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The Hong Kong Institute of Chartered Secretaries

(Incorporated in Hong Kong with limited liability by guarantee)

Submission to the Financial Services Branch of the Financial Services and the
Treasury Bureau on consultation paper on legislative proposal
to introduce a new open-ended fund company (OFC) structure

Dear Sirs,

The Hong Kong Institute of Chartered Secretaries (HKICS) is an independent professional body dedicated to the promotion of its members' role in the formulation and effective implementation of good governance policies as well as the development of the profession of Chartered Secretary in Hong Kong and throughout Mainland China. HKICS was first established in 1949 as an association of Hong Kong members of the Institute of Chartered Secretaries and Administrators (ICSA) of London. It then became a branch of ICSA in 1990 before gaining local status in 1994. HKICS is a founder member of Corporate Secretaries International Association (CSIA) which was established in March 2010 in Geneva, Switzerland to give a global voice to corporate secretaries and governance professionals. HKICS today has over 6,100 members and 3,200 students.

Background

On 4th June 2015, HKICS made a submission to express our support for the development of Open-ended Fund Companies (OFC) under a consultation by the Financial Services Branch, Financial Services and the Treasury Bureau (FSTB). This was on the basis that the proposals being consulted upon were in line with the practices of a number of leading jurisdictions, including the UK. HKICS also agreed with the governance aspects of the proposals including (1) the requirement of adoption of custodians over assets to prevent conflict of interests; (2) responsibilities of directors of OFCs in accordance with the provisions of the new Companies Ordinance (stipulating the higher of an objective or subjective standard for directors' duties); (3) mandatory delegation of investment functions to asset manager registered for Type 9 regulated activity; (4) main regulatory responsibilities being vested with the SFC (and the regulatory use of ss. 213 and 214 of the SFO), with regulatory oversight by the Companies Registry in respect of company filing requirements; and (5) adoption of the SFC Handbook (including meeting requirements) and future subsidiary legislation and OFC Codes, subject to further market consultations.

Support for OFC Proposal

Following on from FSTB's earlier consultation, we have now been asked to comment on the 'Legislative Proposal to introduce an Open-ended Fund Company Regime in Hong Kong' by the FSTB. In relation thereto, we agree with the following proposals which are in line with the earlier consultation of the FSTB and good governance, namely:

- The legal framework for the establishment and regulation of OFC being under the Securities and Futures Ordinance (SFO) with the substantive and procedural rules being under the SFO and its subsidiary legislations respectively;
- The limitation of the use of an OFC as an investment fund (to be extended to Over-the-Counter (OTC) derivatives in future) instead of general commercial activities like trade and business for other types of companies in view of the highly specialised nature of the OFC;
- The key operators of an OFC being the directors, investment manager and custodian, with the investment manager being required to be licensed under Type 9 (asset management) licence, along with the expected separation of asset management with an independent custodian, and appointment of Hong Kong process agents for submission to Hong Kong courts' jurisdiction as with other types of authorized funds;

- The registration and authorization by the SFC in accordance with section 104 of the SFO, and the regulatory extension of ss. 213 and 214 of the SFC to cover OFC activities; and
- The adoption of company law concepts like directors' statutory standard of care and common law fiduciary duties with relaxations for capital reductions and distributions.

Other Matters

In relation to other matters, we have no issue with (1) the definition of OFC as a collective investment scheme (CIS) and the status of sub-funds thereunder; (2) the role of the Companies Registry (CR) in assisting in the incorporation of the OFC; (3) the concurrent filings with the SFC of the incorporation form and the Business Registration Ordinance (BRO) application; (4) the determination by the SFC of compliance with the SFO and related rules, regulations and codes for authorization purposes; (5) the CR issuing the first Business Registration Certificate for the Commissioner of Inland Revenue; and (6) thereafter transfer of information to the Inland Revenue Department (IRD).

As to (7) the operations of the OFC and related matters like segregated liability of sub-funds: the protected cell structure; (8) cancellation of registration of an OFC; (9) termination and winding-up of an OFC supervision and enforcement powers in relation to an OFC are matters that we have no issue with. For (10) the other implementation details of the OFC Code, we have assumed that the SFC would conduct a separate consultation to provide time for the market participants and other relevant stakeholders to provide their comments upon the detailed proposals. As to (11) the taxation and stamp duty aspects, we would leave these for the fund industry to comment upon. However, we have member observations that unless stamp duty and profits tax of the proposed structure are both explicitly and expressly exempted, traction for the use of the OFC structure may be adversely affected. Also, private funds may choose to bypass the Hong Kong OFC structure so as not to be subject to the SFC authorization process unless exemptions are available.

Practical Implementation

We also have member views that the following further matters be considered for the practical implementation of the OFC Structure, which in no way derogates from our support for the development of the OFC structure as they relate to follow on steps following enabling legislations:

- As the articles of an OFC have to contain certain provisions set by the SFC for approval by the SFC, please consider whether it would be viable to have a set of model articles with mandatory provisions for OFCs. Please refer to the model articles for private and public companies under the Companies Ordinance which could be used as the basis for a set of OFC articles, if appropriate;
- It could be considered whether the Cayman Islands share capital structure should be adopted. That is, shares are classified into (a) management shares, and (b) non-participating shares. Management shares are owned by the shareholders who have control over the OFC, whereas the non-participating shares, which are non-voting shares save for matters that are affecting their class rights, are offered to the investors who do not have control over the company. The general management of an OFC will vest with the board with certain issues which require shareholders' approval under the Companies Ordinance like change of name and the management shareholders. If this approach is adopted, as with a unit trust, sale and purchase of units is not subject to stamp duty, the sale and purchase of the non-participating shares should also not be subject to stamp duty.

- To make OFCs attractive, the administration of the OFCs must be straight-forward and not costly, especially where the OFCs are closely held, and this could be considered under any definitions of the OFC, where appropriate. Also, the allotment and issue, redemption, transfer, etc. of the non-participating shares share capital are exempted from reporting to the Companies Registry. Only the movements in the management shares are to be disclosed or reporting in the same way as in a conventional HK company.
- Seminars on the scheme should be launched well in advance so that the service providers, in particular, the company secretarial practitioners are well informed to promote the scheme to potential clients.

If you have any questions, please feel free to contact Dr Maurice Ngai FCIS FCS(PE), President of HKICS or Mohan Datwani FCIS FCS(PE), Senior Director and Head of Technical and Research at 2881 6177.

Yours faithfully,

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President
The Hong Kong Institute of Chartered Secretaries (HKICS)