

**Bills Committee on Securities and Futures (Amendment) Bill 2016**

**Responses to the views provided by organizations in written submissions to the Bills Committee and deputations at the meeting on 21 March 2016**

Views	Responses
<p><b>Overarching Principles</b></p> <p><i>Organisations: CompliancePlus Consulting Limited (“CompliancePlus”), The Hong Kong Association of Banks (“HKAB”), The Hong Kong Institute of Chartered Secretaries (“HKICS”), The Hong Kong Institute of Directors (“HKIoD”), Hong Kong Investment Funds Association (“HKIFA”), Vanguard Investments Hong Kong Limited (“Vanguard”) and Timothy Loh Solicitors</i></p>	
<p>1. Support the Government’s proposal to introduce an open-ended fund company (“OFC”) structure to Hong Kong as it can expand the legal structure for investment funds domiciled in Hong Kong.</p>	<p>Noted. The proposal is a major policy initiative to develop Hong Kong as a full-fledged fund and asset management centre.</p>
<p><b>Legislative / Regulatory Framework</b></p> <p><i>Organisations: HKAB and Hong Kong Bar Association (“HKBA”)</i></p>	
<p>2. It is not clear to what extent the provisions under the Companies Ordinance (Cap. 622) (“CO”) and the Companies (Winding-up and Miscellaneous Provisions) Ordinance (Cap. 32) (“CWUMPO”) are applicable to the OFC.</p>	<p>The OFC regime will be established under the SFO and its subsidiary legislation (“the OFC Rules”). It will therefore be the SFO and the OFC Rules which will be applicable to OFCs.</p> <p>The provisions in the CO and the CWUMPO relevant to OFCs are set out either directly in the Bill or will be clearly set out/referred to in</p>

Views	Responses
<p>The Securities and Futures (Amendment) Bill 2016 (“Bill”) should also make clear whether it is the provisions under the Securities and Futures Ordinance (Cap. 571) (“SFO”) which take precedence in the event that they are in conflict with those in the CO and the CWUMPO.</p>	<p>the OFC Rules, with relevant modifications as appropriate. If any CO or CWUMPO provision is not contained or specifically referred to in the amended SFO or the OFC Rules, it will not apply to OFCs.</p>
<p>3. The CO and CWUMPO provisions designed to protect the shareholders of a company should be applicable to an OFC. The requirement of a shareholder holding the shares for six months (under section 179 of the CWUMPO) before he has the locus to present a petition for winding up under section 177(1) of the CWUMPO may need to be revised.</p>	<p>We consider that section 179 of the CWUMPO should apply to OFCs, for consistency with the company law regime having regard to the corporate nature of OFCs.</p>
<p>4. It is not clear whether it is envisaged that the investment to be made by the investors will be in the form of: (1) a subscription of the issued shares of an OFC; (2) an investment in the funds (or sub-funds) managed by the OFC; or (3) both. If what is envisaged is that an investor will be investing in the OFC by subscribing for its issued shares in the OFC, and the OFC then use the money derived from the subscription to invest in the funds (or</p>	<p>It is typical and common market practice in Hong Kong and other major overseas jurisdictions for investors to invest in open-ended investment funds (not just OFCs but such funds generally) by way of subscription and redemption of units/shares in the fund.</p> <p>Under the proposed OFC regime, investors will own the interests in the assets acquired by an OFC by holding the shares of the OFC. The investor could dispose of his/her investment by way of redemption of his/her shares in the OFC. During the redemption process, the underlying assets of the OFC will be disposed of by the OFC in return for monies which will be returned to investors. A</p>

