EVERSHEDS 安睿國際律師事務所

Eversheds
21/F, Gloucester Tower
The Landmark
15 Queen's Road Central
Hong Kong
香港中環皇后大道中 15 號
置地廣場告羅士打大廈 21 樓

T: +852 2186 3200
F: +852 2186 3201

eversheds.com

Securities and Futures Commission
35/F, Cheung Kong Centre
2 Queen's Road Central
Hong Kong

Date: 22 February 2017
Your ref: CP on Proposals to Enhance Asset Management Regulation and Point-of-Sale Transparency

By Electronic Submission

Dear Sirs

Subject: **Consultation Paper on Proposals to Enhance Asset Management Regulation and Point-of-Sale Transparency (the "Consultation Paper")**

We refer to the above Consultation Paper, released in November 2016. We thank you for the opportunity that you have offered to provide feedback on the proposals set out in the Consultation Paper. We have collated views from a selection of interested parties and stakeholders from asset management firms and financial institutions, compliance and service providers, who have provided feedback to us on a no-names basis ("participants"). We have set out such feedback below for your consideration.

In respect of the specific questions raised in the Consultation Paper we have adopted the numbering used in the Consultation Paper. Unless specifically defined in this response, we have also adopted the defined terms and acronyms used in the Consultation Paper. Where the participants either have no particular comment or we consider the principal comments to have been dealt with in another section, we have simply marked "no particular comments" against that question.

	Question	Reply
1	Do you have any comments on the proposed clarification that the FMCC applies to the business activities carried out by fund managers which would include the management of discretionary accounts.	We have conflated our response to this with the following question, below.
2	Under the current proposal, some of the proposed enhancements are not applicable to all Fund Managers but only to those responsible for the overall operation of a fund or having de facto control of the oversight or operation of	Certain participants felt that the proposals did not take into account the specific challenges of certain fund structures, such as unauthorised funds, where a too intense focus on the role of the fund manager might ignore the control that the board of directors of a fund exercises (an example would be that it is the board of directors of a fund which enters into

hkg_lib1\993013\2

Partners

Butcher Charles Robert 畢查理
Chau Yiu Sum 周耀深
Gray Ian John Basil*
Hui Chun Kin Norman 許俊健
Lemin Jae
Matthews Richard Alistair*
Mok Chung Kwan Stephen 莫仲堃
Ong Tze-Wei Kingsley 王世偉
Shek Rachael Ming Kei 石明杰
Van Dale Jennifer 包正芬
Yau Yiu Hong Michael 邱耀匡
Yeadon Mark Philip 伊敦文

Registered Foreign Lawyers
Ferguson Adam Timothy Baty 傅家信
Kitts Stephen 孔述德
Marquis Veronique Elisabeth
Stamp Nigel Colin Harris 南捷思
*Non-Resident Partner

	the fund. Do you agree with such an approach? If so, do you have any views on which of the proposed enhancements should only be applicable to those Fund Managers who are responsible for the overall operation of a fund or have de facto control of the oversight or operation of the fund? Please explain your views.	custody agreements and similar documents, and therefore has overall control of – and the contractual relationships to enforce that control with – the various service providers to the fund). By imposing greater regulatory responsibility on fund managers – and potentially purporting to minimise the control exercised by a board of directors, there is a risk that offshore funds could be effectively "on-shored" from a tax and regulatory perspective by virtue of a regulatory-imposed standard of responsibility which does not necessarily properly reflect the reality of fund governance. It would be beneficial for the SFC to work together with the tax authorities in particular to ensure that any such unintentional "on-shoring" does not occur. Likewise, in the trust space in particular, it will not necessarily be the fund manager who has the overall final say in the management and operation of the fund. A more in depth consideration of the differences between retail authorised funds, private funds, and the different legal structures available, would be beneficial. Linked to this, participants expressed concern about how trustee's fiduciary duties would be affected by the proposed scope of the FMCC. There could conceivably be a reduction in protection for investors in the event of a breach or other serious issue – trustees could point to the regulatory regime applicable to the fund manager, to absolve themselves of responsibility, whilst fund managers would argue that fiduciary responsibilities of trustees prevailed. Clarity on this would be required. In reality, however, participants appreciate that in practice there is a shared responsibility between the fund manager and the board of directors of a fund – and that all funds are run better when managers take at least some responsibility for the operation of the fund. The principles behind the proposals are therefore, in the main, supported. Concerns were raised by participants as to how the revised standards would be applied practically by the SFC, so as to ensure that supervision and enforcement approaches are consistent between teams and case officers. Concerns were raised that some market participants may in the future structure funds so as to render these measures practically ineffective. In instances where (i) the Hong Kong Manager is only appointed as the investment manager/sub-manager which does not include the "overall operation of the fund"; and /or (ii) the fund is not authorized by the SFC for distribution in Hong Kong, certain participants do not believe that these funds should be subject to the fund-level requirements in the Code. As a secondary point, there are concerns that extraterritorial reach may create conflicts of laws. For example, in the cases

