



Hong Kong

January 2019

AMENDMENTS TO HONG KONG CODE ON UNIT TRUSTS AND MUTUAL FUNDS EFFECTIVE 1 JANUARY 2019

Introduction

On 6 December 2018, Hong Kong's Securities and Futures Commission (**SFC**) released its consultation conclusions¹ to its consultation² on proposed amendments to the Hong Kong Code on Unit Trusts and Mutual Funds (**Hong Kong Code on Unit Trusts**). The amendments are aimed at updating the regulatory regime for SFC-authorized funds and addressing the risks posed by financial innovation and other market developments.

The revised Hong Kong Code on Unit Trusts and other consequential amendments to related codes took effect on 1 January 2019.

I. Amendments relating to Key Operators

Management companies

Minimum capital requirement

The minimum capital requirement for management companies of SFC-authorized funds has been increased from HK\$1 million to HK\$10 million (or its equivalent). The new minimum

capital requirement does not apply to investment delegates (i.e. entities to whom the investment management function has been delegated).

Investment expertise and experience

The revised Hong Kong Code on Unit Trusts introduces flexibility for fund management groups with a multinational presence to enable management companies to leverage group resources and expertise from different offices. The key personnel requirement for management companies of public funds currently requires at least two key personnel of a public fund to be dedicated full-time staff with at least five years' experience in managing public funds with reputable institutions. Under the revised Hong Kong Code on Unit Trusts, the key personnel requirement on public funds investment management experience will be satisfied if the management company:

- i) belongs to a well-established fund management group; and
- ii) can demonstrate that, on a group-wide basis, it possesses the requisite experience and resources as well as an appropriate oversight system to administer public funds.

It should be noted that key personnel can be individuals who act for both the management company and investment delegates within the same fund management group, provided that the key personnel allocate sufficient time and attention to manage the SFC-authorized funds.

1 Consultation Conclusions on Proposed Amendments to the Hong Kong Code on Unit Trusts and Mutual Funds. 6 December 2018. <https://www.sfc.hk/edistributionWeb/gateway/EN/consultation/conclusion?refNo=17CP8>

2 Consultation Paper on Proposed Amendments to the Hong Kong Code on Unit Trusts and Mutual Funds. December 2017. <https://www.sfc.hk/edistributionWeb/gateway/EN/consultation/openFile?refNo=17CP8>

When considering whether or not a fund management group is “well-established”, the SFC may consider factors such as the group’s overall experience, resources and capabilities, including the amount of time that the group has been managing public funds, its regulatory record, the assets under management attributable to public funds, group-wide internal controls and risk management systems for the management of public funds, and the jurisdictions where the related investment functions and operations of the group are established. Delegates belonging to a well-established fund management group can also use the flexibility to rely on group investment expertise.

Further, the existing general obligations of management companies for the overall operations of their funds will be codified. Management companies need to ensure proper selection and monitoring of the funds’ service providers, including trustees and custodians. In this respect, management companies should also ensure trustees and custodians are properly qualified to perform their duties.

The SFC has also codified the requirement for self-managed schemes (i.e. those managed by the scheme’s board of directors rather than a management company) to delegate the fund’s investment management function to a qualified investment manager in compliance with Chapter 5 of the Hong Kong Code on Unit Trusts.

Trustees and custodians

Eligibility

The revised Hong Kong Code on Unit Trusts explicitly codifies the eligibility requirements for trustees and custodians which must be:

- a) a bank licensed under the Hong Kong Banking Ordinance;
- b) a banking institution incorporated outside of Hong Kong which is subject to prudential regulation and supervision acceptable to the SFC;
- c) a trust company registered under Part VIII of the Trustee Ordinance which is a subsidiary of a bank under (a) or a banking institution under (b);

- d) an entity which is authorised to act as a trustee or custodian of a scheme and which is prudentially regulated and supervised by an overseas supervisory authority acceptable to the SFC; and
- e) a trust company which is a trustee of a registered scheme as defined in section 2(1) of the Mandatory Provident Fund Schemes Ordinance.