Views	Responses
<p>sub-funds), then the suggestion to dispense with the provisions governing maintenance of capital is problematic.</p>	<p>reduction in capital will necessarily ensue as the shares would be extinguished.</p> <p>The purpose of introducing the OFC regime is to enable open-ended investment funds to be established in corporate form with variable capital. As an open-ended investment fund needs the flexibility to vary its capital in order to meet investor subscriptions and redemptions, the current legal framework for companies under the CO with various restrictions on capital reduction is not conducive for use by investment funds to be established in corporate form. Similar OFC structures with variable capital (i.e. with no restriction on capital reduction) are also well-established in overseas major jurisdictions including the UK, Ireland, Luxembourg and the US.</p>
<p>5. The Bill does not draw clear distinction between publicly and privately offered OFCs in the regulatory framework, and subjecting privately offered OFCs to the OFC Code would create disparity with private funds taking other forms.</p> <p>Also, regulation of publicly offered OFCs should be consistent with the regulation over existing public unit trusts or mutual funds domiciled in other jurisdictions but authorised for sale in Hong Kong under the existing Code on Unit Trusts and Mutual Funds (“UT Code”).</p>	<p>The OFC Code is intended to lay down the basic or minimum operational requirements applicable to all OFCs with reference to international regulatory practices and standards. Where the basic requirements in the OFC Code are met, other matters in respect of the operation of privately offered OFCs would remain largely governed by the OFCs’ individual constitutive and offering documents. Privately offered OFCs would not be subject to the extensive requirements in the UT Code. The imposition of certain essential regulatory requirements on a privately offered corporate fund is broadly in line with the approach in the UK, Ireland and Luxembourg.</p> <p>In considering the regulatory framework for privately offered OFCs, we are minded to take a measured approach having regard to international regulatory practices and standards such as fundamental International Organization of Securities Commissions (“IOSCO”)</p>

Views	Responses
	<p>principles, and the primary purpose of an OFC as an investment fund.</p> <p>As for publicly offered OFCs, they would, in addition to the OFC Code, be subject to the requirements under the UT Code, consistent with other Securities and Futures Commission (“SFC”)-authorized publicly offered funds.</p>
<p><b>Formation, Incorporation and Other Operational Details</b></p> <p><i>Organisations: CompliancePlus, HKAB, HKICS, HKIFA and Vanguard</i></p>	
<p>6. The proposals related to the operations of the OFC, such as segregated liability of sub-funds, cancellation of registration, termination and winding up, and the SFC’s supervision and enforcement are supported.</p>	<p>Noted.</p>
<p>7. The registration and incorporation process for OFCs should be streamlined. There should also be an indicative timeframe for approval and registration of investment vehicles, with the requirement for documentary evidence for certain eligibility criteria waived.</p>	<p>A “one-stop” service will be provided for the registration, incorporation and business registration of an OFC, under which the SFC will be the primary recipient of all application documents (including the documents required by the SFC for registration, the Companies Registry (“CR”) for incorporation and the Inland Revenue Department for business registration). Once the SFC is satisfied that the registration requirements are met, it will issue a notice of registration to the CR and forward to the CR the relevant incorporation and business registration documents and fees. The CR will then incorporate an OFC if it is satisfied that the requirements for incorporation have been met. The registration of the OFC will take</p>

<b>Views</b>	<b>Responses</b>
	<p>effect on the day of issue of the certificate of incorporation by the CR. Under the one-stop service, the CR will also issue to the OFC the first business registration certificate on behalf of the Commissioner of Inland Revenue simultaneously with the certificate of incorporation. Following the incorporation of the OFC, corporate filings are largely expected to be made solely with the CR by the OFC. The arrangement is expected to enhance efficiency and save costs.</p> <p>We note that similarly in some overseas jurisdictions, for example the UK and Ireland, substantive regulatory requirements are maintained for the approval of the establishment of the investment vehicle.</p> <p>As to the timeframe of the “one-stop” process, the SFC and the CR will publish the general processing time in handling relevant applications, which is expected to be broadly in line with existing practice.</p>
<p>8. It could be considered whether the Cayman Islands share capital structure should be adopted, i.e. shares are classified into management shares and non-participating shares.</p>	<p>It is generally envisaged that there will be no prohibition on share class creation. This will be governed by the constitutive documents of the OFC and subject to the relevant OFC Code requirements, for example clear disclosure in the offering documents and, in the case of a publicly offered OFC, observation of any applicable requirements in the UT Code.</p>
<p>9. To make OFCs attractive, the administration of OFCs must be straightforward and not costly. Also, the allotment and issue, redemption, transfer, etc. of the non-participating shares share</p>	<p>Taking into account the comments received during the consultation, a “one-stop” service will be provided for the registration, incorporation and business registration of an OFC. Following the incorporation of the OFC, corporate filings are largely expected to be made solely with the CR by the OFC. The arrangement is expected to enhance</p>

