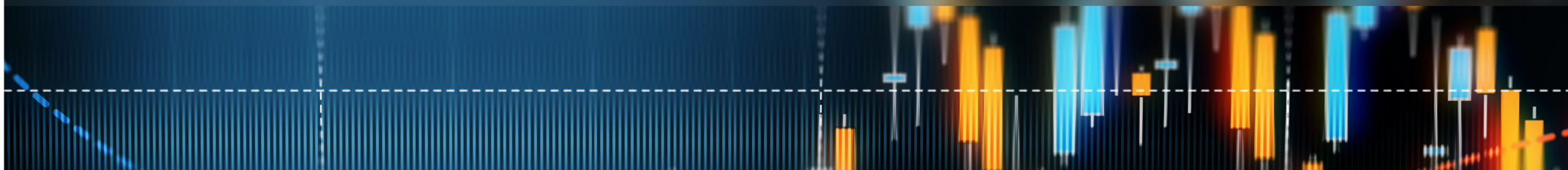


C L I F F O R D
C H A N C E



LEGAL PERSPECTIVE: LAUNCHING HONG KONG DOMICILED FUNDS

NOVEMBER 2021

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LEGAL AND REGULATORY FRAMEWORK FOR OFC



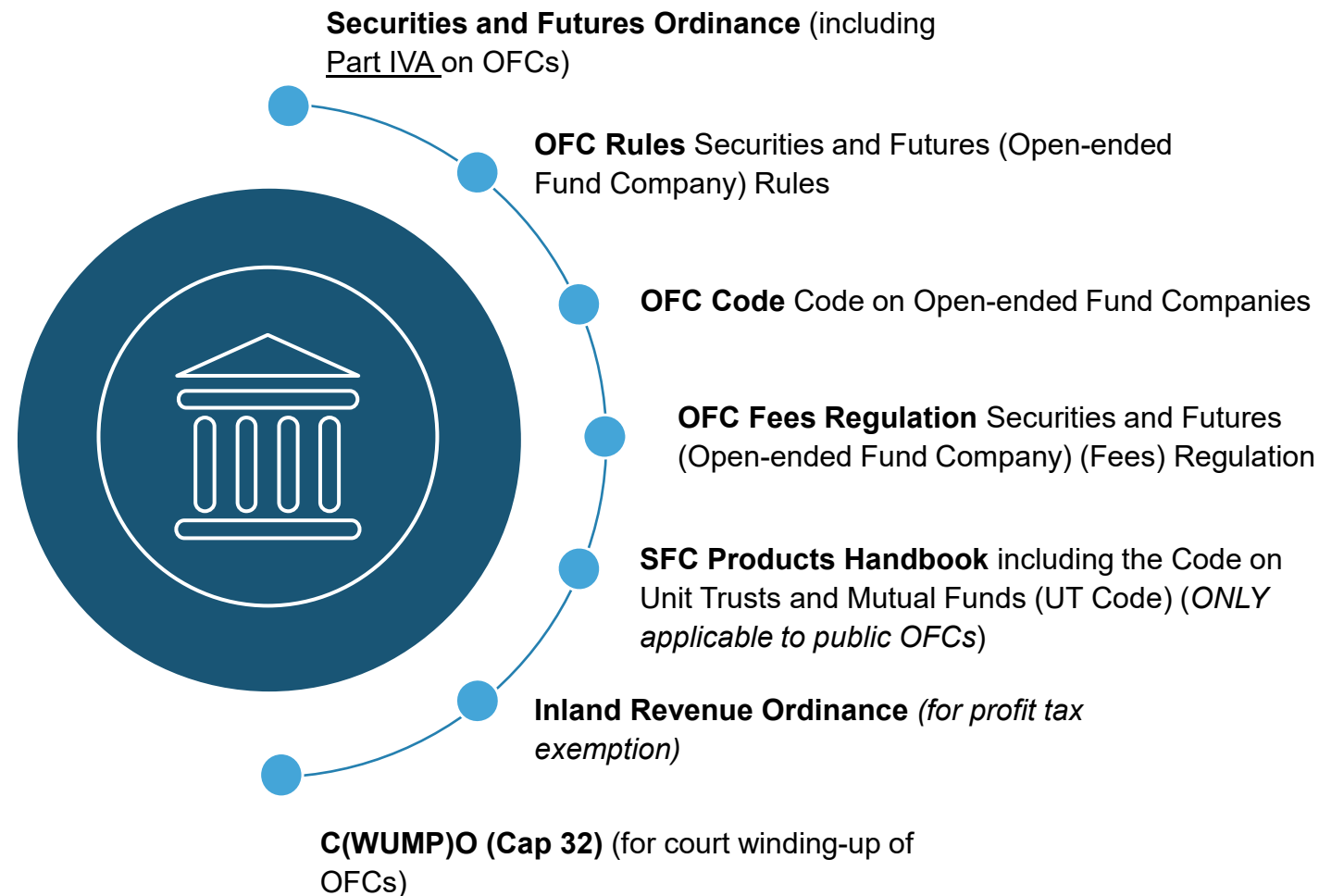
INTRODUCTION



- Traditionally, a Hong Kong domiciled open-ended investment fund could only be established in the form of an unit trust but not in corporate form due to capital protection provisions under the Companies Ordinance (Chapter 622)
- However, a variable capital corporate fund structure is available in most major fund centres
- SFC introduced OFCs on 30 July 2018 to provide a corporate vehicle option
- Similar developments outside of HK
 - Singapore: variable capital companies (VCC)
 - Australia: corporate collective investment vehicles (CCIV)