General obligations

The general obligations of trustees and custodians have been enhanced to meet standards on the custody of fund assets set by the International Organisation of Securities Commissions (**IOSCO**) and other major jurisdictions. These require trustees and custodians to:

- a) exercise reasonable care, skill and diligence in the selection, appointment and ongoing monitoring of nominees, agents and delegates involved in the custody or safekeeping of fund assets;
- b) maintain proper records in their books under the name of the fund of fund assets which by nature cannot be held in custody;
- c) segregate fund assets from:
 - assets of the management company, investment delegates and their connected persons;
 - assets of the trustee/custodian and any nominees, agents or delegates in the custody chain; and
 - assets of other funds and clients unless held in an omnibus account with adequate safeguards. Trustees and custodians are required to perform frequent and appropriate reconciliations for omnibus accounts to ensure that all fund assets are properly recorded;
- d) take reasonable care to ensure that fund cash flows are properly monitored;
- e) put in place appropriate measures to verify ownership of fund assets; and

- f) maintain clear mechanisms for prompt escalation of potential breaches of its obligations and duties to the senior management of the trustee or custodian and the management company and to report material breaches to the SFC on a timely basis.

Periodic review of the internal controls and systems of trustees and custodians

Trustees and custodians are required to appoint an independent auditor to periodically review their internal controls and systems. Appendix G to the Hong Kong Code on Unit Trusts sets out the minimum scope of an internal control review which will be acceptable to the SFC.

The amendments to the Hong Kong Code on Unit Trusts have extended the scope, and raised the level of review required under Appendix G by:

- a) extending the review's scope by setting out the minimum areas to which the control objectives and policies must be applied;
- b) increasing the level of the independent auditor's review to require opinions as to the design suitability and operating effectiveness of controls; and
- c) requiring the independent auditor to report material weaknesses or failures in controls or control systems identified and provide recommendations for improvement (including the response from the trustee's or custodian's management).

The period allowed for trustees and custodians to file the review report (which should include a copy of the auditor's report and the trustee's or custodian's report) with the SFC has been extended from four to six months after the end of the period under review. Management's response to the auditor's report should also be attached, where applicable.

II. Permitted Investments for SFC-authorized Funds

Amendments to the Hong Kong Code on Unit Trusts have modernised the core investment requirements for SFC-authorized funds set out in Chapter 7 to include specific provisions covering securities lending, sale and repurchase (**repo**) and reverse repurchase (**reverse repo**) transactions and to provide greater flexibility for investing in derivatives.

Diversification, liquid assets and borrowings

Diversification requirements

To ensure proper diversification of SFC-authorized funds, the revised Hong Kong Code on Unit Trusts introduces:

- i) a group limit where the aggregate value of a fund's investment in or exposure to entities within the same group may not exceed 20% of the fund's net asset value (**NAV**); and
- ii) a separate diversification limit on cash deposits where the value of a fund's cash deposits made with the same entity or entities within the same group may not exceed 20% of the fund's NAV.

The revised Hong Kong Code on Unit Trusts allows cash deposits to exceed the 20% limit in specific circumstances including: (i) before the launch of a fund; (ii) after the launch of a fund and before the fund is fully invested; (iii) cash proceeds from the liquidation of investments before the merger or termination of the fund; (iv) upon receipt of subscription proceeds pending investment; and (v) when cash is held for settlement of redemption and other payment obligations.

Illiquid assets

A general principle requiring investments held by a fund to be liquid has been included in the preamble to Chapter 7.

A fund's investments in illiquid assets (i.e. securities and other financial products or instruments that are not listed, quoted or dealt in on an organised market) are now subject to a maximum limit of 15% of the fund's NAV (7.3).

Loans and borrowings

The ability of funds to lend, guarantee or otherwise become liable for a third party's indebtedness with the consent of the trustee or custodian has been removed. The prohibition on funds lending is now absolute (7.17). Repurchase transactions complying with 7.32 to 7.35 are not subject to this prohibition.

