FSDC Paper No. 19

Strengthening Hong Kong as a Retail Fund Distribution Centre

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1. Executive Summary

1. This paper outlines our objective to make Hong Kong the leading fund distribution centre in the Asia Pacific Region, in the medium term, and internationally in the longer term. We believe this can best be achieved by:

   i. Promoting and facilitating the creation of diversified fund distribution platforms where investors can have access to a wide range of investment choices.
   ii. Allowing investors to buy funds via a process which is viewed as one of the smoothest and most efficient (to the client) in the world.
   iii. Continuing to leverage Hong Kong's reputation as a trusted and well-regulated regional and global financial centre.

2. Asset Managers are grappling with issues around penetration in new markets and among various challenges they face, distribution is a key issue for many.

3. Chinese asset managers are looking for appropriate distribution channels as part of their strategy of going global and international players who will soon have access to sell their funds into China with the mutual recognition scheme are also assessing their distribution strategies.

4. Online platforms are options being considered but there are concerns around a lack of clear guidance addressing KYC and Suitability.

5. The industry is actively seeking more alternatives to effect distribution with pressure building to reduce costs on the end investor. New distribution platforms are continuing to emerge both globally and in the region and many are led by either the local regulator or the government.

6. Examples include the Korean fund supermarket, an initiative led by the regulator and the mfund, a platform launched by ASX in Australia and again initially driven by the government. On top of these changes, opportunities to sell cross-border are emerging with the establishment of three fund-passporting regimes and the issues around distribution will be further exacerbated as industry players look to enter new markets across Asia.

7. These developments will have long term impacts on Hong Kong - greater funds flow and AUM growth, a larger asset management workforce, and a boost to economic activity. There is a significant opportunity to further enhance Hong Kong as a global asset management and funds hub if HK is able to find appropriate solutions to enable the fund managers to solve the distribution issue.

8. We have provided various recommendations for Hong Kong to further enhance its status as the fund distribution centre in the Asia Pacific region:

   Support the diversification of fund distribution and innovation

   We recommend that the policy makers actively encourage and develop the establishment of more diversified distribution channels in Hong Kong (especially through new online platforms and possibly exchange platforms). Similar to other countries such as Korea and Australia, policymakers in Hong Kong can help champion specific initiatives which will help broaden the range of distribution channels.

Provide additional guidance on Suitability requirements

With respect to both KYC/AML and Suitability we recommend that the SFC consider consolidating and updating its guidance by publishing clear and detailed guidance for the industry which provides certainty around client on-boarding processes and ongoing AML and Suitability requirements especially in view of the growing prominence of e-platforms. Appropriate guidance could include a suggested pro-forma Investor Risk Profiling Questionnaire, guidance on non-face-to-face on-boarding, guidance on execution only transactions and prescriptive guidance on good and poor practice in relation to automated adviser tools.

Use FinTech and enhance the KYC process

Hong Kong should consider creating a central repository for effecting KYC and AML procedures similar to the KYC registration agencies launched by the Securities and Exchange Board of India (Sebi). A central KYC registration agency aims at creating a centralised pool of investor details, which could then be used by intermediaries and clients so that clients would get the due diligence process done just once and all market intermediaries could access it. This will create greater efficiencies across the financial services industry and will also allow greater AML supervision by regulators.

Continue to engage with and develop cross-border initiatives

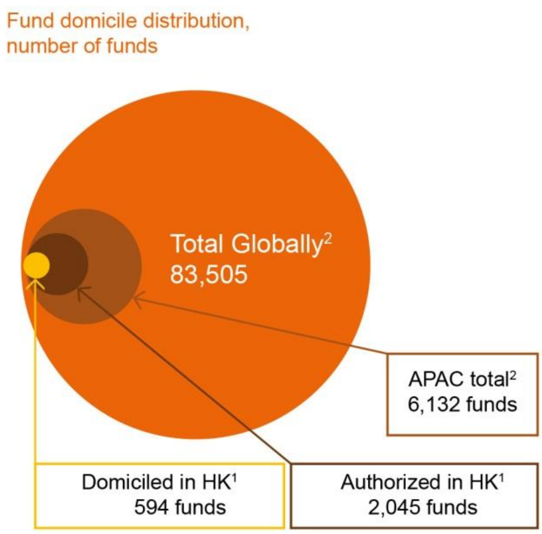
We recommend that the government and regulators continue to develop new cross-border initiatives which will ultimately facilitate fund distribution in Asia. Initially, the key focus should be on the development and expansion of Mutual Recognition of Funds (MRF). This initiative is expected to secure Hong Kong's future as a financial centre by making it the preferred location from which international fund managers could market funds into the Mainland and for mainland fund managers to distribute funds internationally. However, it is also important for Hong Kong to continue to participate in the development of the Asian Region Fund Passport debate as Hong Kong should also look to become a fund distribution gateway for the rest of Asia in due course.

2. Introduction and Key Issues

9. Hong Kong is at the centre of one of the fastest growing regions in the world. With its strong financial system, strong rule of law and lack of foreign exchange controls it is well positioned to become the leading fund provider to the increasingly affluent populations of Asia. However, this opportunity is likely to be achieved only if we address a number of key challenges.

10. This paper seeks to address those challenges by making specific recommendations to aimed at creating a more dynamic highly efficient fund distribution centre which is underpinned by clear regulatory guidance, provides a broad choice of the world's funds to investors, allows for greater competition between firms (and hence lower fees) and an environment which promotes innovation across the industry.

2.1 Opportunities



Sources: 1) SFC Statistics, SFC; 2) PwC Analysis

Hong Kong: Global Asset Management Centre

11. In 2010, Asia ex-Japan's weight in the MSCI World Index was only 9%, while its total contribution to GDP approximated 18%. By 2020, Asia ex-Japan's contribution to GDP could be well above 25%[1.] As this becomes reflected in the MSCI World Index, it will result in new and substantial money flows into the capital markets in Asia. These flows will be considerably enhanced by the further internationalisation of the Renminbi ("RMB"), which will further open up what will eventually become one of the world's most significant asset management markets

[1] http://www.pwc.com/gx/en/asset-management/publications/pdfs/pwc-asset-management-2020-a-brave-new-world-final.pdf

12. The opportunities are immense in Asia. Assets under management in Asia are set to grow faster than in the developed world over the next decade, driven by a shift in economic power, growing pension funds and a growing proportion of High Net Worth Individuals residing in Asia. Funds available for distribution in Asia accounted for only 7% of funds available for distribution globally, creating an immense opportunity for more funds to be created and be accessible regionally. Recognising the growth potential of more funds being created regionally, across Asia, many initiatives are underway with a view to creating a regional fund passport ultimately. While a number of other countries in the region are embarking on similar steps to become important regional fund centres, Hong Kong has the leading edge as a regional fund distribution centre and must ensure that it continues to retain its position.

