

7 December 2001

Securities & Futures Commission  
12/F, Edinburgh Tower  
15 Queen's Road Central  
The Landmark  
Hong Kong

Dear Sirs

**Re: CONSULTATION PAPER ON THE OFFERING OF HEDGE FUNDS**

In response to the above I set out my comments and observations.

The emphasis of your document appears to be that the general public are not "equipped" to invest in hedge funds but they are "qualified" to invest in other existing public offerings. I find this odd when I look at the amount of money local investors have lost by investing in public offerings in Hong Kong. I wasn't aware of the Commission's concerns being as great when numerous "technology" and new economy shares were listed on GEM. Every listed security has the potential to lose an investor 100% of his capital and I genuinely believe that Hong Kong investors are aware of this. The level of disclosure and the attached "risk warnings" should, in my opinion, be consistent with other investments available in Hong Kong if Hong Kong is to retain its reputation as a "level playing field" that does not favour any particular sector of the community. Having said that my specific comments are as follows:

#### **General Shape of the Regulation**

I believe that regulation should recognize the differing risks attached to single hedge funds relative to multi manager fund of funds.

Individual hedge funds carry manager risk and strategy risk. In addition investors will need to complete their own due diligence on the related service providers ie Custodian, Trustee, Prime Broker etc.

Fund of funds carry a reduced level of manager risk as they are, by definition, invested across a number of managers which should in normal circumstances provide a degree of diversification. In addition, many fund of funds will invest across a range of independent strategies which again provides diversification to the investor. Subject to the Commission being satisfied with the fund of funds ability to manage a portfolio of hedge funds (please see comments later regarding competency) the investor will benefit from a professional and ongoing due diligence process by investing in a fund of funds over and above a single manager hedge fund.

In recognition of the greater diversification and level of portfolio management and due diligence provided by fund of funds I believe they should be offered to the public with a lower minimum subscription amount. I feel that USD25,000 (HKD200,000) is an appropriate figure. Single manager funds should be offered with a minimum of USD250,000 (HKD2m). This would not be a major impediment to single manager funds as this figure is most likely lower than their existing minimum subscription levels.

Furthermore, I believe that very few single manager hedge funds will bother to register in Hong Kong as they are not interested in retail investors and their short term investment horizons. This may impact on the position of fund of funds (who could provide a convenient portfolio management service to the retail public) if they are restricted to SFC authorized funds, as the universe of hedge funds available would be too small to run a diversified portfolio (see final paragraph).

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**Regulation of Managers**

Your suggested "competence" criteria is reasonable. Managers should have a five year track record in the specific strategy(ies) that they trade and should manage USD250m in those strategies. It is critical that the Commission recognizes the different skills needed to run a hedge fund/alternative strategy fund as opposed to a traditional fund. I.e. an existing mutual fund company of USD1 billion of assets under management would not be qualified (in my opinion) unless they had relevant experience (5 years) and assets (USD250m) in the particular strategy they were offering.

**Competence of Distributors**

All distribution sources including banks should be properly trained on the funds to be sold. I believe that an industry agreed competence test should be established and only advisor/intermediaries who had passed the test/exam could advise. Without a common standard the whole issue of competence becomes a farce.

I am very happy to assist the Commission or any appointed group with the development of a competence test.

**Regulation of hedge funds within a fund of funds**

It is my understanding that fund of funds will be able to invest in any hedge fund they choose, in keeping with point a) iii) of annex 1. Any attempt to limit the fund of funds choice of hedge fund to one's authorized in Hong Kong would render the whole exercise worthless for reasons already stated. The onus for manager due diligence should rest with approved fund of fund managers.

I eagerly await the outcome of your consultation process.

Yours faithfully



Patrick Tuohy  
Managing Director