



Alternative Investment Management Association

Supervision of Markets Division
Securities and Futures Commission
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Submitted by email:
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Dear Sirs

Response to Supplemental Consultation on the OTC Derivatives regime for Hong Kong - proposed scope of new/expanded regulated activities and regulatory oversight of systemically important players

The Alternative Investment Management Association (AIMA)¹ welcomes the opportunity to provide comments on the Supplemental Consultation on the OTC Derivatives Regime for Hong Kong, issued by the Hong Kong Monetary Authority (HKMA) and the Securities and Futures Commission (SFC) in July 2012.

Although in general, AIMA supports the proposed scope of the new and expanded regulatory activities, we have the following comments in response to the specific consultation questions:

Q1. Do you have any comments or concerns about our proposals for how the initial ambit of the new Type 11 RA should be cast, and the specific activities to be excluded from its scope? If you consider additional carve-outs are needed, please elaborate with justification.

AIMA recommends it is made explicit that a person or entity does not need to be licensed for Type 11 RA where (i) that person or entity has appointed a discretionary asset manager and (ii) the discretionary asset manager has entered into an OTC derivative on behalf of that person or entity i.e. as a result, that person or entity becomes a counterparty to the OTC derivatives transaction. For this purpose, the term discretionary asset manager should include both persons licensed or registered for Type 9 RA and persons carrying on an equivalent business and regulated under the law of any place outside Hong Kong.

The above can be included as a separate carve-out or can be included in the definition of "price taker". It would make it clear that investment funds, retirement funds, charities and others that appoint discretionary asset managers do not themselves need to be licensed for Type 11 RA. We note this carve out will not affect their obligations to report or clear OTC derivatives transaction, where appropriate.

¹ AIMA is the trade body for the hedge fund industry globally; our membership represents all constituencies within the sector - including hedge fund managers, fund of hedge funds managers, prime brokers, fund administrators, accountants and lawyers. Our membership comprises over 1,200 corporate bodies in over 40 countries.



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Q4. Do you have any comments or concerns about our proposals for expanding the scope of the existing Type 9 RA?

AIMA agrees with the expansion of the scope of the existing Type 9 RA to include managing portfolios which include OTC derivatives. However, AIMA would appreciate confirmation as to whether our members will be permitted to manage portfolios which include OTC derivative transactions without applying for an expanded Type 9 RA licence, where the OTC derivative transactions are managed by an appropriately regulated third party (which maybe a group company doing business outside of Hong Kong where it is permitted to deal or manage OTC derivatives).

Q5. Do you have any comments or concerns about our proposed transitional arrangements for the new Type 11 and Type 12 RAs, and for the expanded Type 9 RA?

Transitional application period

AIMA is of the view that the proposed transitional application period of four to six weeks is too short given the likely number of applications for new or expanded licences. This is unlikely to give adequate time for financial institutions properly to compile properly their applications, with a knock-on effect on the SFC's already limited application-processing time. AIMA is of the view that a transitional period of at least three - six months would be more appropriate.

Deemed licensing

In general, AIMA supports the concept of deemed licensing. However, it is important that the deemed requirements are set at an appropriate level to allow the majority of existing players to transition to the new rules in a seamless manner and thus prevent unnecessary market disruption. The following views expressed bearing in mind the limited scope of the Type 9 licenses held by most hedge fund managers in Hong Kong - namely that they are not permitted to hold client assets and to only provide services to professional investors.

- The requirement for both the applicant and its proposed responsible officers to have the relevant type and length of experience is unreasonable, as it discriminates against recently-established firms. AIMA believes the experience requirements should only apply to the applicant's responsible officers.
- The requirement for the relevant experience to have been obtained in Hong Kong is too restrictive and deviates from the SFC's general approach to required industry experience (and demonstrated in its recent consultation on the regulation of sponsors). AIMA believes the experience requirement should not be restricted to experience in Hong Kong.
- The suggestion that the relevant experience has been obtained in "the two years immediately before the coming into effect of the new regime" is too restrictive and fails to recognise the longevity of responsible officers. AIMA believes the experience requirement should be one that can be achieved either (i) in a shorter period [6] months immediately prior to the coming into effect of the new regime, or (ii) a longer period of experience achieved over a period of time prior to the coming into effect of the new regime, for example, the SFC may consider two years experience within the last (for example) six years. This would be consistent with the relevant industry requirements for a new license generally - where experience is not required to be immediately prior to the application for the license.



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- We would request further that, as with other licenses, conditions may be attached to the License, and that a firm would not as a matter of course be refused a licence where only one responsible officer meets the required experience, and that the extent of permitted OTC derivative management within the portfolio will be limited by conditions whether at the firm level or an individual responsible officer level via use of the non-sole condition. Furthermore, confirmation requested in our response to Question 4 is important in the context of this scenario.
- Whilst the Supplemental Consultation is silent on new Type 9 licence applications after the OTC derivatives regime has come into operation, we assume the process will remain unchanged other than to factor in the OTC derivative experience of the responsible officers, and where this may be acting in one or both responsible officers, the extent of permitted OTC derivative management within the portfolio will be limited by conditions whether at the firm level or an individual responsible officer level via use of the non-sole condition.

Rejection of application

AIMA is of the view that if an application for an expanded Type 9 RA licence is rejected, it is in the client's best interests that the financial institution be given sufficient time to make appropriate arrangements for the adjustment or hand-over of the client's portfolio. AIMA suggests the SFC permits a three month adjustment period before the institution is required to itself cease to engage in OTC derivatives transactions.

In relation to rejected applications for Type 11 and Type 12 RAs, the applicant should be entitled to close out existing transactions within a reasonable time-scale, but should be prevented from entering into new ones.

We are happy to discuss any of these points with you in greater detail should you so wish.

Yours faithfully