13. The latest technological advances are seriously challenging the status quo in many industries and in many aspects of daily life. Over the next decade the average investor base profile and their expectations will change dramatically. Convenience, simplicity, transparency, security and cost will continue to be important factors in building clients' trust and loyalty. Consumer benefits will be substantial with increased ease of access and a breadth of online platforms and mobile phone applications to allow consumers near instant access to fund purchases with minimal administrative burden.

14. This shift in customer focus is already underway and disruptors are introducing many innovative ways of interacting with customers. Many countries are already looking at their Financial Technology ("FinTech") strategy which many see as not just a challenge to existing regulations but an opportunity to improve their competitive edge. With technology breakthrough and innovation, there is an opportunity for Hong Kong to develop an industry which can be highly efficient, focussed on customer needs and at the same time, compliant with the regulatory framework.

15. As a major distribution centre, it is expected that further jobs will be created in the fund management industry well exceeding the 34,300 staff[2] currently employed, 70% currently being in sales and marketing. The number of staff employed in distribution is estimated to be even higher when taking into account staff employed by banks that make up the largest distribution channel in Hong Kong.

2.2 Challenges

16. Within this macro, social and technological evolution, Hong Kong is well-positioned to capitalise on the opportunities available to it. However a number of potential obstacles could still prevent it from doing so unless clear and definite steps are taken to address them. These obstacles are seen in the lack of diversity of distribution channels and burdensome on-boarding procedures which are not suited to the digital era.

17. Compared to other global markets, fund distribution channels in Hong Kong are largely concentrated in the banking sector and with a small number of banks. In addition, no significant Independent Financial Advisers ("IFA") industry has developed in Hong Kong unlike in the UK and US. Diversification of existing distribution channels is necessary to better cater for the growing number of industry participants and diversity of investors and lower barriers to entry for new asset managers.

[2] SFC Fund Management Survey 2014- released July 2015.

18. Hong Kong is a relatively small market with a population of just 7 million people. To become a major fund centre with economies of scale, Hong Kong will need to expand through the sale of funds to overseas investors while keeping fixed costs at a reasonable level. Funds distributed to overseas investors accounted for over 70%[3] of Hong Kong fund sales in 2014 and overseas investors will continue to be an important part of HK's fund management industry.

19. Industry practice around the client on-boarding process is seen as unnecessarily burdensome, costly and discouraging to investors. This process is often taken to require face to face identification and therefore presents problems for online platforms in particular. For this reason, while online platforms have started to gain prominence in more developed markets, they have been slow to take off in Hong Kong. Clear on-boarding guidance will also help participants develop their e-platforms strategy more confidently and hence speed up reforms in distribution.

20. Hong Kong is not alone on the issues around suitability and on-boarding. In the UK, the Financial Conduct Authority ("FCA") has published a paper on Retail Investment Advice, clarifying the boundaries and exploring the barriers to market development. The FCA acknowledges that a well-functioning retail investment market needs different delivery mechanisms to be fully effective for a broad range of potential investors and that there are benefits to well-designed, low-cost methods of meeting customers' straightforward needs. The FCA's guidance makes clear to firms, the range of possibilities they have open to them, the requirements of each and the FCA's approach to them.

21. Significant inefficiencies in the KYC and AML procedures are also seen across the financial services industry. In the absence of a central repository for performing KYC and AML checks, each and every financial institution is required to build their own system and process which comes at a significant cost. This cost is replicated at each and every financial institution. With direct distribution, asset managers will need to invest further in their own on-boarding procedures. In a market where compliance and regulatory talent is already very scarce, there is a need to review the possibility of implementing a central repository for KYC and AML checks through greater use of biometric data.

[3] SFC Fund Management activities survey 2014.

3. List of Recommendations to strengthen Hong Kong as a fund distribution centre

22. In order to maximise the opportunities and address the challenges outlined above, we have made four specific recommendations.

3.1 Support the diversification of fund distribution and innovation

23. We recommend that the policy makers actively encourage and develop the establishment of more diversified distribution channels in Hong Kong (especially through new online platforms and possibly exchange platforms). Similar to other countries such as Korea and Australia, policymakers in Hong Kong can help champion specific initiatives which will help broaden the range of distribution channels.

3.2 Provide additional guidance on Suitability requirements

24. With respect to both KYC/AML and Suitability we recommend that the SFC consider consolidating and updating its guidance by publishing clear and detailed guidance for the industry which provides certainty around client on-boarding processes and ongoing AML and Suitability requirements especially in view of the growing prominence of e-platforms. Appropriate guidance could include a suggested pro-forma Investor Risk Profiling Questionnaire, guidance on non-face-to-face on-boarding, guidance on execution only transactions and prescriptive guidance on good and poor practice in relation to automated adviser tools.

3.3 Use FinTech and enhance the KYC process

25. Hong Kong should consider creating a central repository for effecting KYC and AML procedures similar to the KYC registration agencies launched by the Securities and Exchange Board of India ("Sebi"). A central KYC registration agency aims at creating a centralised pool of investor details, which could then be used by intermediaries and clients so that clients would get the due diligence process done just once and all market intermediaries could access it. This will create greater efficiencies across the financial services industry and will also allow greater AML supervision by regulators.

3.4 Continue to engage with and develop cross-border initiatives

26. We recommend that the government and regulators continue to develop new cross-border initiatives which will ultimately facilitate fund distribution in Asia. Initially, the key focus should be on the development and expansion of Mutual Recognition of Funds ("MRF"). This initiative is expected to secure Hong Kong's future as a financial centre by making it the preferred location from which international fund managers could market funds into the Mainland and for mainland fund managers to distribute funds internationally. However, it is also important for Hong Kong to continue to participate in the development of the Asian Region Fund Passport debate as Hong Kong should also look to become a fund distribution gateway for the rest of Asia in due course.

4. Recent market developments and positioning Hong Kong

27. Hong Kong was ranked third for its asset management in the latest Global Financial Centres Index survey, while the top two places were occupied by New York and London[4]. Hong Kong's strong rule of law and regulatory framework together with its strategic location in Asia and relationship with China provide the confidence for investors and industry players at large to make Hong Kong their domicile of choice to do business.

28. According to the Fund Management Activities Survey 2015 issued by the SFC, Hong Kong's combined fund management business reached a record high of USD 2.3 trillion as at the end of 2014. AUM in Asia ex Japan and Australia reached USD 4.5 trillion. Funds from overseas investors are the major source for the fund management business in Hong Kong and accounted for over 70% of the fund management business.

29. Growth in Hong Kong has been fuelled by the many policy initiatives introduced by the Mainland and Hong Kong regulatory authorities aimed towards China's financial market liberalisation. Hong Kong has a long history of serving the financial needs of China as its markets have opened up and the growth story in Hong Kong is expected to continue.

4.1 Initiatives relating to Mainland China

30. The further opening of China's capital market is the catalyst enabling Hong Kong to enhance its leading position as a major asset management centre. Hong Kong's role as the world's leading provider of RMB products outside Mainland China is one of the key drivers behind the growth of its fund management business. Over the past decade, offshore RMB business in Hong Kong has developed rapidly with the Mainland China government's policy support resulting in an increasing breadth of innovative products and offerings.