Funds' borrowing limit has been reduced to 10% of NAV (from 25% previously) (7.21).

The following are not subject to the restrictions on borrowing: back-to-back loans, securities lending transactions, and repo transactions complying with 7.32 to 7.35.

Derivatives investments

Prior to the amendments, the Hong Kong Code on Unit Trusts (**Previous Hong Kong Code on Unit Trusts**) provided that Hong Kong domiciled SFC-authorized funds were subject to different limits on investments in derivatives depending on the type of fund. For example, Chapter 7 of the Previous Hong Kong Code on Unit Trusts generally provided that plain vanilla funds could only invest in three specific types of derivatives (futures, options and warrants) with separate limits. Further, Chapter 8.9 of the Previous Hong Kong Code on Unit Trusts generally provided that funds with extensive derivatives investments could invest in different types of derivatives to achieve their investment objectives of up to 100% of their NAV based on the commitment approach. The commitment approach is where derivative positions acquired for investment purposes are converted into their equivalent prevailing market values in their underlying assets (**Commitment Approach**).

Overall limit on derivatives investments by Chapter 7 funds (plain vanilla funds)

The revised Hong Kong Code on Unit Trusts removes the requirement that plain vanilla funds may only invest in futures, options and warrants.

Furthermore, the revised Hong Kong Code on Unit Trusts imposes an overall limit of 50% of the fund's NAV on the use of derivatives for investment purposes (but not hedging purposes) by plain vanilla public funds. After further consultation with the industry, the SFC noted that the use of derivatives in certain circumstances should not be included in calculating the 50% limit. Consequently, the SFC modified the calculation method for the overall limit of 50% to exclude the use of derivatives which would not result in incremental leverage at the fund portfolio level. In particular, the use of derivatives in (i) netting, hedging and risk mitigation; (ii) cash flow management; (iii) market access or exposure replication (without incremental leverage at the fund portfolio level); and (iv) investment in conventional convertible bonds may be excluded from the calculation of the funds' net derivative exposures.

The Consultation Conclusions note that SFC-authorized funds (whether domiciled in Hong Kong or offshore and including UCITS funds) with derivative investments exceeding 50% of their NAV, will be regarded as derivative funds subject to the enhanced distribution requirements under 5.1A and 5.3 of the Code of Conduct for Persons Licensed by or Registered with the SFC.

Where a fund uses derivatives for hedging or risk mitigation purposes, the management company must ensure compliance with the hedging principles set out in 7.25 of the revised Hong Kong Code on Unit Trusts. If derivatives involved in hedging or risk mitigation arrangements are not referenced to the same corresponding underlying assets being hedged, additional requirements apply.

The SFC will publish further guidance on the use of derivative investments for SFC-authorized funds and the calculation methodology for net derivative exposures (with examples) which may be updated from time to time. The calculation methodology for net derivative exposures will apply to all SFC-authorized funds.

Disclosure to investors

The revised Hong Kong Code on Unit Trusts introduces a new disclosure requirement whereby all SFC-authorized funds (domiciled in Hong Kong or offshore and including UCITS) must disclose in the product Key Facts Statement (**KFS**) the purpose of, and expected maximum leverage arising from, derivative investments based on the Commitment Approach. The templates for the KFS for the enhanced disclosure requirements for derivative instruments will be posted on the SFC website.

The interim and annual financial reports of Hong Kong domiciled funds are also required to include disclosures on exposure arising from the use of financial derivative instruments (under Appendix E – Contents of Financial Reports to the Hong Kong Code on Unit Trusts).

Additionally, a new column has been added in the list of SFC-authorized funds on the SFC website to specify whether an SFC-authorized fund is or is not a derivative fund.

Other safeguards

The following investor protection measures have been introduced:

a) *Diversification*

Exposure to a reference entity of a derivative, together with other investments of the fund are subject to:

i) a single entity limit of 10% of the fund's NAV;
and

ii) a group limit of 20% of the fund's NAV.

b) *Counterparties in Over-the-Counter (OTC) derivatives transactions*

A counterparty in an OTC derivatives transaction or its guarantor must be a substantial financial institution (7.28(b)). A "substantial financial institution" is defined as an authorised institution under the Banking Ordinance or a financial institution which is subject to prudential regulation and supervision on an ongoing basis with a minimum NAV of HK\$2 billion or its foreign currency equivalent.

