CompliancePlus Consulting

Compliance Consulting • Funds Consulting
Regulatory Consulting • Compliance Training

Submission to Consultation Paper issued by the Securities and Futures Commission on the Proposals to Enhance Asset Management Regulation and Point-of-sale Transparency (the "Proposal")

February 2017

CompliancePlus Consulting Limited
801, Two Exchange Square, 8 Connaught Place, Central, Hong Kong
Tel: (852) 3487 6903 www.complianceplus.hk

Introduction

The Securities and Futures Commission (the "**SFC**") has issued a Consultation Paper on Proposals to Enhance Asset Management Regulation and Point-of-sale Transparency (the "**Consultation Paper**") on 23 November 2016.

This submission is made in response to the Consultation Paper with our comments and suggestions set out below. Terms defined or given a particular construction in the Consultation Paper have the same meaning in this Response unless a contrary indication appears.

1. **Do you have any comments on the proposed clarification that the Fund Manager Code of Conduct ("FMCC") applies to the business activities carried out by fund managers which would include management of discretionary accounts?**

   We agree to the proposition that the FMCC shall cover all business activities carried out by persons licensed or registered for Type 9 (Asset Management) Regulated Activity, which primarily consist of management of collective investment schemes ("**CIS**") and discretionary accounts, which are activities of similar nature involving the establishing of investment mandate on behalf of the investor with investment discretion and trading authority.

   The proposed clarification regarding the applicability of the FMCC, along with the deletion of paragraph 1.4 of the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (the "**Code of Conduct**"), enhances uniformity and predictability of the regulatory regime towards the asset management industry in Hong Kong. It will be easier for licensed/ registered persons to understand and conform to their corresponding relevant regulatory requirements.

   Along with the clarifications on the regulatory regime, we are aware that the SFC has introduced numerous additional regulatory requirements and thresholds for all asset managers. Despite the proposed enhancements being alleged to be largely principles-based and the focus of regulations will remain on public funds (as mentioned in paragraph 18 of the Consultation Paper), it is notable that the

proposed enhancements to the FMCC have mostly introduced clear and unambiguous requirements for licensed/ registered persons regarding implementation of internal policies and disclosure to investors.

We are concerned that the proposals will essentially blur the differences between private and public funds, which disproportionately increase the burden of private fund managers and discretionary account managers serving professional investors in achieving to comply with the newly imposed regulatory requirements.

The International Organization of Securities Commissions ("**IOSCO**") principles and Financial Stability Board ("**FSB**") recommendations that the SFC referenced have not specifically distinguished between public and private funds.

However, being the sole regulator in the securities and futures industry of Hong Kong, the SFC could have taken into account the local circumstances and the inherent difference between public and private funds, and accordingly provide clear direction regarding how those principles and recommendations are to be adopted in Hong Kong, which would be in line with the purpose of introducing all the enhancements to ensure clarity and predictability in the industry, whilst maintaining the attractiveness and simplicity of the private fund sector as opposed to the public fund sector.

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 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.**

Certain proposed enhancements and requirements in the Consultation Paper will only be applicable to Fund Managers responsible for the overall operation of a fund or having de facto of the oversight or operation of the fund.

It was mentioned that the proposal has taken into account the heterogeneous nature of the asset management industry activities, structures and responsibilities among relevant parties, under which the SFC considers certain responsibilities shall be placed on the manager with overall or de facto control, even that person may not be the person bearing legal responsibility for the fund's decisions.

The proposal may easily cause confusion on roles and responsibilities on co-managers who manage a fund that they may not easily or clearly decide whom should have overall responsibilities of the operation of the fund. This may create a compliance loophole.

For example, a Luxembourg domiciled fund appoints several sub-investment managers in Hong Kong to co-manage a retail fund in Hong Kong. The Hong Kong based sub-investment managers may claim that the Luxembourg based investment manager is responsible for the overall operation of the fund and have de factor oversight that they are only sub-managers. However, the Luxembourg based investment manager is not licensed with the SFC.

For hedge fund or private fund, such confusion can be created if the fund is jointly managed by different managers who can also claim that they do not have de facto control that an offshore based investment manager should be responsible for the overall operation of the fund.

The SFC should be mindful of this possible loophole that some co-managers may make use of this to get around compliance obligations that should have been applicable to them under the existing FMCC.

