expressed as an annual percentage;
- (c) fee payable to trustee/custodian;
- (d) preliminary expenses to be amortized against the property of the scheme; and
- (e) all other material fees and charges payable out of the property of the scheme.

**D11 Meetings**

Provisions on the manner in which meetings are conducted in accordance with 6.15.

**D12 Transactions with Connected Persons**

The following must be stated:-

- (a) cash forming part of the property of the scheme may be placed as deposits with the trustee/custodian, management company, the investment adviser or with any connected persons of these companies (being an institution licensed to accept deposits) so long as that institution pays interest thereon at no lower rate than is, in accordance with normal banking practice, the commercial rate for deposits of the size of the deposit in question negotiated at arm's length;
- (b) money can be borrowed from the trustee/custodian, management company, the investment adviser or any of their connected persons (being a bank) so long as that bank charges interest at no higher rate, and any fee for arranging or terminating the loan is of no greater amount than is in accordance with normal banking practice, the commercial rate for a loan of the size and nature of the loan in question negotiated at arm's length;
- (c) any transactions between the scheme and the management company, the investment adviser, directors of the scheme or any of their connected persons as principal may only be made with the prior written consent of the trustee/custodian; and
- (d) all transactions carried out by or on behalf of the scheme must be at arm's length and executed on the best available terms. Transactions with persons connected to the management company, investment adviser or directors of the scheme may not account for more than 50% of the scheme's transactions in value in any one financial year of the scheme.

**D13 Distribution Policy and Date**

Distribution policy and approximate date when income will be distributed (if applicable).

**D14 Annual Accounting Period**

Calendar year date on which the annual accounting period ends. In the case of an umbrella fund, the accounting period should be the same for all constituent funds.

**D15 Base Currency**

A statement of the base currency of the scheme.

**D16** Modification of the Constitutive Documents

A statement of the means by which modifications to the constitutive documents can be effected [see 6.7].

**D17** Termination of Scheme

A statement of the circumstances in which the scheme can be terminated.



## **Appendix E**

### **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 unauthorized schemes in the reports must be indicated as "Not authorized 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.

*Notes: (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.

## **Appendix F**

(Deleted)

## **Appendix G**

### **Guidelines for Review of Internal Controls and Systems of Trustees / Custodians**

#### **INTRODUCTION**

1. Pursuant to 4.1 of this Code, trustees/custodians of collective investment schemes are required to be approved by the SFC. An acceptable trustee/custodian should either:
  - (a) on an ongoing basis, be subject to regulatory supervision; or
  - (b) appoint an independent auditor to periodically review its internal controls and systems on terms of reference agreed with the SFC and should file such report with the SFC.
2. As a general guide, in determining the acceptability of an overseas supervisory authority, the SFC will have to be satisfied that either the overseas regulatory authority or its delegate carries out regular inspection of trustees/custodians within its jurisdiction or the latter is subject to regular review in a manner generally consistent with the SFC requirement. In the latter case, the auditor's report should be filed with the SFC.

#### **PURPOSE OF GUIDELINES**

3. These Guidelines provide further guidance to trustees and custodians of scheme regarding compliance with the periodic internal control review requirement of the Code. These Guidelines set out the minimum best practice for trustees/custodians and auditors of scheme in order to facilitate the agreement of the scope of an internal control review on terms which will be acceptable to the SFC. These Guidelines have been developed in consultation with the Hong Kong Trustees Association and the Hong Kong Society of Accountants.
4. For the purpose of these Guidelines, the term “auditors” refers to the independent reporting accountants who are engaged in reporting on the internal controls of the trustee/custodian of scheme.



## SCOPE OF REVIEW

5. The internal control review should involve all material procedural and control elements relevant and necessary to the responsibilities of trustees/custodians in relation to scheme. The review should be conducted in accordance with generally acceptable international auditing practices<sup>2</sup>.
6. The engagement letter between the trustee/custodian and the auditor should incorporate or refer to the following Terms of Reference which sets out, as a minimum, the scope of review for compliance with the requirements of the Code. The trustee/custodian may engage the auditor to expand the scope of the review, and it is important that this is agreed with the auditor before the commencement of the review.
7. Where the trustee/custodian or an associated company carries on part of its responsibilities outside Hong Kong in a jurisdiction in which the SFC considers that there is inadequate regulatory supervision or review (as described in paragraph 2), then the scope of the review should include those functions undertaken outside Hong Kong in a way which satisfies the auditor issuing the report. Notwithstanding that an offshore company may be appointed trustee/custodian, if the trustee/custodian confirms that all relevant functions are carried out by it or its delegates in Hong Kong, the scope of the review can be so limited.