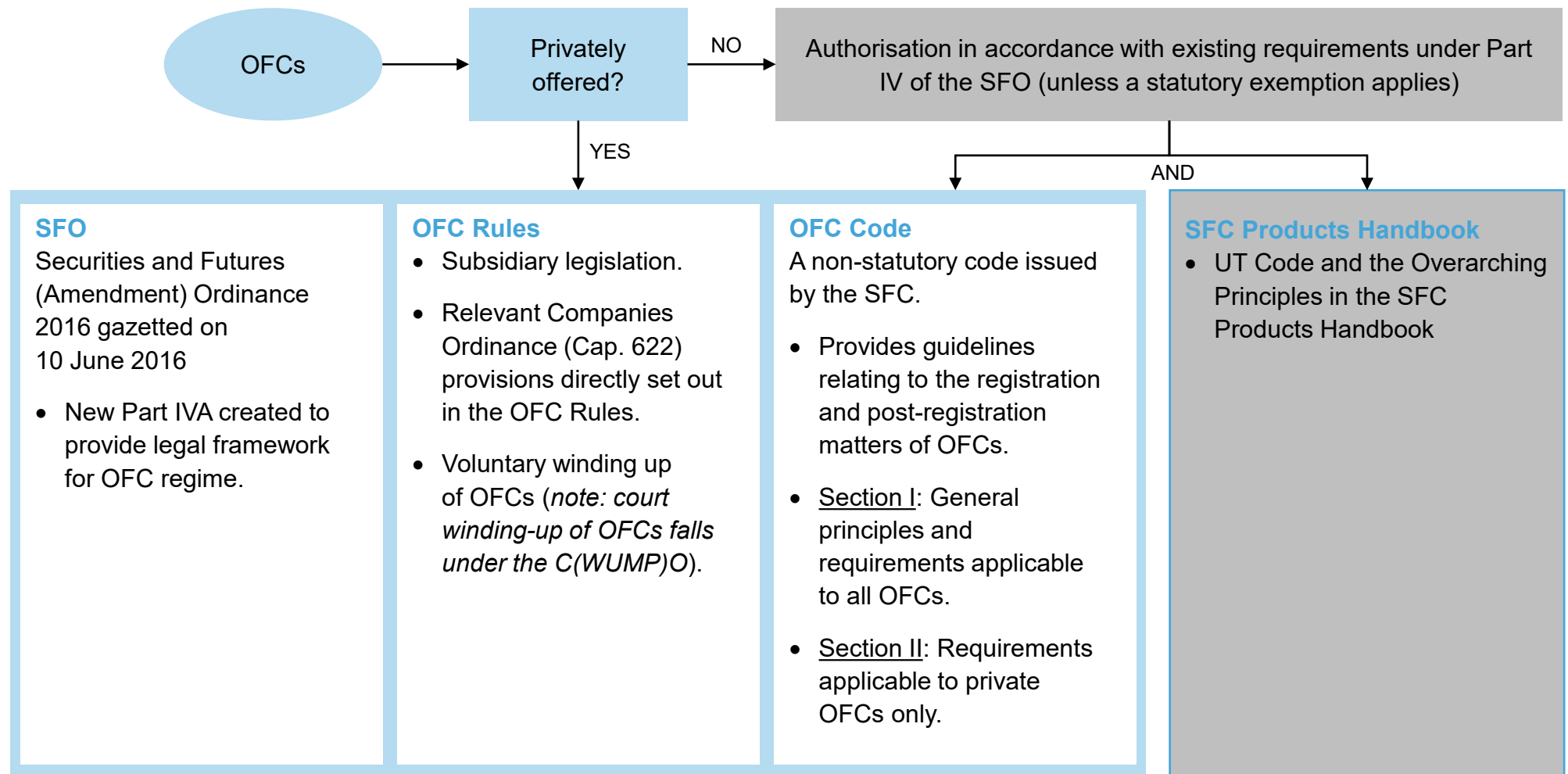
LEGAL AND REGULATORY FRAMEWORK FOR OFC

THE OFC REGIME CAME INTO EFFECT ON 30 JULY 2018

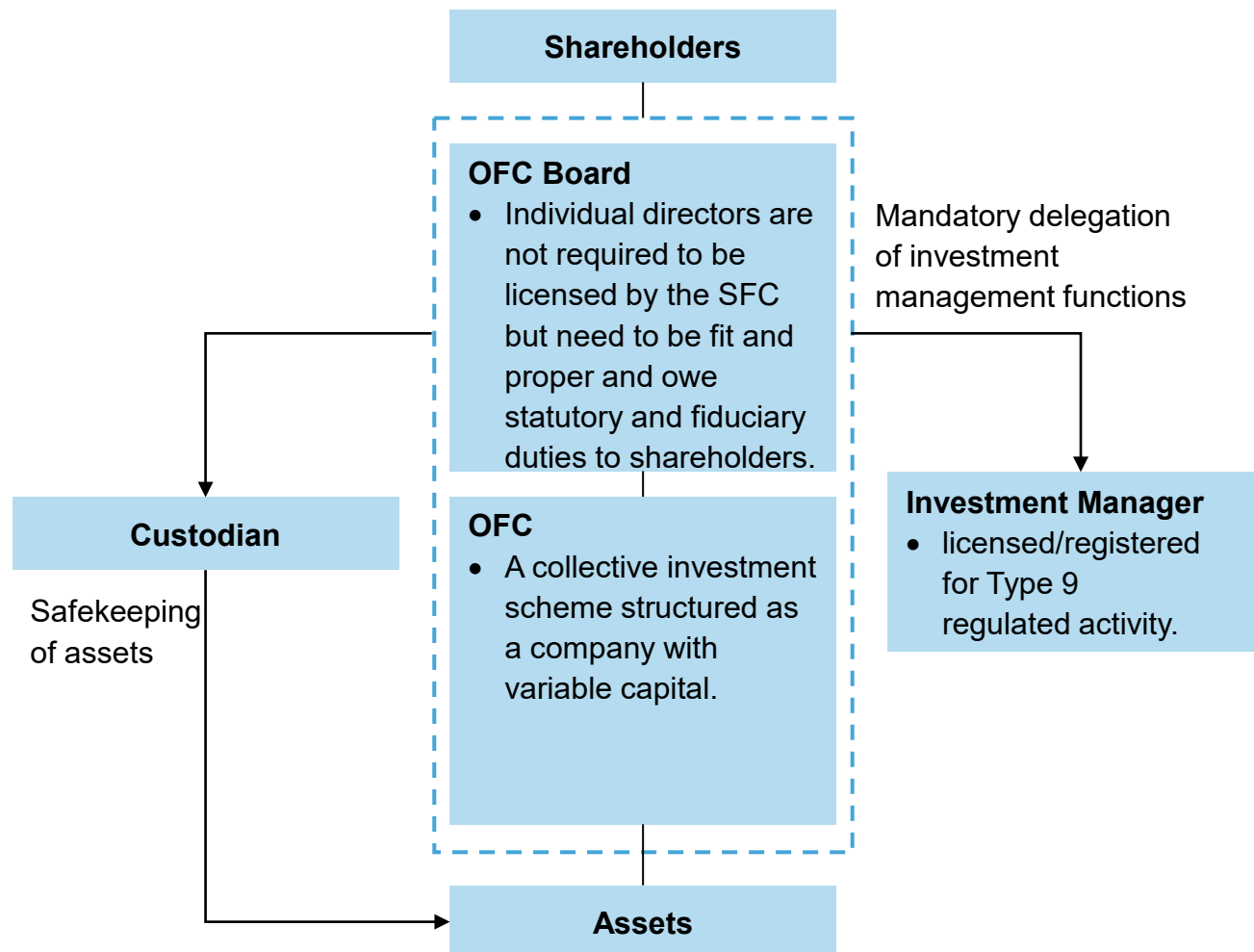


- **Primary regulator:** SFC.
- **Incorporation and corporate filings:** Companies Registry (CR).
- **Winding up:** Official Receiver's Office (ORO).

LEGAL AND REGULATORY FRAMEWORK FOR OFC



OFC STRUCTURE



- Not subject to restrictions under Companies Ordinance (CO) on (1) capital reduction; (2) distribution out of capital.
- Can be used for both listed (e.g. ETFs) or unlisted funds.
- Can be used for both public and private funds.
- Can be used for closed-ended funds (i.e. can impose redemption terms and conditions subject to clear disclosure).

PRIVATE OFCs



Privately offered OFCs

- **Key operators** – directors, custodian and investment manager to meet basic eligibility requirements
- **Investment scope** – No investment restrictions – private OFCs can invest in all asset classes without any limit
- Compliance with basic principles and structural requirements
 - No pre-vetting of offering documents or SFC approval required for changes to the OFC's instrument of incorporation, offering documents, investment strategy and assets
 - SFC approval required for change of name, appointment of key operators, establishment of sub-funds and termination of OFC or sub-fund only

KEY OPERATORS - DIRECTORS



- An OFC must have at least two directors, who must be