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?**

We agree to the proposals for fund managers engaging in securities lending, repo and similar OTC transactions on behalf of the funds it manages.

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?**

We agree to the proposal that Fund Managers should design their own haircut methodologies reflecting the FSB standards. Adoption of a haircut covering the maximum expected decline in the market price of the collateral asset due to price volatility or liquidating costs. It would be beneficial for the fund manager to manipulate its risk profile and better estimate the acceptable level of margin and leverage in light of changing financial conditions.

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.**

We find the requirement to disclose details of non-cash collateral re-hypothecation sufficient to enable investors to have adequate understanding the risks and exposure to the fund. With reference to the nature of non-cash collateral as differentiated from cash collateral, the asset managers need not be subject to the liquidity management requirement as required for cash collateral.

For re-hypothecation of non-cash collateral, implementation and disclosure of a suitable and prudent haircut methodology, along with disclosure of details of such re-hypothecation, shall be sufficient for investors to adequately inquire into the associated risk factors in relation to such acts of reinvestment.

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?**

There are three proposed requirements on reporting to fund investors about securities lending, repo and similar OTC transactions in the Consultation Paper, namely:

(a) Disclosure of summary of securities lending, repo and similar OTC transactions policy, risk management policy in fund offering documents;

(b) Provide information relating to securities lending, repo and similar OTC transactions at least annually and upon request; and

(c) When a third-party agent conducts securities lending and repo activities for the fund manager's behalf, the fund manager should obtain access to the relevant information from the agent for disclosure purposes.

We find the proposed disclosure to be excessively onerous to the fund manager, both to the scope and the time frame of the requirements. Considering that fund managers will have to formulate and illustrate their own transactions policy, collateral valuation and management policy, haircut methodologies and all of the corresponding risk management policies, we find that the investors shall have sufficient information to understand the associated risks for the relevant fund.

The enhanced disclosure requirements will likely lead to invasive effects as information in relation to the above policies are closely linked to formulation of fund strategies and fund investment planning, which are often categorized as commercially sensitive information. Such disclosure will be detrimental to fund managers but not necessarily beneficial for investors in understanding relevant risk factors.

In addition, given the ample information that is available to investors, we do not find it necessary for the fund manager to be subject to disclosing information in such details within a short time period. We consider that the "at least annually and upon request" requirement could be changed to annually with less detail than those proposed in Appendix C of the Consultation Paper.

The proposal does not state clearly the disclosure requirements apply to public funds only or not. We would emphasis our house view that when it comes to disclosure, private fund managers should not be subject to the identical stringent standards as public fund managers due to the fundamentally different business nature and target customers.

7. Do you have any comments on the above proposals regarding custodian and safe custody of fund assets?

We agree to the proposals regarding custodian and safe custody of fund assets.

8. Do you have any comments on the above proposals regarding liquidity risk management?

We share the view of the SFC in the proposals regarding liquidity risk management.

In reading the relevant materials in relation to the SFC's proposal, we have our attention drawn to the SFC's Circular to management companies of SFC-authorized funds on liquidity risk management dated 4 July 2016 which specifically refers to SFC-authorized funds only.

We note that the SFC intends to adopt the Principles of Liquidity Risk Management for CIS issued by the IOSCO in 2013 which sets out a framework of principles for managing liquidity risks of CIS. One important feature of the principles is that they apply to both public and private funds.

We also note that some of the principles raised by the IOSCO may appear to be more relevant to public or open-ended funds but we also acknowledge that some of the principles remain of certain relevance to private funds as well.

While the revised FMCC contains a statement that the extent of application of such principles will depend on the nature, liquidity profile and asset-liability management of the fund, we accept that this has mitigated the stiffness of the proposed principles and therefore Fund Managers shall be able to decide which of the principles will be applicable in each individual case.

Regarding stress test, we take the view that Fund Managers should be given discretion to decide which fund or account requires regular stress testing since not all types of funds or accounts need stress testing. The extent or frequency of such testing shall also be left for Fund Managers to decide depending on the nature and liquidity profile of each fund.

While the SFC has previously issued a circular on liquidity risk management which covered many of the proposed liquidity risk management policies introduced in the current proposed revision of the FMCC, it has to be noted that the circular is

applicable to SFC-authorized funds i.e. public funds only but the proposed changes apply to both public funds and private funds.