<b>Views</b>	<b>Responses</b>
<p>capital should be exempted from reporting to the CR.</p>	<p>efficiency and save costs. Please refer to item 7 above for details.</p> <p>Certain filings will not be applicable to OFCs, including share allotment, redemption, transfer, and increase in share capital. Other filings such as information on company secretary, list of members, information on mortgages and charges will also be inapplicable. Further, we have removed the requirement for OFCs to file an annual return, taking into account the comments received.</p>
<p>10. The implementation details, including approval for changes in the provisions of the instrument of incorporation, tax return filing, financial reporting, and the requirements for requisitioning an extraordinary general meeting, are expected to be set out in the subsidiary legislation and/or the OFC Code. Sufficient time should be given to market participants to comment on the detailed proposals.</p>	<p>The detailed operational requirements of the OFC regime will be set out in the OFC Rules and/or the OFC Code, which will be subject to separate public consultation by the SFC. The SFC expects to provide reasonable time for response to the consultation proposals.</p>
<p>11. 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.</p>	<p>Noted. It is envisaged that relevant briefings will be arranged in conjunction with the implementation of the OFC regime.</p>

Views	Responses
<p><b>Basic Requirements and Duties of Directors</b></p> <p><i>Organisations: HKAB, HKBA and HKIoD</i></p>	
<p>12. The Bill does not specify the eligibility criteria for directors. In particular, there are also good grounds to require majority independent out of a minimum of three directors. OFC directors should also have the benefits of proper shields of liability in performing their duties.</p>	<p>Sections 112T, U, V, W, X, ZC, ZD and ZE under Division 7 of the Bill have specified the eligibility, duties and liabilities of OFC directors. Any other requirements in this regard will be provided for in the OFC Rules and/or the OFC Code, which will be subject to separate consultation by the SFC.</p> <p>As to the proposal for majority independent out of a minimum number of directors, we note that more respondents, on the contrary, considered the requirement of having at least one director that was independent of the investment manager unnecessary and onerous, and may reduce the OFC’s attractiveness compared to the unit trust structure or comparable corporate fund vehicles in other jurisdictions such as the Cayman Islands.</p> <p>On balance, we consider the requirement for an independent director essential given that the board of directors is expected to provide an extra layer of oversight on the activities of the OFC for the shareholders.</p> <p>Under section 112U(4) of the Bill, the liabilities of directors for breach of duties would be the same as if the directors were directors of an ordinary company. It follows that the corresponding defences for directors of an ordinary company, including those under the common law, would also apply to directors of OFCs.</p>

