Responses to Consultation Paper on Proposals to Enhance Asset Management Regulation and Point-of-sale Transparency

We seek clarifications on several references to management fees and performance fees in the Consultation Paper (including, inter alia, Point 21 on Page 8; Point 75(b) and Point 76 on Page 20; and Point 5.4.1 on Page 21). Based on the wording of the Consultation Paper, it will be helpful to the Financial Technology ("Fintech") community for the Securities and Futures Commission ("SFC") to clarify whether any new rules (or enhancements to existing ones) will or will not be automatically applied based on fee structure.

1. Some Fintech mandates in investment management are compensated based on a share of the management fee (as basis points of Asset Under Management or "AUM") or performance fee, and perhaps subject to certain minimums and caps. The classic example here is that it is standard industry practice for custodian software to be charged based on AUM. Fintech firms should not be treated differently simply because of the fee structure demands made by their investment manager clients.

2. That is the business reality because the (typically larger) investment managers want a simple cost structure to align sources of their own revenues to cost. The (usually smaller) Fintech companies do wish to be compensated based on traditional fixed fee arrangements, but they may not have the negotiation leverage to make the demand (i.e. investment managers are basically demanding that Fintech companies share their business risk as service providers). Therefore, it should be made clear that the applicability of the new rules (or enhancements to existing ones) should not be tied to fee structures; instead, they should be tied to the nature of the business as well as which party is facing end investors. For example, any new rules (or enhancements to existing ones) should not be automatically applicable to a robo-advisor that is sharing its profits with its distributors simply based on its fee structure; instead, the criteria should be based on the nature of the service provided by the robo-advisor, as in whether it is providing essentially the same type of service similar to those provided by other human investment advisors today.

3. The issue that needs to be further clarified is when the suitability mechanism is not directly controlled by the Fintech provider but the Fintech provider is expected to work with it:
    i) Fintech companies should demonstrate reasonable efforts to incorporate outputs from the suitability mechanism provided by their investment manager clients.
    ii) Generally, it may not be feasible to hold Fintech providers responsible for the outputs for the suitability mechanism, since the

Fintech providers do not have causal relationships with the end investors, especially after customary exemption/liability clauses are included. Fintech providers should review the reasonableness of the inputs as given to them and flag such inputs as potential errors (one example of a grossly unsuitable situation will be labelling a 70-year-old grandmother as aggressive investors). As long as Fintech providers have demonstrated reasonable professional judgement in the use of such inputs, the burden should sit with their investment manager clients.

iii) Where there are reasonable questions, Fintech companies should not allow any automated processing but flag the outputs for intervention or exception handling (or send it back to an exception mechanism at the client - whether the intervention is by human or by an automated mechanism). The investment manager clients should be made aware of that they bear burden of automating (especially when the clients have full control of the parameters, as in Microsoft as a software provider cannot be held liable for spamming if a user chooses to send spam-emails with Microsoft's automated email clients.) However, a Fintech provider should provide reasonable user education or even certify the user for achieving an appropriate level of competency. It should be noted that we currently offer such educational courses under the sponsorships by the relevant regulator authorities in the region, so that this is highly achievable in practice.

4. Any new rules (or enhancements to existing ones) should generally apply in a Business-to-Consumer ("B2C") context when a Fintech provider works directly with end investors. Consistent with international practice, mandates targeting sophisticated High Net Worth "HNW" investors and institutional Business-to-Business "B2B" users should be excluded.

5. For the avoidance of doubt, the issue should not be about whether the intermediate provider is a Fintech company or not: It will be helpful to the Fintech community for the SFC to clarify that the primary responsibility of compliance should sit with the <u>party</u> deploying the suitability mechanism. For example, if the Fintech provider is performing the suitability function (as in some point-of-sale platform) then in principle they should be held accountable for any failure in meeting applicable suitability requirements. There is a significant number of traditional non-Fintech companies, such as independent research houses and index providers, that are providing essentially the same services as certain Fintech providers do using less technical or non-technical means. Currently, they sit entirely outside of global regulatory regimes. Our view is that similar activities should continue to stay outside of any regulatory regime, in order to be fair to the entire industry whether a service provider chooses to use a vogue label by calling itself a Fintech company or not.