## TERMS OF REFERENCE

8. The precise terms of the review engagement will be as agreed between the trustee/custodian and the auditor in each particular case. Terms of Reference for the review should be incorporated in the review engagement letter and should, as a minimum, include the following:

### **A. REPORT BY THE MANAGEMENT OF THE TRUSTEE/CUSTODIAN**

The management of the trustee/custodian must issue a report to describe the control objectives. As a minimum, control objectives should include the following:

- Maintenance of a control environment
- Compliance with applicable legal and regulatory requirements
- Compliance with control policies and procedures
- Safekeeping of assets against loss

The controls designed to meet the above objectives may vary from firm to firm. The SFC does not mandate specific controls to meet the control objectives. It is the responsibility of the management of the

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<sup>2</sup> For example: *Practice Note 860.2* issued by the Hong Kong Society of Accountants; or *Technical Release AUDIT 4/97* issued by the Institute of Chartered Accountants in England and Wales (ICAEW) in the UK.

trustee/custodian to design suitable controls and ensure that these are effective and properly implemented for the purpose of achieving the control objectives so identified.

In addition, the report should describe the internal control policies and procedures designed for achieving the control objectives.

## **B. OBJECTIVE OF THE REVIEW ENGAGEMENT**

The objective of the engagement is to review the control objectives and procedures as described in the report issued by the trustee/custodian and to report on the findings of the review to the management of the trustee/custodian.

## **C. REPORT BY THE AUDITOR**

The auditor should issue a report, addressed to the management of the trustee/custodian, detailing the scope of the review work carried out relating to the report by management and the conclusions reached. The report should state, as a minimum:

- (i) a summary of the terms of engagement (or attach a copy of the letter of engagement);
- (ii) the respective responsibilities of the management of the trustee/custodian and the auditor;
- (iii) the basis of the auditor's opinion (detailing the scope of work); and
- (iv) the auditor's opinion.

## **D. AUDITOR'S OPINION**

As a minimum requirement, the auditor's opinion should state:

- (i) whether the accompanying report by the management of the trustee/custodian describes fairly the control procedures in place during the period under review; and
- (ii) whether the specific control procedures tested (with details described) operated as described during the period under review.

Where applicable, the auditor should state the limitations to the tests performed and whether such limitations have any material impact on the auditor's opinion.

## **PERIOD UNDER REVIEW**

- 9. The period under review should be for a period of at least twelve months and should coincide with the financial year of the trustee/custodian unless otherwise agreed with the SFC.

## **FILING OF REPORTS WITH THE SFC**

10. The management of the trustee/custodian should file a copy of the auditor's report and the trustee/custodian report (as described in paragraph 8) with the SFC within four months from the end of the period under review. Where applicable, management response to the auditor's report should also be attached. The reports should be sent to:

Investment Products Department  
Securities & Futures Commission  
8/F Floor, Chater House  
8 Connaught Road Central  
Hong Kong

## **FREQUENCY OF REVIEW**

11. The review of internal controls and systems of trustees/custodians of scheme should be conducted on an annual basis. The SFC reserves the right to demand more frequent review of a trustee or custodian should this be deemed necessary.

## Appendix H

### Guidelines on Hedge Funds Reporting Requirements

#### Introduction

*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. The Commission advocates additional information to be disclosed if it is deemed to be appropriate and informative to holders, taking into account the objective and strategy of the scheme.*

1. Pursuant to 5.17 and 11.6 of this 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 8.7(v) of this 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:

<u>Nature of reports</u>	<u>No. of reports for each scheme financial year</u>	<u>Timeframe for filing and distribution to holders</u>
Annual report	One	Within four months of the end of the relevant financial year, except for funds 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, except for FoHFs where the timeframe for filing and distribution to holders is within six weeks 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 is specifically encouraged to include a glossary to explain their meaning and their implications to investors. Where financial terms are used in the scheme reports, the management company must provide their calculation bases, definitions, and any underlying assumptions.

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 contain the information as required by Appendix E of the Code, with the exceptions as provided in paragraph 6.
6. 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. 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.*

*With respect to any scheme that is a FoHFs, the management company should disclose:*

- a. *Exposures (including cash and cash equivalent holdings\*) for the scheme at the scheme level as of the reporting date (expressed in percentage terms of net asset value of the scheme) categorized by 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;*
- b. *The names and percentage values (based on net asset value of the scheme) of the top five underlying funds held by the scheme as of the reporting date;*
- c. *The number of underlying funds and the number of underlying fund managers included in the scheme as of the reporting date; and*
- d. *(Where the scheme is a multi-strategy FoHFs) disclosure of the number of underlying funds and underlying fund managers under each hedge fund strategy.*

*With respect to other schemes, the management company should disclose:*

- a. Exposures (including cash and cash equivalent holdings\*) for the scheme as of the reporting date (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;*
- b. The names and amounts of the top five long positions and top five short positions held by the scheme on a gross basis as of the reporting date; and*
- c. The aggregated gross long and short positions held by the scheme as of the reporting date (expressed in percentage terms of the net asset value of the scheme);*

*\* “Cash equivalent holdings” are defined as those assets with a maturity of less than one year and which are readily transactable in an arm’s length transaction between willing and knowledgeable parties.*

## **Requirements Specific to Annual Reports**

7. Where performance fees were borne by the scheme during the financial year, the annual reports of the scheme must contain the amount of such performance fees payable at the scheme level expressed as a percentage of average net asset value of the scheme as at the end of the financial year and the calculation basis.

