

By Email (utc-consultation@sfc.hk)

21 January 2026

Securities and Futures Commission
54/F, One Island East
18 Westlands Road
Quarry Bay, Hong Kong

Dear Sir/Madam,

Re: Consultation Paper on Proposed Amendments to the Code on Unit Trusts and Mutual Funds

CFA Society Hong Kong and CFA Institute (collectively, we) appreciate the opportunity to respond to the above Consultation Paper issued by the Securities and Futures Commission (the SFC). As a leading professional body committed to promoting high standards of integrity, transparency, and investor protection, we are pleased to offer our comments in alignment with our advocacy mission.

We support the SFC's overall objectives to modernize Hong Kong's retail fund framework and strengthen regulatory oversight while enhancing investor protection. In particular, we welcome the proposed adoption of the Value-at-Risk (VaR) approach to align with international standards, the streamlined classification of complex products, and the formalization of Anti-Dilution Tools (ADTs) to ensure fairness for long-term investors.

Our response emphasizes that the phased expansion of retail access to private markets should be underpinned by rigorous "fit-for-purpose" guardrails. It is important to address information asymmetries and potential valuation lags through independent oversight and transparent disclosure. We also wish to highlight the value of aligning product design with retail investor understanding and risk tolerance. Given the historical sensitivities within the Hong Kong market and the durable legacy of past market events, ensuring that complexity labels and disclosure requirements clearly communicate underlying structural risks is beneficial for maintaining investor confidence and market integrity.

We thank the SFC for its proactive engagement with market stakeholders on these important reforms. We would be pleased to elaborate further on our views and suggestions. Should you have any questions, please contact Mr. Matthew Chan, Managing Director of CFA Society Hong Kong, at matthew.chan@cfahk.org, or Ms. Mary Leung, CFA, Senior Advisor, Research and Advocacy, Asia Pacific at CFA Institute, at mary.leung@cfainstitute.org.

Sincerely,

For and on behalf of
CFA Society Hong Kong

Matthew Chan
Managing Director

For and on behalf of
CFA Institute

Mary Leung, CFA
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About CFA Society Hong Kong and CFA Institute

CFA Society Hong Kong (the “Society”) is a non-profit organization founded in 1992. The Society shares the mission of CFA Institute (the “Institute”) in raising the professional and ethical standards of financial analysts and investment practitioners through our advocacy and continuing education efforts. In addition to promoting the CFA® designation in Hong Kong, the Society aims to provide a forum for our members, the Institute, other investment practitioners and regulators for networking and the exchange of industry insights and best practices.

CFA Institute is a global, not-for-profit professional association of more than 181,000 members, as well as 160 member societies around the world. The Institute administers the Chartered Financial Analyst® (CFA) Program. Our members include investment analysts, advisers, portfolio managers, and other investment professionals. Our advocacy positions are informed by our global membership, which invests both locally and globally.



Response Section

Question 1: Do you agree with the proposal to accept the VaR approach alongside the existing NDE approach under Hong Kong's retail fund framework?

We support. This change would align Hong Kong's retail fund framework with established international practices, such as the EU UCITS directive and US SEC Rule 18f-4. Offering VaR as an option provides an additional, risk-sensitive tool for measuring sophisticated strategies while allowing simpler funds to maintain the more straightforward NDE method for compliance. This dual approach is important for market efficiency. Under current NDE rules, fixed income funds may appear "derivative-heavy" and are classified as complex simply because they use derivatives to manage duration. In reality, these trades often reduce or adjust interest rate sensitivity rather than adding net risk to the portfolio. Conversely, equity funds seldom exceed the 50% NDE derivative threshold, meaning the VaR approach provides a much-needed holistic view that the NDE approach may not fully capture for more sophisticated mandates.

From a market perspective, the current 50% NDE limit provides a useful baseline, but may overstate the actual economic risk of certain diversified portfolios. The VaR approach addresses this by providing a holistic view of the portfolio, which can more accurately capture how different positions, such as hedges, offset one another.