31. The Qualified Foreign Institutional Investor Scheme ("QFII") programme, introduced in 2003, enables international institutional investors to invest in China's RMB-denominated capital market under a quota system while the Qualified Domestic Institutional Investor Scheme ("QDII") programme introduced in April 2006 enables China's domestic institutions to invest overseas under a quota system.

32. More recently, the Shanghai – Hong Kong Stock Connect, launched in November 2014, is seen as another monumental event and for the first time enables a feasible, controllable and expandable channel for mutual market access between the Mainland and Hong Kong by a broad range of investors, paving the way for further opening up of China's capital account and RMB internationalisation[5]. Under all these new policy initiatives, capital flows to and from China flow predominantly through Hong Kong providing compelling reasons for firms to establish and do business in Hong Kong.

33. Of more direct impact on the funds industry, are the RMB Qualified Institutional Investors scheme ("RQFII"), introduced in 2012 and the MRF which became effective on 1 July 2015.

34. The RQFII scheme has enabled the broadening of investment products available to investors and at the same time has led to the establishment of more Hong Kong domiciled funds for both regulatory and tax reasons.

[4] http://www.longfinance.net/images/GFCI17_23March2015.pdf
[5] http://www.ft.com/cms/s/0/60abe67e-d460-11e4-9bfe-00144feab7de.html?siteedition=uk#axzz3aSesNPEr

35. The MRF is seen as a major breakthrough for the funds industry. For the first time, Hong Kong funds can now be sold into China and vice versa and it lays a foundation for the strengthening of financial and regulatory ties between Hong Kong and China towards greater integration of the Hong Kong and Mainland asset management industry. The exclusivity given to Hong Kong under the MRF program is expected to be maintained for a reasonable length of time to enable the prudential supervision of fund offerings into each market.

36. Under the MRF framework, qualifying funds established in China and approved by the CSRC and managed by CSRC licensed management firms are subject to a streamlined authorisation process by the SFC and likewise qualifying funds established in Hong Kong and approved by the SFC and managed by SFC licensed management firms will be subject to a streamlined authorisation process by the CSRC. The Mutual Fund Recognition Scheme is subject to an initial aggregate net quota (i.e., for all funds) of RMB300 billion applicable each way with each Registered Fund having individual quotas that are calculated based on a set percentage of the amount of assets under management by a Registered Fund[6].

37. MRF opens up more investment choices for investors from Mainland China, and more business for the local financial services industry. As more Hong Kong domiciled funds are authorised and as more international managers establish their offices in Hong Kong, there is expected to be further demand for professional services throughout the entire value chain supporting the asset management markets, i.e. asset managers, fund administrators, transfer agents, custodians, brokers, legal, accounting and various consulting services. (Out of the 34,400 staff employed by the asset management industry in 2014, only 15% were represented by asset managers and traders).

38. With the implementation of MRF in July 2015, it is anticipated that Hong Kong’s role as a domicile, investment management, distribution and sales centre for the asset management business will expand. The SFC has stated that it will continue to work closely with Mainland and overseas regulators as well as stakeholders to maintain an effective and progressive regulatory framework for the benefit of both the financial industry and investing public.

39. It is anticipated that the development and growth of Hong Kong’s asset management industry will add to its prominence both domestically and internationally and that this in turn will expand to involve the entire value chain.

4.2 Other initiatives relating to passporting of funds

40. Beyond China, wealth management across Asia is also expected to continue to grow very significantly. Many Asian countries recognise the benefit asset management affords in enhancing their territory as a major global financial services centre. Specifically in the area of global fund distribution, various initiatives are emerging with a view to the establishment of a global fund distribution centre in Asia. Aside from the Hong Kong-China MRF, the establishment of an Asian Regional Fund Passport and the ASEAN Framework for Cross-Border Offering of Funds are underway, and collectively provide a number of potential opportunities for the expansion of Hong Kong’s fund distribution industry in the region.

[6] http://www.klgates.com/files/Publication/cbf3aff1-886e-46c6-848c-d20d47111c0/Presentation/PublicationAttachment/a5b24160-6b33-46ff-823c-d4e3b136c4de/MutualRecognitionofFundsbetweenMainlandChinaandHongKong.pdf

41. The ASEAN Capital Markets Forum ("ACMF") has announced that the ASEAN Framework for cross-border offering of funds is operational in Malaysia, Singapore and Thailand. This Framework allows fund managers operating in a member jurisdiction to offer funds constituted and authorised in one jurisdiction to retail investors in another jurisdiction for the first time under a streamlined authorisation process. In a separate initiative relating to the offering of funds to non-retail investors, the three countries also agreed to provide mutual assistance in relation to the supervision of cross-border offering of funds.

42. Australia initiated the APEC funds passport proposal following a 2009 review by the Australian government into "Australia as a financial centre" (known as the Johnson Report). The Asia Region Funds Passport ("ARFP") is an APEC initiative that is expected to create a regulatory arrangement for the cross-border offering of mutual funds in participating economies.

43. The passport allows mutual funds established and regulated in one passport member state to be offered to investors in other passport member states. This will take place under a clearly defined framework which seeks to ensure that the laws and regulations of the participating economies are applied in a consistent sound and coherent manner. However a significant challenge to the ultimate success of such passport remains the current lack of harmonisation of cross border tax issues. Until this is addressed the effectiveness of the passport is likely to remain under question.

44. By supporting regulatory consistency, it is envisaged that the passport will result in an increased number of Asia region-based funds being offered in each member state. This expected increase in mutual fund activity in the region is expected to have a positive impact on investors, the Asia region funds industry, and the broader economy in each participating jurisdiction.

45. While Hong Kong is not yet a signatory to the ARFP it is anticipated that participation will be considered at some point. This would allow Hong Kong to benefit from an inflow of foreign funds and an outflow of local funds to participating countries with greater ease, thereby providing a broader range of investor choice through direct access to otherwise inaccessible markets, instruments and offshore expertise as well as access to additional overseas capital and greater economies of scale.

46. This initiative presents another potential opportunity for Hong Kong to sell its authorised funds across multiple countries in Asia and for a wider set of funds to be marketed into Hong Kong from the region. While it remains at an early stage, Hong Kong should position itself to maximise the opportunity.

47. We recommend that the government and regulators continue to develop new cross-border initiatives which will ultimately facilitate fund distribution in Asia. Initially, the key focus should be on the development and expansion of MRF. This initiative is expected to secure Hong Kong's future as a financial centre by making it the preferred location from which international fund managers could sell investments into the Mainland and for mainland fund managers to distribute funds internationally. However, it is also important for Hong Kong to continue to participate in the development of the Asian Region Fund Passport debate as Hong Kong should also look to become a fund distribution gateway for the rest of Asia in due course.