 - natural person;
 - aged 18 or above; and
 - not an undischarged bankrupt unless with the leave of the court.
- At least one of the directors must be an independent director, who must not be a director or employee of the custodian
- Directors must delegate investment management functions to the investment manager by an investment management agreement
- A non-resident director must appoint a process agent to receive any process or notice
- Each director must be of good repute, appropriately qualified, experienced and proper for the purpose of carrying out the business of the OFC
 - whether the person has relevant qualifications and/ or experience; and
 - whether the person, or any business with which the person has been involved, has been held by any court or competent authority to have breached any company, securities or financial markets laws and regulations, has been held for fraud or other misfeasance; or has been disciplined by, or disqualified from, any professional body.

KEY OPERATORS – INVESTMENT MANAGER

Eligibility

- Must be registered or licensed for Type 9 (asset management) regulated activity
- Must be and remain fit and proper, at and after the registration of the OFC

Investment Manager is expected to:

- Have sufficient experience, expertise and competence in managing the asset types in which the OFC will invest
- Carry out investment management functions of the OFC in accordance with the instrument of incorporation and investment management agreement
- Fulfill the duties and functions in compliance with applicable laws and regulations (including the Fund Manager Code of Conduct the Code of Conduct for Persons Licensed by or Registered with the SFC, the Management, Supervision and Internal Control Guidelines for Persons Licensed by or Registered with the Securities and Futures Commission, the Guideline on Anti-Money Laundering and Counter-Financing of Terrorism (For Licensed Corporations) and the Guideline on Anti-Money Laundering and Counter-Financing of Terrorism (For Authorized Institutions))

KEY OPERATORS

CUSTODIAN

Eligibility

- For private OFCs (i) same requirements as to the type of entities and capital requirements as those under the UT Code; or (ii) a licensed corporation or registered institution licensed or registered for Type 1 regulated activity which meets eligibility criteria under 7.1(b)(ii) of the OFC Code

Duties of custodian

- Statutory duty to take reasonable care, skill and diligence to ensure the safe keeping of the scheme property of the OFC that is entrusted to it (same for sub-custodian)
- Proper segregation of assets
- Safe-keeping and record keeping of assets
- Sufficient experience, expertise and competence in safekeeping the asset types in which the OFC
- Exercise due care in the selection, appointment and ongoing monitoring of its delegates, including sub-custodians