A fund's net exposure to a single counterparty in OTC derivatives transactions may not exceed 10% of its NAV.

The aggregate value of a fund's net exposure to an OTC derivatives counterparty, together with the fund's other investments, are subject to:

i) a single entity limit of 10% of the fund's NAV;
and

ii) a group limit of 20% of the fund's NAV.

Where a fund receives collateral from an OTC derivatives counterparty, the collateral must meet the enhanced requirements for collateral described below.

c) *Asset coverage*

7.29 now requires that a fund must be able to meet all its payment and delivery obligations under all derivatives transactions (whether entered into for hedging or investment purposes). As part of its risk management process, management companies are required to monitor and ensure that derivatives transactions are adequately covered on an ongoing basis.

Securities financing transactions

Securities Financing Transactions are defined as securities lending, repo and reverse repo (7.32).

The following explicit provisions have been included in the Core Investment Requirements of Chapter 7:

a) a fund may engage in Securities Financing Transactions if it is in the best interests of holders to do so and associated risks have been properly addressed;

b) counterparties to Securities Financing Transactions must be financial institutions subject to ongoing prudential regulation and supervision.

c) a fund should have at least 100% collateralisation in respect of Securities Financing Transactions marked to market daily to ensure that there is no uncollateralised counterparty risk exposure arising from these transactions;

d) all revenue arising from Securities Financing Transactions, net of direct or indirect expenses as reasonable and normal compensation in relation to the services rendered, should be returned to the fund; and

e) a fund should ensure that it is able, at any time, to recall all the securities or the full amount of cash involved or terminate the Securities Financing Transactions.

Collateral

Requirements relating to collateral were previously set out in Chapter 8.8 of the Hong Kong Code on Unit Trusts which governs structured funds. Enhanced requirements for collateral are consolidated in Chapter 7 of the revised Hong Kong Code on Unit Trusts.

To reduce the counterparty risk arising from OTC derivatives investments and Securities Financing Transactions, the following requirements for collateral have been introduced:

a) Prudent haircut policy

Collateral is required to be subject to a prudent haircut policy. Haircuts should be based on the market risks of the assets used as collateral to cover the potential maximum decline in collateral value in liquidation. The haircut to be applied to the collateral should be based on risk assessments performed by the management company, which should consider the nature and quality of the collateral and the fund's investment objectives and strategy. When designing the haircut policy, the price volatility of the asset used as collateral should be considered. Other specific characteristics of the collateral should also be considered and are set out in paragraph 55(a) of the Consultation Paper.

b) Reinvestment of collateral

Non-cash collateral received may not be sold, re-invested or pledged. Cash collateral received may only be reinvested in short-term deposits, high-quality money market instruments and money market funds authorised under Chapter 8.2 of the Hong Kong Code on Unit Trusts.

c) Prohibited assets as collateral

Generally, collateral should not include:

- i) structured products whose payouts rely on embedded derivatives or synthetic instruments;
- ii) securities issued by special purpose vehicles, special investment vehicles or similar entities; or
- iii) securitised products or unlisted collective investment schemes.

New disclosure requirements provide that funds must disclose:

- a) information relating to their collateral policy in their offering documents (as required by Appendix C) (Chapter 7.37); and
- b) a description of their collateral holdings in their financial reports (as required by Appendix E) (Chapter 7.38).

Investments in other funds

Funds are allowed to invest in other funds subject to the provisions of the Hong Kong Code on Unit Trusts. The relevant provisions have been consolidated and existing practices have been codified by:

- a) deleting from Chapter 8 the section on unit portfolio management funds (**UMPF**) (i.e. fund of funds) since these funds will be subject to the requirements under the Core Investment Requirements in Chapter 7;
- b) amend the definition of a feeder fund to mean a fund which may invest 90% or more of its NAV (rather than all of the fund's assets as previously required) in a single fund, being the master fund; and
- c) existing UPMFs will be classified as Chapter 7 funds and will be subject to the Core Investment Requirements in Chapter 7.