5. Fund distribution landscape

5.1 Hong Kong fund distribution landscape

48. Fund distribution in Hong Kong is dominated by the banking sector. It is estimated that 78% of retail funds are distributed through this channel[7]. While many large existing asset managers have been able to enjoy a strong relationship with the large distributors in Hong Kong, the newer entrants to the industry struggle to secure shelf space. Alternative distribution channels available to the newer entrants are limited as banks have been able to capitalise on their existing broad retail distribution network, making it difficult for new entrants or distribution channels to take hold and develop.

49. Insurance firms have been able to gain some traction through the distribution of investment-linked insurance products and along with online platforms, fund of funds and master trusts, now make up 19%[8] of the fund distribution market. The remaining 3%[9] of funds are distributed through brokers, agents, Independent Financial Advisors ("IFA") and distribution companies with a small number of asset managers distributing directly to the market due to the lack of comprehensive platforms to facilitate the direct distribution of funds.

50. Whilst the Hong Kong bank distribution model has its benefits, including the fact that the banks have made substantial investment in developing user-friendly and regulatory compliant distribution platforms, it also presents draw-backs. Since retail fund distribution is concentrated in one channel, the banks are able to maintain a controlling influence on both the fees and the type and range of products available to investors.

51. A concentrated distribution channel presents challenges throughout the value chain. Fund Managers are required to pay high charges demanded by distributors with a commanding market position and have difficulty securing shelf space for new products. New market entrants are met with high barriers to entry and developing new distribution channels is difficult. In addition, investors have limited means of comparing available funds in one location given the restricted range of products that a bank may offer and opaque cost structures can hide distribution charges and high upfront costs in a wrapped fee.

52. A key challenge relating to fund distribution is the alignment of interest between distributors and investors. Distributors are incentivised by asset managers and their interest may not always be aligned to that of the investors when providing advice.

53. The investor on-boarding and product suitability determination at the point of sale for funds adopted by the distributors, largely follow the same procedures across their banks notwithstanding that funds are meant to be lower risk products offering greater diversification of market exposure. The on-boarding process and procedures implemented by the banks have in large part also been adopted by non-bank distributors who are concerned about the potential risks of regulatory non-compliance. This has resulted in the on-boarding process across the entire intermediary industry being undertaken in an overly burdensome manner.

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[7] PricewaterhouseCoopers, PwC Roundtable – The Future of Funds Distribution in Asia 2014.

[8] Ibid

[9] Ibid

54. In the quest for enhancing Hong Kong as a major asset management centre, Hong Kong must allow more diversification of distribution channels to reduce dependency on the banks and provide greater regulatory clarity as to how the suitability obligations are expected to be implemented across different distribution channels. The Global Financial Crisis (“GFC”) and the impact of greater regulatory scrutiny on the banking sector has led many large financial institutions to revisit their business model and many have started to reorganise themselves to focus more on niche markets.

5.2 Comparison with other markets

Funds distribution in Asia*

Channel (% share)	Hong Kong	Australia	China	Korea	Japan	Taiwan
Banks	78%	75%***	42%	27%	33%	30%
Brokers / agents / IFAs / Distribution companies	3%	25%	13%	63%	66%	9%
Fund company direct sales	-	<5%	35%	5%	1%	43%
Other**	19%	-	10%	4%	-	17%

* Source: Asset Management Industry bodies as of December 2013
** Insurance companies, e-platform, fund of funds
*** In Australia, wrap (master trust) platforms are largely owned by banks

55. Across Asia, the level of concentration and the principal distribution channels vary. For example, 76% of distribution in Australia is via insurance companies, online platforms, funds of funds and master trusts whereas in Korea and Japan, brokers, agents, IFAs and distribution companies account for 63% and 66% of the distribution market respectively[10]. The distribution of mutual funds in mainland China is concentrated in the banks (43%) and fund managers via direct sales (35%)[11]. On-line platforms, such as the ones offered by the likes of Alibaba and Tencent have started to also change the distribution landscape in China.

56. In June 2013, the Alibaba Group launched Yu’e Bao, a value added service on the Alipay balance account, which automatically invests in Tianhong Zenglibao Money Management Fund, the 50th largest asset manager in China at that time (51% of its shares were acquired by Alibaba in October 2013), and now it is the largest.

57. Following Yu’e Bao’s success, a number of other companies have launched similar offerings. Among these, the most notable cases come from another internet technology giant in China, Tencent Group, that launched its fund distribution platform “Caifutong” on its popular instant communication App “WeChat”, which had more than 468 million active users as of Q3 2014.

[10] Ibid.
[11] Ibid.

58. Hong Kong also differs from certain other developed markets, such as the US and UK, where privately owned fund distribution platforms, IFAs, wrap accounts, and exchange-owned fund distribution platforms play a large role[12].

59. In Europe, where asset management firms are often subsidiaries of large financial groups, and bank networks are by far the main channels for mutual fund distribution, open architecture (i.e., the opening of distribution networks to outside investment products) is expected to broaden the range of investment products and strategies, and foster competition by introducing new fund providers.

60. Robo-Advisers are key game changers which will transform the industry and investor attitudes and are also expected to play a key role in the growth of Hong Kong's fund distribution industry, specifically through the growth of online and possibly exchange based platforms. Such platforms have already proven to be a success in a number of overseas jurisdictions and have helped diversify fund distribution channels and provide access to funds and a broader range of investors.

61. In several Asian markets, regulators are among the drivers of the establishment of these disruptors as they become increasingly consumer focused. Korea's online supermarket, Fund Online Korea ("FOK") and India's MF Utility ("MFU"), which were launched in April 2014 and March 2015 respectively, were heavily championed by the country's regulators and fund associations[13], as was Australia's M Fund initiative.

62. The wealth management industry is moving towards strengthening front end tools, for both advisors and end investors, in order to create a new value added offering, including execution only operations, which provide investors with an online bridge to the market, and automated portfolio management. It is important that Hong Kong remains at the forefront of these developments and allows innovation to improve the investor experience and access to broader range of investment products.

63. One such example is the announcement by Alibaba Group Holding Ltd.'s finance affiliate that it was launching a wealth-management application which helps users buy into hundreds of funds and track stocks from Hong Kong to the NASDAQ off their smartphones. The app lets users buy some 900 fund products from more than 80 Chinese financial institutions commission-free.

64. In response to technological advances such as this, China's central bank is considering a draft regulation that proposes a cap on the amount individuals can pay via online payment services to 5,000 Yuan daily, unless their identities are verified by a security token and electronic signature. The draft rules are seen by Chinese banking analysts as limiting the growth of Internet finance[14].

65. The following section further discusses some of the developments and innovations in fund distribution within Asia and globally.

5.3 Emerging trends in fund distribution channels

66. Concerns around over concentration of distribution channels, alignment of interest between distributors and investors, high fee charges, lack of transparency on fee charges and lack of

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12 PricewaterhouseCoopers, PwC Roundtable – The Future of Funds Distribution in Asia 2014.

