

Securities and Futures Commission  
Supervision of Markets Division  
8th Floor  
Chater House  
8 Connaught Road Central  
Hong Kong

31 August 2012

**Supplemental consultation on the OTC derivatives regime for Hong Kong  
("Supplemental Consultation")**

Dear Sir/Madam

We are writing to make one specific point in relation to the proposed changes to the licensing regime, as set out in the Supplemental Consultation, which is of relevance to the fund management industry.

Generally, we support the approach proposed in the Supplemental Consultation in respect of fund managers, namely:-

- Expanding the Type 9 regulated activity to encompass management of portfolios of OTC derivatives transactions (in addition to securities and futures contracts); and
- The introduction of an exemption for Type 9 licensed or registered persons from the new Type 11 regulated activity where fund managers deal in, or advise on, OTC derivative transactions for the purposes of carrying on their fund management activities.

However, we think that it would also be important to introduce an equivalent exemption in respect of Type 3 regulated activity (leveraged foreign exchange trading). As you will be aware, there is no specific exemption for fund managers in respect of Type 3. There are a number of other exemptions which are potentially available to fund managers including the minimum credit rating exemption (as set out in the Securities and Futures (Leveraged Foreign Exchange Trading-Exemption) Rules), the hedging exemption (set out in paragraph (ii) of the definition of "leveraged foreign exchange trading") and the "dealing through" exemption (set out in paragraph (xiv) of the definition of "leveraged foreign exchange trading").

However, the availability of these exemptions for fund managers is not at all clear. For instance, many fund managers will not be in a position to satisfy the requirements of the minimum credit rating exemption, and the hedging exemption appears to be designed for corporate end users hedging their currency risks rather than for fund managers hedging currency risks in respect of the underlying fund or portfolio that

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they manage. Accordingly, the position for fund managers who wish to trade in currency derivatives as part of their asset management strategy (as many do) is uncertain. The issue is further complicated by the high capital requirements for Type 3 (under the Securities and Futures (Financial Resources) Rules) which may be appropriate for brokers trading in currency derivatives but not for fund managers (who do not of course take on risk in connection with their trading).

The reforms to the licensing regime provide a convenient opportunity to resolve the current uncertainty by the introduction of an exemption for fund managers from the Type 3 regulated activity where they trade in currency derivatives for the purpose of their fund management activities. This would also ensure consistency with the proposed exemption in respect of Type 11. If the exemption from Type 3 was not introduced, then fund managers would be exempt from trading in derivatives referencing all other asset classes (e.g. interest rate derivatives, commodity derivatives etc.) but may still be subject to a Type 3 licence requirement where they trade in currency derivatives. This would not make sense from a policy perspective and we assume that this is not the intention of the Securities and Futures Commission.

Please do not hesitate to contact us if you have any questions on the above.

Yours faithfully

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