		where the investment management of – as an example - Luxembourg SICAVs is delegated to Hong Kong affiliates, the delegated investment manager may not have the authority to impose the FMCC requirements on the Management Company (e.g. with regards to the fund valuation principles or the appointment of independent auditors). In reference to the following sentence in paragraph 18 (page 7) of the consultation paper: "(...) *the focus of our regulations at the fund level remains on public funds offered to the investing public in Hong Kong*", this focus should be specified in the FMCC and it should be clear that overseas funds, the investment management of which is delegated to Hong Kong for investment management only but the funds are not authorised in Hong Kong are not required to follow the relevant requirements in respect of those funds. In any case, it would be helpful if the SFC could list out the fund-level requirements that are not applicable to unauthorized funds in a manner which is similar to Appendix 1 for Discretionary Accounts. In reference to the first paragraph of page 2 of the revised FMCC (page 34 of the consultation paper): "*Where a Fund Manager is a delegate of another fund manager for the management of a portfolio within a fund, a reference to its "client" in this Code is a reference to the delegating fund manager, and a reference to "fund" in this Code is a reference to the portfolio managed by the delegated Fund Manager.*", as currently worded, this section only covers scenarios where the delegated manager manages a portion of the fund. One of the participants has suggested that it might be appropriate to revise the wording as follows: "*Where a Fund Manager is a delegate of another fund manager for the management of a fund or a portfolio within a fund, a reference to its "client" in this Code is a reference to the delegating fund manager, and a reference to "fund" in this Code is a reference to the portfolio managed by the delegated Fund Manager.*"
3	Do you have any comments on the above proposals which will be applicable to a Fund Manager which engages in securities lending, repo and similar OTC transactions on behalf of the funds it manages?	Participants consider that – as acknowledged by the SFC – in circumstances where securities lending and similar activities were delegated to specialist third parties, the Fund Manager might not have sufficient granular visibility on a per fund basis to enable it to create, enforce, and disclose any policies properly. Questions were raised as to the kind of oversight the SFC expects Fund Managers to put in place in respect of those relationships and how Fund Managers are to obtain the relevant disclosures. Clarity on these points would be appreciated. Generally, however, many participants felt that the SFC were right to place an obligation on Fund Managers to create and enforce an appropriate policy dealing with these matters as well as more general risk management policies. There are concerns that smaller perhaps less sophisticated firms may find it difficult to comply with these new requirements at the outset. It might therefore be appropriate to consider applying an extended lead-in period for compliance for such smaller

		market participants who may need to undertake a larger amount of preparatory work before being ready for full compliance.
4	Do you have any views or comments on the proposal that Fund Managers should design their haircut methodologies which should reflect the standards set by the FSB in its recommendations?	No particular comment.
5	Is the requirement to disclose details of non-cash collateral re-hypothecation sufficient to enable investors to understand the relevant risks and exposures to the fund? Please explain your views.	No particular comment.
6	Do you have any comments on the proposed requirements on reporting to fund investors? In particular, do you have any comments on the minimum disclosure requirements proposed?	Some participants felt that public disclosure could have the unintended consequence of disadvantaging fund managers in certain circumstances as it might expose otherwise confidential investment positions.
7	Do you have any comments on the above proposals regarding custodian and safe custody of fund assets?	Participants wished to see, generally, the SFC work closely with other regulators and stakeholders in the development of these requirements. In particular, engagement with the FSDC, the HKMA, and the tax authorities would be beneficial to ensure that regulatory developments are undertaken in a cohesive and collaborative fashion. Participants considered that functional – rather than structural – independence between custody and investment functions where firms self-custodise assets is sufficient to protect investors' interests whilst not imposing an additional – and potentially costly - further regulatory burden requiring restructuring of a firm's activities. It is important to bear in mind that in general – whether a fund is structured as a corporate vehicle or a trust, the custodian will not be appointed by the fund manager nor will the fund manager have a contractual relationship with the custodian. Whilst this is acknowledged – in the case of corporate vehicles – in the Consultation Paper, it would be beneficial for the SFC to clarify: (i) its expectations (including documentation required) on the fund manager with regard to selection, appointment and ongoing monitoring of the custodian); and (ii) its expectations with regard to the difference between the roles of the board, trustee, and fund manager in respect of the management of the role of the custodian.
8	Do you have any comments on the above proposals regarding liquidity risk management?	Generally, participants support efforts to implement strong and effective liquidity risk management policies and procedures and understand the necessity of implementing and maintaining liquidity risk management programs that are tailored to meet the specific characteristics and risks of different investment products. Overall, participants support