From an investor protection standpoint, while we support the VaR approach, we emphasize that certain products should remain "complex" by default. Hedge funds and private equity funds should inherently be classified as complex, as they often utilize strategies such as substantial leverage and short-selling, and invest in illiquid assets that are difficult to value. In contrast, we believe a distinction should be made for assets such as high-yield bonds, which are high-risk but not necessarily structurally complex. These products are often mislabelled as "complex" solely because they use derivatives to manage duration. The SFC should ensure that complexity labelling is reserved for products with structural complexity, such as non-standard optionality or embedded derivatives, to ensure the label remains a meaningful signal for investors.

To ensure this flexibility is paired with appropriate safeguards, the SFC might consider explicitly requiring funds using the VaR approach to maintain independent risk oversight. This helps ensure that risk monitoring remains distinct from portfolio management decisions. To maintain alignment with the international standards, we suggest that VaR should be refreshed and calculated on at least a daily basis for internal risk monitoring. Regarding publication, we suggest that the SFC require disclosure of the highest, lowest, and average VaR utilizations within the fund's interim and annual reports to provide investors with a meaningful view of the fund's risk profile over time. We also support the SFC's inclusion of back-testing and stress-testing as important measures to confirm that VaR models remain reliable during periods of market volatility.

While we note these proposals are intended to take effect immediately upon its gazettal, we suggest that the SFC encourage a voluntary six-month parallel run period to ensure operational readiness. This approach would allow managers to confirm they have high-quality historical data for accurate calculations and provide time to demonstrate a solid track record in risk modelling. It also offers a window for the industry to educate retail investors on the new VaR metrics. This gradual transition will help reduce model risk and ensure the new framework is adopted successfully.

Question 2: Do you support the proposed classification of non-complex products and complex products under this proposed framework?

We support. This change provides clarity for fund managers and helps intermediaries better manage their distribution and suitability obligations. A product's complexity is distinct from its risk level. For example, a high-yield bond fund may carry higher credit risk, but it is not necessarily "complex" unless it features intricate structural terms that are difficult for a retail investor to understand. By keeping such products in the "non-complex" category, provided they stay within the derivative limits, the SFC ensures that traditional investment options remain accessible to the public without unnecessary hurdles.

We also support the move to replace technical derivative percentages in the Product Key Facts Statement (KFS) with a clear "complex/non-complex" label. A simple label is more likely to be understood by a typical retail investor and provides a clear warning for products that require a suitability check. To assist the industry, the SFC might consider providing supplementary examples or FAQs for funds that use simple hedging strategies which might sit on the boundary of the complexity criteria. It is important to remind investors that a "non-complex" label does not mean a fund is "low risk", so that risk disclosures regarding the underlying assets remain a priority for investor education. Finally, the SFC could consider a periodic review mechanism to ensure this framework remains aligned with evolving international standards and continues to reflect global best practices.

Question 3: Do you have any comments on the proposals on incorporating the updated international standards on liquidity risk management of funds?

We believe the framework should be specifically tailored to address the growing intersection of retail funds and private markets.

I. Liquidity Risk Management & Settlement Cycles

We support the principle of aligning redemption terms with underlying settlement cycles to ensure consistency between fund asset liquidity and investor expectations. As global markets transition toward T+1 settlement (e.g., in the US and major emerging markets), fund managers face a "liquidity gap" because they cannot always synchronize the settlement of underlying assets to meet redemption demands within the standard timeframe.

In light of the Revised IOSCO Recommendations, we suggest the SFC provide principles-based clarity on this mismatch rather than setting a strict quantitative threshold for settlement periods. This allows for the necessary operational flexibility to manage cross-border settlement differences while protecting the fund's liquidity profile and preventing forced asset sales at disadvantageous prices.

II. Anti-Dilution Tools

Consistent with the Revised IOSCO Recommendations to mitigate material investor dilution, we support the use of ADTs to ensure that costs of liquidity are borne by the transacting investor. While the "fairness" of a specific ADT is not a straightforward judgment, we believe that transparency is the primary

safeguard. To ensure this, we suggest the SFC require funds to provide regular disclosure in monthly reports regarding the percentage of illiquid assets held. If investors have a clear understanding of a fund's liquidity profile, they are better prepared for the potential application of ADTs or gates, thereby reducing the risk of "first-mover advantage" and protecting the integrity of the fund for remaining retail investors.

