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Ms Sandra Mak
Associate Director
Investment Products Department
Securities and Futures Commission
12/F Edinburgh Tower
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Hong Kong

15th November 2001

Dear Ms Mak

re. Consultation Paper on the Offering of Hedge Funds

Preamble

The undersigned is the Managing Director of HT Capital Management Limited ("HT Capital"), a Hong Kong based and Securities and Futures Commission ("SFC") compliant, fund management company. The author is the business manager with responsibility for running the company day-to-day, specifically legal and accounting issues, compliance and marketing. He has four years experience in fund management and about 25 years experience in Investment Banking.

HT Capital's fund is the HT Asian Catalyst Fund LLC ("the Fund"). The Fund is a long/short one; the investment style is conservative with a natural bias to invest long. It is not a hedge fund. The Fund is not a retail fund and as such is not authorized by the SFC nor has the Registrar of Companies in Hong Kong registered the attendant information memorandum.

Because we do not intend the Fund to be authorized as a retail fund, we have restricted our comments to the first part of the Consultation Paper; we have not proposed any text to amend the code as set out in Annex 1. However, most, if not all of our comments on the first part of the Paper cover the points listed in Annex 1.

We sincerely believe that the greater the level of awareness of the various fund management styles, the greater the benefit to investors, practitioners and regulators alike. In this spirit, we hope that our comments may be received as positive and constructive in the consultative process.

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SFC Paragraphs 5-61

5-24. There are many definitions that may be correctly, or incorrectly, applied to define hedge funds. The simplest explanation is that the role of a hedge fund manager is to post positive returns for investors in both bull as well as bear markets. Returns should be positive regardless of prevailing stock market conditions (bar catastrophic events such as 911).

Historically, retail investors were limited in choice, in the main, to investing in long only funds. Long only fund managers earn fees for buying equities at a price and selling those same equities at a higher price; the resultant profits translate into a positive performance for the fund. This management style works exceptionally well in bull markets but fails dismally in bear markets.

Long only fund managers describe their style as "benchmark" performance. The most popular and widely understood benchmarks are the Morgan Stanley Capital International ("MSCI") indices. In a period of negative performance, a benchmark manager might excuse performance as follows: a fund might be down say 25%, and the MSCI might be down say 33% over the same period. The result therefore might deemed to be positive insomuch as the fund had actually "outperformed" the index. As ludicrous as this sounds, this out performance proclamation was widely accepted until conventional wisdom came of age with the realization that an MSCI index is actually a passive index and, regardless of out performing the index, a loss is still a loss.

The comparison between the performance of a professionally managed portfolio and a passive index is no longer regarded as the useful yardstick it was once thought to be. However, investors still need to compare performance in order to make an informed decision before or during the course of an investment. The most obvious form of comparison is that of like managers. However, this is not too helpful during a period when all long fund managers post negative returns; an investor's choice then is limited to picking the best of the worst.

An alternative management style now beginning to be made available to the retail investor is the braver, more aggressive and riskier management style of "absolute return" or, by any other name, hedge fund. It is unfortunate that hedge funds as a whole were propelled into infamy by the high profile antics of a few; the resultant stigma severely retarded the acceptance of hedge funds as a viable investment alternative by investors, regulators and, perversely, the larger established long only fund management houses. Reappraisals have been slow coming but positive drivers have been a wider understanding of hedge funds and investor demand for viable alternative forms of investment.

25. Agreed. Hedge funds should only be made available to professional, sophisticated or well-informed investors. They should not be offered to the public without any restrictions.

26. We suggest a market segmentation approach by using a net worth check-list (i.e. not a net worth test) together with a minimum subscription amount.

27. We suggest educational forums via seminars. These seminars will hopefully be financed by market practitioners; the SFC might consider lending its name to ensure the highest level of integrity and credibility. In addition, the cost of attendance should be nominal so as to attract and encourage active attendance.

28. Previously discussed as in **26.** above.

29. We suggest a minimum subscription amount of US$50,000 with US$10,000 incrementals.

30. Agreed. The SFC's expectations are fair and logical. The competence of selling agents can be refined as in 27. above.

31-33. Agreed.

34. Please refer to paragraphs **26.** and **29.** above.

35-36. ✓

37-38. Agreed. "Hedge" fund is a generic description. Whilst different types of hedge funds include Merger & Acquisition, Arbitrage, Convertible Bonds etc. the structure of the relevant fund will be essentially the same. It may not be possible and in fact it may be unnecessary to monitor extreme variance in specifications (i.e. gearing, percentage of NAV in any one position etc.) if a standard positioning is prescribed in the Offering Memorandum, say in an "Executive Summary" on page one or two, with a more detailed description contained later in the document.

39. We suggest that perhaps the most important item in the usual assessment criteria be the tenor of hedge fund experience of the fund manager. This should not serve as a restriction nor an inferred approval but should nevertheless be clearly stated upfront in the attendant documentation.