Structured funds

All synthetic SFC-authorised exchange-traded funds (**ETFs**) are subject to the requirement of 100% collateralisation. This requirement is codified in Chapter 8.8 (structured funds) of the revised Hong Kong Code on Unit Trusts and will also apply to unlisted structured funds.

III. Money Market Funds

Definition of money market funds

The revised Hong Kong Code on Unit Trusts defines a "money market fund" as a fund investing in short-term and high quality money market instruments and seeks to offer returns in line with money market rates. Funds having the characteristics of a money market fund or which are presented as having comparable investment objectives (e.g. funds named as "liquid funds" or "cash funds") will also be subject to the requirements for money market funds under Chapter 8.2 of the Hong Kong Code on Unit Trusts.

Permitted assets

To align with IOSCO recommendations, the revised Hong Kong Code on Unit Trusts provides that a money market fund may only invest in short-term deposits, high quality money market

instruments and money market funds which are authorised by the SFC under Chapter 8.2 of the Hong Kong Code on Unit Trusts or regulated in a manner comparable with the SFC authorisation requirements. "Money market instruments" refer to securities normally dealt on the money market such as government bills, certificates of deposit, commercial papers, short-term notes and bankers' acceptances etc. In assessing whether a money market instrument is high quality, its credit quality and liquidity profile must, at least, be considered.

A new provision (Chapter 8.2(j)) allows money market funds to invest in asset-backed securities provided they do not exceed 15% of the fund's NAV.

Repo transactions

In addition to the Core Investment Restrictions governing Securities Financing Transactions, the following additional limits apply to money market funds:

- a) the amount of cash received under repo transactions cannot in aggregate exceed 10% of its NAV; and
- b) the aggregate amount of cash provided to the same counterparty in reverse repo agreements may not exceed 15% of the fund's NAV.

Portfolio maturity limits

The portfolio maturity requirements have been amended to require a money market fund to maintain a portfolio with a weighted average maturity which does not exceed 60 days and a weighted average life not exceeding 120 days (Chapter 8.2(f)).

Minimum liquid asset level

The revised Hong Kong Code on Unit Trusts has reduced the minimum levels of daily and weekly liquid assets required for a money market fund to 7.5% and 15% of NAV respectively.

Safeguards for amortised cost accounting and constant NAV

Money market funds which offer a stable or constant NAV or which adopts an amortised cost accounting for valuation of its assets will only be considered by the SFC on a case-by-case basis (Chapter 8.2(o)).

The revised Hong Kong Code on Unit Trusts provides that money market funds adopting constant NAVs or amortised cost accounting will need to demonstrate to the SFC that proper measures and safeguards in compliance with the relevant IOSCO recommendations on money market funds have been implemented.

IV. Unlisted Index Funds and Index Tracking Exchange Traded Funds

Unlisted index funds and index tracking exchange traded funds (also known as passive ETFs) must comply with Chapter 8.6 of the Hong Kong Code on Unit Trusts. Synthetic index funds or passive ETFs and futures-based index funds or passive ETFs must also comply with the requirements for structured funds under Chapter 8.8 and for futures and options funds under Chapter 8.4A respectively. Additional guidance on passive ETFs is also set out in the Guidelines for regulating index tracking exchange traded funds in Appendix I to the Hong Kong Code on Unit Trusts.

Clarify requirements for funds which adopt hybrid index tracking strategies through derivatives investments

The revised Hong Kong Code on Unit Trusts requires that an index fund or passive ETF must comply with the requirements under Chapter 8.6 and Chapter 8.8 if the fund's derivatives investments in any form exceed 50% of its NAV based on the Commitment Approach.