*Note (1): A nil statement is required if no performance fees were borne by the scheme during the financial year.*

*(2): Where the scheme is a FoHFs, only performance fees at the FoHFs’ level need to be disclosed.*

## **B. Quarterly Reports**

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

8. The Commission requires that quarterly reports be distributed to holders to keep them informed of the scheme activities on a timely basis.
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. In order to facilitate the vetting procedures, upon request from the management company, Commission staff may review and provide comments on the format of the first quarterly report of each scheme before its contents are ready.*

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 must contain the following information regarding the scheme.

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

12. A statement to the effect that the directors of the scheme and/or the management company accept responsibility for the information contained in the quarterly reports as being accurate as at the date of publication.

- (a) Performance review

A commentary by the management company that describes and explains the key factors impacting upon the scheme's financial performance and any style drifts in the scheme 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) at the scheme level and their impact on the scheme's overall strategy, risk profile or future performance.

- (d) Lawsuits

Details of any lawsuits that may have a financial impact on the scheme during the reporting period.

#### ***Portfolio Review***

- (e) 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.

(f) Cash borrowings and other sources of leverage

The amount of cash borrowings and other sources of leverage at the scheme level and a summary of how leverage is calculated 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, consistent with disclosures in the scheme's offering document, taking into account the objective and strategy of the scheme. Where the scheme is a FoHFs, disclosure is only required at the FoHFs' level.*

(g) 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 (e.g. Value at Risk (VaR), Alpha, Sortino ratio, additional Sharpe ratios using alternative risk free rates other than zero, aggregated risk/return statistics, full position disclosure of derivatives and their basis of calculation, time to recovery periods, % of down months, % of up months, delta equivalent of option positions etc.).

The management company must provide the calculation basis, definition and any underlying assumptions of each performance and risk measure either alongside the performance and risk measure or in a separate glossary.

(h) Amount of seed money

Disclosure of the amount of seed money expressed in percentage terms of the net asset value of the scheme contributed by the management company or its connected persons as at the end of the reporting period.

(i) Illiquid holdings

With respect to any scheme that is a FoHFs, the management company must disclose:

- (i) The name(s) of any underlying fund(s) suspended during the reporting period;
- (ii) The acquisition cost of such underlying funds; and
- (iii) The latest status of such underlying funds as at the end of the reporting period.

With respect to other schemes, the management company must disclose the name(s) and acquisition costs of all illiquid holdings\* held by the scheme as at the end of the reporting period, categorized by:



- (i) Derivatives; and
- (ii) Non-derivatives.

\* *“Illiquid holdings” are defined as assets for which there are no readily available market values to be transacted between knowledgeable and willing parties in an arm’s length transaction, or with no registered turnover in the last 30 days prior to and including the reporting date.*

(j) Concentrated exposures

With respect to any scheme that is a FoHFs, the management company should disclose:

- (i) Exposures (including cash and cash equivalent holdings) for the scheme at the scheme level as of the reporting date (expressed in percentage terms of net asset value of the scheme) categorized by 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;
- (ii) The number of underlying funds and the number of underlying fund managers included in the scheme as of the reporting date; and
- (iii) (Where the scheme is a multi-strategy FoHFs) disclosure of the number of underlying funds and underlying fund managers under each hedge fund strategy.

With respect to other schemes, the management company should disclose:

- (i) Exposures (including cash and cash equivalent holdings) for the scheme as of the reporting date (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
- (ii) The aggregated gross long and short positions held by the scheme as of the reporting date (expressed in percentage terms of the net asset value of the scheme).

*Note (1): “Cash equivalent holdings” are defined as those assets with a maturity of less than one year and which are readily transactable in an arm’s length transaction between willing and knowledgeable parties.*

*(2): 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.*

## Appendix

### Information to be Disclosed under Section B.12(g) 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 <sup>3</sup> (annualised year to date)	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) 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.).
- (3) “Year T” denotes the current scheme financial year.
- (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.  
*Note: 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 I

### Guidelines for Regulating Index Tracking Exchange Traded Funds

#### Introduction

1. These guidelines apply to passively managed index tracking exchange traded funds (which will be referred to as “Exchange Traded Funds” or “ETFs” throughout these guidelines)<sup>1</sup> authorized pursuant to the Code on Unit Trusts and Mutual Funds (the “Code”). These guidelines form part of Chapter 8.6 of the Code and are to be read in conjunction with the Code for an overall view of the regulatory framework for ETFs. In case of doubt, an applicant should consult the SFC at the earliest possible time on the application of these guidelines to an Exchange Traded Fund seeking authorization under the Code.
2. These guidelines are devised on the basis that ETFs, whether established in Hong Kong or overseas, should comply with common principles for safeguarding investors’ interests if they seek to be authorized by the SFC. Local and overseas ETFs may seek to rely on the general relief granted in these guidelines from strict compliance with certain Code requirements including investment restrictions and prescribed risk warnings.
3. Overseas ETFs that meet the core requirements for authorized schemes under the Code and are governed by a regulatory framework considered acceptable in these guidelines may seek the SFC authorization by way of a streamlined process. Depending on the specific product type and the way they are governed in their home jurisdictions, overseas ETFs may be deemed to have complied with some or all of the requirements in Chapter 8.6 of the Code in relation to investment restrictions and strategies, index acceptability and the documentation requirements such as constitutive documents, product disclosure documents and financial reports in other parts of the Code.
4. These guidelines also require ETFs that are primarily listed on the local exchange of Hong Kong to adopt an enhanced disclosure regime for real time or near-real time trading information. Overseas ETFs that are primarily listed on overseas exchanges are recommended but are not obliged to comply with this enhanced disclosure regime for real time or near-real time overseas trading information.