13 Cerulli Edge, Asia-Pacific Edition, 3Q 2015, Issue #45, Riding the Wave of Digital Disruption.

14 http://www.bloomberg.com/news/articles/2015-08-18/alibaba-finance-arm-s-newest-app-helps-china-investors-buy-funds

access to broad range of funds products have prompted policy makers and disruptors alike to rethink the distribution model.

67. The development of technology has allowed disruptors to challenge the status quo and create greater competition for meeting end customer need. This has involved the introduction of more innovative customer solutions for customers by providing services through the internet, some of which involve giving personal recommendations and some which do not. Robo-Advisers are a class of financial adviser that provides portfolio management online with minimal human intervention based on algorithms such as Modern portfolio theory that originally served the traditional advisory community. The increase in Robo-advisory services is forcing traditional managers to re-evaluate the existing face-to-face business model and the assumption that clients will always prefer to discuss their investment options directly with an adviser.

68. Because retail investors can now access significant amounts of financial market information anywhere at any time, digital services can address their needs in an easier and more convenient way than nine-to-five financial service providers can.

69. Demographic shifts are also influencing the demand for investment products. The burgeoning middle classes in Asia will need far more retail investment products. Meanwhile the ageing populations of advanced economies such as Hong Kong will demand more post-retirement products and investment solutions.

70. This profound change in demography is set to revolutionise the retail investment landscape and the balance of power within the fund management value chain. A growing percentage of the world's population has grown up with broadband, smart phones, tablet, laptops and social media as a day to day part of life. As such, the asset management industry needs to be able to service this investor base through such channels or risk falling behind other industries able to maximise the use of technology to best serve their client base.

71. Robo-advisers are starting to build white label platforms for distributors, which can be customised according to intermediaries' needs. The ongoing customisation of robo-platforms will give financial advisors the opportunity to better serve their clients with low cost and personalised solutions.

72. Investments in technology are fundamental for advisors and distributors who hope to succeed in the new investor environment where cost pressure is mounting and the level of service is increasing.

5.3.1 Online fund platforms

73. Fund platforms are internet-based services used by intermediaries (and sometimes clients) to view and administer investments. They tend to offer a range of tools which allow advisers and clients to see and analyse portfolios in addition to enabling investors to be more self-directed. As well as arranging transactions, platforms may arrange custody for clients' assets.

74. Investment managers typically pay fund platforms for the right to list their products on a platform. These payments, known as rebates, generally come from the annual management charge paid by the investor to the manager.

75. Within China, Shanghai based IFA firm East Money Information ("Eastmoney"), a key third-party online fund distributor with an e-platform has attracted USD$20billion in inflows in the first three months of this year. The online platform, Tiantian currently holds

2,190 retail funds from 85 fund management companies on its shelf [15]. Tiantian is particularly beneficial for small to midsized fund management companies who may not have a high profile in the market or the ability to get shelf space with the banks.

76. The introduction of fund products sold through online platforms provided by non-financial intermediaries has also created disruption to traditional distribution channels in China. These new entrants have experienced significant growth over the last 12 months, albeit from a low starting point[16].

77. Non-financial intermediaries, particularly those that have a strong online presence, have used their standing distribution chain for commercial goods to introduce money market fund services. By pooling the excess balances of a very large amount of customers, Alibaba and Tencent have built up AUM at a rapid pace[17].

78. For example in Mainland China, Alibaba's online platform Yuebao sells money market funds ("MMFs") which offer yields that to date are materially higher than the bank deposit rate. Tencent started a similar platform known as Licaitong in the beginning of 2014. As of June 2014, AUM of the largest MMF in Yuebao and Licaitong reached RMB 570 billion and RMB 60 billion respectively. These online platforms cover the whole of Mainland China, a reach that is very hard to achieve for physical distributors.

79. An online fund platform with clear presentation of information on each fund can allow investors to have a better and clearer understanding of the fund and its fee structure, e.g., how trailer fees are calculated and charged. However, while the use of fund platforms provides an easy-to-use and accessible means of investing in a broad range of funds, the system can also give an inaccurate impression to investors that the service is free unless clear disclosure is made. In addition, it could also promote product bias, with larger fund managers able to pay higher rebates and gain greater prominence on platforms than smaller peers or those unwilling to pay.

80. One way of addressing this is the UK model where the issue has in part been addressed by the Financial Conduct Authority's ("FCA") introduction of new regulatory rules requiring that customers who access products via a platform now pay an upfront fee directly to the fund supermarket, thus breaking the links between fund managers and the companies who showcase their products. These changes were designed to allow both investors and advisers to compare the costs of investing through different platforms and make an informed decision as to whether using a platform represents good value for money. Another way of addressing this is through greater transparency on fees. Full disclosure may equally serve the purpose of mitigating product bias but places greater reliance on investors to identify and challenge where a platform may be recommending products on the basis of higher commission levels.

81. While the growth of platforms not operated by banks has been slower in Hong Kong than in some other global markets, some independently operated online platforms are starting to appear and this development should lead to more fee competition and lower barriers to entry for new funds.

[15] Ignites Asia – Eastmoney.

[16] Ibid.

[17] Ibid.

5.3.2 Exchange based distribution platforms

82. Exchange based distribution platforms allow unlisted fund products to be transacted and / or settled via stock exchanges and their associated clearing and settlement systems. Under this model exchanges are able to bring fund providers and investors together and often provide order routing, settlement and custody services. Euronext, the Luxembourg Stock Exchange and Deutsche Börse all provide platforms covering their Markets. In Asia Pacific, the Australian Stock Exchange ("ASX") and the Shenzhen Stock Exchange offer similar models. The ASX platform was developed in consultation with Australian Securities and Investments Commission ("ASIC") with the encouragement of the Australian government.

83. There are different operating models for exchange distribution platforms: some facilitate the subscription and redemption of funds (either by investors directly or through exchange brokers) without an active on-screen secondary market; some involve market makers for secondary trading; and some operate a combination of both. Similar to privately owned platforms, exchange distribution platforms may provide information, such as an online portal, that assists retail investors to make their own assessment of the fund prior to investing. Exchange distribution platforms therefore assist retail clients in becoming more "self-directed" in their long-term investment management.

84. While Hong Kong does not currently have an exchange based distribution platform for funds, the ability of Hong Kong Exchanges and Clearing Limited ("HKEx") to provide this service could certainly be explored. Similar to other major exchanges globally, HKEx has an existing cash market settlement infrastructure and a large broker network, both of which could be leveraged to deliver a new channel for distributing funds to investors in Hong Kong. In addition, HKEx has recently established settlement system connections with ChinaClear as part of Shanghai-Hong Kong Stock Connect, which could potentially provide a template for settling cross-border fund transactions under the newly approved Mutual Recognition of Fund scheme.

85. An exchange based distribution model addresses a number of the criticisms directed at existing distribution channels. One observable benefit is the increase in distribution channels in an otherwise concentrated bank-dominated market, thus giving investors more choice in gaining exposure to particular funds. Exchanges are also usually independent, which means they can provide visibility and brand recognition to a much broader range of funds that may struggle to achieve traction with bank distributors. For investors, an exchange-provided, highly visible online portal can also support data analytics to compare and contrast fund performance and fees.