Enhancing the "broadly based" requirement for an underlying index

A key criteria for an index to be acceptable is that it is broadly based (8.6(e)(ii) of the Hong Kong Code on Unit Trusts). The note to 8.6(e)(ii) previously provided that an index with a single constituent security weighting of more than 40% or with its top five constituent securities weighted at more than 75% would be considered to be too concentrated.

Given that overseas jurisdictions require underlying indices to be more diversified, the revised Hong Kong Code on Unit Trusts provides that an index will generally be too concentrated if it has a single constituent security weighting at more than 20%. In exceptional conditions in markets where certain securities are highly dominant, the weighting limit for the largest single component in an index may be 35%. An index with few constituent securities (e.g. five) will not be regarded as broadly based even if it technically meets the 20% or 35% requirement.

Existing SFC-authorized index funds will be allowed a 12-month transition period to comply. The SFC also noted in the Consultation Conclusions that the examples of exceptions under the note to Chapter 8.6(e)(ii) of the revised Hong Kong Code on Unit Trusts are not exhaustive.

Codifying the market maker requirement for passive ETFs

The revised Hong Kong Code on Unit Trusts requires a manager of an SFC-authorized passive ETF to put arrangements in place so that there is at least one market maker for each trading counter of the ETF who will give at least three months' notice prior to terminating market making arrangements.

Listed and unlisted share classes for index funds and passive ETFs

Under the revised Hong Kong Code on Unit Trusts, funds under Chapter 8.6 of the Hong Kong Code on Unit Trusts may have unlisted and/or listed units or share classes subject to the dealing arrangements and risks associated with both share classes being clearly disclosed in the offering documents. The unlisted class and listed class must comply with the requirements for index fund and passive ETF in Chapter 8.6 of the Hong Kong Code on Unit Trusts respectively.

The SFC will issue KFS templates to provide further guidance to the industry. If fund managers wish to offer listed and unlisted units or share classes for an SFC-authorized unlisted fund or ETF, they should first consult the SFC.

Enhanced requirements for securities financing transactions by passive ETFs

Under the revised Hong Kong Code on Unit Trusts, passive ETFs will be subject to enhanced safeguards and disclosures in relation to securities financing transactions.

If a passive ETF's net derivative exposure exceeds 50% of its total NAV, it must disclose to investors information about the financial derivative instruments acquired, such as counterparty exposure and collateral information. Disclosure should be made through the passive ETF's website or other acceptable channels on an ongoing basis and the offering document must direct investors to where this information is published.

Further, where a passive ETF undertakes securities financing transactions which exceed 50% of its total NAV, it must also disclose information on such transactions, such as counterparty exposure and collateral information, on an ongoing basis.

Disclosure requirements for index constituents

In response to questions regarding how frequently index information is required to be updated, the SFC has revised the Hong Kong Code on Unit Trusts to clarify that managers are only required to disclose in the offering document of passive ETFs and index funds a publicly accessible website where the constituents of the index together with their respective weightings are published. Given that the KFS forms part of the offering document, where the KFS has already included the disclosure of a publicly accessible website, the main body of the offering document is not required to provide the same disclosure. The information is required to be updated after each index rebalancing on a retrospective basis and in advance of the next rebalancing.

Streamlining other requirements

The revised Hong Kong Code on Unit Trusts has streamlined a number of requirements for passive ETFs under its Appendix 1. These include the following:

- the Acceptable ETF Regime has been removed in line with the SFC's policy of entering into arrangements with overseas jurisdiction for the mutual recognition of public funds;
- the requirement for a Product Description Document has been removed so that the same disclosure requirements apply to all ETFs; and
- creating a level playing field for trading information disclosure for overseas and Hong Kong ETFs.

V. Listed Open-ended Funds (active ETFs)

A new Chapter 8.10 has been introduced to govern active ETFs which are new to the Hong Kong market. Active ETFs are funds listed and traded on the Hong Kong Stock Exchange which are actively managed and do not track the performance of an index or benchmark.