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<sup>1</sup> An “index tracking ETF” means an index fund (as defined in Chapter 8.6) and whose units/shares are traded on a securities exchange. For avoidance of doubt, the term “ETF” used in these guidelines does not cover actively managed non-index tracking funds.

## **Basic Requirements for ETFs**

5. ETFs, whether local or overseas, must comply with the structural, operational and core investment requirements under the Code. They must also abide by the on-going compliance and reporting requirements under the Code subject to the applicable relief laid down in these guidelines if they seek authorization from the SFC.<sup>1</sup>
6. ETFs that do not conduct initial public offerings or any forms of public sales or subscriptions are not obliged to produce a Hong Kong Offering Document as stated in Chapter 6.1 of the Code. Instead, they must prepare a Product Description Document in both English and Chinese. The term “offering document” shall be replaced by the term “Product Description Document” wherever the former appears in the Code (see Paragraph 10 below) in relation to this type of ETFs.
7. The general principles set out in Chapter 8.6 (a) to (e) of the Code are broadly applicable to ETFs, whether local or overseas, unless otherwise stated in these guidelines.
8. It is a condition for authorizing an ETF that intends to be primarily traded in Hong Kong and authorized under the Code (referred to as “Local ETFs” in these guidelines), that it must be either listed or traded on the Stock Exchange of Hong Kong Limited (the “SEHK”).

## **Streamlined Regulatory Regime for ETFs**

9. ETFs must comply with the Code requirements not otherwise modified or waived by these guidelines.
10. Except as provided in paragraph 24(e) below, an ETF that is not conducting initial public offerings, or any forms of public sales or subscriptions in Hong Kong need not prepare a Hong Kong Offering Document in accordance with Chapter 6.1 of the Code. This ETF must prepare a Product Description Document in both English and Chinese that meets the content requirements in Appendix C of the Code (as modified by these guidelines) which is more particularly set out in **Annex (I)** to these guidelines.

### ***General Relief from Chapter 8.6***

Unless otherwise stated in these guidelines, ETFs, whether local or overseas, must comply with all the applicable provisions governing index funds in Chapter 8.6 of the Code.

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<sup>1</sup> For avoidance of doubt, the term “ETFs” in these guidelines shall, where the context applies, mean ETFs authorized under the Code.

11. *Relief from Chapter 8.6(h):* Investment restrictions in Chapter 8.6(h)(i) and (ii) do not apply if:
- (a) an ETF adopts a representative sampling strategy which does not involve the full replication of the constituent securities of the underlying index in the exact weightings of such index;
  - (b) the strategy is clearly disclosed in the Product Description Document/Hong Kong Offering Document of the ETF (as the case may be);
  - (c) the excess of the weightings of the constituent securities held by the ETF over the weightings in the index is caused by the implementation of the representative sampling strategy;
  - (d) any excess weightings of the ETF holdings over the weightings in the index must be subject to a maximum limit reasonably determined by the ETF after consultation with the SFC. In determining this limit, the ETF must consider the characteristics of the underlying constituent securities, their weightings and the investment objectives of the index and any other suitable factors;
  - (e) limits laid down by the ETF pursuant to paragraph 11(d) above must be disclosed in the Product Description Document/Hong Kong Offering Document (as the case may be);
  - (f) disclosure must be made in the ETF's semi-annual and annual reports as to whether the limits imposed by the ETF itself pursuant to paragraph 11(d) have been complied with in full. If there is non-compliance with the said limits during the relevant reporting period, this must be reported to the SFC on a timely basis and an account for such non-compliance should be stated in the report relating to the period in which the non-compliance occurs or otherwise notified to investors; and
  - (g) nothing in paragraphs 11(d), (e) and (f) above applies to an overseas ETF governed by an Acceptable ETF Regime or by the relevant overseas jurisdiction (see the Note to paragraph (d) in **Annex (III)** to these guidelines).
12. *Disclosure of Risk Warnings under Chapter 8.6(j):* Provisions relating to disclosure of index funds information in Chapter 8.6(j) do not apply where **Annex (I)** does not require the same. In particular, where proper risk warnings are disclosed, provisions relating to disclosure of risk warnings in Chapter 8.6(j)(iv), (v), (vi), (vii), (x), (xi), (xii) and (xiv) need not be strictly adhered to.
13. *Name of the ETF under Chapter 8.6(m):* Chapter 8.6(m) does not apply if the name adopted is not misleading or deceptive as to the nature of the ETF and its investment objectives and strategy.