Views	Responses
<p>13. The requirement that at least one of the directors should appoint a process agent in Hong Kong should be included in the Bill, as this would confer jurisdiction of the Hong Kong courts over the director. Also, the requirement should apply to each of the non-resident director, rather than one of the non-resident directors.</p>	<p>To clarify, the appointment of the process agent is expected to serve the purpose of receiving legal documents rather than conferring jurisdiction of Hong Kong courts. Given the procedural and logistical role of the process agent, it would be more appropriate to place the provision on the process agent in the OFC Rules and/or the OFC Code.</p> <p>Taking into account comments received, the requirement has been revised such that each of the non-resident directors of the OFC will be required to appoint a process agent in Hong Kong to accept service of process.</p>
<p><b>Basic Requirements of Investment Managers</b></p> <p><i>Organisations: CompliancePlus, HKAB, HKIFA and Timothy Loh Solicitors</i></p>	
<p>14. The requirement that an investment manager of an OFC must be licensed or registered for Type 9 (asset management) regulated activity should be removed as this would create disparity with private funds taking other forms.</p>	<p>We maintain that the investment management functions of the OFC should be delegated to SFC-licensed or registered investment managers for the following reasons –</p> <ul style="list-style-type: none"> <li>(a) the requirement is important for investor protection purposes, given that SFC-licensed or registered investment manager will be subject to the applicable requirements under the relevant legislation and codes;</li> <li>(b) with the OFC being managed by a local investment manager, i.e. the high end of the value chain, it is more likely that the manager would hire local services along the service chain, which is conducive to building up Hong Kong’s fund</li> </ul>



Views	Responses
	<p>manufacturing capabilities; and</p> <p>(c) from recent data gathered by the SFC, the majority of Hong Kong-domiciled publicly offered funds are managed by SFC-licensed investment managers. The requirement should not have a significant impact on OFCs' operations.</p>
<p>15. The Government should consider removing the Type 9 licensing requirement for OFC investment managers in the future.</p>	<p>After implementation, we will keep in review the OFC regime from time to time having regard to market developments.</p>
<p>16. The proposal that different investment managers may be appointed for each sub-fund of an OFC on a case-by-case basis is welcomed. It is expected that the operational details pertaining to investment managers will be reflected in the subsidiary legislation and the OFC Code.</p>	<p>Noted.</p> <p>We would like to add that any sub-delegation by the investment manager for each sub-fund will be subject to requirements under the UT Code in the case of publicly offered OFCs. No restriction on such sub-delegation is intended to be imposed on privately offered OFCs.</p> <p>Notwithstanding such sub-delegation, the investment manager will remain responsible for all of its duties and responsibilities. The investment managers will be expected to implement appropriate measures and exercise reasonable care, skill and diligence in connection with the selection, appointment and ongoing monitoring of their delegates.</p> <p>The detailed requirements of investment managers, such as duties, liabilities and eligibility requirements, will be set out in the OFC Rules and/or the OFC Code, which will be subject to separate</p>

Views	Responses
	consultation by the SFC.
<p><b>Basic Requirements of Custodians</b></p> <p><i>Organisations: HKAB, HKBA, HKIFA and Timothy Loh Solicitors</i></p>	
<p>17. The custodian requirement should be removed for privately offered OFCs.</p>	<p>Having regard to investor protection and to avoid potential conflicts of interest, we maintain that the assets of the OFC must be segregated from those of the investment manager and entrusted to a separate, independent custodian for safe keeping. This requirement is also in line with the relevant IOSCO principle requiring segregation of assets.</p>
<p>18. The regime should provide for scenarios where custodians may disclaim liabilities for investment instruments that cannot be safe kept by them, such as bilateral private deals, non-listed derivatives, non-tradable instruments and so forth.</p>	<p>It is envisaged that the requirements on the safe keeping of different types of assets and relevant liabilities will be set out in the OFC Code, which will be subject to separate public consultation by the SFC.</p> <p>It should be noted that for publicly offered SFC-authorized funds, under the UT Code, nothing in the constitutive documents may provide that the custodian can be exempted from liability through fraud or negligence, nor may they be indemnified against such liability.</p>
<p>19. The proposal that different custodians may be appointed for each sub-fund, and that brokers or prime brokers can act as custodians on a case-by-case basis is welcomed. It is expected that the operational details related to custodians will be reflected in the subsidiary</p>	<p>Noted. Operational matters and requirements relating to custodians, as well as sub-custodians and delegation, are expected to be set out in the OFC Rules and the OFC Code, which will be subject to separate public consultation by the SFC.</p>