Active ETFs are subject to the investment restrictions imposed by the Core Investment Requirements in Chapter 7 of the Hong Kong Code on Unit Trusts. They are subject to the requirement to update and publish indicative NAV per unit or share every 15 seconds during trading hours. Active ETFs must publish full portfolio information to the public on a monthly basis with a one-month time lag.

To enable investors to easily differentiate active and passive ETFs, the SFC will require ETFs to clearly disclose, in the disclosure box of the KFS, whether the fund is an active or passive ETF. For a fund with listed and unlisted share classes, the fund name in the KFS should include "(ETF class)" or "(unlisted class)". Additionally, the SFC website will be updated to allow investors to easily locate information on active and passive ETFs.

VI. Closed-ended Funds

Closed-ended funds normally have restrictions on redemption and are typically used to invest in relatively less liquid assets or restricted markets.

A new Chapter 8.11 of the revised Hong Kong Code on Unit Trusts has been added to codify the requirements for closed-ended funds seeking SFC authorisation. The new Chapter 8.11 includes the following provisions:

- Funds to be widely held

Closed-ended funds are required to have procedure(s) and mechanism(s) in place for it to be widely held. They must also have a broad base of holders having regard to the adequate shareholder spread requirement for listings of investment companies under the Listing Rules³.

- Trading discount

Closed-ended funds are required to put in place measures and mechanisms to address any prolonged significant discount of its trading price on the Hong Kong Stock Exchange to its NAV. These measures must be fair to holders and must be properly disclosed;

- Redemptions, takeovers and mergers

Any form of redemption, takeover or merger undertaken by a closed-ended fund must be carried out in a manner that is fair and equitable to all holders. The fund's management company, trustee and custodian are required to consult the SFC as early as possible.

³ Under Chapter 21 of the Listing Rules investment companies listed on the Hong Kong Stock Exchange are required to have at least 300 shareholders and no person controlling 30% or more of the votes exercisable at any general meeting of the investment company.

Further, chapter 8.11(d) of the revised Hong Kong Code on Unit Trusts allows flexibility in the timing of redemption proceeds payments where payment within the prescribed 90 calendar day period is impractical due to legal or regulatory requirements.

VII. Operational Matters and On-going Disclosure and Reporting Requirements

The revised Hong Kong Code on Unit Trusts includes amendments in areas including valuations, fees and expenses, liquidity management and fund termination which are in line with IOSCO standards.

Valuation and pricing

Under the revised Hong Kong Code on Unit Trusts:

- Any error made in the pricing of units or shares are required to be corrected as soon as possible and notified to the trustee or custodian in a timely manner;
- Any incorrect pricing of 0.5% or more of a fund's NAV per unit/share must be notified to the trustee or custodian and the SFC immediately; and
- Recurring pricing errors due to the same incident or mistake which in aggregate amount to 0.5% or more of the fund's NAV per unit/share or NAV must be reported to the SFC immediately.

Financial reports

The information required to be included in financial reports is set out in Appendix E to the Hong Kong Code on Unit Trusts. Revisions have been made to clarify that:

- annual reports must be prepared in compliance with internationally recognised accounting standards, which include Hong Kong Financial Reporting Standards, International Financial Reporting Standards, or any others that are acceptable to the SFC;
- interim reports must apply the same accounting policies and computation methods as those used in the annual reports; and

- c) interim reports and annual reports will be permitted to cover an extended reporting period where a fund is first launched or upon its termination.

The requirements for the content of financial reports in Appendix E of the Hong Kong Code on Unit Trusts have also been revised in line with developments in accounting standards for financial reporting.

Codification of existing requirements and practices

The following existing requirements have been codified:

- a) the principles and requirements for the valuation of fund assets and the liquidity risk management of the fund as set out in the SFC's circulars, "Circular to Management Companies and Trustees/Custodians of SFC-authorized Funds – Relating to Fair Valuation of Fund Assets" of 20 July 2015 and "Circular to management companies of SFC-authorized funds on liquidity risk management" of 4 July 2016;
- b) disclosure requirements with respect to the calculation basis of performance fees charged by a fund as set out in the SFC's "Guide on Practices and Procedures for Application for Authorisation of Unit Trusts and Mutual Funds";
- c) streamlined measures for handling scheme changes (with further clarification of the requirements for the notification of investors); and
- d) requirements regarding the fair treatment of the interests of holders in the case of fund termination.