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?**

Based on our experience, we have observed some practices which have been commonly used in the fund industry. As an example, regular risk analysis for the Fund which includes reports on exposure and concentration; risk concentration; VAR; historical stress testing; sensitivity analysis; and liquidity breakdown, are prepared.

As adopted by some Fund Managers, the liquidity of a Fund's portfolio is being measured, based on the Fund's portfolio positions, as the percentage of the portfolio that could be liquidated within five trading days and within one month would be calculated which then reflects the minimum liquidity of positions.

As an indicative liquidity target, Fund Managers may lay down a standard where for example 75% of the positions could be liquidated within two trading days under normal market conditions. Also, where applicable, liquidation costs are assessed on a weekly basis and presented during weekly investment committee meetings.

While the measurement of the liquidity of fund portfolios is more principle-based rather than prescriptive in the current regulatory framework, we are of the view that it is adequate in the sense that a rigid definition or prescribed limitation should be avoided.

Currently in Hong Kong, the use of liquidity management tools does not need any prior approval from the SFC. While we note that the use of liquidity management tools requires regulatory approval in some jurisdictions, we would like to maintain the view that the SFC shall not go any further to require regulatory approval in this realm as long as it has been disclosed in the offering documents.

10. Do you consider it appropriate for Fund Managers to disclose the maximum leverage of the fund it manages to fund investors?

In the present revised FMCC, it is proposed that Fund Manager should disclose the maximum level of leverage to fund investors by stating such information in the fund's offering document.

According to the Proposal, the minimum disclosure to be afforded is disclosing such information in the fund's offering document. In other words, such disclosure is made before any investments made by investors. In this regard, we would like to propose that disclosure should also be made upon any material changes to the information.

We note that in certain jurisdictions leverage limits are imposed to restrict the maximum level of leverage that can be employed by Fund Managers. In contrast, the SFC has not imposed any specific leverage limits and does not require Fund Managers to disclose such information to the SFC directly.

In this regard, we are satisfied with the current proposal that the mere disclosure of the maximum leverage to fund investors is already adequate provided that Fund Managers should have an implied obligation to monitor the use of leverage as a risk management measure on an ongoing basis through the risk management framework entailed in the revised FMCC.

11. Do you have any comments on how leverage should be calculated?

We accept the SFC's view that there is currently no general consensus on how leverage should be calculated and under this premise Fund Managers shall not be restricted to prescribe particular methods of leverage calculation.

Based on research, we note that regulators in some jurisdictions impose prescribed leverage calculation methods that Fund Managers are obliged to use. As an example, in Europe, Fund Managers are required under the Alternative Investment Fund Managers Directives (AIFMD) to use 2 prescribed methods for calculating the amount of leverage employed, i.e. the Gross Method (under which all positions of the AIF are taken into account, and derivative exposures are

translated into the market value of equivalent positions; and the leverage is the gross sum of all the translated exposures) and the Commitment Method (under which hedged or offsetting positions are netted against each other before the leverage is calculated).

We believe that to prescribe a particular calculation method among the existing variants may add further complexity to the established industry practices in Hong Kong given that Fund Managers have the flexibility to opt for their own selection of the most appropriate calculation method based on their expertise as well as the characteristics of each portfolio.

Despite the direction of not prescribing a particular calculation method, we note that the SFC proposes that Fund Managers should take into account two items, namely Financial Leverage (arising from borrowings of money or securities directly from counterparties) and Synthetic Leverage (arising from the use of derivatives such as options, futures or swaps) in their calculation.

In this respect, we do not have any further comments given that the express inclusion of synthetic leverage is important in order to obtain an accurate reading of the exposure that is implied by derivative positions and in other words provide a complete appreciation of all the leverage that is employed by a fund to gain market exposure.

We are of the opinion that the mere disclosure of the basis of leverage calculation in funds' offering document as proposed already suffice for the purpose of protecting investors' interests.

It is further agreed that Fund Managers shall have the discretion to select appropriate leverage calculation methods under the prerequisite that the method selected is reasonable and prudent and have regard to international best practices and that disclosure is made.

12. **Do you have any comments on the other amendments proposed to the FMCC?**

(i) Fund Portfolio Valuation

We note that the revised FMCC expressly provides for the valuation policies and procedures and the valuation process to be reviewed at least annually by a competent and functionally-independent party. Such party should also test the valuation procedures by which fund assets are valued.

We reckon that this new measure would necessarily involve the need for Fund Managers to hire external service providers.