86. As well as reducing the volume of contractual agreements, the ability to enter into master distribution agreements with brokers and fund managers means that provider due diligence could be facilitated by the exchange, thus reducing operational burdens. Due diligence and on-boarding of investors would be undertaken by the brokers, who are themselves licensed persons.

87. In order for an exchange distribution platform to be successful, the fees charged to investors and fund managers would need to be competitive compared to the other prevalent distribution channels. If exchange distribution requires brokers to act as distributors, fees may reappear in the system in the form of broker distribution fees and commissions, so the fee structure would need to be fully transparent to investors.

88. In addition, the introduction of any new distribution channel may require greater investor education and awareness as well as a change in investor behaviour. Hong Kong retail investors have historically been reliant on banks for advice whereas an exchange distribution platform would require investors to act in a more self-directed fashion.

However, retail brokers in Hong Kong may welcome the possibility of extending the provision of their investment advice from stocks to mutual funds, as (assuming the broker receives part of the trailer fee) this would allow them to earn more stable asset-based income compared to transaction-based commissions only.

89. Despite these challenges, facilitating the use of electronic and online platform has clear positive implications for various Hong Kong market participants, and we encourage serious consideration to be given to it by the Hong Kong policy makers.

5.3.3 Others

90. Industry owned platforms are also emerging. Korea has taken a more direct approach to reforming fund distribution with the introduction of its web based Fund Supermarket Korea last year. This initiative was created by the Korean Government in an effort to lessen the dominating influence of local finance companies. The Supermarket enables a broader range of products offered by multitude fund providers to be accessible by investors. Ownership of the platform is spread among its 47 foundation members, which include 41 of Korea's largest fund providers. Participation in the Supermarket was compulsory for its foundation members. One major benefit to investors using the platform is the lower management fees they can expect to pay, with fees as low as one third the cost of funds sold elsewhere.

91. We recommend that the policy makers actively encourage and develop the establishment of more diversified distribution channels in Hong Kong (especially through new online platforms and possibly exchange platforms). Similar to other countries such as Korea and Australia, policymakers in Hong Kong can help champion specific initiatives which will help broaden the range of distribution channels.

6. Regulatory Framework

92. Our engagement with the industry has found inconsistency regarding the application of the regulatory framework (or an overly cautious interpretation of how it is applied) by firms for selling products to consumers. The SFC remains very focused on suitability and has been rightly critical of certain segments of the industry not doing enough. However, a lack of certainty and concerns about the implications of potential non-compliance may have led to some firms implementing overly onerous controls and restrictions over their distribution businesses

93. KYC requirements are also considered to be challenging due to the fact that most distributors require face to face on-boarding. One further regulatory consideration discussed below is in relation to the product approval process and how this can affect the range of products available.

94. While it is accepted that the suitability framework is fundamental to a fair regulatory regime, what is expected to meet suitability requirements will depend on a number of factors. Our view is that this is not fully understood or appreciated by the industry which has accordingly adopted unnecessarily cumbersome and burdensome processes.

6.1 Suitability requirements - including non-advised business (Self-Directed)

95. Suitability requirements seek to ensure that, where firms make a recommendation or solicitation they obtain sufficient information about their customers to ensure that the business conducted for them, or on their behalf, is appropriate to their circumstances.

96. In Hong Kong, the primary requirement to ensure the suitability of investments for clients is contained in the Code of Conduct. The Code of Conduct requires that "Having regard to information about the client of which the licensed or registered person is or should be aware through the exercise of due diligence, the licensed or registered person should, when making a recommendation or solicitation, ensure the suitability of the recommendation or solicitation for that client is reasonable in all the circumstances". The Code also contains provisions imposing additional obligations to assess and characterize investors' understanding of derivatives in the context of derivative products.

97. Since the global financial crisis and the large scale miss-selling of mini-bonds primarily through the bank distribution channel, the SFC and Hong Kong Monetary Authority ("HKMA") have made a concerted effort to reinforce the obligation of licensed and registered persons to ensure that investment products are suitable for their clients. In addition, firms have been asked to supplement their disclosure obligations to ensure that clients of distributors understand the risks of their investment decisions. Unlike other jurisdictions where suitability only applies when there is a personal recommendation (i.e. advice which is personal to the investor), in Hong Kong it applies also when there is a solicitation (even though no advice is being given). What constitutes solicitation is potentially extremely broad.

98. In its Circular to All Licensed Persons dated 8 May 2007 (which remains in effect), the SFC issued a list of questions and answers setting out guidance on what suitability obligations are expected of licensed and registered persons who are engaged in investment advisory, portfolio management and distribution activities involving the making of investment recommendations and/or solicitations. However, the application of such guidance in seeking to implement a streamlined client on-boarding process has proved challenging.

99. The Report to the Financial Secretary on Issues Raised by the Mini-bonds Crisis, issued in December 2008, proposed a number of regulatory changes, some of which have since been adopted and reflected in the following changes:

i. a tightening of the obligations on licensed and registered persons to assess the suitability of derivative products for clients (Paragraph 5.1A of the Code of Conduct effective 4 June 2011),
ii. a refinement of the requirements for evidencing whether a person qualifies as a professional investor (an amendment to the Professional Investors Rules, effective 16 December 2011); and
iii. the requirement on intermediaries to disclose the receipt of monetary and non-monetary benefits in connection with the distribution of investment products (Paragraph 8.3A of the Code of Conduct effective 4 June 2011).

100. On 25 September 2014, the SFC issued its conclusion to a consultation paper on proposed amendments to the professional investor regime which included, inter alia, a proposal to remove the exemption from the suitability requirement for professional investors who are individuals. The consultation conclusion has confirmed the SFC's intention not to allow intermediaries to be exempt from the Suitability Requirement or rely on the other existing Code exemptions that are inherently linked with the Suitability Requirement and/or have significant bearing on investor protection (e.g., the need to enter into a written client agreement) when serving Individual Professional Investors[18].

101. As a result of these changes firms have adopted more stringent internal controls, including those relating to their suitability assessment processes. Some market participants now feel that the pendulum may have swung too far in that firms have gone beyond the regulatory standard by implementing potentially obstructive processes which prevent informed access by investors to investment products.

102. Typically, where greater reliance is placed by the customer on the intermediary, stricter suitability requirements are applied, including where the intermediary provides individual portfolio management or investment advice.

103. It is uncertain how the Code of Conduct affects "self-directed" transactions, i.e. unsolicited and non-advised transactions under specific client instruction. For example, a client without experience in investment products may place an order to subscribe for units in a fund by fax and then expect the order to be executed by a licensed or registered person without further communication. Under such circumstances, it is unclear whether a licensed or registered person may proceed with the transaction or whether a licensed or registered person must withhold execution until he has explained or warned the client of the relevant risks associated with the fund.