### ***Modified Post-Authorization Notification and Approval Procedures***

14. The notification and approval requirements under 11.1A and 11.7 of the Code are modified to the following extent:
- (a) *Increase in Fees and Charges in 11.1A*: The prior notice requirements under 11.1A does not apply to adjustments in management fees if:
    - (i) the proposed adjustments in management fees do not require holders' approval; and
    - (ii) either a notice for the fee adjustments is published as stated in paragraph 14(c) or where the ETF is governed by an Acceptable ETF Regime or in the relevant overseas jurisdiction (see the Note to paragraph (d) in **Annex (III)**), there is no notification requirement for this type of fee adjustments in that jurisdiction;
  - (b) *Publication of NAV in Local Newspapers in 11.7*: On the basis that information is available to investors in accordance with paragraphs 17 to 21 in these guidelines (where applicable), the obligation under 11.7 to publish NAV in local newspapers is dispensed with. The management company must immediately notify the SFC as soon as practicable if dealing in units/shares on the SEHK ceases or is suspended.
  - (c) Unless otherwise waived or provided for in paragraph 24(g) below, all notices and public announcements made by ETFs in accordance with the Code and these guidelines must be prepared in both English and Chinese.

*Note: for avoidance of doubt, nothing in paragraph 14 shall exempt an ETF from compliance with 11.1, 11.4 and 11.5 of the Code.*

### **Recommended Best Practice for the Publication of Key Features Summary by ETFs**

15. ETFs, whether local or overseas, may publish and distribute a Key Features Summary to investors in the following manner:
- (a) The first Key Features Summary should be made available at or before the first date of trading in the Hong Kong market or the first date of initial public offering of the ETF in Hong Kong (whichever is earlier or applicable);
  - (b) Subsequent to the first Key Features Summary, an ETF should, at least, review and (if necessary) update its Key Features Summary on a half-yearly and yearly basis. It should also update the Key Features Summary whenever there are material changes to the information contained in it.

The Key Features Summary should be made available at the same time as the publication of each semi-annual and annual report of the ETF.

16. The use of Key Features Summary is a recommended best practice for ETFs. ETFs should consider the following when preparing the Key Features Summary:
  - (a) ETFs may at their discretion adopt their own format and make disclosure of their key information;
  - (b) ETFs may also consider using a single document to contain the product summary of various ETFs managed by the same management company;
  - (c) The recommended contents for a Key Features Summary are set out in **Annex (II)**. A Key Features Summary should be written in plain English and Chinese.
  - (d) If an ETF decides to issue a Key Features Summary (whether following the recommended contents in **Annex (II)** or not), the first Summary must be submitted for authorization by the SFC. For subsequent updates of data and figures in a Key Features Summary, these may be made without prior approval of the SFC. An ETF should file its Key Features Summary with the SFC each time it is published unless otherwise waived.

## **Dissemination of Trading Information by ETFs**

### ***Local ETFs***

17. In addition to information commonly available for stocks during the trading hours of the SEHK (e.g. bid/ask prices and queuing displays), local ETFs must provide the following trading information to the public on a real time or near-real time basis unless otherwise waived, via any suitable channels in paragraph 18 below:
  - (a) Estimated NAV or R.U.P.V.<sup>2</sup>;
  - (b) Last closing NAV;
  - (c) Notices for suspension and resumption of trading; and
  - (d) Composition of constituent securities (where practicable).
18. Information in paragraphs 17 (a) to (d) above may, where applicable, be made available to investors in Hong Kong through one or more of the following means:

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<sup>2</sup> R.U.P.V. as used on the information pages of information vendors in relation to ETFs listed on the SEHK stands for “Reference Underlying Portfolio Value” which is updated at 15-second intervals during trading hours and is equivalent to the aggregate of the total value of the Index Basket Shares per Creation Unit (which is calculated by multiplying the nominal price of the Index Basket Share by the number of the respective Index Basket Shares) and the prior day estimated total cash component per Creation Unit divided by the number of Units in a Creation Unit.

- (a) ETF's own website; or
- (b) A hyperlink of (a) to the website of Hong Kong Exchange and Clearing Limited ("HKEx"); or
- (c) Information pages of information vendors which disseminate trading information of ETFs in their ordinary course of business and whose information is accessible by retail brokers in Hong Kong (whether as paid services or not); or
- (d) Any other channels that the SFC considers acceptable.

***Overseas ETFs that have Cross-listing or Cross-trading Status on the SEHK***

19. Overseas ETFs authorized by the SFC that are cross-listed or cross-traded on the SEHK must provide local trading information in relation to their trading on the SEHK. Local trading information includes notices for suspension and resumption of trading on the SEHK. It is a recommended best practice for such overseas ETFs to provide their overseas markets' trading information that is of the same nature as described in paragraphs 17(a) to (d) above where trading hours of the relevant overseas market and those of the SEHK overlap.
20. Information provided to investors according to paragraph 19 may be made available via any of the channels stated in paragraph 18 or via the website of overseas exchanges on which such ETFs are traded.