This may increase the operational cost for Fund Managers who do not appoint external third parties to perform valuation services. The Fund Managers may need to appoint one for the sole purpose of the review of valuation policies, procedures and process under the revised FMCC.

We are of the view that the review of the valuation policies, procedures and process shall remain the responsibility of the Fund Managers while they should decide whether the appointment of an external service provider is viable.

(ii) Audited Financial Statements

In respect of audited financial statements, the revised FMCC expressly require the appointment of an independent auditor to perform audit of financial statements and produce annual reports. In this regard we agree with this amendment since this requirement is merely a codification of the existing industry practice and that it has already been much of the industry standard.

(iii) Side Pockets

We note that the newly inserted section on side pockets in the revised FMCC is mainly an incorporation of the relevant requirements set out in the SFC's Circular to All Licensed Corporations Engaged in Hedge Funds Management Business dated 27 October 2008. We do not have any particular comments towards this incorporation which serves as a comprehensive guidance to Fund Managers. We also agree with the disclosure requirements with regards to side pockets as proposed.

(iv) Reporting

Under the revised FMCC, the SFC proposed that it would collect information relevant to leverage, assets, liabilities and a fund's securities lending, repo and similar over-the-counter transactions from Fund Managers from time to time or on an ad hoc basis.

However, the provision has not defined the conditions or criteria for a Fund Manager to be required to provide such information on a periodic basis instead of an ad hoc basis. As such, we would like the SFC to provide further clarifications such as the data collection format or templates as the SFC has previously conducted surveys on fund managers.

(v) House Accounts

We note that the revised FMCC proposes that aggregation of house orders with client orders should only be made if it is in the best interests of clients which imply that this contemplation shall be made before any aggregation of house orders is carried out. We agree that this serves as a clarification to the previous provision which only provides for a retrospective duty as it states that client's order takes priority in partially filled orders when a client order has been aggregated with another order without specifying the term of house orders.

(vi) Electronic Trading

We accept the removal of the section on Electronic Trading from the existing FMCC in light of the fact that licensed persons engaging in electronic trading have already been required to comply with the Code of Conduct.

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 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 request**

pro rata allocation have concerns that the flexibility can be abused by the licensed manager?

We acknowledge there are circumstances where it is in the best interests of clients to aggregate their orders with house orders.

If client orders and house orders are aggregated, it is conceivable that the total trading volume will increase as a result. Accordingly it can be reasonably expected to result in a better price, lower transaction cost or overall better transaction terms.

In such circumstances, aggregating client orders and house orders may be beneficial to clients provided. It is unlikely that the aggregation of orders will work overall to the disadvantage of any fund which order is to be aggregated.

Apart from lower execution costs or better commission rates typically associated with large orders, the aggregation of client and house orders may also achieve administrative convenience.

The SFC should be more open to aggregation of client and house order but the SFC should set out clear criteria or compliance requirements for the fund managers to follow such as below:

- Keeping record of the rationale for the aggregation of the orders
- Written justification of the economic or costs benefits that can bring to clients
- Aggregation of such orders will have no prejudicial impact on clients or portfolio or account managed by the fund managers
- Client's requests must be kept and such request should be made prior to the aggregation of the orders and the fund manager can reject such client's request if it is illegal or non-compliance
- Compliance prior approval must be obtained
- SFC can request for inspection of such records when necessary

14. Do you have any comments on the suggested risk-management control techniques and procedures as set out in Appendix 2?

We note that the suggested risk-management control techniques and procedures for funds as set out in Appendix 2 is intended to be a comprehensive and extensive guidance to Fund Managers regarding risk management policies, governance structures and procedures.

The suggested techniques and procedures are an elaboration of the existing suggested risk management control techniques and procedures as set out in the Management, Supervision and Internal Control Guidelines for Persons Licensed by or Registered with the SFC (ICG) but tailored to specifically apply in the context of funds.

As the suggested techniques and procedures in Appendix 2 identify the different types of risk that may be relevant such as market risk, liquidity risk, issuer and counterparty credit risk and operational risk, we agree that this should serve as an useful guidance to Fund Managers when complying with the risk management policies as required by the FMCC.

15. Do you have any comments on the requirements set out in Appendix 1?

The purpose of the Appendix 1 is to further provide operational guidelines specific to discretionary account managers.