40. Disagree. The term "Private Fund" normally refers to direct investments i.e. non-listed investments. The correlation between private fund management and hedge fund management is so slight as to be irrelevant.

41. Does this refer to the aggregate size of all funds managed or specifically to each hedge fund? Regardless, we see little merit or investor protection in the size of a fund. Furthermore, it may be argued that smaller funds might be easier to manage, as they are able to facilitate major portfolio changes according to and as when required according to extreme market volatility.

42. Agreed. Adequate risk management systems and internal controls should be clearly stated in all of the fund's documentation. The fund's agents i.e. the Administrator, Custodian, Trustee, Prime Broker, and Auditor etc. monitor the application of systems and controls. These agents, except perhaps the auditor, should most definitely be "substantial financial institutions" or, at the very least, fully reflect the experience and integrity of the same.

43. We agree but, "…An undertaking from the fund manager in this regard is hence considered necessary…' sounds very much as though the SFC might be wanting an "undertaking" to be an indemnification. If this is the case, fund managers will not be able to or, be unwilling to indemnify their selling agents for a number of valid reasons, potential negative financial impact on the manager's resources being the most obvious. However, we agree that managers assume responsibility for the actions of their selling agents albeit on a best-endeavours basis.

44. Agreed, as it pertains to retail funds.

45. Agreed.

46. Agreed, conditional upon **42.** above. It is common market practice for hedge funds with assets in excess of say US$50 million to have two Prime Brokers. In any event, there are a very limited number of financial houses that hold themselves out to be Prime Brokers; the current players tend to be of the highest professional and financial integrity.

47. ✓

48. Agreed. We suggest one Dealing Day per month, say the 1st or the 15th business day of the month. In addition, transparency should be upheld by a "Monthly Update" detailing an overview (but not a micro view) of the investment strategy undertaken during the month under review. This is commonplace amongst non-retail hedge funds and should be easily facilitated by retail funds. When sent by e-mail, Monthly Updates should be e-mailed whenever possible in Portable Document Format for security reasons.

49. Disagree. The giving of a minimum 30 days prior notice to the next Dealing Date should be adequate notice to effect redemptions. Hedge funds are, by definition, dynamic funds; some allowance in building a core portfolio whilst wanting to avoid premature redemptions can be achieved by the imposition, at the manager's discretion, of a redemption fee of say 2%, in the event that redemptions are made within 12 months of the original subscription.

50. Agreed.

51. Agreed.

52. We believe high-on-high performance fees and annual payment of the same to be wholly appropriate for hedge funds (absolute return funds). A typical wholesale hedge fund fee structure might comprise the following: -

Management Fee: 1.25%-1.75% pa.
Performance Fee: 15%-20% annual high-on-high
Subscription Fee: 2.00% flat
Redemption Fee: 2.00% flat

Both the Subscription and Redemption Fees are normally waived simply because wholesale investors are averse to paying them. The whole fee structure therefore is skewered to performance i.e. the manager's remuneration is very much linked to performance. Whether or not Hong Kong based retail hedge funds adopt the same structure with similar fees remains to be seen. However, we believe that fees, in whatever form, should be at the discretion of the manager and, provided fee structures are fully disclosed and understood, fees should not be of concern to regulators.

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53. Agreed and very much a fast growing sector.

54. Agreed.

55. Agreed.

56. Fully agreed, we have had first-hand experience with this. When revising our Information Memorandum, our legal advisors drafted a so-called "purist" explanation of the high-on-high performance fee calculation. After reading the draft version three or four times we understood the section; when the same section was reviewed by potential investors, the consensus view was that it was far too complicated and difficult to understand. We then reverted to a simpler format, which in the absence of illustrations, was easily understood by all. We therefore suggest that simplicity and an up-front glossary of technical terms be conditions precedent.

57. In the event that offering documents, advertising material and subscription forms clearly state that the fund is a hedge fund together with the requisite health warnings viz. "...price of units may go down as well as up..." and "...past performance is no guarantee of future returns..." then we believe that any additional warnings would be somewhat superfluous to the cause.

58. As mentioned in **48.** above, we suggest a macro description as being adequate. Some managers do in fact disclose either the entire portfolio or the top five or ten holdings; we suggest this practice continues to be entirely at the discretion of the manager. In addition, monthly updates are normally sent out within a week or two after the month end and as such, at the time of their despatch, portfolios, positions and strategies would be difficult to replicate by competitors as market conditions as well as prices well may have changed.

59. Agreed. In the interests of transparency, we support a narrative report on a monthly basis.

60. Apart from the audited annual accounts, monthly reports should in the main be non-financial but be narrative in explaining the fund's strategy and performance for the month under review.

61. As mentioned in **26.** and **29.** above, we advocate a market segmentation approach together with a minimum subscription amount of US$50,000.

We would be pleased to meet with you and discuss our comments in more detail if you so wish.

Sincerely yours

Karl M. Hurst
Managing Director