III. Retail Access to Private Markets (Governance & Valuation)

We support the SFC's phased approach to enabling retail access to private markets, as it facilitates portfolio diversification and aligns Hong Kong with international trends in alternative asset availability. However, this support is contingent upon the implementation of rigorous governance standards to mitigate the unique structural risks inherent in private equity and credit.

As highlighted in the CFA Institute's (2024) report, *Private Markets: Governance Issues Rise to the Fore*, a primary concern for these assets is "information asymmetry," driven largely by valuation practices that lack the immediacy of public markets. Unlike publicly traded securities, private market valuations are regularly "marked-to-model" rather than "mark-to-market," creating a significant "valuation lag" where fund prices may not reflect current market realities for some time¹. This discrepancy creates an arbitrage risk where sophisticated or "insider" investors can redeem units at a stale, overvalued NAV, effectively transferring losses to the remaining retail investors when the valuation eventually adjusts downward (CFA Institute 2024).

Recent market experience, including the voluntary withdrawal of authorized retail alternative credit products, suggests that retail readiness and understanding of private market structures may be less robust than industry assumptions. Furthermore, the durable legacy of the Lehman "mini-bond" saga in Hong Kong has created high expectations for the selling process and client suitability. To prevent performance-induced risks, product design should remain closely aligned with retail motivations.

To address these vulnerabilities, we suggest that the SFC mandate several key "guardrails" for any retail fund exceeding the 15% illiquid asset threshold. Consistent with global professional standards, these should include requirements for periodic independent valuation opinions and annual independent audits (CFA Institute 2024). Furthermore, to ensure retail investors can make informed decisions, managers should be required to provide standardized statements periodically, e.g. quarterly, that offer clear, unbundled disclosure of fees, expenses, valuation policies and assumptions, conflicts of interest, and performance metrics. Given the SFC's proposal for a 'hallmark' of at least monthly redemption opportunities, the use of ADTs serves as an important mechanism to mitigate potential dilution and protect the interests of long-term investors. These tools ensure that the explicit and implicit costs of liquidity are borne by the transacting investor, thereby preventing dilution and upholding the principle of fairness for long-term retail holders. By adopting these targeted regulatory measures, the SFC can encourage product innovation while maintaining the high investor protection standards expected of Hong Kong's retail fund regime.

¹ CFA Institute, 2024. *Private Markets: Governance Issues Rise to the Fore*. [online] Charlottesville: CFA Institute Research and Policy Center. Available at: <https://rpc.cfainstitute.org/en/research/surveys/2024/private-markets-governance-issues>

Question 4: Do you have any comments on the proposed requirements for the use of ADTs?

We support the SFC's proposal to provide a more structured ADT framework. Formalizing the requirements for tools like swing pricing and anti-dilution levies promotes industry consistency and ensures that the costs of liquidity are shared fairly among investors. To ensure these tools function effectively, we believe robust internal governance is important. The decision to activate or adjust ADTs should be overseen by a risk management function that is independent of portfolio management to avoid potential conflicts of interest. Furthermore, we suggest that the SFC allow managers the flexibility to calibrate swing thresholds based on the specific liquidity profiles of different asset classes, rather than a "one-size-fits-all" approach.

From an investor protection and market integrity standpoint, we suggest a strategy of appropriate and balanced transparency. While the existence and purpose of ADTs should be clearly disclosed in the KFS, specific numerical thresholds or swing factors should remain confidential to prevent predatory trading or "gaming" of the NAV. Finally, the successful implementation of ADTs requires coordination with third-party service providers. We suggest a reasonable transition period to allow managers to update their systems and agreements with trustees and administrators, ensuring these protective tools can be applied accurately and without operational delay.