The Consultation Conclusions also note that the accounting standards adopted by UCITS funds will continue to be deemed acceptable to the SFC.

VIII. Streamlining of Specialised Funds

In view of the amendments to the Core Investment Requirements of Chapter 7, the SFC has removed Chapter 8.3 on warrant funds and Chapter 8.4A on futures and options funds. There are no warrant funds currently. In future, existing futures and options funds, depending on their investment strategies and risk profiles, should comply with the requirements under either Chapter 8.9 on funds with extensive derivatives investments or Chapter 8.7 on hedge funds.

Chapter 8.5 on guaranteed funds has also been removed. The requirements for guarantors and disclosures in offering documents for funds which have guaranteed features (i.e. funds structured so that a guaranteed amount will be paid to investors on a specified date) are now set out in the Core Investment Requirements of Chapter 7.

IX. Consequential Amendments to the SFC Code on MPF Products, the Code on Pooled Retirement Funds and the Code on Investment-Linked Assurance Schemes

Consequential amendments have been made to the SFC Code on MPF Products, the Code on Pooled Retirement Funds and the Code on Investment-Linked Assurance Schemes and these are set out in Appendix E to the Consultation Conclusions.

X. Application of Amendments to UCITS Funds

UCITS funds account for a significant proportion of SFC-authorized funds. In the past, the SFC has adopted a streamlined approach to the authorisation of UCITS funds in accordance with the "General Circular to SFC-approved Fund Management Companies - Interim Measures on the Disclosure and Submission Requirements for the authorisation of UCITS III Funds domiciled in Luxembourg, Ireland and the United Kingdom by the SFC" (31 March 2005) and "Circular to Fund Management Companies of SFC authorised Funds - Streamlined Measures for Processing UCITS III Schemes with Special Features" (30 March 2007) (**Interim Measures**).

The SFC intends to maintain the adopted streamlined measures for processing applications for the authorisation of UCITS funds.

Appendix B to the Consultation Conclusions sets out the application of the revised Hong Kong Code on Unit Trusts to UCITS funds. This will be published on the SFC website as guidance (to be updated from time to time) and will replace the Interim Measures.

Further, Annex 1 of the Guide on Practices and Procedures for Application for Authorisation of Unit Trusts and Mutual Funds⁴ will be revised to include enhanced disclosure requirements for the expected maximum leverage arising from derivatives investments.

⁴ Guideline on Practices and Procedures for Application for Authorization of Unit Trusts and Mutual Funds. https://www.sfc.hk/web/files/PCIP/FAQ-PDFs/Guide%20on%20Practices%20and%20Procedures%20for%20Application%20for%20Authorization%20of%20UTMFs_20181008.pdf

Implementation Timeline

Existing Funds and Operators

Existing funds are funds which: (i) were authorised before 1 January 2019; or (ii) applied for SFC authorisation before 1 January 2019 and are subsequently authorised.

Existing operators are management companies which were managing SFC-authorised funds as at 1 January 2019 and trustees and custodians of SFC-authorised funds at that date.

A 12-month transition period from 1 January 2019 applies for existing funds and operators to comply with the revised Hong Kong Code on Unit Trusts. During this 12-month transition period, existing funds and operators may continue to operate in accordance with the relevant circulars and guidelines which are currently in place.

Existing funds which will continue to be offered to the public in Hong Kong must produce a KFS with the enhanced disclosure for derivatives investments by 1 January 2020.

New Funds and Operators

“New funds” are those which apply for SFC authorisation on or after 1 January 2019, while “new operators” are management companies not managing SFC-authorised funds, and trustees and custodians not appointed with respect to SFC-authorised funds, on 1 January 2019.

The revised Hong Kong Code on Unit Trusts applies to all “new funds” with “new operators” from 1 January 2019.

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