***Prior disclosure in the Product Description Document/Hong Kong Offering Document***

21. ETFs, whether local or overseas, must make prior disclosure of the types of trading information and channels through which such information is made available to investors in their Product Description Document/Hong Kong Offering Document (as the case may be). An ETF should also disclose the type of trading information (falling within the recommended best practices in these guidelines) that is not made available to investors in its Product Description Document/Hong Kong Offering Document (as the case may be).

**Publication of ETFs' Materials in Hong Kong**

22. An ETF, whether local or overseas, must ensure that the following documents are made readily available to Hong Kong investors through any of the ETF's own website or such other channels as the SFC considers appropriate:
  - (a) Product Description Document/Hong Kong Offering Document (as the case may be);
  - (b) The ETF's offering document or prospectus (as the case may be) prepared in accordance with the regulations of the Acceptable ETF Regime or the relevant overseas jurisdiction (see the Note to paragraph (d) in **Annex (III)**) ("ETF's Overseas Offering Document") (where applicable);
  - (c) Key Features Summary (where applicable);



- (d) Latest version of the semi-annual and annual financial reports of the ETF; and
- (e) All notices and public announcements issued by the ETF in either the Acceptable ETF regime or the relevant overseas jurisdiction (see the Note to paragraph (d) in **Annex (III)**) and in Hong Kong.

*Note: Where an ETF is listed or traded on the SEHK, it may, but is not required to, make available the abovementioned documents to investors in Hong Kong by way of hyperlinks to the HKEx website.*

### **Streamlined Recognition Process for Overseas ETFs Listed in an Acceptable ETF Regime**

23. An overseas ETF that meets the core structural and operational requirements in the Code and is regulated in an Acceptable ETF Regime, may be authorized through a streamlined recognition process. The specific relief in paragraph 24 applies to this type of overseas ETF such that they will be deemed to have complied with certain Code requirements including constitutive documentation requirements, index acceptability and the prescribed contents for financial reports.

*Note: In determining whether a regime is an Acceptable ETF Regime, the regulatory principles set out in **Annex (III)** would be considered.*

24. An overseas ETF that complies with the conditions set out in **Annex (IV)** may rely on the following specific relief for a streamlined process for authorization in addition to the general relief in paragraphs 11 to 14.
- (a) *Acceptability of Index in 8.6(e)*: The index that such an overseas ETF tracks will be deemed to have complied with 8.6(e)(i) to (v) except where such index or its methodology contradicts the fundamental principles of a representative, diversified, investible and transparent index.
  - (b) *Reporting Requirements in 8.6(f)*: 8.6(f) only applies to (i) any significant events relating to the index that might affect the authorization or listing status of an overseas ETF in an Acceptable ETF Regime; and (ii) any other events in relation to the index that the Acceptable ETF Regime would require notification to investors. Notification of these events must be published in Hong Kong in both English and Chinese and notified to the SFC on a timely basis.
  - (c) *Replacement of Index in 8.6(k)*: Subject to paragraphs 24(a) and 24(g) of these guidelines, 8.6(k) does not apply to the replacement of index. Any replacement of index must be notified to investors and the SFC on a timely basis.
  - (d) *Disclosure in Financial Reports in 8.6(l) and Appendix E*: ETFs that have prepared their semi-annual and annual financial reports in accordance with their own governing overseas regulations, which reports

are not qualified by their auditors, will be relieved from full compliance with the content requirements of 8.6(1) and Appendix E.

- (e) *Product Description Document*: Notwithstanding paragraph 10 above, the Product Description Document for an ETF from an Acceptable ETF Regime does not have to set out all the details of the information stated in **Annex (I)** to these guidelines if:
  - (i) The Product Description Document takes the form of a summary of the salient features of the ETF including appropriate risk warnings as to the level of disclosure contained in it. This Product Description Document has to be prepared in both English and Chinese;
  - (ii) The ETF's Overseas Offering Document is available to investors in Hong Kong via the ETF's own website, the website of the overseas exchange on which it is primary listed or the HKEx website (if applicable); and
  - (iii) The ETF's Overseas Offering Document mentioned in paragraph 24(e)(ii) may be made available in either English or Chinese.
- (f) *Constitutive Documents*: The constitutive documents will be deemed to have complied with Appendix D of the Code in so far as these are related to the structural and operational aspects of the ETF.

*Note: ETFs fall within the categories of Specialized Schemes under Chapter 8 of the Code and the concept of Recognized Jurisdiction Schemes is not directly applicable. However, in considering whether the constitutive documents of an ETF from an Acceptable ETF Regime is in compliance with the Code requirements, for example, Appendix D, the SFC would consider whether the home regulations in the Acceptable ETF Regime share similar principles in providing structural safeguards for investor protection. Accordingly, strict compliance with Appendix D and other operational requirements may not be required.*

- (g) *Notification and Language Requirement in respect of Notices under 11.1 to 11.2B*: Notices in relation to scheme changes that require the SFC's prior approval pursuant to 11.1 of an ETF that is primarily regulated in an overseas jurisdiction have to be published or made generally available to investors in Hong Kong. Unless otherwise waived, these notices must be in both English and Chinese, and be published on a timely basis and in such manner as the ETF considers appropriate.

