

Investment Management Alert

February 25, 2016

The Introduction of an Open-Ended Fund Company Regime in Hong Kong

Introduction

Under the current legal and regulatory regime relating to the establishment of investment funds in Hong Kong, an open-ended investment fund in Hong Kong can only take the form of a unit trust. This is mainly due to the restrictions on capital reductions in the Companies Ordinance (Cap. 622) (CO), which do not allow for a Hong Kong company to vary its share capital to meet shareholder subscription and redemption requests. The Hong Kong government recently published the Securities and Futures (Amendment) Bill 2016 (“Amendment Bill”), which will amend the Securities and Futures Ordinance (Cap. 571) (SFO) and other existing legislation to introduce a framework for the establishment and regulation of open-ended fund companies (OFCs) in Hong Kong.

Background

Following a public consultation conducted in March 2014, the Financial Services and the Treasury Bureau published the conclusions of the public consultation on 15 January 2016, and the Amendment Bill was gazetted on the same day. The Amendment Bill provides a broad legal, regulatory and tax framework for OFCs and will be supplemented by subsidiary legislation containing more detailed provisions, as well as guidelines and codes issued by the Securities and Futures Commission (SFC). The aim of the Amendment Bill is to provide additional choices in terms of fund structures and to promote fund product manufacturing in Hong Kong, with the overall goal being to strengthen Hong Kong’s position as an international asset management centre.

Features of the New Open-Ended Fund Company

The legislation provides for open-ended collective investment schemes established in company form under the SFO (as opposed to under the CO for a conventional Hong Kong company), with limited liability and variable share capital. OFCs will share many of the same characteristics as conventional Hong Kong companies, including a constitutive document and a board of directors who are subject to fiduciary duties. It is also anticipated that the winding-up rules applicable to OFCs will closely follow the process provided for in the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32).

As OFCs are designed to be investment vehicles, they will have greater flexibility than conventional companies. They may:

- vary their share capital to meet investor subscription and redemption requests
- distribute assets out of share capital subject to solvency and disclosure requirements

- be structured using an umbrella fund structure, allowing for subfunds, where the assets of each subfund are managed in accordance with the investment objectives and policies specific to that subfund; and
- take the form of a publicly or privately offered fund.

The existing profits tax exemption regime for investment funds registered with the SFC will apply equally to publicly offered OFC's. A profits tax exemption will also be extended to privately offered OFC's with their centre of management and control outside of Hong Kong. The request of industry players during the public consultation for the profits tax exemption to also apply to privately offered OFCs with their centre of management and control in Hong Kong will require further consideration and consultation with industry in light of the potential for abuse.

Requirements and Regulation

OFCs will not be required to be licensed corporations under the SFO, but will have to be registered with the SFC before they can be incorporated by the Companies Registry:

- An OFC's investment management functions must be delegated to an investment manager approved by its board of directors and licensed by, or registered with, the SFC to carry on Type 9 regulated activity.
- An OFC's assets must be entrusted to an independent custodian and must be segregated from the assets of the investment manager. The independent custodian may be Hong Kong-incorporated or may be an overseas custodian that is acceptable to the SFC and meets the requirements in the SFC Handbook.
- In addition to appointing an investment manager and custodian, each OFC must appoint at least two directors and an auditor.
- The Amendment Bill designates each director, investment manager and custodian a "specified officer" and states that any provision in an OFC's constitutional document purporting to exempt a specified officer from liability in connection with the specified officer's misconduct will be void.
- The investment scope of privately offered OFCs is limited to assets that may be managed by Type 9 licensed entities, with a 10 percent de minimis limit for investing in other asset classes.
- Publicly offered OFCs will be able to invest in asset classes in accordance with the SFC's product code requirements and authorisation conditions, consisting mainly of securities, futures and over-the-counter derivatives.

The SFC will be the primary regulator responsible for the registration and regulation of OFCs under the SFO and will be empowered to make subsidiary legislation and publish related guidelines or codes to regulate and provide guidance on the incorporation, management, operation and business of OFCs. The Companies Registry will be responsible for the incorporation and administration of statutory corporate filings of OFCs. As with conventional Hong Kong companies, the Companies Registry will keep information records on each OFC, and such information will be made available for public access.

Next Steps

The Amendment Bill was given its First Reading by the Legislative Council on 27 January, and a Bills Committee was formed on 29 January. The first meeting of the Bills Committee was scheduled for 23 February. The Amendment Bill must still be given a Second Reading and a Third Reading before it is enacted by the Legislative Council, after which it will come into operation on a day to be designated by the Secretary for Financial Services and the Treasury by notice published in the *Gazette*.

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