

Investment Management Alert

Akin Gump
STRAUSS HAUER & FELD LLP

Hong Kong to Adopt a Limited Partnership Regime for Funds

May 8, 2020

Key Points

- The Financial Services and the Treasury Bureau proposed a limited partnership regime for investment funds in Hong Kong to enhance the attractiveness of the Hong Kong asset and wealth management industry.
- Similar to other jurisdictions, such as the Cayman Islands and Singapore, with a similar regime, the Hong Kong limited partnership fund regime will assume a registration system.
- The Hong Kong government is targeting to enact the Limited Partnership Fund Bill by the end of August 2020.

Introduction

Private equity (PE) funds are commonly established in the form of a limited partnership. However, this has not been an option for investment managers who wish to establish a Hong Kong domiciled PE fund. The current Limited Partnership Ordinance (Cap. 37) (LPO) is an antiquated piece of legislation that was first enacted in 1912 when the concept of a PE fund did not exist. Despite having been amended since then, it is not capable of meeting the needs of contemporary PE funds because it does not envisage devices used by modern PE funds such as capital contributions, draw down mechanisms, capital calls, profits distribution and other features which are essential for a PE fund to operate properly.

In light of the foregoing and with a view to increase the appeal of Hong Kong as an asset management center for the PE industry which has seen enormous growth in recent years, the Financial Services and the Treasury Bureau carried out an industry consultation on the establishment of a stand-alone limited partnership regime designed specifically for investment funds in Q3 2019. The limited partnership fund (LPF) regime was put forward in the Legislative Council in December 2019 for discussion and the Limited Partnership Fund Bill (Bill) was gazetted on 20 March 2020. It is anticipated that the ordinance will come into effect in late August 2020.

Contact Information

If you have questions about this alert, please contact:

Anne-Marie Godfrey

Partner

Anne-marie.godfrey@akingump.com

Hong Kong

+852 3694.3040

Key Features of a Limited Partnership Fund

The Bill is tailored to investment funds wishing to adopt the form of a limited partnership. The key features in the Bill governing the establishment and operation of LPFs are set out below.

Constitution

An LPF does not have a separate legal personality. It must be constituted under a limited partnership agreement and have one general partner and at least one limited partner. The name of the LPF must contain the words “Limited Partnership Fund” or “LPF” as the last words of the name. An LPF is required to have a registered office in Hong Kong.

Registration

The Bill proposes a registration scheme for LPFs. In order to register a fund as an LPF, a Hong Kong law firm or solicitor must submit the required information and the specified fee on behalf of the general partner of the fund to the Registrar of Companies (ROC). The ROC will issue a certificate of registration upon successful registration.

The ROC will maintain a register of LPFs (LPF Register) containing the information submitted by LPFs to the ROC as well as the certificates issued by the ROC and an index of the names of every LPF (LPF Index). The LPF Register and the LPF Index will be available for public inspection. Note that information (such as the audited financial statements and register of partners) which is specified to be excluded from public inspection in the Bill will not be available for public inspection (see the “*Ongoing Compliance*” section below for more details).

The Partners

General Partner

A general partner may be:

- an individual who is at least 18 years old;
- a Hong Kong-incorporated private company limited by shares;
- a registered non-Hong Kong company;
- a limited partnership registered under the LPO;
- an LPF; or
- a non-Hong Kong limited partnership (with or without a legal personality).

The general partner has unlimited liability for all the debts and obligations and ultimate responsibility for the management and control of an LPF.

Limited Partner

A limited partner may be:

- an individual;
- a corporation;

- a partnership of any kind;
- an unincorporated body; or
- any other entity.

A limited partner does not have day-to-day management rights or control over the assets of the LPF and does not owe any fiduciary duty to the general partner or other limited partners. A limited partner's liability for the debts and obligations of the LPF is limited to its agreed contribution unless it takes part in the management of the LPF.