## **Miscellaneous**

- 25. These guidelines do not apply retrospectively to index tracking exchange traded funds already authorized on or before 24 October 2003.

26. With respect to ETFs that have been submitted to the SFC for approval pursuant to the Code but have not been authorized before 24 October 2003, they may elect to comply with the Code as amended by these guidelines.
27. These guidelines do not preclude the right of the SFC to impose any conditions for the authorization of an ETF as may be reasonable in the circumstances.

**Information to be Disclosed in the Product Description Document**

This list is not intended to be exhaustive. The SFC may require further information to be disclosed which may be necessary for investors to make an informed investment decision.

<b>Summary of Information to be Disclosed</b>	<b>Sections under Appendix C and Chapters of the Code and Other Relevant Information for ETFs Authorized Pursuant to the ETF Guidelines</b>
Constitution of the ETF	C1
Investment Objectives and Restrictions	C2
Description of Underlying Index	<ul style="list-style-type: none"> <li>• 8.6(j)(i)</li> <li>• 8.6(j)(ii)</li> </ul>
Other Information regarding the Index	8.6(j)(xiii)
Means by which investors may obtain relevant information regarding the ETF and the index	<ul style="list-style-type: none"> <li>• Types of real time or near-real time information of the ETF that is made available and the sources from which these information could be obtained, e.g. stock code, ticker symbol, website of the ETF etc.</li> <li>• 8.6(j)(viii)</li> <li>• 8.6(j)(ix)</li> </ul>
Operators and Principals	<ul style="list-style-type: none"> <li>• C3 + any other relevant operators such as participating dealers etc.</li> </ul>
Characteristics of Units/Shares	<ul style="list-style-type: none"> <li>• C4 (if applicable) + trading lot size</li> <li>• C5</li> <li>• C6</li> <li>• C7</li> </ul>
Creation and Redemption Procedures	<ul style="list-style-type: none"> <li>• C9 (if applicable) + procedures for buying/selling units/shares on the stock exchange + creation and redemption procedures of the underlying basket of stocks by participating dealers</li> <li>• C10 (if applicable)</li> <li>• C11</li> <li>• C12</li> </ul>
Distribution Policy	<ul style="list-style-type: none"> <li>• C13</li> </ul>
Fees and Charges	<ul style="list-style-type: none"> <li>• C14(a) (if applicable)</li> <li>• C14(b) (see 6.16 and 6.18)</li> <li>• Fees borne by investors trading on the stock exchange, e.g. brokerage fee, transaction levy, stamp duty etc.</li> <li>• C14(c) (as amended by these guidelines)</li> </ul> <p><i>Note: Fees should be clearly presented in tabular form</i></p>
Connected Party Transaction	C15
Taxation	C16

Reports and Accounts	<ul style="list-style-type: none"> <li>• C17</li> <li>• C18 or the website address on which the financial reports are published</li> </ul>
Warnings	<ul style="list-style-type: none"> <li>• C19</li> <li>• Proper risks warnings suitable for index tracking ETFs, including those for tracking errors, liquidity of underlying securities, circumstances that may affect the accuracy and completeness in the calculation of the index etc. Note: With proper risk warnings, 8.6(j)(iv)- (vii), (x) – (xii) and (xiv) need not be strictly adhered to.</li> </ul>
General Information, e.g. date of publication of the Product Description Document, constitutive documents available for inspection etc.	<ul style="list-style-type: none"> <li>• C20</li> <li>• C21</li> <li>• C22</li> <li>• C23</li> <li>• 6.15</li> <li>• Provisions on stock lending</li> </ul>
Termination of the ETF	C24 (see 11.4 and 11.5)
Authorization conditions and Waivers Granted to the ETF	<ul style="list-style-type: none"> <li>• Self-imposed limits for any excess weightings of the ETF holdings over the weightings in the index</li> <li>• Waivers granted from compliance with the Code and/or any authorization conditions imposed on the ETF</li> </ul>

## Recommended Contents for the Key Features Summary

[Name of the ETF] [Date]

**Important** – This is only a summary of the key features of [the name of ETF] and is not intended to be or to replace the Product Description Document/Hong Kong Offering Document/ETF’s Overseas Offering Document (as the case may be). **You should read the Product Description Document/Hong Kong Offering Document/ETF’s Overseas Offering Document (as the case may be) carefully before you invest.** The Product Description Document/Hong Kong Offering Document/ETF’s Overseas Offering Document (as the case may be) is available from your broker free of charge upon your request [or (where applicable), may be downloaded via the website of the HKEx (*Website link: HKEx*)].

You should consult your professional advisers if you have doubts about the contents of this summary and/or the Product Description Document/Hong Kong offering document/ETF’s Overseas Offering Document (as the case may be).

### 1. **What is the ETF’s objective and what index does it track?**

A: Describe the investment objective of the ETF and name the underlying index.

### 2. **Where is the ETF traded?**

A: State the exchange(s) on which the ETF is traded and whether it is fungible between markets.