		the proposals for liquidity risk disclosures provided that such disclosures are clear and effective and the requirements can be adapted, as necessary, to take into account the different models of investment products. In particular, it should be noted that the vehicles in which investors will be most exposed to liquidity risk are open-ended fund vehicles which typically need to manage liquidity carefully to ensure that redemptions can be met in an orderly and equitable fashion. It is clearly important therefore that investors in such vehicles understand not only that there is a liquidity risk (to a greater or lesser extent depending on the type of assets which make up the scheme property) but also the tools that a fund manager (whether unilaterally or in conjunction with or through the directors or trustee of a fund) may employ in mitigating the adverse effects of poor liquidity cycles. For firms which have a global corporate structure, it would be preferable to ensure that sufficient time (perhaps longer than that proposed) is allowed to take into account the need for global discussion, sign-off, and alignment of such liquidity (and risk management) policies. In some cases it may not be possible for a firm in Hong Kong which has a headquarters, or significant business activities elsewhere in the world, to act unilaterally in adopting a policy or risk mitigation limits which may well affect the operation of business lines elsewhere in the organisation. There is some concern that terms such as "tools" and "measures" in the context of liquidity management are not defined, with some comments that uncertainty as to what the SFC considered would be caught here. The proposal to require fund managers to disclose the entry into and principal terms of side letters is a positive step which is broadly in line with similar requirements in certain other regimes. Where side letters offer preferential redemption rights, some participants felt that the SFC could consider prohibiting such terms altogether, given that terms which offer preferential redemption rights to certain investors can cause significant prejudice to other investors, most of whom will be those who are less sophisticated and less able to negotiate similar terms for themselves.
9	Do you have any suggestions on any particular liquidity management measures which a Fund Manager should put in place for effective liquidity management, for example, in terms of setting liquidity targets or stress testing?	Whilst supporting the principles behind the SFC's proposals, it is important to ensure that there is sufficient flexibility in setting liquidity targets, thresholds, and stress testing regimes as well as the stress test governance mechanisms so as to permit firms with overseas operations to design a global risk management framework taking into account the requirements of regimes in other jurisdictions.
10	Do you consider it appropriate for Fund Managers to disclose the maximum leverage of the fund it manages to fund investors?	No particular comment.

11	Do you have any comments on how leverage should be calculated?	There are two opinions with regard to the calculation of leverage. Given that in Europe, in particular, pursuant to the Alternative Investment Fund Manager's Directive, and the requirements for UCITS, there are specific methods of calculating leverage / global exposure and disclosing such calculation methodology and usage parameters to investors, it would be sensible to align as much as possible with the standards prevalent in those other jurisdictions so as to assist investors to understand leverage figures, how they are calculated, and be able to compare effectively the leverage exposures of different funds. If there isn't a standardised method of calculating leverage, it will be debateable whether leverage disclosures will have any real meaning for investors without investors going into detailed comparisons of calculation methodology. If investors are to be able to make informed decisions about the impact of leverage on a fund, they must be able to easily compare leverage figures in a meaningful way. This area is already opaque and technical for retail investors – making the disclosures as meaningful as possible should therefore be a primary consideration. There is a secondary concern that, absent clear guidance from the SFC, it could be difficult for firms to manage their regulatory risk and comply with the requirements to the extent expected by the SFC. Other views state that funds should retain flexibility to determine the basis of calculation of leverage as it is likely that the appropriate approach to measure leverage may vary depending on the type of instruments involved and the purpose for which it is employed. This line of thinking considers that there is no appropriate "one-size-fits-all" approach which would appropriately reflect different types of funds or asset classes. A transition period of sufficient length (potentially greater than that proposed in the Consultation Paper) to allow firms to address this requirement would be preferable.
12	Do you have any comments on the other amendments proposed to the FMCC?	In respect of the fund portfolio valuation proposals, it should be noted that for UCITS / Luxembourg funds where the investment management function is delegated to a Hong Kong fund manager, responsibility for valuation remains at management company level and in practice fund managers are usually not permitted to participate in valuation decisions. We would assume that this practice is covered by the requirement that the valuation requirements apply when a fund manager has responsibility for overall oversight of a fund (or has had the valuation function delegated to him).
13	Under the existing requirement, where a client's order has been aggregated with a house order, the client's order must take priority in any subsequent allocation of partially filled orders. Are there any circumstances where it is in the best interests of clients to aggregate their orders with house orders? What	No particular comment.