- Internal controls for private OFC:

- OFC directors to review the adequacy of the custodian's internal controls which should be commensurate with the OFC's nature, scale and complexity – audit certificate not mandatory

A non-Hong Kong custodian (i.e. a custodian incorporated outside Hong Kong) must have a process agent to receive any process or notice

- Exception: a non-Hong Kong custodian that is a “registered non-Hong Kong company” as defined in the CO, since the CO already provides for a local authorised representative for service of documents

OFFERING DOCUMENTS

General Principle

- Disclosure should be clear, concise and effective; ongoing disclosure of information shall be disseminated in a timely and efficient manner

Must comply with disclosure requirements in the OFC Code, for example:

- Its nature as an OFC with variable capital with limited liability
- For an umbrella OFC, statement on the segregated liability between sub-funds and warning regarding the enforceability of such segregation in foreign courts:

“Important - while section 112S of the SFO provides for segregated liability between sub-funds, the concept of segregated liability is relatively new. Accordingly, where claims are brought by local creditors in foreign courts or under foreign law contracts, it is not yet known how those foreign courts will react to section 112S of the SFO.”

- Circumstances for cessation of office of key operators and removal procedures
- Custody arrangements of the OFC's property and associated material risks
- Termination: summary of circumstances for termination, party who may apply and any shareholders' approval required
- Manner in which shareholders may obtain the OFC's information and make enquiries

For private OFC:

- Must also disclose the investment scope and restrictions.
- Must contain clear disclosures on all material risks specific to the type and nature of assets in which the OFC is invested, in particular where the OFC invests 10% or more of the GAV of the OFC in non-financial or other less common asset class(es)
- OFC to send the offering document to SFC for filing as soon as practicable following issuance by the OFC.
- In the case of changes to the offering documents, should be filed with the SFC within 7 days from date of issuance of the revised offering documents.

CHANGES REQUIRING SFC'S APPROVAL

- Change of name of an OFC or its sub-fund
- Appointment of key operators (directors, investment manager and custodian)
- Establishment of sub-funds
- Termination of the OFC or its sub-fund



SUB-FUNDS – PROTECTED CELL REGIME

- Part IVA of the SFO (section 112S) provides for the segregated liability of sub-funds of an OFC to limit the contagious effect of insolvency of a sub-fund within an umbrella OFC
- For an umbrella OFC, its instrument of incorporation and offering document must contain a statement on the segregated liability of its sub-funds
- To fortify the protected cell regime, certain terms are implied into the contracts and transactions entered into by an umbrella OFC under the OFC Rules:
 - the counterparty agrees not to seek recourse to any assets of a sub-fund to discharge any liability not incurred on behalf of that sub-fund;
 - if the counterparty succeeds to have such recourse to the sub-fund's assets, the counterparty will pay a sum to the OFC equal to the value of benefit it has obtained; and
 - if the counterparty succeeds in seizing the assets of the sub-fund for unrelated liabilities, it will hold such assets or proceeds for sale of assets on trust for the OFC.
- For an umbrella OFC, a standard warning statement must also be included in the offering document regarding the enforceability of section 112S in foreign courts.



LIMITED PARTNERSHIP FUND REGIME

BACKGROUND

Local push factors

- Hong Kong's Limited Partnerships Ordinance (“**LPO**”) more than a century ago is outdated and not designed for funds
 - No suitable legal framework for establishing a limited partnership as an investment vehicle in Hong Kong
- Hong Kong government wanted to further diversify Hong Kong's fund structures following introduction of open-ended fund company regime in July 2018

Global push factors

- OECD Base Erosion and Profit Shifting package and concept of “economic substance”
- New laws in Cayman Islands (to date the most favoured jurisdiction for offshore PE/VC funds)

The Limited Partnership Fund Ordinance (“**LPFO**”) comes into operation on **31 August 2020**

ELIGIBILITY

The fund is eligible to be registered as a limited partnership fund (“LPF”) under the LPFO if, amongst other things, the fund:

- Meets the definition of a "fund" under the LPFO and is constituted by a Limited Partnership Agreement (“LPA”)
- Has one General Partner (“GP”)
 - Can be an individual, Hong Kong private limited company, registered non-Hong Kong company, limited partnership under the LPO or an LPF, non-Hong Kong limited partnership with or without legal personality
 - If the GP is another LPF or a non-Hong Kong limited partnership without a legal personality, it must appoint an authorized representative in Hong Kong
- Has at least one Limited Partner (“LP”)
 - LP can either be an individual, a corporation, a partnership, an unincorporated body or any other entity (and each such person may hold an LPF interest as trustee)
- Has an office in Hong Kong to receive communications and notices
- Limitations
 - Not all the partners of the LPF may be corporations in the same group of companies with the exception of a 2-year initial period (which allows time for fundraising)
 - Not all LPs may be employees or former employees or their close relatives

OPERATION OF AN LPF

In line with the limited partnership regimes in the Cayman Islands, England and Wales and Singapore, an LPF will not have legal personality. Partners have contractual freedom as to what may be drafted into an LPA in respect of the operation of the fund

General Partner

A GP will have unlimited liability for all the debts and obligations of the fund, ultimate responsibility for the management and control of the fund and must:

- appoint an investment manager (which may be a Hong Kong resident individual, a Hong Kong company or a registered non-Hong Kong company)
- appoint a "responsible person" to carry out the AML/CTF measures under the Anti-Money Laundering and Counter-Terrorist Financing Ordinance
- appoint an independent auditor to carry out the audits of the financial statements of the fund
- ensure proper custody arrangements for the assets of the fund
- file an annual return with the Registrar of Companies annually and notify the Registrar of Companies of certain changes to the LPF specified in the LPFO

OPERATION OF AN LPF

Limited Partner

- An LP will have the right to participate in the income and profits arising from the management of the assets and transactions of the fund by the GP in, and the investment manager of, the fund
- Fiduciary duty not owed to GP or any other limited partner of the fund and no day-to-day management rights or control over the assets held by the fund
- Not liable to the debts and obligations of the fund beyond amount of limited partner's agreed contribution to the fund if limited partner does not take part in the management of the fund

OPERATION OF LPF ACTIVITIES NOT REGARDED AS MANAGEMENT OF LPF

Activities not regarded as management of LPF as set out in Schedule 2 of the LPFO include:

- LPs serving on a board or committee of the fund, appointing a person to serve on a board or committee of the fund and exercising any right or power conferred under the LPA of the fund
- discussing with or advising the GP or the investment manager of the fund about the business, prospects, affairs or transactions of the fund, and approving or authorising the GP or the investment manager of the fund to do anything in connection with the business, prospects, affairs or transactions of the fund
- certain decisions such as whether a person should become or cease to be the GP of the fund, whether the term of the fund should be extended, a change in the investment scope of the fund and changes in the persons responsible for the day-to-day management of the fund

PUBLICLY AVAILABLE RECORDS AND CONFIDENTIALITY

Registrar of Companies must:

- Establish and maintain a register of LPF and an index of the names of every LPF and make available for public inspection:
 - the identify of the GP, the authorized representative (if applicable) and the investment manger of the LPF; and
 - the particulars of the LPF, current and former GP(s), investment manager(s) and authorized representative(s) of the LPF

The identity of the LP(s), their capital commitments or contributions or the investment objective of the fund will not be available in the public register.

RECORD KEEPING

The GP / investment manager is required to maintain a proper record of the following:

- Audited financial statements of the LPF
- A register of partners
- In relation to a customer of the fund (including LPs), records pertaining to AML/CFT measures
- Documents and records of each transaction carried out by the LPF
- The controller of each of the partners in the fund

These records must be kept at the registered office of the LPF or any other place in Hong Kong made known to the Registrar of Companies and are to be made available for inspection by government bodies but not for public inspection.



BENEFITS OF HONG KONG DOMICILED FUNDS



Benefits of Hong Kong domiciled funds:

- Facilitates international fund distribution
- Cost-savings over offshore structure
- Caters for different types of funds
- Tax incentives
- Fast set-up
- May tap into Hong Kong's deep capital pool sourced from local and international investors
- Easy management and administrative convenience
- Protected-cell feature (OFC)
- Investor protection and confidence in robust regime

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