Having taken into account the fact that while limited partners generally do not participate in the management of a fund, they may be involved in certain decision-making processes relating to the LPF, the Bill provides for a non-exhaustive list of safe harbor activities the performance of which by a limited partner would not constitute management of the LPF. Some examples of the safe harbor activities are as follows:

- acting as an agent, member, contractor, officer or employee of the LPF;
- acting as an agent, director, shareholder, member, contractor, officer or employee of the general partner;
- serving on a board or committee of the LPF or the general partner;
- consulting, investigating, reviewing, approving or advising on the accounts, the valuation or the assets of the LPF or the affairs of the LPF;
- taking part in a decision relating to a change in the persons responsible for the day-to-day management of the LPF;
- taking part in a decision relating to a change in the investment scope of the LPF;
- taking part in a decision on whether the term of the LPF should be extended;
- taking part in a decision relating to entering into contracts with other parties in relation to the business of the LPF; or
- taking part in a decision relating to the participation by a limited partner in the LPF in a particular investment by the LPF.

These safe harbor provisions will allow limited partners to participate in limited partner advisory committees and to vote on matters pertaining to the conduct of business of the LPF without being deemed to be engaged in the management of the LPF in a manner that would jeopardise its limited liabilities.

Service Providers and Specified Roles

Investment Manager

The general partner must appoint an investment manager to perform the day-to-day investment management functions of the LPF. The investment manager must be one of the following:

- a Hong Kong resident who is at least 18 years old;
- a company established in Hong Kong; or
- a registered non-Hong Kong company.

The general partner may appoint itself as the investment manager. The fact that the investment manager needs to be operating in Hong Kong will mean that this entity will

need to obtain a type 9 (asset management) licence from the Securities and Futures Commission.

Auditor

The general partner must appoint an auditor which is independent of the general partner and the investment manager to perform audits of the LPF's financial statements on an annual basis.

Responsible Person

The general partner must appoint a "responsible person" to perform anti-money laundering / counter-terrorist financing (AML) functions in accordance with Schedule 2 to the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (Cap. 615) (AMLO), including performing customer due diligence and keeping relevant records.

A responsible person should fall within one of the below categories:

- an authorized institution;
- a licensed corporation;
- an accounting professional; or
- a legal professional.

The general partner is allowed to take up the role of a responsible person.

We are of the view that it would be preferable if a wider range of parties could undertake this role and if compliance with the AML laws of other reputable jurisdictions were sufficient.

Authorized Representative

In the event the general partner is another LPF or a non-Hong Kong limited partnership without a legal personality, the Bill mandates the general partner to appoint an "authorized representative" for the LPF. The authorized representative and the general partner will be jointly and severally liable for all the debts and obligations of the LPF. The authorized representative will also have ultimate responsibility for the management and control of the LPF together with the general partner.

An authorized representative must be one of the following:

- a Hong Kong resident who is at least 18 years old;
- a company; or
- a registered non-Hong Kong company.

Ongoing Compliance

The general partner must file an annual return to the ROC together with the specified fee within 42 days after the anniversary of the date on which the LPF's certificate of registration is issued. The annual return must include a declaration that the LPF (i) has been in operation or has carried on business as a fund during the 12 months before the anniversary, and (ii) will be in operation or will carry on business as a fund in the 12 months after the anniversary. The ROC is empowered to strike an LPF's name off

the LPF Register if it is not in operation or is not carrying on business as a fund 24 months after its registration.

The LPF must keep records of the following at its registered office or another address notified to the ROC:

- the audited financial statements;
- a register of partners;
- AML records required under Schedule 2 to the AMLO;
- the LPF's transaction documents and records; and
- the controller of each of the partners of the LPF.

The audited financial statements need to be made available to the limited partners of the LPF. The Bill specifies that the foregoing information is not available for public inspection. This addresses many private funds' concern to maintain confidentiality especially in respect of the limited partners.

Dissolution and Liquidation

There are two main ways under which an LPF's life may be brought to an end.