104. A "solicitation" can be interpreted to mean any advertisement for an investment product, regardless of whether it amounts to an "offer". Clearly in many cases (e.g. newspaper advertisement) it is not practical to conduct KYC and suitability assessment when the ad is placed or read by potential investors. Because the definition is potentially so wide, it is hard to see how an investor can ever get to hear about a product without having received a solicitation. The logical extension of this is that suitability must always be assessed for individual investors, which renders online platforms, off-the-page advertising and other form of execution only business inoperable under the current framework.

105. The continuing advancement of technology developments brings with it a number of regulatory challenges. Regulators need to be quick to react to new ways of interacting with

[18] http://www.sfc.hk/edistributionWeb/gateway/EN/consultation/conclusion?refNo=13CP1

investors and to provide clarity where it is lacking so that firms understand what is permissible within the regulatory framework.

106. In the UK, the FCA published detailed guidance following research into the extent to which:

  i. there was a difference between their expectations of firms and the firms' understanding of what was required of them;
  ii. how any difference in understanding might affect the availability of products and services offered to customers; and
  iii. the extent to which this might be affected by a lack of clarity around the FCA's rules, their implementation and their supervision. In particular, they considered how this 'expectations gap' might result in firms shying away from providing products or services that would benefit customers for fear of falling foul of the rules[19].

107. The paper addresses a range of issues including clarifying the current regulatory landscape on personal recommendations in relation to retail investments, bringing together in one place the existing FCA guidance that is available to firms (particularly on simplified advice) and from the Committee of European Securities Regulators ("CESR") and the European Securities and Markets Authority ("ESMA"). It also summarises the results of the thematic work that the FCA have recently carried out examining the new distribution models firms are using to sell investment products to customers in the retail investment market, some of which provide a personal recommendation and some of which do not.

108. The paper also reports on the FCA's customer research carried out specifically for the paper, to understand how customers use services without a personal recommendation; and their perception of the service they receive provides detailed examples of business models and in each case offer a view on whether the FCA thinks the example is regulated advice or not. Finally, the paper introduces Project Innovate, which is designed to encourage innovative business models in the interest of consumers.

109. This paper is a very useful example of how regulators can positively impact the growth and development of a market segment by providing a clear set of rules and guidance for firms to adhere to.

110. With regard to Suitability we recognise the need for a robust and effective framework to ensure that investors are not sold investment products that misalign with their risk profile. We therefore do not support relaxing the requirement that advice be suitable; however, we do recommend that the current risk appetite rating system for funds be reviewed.

111. As noted, there is a lack of industry understanding around elements of the suitability process and a lack of regulatory guidance on this matter. It is therefore suggested that, much like the FCA, the SFC publish clear guidance in order for firms to better understand their obligations and what is deemed to be acceptable practice by the industry across different distribution channels. Such guidance could include a pro-forma Investor Risk Profiling Questionnaire, guidance on execution only transactions and prescriptive guidance on good and poor practice, similar to that which the FCA recently published.

112. Clarification around existing regulation would help make Hong Kong's fund market more easily accessible to investors. In addition, it could more clearly define how a risk based approach can be applied to SFC authorised mutual funds which, due to their diversified nature, tend to present a lower risk than single stocks or other packaged products. Guidance on how a risk based approach should be applied would ultimately allow intermediaries to

[19] http://www.fca.org.uk/static/documents/guidance-consultations/gc14-03.pdf

adopt a more pragmatic approach and to offer a smoother on-boarding process to retail investors.

113. The implementation of these recommendations could open up the fund management market to new business models that are able to better service retail investors at a lower cost and that are operating within clearly defined parameters.

114. With respect to both KYC/AML and Suitability we recommend that the SFC consider consolidating and updating its guidance by publishing clear and detailed guidance for the industry which provides certainty around client on-boarding processes and ongoing AML and Suitability requirements. Appropriate guidance could include a suggested pro-forma Investor Risk Profiling Questionnaire, guidance on non-face-to-face on-boarding, guidance on execution only transactions and prescriptive guidance on good and poor practice in relation to automated adviser tools.

6.2 KYC and AML requirements

115. The Anti-Money Laundering Ordinance ('AMLO') imposes requirements relating to customer due diligence ("CDD") and record-keeping on Financial Institutions ('FI') and provides regulatory authorities with the powers to supervise compliance with these requirements and other requirements under the AMLO.

116. FI's are required to consider the additional risk posed by non-face-to-face business, in accordance with the risk based approach and procedures they have adopted. While guidance on non-face-to face is limited there are some specific rules or guidance relating to non-face-to-face business which the industry does not appear to use.

117. While under the existing rules firms are allowed to apply a risk based approach to non-face-to-face business, the lack of specific guidance has meant a cautious approach has been adopted by industry participants who have tended to require that face to face CDD is conducted for customers who wish to invest in mutual funds. Given technological advancements and the need to compete with overseas markets, insistence on face to face CDD is incompatible with Hong Kong's aim to be a competitive funds distribution centre in the region and globally.

118. Hong Kong can be contrasted to those jurisdictions where a large volume of funds are distributed online such as the UK and the US, where more prescriptive rules have provided sufficient certainty for such distribution channels to develop.

119. In the UK, where a customer is not physically present for identification purposes, a firm must take specific and adequate measures to compensate for this higher risk by applying one or more of the following measures[20]:

i. Ensuring that the customer's identity is established by additional documents, data or information;
ii. Supplementary measures to verify or certify the documents supplied, or requiring confirmatory certification by a credit or financial institution; or
iii. Ensuring that the first payment is carried out through an account opened in the customer's name with a credit institution.

120. Whereas in the US, where a customer approaches an institution remotely, the institution is required to deploy additional monitoring controls against transactions originating in such

[20] PwC Suitability and KYC Global Comparison Matrix May 2015.

higher risk accounts. Local guidance includes examples of non-documentary verification methods that a financial institution may use, including[21]:

i. contacting a customer after the account is opened;
ii. requiring identification documentation to be notarised; and
iii. comparing the identifying information against fraud and negative check databases, etc.

121. The additional guidance and clarity provided in the UK, US and a number of other jurisdictions has provided a level of certainty that does not currently exist in Hong Kong and has helped firms adopt a practical approach to conducting KYC and AML checks on clients that is aligned with regulatory expectation and allows an efficient and risk based due diligence process to be conducted for face-to-face and non-face-to-face interactions.

6.2.1 KYC registration agencies

122. The administrative burden attached to existing investment account opening processes is seen as a hindrance both in terms of investors experiencing a smooth and efficient client on-boarding process and for the development of online distribution platforms. This is largely due to the market practice of requiring clients to present themselves and their identification documentation in person. The existing process has been described above, however the centralisation of customer due diligence in a central registration database could provide a viable alternative.

123. In 2011, the Securities and Exchange Board of India ("Sebi") launched KYC registration agencies ("KRAs") to create a centralised pool of investor details, which could then be used by brokerages and clients to reduce account-opening documentation requirements. The system was designed so that investors could get their due diligence process completed just once and all market intermediaries could access it[22]. It is understood that the Singapore fund management industry is exploring the possibility of setting up a similar model.