### 3. **What is the index comprised of?** [*Note: Information may be presented in tabular form where appropriate*]

A: Describe the objective of the index, e.g. the sector/market it seeks to reflect.

### 4. **What is the strategy or methodology employed by the ETF in order to track the index?**

### 5. **How can I obtain market and trading information about the ETF and the underlying index?**

A: State the relevant information that investors should be aware of and provide the corresponding website addresses. For example:

- ETF’s own website (if any);
- Latest index information and news (*Website Link: index provider*);
- HKEx announcement (*Website Link: HKEx*) (*where applicable*);
- Announcements/notices posted on the overseas exchange on which primary listing of the ETF takes place (*Website Link: the primary overseas exchange where the ETF is being traded*) (*where applicable*); and

- Sources where additional trading information could be found, e.g. names of information vendors.

A statement to alert investors that they should actively check the above information on a regular basis since the above information may materially impact on their investment holdings.

**6. Quick Facts** *[Note: Information may be presented in tabular form where appropriate], e.g.*

- Stock code;
- Sources where the NAV, R.U.P.V, the underlying index level are published;
- Ticker symbol;
- Trading lot size;
- Main operators – e.g. management company, participating dealers, Hong Kong representative etc.; and
- Top 10 holdings of the ETF as of the date of the Key Features Summary.

**7. What are the risks associated with the ETF?** *[Note: Insert proper risk warnings depending on the nature of the ETF and the index, including but not limited to the following suggested items]*

- Liquidity risks;
- Tracking error risks and the circumstances under which tracking errors may occur;
- Trading risks – e.g. disruptions to the creation and redemption process, suspension of trading etc.;
- Risks and constraints arisen from the employment of certain strategies; and
- Applicable risk warnings required under Appendix C19 of the Code.

**8. How can I purchase and sell the ETF?**

**9. What are the fees and charges involved in this investment?** *[Note: Fees of the ETF should be clearly presented in tabular form]*

A: State all the fees and charges involved and divide them into at least the following four categories:

- a) Fees and charges payable by investors trading the ETF via the stock exchange
- b) Brokerage commission paid by investors in trading the ETF
- c) Fees payable by participating dealers in dealing directly with the ETF e.g. block creation and redemption
- d) Fees borne by the ETF

**10. Will I receive any income or dividend from the investment?**

**11. Who can I contact for enquiries or to obtain further information?**

## General Principles for an Acceptable ETF Regime

In determining whether a regime is an Acceptable ETF Regime, the following regulatory principles would be considered:

- (a) The availability of a mutual co-operation and assistance agreement for fund management activities between the principal securities regulator of the Acceptable ETF Regime and the SFC;
- (b) The similarity or comparability of the overall securities regulatory framework provided by the overseas jurisdiction where there is substantial interest in the ETF and in which it is primarily listed. The SFC will consider the extent to which these overseas jurisdictions' structural and operational requirements and disclosure standards on ETFs are comparable or equivalent to the principles adopted by the SFC for regulating collective investment schemes;
- (c) The overall and combined effect of the rules and regulations, the regulatory infrastructure of an Acceptable ETF Regime where the ETF is primarily listed and in which there is substantial interest and the effectiveness of the administration of these rules and regulations, should be able to afford comparable investor protection to that provided under the Hong Kong regulatory framework; and
- (d) The overseas stock exchange on which primary listing of the ETF takes place should provide a system for efficient public dissemination of trading and other information relevant to the trading of ETFs. Information about the index which the ETF tracks is either published generally or otherwise made readily available to the public in electronic or other means.

*Note: It is acknowledged that the regulatory framework for ETFs in some overseas jurisdictions may meet substantially but not all of the above principles in **Annex (III)** for recognition as an Acceptable ETF Regime. In these circumstances, the SFC would consider on a case-by-case basis the extent to which these ETFs may be granted partial relief under these guidelines and if any corresponding or alternative safeguards for investor protection should be imposed in consideration of the relief being granted.*

Once it is established that an overseas ETF is regulated in an Acceptable ETF Regime, such ETF must also comply with the conditions in **Annex (IV)** in order to be eligible for the specific relief in paragraphs 23 and 24 of the guidelines.



**Compliance Conditions for Overseas ETFs**

An overseas ETF that seeks to rely on the specific relief in paragraphs 23 and 24 of the guidelines must comply with the following conditions:

- (a) Compliance with the applicable laws and regulations of the relevant Acceptable ETF Regime;
- (b) Compliance with the applicable listing rules and trading rules of the overseas exchange on which the ETF is primarily listed;
- (c) There are no changes in the laws and regulations of the Acceptable ETF Regime and the relevant overseas listing rules governing the offering and the listing of the ETF that would materially affect the Acceptable ETF Regime's comparability with that of Hong Kong. Where any material changes would be made to the securities regulations or the applicable listing rules of the Acceptable ETF Regimes thereby affecting their comparability with those of Hong Kong, the ETF or its management company must inform the SFC as soon as practicable; and
- (d) The ETF complies in full with the applicable provisions in the guidelines.