We understand the intention of the SFC to differentiate the regulatory requirements of discretionary account managers. However, we find the proposed Appendix 1 with particular requirements not applicable and additional requirements for discretionary account managers may not be the most user-friendly way of presentation as the users will have to flip the code back and forth to cross-reference the Appendix 1 with provisions in the main content of the FMCC. Instead, we suggest adding footnote to the main text of the FMCC for easy reference by the readers.

Regarding the performance review and valuation reporting by the discretionary account manager, we believe that the managers should disclose the details of delegation of reporting responsibilities (if any) to the investors. From current industry practice, some discretionary account managers may delegate some of the reporting responsibilities to the administrator so as to reduce the

administrative burden. Hence, we believe the Appendix 1 should also require the discretionary account managers to disclose the relevant details to facilitate a better transparency if applicable.

For the minimum content requirement of discretionary management agreement, the following clauses should also be included in the agreement for several reasons.

(a) Proxy voting and voting rights: It helps to identify the rights of investors and the managers on who should vote to encourage voting
(b) Prompt notification to investors on other material matters such as trade errors, operational disruption, business discontinuity, disciplinary actions or ongoing investigation

The SFC should also consider other industry best practices when formulating and revising the Appendix 1 as appropriate such as the "Managed Account Guide" issued by The Alternative Investment Management Association ("**AIMA**").

16. Do you think a 6-month transition period following gazettal of the final from 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.

We believe a longer transition period of at least 12 months is necessary following gazettal of the final from of the amendments to the FMCC.

It is foreseen that the proposal is broad in scope and will necessarily lead the fund manager to have operational and personnel changes that they will need time to ensure compliance.

Apart from provision of transitional period, guidance shall be provided to Fund Managers at earlier stage, preferably after issuance of the conclusions to this Consultation Paper, by issuance of circulars, guidelines and Frequently Asked Questions and organizing workshops to provide implementation directions to the industry.

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?**

We agree with SFC's views that adoption of a pay-for-advice model with a complete ban on receipt of commissions by intermediaries will not be feasible in Hong Kong, taking into consideration of the general unwillingness of Hong Kong people to pay for financial planning and advisory services.

Complete separation of financial advisory services from other relevant services will as a result hinder the business of such service providers and hinders market vibrancy.

To address the inherent conflicts of interest arising from benefits received and receivable by intermediaries in return for selling and recommending products, a certain extent of disclosure is necessary to enhance transparency and investor protection.

We agree that the use of the term "independence" shall be restricted as proposed due to the potential effect of confusion to investors. Under the proposed scheme it shall be easier for investors to differentiate between "real" independent advisors from those affiliated to other service providers.

Nevertheless, we have reservations towards the proposed enhanced disclosure requirements in terms of the extent and scope of such disclosure, which we will further illustrate in the answers below.

18. **Do you have any comments on the proposed disclosure requirement in relation to independence set out above?**

As mentioned in response to Question 17, we agree with the proposed disclosure requirement in relation to the status of independence. It will notably enhance market transparency by getting investors informed of conflicts of interest issues before entering into agreements with financial services providers.

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)?**

We do not support the proposal regarding enhanced disclosure under this Consultation Paper. We are of the view that the proposed requirements have several downsides, and such downsides are not proportionate to the benefits that can be brought to investors.

We find the requirement of disclosing the existence, nature and amount of all monetary and non-monetary benefits received and receivable for every specified products to be excessive.

It will likely trigger confidentiality issues as it attempts to unfold and disclose all contractual arrangements between product issuer and financial advisors reached upon private negotiation.

It would result in a cut-throat price competition in the industry which we consider to be unhealthy in nature and will significantly hinder the business of the financial advisory industry as a whole.

In addition, we find the requirements of disclosing the range of the benefits received to be impractical. It is mentioned in paragraph 98 of the Consultation Paper that the range of such benefits should *reasonably* reflect the terms of agreement with party providing the benefits.

We find the reasonableness requirement to be unclear and unnecessary. It would be difficult and impractical for the SFC to comment on and intervene the outcome of private commercial negotiations.

It will also be difficult to determine the reasonableness of such fees given the heterogeneous nature of the asset management industry. We consider that the intermediaries will just seek a leeway to disclose a broad range of benefits received and receivable from the product issuers.

Ultimately, this requirement will be difficult to enforce and the figures give very low indicative value to investors when making their investment decisions.