124. Sebi has allowed certain categories of institutions to set up KRAs, which essentially maintain the KYC details of investors store their records and provide them to market participants at a nominal charge. The five entities between them manage a total of approximately 20 million investor accounts[23].

125. It should be noted that this model has attracted some criticism. Brokerage officials consider the utility of KRAs is limited since a lot of the due diligence continues to be done manually as a number of physical documents still need to be signed by clients. In addition, since many brokerages fear that the information could be old, they prefer to go through the KYC process themselves. However, Sebi have said that the regulator has abolished most of the client-broker agreements though some brokerages insist on voluntary agreements, which are done offline[24].

126. It is apparent that the KYC central registration system has its limitations and will need further development before it is considered a full replacement for face-to-face KYC. At present it is difficult to replicate documentation related to additional or specialised services offered by brokerages as those might vary across market participants. Fund Managers,

[21] Ibid.
[22] https://www.nsekra.com/
[23] Ibid.
[24] http://www.livemint.com/Money/LcuvOLuU6tpYk0aNo8hyEO/Sebis-plan-for-KYC-registration-agencies-fails-to-make-a-ma.html

however, are believed to be benefiting from KRAs as there is uniformity in the documentation procedures in the mutual fund industry and it is our view that it would benefit the financial sector in Hong Kong if the industry were to introduce a centralised registration system.

127. If Hong Kong were to consider introducing a similar model there would need to be close consideration of the level of consistency across required documentation as an effective process must work in full and not just in part. Further, if the setting up of a centralised registration system is too onerous, the alternative is to adopt a risk-based approach as to KYC procedures and we suggest that regulators provide greater clarity on what is acceptable practice.

128. We recommend that Hong Kong should consider creating a central repository for effecting KYC and AML procedures similar to the KYC registration agencies launched by the Securities and Exchange Board of India. A central KYC registration agency aims at creating a centralised pool of investor details, which could then be used by intermediaries and clients so that clients would get the due diligence process done just once and all market intermediaries could access it. This will create greater efficiencies across the financial services industry and will also allow greater AML supervision by regulators.

6.3 Product Approval process

129. In order for interests in a fund to be marketed to the public in Hong Kong, the fund must be authorised by the SFC under Section 104 SFO. The conditions for authorisation are set out in the SFC's Handbook for Unit Trusts and Mutual Funds, Investment-Linked Assurance Schemes and Unlisted Structured Products. In addition, any invitation to the public to acquire shares in the fund must be authorised by the SFC under Section 105 SFO.

130. The SFC is receptive to a range of different fund structures. To be authorized in Hong Kong, investment funds should comply with the SFC's Handbook or, in the case of specialized funds such as real estate investment trusts, other applicable codes. Broadly, to obtain authorisation, overseas investment funds must satisfy the SFC as to the suitability of their structural, and operational requirements, and investment restrictions, and the suitability of their key operators (investment manager and trustee / custodian).

131. While the Code does not impose any specific domicile requirements in relation to a Scheme, it does encompass a concept of Recognised Jurisdiction Schemes ("RJS") which, by virtue of qualifying as such, means the Scheme is deemed to comply with the material provisions of the Code and hence benefit from a more streamlined authorisation process than non RJS schemes. The current list of RJS Schemes comprises retail schemes authorised in the following jurisdictions: Australia, France, Germany, Guernsey, Ireland, Isle of Man, Jersey, Luxembourg, Malaysia, Taiwan, UK and the US. Any funds not on this list (for example funds domiciled in Singapore and Japan) will be subject to a more in-depth authorisation process requiring full compliance with the relevant code.

132. Under the existing framework product providers face a number of challenges in seeking to authorise their schemes under current regulatory framework including time to market issues , costs (mainly relating to legal and operational costs arising from a negotiated authorisation process), additional disclosure requirements, approval of investment managers and approval process of subsequent changes post SFC authorisation

133. The time taken to approve a fund in Hong Kong has not compared favourably to other fund domicile and distribution centres. In order to encourage more promoters to authorise their

products in Hong Kong, the regulatory environment needs to improve to facilitate a more streamlined and efficient process. To that end, the SFC is consulting on the development of a two-stream process whereby standard applications (for example, new sub-funds under existing SFC-authorised umbrella funds that are non-complex) would be processed under a fast track system that would target between a 4-8 weeks authorisation time. In addition, the SFC is aiming to shorten the authorisation timetable for non-standard applications to approximately 8-12 weeks.

134. We welcome this initiative from the SFC which is expected to bring Hong Kong more in line with its competitors by reducing the time to market for fund authorisations.

7. Conclusion

135. Hong Kong has traditionally been a destination for fund distribution. This is reflected in the high number of offshore domiciled funds and the high percentage of the domestic asset management workforce employed in sales and marketing such funds.

136. However, Asia's fund market is now changing, through the growth of its middle class, a rapidly ageing population, the disruption of traditional distribution channels by the entrance of new ones and emerging opportunities to sell across borders, as well as the establishment of fund-passporting regimes.

137. In this environment, distribution will no longer be a single-step process, but a multi-faceted undertaking with many considerations. These considerations will include investor segmentation, improving the customer experience, building stronger brand trust and loyalty, developing more relevant products and, of course, how and where to distribute.

138. Against this backdrop, Hong Kong should also allow the growth of FinTech and encourage innovation which will enable greater competition and better service to investors.

139. We hope that the opening up of additional distribution channels and the introduction of legislation around passporting and mutual recognition will further expand Hong Kong's capacity for asset management activities. To this end the recommendations made in this paper aim to provide the following benefits:

    i. create a more flexible and diverse distribution and business environment for fund managers to meet market demand, which in turn could attract more mutual funds and private funds to domicile in Hong Kong;
    ii. build up Hong Kong's fund manufacturing capabilities to complement the existing fund distribution network and develop Hong Kong into a full fund service centre, which would increase opportunities for fund servicing work and other support functions and thus, create more employment opportunities in those areas; and
    iii. enhance Hong Kong's fund platform and infrastructure to facilitate the increasing number of public and private fund managers who wish to domicile their funds in Hong Kong, hence further deepening Hong Kong's funds market.

140. The Hong Kong regulators have demonstrated their desire to develop and grow Hong Kong as a major asset management centre, within a structured and thought through framework that puts investor assist protection at its core.

141. We enthusiastically support the recent regulatory initiatives in this regard and trust that the industry, regulatory bodies and policy makers take forward the recommendations set out in this paper with the same rigour.

About the Financial Services Development Council, Hong Kong

Established in January 2013, the Financial Services Development Council (FSDC), Hong Kong is a high-level and cross-sector platform to engage the industry and formulate proposals to promote the further development of Hong Kong's financial services industry and map out the strategic direction for development. The FSDC will advise the Hong Kong SAR Government on areas related to diversifying the financial services industry, enhancing Hong Kong's position and functions as an international financial centre of our country and in the region, and further consolidate our competitiveness through leveraging the Mainland to become more global.

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