To assist supervisory monitoring, the SFC might consider providing guidance on standardized data points, such as tool types used and activation frequency, to help detect systemic liquidity stress while allowing managers flexibility in their reporting formats.

Question 5: What is your view on the proposed requirements on underlying investments by MMFs?

We support the SFC's proposal to refine the requirements for Money Market Funds (MMFs) underlying investments, as these funds are often used by retail investors as a "cash-plus", liquid alternative. From an investor protection perspective, MMFs prioritize capital preservation and liquidity over yield. We agree with the focus on high-quality, short-term instruments and believe that requiring a high minimum credit rating for underlying assets is important to prevent "style drift" during periods of market volatility. We specifically wish to highlight the risks associated with MMFs that place significant portions of their portfolios in fixed deposits. If a retail investor redeems their units early, the MMF may be forced to break these deposits and incur breakage costs, causing the fund to suffer a loss. From an investor protection standpoint, we support the use of ADTs, such as redemption penalties or gates, to ensure that the individual investor who is leaving, rather than the remaining retail investors, bears the actual cost of that liquidity.

Furthermore, we believe that the proposed liquidity buckets (daily and weekly liquid assets) are a sensible way to ensure MMFs can meet redemption demands without being forced to sell assets at a loss. To ensure market efficiency, we suggest that the SFC provide clear guidance on the treatment of high-quality "unrated" issuers, such as government-linked entities. This prevents a "crowded trade" risk in a narrow pool of assets. For example, if all MMFs are restricted to a small group of top-rated issuers, they may all attempt to purchase or sell the same instruments simultaneously. This concentration can reduce liquidity and increase price volatility during periods of market stress, whereas including high-quality unrated issuers helps diversify the market. We also emphasize that investor education is key; the KFS should clearly explain that while MMFs invest in high-

quality assets, they are not guaranteed products. This balanced approach ensures that MMFs remain a safe and efficient tool for liquidity management while providing the transparency that investors deserve.

Question 6: Do you agree with the proposed requirements for CNAV MMFs?

We support. Maintaining a stable NAV requires high levels of transparency and capital resilience. From an investor protection standpoint, we support the proposal that only funds investing in the highest-quality government securities should be permitted to use the CNAV model. This ensures that the "stable price" promise is backed by assets with minimal credit and liquidity risk. To protect the broader market, we also agree with the requirement for a "liquidity fee" or "redemption gate" mechanism that triggers if the fund's weekly liquid assets fall below a certain level. This prevents a "run on the fund" and ensures that those who stay in the fund are not unfairly penalized by those who exit first during a crisis.

However, to maintain market efficiency, we suggest that the SFC remains flexible regarding the specific "trigger" points for these liquidity tools. While clear rules are necessary, triggers that are too rigid can sometimes cause unnecessary panic among retail investors. We suggest that the KFS explicitly explains the "stable NAV" is not a guarantee and describes the circumstances under which the fund might convert to a variable NAV model. This balanced approach provides investors with the convenience of a stable-price product while ensuring they are fully aware of the underlying risks and the protective measures in place to safeguard their capital.

Question 7: Do you support the proposed approach regarding the KP Requirements?

We support the SFC's proposed approach to move toward an institutional assessment of investment management experience for well-established fund groups and those in MRF jurisdictions. Transitioning away from the rigid requirement of naming two specific Key Personnel (KP) for these firms promotes operational efficiency and recognizes that sophisticated management companies rely on a "team-based" approach and institutionalized risk processes rather than the expertise of a few individuals.

From a market efficiency perspective, this change reduces the administrative burden on global firms when there are internal personnel rotations, provided the group's overarching track record remains sound. However, to maintain high investor protection standards, we emphasize that the "well-established" groups deemed to have complied with these requirements should still demonstrate that their broader investment teams possess high levels of technical competency. We suggest that the SFC consider team stability and turnover as a key factor in its assessment. An institutional track record is most reliable when there is continuity in the investment team; therefore, significant or total turnover in a fund management team should trigger a re-evaluation of whether the KP Requirements should be reapplied to ensure the "human resources" remains sufficient.

