

HONG KONG REGULATION E-BULLETIN

GOVERNMENT TO INTRODUCE OPEN-ENDED FUND COMPANIES IN HONG KONG

On 15 January 2016, the Financial Services and Treasury Bureau (**FSTB**) issued its [consultation conclusions](#) regarding the proposal to introduce a new open-ended fund company (**OFC**) structure in Hong Kong. The *Securities and Futures (Amendment) Bill 2016*, which incorporates the proposed amendments to the *Securities and Futures Ordinance (SFO)* and other legislation for this purpose was gazetted on the same day. A [brief](#) to the Legislative Council has also been made available.

Background

Currently, under the laws of Hong Kong, an open-ended investment fund can only be established in the form of a unit trust. It cannot be in corporate form due to the various restrictions which exist in relation to capital reductions under the Hong Kong *Companies Ordinance*. In response to the market need for more flexibility around investment fund vehicles and the international practice of using a corporate fund structure, the OFC structure has been proposed. The FSTB hopes that the introduction of OFCs will be “conducive to Hong Kong’s further development as an international asset management centre”.

Consultation conclusions

The FSTB conducted a consultation on the proposed OFC regime in March 2014 and received 27 written submissions from, among others, industry groups, law firms and fund operators. The responses indicated that there was support for introducing an OFC structure in Hong Kong with many comments primarily focusing on technical issues. Further details can be found in the [consultation conclusions](#).

What are OFCs?

OFCs are open-ended collective investment schemes structured as corporates with limited liability and variable share capital. They can be publicly or privately offered.

The OFC structure proposed in the consultation conclusions will have similar characteristics to a conventional limited company in that:

- › the OFC will have a legal personality;
- › the OFC will have a constitutional document;

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- › the OFC will be governed by a board of directors who are subject to fiduciary duties; and
- › the liability of the OFC's shareholders will be limited to the amount unpaid on their shares.

However, being an investment vehicle, the proposals provide that OFCs:

- › will have the flexibility to vary their share capital in order to meet shareholder subscription and redemption requests;
- › may distribute out of share capital subject to solvency and disclosure requirements; and
- › should not be required to be licensed as a licensed corporation under the SFO but will have to be registered with the Securities and Futures Commission (**SFC**) and will be primarily regulated by the SFC.

Setting up an OFC

There will be a "one-stop shop" approach for the incorporation and registration of an OFC. An applicant should apply to the SFC for registration of the OFC. Once the SFC is satisfied that the registration requirements have been met, it will issue a notice of registration to the Registrar of Companies (**CR**) to facilitate the OFCs incorporation and business registration. OFCs which seek to offer their shares to the public must also apply for authorisation under the SFO.

The SFC will be the primary regulator responsible for the registration and regulation of OFCs under the SFO. The CR will be responsible for the incorporation and administration of statutory corporate filings of OFCs.

The key operators of an OFC

The OFC board will provide high-level oversight of the affairs of the OFC and the directors will owe the relevant statutory and fiduciary duties to the OFC.

The directors, the investment manager and the custodian are proposed to be the "key operators" of the OFC. Similar to the OFC itself, the directors of the OFC need not be licensed under the SFO; however, the OFC will delegate its investment management to an investment manager who must be licensed by or registered with the SFC to carry out asset management regulated activity. In addition, the assets of the OFC must be segregated from that of the investment manager and entrusted to a separate, independent custodian for safekeeping.

While there is no requirement for the directors to be resident or for the custodian to be incorporated in Hong Kong, each non-resident director and any overseas custodian is required to appoint a process agent in Hong Kong.

Investment mandate and fund structure

The government proposes to allow publicly offered OFCs to invest in asset classes in accordance with the SFC's product code requirements and authorisation conditions (ie, securities, futures and OTC derivative products).

For privately offered OFCs, the government has determined that their investment scope should align with Type 9 (asset management) regulated activity with a "10% de-minimis exemption". This activity can encompass investments in cash, currency forwards and loans and the 10% de-minimis exemption means that a maximum of 10% of the total gross asset value of the fund may be invested in other asset classes.

OFCs are permitted to be set up as an umbrella fund (i.e. have a

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number of sub-funds which have different investment objectives and policies). Further, a “protected cell structure” is available such that the assets of each sub fund cannot be used to discharge the liabilities of the umbrella fund or other sub-funds.

Termination and winding up of OFCs

Provided that: (i) it is certified as solvent by its board and an independent and qualified auditor; and (ii) its shareholders have been given reasonable notice, an OFC can go through a streamlined termination process and then apply to SFC for cancellation of its registration.

The winding up process for an OFC, whether solvent or insolvent, will be similar to that which exists for companies under the *Companies (Winding Up and Miscellaneous Provisions) Ordinance*.

Supervision and enforcement

The FSTB has considered the overseas regimes which have similar corporate vehicles including the UK, Ireland, Luxembourg and the Cayman Islands and will use what it has learned to formulate the supervisory and enforcement framework. It is expected to include the following elements:

- The SFC licensed investment manager of the OFC will be subject to the SFC’s *Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission*, the *Fund Manager Code of Conduct* and the proposed OFC code;
- The OFC and its key operators will be subject to the OFC legislation and the proposed OFC code and will have to comply with certain registration requirements;
- The SFC’s investigatory powers will be extended to apply to OFCs; and
- In relation to civil and criminal powers, the relevant existing provisions of the SFO would apply including those provisions which provide remedies for investors.

Way forward

The *Securities and Futures (Amendment) Bill 2016* was introduced into the Legislative Council on 27 January 2016. The SFC will conduct a separate public consultation on the draft OFC rules and the OFC code in which they plan to set out the more detailed requirements and guidance for OFCs.

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