Views	Responses
legislation and the OFC Code.	
20. The requirement that the custodian must at least have a place of business or a process agent in Hong Kong should be included in the Bill, as this would confer jurisdiction of the Hong Kong courts over the custodian.	To clarify, the appointment of the process agent is expected to serve the purpose of receiving legal documents rather than conferring jurisdiction of Hong Kong courts. Given the procedural and logistical role of the process agent, it would be more appropriate to place the provision on the process agent in the OFC Rules and/or the OFC Code.
<p><b>Investment Scope</b></p> <p><i>Organisations: CompliancePlus, HKAB and HKBA</i></p>	
21. The 10% <i>de minimis</i> limit for privately offered OFCs would create disparity with typical Cayman Islands private funds, and restrict investment in other asset classes such as commodities and real property.	<p>We consider the proposed investment scope for privately offered OFCs appropriate on the grounds that –</p> <ul style="list-style-type: none"> <li>(a) the OFC is not designed to operate as a corporate entity for the purposes of general commercial business or trade. Accordingly, the asset classes in which a Hong Kong OFC could invest should fall predominantly within the scope of Type 9 (asset management) regulated activity; and</li> <li>(b) the investment activities of OFCs would be required to be delegated to an investment manager licensed by or registered with the SFC, therefore the investment scope should remain largely aligned with Type 9 (asset management) regulated activity to enable the current regulatory handle of the SFC in terms of licensing, supervision and enforcement to apply to investment managers of OFCs.</li> </ul>

Views	Responses
	<p>The proposed investment scope should be able to accommodate a very substantial part of the asset classes that privately offered OFCs normally invest in (e.g. cash, currency forwards, loans or distressed debt structured in the form of securities). We also note that the investment scope of those privately offered funds which seek to benefit from the existing profits tax exemption is already restricted in practice.</p> <p>While noting that there are no specified restrictions on permitted asset classes for privately offered funds in some overseas jurisdictions, we are given to understand that in practice, not all asset classes may be accepted and may depend on various factors, such as whether the custodianship requirements can be satisfied.</p>
22. The 10% <i>de minimis</i> limit cannot be found in the Bill.	The 10% <i>de minimis</i> limit will be provided for in the OFC Rules and/or the OFC Code.
<p><b>Streamlined Termination</b></p> <p><i>Organisations: CompliancePlus, HKAB and HKBA</i></p>	
23. OFC may “end” either by way of termination (streamlined termination process) or by way of winding-up process. There should be a specific provision in the SFO setting out that an OFC (or any of its sub-funds) may cease operation by way of termination.	<p>Streamlined termination is provided for under section 112ZH of the Bill, which sets out the SFC’s power to cancel the registration on application of an OFC.</p> <p>The details of the streamlined termination arrangement will be provided for in the OFC Rules and/or the OFC Code, which will be subject to separate consultation by the SFC.</p>

Views	Responses
<p>24. While the clarification that the SFC and the custodian are entitled to petition for winding up is welcomed, there is concern about the time taken for the SFC’s approval of the termination of privately offered OFCs. Such termination can be administered more cost effectively and expediently by way of notification or filing to the SFC and the CR instead.</p>	<p>Termination of privately offered OFCs by way of application to the SFC can be conducted in a streamlined manner where it is carried out in accordance with its instrument of incorporation, and basic regulatory requirements such as certification of solvency and provision of reasonable prior notice to investors are met. The detailed grounds of such termination will be set out in the OFC Code.</p> <p>We maintain that prior approval by the SFC will be required for streamlined termination of both publicly and privately offered OFCs for investor protection purposes.</p>
<p><b>Tax and Stamp Duty Treatment</b></p> <p><i>Organisations: HKAB, HKICS, Joint Liaison Committee on Taxation, and Timothy Loh Solicitors</i></p>	
<p>25. Unless stamp duty and profits tax of the proposed OFC structure are both explicitly and expressly exempted, traction for the use of the OFC structure may be adversely affected, and Hong Kong’s OFC regime would lose momentum.</p>	<p>Under the Stamp Duty Ordinance (Cap. 117) (“SDO”), exemption is given to: (i) all transfers of units under listed unit trust schemes (which are mainly exchange traded funds (“ETFs”))<sup>1</sup> and (ii) transfers of units under unlisted unit trust schemes by way of allotment and redemption<sup>2</sup>. Following the enactment of the Bill, the same stamp duty exemptions will apply to shares of listed and unlisted OFCs.</p>