In this regard, we continue to believe that the presence of team members holding globally recognized professional designations, such as the Chartered Financial Analyst (CFA) credential, serves as a reliable indicator of the technical expertise and ethical grounding necessary to manage public funds. We also suggest that the SFC provide clear, non-exhaustive criteria for what constitutes a "well-established fund management

group" (e.g., minimum AUM, years of operation, years of experience in the team, and team retention metrics) to provide the industry with greater certainty during the application process.

Question 8: Do you have any comments on the proposals on investment in non-SFC authorised master fund?

We support the SFC's proposal to extend the flexibility currently afforded to ETFs to unlisted feeder funds. Allowing authorized feeder funds to invest in non-SFC authorized master funds, provided they are managed by reputable groups in high-standard jurisdictions, significantly enhances market efficiency. This move allows Hong Kong investors to access global strategies and institutional-scale portfolios that may not have a standalone retail version in the local market, thereby reducing costs through economies of scale.

However, from an investor protection standpoint, we emphasize that the "substantially comparable investor protection" requirement must be robustly enforced. We believe the primary responsibility should rest with the local management company to perform and document thorough due diligence on the master fund's valuation, liquidity, and custody standards to ensure they align with the spirit of the UT Code.

To maintain transparency, we suggest that any material risks or significant regulatory differences in the master fund's jurisdiction, such as differences in investor compensation schemes, statutory dispute resolution mechanisms, or frequency of reporting, be clearly summarized in the KFS. Furthermore, to prevent this structure from being used to bypass local requirements for highly complex or illiquid assets, we suggest the SFC provide a clear list of recognized jurisdictions to provide the industry with greater certainty. This balanced approach protects the integrity of the Hong Kong market while granting investors the full benefits of global diversification.

Question 9: Do you have any comments on the proposal of merging Chapter 8.8 and 8.9 of the UT Code into a single chapter?

We support. From a market efficiency perspective, this merger simplifies the UT Code by removing the often-blurry distinction between "structured funds" and "derivative-heavy funds." A single chapter covering "structured funds and other complex funds" provides greater clarity, reduces the administrative burden on fund managers, and ensures that the regulatory requirements for products with non-linear or intricate risk profiles are more consistent.

From an investor protection standpoint, we emphasize that this consolidation must not result in a "watering down" of specialized safeguards. We agree with the SFC's assessment that funds authorized under this revised chapter should likely be classified as complex products. The unique risks associated with these strategies, such as counterparty risk, valuation opacity, and complex payout formulas, require high standards of oversight.

We suggest that the SFC use this opportunity to refine the KFS requirements for this unified category, ensuring that "bottom-line" risks are explained in plain language that a retail investor can reasonably understand. This

ensures that while the regulatory framework becomes more efficient for professionals, the protective guardrails remain transparent and accessible for the public.

Question 10: Do you have any comments on the proposed consequential amendments to the PRF Code, the MPF Code, the ILAS Code and the REIT Code?

We support. From a market efficiency standpoint, it is important that these codes remain aligned with the core standards of the UT Code to maintain a consistent regulatory standard across Hong Kong's investment landscape. As many fund managers operate products across several of these regimes, a unified set of rules, particularly regarding liquidity risk management, MMF requirements, and the use of ADTs, reduces operational complexity and minimizes compliance risks.

We also welcome the clarification regarding active ETFs. Ensuring that an active ETF must also comply with specialized requirements (such as those for complex funds) if it adopts those strategies provides much-needed transparency for the growing ETF market in Hong Kong.

From an investor protection perspective, these amendments are an important tool to prevent regulatory arbitrage, where differences in rules are exploited to avoid stricter oversight, ensuring that similar investment risks are managed with the same degree of rigor regardless of the product's legal wrapper. While we support this alignment, we suggest that the SFC remains mindful of the unique operational constraints inherent in specialized products, such as the statutory withdrawal requirements of the MPF or the insurance-linked nature of ILAS. Ensuring these amendments are applied in a way that is "fit-for-purpose" will strengthen the integrity of the market while providing a predictable environment for both managers and long-term savers.