Fund Manager Code of Conduct

Common deficiencies

August 2021

Background

The Securities and Futures Commission (“SFC”) published the **revised Fund Manager Code of Conduct** (“FMCC”), which came into effect in November 2018. The revised FMCC introduced a number of significant changes on fund managers’ responsibilities for the overall operation of their funds and discretionary accounts.

Since the introduction of the revised FMCC, we have performed various independent reviews for a range of fund managers and noted a number of deficiencies. Summarised below are the **key updates introduced** in the revised FMCC and some **common deficiencies observed** during our reviews.

Key updates introduced

Fund portfolio valuation	Fund managers are required to **establish appropriate policies and procedures** (valuation policies) to ensure proper and independent valuation of the fund assets can be performed and valuation methodologies are consistently applied. The valuation policies should be **at least annually reviewed** by a competent and functionally-independent party.
Liquidity risk management	Fund managers should establish, implement and maintain **effective liquidity management policies and procedures** to monitor the liquidity risk of funds. Fund managers should also **periodically review** the effectiveness of the policies and procedures and update such policies as appropriate.
Custody of fund assets	Fund managers should ensure **fund assets are segregated from the fund managers’ assets**. Where applicable, fund managers should select and appoint a **custodian** with a formal **custody agreement** in place. Any significant changes to the custody agreement or material risks to investors should be disclosed to the fund investors.
Securities lending, repurchase agreements (repo) and reverse repo	Fund managers should put in place a **collateral valuation and management policy** and a **cash collateral reinvestment policy** governing securities lending, repo and reverse repo, including collateral and haircut policy. Minimum information required for disclosure to fund investors on an annual basis is also set out by the SFC.
Disclosure of leverage	Fund managers should **disclose** to fund investors the expected maximum level of leverage will be employed on behalf of the fund and the basis of calculation of leverage.
Side pockets	Fund manager must ensure that required information are **disclosed** to fund investors before any "side pocket" is introduced in a fund, including the limit to total assets to be put in the side pockets, overall fee structure and charging mechanism.

Common deficiencies

Governance –
While most fund managers have established governance structure commensurate with their nature, size, complexity and risk profile, it is commonly observed that the roles and responsibilities, and meeting frequency of respective governance forums or committees were not formalized or properly evidenced.

Risk management –
There are often inadequate policies, control procedures or a designated risk management function to identify, quantify and manage the risks. In addition, audit trails were often not properly maintained, in particular, rationale of deviation, remedial actions and corresponding management review and approval.

Valuation –
It is common for fund managers to appoint a third party to perform valuation services. However, we observed fund managers often struggle to demonstrate or provide evidence that they have exercised due skill, care and diligence in the selection process, and in the ongoing review of the third party's activities and performance.

Conflicts of interest and best execution –
Transactions carried out on behalf of a fund with a connected person are common for fund managers within a financial services group, e.g. deposit funds with a connected bank. However, such transactions were often not carried out on an arm's length basis or consistent with best execution standards. In addition, there are often inadequate internal controls to manage potential conflicts of interest.

How KPMG can help

To support you in your journey of maintaining a robust and effective governance structure, risk management framework and internal control environments for your fund management business, we are delighted to offer support in any of the abovementioned areas, including but not limited to:

- Conduct **mock inspections and/ or interviews** with Managers-in-charge (MICs) and other key stakeholders against relevant regulatory requirements and expectations and assist you in **preparing for any upcoming on-site inspection**
- Assess the **design and effectiveness of the governance structure and risk management framework**, especially management oversights, 3 lines of defence, roles and responsibilities of risk management and audit functions, etc.
- Evaluate **internal control design and operating effectiveness** in all or selected areas under the FMCC
- Provide **remediation support** through recommending remedial actions required or assessing the adequacy and effectiveness of remedial actions designed/ or implemented by the fund managers to close the identified gaps.

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