	are those circumstances which justify that they are in the best interests of clients? Are there any circumstances in which an institutional professional investor should be able to request pro rata allocation of aggregated but partially filled orders, on the terms specified by such an investor? What are those circumstances? Does the investor who requests pro rata allocation have concerns that the flexibility can be abused by the licensed manager?	
14	Do you have any comments on the suggested risk-management control techniques and procedures as set out in Appendix 2?	No particular comment.
15	Do you have any comments on the requirements set out in Appendix 1?	No particular comment.
16	Do you think a 6-month transition period following gazettal of the final form of the amendments to the FMCC is appropriate? If not, what do you think would be an appropriate transition period and please set out your reasons.	No particular comment other than as included in the context of other responses.
17	What is your view on a pay-for-advice model for Hong Kong? Do you have any comments on our suggested approach to addressing the inherent conflicts of interest arising from receipt of commissions by intermediaries from other parties including product issuers?	No particular comment.
18	Do you have any comments on the proposed disclosure requirement in relation to independence set out above?	Participants expressed concern that the proposals might result in regulatory arbitrage between the SFC, HKMA, and the Office of the Commissioner of Insurance, whereby certain advisors not covered by the SFC's proposal (for example distributors of insurance products which, it is felt, can offer greater commissions to advisors and distributors with lower disclosure standards) might be unfairly benefitted by not having to make similar disclosures. This might also skew investors' perceptions as investors may not understand that such other products are not subject to the same disclosure requirements as those covered by the SFC's proposals. In an extreme case, this could lead to investors mistakenly considering that such insurance products are preferable investments simply because due to the lower disclosure standards, they can better disguise the costs of advice or lack of independence. It would therefore seem sensible for the SFC to work to ensure that the approach across regulators in Hong Kong is aligned. Participants noted that "independence" as a concept is not determined merely by considering what commission or financial benefit is received by a distributor or advisor. It should be made clear that there is a more fundamental

		independence requirement – that of fiduciary duties to investor clients in terms of selecting the best or most appropriate investments. It might be beneficial for the SFC to consider further how to ensure that advisors act in the best interests of their investor clients. Many participants however felt that the proposals represented a healthy step forward given the clear inherent bias in advisors receiving remuneration from the firms they promote. It was felt that the requirement to disclose fees upfront – along with an indication in dollars of trail – was a positive step and in line with the thinking of regulators in other jurisdiction. Generally, investors seem to respond better to analysing figures set out in dollars – or real terms – rather than abstract percentages which can appear small when taken out of context of the size of the investment or the asset pool of a fund. To build on this, and to refer back to the paragraph above, it might be beneficial to consider extending disclosures to cover how investment advisors make investment selection decisions and the criteria used to select preferred investment options or "best buy" lists (perhaps in a key facts sheet or statement which they must keep up to date). Advisors and managers should also disclose the range of investment products that they use to make selections and the extent to which they are – formally or informally – "tied" to a selected range.
19	Do you have any comments on the enhanced disclosure proposed with regard to monetary benefits received or receivable by intermediaries that are not quantifiable prior to or at the point of entering into a transaction (and in particular, in relation to specific types of investment products)?	In addition to the above there was concern that sensitive competitive information might be disclosed in making public the rates of commission paid – although this is perhaps primarily of greater concern for the distributors or advisors themselves. It would be useful for the SFC to consider how easy it will be for market participants to comply when in many cases, commissions are paid on the basis of the total assets attributable to clients introduced by an advisor or distributor. It might therefore be difficult in practice to break the disclosures down on a fund by fund or class by class basis. Generally, in relation to the proposed disclosures, participants considered that greater clarity would be beneficial in terms of distinguishing between the commissions or other payments or benefits received by a financial advisor from a fund or investment provider, and the charges and fees imposed by the advisor itself.
20	Do you have any comments on the suggested manner of disclosure of trailer fees (in the context of funds) set out in the sample disclosure above? Do you have any other suggestions to ensure that the disclosure of non-quantifiable monetary benefits relating to other types of investment products will be clear, fair, meaningful and easily understood by investors?	Please see above.
21	Do you think a 6-month transition period following gazettal of the final form of the amendments to the Code of	No particular comment.

	Conduct is appropriate? If not, what do you think would be an appropriate transition period and please set out your reasons.	

This submission is made by Eversheds on behalf of the participants.

Should you have any questions, please do not hesitate to contact

Yours faithfully

Eversheds