Next Generation of Funds in Asia: Hong Kong’s Open-ended Fund Company

Thursday, November 10, 2016

On 10 June 2016, the Securities and Futures (Amendment) Bill 2016, which introduces the legal framework for the open-ended fund company (“OFC”) regime, was enacted as an ordinance (“Ordinance”) in Hong Kong. The Ordinance is not currently in operation, but will commence on a date to be determined by the Secretary for Financial Services and the Treasury. The introduction of the OFC regime creates an alternative form of investment fund vehicles for the Hong Kong asset management industry. This development aims to encourage the asset management industry to domicile their investment funds in Hong Kong and promote Hong Kong as a premier international asset management centre.

BACKGROUND

Before the enactment of the Ordinance, an open-ended investment fund in Hong Kong would typically be established in the form of a unit trust due to restrictions on capital reduction and distributions of companies incorporated under the Companies Ordinance (Chapter 622 of the Laws of Hong Kong) (“CO”). Although unit trusts are widely used as investment fund vehicles in common law jurisdictions, the new corporate structure would allow additional flexibility for international investors from a tax and regulatory perspective.

ESSENTIAL FEATURES OF AN OFC

An OFC is a collective investment scheme (“CIS”) structured as a corporation with limited liability and will be able to be set up as either a publicly offered OFC (“Public OFC”) or privately offered OFC (“Private OFC”).

An OFC will have certain distinctive features and characteristics, namely:

1. OFCs will have a variable share capital structure to allow flexibility in meeting subscription and redemption requests and will not be bound by the share capital reduction restrictions applicable to companies incorporated under the CO.

2. OFCs will be able to distribute out of share capital subject to solvency and disclosure requirements and will not be bound by distribution out of share capital restrictions applicable to companies incorporated under the CO.

3. OFCs will be able to be established as an umbrella fund with protected cells, i.e., separately pooled sub-funds within the OFC with liabilities segregated from the other cells, similar to a Cayman Islands segregated portfolio company. Each sub-fund will be able to have a pool of assets that is managed in accordance with the investment objective and policy of that sub-fund.

INVESTMENT SCOPE OF OFCS

The primary purpose of a Hong Kong OFC is to operate as an investment fund vehicle. OFCs are not designed to operate as a corporate entity in carrying on general commercial business or trade.

For Public OFCs, it is expected that the investment scope will need to comply with the Securities and Futures
Commission’s ("SFC") product code requirements and authorization conditions (i.e., the same requirements as retail funds).

For Private OFCs, it is expected that the investment scope will predominantly invest in securities and futures (and later over-the-counter derivatives when the relevant laws have been enacted) that fall within the scope of Type 9 regulated activity under the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong) ("SFO"). In addition, it is proposed that a Private OFC will be allowed a 10% de minimis limit (i.e., a maximum of 10% of the gross asset value of the fund) for investing in other asset classes.

The exact investment scope will be subject to further guidance from the SFC (see paragraph 8 below).

REQUIRED KEY OPERATORS

1. Directors
   a. An OFC will be required to have at least two directors who are natural persons and have attained the age of 18 years at the time of appointment.
   b. Directors of an OFC will owe the company the same fiduciary duties and the duty to exercise reasonable care, skill, and diligence that apply to directors of a conventional company.

2. Investment Manager ("IM")
   An OFC will be required to delegate its investment management function to an IM who is an intermediary licensed or registered for Type 9 regulated activity (asset management) under the SFO.

3. Custodian
   Unless specified otherwise by the SFC, assets of an OFC will be required to be entrusted to an independent custodian. Such assets must be segregated from the investment manager. It is expected that the requirements on such custodians shall be the same as those applicable under the Code on Unit Trusts and Mutual Funds (i.e., the same requirements as custodians for retail funds).

4. Auditor
   An OFC will also be required to appoint an auditor for each financial year.

OTHER REQUIREMENTS

1. Name
   It is required that the English name of an OFC must end with “Open-ended Fund Company” or “OFC”; and the Chinese name of the OFC must end with “開放式基金公司”.

2. Registered office
   An OFC will be required to have a registered office in Hong Kong.

INCORPORATION PROCEDURE

Any person who wishes to set up an OFC will be required to satisfy the relevant requirements for registration and apply to become registered with the SFC. Such requirements will include appointment of the relevant key operators, name, and registered office (as mentioned above), as well as other requirements as may be prescribed in the SFO and the OFC Rules.

Upon the successful registration with the SFC, the Registrar of Companies will be informed of the registration. An incorporation form and a copy of the instrument of incorporation (i.e., the articles of incorporation) of the proposed OFC will then have to be delivered to the Registrar of Companies to complete the registration.

LEGAL FRAMEWORK OF THE OFC

The Ordinance provides a legal framework for the establishment and operation of OFCs in Hong Kong and sets
out various enabling provisions as well as amendments to the SFO and other related ordinances. The SFC will conduct a separate public consultation and formulate the subsidiary legislation ("OFC Rules") and the relevant code ("OFC Code") to provide detailed guidance on the operational requirements of the OFC regime.

Given that OFCs are set up to function as an investment fund vehicle, the SFC will be the primary regulator responsible for the registration, regulation, and supervision of OFCs. Since an OFC is a corporate entity, the Companies Registry of Hong Kong will be responsible for the incorporation and relevant statutory corporate filings of OFCs.

CONCLUSION

The introduction of the OFC regime evidences the effort of the Hong Kong Government to cement Hong Kong as a premier international asset management center. The intent of the introduction of this new OFC structure is to create a more flexible business environment for investment funds and to broaden Hong Kong’s fund domiciliation platform.

It is expected that a separate public consultation on the draft OFC Rules and OFC Code will be conducted by the authorities in the coming months. Fund managers and other market participants must remain vigilant of the latest development as well as the commencement date of the Ordinance, which will be gazetted by the Government in due course.

Copyright 2019 K & L Gates

Source URL: https://www.natlawreview.com/article/next-generation-funds-asia-hong-kongs-open-ended-fund-company