A straightforward way to terminate an LPF is to dissolve it in accordance with the relevant terms and conditions as set out in the limited partnership agreement. The partners of the LPF have freedom to agree how these terms and conditions are drafted. In addition, if (i) the general partner is bankrupt, dissolved or dead, (ii) a winding-up order is made by the court in respect of the general partner, or (iii) the general partner ceases to be such, and the general partner is not replaced within a period of thirty days after the date on which one of the foregoing circumstances occurs, the LPF is dissolved on the expiry of the period. A notification of dissolution must be filed with the ROC within 15 days after the LPF is dissolved.

Alternatively, an LPF can be terminated by the court. The court may order an LPF to be dissolved, on application by a partner or a creditor of the LPF, on various grounds such as where the court finds that it is just and equitable to do so. The court may also order the LPF to be wound up as an unregistered company under Part X of the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32) upon presentation of a winding up petition to the court.

Taxation and Stamp Duty

The profits tax exemption that currently applies to private funds will apply to an LPF if it meets the definition of a "fund" under section 20AM of the Inland Revenue Ordinance (Cap. 112) (IRO) and is subject to certain exemption conditions in the IRO. The profits tax exemption will apply to transactions in qualifying assets specified in Schedule 16C to the IRO and transactions incidental to the carrying out of qualifying transactions.

No stamp duty will be chargeable where an interest in an LPF is contributed, transferred or withdrawn. This is because an interest in an LPF does not constitute a "stock" under section 2 of the Stamp Duty Ordinance (Cap. 117).

The Financial Secretary announced in the 2020-21 Budget that it is the Hong Kong government's intention to introduce tax concession for carried interest issued by PE funds operating in Hong Kong, subject to the fulfilment of certain conditions. The

government will consult the industry on this proposal and expects that the relevant arrangement will be applicable starting from 2020-21 upon completion of the legislative exercise.

Moving Forward

The Bill is targeted to be enacted by the end of August this year. The LPF regime is introduced at an opportune time. The Cayman Islands has traditionally been a popular jurisdiction for investment managers to set up PE funds. To align with the requirements for geographically mobile activities to have economic substance under the Organization for Economic Co-operation and Development (OECD) standard for Base Erosion and Profit Shifting (BEPS), the Cayman Islands implemented certain reporting and economic substance requirements in 2019. This has prompted many investment managers to re-examine their fund structures as the new requirements mean that their Cayman Islands incorporated managers have become subject to more onerous regulatory obligations.

In February 2020, the Cayman Islands government enacted the Private Funds Law 2020 (PFL) and an amendment to the Mutual Funds Law (2020 Revision) (MFL). The PFL requires Cayman Islands closed-ended funds which fall within the definition of a private fund (including PE funds) to register with the Cayman Islands Monetary Authority (CIMA). The amendment to the MFL also results in open-ended funds, which were previously exempt from CIMA regulation for having not more than fifteen investors holding the equity interests of the relevant mutual fund, having to register with CIMA.

Further, the EU Council added the Cayman Islands to the EU's blacklist of non-cooperative jurisdictions for tax purposes, which blacklist comprises jurisdictions which are perceived to encourage abusive tax practices.

The Hong Kong Fund Manager Code of Conduct also requires funds (including Cayman Islands PE funds) to be audited where they are managed by a Hong Kong SFC licensed manager, and the fees for maintaining the registration of a Hong Kong limited partnership are considerably lower than those payable in the Cayman Islands.

In light of the foregoing factors, which have made Cayman Islands funds less attractive, a window has been opened for investment managers to consider an alternative jurisdiction to operate their funds. Coupled with a shifting preference from offshore to onshore fund structures and activities, the LPF regime, if properly promoted and operated, has the potential to propel Hong Kong in the direction of a fund formation destination.

The full text of the Bill can be accessed via the link below:

<https://www.legco.gov.hk/yr19-20/english/bills/b202003201.pdf>

akingump.com