With reference to the conduct of selling other non-security products, it also does not require the financial advisor to disclose the range of commission or income arrangement from receipt of commissions by intermediaries from other parties including product issuers.

Using Hong Kong Insurance industry as an illustration, insurance brokers regulated under the Insurance Authority only requires to be independent and good faith without requiring to disclose particular commission arrangement between the insurance brokers and the insurer before entering into the agreements, based on the Minimum Requirements for Insurance Brokers specified by the Insurance Authority.

Meanwhile, the Mandatory Provident Fund ("**MPF**") industry, the MPFA also does not require the intermediaries to disclose a detailed fee arrangement between intermediaries themselves and the MPF managers. Therefore, such disclosure requirements on non-quantifiable monetary benefits received or receivable may create an unfair playing field.

The SFC should strike a balance between protecting of investors' interest and ensuring commercial confidentiality. We consider the current proposal to be excessive and will likely be impractical, under which the extent of disclosure could be tuned down to avoid administrative difficulties and hindrance to the market.

We suggest that, prior to or at the point of entering into a transactions, intermediaries should not be required to disclose its detailed fee arrangement with product issuers.

Instead, they shall only be required to disclose the existence of affiliation with outside parties, and the maximum amount of benefits that they could receive. Intermediaries shall only be required to disclose the detailed breakdown of the fee arrangement after entering into the transaction through issuance of periodic statements or reports.

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 the disclosure of non-quantifiable monetary benefits relating to other types of investment products will be clear, fair, meaningful and easily understood by investors?**

As illustrated in our response to Question 19, we find the proposed trailer fee disclosure to be excessive and unnecessary given that the financial advisor has not entered into a transaction with the investor. The "range of benefits to be received" will be too wide in practice thus will not be a clear and meaningful indicator for investors in considering their investment decisions.

We suggest that financial advisors shall only be required to disclose their independence status, as well as outlining the maximum amount of benefits received prior to entering into transactions with investors. Detailed breakdown of the trailer fee arrangements shall only be required after the investor has subscribed in the corresponding portfolio.

21. **Do you think a 6-month transition period following gazettal of the final form of the amendments to the Code of Conduct is appropriate? If not, what do you think would be an appropriate transition period and please set out your reasons.**

We believe a longer transition period of at least 12 months is necessary following gazettal of the amendments to the Code of Conduct.

22. **Comments on removal of Paragraph 1.4 of the Code of Conduct**

It is also noted that the Paragraph 1.4 of Code of Conduct stating that the provisions of Code of Conduct does not apply to Fund Managers is removed. The amendment means fund managers are required to comply with all provisions of the Code of Conduct.

Historically, paragraph 1.4 was required by the asset management industry so that they can be clear that primarily they should comply with Fund Manager Code of Conduct.

With this proposed deletion, the fund managers may be confused as to which provisions they should comply if both Code of Conduct and Fund Manager Code of Conduct have different requirements on same compliance area. The SFC may consider conducting a mapping or an analysis of any compliance conflicts that may arise from the proposed deletion.

The SFC should issue circulars or FAQs to clarify any ambiguity that may arise from the proposed deletion or address these concerns in any workshops that the SFC may organize.

Conclusion

In general, we welcome changes and clarifications to be made to the FMCC and Code of Conduct to clarify the regulatory regime of the asset management industry in Hong Kong, as well as bringing forward changes to the regime in response to the up-to-date internationally recognized regulatory standards. This can facilitate the development of Hong Kong as an asset management centre.

We appreciate the SFC's efforts in putting forward all the changes. It is always a challenging task to balance between enhancing protection of investors' interest and preservation of free market with minimal intervention.

It is however observable that the SFC's proposal indicates a propensity towards imposition of an enhanced level of rules and regulations in the asset management industry on private fund sectors.

We also observed that the SFC has referenced recommendations and policies published by international bodies including the IOSCO and the FSB when coming into the proposed enhancements. We hope that the SFC could take into account the actual market situation in Hong Kong and the existing distinction in the regulatory requirements of private fund sector and public fund sector rather than directly adopting those recommendations and policies.

Finally, given the broad scope and wide variety of changes and enhancements to be put in place, we hope the SFC to provide a longer transitional period for the existing licensed corporations, as it is foreseeable that numerous small-sized asset managers

will encounter difficulties in adopting and implementing the proposed schemes and requirements. The SFC shall also issue FAQs and organize workshops to get the industry prepared for the upcoming changes.

-END-