<sup>1</sup> Section 19(1DA) of the SDO provides that transfers of shares or units of ETFs are not subject to stamp duty.

<sup>2</sup> Under section 19(16) of the SDO, “sale or purchase” is defined to exclude allotment. By virtue of section 19(1A)(a) of the SDO, a sale or purchase of units under a unit trust scheme is exempt from stamp duty if the sale or purchase is effected by extinguishment.

Views	Responses
	<p>As for profits tax, under the current Inland Revenue Ordinance (Cap. 112) (“IRO”), publicly offered funds (whether onshore or offshore)<sup>3</sup> and offshore funds (whether publicly offered or privately offered)<sup>4</sup> are exempt from profits tax. Taking into account the general support, we propose under the Bill that the existing profits tax exemption regime should equally apply to OFCs.</p> <p>On par with the profits tax treatment for onshore privately offered funds under the existing tax exemption regime, onshore privately offered OFCs will be subject to profits tax. We nonetheless recognize that tax treatment is usually one of the main considerations influencing the decision of fund managers on the jurisdiction where the fund is domiciled and managed. On the other hand, we are also aware that exempting onshore privately offered OFCs may give rise to concerns about tax avoidance. We need to be mindful of possible adverse Base Erosion and Profits Shifting (“BEPS”) implications and the effectiveness of any safeguards to avoid such tax incentive being labelled as a harmful tax practice under the BEPS action plan.</p> <p>In this regard, we have issued a concept paper on “Proposed extension of profits tax exemption to onshore privately offered OFCs” to industry associations and professional bodies in order to gauge the industry’s preliminary views on the issue. We will carefully consider the views received and critically review the necessary safeguards to</p>

<sup>3</sup> Section 26A of the IRO provides for profits tax exemption to public funds, including mutual funds, unit trusts or similar collective investment schemes authorized by the SFC under section 104 of the SFO or similar bona fide widely held investment schemes which comply with the requirements of a supervisory authority within an acceptable regulatory regime.

<sup>4</sup> Section 20AC of the IRO provides for profits tax exemption to offshore funds, whether publicly or privately offered. The exemption is restricted to profits derived from specified transactions carried out through or arranged by specified persons; or by funds which are qualifying funds.

Views	Responses
	plug possible loopholes for abuse. Any necessary amendments for any further profits tax exemption will be taken forward in a separate exercise.
26. The amendments to the IRO do not go far enough in achieving the necessary demarcation between the sub-funds of an OFC (i.e. each sub-fund within an OFC structure should be treated as a separate person for profits tax purposes). One consequence is that there would be no segregated tax liability to avoid “tainting”.	We take note of the issues in relation to the demarcation between the sub-funds of an OFC. The issues will be addressed when formulating the possible proposal of extending profits tax exemption to onshore privately offered OFCs.

*Note: The comments made by HKBA on the drafting of the Bill were based on an earlier draft of the Bill. These have been taken into account as appropriate when finalizing the Bill for introduction into the Legislative Council. We have therefore not included these comments in the present paper.*

**Financial Services and the Treasury Bureau  
Securities and Futures Commission  
Companies Registry  
Inland Revenue Department  
April 2016**